Kentucky Utilities Co.

January 24, 2025

Primary contact

Phalguni Adalja, CFA
Toronto
1-416-507-3212
phalguni.adalja
@spglobal.com

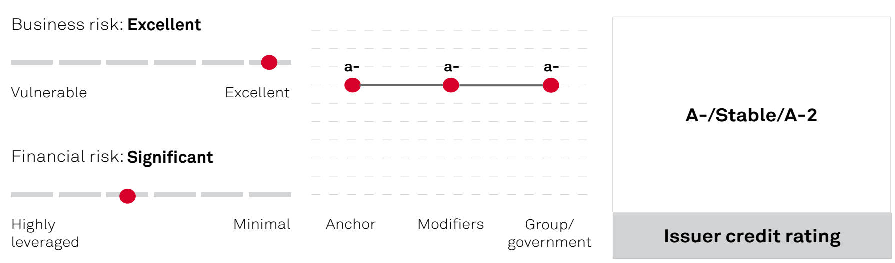
Secondary contact

Matthew L O'Neill
New York
1-212-438-4295
matthew.oneill
@spglobal.com

Research contributor

Kashish C Khandheria
CRISIL Global Analytical Center, an S&P Global Ratings affiliate
Pune

Ratings Score Snapshot



Credit Highlights

Overview

Key strengths	Key risks
Fully regulated vertically integrated electric utility	Limited geographic diversity and relatively small customer base
Credit-supportive regulatory framework	Moderate operational and environmental risk relating to coal-fired generation
Financial measures benefit from timely cost-recovery mechanisms	Negative discretionary cash flow, in part reflecting greater capital spending

Kentucky's constructive regulatory environment supports Kentucky Utilities Co.'s (KU) credit quality. We view Kentucky's regulatory jurisdiction to be credit supportive buoyed by the use of forward test years for base rate cases as well as use of constructive recovery mechanisms such as environmental cost recovery surcharge, retired asset recovery rider, gas line tracker, and a pass-through fuel cost mechanism, all of which help mitigate regulatory lag and stabilize the utility's operating cash flow.

The capital investment plan in Kentucky is underpinned by continued need to support future growth and maintain compliance with environmental standards. Capital spending in Kentucky, both for Louisville Gas & Electric Co.(LG&E) and KU (about $6.4 billion from 2024-2027) is primarily focused on system enhancements (generation investment, system hardening, digital transformation) and energy transition plans. These projects would allow the company to support demand growth, improve system reliability, and reduce emissions (aligning with parent PPL Corp.'s 2050 net zero ambition).

LG&E and KU recently filed an integrated resource plan with the Kentucky Public Service Commission (KPSC) demonstrating the need for additional generation needs due to anticipated growth from data center demand and economic growth. As per management, active data center requests in Kentucky have increased to nearly 3 gigawatts (GW) from 2 GW for the period 2026-2034. While there could be further upside to the current capital plan and this could potentially pressure credit metrics, S&P Global Ratings expects it to be partially offset by cash inflows in the form of authorized allowance for funds used during construction (AFUDC) for construction projects. Based on the current capital plan, we project KU's funds from operations (FFO) to debt will average 18% in 2025 and 2026.

LG&E and KU continue to progress toward reducing their coal-based generation exposure. In 2023, parent PPL Corp., which is also the parent company of LG&E, received regulatory approval from the KPSC to reduce its exposure to coal-fired generation by replacing it with a combination of gas-fired generation plants, solar, and battery storage. Subsequently, in February 2024, LG&E and KU entered into an agreement to begin construction of Mill Creek Unit 5 Generating Station. The natural gas combined-cycle facility will be jointly owned by LG&E (31%) and KU (69%), with an estimated project cost of about $1 billion, and commercial activities are expected to begin around mid-2027. This is part of the company's plan to replace about 600 MW of coal generation that is being retired by the end of 2027

Outlook

The stable rating outlook on KU reflects that of its ultimate parent, PPL Corp., which we base on our expectation that PPL Corp.'s business risk profile will not weaken, and the parent's consolidated financial measures will remain stable. Specifically, we expect PPL Corp.'s FFO to debt will be in the 16%-18% range through the outlook period.

