Industry Top Trends Midyear 2021

Resilience, Recovery, Risks

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S&P Global Ratings

Industry Top Trends Update

Industry Top Trends

Midyear 2021

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Key Takeaways

- The outlook for North American and European corporate sectors has improved sharply. Upgrades are outpacing downgrades by a factor of three to one.
- All sectors have seen their net outlook bias (a downgrade risk indicator) improve this year. For just over half, this measure is less negative than it was pre-pandemic. Pent-up demand appears plentiful, and the U.S. experience suggests ending restrictions unleashes this.
- There are substantial variations in the pace of recovery across and within sectors, and weaker credits remain vulnerable to a loss of economic momentum. The shape of the post-pandemic world is uncertain and questions remain about business-model implications.
- Concerns around financial policy choices abound. Companies are directing their rapid improving cash flow towards capital spending, acquisitions and, in some cases, shareholder rewards. The improvement in credit metrics is consequently slower.

S&P Global Ratings analysts have published 39 midyear Industry Top Trends updates for Europe and North America. The one-page updates summarize of our evolving views, focusing on what's changed, how the recovery is taking shape, and what are the key risks around our baseline assumptions. They include details of ratings distributions, ratings changes in the first half of the year, and our COVID-19 heat maps, which assess growth prospects and the assumed trajectory of credit metrics. They are drawn from our assessments of more than 5,000 rated corporate and infrastructure entities. All individual Industry Top Trends reports can be accessed here. For updates on Asia-Pacific, please see Sector Roundup Asia-Pacific Q3 2021: Some Pain, Some Gain (June 29, 2021).

In broad terms, the reports describe resilience and recovery in corporate sectors. Even those sectors most affected have seen the outlook stabilize, aided by ready access to cheap funding and improving economic prospects. For some sectors, recovery is too weak a word--they are back to pre-pandemic revenue levels and, in some cases, are booming. Cost inflation, supply shortages and even labor shortages are affecting many industries in different ways but for the most part we expect that this can be managed without hurting margins. However, should inflation pressures prove more than transitory then margin pressures would intensify.

New COVID variants and financial policy choices are main risk concerns. Beyond the overarching concern that COVID-19 variants may subvert existing vaccines and trigger a new crisis, financial policy choices are a particular risk. Unsurprisingly given the current cost of debt, there appears little appetite to retire debts taken on during the pandemic. Most sectors seem happy to have leverage ratios fall as a result of rising EBITDA alone. Capital spending and merger activity are both rapidly increasing. Still, there are wide variations in the pace of recovery across and within sectors, and the weaker ends of the credit spectrum remain acutely vulnerable to any economic deterioration.

Key Themes

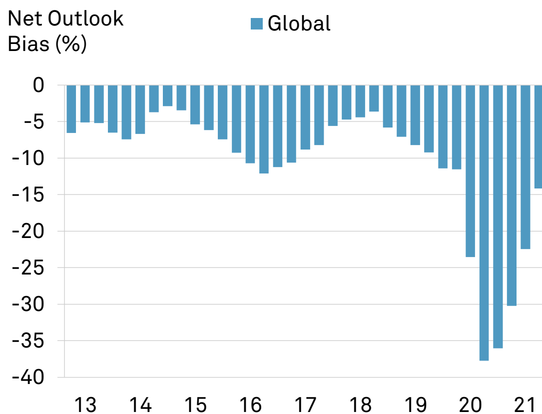
Sector outlooks have improved, even for those hard hit by COVID-19. Enormous fiscal and monetary stimulus and rapid vaccination rollouts in many countries has brought about a swift economic recovery and a sharp improvement in the global credit outlook. There have been three times as many upgrades as downgrades this year and the end-quarter net outlook bias--an indicator of potential ratings actions--has fallen to minus 14% from a peak of minus 38% a year ago (see charts 1 and 2). All 20 corporate sectors have seen their net outlook biases become less negative this year, and 11 out of the 20

Industry Top Trends Update

are now less negative than they were pre-pandemic in December 2019. Many sectors are enjoying boom conditions--building materials, capital goods, metals and mining--and even those that have struggled and suffered multiple defaults are now showing resilience, benefitting from ample liquidity and a strong market appetite for risk.

Chart 1

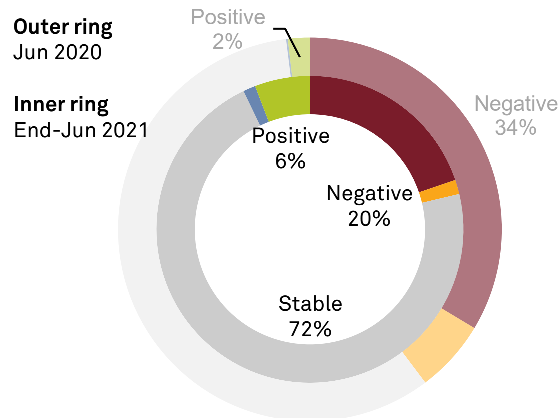
Global Nonfinancial Corporate Net Outlook Bias



Source: S&P Global Ratings. Data as of end-quarter.

Chart 2

Global Nonfinancial Corporate Net Outlook Bias



Source: S&P Global Ratings. Data as of end-quarter.

New waves of vaccine-resistant COVD-19 are the biggest risk to the recovery. With any near-term substantive withdrawal of fiscal and monetary stimulus lying outside our base case, the risk that new vaccine-resistant variants of COVID-19 force renewed restrictions is the most frequently mentioned sector risk. While many sectors have proved resilient to the pandemic and many of those most affected have had government support and plentiful market liquidity, this scenario could raise renewed solvency questions for the weakest credits. Aside from the pandemic, China's growth cycle remains particularly important for autos, capital goods, chemicals, and the energy and materials sectors.

There's plentiful pent-up demand, and plentiful evidence that lifting COVID-19 restrictions unleashes it. Prospects for unleashing pent-up demand are flagged across many of the reports. European households accumulated excess savings of EUR300 billion last year, equivalent to 2.7 percentage points of GDP. Encouragingly, the evidence from the U.S.--further along in the recovery than Europe--suggests that the lifting of restrictions is translating into an upturn in activity in areas hard hit by the pandemic. Demand is surging for U.S. domestic leisure travel and many dine-in restaurants returned to pre-pandemic levels in the second quarter. Clothing retailers were hard hit by the pandemic but are seeing a strong demand recovery.

Not all recoveries are equal, with wide variations still apparent. We revised our outlooks to positive for low-cost airlines catering to domestic U.S. leisure travel, while airlines focused on business and international travel still face uncertainty. This manifests in a likely increase in narrowbody aircraft production in 2022, while widebody production is likely to remain weak until international travel restrictions are dropped. In Europe, we expect regional and midscale hotels focused on business travelers from small and midsized companies will rebound faster than those in urban areas in luxury and upscale segments. Toll road traffic is starting to achieve 2019 levels, but European airport traffic in June was still 67% below that year.

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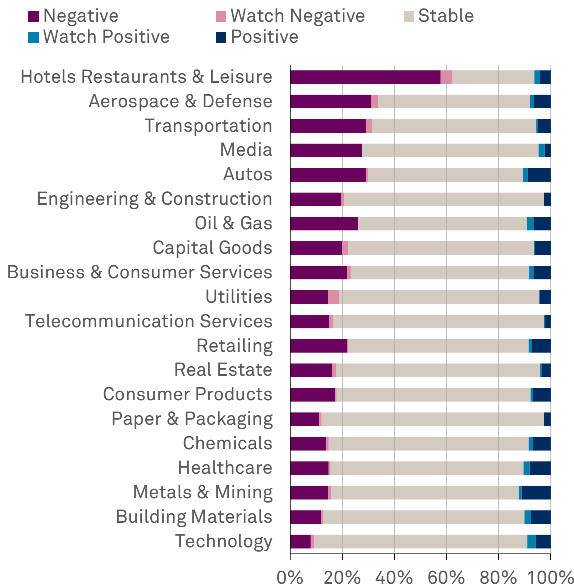
Chart 3

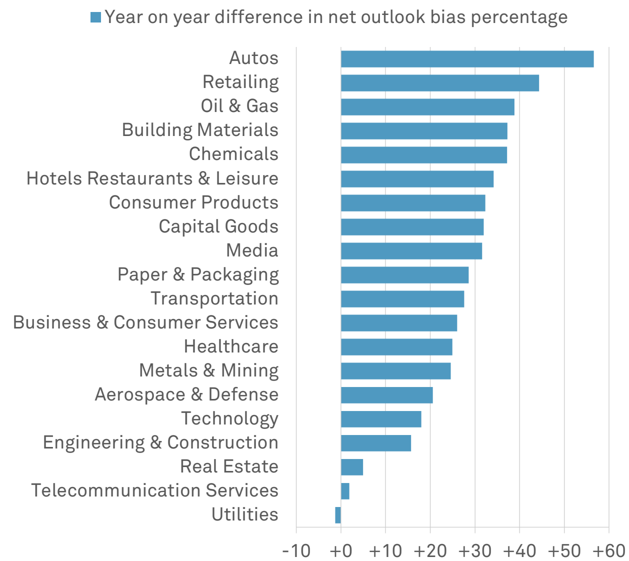
Global Ratings Outlook Distribution By Industry (Ranked By Net Outlook Bias)



Source: S&P Global Ratings. Ratings data as of end-June 2021.

Chart 4

Year-On-Year Difference In Global Industry Net Outlook Bias



Source: S&P Global Ratings. Ratings data as of end-June 2021.

Credit health is still fragile at the weaker end of the credit spectrum. About 60% of companies in our rated European travel portfolio have 'CCC' ratings. Resumed demand and growth is critical to alleviate the expanded debt burdens that many leisure companies added to survive the downturn. Even in sectors where the recovery is well underway, there are pockets of risk. In North American building materials, issuer downgrades and the volume of new 'CCC'-rated unsecured debt have increased markedly in 2021.

Cost inflation and supply chain risks loom large but appear under control for now. In sectors most exposed to sharply rising raw material and freight costs--building materials, capital goods, chemicals, homebuilders--we believe these can largely be passed on given the strength of demand. Supply-chain disruptions, particularly those linked to the global shortage of semiconductors, are having a more tangible impact for the time being. However, both pressures feature prominently amongst risks around the baseline. Should inflation pressures persist and prove more than transitory, the impact on margins is likely to be significant. Labor costs too are a concern. For example, trucking and parcel express carriers are often reliant on short-term employees and are facing cost pressures from shortages. Restaurants and retail supply chains are experiencing similar issues. Also, for sectors that have regulated pricing, should inflation take hold, the lag between costs and regulatory adjustments would likely weaken credit metrics.

A focus on growth rather than deleveraging. Corporate leverage rose sharply in the wake of the pandemic taking debt-to-GDP from 91% in 2019 to an estimated 104% in 2020. The broad message from the industry updates is a preference to reduce leverage simply by increasing EBITDA rather than by retiring debt. For private-equity-owned companies, dividend recapitalization has picked up. For the broader corporate universe, the focus appears to be on seeking growth and adjusting to pandemic-accelerated secular changes through capital expenditure (capex) and mergers and acquisitions (M&A). M&A was a key theme highlighted in the year-end ITT reports, and there has been a substantial upswing in activity this year (see chart 5). In contrast, capex assumptions were relatively subdued six months ago, but these have seen a dramatic upswing in recent months (see chart 6). Financial policy concerns feature heavily amongst the key risks to the baseline. The

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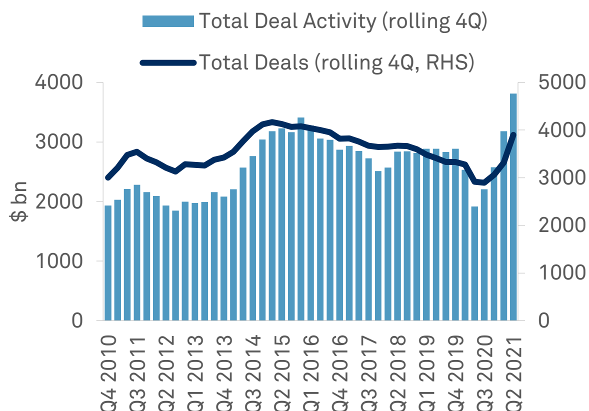
decision to invest may be welcome in broader economic terms, but it does pose credit risks in the context of higher leverage.

Chart 5

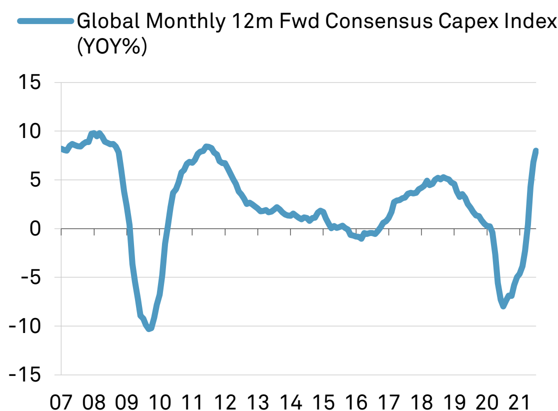
Global M&A Deals Have Surged In Recent Quarters



Source: S&P Global Market Intelligence.
Data includes deal value greater than $100 million.

Chart 6

Year Over Year Change In 12 Month Forward Consensus Capex Forecast



Source: S&P Global Ratings, S&P Global Market Intelligence. Universe is Global Capex 2000. Consensus revisions are unweighted local currency.

Some sectors face a degree of regulatory and policy uncertainty. Drug pricing in the U.S. is likely to remain under scrutiny. Antitrust and competition policy for technology and technology companies is likely to become contentious again, particularly given their strong financial performance during the pandemic but also their importance to the success of home working. A number of regulatory decisions are due for European airports by the end of 2021, and regulators will have a hard job reconciling the need to increase tariffs with the fragile traffic recovery.

The new normal is still being defined for many sectors. Shifts in post-pandemic travel patterns will drive and shape the recovery across various transportation segments. E-commerce and remote working trends could hurt longer-term prospects for retail and office real estate assets. Audience fragmentation and the increasing importance of streaming platforms continues to cause a rapid evolution in the media ecosystem. Electric vehicle (EV) adoption is accelerating given strong policy support and emissions targets. EV sales could exceed our base-case of 10% of U.S. light-vehicle sales by 2025, versus barely 2% last year.

ESG and climate change considerations are moving centerstage for many sectors. Carbon emission reduction targets are driving a transformation in the utility sector, necessitating sustained increases in capital spending. Steel producers globally are aiming to reduce their carbon intensity, which ranks among the highest of any industry. For the energy and materials sectors more broadly, ESG factors are influencing the availability and cost of funding for some projects.

Only a rating committee may determine a rating action and this report does not constitute a rating action.

Industry Top Trends Update Europe

Aerospace and Defense

Will summer travel restrictions delay recovery?

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What's changed?

Commercial aerospace revenue and earnings began to stabilize after sharp declines in 2020. Although demand for commercial passenger aircraft remains weak, aircraft manufactures have largely reached planned lower production rates and further cuts are unlikely. Earnings and cash flow are also starting to benefit from last year's cost-reduction efforts. However, if the European summer travel window remains partially shut, this could add pressure.

Airbus is well positioned to capitalize on the recovery. After entering the pandemic in a strong financial position and lowering production rates through 2020, we expect Airbus' free operating cash flow (FOCF) to be slightly positive in 2021 despite the ongoing adverse operating conditions. In coming years, we project Airbus will gradually improve cash flow generation and generate positive FOCF.

European governments' rising defense budgets continue to support sales. European defense spending is set to exceed $300 billion in 2021, with the U.K., Germany, France, and Italy spending on average 4% more than in 2020. Near-term prospects for defense spending in Europe therefore look robust. Despite the pandemic, governments continue to boost spending to modernize their defense capabilities in the face of rising threats.

How is recovery taking shape?

Demand for narrowbody (single aisle) planes will lead recovery. Domestic travel is likely to recover faster than long-haul international travel, so narrowbody demand will likely recover before that for widebodies (twin aisle). Airbus has said it could increase production of its A320neo and A220 narrowbodies in the latter part of 2021 if demand warrants. Widebody production will likely remain very low through at least 2022, and rates could be cut further if government travel restrictions remain in place. As flying increases, demand for aftermarket parts and services should also rise.

Credit ratios for commercial aerospace firms will take a few years to recover. Despite likely increases in revenue and earnings over the next year, credit ratios are unlikely to reach 2019 levels until 2023 or later. However, this will vary based on a company's mix of commercial/military, original equipment manufacturer (OEM)/aftermarket, and narrowbody/widebody sales.

