



Credit Opinion: **Union Electric Company**

Global Credit Research - 10 Aug 2012

St. Louis, Missouri, United States

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Baa2
First Mortgage Bonds	A3
Senior Secured	A3
Bkd Sr Unsec Bank Credit Facility	Baa3
Senior Unsecured Shelf	(P)Baa2
Pref. Stock	Ba1
Commercial Paper	P-3
Parent: Ameren Corporation	
Outlook	Stable
Issuer Rating	Baa3
Senior Unsecured	Baa3
Subordinate Shelf	(P)Ba1
Pref. Shelf	(P)Ba2
Commercial Paper	P-3

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Key Indicators

[1]Union Electric Company

	LTM 3/31/2012	2011	2010	2009
(CFO Pre-W/C + Interest) / Interest Expense	4.5x	4.6x	5.0x	4.5x
(CFO Pre-W/C) / Debt	21%	21%	24%	22%
(CFO Pre-W/C - Dividends) / Debt	11%	12%	19%	18%
Debt / Book Capitalization	43%	43%	43%	44%

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

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

Opinion

Rating Drivers

Below average regulatory framework, although recent rate case outcome was more credit supportive

High environmental capital expenditures moderated by increased use of low sulfur coal

Improved cash flow coverage metrics

Preliminary steps toward new nuclear development could increase risk profile longer term

Corporate Profile

Union Electric Company (d/b/a Ameren Missouri, Baa2 Issuer Rating, stable outlook) is a vertically integrated utility with a regulated electric generation, transmission and distribution system and a regulated natural gas transmission and distribution system in the state of Missouri, with a service territory in and around the city of St. Louis. Union Electric is the largest subsidiary of Ameren Corporation (Ameren, Baa3 Issuer Rating, stable outlook), an energy holding company with regulated and unregulated operations in both Missouri and Illinois.

SUMMARY RATING RATIONALE

Union Electric's rating reflects a below average regulatory framework in Missouri; high environmental capital expenditures that have been partly mitigated by the increased use of low sulfur coal; and improved cash flow coverage metrics over the last few years that are now strong for its Baa2 rating. We note that Union Electric's most recent rate case outcome was generally supportive of the utility's credit profile and has helped reduce regulatory lag. However, the utility has thus far been unable to obtain rate recovery for preliminary expenditures related to an early site permit for potential new nuclear generation and was denied recovery of some Taum Sauk pumped storage facility enhancements beyond what was recovered from insurance.

DETAILED RATING CONSIDERATIONS

- Below average regulatory framework in Missouri, although most recent rate case outcome was more credit supportive and has helped reduce regulatory lag

Union Electric operates in what we have considered to be a below average regulatory framework for investor owned utilities in Missouri, which has resulted in significant regulatory lag and prevented the utility from earning close to its allowed return on equity over the years. Factors contributing to our regulatory assessment include lengthy 11 month base rate case timelines; the lack of interim rate relief; the use of historical test years; less than full recovery of fuel costs in rates; and a requirement that fuel costs be recovered through normal base rate proceedings rather than through more timely automatic rate adjustment mechanisms.

The company's most recent rate case outcome, in July 2011, was more supportive of credit quality than some previous cases with the Missouri Public Service Commission (MPSC) approving a \$172 million rate increase based on a 10.2% return on equity. The increase included \$52 million of higher fuel costs than had been authorized in its May 2010 rate case order. This outcome compared to an amended company request of \$211 million. The order also approved the continued use of certain cost trackers, including vegetation management, infrastructure, and pension and postretirement benefits. Union Electric was denied recovery of \$89 million of costs related to enhancements to its Taum Sauk pumped storage facility in excess of those covered by insurance.

Union Electric has a new rate case pending, filing for a \$376 million electric rate increase in February 2012 or an approximate 14.6% increase in customer rates. The request included \$103 million for higher fuel costs, \$85 million for reliability, environmental, and renewable energy regulations, and \$81 million for proposed energy efficiency spending. The rate increase is premised on a 10.75% ROE, a 52% capital structure, and an electric rate base of \$6.8 billion.