Downside scenario

We could lower the ratings on PPL Corp. and its subsidiaries within the next 24 months if:

- The parent's business risk profile remains unchanged; and
- Core credit ratios weaken such that PPL Corp.'s FFO to debt (S&P Global Ratings'-adjusted) falls consistently below 16%.

Upside scenario

Given our assessment of PPL Corp.'s business risk and our base-case assumptions, we do not anticipate raising our rating on PPL Corp. during the next 24 months. However, we could raise our ratings if:

- PPL Corp.'s FFO to debt (S&P Global Ratings'-adjusted) exceeds 21% on a consistent basis; and
- It maintains or improves its business risk.

Our Base-Case Scenario

Assumptions

- Gross margin growth in 2024 spurred by modest volumetric growth and ongoing rate recovery for capital spending, including on environmental compliance equipment;
- Average annual capital spending of close to $1 billion in 2025 and 2026 for upgrading generation infrastructure to meet environmental standards, to improve transmission and distribution assets, and to cater rising demand for data centers;
- Annual dividend payout in line with historical levels;
- Negative discretionary cash flows through 2026; and
- All debt maturities are refinanced.

Key metrics

Kentucky Utilities Co.--Forecast summary

	2023a	2024e	2025f	2026f
FFO to debt (%)	22.8	19-21	18-20	16-18
Debt to EBITDA (x)	3.4	3.5-4.0	3.5-4.5	4.0-4.5
FFO cash interest coverage (x)	6.9	6.0-6.5	5.5-6.0	5.0-5.5

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast. FFO--Funds from operations.

Company Description

KU is a vertically integrated electric utility providing service to about 573,000 customers, out of which 545,000 are in Kentucky and the balance of 28,000 customers are in southwestern Virginia. The company operates as a subsidiary of PPL Corp.

Peer Comparison

Kentucky Utilities Co.--Peer Comparisons

	Kentucky Utilities Co.	Kentucky Power Co.	Appalachian Power Co.	Louisville Gas & Electric Co.
Foreign currency issuer credit rating	A-/Stable/A-2	BBB/Negative/--	BBB+/Negative/A-2	A-/Stable/A-2
Local currency issuer credit rating	A-/Stable/A-2	BBB/Negative/--	BBB+/Negative/A-2	A-/Stable/A-2
Period	Annual	Annual	Annual	Annual
Period ending	2023-12-31	2023-12-31	2023-12-31	2023-12-31
Mil.	$	$	$	$
Revenue	1,884	615	3,689	1,613

Kentucky Utilities Co.--Peer Comparisons

EBITDA	943	189	1,106	758
Funds from operations (FFO)	739	126	788	580
Interest	142	72	306	110
Cash interest paid	126	66	271	94
Operating cash flow (OCF)	656	76	698	613
Capital expenditure	572	155	1,039	378
Free operating cash flow (FOCF)	84	(79)	(340)	235
Discretionary cash flow (DCF)	(190)	(79)	(341)	(92)
Cash and short-term investments	14	1	5	18
Gross available cash	14	1	5	18
Debt	3,242	1,364	6,409	2,559
Equity	4,152	955	5,277	3,172
EBITDA margin (%)	50.1	30.7	30.0	47.0
Return on capital (%)	7.3	2.9	4.9	7.8
EBITDA interest coverage (x)	6.6	2.6	3.6	6.9
FFO cash interest coverage (x)	6.9	2.9	3.9	7.2
Debt/EBITDA (x)	3.4	7.2	5.8	3.4
FFO/debt (%)	22.8	9.3	12.3	22.7
OCF/debt (%)	20.2	5.6	10.9	24.0
FOCF/debt (%)	2.6	(5.8)	(5.3)	9.2
DCF/debt (%)	(5.9)	(5.8)	(5.3)	(3.6)

