ILLINOIS
AMERICAN WATER

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ORIGINAL

June 10, 2013

Ms. Elizabeth A. Rolando, Chief Clerk
Illinois Commerce Commission
527 E. Capitol Avenue
Springfield, IL 62701

Report

RE: Docket No. 06-0336
Notice of Standard & Poor's and Moody's Reports

Dear Clerk:

In compliance with Condition 2 of the June 27, 2007 Order, we are providing a May 24, 2013 credit report from Standard & Poor's Ratings Services and a May 30, 2013 credit report from Moody's Investor Service. Please let me know if I can be of any further assistance.

Very truly yours,

John J. Reichart
Corporate Counsel

Encls.

cc: Alan Pregozen

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RATINGS SERVICES

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Research Update:

American Water Works Co. Inc. And Subsidiaries Corporate Credit Ratings Raised To 'A-'

Primary Credit Analyst:
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Research Update:

American Water Works Co. Inc. And Subsidiaries Corporate Credit Ratings Raised To 'A-'

Overview

- American Water Works Co. Inc.'s financial measures continue to gradually improve, primarily reflecting the company's improved effective management of regulatory risk.
- We are raising our corporate credit rating on the company and its subsidiaries, American Water Capital Corp., New Jersey-American Water Co., and Pennsylvania-American Water Co., to 'A-' from 'BBB+'. The outlook is stable.
- The stable outlook reflects our expectation that the company will continue to effectively manage its regulatory risk, enabling the regulated business to, on average, earn its allowed return on equity. Under our baseline forecast, we expect funds from operations (FFO) to debt of more than 16% and debt to EBITDA of about 4.5x.

Rating Action

On May 24, 2013, Standard & Poor's Ratings Services raised its corporate credit rating on regulated water utility company American Water Works Co Inc. (AWW) and subsidiaries American Water Capital Corp. (AWCC), New Jersey-American Water Co., and Pennsylvania-American Water Co. to 'A-' from 'BBB+'. The outlook is stable.

Rationale

The upgrade reflects sustained improvements in cash flow and leverage measures, which reflect the company's improved management of regulatory risk and the continued execution of its cost management initiative. We expect that the company will continue its relatively conservative financial policies to maintain its credit measures.

Standard & Poor's ratings on AWW and its subsidiaries reflect its "excellent" business risk profile and "significant" financial risk profile. The excellent business risk profile reflects the company's mostly monopolistic businesses that provide an essential service in regulatory jurisdictions that we generally view as credit supportive. In addition, the company's geographic diversity, reliability, and efficiency further support its business risk profile. We currently view the company as consisting of 95% regulated businesses and 5% unregulated businesses on an EBITDA basis. The unregulated businesses only marginally affect the company's business risk profile because of its modest expected capital requirements, affiliation with company's regulated service jurisdictions, and its lower risk service contracts.

AWW's regulatory framework includes reasonably allowed returns on equity and various cost-recovery mechanisms, including incentives for infrastructure improvements, which we view as supportive of credit quality. In a number of jurisdictions, which represent about 50% of consolidated revenues, the utility recovers replacement capital spending between rate cases up to a stated percentage. The importance of infrastructure surcharge mechanisms has increased, given AWW's large capital program. Certain states also allow for surcharges related to the cost of power, chemicals, and purchased water. We generally expect that AWW will continue to request additional recovery mechanisms to cover its rising operating costs, capital spending, and pension and other postretirement obligations.

The company's geographic reach provides it with market, cash flow, and regulatory diversification. AWW provides regulated water and wastewater services to about 3.2 million customers in 16 states. AWW's elevated capital-spending requirements for infrastructure replacement, increased costs of compliance with water quality standards, and reliance on acquisitions to provide growth partly offset these strengths.

AWW's reliability of supply is high, as the company owns a substantial number of treatment facilities for surface and groundwater treatment, and the majority of supply comes from surface and groundwater. In 2012, surface water provided 66% of supply, groundwater 27%, and purchased water about 7%.

