

DIRECT TESTIMONY  
of  
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Finance Department  
Financial Analysis Division  
Illinois Commerce Commission

Ameren Illinois Company d/b/a Ameren Illinois  
Proposed General Increase in Gas Rates

Docket No. 15-0142

June 9, 2015

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1

## WITNESS IDENTIFICATION

2 **Q1. Please state your name and business address.**

3 A1. My name is Sheena Kight-Garlich. My business address is 527 East Capitol  
4 Avenue, Springfield, IL 62701.

5 **Q2. What is your current position with the Illinois Commerce Commission**  
6 **(“Commission”)?**

7 A2. I am a Senior Financial Analyst in the Finance Department of the Financial  
8 Analysis Division.

9 **Q3. Please describe your qualifications and background.**

10 A3. In May of 1998, I received a Bachelor of Business degree in Finance and  
11 Marketing from Western Illinois University in Macomb, Illinois. I earned a Master  
12 of Business Administration degree, with a concentration in Finance, also at  
13 Western Illinois University in May of 2001. I have been employed by the  
14 Commission since January of 2001. I was promoted to Senior Financial Analyst  
15 on October 1, 2004.

16 **Q4. Please state the purpose of your testimony in this proceeding.**

17 A4. The purpose of my testimony is to present my analysis of the cost of capital,  
18 including the cost of common equity, for Ameren Illinois Company (“Ameren  
19 Illinois” or the “Company”). In addition, I will respond to the direct testimony of  
20 Company witness Robert B. Hevert (Ameren Ex. 5.0 (Rev.)).

21

## COST OF CAPITAL

22 **Q5. Please summarize your cost of capital findings for Ameren Illinois.**

23 A5. I recommend a 7.51% overall rate of return for Ameren Illinois, as shown on  
24 Schedule 3.01, that incorporates my recommended cost of common equity of  
25 9.31%. The Company's proposed 8.32% overall rate of return for the Company is  
26 also presented on Schedule 3.01.

27 **Q6. Please define the overall cost of capital for a public utility.**

28 A6. The overall cost of capital equals the sum of the costs of the capital structure  
29 components (i.e., debt, preferred stock, and common equity) after weighting each  
30 by its proportion to total capital. It represents the rate of return the utility needs to  
31 earn on its assets to satisfy contractual obligations to, or the market requirements  
32 of, its investors.

33 **Q7. Why must one determine an overall cost of capital for a public utility?**

34 A7. A primary goal of regulation is to properly balance the interests of a utility's  
35 ratepayers and investors. This is accomplished by minimizing the cost of reliable  
36 service to ratepayers while allowing utilities to earn a fair and reasonable rate of  
37 return on rate base.

38 Under the traditional regulatory model, ratepayer and shareholder interests are  
39 balanced when the Commission authorizes a rate of return on rate base equal to  
40 the public utility's overall cost of capital, as long as that overall cost of capital is  
41 not unnecessarily expensive.<sup>1</sup> When public utilities charge rates that reflect an

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<sup>1</sup> The remainder of the discussion assumes that the utility's overall cost of capital is not unnecessarily expensive; that is, the utility's cost of capital reflects a reasonable balance between financial strength and cost.

42 authorized rate of return that exceeds the cost of capital, consumers are  
43 encumbered with excessive prices. Conversely, when public utilities charge  
44 rates that reflect an authorized rate of return below the cost of capital, the  
45 financial integrity of the utility suffers, making it difficult for the utility to attract  
46 capital at a reasonable cost. Ultimately, the utility's inability to raise sufficient  
47 capital would impair service quality. Consumers are best served when the  
48 authorized rate of return on rate base equals the overall cost of capital.

49 In authorizing a rate of return on rate base equal to the overall cost of capital, all  
50 costs of service are assumed reasonable and accurately measured. If  
51 unreasonable costs continue to be incurred, or if any reasonable cost of service  
52 component is measured inaccurately, then the allowed rate of return on rate base  
53 will not balance ratepayer and investor interests.

#### 54 **Capital Structure**

55 **Q8. What capital structure did the Company propose for Ameren Illinois?**

56 A8. The Company proposes using a forecasted average 2016 capital structure that  
57 contains 1.34% short-term debt, 47.43% long-term debt, 1.23% preferred stock,  
58 and 50.00% common equity, as shown on Schedule 3.01.

59 **Q9. What capital structure do you recommend for Ameren Illinois?**

60 A9. I recommend accepting the Company's forecasted average 2016 ("average  
61 2016") capital structure.

62 **Q10. Do you agree that the Company's proposed capital structure is reasonable**  
63 **for setting rates?**

64 A10. Yes. Ameren Illinois' capital structure is reasonable for the reasons set forth in  
65 Ameren Ex. 4.2. Specifically, based on the Company's business risk and  
66 financial risk, Standard and Poor's and Fitch have assigned Ameren a BBB+  
67 credit rating with a stable outlook.<sup>2</sup> Moody's has assigned Ameren Illinois an A3  
68 credit rating with a stable outlook.<sup>3</sup>

69 **Q11. Does capital structure affect the overall cost of capital?**

70 A11. Yes; although, that effect is complex and difficult to measure. As a utility  
71 increases the proportion of common equity in its capital structure, the resulting  
72 decline in financial risk reduces the cost of each capital component. However,  
73 since common equity is the most costly capital structure component, after a  
74 point, further increasing the proportion of common equity would increase the  
75 overall cost of capital. Conversely, since debt is less costly than equity,  
76 increasing the proportion of debt in the capital structure could reduce the overall  
77 cost of capital. However, after a point, further raising the proportion of debt in the  
78 capital structure would increase financial risk, thereby causing the cost of all  
79 capital components to rise. Hence, an increasing proportion of debt could  
80 increase the overall cost of capital. Therefore, the Commission should not  
81 determine the overall rate of return from a utility's actual capital structure if the  
82 Commission concludes that capital structure adversely affects the overall cost of  
83 capital.

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<sup>2</sup> Standard and Poor's Ratings Services, "Summary: Ameren Illinois Co.," May 14, 2015, 2;  
FitchRatings, "Fitch Upgrades Ameren Illinois Co.; Affirms Ameren and Union Electric," March 31, 2015.

<sup>3</sup> Moody's Investors Service, "Rating Action: Moody's upgrades Ameren corp. and Ameren Illinois;  
affirms Union Electric; outlooks stable," April 7, 2015.

84 An optimal capital structure would minimize the cost of capital and maintain a  
85 utility's financial integrity. Unfortunately, determining whether a capital structure  
86 is optimal remains problematic because: (1) the cost of capital is a continuous  
87 function of the capital structure, rendering its precise measurement along each  
88 segment of the range of possible capital structures problematic; (2) the optimal  
89 capital structure is a function of operating risk, which is dynamic; and (3) the  
90 relative costs of the different types of capital vary with dynamic market  
91 conditions. Consequently, one should determine whether the capital structure is  
92 consistent with the financial strength necessary to access the capital markets  
93 under most conditions, and if so, whether the cost of that financial strength is  
94 reasonable.

95 **Cost of Short-term Debt**

96 **Q12. What is Ameren Illinois' cost of short-term debt?**

97 A12. Ameren Illinois' cost of short-term debt is 0.45%. Ameren Illinois' predominate  
98 source of short-term debt is commercial paper,<sup>4</sup> which is rated A2/P2 from the  
99 rating agencies.<sup>5</sup> To estimate Ameren Illinois' cost of short-term debt, I  
100 converted the May 27, 2015, 0.44% discount rate on 30-day, A2/P2 commercial  
101 paper into an annual yield of 0.45%.<sup>6</sup>

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<sup>4</sup> Ameren Ex. 4.0 (Rev.), 16.

<sup>5</sup> Standard and Poor's Ratings Services, "Summary: Ameren Illinois Co.," May 14, 2015; Moody's Investors Service, Credit Opinion: Ameren Illinois Company, April 8, 2015.

<sup>6</sup> The Federal Reserve Board, *Federal Reserve Commercial Paper, Commercial Paper Rates and Outstanding Summary*, [www.federalreserve.gov/releases/cp/](http://www.federalreserve.gov/releases/cp/), May 28, 2015.

102

### Cost of Bank Facility

103 **Q13. Do you agree with the Company's cost of its bank facility?**

104 A13. Yes. The cost of the Company's bank facility is 0.04%.<sup>7</sup>

105

### Cost of Long-term Debt

106 **Q14. What is the embedded cost of long-term debt for Ameren Illinois?**

107 A14. As shown on Schedule 3.02, Ameren Illinois' embedded cost of long-term debt  
108 for the average 2016 measurement period equals 5.79%.

109 **Q15. What adjustments did you make to the Company's cost of long term debt?**

110 A15. I adjusted the coupon rate for the proposed 2015 and 2016 issuances. For the  
111 forecasted coupon rate on the 2015 issuance, I added the current yield on 30-  
112 year Treasury bonds (2.88%)<sup>8</sup> to the Company's estimated 115 basis point yield  
113 spread to arrive at an interest rate of 4.03%.<sup>9</sup> For the 2016 issuance, I added the  
114 current yield on 10-year Treasury notes (2.14%)<sup>10</sup> to the Company's estimated  
115 90 basis point yield spread for a forecasted coupon rate of 3.04%.<sup>11</sup>

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<sup>7</sup> Ameren Ex. 4.0 (Rev.), 17-18, Schedule WPD-1 Gas.

<sup>8</sup> The Federal Reserve Board, Federal Reserve Statistical Release: H.15, Selected Interest Rates, Daily Update, [www.federalreserve.gov/releases/H15/update/](http://www.federalreserve.gov/releases/H15/update/), May 27, 2015.

<sup>9</sup> Company work paper, Schedule WPD-3 Gas (Part 3), page 1.

<sup>10</sup> The Federal Reserve Board, *Federal Reserve Statistical Release: H.15, Selected Interest Rates, Daily Update*, [www.federalreserve.gov/releases/H15/update/](http://www.federalreserve.gov/releases/H15/update/), May 27, 2015.

<sup>11</sup> Company work paper, Schedule WPD-3 Gas (Part 3), page 1.

116 **Cost of Preferred Stock**

117 **Q16. Do you agree with the Company's embedded cost of preferred stock?**

118 A16. Yes. The Company's embedded cost of preferred stock is 4.98%.<sup>12</sup>

119 **Cost of Common Equity**

120 **Q17. What is your estimate of the Company's cost of common equity?**

121 A17. My analysis indicates that Ameren Illinois' cost of common equity equals 9.31%.

122 **Q18. How did you measure the investor required rate of return on common**  
123 **equity for Ameren Illinois?**

124 A18. To estimate the cost of common equity for Ameren Illinois, I began with the data  
125 that Mr. Hevert used in his multi-stage or non-constant growth discounted cash  
126 flow ("NCDCF") and Capital Asset Pricing Model ("CAPM") analyses, but  
127 corrected the most significant flaws in those analyses.<sup>13</sup> I applied the models to  
128 Mr. Hevert's sample, to which I hereafter refer to as the "Gas Sample."

129 **Discounted Cash Flow ("DCF") Analysis**

130 **Q19. Please describe the general concept of a DCF analysis.**

131 A19. For a utility to attract common equity capital, it must provide a rate of return on  
132 common equity sufficient to meet investor requirements. DCF analysis  
133 establishes a rate of return directly from investor requirements. DCF analysis  
134 does not include a direct measure of a utility's operating and financial risks since

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<sup>12</sup> Schedule WPD-4 Gas, 4

<sup>13</sup> Ameren Ex. 5.0 (Rev.), 3, 6.

135 the market price of a utility's stock already embodies the market consensus of  
136 those risks.<sup>14</sup>

137 According to DCF theory, a security price equals the present value of the cash  
138 flow investors expect it to generate. Specifically, the market value of common  
139 stock equals the cumulative value of the expected stream of future dividends  
140 after each is discounted by the investor-required rate of return.

141 **Q20. Please describe the DCF model with which you measured the investor**  
142 **required rate of return on common equity.**

143 A20. As it applies to common stocks, DCF analysis is generally employed to  
144 determine appropriate stock prices given a specified discount rate. Since a DCF  
145 model incorporates time-sensitive valuation factors, it must correctly reflect the  
146 frequency of the dividend payments that stock prices embody. As such,  
147 incorporating stock prices that the financial market sets on the basis of quarterly  
148 dividend payments into a model that ignores the time value of quarterly cash  
149 flows constitutes a misapplication of DCF analysis. The companies in my  
150 samples pay dividends quarterly; therefore, I applied a quarterly NDCDF model  
151 to measure the annual required rate of return on common equity.<sup>15</sup>

152 **Q21. Why did you apply a NDCDF model in this proceeding?**

153 A21. A single-stage, constant growth DCF model employs a single growth rate  
154 estimate which is assumed to be sustainable infinitely. Thus, the cost of  
155 common equity calculation derived from a constant growth estimate is  
156 appropriate if the near-term growth rate forecast for each company in the sample

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<sup>14</sup> Security prices are inversely related to risk.

<sup>15</sup> Mr. Hevert also relied on a multi-stage, or non-constant, DCF model. Ameren Ex. 5.0 (Rev.), 3.

157 is expected to equal its average long-term dividend growth. However, the 3-5  
158 year growth rate for the Gas Sample is not sustainable over the long-term.  
159 Therefore, I implemented a NCDDCF model.

160 **Q22. How did you assess the long-term sustainability of the 3-5 year growth**  
161 **rates?**

162 A22. The average 3-5 year growth rate is 5.2% for the Gas Sample, while my estimate  
163 of the long-term gross domestic product (“GDP”) growth rate is 4.4%<sup>16</sup> In theory,  
164 no company could sustain indefinitely a growth rate greater than that of the  
165 overall economy, or it would eventually grow to dominate the entire economy.  
166 Moreover, since utilities in particular are generally below-average growth  
167 companies, the sustainability of an above average growth rate is particularly  
168 dubious. Given that the average growth rate for the Gas Sample is greater than  
169 the overall growth expectations for the economy, the sustainability of the average  
170 3-5 year growth rates for the Gas Sample is unlikely.

171 **Q23. Why is the long-term GDP growth rate a reasonable estimate for the steady-**  
172 **state stage growth for the Gas Sample?**

173 A23. Ideally, company-specific steady-state growth rate estimates are preferable but  
174 are not available. Thus, while the long-term GDP growth rate might be biased  
175 upward for generally below average growth companies such as utilities, it is  
176 much closer to the growth rate that investors could reasonably expect utilities to  
177 sustain over the long term.

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<sup>16</sup> The calculation of the long-term growth in GDP is described later.

178 **Q24. Please describe how you modeled your NDCDF analysis.**

179 A24. I modeled three stages of dividend growth. The first, a near-term growth stage,  
180 is assumed to last five years. The second stage is a transitional growth period  
181 lasting from the beginning of the sixth year through the end of the tenth year.  
182 Finally, the third, or “steady-state,” growth stage begins at the end of the tenth  
183 year and is assumed to last into perpetuity. An expected stream of dividends is  
184 estimated by applying these stages of growth to the current dividend. The  
185 discount rate that equates the present value of this expected stream of cash  
186 flows to the company’s current stock price equals the market-required return on  
187 common equity.

188 **Q25. How did you utilize Mr. Hevert’s data in your NDCDF analysis?**

189 A25. I used Mr. Hevert’s Gas Sample to conduct my NDCDF analysis. I also used  
190 some of the growth rate estimates provided by Mr. Hevert in Ameren Illinois Ex.  
191 5.1, to derive the 5.2% average growth rate for the Gas Sample for the near-term  
192 growth stage. Instead of relying on the 30-day stock price that Mr. Hevert used  
193 for the Gas Sample, I used the closing stock prices as of November 28, 2014.

