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South Carolina Public Service Authority; Retail Electric

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Long Term Rating	A/Negative	Downgraded

Rationale

S&P Global Ratings lowered its rating on the South Carolina Public Service Authority's (Santee Cooper) $7.0 billion senior-lien debt to 'A' from 'A+'. The outlook is negative.

The downgrade reflects the application of our "U.S. Municipal Retail Electric And Gas Utilities" criteria, published Sept. 27, 2018, and the utility's ongoing exposure to judicial and political challenges stemming from its $4.5 billion investment in the abandoned V.C. Summer nuclear plant expansion. Subsumed within the $4.5 billion investment are project-related transmission assets that Santee Cooper plans to redeploy.

The rating reflects our opinion of the utility's strong enterprise risk profile and strong financial profile.

We base our view of the strong enterprise risk profile on the interplay among the following:

- Very strong economic fundamentals, marked by about 960,000 retail customers consisting of the 185,000 retail customers Santee Cooper serves directly and the 775,000 retail customers it serves indirectly through its largest wholesale customer, Central Electric Power Cooperative;
- A strong market position, reflecting the direct retail customers' favorable retail rates that are about 10% below the state's average;
- A vulnerable operational management assessment, reflecting the political, litigation, managerial, and operational fallout the utility faces after abandoning plans to complete the construction of two additional nuclear units at the V.C. Summer nuclear plant; and
- The electric utility sector's extremely strong industry risk assessment, which assesses volatility relative to other industries and sectors.

We view Santee Cooper's financial profile as strong, reflecting the following:

- The benefits of strong fixed-charge debt service coverage (DSC) metrics, very strong liquidity, and adequate leverage measures;
- Principal amortization is uneven, ranging from $158 million in 2016-$32 million in 2018. However, the utility achieved DSC (S&P Global Ratings-calculated) of 1.3x on fiscal 2016's principal amortization. Based on the utility's

financial projections, we calculate the potential of achieving DSC of 1.4x in 2020-2022 on about $130 million of annual principal amortization. Imputing capacity charges in connection with power purchases reduces DSC by about six-seven basis points in our fixed charge coverage (FCC) calculation. We note that while the financial forecast assumes a steady-state scenario for Santee Cooper, the legislature has established an early 2020 target for receiving bidders' solicitations to purchase Santee Cooper and the utility's competing plan to restructure the business;

- We view 2018's 76% debt-to-capitalization ratio as adequate;
- We consider 2018's unrestricted cash and investments representing days' cash equal to more than nine months' operating expenses to be very strong and capacity available under credit lines further strengthens liquidity. However, the utility will likely reduce cash as it applies to debt reduction and capital projects funds it received from Toshiba Corp., as guarantor of the V.C. Summer nuclear plant's construction contractor; and
- Our financial profile assessment also considers projections showing declining debt balances in the face of $1.2 billion of 2019-2023 capital projects because amortizing existing debt will temper debt additions. In addition, the utility will support a significant portion of the capital program with funds available after debt service and payments received from Toshiba Corp. as guarantor of its subsidiary, Westinghouse Electric Co., which rejected the V.C. Summer construction contract in its bankruptcy proceedings.

Outlook

The negative outlook reflects our view that despite strong financial metrics, cancelling the V.C. Summer nuclear plant expansion exposes the utility to many uncertainties. These include the political and judicial challenges focusing on Santee Cooper's continuing ownership of the utility, the composition of its board, and its right to recover from ratepayers the $4.5 billion it invested in the nuclear project. In our opinion, cancelling the V.C. Summer units removes the option of replacing coal generation with nuclear resources as a means of reducing greenhouse gas emissions. We believe a significant reliance on coal exposes the utility to the specter of more stringent regulations governing power plant emissions.

Upside scenario

We do not expect to raise the rating during our two-year outlook horizon unless there is greater certainty that the utility can recover its V.C. Summer investments at a level that supports strong financial metrics. An upgrade is also unlikely while legal and political challenges to the utility's ownership structure remain outstanding. We believe that legislative directives to explore the sale or restructuring of the utility could frustrate long-term strategic planning. In addition, prospects for significant coal dependence could expose the utility to more stringent emissions regulations.

