NRR-PMDAPEm Resource

From: Morgan, Nadiyah
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To: Morgan, Nadiyah
Subject: Exelon Fitch Credit Rating Report
Attachments: EXC_2.7.2014.pdf

From: Tyler, Edmund M:(CENG)
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To: Morgan, Nadiyah; Simmons, Anneliese
Cc: Montgomery, Bruce S:(CENG); Jones, Jeanne Marie Nurthen:(GenCo-Nuc); Wright, Bryan P:(Constellation); John Matthews; Decker, Lisa:(CENG); Domeyer, Tamra:(BSC); Williams, Jeffrey R:(GenCo-Nuc); Millon, Edward L:(GenCo-Nuc)
Subject: FW: Proposed Email to NRC

In a conference call between Exelon, Constellation Energy Nuclear Group and NRC staff on February 10, 2014, Exelon agreed to send the NRC an updated Fitch credit rating report on Exelon Corp. and its subsidiaries. The report is attached.

If you have any questions, please contact Bruce Montgomery or me.

Ned Tyler
Constellation Fleet Licensing

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FITCH REVISES EXC AND EXGEN RATING OUTLOOK TO NEGATIVE; COMED UPGRADED

Fitch Ratings-New York-07 February 2014: Fitch Ratings has taken a number of actions with respect to the ratings and Rating Outlooks of Exelon Corp. (EXC) and its subsidiaries. The ratings actions include the following:

--Affirmed the 'BBB+' Issuer Default Ratings (IDR) and instrument ratings of Exelon Corp. (EXC) and Exelon Generation Co., LLC (Exgen) and revised the Rating Outlook for each entity to Negative from Stable.

--Upgraded the IDR of Commonwealth Edison Co. (Comed) to 'BBB' from 'BBB-' and revised the Rating Outlook to Stable from Positive. Comed's instrument ratings were also upgraded one-notch.

--Affirmed the 'BBB' IDR and instrument ratings of Baltimore Gas and Electric Co. (BGE) and revised the Rating Outlook to Positive from Stable.

--Affirmed the 'BBB+' IDR and instrument ratings of PECO Energy Co. (PECO) with a Stable Rating Outlook.

The Negative Rating Outlooks for EXC and Exgen primarily reflect the continued down trend in gross margin and credit protection measures due to the on-going weakness in forward power and natural gas prices, soft power demand and aggressive competition in the retail supply business. Exgen remains the largest contributor to EXC's cash flow and as such the Negative Ratings Outlook for EXC mirrors that of its non-regulated subsidiary. The revised Rating Outlook also considers that credit protection measures, although declining remain solidly within the investment grade category.

The upgrade of Comed reflects the improvement in credit metrics due in large measure to tariff increases over the past several years and the greater predictability of earnings and cash flow due to the implementation of a formula rate plan (FRP) in Illinois.

Similarly, the Positive Rating Outlook for BGE results from higher rates and improving credit measures.

The rating and Stable Rating Outlook for PECO are consistent with the company's strong credit profile.

Key Rating Drivers

Exelon Corp.

Competitive Generation Business: Low power prices, weak demand and aggressive competitive pricing behavior have adversely affected wholesale and retail margins and are expected by Fitch to persist for several more years keeping pressure on credit quality measures.

Utility Earnings Contribution: The consolidated ratings also consider the contributions of EXC's three regulated utilities, which account for about 50% of consolidated earnings and cash flow. The utilities have sound and/or improving credit profiles, limited commodity price risk and a relatively predictable earnings stream, balancing the more volatile earnings and cash flow of the commodity sensitive merchant business.

Prudent Financial Management: Management has taken a number of steps over the past 15-months to reduce financial commitments and solidify credit quality in the face of persistently low power prices that are pressuring wholesale and retail profit margins. The credit supportive actions include substantial reductions in merchant capex and the common stock dividend. Consequently, financial metrics are expected by Fitch to remain solidly within the investment grade category. In February 2013, EXC reduced its common stock dividend by 40%, saving nearly $750 million annually. The dividend reduction followed a $2.3 billion reduction in merchant capex that have subsequently been further reduced.

Financial Position: The combined reductions of the common stock dividend and capex have solidified EXC's financial position. Fitch estimates EXC's adjusted ratio of funds from operations (FFO)/ interest to be in excess of 6.0x over the next several years and FFO/debt to approximate 30%.

Liquidity: Liquidity is ample and debt maturities should be manageable. On a consolidated basis committed credit facilities aggregate $8.4 billion, and extend to 2018.

Rating Sensitivity

Positive
Other than an unexpected change in business strategy (i.e. additional sources of regulated earnings and cash flow), positive rating action at the parent is unlikely at the present rating level.

Negative
Lack of rate support for utility infrastructure investments or changes in the commodity cost recovery provisions in Illinois, Pennsylvania or Baltimore.

More aggressive growth strategy that increased business risk and/or leverage.

Increase in risk appetite as evidenced by change in hedging strategy at Exgen.