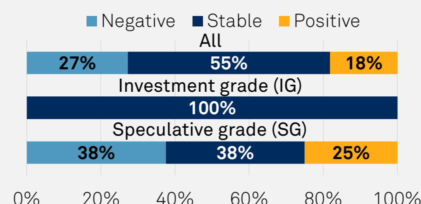
Defense contractors should see steady or improving ratios. Few firms were materially impacted by the pandemic and near-term demand remains solid. Improving earnings and cash flow could be offset by mergers and acquisitions or higher shareholder returns.

What are the key risks around the baseline?

New waves of COVID-19 disrupting air travel recovery. The European summer holiday season hangs in the balance, with continuous government-led changes to travel restrictions dragging down the expected numbers of flights at a critical time of the financial year for airlines. Whether this knocks on to OEMs and results in further production cuts is unclear at this stage.

Supply chain issues slow recovery in build rates. Many suppliers took significant actions to reduce costs during the pandemic and may not have cash to invest in working capital to support higher rates. They may also have difficulty finding workers with the necessary skills or need to raise wages to attract employees.

Outlook Distribution



Ratings Statistics*

	IG	SG	All
Ratings	3	8	11
Downgrades	0	1	1
Upgrades	0	1	1

Ratings data as of end-June 2021. *Year to date.

COVID-19 Heat Map

Commercial Aerospace

Estimated recovery to 2019 credit metrics	>2023
Potential negative long-term industry disruption	Yes

2020 Versus 2019		
Revenue decline	EBITDA decline	Incremental borrowings
25%-50%	40%-60%	10%-25%

2021 Estimates Versus 2019	
Revenue decline	EBITDA decline
20%-30%	30%-40%

Defense Contractors

Estimated recovery to 2019 credit metrics	No decline
Potential negative long-term industry disruption	Yes

2020 Versus 2019		
Revenue decline	EBITDA decline	Incremental borrowings
0%-5%	No decline	No increase

2021 Estimates Versus 2019	
Revenue decline	EBITDA decline
0%-10%	>2019

Industry Top Trends Update Europe

Automotive

Strong global sales recovery improves sector outlook

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What's changed?

We improved our 2021 forecasts slightly. For light vehicles (LV), we expect global sales growth of 8%-10%, up from 7%-9% previously. The global auto industry is recovering faster than expected from COVID-19, supported by sound demand, a favorable pricing environment, fiscal stimulus in the main auto markets, and greater reliance on private mobility.

The global semiconductors shortage is limiting supply. Visibility on recovery this year remains low primarily due to the semiconductor shortage, but the industry is allocating scarce semiconductors to higher-margin vehicles and learning to capture the benefits of lower inventories in the form of better pricing for new and used cars.

Electic vehicle (EV) adoption is accelerating, thanks to supportive policies. EV car sales in Europe more than doubled year on year as of May 2021, according to EV Volumes. This reflects increasing political support for the industry's energy transition under the European Green Deal. The European Commission adopted several legislative proposals, including a stricter net reduction target of at least 55% for greenhouse gas emissions by 2030. The faster transition could weigh on margins (before subsidies) and is increasing pressure to quickly ramp-up the EV supply chain and achieve further cost reductions for battery cells, in our view.

How is recovery taking shape?

Europe is lagging behind the very strong U.S. and Chinese markets, as a result of COVID-19-related restrictions during first-half 2021 and a slower vaccination rollout. As of mid-2021, however, global LV sales totaled 42 million units, which is on track to meet our annual forecast of 83 million-85 million units.

Profitability will be supported in 2021 by favorable pricing. This should help offset any increase in raw material prices and margin pressure from the shift of sales to EVs. Capital expenditure and research and development intensity remain high, although some of those investments are increasingly made in joint ventures (JVs) that are not fully consolidated and therefore do not directly burden EBITDA and free operation cash flows of original equipment makers (OEMs) or auto suppliers.

The need to manage investments carefully and pool resources is rising. We expect OEMs and auto suppliers will look to mergers and acquisitions or partnerships to reposition portfolios toward EV and digital technology. Most deals are new JVs and partnerships with limited direct implications on credit metrics, such as Stellantis-Foxconn or Daimler Truck-AB Volvo, but we could see more material transactions.

What are the key risks around the baseline?

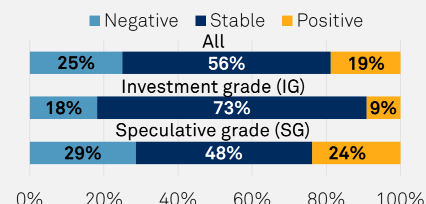
An extended chip shortage. Although it is not in our base case, an extended or more pronounced chip shortage could result in prolonged production downtime.

China cooling down. China has been a major profit driver particularly for German OEMs. If the softening trend as observed in wholesales in the second quarter continues in second-half 2021, this could weigh on revenue and margin recovery.

Latest Related Research

- Global Auto Sales Forecasts: The Recovery Gears Up, May 11, 2021
- Global Heavy Truck Sales Forecasts: Declines In APAC Offset Growth In U.S. And EMEA, June 10, 2021

Outlook Distribution



Ratings Statistics*

	IG	SG	All
Ratings	11	21	32
Downgrades	0	0	0
Upgrades	1	3	4

Ratings data as of end-June 2021. *Year to date.

COVID-19 Heat Map

Automotive	
Estimated recovery to 2019 credit metrics	2022
Potential negative long-term industry disruption	No

2020 Versus 2019		
Revenue decline	EBITDA decline	Incremental borrowings
15%-25%	25%-40%	<5%

2021 Estimates Versus 2019	
Revenue decline	EBITDA decline
0%-10%	0%-10%

Industry Top Trends Update Europe

Building Materials

Widespread growth in most European countries

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What's changed?

We revised to stable three-quarters of negative outlooks in the speculative-grade category. At mid-2021, only 18% of speculative-grade companies had a negative outlook, down from 70% at end-2020. This reflects our expectation of continued solid performance in 2021, after a steady recovery in second-half 2020.

Rising raw material costs have only resulted in limited margin pressure. This reflects companies' focus on operating efficiency and ability to pass on higher raw material costs to final products, due to solid demand for building material products. As such, we expect EBITDA margins will remain at a high level within the cycle.

Dividend recapitalization has picked up. During the first half of 2021, about one-thirds of companies in the 'B' rating category paid dividends to their private equity owners, reflecting benign financial and operating conditions. As result, we anticipate no or limited financial deleveraging in 2021.

How is recovery taking shape?

Revenue will rebound to pre-pandemic levels by end-2021. This reflects strong volume growth in the first half of 2021 and healthy backlogs at least for the next couple of years, sustained by recovered consumer demand and fiscal stimulus.

Cheap debt and improved business confidence support more spending and mergers and acquisitions. Capital expenditure should increase 23% in 2021, following a 13% drop in 2020. As such, we expect limited or no deleveraging for investment-grade companies in 2021.

Infrastructure and residential building renovation are leading the recovery. We expect the rebound in residential construction to center on renovation rather than new construction, which also reflects Europe's demographic trends. Companies more exposed to commercial construction should recover to 2019 levels only in 2023.

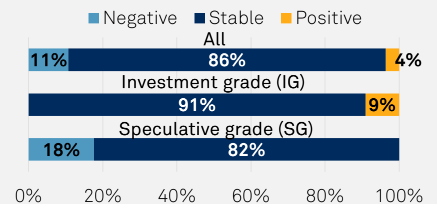
What are the key risks around the baseline?

A quick return to aggressive financial policies. Financial policy is among the key potential drivers of future rating actions on large companies; some have already announced they will return to their pre-pandemic shareholder friendly plans, which include larger dividends or share buybacks.

Persistently high cost inflation leading to a severe margin decline. Building material companies have so far been able to contain margin pressure from increased raw material costs, but persistently high cost inflation, for example spreading to energy and labor, could significantly reduce margins and cash flow.

"Carbon leakage" should be a limited risk for EU-based cement players in the medium term. The EU's carbon cross-border adjustment mechanism should mitigate the negative effects of the progressive phase-out of free carbon allowances. Still, there is a risk of EBITDA reduction if the phase-out is too quick and companies are unable to pass the higher carbon costs on to clients.

Outlook Distribution



Ratings Statistics*

	IG	SG	All
Ratings	11	17	28
Downgrades	0	1	1
Upgrades	2	0	2

Ratings data as of end-June 2021. *Year to date.

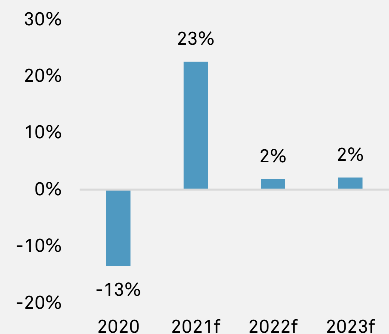
COVID-19 Heat Map

Building Materials	
Estimated recovery to 2019 credit metrics	H2 2021
Potential negative long-term industry disruption	No

2020 Versus 2019		
Revenue decline	EBITDA decline	Incremental borrowings
5%-10%	0%-10%	5%-10%

2021 Estimates Versus 2019	
Revenue decline	EBITDA decline
0%-10%	0%-10%

Capital Expenditure Outlook



Industry Top Trends Update Europe

Capital Goods

A rapid recovery

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What's changed?

The sector outlook has stabilized. The net negative outlook bias among issuers we rate in Europe, the Middle East and Africa--a measure of future downgrade risk--sunk to 6% as of June from 50% a year ago. Most rating actions in 2021 have been positive, and the risk of defaults has eased, even at the low end of the rating scale.

The fast global economic rebound is supporting the sector's growth. We revised our 2021 global GDP growth forecast up to 5.9% and see upside risks. Crucially, the U.S. and China--which account for almost 40% of the global economy--are both growing rapidly. This boosted industrial production and orders in the first half of 2021. We expect growth will continue, but with somewhat slowing momentum, and that 2021 will mark a significant expansion in terms of top lines and margins for the capital goods sector.

How is recovery taking shape?

The eurozone is seeing rapid growth of orders and production. IHS Markit revised its Eurozone Manufacturing Purchasing Managers Index to a record high of 63.4 in June 2021, and new orders experienced their third-fastest reported increase ever. The positive momentum lifted the capital goods sector's output and order books due to increased investment and use of manufacturing output-related consumables and services, which we expect to continue throughout the year. We see strong momentum in all main end markets, barring commercial aerospace.

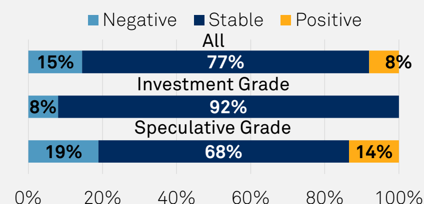
We expected improvement in the sector's performance and credit metrics. On a global basis, in 2021, we forecast revenue growth for the rated capital goods sector of 25%, after a marked contraction of 21% last year, and operating margins nearly recovering to 2019 levels (forecast aggregated EBITDA margin 14.4% in 2021 versus 14.7% in 2019). We also expect aggregated sector credit metrics will significantly improve during 2021 from stronger operating performance and return to pre-pandemic levels in 2022.

What are the key risks around the baseline?

Material price increases and supply-chain constraints. The price of most raw materials jumped due to the post-pandemic rebound, which is likely to slow margin expansion across the sector. However, we expect that supply-chain constraints for most materials and components will slowly ease in the second half of the year. We also think in certain cases, such as microchips, the shortage will boost investment in production capacity and benefit companies providing manufacturing technology.

Spikes in COVID-19 outbreaks during the fall and winter. Vaccine hesitancy rather than supply in Europe may prevent countries from reaching targeted vaccination levels over the summer. Additionally, the spread of variants could delay recovery of sectors that were already severely hit, like aerospace. While we do not include a new wave of shutdowns in our sector base case, we see a potential downside in the form of slowing recovery toward the year-end if governments reintroduce pandemic-related restrictions in the main European economies.

Outlook Distribution



Ratings Statistics*

	IG	SG	All
Ratings	25	37	62
Downgrades	0	2	2
Upgrades	0	5	5

Ratings data as of end-June, 2021. *Year to date

COVID-19 Heat Map

Capital Goods		
Estimated Recovery To 2019 Credit Metrics	2022	
Potential Negative Long-Term Industry Disruption	--	
2020 Versus 2019		
Revenue Decline	EBITDA Decline	Incremental Borrowings
5% to 10%	15% to 25%	5 to 10%
2021 Estimates Versus 2019		
Revenue Decline	EBITDA Decline	
0 to 10%	0 to 10%	

Industry Top Trends Update Europe

Chemicals

Recovering to pre-pandemic credit metrics

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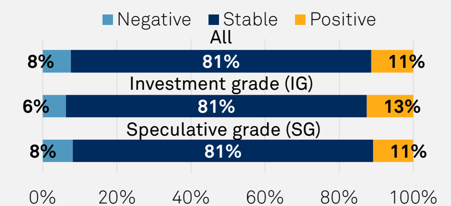
Outlook Distribution



Ratings Statistics*

	IG	SG	All
Ratings	16	37	53
Downgrades	0	2	2
Upgrades	0	4	4

Ratings data as of end-June 2021. *Year to date.

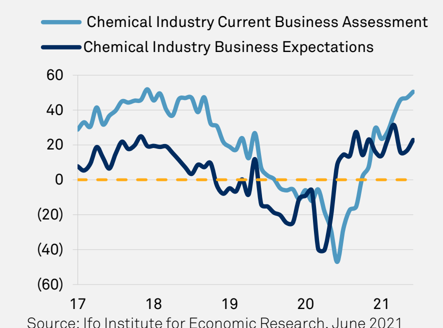
COVID-19 Heat Map

Chemicals	
Estimated recovery to 2019 credit metrics	2H 2021
Potential negative long-term industry disruption	No

2020 Versus 2019		
Revenue decline	EBITDA decline	Incremental borrowings
5%-10%	10%-15%	5%-10%

2021 Estimates Versus 2019	
Revenue decline	EBITDA decline
0%-10%	0%-10%

IFO Sentiment Survey for German Chemical Industry



Source: Ifo Institute for Economic Research, June 2021

What's changed?

Demand is rebounding. Chemical companies are benefiting from a broad-based recovery in global demand, with strong momentum in Asia, followed by the U.S. and Europe. On the back of strong GDP and industrial production growth worldwide, many commodity chemical products are seeing pricing and volumes develop favorably.

Higher input costs are manageable. Raw material price inflation seems manageable for most companies we rate, since strong demand allows for the pass-through to customers. For some downstream specialty chemical businesses, we expect a typical quarterly lag in pass-through, with a potential impact on margins.

Fertilizers are experiencing strong momentum. Fertilizer companies should benefit from peak cycle conditions in potash, phosphate, and nitrogen markets in 2021, driven by healthy farm economics due to strong pricing for agricultural commodities and limited capacity additions. We will monitor Chinese exports of phosphate and nitrogen, and capacity additions in the near term though.

How is recovery taking shape?

EBITDA levels should recover this year. Given robust macroeconomic recovery and healthy demand from key end markets, we forecast many European chemical companies will report EBITDA close to 2019 levels already this year.

Credit metrics should also reach 2019 levels in 2021. Since 2020 was less severe than we anticipated for many European chemical companies, and given robust demand leading to solid EBITDA growth, we forecast that companies will restore their credit metrics already by year-end 2021 to pre-pandemic levels.

Most companies carry stable outlooks. Our outlook distribution reflects our view that the improvement in credit metrics is sustainable. Of the European chemical companies we rate, 81% carry a stable outlook, and we have slightly more positive outlooks (11%) than negative (8% down from 39% at mid-2020).

What are the key risks around the baseline?

A shift to more aggressive financial policies. Chemical companies reduced capital expenditure and paused mergers and acquisitions (M&A) in 2020 to preserve cash. This may change in light of favorable industry conditions and still-low financing costs. While M&A activity is high in the sector in 2021, many companies have indicated an appetite for organic growth as well as bolt-on and midsized acquisitions rather than transformational deals.

Supply-demand imbalances after 2021. Following the strong rebound in demand in 2021, we see a risk that capacity additions in certain commodity chemicals, such as olefins and intermediates, may exceed demand growth in the coming years, putting pressure on these products' operating rates and pricing.

