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EVRG.N - Q2 2021 Evergy Inc Earnings Call

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OVERVIEW:

Co. reported 2Q21 adjusted earnings of $195m and adjusted EPS of $0.85. Expects 2021 adjusted EPS to be $3.20-3.40.

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Michael Jay Lapides *Goldman Sachs Group, Inc., Research Division - VP*

PRESENTATION

Operator

Thank you for standing by, and welcome to the Second Quarter 2021 Evergy, Inc. Earnings Conference Call. (Operator Instructions) Please be advised that today's call is being recorded. (Operator Instructions)

I would now like to hand the call over to Lori Wright, Vice President, Investor Relations and Treasurer. Please go ahead.

Lori A. Wright - *Evergy, Inc. - VP of Corporate Planning & IR and Treasurer*

Thank you, Michelle. Good morning, everyone, and welcome to Evergy's second quarter call. Thank you for joining us this morning. Today's discussion will include forward-looking information. Slide 2 and the disclosure in our SEC filings contain a list of some of the factors that could cause future results to differ materially from our expectations and include additional information on non-GAAP financial measures. The releases issued this morning, along with today's webcast slides and supplemental financial information for the quarter are available on the main page of our website at investors.evergy.com.

On the call today, we have David Campbell, Evergy's President and Chief Executive Officer; and Kirk Andrews, Executive Vice President and Chief Financial Officer. David will cover our second quarter highlights, our latest regulatory and legislative priorities and preview our upcoming Investor Day. Kirk will cover in more detail the second quarter results, the latest on sales and customers and our financial outlook for the remainder of the year. Other members of management are with us and will be available during the question-and-answer portion of the call.

I will now turn the call over to David.

David A. Campbell - *Evergy, Inc. - President, CEO & Director*

Thanks, Lori, and good morning, everyone. I'll begin on Slide 5. This morning, we reported second quarter adjusted earnings of $0.85 per share compared to $0.68 per share a year ago, equal to a 25% increase. On a period-over-period basis, these results were primarily driven by higher transmission margin, an increase in weather-normalized demand, higher other income and income tax benefits.

On our prior earnings call, I highlighted that our nuclear plant, Wolf Creek, had started its planned refueling outage. I'm pleased to report that the Wolf Creek team completed the outage under budget, continuing the excellent operational performance at the plant. Company-wide, we've maintained a steady trend of strong cost management as we strengthen our continuous improvement culture. Our team's execution has enabled a solid start to the year, and we are reaffirming our 2021 adjusted EPS guidance of $3.20 to $3.40 per share. We plan on giving an updated perspective on 2021 performance as part of our Investor Day next month. This morning, we're also reaffirming our target of compound annual EPS growth of 6% to 8% from 2019 through 2024.

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Moving on to Slide 6, I'll provide a summary of our regulatory and legislative priorities and recent activities. First, with respect to our sustainability transformation plan dockets, we completed the final STP workshops in Kansas and Missouri, wrapping up the items outlined in both procedural schedules. These dockets will remain open as we continue to file responsive follow-up information. As I've said before, this constructive process has been beneficial as it has allowed us to educate and inform our stakeholders on our strategic business plan while also providing a channel for receiving constructive feedback from the parties.

Another policy priority that we have identified is securitization legislation. While passage of this legislation was not critical to the near-term elements of our plan, through hard work with staff and other parties in both states, we are pleased that securitization was passed this year in both Kansas and Missouri. Kansas House Bill 2072 was signed into law in April, while Missouri House Bill 734 was signed by Governor Parson in early July and becomes law at the end of this month.

Given the filing deadlines for our long-term resource plan in both states, securitization financing was not considered in the analysis relating to our respective integrated resource plans. However, having the law in place in both states, we'll factor into our ongoing analysis of the preferred plan for the future evolution of our generation portfolio and the approach that will optimize affordability, reliability and sustainability.

Securitization is particularly helpful with respect to optimizing the affordability aspect of our ongoing generation fleet transition. Along with enabling the cost-effective handling of extraordinary costs and undepreciated values, the securitization law in Kansas also includes predetermination features. This will allow us to collaborate with regulators on the topic of removing coal from rate base and replacing it with renewables in advance of implementing any actions.

