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Research Update:

PPL Electric Utilities Corp. Outlook Revised To Negative, 'A-' Credit Rating Affirmed

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Rationale

On Jan. 27, 2009, Standard & Poor's Ratings Services revised its outlook on PPL Electric Utilities Corp. (PPLEU) to negative from stable. At the same time, we affirmed our 'A-' corporate credit rating on the transmission and distribution (T&D) utility.

This reflects our outlook revision on parent PPL Corp. (BBB/Negative/--) to negative and our expectation of PPLEU's weakening stand-alone credit profile after $200 million of revenue from a competitive transition charge (CTC) ends at the end of 2009. Allentown, Pa.-based PPLEU has about $1.4 billion.

The ratings on PPLEU reflect the insulation of the utility from PPL, an excellent utility-only business risk profile, and an aggressive financial risk profile. PPLEU's insulation from the rest of PPL is through structural enhancements that place certain restrictions on the utility's business and financial activities, but does not isolate PPLEU from the parent's credit quality. Therefore, lower ratings on PPL could result in lower ratings on PPLEU.

The excellent business risk profile reflects an electric T&D utility serving about 1.4 million customers in central and eastern Pennsylvania. The customer base, which exhibits no meaningful concentration, is largely residential and commercial (about 80% of sales), and historically has demonstrated modest annual customer and load growth. PPLEU's credit profile benefits from T&D rate increases and an automatic adjustment mechanism to recover future transmission-related costs. However, uncertainty about the future of competitive markets in Pennsylvania and a smooth transition period does temper the utility's business profile.

The utility currently operates as provider of last resort (POLR) of power to electric customers at preset prices. To meet its POLR obligation and mitigate supply risk and exposure to market prices through 2009, PPLEU entered into a full-requirements long-term supply contract with PPL EnergyPlus LLC, a subsidiary of PPLEU affiliate PPL Energy Supply LLC. We historically have considered this arrangement supportive to PPLEU's credit quality as it transfers supply volume and price-related risks to PPL Energy Supply. For POLR load beginning in 2010, PPLEU is procuring power with six semi-annual request-for-proposals (RFP) in March and September of which four have been completed. We consider advanced approval credit supportive for PPLEU.

Separately, the Pennsylvania Public Utility Commission approved PPLEU's mitigation plan that gives customers the option to make additional payments through 2009 over currently approved rates, with their accrued balances, starting in 2010 and continuing through 2011, being amortized as bill credits to mitigate higher rates. For residential and small commercial customers for the 2011 through mid-2014 time period, PPLEU filed a plan that will include load following contracts solicited for 12- and 24-month blocks, block procurements for five- and 10-year periods with spot purchases as needed. We expect an order by mid-2009.

For the 12 months ended Sept. 30, 2008, PPLEU's adjusted financial measures are adequate for the rating, with about 3.5x funds from operations (FFO) interest coverage, 22.4% FFO to total debt, and 51% debt to capital. Free operating cash (FFO less capital expenditures) was positive and net cash flow (FFO less dividends) relative to capital expenditures was 87%. Absent any significant changes in PPLEU's financial policy, after the $200 million from the CTC ends at the end of 2009, we expect cash flow measures to weaken materially.

Short-term credit factors

The short-term and commercial paper rating on PPLEU is 'A-2'. PPLEU's liquidity is adequate with a $200 million credit facility ($190 million after eliminating the committed amount of Lehman Brothers Bank) that expires in May 2012 and supports the utility's commercial paper program. After reflecting letters of credit and draws, availability was about 30%. With the uncertainty in the financial markets, PPLEU issued $400 million of senior secured bonds to partly prefund an August 2009 maturity of $486 million. This may weaken financial measures before the maturity is retired, but will likely be manageable. As of Sept. 30, 2008, PPLEU had $67 million of unrestricted cash.

Outlook

The negative outlook on PPLEU reflects the linkage with parent PPL along with our expectation that financial measures at the utility could weaken beginning in 2010. Ratings may be lowered if PPL's rating is lowered without any change to the current linkage between PPLEU and its parent. Unless financial measures will be maintained after the CTC ends in 2009, ratings could be lowered regardless of the rating on PPL. A less than smooth transition to competitive power procurement markets for the utility could result in lower ratings. The outlook could be revised to stable if measures are taken to strengthen the independence of the utility and to maintain stronger financial measures at the utility.

Ratings List

Outlook Revised, Rating Affirmed

PPL Electric Utilities Corp.	To	From
Corporate credit rating	A-/Negative/A-2	A-/Stable/A-2

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