194 **Q26. Why did you measure the stock price on November 28, 2014?**

195 A26. A current stock price reflects all information that is available and relevant to the  
196 market; thus, it represents the market's assessment of the common stock's  
197 current value. Although Staff would typically use the most up-to-date market  
198 parameters available at the time of the cost of common equity analysis, three to  
199 five year growth rate estimates were unavailable for several of the companies in  
200 the Gas Sample in March, April, and May of this year. Thus, due to the lack of  
201 analyst growth rates for the Gas Sample and for the sake of minimizing issues in

202 this proceeding, I have elected to use November 28, 2014, since it is the last day  
203 in Mr. Hevert's 30-day average stock price. I measured each company's current  
204 stock price with its closing market price from November 28, 2014. This allows for  
205 a more direct comparison to Mr. Hevert's DCF results. The stock prices for the  
206 companies in the Gas Sample appear on Schedule 3.03.

207 Since stock prices reflect the market's concurrent expectation of the cash flows  
208 the securities will produce and the rate at which those cash flows are discounted,  
209 an observed change in the market price does not necessarily indicate a change  
210 in the required rate of return on common equity. Rather, a price change may  
211 reflect investors' re-evaluation of the expected dividend growth rate. In addition,  
212 stock prices change with the approach of dividend payment dates.

213 Consequently, when estimating the required return on common equity with the  
214 DCF model, one should measure the expected dividend yield and the  
215 corresponding expected growth rate concurrently. Using a historical stock price  
216 along with current growth expectations, as Mr. Hevert has done, or combining an  
217 updated stock price with past growth expectations increases the inaccuracy of  
218 estimates of the market-required rate of return on common equity.

219 **Q27. How did you estimate the growth rate parameters for the DCF analysis?**

220 A27. For the first stage, which is assumed to last five years, I started with the earnings  
221 per share ("EPS") growth estimates from Zacks and Value Line, as presented by  
222 Mr. Hevert on Ameren Illinois Ex. 5.1. I also included the Bloomberg  
223 Professional ("Bloomberg") EPS growth estimates and Value Line dividend per  
224 share ("DPS") growth estimates.<sup>17</sup> In order to give equal weight to each growth

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<sup>17</sup> Ameren Illinois' Response to Staff Data Requests SK 2.05A and SK 4.01.

225 estimate source, I averaged the Value Line EPS and DPS growth estimates into  
226 a single Value Line growth projection. I then computed the average of the growth  
227 estimates from Zacks, Bloomberg, and the average Value Line growth projection.  
228 The first stage growth estimates average 5.2% for the Gas Sample, as presented  
229 on Schedule 3.04.

230 In the intervening five-year transitional stage, the growth rate employed equals  
231 the average of the growth rate used for the first stage and the third stage growth  
232 rate. For the third stage, which begins at the end of the tenth year, I calculated  
233 forecasted nominal GDP growth beginning in 2024 to estimate the long-term  
234 growth expectations of investors. The nominal GDP growth rate is composed of  
235 two parts, the expected real growth rate and the expected inflation rate. I  
236 estimated the expected real growth rate from the average of the Energy  
237 Information Administration (“EIA”) and IHS Global Insight’s (“IHS”) forecasts of  
238 real GDP. EIA forecasts that real GDP will average 2.4% over the 2024-2040  
239 period.<sup>18</sup> Similarly, IHS forecasts that real GDP will average 2.3% over the 2024-  
240 2044 period.<sup>19,20</sup> I averaged the EIA (2.4%) the IHS (2.3%) real GDP forecasts  
241 to calculate my 2.3% long-term estimate of real GDP growth.

242 I extrapolated an estimate of the expected inflation rate from the difference in  
243 yields on U.S. Treasury bonds, which contain a premium for expected inflation,

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<sup>18</sup> Energy Information Administration, *Annual Energy Outlook 2014, Table 20, Macroeconomic Indicators*, [www.eia.doe.gov/oiaf/aeo/](http://www.eia.doe.gov/oiaf/aeo/), April 2014.

<sup>19</sup> IHS Global Insight, *The U.S. Economy: The 30-Year Focus, Fourth Quarter 2014*, Table 1: Summary of the U.S. Economy, November 2014.

<sup>20</sup> The 2.3% real GDP growth rate estimate is within the 2.2% - 2.5% range of the annual average percentage growth rates published by the Interindustry Forecasting Project at the University of Maryland (“INFORUM”), the Social Security Administration, International Energy Agency (“IEA”), ExxonMobil, and Oxford Economics Group (“OEG”) for the 2025 – 2040 measurement period. See U.S. Energy Information Administration, “Annual Energy Outlook 2014,” CP-2.

244 and U.S. Treasury Inflation-Protected Securities (“TIPS”), which do not contain a  
245 premium for expected inflation. The formula for this calculation is:

246 
$$\text{Expected inflation} = (1 + \text{UST}) / (1 + \text{TIPS}) - 1$$

247 Where UST = yield on U.S. Treasury bonds; and  
248 TIPS = yield on U.S. Treasury Inflation-Protected Securities.

249 An implied 20-year forward TIPS yield in ten years of 1.19% was derived from  
250 the 0.39% 10-year and 0.92% 30-year TIPS rates for November 28, 2014. An  
251 implied 20-year forward U.S. Treasury rate in ten years of 3.25% was derived  
252 from the 2.18% 10-year and 2.89% 30-year U.S. Treasury rates for November  
253 28, 2014.<sup>21</sup> The implied 20-year forward rates were calculated using the  
254 following formula:

255 
$${}_{20}f_{10} = [(1 + {}_{30}r_0)^{30} / (1 + {}_{10}r_0)^{10}]^{1/20} - 1$$

256 Where  ${}_{20}f_{10}$  = the implied 20-year forward rate in ten years;  
257  ${}_{30}r_0$  = the current 30-year rate; and  
258  ${}_{10}r_0$  = the current 10-year rate.

259 Therefore, the estimate of long-term expected inflation equals 2.0%:

260 
$$(1 + 3.25\%) / (1 + 1.19\%) - 1 = 2.0\%.$$

261 The two components of nominal overall economic growth were then combined to  
262 estimate the long-term growth rate for the third stage, using the following formula:

263 
$$\text{Nominal GDP growth} = [(1 + \text{Real GDP}) * (1 + \text{Inflation})] - 1$$

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<sup>21</sup> The Federal Reserve Board, *Federal Reserve Statistical Release: Selected Interest Rates, H.15 Daily Update*, [www.federalreserve.gov/releases/H15/update](http://www.federalreserve.gov/releases/H15/update), December 1, 2014.

264 Therefore, from the long-term estimates of real GDP growth of 2.3% and  
265 expected inflation of 2.0%, the long-term estimate of nominal GDP growth equals  
266 4.4%:

267 
$$\text{Nominal overall economic growth} = (1 + 2.3\%) * (1 + 2.0\%) - 1 = 4.4\%$$

268 I also calculated the nominal economic growth EIA forecasted for the 2024-2040  
269 period (4.4%) and IHS forecasted for the 2024-2044 period (4.4%). Finally, I  
270 averaged the 4.4% midpoint of the EIA and IHS forecasts with the 4.4% nominal  
271 GDP growth estimate described above to derive my estimate of long-term growth  
272 of 4.4%.<sup>22</sup>

273 **Q28. Why did you exclude Mr. Hevert's First Call growth estimate from your first**  
274 **stage growth estimates?**

275 A28. Mr. Hevert's First Call growth estimate was obtained from Yahoo!<sup>23</sup> As shown in  
276 Attachment A, Yahoo! indicated that it does not replace or remove analyst growth  
277 estimates until a new estimate is provided. Further, Yahoo! currently does not  
278 have procedures to ensure the growth estimates are timely.<sup>24</sup> Hence, the  
279 accuracy of the Yahoo! growth estimates as a proxy for investor growth  
280 expectations is doubtful. Therefore, I substituted the Bloomberg growth  
281 estimates for Mr. Hevert's First Call growth estimates.

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<sup>22</sup> The numbers presented were rounded to the nearest tenth of a percent.

<sup>23</sup> Ameren Illinois WPD-6 – Gas (Part 31).

<sup>24</sup> Attachment A.

282 **Q29. What is your NCD CF estimate of the required rate of return on common**  
283 **equity for the Gas Sample?**

284 A29. My NCD CF estimate of the required rate of return on common equity for the Gas  
285 Sample is 8.12%, as shown on Schedule 3.05.

286 **Capital Asset Pricing Model**

287 **Q30. Please describe the Capital Asset Pricing Model.**

288 A30. The Capital Asset Pricing Model (“CAPM”) is a one-factor risk premium model  
289 that mathematically depicts the relationship between risk and return as:

290 
$$R_j = R_f + \beta_j \times (R_m - R_f)$$

where  $R_j$   $\equiv$  the required rate of return for security  $j$ ;

$R_f$   $\equiv$  the risk-free rate;

$R_m$   $\equiv$  the expected rate of return for the market portfolio; and

$\beta_j$   $\equiv$  the measure of market risk for security  $j$ .

291 In the CAPM, the risk factor is market risk, which is defined as risk that cannot be  
292 eliminated through portfolio diversification. To implement the CAPM, one must  
293 estimate the risk-free rate of return, the expected rate of return on the market  
294 portfolio, and a security or portfolio-specific measure of market risk.

295 The CAPM is based on the theory that the market-required rate of return for a given  
296 risk-bearing security equals the risk-free rate of return<sup>25</sup> plus a risk premium that

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<sup>25</sup> The risk-free rate of return is the rate of return on an investment with zero risk. This represents the absolute minimum return an investor demands as compensation for deferring consumption.

297 investors expect in exchange for assuming the risk associated with that security.  
298 Mathematically, a risk premium equals the difference between the expected rate  
299 of return on a risk factor and the risk-free rate. If the risk of a security is measured  
300 relative to a portfolio, then multiplying that relative measure of risk and the  
301 portfolio's risk premium produces a security-specific risk premium for that risk  
302 factor.

303 The CAPM methodology is consistent with the theory that investors are risk-  
304 averse. That is, investors require higher returns to accept greater exposure to risk.  
305 Thus, if investors had an opportunity to purchase one of two securities with equal  
306 expected returns, they would purchase the security with less risk. Conversely, if  
307 investors had an opportunity to purchase one of two securities with equal risk, they  
308 would purchase the security with the higher expected return. In equilibrium, two  
309 securities with equal quantities of risk have equal required rates of return.

310 **Q31. How did you estimate the risk-free rate of return?**

311 A31. I examined the suitability of the yields on four-week U.S. Treasury bills and thirty-  
312 year U.S. Treasury bonds as estimates of the risk-free rate of return.

313 **Q32. Why did you examine the yields on U.S. Treasury bills and bonds as**  
314 **measures of the risk-free rate?**

315 A32. The proxy for the nominal risk-free rate should contain no risk premium and  
316 reflect similar inflation and real risk-free rate expectations to the security being  
317 analyzed through the risk premium methodology.<sup>26</sup> The yields of fixed income

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<sup>26</sup> The real risk-free rate and inflation expectations compose the non-risk related portion of a security's rate of return.

318 securities include premiums for default and interest rate risk. Default risk  
319 pertains to the possibility of default on principal or interest payments. The federal  
320 government's fiscal and monetary authority makes securities of the United States  
321 Treasury virtually free of default risk. Interest rate risk pertains to the effect of  
322 unexpected interest rate fluctuations on the value of securities.

323 Since common equity theoretically has an infinite life, its market-required rate of  
324 return reflects the inflation and real risk-free rates anticipated to prevail over the  
325 long run. U.S. Treasury bonds, the longest term treasury securities, are issued  
326 with terms to maturity of thirty years; U.S. Treasury notes are issued with terms  
327 to maturity ranging from two to ten years; U.S. Treasury bills are issued with  
328 terms to maturity ranging from four to fifty-two weeks. Therefore, U.S. Treasury  
329 bonds are more likely to incorporate within their yields the inflation and real risk-  
330 free rate expectations that drive, in part, the prices of common stocks than either  
331 U.S. Treasury notes or Treasury bills.

332 However, due to relatively long terms to maturity, U.S. Treasury bond yields also  
333 contain an interest rate risk premium that diminishes their usefulness as  
334 measures of the risk-free rate. U.S. Treasury bill yields contain a smaller  
335 premium for interest rate risk. Thus, in terms of interest rate risk, U.S. Treasury  
336 bill yields more accurately measure the risk-free rate.

337 **Q33. Given the similarity in the inflation and real risk-free rate expectations that**  
338 **are reflected in the yields on U.S. Treasury bonds and the prices of**  
339 **common stocks, does it necessarily follow that the inflation and real risk-**  
340 **free rate expectations that are reflected in the yields on U.S. Treasury bills**  
341 **and the prices of common stocks are dissimilar?**

342 A33. No. To the contrary, short and long-term inflation and real risk-free rate  
343 expectations, including those that are reflected in the yields on U.S. Treasury  
344 bills, U.S. Treasury bonds, and the prices of common stocks, should equal over  
345 time. Any other assumption implausibly implies that the real risk-free rate and  
346 inflation are expected to systematically and continuously rise or fall.

347 Although expectations for short and long-term real risk-free rates and inflation  
348 should equal over time, in finite time periods short and long-term expectations  
349 may differ. Short-term interest rates tend to be more volatile than long-term  
350 interest rates.<sup>27</sup> Consequently, over time U.S. Treasury bill yields are less biased  
351 (i.e., more accurate) but less reliable (i.e., more volatile) estimators of the long-  
352 term risk-free rate than U.S. Treasury bond yields. In comparison, U.S. Treasury  
353 bond yields are more biased (i.e., less accurate) but more reliable (i.e., less  
354 volatile) estimators of the long-term risk-free rate. Therefore, an estimator of the  
355 long-term nominal risk-free rate should not be chosen mechanistically. Rather,  
356 the similarity in current short and long-term nominal risk-free rates should be  
357 evaluated. If those risk-free rates are similar, then U.S. Treasury bill yields  
358 should be used to measure the long-term nominal risk-free rate. If not, some  
359 other proxy or combination of proxies should be used.

---

<sup>27</sup> Fabozzi, ed., The Handbook of Fixed Income Securities, Fifth Edition, Irwin, p. 827.

360 **Q34. What are the yields on four-week U.S. Treasury bills and thirty-year U.S.**  
361 **Treasury bonds?**

362 A34. As of November 28, 2014, four-week U.S. Treasury bills were yielding 0.04% and  
363 thirty-year U.S. Treasury bonds were yielding 2.89%.<sup>28</sup> Schedule 3.06 presents  
364 the published quotes and effective yields.

365 **Q35. Of the U.S. Treasury bill and bond yields, which is currently a better proxy**  
366 **for the long-term risk-free rate?**

367 A35. For a growing economy with inflation, such as that of the U.S., a long-term risk-  
368 free rate near zero is implausible; therefore, the U.S. Treasury bond yield of  
369 2.89% currently more closely approximates the long-term risk-free rate than the  
370 U.S. Treasury bill yield of 0.04%. It should be noted, however, that the U.S.  
371 Treasury bond yield is an upwardly biased estimator of the long-term risk-free  
372 rate due to the inclusion of an interest rate risk premium associated with its  
373 relatively long term to maturity.

374 **Q36. How was the expected rate of return on the market portfolio estimated?**

375 A36. The expected rate of return on the market was estimated by conducting a DCF  
376 analysis on the firms composing the S&P 500 Index ("S&P 500") as of  
377 September 30, 2014. That analysis used dividend information from  
378 Morningstar.com and closing market prices reported by Zacks Research Wizard  
379 (Zacks). Growth rate estimates were obtained primarily from Zacks and  
380 secondarily from Reuters on October 1, 2014.<sup>29</sup> Firms not paying a dividend as  
381 of September 30, 2014, or for which neither Zacks nor Reuters growth rates were

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<sup>28</sup> The Federal Reserve Board, *Federal Reserve Statistical Release: H.15, Selected Interest Rates, Daily Update*, [www.federalreserve.gov/releases/H15/update/](http://www.federalreserve.gov/releases/H15/update/), December 1, 2014.

<sup>29</sup> Growth rates were obtained from Reuters only if unavailable from Zacks.

382 available were eliminated from the analysis. The resulting company-specific  
383 estimates of the expected rate of return on common equity were then weighted  
384 using market value data from Zacks on September 30, 2014. The estimated  
385 weighted average expected rate of return for the remaining 415 firms, composing  
386 84.5% of the market capitalization of the S&P 500, equals 12.40%.