Within the next few months, we plan to file for predetermination of our latest plans for the retirement of coal at the Lawrence Energy Center and the upcoming solar edition in Kansas.

The Missouri legislation shares many features in common, but there are distinguishing elements. For example, in Kansas, a predetermination is required before retiring coal with the securitization of financing order. The Missouri decisional prudence process is similar to predetermination, though in Missouri, it is optional rather than mandatory, and Missouri approach contemplates an asset retirement plan that can be broader in nature.

The Missouri law also refers explicitly to evaluating the retention of coal and rate base for reliability purposes, even if capacity factors remain relatively low, for example, due to such factors as seasonal coal operations or low SPP energy prices as more renewables come online. In addition, the Missouri legislation provides for a new investment in replacement assets up to an amount equal to the securitized assets. In both states, these features will help to enable a well-planned and predictable process as we advance our fleet transition.

I'll turn now to winter storm Uri costs. In Kansas, we've been granted authority to defer these costs and we filed an application seeking a recovery in return of storm impacts through fuel adjustment mechanisms starting in April 2022. The net impact for Kansas Central would result in approximately $115 million of costs recovered from customers over a 2-year period. At Kansas Metro, during winter storm Uri, we experienced higher-than-normal off-system sales. These sales exceeded the fuel and purchase power costs during the event. As a result, the increased margin will benefit Kansas Metro customers by an estimated $35 million, which will be passed through the fuel costs over a 1-year period beginning in April 2022.

In Missouri, we have requested similar AAO deferral treatment for the winter weather costs and expect a commission order on this process later this year. Metro customers on the Missouri side will receive their allocated portion of the higher off-system sales margins, which we currently estimate is around $25 million in customer benefit, which we have asked to deliver to the fuel adjustment mechanism over a 1-year period.

Conversely, Missouri West customers were subject to higher fuel and purchase power costs during their winter weather event. Given the amount of these higher costs upon receipt of deferral authority, we intend to utilize the recently signed securitization legislation to request commission approval to securitize the excess costs and recover them over an extended period. Specifically, we expect to request securitization of approximately $295 million with recovery over a 15-year period, which would minimize and smooth the impact for our customers.

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Slide 7 highlights topics that we expect to cover during our upcoming Investor Day, which will be held virtually on September 21. At the event, we expect to focus on our strategic business objectives and overall priorities for the business. Along with an update on STP execution through 2024, we expect to comment on 2021 and provide a first look at the company's 2022 earnings outlook. We'll describe how Evergy is driving operational excellence across our business, including reliability, customer service, generation availability and cost. We'll discuss our capital deployment and infrastructure investment plans.

We'll also profile our ongoing focus on regional rate competitiveness, which is a key priority for our team as it is for our customers and our regulators. Our objective as a company is to become recognized for driving operational excellence and delivering excellent service to our customers at regionally competitive rates. We aspire to be clear in our objectives and consistent in our execution so that our regulators, investors and all of our stakeholders know what to expect and know that we will deliver. We will also discuss our long-term growth drivers and objectives, including those relating to our ESG profile and generation fleet transition. Investor Day will give Kirk and I, along with our colleagues, a chance to expand on the significant value potential we see at Evergy.

Along these lines, Slide 8 summarizes Evergy's investment thesis. As an all-electric Midwestern utility, well positioned geographically to capitalize on cost-effective renewables options, we strive for consistency in performance and being known for execution and delivering results. Customers are at the forefront as affordable and reliable service are paramount objectives. Operational excellence is a critical enabler to achieving these objectives, and we are committed to a continuous improvement path in reliability, customer service, transmission and distribution services and fleet operations.

Stakeholder collaboration and constructive relationships with our regulators and other key partners in Kansas and Missouri are also foundational. The passage of securitization legislation in both states was a great example of that collaborative process in action, and we look forward to an open constructive dialogue with stakeholders throughout the years ahead.