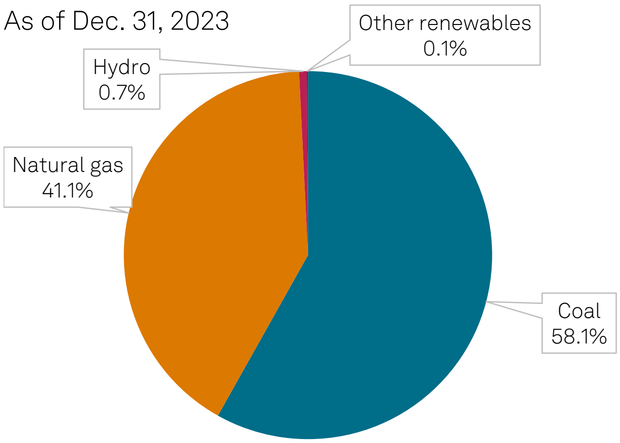
Business Risk

KU's business risk profile is based on our assessment of the company's regulated vertically integrated electric utility operations under Kentucky's generally constructive regulatory framework, which provides for the timely recovery of approved capital expenditures. KU has moderate scale, with 573,000 customers and limited geographic diversity, because it operates almost entirely in Kentucky. It generates about 60%-65% revenues from residential and commercial customers, which can insulate the company from fluctuations in electricity demand and supports relatively stable operating cash flow.

The company has generation capacity of about 4,800 MW, including sizable coal-fired capacity. KU has been upgrading coal units to comply with environmental regulations. It can recover the costs for these upgrades through an environmental cost-recovery mechanism, which limits regulatory lag and supports the credit profile. Under KPSC regulation, the company benefits from other recovery mechanisms such as a pass-through fuel cost and a purchased-power cost-recovery rider. These mechanisms help stabilize the company's operating cash flow. Moreover, KU's low-cost generation and efficient operations contribute to competitive rates for customers.

Kentucky Utilitites Co. generation mix

As of Dec. 31, 2023



Source: Company filings.

Financial Risk

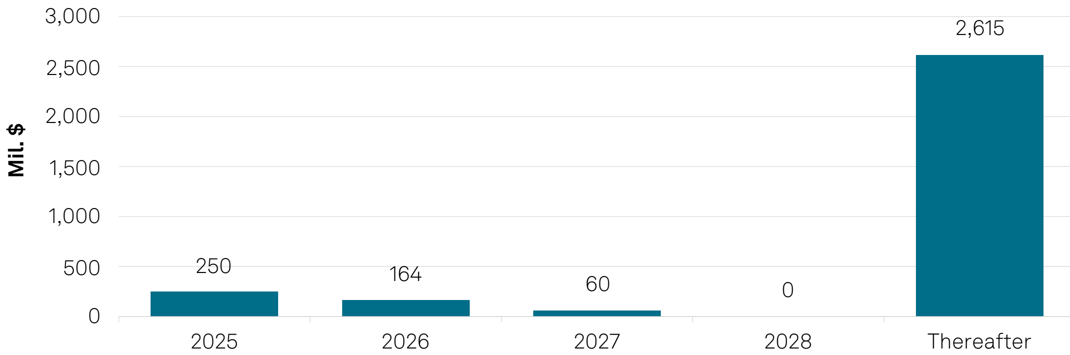
Under our base-case scenario, we project that KU's adjusted FFO to debt will average about 18% over the next two years. Over the next few years, we expect KU's credit measures will benefit from the use of regulatory mechanisms to recover invested capital cost. We expect continued capital spending averaging close to $1 billion each in 2025 and 2026, which, when combined with the utility's dividend, will result in negative discretionary cash flow. We expect the deficit will be partially funded with debt. We expect debt leverage will be relatively modest for a regulated utility as indicated by debt to EBITDA in the 4.0x-4.5x range over the next few years. Bolstering the financial risk profile determination is the supplemental ratio of adjusted FFO cash interest coverage averaging about 5.5x.