Exelon Generation Company, LLC
Operating environment: The operating environment for Exgen's competitive generation business is expected to remain challenging with sluggish demand and low natural gas and power prices likely to persist for several years with a downtrend in gross margin. Favorably, Exgen is expected to be free cash flow (FCF) positive due to reduced capex and dividend requirements, easing the pressure on cash flow and credit quality measures during a low point in the commodity cycle.

Competitive Position: Exgen's largely nuclear-fueled generating fleet is positioned low on the dispatch curve and likely to be dispatched under any price scenario. The nuclear fleet is also well positioned to benefit from any uplift in power prices from higher environmental costs or plant retirements and requires limited environmental remediation expenditures. Nonetheless, several nuclear plants operating in regions without a capacity market are at risk for closure.

Expense Reductions: Exgen entered into a service agreement to operate the Constellation Energy Nuclear Group (CENG) nuclear fleet that is expected by management to generate annual savings of roughly $50 million - $70 million annually (Exgen's share is 50%) with a $20 million cost to achieve. NRC approval is required. CENG is a joint venture with Electricite de France. The transaction is expected to close late in 2014 Q1 or early Q2.

Financial Position: Exgen's financial position has weakened in recent years, but remains solidly within the investment grade category. Fitch expects expense and debt reductions to offset on-going declines in gross margin and stabilize credit metrics at or near current levels. Fitch estimates Exgen's adjusted ratio of EBITDA/interest to range between 5.5x and 6.0x and debt/EBITDA at about 2.5x - 2.75x. Cash flow measures are expected to be stronger with FFO/debt to be in excess of 40% and FFO/interest to exceed 7.0x.

Debt Reduction: Since the dividend reduction Exgen has retired $950 million of recourse debt with cash including $450 million of callable junior subordinated debt at par in June 2013 and $500 million of maturing senior debt in January 2014. Additional debt retirements are anticipated in 2015.

Revised Growth Plan: Planned capital expenditures were reduced $2.3 billion and now aggregate $6.8 billion over the 2014-2016 time frame. The reductions were primarily investments in unidentified renewable projects and cancelling planned nuclear uprates at the LaSalle and Limerick units, totaling nearly 600 MW to beyond 2019. Over the three-year period through 2016, growth capex is now about $775 million for nuclear uprates and wind and solar projects, including the build-out of the Antelope Valley Solar Ranch (AVSR). Exgen will also be investing approximately $350 million to construct generation in Maryland required as part of the Constellation merger approval. Fitch believes other investments are likely, but will be limited to contracted renewables or possibly distressed merchant assets in regions that have a well-functioning capacity market and/or a tight reserve position.

Rating Sensitivity

Positive:
There are no developments that are likely to lead to a positive rating action.

However, ratings could be maintained if there is clear evidence of a sustainable improvement in power prices and/or capacity revenue.

Negative:
A further decline in gas and power prices;
An unexpected reversion to a more aggressive growth strategy.

Commonwealth Edison Co.
Strong Credit Metrics: Higher rates effective Jan. 1, 2014 and the FRP plan that allows for annual rate adjustments should allow Commonwealth Edison Co. (Comed) to sustain its currently sound financial position over the next few years. Fitch estimates EBITDA/interest will average about 5.0x, FFO/interest 4.5x, FFO/debt 18% - 20% and debt/EBITDA about 3.75x over the next several years. Each measure is strong for the current rating.

Regulatory Predictability: The FRP implemented in October 2011 provides increased regulatory predictability in Illinois. The FRP recognizes forward looking capital additions and includes a true-up mechanism reducing, albeit not eliminating, rate lag.

Constructive Rate Decision: In December 2013, the Illinois Commerce Commission approved a $341 million increase in distribution rates or approximately 97% of the company's rate request.

Commodity Price Exposure: Ratings and credit quality benefit from the absence of commodity price exposure, which limits cash flow volatility and reduces business risk.

Rising Capex: Capital expenditures are forecasted to rise to approximately $5.7 billion over the three-year period 2014-2016, compared to $3.7 billion in the prior three-year period. The higher outlays are primarily driven by the Illinois Energy Infrastructure Modernization Act (EIMA), which requires Comed to invest an incremental $1.3 billion on electric system upgrades over five years and an additional $1.3 billion for smart grid deployment over 10 years. The legislation provides for recovery through the FRP filings. The capex forecast also reflects an increase in transmission expenditures, which are subject to credit supportive Federal Energy Regulatory Commission (FERC) regulatory policies.

Like-Kind-Exchange: Comed's exposure to the IRS's disallowance of the tax benefits associated with a like-kind-exchange is a credit concern, however, the issue is not likely to be resolved for several years and was not factored into the rating decision. As of Sept. 30, 2013, Comed's potential tax and interest that could become payable, excluding penalties, is $305 million.

Rating Sensitivity

Positive:
A continuation of constructive outcomes in FRP filings;

Ability to reduce leverage below 3.5x.

Negative:
Lack of rate support for infrastructure investments or changes in the commodity cost recovery provisions.

