MOODY'S
INVESTORS SERVICE

CREDIT OPINION
6 January 2017

New Issue

Rate this Research

RATINGS

Transource Energy, LLC

Domicile	United States
Long Term Rating	A2
Type	LT Issuer Rating - Dom Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Transource Energy, LLC

Competitive Transmission-Only Holding Company

Summary Rating Rationale

Transource's A2 issuer rating reflects its lower business risk profile as an intermediate holding company with FERC-regulated transmission only projects through FERC Order 1000 competitive process. It operates under FERC's credit-supportive regulatory framework, which provides a full forward looking formula rate mechanism, resulting in transparent and visible cash flows and credit metrics. Its rating also incorporates the sponsor support Transource receives from American Electric Power Company, Inc. (AEP, Baa1 stable) and Great Plains Energy Inc. (GPE, Baa2 RUR-down), which owns 86.5% and 13.5%, respectively. The rating factors in the anticipated large capital investment over the next 2-3 years as Transource completes two of its transmission projects. Transource currently has two projects, the Iatan-Nashua transmission line and the Sibley-Mullin Creek-Nebraska City transmission line, in service.

Credit Strengths

» Lower risk business profile as a pure-play transmission company

» Supportive FERC regulatory framework with forward looking formulaic rates

» Strong joint venture parent companies, AEP and GPE

Credit Challenges

» Large capital expenditure program underway

» Leverage expected to increase before cash flow increase

» Growth depends on projects awarded through competitive process

Rating Outlook

Transource's stable outlook reflects the stability and predictability of cash flows that result from the FERC regulatory framework, including full forward looking formulaic rate mechanism, and various credit supportive incentives approved by FERC. It also incorporates our expectation that there are some execution risks as the company completes its projects. We also expect the company to maintain leverage and generate cash flow metrics that are consistent and appropriate for the rating.

Factors that Could Lead to an Upgrade

A rating upgrade could be considered if Transource's metrics improve materially such that its three-year average funds from operations (FFO) to net debt is above 20% on a sustained basis. Also, if the funding of the capital investment relies less on external financing and more on equity infusion from AEP and GPE, Transource's rating could see a positive momentum.

Factors that Could Lead to a Downgrade

A rating downgrade could be considered if Transource relies more on external financing to fund its capital investment program, such that its FFO to net debt decreases to approximately 16% on a sustained basis. If Also, if the regulatory environment becomes less constructive and the regulatory lag for cost recovery becomes longer, a downgrade could be considered.

Detailed Rating Considerations

LOWER BUSINESS RISK PROFILE AS TRANSMISSION ONLY COMPANY

Transource is an intermediate holding company formed through a joint venture between AEP and GPE who are investment grade regulated utility holding companies. Transource was specifically formed to participate in the competitive processes for transmission development. Transource receives financial and operational support from AEP and GPE through their operating agreement and service agreements.

Its rates for the transmission projects are established through FERC, whose regulatory framework we view to be credit supportive. Transource is regulated by FERC only and is insulated from the potential increase in contentiousness from any changes in regulatory environment on a state or local level. Transource's four projects are geographically diverse. These projects are in two regional transmission organization (RTO) markets - Southwest Power Pool (SPP) and PJM Interconnection (PJM) – covering four states, Maryland, Missouri, Pennsylvania, and West Virginia.

In addition to transparent rate setting mechanisms, Transource faces limited revenue risk as its revenue is based on investments rather than usage volume. Furthermore, Transource faces limited counterparty risk as its revenue is collected through the RTOs from the load-serving entities who are typically investment-grade utilities. Transmission revenue is collected from the respective transmission customers through the Open Access Transmission Tariff (OATT) and is allocated to the transmission owners, such as Transource, by RTOs based on the specific revenue requirement determined by FERC.

SUPPORTIVE FERC REGULATORY FRAMEWORK

Transource's investments are FERC regulated transmission only projects. There is a higher level of certainty and transparency in its rates as they are established through a formulaic mechanism. Transource's rates are established on a project-by-project basis and using a full forward-looking formula mechanism, minimizing regulatory lag in investment cost recovery. In addition, the rates are adjusted annually with a true-up mechanism for over/under recovery. Three of its projects have established return on equity (ROE). Transource filed with FERC to establish an ROE and forward-looking formula rate for the fourth project which is currently under a design phase. FERC has a 60-day statutory deadline to respond.

In addition to the full forward-looking formula rate, FERC allows formula rate incentives, including return on construction work in progress (CWIP) and hypothetical capital structure during construction, a credit positive.

SIGNIFICANT CAPITAL INVESTMENT PLANNED OVER THE NEXT THREE YEARS

Over the next three years, Transource should have two projects under construction and its capital investment is expected to total approximately $240 million. The Thorofare Area project, located in West Virginia, is a 25-mile 138 kV line, and is expected to be in service in June 2019. FERC authorized a forward-looking formula rate, including a base ROE of 10% with a 50 basis points (bps) RTO ROE incentive adder, and 100% CWIP in rate base. The Southern PA project crosses the Maryland and Pennsylvania border, covering approximately 42 miles. Transource made a filing with FERC in November 2016 to establish rates to recover the investment cost.