A slowdown in China. Any slowdown in China, the growth engine of the world's chemical industry, would weigh on many European chemicals companies.

Latest Related Research

- The Hydrogen Economy: Industrial Gas Companies Are In Pole Position, April 22, 2021
- The Hydrogen Economy: Green Hydrogen May Transform The Fertilizer Industry, April 22, 2021

Industry Top Trends Update Europe

Consumer Products

Seeking growth through digitization and innovation

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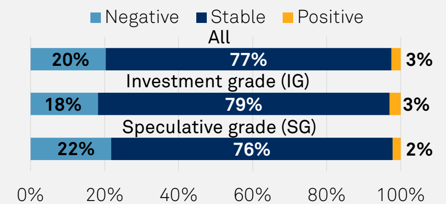
Outlook Distribution



Ratings Statistics*

	IG	SG	All
Ratings	33	46	79
Downgrades	0	2	2
Upgrades	0	6	6

Ratings data as of end-June 2021. *Year to date.

COVID-19 Heat Map

Estimated Recovery To 2019 Credit Metrics	
Packaged foods / personal and home care / agricultural products and ingredients (A&I)	No decline
Alcoholic beverages	2022
Luxury and discretionary	2022
Potential Neg. Long-Term Industry Disruption	
Packaged foods / personal and home care / A&I	No
Alcoholic beverages	No
Luxury and discretionary	No

2020 Versus 2019

Revenue decline	EBITDA decline	Incremental borrowings
Pack. foods / personal and home care / A&I		
No decline	No decline	No increase
Alcoholic beverages		
10%-15%	15%-25%	<5%
Luxury and discretionary		
15%-25%	25%-40%	<5%

2021 Estimates Versus 2019

Revenue decline	EBITDA decline
Pack. foods / personal and home care / A&I	
≥2019	≥2019
Alcoholic beverages	
0%-10%	0%-10%
Luxury and discretionary	
10%-20%	10%-20%

What's changed?

Strong brands and diversification lend resilience. Branded consumer staples upped their market share on back of strong home consumption. While sales dropped in the discretionary and travel retail-reliant segments such as personal luxury and beauty, companies with strong brands and e-commerce managed to limit the impact on credit metrics with costs- and cash-saving measures.

Scrutiny of product portfolios for strategic fit, sustainability, and growth objectives has intensified. The pandemic prompted consumer goods companies to scrutinize and reshape their product and brand portfolios to a greater degree than before. Evolving consumption patterns and sustainability considerations will drive portfolio transformation through investment, bolt-on acquisitions, and disposals.

Digitization increased as the shift in distribution channels gains pace. Branded consumer goods companies are investing in technology to accelerate growth in e-commerce and direct-to-consumer operations. Digitization, however, goes beyond e-commerce and is helping garner insights into consumer needs and contribute to efficiencies and innovation in products, supply chain, marketing, and distribution.

How is recovery taking shape?

On-trade and out-of-home consumption are picking up. While we expect home consumption to remain strong, ongoing vaccination rollouts and the resumption of travel and leisure activities will lead to sales recovery for impacted segments like personal luxury, beauty and alcoholic beverages.

High household savings and pent-up demand will support spending. European households accumulated excess savings of about 12 percentage points of disposable income last year, or €300 billion or 2.7 percentage points of GDP. This, together with pent-up demand, will support strong consumer spending, and premiumization trends in certain segments.

Credit metrics should reach 2019 levels by 2022. Diminishing COVID-19-related costs and efficiency measures should support recovery, as out-of-home activities, on-trade consumption, and discretionary sales recover.

What are the key risks around the baseline?

Uneven vaccine rollouts and new variants could impede a return to normal activity and global recovery.

Higher leverage on the back of a shift in financial policy. Large debt-financed mergers and acquisitions to capture growth, with a continued focus on shareholder returns, given improving outlooks and low financing costs, could increase leverage.

Though not our base case, the build-up in inflation is a risk. Headline inflationary pressures will rise this year due to higher energy prices and a rebound in commodity prices on restocking and higher activity. Smaller companies with leveraged capital structures will have limited flexibility if inflation remains persistent.

Latest Related Research

- Premium Alcohol Beverages Flow Generously Amid The Global On-Premise Dry Spell, May 26, 2021
- U.S. Menthol Ban Will Test Tobacco Companies' Preparedness For Future Restrictions, May 5, 2021

Industry Top Trends Update Europe

Health Care

Recovery is uneven and M&A may pressure rating headroom

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What's changed?

Diversified, innovative, and adaptive portfolios will be a differentiating factor for health care companies. Continued, and in some cases accelerated, investments into product and process innovations during the pandemic have supported top-line growth and market-share gains. Cost and cash management are also helping to protect margins and cash balances, shielding credit metrics from significant deterioration and preparing companies for growth post-pandemic.

Pricing and reimbursement are back on the agenda. As health care systems start to recover, unresolved risks regarding reimbursement are resurfacing. Public debate focuses on the accessibility and affordability of medicine and quality care, including price transparency. Ensuring wider patient access while improving therapies' cost effectiveness is increasingly a goal for companies, and sustainability strategies are evermore integrated into operational management.

Sustainability-linked instruments are on the rise. The post-pandemic period is an opportunity for companies to review their policies and protocols, implement new technology to improve care and supply chain management, and to define their sustainability strategies. Sustainability-linked financial instruments can help companies raise funds while highlighting their green or social commitments and reinforcing their sustainability strategy to investors, lenders, and the public.

How is recovery taking shape?

Products and services related to elective procedures were the hardest hit, but are slowly recovering. Europe is lagging the U.S. in recovery, also due to summer holidays, but we expect a pick-up in second-half 2021, depending on COVID-19-related hospitalization rates.

Pharma remains resilient. It faced some slower performance in new treatments and diagnosis, but is seeing growth as patients return and treatments resume.

Health care services has benefited from government support. In France, for instance, reimbursement will last at least for the next 18 months. Recovery in dialysis services, which saw high patient mortality from COVID-19, will take longer, and providers turned to restructuring measures to manage margin pressure.

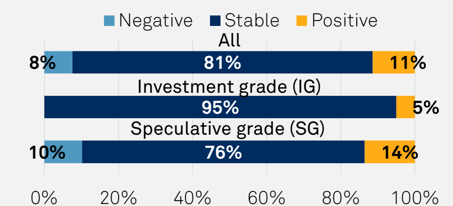
Diagnostic companies saw profits rise from COVID-19 testing, reflecting high demand and some favorable pricing. However, we expect this contribution to profits will materially decline in 2022, as the wider population gains immunity to COVID-19.

What are the key risks around the baseline?

M&A spending, as companies sit on significant cash balances and are taking advantage of favorable funding conditions. Increasing transaction volumes and high multiples are raising leverage and could pressure metrics and ratings.

Renewed debate around drug pricing and reform in the U.S. could hamper growth prospects for pharma companies over medium term.

Outlook Distribution



Ratings Statistics*

	IG	SG	All
Ratings	19	60	79
Downgrades	0	3	3
Upgrades	0	1	1

Ratings data as of end-June 2021. *Year to date.

COVID-19 Heat Map

Estimated Recovery To 2019 Credit Metrics

Health care - pharmaceuticals	No decline
Health care - services	2H 2021
Health care - equipment	2H 2021

Potential Neg. Long-Term Industry Disruption

Health care - pharmaceuticals	No
Health care - services	No
Health care - equipment	No

2020 Versus 2019

Revenue decline	EBITDA decline	Incremental borrowings
Health care - pharmaceuticals		
No decline	No decline	No Increase
Health care - services		
0%-5%	0%-10%	<5%
Health care - equipment		
10%-15%	15%-25%	<5%

2021 Estimates Versus 2019

Revenue decline	EBITDA decline
Health care - pharmaceuticals	
≥2019	≥2019
Health care - services	
≥2019	≥2019
Health care - equipment	
≥2019	≥2019

Latest Related Research

- European Hospitals Turn To Sustainability-Linked Financing To Advance Their ESG Goals, July 1, 2021
- EU's Vaccine Supply Boost Will Aid The Race Against COVID Mutations, April 28, 2021

Industry Top Trends Update Europe

Homebuilders and Developers

Solid demand and softer supply

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What's changed?

Pent-up demand and disposable income are supporting developers' sales and average selling prices. Prices are also bottoming out in the United Arab Emirates, after years of contraction, mostly thanks to international investors.

Demand for residential new builds is holding up, thanks to good access to mortgage loans, favorable funding conditions, and government stimuli. Many governments intervened through bulk purchases, tax incentives, and subsidized mortgages.

Supply is becoming constrained in several European markets, supporting prices but limiting developers' sales volume potential. In France, for example, the number of granted permits and construction starts contracted significantly this year.

How is recovery taking shape?

Developers' sales and EBITDA should approach 2019 levels by 2021. Some may be able to fully recover to pre-COVID-19 levels. By mid-2022, we expect most developers will surpass 2019 levels.

Leverage metrics should mostly recover to 2019 levels by 2021. This is due to solid cash flow generation and debt repayments, except in Russia where the use of project finance loans will likely constrain deleveraging efforts.

The increase in building costs will likely exert pressure on margins this year, given the lack of building materials and labor shortages. We think the pressure could carry into 2022, if the situation doesn't improve.

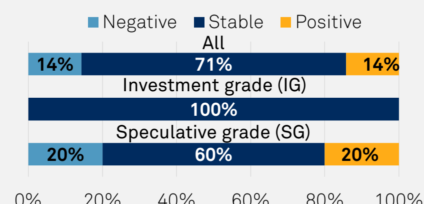
What are the key risks around the baseline?

Persistent cost inflation and lack of building materials. This would likely weigh on developers' margins and the pace of construction.

The premature end of government stimuli or an increase in property taxation. An abrupt ending of stimulus measures or higher tax could hamper demand for residential new builds.

Tighter lending conditions. Homebuilders operating in markets like France, Germany, and the U.K. rely heavily on mortgage sales. Moreover, limited access to capital by property developers could also hamper their ability to buy land.

Outlook Distribution



Ratings Statistics*

	IG	SG	All
Ratings	2	4	6
Downgrades	0	0	0
Upgrades	0	0	0

Ratings data as of end-June 2021. *Year to date.

COVID-19 Heat Map

Homebuilders And Developers	
Estimated recovery to 2019 credit metrics	2022
Potential negative long-term industry disruption	No

2020 Versus 2019		
Revenue decline	EBITDA decline	Incremental borrowings
5%-10%	10%-15%	5%-10%

2021 Estimates Versus 2019	
Revenue decline	EBITDA decline
0%-10%	0%-10%

Latest Related Research

- Russia's Housing Boom Isn't Likely To Burst—Or Bust, March 19, 2021
- Dubai's Property Market In 2021: A Tough Year On The Road To Recovery, March 1, 2021
- Industry Top Trends 2021: Homebuilders and Developers, Dec. 10, 2020

Industry Top Trends Update Europe

Hotels, Gaming, and Leisure

COVID-19-related restrictions remain the biggest threat

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What's changed?

The travel sector's recovery remains contingent on a gradual easing of government restrictions. We expect leisure travel will lead the sector recovery, while business travel will lag, and only recover to pre-pandemic levels by 2023.

Discretionary leisure has been hit hard. The pandemic hurt discretionary leisure businesses, such as theme parks and sports, the most. Governments' COVID-19-related restrictions continue to impair performance materially.

The gaming sector's performance is mixed. There is divergence in gaming companies' financial performance and recovery prospects. Online, diversified, and multiproduct operators have generally fared better.

How is recovery taking shape?

Leisure demand will drive the recovery for hotels and lodging. The near-term recovery will be spurred in particular by domestic tourism and short-haul/regional leisure demand, such as holiday parks and local theme parks. We expect regional economy and midscale hotels focused on business travelers from small and midsized companies will rebound faster than those in urban areas in luxury and upscale segments.

Discretionary leisure will be slow to recover. While there is pent-up demand for discretionary leisure spending, we expect continued travel restrictions and tentative consumer confidence will result in a gradual recovery beyond 2021.

The gaming sector will see faster recovery than the broader sector. Although recovery is uneven among players, we believe most gaming companies' credit metrics will have completely recovered by second-half 2022, ahead of and stronger than those of the broader sector.

What are the key risks around the baseline?

Longer-term restrictions. While we forecast a gradual sector recovery into 2022, further lockdowns are a material downside risk, for example from new virus strains. Longer-term restrictions related to social distancing and freedom of movement remain potential obstacles to a speedier recovery.

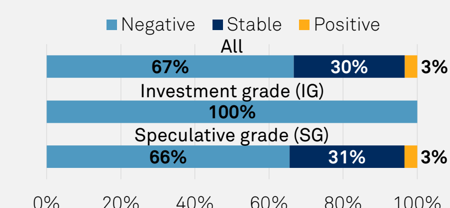
A slow recovery increasing default risk. About 60% of companies in our rated travel portfolio carry ratings in the CCC category. Many leisure companies added additional debt during the pandemic to bolster liquidity and survive the downturn. Resumption of demand and economic growth is critical to alleviate debt burdens. If recovery takes longer and 2022 is also a transition year, default rates could rise.

Regulation and mergers and acquisitions (M&A). The impact of gaming regulation developments in the U.K., Germany, and Italy could be material for some issuers. M&A are likely to remain a key factor in 2021, following continued consolidation and pursuit of the U.S. market opportunity.

Latest Related Research

- As European Hotels Grapple With Prolonged Restrictions, Are Operators And Landlords Sharing The Pain?, Feb. 24, 2021
- COVID-19 Heat Map: Pent-Up Demand And Supply Shortages Further Improve Recovery Prospects For Credit Quality, June 8, 2022

Outlook Distribution



Ratings Statistics*

	IG	SG	All
Ratings	1	30	31
Downgrades	0	3	3
Upgrades	0	1	1

Ratings data as of end-June 2021. *Year to date.

COVID-19 Heat Map

Estimated Recovery To 2019 Credit Metrics	
Gaming	2022
Lodging and hospitality	2023
Cruise lines	2023
Theme parks and other visitor attractions	2023
Potential Neg. Long-Term Industry Disruption	
Gaming	Yes
Lodging and hospitality	Yes
Cruise lines	Yes
Theme parks and other visitor attractions	No

2020 Versus 2019

Revenue decline	EBITDA decline	Incremental borrowings
Gaming		
25%-50%	40%-60%	5%-10%
Lodging and hospitality		
>50%	>60%	10%-25%
Cruise lines		
>50%	>60%	<5%
Theme park and other visitor attractions		
>50%	>60%	10%-25%

2021 Estimates Versus 2019

Revenue decline	EBITDA decline
Gaming	
10%-20%	20%-30%
Lodging and hospitality	
>50%	>50%
Cruise lines	
>50%	>50%
Theme parks and other visitor attractions	
40%-50%	>50%

Industry Top Trends Update Europe

Media and Entertainment

Recovery amid an accelerating shift to digital

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What's changed?

Most media companies are on track for recovery, thanks to the macroeconomic rebound, easing of COVID-19-related restrictions, and release of pent-up consumer demand. Subscription-based businesses, such as online service providers and data publishers, showed resilience in 2020 and steady organic growth in 2021. Some investment-grade issuers even strengthened their balance sheets during the pandemic, thanks to cost savings and lower shareholder returns.

The negative rating bias has reduced. Most companies are on course to restore credit metrics by 2022. We think liquidity and default risks have abated since 2020, even for issuers with high debt or tight liquidity and covenant headroom. Outlooks in the out-of-home (OOH) sector remain negative though, since operations only recently resumed and recovery may be bumpy.

Mergers and acquisitions (M&A) are on the rise, due to the media landscapes' fragmentation and the race to acquire and put out content. Similar to the U.S., we expect consolidation in Europe. This is supported by the recent merger announcement from France's top broadcasters TF1 and M6.

How is recovery taking shape?

Advertising is bouncing back. Revenue and earnings of ad agencies, TV broadcasters, as well as print and digital publishers will see strong recovery in 2021-2022. Total advertising revenue may reach 2019 levels in 2021 on the back of GDP growth, higher ad spending by corporations, rapid growth in digital advertising, and resumed sports events. Print and outdoor advertising will recover later in 2022.

Revenue in the OOH sector remains well below pre-pandemic levels. Cinemas have reopened, and sports events, concerts, trade shows and conferences are resuming, albeit at reduced capacity. We think the sector's recovery will gain pace in second-half 2021, but that revenue and earnings will reach 2019 levels only in 2022 and restoring credit metrics could take even longer.