AWW's consolidated financial risk profile is significant under our criteria and reflects our baseline forecast that consolidated FFO to debt and debt to EBITDA will approximate 16% and 4.5x, respectively, over the medium term. As of year-end 2012, AWW's adjusted debt, including capitalized operating leases and tax-affected pension and postretirement obligations, was about $6.2 billion, for a debt-to-capital ratio of about 58% and a debt to EBITDA ratio of 4.5x. AWW's consolidated FFO were about $1 billion, for an FFO to total debt ratio of about 16.4% and FFO to interest of 4.1x. We consider these credit measures to be sufficient for the significant financial risk profile.

We expect that the company will continue to have negative discretionary cash flow, primarily reflecting continued high capital spending. AWW estimates that it will spend about $800 million to $1 billion annually in each of the next three years to replace infrastructure, build new facilities to comply with water quality standards, and initiate projects to enhance reliability, quality of service, and efficiency. We expect that the company will finance its cash needs in a manner that preserves its credit quality.

Liquidity

The short-term rating on AWW and AWCC is 'A-2' and largely reflects the long-term corporate credit ratings and our view of the company's "adequate" liquidity under Standard & Poor's corporate liquidity methodology. We base our liquidity assessment on the following factors and assumptions:

- AWW's liquidity sources during the next 12 months, including cash, FFO, and credit facility availability, should exceed uses by more than 1.2x.
- Debt maturities are manageable during the next 12 months, with no substantial maturities coming due until 2017.
- Liquidity sources would exceed uses even if EBITDA decreases by 15%.
- AWW's ability to absorb high-impact, low-probability events with limited need for refinancing, its flexibility to lower capital spending or sell assets, its sound bank relationships, its solid standing in credit markets, and its generally prudent risk management.

In our analysis of liquidity during the next 12 months, we assume about $1.7 billion of liquidity sources, consisting primarily of FFO and credit facility availability. We estimate uses of $1.4 billion of liquidity for capital spending, maturing debt, and shareholder distributions.

The company maintains a bank credit facility totaling $1 billion that expires in October 2017. As of March 31, 2013, the company had $637 million available under the facility. The bank facilities require the parent and the utilities to maintain a minimum total funded debt to capitalization ratio of 70%, with which they comfortably comply.

Recovery analysis

We assign recovery ratings to first mortgage bonds (FMBs) issued by U.S. utilities, which can result in issue ratings being notched above a corporate credit rating (CCR) on a utility depending on the rating category and the extent of the collateral coverage. The FMBs issued by U.S. utilities are a form of "secured utility bond" (SUB) that qualify for a recovery rating as defined in our criteria (see "Collateral Coverage and Issue Notching Rules for '1+' and '1' Recovery Ratings on Senior Bonds Secured by Utility Real Property, Feb. 14, 2013). The recovery methodology is supported by the ample historical record of 100% recovery for secured bondholders in utility bankruptcies in the U.S. and our view that the factors that enhanced those recoveries (limited size of the creditor class and the durable value of utility rate-based assets during and after a reorganization given the essential service provided and the high replacement cost) will persist in the future. Under our SUB criteria, we calculate a ratio of our estimate of the value of the collateral pledged to bondholders relative to the amount of FMBs outstanding. FMB ratings can exceed a CCR on a utility by up to one notch in the 'A' category, two notches in the 'BBB' category, and three notches in speculative-grade categories, depending on the calculated ratio.

New Jersey American Water and Pennsylvania American Water's FMBs benefit from a first-priority lien on substantially all of the utility's real property owned or subsequently acquired. Collateral coverage of more than 1.5x supports a recovery rating of '1+' and an issue rating one notch above the CCR.