We assess KU's financial risk profile using our medial volatility financial benchmarks, reflecting lower-risk regulated utility operations and effective management of regulatory risk. These benchmarks are more relaxed than those used for typical corporate issuers.

Debt maturities

Kentucky Utilities Co. debt maturity schedule

As of Sept 30, 2024



Source: Company filings.

Kentucky Utilities Co.--Financial Summary

Period ending	Dec-31-2018	Dec-31-2019	Dec-31-2020	Dec-31-2021	Dec-31-2022	Dec-31-2023
Reporting period	2018a	2019a	2020a	2021a	2022a	2023a
Display currency (mil.)	$	$	$	$	$	$
Revenues	1,760	1,740	1,690	1,826	2,074	1,884
EBITDA	772	834	830	867	923	943
Funds from operations (FFO)	650	693	676	689	732	739
Interest expense	116	123	126	123	122	142
Cash interest paid	97	102	110	106	113	126
Operating cash flow (OCF)	589	565	555	617	669	656
Capital expenditure	562	610	510	560	547	572
Free operating cash flow (FOCF)	27	(45)	45	57	122	84
Discretionary cash flow (DCF)	(219)	(274)	(155)	(193)	(174)	(190)
Cash and short-term investments	14	12	22	13	21	14
Gross available cash	14	12	22	13	21	14
Debt	2,785	2,952	2,988	3,040	3,112	3,242
Common equity	3,442	3,574	3,782	3,928	4,038	4,152
Adjusted ratios						
EBITDA margin (%)	43.9	47.9	49.1	47.5	44.5	50.1
Return on capital (%)	7.8	7.7	7.0	7.0	7.3	7.3
EBITDA interest coverage (x)	6.6	6.8	6.6	7.1	7.6	6.6
FFO cash interest coverage (x)	7.7	7.8	7.1	7.5	7.5	6.9
Debt/EBITDA (x)	3.6	3.5	3.6	3.5	3.4	3.4
FFO/debt (%)	23.3	23.5	22.6	22.7	23.5	22.8
OCF/debt (%)	21.1	19.1	18.6	20.3	21.5	20.2

Kentucky Utilities Co.--Financial Summary						
FOCF/debt (%)	1.0	(1.5)	1.5	1.9	3.9	2.6
DCF/debt (%)	(7.9)	(9.3)	(5.2)	(6.4)	(5.6)	(5.9)

Reconciliation Of Kentucky Utilities Co. Reported Amounts With S&P Global Adjusted Amounts (Mil. $)

	Debt	Shareholder Equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
Financial year	Dec-31-2023									
Company reported amounts	3,157	4,152	1,884	908	516	135	943	647	190	572
Cash taxes paid	-	-	-	-	-	-	(78)	-	-	-
Cash interest paid	-	-	-	-	-	-	(125)	-	-	-
Lease liabilities	20	-	-	-	-	-	-	-	-	-
Operating leases	-	-	-	10	1	1	(1)	9	-	-
Accessible cash and liquid investments	(14)	-	-	-	-	-	-	-	-	-
Asset-retirement obligations	52	-	-	5	5	5	-	-	-	-
Nonoperating income (expense)	-	-	-	-	8	-	-	-	-	-
Debt: Debt serviced by third parties	27	-	-	-	-	-	-	-	-	-
EBITDA: other income/ (expense)	-	-	-	20	20	-	-	-	-	-
D&A: other	-	-	-	-	(20)	-	-	-	-	-
Interest: Amortized cost	-	-	-	-	-	1	-	-	-	-
Total adjustments	85	-	-	35	14	7	(204)	9	-	-
S&P Global Ratings adjusted	**Debt**	**Equity**	**Revenue**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from Operations**	**Operating cash flow**	**Dividends**	**Capital expenditure**
	3,242	4,152	1,884	943	530	142	739	656	190	572

Liquidity

The short-term rating on KU is 'A-2', based on the issuer credit rating on the company. As of Sept. 30, 2024, we assess KU’s stand-alone liquidity as adequate because we believe the company’s liquidity sources will likely cover uses by more than 1.1x over the next 12 months and meet cash outflows even if EBITDA declines 10%. We believe the company’s predictable regulatory framework provides a manageable level of cash flow stability for the company even in times of economic stress.