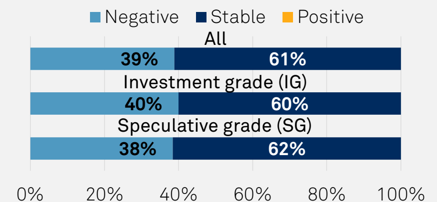
What are the key risks around the baseline?

Resurgence of the pandemic. A surge in COVID-19 cases could result in heightened restrictions and delay recovery, especially in the OOH sector. Some businesses may be unable to sustain or refinance existing capital structures.

Pressure on margins, especially in 2022. This could come from cost inflation from enhanced health and safety measures, rising wages, and competition for talent, for example in the advertising or content production industries.

Longer-term secular trends and a changing media ecosystem. Increasing audience fragmentation, expanding streaming options, and accelerating declines in traditional linear TV and print media will speed up the evolution to a streaming-centric and more digital media universe.

Outlook Distribution



Ratings Statistics*

	IG	SG	All
Ratings	10	27	37
Downgrades	0	1	1
Upgrades	0	2	2

Ratings data as of end-June 2021. *Year to date.

COVID-19 Heat Map

Media And Entertainment	
Estimated recovery to 2019 credit metrics	2022
Potential negative long-term industry disruption	Yes

2020 Versus 2019		
Revenue decline	EBITDA decline	Incremental borrowings
10%-15%	25%-40%	5%-10%

2021 Estimates Versus 2019	
Revenue decline	EBITDA decline
0%-10%	0%-10%

Latest Related Research

- All3 Media Parent DLG Acquisitions Outlook Revised To Stable On Production Recovery; 'B' Rating Affirmed, June 28, 2021
- Springer Nature Outlook Revised To Stable Following A Solid Operating Performance; 'B+' Rating Affirmed, June 24, 2021

Industry Top Trends Update Europe

Metals and Mining

A rising tide lifts all boats (until it turns)

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What's changed?

Demand is strong. Resilience in China and recovering activity across major economies, with rapid restocking, has reinforced the rebound in the metals and mining market that began in 2020.

Prices are supported by supply constraints and limited capacity increases. The lack of the new projects and producers of many minerals struggling to ramp up volumes to meet demand will support healthy prices in the coming years.

Environmental, social, and governance (ESG) is gaining importance. In light of rising public interest in sustainability, the availability and cost of funding are real factors for some projects. We may see more environmental initiatives as players benefit from stronger cash flows.

How is recovery taking shape?

Prices are rocketing. Iron ore and copper reached record prices in 2021, and even gold remains high in a historical context. Industrial metals are generally benefiting from market imbalances, even if restocking volumes moderate in 2021.

Steel is strong too. Steel product prices, at multiyear highs, and margins are benefiting from recovery in the automotive and construction sectors, and helped by the tentative return of product supply. High input costs are being passed on for now, although these may become a dampener on demand. Stimulus programs in the U.S. and Europe should provide medium-term demand.

Most players are maintaining financial and investment prudence, in contrast to previous cycles. Companies with investment-grade ratings are well positioned and some speculative-grade names have upside potential.

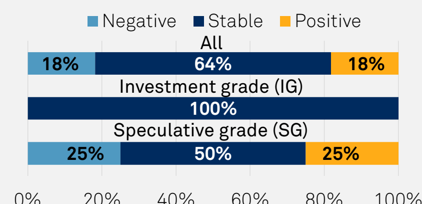
What are the key risks around the baseline?

Loss of financial restraint. A return of commitments to mega-projects, especially before an (inevitable) correction in prices and cash flow, could create a mismatch between cash flow from operations and commitments, leading to pressure on certain companies.

Shocks from China. A softening of actual demand or market expectations for China, the main economy for metals markets, would weaken a key support for prices. However, this is not our base case, at this stage.

Mismanagement of ESG. Individual credits could see an outsize impact, given the industry's inherent exposure to ESG risks.

Outlook Distribution



Ratings Statistics*

	IG	SG	All
Ratings	6	16	22
Downgrades	0	0	0
Upgrades	0	0	0

Ratings data as of end-June 2021. *Year to date.

COVID-19 Heat Map

Metals and Mining	
Estimated recovery to 2019 credit metrics	2021
Potential negative long-term industry disruption	No

2020 Versus 2019		
Revenue decline	EBITDA decline	Incremental borrowings
0%-5%	0%-10%	No increase

2021 Estimates Versus 2019	
Revenue decline	EBITDA decline
>2019	>2019

Latest Related Research

- Metal Price Assumptions: Prices Stay Hot, But No Signs Of A Melting Point, June 29 2021
- The Hydrogen Economy: Steel Producers Have A Long Way To Go, April 22, 2021
- Credit Conditions Europe Q3 2021: Late-Cycle Redux, June 29, 2021

Industry Top Trends Update Europe

Oil and Gas

The use of today's cash flow will impact future resilience

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What's changed?

Oil demand is rebounding. Underpinned by OPEC+ supply restraints, oil prices are enjoying a strong recovery. Even so, global demand may not return to 100 million barrels per day until late 2022.

Gas prices are up too. Annual average TTF prices for 2021 will likely be more than double the 2020 average of $3.2 million British thermal units, having sunk below U.S. Henry Hub prices at times in 2020.

Oil refining margins improved, but remain weak. Aggregate demand below 2019 levels and surplus refining capacity means margins remain pressured by low utilization and high input crude prices.

How is recovery taking shape?

Oil and gas producers are banking strong cash flows. The rebounding oil and gas prices with low costs and restrained capital expenditure (capex) are a dramatic reversal from 2020.

Producers remain prudent with regard to spending, for now. Capex is unlikely to jump in 2021, and will probably end the year comfortably inside companies' caps or guidance ranges.

With net debt down, financial policies will become more important. More cash means choices about how far to cut net debt, and how much to release to shareholders. We revised to stable our negative outlooks on some companies where we have visibility on sustainable debt and leverage profiles.

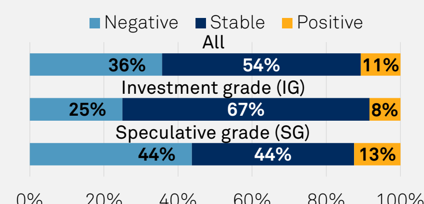
What are the key risks around the baseline?

Loss of market confidence. Oil prices are benefiting from expectations of a continued demand recovery and supply discipline. If COVID-19 become materially impactful or supply returns too rapidly, prices could soften.

Big capex plans for 2022. A more robust price outlook implies more investment options--in both oil and alternatives. Committing to big plans could become a burden if prices fall.

A U.S. shale rebound. Public companies are exhibiting operating and financial discipline, but if WTI oil remains at $70 per barrel investment and production growth could come back too fast for demand.

Outlook Distribution



Ratings Statistics*

	IG	SG	All
Ratings	12	18	30
Downgrades	2	3	5
Upgrades	0	5	5

Ratings data as of end-June 2021. *Year to date.

COVID-19 Heat Map

Oil And Gas	
Estimated recovery to 2019 credit metrics	2022
Potential negative long-term industry disruption	No

2020 Versus 2019		
Revenue decline	EBITDA decline	Incremental borrowings
25%-50%	40%-60%	<5%

2021 Estimates Versus 2019	
Revenue decline	EBITDA decline
10%-20%	10%-20%

Latest Related Research

- S&P Global Ratings Raises Short-Term Oil And Gas Price Assumptions On Improving Market Conditions, June 16, 2021
- Credit Conditions Europe Q3 2021: Late-Cycle Redux, June 29, 2021
- The ESG Winds Of Change Could Become A Tempest For Global Oil And Gas Producers, June 2, 2021

Industry Top Trends Update Europe

Real Estate (REITs)

Paving the way for renewed growth

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What's changed?

Shopping center reopenings are spuring rent recovery, after several waves of store closures and rent deferals. Following a 16% drop in rental income on average in 2020, the European REIT market is gradually improving, supported by the lifting of COVID-19-related restrictions, and surprisingly resilient rent uplifts on new leases in most countries.

Office rents and valuations are proving resilient. Office REITs' performance was broadly stable in 2020, despite low utilization rates and subdued leasing markets. Tenants and investors' preferences are becoming more visible, with grade-A, centrally located assets that have green credentials receiving the most interest.

The residential rental market remains robust. The pandemic had little effect on the German and Nordic residential markets, which exhibit high rent collection rates and low tenant defaults. The sector continues to attract investors, although rising environmental standards and cost of construction require higher capital expenditure.

Industrial and logistics enjoy strong demand from tenants and investors. With booming e-commerce, corporates' needs for logistic space largely outpaces supply.

How is recovery taking shape?

Retail REITs' revenue is likely to rebound only modestly (0%-5%) this year, with more pronounced recovery (5%-10%) in 2022. The lifting of COVID-19-related restrictions has been very gradual in 2021, and losses from deferred rent and additional vacancies will also weigh on performance this year.

Office rental growth should remain mostly flat until 2022, with declines in the low-single digits. Tenant demand should remain weak despite economic recovery as companies reevaluate their needs. That said, REITs' share of revenue at risk of vacancy or negative reversion remains modest at about 11% per year.

Most credit metrics should recover by 2022. While interest coverage has remained relatively strong, debt to EBITDA should recover to 2019 levels by 2022, thanks to lower investments and rising revenue. Debt to debt and equity should take slightly longer to recover, given limited revaluation prospects, but remain satisfactory.

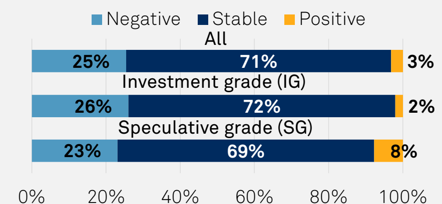
What are the key risks around the baseline?

Strong resurgence of COVID-19 cases and new restrictions on shopping centers. More social distancing measures would likely harm tenants' capacity to pay rent.

Debt-funded mergers and acquisitions. Given that REITs' shares trade at discount to their net asset value and funding conditions remain good, the consolidation trend is likely to continue, especially in the residential sector.

A harsher valuation correction than we currently expect. Most of our ratings can absorb a 5% value decline in 2021, but over 10% would likely trigger downgrades.

Outlook Distribution



Ratings Statistics*

	IG	SG	All
Ratings	47	12	59
Downgrades	2	0	2
Upgrades	2	0	2

Ratings data as of end-June 2021. *Year to date.

COVID-19 Heat Map

Real Estate (REITs)	
Estimated recovery to 2019 credit metrics	2022
Potential negative long-term industry disruption	Yes

2020 Versus 2019		
Revenue decline	EBITDA decline	Incremental borrowings
5%-10%	0%-10%	<5%

2021 Estimates Versus 2019	
Revenue decline	EBITDA decline
0%-10%	0%-10%

Latest Related Research

- SLIDES: EMEA Real Estate (REITs) Paving The Way For Renewed Growth, July 16, 2021
- European Office REITs Should Prove Resilient To A Gradual Decline In Tenant Demand, April 29, 2021

Industry Top Trends Update Europe

Retail and Restaurants

Poised to shake off the pandemic blues

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What's changed?

Retailers' have shown higher-than-anticipated resilience to extremely tough operating conditions. Most European retailers we rate have protected their balance sheets well through cost reduction and prudent financial management, despite a sharp drop in earnings. This has prompted many positive rating actions in recent months.

E-commerce accelerated rapidly, becoming a meaningful earnings driver. Retailers are investing heavily in technology, storage, and distribution to develop omnichannel capabilities. Margin dilution from online sales remains a concern for grocers, while nonfood retailers are less tolerant of loss-making stores.

The importance of sustainability has increased. The social and environmental agenda is gaining traction, with more focus on plastics reduction and sustainable supply chains. Demand for fresh, plant-based foods and organic produce is rising.

How is recovery taking shape?

Retail sales are picking up. Economic recovery, vaccination rollouts, and the release of pent-up demand following the reopening of nonessential stores will support a recovery in retailers' top lines.

Credit metrics should reach 2019 levels only by 2023 for many nonfood retailers. Factoring in the significant cash burn during store closures and the deferral of capital expenditure, we expect discretionary and nonessentials retailers, restaurants, and pubs to prioritize investment over deleveraging.

High levels of household savings should support consumption. European households accumulated excess savings of about 12 percentage points of disposable income in 2020 (€300 billion or 2.7 percentage points of GDP). This, together with pent-up demand, should support strong consumer spending.

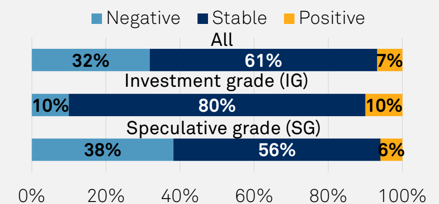
What are the key risks around the baseline?

Uneven vaccine rollouts and new variants could impede a return to normal activity and global economic recovery.

Though not our base case, the build-up in inflation is a risk. Headline inflationary pressures will rise this year, linked to higher energy prices and a rebound in commodity prices on restocking and higher activity levels. Competition will remain intense, but retailers with leveraged capital structures have limited promotional flexibility if inflation remains persistent.

Solvency issues remain acute for some retailers. Of our rated retail portfolio, 9% defaulted since the onset of the pandemic, and over 9% remain in the 'CCC' rating category. These retailers will struggle to capitalize on post-pandemic recovery due to strong competition, limited capital to invest in digital transformation, and high pre-COVID-19 leverage that the pandemic has only exacerbated.

Outlook Distribution



Ratings Statistics*

	IG	SG	All
Ratings	10	34	44
Downgrades	0	1	1
Upgrades	1	3	4

Ratings data as of end-June 2021. *Year to date.

COVID-19 Heat Map

Estimated Recovery To 2019 Credit Metrics	
Retail - essential/grocery	No decline
Retail - nonessential	2023
Retail - restaurants	2023
Potential Neg. Long-Term Industry Disruption	
Retail - essential/grocery	No
Retail - nonessential	Yes
Retail - restaurants	Yes

2020 Versus 2019

Revenue decline	EBITDA decline	Incremental borrowings
Retail - essential/grocery		
No decline	0%-10%	<5%
Retail - nonessential		
15%-25%	25%-40%	10%-25%
Retail - restaurants		
25%-50%	40%-60%	10%-25%

2021 Estimates Versus 2019

Revenue decline	EBITDA decline
Retail - essential/grocery	
≥2019	≥2019
Retail - nonessential	
0%-10%	10%-20%
Retail - restaurants	
10%-20%	20%-30%

Latest Related Research

- European Retailers Seek To Reopen Their Doors To Usher In The Post-Pandemic Recovery, June 29, 2021
- U.K. Pubs, Shaken And Stirred, Look To Recover After A Cocktail Of Headwinds, April 8, 2021

Industry Top Trends Update Europe

Telecommunications

Stable, but still searching for growth

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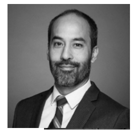


What's changed?

European telecoms are seeing a modest rebound. Most players posted relatively stable performance in 2020, with revenue dips of only 2%-3% on average. As such, the rebound has been small as markets recover from the economic impact of COVID-19. We forecast revenue growth of about 1% for 2021, mainly from fixed broadband.

The mobility segment was hit hard and will be slow to rebound. Mobility was the most affected as a result of lockdowns and a near-halting of travel. We don't expect a return to 2019 levels of business and international travel until 2023, leaving roaming mobility revenue suppressed for at least another year.

How is recovery taking shape?

Infrastructure investment is strong. We forecast sustained high investment in fiber and 5G rollouts over the next two-to-three years, averaging 18% of revenue. Fixed-line retail and wholesale may benefit as durable in-home broadband demand and greater fiber availability spurs customer upgrades. In mobile, however, we see low short-term commercial prospects for 5G until compelling use cases emerge.

Asset sales will continue. We expect more infrastructure sales, provided that well-managed tapering and only transitory inflation maintain buyer access to attractive capital markets. Operators pursuing tower sales benefit from high valuation proceeds that can improve balance sheets and financial flexibility, while fiber sales can push expensive rollouts off balance sheet.

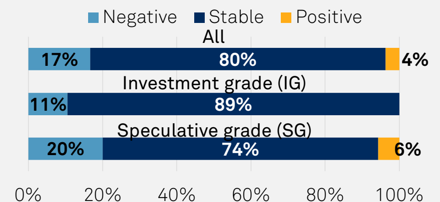
Government policy will likely remain supportive. Telecoms affirmed their services' strategic importance during the pandemic, and we expect governments will encourage robust infrastructure investment. This includes funds to accelerate digitization and infrastructure upgrades from EU Next Generation and national programs, relaxation of wholesale pricing controls, and possibly greater tolerance for consolidation through mergers and acquisitions.

