

Research Update:

# Evergy Inc. And Subsidiaries Downgraded By One Notch On Weakening Financials; Outlook Revised To Stable

November 29, 2023

## Rating Action Overview

- On Nov. 21, 2023, the Kansas Corporation Commission (KCC), adopted a settlement in the pending rate cases of Evergy Inc.'s Kansas subsidiaries, Evergy Kansas Central Inc. and Evergy Metro Inc. (Metro), and authorized Evergy Kansas Central a \$74 million increase and Metro a \$32.9 million decrease. New rates will be effective Dec. 21, 2023.
- Evergy's consolidated financial measures have weakened over the past few years from higher expenses, including interest and capital spending, and lower cost recovery. We therefore expect Evergy's S&P Global Ratings-adjusted funds from operations (FFO) to debt will consistently be in the 14%-15% range through 2026.
- Accordingly, we lowered our issuer credit ratings one notch on Evergy and its subsidiaries Evergy Kansas Central, Evergy Missouri West Inc., and Evergy Kansas South Inc. to 'BBB+' from 'A-'. We also lowered Evergy Metro's issuer credit rating one notch to 'A-' from 'A'.
- We affirmed our 'A-2' short-term and commercial paper ratings on Evergy, Evergy Kansas Central, and Evergy Missouri West. We lowered our short-term and commercial paper ratings on Metro to 'A-2' from 'A-1'. Additionally, we affirmed our 'A-2' short-term rating on Evergy Kansas South.
- We also lowered our rating on senior unsecured debt at Evergy to 'BBB' from 'BBB+' and at Metro to 'A-' from 'A'. Metro's first-mortgage bonds have been lowered to 'A' from 'A+' and the recovery rating remains '1+'.
- We affirmed our first-mortgage bond issue-level ratings at Evergy Kansas Central, Evergy Kansas South, and Evergy Missouri West at 'A' and the recovery ratings remain '1+'.
- The stable outlook on Evergy and its subsidiaries reflects our expectation that FFO to debt will be in the 14%-15% range through 2026.

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## Rating Action Rationale

**We lowered the issuer credit ratings on Evergy and its subsidiaries by one notch.** The downgrade reflects weaker financials and an expectation of ongoing weaker financial measures through 2026. The recent rate case outcomes for the two Kansas utilities were settled below our base case, driving the weaker-than-expected financial metrics. The settlement resulted in a net increase of \$74 million for Evergy Kansas Central and a \$32.9 million reduction in rates for Evergy Metro, compared to the initial request of a net increase of \$204 million and \$14 million, respectively. The rate outcomes are the first rate outcomes for the Kansas utilities since the merger between Great Plains Energy Inc. and Westar Energy Inc. in 2018. The Kansas utilities represent approximately 60% of the total rate base of Evergy Inc. Moreover, delay in the securitization of extraordinary costs incurred by Evergy Missouri West during the winter weather event in 2021 has continued to pressure consolidated financial measures. Additionally, in 2022, the company's funds from operations (FFO) to debt stood at 15%, which was below our downgrade threshold. Although we expect the company will continue to implement its cost-management strategy, we expect high capital expenditure (approximately \$2.0 billion-\$2.5 billion annually), regulatory lag, inflation, and higher interest rates to pressure consolidated financial measures through at least 2026. Accordingly, we expect financial measures, including FFO to debt, to be in the range of 14%-15% through 2026.

**We expect the company's capital expenditure (capex) will remain elevated.** We expect capital spending at Evergy and its subsidiaries to remain higher as the utilities continue to execute on their energy transition plans by closing coal-fired generation and replacing it with new generations including renewables. We expect most of the capital spending to be funded with debt, resulting in FFO to debt in the 14%-15% range over the next several years. We expect debt to EBITDA in the range of 5.0x-5.5x.

**We continue to assess Evergy's business risk profile as excellent.** We continue to assess Evergy's business risk profile as excellent. While Evergy and its subsidiaries operate mostly as fully regulated utilities, higher reliance on coal weakens our business risk profile assessment. Currently, coal constitutes about 38% of Evergy's total capacity. Evergy's unregulated energy marketing business housed within Evergy Kansas Central also modestly weakens the company's business risk profile.