As we've described, infrastructure improvements are featured in our sustainability transformation plan. Investments in grid modernization and the ongoing transformation of our generation fleet will enable us to better leverage technology, improve resiliency and efficiency and help us to optimize across the objectives of affordability, reliability and sustainability.

Disciplined cost management and rigorous performance benchmarking are necessary complements to our investment program in order to ensure that our service and rates remain cost competitive and affordable. The company has established a strong track record in cost management since the merger, and we see ongoing opportunities to maintain that trajectory.

The final element of our investment thesis that I'll highlight is financial excellence, including a strong balance sheet and an attractive total shareholder return, driven by our targeted 6% to 8% annual EPS growth from 2019 through 2024, plus our dividend yield.

In summary, we are very excited about the opportunities for our company during this period of change in our industry, and we are committed to the sustained effort that will be required to deliver against our high-performance objectives. We look forward to discussing our strategy and investment thesis in greater depth next month.

I will now turn the call over to Kirk.

Kirkland B. Andrews - *Evergy, Inc. - Executive VP & CFO*

Thanks, David, and good morning, everyone. I'll start with results for the quarter on Slide 10. For the second quarter of 2021, Evergy delivered adjusted earnings of $195 million or $0.85 per share compared to $154 million or $0.68 per share in the second quarter of 2020. The 25% increase in second quarter adjusted EPS was driven by the following items as shown on the chart from left to right. First, although cooling degree days were relatively consistent versus the second quarter of 2020, we saw fewer heating degree days this past quarter resulting in a $0.02 per share unfavorable contribution from weather versus 2020.

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This weather variance was more than offset by the following: a 3.4% increase in weather-normalized demand or approximately $0.03 per share; higher transmission revenue drove about $0.05 per share, resulting from our ongoing investments in transmission; O&M expense was approximately $11 million lower or $0.04 per share due to lower bad debt expense during the quarter as collections and aging of receivables improved; other income increased $0.03 per share, driven by a $4 million increase in equity AFUDC, $5 million of higher investment earnings resulting from unrealized gains on equity investments and $2 million of higher COLI proceeds; finally, we realized higher income tax benefits due to increased amortization of excess deferred income taxes, or EDIT, and the timing of tax credit recognition to maintain our projected annual effective tax rate.

Adding to our first quarter results to these numbers, I'll turn next to year-to-date results, which you'll find on Slide 11. For the 6 months ended June 30, 2021, adjusted earnings were $320 million or $1.40 per share compared to $248 million or $1.09 per share for the same period last year. Again, moving from left to right, our year-to-date adjusted EPS drivers versus 2020 include the following: the colder winter weather during the first quarter more than offset fewer heating degree days in the second quarter leading to $0.05 per share favorable contribution from weather year-to-date versus 2020. As weather overall during the first half of 2020 was near normal, this $0.05 per share also represents the EPS contribution versus normal weather.

Weather normalized demand increased just over 2% year-to-date, driving approximately $0.05 of EPS. As expected, higher transmission revenues helped drive a $0.06 increase versus 2020. Year-to-date, we've also realized approximately $0.08 of increased earnings from lower tax expense driven by higher amortization of excess deferred income taxes as well as accelerated timing within the year of tax credit recognition.

As you may recall from my remarks during the first quarter, this latter item, primarily resulted from the increase in earnings during the first quarter as our recognition of benefits from tax credits is driven by the shape of pretax earnings during the year. This item represents approximately $0.05 of positive EPS year-to-date and is merely the result of this intra-year timing. Consequently, we do not expect this $0.05 per share to result in a variance to our full year results.

Finally, $0.07 of the year-to-date EPS increase was the result of higher equity AFUDC, higher unrealized gains on equity investment and higher COLI proceeds. Although COLI proceeds represent a year-over-year increase versus 2020, where the majority of our earnings from this item came late in the year, our year-to-date contribution from COLI in 2021 is nonetheless modestly below expectations.