What are the key risks around the baseline?

An uptick in competition. Competitive telecom markets like Italy and Spain could face weaker consumer prospects if high unemployment and low consumer spending raise demand elasticity. Low-price value challengers may have a window to increase market share, reigniting price competition after reduced churn rates amid the pandemic. This could impair operators' ability to pass on potential costs increases.

Delayed shocks from the pandemic. While not in our base case, a disruptive withdrawal of emergency support, like short-term work and furlough schemes, could unravel some of the cushions provided over the past year. This could particularly impact small and midsized enterprise demand for telecom services, which fared better than we expected during the pandemic.

Outlook Distribution



Ratings Statistics*

	IG	SG	All
Ratings	19	35	54
Downgrades	0	2	2
Upgrades	1	0	1

Ratings data as of end-June 2021. *Year to date.

COVID-19 Heat Map

Telecommunications		
Estimated recovery to 2019 credit metrics	2022	
Potential negative long-term industry disruption	No	
2020 Versus 2019		
Revenue decline	EBITDA decline	Incremental borrowings
0%-5%	0%-10%	<5%
2021 Estimates Versus 2019		
Revenue decline	EBITDA decline	
0%-10%	≥2019	

Latest Related Research

- Telecom Fiber Sales: Limited Financial Benefits And Big Credit Questions, Nov. 31, 2020
- The U.K. Telecoms Market Will Pick Up In 2021-2022 As Pandemic Headwinds Ease And Fiber Investments Accelerate, Dec. 10, 2020

Industry Top Trends Update Europe

Transportation

Airlines see slow traffic recovery, while shipping thrives

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What's changed?

European air travel is coming back, but sluggishly. Domestic and short-haul leisure travel will provide support, but a full recovery depends on long-haul and corporate traffic, which will take time to return. Stronger airlines tapped capital markets for fresh liquidity, while additional government support has poured in for vulnerable carriers. Much of it needs to be repaid though, resulting in more leveraged balance sheets and a longer path to recovery.

The global container shipping industry is flourishing. A strong pickup in e-commerce, consumer spending shifting to tangible goods from services, congestion in major maritime ports, and disruption of logistical supply chains is tying up containership capacity. Freight rates are reaching record highs as a result. We've taken numerous positive rating actions on container shipping companies we rate, and more are likely to follow.

Dry bulk trade rebounded quickly, and COVID-19-related disruptions lend support to shipping charter rates. New vessel deliveries will diminish, underpinned by the current all-time-low order book and marginal new ship ordering in the year to date. Simultaneously, China's imports of dry bulk commodities remain healthy.

How is recovery taking shape?

A meaningful rebound in air travel is delayed to after the lucrative summer season. Local travel restrictions amid new virus strains and uneven national vaccination rates have hampered air travel. European borders are gradually opening to vaccinated travelers, but the pace varies by country. Low-cost airlines and leisure carriers will be the first to recover, while the legacy carriers will take longer because they rely more on intercontinental and corporate traffic, which lags.

We see upside to container liners' 2021 earnings. Notwithstanding the recent spike in new ship orders, containership supply growth is unlikely to surpass firm demand growth in the coming quarters, propping up freight rates, which we forecast will gradually moderate from current record-highs from late 2021 at the earliest, as the pandemic's impact on container shipping eases.

Dry bulk shipping displays solid fundamentals, while oil shipping lags. The Chinese government's stimulus measures to prop up the country's economy amid the pandemic translate to a need for dry bulk commodities, such as iron ore. Meanwhile, global demand for minor bulk and grains is solidifying, and new ship supply growth is tightening. We expect 2021 tanker charter rates will lag 2020 levels, but remain profitable.

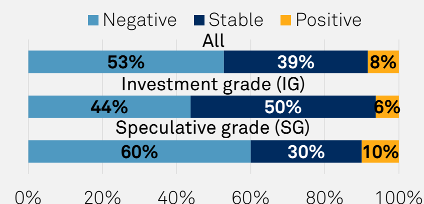
What are the key risks around the baseline?

Vaccine hesitancy and refusal disrupting a fragile recovery in air travel. A meaningful return to flying hinges on vaccination reaching critical mass and existing vaccines preventing serious illness and hospitalization. If unemployment continues to rise, consumers' willingness to travel will drop.

Elevated fuel prices persisting longer than we currently expect. This could disrupt the path to recovery for airlines and strong trading momentum for container liners as well as trim their profitability unless the cost inflation is successfully passed through to customers. Dry bulk ship and tanker operators are less exposed.

A surge in new builds threatening capacity utilization. Given the shipping sector's historically poor supply discipline, there is a risk that the ordering of new vessels intensifies, destabilizing improving supply-demand conditions in the medium term.

Outlook Distribution



Ratings Statistics*

	IG	SG	All
Ratings	16	22	38
Downgrades	0	2	2
Upgrades	2	5	7

Ratings data as of end-June 2021. *Year to date.

COVID-19 Heat Map

Transportation - Airlines	
Estimated recovery to 2019 credit metrics	>2024
Potential negative long-term industry disruption	Yes

2020 Versus 2019		
Revenue decline	EBITDA decline	Incremental borrowings
>50%	>60%	>25%

2021 Estimates Versus 2019	
Revenue decline	EBITDA decline
>50%	>50%

Transportation - Shipping	
Estimated recovery to 2019 credit metrics	No decline
Potential negative long-term industry disruption	--

2020 Estimates Versus 2019		
Revenue decline	EBITDA decline	Incremental borrowings
No decline	No decline	No increase

2021 Estimates Versus 2019	
Revenue decline	EBITDA decline
>2019	>2019

Industry Top Trends Update Europe

Transportation Infrastructure

The dual-track recovery shows a widening gap

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What's changed?

Variation in demand recovery across sectors has become more pronounced, with European airports and rail still the worst hit. These subsectors will likely post performance similar to or only slightly better than 2020 levels this year, despite large government support packages for rail and airports' continued spending cuts.

Toll road traffic is starting to converge with 2019 levels. This is fueling a strong appetite for mergers and acquisitions. Vinci place a bid for ACS Industries due to the appeal of its renewable generation pipeline, and Atlantia agreed to sell its Italian operation Autostrade Per L'Italia to a government-approved consortium.

EU-wide COVID-19 recovery plans and the Green Deal are supporting infrastructure investment. These could revive or start new projects aimed to improve the resilience and lower the climate impact of transportation.

How is recovery taking shape?

European airports remain in the doldrums. Despite a ramp-up in vaccinations and the rollout of digital COVID certificates in Europe, governments continue to take a cautious stance on cross-border travel due to new virus variants. Airport traffic at rated airports has been at just 10%-15% of 2019 levels, since the start of the year.

Toll roads and car parks show mixed results by country. As restrictions are lifted, road traffic has rebounded more quickly than other forms of transport, since people prefer cars to public transport for safety reasons.

Consumer spending and inflation are on the rise. We expect a boost to leisure trips as well as retail revenue at airports and rail stations. It remains to be seen if infrastructure companies will be able to pass on inflation to consumers, even if entitled to do so in their tariffs.

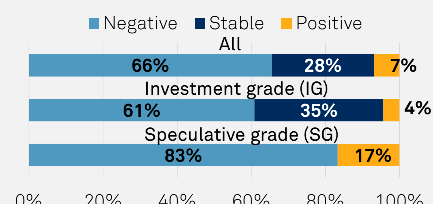
What are the key risks around the baseline?

Renewed pandemic-related restrictions could delay meaningful resumption of international travel to after the lucrative summer season, and present downside risk to air travel in Europe below our estimate of 30%-50% of 2019 levels in 2021.

The level of regulated tariffs for airports. A number of regulatory decisions are due for European airports by the end of 2021, and regulators will have a hard job reconciling the need to increase tariffs with the fragile traffic recovery.

Consumer behavior post-pandemic. Trains, roads, and car parks could see fewer commuters, but this could be partially offset by the continued stickiness of seasonal subscriptions.

Outlook Distribution



Ratings Statistics*

	IG	SG	All
Ratings	23	6	29
Downgrades	0	1	1
Upgrades	1	1	2

Ratings data as of end-June 2021. *Year to date.

COVID-19 Heat Map

Estimated Recovery To 2019 Credit Metrics	
Transport infra - toll roads	2022
Transport infra - airports	>2024

Potential Neg. Long-Term Industry Disruption	
Transport infra - toll roads	No
Transport infra - airports	Yes

2020 Versus 2019

	Revenue decline	EBITDA decline	Incremental Borrowings
Transport infra - toll roads	15%-25%	15%-25%	5%-10%
Transport infra - airports	>50%	>60%	>25%

2021 Estimates Versus 2019

	Revenue decline	EBITDA decline
Transport infra - toll roads	10%-20%	10%-20%
Transport infra - airports	>50%	>50%

Latest Related Research

- Moving On: Atlantia And Autostrade per l'Italia Plan A Divorce, May 26, 2021
- Another Stretch Year for Europe's Airports, March 22, 2021
- Europe's 2021 Air Passenger Traffic Likely To Stall At 30%-50% Of 2019 Level, Feb. 18, 2021

Industry Top Trends Update Europe

Utilities

It's all about the energy transition

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What's changed?

Climate regulation is accelerating. European energy transition policies are taking the form of enhanced national renewable targets, higher carbon-reduction goals, government subsidies, and the implementation of a European taxonomy for sustainable activities. The energy transition is becoming more concrete, with clearer price signals and legal frameworks, which is positive for the sector.

Carbon prices are at historical highs. Anticipation of stricter trading volumes led carbon prices to surge above €50 per ton in 2021 from about €25 over 2019-2020. This is expediting fuel switching away from the most polluting energy sources.

Annual investments will rise about 30% over 2020-2023. The top-25 European utilities plan to up investment in more defensive renewables and networks, which will slowly strengthen their business risk profiles, but tighten balance sheets.

How is recovery taking shape?

High power prices support power generators' earnings. This is underpinned by higher carbon prices, tightening of supply from nuclear and thermal plant closures, and economic recovery. European power prices almost doubled in first-half 2021 compared with 2020 levels, and baseload producers will benefit the most.

Power demand offers brighter prospects. We see improved growth prospects in Europe, thanks to economic recovery and the electrification of economies to reduce carbon emissions, particularly for heavy industries and heating. Growth in power purchase agreements could substitute subsidy schemes.

Debt financing remains attractive. The cost of debt remains low and the sector's attractiveness for green financing further compresses yields. We anticipate utilities will continue seizing (re)financing opportunities, particularly on hybrids.

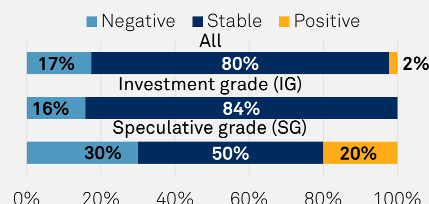
What are the key risks around the baseline?

Nuclear and gas remain in limbo. Uncertainties persist for European gas assets as growth prospects depend on EU taxonomy and technological progress on green gases. For nuclear, financing life extension and new projects remain complex.

Lower profitability from renewables. Tougher competition for new renewable projects combined with more risk appetite could weaken returns further. That said, the growth of investment opportunities and competitive advantage for market leaders mitigate these risks at least over the coming three years.

A squeeze in network remuneration. Recent regulatory reviews have led to a decline in remuneration for power and gas networks, at a time of significant investment need, especially for power. Operators' ability to cut costs, grasp bonuses, and adapt shareholder remuneration are key for rating stability.

Outlook Distribution



Ratings Statistics*

	IG	SG	All
Ratings	82	10	92
Downgrades	1	1	2
Upgrades	5	1	6

Ratings data as of end-June 2021. * Year to date.

COVID-19 Heat Map

Utilities	
Estimated recovery to 2019 credit metrics	2022
Potential negative long-term industry disruption	No

2020 Versus 2019		
Revenue decline	EBITDA decline	Incremental borrowings
0%-5%	0%-10%	<5%

2021 Estimates Versus 2019	
Revenue decline	EBITDA decline
0%-10%	0%-10%

Latest Related Research

- The Hydrogen Economy: Storage Is Paramount For Utilities In The Long Term, April 22, 2021
- The Energy Transition And The Diverging Credit Path For European Utilities, Feb. 16, 2021
- The Energy Transition And What It Means For European Power Prices And Producers: January 2021 Update, Jan. 27, 2021

Industry Top Trends Update North America

Aerospace and Defense

Commercial aerospace no longer losing altitude

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What's changed?

Commercial aerospace revenues and earnings begin to stabilize after large declines in 2020. Although demand for jetliners remains weak, aircraft manufacturers have largely reached planned lower production rates and further cuts are unlikely. Earnings and cash flow are also starting to benefit from cost-reduction efforts taken last year.

Key Boeing programs still having issues. After resuming 737 MAX deliveries in December 2020, Boeing had to temporarily halt production due to an electrical issue. Deliveries of the 787 paused in late 2020 due to quality issues, resumed briefly in 2021 but had to pause again in May pending regulatory approval of the fix.

The fiscal 2022 U.S. defense budget request supports near-term sales growth. Total spending budget is up 1.6%, with growth in R&D but lower procurement spending. So far, no major program cuts, but some spending priorities have shifted.

How is recovery taking shape?

Narrowbody demand to lead recovery. Higher domestic travel in the U.S. and other countries with high vaccination rates should support increasing production of narrowbody aircraft in 2022. Widebody production likely to remain weak until international travel restrictions dropped. As flying increases, demand for aftermarket parts and services should also grow.

Credit ratios for commercial aerospace firms will take a few years to recover. Despite likely increases in revenues and earnings over the next year, credit ratios are unlikely to reach 2019 levels until 2023 or later. However, this will vary based on a company's mix of commercial/military, OEM/aftermarket, and narrowbody/widebody sales.

Defense contractors should see steady or improving ratios. Few firms were materially affected by the pandemic and near-term demand remains solid. Growing earnings and cash flow could be offset by higher M&A or shareholder returns.

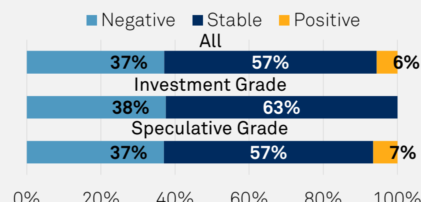
What are the key risks around the baseline?

New virus outbreaks disrupt air travel recovery. The recovery in air travel is already going to be very uneven around the world and outbreaks like in India could stall the improvement, perhaps leading to a renewed round of aircraft order cancellations or deferrals.

Further issues on the MAX or 787. An extended delay in receiving approval to resume 787 deliveries could result in further production cuts. Similarly, additional issues on the MAX could disrupt Boeing's plans for gradual production increases.

Supply chain issues slow recovery in build rates. Many suppliers took significant actions to reduce costs during the pandemic and may not have cash to invest in working capital to support higher rates. They may also have difficulty finding workers with the necessary skills or need to raise wages to attract employees.

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	8	47	55
Downgrades	2	5	7
Upgrades	1	2	3

Ratings data as of end-June, 2021

COVID-19 Heat Map

Commercial Aerospace		
Estimated Recovery To 2019 Credit Metrics	>2023	
Potential Negative Long-Term Industry Disruption	Yes	
2020 v. 2019		
Revenue Decline	EBITDA Decline	Incremental Borrowings
25% to 50%	40% to 60%	10% to 25%
2021 Estimates v. 2019		
Revenue Decline	EBITDA Decline	
30% to 40%	30% to 40%	

Defense Contractors		
Estimated Recovery To 2019 Credit Metrics	No decline	
Potential Negative Long-Term Industry Disruption	Yes	
2020 v. 2019		
Revenue Decline	EBITDA Decline	Incremental Borrowings
No decline	No decline	No increase
2021 Estimates v. 2019		
Revenue Decline	EBITDA Decline	
>2019	>2019	

Industry Top Trends Update North America

Autos

Pent-up demand, strong pricing will limit downside risks

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What's changed?

Modest pressure on auto sales forecasts. Despite strong demand, we expect some pressure on volume recovery compared with our 2021 base case (14%-16% improvement from 2020) because of the combined impact of electronic components shortage (chips) and unexpected supply-chain disruptions in 2021.

