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Credit Opinion: Ameren Illinois Company

Global Credit Research - 06 Oct 2010

Peoria, Illinois, United States

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Baa3
First Mortgage Bonds	Baa1
Senior Secured	Baa1
Bkd Sr Unsec Bank Credit Facility	Baa3
Preferred Stock	Ba2
Parent: Ameren Corporation	
Outlook	Stable
Issuer Rating	Baa3
Senior Unsecured	Baa3
Subordinate Shelf	(P)Ba1
Preferred Shelf	(P)Ba2
Commercial Paper	P-3

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Opinion

Rating Drivers

- Recent rate case outcome unsupportive of credit quality

- Renewed concern over political and regulatory risk in Illinois

- Financial metrics expected to remain adequate for current low investment grade rating

- High capital expenditures have been somewhat cut back following rate case

- Recently renewed credit facility through 2013 has strengthened liquidity

Corporate Profile

Ameren Illinois Company (AIC; Baa3 Issuer Rating, Stable Outlook) is a regulated electric and natural gas transmission and distribution utility with a service territory in central and southern Illinois formed by the merger of Ameren's three Illinois utility subsidiaries: the former Central Illinois Light Company (AmerenCILCO), Central Illinois Public Service Company (AmerenCIPS) and Illinois Power Company (AmerenIP). AIC is a wholly-owned subsidiary of Ameren Corporation (Ameren; Baa3 Issuer Rating, Stable Outlook). The company will be conducting business as Ameren Illinois.

Recent Events

On October 1, 2010, Ameren completed a corporate reorganization that combined Ameren's three Illinois transmission and distribution utilities into a single utility called Ameren Illinois Company. The merger was accomplished by merging AmerenCILCO and AmerenIP with and into AmerenCIPS.

On September 10, 2010, Ameren and its subsidiaries entered into new three-year bank credit facilities totaling $2.1 billion, including an $800 million credit facility for Ameren Illinois Company

On May 6, 2010 the Illinois Commerce Commission (ICC) finalized its April 29, 2010 rate case decision allowing a $2.2 million electric rate increase and ordering a $7.5 million gas rate decrease for AmerenCILCO, a $17.5 million electric rate increase and $1.7 million gas rate decrease for AmerenCIPS, and a $15.4 million electric rate increase and $11.3 million gas rate decrease for AmerenIP. These results were far below Ameren's original requests and the company filed for a rehearing. In June, the ICC agreed to rehear certain aspects of the case and in July, the ICC staff recommended an additional revenue increase of $11 million in aggregate, with a final decision due from the ICC in November.

Rating Rationale

AIC's Baa3 Issuer Rating reflects improved financial metrics at Ameren's Illinois utilities resulting from higher electric and gas delivery service rates implemented in late 2008 and what Moody's had considered to be an improving political and regulatory environment for the company in Illinois. However, Ameren's most recent Illinois rate case outcomes were unsupportive of credit quality and could put pressure on the utility's financial metrics going forward, although they are expected to remain adequate to support current ratings. The rate case outcomes have also renewed our concern about political and regulatory risk for the company in Illinois and maintenance of AIC's ratings at current levels over the long-term is highly dependent on the outcomes of future rate cases and the overall regulatory environment for utilities in Illinois.

DETAILED RATING CONSIDERATIONS

The key rating drivers for AIC are:

- Recent rate case outcomes were unsupportive of utility credit quality

On May 6, 2010, the ICC approved a $35.1 million electric rate increase and a $20.5 million gas rate reduction for Ameren's three Illinois utilities combined, far below the company's original July 2009 request for a $180.7 million electric rate increase and $45.1 million gas rate increase, which it later lowered to $115 million and $15.3 million, respectively. Notably, the amounts approved were well below the recommendations of both the ICC Staff and Administrative Law Judges, a particularly negative development from a credit standpoint. Although the new electric rates were based on allowed ROE's ranging from 9.9% to 10.26% and the new gas rates based on allowed ROE's ranging from 9.19% to 9.4% ROEs, the earned ROE of Ameren's Illinois utilities was only in the 7% range in 2009 due to the significant regulatory lag that has characterized their returns in recent years. The outcomes of the most recent rate cases will do little to decrease this regulatory lag and will constrain the company's financial metrics going forward. The ultimate effect on metrics is largely dependent on the ability of the company to mitigate the impact of the rate case through the delay or cancellation of certain projects and reduced capital expenditures. There is also a rehearing of the rate case pending, with the ICC staff recently recommending an additional rate increases of $11 million, and a final decision due from the ICC in November.