Outlook

The stable outlook reflects our expectation that the company will continue to effectively manage its regulatory risk, filing for timely rate relief, and be able to generally earn, on average, its allowed return on equity. Under our baseline forecast, we expect FFO to total debt of more than 16% and debt to EBITDA of about 4.5x. Key risks to our base case scenario include the company disproportionately expanding its unregulated businesses. We expect the company to finance acquisitions in a manner that supports credit quality, and continuing to effectively execute its cost-management initiative.

We could raise the ratings if FFO to total debt consistently remained more than 18% and debt to EBITDA were less than 4.5x. This could most probably occur if the company were able to manage its regulatory risk and achieve considerably higher-than-expected rate case outcomes.

We could lower the rating if regulatory risk increased or financial performance stalled or deteriorated, which could result from substantial debt financing of capital spending or acquisitions, such that FFO to debt fell to less than 14% and debt to EBITDA rose to more than 5x.

Related Criteria And Research

- Criteria - Corporates - Utilities: Collateral Coverage and Issue Notching Rules for '1+' and '1' Recovery Ratings on Senior Bonds Secured by Utility Real Property, Feb. 14, 2013
- Criteria - Corporates - Utilities: Assessing U.S. Utility Regulatory Environments, Nov. 7, 2007
- Criteria - Corporates - Utilities: Notching Of U.S. Investment-Grade Investor-Owned Utility Unsecured Debt Now Better Reflects Anticipated Absolute Recovery, Nov. 10, 2008
- Criteria: Key Credit Factors: Business And Financial Risks In The Investor-Owned Utilities Industry, Nov. 26, 2008.
- Criteria - Corporates - General: Methodology And Assumptions: Standard & Poor's Revises Key Ratios Used In Global Corporate Ratings Analysis, Dec. 28, 2011
- Criteria - Corporates - General: Methodology: Short-Term/Long-Term Ratings Linkage Criteria For Corporate And Sovereign Issuers, May 15, 2012
- Criteria - Corporates - General: 2008 Corporate Criteria: Commercial Paper , April 15, 2008
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008
- Criteria - Corporates - General: 2008 Corporate Ratings Criteria: Ratios And Adjustments, April 15, 2008

Ratings List

Upgraded; Outlook Action; Ratings Affirmed

	To	From
American Water Works Co. Inc.		
American Water Capital Corp.		
Corporate Credit Rating	A-/Stable/A-2	BBB+/Positive/A-2
American Water Capital Corp.		
Senior unsecured	A-	BBB+

Upgraded; Outlook Action

	To	From
New Jersey-American Water Co.		
Pennsylvania-American Water Co.		
Corporate Credit Rating	A-/Stable/--	BBB+/Positive/--

Ratings Affirmed

American Water Capital Corp.	
Commercial paper	A-2

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

Moody's
INVESTORS SERVICE

Credit Opinion: American Water Works Company, Inc.

Global Credit Research - 30 May 2013

Voorhees, New Jersey, United States

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Baa1
New Jersey-American Water Company, Inc.	
Outlook	Stable
Issuer Rating	A3
American Water Capital Corp.	
Outlook	Stable
Issuer Rating	Baa1
Senior Unsecured	Baa1
Bkd Subordinate Shelf	(P)Baa2
Commercial Paper	P-2
Pennsylvania-American Water Company	
Outlook	Stable
Issuer Rating	A3
Bkd Senior Secured	A1

Contacts

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Key Indicators

[1]**American Water Works Company, Inc.**

	LTM 1Q13	2012	2011	2010
(FFO + Interest) / Interest Expense	3.9x	3.9x	3.6x	3.2x
FFO / Net Debt	16%	16%	14%	13%
RCF / Capex	0.91x	0.84x	0.82x	0.82x
Debt / Capitalization	51%	51%	54%	55%

[1] All ratios calculated in accordance with the Regulated Water 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

Well diversified utility operations in supportive regulatory environments

Improved financial profile

Sizeable ongoing capital demands

Support agreement at AWCC not a "guarantee" but sufficient for credit substitution

