Credit Opinion: Ameren Illinois Company

Global Credit Research - 05 Oct 2011

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
Pref. Stock	Ba2
Parent: Ameren Corporation	
Outlook	Stable
Issuer Rating	Baa3
Senior Unsecured	Baa3
Subordinate Shelf	(P)Ba1
Pref. Shelf	(P)Ba2
Commercial Paper	P-3

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Key Indicators

[1]**Ameren Illinois Company**

	LTM 6/30/2011	2010	2009
(CFO Pre-W/C + Interest) / Interest Expense	5.3x	5.2x	4.4x
(CFO Pre-W/C) / Debt	32%	29%	25%
(CFO Pre-W/C - Dividends) / Debt	21%	23%	20%
Debt / Book Capitalization	39%	40%	39%

[1] All ratios calculated in accordance with the Global Regulated Electric Utilities Rating Methodology using Moody's standard adjustments.

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Rating Drivers

- Below average regulatory framework with unsupportive 2010 rate case outcome

- Pending 2011 rate case important to the maintenance of current credit profile

- Financial metrics are adequate to support a mid-Baa rating following adjustments

- High capital expenditures for transmission and distribution system reliability

Corporate Profile

Ameren Illinois Company (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 that was 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 conducts business as Ameren Illinois.

SUMMARY RATING RATIONALE

The rating of Ameren Illinois reflects a below average regulatory framework in Illinois, with considerable ongoing political involvement in utility regulatory matters and a 2010 rate case outcome that was detrimental to credit quality, constraining the utility's rating at current levels. The 2010 rate case outcome also renewed our concern about political and regulatory risk for the company in Illinois. Continued maintenance of the company's ratings at current levels over the long-term is highly dependent on pending and future rate case outcomes and the overall regulatory environment for utilities in Illinois.

DETAILED RATING CONSIDERATIONS

- Below average regulatory framework in Illinois with unsupportive 2010 rate case outcome

Ameren Illinois operates in what Moody's has considered for some time to be a below average regulatory framework for investor owned utilities. Moody's viewed the company's 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 Ameren's three Illinois utilities for ten years. Following the 2007 settlement and a reasonably supportive rate case outcome for the company in 2008, Moody's returned the senior unsecured and Issuer Rating of Ameren's Illinois utilities to investment grade, indicating that we believed the company would be able to obtain sufficient regulatory relief going forward to maintain investment grade credit quality.

However, on May 6, 2010, the Illinois Commerce Commission (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 Ameren Illinois did later obtain some additional rate relief following the rehearing of several aspects of the order, the unexpectedly low initial rate case outcome renewed Moody's concerns about the credit supportiveness of the regulatory and political environment for Ameren in Illinois.

In addition, 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 case was presided over by new ICC commissioners, including a newly appointed ICC Chairman, who had replaced a long serving commissioner well known in both the industry and in the financial community. As a result, the first factor in our rating methodology, Regulatory Framework, is scored at a below average Ba for Ameren Illinois, 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 again lead to negative rating actions on the company, as occurred between 2005 and 2007.

- Pending 2011 rate case is important to the maintenance of the utility's credit profile

On February 18, 2011, Ameren Illinois filed for a $60 million electric rate increase based on an 11.25% return on equity and for a $51 million gas rate increase based on an 11.0% return on equity, using a forward test year. On June 29, 2011, the ICC staff recommended a $10.3 million electric rate reduction based on a 9.72% return on equity and a $16.2 million gas rate increase based on an 8.9% return on equity. The substantial $70 million difference in the company's electric rate request and the ICC staff recommendation, most of which relates to the disparity in recommended return on equity, is of particular concern from a credit standpoint.

Ameren Illinois has since filed rebuttal and surrebuttal testimony requesting a rate increase totaling $89 million (down from its original $111 million request) and reducing its requested return on equity by .25% in both the electric and gas rate cases, primarily reflecting an updated assessment of capital market conditions. In rebuttal testimony last month, the ICC Staff revised their recommendation to a $31 million rate increase ($2 million electric and $29 million gas). The Administrative Law Judge order is scheduled for November 15, 2011 and a decision by the ICC is required by January 2012. Moody's views the use of a forward test year in this rate case as a credit positive development and the outcome will be important to the maintenance of the utility's credit profile and in determining the future direction of utility regulation for Ameren in Illinois.

- Financial metrics are adequate to support a mid-Baa rating following adjustments

The cash flow coverage metrics of Ameren Illinois improved in 2009 and 2010 as a result of higher electric and delivery service rates that became effective October 1, 2008 following the last credit supportive rate case outcome received by the company. These include CFO pre-working capital interest coverage in the 4.0x range and CFO pre-working capital to debt in the 20% range for these years, after adjusting for bonus depreciation and operating cash flow from discontinued operations. The latter cash flow consists of the operating results of AmerenEnergy Resources Generating Company, a former subsidiary of AmerenCILCO which was transferred to Ameren as part of the corporate reorganization creating Ameren Illinois. Going forward, Ameren Illinois is expected to exhibit financial metrics that should remain supportive of a mid-Baa rating, including CFO pre-working capital interest coverage in the 4.0 times range and CFO pre-working capital to debt in the high-teens, although that will be largely dependent on the outcomes of its pending and future rate cases. Financial metrics may continue to remain constrained by higher spending for transmission and distribution system reliability, low earned rates of return (Ameren expected a 2011 core ROE of from 8.3% to 8.9% on its combined Missouri and Illinois regulated utility equity as of August 4, 2011), and resulting regulatory lag.