- Renewed political and regulatory risk for Ameren in Illinois

Moody's had viewed Ameren's Illinois regulatory and political environment as having improved since a 2007 electric rate settlement narrowly averted a potentially devastating extension of a rate freeze that had been in place at all of Ameren's Illinois utility subsidiaries. However, the most recent rate case outcome has renewed our concerns about Ameren's political and regulatory relationships in Illinois and the credit supportiveness of the company's overall political and regulatory environment. The rate case was characterized by a high degree of both special interest and political involvement, including public opposition from the state's attorney general as well as several state representatives. This was partly driven by the size of the company's original rate request, particularly considering challenging economic conditions in Ameren's central and southern Illinois service territory. The company's original rate increase request was later scaled back considerably by the company as public and political opposition mounted. The company was also able to incorporate updated assumptions in its revised rate request, including lower interest rates, lower gas costs, and the cost cutting measures it had put in place. The case was presided over by new ICC commissioners, including a newly appointed ICC Chairman, who had replaced a long serving commissioner who was well known in both the industry and in the financial community. The magnitude of the company's initial rate increase requests, in light of economic conditions in southern Illinois, may have partly contributed to the negative public reaction and a relatively contentious rate proceeding.

Following the 2007 electric rate settlement and a reasonably supportive rate case outcome in 2008, Moody's returned the senior unsecured and Issuer Rating of Ameren's Illinois utilities to investment grade, indicating that we believed that the company would be able to obtain sufficient regulatory relief to maintain investment grade credit quality. The unexpectedly negative rate case outcome has raised concerns that the state may be returning to a less supportive regulatory environment. As a result, the first two factors in our rating methodology, Regulatory Framework and Ability to Recover Costs and Earn Returns, are both scored at a below average Ba for AIC, representing a significant constraint on the company's ratings and credit quality. Additional political intervention in the regulatory process or further unsupportive rate case outcomes could lead to negative rating actions on the company, as occurred between 2005 and 2007.

- Financial metrics expected to remain adequate for current low investment grade rating

The cash flow coverage metrics of Ameren's Illinois utilities generally improved in 2009 as a result of higher electric and delivery service rate cases that became effective October 1, 2008 following a credit supportive rate case outcome in 2008. These included CFO pre-working capital interest coverage in the 3.5x range and CFO pre-working capital to debt in the 19% range. AmerenCILCO's ratios have been generally higher due to the inclusion of cash flow from AmerenEnergy Resources Generating Company (AERG), which is now part of Ameren's unregulated generating subsidiary, Ameren Energy Resources Company.

Going forward, AIC is expected to exhibit financial metrics adequate for a low investment grade rating , including CFO pre-working capital interest coverage in the 3.5 times range and CFO pre-working capital to debt in the mid-teens. The company will continued to be negatively affected by higher spending for transmission and distribution system reliability, low earned rates of return, and resulting regulatory lag. Any improvement in financial metrics is highly dependent on the outcome of the pending rehearing of its recent rate case and on the outcomes of future transmission and distribution rate cases.

- High capital expenditures, some for system reliability, were reduced slightly following the rate case outcome

AIC has a substantial capital expenditure program for investments in transmission and distribution system expansion and reliability with the three Illinois utilities together forecasting capital expenditures of $270 million in 2010 (down $60 million from estimates provided earlier this year as a result of the rate case outcome) and a total of $1,260 to $1,710 million over the 2011-2014 time period. Ameren as a system had reduced the planned capital and operating expenditure budgets of its regulated businesses and has indicated that it will try to identify further possible opportunities to control capital costs and O&M expenditures in 2010 and beyond. Moody's views such capital expenditure reductions positively to the extent they don't impact transmission and distribution system reliability, which could negatively affect the company's public image in an already challenging political and regulatory environment.