Downside scenario

We could lower the rating if judicial or legislative developments impede Santee Cooper's ability to recover nuclear project development costs from ratepayers and financial metrics weaken.

Utility Description And Credit Overview

Santee Cooper, based in Moncks Corner, S.C., is a state-owned electric and water utility. In 2018, Santee Cooper's revenues from electric sales to wholesale customers represented about 61% of operating revenues. Water sales represented only 0.5% of 2016-2018 operating revenues.

The electric business directly serves about 185,000retail customers. The utility also serves another 775,000 electric customers primarily through its largest wholesale customer, Central Electric Power Cooperative.

Peak demand and energy sales were stable in 2016-2018 at about 5,700 megawatts and 24,000 gigawatt hours, respectively. Residential, commercial, and industrial customers represent equal shares of the retail business revenues. Residential customers represent about two-thirds of Central Electric's retail customers.

In mid-2017, the utility abandoned the nuclear construction project at the V.C. Summer site after investing $4.5 billion in the plants. The utility cited the project's significant delays, substantial cost overruns, and uncertain completion costs in support of its abandonment decision. Although these positions are compelling, the project nevertheless contributed to almost doubling the utility's debt over a decade without delivering prospects for producing project revenues to defray the added debt burden.

Cost overruns and abandonment triggered customer and political backlash, and litigations and legislation targeting the utility. Legislative efforts include directives to explore the sale or restructuring of Santee Cooper. The fallout includes contentious board and management changes. Litigations seek to preclude Santee Cooper from recovering investments in the abandoned project, hold Santee Cooper liable for the quality of its construction-related disclosure, and challenge the utility's claims to title to nuclear project component parts. Lastly, cancelling the project removes prospects for replacing carbon-laden coal-fired generation with nuclear generation. Market purchases of gas-fired electricity remain an option for reducing coal-fired production. Coal represented 46% of 2018's energy supply, followed by natural gas at 22%, purchases at 20%, and nuclear at 10%.

Enterprise Risk

Economic fundamentals: Very strong

The utility benefits from serving about 960,000 customers directly and indirectly, and it has a broad footprint across South Carolina. Residential, commercial, and industrial customers represent equal shares of the direct retail business's revenues. Residential customers represent about two-thirds of Central Electric's retail customers and Central Electric represented two-thirds of Santee Cooper's 2018 operating revenues. Central Electric's residential concentration and its large contribution to Santee Cooper's revenue stream temper the modest contribution of Santee Cooper's direct-serve residential customers. The system's moderate 53% load factor in 2017 and 2018 reflects the significant role of Central Electric's residential customers.

We believe that South Carolina's low income levels, at about 88% of the national average, temper the contributions of very low unemployment rates.

Market position: Strong

We view retail rate competitiveness among the customers Santee Cooper serves directly to be strong, based on a weighted-average retail rate equal to 90% of the state's average system rate. The utility projects modest rate increase of about 1.5% per year through 2023, which should help maintain relative competitiveness.

Operational management assessment: Vulnerable

Abandoning the V.C. Summer nuclear project exposes the utility to multiple operational, political, and litigation challenges. In our view, these exposures place significant demands on management. We believe they have the potential to divert attention from strategic planning.

Recently enacted legislation sets a January 2020 deadline for the state's Department of Administration to receive bids for the purchase of the utility and for the utility to submit a restructuring plan as an alternative to the anticipated bids. The state's ongoing ownership of the utility, the board's composition, and the right to recover investments in the abandoned nuclear project all present significant uncertainties. Moreover, the utility faces several litigations. In addition to legal claims challenging Santee Cooper's right to recover its V.C. Summer plant investments, additional litigations assert that Santee Cooper's disclosures to investors insufficiently detailed the particulars of the construction project's delays and cost overruns. In other litigation, the project's construction contractor claims title to portions of the nuclear project's material.