Turning to Slide 12, I'll provide a brief update on recent sales and customer trends. Weather-normalized retail sales increased 3.4% during the second quarter as compared to last year. This was primarily driven by the partial recovery of the commercial industrial sector from the initial shutdowns from COVID-19 in 2020. Residential sales decreased compared to last year when extensive lockdowns kept individuals at home. While these shifts indicate a continued trend towards a more normal demand mix, commercial and industrial recovery has been slower than expected while residential demand remains above expectations. Year-to-date, weather-normalized demand increased 2.2%. When combined with favorable weather year-to-date, overall sales were in line with our expectations.

Turning finally to Slide 13. Based on our year-to-date results and outlook for the balance of the year, we are reaffirming our adjusted EPS guidance of $3.20 to $3.40 per share. And as we continue to execute our cost management and rate base investment objectives as part of the STP, we are also reaffirming our long-term compounded annual EPS growth target of 6% to 8% from 2019 through 2024. We've had a solid start to the year, but with about half of our annual earnings typically showing up in the third quarter, we will remain focused on execution through the summer, and I look forward to speaking with all of you again during our Investor Day on September 21.

And with that, I'll turn it back over to David.

David A. Campbell - *Evergy, Inc. - President, CEO & Director*

Why don't we go ahead and shift to questions. Let's open up to Q&A.

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Michael Lapides with Goldman Sachs.

Michael Jay Lapides - *Goldman Sachs Group, Inc., Research Division - VP*

I have 2, totally unrelated to each other. First, on thinking about the long-term generation plan, I want to make sure I heard you correct that your original plan, your STP did not incorporate securitization. How does securitization potentially impact the plan? And how do you think about the reliability needs of having solid fuel assets on the system, given just what your region and a large swath of the country over the last 6 months have experienced?

David A. Campbell - *Evergy, Inc. - President, CEO & Director*

Michael, so -- and thank you for your question. That will give me an opportunity to clarify. So the securitization legislation didn't impact our financial plan outlook in '21 to '24. So the passage of the law didn't impact the growth rate that we teed up in our objectives during that time period. It has been a long-term objective and we view it as a pretty important enabler beyond that forecast period. So passage of law in both states, we think is going to be a helpful enabler as we work the plan over the coming decades.

Now we've published our Integrated Resource Plan. And in that, you'll see that the phasing and pacing of coal retirements is one that is relatively -- it's done on a relatively steady basis as opposed to accelerated over a near-term time frame. We do think that the utilization of coal will increase over time (Evergy intended to say "decrease over time"), but part of the factor impacting the phasing or retirement of coal and solid fuel reflects the factors that you identified, which is making sure that we can ensure reliability, the extreme weather that we saw in February and the first rolling outages in SPP and then the extreme heat in parts of the country that we've seen. We haven't seen extreme heat in our part of the country that we have seen a couple of resource alerts in SPP so far this summer.

And obviously, in other parts of the country, it has been extreme and has led to some strains on the grid, all reinforce that making sure we leave an eye on reliability is very important as you work on the -- as you think about the fleet transition, and we think securitization will help.

All that said, we updated our emissions reduction targets as part of our last quarter call. As you saw, we've got a 70% reduction by 2030 objective and a net 0 target by 2045. So we think we're driving to strike the right balance, and we'll constantly be looking at that to make sure that we're balancing across affordability, reliability and sustainability. Hopefully, that gets to your question.

Michael Jay Lapides - *Goldman Sachs Group, Inc., Research Division - VP*

No, that helps. That helps. That helps a ton. Follow-up, O&M has averaged about year-over-year, down about $12 million, $13 million a quarter. Kirk, should we assume a similar run rate when we think about the second half of the year? And then the pace of O&M reductions as you enter 2022, do you still see a pretty sizable cost savings opportunity for 2022 and beyond?

Kirkland B. Andrews - *Evergy, Inc. - Executive VP & CFO*

Thanks, Michael, we do. Just as a reminder, when you think about the year-to-date results or year-over-year differences, as I noted, one of those contributing factors, at least this year, we saw some favorability on bad debt expense, which is certainly a positive. Overall, our outlook for the year remains unchanged from the indications I gave on the fourth quarter call when we first introduced guidance. One of the key success factors, that having joined the company in 2021 as the CFO, I can take little credit for, but the management team, as you'll recall, was able to deliver a cadence of O&M in 2020, which actually was in line with our 2021 objective.