**We revised our assessment of the comparable ratings analysis (CRA) modifier to negative from neutral.** Our revised CRA modifier reflects our assessment of Evergy's business risk profile and financial risk profile being relatively weaker within their respective categories.

## Outlook- Evergy Inc.

The stable outlook on Evergy and its subsidiaries including Evergy Missouri West, Evergy Kansas Central, and Evergy Kansas South reflects our expectation that financial measures, specifically FFO to debt, will remain consistently above our downgrade threshold, albeit with a minimal financial cushion. Our base-case forecast assumes FFO to debt of 14%-15% through 2025.

## Downside scenario

We could lower our ratings on Evergy and its subsidiaries in the next 24 months if:

- FFO to debt consistently weakens below 13% or;
- Business risk increases from weaker regulatory risk management, or a material increase in its nonregulated energy marketing business.

## Upside scenario

We could raise our ratings on Evergy and its subsidiaries over the next 24 months if Evergy's financial performance improves such that it maintains FFO to debt consistently greater than 16% without increasing its business risk.

## Outlook - Evergy Metro Inc.

The stable outlook on Evergy Metro Inc. reflects that of parent Evergy Inc., which reflects our expectation that financial measures, specifically funds from operations (FFO) to debt will remain consistently above our downgrade threshold, albeit with a minimal financial cushion. Our Evergy Metro base-case assumes stand-alone FFO to debt in the 19%-22% range through 2025.

## Downside Scenario

We could lower our rating on Evergy Metro over the next 24 months if we lower our rating on parent Evergy or if the utility's stand-alone financial measures weaken such that its FFO to debt remains consistently below 16%.

## Upside Scenario

Although unlikely, we could raise our rating on Evergy Metro over the next 24 months if we raise the rating on parent Evergy, and Evergy Metro is able to consistently maintain its stand-alone credit profile in line with current levels.

## Company Description

Evergy Inc. is a holding company that owns four vertically integrated electric utilities in Kansas and Missouri (Evergy Kansas Central, Evergy Kansas South, Metro, and Evergy Missouri West) that, combined, serve 1.7 million customers.

## Our Base-Case Scenario

- Gross margin of approximately 75% annually through 2026 due to periodic rate cases and volumetric growth.
- The recovery of costs from the February 2021 winter storm of about \$300 million in Missouri

and approximately \$120 million in Kansas.

- Capital spending of \$11.6 billion through 2027.
- Annual dividend growth of approximately 7%.
- Negative discretionary cash flow through 2026, indicating external funding needs, that we believe will be largely funded with debt.
- All debt maturities are refinanced.

## **Liquidity**

We base the 'A-2' short-term rating on our long-term issuer credit rating on Evergy. As of Sept. 30, 2023, we assess Evergy's liquidity as adequate, which reflects our expectation that sources of cash will be more than 1.1x uses over the next 12 months, even if forecast EBITDA declines 10%. We use slightly less stringent thresholds to assess Evergy's liquidity because we believe its constructive regulatory framework provides manageable cash flow stability even in times of economic stress. Evergy maintains \$2.5 billion in committed credit facilities through 2027. We believe the company can lower its high capital spending during stressful periods, which limits the need to refinance under such conditions. Furthermore, our assessment reflects Evergy's generally prudent risk management, sound relationships with banks, and a satisfactory standing in the credit markets. Overall, we believe Evergy will likely withstand adverse market circumstances during the next 12 months with sufficient liquidity to meet its obligations. We expect Evergy to manage upcoming long-term debt maturities and refinance well in advance of scheduled due dates.

### **Principal liquidity sources**

- Cash and liquid investments about \$40 million as of September 2023;
- Revolving credit facility availability of approximately \$2.5 billion;
- Estimated cash FFO of \$2.3 billion; and
- Proceeds from new debt issued in November 2023 for \$300 million at Evergy Kansas Central and approximately \$79 million at Evergy Metro.

### **Principal liquidity uses**

- Debt maturities, including outstanding commercial paper, of \$3.5 billion;
- Working capital outflows of about \$30 million;
- Capital spending (maintenance) of \$625 million; and
- Dividends of about \$605 million.

## **Issue Ratings - Subordination Risk Analysis**

## Capital structure

As of Sept. 30, 2023, Evergy's capital structure consists of about \$10.2 billion of long-term debt, including \$7.3 billion of priority debt consisting of senior secured and senior unsecured debt at its utility subsidiaries.