The utility's diverse generation fleet includes coal, natural gas, nuclear, renewable, and hydroelectric facilities. Coal-fired generation produced 46% of Santee Cooper's fiscal 2018 energy requirements, followed by natural gas at 22%. Plans to use the proposed V.C. Summer units to reduce coal reliance evaporated with the project's cancellation. The utility projects an essentially static generation fleet through 2028, but market purchases of gas-fired electricity remain an option for reducing coal-fired production. Rounding out power supply resources are purchases from other generation owners and the utility's interest in the existing V.C. Summer nuclear plant. Santee Cooper exhibits a significant reserve margin of 25%-33%.

We believe that customer and political displeasure with supporting $4.5 billion of nuclear debt dilutes the financial flexibility that we typically associate with autonomous rate-setting authority and automatic pass-through mechanisms.

Industry risk: Extremely strong

Consistent with "Methodology: Industry Risk," published Nov. 19, 2013, we consider industry risk for municipal retail electric and gas utilities covered under these criteria very low, and therefore extremely strong compared with that of other industries and sectors.

Financial Risk

Coverage metrics: Strong

Although principal amortization is uneven, ranging from $158 million in 2016-$32 million in 2018, the utility achieved DSC of at least 1.3x in fiscal 2016 when principal amortization was $158 million, which we consider very strong. Based on the utility's financial projections, we calculate the potential of achieving DSC of at least 1.4x in 2020-2022 on about $130 million of annual principal amortization. However, our FCC calculations erode coverage by six-seven basis points to a level that we consider strong. FCC treats portions of payments to other energy suppliers as debt service rather than operating expenses because we view these payments as vehicles for funding the suppliers' recovery of their investments in generation assets serving the utility.

Debt and liabilities: Adequate

S&P Global Ratings' leverage ratio calculations yielded a 76% debt-to-capitalization ratio for 2018, which we consider adequate for a vertically integrated utility. Projections show that the utility will reduce debt to $6.8 billion by 2023, or by almost 9% compared with 2019, as the utility applies to debt reduction a portion of the payment Toshiba made to Santee Cooper in its capacity as guarantor of Westinghouse Electric. Nevertheless, the debt-to-capitalization ratio will remain at about 70%. Debt amortization and cash from operations should offset the new-money requirements of $1.2 billion of 2019-2023 capital spending.

Liquidity and reserves: Very strong

The utility recorded $950 million of unrestricted cash and investments at Dec. 31, 2018, which we view as representing a very strong nine months' of operating expenses. We view liquidity as robust in both absolute and relative terms. At year-end 2017 and 2018, in addition to unrestricted cash and investments, the utility reported $529 million and $739 million, respectively, of capacity available under revolving credit facilities, which bolstered its liquidity position.

Ratings Detail (As Of June 25, 2019)		
South Carolina Pub Svc Auth retail elec (AGM)		
Unenhanced Rating	A(SPUR)/Negative	Downgraded
South Carolina Pub Svc Auth retail elec (AGM) (SECMKT)		
Unenhanced Rating	A(SPUR)/Negative	Downgraded
South Carolina Pub Svc Auth retail elec (AGM) (SEC MKT)		
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South Carolina Pub Svc Auth retail elec (AGM) (SEC MKT)		
Unenhanced Rating	A(SPUR)/Negative	Downgraded
South Carolina Pub Svc Auth retail elec (ASSURED GTY)		
Unenhanced Rating	A(SPUR)/Negative	Downgraded
South Carolina Pub Svc Auth retail elec (BHAC) (SEC MKT)		
Unenhanced Rating	A(SPUR)/Negative	Downgraded
South Carolina Pub Svc Auth retail elec (National)		
Unenhanced Rating	A(SPUR)/Negative	Downgraded
South Carolina Pub Svc Auth retail elec (National)		
Unenhanced Rating	A(SPUR)/Negative	Downgraded
South Carolina Pub Svc Auth retail elec (National)		
Unenhanced Rating	A(SPUR)/Negative	Downgraded
South Carolina Pub Svc Auth rev oblig (Taxable) ser 2016D due 12/01/2056		
Unenhanced Rating	A(SPUR)/Negative	Downgraded
South Carolina Pub Svc Auth rev oblig		

Ratings Detail (As Of June 25, 2019) (cont.)		
Unenhanced Rating	A(SPUR)/Negative	Downgraded

Many issues are enhanced by bond insurance.