Corporate Profile

Headquartered in Voorhees, New Jersey, American Water Works Company, Inc. ("American Water"), is the largest investor-owned provider of water, wastewater and related services in North America, with operations serving over 15 million people across approximately 30 states in the US and Canada. American Water is a holding company and does not have any direct debt obligations; rather, it primarily issues debt through its non-operating financing subsidiary American Water Capital Corp. (AWCC), which has a support agreement with American Water. The family's consolidated debt also includes obligations issued at the regulated subsidiary level. At March 31, 2012, approximately $3.7 billion of long-term debt was issued at the AWCC level (70% of consolidated long-term debt of $5.3 billion), $2.7 billion of which has been advanced via inter-company notes to various regulated utility subsidiaries.

Rating Rationale

American Water's Baa1 issuer rating reflects its low risk, regulated utility holdings and the geographical diversity of its operations across the US. The rating is also driven by management focus on investment in supportive regulatory regimes and reducing regulatory lag, which has recently improved the company's regulatory risk profile and financial metrics. The company benefits from a newly implemented $1 billion credit facility, as it faces a robust capital plan over the next several years.

DETAILED RATING CONSIDERATIONS

PRIMARILY A LOW RISK UTILITY HOLDING COMPANY

As a holding company with approximately 90% of its revenue produced by water utility companies, American Water is viewed as having a low business risk, primarily rate regulated credit profile. We view the business risk of water utilities as lower than that of electric and gas utility peers, as the essential nature of a water utility is of paramount importance. Additionally, the resource costs and liquidity pressures for a water utility are far more manageable than those of vertically integrated and distribution utilities having to deal with commodity cost volatility or assets of a complex grid. Furthermore, we see less regulatory disallowance risk, as water utility bills are small in comparison to its electric and gas peers and less prone to negative political intervention in the rate making process.

American Water's non-regulated water services segment is relatively small (11% of revenues in 2012) and is comprised of contracted water services with predominantly governmental entities, homeowner services and a biosolids management group. The contracted operations group has historically comprised around 70% of the unregulated contributions to consolidated revenue, but on August 1, 2012 American Water was selected by New York City to provide service line protection programs to the city's homeowners. This development is likely to increase both the homeowner revenue contribution to the unregulated segment, as well as increase the amount of unregulated influence on consolidated revenue and cash flow. Nevertheless, we do not anticipate the unregulated segment growing beyond 15% of the consolidated operations.

We note as well that while non-regulated operations typically bring added credit risk, we do not believe that these activities impact the overall credit negatively as they are in related lines of business (contract water services) and have not, to date, required a significant amount of capital or reliance on credit support from the parent.

SUPPORT AGREEMENT WITH AMERICAN WATER CAPITAL CORP

AWCC, a Delaware corporation, is the wholly-owned finance subsidiary of American Water, whose purpose is to streamline the financing function, create cash management efficiencies, and lower the cost of capital for American Water's regulated water utility subsidiaries. The source of upstream debt service funding comes from the regulated utility operations, which make cash principal and interest payments directly to AWCC. As noted above, approximately $2.7 billion of AWCC's long-term debt has been advanced to several regulated utility subsidiaries via intercompany loans which is incorporated in their respective capital structures for rate-making purposes. We expect any additional up-streamed cash flows, in the form of dividends, will be limited to the retained, undistributed or current earnings of each jurisdiction.

AWCC's Baa1 senior unsecured rating is equalized with its parent, American Water, which provides credit enhancement through a support agreement between American Water and AWCC. The features contained in the support agreement, that support Moody's view of credit substitution include: 1) no termination of the support agreement until all debt shall have been irrevocably paid in full, without the majority lenders' consent, 2) American Water has agreed to make timely payment of interest, principal or premium on any debt issued by AWCC, 3) the aforementioned payment is in the form of cash or liquid assets and not merely collection, 4) American Water waives any claims related to a failure or delay by AWCC in enforcing its rights under the support agreement, 5) the support agreement is binding on any successors of American Water, 6) the lender may proceed directly against American Water to obtain payment of defaulted interest, principle or premium, and 7) any changes to the support agreement that adversely affect third parties must be approved by such parties. Furthermore, American Water has committed to own, during the term of the support agreement, all of the voting stock of AWCC and to ensure that a positive tangible net worth at AWCC will be maintained at all times and the guarantee is governed by the laws of the state of New York, which we view to be hospitable to the enforcement of guarantees.