387 **Q37. How did you measure market risk on a security-specific basis?**

388 A37. Beta measures risk in a portfolio context. When multiplied by the market risk  
389 premium, a security's beta produces a market risk premium specific to that  
390 security. To estimate the beta of the Gas Sample, I supplemented Mr. Hevert's  
391 Value Line betas with the Zacks betas and betas calculated using a regression  
392 analysis that the Commission has routinely adopted for the CAPM.

393 Value Line estimates beta for a security with the following model using an  
394 ordinary least-squares technique:<sup>30</sup>

395 
$$R_{j,t} = \alpha_j + \beta_j \times R_{m,t} + \varepsilon_{j,t}$$

where  $R_{j,t}$   $\equiv$  the return on security  $j$  in period  $t$ ,

$R_{m,t}$   $\equiv$  the return on the market portfolio in period  $t$ ,

$\alpha_j$   $\equiv$  the intercept term for security  $j$ ;

$\beta_j$   $\equiv$  beta, the measure of market risk for security  $j$ ; and

$\varepsilon_{j,t}$   $\equiv$  the residual term in period  $t$  for security  $j$ .

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<sup>30</sup> Statman, Meir, "Betas Compared: Merrill Lynch vs. Value Line", *The Journal of Portfolio Management*, Winter 1981.

396 A beta can be calculated for firms with market-traded common stock. Value Line  
397 calculates its betas in two steps. First, the returns of each company are  
398 regressed against the returns of the New York Stock Exchange Composite Index  
399 (“NYSE Index”) to estimate a raw beta. The Value Line regression employs 259  
400 weekly observations of stock return data. Then, an adjusted beta is estimated  
401 through the following equation:

402 
$$\beta_{adjusted} = 0.35 + 0.67 \times \beta_{raw}.$$

403 The regression analysis applies an ordinary least-squares technique to the  
404 following model to estimate beta for a security or portfolio of securities:

405 
$$R_{j,t} - R_{f,t} = \alpha + \beta (R_{m,t} - R_{f,t}) + \varepsilon_t$$

where  $R_{j,t}$   $\equiv$  the return on security  $j$  in period  $t$ ,

$R_{f,t}$   $\equiv$  the risk-free rate of return in period  $t$ ,

$R_{m,t}$   $\equiv$  the return on the market portfolio in period  $t$ ,

$\alpha$   $\equiv$  the intercept term for security  $j$ ;

$\beta$   $\equiv$  beta, the measure of market risk for security  $j$ ; and

$\varepsilon_t$   $\equiv$  the residual term in period  $t$  for security  $j$ .

406 The regression analysis beta estimate for my sample was calculated in three  
407 steps. First, the U.S. Treasury bill return was subtracted from the average  
408 percentage change in the sample’s stock prices and the percentage change in  
409 the NYSE Index to estimate each portfolio’s return in excess of the risk-free rate.  
410 Second, the excess returns of each sample were regressed against the excess  
411 returns of the NYSE Index to estimate a raw beta. The regression analysis

412 employs sixty monthly observations of stock and U.S. Treasury bill return data.

413 Third, an adjusted beta is estimated through the following equation:

414 
$$\beta_{adjusted} = 0.33743 + 0.66257 \times \beta_{raw}.$$

415 Like Staff's regression beta, Zacks employs 60 monthly observations in its beta  
416 estimation. However, Zacks betas regress stock returns against the S&P 500  
417 Index rather than the NYSE Index. Further, the beta estimates Zacks publishes  
418 are not adjusted (i.e., raw). Thus, I adjusted them using the same formula used  
419 to adjust the regression beta.

420 **Q38. Why do you use an adjusted beta estimate?**

421 A38. Some empirical tests of the CAPM suggest that the linear relationship between  
422 risk, as measured by raw beta, and return is flatter than the CAPM predicts. That  
423 is, securities with raw betas less than one tend to realize higher returns than the  
424 CAPM predicts. Conversely, securities with raw betas greater than one tend to  
425 realize lower returns than the CAPM predicts. Adjusting the raw beta estimate  
426 towards the market mean of 1.0 results in a linear relationship between the beta  
427 estimate and realized return that more closely conforms to the CAPM  
428 prediction.<sup>31</sup> Securities with betas less than one are adjusted upwards thereby  
429 increasing the predicted required rate of return towards observed realized rates  
430 of return. Conversely, securities with betas greater than one are adjusted  
431 downwards thereby decreasing the predicted rate of return towards observed  
432 realized rates of return.

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<sup>31</sup> Litzenberger, Ramaswamy and Sosin, "On the CAPM Approach to the Estimation of a Public Utility's Cost of Equity Capital," *Journal of Finance*, May 1980.

433 **Q39. Why do you rely on three approaches to calculate the betas for your**  
434 **samples?**

435 A39. True betas are forward-looking measures of investors' expectations of market  
436 risk. As such, true betas are not observable. Betas that Staff calculates and  
437 betas that Zacks, Value Line, and other financial information services publish are  
438 proxies for true betas. Therefore, like all proxies, beta estimates are subject to  
439 measurement error. No single, definitively "correct" beta for a given company  
440 exists. Beta measurements can overstate a security's risk, and consequently its  
441 cost, at times, and understate it at other times. Indeed, this is true of any cost of  
442 common equity estimation methodology. The inevitable presence of  
443 measurement error is why I recommend against reliance on any single model to  
444 estimate the cost of common equity. Similarly, using multiple approaches to  
445 estimate beta mitigates the effect of measurement error in beta estimates on my  
446 cost of common equity estimate.

447 **Q40. What is the beta estimate for the Gas Sample?**

448 A40. The regression beta estimate for the Gas Sample is 0.73. The average Value  
449 Line beta and average Zacks beta for the Gas Sample are 0.79 and 0.74,  
450 respectively, as shown in Table 1 below.<sup>32</sup>

---

<sup>32</sup> Value Line beta estimates are from Ameren Illinois Ex. 5.4; Zacks beta estimates are from Zacks Research Wizard, November 28, 2014.

**Table 1: Company Betas**

Company	Value Line Estimate	Zacks Estimate*
AGL Resources Inc.	0.80	0.64
Atmos Energy Corp.	0.80	0.71
New Jersey Resources	0.80	0.73
Northwest Natural Gas Co.	0.70	0.70
Piedmont Natural Gas Co.	0.80	0.74
South Jersey Industries Inc.	0.80	0.82
Southwest Gas Corp.	0.85	0.81
WGL Holdings Inc.	0.75	0.79
Average	0.79	0.74

\* After adjustment

451 Since the Zacks beta estimate (0.74) and the regression beta estimate (0.73) are  
 452 calculated using monthly data rather than weekly data (as Value Line uses), I  
 453 averaged those results to avoid over-weighting that approach. The average of  
 454 those two estimates is 0.74. I then averaged that result with the Value Line beta  
 455 (0.79), which produces a beta for the Gas Sample of 0.76.

456 **Q41. What required rate of return on common equity does the CAPM estimate for**  
 457 **the Gas Sample?**

458 A41. The CAPM estimates a required rate of return on common equity of 10.12% for  
 459 the Gas Sample. The computation of that estimates appears on Schedule 3.06.

460 **Cost of Equity Recommendation**

461 **Q42. Based on your entire analysis, what is your estimate of Ameren Illinois'**  
 462 **cost of common equity?**

463 A42. A thorough analysis of the required rate of return on common equity requires  
 464 both the application of financial models and the analyst's informed judgment. An

465 estimate of the required rate of return on common equity based solely on  
466 judgment is inappropriate. Nevertheless, because techniques to measure the  
467 required rate of return on common equity necessarily employ proxies for investor  
468 expectations, judgment remains necessary to evaluate the results of such  
469 analyses. Along with NCD CF and CAPM cost of equity analyses, I considered  
470 the observable 4.16% rate of return the market required on less risky A-rated  
471 long-term utility debt at the time of time of the analysis.<sup>33</sup> Based on my analysis,  
472 Ameren Illinois' investor-required rate of return on common equity equals 9.31%.

473 **Q43. How did you minimize measurement error in your cost of common equity**  
474 **analyses?**

475 A43. The models from which the individual company estimates were derived are  
476 correctly specified and, thus, contain no source of bias. Moreover, except for the  
477 use of U.S. Treasury bond yields as a proxy for the long-term risk-free rate and  
478 3-5 year analyst growth estimates as a proxy for the long-term growth estimates  
479 in the market rate of return,<sup>34</sup> I am unaware of bias in my proxy for investor  
480 expectations. In addition, measurement error has been minimized through the  
481 use of a sample, since estimates for a sample as a whole are subject to less  
482 measurement error than individual company estimates.

---

<sup>33</sup> The Value Line Investment Survey, "Selection & Opinion," November 28, 2014.

<sup>34</sup> The market-weighted average of the analyst three to five year EPS growth estimates used to determine the estimated market return is too high to be sustainable; therefore, my estimate of the required rate of return on the market portfolio is upwardly biased, which in turn, causes my CAPM-derived estimate of the cost of common equity to be upwardly biased.

483 **Q44. Please summarize how you determined that the investor-required rate of**  
484 **return on common equity for Ameren Illinois equals 9.31%.**

485 A44. The average investor-required rate of return on common equity for the Gas  
486 Sample, 9.12%, is based on the average of its NCD CF-derived results (8.12%)  
487 and risk-premium-derived results (10.12%). I then added a risk premium to  
488 reflect the higher level of overall risk of Ameren Illinois relative to the Gas  
489 Sample. Adding a 0.19% risk adjustment to the 9.12% Gas Sample average,  
490 results in a 9.31% estimate of the Company's cost of common equity.

491 **Q45. How did you assess the comparability of the overall risk of the Company**  
492 **versus the Gas Sample?**

493 A45. The credit ratings assigned to a company reflect both business and financial  
494 risk.<sup>35</sup> Since credit ratings reflect a company's overall risk, I compared the credit  
495 ratings of the Gas Sample and Ameren Illinois. The Gas Sample has an average  
496 credit rating of A-/A3/A- from the three rating agencies.<sup>36</sup> Ameren Illinois has a  
497 credit rating of BBB+/A3/BBB+ by the rating agencies. Whereas Moody's rates  
498 Ameren Illinois at the same average rating as the Gas Sample, both S&P and  
499 Fitch rate Ameren Illinois one credit rating notch lower. Thus, the Gas Sample's  
500 average credit rating indicates that it is slightly less risky than Ameren Illinois.  
501 Financial theory posits that investors require higher returns to accept greater  
502 exposure to risk. Conversely, the investor-required rate of return is lower for  
503 investments with less exposure to risk. Thus, in my judgment, given the  
504 difference between the credit ratings for the Company and the average credit  
505 rating of the Gas Sample, the Sample's average cost of common equity should

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<sup>35</sup> A description of how S&P, Moody's, and Fitch determine a utility's credit rating are shown in Attachments B, C and D, respectively.

<sup>36</sup> The credit ratings are presented in the order S&P/Moody's/Fitch.

506 be adjusted upward to determine the final estimate of the Company's cost of  
507 common equity.

508 **Q46. How did you estimate the adjustment to the cost of common equity of the**  
509 **Gas Sample?**

510 A46. To estimate the appropriate risk adjustment, I began with the spread between  
511 long-term utility bonds rated A and Baa by Moody's. According to Moody's, on  
512 May 26, 2015 A-rated long-term utility bonds yielded 4.15%, while Baa rated  
513 long-term utility bonds yielded 4.88%.<sup>37</sup> Since the Gas Sample and Ameren  
514 Illinois credit ratings average only two-thirds of a ratings notch apart and each  
515 credit rating is subdivided into three ratings notches (e.g., Baa1, Baa2, Baa3) I  
516 then divided the 0.73% spread by 3 to estimate the incremental yield for a single  
517 ratings notch. This results in a 0.24% yield spread per notch. I also considered  
518 the Value Line long-term utility bond yields of 4.16% for A-rated utility bonds and  
519 4.55% for Baa rated utility bonds.<sup>38</sup> Dividing this 0.39% spread by three results  
520 in a 0.13% yield spread per notch. I then took a simple average of the two,  
521 resulting in the 0.19% upward financial risk adjustment to the cost of common  
522 equity estimate for the Gas Sample. Adding the 0.19% financial risk adjustment  
523 to the 9.12% cost of common equity estimate for the Gas Sample, results in an  
524 investor-required rate of return on common equity for Ameren Illinois of 9.31%.

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<sup>37</sup> Moody's Investors Service, *Daily Bond Yields and Key Indicators*, May 27, 2015.

<sup>38</sup> The Value Line Investment Survey, Selection & Opinion, June 5, 2015, 4193.

525

## RESPONSE TO MR. HEVERT

526 **Q47. What cost of equity did Mr. Hevert recommend for the Company?**

527 A47. Mr. Hevert recommended a 10.25% cost of equity for Ameren Illinois.

528 **Q48. How did Mr. Hevert estimate Ameren Illinois' cost of common equity?**

529 A48. Mr. Hevert relied upon the NCD CF model and the CAPM to derive his 10.25%  
530 cost of common equity for Ameren Illinois. Mr. Hevert also presented, but did not  
531 rely upon, an Alternative CAPM and the bond yield plus risk premium approach.<sup>39</sup>

532 **Table 2:** Summary of Mr. Hevert's Analyses<sup>40</sup>

533	<u>Model</u>	<u>Sample Estimate</u>
534	NCDCF	9.12% - 9.84%
535	CAPM	10.55% - 10.77%
536	Alternate CAPM	11.32% - 13.76%
537	Bond yield plus risk premium	10.03% - 10.76%
538		

539 **Q49. Please evaluate Mr. Hevert's analysis of the Company's cost of equity.**

540 A49. Mr. Hevert's analysis contains several errors that lead him to over-estimate the  
541 Company's cost of common equity. The most significant flaws in Mr. Hevert's  
542 analysis of the Company's cost of common equity are the following:

543 1) His NCDCF analysis is overstated because:

544 a. He employs a long-term growth rate that is not sustainable; and

---

<sup>39</sup> Ameren Ex. 5.0 (Rev.), 27-31.

<sup>40</sup> Ameren Ex. 5.0 (Rev.), 44-45.

545 b. He assumes that the payout ratios of the proxy group companies will  
546 converge to 68.74%.

547 2) His estimates of the investor-required return on the market portfolio used in  
548 his CAPM analyses includes questionable data.

549 **DCF Analysis**

550 **Q50. Please describe the significant flaws with Mr. Hevert's NCDCF analysis.**

551 A50. The two significant flaws in Mr. Hevert's NCDCF are his long-term growth rate  
552 and payout ratio. Correcting these two flaws as described below would result in a  
553 mean NCDCF estimate of 7.77% for the Gas Sample.

554 Although I do not agree with Mr. Hevert's use of a 30-day average stock price,  
555 his retention growth estimate, or First Call growth estimates from Yahoo!,  
556 adjusting for those three items does not have a material effect on the estimated  
557 ROE. Thus, I will not take further issue with them in this case.

558 Long-Term Growth Rate

559 **Q51. Please summarize your concerns with the long-term growth rate that Mr.  
560 Hevert used in his DCF analysis.**

561 A51. The long-term growth rate that Mr. Hevert used in the final stage of his NCDCF  
562 analyses for the Gas Sample is not sustainable. Specifically, in order to sustain  
563 5.61% growth given Mr. Hevert's assumed 31.26% earnings retention rate, the  
564 companies in Mr. Hevert's Gas Sample would have to indefinitely sustain, on  
565 average, a 17.95% return on new common equity investment (ROE), which is

566 75% higher than Mr. Hevert's 10.25% cost of common equity recommendation  
567 for Ameren Illinois gas operations. The implausibility of the Gas Sample  
568 sustaining an average 17.95% ROE indefinitely becomes obvious when one  
569 considers the ROE for the Gas Sample averaged 10.99% during 2004 – 2014,  
570 with only one single company achieving an 17.95% ROE in one single year  
571 during that measurement period. Furthermore, a 17.95% return on retained  
572 earnings is 60% greater than Value Line's projected 11.25% ROE for the Gas  
573 Sample.<sup>41</sup>

574 Further, Mr. Hevert's long-term growth rate of 5.61% is based on the historical  
575 growth in real GDP of 3.27% from 1929-2013 and a long-term projected inflation  
576 rate of 2.27%. Historical data should not be used to estimate the forward-looking  
577 rate of return on common equity. First, historical data favors outdated  
578 information that the market no longer considers relevant over the most-recently  
579 available information. Second, historical data reflects conditions that may not  
580 continue in the future. As shown in Table 3 below, professional forecasts of  
581 long-term real GDP range from 2.2% to 2.5%.