Supply chain disruptions will delay improvement. Semiconductor-related chip shortages continues to hamper supply, which will lead to a significant cash flow burn in the second quarter and delay recovery in cash flow adequacy metrics by up to six months to mid-2022.

Upside from electric vehicles (EVs). The Biden administration announced a $174 billion commitment to accelerate EV deployment, including point-of-sale rebates, tax incentives, and 500,000 chargers by 2030. As a result, EV sales could exceed our base-case of 10% of U.S. light vehicle sales by 2025 (versus barely 2% in 2020).

How is recovery taking shape?

Volumes will recover by late 2023. The outlook is improving, but we expect annual U.S. light vehicle sales to remain below 2019 levels through 2023. The global semiconductor shortage will likely cut into 2021 production levels. This still supports our recovery assumption for 2023.

Profits benefit from strong prices. Our 2021 and 2022 EBITDA estimates are not severely affected because higher prices on more profitable light trucks will support pricing and partially offset the current demand/supply imbalance. The impact of inflation (chip shortages and rising metal prices) will be transitory.

Credit metrics should stabilize to pre-pandemic levels by 2023. Most issuers will look to preserve liquidity, maintain prudence on reinstating dividends, and limit large debt-financed acquisitions.

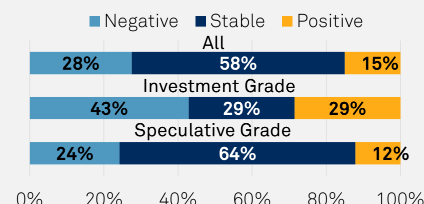
What are the key risks around the baseline?

Higher commodity, freight, and labor costs. If the current inflationary phase is not transitory (extends beyond mid-2022) it could be difficult to pass through higher costs to customers in 2022. If inflation does not normalize by mid-2022 it could limit stable outlooks and add downside risks to several ratings.

Economic headwinds. New virus strains, rising gas prices, or slowing housing starts could keep consumers cautious and curtail automotive demand recovery.

Electrification is a risk for market positions and cash flows. Traditional automakers (Ford, GM) will reduce the EV market share gap versus Tesla but battery costs will remain a challenge. If EV adoption exceeds our base case by 2025, aggressive model launches will add headwinds for traditional automakers' profits and for several powertrain-focused auto suppliers' volumes.

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	7	33	40
Downgrades	0	0	0
Upgrades	0	7	7

Ratings data as of end-June, 2021

COVID-19 Heat Map

Automotive	
Estimated Recovery To 2019 Credit Metrics	2023
Potential Negative Long-Term Industry Disruption	--

2020 v. 2019		
Revenue Decline	EBITDA Decline	Incremental Borrowings
15% to 25%	25% to 40%	10% to 25%

2021 Estimates v. 2019	
Revenue Decline	EBITDA Decline
10% to 20%	10% to 20%

Latest Related Research

- High-Flying Battery Makers Have Much To Win And Lose, June 20, 2021
- Global Heavy Truck Sales Forecasts: Declines in APAC Offset Growth in U.S And EMEA, June 10, 2021
- Global Auto Sales Forecasts: The Recovery Gears Up, May 11, 2021

Industry Top Trends Update North America

Building Materials

A revenue boom faces higher costs

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What's changed?

Building and renovation are on a roll. Strong revenue growth in 2021 faces some margin pressure from higher costs because many companies in the sector rely on the ability to pass through volatile commodity costs for their earnings.

A busy first half will likely pay off in the latter half of the year. Working capital is typically a use of cash in the first half of the year before releasing cash later in the year. The record commodity prices so far this year could exaggerate this volatility.

Infrastructure plans will likely benefit building materials. Even if the proposed programs are not purely building-related (i.e. health and climate rather than roads and bridges), this sector is well positioned for above-trend growth given the constant demand from economic expansion and the pent-up demand from aging hard assets like homes.

How is the recovery taking shape?

Pandemic-induced home spending adds to a decade of good growth. Revenues bounced back quickly in 2020, thus we expect underlying profits to continue to benefit from a strong revenue performance.

Stronger fundamentals will likely enable deleveraging from earnings. The trajectory of credit quality will depend on financial priorities. Some manufacturers are investing to expand production while financial sponsors are using the unprecedented access to the debt markets to fund dividends from leveraged credits.

Financial policies predominate. Issuers across the ratings spectrum face a range of capital options over the next several years. The prospects for mergers and acquisitions (M&A) are elevated given the high degree of fragmentation, which many aim to consolidate, a generational change in ownership for small companies, and ambitious activity by financial sponsors.

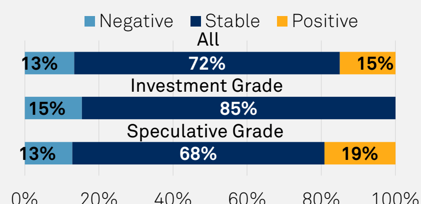
What are the key risks around the baseline?

Revenues reverse pandemic surge while costs stay high. Most issuers point to a pass-through model for commodity inputs, which buffers the largest portion of any cost increase. Margins could be squeezed if throughput is constrained and conversion costs escalate for labor costs and availability due to supply chain disruptions, trade friction, and higher freight costs.

Financial sponsors consume much of the credit buffer. The credit measures of the riskiest cohort of credits have worsened significantly, leading to downgrades, as financial sponsors tap the debt markets to pull cash from entities in regular strategic transition to fund M&A or sponsor ownership changes.

Low-rated debt could increase default risks down the road. Issuer downgrades and the volume of new 'CCC'-rated unsecured debt have increased markedly in 2021. Several of these companies were leveraged buyouts (LBOs) that defaulted before the financial crisis in 2008-2009.

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	13	47	60
Downgrades	0	6	6
Upgrades	1	3	4

Ratings data as of end-June, 2021

COVID-19 Heat Map

Building Materials	
Estimated Recovery To 2019 Credit Metrics	2H 2021
Potential Negative Long-Term Industry Disruption	--

2020 v. 2019		
Revenue Decline	**EBITDA Decline**	**Incremental Borrowings**
0% to 5%	0% to 10%	No increase

2021 Estimates v. 2019	
Revenue Decline	**EBITDA Decline**
>2019	>2019

Industry Top Trends Update North America

Capital Goods

As end markets recover, cost inflation risk rises

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What's changed?

Faster-than expected demand recovery after COVID disruption. Industrial demand is reviving, driven by economic and end-market recovery. Manufacturing activity in the U.S. remains expansionary at 60.6 in June vs. 52.6 a year ago.

Supply chain headwinds could dampen margin recovery. Cost inflation could be meaningful (particularly for raw materials, labor, and freight), but we think rated issuers can pass on higher costs given the improving demand. Companies are also increasing their supply base and building inventory to manage these headwinds. Rising costs could drag margin recovery, but EBITDA recovery should get closer to 2019 levels in 2021.

Moderating negative rating bias. Rating actions in 2021 have swung between positive and negative. We expect the negative rating bias to ease from 23% in the second half of 2021 as credit metrics improve. We had more upgrades than downgrades in 2021, mostly at the low end of the rating spectrum.

How is recovery taking shape?

Recovery across end markets. As economic recovery accelerates, we expect inventory restocking and higher customer capex. This should lead to revenue growth in the mid- to high-single-digit range in 2021, approaching 2019 levels. The recovery in commercial aerospace and oil & gas end markets could lag, delaying improvement for some issuers.

Profitability growth. We expect overall EBITDA margin to improve after the decline in 2020, driven by higher volumes, benefit of prior cost cuts, and the ability to pass on cost increases. We think the cost increases are temporary until supply chains normalize. Higher working capital and capex could dampen free cash flow to some extent.

Credit metrics should reach 2019 levels by 2022. Credit metrics recovery should support greater rating stability in the rest of 2021 and ease negative ratings bias. Improving cash flow should also alleviate liquidity pressure for issuers in the 'CCC' and 'B' categories.

What are the key risks around the baseline?

Weak recovery in global markets. Many diversified industrials are exposed to global markets. New strains of COVID could result in regional lockdowns that hamper the economic recovery.

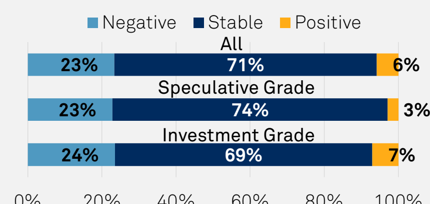
Weaker ability to pass on cost increases. Persistent inflation and lingering cost increases into 2022, coupled with weaker demand, could lead to meaningful margin pressure, particularly if supply chain disruption is prolonged.

Shifts in financial policy could add ratings pressure. We expect an increase in M&A or share repurchases given improving outlook and low financing costs. Meaningful debt-financed M&A or share repurchases could drive lower ratings or outlook revisions despite an improving operating environment.

Latest Related Research

- Capital Goods Sector 2021: Credit Quality Is Stabilizing, March 2, 2021

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	35	86	121
Downgrades	0	4	4
Upgrades	0	11	11

Ratings data as of end-June, 2021

COVID-19 Heat Map

Capital Goods		
Estimated Recovery To 2019 Credit Metrics	2022	
Potential Negative Long-Term Industry Disruption	--	
2020 v. 2019		
Revenue Decline	**EBITDA Decline**	**Incremental Borrowings**
10% to 15%	15% to 25%	<5%
2021 Estimates v. 2019		
Revenue Decline	**EBITDA Decline**	
0% to 10%	10% to 20%	

Industry Top Trends Update North America

Chemicals

Credit quality rebounds

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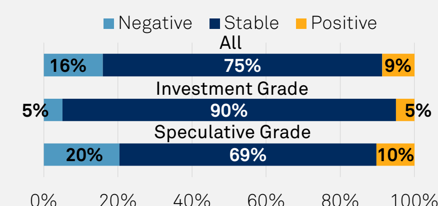
Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	20	51	71
Downgrades	0	1	1
Upgrades	6	11	17

Ratings data as of end-June, 2021

COVID-19 Heat Map

Chemicals		
Estimated Recovery To 2019 Credit Metrics	2H 2021	
Potential Negative Long-Term Industry Disruption	--	
2020 v. 2019		
Revenue Decline	**EBITDA Decline**	**Incremental Borrowings**
5% to 10%	15% to 25%	<5%
2021 Estimates v. 2019		
Revenue Decline	**EBITDA Decline**	
0% to 10%	0% to 10%	

What's changed?

Demand bounces back. Global demand for most chemicals continues to rebound from last year's levels, benefitting from recovering end markets, consumer spending, and economies. We anticipate demand for commodity and specialty chemicals will remain strong throughout the year.

Rising, but manageable, input cost pressure. Costs for several chemical inputs including base chemical input such as ethylene and propylene, have increased, and are likely to remain high or rise further. However, a favorable demand environment makes it easier for chemical producers to pass on cost increases.

Improved pricing/margin environment. Prices for some chemicals, especially commodity chemicals, have increased to levels that are higher than input cost increases. This pricing environment is shaped in part by first-half 2021 supply shortages for some chemicals caused by adverse weather in some domestic manufacturing locations.

How is recovery taking shape?

Mixed pace of earnings recovery. We expect many companies will achieve or exceed pre-pandemic 2019 EBITDA this year, with earnings for some subsectors—including petrochemicals and fertilizers—resembling peak-cycle levels. Earnings at other companies will recover more slowly, impeded, in part, by less favorable underlying market conditions or company specific factors.

Strengthening credit metrics. Although first-quarter 2021 earnings for many companies were impaired by unexpected weather-related events, we see potential for stronger credit metrics over the next few quarters. Company-specific factors will influence the sustainability of this improvement beyond the current year.

Outlooks are mainly stable. A vast majority of North American outlooks—approximately three-quarters—are stable. Our outlooks reflect our view that the recovery is well under way, but that some of the extraordinary commodity price run-ups are prone to volatility, which is characteristic of the sector.

What are the key risks around the baseline?

Financial policy. Following a year of subdued acquisitions and share buybacks, companies may ramp up growth opportunities and shareholder rewards. While operating results this year will support strengthening credit metrics, an aggressive financial policy might offset—or even set back—improvements.

Macroeconomic setbacks. Unexpected slowdowns in economic activity or end markets, or a flare up of trade related uncertainties that dampened chemical demand in 2019, could influence credit quality.

Oversupply. Although an oversupply situation might seem improbable now, a year of strong earnings and cash flows and increased optimism about future demand could raise prospects for future supply increases domestically or globally. This is a greater risk for commodity chemicals.

Industry Top Trends Update North America

Consumer Products

A gradual return to normalcy

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What's changed?

Demand for consumer staples is reversing. Packaged food, household products, and personal care companies' revenue growth is declining as companies lap outsized results from increased consumption and pantry loading. At-home food consumption remains above pre-pandemic levels but will continue to moderate as food away from home returns. Ratings and outlooks remain stable given significant leverage reduction that occurred largely because of EBITDA growth.

Durables, apparel, cosmetics, and food service distribution recovered quickly. These discretionary sectors were disrupted during the pandemic because of plant, retail, and restaurant closures. We have reversed negative rating actions we took last year, given the quicker-than-expected recovery driven by demand for home-related goods and the economic reopening.

New consumer behaviors are likely to stick beyond the pandemic. Consumers chose brands they trusted, increased e-commerce purchases, adopted more pets, worked at home, ate at home, invested in their homes, focused on health and wellness, and allowed themselves to snack and indulge in premium products. We believe many of these behaviors will remain, with variation by region, category, and channel.

How is recovery taking shape?

Consumer staples are up against tough comparisons. These companies experienced outsized demand during the height of the pandemic. Revenue in 2021 will be higher than 2019 but lower than 2020 as companies lap extraordinary quarters. In 2022, we expect organic growth to return to at least 1%-3%.

Recovery for consumer discretionary products exceeded our expectations. During the second half of 2020, consumer durables experienced substantial growth because of increased spending on home goods. We believe growth will moderate in the second half of 2021 into 2022. In apparel and cosmetics, we expect continued recovery in 2021 and 2022 as consumer mobility increases.

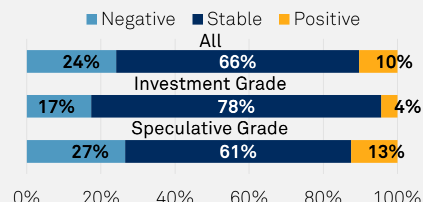
What are the key risks around the baseline?

Input, labor, freight, and transportation costs are higher. Historically, companies have been able to offset inflation with pricing actions and/or productivity initiatives. However, pricing actions and supply chain disruptions could result in lower demand or loss of market share to private label. The inability to offset inflation, coupled with lower demand than in 2020, could hurt profitability.

Coronavirus variants could emerge. While we believe a broad-based lockdown is unlikely, localized outbreaks could dampen recent positive trends for consumer discretionary companies and away-from-home consumption, but benefit staples.

Aggressive financial policies could pressure credit measures. During the height of the pandemic, many companies focused on enhancing liquidity. Since then, consumer staples issuers have resumed mergers and acquisitions (M&A) and shareholder returns. We believe the risk that the extra liquidity could be used for M&A is modest because we expect most issuers to focus internally after a challenging 2020, and for transactions to be small.

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	46	128	174
Downgrades	0	6	6
Upgrades	0	16	16

Ratings data as of end-June, 2021

COVID-19 Heat Map

Consumer Staples		
Estimated Recovery To 2019 Credit Metrics	No decline	
Potential Negative Long-Term Industry Disruption	--	
2020 v. 2019		
Revenue Decline	EBITDA Decline	Incremental Borrowings
No decline	No decline	No increase
2021 Estimates v. 2019		
Revenue Decline	EBITDA Decline	
≥2019	≥2019	

Consumer Discretionary		
Estimated Recovery To 2019 Credit Metrics	2022	
Potential Negative Long-Term Industry Disruption	--	
2020 v. 2019		
Revenue Decline	EBITDA Decline	Incremental Borrowings
10% to 15%	15% to 25%	5% to 10%
2021 Estimates v. 2019		
Revenue Decline	EBITDA Decline	
0% to 20%	0% to 20%	

Industry Top Trends Update North America

Health Care

Positive rating actions likely to outpace negative ones in 2H

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What's changed?

Accelerated pace of disruption post-pandemic. We project mid-single-digit percent growth for the industry post-pandemic. However, the pandemic has accelerated various industry changes, such as the use of telehealth, homecare delivery, and value-based care. How permanent these shifts are will have longer-term implications for the industry and individual players.