On July 6, 2012, the MPSC Staff recommended a \$210 million rate increase based on a 9% return on equity, the upper end of the Staff's indicated ROE range of 8% to 9%. The bulk of the difference between the two rate increase amounts comes from the lower ROE recommended by the Staff. Of concern from a credit standpoint is the Staff's recommendation that the percentage of fuel costs to be recovered from customers be reduced to 85% from 95% currently, which we would view as credit negative. Most utilities in credit supportive regulatory environments recover 100% of fuel costs. The Staff's position is consistent with previous Staff recommendations that we have viewed as potentially detrimental to the utility's credit quality. However, based on previous experience, we expect the MPSC to approve a more credit supportive rate case outcome when it comes to a decision or the parties reach a settlement by December.

- High environmental compliance requirements moderated by increased use of low sulfur coal

Union Electric generated 77% of its electricity from coal in 2011, making it vulnerable to potential additional costs associated with EPA mandated environmental compliance regulations. The company has and will continue to incur

substantial costs to comply with regulations associated with SO₂, NO_x, and mercury emissions from its coal plants, some of which may ultimately be retired. Other rules for coal ash handling and regulations under the Clean Water act could add to both operating expenses and capital expenditure requirements. Union Electric projects it will spend \$665 million on capital expenditures in 2012 and between \$2.2 billion and \$3.0 billion over the 2013-2016 time period. The utility's current rating and outlook incorporate the expectation that the company will be able to recover its environmental expenditures in rates, although these costs could be subject to some regulatory lag.

Union Electric's capital expenditures moderated to \$550 million in 2011 from nearly \$900 million in 2008 and 2009 as the company reduced and postponed planned capital expenditures for its distribution system, power plant improvement, and other purposes. The company has entered into a long-term contract for the purchase of 91 million tons of ultra-low sulfur coal from Peabody Energy through 2014. The contract will allow the company to avoid some environmental expenditures by 2014 and delay the installation of additional scrubbers in Missouri until after 2017. The company converted its plants to burn low sulfur coal and has completed the installation of scrubbers at its Sioux coal generating plant, further facilitating the use of low sulfur coal. Union Electric estimates this coal contract will reduce the company's capital expenditures for the 2011-2015 time period by approximately \$500 million.

- Improved cash flow coverage metrics that are now strong for its Baa rating

Union Electric's cash flow coverage metrics have improved and stabilized over the last three years and are now at or slightly above our parameters for a Baa rating as outlined in Moody's Regulated Electric and Gas Utilities Rating Methodology. These include cash flow from operations before working capital adjustments (CFO pre-W/C) to debt of 24.0% in 2010 and 20.6% in 2011. Financial metrics have been positively affected by higher electric and gas margins resulting from rate increases that went into effect in March 2009, June 2010, and July 2011, which have helped reduce regulatory lag. The company's coverage metrics have also benefited to some degree from bonus depreciation, a temporary acceleration of future cash flows, although this will have less of an impact going forward. The continued maintenance of financial ratios at these levels will depend on the outcome of the company's pending rate case, its ongoing cost control and efficiency efforts, economic conditions within its service territory, and the impact of any future environmental compliance requirements.

- Preliminary steps toward new nuclear construction could increase risk profile longer term

On April 19, 2012, Union Electric announced that it had entered into an agreement with Westinghouse Electric Corporation to exclusively support Westinghouse's application for investment funds of up to \$452 million to support engineering and design activities related to the development of small modular reactors (SMR's). This agreement is the latest in a series of efforts by the company to recover costs related to potential new nuclear generation at its Callaway nuclear plant site near Fulton, Missouri.

Union Electric filed an application with the U.S. Department of Energy for federal loan guarantees for new nuclear construction several years ago. The company also attempted but was not successful in obtaining rate recovery through legislative means for \$45 million of costs related to an early site permit for a second nuclear unit at the Callaway site. Bills were introduced in 2011 and 2012 in the Missouri legislature but failed to make significant headway. The most recent effort is on hold pending the outcome of the Westinghouse application.

If the company does move forward with new nuclear construction, it would increase the business and operating risk profile of Ameren and Union Electric significantly. Unlike states like Georgia, Florida, and South Carolina that have passed legislation assuring recovery of nuclear power development costs, laws in Missouri specifically prevent utilities from recovering nuclear construction costs before plants are placed in service, a substantial risk to any utilities considering new nuclear generation in the state. Some regulatory assurance on cost recovery before beginning construction would be critical to the maintenance of credit quality.