582

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<sup>41</sup> Ameren Illinois' Response to Staff Data Request SK 2.05, Value Line Reports, September 5, 2014.

**Table 3: Long-Term Real GDP Growth Forecasts**

Forecaster	Real GDP Growth Forecast <sup>42</sup>	Forecast Period
EIA	2.4%	2024-2040
IHS	2.3%	2024-2044
INFORUM	2.3%	2025-2040
Social Security Administration	2.2%	2025-2040
ExxonMobil	2.2%	2025-2040
OEG	2.5%	2025-2040
Blue Chip Financial Forecasts	2.3%	2021-2025

583 All of these projected growth rates for real GDP indicate that Mr. Hevert’s  
 584 historical real GDP growth estimate overstates the level of growth expected over  
 585 the long-term and thereby overstates the investor-required rate of return for the  
 586 companies in his Gas Sample. Simply substituting a 4.40% terminal growth rate  
 587 (like Staff) for Mr. Hevert’s 5.61% terminal growth rate, into Mr. Hevert’s NDCDF  
 588 model would result in a mean estimated ROE for the Gas Sample of 8.45%, 98  
 589 basis points lower than his mean estimated ROE of 9.43%.

590 Payout Ratio

591 **Q52. Please explain the problem with Mr. Hevert’s historical average industry**  
 592 **payout ratio.**

593 A52. First, as noted above, Mr. Hevert’s reliance on historical data is problematic.  
 594 Historical data reflects conditions that may not continue in the future. In other  
 595 words, use of average historical data implies reversion to a mean. However,  
 596 there is no method for determining the true value of that mean let alone the

---

<sup>42</sup> Energy Information Administration, Annual Energy Outlook 2014, Table A20, Macroeconomic Indicators, [www.eia.doe.gov/oiaf/aeo/](http://www.eia.doe.gov/oiaf/aeo/), April 2014; IHS, The U.S. Economy: The 30-Year Focus, Fourth Quarter 2014, Table 1: Summary of the U.S. Economy; U.S. Energy Information Administration, “Annual Energy Outlook 2014,” CP-2; and Ameren Illinois’ Response to Staff Data Request SK 1.04, Blue Chip Financial Forecasts, December 1, 2014.

597 length of time over which mean reversion will occur. Thus, any historical  
598 measurement period chosen is arbitrary, rendering the results uninformative.

599 Second, Mr. Hevert has not shown that his particular estimate of the historical  
600 industry average is an appropriate predictor of each Gas Sample companies'  
601 long-term payout ratio. In fact, only 3 of the 8 companies in the Gas Sample are  
602 expected to increase its dividend payout ratio from 2014 to 2018 according to Mr.  
603 Hevert.<sup>43</sup> Further, Mr. Hevert's 2024 historical industry payout ratio is higher for  
604 each Gas Sample company than its Value Line forecasted payout ratio for 2017-  
605 2019.

606 Notably, if Mr. Hevert's model held the dividend payout ratio at Value Line's  
607 forecasted 2018 level (instead of creating his own forecasted increase equal to  
608 an ad hoc historical industry average payout ratio by 2024), his NCD CF analysis  
609 would have produced a mean return on equity estimate of 8.81%, 62 basis points  
610 lower than Mr. Hevert's mean estimate, even while retaining his long-term growth  
611 estimate of 5.61%.

612 **CAPM Market Return**

613 **Q53. Please describe the problems with Mr. Hevert's estimates of the investor-**  
614 **required rate of return on the market.**

615 A53. Mr. Hevert's estimates for the investor-required rate of return on the market are  
616 problematic because of his use of questionable inputs for the market  
617 capitalization and unsustainable long-term growth estimates. Mr. Hevert

---

<sup>43</sup> Ameren Ex. 5.1.

618 developed two estimates of the return on the market by calculating the required  
 619 return on the S&P 500 Index using data from Bloomberg and Value Line. First,  
 620 Mr. Hevert's market capitalization inputs are questionable because of the  
 621 numerous discrepancies between the market capitalization data from his two  
 622 sources. The market capitalization for a company is simply its stock price  
 623 multiplied by the total number of shares outstanding. Therefore, if the source  
 624 data is for the same date, there should be no difference in the market  
 625 capitalizations obtained from Bloomberg and Value Line.

626 Second, Mr. Hevert's market return analyses rely on long-term growth rates that  
 627 are not sustainable. Mr. Hevert's market return analysis using Value Line data  
 628 incorporates long-term growth estimates of 129%, 94.5%, 74.5% and 72.5% for  
 629 four dividend paying companies. These four growth-rate estimates are clearly  
 630 unsustainable<sup>44</sup> and account for 0.5% of his estimated rate of return on the  
 631 market. Removing these four growth rates reduces Mr. Hevert's Value Line  
 632 derived estimate of the return on the market to 12.33% from 12.85%. Table 4  
 633 below shows the effect of just removing those four companies on Mr. Hevert's  
 634 CAPM estimates.

**Table 4:** Adjusted CAPM Cost of Equity Estimates

	<b>Value Line Derived Market Risk Premium</b>	
	Hevert	Adjusted*
<i>Value Line Beta</i>	10.77%	<b>10.35%</b>
<i>Five-Year Calculated Beta</i>	10.73%	<b>10.32%</b>
*The adjusted column reflects Mr. Hevert's Market Risk Premium adjusted to remove the four companies with long-term growth rates of 129%, 94.5%, 74.5% and 72.5%.		

<sup>44</sup> Growth rate sustainability was discussed previously on page 9.

635

## Flotation Cost Adjustment

636 **Q54. Is the flotation cost adjustment reflected in Mr. Hevert's cost of equity**  
637 **recommendation?**

638 A54. No. As shown on Attachment E, the Company notes that no explicit adjustment  
639 to Mr. Hevert's ROE recommendation was made for flotation cost, although it  
640 was considered in determining the ROE range.<sup>45</sup>

641 **Q55. Why is Mr. Hevert's proposed flotation cost calculation inappropriate?**

642 A55. Mr. Hevert's flotation cost calculations were based on the costs of issuing equity  
643 that were incurred by Ameren Illinois' parent company, Ameren Corp., and the  
644 Gas Sample companies in their two most recent common equity issuances.  
645 Based on those issuance costs, he calculated a flotation cost of 0.11% (11 basis  
646 points) for Ameren Illinois. He did not make a specific flotation cost adjustment,  
647 but claims to have considered the effect of flotation costs in determining where  
648 Ameren Illinois' ROE falls within the range of results.<sup>46</sup>

649 The Commission has repeatedly rejected generalized flotation cost adjustments  
650 in previous cases as an inappropriate basis for raising utility rates.<sup>47</sup> Moreover,  
651 the Commission has rejected similar flotation cost proposals by Mr. Hevert (*i.e.*,

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<sup>45</sup> Ameren Illinois' Response to Staff Data Request SK 2.03.

<sup>46</sup> Ameren Ex. 5.0 (Rev.), 3.

<sup>47</sup> Ameren Illinois Company d/b/a Ameren Illinois, ICC Order Docket No. 11-0282, 126 (Jan. 10, 2012); MidAmerican Energy Company, ICC Order Docket No. 01-0696, 24 (Sept. 11, 2002); Central Illinois Public Service Company (AmerenCIPS) and Union Electric Company (AmerenUE), ICC Order Docket Nos. 02-0798/03-0008/03-0009 (Cons.), 89 (Oct. 22, 2003); Central Illinois Light Company, ICC Order Docket Nos. 01-0465/01-0530/01-0637 (Cons.), 79 (March 28, 2002); Northern Illinois Gas Company d/b/a Nicor Gas Company, ICC Order Docket No. 04-0779, 94 (Sept. 20, 2005); North Shore Gas Company and The Peoples Gas Light and Coke Company, ICC Order Docket Nos. 07-0241/07-0242, 102 (Feb. 5, 2008).

652 flotation cost calculations that are based on the equity issuance costs of the  
653 parent company and the proxy group companies). Specifically, the  
654 Commission's Order in Docket No. 13-0192 states:

655 The Commission observes that the AIC proposal is essentially the  
656 same as was advanced by AIC, and rejected by the Commission, on  
657 page 126 of its Order in Docket No. 11-0282. The Commission  
658 found, in part, "The Commission concludes that the record in this  
659 proceeding does not justify an upward adjustment to the cost of  
660 common equity to reflect flotation costs...The Commission, however,  
661 is not amenable to approving a flotation cost adjustment based upon  
662 an average of flotation costs for other utilities, as Mr. Hevert  
663 calculated in his direct testimony." The Commission's rationale in  
664 Docket No. 11-0282 is equally applicable to the record in the current  
665 case. In the instant proceeding, the Commission finds, as it did in  
666 Docket No. 11-0282, that the record does not justify an upward  
667 adjustment to the cost of common equity to reflect flotation costs.<sup>48</sup>

668 The Commission's rationale in Docket No. 11-0282 is equally applicable to the  
669 record in the current case. Since Mr. Hevert's calculation is not based on  
670 issuance costs that the Company has incurred but has not previously recovered  
671 through rates, it should not be considered in setting the investor-required rate of  
672 return on common equity.

---

<sup>48</sup> Ameren Illinois Company d/b/a Ameren Illinois, ICC Order Docket No. 13-0192, 165-166 (December 18, 2013).

673

**Other Issues Presented by Mr. Hevert**

674 **Q56. In addition to the NDCDF and CAPM analyses presented by Mr. Hevert, he**  
675 **also presents a bond yield plus risk premium approach and “alternate**  
676 **CAPM analyses.” Are the bond yield plus risk premium approach and**  
677 **alternate CAPM analyses reflected in Mr. Hevert’s cost of equity**  
678 **recommendation?**

679 A56. No. As shown in Attachment F, according to the Company, “Mr. Hevert did not  
680 make an adjustment to his Cost of Equity recommendation in consideration of the  
681 results of his Bond Yield Plus Risk Premium approach.”<sup>49</sup> Also, shown in  
682 Attachment G, “Mr. Hevert’s Cost of Equity recommendation does not rely on the  
683 results of his alternate CAPM analyses.”<sup>50</sup> Recently in Docket No. 14-0371, the  
684 Commission stated that it did not address issues that were not relied upon to  
685 develop the cost of equity recommendation.<sup>51</sup> Thus, I will not address the  
686 infirmities in either Mr. Hevert’s bond yield plus risk premium approach or his  
687 alternate CAPM analyses, since he did not rely upon them to develop his cost of  
688 equity recommendation.

689 **Q57. Does this conclude your direct testimony?**

690 A57. Yes, it does.

---

<sup>49</sup> See Attachment F, Ameren Illinois’ Response to Staff Data Request SK 2.15.

<sup>50</sup> See Attachment G, Ameren Illinois’ Response to Staff Data Request SK 2.14.

<sup>51</sup> Liberty Utilities (Midstates Natural Gas) Corp d/b/a Liberty Utilities, ICC Order Docket No. 14-0371, 65 (February 11, 2015).

**Ameren Illinois Company**

Weighted Average Cost of Capital

**Staff Proposal**  
 Average 2016

	<u>Percent of Total Capital</u>	<u>Cost</u>	<u>Weighted Cost</u>
Long-term Debt	47.43%	5.79%	2.75%
Short-term Debt	1.34%	0.45%	0.01%
Preferred Stock	1.23%	4.98%	0.06%
Common Equity	50.00%	9.31%	4.66%
Bank Facility Costs	<u>                    </u>	<u>                    </u>	<u>0.04%</u>
Total Capital	100.00%		
<b>Weighted Average Cost of Capital</b>			<b>7.51%</b>

**Company Proposal**  
 Average 2016

	<u>Percent of Total Capital</u>	<u>Cost</u>	<u>Weighted Cost</u>
Long-term Debt	47.43%	5.92%	2.81%
Short-term Debt	1.34%	2.28%	0.03%
Preferred Stock	1.23%	4.98%	0.06%
Common Equity	50.00%	10.25%	5.13%
Bank Facility Costs	<u>                    </u>	<u>                    </u>	<u>0.04%</u>
Total Capital	100.00%		
<b>Weighted Average Cost of Capital</b>			<b>8.07%</b>

**Ameren Illinois Company**  
**Embedded Cost of Long-Term Debt**  
**Average 2016**

Debt Issue Type, Coupon Rate (A)	Date Issued (B)	Maturity Date (C)	Principal Amount (D)	Face Amount Outstanding (E)	Unamortized Debt		Carrying Value (H)	Coupon Interest Expense (I)	Amortization of Debt		Annual Interest Expense (L)	
					Discount or (Premium) (F)	Expense (G)			Discount or (Premium) (J)	Expense (K)		
<b><u>First Mortgage Bonds</u></b>												
<b><u>AIC</u></b>												
2.700%	Senior Sec Notes	08/20/12	09/01/22	400,000,000	400,000,000	88,800	2,014,502	397,896,698	10,800,000	14,400	326,676	11,141,076
3.250%	Senior Sec Notes	12/10/14	03/01/25	300,000,000	300,000,000	145,049	2,502,304	297,352,648	9,750,000	16,683	287,805	10,054,488
4.800%	Senior Sec Notes	12/10/13	12/15/43	280,000,000	280,000,000	1,371,601	3,251,836	275,376,563	13,440,000	50,028	118,608	13,608,636
4.300%	Senior Sec Notes	06/30/14	07/01/44	250,000,000	250,000,000	1,325,184	3,051,216	245,623,600	10,750,000	47,328	108,972	10,906,300
3.040%	Senior Sec Notes	12/15/16	01/15/27	250,000,000	10,416,667	-	108,923.04	10,307,744	-	-	10,847	327,514
4.030%	Senior Sec Notes	12/15/15	01/15/46	250,000,000	250,000,000	-	3,130,107	246,869,893	10,075,000	-	105,956	10,180,956
<b><u>CIPS</u></b>												
6.125%	Series AA	12/15/98	12/15/28	60,000,000	60,000,000	168,072	238,996	59,592,932	3,675,000	13,536	19,248	3,707,784
6.700%	Series CC	06/14/06	06/15/36	61,500,000	61,500,000	225,840	410,160	60,864,000	4,120,500	11,292	20,508	4,152,300
<b><u>CILCO</u></b>												
6.200%	Senior Secured Notes	06/14/06	06/15/16	54,000,000	24,750,000	4,367	13,472	24,732,161	1,534,500	8,734	26,945	1,570,179
6.700%	Senior Secured Notes	06/14/06	06/15/36	42,000,000	42,000,000	154,080	385,920	41,460,000	2,814,000	7,704	19,296	2,841,000
<b><u>IP</u></b>												
6.250%	Senior Sec Notes	06/14/06	06/15/16	75,000,000	34,375,000	3,281	24,082	34,347,638	2,148,438	6,550	48,080	2,203,067
6.125%	Senior Sec Notes	11/20/07	11/15/17	250,000,000	250,000,000	38,947	353,923	249,607,130	15,312,500	27,492	249,828	15,589,820
6.250%	Senior Sec Notes	04/08/08	04/01/18	337,000,000	143,512,000	58,506	189,189	143,264,305	8,969,500	33,432	108,108	9,111,040
9.750%	Senior Sec Notes	10/23/08	11/15/18	350,000,000	273,787,500	1,025,710	646,622	272,115,169	26,694,281	431,566	272,065	27,397,912
5.790%	Senior Sec Notes	10/23/08	11/15/18	50,000,000	39,112,500	-	-	39,112,500	2,264,614	-	-	2,264,614
<b><u>Pollution Control Bonds</u></b>												
<b><u>IP</u></b>												
5.700%	PCB Series 1994 A	02/01/94	02/01/24	35,615,000	5,000	239	68	4,693	285	31	9	325
<b><u>CILCO</u></b>												
5.900%	PCB Series H	08/01/93	08/01/23	32,000,000	5,000	-	15	4,985	295	-	2	297
Total Mortgage and Pollution Control Bonds				\$ 3,077,115,000	\$ 2,419,463,667	\$ 4,609,676	\$ 16,321,334	\$ 2,398,532,658	\$ 122,665,579	\$ 668,776	\$ 1,722,952	\$ 125,057,308