The Sibley-Mullin Creek – Nebraska City project came in service at the end of 2016. It is approximately 175 miles (of which 135 miles is owned by Transource). FERC has granted 9.8% base ROE but with the incentive RTO ROE adder, all-in ROE is 11.3%.

STABLE KEY METRICS SUPPORTED BY TRANSPARENT RATE ADJUSTMENTS

We estimate Transource's key metrics such as FFO to net debt to average around 17% over the next three years. Compared to the 16%-19% FFO to net debt average of AEP Transmission Company (AEP Transco, A2 stable), AEP's other transmission only company, Transource's FFO to net debt is comparable. However, we view that there is higher concentration risk around Transource's four projects and cash flow compared to AEP Transco, which has a larger and longer backlog of the projects.

In order to fund the construction, Transource is expected to increase its debt level. Thus, we expect its FFO to net debt to decline with the debt level increasing at a higher rate than the cash flow. We expect Transource's cash flow to improve over the next three years and beyond as constructions are completed and its projects are in service. Based on its lower risk business risk profile and limited revenue and counterparty risks under the transparent FERC regulatory framework, we expect Transource's metrics to be stable on average.

As Transource is focused on growing its rate base, it is expected that the equity contribution received from its sponsors will be higher than any dividend distributed to the sponsors. Effectively, Transource does not plan to distribute any dividend to AEP and GPE over the next four years while it completes the projects. In addition, any development expenses incurred at Transource will be funded through equity from AEP and GPE. Moody's base case factors in the development expenses in the calculation of FFO as these expenses are incurred at Transource. If we adjust FFO to exclude the development expenses, Transource's FFO to net debt would be higher ranging from 20% to 25% over the next three years.

Liquidity Analysis

We expect Transource to maintain adequate liquidity over the next 12-18 months.

Transource's liquidity supports its planned investments. Transource does not have its own credit facility. However, Transource Missouri, LLC, a utility subsidiary of Transource, has a $175 million credit facility expiring in January 2018. Transource Missouri is the only entity within the Transource family that has a project in service. The facility includes a $50 million accordion feature and also supports letters of credit up to $30 million. As of 30 September 2016, Transource Missouri has borrowed $115.5 million on the facility.

As of year-to-date ended 30 September 2016, Transource has funded $80.2 million of construction expenditures with internally generated Cash Flow from Operations (CFO) of $22.5 million. FFO in the same period was $16.8 million. Funding gaps are expected to be met through equity contributions from parent and revolver borrowings. AEP and GPE are expected to make periodic and consistent equity contributions to Transource to maintain the appropriate capital structure during the construction phase of Transource's projects.

Corporate Profile

Transource Energy (A2 Issuer Rating, stable) is an intermediate holding company with FERC-regulated transmission only projects through FERC Order 1000 competitive process. It is formed through a joint venture between American Electric Power Company, Inc. (Baa1, Stable) with 86.5% ownership and Great Plains Energy Company, Inc. (Baa2, RUR-Down) with 13.5% ownership. Transource has two transmission lines in service in Southwest Power Pool (SPP) and two projects either under constructions or in design phase in PJM Interconnection (PJM).

Rating Methodology and Scorecard Factors

Exhibit 1

Rating Factors				
Transource Energy				
Regulated Electric and Gas Networks Industry Grid [1][2]	**Current FY 2015**		**Moody's 12-18 Month Forward View As of Date Published [3]**	
Factor 1 : Regulatory Environment and Asset Ownership Model (40%)	**Measure**	**Score**	**Measure**	**Score**
a) Stability and Predictability of Regulatory Regime	Aaa	Aaa	Aaa	Aaa
b) Asset Ownership Model	Aaa	Aaa	Aaa	Aaa
c) Cost and Investment Recovery (Ability and Timeliness)	Aa	Aa	Aa	Aa
d) Revenue Risk	Aaa	Aaa	Aaa	Aaa
Factor 2 : Scale and Complexity of Capital Program (10%)				
a) Scale and Complexity of Capital Program	Ba	Ba	Ba	Ba
Factor 3 : Financial Policy (10%)				
a) Financial Policy	Baa	Baa	Baa	Baa
Factor 4 : Leverage and Coverage (40%)				
a) FFO Interest Coverage (3 Year Avg)	6.1x	Aa	5x - 7x	Aa
b) Net Debt / Fixed Assets (3 Year Avg)	45.8%	A	40% - 43%	Aa
c) FFO / Net Debt (3 Year Avg)	11.3%	Baa	16% - 19%	Baa
d) RCF / Net Debt (3 Year Avg)	11.3%	Baa	16% - 19%	A
Rating:				
Indicated Rating from Grid Factors 1-4		A2		A2
Rating Lift			0	0
a) Indicated Rating from Grid		A2		A2
b) Actual Rating Assigned				A2

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2] As of 12/31/2015.
[3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.
Source: Moody's Financial Metrics™

Ratings

Exhibit 2

Category	Moody's Rating
TRANSOURCE ENERGY, LLC	
Outlook	Stable
Issuer Rating	A2

Source: Moody's Investors Service

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