Moody's Investors Service

Rating Action: Moody's changes outlook for PPL and PPL Electric to negative

Global Credit Research - 11 May 2009

Approximately $2.5 billion of securities affected

New York, May 11, 2009 -- Moody's Investors Service revised the outlook of PPL Electric Utilities Corporation (PPL Electric: Baa1 senior unsecured), its parent PPL Corporation (PPL: Baa2 Issuer Rating) and its affiliate PPL Capital Funding, Inc. (PPL Capital: Baa2 senior unsecured guaranteed by PPL Corp) to negative from stable. The ratings of PPL Corp's subsidiary PPL Energy Supply, LLC (PPL Supply: Baa2 senior unsecured) are affirmed and the outlook remains stable.

The negative outlook for PPL Electric reflects our expectation that beyond 2009, as PPL Electric implements market rates for generation, and begins to incur significant capital expenditures in support of its distribution and transmission infrastructure, its financial metrics will deteriorate significantly and will remain below levels demonstrated by electric utilities with senior unsecured ratings of Baa1 for the foreseeable future. The negative outlook also considers the potential for additional pressure on cash flows if measures to avoid rate shock are taken that result in significant deferrals of purchased power costs or if regulatory support for capital investment is reduced or delayed.

Although PPL Electric has been operating under a capped generation rate as it transitions to market rates in 2010, its cash flows have remained robust as the company has been meeting its entire Pennsylvania provider of last resort (POLR) obligation via fixed price power purchase agreements with its affiliate, PPL Supply. In addition, through 2009, cash flows from operations have been enhanced by the receipt of competition charge revenues, which will end in 2009. Going forward, retail rates for generation are intended to be a direct pass through of power costs with no additional margin for the utility. At the same time, capital spending is expected to increase significantly while debt levels are initially maintained but ultimately increase as well. Although PPL EU's ratio of cash flow from operations excluding the impact of working capital changes (CFO pre-W/C) to adjusted debt (Debt), calculated in accordance with Moody's standard analytical adjustment is currently in the range of 30%, beyond 2009, we anticipate this metric will move into the mid-teens and remain there on a sustainable basis. These credit metrics are considered to be more consistent with a senior unsecured rating in the middle of the Baa rating category.

The Baa2 rating and stable outlook for PPL Supply recognizes that the company is in transition as its primary Pennsylvania market moves toward the full implementation of electric retail competition and the use of market rates for generation. For PPL Supply this will begin in 2010. Historically, PPL Supply's cash flows have been relatively stable as the majority of the company's production has been dedicated to supply its utility affiliate at fixed prices. As a result, its credit metrics have remained within the ranges appropriate for electric utilities rated in the mid-to-high Baa range. Beyond 2009, we anticipate increased volatility of cash flows, mitigated to some extent by PPL Supply's hedging strategy; however, we also anticipate a strengthening of its cash flow credit metrics commensurate with the company's increased business risk. PPL Supply's credit metrics will also continue to be impacted by the ownership of its U.K. distribution utilities, which benefit from reasonably stable cash flow, but also employ leverage commensurate with their regulated network activities.

The negative outlook for PPL Corp and PPL Capital recognizes the increasing proportion of corporate earnings and cash flow that is anticipated to be generated by PPL Supply and considers the structurally subordinate position of the unsecured lenders at these entities relative to the unsecured debt at the subsidiary levels. In addition, a downgrade of PPL EU to Baa2 would result in all of PPL Corp's direct material cash flow being generated by subsidiaries having senior unsecured ratings of Baa2. Under this scenario, notching for structural subordination would result in a senior unsecured/Issuer Rating of Baa3 at PPL Capital/PPL Corp.

The principal methodology used in rating PPL EU and PPL Corp was Rating Methodology: Global Regulated Electric Utilities. It can be found at www.moodys.com in the Credit Policy & Methodologies directory, in the Ratings Methodology subdirectory. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Credit Policy & Methodologies directory.

PPL Supply's ratings were assigned by evaluating factors believed to be relevant to the credit profile, such as i) the business risk and competitive position of PPL Supply versus others within its industry or sector, ii) the capital structure and financial risk of PPL Supply, iii) the projected performance of PPL Supply over the near to intermediate term, and iv) PPL Supply's history of achieving consistent operating performance and meeting financial plan goals. These attributes were compared against other issuers both within and outside of PPL Supply's core peer group and PPL Supply's ratings are believed to be comparable to ratings assigned to other issuers of similar credit risk.

Moody's last rating action on PPL EU, PPL Corp, and PPL Capital occurred March 31, 2006 when PPL EU's senior unsecured debt was upgraded to Baa1 from Baa2, PPL Capital's senior unsecured debt was upgraded to Baa2 from Baa3, and a Baa2 Issuer Rating was assigned to PPL Corp.

Moody's last rating action on PPL Supply occurred November 23, 2004 when a rating of Prime-2 was assigned to its commercial paper program. This rating was withdrawn February 3, 2009 for business reasons.

PPL Corporation is a diversified energy holding company headquartered in Allentown, Pennsylvania. PPL Electric Utilities Corporation is a regulated transmission and distribution utility; PPL Energy Supply, LLC is a holding company engaged primarily in non-regulated generation and marketing of power in the U.S. and the regulated delivery of electricity in the U.K., it is also a subsidiary of PPL Corporation.

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