Net (Gain)/Loss on Reacquired Debt

Central Illinois Public Service Company Legacy Reacquired Debt:

Variable	2004 Series	04/17/08	07/01/25	\$	-	\$	-	\$	485,136	\$	(485,136)	\$	-	\$	-	53,904	\$	53,904
13.625%	FMB Series U	03/31/86	01/01/16	-	-	-	-	-	-	-	0	-	-	-	158	-	158	
9.125%	FMB Series T	05/31/92	05/01/22	-	-	-	-	368,064	(368,064)	-	-	-	-	62,208	-	62,208		
8.500%	FMB Series W	12/15/98	04/01/21	-	-	-	-	501,526	(501,526)	-	-	-	-	103,764	-	103,764		
6.375%	PCB Series B	01/01/93	05/01/28	-	-	-	-	151,008	(151,008)	-	-	-	-	12,672	-	12,672		
6.750%	PCB Series C	06/01/93	06/01/28	-	-	-	-	66,672	(66,672)	-	-	-	-	5,556	-	5,556		
5.850%	PCB Series A	08/01/93	08/01/26	-	-	-	-	49,898	(49,898)	-	-	-	-	4,908	-	4,908		
6.375%	PCB Series 1993A	12/22/04	06/01/25	-	-	-	-	207,684	(207,684)	-	-	-	-	23,076	-	23,076		
5.900%	PCB Series B-2	12/20/04	05/01/28	-	-	-	-	209,638	(209,638)	-	-	-	-	17,592	-	17,592		
5.700%	PCB Series C-2	12/20/04	08/01/26	-	-	-	-	150,548	(150,548)	-	-	-	-	14,808	-	14,808		
7.610%	Series 97-2	09/15/10	06/01/17	-	-	-	-	101,255	(101,255)	-	-	-	-	110,460	-	110,460		
5.500%	Series 2000A	09/06/12	09/01/22	-	-	-	-	106,930	(106,930)	-	-	-	-	17,340	-	17,340		
5.950%	Series C1	01/01/14	08/15/26	-	-	-	-	317,141	(317,141)	-	-	-	-	31,452	-	31,452		
5.700%	Series C2	01/01/14	08/15/26	-	-	-	-	29,280	(29,280)	-	-	-	-	2,880	-	2,880		

Central Illinois Light Company Legacy Reacquired Debt:

Variable	PCB Series 2004	04/17/08	10/01/39	-	-	-	-	275,094	(275,094)	-	-	-	-	11,832	-	11,832
Variable	PCB Series 2004	04/17/08	10/01/26	-	-	-	-	65,682	(65,682)	-	-	-	-	6,408	-	6,408
7.730%	FMB	07/17/06	06/01/16	-	-	-	-	10,760	(10,760)	-	-	-	-	21,650	-	21,650
7.730%	FMB	07/17/06	06/01/36	-	-	-	-	266,400	(266,400)	-	-	-	-	13,320	-	13,320

**Ameren Illinois Company**  
**Embedded Cost of Long-Term Debt**  
**Average 2016**

Debt Issue Type, Coupon Rate (A)	Date Issued (B)	Maturity Date (C)	Principal Amount (D)	Face Amount Outstanding (E)	Unamortized Debt		Carrying Value (H)	Coupon Interest Expense (I)	Amortization of Debt		Annual Interest Expense (L)
					Discount or (Premium) (F)	Expense (G)			Discount or (Premium) (J)	Expense (K)	
9.625% FMB	02/20/92	01/01/22	-	-	-	148,302	(148,302)	-	-	26,964	26,964
9.250% FMB	03/02/92	01/01/22	-	-	-	143,484	(143,484)	-	-	26,088	26,088
9.250% FMB	02/20/92	01/01/22	-	-	-	96,954	(96,954)	-	-	17,628	17,628
11.375% PCB Series C	09/01/92	02/01/18	-	-	-	31,692	(31,692)	-	-	20,016	20,016
6.125% PCB Series B	09/12/93	08/01/23	-	-	-	28,135	(28,135)	-	-	3,972	3,972
6.200% PCB Series A	10/01/93	08/01/23	-	-	-	24,310	(24,310)	-	-	3,432	3,432
8.200% FMB	04/30/03	01/01/22	-	-	-	774,319	(774,319)	-	-	138,684	138,684
7.800% FMB	04/30/03	02/01/23	-	-	-	154,720	(154,720)	-	-	23,208	23,208
6.500% PCB Series E	12/22/04	10/01/39	-	-	-	196,416	(196,416)	-	-	8,448	8,448
6.500% PCB Series F	12/22/04	10/01/26	-	-	-	17,466	(17,466)	-	-	1,704	1,704
5.900% PCB Series 1993	01/16/14	08/01/23	-	-	-	95,115	(95,115)	-	-	13,428	13,428
<b>Illinois Power Company Legacy Reacquired Debt:</b>											
Variable Series 1997 A,B,C	05/28/08	03/01/18	-	-	-	513,765	(513,765)	-	-	293,580	293,580
Variable Series 2001 Non-AMT	05/20/08	03/01/18	-	-	-	494,823	(494,823)	-	-	282,756	282,756
Variable Series 2001 AMT	05/20/08	03/01/18	-	-	-	200,487	(200,487)	-	-	114,564	114,564
7.500% MB due 2025	08/16/93	07/01/25	-	-	-	257,785	(257,785)	-	-	28,380	28,380
7.500% MB due 2025	04/01/96	07/01/25	-	-	-	(119,556)	119,556	-	-	(13,284)	(13,284)
9.375% MB due 2016	03/22/93	02/01/23	-	-	-	890,640	(890,640)	-	-	133,596	133,596
8.875% MB due 2008	03/22/93	02/01/23	-	-	-	449,040	(449,040)	-	-	67,356	67,356
10.750% FMB due 2015	03/01/95	12/01/24	-	-	-	339,259	(339,259)	-	-	40,308	40,308
Variable FMB due 2028	05/01/01	11/01/28	-	-	-	631,812	(631,812)	-	-	51,228	51,228
9.875% MB due 2004	07/01/86	07/01/16	-	-	-	1,659	(1,659)	-	-	3,327	3,327
14.500% IPF Deb due 1989	09/30/86	09/01/16	-	-	-	98,731	(98,731)	-	-	149,110	149,110
Variable PCB due 2017	05/01/01	03/01/17	-	-	-	23,064	(23,064)	-	-	34,596	34,596
10.750% PCB C due 2013	12/15/93	11/01/28	-	-	-	913,604	(913,604)	-	-	74,076	74,076
11.625% FMB due 2014	05/01/94	02/01/24	-	-	-	192,192	(192,192)	-	-	25,344	25,344
8.300% PCB E due 3/1/2015	07/29/87	04/01/17	-	-	-	59,904	(59,904)	-	-	79,872	79,872
7.625% PCB F,G & H due 2016	06/02/97	04/01/32	-	-	-	1,090,152	(1,090,152)	-	-	69,216	69,216
5.400% PCB B due 5/2007	03/06/98	03/01/28	-	-	-	208,600	(208,600)	-	-	17,880	17,880
IP Capital MIPS	05/30/00	12/01/43	-	-	-	1,806,868	(1,806,868)	-	-	65,904	65,904
IP Financing I TOPRS	09/30/01	01/01/45	-	-	-	1,918,962	(1,918,962)	-	-	67,332	67,332
6.250% Senior Sec Notes	08/27/12	09/01/22	-	-	-	27,048,332	(27,048,332)	-	-	4,386,216	4,386,216
9.750% Senior Sec Notes	08/27/12	09/01/22	-	-	-	18,965,373	(18,965,373)	-	-	3,071,826	3,071,826
5.700% PCB 94A due '24	01/16/14	02/01/24	-	-	-	2,158,338	(2,158,338)	-	-	284,616	284,616
5.400% PCB 98A & 98B due '28	01/16/14	03/01/28	-	-	-	457,380	(457,380)	-	-	39,204	39,204
Total Net (Gain)/Loss on Reacquired Debt			\$ -	\$ -	\$ -	\$ 63,674,843	\$ (63,674,843)	\$ -	\$ -	\$ 10,164,563	\$ 10,164,563
Total Long-Term Debt			\$ 3,077,115,000	\$ 2,419,463,667	\$ 4,609,676	\$ 79,996,176	\$ 2,334,857,815	\$ 122,665,579	\$ 668,776	\$ 11,887,515	\$ 135,221,870
Embedded Cost of Long-Term Debt											5.79%

Notes: Column (H) = Columns (E) + (F) + (G)  
Column (L) = Columns (I) + (J) + (K)  
Embedded Cost of Long-Term Debt = Column (L) ÷ (H)

**Ameren Illinois Company  
 Prices and Dividends**

**Gas Sample**

**Current Dividend**

<u>Company</u>	<u>D<sub>0,1</sub></u>	<u>D<sub>0,2</sub></u>	<u>D<sub>0,3</sub></u>	<u>D<sub>0,4</sub></u>	<u>Next Dividend Payment Date</u>	<u>Stock Price</u>
AGL Resources	\$ 0.490	\$ 0.490	\$ 0.490	\$ 0.490	03/01/15	\$ 52.31
Atmos Energy	0.370	0.370	0.370	0.390	03/09/15	53.70
New Jersey Resources	0.420	0.420	0.420	0.450	01/02/15	57.90
Northwest Natural Gas	0.460	0.460	0.460	0.465	02/13/15	46.51
Piedmont Natural Gas	0.310	0.320	0.320	0.320	01/15/15	37.48
South Jersey Industries	0.473	0.473	0.473	0.473	12/30/14	57.08
Southwest Gas	0.330	0.365	0.365	0.365	03/02/15	57.89
WGL Holdings	0.420	0.440	0.440	0.440	02/01/15	48.87

**Ameren Illinois Company**

**Gas Sample**

**First (Near Term) Growth Stage**

<u>Company</u>	<u>Zacks EPS</u>	<u>Bloomberg EPS</u>	<u>Value Line EPS/DPS*</u>	<u>Average Growth Rate</u>
AGL Resources	4.00%	5.50%	7.50%	5.67%
Atmos Energy	7.00%	7.35%	5.50%	6.62%
New Jersey Resources	4.00%		4.25%	4.13%
Northwest Natural Gas	4.00%	4.00%	4.50%	4.17%
Piedmont Natural Gas	5.00%	5.00%	3.50%	4.50%
South Jersey Industries	6.00%		8.00%	7.00%
Southwest Gas	5.50%	4.00%	6.50%	5.33%
WGL Holdings	5.25%		3.25%	4.25%
Average				5.21%

\* The Value Line growth estimate is the average of earnings per share and dividends per share estimates for 2017-2019.

**Ameren Illinois Company**

**Gas Sample**

<u>Company</u>	<u>NCD CF Estimate</u>
AGL Resources	8.77%
Atmos Energy	7.86%
New Jersey Resources	7.61%
Northwest Natural Gas	8.52%
Piedmont Natural Gas	8.09%
South Jersey Industries	8.65%
Southwest Gas	7.24%
WGL Holdings	8.22%
Average	8.12%

**Ameren Illinois Company**

**CAPM Analysis**

Interest Rates as of November 28, 2014

U.S. Treasury Bills		U.S. Treasury Bonds	
<u>Discount Rate</u>	<u>Effective Yield</u>	<u>Equivalent Yield</u>	<u>Effective Yield</u>
0.04%	0.04%	2.89%	2.91%

**CAPM Cost of Equity Estimates\***  
**Gas Sample**

<u>Risk-Free Rate</u>		<u>Beta</u>		<u>Risk Premium</u>		<u>Cost of Common Equity</u>
2.91%	+	0.76	*	(12.40% - 2.91%)	=	10.12%

\*Risk-Free Rate Proxy is the 30-year U.S. Treasury Bond Yield.

**From:** [Yahoo! Finance](#)  
**To:** [Kight-Garlich, Sheena](#)  
**Subject:** RE: General Question (KMM168289484V80553L0KM)  
**Date:** Saturday, July 10, 2010 12:46:22 PM

---

Hello Sheena,

Thank you for writing to Yahoo! Finance.

I understand you have some additional questions with regards to our Analyst Estimates data. I'd be happy to further assist you with this.

We add the data Thomson and Morningstar provides us as soon as it becomes available. However, if we are not provided a forecast, it will not be updated. The previously data will be displayed until we get an update. There is no set time the data will remain, once theres an update the old data is replaced. At this time, we do not have a policy for ensuring this data is updated timely, at this is part of our free services not included in the Real-Time Quotes premium subscription.

I hope I have addressed and understood your question or concern. If not, please don't hesitate to reply to this email and we will gladly assist you further.

Thank you again for contacting Yahoo! Finance.

Regards,

Murray

Yahoo! Finance Customer Care

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Download optimize Firefox: <http://bit.ly/dyQBE9>

Original Message Follows:  
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Norma,

My question does not concern how often Thomson Financial or MorningStar update their information but on what is Yahoo! Finance's policy for updating the information. For example, Thomson provides an analyst forecast for a Company on January 15, 2009. As of today Thomson has not provided any other forecast for that company, does Yahoo! remove the forecast after 6-month, 12-months, or does the forecast remain until a newer forecast is received? Does Yahoo! have a policy for ensuring that the forecast it publishes are timely?

Thank you,

Sheena Kight-Garlich

-----Original Message-----

From: Yahoo! Finance [<mailto:finance-admin@cc.yahoo-inc.com>]

Sent: Thursday, July 08, 2010 2:46 PM

To: Kight-Garlich, Sheena

Subject: Re: General Question (KMM168221993V34339LOKM)

Hello Sheena,

Thank you for writing to Yahoo! Finance.

I understand you have some questions with regards to our Analyst Estimates, five year growth estimates and updates. I'd be happy to assist you with your inquiry.

Our Analyst Estimates information is provided to us by the Thomson Financial Network and MorningStar, Inc. For details on calculations and updates, you can contact each company and review what they have on file for your company and update that data as necessary per their processes. You can reach each of the companies at these email addresses:

[TWMsupport@thomson.com](mailto:TWMsupport@thomson.com)

[dataquestions@morningstar.com](mailto:dataquestions@morningstar.com)

If you have any further questions, suggestions, or concerns, please let us know.

Thank you again for contacting Yahoo! Finance.

Regards,

Norma

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-----

Mail-Id:

w12.help.sp1.yahoo.com-/l/us/yahoo/finance/general.html-1278520700-7232

1. What is your name and Yahoo! ID?

-----  
Name: Sheena

Yahoo! ID: -----

2. What is your email address?

Email Address: skight@icc.illinois.gov

3. What are you writing about?

-----  
Subject: General Question

4. If you are writing about a particular company, which one?

-----  
Ticker Symbol:

Company Name:

5. If you are writing about a Portfolio, which one?

-----  
Portfolio Name:

6. Please describe the issue you are experiencing

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I was inquiring as to how often the analyst next 5 year growth estimates are updated. How long are analyst estimates good for? (e.g. 6 months or until a new estimate is received) How long does Yahoo! keep an estimate before it is removed for timeliness? I noticed that Thomson Financial Network is the source for analyst growth estimates. I looked up several companies on both Yahoo! and Thomson Reuters. Thomson Reuters did not have growth rates available for the companies, however Yahoo! did have 5 yr growth estimates. (examples of compaies: CTWS-Connecticut Water Service Inc.; MSEX- Middlesex Water Co.; PNNW- Pennichuck Corp.; SJW- SJW Corp.; SWWC- Southwest Water Co.; YORW- York Water Co.) Thank you for your time.