Improved operating performance is driving the net positive rating actions. We took 44 positive rating actions on the U.S. health care sector in the first half of 2021 versus only 13 negative actions, a dramatic reversal from the net negative actions in recent years. This shift reflects both recovery from declines that had prompted negative rating actions last year and improved operating performance.

The sustainability of cost savings is uncertain. Contributing to the improved operating performance was companies' cost-cutting and increased efficiency during the pandemic. The question is how sustainable these cost savings are.

How is recovery taking shape?

All health care subsectors largely recovered by the end of 2020. Patient and procedure volumes in many areas are within 5%-10% of pre-pandemic levels. The largely successful vaccination program has lowered infection and hospitalization rates, lessening strain on health care systems and providers. As a result, we project credit metrics will be largely restored by year-end 2021.

We expect COVID-19-related tailwinds to gradually subside. Pandemic-related tailwinds for select players—in the life science, medical products, and diagnostic industries—will gradually subside in the second half of the year. How aggressively companies reinvest the windfall in the form of M&A will affect ratings.

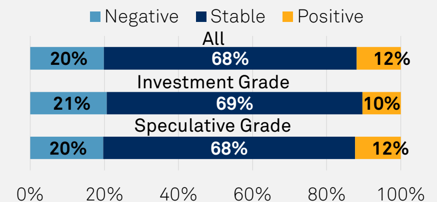
What are the key risks around the baseline?

Heightened pressure to control health care costs. U.S. health care spending was projected to grow at 5.3% pre-pandemic, and while spending likely declined in 2020, it will resume its ascent in 2021 and beyond. With President Biden's initiatives on the pandemic, unemployment, and infrastructure largely revealed, health care is likely next on the agenda.

Pharma will receive increased focus. Despite the political divide in Washington, pharmaceutical pricing reform continues to have bipartisan support. Legislative moves could have an impact on the industry.

Merger and acquisition activity resumes. Health care M&A, heavy in recent years as industry players sought to improve their competitive positions in the increasingly disrupted industry, has largely resumed. This started in the third quarter of 2020 for pharma and medical devices and in 2021 for the services sector. Given high valuations, credit metrics will likely be stressed despite the improving operating performance, leading to pressure on ratings.

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	29	123	152
Downgrades	1	0	1
Upgrades	2	11	13

Ratings data as of end-June, 2021

COVID-19 Heat Map

Estimated Recovery To 2019 Credit Metrics	
Health care - Pharmaceuticals	1H 2021
Health care - Medical Products	1H 2021
Health care - Services	2H 2021
Potential Neg. Long-Term Industry Disruption	
Healthcare - Pharmaceuticals	--
Healthcare - Medical Products	--
Healthcare - Services	Yes

2020 v. 2019		
Revenue Decline	EBITDA Decline	Incremental Borrowings
Health care - Pharmaceuticals		
0% to 5%	0% to 10%	No increase
Health care - Medical Products		
0% to 5%	0% to 10%	No increase
Health care - Services		
10% to 15%	10% to 15%	5% to 10%

2021 Estimates v. 2019	
Revenue Decline	EBITDA Decline
Health care - Pharmaceuticals	
≥2019	≥2019
Health care - Medical Products	
≥2019	≥2019
Health care - Services	
0% to 10%	0% to 10%

Latest Related Research

– The Health Care Credit Beat: U.S. Economic Recovery Doesn't Have to Follow Herd Immunity, June 11, 2021

Industry Top Trends Update North America

Homebuilders and Developers

U.S. homebuilders use boom to improve credit quality

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What's changed?

We expanded the number of investment-grade companies. We raised three ratings to investment grade in 2021 for a total of five issuers, or 19% of the companies we rate. Lower debt levels and strong profits underpin a return to investment grade a decade after the U.S. housing crisis.

Pricing power outstrips higher input costs so far. Lumber prices skyrocketed during the pandemic, adding to elevated land and labor costs, but new home prices to date have offset this. Lumber is 50% off its high in 2021 but remains near a multiyear high.

Increased digitization of the homebuying process. Slower foot traffic and a potentially slower closing process because of social distancing has accelerated the digitization of homebuying, enabling better sales conversion from more-serious buyers and potentially lower costs.

How is recovery taking shape?

We maintain a positive outlook bias. We have a positive outlook on about 19% of issuers in the U.S. homebuilder industry because financial discipline before and during the pandemic has yielded stronger ratios and a growing credit buffer.

Industry fundamentals look attractive. The industry benefits from good long-term demand, stronger pricing amid tight supply, record-low mortgage rates, good cost management, and judicious capital allocation.

More upgrades expected over the next 12 months. We expect most homebuilder ratings to hold steady for the remainder of the year, but the upward bias among lower-rated issuers and moderate downside risks indicates a few more upgrades.

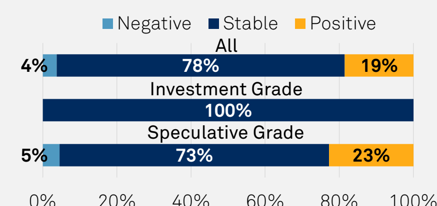
What are the key risks around the baseline?

Higher mortgage rates. A rise in mortgage rates off record lows could sap the important price growth that has sustained margins amid higher costs and an industrywide shift to lower price points.

House prices appreciate more than wage growth. The supply/demand imbalance has caused greater home price appreciation than expected. As this occurs, first-time/entry-level homebuyers could get priced out of the market.

Construction pace slows to limit sales to the amount that can be built. Construction pace is limited by high lumber costs, materials bottlenecks, and a shortage of land and labor. Some builders are responding to the demand by limiting sales to ensure they don't sell more homes than they can construct at one time.

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	5	22	27
Downgrades	0	0	0
Upgrades	3	5	8

Ratings data as of end-June, 2021

COVID-19 Heat Map

Homebuilders & Developers	
Estimated Recovery To 2019 Credit Metrics	No decline
Potential Negative Long-Term Industry Disruption	--

2020 v. 2019		
Revenue Decline	EBITDA Decline	Incremental Borrowings
No decline	No decline	No increase

2021 Estimates v. 2019	
Revenue Decline	EBITDA Decline
>2019	>2019

Latest Related Research

- Peer Comparison: Built To Last? Several U.S. Homebuilders Lay The Foundations For Investment Grade, April 1, 2021
- Lennar Corp. Upgraded To 'BBB-' From 'BB+' On Robust Multiyear Performance And Lower Debt; Outlook Stable, June 9, 2021

Industry Top Trends Update North America

Hotels, Gaming, and Leisure

Dawn arrives, but with a long, painful recovery for some

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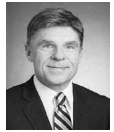

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What's changed?

U.S. RevPAR could be modestly better in 2021. We believe 2021 U.S. revenue per available room (RevPAR) could be slightly better than we had assumed earlier in the year—25% to 35% below 2019—because of a surge in leisure travel and demand for lower-priced hotels that is currently trending better than 2019. Higher-priced full-service hotels lag significantly but should take off this fall.

Las Vegas' recovery is underway. Pent-up demand for leisure travel is accelerating the market's recovery despite limited conventions and international visitors. A return of these travelers should benefit 2022 and help smooth any pullback in leisure travel.

Strong U.S. regional theme park attendance. If out-of-home (OOH) entertainment trends are sustained through the summer, attendance at the nation's theme parks could be significantly better than assumed just a few months ago.

How is recovery taking shape?

Pent-up leisure demand. The demand surge in hospitality and OOH entertainment will not last at these levels when employees return to office and kids to school. While we believe business and group travel will recover faster starting in the autumn, it will need time to ramp up and may not totally offset the leisure lull.

Regional gaming could face some margin pressure. Regional gaming operators are enjoying stronger margins and cash flows due to cost cuts, even at lower revenue. But some costs, like marketing and labor, may return closer to 2019 levels as other travel and entertainment options fully reopen and compete for consumers' discretionary income.

U.S. cruising resumes. Cruises are gradually restarting but it will be a while before all ships are back in service and occupancy grows. It will likely take years for operators to dig out from the extraordinary debt incurred to survive the pandemic.

What are the key risks around the baseline?

Financial policy decisions. A more aggressive financial policy toward mergers and acquisitions or the resumption of shareholder returns could slow a recovery in credit measures, especially with accommodating capital markets.

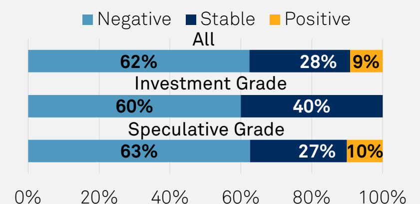
Virus variants. A virus strain that renders vaccines less effective or causes a significant spike in cases among the unvaccinated could slow the travel recovery by diminishing consumers' confidence in leisure travel, delaying the resumption of business and group travel, and possibly leading to additional regulatory headwinds for cruise lines.

Surviving fitness operators invest. Despite very high leverage, fitness operators plan to invest in new clubs to increase share instead of repaying debt issued during the pandemic. All fitness ratings remain in the 'CCC' category.

Latest Related Research

- U.S. Lodging Might Be Reaching An Inflection Point On The Path To Recovery, May 11, 2021
- U.S. Travel Industry's Recovery Is On Standby, April 28, 2021

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	10	100	110
Downgrades	1	6	7
Upgrades	0	16	16

Ratings data as of end-June, 2021

COVID-19 Heat Map

Estimated Recovery To 2019 Credit Metrics	
Fitness	2023
Gaming	2022
Hotels	2023
Cruise	>2023

Potential Neg. Long-Term Industry Disruption	
Fitness	Yes
Gaming	--
Hotels	Yes
Cruise	Yes

2020 v. 2019		
Revenue Decline	EBITDA Decline	Incremental Borrowings
Fitness		
25% to 50%	>60%	10% to 25%
Gaming		
25% to 50%	40% to 60%	10% to 25%
Hotels		
25% to 50%	>60%	10% to 25%
Cruise		
>50%	>60%	>25%

2021 Estimates v. 2019	
Revenue Decline	EBITDA Decline
Fitness	
30% to 40%	40% to 50%
Gaming	
10% to 20%	10% to 20%
Hotels	
25% to 35%	40% to 50%
Cruise	
>50%	>50%

Industry Top Trends Update North America

Media and Entertainment

Pandemic in the rearview mirror, secular trends in focus

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What's changed?

Rating activity is skewing positive. The U.S. economy's recovery has accelerated, supported by government stimulus, and widespread vaccination, allowing markets to reopen. Positive rating actions have exceeded negative actions by 3:1.

Out-of-home (OOH) entertainment is starting to show signs of recovery. Live events, theme parks, film and TV studios, and movie exhibitors are continuing to ramp up operations as government-imposed capacity restrictions ease, although revenues will not likely return to pre-pandemic levels before 2022 at the earliest.

M&A activity has picked up. Companies are bolstering content offerings to increase subscribers on their owned streaming services. Pending transactions include Discovery/WarnerMedia, Amazon/MGM, and Univision/Televisa's media assets.

Secular trends are front and center. As the direct impact from the pandemic recedes, focus has returned to pre-pandemic concerns, including worsening decline in linear TV, faster shifts in advertising, ongoing elevated spending on content, and increased competition among streaming services.

How is recovery taking shape?

OOH entertainment is recovering fast. Demand at OOH venues is strong as governments and local municipalities relax/end restrictions. Concerns about a COVID resurgence/new variants are not affecting consumer behavior significantly.

Advertising-dependent sectors rebound. We've seen 8.8% growth in ad spending in 2021, although recovery is uneven across sectors. Digital advertising growth remains robust. TV and billboard advertising should return to 2019 levels in 2021. Radio and transit advertising will take longer to recover.

Credit metrics are recovering; ratings may not. While revenues could generally return to 2019 levels by 2022, secular trends unleashed/accelerated by the pandemic may delay rating recoveries for many companies, especially those that borrowed to bolster liquidity while generating little to no cash flow.

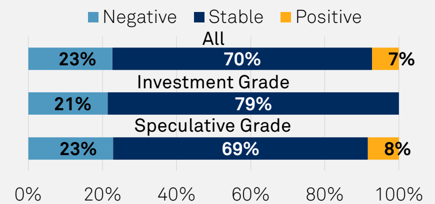
What are the key risks around the baseline?

A slowdown in economic growth. A third COVID wave that leads to an economic pullback would hurt recovery of advertising-dependent sectors.

Accelerating secular trends. Fragmenting audiences and shifts in advertising toward digital platforms may accelerate, increasing pressures on legacy media.

Debt repayment is not prioritized. Companies with elevated leverage prioritize cash balances toward investments, acquisitions, or shareholder returns rather than debt repayment, delaying the return to pre-pandemic credit measures.

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	14	96	110
Downgrades	0	4	4
Upgrades	0	12	12

Ratings data as of end-June, 2021

COVID-19 Heat Map

Ad Supported Media		
Estimated Recovery To 2019 Credit Metrics	1H 2021	
Potential Negative Long-Term Industry Disruption	--	
2020 v. 2019		
Revenue Decline	EBITDA Decline	Incremental Borrowings
10% to 15%	15% to 25%	5% to 10%
2021 Estimates v. 2019		
Revenue Decline	EBITDA Decline	
0% to 10%	0% to 10%	

Out-of-Home Entertainment		
Estimated Recovery To 2019 Credit Metrics	2023	
Potential Negative Long-Term Industry Disruption	Yes	
2020 v. 2019		
Revenue Decline	EBITDA Decline	Incremental Borrowings
>50%	>60%	>25%
2021 Estimates v. 2019		
Revenue Decline	EBITDA Decline	
40% to 50%	>50%	

Latest Related Research

- The Post-Pandemic Recovery Will Be Coming Soon To A U.S. Movie Theater Near You, April 29, 2021
- 2021 Advertising Trends Are Nicely Up, With Some Sectors Lagging, April 12, 2021
- Here's What The U.S. Media And Entertainment Sector Has In Store For 2021, Jan. 6, 2021

Industry Top Trends Update North America

Metals and Mining

Surging metals prices power windfall profits

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What's changed?

Backlogs surge to historic highs. The inventory rebuild from an unexpected rebound in demand for most metals is being hampered by the inherent tightness of some metals or producer discipline. Steel mills are reporting record order backlogs as buyers scramble for material.

Environmental, social, and governance (ESG) factors influence investment decisions and credit. Steel producers globally are aiming to reduce their carbon intensity, which ranks among the highest of any industry.

Financial discipline could pay off. The focus on improving returns for the past three to five years has bolstered the financial firepower of most metals and mining companies, supporting credit quality and expanding capacity for shareholder returns, acquisitions, and large investments.

How is recovery taking shape?

Prices spike as restocking sparks shortages. Iron ore, copper, and steel have led many commodities to record prices in 2021, and even gold remains high. Still, prices could drop quickly if restocking volumes moderate later this year.

Record low interest rates and a weaker U.S. dollar benefit prices. The inverse relationship between U.S. monetary factors and metals prices has underpinned some of the recent price surge.

Financial policies are intact. In contrast to previous cycles, we see sustained financial and investment prudence for most companies. Investment-grade issuers are well-positioned, and some speculative-grade issuers have upside potential.

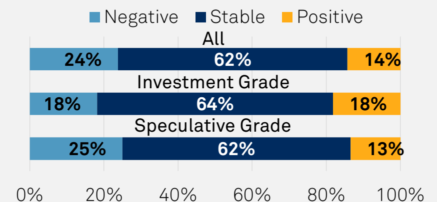
What are the key risks around the baseline?

Big cash flow enables big decisions. The cyclical strength of prices is partly supported by reduced investment in recent years. Credit quality could take a hit if large debt-financed mergers and acquisitions or capital projects coincide with an inevitable downturn.

Higher production contributes to product surpluses. A return to robust inventories could deflate prices quickly.

ESG factors dominate. Marginal investment and current operating risks loom perpetually in this sector. Individual credits can see a larger relative effect, given the industry's inherent exposure to ESG risks.