## Analytical conclusions

- We rate Evergy's senior unsecured debt one notch below the issuer credit rating because priority debt exceeds 50% of the company's consolidated debt, after which we could consider Evergy's debt structurally subordinated.
- We rate Metro's senior unsecured debt the same as the issuer credit rating because it is the debt of a qualifying investment-grade utility.

## Issue Ratings - Recovery Analysis

### Key analytical factors

- The first-mortgage bonds (FMBs) of Evergy Kansas Central, Evergy Kansas South, and Evergy Missouri West 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+', reflecting our expectation of full recovery (100%) in the event of a payment default and an issue-level rating two notches above the issuer credit rating.
- The FMBs at Evergy Metro also have a collateral coverage of more than 1.5x, supporting a recovery rating of '1+' and reflecting our expectation of full recovery (100%) in the event of a payment default and an issue-level rating one notch above the issuer credit rating.

## Ratings Score Snapshot

### Evergy Inc.

Issuer Credit Rating: BBB+/Stable/A-2

Business risk: Excellent

- Country risk: Very Low
- Industry risk: Very Low
- Competitive position: Strong

Financial risk: Significant

- Cash flow/leverage: Significant

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+

## **Evergy Metro**

Issuer Credit Rating: A-/Stable/A-2

Business risk: Excellent

- Country risk: Very Low
- Industry risk: Very Low
- Competitive position: Strong

Financial risk: Significant

- Cash flow/leverage: Significant

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: Positive (+1 notch)

Stand-alone credit profile: a

- Group credit profile: bbb+
- Entity status within group: Insulated

## **Evergy Missouri West**

Issuer Credit Rating: BBB+/Stable/A-2

Business risk: Strong

- Country risk: Very low

- Industry risk: Very low
- Competitive position: Satisfactory

Financial risk: Significant

- Cash flow/leverage: Significant

Anchor: bbb

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: Neutral (no impact)

Stand-alone credit profile: bbb

- Group credit profile: bbb+

## **Evergy Kansas Central**

Issuer Credit Rating: BBB+/Stable/A-2

Business risk: Excellent

- Country risk: Very low
- Industry risk: Very low
- Competitive position: Strong

Financial risk: Significant

- Cash flow/leverage: Significant

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: Neutral (no impact)

Stand-alone credit profile: a-

- Group credit profile: bbb+

## **Evergy Kansas South**

Issuer Credit Rating: BBB+/Stable/A-2

Business risk: Excellent

- Country risk: Very low
- Industry risk: Very low
- Competitive position: Strong

Financial risk: Modest

- Cash flow/leverage: Modest

Anchor: aa

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: aa-

- Group credit profile: bbb+

## **Related Criteria**

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013



- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | Utilities: Collateral Coverage And Issue Notching Rules For '1+' And '1' Recovery Ratings On Senior Bonds Secured By Utility Real Property, Feb. 14, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Ratings List

### Downgraded; Outlook Action

	To	From
<b>Evergy Metro Inc.</b>		
Issuer Credit Rating	A-/Stable/A-2	A/Negative/A-1

### Downgraded; Outlook Action; Short-Term Ratings Affirmed

<b>Evergy Inc.</b>		
<b>Evergy Missouri West Inc.</b>		
<b>Evergy Kansas South Inc.</b>		
<b>Evergy Kansas Central Inc.</b>		
Issuer Credit Rating	BBB+/Stable/A-2	A-/Negative/A-2

### Issue-Level Ratings Lowered

<b>Evergy Inc.</b>		
Senior Unsecured	BBB	BBB+

### Issue-Level Ratings Affirmed

<b>Evergy Inc.</b>		
<b>Evergy Kansas Central Inc.</b>		
<b>Evergy Missouri West Inc.</b>		
Commercial Paper	A-2	

### Issue-Level Ratings Affirmed; Recovery Ratings Unchanged

<b>Evergy Kansas Central Inc.</b>		
<b>Evergy Kansas South Inc.</b>		
<b>Evergy Metro Inc.</b>		
<b>Evergy Missouri West Inc.</b>		
Senior Secured	A	
Recovery Rating	1+	

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