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# Research

Summary:

# Kansas City Power & Light Co.

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## Table Of Contents



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**Summary:**

# Kansas City Power & Light Co.

| | | |
|---|---|---|
| **Business Risk:** EXCELLENT<br>Vulnerable — Excellent | a- / a- / a-<br>Anchor / Modifiers / Group/Gov't | CORPORATE CREDIT RATING |
| **Financial Risk:** SIGNIFICANT<br>Highly leveraged — Minimal | | **BBB+/Stable/A-2** |

## Rationale

| Business Risk: Excellent | Financial Risk: Significant |
|---|---|
| • Regulated electric utility that provides electricity in the greater Kansas City metropolitan area<br>• Relatively stable cash flows from regulated electric operations<br>• Generally supportive regulatory framework in both Kansas and Missouri<br>• Competitive electric rates | • Capital spending remains mostly steady<br>• Rate surcharges mitigate some regulatory lag<br>• Financial measures that have improved somewhat but are still in line with our assessment of the financial risk profile<br>• Continuing commitment to credit quality and maintenance of balanced capital structure |

### Outlook: Stable

Our stable rating outlook on parent company Great Plains Energy Inc. (GPE) and utility subsidiary Kansas City Power & Light Co. (KCP&L) reflects our expectation that management will continue to focus on core utility operations and reach constructive regulatory outcomes to avoid any weakening of the company's business risk profile. The outlook also reflects our consolidated base case forecast level of adjusted FFO to debt of 18%, in line with the existing "significant" financial risk profile.

#### Downside scenario

We could lower the ratings if core financial measures were to consistently underperform our consolidated base case forecast and were to remain consistently at less credit-supportive levels, including adjusted FFO to total debt below 13%. This could occur if rate case outcomes are consistently less than expected, regulatory lag materially rises, or if capital spending increases and is primarily debt financed.

#### Upside scenario

We could raise the ratings if the company's business risk profile strengthens. Economic growth in the company's service territories could strengthen, boosting operating cash flow from the utilities, thereby bolstering the business risk profile. We could also raise the ratings if financial measures strengthened and consistently exceeded our base case forecast, including adjusted FFO to total debt consistently at the high end of the "significant" financial risk profile category. Improved financial measures could occur through stronger operating cash flow or greater equity funding of capital investments.

## Standard & Poor's Base-Case Scenario

| Assumptions | Key Metrics |
|---|---|
| • The economic conditions in the company's service territory continue to improve incrementally resulting in improving cash flow measures<br>• Annual EBITDA growth over the forecast period<br>• Adequate regulatory outcomes in Kansas and Missouri<br>• Current rate surcharges retained<br>• La Cygne construction completed on time and on budget | In our base case, we expect KCP&L's key financial measures to be equivalent to historical performance during the next few years. For 12 months ended Dec. 31, 2013, funds from operations (FFO) to debt was 17%, squarely in the significant category under our medial volatility benchmarks. Debt to EBTIDA was about 4.5x, at the lower end of the aggressive category under our medial volatility benchmarks. Cash flow from operations (CFO) to debt has been robust at 18%. We expect discretionary cash flow to remain negative over the next few years, raising external funding needs. This reflects capital spending and dividend payments to parent GPE. Beyond our base-case forecast, we expect to see financial measures similar to historical levels. |

## Business Risk: Excellent

We base our assessment of KCP&L's business risk profile on what we view as the company's "strong" competitive position, "very low" industry risk derived from the regulated utility industry, and the "very low" country risk of the U.S. where the utility operates. KCP&L's competitive position reflects the company's fully regulated integrated electric utility operations and our expectation for continued solid operational performance and a generally credit-supportive regulatory environment. The utility serves about 515,000 retail customers primarily in the greater Kansas City metropolitan area. The competitive position is also supported by an economically healthy service territory centered on a single metropolitan area with little industrial concentration, solid nuclear operations, very low fuel costs, and competitive electric rates. These attributes are partially offset by nuclear risks associated with the 47%-owned Wolf Creek station. The utility now operates with generally supportive regulation, cash flow stability from its customer base, and the absence of competition. Ongoing capital spending will require timely recovery of these costs through various rate mechanisms including base rates and rate surcharges that should strengthen cash flow.