Sheena Kight-Garlich

How often does the problem occur?: Not set by user

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Date Originated: Wednesday July 7, 2010 - 09:38:20

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AOL: no

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# RatingsDirect®

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## Summary:

### Ameren Illinois Co.

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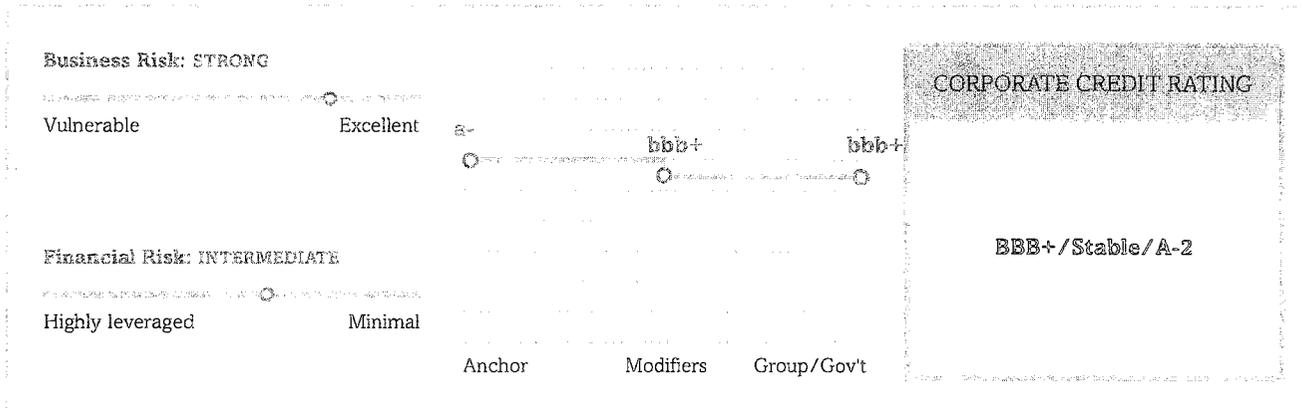
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Summary:

Ameren Illinois Co.



Rationale

Business Risk: Strong	Financial Risk: Intermediate
<ul style="list-style-type: none"> <li>• Fully rate-regulated lower-risk electric and gas utility businesses.</li> <li>• Relatively stable operating cash flow from utilities.</li> <li>• Greater volatility of profitability compared with the regulated utility industry average.</li> <li>• Slower-than-average economic growth within the company's service territory.</li> <li>• Regulatory framework in Illinois provides cash flow support.</li> </ul>	<ul style="list-style-type: none"> <li>• Ongoing cost recovery of incremental capital spending and operating expenses.</li> <li>• Capital spending that is expected to be greater than annual historical amounts.</li> <li>• Financial measures that continue to perform in line with our assessment of the financial risk profile.</li> <li>• Negative discretionary cash flow indicating a need for external funding.</li> </ul>

**Outlook: Stable**

The stable rating outlook on utility Ameren Illinois Co. (AI) reflects that of parent Ameren Corp. This outlook reflects our base-case forecast level of Ameren's adjusted funds from operations (FFO) to debt of about 22% over the next two years. Fundamental to our forecast is our expectation that the company will continue to manage its regulatory risk, enabling some of the regulated companies to earn their allowed return on equity. We also expect that the company will disproportionately invest in lower-risk rate-regulated electric transmission assets that will gradually strengthen the company's business risk profile.

**Downside scenario**

We could lower the ratings over the next two years if the company's ability to manage its regulatory risk weakens or if its financial performance unexpectedly deteriorates such that the core financial measures are consistently below 13%. This could occur if rate case outcomes are consistently weaker than expected, regulatory lag increases, or if there is a material increase to capital spending that is primarily funded with debt.

**Upside scenario**

We could raise the ratings over the next two years if the company's business risk profile improves such that the regulatory lag consistently diminishes and that the economic growth in the company's service territory strengthens. We could also raise the ratings if the company's financial measures improve above our base-case forecast, such that the core financial ratio of FFO to debt consistently exceeds 23%. This could occur when the company completes its large capital projects while also effectively managing costs.

**Standard & Poor's Base-Case Scenario**

Assumptions	Key Metrics																
<ul style="list-style-type: none"> <li>• The economic conditions in the utility's service territory continue to improve incrementally resulting in improving cash flow measures</li> <li>• Annual EBITDA growth over the forecast period</li> <li>• Adequate regulatory outcomes in Illinois</li> <li>• Current rate surcharges are retained</li> </ul>	<table border="1"> <thead> <tr> <th></th> <th>2014A</th> <th>2015E</th> <th>2016E</th> </tr> </thead> <tbody> <tr> <td>FFO/total debt (%)</td> <td>28.7</td> <td>27.2-28.5</td> <td>24.2-25.5</td> </tr> <tr> <td>Debt/EBITDA (x)</td> <td>3.2</td> <td>3.3-3.5</td> <td>3.3-3.5</td> </tr> <tr> <td>OCF/total debt (%)</td> <td>19.3</td> <td>25-27</td> <td>24-25</td> </tr> </tbody> </table>		2014A	2015E	2016E	FFO/total debt (%)	28.7	27.2-28.5	24.2-25.5	Debt/EBITDA (x)	3.2	3.3-3.5	3.3-3.5	OCF/total debt (%)	19.3	25-27	24-25
		2014A	2015E	2016E													
	FFO/total debt (%)	28.7	27.2-28.5	24.2-25.5													
	Debt/EBITDA (x)	3.2	3.3-3.5	3.3-3.5													
OCF/total debt (%)	19.3	25-27	24-25														
<p>Note: Standard &amp; Poor's adjusted figures. A—Actual, E—Estimate, FFO—Funds from operations, OCF—Operating cash flow.</p>																	

**Business Risk: Strong**

We base our assessment of AI's business risk profile on what we view as the company's "satisfactory" competitive position, "very low" industry risk stemming from the regulated utility industry, and "very low" country risk of the U.S.

where the utility operates. AI's competitive position reflects the company's fully regulated electric transmission and distribution and natural gas distribution operations and our expectation for continued operational performance and a generally credit supportive cost recovery. The utility, which is regulated by the Illinois Commerce Commission, is relatively large with 1.2 million electric customers and about 800,000 gas customers in central and southern Illinois. Additional customer and cash flow diversification is through the Federal Energy Regulatory Commission-regulated electric transmission operation, which constitutes roughly 15% of rate base. Somewhat moderating these strengths, over the past few years, the utility's profitability had more volatility compared to the regulated utility industry average.

### Financial Risk: Intermediate

Based on our medial volatility financial ratio benchmarks, our assessment of AI's stand-alone financial risk profile is "intermediate". This reflects the lower-risk regulated utility operations and the recurring cash flow from providing electric and natural gas. As a utility, capital spending is ongoing for maintenance purposes and for new projects. Recovery of these costs through rates has mostly been authorized. External funding needs exist over the next few years since our base-case scenario reflects discretionary cash flow that we expect to remain negative. Steady cost recovery through the regulatory process will be required to maintain cash flow measures, including FFO to total debt above 25% on average and operating cash flow to debt greater than 24%. We expect debt to EBITDA to remain around 3.2x on average, in line with the range for an "intermediate" financial risk profile.

### Liquidity: Adequate

AI's liquidity reflects that of parent Ameren, which has "adequate" liquidity, as our criteria define the term. We believe the company's liquidity sources are likely to cover uses by more than 1.1x over the next 12 months and to meet cash outflows even with a 10% decline in EBITDA.

There are sizable debt maturities over the next three years, with \$395 million due in 2016 and \$681 million in 2017. We expect the company to refinance these maturities given its satisfactory standing in the credit markets.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"><li>• We estimate FFO of about \$1.9 billion in 2015</li><li>• Credit facility availability of an estimated \$2.1 billion in 2015.</li></ul>	<ul style="list-style-type: none"><li>• Capital spending of approximately \$1.4 billion expected in 2015.</li><li>• Working capital outflows of \$150 million in 2015.</li><li>• Dividends of about \$400 million in 2015.</li><li>• Debt maturities, including short-term debt issuances, of roughly \$400 million in 2015.</li></ul>

### Other Credit Considerations

The stand-alone credit profile on AI reflects our application of a one-notch negative adjustment for our "comparable

*Summary: Ameren Illinois Co.*

rating analysis". This negative adjustment reflects our expectations that the financial measures will approximate the lower end of the range for the "intermediate" financial risk profile category.

## Group Influence

Under our group rating methodology, we assess AI to be a core subsidiary of Ameren, reflecting our view that AI is highly unlikely to be sold and has a strong long-term commitment from senior management. There are no meaningful insulation measures in place that protect AI from its parent and therefore, AI's issuer credit rating is in line with Ameren's group credit profile of 'bbb+'.

## Ratings Score Snapshot

### Corporate Credit Rating

BBB+/Stable/A-2

### Business risk: Strong

- **Country risk:** Very low
- **Industry risk:** Very low
- **Competitive position:** Satisfactory

### Financial risk: Intermediate

- **Cash flow/Leverage:** Intermediate

### Anchor: a-

### Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Negative (-1 notch)

### Stand-alone credit profile : bbb+

- **Group credit profile:** bbb+
- **Entity status within group:** Core (no impact)

## Recovery Analysis

AI's first mortgage bonds 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 two

notches above the issuer credit rating (ICR).

## Issue Ratings

We rate the preferred stock two notches below the ICR to reflect the discretionary nature of the dividend and the deeply subordinated claim if a bankruptcy occurs.

The short-term rating on AI is 'A-2' based on our ICR on the company and our assessment of its liquidity as at least adequate.

## Related Criteria And Research

### Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Notching Of U.S. Investment-Grade Investor-Owned Utility Unsecured Debt Now Better Reflects Anticipated Absolute Recovery, Nov. 10, 2008
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

### Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
<b>Strong</b>	aa/aa-	a+/a	<b>a-/bbb+</b>	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

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## Assessing U.S. Investor-Owned Utility Regulatory Environments

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# Assessing U.S. Investor-Owned Utility Regulatory Environments

Regulatory advantage is the most heavily weighted factor when Standard & Poor's Ratings Services analyzes a regulated utility's business risk profile. One significant aspect of regulatory risk that influences credit quality is the regulatory environment in the jurisdictions where a utility operates. A utility management team's skill in dealing with regulatory risk can sometimes overcome a difficult regulatory environment. Conversely, companies' regulatory risk can increase even with supportive regulatory regimes if management fails to devote the necessary time and resources to the important task of managing regulatory risk. We modify our assessment of regulatory advantage to account for this dynamic in our ratings methodology (for the criteria we use to rate utilities, see "Corporate Methodology," and "Key Credit Factors For The Regulated Utilities Industry," published Nov. 19, 2013, on RatingsDirect.)

There are specific factors we use in the U.S. to assess the credit implications of the numerous regulatory jurisdictions here that help us determine the "preliminary regulatory advantage" in our credit analysis of each investor-owned regulated utility. We organize the subfactors of regulatory advantage into four categories:

- Regulatory stability,
- Tariff-setting procedures and design,
- Financial stability, and
- Regulatory independence and insulation.

## Regulatory Stability

The foundation of our opinion of a jurisdiction is the stability of its approach to regulating utilities, encompassing transparency, predictability, and consistency. Given the maturity of the U.S. investor-owned utility industry, the long history of utility regulation (going back to the early 20th century) and the well-established constitutional protections accorded to utility investments, we emphasize the principle of consistency when weighing regulatory stability. We also incorporate the degree to which the regulatory framework either explicitly or implicitly considers credit quality in its design.

### Durability of regulatory system

An established, dependable approach to regulating utilities is a hallmark of a credit-supportive jurisdiction. Bondholders lend capital to utilities over long periods to fund the development of long-lived assets. A firm understanding of the basic "rules" that will govern how the utility will recover its costs, including servicing its debt and the return on its capital over an extended period, is essential to accurately assess credit risk. Major or frequent changes to the regulatory model invariably raise risk due to the possibility of future changes. Steady application of transparent, comprehensible policies and practices lowers risk.

How long a regulatory framework has been in place is the most important factor in this area. We view jurisdictions as most supportive when there have been no major changes or where the approach has been consistent for a long time and is not prone to further changes. Jurisdictions that have undergone a major, fundamental change in the regulatory

*Assessing U.S. Investor-Owned Utility Regulatory Environments*

paradigm that seems to be working well are a little less supportive, and less so a jurisdiction that is transitioning to a new regulatory approach. Credit risk rises if the transition attracts negative political attention. The less-supportive jurisdictions are those that frequently alter the basic regulatory approach. We also view less favorably the framework's development if policy disputes or legal actions cause contention, indicating that the political consensus regarding utility regulation is fragile.

Some jurisdictions permit competitive markets to prevail for some important functions of the delivery of utility services, notably wholesale markets for electricity and retail markets for electric or gas service. In others, vertical integration is the norm. A jurisdiction's credit-supportiveness can suffer if market forces directly influence major cost items that utilities could otherwise control through cost-based regulation because of the potential volatility it creates. The risk inherent in a market-based model is straightforward: utility rates are more volatile when markets influence them rather than fully embedded costs, and regulators are apt to resist full and timely recovery when market price changes are abrupt and substantial (and perhaps misunderstood). We observe less support for credit quality in jurisdictions that are in the midst of deregulating important parts of the utility framework. The uncertainty of the timing of reaching the outcome--and what the result will be--is a negative factor from a credit perspective. Utilities are also prone to financial stress when the transition to competition causes potential "rate shock" for customers that regulators could resist.

#### **Transparency of regulatory framework and attitude toward credit quality**

We believe regulation works best when it is rule-based. Bondholder interests are better protected by the presence of and adherence to a pre-set code of rules and procedures that we can look to when assessing risk. Risk is lower when the rules are more transparent and when they take into account utilities' financial integrity. We regard jurisdictions that require regulators to protect utilities' financial soundness and have transparent policies and procedures as the most credit-supportive. We ascribe higher risk in jurisdictions where policies and procedures support financial integrity, but where inconsistency can selectively arise. We believe a jurisdiction provides even less support when transparency merely exists. We see less support when any of these credit factors are absent, or if the regulator's record on following precedent is poor.

#### **Tariff-Setting Procedures**

We review rate decisions as part of our surveillance on each U.S. utility. We focus on the jurisdiction's overall approach to setting rates and the process it uses to establish base rates (practices pertaining to separate tariff provisions for large expenses are in the "Financial Stability" part of our analysis). We focus on whether base rates, over time, fairly reflect a utility's cost structure and allow its managers an opportunity to earn a compensatory return that provides bondholders with a financial cushion that supports credit quality. If the process is geared toward an incentive-based system, our analysis centers on the risks related to the incentive mechanisms. If the jurisdiction has vertically integrated utilities, we review the resource procurement process and assess how it affects regulatory risk.

#### **Ability to timely recover costs**

We review authorized returns and capital structures in our analysis, but we focus mainly on actual earned returns. Examples abound of utilities with healthy authorized returns that have no meaningful expectation of earning those

returns due to, for example, rate case lag (i.e., the relationship between approved rates and the age of the costs used to set those rates) or expense disallowances. Also, the absolute level of financial returns is less important in our analysis than that return's stability, and we note the equity component in the capital structure used to generate the revenue requirement in rate proceedings. Higher authorized and earned returns and thicker equity ratios translate into better credit measures and a more comfortable equity cushion for bondholders. We consider a regulatory approach that allows utilities the opportunity to consistently earn a reasonable return as a positive credit factor.

A very credit-supportive jurisdiction is one in which all of the utilities it regulates consistently earn above-average returns. We assess jurisdictions lower if only some of them do, and lower still if the earnings records are below average or highly variable from year to year. We deem jurisdictions as weaker when all utilities earn well-below-average returns, and we consider jurisdictions where all utilities consistently earn exceedingly poor returns, including years with negative returns, as weakest.