Liquidity

Union Electric's liquidity position is highly tied to the overall liquidity of the parent company with which it shares revolving credit facilities and a money pool arrangement. Union Electric maintains a joint \$800 million bank credit facility with the parent that matures on September 10, 2013, under which it has a borrowing sublimit of \$500 million. Under the terms of the credit facility, Ameren and Union Electric must each maintain a total debt to capitalization ratio of no greater than 65%. As of June 30, 2012, both companies were in compliance with this covenant with debt to capitalization ratios of 48% and 48%, respectively.

Union Electric had no short-term borrowings under the facility as of June 30, 2012, with the full amount available under its \$500 million borrowing sublimit. Parent company Ameren had \$30 million of commercial outstanding and

\$15 million of letters of credit outstanding at June 30, 2012. Ameren had \$117 million of cash and cash equivalents on hand on a consolidated basis as of June 30, 2012. Of this amount, none was at Union Electric, down from \$201 million on December 31, 2011. Union Electric has a \$178 million of long-term debt coming due over the next twelve months, including \$173 million of senior secured notes due September 1, 2012 that we expect will be refinanced.

Rating Outlook

The stable rating outlook reflects a more credit supportive recent rate case outcome that has reduced regulatory lag, cash flow coverage metrics that are strong for its rating, the modest decrease in capital expenditures due somewhat to higher use of low sulfur coal, and our expectation that the company's pending rate case outcome will not be detrimental to credit quality.

What Could Change the Rating - Up

A continued improvement in the credit supportiveness of the regulatory environment in Missouri, including future rate case outcomes that improve credit quality and reduce regulatory lag; clarity on additional costs associated with pending environmental regulation; the maintenance of recently higher cash flow coverage metrics on a sustained basis, including cash flow from operations before working capital adjustments plus interest to interest above 4.0x and cash flow from operations before working capital adjustments to debt above 20%.

What Could Change the Rating - Down

Adverse regulatory developments or unsupportive rate case outcomes; substantial new capital expenditure requirements related to pending environmental compliance; significant movement forward on new nuclear construction without assured cost recovery; a decline in cash flow coverage measures, including cash flow from operations before working capital adjustments plus interest to interest below of 3.5x and cash flow from operations before working capital adjustments to debt below 16% on a sustained basis.

Rating Factors

Union Electric Company

Regulated Electric and Gas Utilities Industry [1][2]	Current 3/31/2012		Moody's 12-18 month Forward View* As of August 2012		
Factor 1: Regulatory Framework (25%)	Measure	Score		Measure	Score
a) Regulatory Framework		Ba			Ba
Factor 2: Ability To Recover Costs And Earn Returns (25%)					
a) Ability To Recover Costs And Earn Returns		Baa			Baa
Factor 3: Diversification (10%)					
a) Market Position (5%)		Ba			Ba
b) Generation and Fuel Diversity (5%)		Ba			Ba
Factor 4: Financial Strength, Liquidity And Key Financial Metrics (40%)					
a) Liquidity (10%)		Baa			Baa
b) CFO pre-WC + Interest/ Interest (3 Year Avg) (7.5%)	4.8x	A	4.5 - 5.0x	A	
c) CFO pre-WC / Debt (3 Year Avg) (7.5%)	22.6%	A	18% - 22%	Baa	
d) CFO pre-WC - Dividends / Debt (3 Year Avg) (7.5%)	16.2%	Baa	12 - 15%	Baa	
e) Debt/Capitalization (3 Year Avg) (7.5%)	43.5%	A	40 - 45%	A	
Rating:					
a) Indicated Rating from Grid		Baa2		Baa2	

b) Actual Rating Assigned		Baa2		Baa2
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* THIS REPRESENTS MOODY'S FORWARD VIEW; NOT THE VIEW OF THE ISSUER; AND UNLESS NOTED IN THE TEXT DOES NOT INCORPORATE SIGNIFICANT ACQUISITIONS OR DIVESTITURES

[1] All ratios are calculated using Moody's Standard Adjustments. [2] As of 3/31/2012; Source: Moody's Financial Metrics



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