Industry Top Trends Update

Oil and Gas

Improved credit quality but industry still faces headwinds

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What's changed?

Hydrocarbon prices. Prices recovered due to a supportive OPEC production policy and demand recovery as global economies began to reopen. Natural gas prices recovered due to producer discipline, a strong domestic economic recovery, and a healthy liquefied natural gas (LNG) export market.

New administration. The administration has made no qualms about its intentions to regulate the oil and gas industry and its affinity for renewable energy. We believe the administration will increase regulation and reduce subsidies/tax deductions for the industry while promoting clean energy initiatives. The operating environment for domestic shale producers will undoubtedly become more difficult.

Mergers and acquisitions. Despite the higher oil and gas prices, the industry is facing some severe headwinds, forcing companies—particularly independent oil and gas companies—to review their business models and assess if they can continue to deliver value to investors. Increased environmental, social, governance (ESG), and climate regulation, loss of tax subsidies/deductions, capital market access concerns, and renewable encroachment are some of the challenges facing the North American oil and gas industry.

How is recovery taking shape?

Conservative financial policy. Producers in North America remain focused on generating free cash flow due to investor demand to return capital. Producers have remained disciplined in their capital spending and maintaining healthy balance sheets while balancing shareholder initiatives.

Rating actions. Many companies are focused on maintaining a healthy balance sheet, but it may not translate to upgrades. Positive rating actions, especially for investment-grade companies, will likely be predicated on the ability to retire debt as opposed to achieving strong leverage or cash flow metrics through higher hydrocarbon prices. Companies that have debt maturing and have committed to retiring those maturities have the best prospects for upgrades.

Oilfield service (OFS) companies are not reaping the fruits of higher oil prices. Unlike exploration and production (E&P) companies, OFS issuers will find it difficult to post significant margin improvement due to E&P issuers' focus on free cash flow. E&P capital spending restraint and cost efficiencies remains in focus, hampering OFS ability to improve margins.

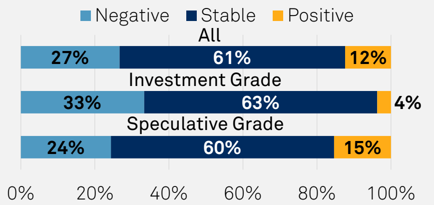
What are the key risks around the baseline?

OPEC. OPEC has remained supportive during the pandemic; however, any disagreements or a renewed focus on gaining market share could disrupt oil prices.

COVID. Global demand has made a nice recovery but the virus and its mutations are still concerns. Any mutation that could evade the benefits of vaccines could result in a significant drop off in demand.

Shale production. How long will shale producers demonstrate production restraint? A sustained level of very high oil prices could sway investor sentiment and result in producers substantially ramping up production.

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	27	78	105
Downgrades	4	2	6
Upgrades	0	15	15

Ratings data as of end-June, 2021

COVID-19 Heat Map

Oil and Gas		
Estimated Recovery To 2019 Credit Metrics	2022	
Potential Negative Long-Term Industry Disruption	--	
2020 v. 2019		
Revenue Decline	**EBITDA Decline**	**Incremental Borrowings**
15% to 25%	15% to 25%	No increase
2021 Estimates v. 2019		
Revenue Decline	**EBITDA Decline**	
0% to 10%	0% to 10%	