Liquidity Profile

AIC maintains an adequate liquidity profile that was recently strengthened on September 10, 2010 when AmerenCILCO, AmerenCIPS and AmerenIP entered into a new, three year $800 million unsecured bank credit agreement, which is now available to Ameren Illinois Company. The credit facility is shared with the Ameren parent company, whose maximum borrowing amount available is $300 million. The facility includes covenants requiring that Ameren and each Illinois utility (and AIC going forward) to maintain consolidated indebtedness of not more than 65% of its consolidated total capitalization. At June 30, 2010, the ratios for Ameren, AmerenCIPS, AmerenCILCO, and AmerenIP were 50%, 44%, 38%

and 45%, respectively. In addition, Ameren is required to maintain a ratio of consolidated funds from operations plus interest expense to consolidated interest expense of 2.0 to 1. As of June 30, 2010, it was in compliance with this financial covenant with a ratio of 4.7 times.

In addition to this credit facility, AIC also participates in a utility money pool arrangement with the parent company, giving it access to additional funds, if necessary. Ameren reduced its dividend in 2009, which has reduced system negative free cash flow and external financing requirements on a consolidated basis which should help maintain the overall system's liquidity. The company has also maintained adequate access to the capital markets at both the utility and parent company levels. At June 30, 2010, Ameren's Illinois utilities had no draws outstanding under their previous $800 million credit facility and a total of $403 million of cash and cash equivalents on hand. The only long-term debt due over the next year is $150 million of first mortgage bonds at AmerenCIPS, which Moody's expects will be refinanced. AmerenCILCO did have a $243 million note payable to Ameren outstanding at June 30, 2010, the proceeds of which have been mostly used to finance environmental capital expenditures at AERG and will not be an obligation of AIC going forward.

Rating Outlook

The stable outlook reflects Moody's expectation that financial metrics will remain adequate to support the low investment grade of the merged Ameren Illinois Company, and that political and regulatory risk for Ameren in Illinois will not increase further. The most recent rate case outcome should be sufficiently mitigated by management actions to reduce costs and capital expenditures and will not result in a material degradation of these financial metrics. Nevertheless, the stable outlook is highly contingent on future rate case outcomes that are more supportive of credit quality than the most recent one.

What Could Change the Rating - Up

The ratings could be raised if there is an improvement in the regulatory and political environment for AIC in Illinois; if there are future credit supportive distribution rate case outcomes; if financial metrics remain at robust levels after the reorganization, including CFO pre-working interest coverage above 3.5x and CFO pre-W/C to debt in the high teens on a sustainable basis.

What Could Change the Rating - Down

The ratings could be lowered if future distribution rate cases do not provide sufficient rate relief to maintain ratios; if there is additional political intervention in the regulatory process; if rising operating costs or other factors put pressure on financial metrics including CFO pre-working capital interest coverage below 3.0x and CFO pre-working capital to debt below 15% for an extended period.

Rating Factors

Ameren Illinois Company[1]

Regulated Electric and Gas Utilities	Aaa	Aa	A	Baa	Ba	B
Factor 1: Regulatory Framework (25%)					X	
Factor 2: Ability to Recover Costs and Earn Returns (25%)					X	
Factor 3: Diversification (10%)						
a) Market Position (10%)					X	
b) Generation and Fuel Diversity (0%)						
Factor 4: Financial Strength, Liquidity & Financial Metrics (40%)						
a) Liquidity (10%)				X		
b) CFO pre-WC + Interest / Ineterest (7.5%) (3yr Avg)				X		
c) CFO pre-WC / Debt (7.5%) (3yr Avg)					X	
d) CFO pre-WC - Dividends / Debt (7.5%) (3yr Avg)				X		
e) Debt / Capitalization or Debt / RAV (7.5%) (3yr Avg)				X		
Rating:						
a) Methodology Implied Senior Unsecured Rating				**Ba1**		
b) Actual Senior Unsecured Rating				**Baa3**		

[1] Illinois Power's historical financial metrics are used above in Factor 4 as Illinois Power constitutes the largest portion of Ameren Illinois Company.

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