Utilities – US

Toshiba Financial Woes Are Credit Negative for Vogtle and Summer Nuclear Projects

The decline in the credit quality of Toshiba Corporation (Caa1, ratings under review) has incrementally increased credit risk at the Vogtle and VC Summer new nuclear plants being built by Georgia Power Company (A3 stable) and South Carolina Electric and Gas Company (SCE&G, Baa2 stable), respectively, in partnership with four other entities. Toshiba is the parent company of both project’s EPC contractor, Westinghouse Electric Company LLC (unrated), and the guarantor of certain Westinghouse obligations under the EPC contracts.

On 28 December 2016, Moody’s Japan K.K. downgraded Toshiba’s corporate family rating (CFR) to Caa1 from B3, principally reflecting Moody’s deepening concerns over the sustainability of Toshiba’s near-term liquidity, as well as the substantive and rapid erosion of its equity base. The downgrade came after the company’s announcement of a likely material impairment loss related to the acquisition of a US nuclear construction and services provider, CB&I Stone & Webster Inc. (unrated), by Westinghouse in December 2015.

Although Toshiba is still assessing the exact amount of the impairment loss, its financial metrics will likely deteriorate further, potentially resulting in a negative equity position. The impairment loss could further lead to a breach of the company’s bank debt financial covenants. Toshiba’s ratings remain on review for further downgrade.

Georgia Power and its partners have insulated themselves to some degree from the near term impact of Toshiba’s financial deterioration by requiring that Westinghouse provide letters of credit or other credit enhancement in the event of a credit rating downgrade of Toshiba. In January 2016, after an earlier downgrade, Westinghouse provided Georgia Power and the other Vogtle project owners with letters of credit totaling $920 million.

SCE&G and the VC Summer project owners are insulated to a lesser degree as they are entitled to letters of credit of up to $100 million - calculated as 15% of the highest three months billings during the applicable year. As of September 2016, $45 million of letters of credit had been posted. As an additional protection, certain intellectual property, including design documentation (approximately 94% complete) and related software is currently being escrowed for the benefit of the VC Summer owners.

There are longer-term risks, however, with regard to Toshiba’s continued commitment to its US nuclear business considering that the business has been the source of the latest impairment loss. According to Toshiba, Westinghouse has found that the cost to complete the US nuclear projects will far surpass the original estimates, mainly due to increases in key project parameters, resulting in far lower asset value than originally determined, leading to
a possible recognition of goodwill far exceeding its original December 2015 estimate of $87 million. Its current estimation shows a level of several 100 billion yen or several billion US dollars. The company plans to determine the amount of goodwill by the time it announces its third quarter results in mid-February.

While it is still too early to determine the future of Toshiba’s nuclear business, any exit or sale of this business could have adverse consequences for the Vogtle and VC Summer projects by potentially introducing a new party into the process while two projects are less than 50% constructed. Even if Toshiba decides to keep its US nuclear business, a financially constrained Toshiba parent company could make any additional costs and/or disputes with Westinghouse more difficult to resolve, or could result in additional project delays if there are insufficient funds available to maintain the currently agreed project schedules.

Georgia Power’s Plant Vogtle Units 3 and 4 consist of two Westinghouse AP1000 nuclear units (with electric generating capacity of approximately 1,100 MWs each) being built at the utility’s existing Plant Vogtle nuclear plant site. Georgia Power owns 45.7% of the new units, with the remainder owned by its current Vogtle nuclear plant partners: Oglethorpe Power Corporation (Baa1 senior secured, stable) at 30%; Municipal Electric Authority of Georgia’s (MEAG Power) (Project M - A2 stable; Project P - Baa2 stable; and Project J - A2 stable) at 22.7%; and the City of Dalton (Aa2 general obligation) at 1.6%.

SCE&G’s VC Summer Units 2 and 3 are two Westinghouse AP1000 nuclear units (with electric generating capacity of approximately 1,117 MWs each) being built at the utility’s existing VC Summer plant site. SCE&G owns 55% of the new units, with the remaining 45% owned by South Carolina Public Service Authority (A1 stable).