FitchRatings

FITCH UPGRADES CMS TO 'BBB', CONSUMERS TO 'A-'; OUTLOOK STABLE

Fitch Ratings-New York-02 March 2016: Fitch Ratings has upgraded CMS Energy Corporation's (CMS) Long-Term Issuer Default Rating (IDR) to 'BBB' from 'BBB-'. In addition, Fitch has upgraded Consumers Energy Company's (Consumers) Long-Term IDR to 'A-' from 'BBB'. The Short-Term IDR on each entity has been upgraded to 'F2' from 'F3'. Fitch has assigned Consumers an 'F2' commercial paper (CP) rating. The Rating Outlook for both is Stable. A full list of rating actions is included at the end of this release.

The one-notch upgrade on CMS' Long-Term IDR reflects Fitch's expectations for improving consolidated credit metrics over Fitch's forecast horizon, supported by strong and relatively predictable earnings and cash flows at Consumers. Fitch expects CMS' FFO-adjusted leverage to strengthen to 4.2x by 2018 from 5.3x in 2015.

The two-notch upgrade at Consumers reflects the utility's strong financial performance, which surpassed Fitch's prior expectations, and an above-average, credit-supportive regulatory environment in Michigan. The utility has been able to generate strong earnings growth through investment in electric and gas infrastructure projects, balanced general rate case outcomes, and ongoing efforts to minimize operating and maintenance (O&M) expense while enhancing operating efficiencies. Given the aforementioned factors and the significant amount of parent-level debt at CMS, Fitch considers a two-notch separation between the Long-Term IDRs of Consumers and CMS to be appropriate at the current ratings levels.

KEY RATING DRIVERS

Constructive Regulatory Environment

Credit quality benefits from a stable and constructive regulatory environment in Michigan. The Michigan Public Service Commission (MPSC) and supportive state legislation have mitigated regulatory lag by allowing the use of a forward test year and six-month self-implementation and by mandating a 12-month regulatory review period. Pending state legislation would reduce the regulatory review period to 10 months and provide further enhancements to the existing 2008 Michigan Energy Law. In addition, an automatic power supply cost recovery mechanism and a gas cost recovery mechanism facilitate timely recovery of commodity costs.

Consumers' Strong Financial Profile

Consumers has a strong financial profile. Leverage metrics are solid, with adjusted debt-to-EBITDAR and FFO-adjusted leverage both expected to remain under 3.0x through 2018. Coverage metrics should also remain supportive of credit quality, with EBITDA interest coverage and FFO fixed charge coverage both expected to average around 7.0x through 2018. Despite its large capex program, Consumers is expected to be able to maintain its robust financial profile, benefiting from a regulatory environment that allows the utility to recover its capital investments in a timely manner and earn its authorized return on equity (ROE).

Large Capex Program

Consumers has a large capex program that is projected to total $17 billion over the 2016-2025 timeframe. About 37% of that is expected to go toward gas infrastructure & maintenance, about one-third toward electric maintenance, and the remainder split among electric distribution & reliability, new generation, and environmental. Another $3 billion of additional capex opportunities exist, including generation capacity, gas infrastructure, renewables, and grid modernization, that could expand the 10-year capex total to $20 billion.

Concerns about the large capex program are mitigated by the use of cash savings from O&M cost reductions, bonus depreciation, and net operating loss carryforwards (NOLs) to fund some of the growth. In addition, Consumers' investment plan is aligned with state and MPSC energy policy, emphasizing utility infrastructure improvement and economic growth.

CMS' Ownership of Consumers

The low-risk regulated electric and natural gas utility operations of Consumers contribute greater than 95% of CMS' consolidated EBITDA. Fitch expects Consumers to remain CMS' lone core business and primary driver of consolidated growth over the long term, further strengthening CMS' consolidated earnings mix. The constructive regulatory environment in Michigan allows Consumers to recover its costs and earn a return on its invested capital in a timely manner, providing a level of certainty to earnings and cash flows.

High Parent-Level Debt Balance

Leverage at CMS is high compared to its peers, and Fitch expects no significant change in the amount of parent-level debt over the next two years. At Dec. 31, 2015, consolidated long-term debt was slightly more than $9.1 billion, which includes $5.4 billion at Consumers, $1.1 billion at CMS' Utah-based bank subsidiary EnerBank, and $2.6 billion at the parent. Excluding the debt at EnerBank, which is a self-funding entity, and the $353 million of securitization debt at Consumers, CMS and Consumers had an aggregate of nearly $7.7 billion of long-term debt outstanding, of which $2.6 billion, or 34%, was parent-only debt.

Consolidated debt is expected to increase over the forecast period (2016-2018) as a result of future debt issuances at Consumers to help fund the utility's large capex program. Fitch assumes moderate levels of equity infusions from the parent to maintain the utility's capital structure. Fitch expects CMS and Consumers to maintain access to capital markets at reasonable levels in order to refinance near-term maturities and for additional borrowings at the utility to fund growth capex.