- High capital expenditures for transmission and distribution improvements and reliability

Ameren Illinois has a substantial capital expenditure program for transmission and distribution system expansion and reliability with the company forecasting capital expenditures of $350 million in 2011 and a total of between $1.8 billion and $2.1 billion over the 2012-2015 time period. Ameren as a system has reduced the planned capital and operating expenditure budgets of its regulated businesses and has indicated that it will continue to identify further possible opportunities to control capital costs and O&M expenditures going forward. 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 environment.

Ameren and Commonwealth Edison, the other major investor-owned utility in Illinois, have been working with state legislators to enact legislation that would facilitate the modernization of the state's electric grid. The legislation includes a policy-based approach that would provide a more predictable ratemaking system via annual formula rate plans (FRP), which Moody's would view as a credit positive. The legislation was passed by both houses of the Illinois legislature but vetoed by the governor of Illinois on September 12, 2011. A veto session of the Illinois legislature convenes on October 25 and could vote to override the veto or consider changes to or other versions of this legislation.

Liquidity Profile

Ameren Illinois maintains an adequate liquidity profile that is supported by a three year $800 million unsecured bank credit agreement that expires in September 2013. The Illinois credit facility is shared with the parent company, whose maximum borrowing amount available is $300 million. The facility includes covenants requiring that Ameren and Ameren Illinois maintain consolidated indebtedness of not more than 65% of its consolidated capitalization. At June 30, 2011, the ratios for Ameren and Ameren Illinois were 49% and 40%, 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, 2011, it was in compliance with this financial covenant with a ratio of 5.0.

In addition to this credit facility, Ameren Illinois also participates in a utility money pool arrangement with the parent company, giving it access to additional funds if needed. Ameren reduced its dividend in 2009, which has reduced system negative free cash flow and external financing requirements on a consolidated basis and has helped maintain the overall system's liquidity. For the six months ending June 30, 2011, neither Ameren nor Ameren Illinois were borrowed under the Illinois credit facility. Ameren Illinois had $253 million of cash on hand as of June 30, 2011, down from $322 million as of December 31, 2011. The company paid off $150 million of first mortgage bonds that were due in the second quarter of 2011 and has no additional long-term debt due until 2013, except for $1 million of pollution control bonds maturing in 2012.

Rating Outlook

The stable outlook reflects Moody's expectation that the outcome of the company's pending rate case will be a supportive enough to support financial metrics at investment grade rating levels, and that political and regulatory risk for Ameren Illinois will not increase further. While its unfavorable 2010 rate case outcome has been somewhat mitigated by management actions to reduce costs and capital expenditures, a second adverse rate case outcome could pressure ratings. Maintenance of the stable outlook is highly contingent on future rate case outcomes that are more supportive of credit quality than the 2010 outcome.

What Could Change the Rating - Up

The ratings could be raised if there is an improvement in the regulatory and political framework for Ameren Illinois, if there are future credit supportive rate case outcomes, if financial metrics are sustained at levels that are strong for the Baa rating category, including CFO pre-working interest coverage above 4.0x and CFO pre-W/C to debt in the high teens, after adjusting for bonus depreciation and other one-time items.

What Could Change the Rating - Down

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

Rating Factors

Ameren Illinois Company

Regulated Electric and Gas Utilities Industry [1][2]	**FY 12/31/2010**		**Moody's 12-18 month Forward View* As of June 2011**	
Factor 1: Regulatory Framework (25%)	Measure	Score	Measure	Score
a) Regulatory Framework		Ba		Ba
Factor 2: Ability To Recover Costs And Earn Returns (25%)				
a) Ability To Recover Costs And Earn Returns		Ba		Ba
Factor 3: Diversification (10%)				
a) Market Position (10%)		Ba		Ba
b) Generation and Fuel Diversity (0%)		na		na
Factor 4: Financial Strength, Liquidity And Key Financial Metrics (40%)				
a) Liquidity (10%)		Baa		Baa
b) CFO pre-WC + Interest/ Interest (2 Year Avg) (7.5%)	4.8x	A	4.0x - 4.5x	Baa
c) CFO pre-WC / Debt (2 Year Avg) (7.5%)	26.8%	A	17% - 22%	Baa
d) CFO pre-WC - Dividends / Debt (2 Year Avg) (7.5%)	21.5%	A	10% - 15%	Baa
e) Debt/Capitalization (2 Year Avg) (7.5%)	39.3%	A	40% - 45%	A
Rating:				
a) Indicated Rating from Grid		Baa3		Baa3
b) Actual Rating Assigned		Baa3		Baa3

* THIS REPRESENTS MOODY'S FORWARD VIEW; NOT THE VIEW OF THE ISSUER; AND UNLESS NOTED IN THE TEXT DOES NOT INCORPORATE SIGNIFICANT ACQUISITIONS OR DIVESTITURES

[1] All ratios are calculated using Moody's Standard Adjustments. [2] As of 12/31/2010(LTM); Source: Moody's Financial Metrics