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Summary:

Middleton Municipal Electric Department, Massachusetts; Retail Electric

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Credit Profile

Middleton Mun Elec Dept ICR

Long Term Rating

A/Stable

Affirmed

Rationale

S&P Global Ratings affirmed its 'A' issuer credit rating (ICR) on Middleton Municipal Electric Department (MELD), Mass. The outlook is stable.

The rating reflects what we view as the following strengths:

- The utility's competitive rates, with residential rates 32% below the state average;
- Historically good fixed-charge coverage (FCC), which ended fiscal 2016 at 1.36x;
- Strong liquidity, especially given the limited needs of its distribution-only electric system, which ended fiscal 2016 with just under a year of operating expenditures or \$11.9 million;
- A manageable direct debt burden and limited capital needs, which we expect the utility to fund internally; and
- The plant's role as a small distribution system with a largely residential customer base, which we believe provides stability and predictability to the customer base.

In our opinion, the following weaknesses offset these strengths:

- A shallow service area economy with a large degree of customer concentration, with the 10 largest customers accounting for 35% of electric revenues, which we believe leaves the utility at risk for load loss;
- The lack of a multi-year financial forecast; and
- Middleton's participation in Massachusetts Municipal Wholesale Electric Co.'s (MMWEC) Seabrook and Millstone nuclear projects, which we believe exposes the utility to some operational risk.

Middleton's business profile of '4' reflects our assessment of a solid competitive position and supportive state regulatory environment, although a high user concentration and limited customer base that inherently limits financial and operational flexibility mitigate these factors. We assign business profiles on a 10-point scale, in which '1' is the strongest.

Middleton (population 9,869) is in Essex County 19 miles south of Boston in northern Massachusetts. Good highway and rail access facilitate transportation throughout the region and into Boston. Although we consider the regional economy of Essex County broad and diverse, we note the MELD serves 3,705 customers within the municipal boundary. The service area is stable and has seen little customer growth over the past five years. Residential sales account for 38% of utility revenue in 2016, which we believe contributes to stability and predictability of the customer base. Commercial and industrial customers account for 24% and 36% of 2016 revenue, respectively.

Though we believe the customer base is stable, there is concentration, with the 10 largest users accounting for 35% of utility revenues, which we believe leaves the utility at risk for load loss. The top customer, Bostik Findley, Inc., is the world's fourth-largest manufacturer and supplier of adhesives and sealants, is headquartered in Middleton, and represents 11% of system revenues.

The electric utility is a distribution only system. Middleton participates in several of MMWEC nuclear projects, providing it with about 37% of its power needs, but also requiring it to share in operation and maintenance costs as well as debt service of the generation projects. MELD participates in the Millstone Unit 3 and Seabrook Unit No. 1 nuclear facilities, as well as Stonybrook intermediate and peaking facilities. The all-in cost of power from MMWEC is what we view as high due to the significant amount of project-related debt. However, the MMWEC debt amortizes in fiscal 2018, so when it rolls off, Middleton's cost of power from MMWEC should be more favorable. The remaining energy comes primarily from several bilateral agreements and purchases at Independent System Operator (ISO) New England on the spot market, which accounted for nearly 17% of purchased power in fiscal 2016.

Middleton has a purchased power adjustment it implements monthly on top of the base rate. This is a credit positive to the extent that the utility relies on the spot market for about 15% of supply, which can be more volatile than its contracted supply costs.

The system-wide rates are competitive and below state averages. According to 2015 data from the Energy Information Administration, MELD's residential rates are 68% of the state's rates on a cents per kilowatt-hour basis. Commercial and industrial rates are 96% and 104% of the state's rates, respectively. In our view, fixed cost coverage, which includes Middleton's portion of total MMWEC debt service and demand costs from ISO NE purchases, has been historically good. FCC has ranged from 1.35x to 1.73x over the past five years, and ended fiscal 2016 at 1.36x. We believe coverage levels are good for the current rating. However, we note that as the MMWEC debt amortizes and Middleton's fixed costs decline, coverage may improve. We also believe MELD has strong liquidity on a days' cash basis, with nearly 351 days or \$11.98 million.

Middleton expects to finance any capital needs internally. There is no direct bonded debt outstanding, but the utility is responsible for servicing a small amount of the town's debt issued on its behalf, and a small portion of off-balance-sheet debt related to its MMWEC entitlement.

Outlook

The stable outlook reflects our expectation that coverage metrics will remain at least at current levels, given the retiring MMWEC obligations, which mitigates some risk for the utility's high degree of customer concentration and small size.

Upside scenario

Although a majority of the obligation to support MMWEC debt will be rolling off, we believe the system's revenue concentration among its top customers and limited service area economy currently preclude a higher rating.

Downside scenario

Though unlikely, if increases in ISO NE fixed costs cause a strain on the utility's ability to maintain good FCC or liquidity, despite MMWEC debt rolling off, we could lower the rating.

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