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## Research Update:

# AmerenEnergy Generating Co. Ratings Lowered Following Public Disclosure

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## Research Update:

# AmerenEnergy Generating Co. Ratings Lowered Following Public Disclosure

## Overview

- The rating on AmerenEnergy Generating Co. (GenCo) reflects its stand-alone credit quality without any support from parent Ameren Corp. following Ameren's 8-K disclosure on Dec. 20, 2012, that it intends to exit the merchant generation business.
- We are lowering our corporate credit rating on GenCo to 'B-' from 'B'. The outlook is stable.
- We are lowering our rating on GenCo's senior unsecured debt to 'B' from 'B+', reflecting our expectation of substantial (70%-90%) recovery in the event of a payment default.
- The stable outlook incorporates our base case expectation of continued gross margin pressure and the high probability that GenCo will be sold or restructured within the next five years.

## Rating Action

On Dec. 21, 2012, Standard & Poor's Ratings Services lowered its corporate credit on AmerenEnergy Generating Co. to 'B-' from 'B'. We also lowered the ratings on GenCo's senior unsecured debt to 'B' from 'B+', reflecting a '2' recovery rating, which indicates our expectation of substantial (70%-90%) recovery in the event of a payment default. The outlook is stable.

## Rationale

The downgrade on AmerenEnergy Generating Co. reflects its stand-alone credit quality, including its "highly leveraged" financial risk profile and "weak" business risk profile. Our view of GenCo is based on its stand-alone credit quality with no parental support. This reflects Ameren Corp.'s recent 8-K disclosure that it is determined to exit the merchant generation business and to ultimately eliminate GenCo's reliance on its financial and shared services support.

GenCo's highly leveraged financial risk profile reflects Standard & Poor's base-case scenario that cash flow measures will materially weaken over the next three years. We expect funds from operations (FFO) to debt to weaken to less than 7% and debt to EBITDA to increase to more than 10x, reflecting cash flow measures that are consistent with the highly leveraged financial risk profile category. For the 12 months ended Sept. 30, 2012, FFO to debt decreased to 14.2% compared with 24.2% at year-end 2011, adjusted debt to EBITDA weakened to 4.6x compared with 3.4x at year-end 2011, and adjusted debt

to total capital slightly improved to 47.6 from 48.5% at year-end 2011. Under Standard & Poor's base-case scenario, we expect that over the next three years the U.S. economy will continue to grow slowly at an annual GDP growth rate of about 2.5%. Under this scenario, electricity demand growth by itself would be insufficient to substantially increase the market price of electricity.

While GenCo has materially reduced capital spending over the next three years, partially by decelerating spending on the Newton scrubber project, we expect that its discretionary cash flow will turn negative as higher-priced electricity hedges expire. To meet its cash obligations, GenCo.'s management will have to continue to identify further opportunities to reduce costs, use its available cash, and potentially sell assets.

GenCo's weak business risk profile reflects its ultimate dependence on the market price of electricity, which has remained low. Management has proactively addressed those areas that it can directly influence, including maintaining a consistent hedging program, reducing costs and capital spending, receiving a variance from the Illinois Pollution Control Board to extend the state's compliance date for the multipollutant standards, and solidifying GenCo's liquidity by entering into a minimum \$100 million asset put option with Ameren. However, while GenCo's three-year rolling hedging strategy provided a degree of price insulation over the past two years, sustained low power prices have undermined this credit enhancement. Over the next year, we expect that expiring higher-priced hedges will continue to be replaced by lower market prices. While we expect that management may continue to identify further cost reduction opportunities, the business risk profile will continue to be pressured by the company's Midwest location, which lacks a robust capacity market and higher congestion pricing.

## **Liquidity**

GenCo has "strong" liquidity and can more than cover its needs for the short-term, even if EBITDA decreases. Our liquidity assessment is based on the following factors and assumptions:

- We expect the company's liquidity sources (including cash, FFO, and potential asset sales) over the next 12 months to exceed its uses by more than 1.8x.
- GenCo does not have long-term debt maturities until 2018.
- Even if EBITDA decreases by 30%, we believe net sources will be in excess of liquidity requirements.
- The company has sound relationships with its banks and has generally prudent risk management, including its flexibility to lower capital spending and ability to exercise its \$100 million asset put option.

In our analysis, we assumed liquidity of about \$150 million over the next 12 months, primarily consisting of cash, FFO, and potential asset sales. We estimate the company will use about \$80 million over the same period for capital spending and working capital needs.

GenCo terminated its \$500 million credit facility in November 2012. GenCo's bond indenture includes financial covenants that must be met for GenCo to incur additional indebtedness. These financial covenants include a debt-to-capital ratio of no greater than 60% and a minimum interest coverage ratio of 2.5x. Because of these financial covenants, GenCo projects that it will not be able to borrow additional funds from external third parties as of March 31, 2013. Therefore, our assessment of GenCo's strong liquidity does not rely on external third party borrowings.

### **Recovery analysis**

GenCo's unsecured notes are rated 'B', one notch higher than the corporate credit rating. The '2' recovery rating indicates our expectation of substantial (70%-90%) recovery. For the full recovery report on RatingsDirect please see Recovery Report: AmerenEnergy Generating Co.'s Recovery Rating Profile, published on Dec. 10, 2012.

### **Outlook**

The stable outlook incorporates our base-case scenario that GenCo's profit margins will remain pressured because of low electricity market prices and the expiration of a higher hedged position. We also assume that because of Ameren's decision to exit the merchant business, GenCo will be sold or restructured within the next five years. Under our base-case scenario, the company's financial measures will weaken so that FFO to debt will be less than 7% and debt to EBITDA will be more than 10x. We would lower the ratings if our assessment of the company's strong liquidity weakens to less than adequate or if FFO to debt is less than 4%. Although we currently view an upgrade as highly unlikely given Ameren's recent disclosure, the ratings could be raised if the company's FFO to debt were to be consistently greater than 12%.

### **Related Criteria And Research**

- Business Risk/Financial Risk Matrix Expanded, Sept. 18, 2012
- Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Criteria Guidelines For Recovery Ratings On Global Industrials Issuers' Speculative-Grade Debt, Aug. 10, 2009
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008
- Standard & Poor's Extends Recovery Ratings To Unsecured Speculative-Grade Corporate Issues, March 21, 2008
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

### **Ratings List**

Downgrade; Recovery Rating Unchanged

*Research Update: AmerenEnergy Generating Co. Ratings Lowered Following Public Disclosure*

	To	From
AmerenEnergy Generating Co.		
Corporate Credit Rating	B-/Stable/--	B/Stable/--
Senior Unsecured Debt	B	B+
Recovery Rating	2	2

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