We examine "regulatory lag" along with the record of earned returns to assess timeliness. Credit-supportive jurisdiction typically have a track record of little regulatory lag, indicating that responsibility for a poor or uneven earnings history lies more with management than its regulators. In addition to the regulator's efficiency in completing rate cases, we consider the obsolescence of the costs on which the rates are based, the timing of interim rates, and other practices (such as allowing rates to automatically change in a future period based on inflation) that affect a utility's ability to earn its authorized return.

If a jurisdiction uses incentives as the primary ratemaking tool and institutes a comprehensive incentive program that allows revenues and costs to diverge, we evaluate the incentive mechanisms' effect on a utility's earnings capability and stability. A common approach features an extended period between base rate reviews, during which rates change according to a formula based on inflation, a predetermined productivity factor, and capital spending. An incentive-based program can be close to credit-neutral compared with systems that permit more frequent and dynamic rate changes if the risk is symmetrical (i.e., an equal opportunity to earn over or under the authorized return and equivalent reward or penalty for doing so) and limited (a maximum or minimum earnings band). The effect on regulatory risk depends on whether we believe the efficiency targets are realistic and achievable, the regulator's treatment of disparities in actual versus authorized spending, and the framework's flexibility to adjust returns for capital market conditions. If there are operating standards, we determine whether they fairly reward or punish utilities if performance deviates from expectations.

There is a muted effect on regulatory risk in jurisdictions where incentives are not central, but are instead used only to augment cost-of-service regulation. A moderate amount of incentives that carry symmetrical risks can even modestly support better credit quality. For example, a fuel-adjustment and purchased-power clause with a sharing mechanism that affects less than 10% of the total fuel costs and cuts both ways when commodity markets change can modestly reduce risk by offering the utility a mild incentive for effective procurement and efficient operations, without unduly exposing it to commodity price risk.

We typically view jurisdictions as credit-supportive if regulators use symmetrical incentive mechanisms sparingly in the rate-setting process. When incentives play a larger role in the rate-setting approach, but are well-designed to evenly allocate risk, we see less support for credit quality. We regard still lower jurisdictions where incentives

*Assessing U.S. Investor-Owned Utility Regulatory Environments*

dominate and are poorly designed. Jurisdictions where incentives significantly degrade risk and are part of a comprehensive incentive regime harbor the most risk for creditors.

### **Oversight of resource procurement**

When applicable, a resource-procurement process that uses objective guidelines to evaluate competing proposals to meet service obligations and keeps the regulator informed and involved in the decisions can, in our view, help to reduce the risk of subsequent disallowances. If the jurisdiction has an "Integrated Resource Plan" or similar mechanism that includes the participation of many parties and it uses it to definitively establish the need for new generation, it diminishes credit risk further.

We typically view the resource-procurement process more favorably if it's competitive, overseen by the regulator, and the regulator must validate the results. A jurisdiction is weaker when the process only features some of those elements. We deem jurisdictions with no regulator involvement in the process--other than to later disallow some cost recoveries based on perfect hindsight--as even less credit-supportive.

Another key issue that can fall under this part of our analysis is the regulatory oversight of large capital projects with long lead times that carry out-sized risks to a utility and its bondholders. Practices such as legislative or regulatory recognition of the need for preapproval of such endeavors, periodic reviews that substantively involve the regulator in the project's progress, and rolling prudence determinations during construction can reduce the general level of risk associated with a utility committing substantial capital well in advance of the rate proceeding that results in the project's placement into the rate base.

We view jurisdictions more favorably when they have an oversight process that includes the regulator's preapproval, ongoing regulatory oversight of a project, and provisions for rolling prudence determinations that improve the chances that all project costs will eventually be reflected in rates. We deem jurisdictions weaker when the process only features some of those elements. We consider jurisdictions even weaker when they don't have any regulatory involvement in the process and have a track record of significant post hoc disallowances of capital costs.

## **Financial Stability**

When we evaluate U.S utility regulatory environments, we consider financial stability to be of substantial importance. Cash takes precedence in credit analysis. A regulatory jurisdiction that recognizes the significance of cash flow in its decision-making is one that will appeal to bondholders.

### **Treatment of significant expenses**

When utilities have major expenses such as fuel and purchased power/gas/water, the presence of separate tariff provisions to facilitate full and contemporaneous recovery is the most prominent factor in this part of our analysis. The timely adjustment of rates in response to changing commodity prices and other expenses that are largely out of management's control is a key feature of a credit-supportive regulatory jurisdiction. The analysis centers on the special tariff mechanisms to determine their effectiveness in producing the cash flow stability they are designed to achieve. The frequency of rate adjustments, the ability to quickly react to unusual market volatility, and the control of opportunities to engage in hindsight disallowances of costs could affect our analysis almost as much as whether the

tariff provisions exist at all. The record of disallowances plays a part when we assess regulatory advantage.

We consider jurisdictions to be very credit-supportive if utilities can recover all high-expense items through an automatic tariff clause that is based on projected costs, adjusts frequently, and has no record of any significant disallowances. We see more risk if separate mechanisms exist, but lack some of the above features. We view jurisdictions that lack independent rate mechanisms for large expenses and have a record of significant disallowances as weakest.

### **Treatment of capital spending**

When applicable, a jurisdiction's willingness to support large capital projects with cash during construction is an important aspect of our analysis. This is especially true when the project represents a major addition to rate base and entails long lead times and technological risks that make it susceptible to construction delays. Broad support for all capital spending is the most credit-sustaining. Support for only specific types of capital spending, such as specific environmental projects or system integrity plans, is less so, but still favorable for bondholders. Allowance of a cash return on construction work-in-progress or similar ratemaking methods historically were extraordinary measures for use in unusual circumstances, but when construction costs are rising, cash flow support could be crucial to maintain credit quality through the spending program. Even more favorable are those jurisdictions that present an opportunity for a higher return on capital projects as an incentive to investors.

Very supportive jurisdictions offer a separate recovery mechanism for all capital spending, a mandated current cash return during construction, and a bonus return for some or all capital projects. We deem a jurisdiction weaker if there is a separate mechanism for only certain kinds of spending and the cash return and higher return are subject to the regulator's discretion. We view jurisdictions that don't allow separate recovery or a current return as being lower on the scale. We assess a jurisdiction as weaker still when it doesn't have independent rate mechanisms for capital projects, and we view it as most risky when full recovery occurs only after a utility's assets become operational.

### **Cash-smoothing mechanisms**

We have a more positive view of jurisdictions that use innovative regulatory provisions that help to smooth cash flow from period to period. For a jurisdiction that focuses on incentives in its basic approach to ratemaking, through multiyear rate plans or a formula rate plan, we view the availability of "reopeners" (to adjust rates for unexpected events out of the utility's control) as key to this part of our analysis. The utility's ability to petition for a rate increase when unexpected or uncontrollable costs arise in the midst of a long-term rate plan is a critical risk mitigant.

Other examples of risk-dampening regulatory policies include hedging program approvals, and decoupling (the separation of a utility's profits from sales) or weather-related mechanisms. If a utility seeks approval of a hedging program to manage exposure to commodity prices, it can reduce risk if there's a clearly stated hedging policy that its regulator has endorsed, and a track record of activity that conforms to the policy that has not been subject to regulatory second-guessing. A well-designed decoupling or weather-normalization mechanism that efficiently adjusts rates to offset the sales effect of economic conditions, customer usage trends, or weather will soften earnings and cash flow volatility to the benefit of bondholders. If applicable, we view a record of regulatory responsiveness to extreme events for utilities that are prone to violent or disruptive weather (like hurricanes) as favorable for credit quality.

A jurisdiction is more credit-supportive if it makes extensive use of extraordinary and credit-supportive rate

*Assessing U.S. Investor-Owned Utility Regulatory Environments*

mechanisms. Also favorable are jurisdictions that use innovative mechanisms selectively, or have regulators that are receptive to reopeners where incentives are the main ratemaking method.

## Regulatory Independence And Insulation

The role of politics in U.S. utility regulation is often misunderstood. In most jurisdictions, the regulator's function is to set and regulate rates and service standards with due regard not only for the interests of those who advance the capital needed to provide safe and reliable utility service, but for other constituents as well. Bondholders should recognize that utility regulation harbors political as well as economic risks. Therefore, how politics could influence regulation helps us evaluate a regulatory environment.

### Political independence of regulator

The primary factor in this part of our analysis is the regulators' (and, when relevant, the judicial body that reviews the regulators' decisions) political independence. We think it's more credit-supportive when the regulator is substantially independent of the political process. Jurisdictions are somewhat less favorable when insulation is strong, such as when the executive branch of government appoints regulators subject to legislative approval. We consider jurisdictions to be further down the scale when the same voters who pay utility bills directly elect the regulators, but institutional efforts have been made to erect some shield for regulators from transient political concerns. We view jurisdictions that arrange for direct political accountability of regulators that persistently influences regulatory decisions as less supportive.

### Record of direct political intervention

The overall atmosphere that a regulator operates in can affect its ability to deliver sound, fair, and timely rate decisions and set prudent regulatory policies that assist utilities in managing business and financial risk. In this part of our evaluation, we may consider the tone that politicians set, the history of political insulation given to the regulatory body, and the behavior of important constituencies that intervene in utility proceedings. We also track the public visibility of utility issues, because we believe that the likelihood of constructive regulatory behavior increases with the comparative obscurity of utility issues.

We view a jurisdiction as having a lower risk if the regulatory environment is marked by cooperative attitudes and constructive interventions in important matters before the regulator. We assess a jurisdiction lower when the atmosphere is more combative and restricts the regulator's ability to act in the long-term best interests of all parties. We consider jurisdictions as weaker if the regulatory environment is so infused with short-term political influence over regulatory decisions that the regulator can't effectively consider investor interests in its decisions.

## Related Criteria And Research

### Related Criteria

- Criteria|Corporates|General: Corporate Methodology, Nov. 19, 2013
- Criteria|Corporates|Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013

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*Assessing U.S. Investor-Owned Utility Regulatory Environments*

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# MOODY'S

## INVESTORS SERVICE

### Credit Opinion: Ameren Illinois Company

Global Credit Research - 08 Apr 2015

Peoria, Illinois, United States

#### Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	A3
First Mortgage Bonds	A1
Senior Secured	A1
Senior Unsecured Shelf	(P)A3
Pref. Stock	Baa2
Commercial Paper	P-2
<b>Parent: Ameren Corporation</b>	
Outlook	Stable
Issuer Rating	Baa1
Senior Unsecured Shelf	(P)Baa1
Subordinate Shelf	(P)Baa2
Commercial Paper	P-2

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#### Key Indicators

[1]Ameren Illinois Company	12/31/2014	12/31/2013	12/31/2012	12/31/2011	12/31/2010
CFO pre-WC + Interest / Interest	4.7x	4.5x	3.8x	4.1x	4.5x
CFO pre-WC / Debt	17.5%	25.5%	19.2%	22.8%	26.2%
CFO pre-WC - Dividends / Debt	17.4%	20.4%	10.7%	7.5%	20.0%
Debt / Capitalization	39.8%	38.4%	39.6%	39.3%	40.2%

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Source: Moody's Financial Metrics

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

#### Opinion

##### Rating Drivers

- Material improvement in regulatory environment
- Greater transparency in cash flows and minimal regulatory lag

- High capital expenditures over the next five years

## **Corporate Profile**

Ameren Illinois Company (Ameren Illinois, A3 stable) is a regulated electric and natural gas transmission and distribution (T&D) utility with approximately 1.2 million electric and 813,000 natural gas customers in central and southern Illinois. Ameren Illinois is a wholly-owned subsidiary of Ameren Corporation (Ameren, Baa1 stable). Ameren Illinois contributed 36% of operating profits and 34% of net income to Ameren in 2014. Ameren Illinois was formed in 2010 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).

Ameren Illinois is subject to rate regulation by the Illinois Commerce Commission (ICC) and the Federal Energy Regulatory Commission (FERC).

## **SUMMARY RATING RATIONALE**

The rating of Ameren Illinois reflects a credit supportive regulatory environment in Illinois aided by improved cost recovery prospects following the passage of the state's Energy Infrastructure Modernization Act (EIMA) in 2011 and the April 2015 extension of the sunset review of the EIMA until 2019. The rating also reflects stable financial metrics, a good liquidity position, and its relatively low risk transmission and distribution business risk profile.

## **DETAILED RATING CONSIDERATIONS**

- Material improvement in regulatory environment

The sunset review for the EIMA was extended by two years to the end of 2019. The EIMA provides a transparent rate setting mechanism, which resets the allowed return on equity (ROE) every year using a formula equaling the average of the monthly yields of the 30-year treasury yield for the calendar year plus 580 basis points, adjusted for the utility's operating performance. The estimated year-end rate base and capital structure are used in all annual electric formula rate cases, minimizing regulatory lag. Under the EIMA, Ameren Illinois will have a transparent cost recovery mechanism and be able to earn an appropriate return on its infrastructure investments through at least 2019.

Ameren Illinois' last electric formula rate update concluded in December 2014, and the new rates became effective on January 1, 2015. In this case, the company's request and the final rate increase authorized by the ICC were very similar. The ICC authorized a \$204 million increase which was based on a 9.25% ROE and a 51% equity ratio. The rate base was valued \$2.261 billion. Ameren Illinois had requested a \$205 million rate increase based on a 9.25% ROE with a 51% equity ratio. Its requested rate base value was \$2.261 billion. As the rates are reset based on the formulaic approach, the ratemaking process is no longer contentious as some rate cases have been in the past, a credit positive. Prior to the passage of the EIMA, the ICC had a history of authorizing below average rates of return and disallowances in rate cases that led to a sometimes contentious relationship with the utilities and longer regulatory lag.

Ameren Illinois filed a new gas distribution rate case in January 2015. The company requested a \$53 million annual rate increase based on a 10.25% ROE with a 50% equity ratio. The rate base value is estimated at \$1.19 billion and a future test year ending December 31, 2016 was used to support the rate increase request. In the same rate case, the company requested the implementation of a decoupling mechanism, which would permit the utility to collect revenue from its residential and small business customers independent of changes in sales volume. It would be a credit positive if the ICC authorized the decoupling mechanism. Evidentiary hearings are scheduled in August 2015 and the Administrative Law Judge (ALJ)'s proposed order is tentatively scheduled in November 2015. The deadline for the final order from the ICC is December 19, 2015 with the new rates becoming effective in January 2016. Ameren Illinois' last gas rate case concluded in December 2013 and the company was authorized a \$32.5 million rate increase based on a 9.08% ROE. We note that Ameren Illinois has a gas infrastructure rider as well and began utilizing it for its gas infrastructure investments in 2015.

- Greater transparency in cash flows with minimal regulatory lag

Based on the improved regulatory environment and the implementation of a formula ratemaking mechanism and gas infrastructure rider, we believe Ameren Illinois has improved the transparency of its cash flows significantly. We expect Ameren Illinois to maintain stable cash flow and credit metrics as the company executes on its long-term capital investment program to grow its electric rate base from \$2.3 billion in 2014 to \$3.0 billion in 2019. In

2014, the 3-year average CFO pre-working capital to debt (CFO pre-WC to debt), interest coverage and RCF to debt ratios were 20.5%, 4.3x, and 16.2%, respectively. We expect metrics such as CFO pre-WC to debt and interest coverage ratios to range from 20% to 23% and from 4.5x to 5.5x, respectively, over this period. These ratios are commensurate with the low-end of the A category according to the scoring grid provided for the low business risk utilities in our Regulated Electric and Gas Utilities methodology published in 2013.

- High capital expenditures over the next five years

Ameren Illinois' 2015-2019 capital expenditures are expected to be up to \$3.9 billion, approximately 44% of Ameren Corp.'s total 5-year investment plan. In 2014, Ameren Illinois invested \$835 million, significantly higher than the average level of \$358 million for the 2010-2012 period. In 2013, Ameren Illinois' total capital expenditures were \$701 million. Pursuant to the EIMA, Ameren Illinois is required to invest an incremental \$625 million between 2012 and 2021 above an historical baseline to modernize its distribution system. Through 2014, Ameren Illinois had spent \$149 million out of the \$625 million EIMA investment requirement. In addition, between 2015 and 2019, Ameren Illinois plans to invest \$1 billion on FERC-regulated electric transmission investments. We expect these energy delivery and transmission investments to be the foundation of Ameren Illinois' stable financial metrics and credit profile.