## Financial Risk: Significant

Based on our medial volatility financial ratio benchmarks, our assessment of KCP&L's financial risk profile is "significant". This reflects the vertically integrated utility model and the recurring cash flow from providing electricity. As a utility, capital spending is ongoing for maintenance purposes and for new projects. Recovery of these costs through rates has generally been supportive. External funding needs exist since our base case reflects discretionary cash flow that we expect to remain negative over the next three years. Steady cost recovery through the regulatory process will be required to maintain cash flow measures, including FFO to debt greater than 16% on average and CFO to debt in excess of 14%, which are both within the range for the significant category. We expect debt to EBITDA to rise to over 4.5x on average, at the lower end of the range for the aggressive category.

## Liquidity: Adequate

KCP&L's liquidity reflects that of GPE, which we consider "adequate", as our criteria defines the term. We believe the company's liquidity sources are likely to cover its uses by more than 1.1x over the next 12 months and to meet cash outflows even with a 10% decline in EBITDA.

There are minimal debt maturities over the next three years with the next material maturities of $350 million in 2017. We expect the company to refinance these given its satisfactory standing in the credit markets.

| Principal Liquidity Sources | Principal Liquidity Uses |
| --- | --- |
| • FFO of about $680 million in 2014<br>• Credit facility availability of about $1.1 billion in 2014 | • Capital spending of about $750 million in 2014<br>• Dividends of about $145 million in 2014<br>• Working capital requirement of approximately $30 million in 2014 |

## Other Modifiers

Modifiers have no impact on the rating outcome.

## Group Influence

The 'a-' stand-alone credit profile for KCP&L reflects our assessment of its business risk and financial risk profiles. This is one notch stronger than that of the current 'bbb+' group credit profile (GCP) for parent GPE. Under our group rating methodology, we consider KCP&L to be integral to the GPE group and we designate it as a core entity. Therefore, we align the issuer credit rating (ICR) on KCP&L with the group credit profile of GPE.

## Ratings Score Snapshot

### Corporate 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)
- **Liquidity:** Adequate (no impact)
- **Financial policy:** Neutral (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

**Stand-alone credit profile : a-**

- **Group credit profile:** bbb+
- **Entity status within group:** Core (-1 notch from SACP)

## Recovery Analysis

- We assign recovery ratings to first-mortgage bonds (FMBs) issued by U.S. utilities, which can result in issue ratings being notched above an ICR on a utility depending on the rating category and the extent of the collateral coverage. The FMBs issued by U.S. utilities are a form of "secured utility bond" (SUB) that qualify for a recovery rating as defined in our criteria. The recovery methodology is supported by the ample historical record of 100% recovery for secured bondholders in utility bankruptcies in the U.S. and our view that the factors that enhanced those recoveries (limited size of the creditor class and the durable value of utility rate-based assets during and after a reorganization given the essential service provided and the high replacement cost) will persist in the future.
- Under our SUB criteria, we calculate a ratio of our estimate of the value of the collateral pledged to bondholders relative to the amount of FMBs outstanding. FMB ratings can exceed an ICR on a utility by up to one notch in the 'A' category, two notches in the 'BBB' category, and three notches in speculative-grade categories depending on the calculated ratio.
- KCP&L's FMBs 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+' and an issue rating two notches above the ICR.

## Related Criteria And Research

### Related Criteria

- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013

- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 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 And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Criteria - Corporates - Utilities: Notching Of U.S. Investment-Grade Investor-Owned Utility Unsecured Debt Now Better Reflects Anticipated Absolute Recovery, Nov. 10, 2008
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008
- 2008 Corporate Criteria: Commercial Paper, April 15, 2008

**Business And Financial Risk Matrix**

| | Financial Risk Profile | | | | | |
|---|---|---|---|---|---|---|
| **Business Risk Profile** | Minimal | Modest | Intermediate | **Significant** | Aggressive | Highly leveraged |
| **Excellent** | aaa/aa+ | aa | a+/a | a- | bbb | bbb-/bb+ |
| Strong | aa/aa- | a+/a | a-/bbb+ | bbb | bb+ | bb |
| Satisfactory | a/a- | bbb+ | bbb/bbb- | bbb-/bb+ | bb | b+ |
| Fair | bbb/bbb- | bbb- | bb+ | bb | bb- | b |
| Weak | bb+ | bb+ | bb | bb- | b+ | b/b- |
| Vulnerable | bb- | bb- | bb-/b+ | b+ | b | b- |