PECO Energy Co.
Strong Credit Profile: Historical and projected credit measures are strong and well in excess of Fitch's target ratios for the current rating category and the companies' peer group of 'BBB+' distribution utilities. Over the next few years, Fitch estimates EBITDA/interest and FFO/interest will average about 7.0x and 6.0x, respectively and FFO/debt and debt/EBITDA about 20% and 3.0x. The strong performance reflects expectations of timely rate recovery and moderate debt financing.

Alternative Regulatory Model: Fitch considers the regulatory legislation enacted in Pennsylvania in February 2012 (HB 1294) to be supportive of credit quality.

Manageable Capital Spending: PECO expects to invest approximately $1.6 billion over the next three years, moderately higher than the $1.4 billion expended in the prior three-years. The expenditures equate to about 2.2x depreciation and amortization, which approximates the industry in average.

Low business Risk: Ratings and credit quality benefit from the absence of commodity price exposure and the associated cash flow volatility.

Rating Sensitivity

PECO Energy Company

Positive:
Sustaining current financial condition could lead to a positive rating action.

Negative:
Not likely given the head room in current ratings.

Baltimore Gas and Electric Company
Credit Metrics: BGE's financial position improved significantly in 2013 largely due to electric and gas rate increases implemented in February 2013, the first increases since December 2010 and the expiration of a $112 million rate credit. Subsequent electric and gas rate increases implemented in December 2013 are expected to drive further improvement in 2014 and beyond. Fitch estimates EBITDA/interest and FFO/interest to exceed 6.0x and FFO/debt and debt/EBITDA of about 25% and 2.5x, respectively.

Dividend Restrictions: BGE is precluded from paying dividends to parent Exelon Corp. (Exelon) through 2014

Regulatory Recovery Mechanisms: Rate adjustment mechanisms outside of base rate cases tend to stabilize BGE's on-going cash flow. These include decoupling for both residential and commercial gas and electricity sales and purchased gas and purchased power recovery mechanisms. In addition, investments in energy efficiency are subject to a tracking mechanism.

Ring-fencing: BGE's funding and Treasury practices result in moderate ring fencing of the utility from its parent Exelon Corp. and affiliates. These include maintaining separate books and records and separate credit facilities and commercial paper programs and allocating parent expenses according to a Cost Allocation Manual that is filed annually with the Maryland Public Service Commission (MPSC). Also, BGE does not participate in the corporate money pool. Furthermore, BGE's financings do not contain any provisions that could result in cross defaults between BGE and Exelon.

Rating Sensitivity

Positive:

A constructive outcome in expected 2014 rate filing.

Negative:
Lack of rate support for infrastructure investments or changes in the commodity cost recovery provisions.

Fitch has affirmed the following ratings with a Negative Outlook:

Exelon Corp.
--Issuer Default Rating (IDR) 'BBB+';
--Senior unsecured debt 'BBB+';
--Commercial paper 'F2';
--Short-term IDR 'F2'.

Exelon Generation Co., LLC
--Issuer Default Rating (IDR) 'BBB+';
--Senior unsecured debt 'BBB+';
--Commercial paper 'F2';
--Short-term IDR 'F2'.

Fitch has affirmed the following ratings with a Positive Outlook:

Baltimore Gas and Electric Company
--Issuer Default Rating (IDR) 'BBB;
--First mortgage bonds 'A-';
--Senior unsecured debt 'BBB+';
--Pollution control revenue bonds 'BBB+'
--Preferred stock to 'BBB-';
--Short-term IDR 'F2';
--Commercial paper 'F2'.

Fitch has upgraded the following ratings with a Stable Outlook:

Commonwealth Edison Company

--Issuer Default Rating (IDR) to 'BBB' from 'BBB-;
--First mortgage bonds to 'A-' from 'BBB+';
--Senior unsecured debt to 'BBB+' from 'BBB';
--Preferred stock to 'BBB-' from 'BB+';
--Short-term IDR to 'F2' from 'F3';
--Commercial paper to 'F2' from 'F3'.

ComEd Financing Trust III
--Preferred stock to 'BBB-' from 'BB+'.

Fitch has affirmed the following ratings with a Stable Outlook:

PECO Energy Co.
--Issuer Default Rating (IDR) 'BBB+';
--First mortgage bonds 'A';
--Senior unsecured debt 'A-';
--Commercial paper 'F2';
--Short-term IDR 'F2'.

PECO Energy Capital Trust III
--Preferred stock 'BBB'.

PECO Energy Capital Trust IV
--Preferred stock 'BBB'.

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Applicable Criteria and Related Research:

--'Corporate Rating Methodology' (Aug. 5, 2013);
--'Recovery Ratings and Notching Criteria for Utilities' (Nov. 19, 2013).

Applicable Criteria and Related Research:
Corporate Rating Methodology: Including Short-Term Ratings and Parent and Subsidiary Linkage
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=715139
Recovery Ratings and Notching Criteria for Utilities
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=722085