MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades Mississippi Power to Baa3, negative outlook; affirms Southern, negative outlook

Global Credit Research - 05 Nov 2015

Approximately $2 billion of debt securities downgraded

New York, November 05, 2015 -- Moody's Investors Service downgraded Mississippi Power Company's ratings, including its senior unsecured debt to Baa3 from Baa2, preferred stock to Ba2 from Ba1 and short-term pollution control revenue bond rating to VMIG-3 from VMIG-2. The rating outlook is negative. Moody's affirmed the ratings of The Southern Company (Southern, Baa1 senior unsecured) with a negative outlook.

RATINGS RATIONALE

"The downgrade of Mississippi Power's ratings is prompted by the election of what we expect to be a less credit supportive Mississippi Public Service Commission (MPSC) at a time when the utility will be pursuing important rate recovery proceedings on the Kemper IGCC plant in 2016," said Michael G. Haggarty, Associate Managing Director. "The election of two new commissioners increases regulatory uncertainty and heightens the risk that the utility will not obtain full and timely rate recovery on all $2.88 billion of costs subject to the MPSC approved cost cap, as well as $1.3 billion of costs exempt from the cap", added Haggarty. While the election outcome could have been worse from a credit standpoint as the most vocal Kemper opponent was defeated, both of the new commissioners have voiced serious concerns and reservations about the plant over the last several months.

The downgrade also reflects Mississippi Power's weak liquidity and standalone financial condition, metrics that we expect to be below investment grade levels for at least one to two years, the continued cost increases and delays at the plant, the potential forfeiture of $234 million of Phase II tax credits because of these delays, and its increasing reliance on the Southern parent company for financial and liquidity support. Although Southern continues to back both Mississippi Power and the project, including making another $75 million equity contribution in September, we believe there are limits to the parent company's continued support for both the company and the Kemper project.

Last month, Mississippi Power revised its plant cost estimate upward by $110 million, mostly reflecting the inclusion of projected costs from April 1, 2016 through June 30, 2016 due to its expectation that the plant will be placed into service during the first half of 2016, including a three month contingency. These cost increases, along with smaller cost increases in July and August, resulted in pre-tax charge to income of approximately $150 million ($93 million after-tax) in the third quarter.

The potential delay of the in-service date beyond 19 April 2016 has led Mississippi Power to reclassify $235 million of Phase II investment tax credits allocated to the project by the IRS as a current liability. Once a final determination is made on the in-service date, which Moody's expects will be later than this date, repayment of the tax credit would be made to the IRS with any funding requirements expected to be provided by Southern.

Mississippi Power is currently collecting $159 million of refundable, emergency interim rates on the commercially operating portion of the plant (including the combined cycle, transmission facilities, natural gas pipeline, and water pipeline), which are in place until hearings are held and a MPSC decision is made on making these rates permanent, expected by 8 December 2015. The emergency rate relief and subsequent proceedings became necessary after the Mississippi Supreme Court invalidated the MPSC approved rate plan Mississippi Power had been operating under since 2013. Mississippi Power is in the process of refunding $353 million of rates already collected (as of 30 June), funding which will need to be provided by the parent.

This funding requirement is in addition to an 18-month promissory note that Mississippi Power provided to Southern earlier this year to fund the return of a $301 million deposit from a partner ending its participation in the plant, South Mississippi Electric. Mississippi Power has also been reliant on short-term bank term loans for its ongoing financing needs in anticipation of a potential securitization of a portion of the Kemper plant costs, with $900 million of bank term loans scheduled to mature on 1 April 2016.

The negative outlook on Mississippi Power's ratings reflects the company's constrained liquidity position combined with the heightened regulatory uncertainty facing the company as it strives to obtain permanent rate relief on the Kemper plant with a new, less credit supportive state regulatory commission coming into office in January. It also reflects the technological and other first-of-a-kind challenges facing the company as it continues the testing and start-up activities on the plant in order to maintain its currently estimated commercial operation date in the first half of 2016.

What Could Change the Rating - Up

An upgrade of Mississippi Power is highly unlikely while there are no permanent cost recovery provisions in place and while the utility is in the midst of completing and testing the Kemper plant. Ratings could be upgraded if there is an MPSC approved plan for the ultimate recovery of costs up to the current $2.88 billion regulatory approved cap and for $1.3 billion of costs outside the cap; if the MPSC demonstrates that it continues to be credit supportive after new commissioners take office in January; and if the utility successfully executes an anticipated lengthy start-up and testing phase. Any upgrade would also be predicated on the maintenance of credit metrics at levels more commensurate with strong Baa rating, including CFO pre-working capital to debt of approximately 20% on a sustained basis.

What Could Change the Rating - Down

A downgrade of Mississippi Power could occur if there is no near term approval by the MPSC on a permanent cost recovery plan for the in-service assets of Kemper; if the interim rates currently in place are invalidated or rolled back for any reason; if the newly constituted MPSC takes actions that are detrimental to Mississippi Power's credit; if there are additional material delays, cost increases, or other problems associated with the plant; if parent company financial and liquidity support for the utility becomes less certain and/or Southern's commitment to the project declines; or if Mississippi Power's CFO pre-working capital to debt falls below 13% for a sustained period.

The affirmation of the ratings of Southern considers the large and diverse nature of its sources of cash flow, with three of its other major operating subsidiaries, Alabama Power Company (A1 senior unsecured, stable), Gulf Power Company (A2 senior unsecured, stable), and Southern Power Company (Baa1 senior unsecured, stable), all maintaining stable rating outlooks. Mississippi Power is one of Southern's smallest subsidiaries, providing approximately 10% of the consolidated company's cash from operations in 2014.

Although Southern's largest utility, subsidiary Georgia Power (A3 senior unsecured) also maintains a stable rating outlook, it has experienced cost increases and delays at its Vogtle new nuclear project that have weakened its relative position at the A3 rating level. However, the recently announced settlement between the Vogtle project owners and the EPC contractors is credit positive in that it resolved long-term disputes that had plagued the projects and provided renewed clarity on the current expected cost of construction. The settlement also ended the litigation between the Vogtle owners and the EPC contractor. The size and importance of Georgia Power and the Vogtle nuclear project make them a much more important driver of Southern's consolidated credit profile and credit rating.

The negative outlook on Southern reflects the company's pending acquisition of AGL Resources, Inc. (unrated), an Atlanta based natural gas distribution company, for approximately $8 billion of cash. The transaction will result in a significant increase in debt at the Southern holding company level at a time when holding company debt has already been increasing, partly to support funding needs at Mississippi Power and portfolio growth at Southern Power. As a result, the rating of Southern is likely to be lowered one notch at or before the closing date of the AGL acquisition if the transaction is financed as currently envisioned. Southern estimates closing will be in the second half of 2016.

The principal methodology used in these ratings was Regulated Electric and Gas Utilities published in December 2013. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

The Southern Company is a utility holding company headquartered in Atlanta, Georgia and the parent company of utility subsidiaries Alabama Power Company, Georgia Power Company, Gulf Power Company, Mississippi Power Company, Southern Electric Generating Company, wholesale power company Southern Power Company, financing subsidiary Southern Company Capital Funding, Inc., and commercial paper issuer Southern Company Funding Corporation.

Downgrades:

..Issuer: Eutaw (City of) AL, Industrial Dev. Board

....Backed Senior Unsecured Revenue Bonds, Downgraded to Baa3/VMIG 3 from Baa2/VMIG 2