MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms Hoosier Energy Rural Electric Cooperative senior secured rating at A2 and issuer rating at A3; outlook stable

24 Oct 2018

New York, October 24, 2018 -- Moody's Investors Service today affirmed Hoosier Energy Rural Electric Cooperative Inc (Hoosier) senior secured rating at A2 and issuer rating at A3. The rating outlook remains stable.

RATINGS RATIONALE

"The rating actions consider Hoosier's sound G&T cooperative business model, anchored by the long-term all-requirements contracts in place with its members which extend to 2055, rate setting autonomy under the contracts, and a not-for-profit low-business-risk operating structure", said Sarah Lee, Analyst. "Tempering these credit positive traits are various degrees of credit risk with Hoosier's small size, comparatively weak equity position relative to similarly rated peers, and in regards to its coal plant, both asset concentration and exposure to carbon transition risk. The potential for capital spending relating to the longer-term issues of maintenance of its coal-fired generation plant and carbon and other environmental regulations is a particular area of concern."

Hoosier has elevated carbon transition risk relative to publicly-owned utilities, with approximately 75% of Hoosier's energy resources in 2017 coming from coal generation. With a supply portfolio dominated by coal, the cooperative is exposed to the lingering uncertainty and risk of potentially needing to make a more rapid transition in its supply portfolio down the road should state/federal carbon policies change. This could bring added compliance costs and introduce additional operating and financial challenges, or create the potential for stranded costs if the plant is shut down before the end of its useful life.

On average, Hoosier's financial metrics are generally commensurate with the profile for "A" rated cooperatives. Three-year average financial metrics for 2015-2017 include funds from operations (FFO) to debt of 8.6% and FFO to interest of 3.18x, both comfortably in line with the "A" rating category according to our Rating Methodology for U.S. Electric Generation & Transmission Cooperatives.

Hoosier's equity to capitalization metric, however, is still considered to be weak for a G&T cooperative in the "A" rating category. After dipping modestly below 16% in 2012-2013, it has improved in each of the past three years (2015-2017) resulting in a three-year average of 19.3%. No base rate increases were implemented since 2011 due to cost savings, and only minor rate adjustments are planned for the forecast period (2018-2022) again owing to cost savings. However, with the PCA adjusting for any changes in fuel and purchased power costs, management forecasts indicate a gradual yet sustainable improvement in the equity ratio, even while continuing regularly scheduled returns of patronage capital to members. During the past two years, the distributions have been roughly $6.5 million annually. We expect that the board will implement modest rate adjustments in subsequent years of the current five-year forecast, if necessary, to ensure maintaining financial metrics at current levels or better.

Hoosier maintains adequate liquidity by supplementing its internally generated cash flow with a multi-year $300 million senior unsecured, committed, syndicated revolver which expires August 11, 2021. The syndicate includes a group of six U.S., international, and regional financial institutions, led by National Rural Utilities Cooperative Finance Corporation, and the facility has a $100 million accordion feature. The quality of the external source of liquidity is considered sound, given its multi-year tenor and there are no onerous financial covenants or any ongoing material adverse change clause as part of the representations and warranties for each borrowing request. The facility had the full $300 million available as of June 30, 2018. In addition, Hoosier has about $67 million of approved but unfunded loans from the Rural Utilities Service (RUS).

Hoosier reported an unrestricted cash and short-term investments balance of $106 million, and current maturities of long term debt of $68 million as of December 31, 2017. Hoosier also has a cushion of credit investment account with the RUS, which had a balance of approximately $116 million at December 31, 2017. The cushion of credit account earns a RUS prescribed 5% interest and all balances deposited, along with interest earned, are restricted solely for repayment of money borrowed under the RUS loan program.

Rating Outlook

The stable rating outlook for Hoosier takes into account our view that the Hoosier board of directors will periodically raise rates if necessary to keep Hoosier on pace with achieving its financial objectives and to cope with other execution risks tied to its capital program over the next several years, particularly related to environmental regulation.

What Could Change the Rating -- Up

The rating could be upgraded if the board remains proactive in obtaining any member support for additional rate increases that might be necessary over the next several years resulting in strengthened financial metrics, including FFO/debt greater than 10.0% and equity to capitalization ratio exceeding 30% on a sustained basis. Also, a rating upgrade is possible with effective management of environmental risks, particularly related to the concentration and dependence on the coal-fired Merom Station, and economic activity improves at a faster than anticipated pace, leading to increased electricity sales.

What Could Change the Rating -- Down

A rating downgrade could occur if there is deterioration in financial performance (e.g., FFO to debt ratio falling below 6% or equity capitalization decreasing to below the mid-teens percentage for an extended period of time). Moreover, a rating downgrade is possible if there are operating difficulties in its baseload generating fleet, if there is movement to subject Hoosier to rate regulation, or if capital expenditures required by regulation should increase to a burdensome level.

Hoosier Energy Rural Electric Cooperative Inc, is an electric generation and transmission cooperative headquartered in Bloomington, Indiana. Hoosier supplies energy to 18 distribution cooperatives in central and southern Indiana counties, and Southeastern Illinois. For the year-ended December 31, 2017, Hoosier reported revenues of $674 million.

The principal methodology used in these ratings was US Electric Generation & Transmission Cooperatives published in August 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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