Although the support agreement has many attributes of what a guarantee provides, we note that it is not specifically or legally considered a guarantee. Also, debt at AWCC does not benefit from any explicit upstream guarantees from the regulated utility subsidiaries nor does the debt obligations of the subsidiaries benefit from any explicit downstream guarantee from American Water or AWCC. Nevertheless, given the agreement's stated protections, and the fact that a significant amount of AWCC's debt has been incurred to finance rate base, we effectively view the support agreement structure as being similar to a guarantee for rating purposes and have made no notching differentiation between the two entities.

INVESTMENT FOCUSED IN MORE SUPPORTIVE STATE JURISDICTIONS

American Water's most significant regulatory exposure is based upon its largest subsidiaries, including New Jersey-American Water (NJ-AWC, A3 stable), Pennsylvania-American Water (PAWC; A3 stable), Missouri-American Water (not rated), and Illinois-American Water (not rated). Collectively, these four water utilities accounted for approximately 60% of American Water's 2012 consolidated revenues. Although there can be differences in the level of profitability at each subsidiary, the regulated nature of American Water's utility business should ensure a relatively stable and healthy return over time. The geographic diversity can also provide a balancing effect to the variability of cash flows due to seasonal weather effects or timing of rate filings.

During 2012, American Water improved its regulatory and credit profile through a series of M&A transactions which resulted in the company's exit from historically challenging jurisdictions, such as Arizona, New Mexico and Ohio, while adding exposure to its more supportive New York service territory. Proceeds from the divestitures were used to complete the New York acquisition, reduce debt and invest in utility capital expenditures. The credit friendly use of proceeds was part of management's stated goal of reducing regulatory lag through focused investment in supportive regulatory jurisdictions.

We expect that roughly half of American Water's $1 billion annual budget will be spent at its two largest subsidiaries (NJ-AWC and PAWC), located in jurisdictions with favorable interim recovery mechanisms and that provide a relatively high degree of recovery through general rate proceedings. For example, in July of 2012, the New Jersey Board of Public Utilities (BPU) approval of NJ-AWC's use of a Distribution System Improvement Charge (DSIC), which allows the company to make separate filings to recovery certain infrastructure replacement costs between general rate case proceedings. Furthermore, in August of 2012 the Pennsylvania Utilities Commission (PUC) adopted legislation that provided for a similar DSIC mechanism, as well as fully projected future test year and combined water and wastewater rate cases. We believe that these regulatory enhancements are a significant benefit to American Water's credit profile.

FINANCIAL IMPROVEMENT IN THE MIDST OF ROBUST CAPEX PLANS

A steady implementation of new general base rates throughout 16 states (totaling around $123 million in 2012) and advancing the use of interim recovery mechanisms and forward test years, where available, has allowed American Water to strengthen its financial profile. Through the LTM period ended March 31, 2013, the company's FFO / Net Debt was around 16% (compared with 14% in 2011, 13% in 2010 and 12% in 2009). Although this cash flow includes the benefits of accelerated bonus depreciation, we feel that the company can produce nearly 15% FFO to debt without one-time benefits from federal largesse and even in the midst of a capital plan that expects to spend around $1 billion, annually, over the intermediate-term. American Water's capex is mostly focused on maintenance capex and system improvements that is spread across many small projects, thus limiting its near-term exposure to any one significant project.

