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Research Update:

EMG Utica 'B' Rating Affirmed, Outlook Stable; Senior Debt Rating Raised To 'B+' On Improved Recovery Expectations

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Overview

- Significant debt paydown in 2017 has resulted in improved financial ratio projections at EMG Utica LLC, with debt to EBITDA now expected to be in the 1.5x–2x range over the next few years. We also have increased confidence that dividend coverage ratios provide sufficient headroom to shield the company during times of moderate stress.
- We are affirming the 'B' corporate credit rating on EMG Utica LLC. The outlook remains stable.
- At the same time, we are revising the recovery rating on the company's $325 million senior secured term loan B to '2' from '3' and raising the issue-level rating on the debt to 'B+' from 'B'.
- The stable outlook reflects our belief that the company will have adequate liquidity to meet its financial obligations over the next 12 months with interest coverage in excess of 10x and a debt-to-EBITDA ratio in the 1.5x-2x area.

Rating Action

On Jan. 18, 2018, S&P Global Ratings affirmed its 'B' corporate credit rating on EMG Utica LLC. The outlook is stable.

At the same time, we raised our issue-level rating on EMG Utica's $325 million senior secured term loan B to 'B+' from 'B'. We also revised the recovery rating on the term loan to '2' from '3', reflecting our expectation of substantial (70%-90%; rounded estimate: 80%) recovery in the event of default.

Rationale

EMG Utica LLC is rated under S&P Global Ratings' non-controlling equity interest (NCEI) criteria, which are used to rate debt instruments issued by entities that own shares in one or more other entities (the investee company). The 'B' corporate credit rating on the company reflects the differentiated credit quality between it and its investee company, MarkWest Utica EMG LLC, of which EMG Utica owns a 44.3% interest. The differentiation reflects the structural subordination of the company relative to MarkWest Utica and the discretionary dividends that it does not control.

The main factors behind EMG Utica's rating include the cash flow stability of its underlying investment, the level of influence on MarkWest Utica's corporate governance and financial policy, EMG Utica's financial ratios, and EMG Utica's ability to liquidate investments to repay debt.

We assess cash flow stability as neutral, which is an improvement from our previous assessment of negative. MarkWest Utica's cash flows are relatively stable and backed by long-term contracts (remaining tenor of about 11-12 years) with 100% fixed fee-based cash flows. The marginal improvement in counterparty creditworthiness and absence of a financial covenant that could limit dividends from MarkWest Utica support the assessment. At the same time, the company is exposed to volumetric risk given that most contracts are structured as acreage dedications rather than minimum volume commitments, which we view more favorably. Despite MarkWest Utica's competitive advantage in its area of operation, we believe some cash flow volatility is likely during periods of commodity price volatility.

We assess corporate governance and financial policy as negative. In our view, EMG Utica has limited influence on the board or management of MarkWest Utica. MarkWest Energy Partners L.P., the partner in the joint venture, has more control over EBITDA generation and dividends as the operator and majority owner.

We assess financial ratios as positive, which is an improvement over our previous assessment of neutral. Our forecast assumes stand-alone debt to EBITDA in the 1.5x-2x range, with interest coverage ratio of about 10x over the next few years. The cash flow sweep has helped to significantly reduce debt, resulting in approximately $38 million of debt reduction in the first three quarters of 2017, which has led to incremental improvement in leverage ratios over the last year.

We base the negative assessment on the ability to liquidate investments on the fact that MarkWest Utica is not publicly traded and it would be difficult to accurately forecast asset valuations relative to debt.

Liquidity

We assess EMG Utica's liquidity as adequate. We forecast liquidity sources to exceed uses by more than 1.5x for the next 12 months. Although this normally maps to a higher liquidity assessment, qualitative factors limit our assessment at adequate, specifically the lack of a satisfactory standing in the capital markets.

Principal liquidity sources:
- Projected funds from operations of about $90 million, and
- Debt service reserve account of about $5 million.

Principal liquidity uses:
- Mandatory debt amortization of about $2 million, and
- Dividends of about $15 million.

Covenants

Covenants include a maximum leverage ratio of 4.5x and an interest coverage ratio of 3x. We expect EMG Utica to maintain an EBITDA cushion in excess of 15% with its financial covenants.

Modifiers

The positive comparable rating assessment reflects the fact that the ultimate parent of MarkWest Utica's majority owner is a master limited partnership. Therefore, we expect the partnership would maintain or increase distributions over time and thus would require the same from the investments it controls. In addition, there is a six-month debt service reserve throughout the loan's life, which we view as positive for creditworthiness. This positive assessment provides a one notch uplift to reach the final rating.

Outlook

The stable rating outlook on EMG Utica reflects our belief that the company will have adequate liquidity to meet its financial obligations over the next 12 months with interest coverage in excess of 10x and a debt-to-EBITDA ratio in the 1.5x-2x range.

Downside scenario

Though unlikely due to the robust metrics, we could lower the ratings if dividends became curtailed such that interest coverage fell below 1.5x.

Upside scenario

Higher ratings are unlikely over the next year, due to the company's limited scale and our view that MarkWest Utica's cash flows are dependent on counterparties with lower ratings. We could consider higher ratings if our view of MarkWest Utica's creditworthiness improved.

Recovery Analysis

Key analytical factors

- We use a discrete asset valuation approach to value EMG Utica's interest in MarkWest Utica EMG in the event that EMG Utica defaults.
- We simulate a default arising from declining commodity prices that result in lower throughput volumes at EMG Utica's investee company, MarkWest Utica EMG LLC. The lower volume throughput leads MarkWest to sharply reduce its dividend, resulting in EMG being unable to service its debt. Our default scenario does not assume a default at MarkWest Utica EMG.
- The term loan holds a first-priority perfected lien on substantially all of the capital stock of the joint venture held by the borrower as well as its ownership interest in the joint venture.

Simulated default assumptions

- Simulated year of default: 2020
- EBITDA at emergence: About $24.5 mil.
- EBITDA multiple: 7x

Simplified waterfall

- Net enterprise value (after 3% admin. costs): $165 mil.
- Valuation split (obligors/non-obligors): 100%/0%
- Secured first-lien debt: $200 mil. (includes six months of prepetition interest)
- Recovery expectations: '2' (70%-90%; rounded estimate: 80%)

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Corporates - General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- General Criteria: Methodology For Companies With Noncontrolling Equity Interests, Jan. 5, 2016
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed

EMG Utica LLC		
Corporate Credit Rating	B/Stable/--	
Upgraded; Recovery Rating Revised		
	To	From
EMG Utica LLC		
Senior Secured	B+	B
Recovery Rating	2(80%)	3(60%)

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.