CMS' Improved Financial Profile

Fitch projects CMS' consolidated leverage metrics will improve over the forecast period and be better than previously expected. Adjusted debt-to-EBITDAR and FFO-adjusted leverage are expected to strengthen to 4.4x and 4.2x, respectively, by 2018. Interest coverage metrics are also expected to support credit quality, with EBITDA interest coverage averaging greater than 4.5x and FFO fixed charge coverage averaging greater than 4.7x through 2018.

Management's focus on O&M cost reductions at Consumers provides support to the consolidated financial profile, lessening the negative near-term financial impact from the utility's large capex program. In addition, the cash flow benefit from bonus depreciation and CMS' NOLs enable the utility to invest more internal capital into improving the reliability of its service while minimizing the need for external sources of capital.

KEY ASSUMPTIONS

Fitch's key assumptions within the rating case for CMS and Consumers include:
--Periodic general rate case (GRC) filings to recover Consumers' investment in rate base and associated costs. Fitch has assumed an average ROE of 10.3%;

--O&M cost reductions averaging 2%-3% per year;
--Average annual electric sales growth of 1% and flat natural gas sales volume;
--Total capex of $17 billion over 2016-2025;
--Earnings per share (EPS) growth of 5%-7% in 2016 and 6%-8% thereafter.

RATING SENSITIVITIES
CMS Energy Corporation

Positive Rating Action: An additional positive rating action is not expected in the near-term for CMS due to its significantly large amount of parent-level debt. However, a positive rating action could occur if it were expected that CMS would achieve an adjusted debt-to-EBITDAR ratio of less than 3.75x on a sustained basis.

Negative Rating Action: A negative rating action could occur if CMS' leverage ratios were expected to weaken on a sustained basis to greater than 4.75x for adjusted debt-to-EBITDAR and greater than 5.25x for FFO adjusted leverage.

Consumers Energy Company

Positive Rating Action: An additional positive rating action is not expected in the near-term for Consumers. The utility's Long-Term IDR is constrained by CMS' more leveraged credit profile and is not expected to exceed a two-notch separation from that of CMS. An upgrade of CMS' Long-Term IDR combined with expectations for Consumers to maintain an adjusted debt-to-EBITDAR ratio of less than 3.25x and a FFO-adjusted leverage of less than 3.5x on a sustained basis could result in a positive rating action.

Negative Rating Action: A negative rating action could result from a less favorable regulatory environment in Michigan or expectations for Consumers' leverage ratios to weaken on a sustained basis to greater than 3.5x for adjusted debt-to-EBITDAR and greater than 4.0x for FFO-adjusted leverage. A downgrade to CMS' Long-Term IDR would likely also result in a downgrade to Consumers' Long-Term IDR in order to maintain a maximum two-notch separation.

LIQUIDITY

Fitch considers CMS' liquidity to be adequate. CMS has a $550 million revolving credit facility (RCF) and Consumers has a $650 million RCF, both of which mature May 27, 2020. CMS' revolver is secured by its ownership of Consumers' common stock, and Consumers' revolver is secured by its first mortgage bonds. Consumers primarily meets its short-term working capital needs through issuances under its $500 million CP program, which is supported by its revolver. Although the amount of outstanding CP does not reduce the revolver's available capacity, Consumers states that it would not issue CP in an amount exceeding the available revolver capacity.

At Dec. 31, 2015, CMS had $1 million of letters of credit (LCs) outstanding, leaving $549 million of availability under its portion of the revolver. Consumers had $249 million of CP outstanding and $9 million in LCs, leaving $392 million of unused availability under its portion of the revolver.

Consumers has full availability under a separate $250 million RCF that matures Nov. 23, 2017 and is secured by its first mortgage bonds. In addition, Consumers has a fully used $30 million LC facility that matures May 9, 2018 and is secured by its first mortgage bonds.

CMS' operations require modest cash on hand. At Dec. 31, 2015, the company had $266 million of unrestricted cash and cash equivalents, $50 million of which was at Consumers, which should be sufficient to cover near-term cash needs.

FULL LIST OF RATING ACTIONS

Fitch has upgraded the following ratings and assigned a Stable Outlook:

CMS Energy Corporation
--Long-Term IDR to 'BBB' from 'BBB-';
--Senior secured debt (bank credit facility) to 'BBB+' from 'BBB-';
--Senior unsecured debt to 'BBB' from 'BBB-';
--Short-Term IDR to 'F2' from 'F3'.

Consumers Energy Company
--Long-Term IDR to 'A-' from 'BBB';
--Senior secured debt to 'A+' from 'A-';
--Senior unsecured debt to 'A' from 'BBB+';
--Preferred stock to 'BBB+' from 'BBB-';
--Short-Term IDR to 'F2' from 'F3'.

Fitch has assigned the following rating:

Consumers Energy Company
--Commercial Paper rating: 'F2'.

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Applicable Criteria
Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage (pub. 17 Aug 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869362