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So we -- if you think about it that way, we got a year ahead on our savings pace. So therefore, our expectation, as a reminder, as I'd indicated when we provided guidance initially was our year-over-year 2020 to '21 O&M -- total O&M, we expect to be relatively flat, and we're on pace to deliver that. A little bit of intra-year timing is largely the contribution for what we're seeing year-to-date. But we do expect a good, continued cadence of O&M reductions as we move forward into '21, '23. Going toward that target to be well comfortably below $1 billion a year by the time we get to 2024.

Michael Jay Lapides - *Goldman Sachs Group, Inc., Research Division - VP*

Okay, Kirk. So I want to make sure I followed. Just for the second half of '21, you don't expect to see similar savings that you've seen year-over-year relative to the first half of '21?

Kirkland B. Andrews - *Evergy, Inc. - Executive VP & CFO*

No. And that would align with our expectation, which continues to be relatively flat year-over-year overall in O&M.

Operator

Our next question comes from Julien Dumoulin-Smith of Bank of America.

Dariusz Lozny - *BofA Securities, Research Division - Research Analyst*

This is Dariusz on for Julien. Just wanted to ask about the retail customer count that you guys highlighted on one of your slides. It's pretty impressive at over 1% year-to-date. Just curious if you could talk a little bit about the composition of that, and perhaps how it compares against your expectations for the year and perhaps how that might look on a prospective basis as well?

Kirkland B. Andrews - *Evergy, Inc. - Executive VP & CFO*

So sure, it's Kirk. Our customer growth, while it's certainly a good indicator year-over-year, the mix, I can't quote you of that off the top of the head, but largely in line with our expectations. However, as I also indicated, despite the fact we've got an increase in customer account, our overall utilization per customer is down year-over-year. That's in line with our expectations because we expected the impact of stay-from-home, which was most acute in the second quarter of last year, to abate as people kind of return to work. That level of abatement has been a slower pace, right? So the stay-at-home effect on a utilization perspective, notwithstanding the fact, we did see that nice year-over-year increase in customers has been elevated relative to our expectations.

And that certainly understand we expect that to continue a little longer now that we've got the impact of the delta variant on the stay-at-home. But overall, despite the fact that we're certainly pleased with the overall increase in customer count. As we expected, the utilization rates per customer comparable year-over-year is down again due to that COVID effect.

Dariusz Lozny - *BofA Securities, Research Division - Research Analyst*

Great. And one more, if I can. On your '25 CapEx, you've had the potential for a $250 million increase in your last couple of slide deck. Just curious if you could maybe discuss the puts and takes as far as what is driving or what will drive the decision as far as when to formally include that in the plan?

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David A. Campbell - *Evergy, Inc. - President, CEO & Director*

So thanks for the question, and we look -- we're glad to clarify that. So we plan to lay that out as part of our Investor Day and just be more specific around it. So we work through our annual planning process with our operating team. We also consider, of course, the renewables plans that we have, and we're going to plan on giving you a -- giving The Street a more firm view of that as part of our Investor Day, just rolling forward into the next year.

Operator

(Operator Instructions) There are no further questions. I'd like to turn the call back over to David Campbell for your closing remarks.

David A. Campbell - *Evergy, Inc. - President, CEO & Director*

Okay. Great. So I'll close with a comment on 2021, and sort of implicit in some of the questions we received, just so I'll go ahead and hit at this. As I mentioned, and as Kirk noted, we're maintaining our guidance range. There are some items in the first half. And as a general matter, Q3 is our biggest quarter -- just some timing onto the first half. Q3 is our biggest quarter. COLI has some uncertainty. We'll, of course, continue to model the impact of the pandemic. But all that said, given where we are now, we would be disappointed if our results in 2021 don't end up in the top half for the full year. We'll plan to provide an update on 2021 as part of our Analyst Day in September, but we're pleased with our solid start, and we appreciate your time with us today, and we wish you a good day. Thank you.

Operator

This does conclude the program. You may all disconnect. Everyone, have a great day.

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