We expect American Water to be able to produce over $1 billion of FFO for the next several years, which means that the company could manage a consolidated, adjusted, debt burden over $6 billion and remain in-line with other Baa1 global water holdco peers, such as Severn Trent PLC (Baa1, stable) and United Utilities Plc (Baa1, stable), which have averaged FFO / Net Debt of 16%, each, over the past five years. While this comparison shows the strong cash flow production capabilities of American Water, the Retained Cash Flow (RCF) to capex metrics of the company (.75x over the past five years) reflects a higher dividend policy, vis-à-vis capital demands, implemented by American Water versus its global peers over the same time period (i.e., Severn Trent at .85x and United Utilities at .80x).

Liquidity

American Water's liquidity is managed through its financing subsidiary, AWCC, which increased its revolver capacity to $1 billion in October 2012. AWCC's credit facility offers support to the $700 million commercial paper program (P-2). Although there are no restrictions for revolver borrowings, related to CP outstanding, we expect the company to leave ample cushion under the revolver to effectively backstop any CP borrowings. The facility has same-day drawing availability and no ongoing material adverse change clause. The lone financial covenant is maximum debt to capitalization ratio of 70%. The facility expires in October 2017 and at March 31, 2013, there were no outstanding borrowings under the credit facility; however, about $334 million of commercial paper was outstanding.

For the LTM period ending March 31, 2013, American Water generated approximately $863 million of cash from operations, had capital expenditures of just over $1 billion and paid dividends of $173 million. The company's negative free cash flow position of about $60 million was met with an increase in short-term debt borrowings. We expect the company to maintain a slightly negative free cash flow position over the near-term.

Rating Outlook

The stable rating outlook reflects our expectation for FFO / Net Debt to remain in the mid teens over the next twelve to eighteen months.

What Could Change the Rating - Up

The ratings for American Water and Capital could be positively impacted by further material improvement to the regulatory support offered to the company, or if FFO / Net Debt metrics were to be sustainable in the mid-teens without the benefits of bonus depreciation.

What Could Change the Rating - Down

AWK's ratings would be negatively impacted by materially negative regulatory decisions, operational concerns such as supply or asset failure or increasing leverage to the point that FFO / Net Debt declines to the low-teen's for an extended period.

Rating Factors

American Water Works Company, Inc.

Global Regulated Water Utilities [1][2]	Current LTM 12/31/2012		Moody's 12-18 month Forward View As of Date Published	
Factor 1: Regulatory Framework & Asset Ownership (40%)	**Measure**	**Score**	**Measure**	**Score**
a) Stability & Predictability of Regulatory Environment		Baa		Baa
b) Asset Ownership		A		A
c) Cost and Investment Recovery (Ability & Timeliness)		Baa		Baa
d) Revenue Risk		A		A
Factor 2: Operational Characteristics & Asset Risk (10%)				
a) Operational Efficiency		Baa		Baa
b) Scale of Capital Program and Asset Condition		Baa		Baa

Factor 3: Stability of Business Model and Financial Structure (10%)					
a) Ability & Willingness to Pursue Opportunistic Corp. Activity		Baa			**Baa**
b) Ability & Willingness to Increase Leverage		Baa			**Baa**
c) Proportion of Revenues Outside Core Water and Wastewater		A			**A**
Factor 4: Key Financial Metrics (40%)					
a) FFO Interest Coverage (3 Year Average)	3.6x	Baa		3.5x - 4.0x	Baa
b) Debt / Capitalization (3 Year Average)	53%	A		45% -55 %	A
c) FFO / Net Debt (3 Year Average)	14%	Baa		11% - 18%	A/ Baa
d) RCF / Capex (3 Year Average)	0.83x	Ba		0.75x - 1.00x	Baa/ Ba
Rating:					
Indicated Rating from Grid		Baa1			Baa1
Actual Rating Assigned		Baa2			Baa1

* 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 12/31/2011; Source: Moody's Financial Metrics

MOODY'S
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