### **Liquidity**

Ameren Illinois' short-term rating is P-2. We expect the company to maintain a good liquidity profile over the next 12 months.

In December 2014, Ameren Illinois amended and extended its 2012 Credit Agreement to December 11, 2019 from November 14, 2017. Under this \$1.1 billion agreement, Ameren Illinois and Ameren Corp. each have a sublimit of \$800 million and \$500 million, respectively. This credit agreement is available to support issuance under Ameren Illinois' commercial paper program, which was reinstated at \$300 million in May 2014 and increased to \$800 million in April 2015. At the end of 2014, \$811 million out of \$1.1 billion was available under the Ameren Illinois' credit agreement. Ameren Illinois had \$32 million of commercial paper outstanding at the end of the year and the remaining balance was allocated to the parent company's commercial paper borrowings and letters of credit.

There is no material adverse change clause that could prevent new borrowings under the facility. Under the credit agreement, Ameren and Ameren Illinois are required to maintain total debt to capitalization of no greater than 65%. At December 31, 2014, both companies were in compliance with this covenant with debt to capitalization ratios of 50% and 47%, respectively.

In addition, the issuance of short-term debt securities by Ameren Illinois is subject to approval by FERC under the Federal Power Act. In September 2014, FERC authorized the issuance of up to \$1 billion of short-term debt securities by Ameren Illinois through September 15, 2016.

On December 31, 2014, Ameren Illinois had \$1 million cash on hand. Ameren Illinois does not have any long-term debt maturing until 2016 when two senior secured notes totaling \$129 million (\$75 million 6.25% due 2016 and \$54 million 6.20% due 2016) are due.

### **Rating Outlook**

The stable outlook for Ameren Illinois reflects our expectation that the utility will continue to invest under the EIMA and recover its investment costs through a defined formula ratemaking mechanism. It also reflects our expectation that the regulatory environment in Illinois will remain constructive for regulated T&D utilities in the state.

### **What Could Change the Rating - Up**

It is unlikely that Ameren Illinois would be upgraded over the near-term. However, if Ameren Illinois demonstrates a significant improvement in its financial profile and credit metrics such that its CFO pre-WC to debt ratio is above 25% on a sustained basis, an upgrade could be considered.

### **What Could Change the Rating - Down**

We do not expect Ameren Illinois to be downgraded based on the current, formula based regulatory framework in Illinois. However, the rating could be downgraded if there is a significant deterioration in the credit supportiveness of the regulatory environment in the state. The rating could also be downgraded if Ameren Illinois is unable to maintain its financial metrics within the range appropriate for its rating. For instance, if CFO pre-WC to debt and interest coverage ratios decline below 15% and 4.0x, respectively, for a sustained period, it could trigger a

downgrade.

## Rating Factors

### Ameren Illinois Company

Regulated Electric and Gas Utilities Industry Grid [1][2]	Current FY 12/31/2014		[3]Moody's 12-18 Month Forward ViewAs of 4/8/2015	
<b>Factor 1 : Regulatory Framework (25%)</b>	<b>Measure</b>	<b>Score</b>	<b>Measure</b>	<b>Score</b>
a) Legislative and Judicial Underpinnings of the Regulatory Framework	A	A	A	A
b) Consistency and Predictability of Regulation	Baa	Baa	A	A
<b>Factor 2 : Ability to Recover Costs and Earn Returns (25%)</b>				
a) Timeliness of Recovery of Operating and Capital Costs	Aa	Aa	Aa	Aa
b) Sufficiency of Rates and Returns	Ba	Ba	Baa	Baa
<b>Factor 3 : Diversification (10%)</b>				
a) Market Position	Baa	Baa	Baa	Baa
b) Generation and Fuel Diversity	N/A	N/A	N/A	N/A
<b>Factor 4 : Financial Strength (40%)</b>				
a) CFO pre-WC + Interest / Interest (3 Year Avg)	4.3x	Baa	5x - 5.5x	A
b) CFO pre-WC / Debt (3 Year Avg)	20.5%	A	20% - 25%	A
c) CFO pre-WC - Dividends / Debt (3 Year Avg)	16.2%	A	19% - 24%	A
d) Debt / Capitalization (3 Year Avg)	39.3%	Aa	35% - 45%	A
<b>Rating:</b>				
Grid-Indicated Rating Before Notching Adjustment		A3		A2
HoldCo Structural Subordination Notching		0		0
a) Indicated Rating from Grid		A3		A2
b) Actual Rating Assigned		A3		A3

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 12/31/2014; Source: Moody's Financial Metrics [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

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# Ameren Illinois Company

## Corporates Ratings Navigator US Utilities

Corporates Ratings Navigator			
Publish Date:	27-Feb-15		
Sector Details:			
Sector:	US Utilities		
Region:	Developed Markets - Americas		
Country:	United States of America		
Country IDR:	AAA	Stable	
Country IDR Action:	Affirmed		
Country Action Date:	19-Sep-14		
Country Ceiling:	AAA		
Ratings History			
Date	IDR	Action	
1-Oct-14	BBB	Stable	Affirmed
14-Mar-14	BBB	Stable	Upgrade
15-Mar-13	BBB-	Stable	Affirmed
28-Jan-13	BBB-	Stable	Affirmed
27-Jan-12	BBB-	Positive	Affirmed
23-May-11	BBB-	Stable	Affirmed
20-May-10	BBB-	Stable	Affirmed

Factor Levels	Sector Risk Profile	Operating Environment	Business Profile					Financial Profile			Issuer Default Rating
			Management and Corporate Governance	Regulation	Market and Franchise	Asset Base and Operations	Commodity Exposure	Profitability	Financial Structure	Financial Flexibility	
aaa											AAA
aa+											AA+
aa											AA
aa-											AA-
a+											A+
a											A
a-											A-
bbb+											BBB+
bbb											BBB Stable
bbb-											BBB-
bb+											BB+
bb											BB
bb-											BB-
b+											B+
b											B
b-											B-
ccc											CCC
cc											CC
c											C
d or rd											D or RD

Bar Chart Legend:			
Vertical Bars = Range of Rating Factor			
Bar Colors = Relative Importance			
<span style="color: red;">■</span>	Higher Importance		
<span style="color: blue;">■</span>	Average Importance		
<span style="color: lightblue;">■</span>	Lower Importance		
Bar Arrows = Rating Factor Outlook			
↑	Positive	↓	Negative
↕	Evolving	□	Stable

Direct Peer Group				
Company Name	IDR	Action	Action Date	
Commonwealth Edison Co.	BBB	Stable	Affirmed	01-Oct-2014
Baltimore Gas and Electric Company	BBB	Positive	Affirmed	01-Oct-2014
Consolidated Edison Co. of New York, Inc. - Con Ed	BBB+	Stable	Affirmed	22-Oct-2014
PECO Energy Co.	BBB+	Stable	Affirmed	01-Oct-2014

Drivers & Sensitivities	
<b>Regulatory Predictability</b>	The formula rate plan (FRP) provides regulatory predictability in Illinois. The FRP recognizes forward-looking rate base additions and includes a true-up mechanism, virtually eliminating rate lag.
<b>Constructive Rate Decision</b>	AIC's most recent FRP proceeding resulted in a net \$200.6 million electric base rate increase that will boost earnings and cash flows through 2015. The rate order was based on a 9.25% return on equity and a 51% common equity ratio.
<b>Elevated but Manageable Capex</b>	AIC estimates capex to amount to about \$3.9 billion over 2015-2019, primarily driven by the Illinois Energy Infrastructure Modernization Act. Fitch expects AIC to fund capex using a balanced mix of internal cash flows and debt.
<b>Robust Credit Metrics</b>	Fitch forecasts adjusted debt/EBITDAR to average 3.1x and FFO fixed-charge coverage to average 4.5x over 2014-2016. Projected credit metrics assume continued balanced rate decisions via FRP filings.
<b>Adequate Liquidity</b>	A total of \$800 million of credit capacity is available under a \$1.1 billion facility that expires in 2019. There are no debt maturities until \$129 million due in 2016 and \$250 million in 2017.
<b>Positive Rating Sensitivities</b>	A positive rating action might be triggered by continued balanced outcomes in FRP filings and adjusted debt/EBITDAR maintaining below 3.5x and FFO lease-adjusted leverage below 3.75x on a go-forward basis.
<b>Negative Rating Sensitivities</b>	A negative rating action might be triggered by the inability to timely recover a sizeable capex via FRP and FERC proceedings.

Analysts	
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Relevant Criteria & References	
<a href="#">Introducing Ratings Navigators for Corporates</a>	
<a href="#">Corporate Rating Methodology</a>	
<a href="#">US Utilities: Ratings Navigator Companion</a>	



## Ameren Illinois Company

## Corporates Ratings Navigator US Utilities

### Operating Environment

aa+	Economic Environment	aa	Very strong combination of countries where economic value is created and where assets are located.
aa	Financial Access	aa	Very strong combination of issuer specific funding characteristics and of the strength of the relevant local financial market.
	Systemic Governance	aa	Systemic governance (eg rule of law, corruption; government effectiveness) of the issuer's country of incorporation consistent with 'AA'.
b-			
ccc			

### Regulation

a	Degree of Transparency and Predictability	a	Track record of transparent and predictable regulation.
a-	Timeliness of Cost Recovery	a	Minimal lag to recover capital and operating costs.
bbb+	Trend in Authorized ROEs	bb	Significantly below-average authorized ROE.
bbb	Mechanisms Available to Stabilize Cash Flows	bbb	Revenues partially insulated from variability in consumption.
bbb-	Mechanisms Supportive of Creditworthiness	bbb	Effective regulatory ring-fencing or minimum creditworthiness requirements.

### Asset Base and Operations

a-	Diversity of Assets	bbb	Good quality and/or reasonable scale diversified assets.
bbb+	Operations Reliability and Cost Competitiveness	bbb	Reliability and cost of operations at par with industry averages.
bbb	Exposure to Environmental Regulations	bbb	Limited or manageable exposure to environmental regulations.
bbb-	Capital and Technological Intensity of Capex	bbb	Moderate reinvestments requirements in established technologies.
bb+			

### Profitability

a	Free Cash Flow	bbb	Structurally neutral to negative FCF across the investment cycle.
a-	Volatility of Profitability	a	Higher stability and predictability of profits relative to utility peers.
bbb+			
bbb			
bbb-			

### Financial Flexibility

a+	Financial Discipline	a	Clear commitment to maintain a conservative policy with only modest deviations allowed.
a	Liquidity	a	Very comfortable liquidity. Well-spread maturity schedule of debt. Diversified sources of funding.
a-	FFO Fixed Charge Cover	bbb	4.5x
bbb+			
bbb			

### Management and Corporate Governance

aa-	Management Strategy	a	Coherent strategy and good track record in implementation.
a+	Governance Structure	bbb	Good CG track record but effectiveness/independence of board less obvious. No evidence of abuse of power even with ownership concentration.
a	Group Structure	aa	Transparent group structure.
a-	Financial Transparency	a	High quality and timely financial reporting.
bbb+			

### Market and Franchise

a	Market Structure	a	Well-established market structure with complete transparency in price-setting mechanisms.
a-	Consumption Growth Trend	bbb	Customer and usage growth in line with industry averages.
bbb+	Customer Mix	a	Favorable customer mix.
bbb	Geographic Location	bbb	Beneficial location or reasonable locational diversity.
bbb-	Supply Demand Dynamics	bbb	Moderately favorable outlook for prices/rates.

### Commodity Exposure

aa-	Ability to Pass Through Changes in Fuel	a	Complete pass-through of commodity costs.
a+	Underlying Supply Mix	n.a.	
a	Hedging Strategy	a	Highly captive supply and customer base.
a-			
bbb+			

### Financial Structure

aa-	Lease Adjusted FFO Gross Leverage	a	3.5x
a+	Total Adjusted Debt/Operating EBITDAR	a	3.25x
a			
a-			
bbb+			

**How to Read This Page:** The left column shows the three-notch band assessment for the overall Factor, illustrated by a bar. The right column breaks down the Factor into Sub-Factors, with a description appropriate for each Sub-Factor and its corresponding category.



The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

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**Ameren Illinois Company's  
Response to ICC Staff Data Requests  
Docket No. 15-0142  
Proposed General Increase in Gas Delivery Service Rates  
Data Request Response Date: 3/25/2015**

SK 2.03

Please specify, in basis points, the adjustment that Mr. Hevert made to his cost of equity recommendation to reflect the discussion of business risk and other considerations (including regulatory risk, weather risk, and flotation costs) on pages 31 through 39 of Ameren Exhibit 5.0.

**RESPONSE**

**Prepared By: Robert B. Hevert  
Title: Managing Partner, Sussex Economic Advisors, LLC  
Phone Number: 508-202-7923**

As noted on page 3, lines 57-59 of Ameren Exhibit 5.0, Mr. Hevert did not make explicit adjustments to his ROE estimates for those factors (regulatory risk, weather risk, and flotation costs), although he did take them into consideration in determining the range in which the Company's Cost of Equity likely falls.

**Ameren Illinois Company's  
Response to ICC Staff Data Requests  
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Proposed General Increase in Gas Delivery Service Rates  
Data Request Response Date: 3/25/2015**

SK 2.15

Mr. Hevert's direct testimony (Ameren Exhibit 5.0, pp. 28-31) describes Mr. Hevert's Bond Yield Plus Risk Premium approach. Is the bond yield plus risk premium approach reflected in his cost of equity recommendation? If so, please specify any adjustment Mr. Hevert made to his cost of equity estimates, in basis points, to arrive at his cost of equity recommendation given his consideration of the bond yield plus risk premium approach.

**RESPONSE**

**Prepared By: Robert B. Hevert  
Title: Managing Partner, Sussex Economic Advisors, LLC  
Phone Number: 508-202-7923**

Mr. Hevert did not make an adjustment to his Cost of Equity recommendation in consideration of the results of his Bond Yield Plus Risk Premium approach. As noted on page 12, lines 228-231 of Ameren Exhibit 5.0, Mr. Hevert relied principally on the Multi-Stage DCF model and the CAPM, and used the results of the Bond Yield Plus Risk Premium approach as a corroborating methodology when arriving at his ROE recommendation.

**Ameren Illinois Company's  
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Data Request Response Date: 3/25/2015**

SK 2.14

Mr. Hevert's direct testimony (Ameren Exhibit 5.0, p. 27) states that he performed an alternate set of CAPM analyses using: (1) the near-term projected 30-year Treasury yield (i.e., 3.68 percent); 2) Bloomberg beta coefficients which are calculated over two years and regression beta coefficients calculated over 18 months; and (3) market risk premiums that were calculated using both dividend paying and non-dividend paying companies. Is the alternate set of CAPM analyses reflected in his cost of equity recommendation? If so, please specify the number of basis points that the alternative set of CAPM analyses added to his cost of equity recommendation.

**RESPONSE**

**Prepared By: Robert B. Hevert**  
**Title: Managing Partner, Sussex Economic Advisors, LLC**  
**Phone Number: 508-202-7923**

No, as noted on page 28, lines 515-516 of Ameren Exhibit 5.0, Mr. Hevert's Cost of Equity recommendation does not rely on the results of his alternate CAPM analyses.

As noted on page 12, lines 231-238 of Ameren Exhibit 5.0, Mr. Hevert's Cost of Equity recommendation relies on the results of his primary CAPM analysis. As explained on pages 22 to 23 (lines 415-420) and page 25 (lines 460-462) of his direct testimony, Mr. Hevert's primary CAPM analysis was developed to reflect certain preferences stated by the Illinois Commerce Commission in Docket No. 13-0192, including (1) the use of Beta coefficients calculated over a five year period; (2) the exclusion of non-dividend paying companies from the calculation of the market risk premium; and (3) the use of current 30-year Treasury yields as the risk-free rate.