In addition, KU has the ability to absorb high-impact, low probability events. This reflects the company's recently upsized $600 million credit facility expiring in December 2029, as well as our belief that KU can scale back its high capital spending projects during stressful periods, indicative of a limited need for refinancing under such conditions.

The assessment also reflects the company's generally prudent risk management, sound relationships with banks (composed of a diversified banking group), and a generally satisfactory standing in credit markets. Wholistically, these factors support our use of slightly lower thresholds to assess liquidity compared with corporate borrowers. Overall, we believe the company should be able to withstand adverse market circumstances over the next 12 months with sufficient liquidity to meet its obligations. The company has its next large long-term debt maturity in 2025 of $250 million, which we expect the company will proactively address this maturity in advance of its scheduled due date.

Principal liquidity sources

- Revolving credit facility availability of $600 million as of Jan 2, 2025;
- Cash and liquid investments of about $16 million as of Sept. 30, 2024; and
- Estimated cash FFO of about $715 million.

Principal liquidity uses

- Debt maturity of $250 million in 2025;
- Assumed maintenance capital spending of about $710 million; and
- Dividends of about $240 million.

Environmental, Social, And Governance

Environmental factors are a negative consideration in our credit rating analysis of KU given its high level of coal-based power generation. More than half of the total generation capacity of about 4,800 MW is coal-fired, representing an environmental risk. KU expects to replace much of its coal-based generation with a combination of natural-gas-fired and renewable generation.

Group Influence

Under our group rating methodology, we consider KU a core subsidiary of ultimate parent PPL Corp. The core status reflects our view that KU is highly unlikely to be sold, has a strong long-term commitment from senior management, is successful at what it does, and contributes significantly to the group. Given its core subsidiary status and PPL Corp.'s group credit profile of 'a-', the issuer credit rating on KU is 'A-'.

Issue Ratings--Recovery Analysis

Key analytical factors

KU's first-mortgage bonds benefit from first-priority lien on substantially all the utility's real property owned or subsequently acquired. Collateral coverage of about 1.5x supports a recovery rating of '1+' and an issue rating one notch above the issuer credit rating.

Rating Component Scores	
Foreign currency issuer credit rating	**A-/Stable/A-2**
Local currency 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-**
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Neutral (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	**a-**

Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- 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
- General Criteria: Country Risk Assessment Methodology And Assumptions, 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: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Industry Credit Outlook North America Regulated Utilities, Jan. 14, 2024
- PPL Electric Utilities Corp., June 25, 2024,

Ratings Detail (as of January 24, 2025)*	
Kentucky Utilities Co.	
Issuer Credit Rating	A-/Stable/A-2
Commercial Paper	
Local Currency	A-2
Senior Secured	A
Issuer Credit Ratings History	
01-Jun-2015	A-/Stable/A-2
10-Jun-2014	BBB/Watch Pos/A-2
15-Apr-2011	BBB/Stable/A-2
Related Entities	
Louisville Gas & Electric Co.	
Issuer Credit Rating	A-/Stable/A-2
Commercial Paper	
Local Currency	A-2
Senior Secured	A
PPL Capital Funding Inc.	
Issuer Credit Rating	A-/Stable/A-2
Senior Unsecured	BBB+
PPL Corp.	
Issuer Credit Rating	A-/Stable/A-2
PPL Electric Utilities Corp.	
Issuer Credit Rating	A/Stable/A-1
Commercial Paper	
Local Currency	A-1
Senior Secured	A+
Rhode Island Energy	
Issuer Credit Rating	A-/Stable/A-2
Commercial Paper	
Local Currency	A-2
Preferred Stock	BBB
Senior Secured	A
Senior Unsecured	A-

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.