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	11	53	64
Downgrades	0	1	1
Upgrades	0	6	6

Ratings data as of end-June, 2021

COVID-19 Heat Map

Metals and Mining	
Estimated Recovery To 2019 Credit Metrics	1H 2021
Potential Negative Long-Term Industry Disruption	--

2020 v. 2019		
Revenue Decline	**EBITDA Decline**	**Incremental Borrowings**
10% to 15%	15% to 25%	5% to 10%

2021 Estimates v. 2019	
Revenue Decline	**EBITDA Decline**
>2019	>2019

Latest Related Research

- Metal Price Assumptions: Prices Stay Hot, But No Signs Of A Melting Point, June 29, 2021
- Cleveland-Cliffs Inc. Upgraded To 'B' From 'B-' On Lower Debt Expectation; Outlook Positive; Debt Ratings Raised, June 22, 2021
- Freeport-McMoRan Inc. Upgraded To 'BB+' From 'BB' On Strong Cash Flows, Lower Expected Leverage; Outlook Stable, April 2, 2021

Industry Top Trends Update North America

Midstream Energy

Sector stable, but future presents challenges

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What's changed?

Improving fundamentals. Commodity prices have strengthened in lockstep with demand as economies reopen. Increased production is improving credit measures as companies spend less on organic growth, leaving them with excess cash flow and increased financial flexibility.

ESG factors. Risk related to climate change and the transition to renewable energy has become more pronounced. The industry's focus on reducing emissions and seeking alternative, low-carbon opportunities will continue to increase.

M&A. Organic growth has slowed considerably. With fewer greenfield projects needed, the industry could be ripe for consolidation. Asset sales are increasing, but large mergers have yet to materialize. We believe asset rationalization will continue as companies focus on core competencies and competitive strengths.

How is recovery taking shape?

Volumes are back. Crude oil and natural gas volumes have rebounded, albeit production is still below pre-pandemic levels. We believe volumes will remain resilient given higher commodity prices, which provide a significant buffer against marginal production costs in most areas.

Financial discipline is holding. Midstream companies are maintaining a disciplined approach to their balance sheets and generating healthy levels of free cash flow. Lower debt levels are providing companies with additional financial flexibility to pursue new projects, partnerships, and acquisitions.

Capital allocation is key. Lower capital spending and stronger EBITDA are making management teams carefully consider how they balance debtholder and shareholder initiatives. We don't view modest share buybacks or distribution increases as harmful to the industry recovery.

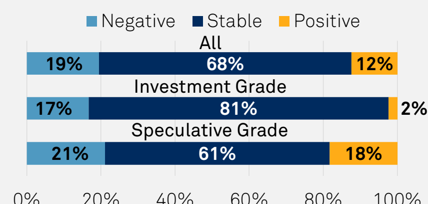
What are the key risks around the baseline?

COVID. The recovery in global demand can falter if the virus and its variants overwhelm the benefits of the vaccines and result in another shutdown.

Regulation. The Biden Administration continues to promote its clean-energy plan and has rolled back more favorable Trump-era industry policies. The recovery could falter if climate regulation increases or drilling limits are enacted.

Price or capital market shocks. Supportive OPEC policies and the demand recovery have helped commodity prices and stimulated drilling. The debt capital markets remain accommodating for most midstream companies. Any change to the status quo on these fronts will risk derailing the recovery.

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	42	72	114
Downgrades	2	8	10
Upgrades	2	8	10

Ratings data as of end-June, 2021

COVID-19 Heat Map

Midstream	
Estimated Recovery To 2019 Credit Metrics	2022
Potential Negative Long-Term Industry Disruption	--

2020 v. 2019		
Revenue Decline	EBITDA Decline	Incremental Borrowings
5% to 10%	10% to 15%	<5%

2021 Estimates v. 2019	
Revenue Decline	EBITDA Decline
0% to 10%	0% to 10%

Latest Related Research

- Credit Quality Improves For Permian G&Ps As Volumes Bounce Back, June 22, 2021
- The Energy Transition: ESG Concerns Are Starting To Present Capital Market Challenges To North American Energy Companies, June 14, 2021
- Risk Analysis: How We Assess Midstream Energy M&A, April 29, 2021
- Canadian Midstream Operators Count On Strong Contract Structure And Diversified Customer Bases To Withstand Industry Shocks, March 31, 2021

Industry Top Trends Update North America

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.

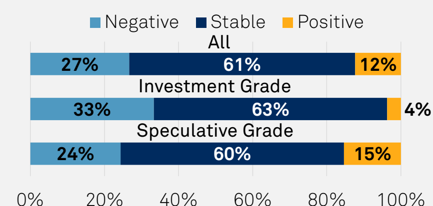
What are the key risks around the baseline?

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%	

Industry Top Trends Update North America

Real Estate

Fundamentals on track to recover

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What's changed?

Recovery gaining traction. Robust economic growth and vaccination rollouts should drive demand. Rent collection has recovered, reaching the mid- to high-90% range across most property types, while occupancy remains stable. Leasing activity should pick up in the second half of 2021.

M&A activity increase. Transaction activity could pick up momentum given better outlook and recovery in equity prices. We've seen a sudden increase in M&A across the retail REIT sector, which could continue.

Moderating negative ratings bias. The upgrade-to-downgrade ratio was 4 to 5 as of June 30, 2021, versus 1 to 13 in 2020. Given stabilizing operating trends and improving cash flow, the negative ratings bias should ease from 18% as of June 30. Still, negative ratings bias is greater for some retail, office, and healthcare REITs.

How is recovery taking shape?

Cash flow improving. We expect net operating income growth for most property types in 2021 after declines in 2020, supported by higher rent collection, fewer deferrals, and a rebound in leasing activity. After negative trends in the first quarter, we expect positive growth starting in the second quarter as REITs mark the one-year anniversary of the impact of COVID-19.

Credit metrics should recover to pre-pandemic levels by 2022. We expect a gradual recovery over the next two years as operating trends stabilize after weakening in 2020. While REITs are gradually reinstating dividend payments, we expect they will remain below 2019 levels and be reset to more sustainable levels.

Good access to capital markets. Debt issuance remains strong in 2021. REITs maintained good access to debt markets given tightening credit spreads and low interest rates. Still, it is unlikely that debt issuance in 2021 will surpass last year's record of $23 billion, unless heightened M&A activity drives a significant increase.

What are the key risks around the baseline?

Debt-funded acquisitions. More aggressive financial policies could pressure ratings. Although we expect most rated REITs to focus on improving their credit metrics, debt-funded acquisitions or more aggressive share repurchases could pressure ratings over the next year.

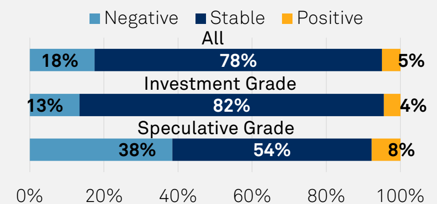
Slower-than-expected recovery. Lack of rebound in leasing activity could delay recovery. Leasing activity is starting to pick up after depressed levels in 2020. Still, re-leasing spreads are negative for malls and flat for strip centers, as tenant quality remains challenged. For office, a slow return to the workplace coupled with a high amount of sublease space could pressure rents and occupancy.

Secular change could delay recovery of some assets. E-commerce and remote working trends could hurt longer-term prospects for retail and office assets. Malls and outlets that are more exposed to discretionary retail are exposed to a weaker tenant base, while office focused in urban markets could see pressure from downsizing from hybrid work models over the next few years.

Latest Related Research

– REITrends: North America Recovery Picks Up Speed, June 10, 2021

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	67	13	80
Downgrades	3	2	5
Upgrades	2	2	4

Ratings data as of end-June, 2021

COVID-19 Heat Map

Real Estate (REITs)	
Estimated Recovery To 2019 Credit Metrics	2022
Potential Negative Long-Term Industry Disruption	Yes

2020 v. 2019		
Revenue Decline	EBITDA Decline	Incremental Borrowings
5% to 10%	10% to 15%	5% to 10%

2021 Estimates v. 2019	
Revenue Decline	EBITDA Decline
0% to 10%	0% to 10%

Industry Top Trends Update North America

Regulated Utilities

Credit quality is weakening

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What's changed?

Texas storm. Climate risks continue to weaken credit quality. The severe winter storm drove up commodity prices and we downgraded two regional gas distribution utilities that were exposed to these higher costs.

Energy transformation. The industry is focused on reaching net zero by further reducing its greenhouse gas (GHG) emissions. The industry's GHG emissions were down about 25% over the past decade and we expect a further 40% reduction in the coming decade, reflecting the growth of renewable generation displacing coal-fired generation.

High capital spending. Annual capital spending has been growing at about 9% and now exceeds $160 billion. This has contributed to negative discretionary cash flow and weaker financial measures.

How is recovery taking shape?

Credit quality is weakening. Year-to-date downgrades are outpacing upgrades by about 7 to 1. We expect that 2021 will be the second consecutive year that downgrades outpace upgrades.

Effective management of COVID-19-related risks. The industry effectively navigated the pandemic-related risks. Higher residential sales somewhat offset lower commercial and industrial sales. Many utilities are filing with their regulators for recovery of COVID 19-related costs.

Minimal financial cushion. About 50% of the industry strategically operates with minimal financial cushion to their downgrade threshold, pressuring credit quality.

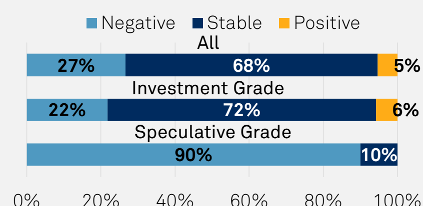
What are the key risks around the baseline?

Tax reform. A higher corporate tax rate would improve the industry's financial measures. Should the corporate tax rate rise to 28%, we estimate the industry's funds from operations to debt would improve by about 100 basis points.

Wildfires. California again received below-average rainfall, remaining susceptible to catastrophic wildfires. However, the utilities have invested billions in wildfire mitigation that they believe will offset the rising environmental risks.

Inflation. The consumer price index (CPI) for the 12-month percentage change rose to 4.2% and 5% for April and May 2021, respectively. The last time the CPI exceeded 5% was 2008. Should inflation take hold and given the regulatory lag for utilities to recover their costs, the industry's financial measures would likely weaken.

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	263	20	283
Downgrades	26	0	26
Upgrades	4	0	4

Ratings data as of end-June, 2021

COVID-19 Heat Map

	Utilities
Estimated Recovery To 2019 Credit Metrics	2022
Potential Negative Long-Term Industry Disruption	--

2020 v. 2019		
Revenue Decline	**EBITDA Decline**	**Incremental Borrowings**
0% to 5%	0% to 10%	<5%

2021 Estimates v. 2019	
Revenue Decline	**EBITDA Decline**
≥2019	≥2019

Latest Related Research

- Credit FAQ: How Are California's Wildfire Risks Affecting Utility Credit Quality? June 3, 2021
- How ESG Factors Are Shaping North American Regulated Investor-Owned Utilities' Credit Quality, April 28, 2021
- North American Regulated Utilities' Credit Quality Begins The Year On A Downward Path, April 7, 2021

Industry Top Trends Update North America

Retail and Restaurants

The road to recovery starts with a spending spree

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What's changed?

Consumers are eager to make up for lost time shopping and dining out. With COVID-19 largely behind them, consumers are making plans to travel, dine out, and socialize. With the change in behavior comes a change in spending trends.

Consumers are shifting spending to goods and services that reflect pent-up demand for activities outside the home. During the pandemic, consumers focused on upgrades to their homes, and home-based activities such as cooking and hobbies. The relaxation of social distancing calls for celebratory dinners and refreshed wardrobes.

They have cash and intend to spend it. Households are financially healthy. Accumulated savings from foregone experiences during the pandemic and generous government support will continue to bolster spending. Rising consumer confidence levels reflect consumers' intention to continue to spend.

How is the recovery taking shape?

Restaurants have rebounded faster than we expected. Many dine-in restaurants reported demand returning to pre-pandemic levels in the second quarter. Casual diners compensated for lost dine-in revenue with off-premise offerings, and protected margins by simplifying menus. Full recovery is within reach. Quick-service restaurants fared relatively well during the pandemic due to their takeout and drive-thru operations.

Apparel is coming back with a vengeance. For many apparel retailers, the shock of the pandemic was too much—more than one-third of retail defaults were in specialty apparel or department stores. The survivors are now benefitting from "revenge spending" as consumers seek a sense of normalcy, but credit metrics for many issuers will not be restored until next year.

Prospects for grocery, home improvement, and other sectors that benefitted from nesting are uncertain. Issuers in these subsectors have had a banner year giving them cushion to absorb a slowdown without hurting credit quality. The strong housing market and hybrid work model are likely to provide support through 2021, but consumers may switch spending back to experiences faster than expected.

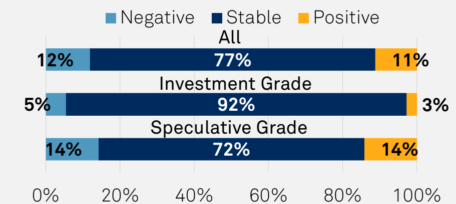
What are the key risks around the baseline?

A resurgence of the virus or new variants could cause localized disruption. We believe another broad-based shutdown is highly unlikely and that consumers would use their social distancing skills while continuing to shop. However, issuers with geographic concentration in hotspots could face a choppy recovery.

Extended supply chain constraints could dampen recovery and eat into margins. Labor shortages and shipping capacity limitations have popped up in restaurant and retail supply chains, causing inflation and stock-outs. We expect these to ease in the third quarter. However, if they worsen and extend into the holiday season, the impact could be meaningful.

Evolving business models present operational risks. The pandemic turbocharged the shift to e-commerce and introduced new ways of shopping to many consumers. Retailers need to invest in omnichannel platforms in the face of these changes.

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	37	106	143
Downgrades	0	1	1
Upgrades	2	26	28

Ratings data as of end-June 2021

COVID-19 Heat Map

Estimated Recovery To 2019 Credit Metrics	
Retail Essential	No decline
Restaurants	1H 2021
Retail - Non-essential	2022
Potential Neg. Long-Term Industry Disruption	
Retail Essential	--
Restaurants	Yes
Retail - Non-essential	Yes

2020 v. 2019		
Revenue Decline	EBITDA Decline	Incremental Borrowings
Retail Essential		
No decline	No decline	No increase
Restaurants		
5% to 10%	10% to 15%	10% to 25%
Retail - Non-essential		
15% to 25%	40% to 60%	10% to 25%

2021 Estimates vs. 2019	
Revenue Decline	EBITDA Decline
Retail Essential	
≥2019	≥2019
Restaurants	
≥2019	≥2019
Retail - Non-essential	
0% to 10%	0% to 10%

Industry Top Trends Update North America

Technology

Positive rating actions bias for 12 months and counting

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What's changed?

Broad-based semi supply shortage to last through 2021. Relief is coming from higher utilization of existing fabs and capacity additions, which take longer, but strong demand from macroeconomic recovery and the boost in information technology (IT) spending following delayed spending in 2020 result in demand that is outstripping supply.

Demand within the sector is leading to positive rating actions. We took 50 positive rating actions (including outlook revisions) in the first half 2021 as tech companies faced the best demand environment in years. This is in contrast with the 31 positive rating actions we took in the second half 2020, when many rating actions were to reverse pandemic-related negative actions from the first half of 2020.

Risk of antitrust actions on Big Tech is rising. U.S. lawmakers have introduced bipartisan bills aimed at beefing up antitrust law. Still, we believe significant breakups that would cause downgrades are unlikely. New antitrust laws with more rigorous enforcement is possible, but Big Tech companies will likely be able to manage these potentially negative effects while preserving their credit profiles.

How is recovery taking shape?

We revised our global IT spending forecast upward in April 2021. We expect about 6% growth in 2021, double the 3% growth expectation we set in December 2020.

Hardware sales have recovered faster than we expected. The earnings recovery we've observed so far bodes well for 2021 operating performance and credit ratios, even though capacity constraints and component shortages could limit material improvement in the second half of year.

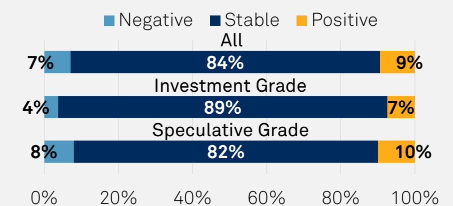
What are the key risks around the baseline?

U.S. tech companies' profitability and cash flow could suffer if inflation picks up and turns out to be more lasting. Thus far, the higher cost pressure on account of COVID-19 or supply chain component shortages, though pervasive, has been benign. End-customer demand is strong, but persistent inflation pressure could lead to compressed margins, higher consumer prices, and softer demand.

U.S.-China tension remains a wildcard. While the Biden Administration's approach includes more allies and may be more predictable, supply bans on Chinese firms, tariffs, and high scrutiny of mergers and acquisitions (M&As) remain. China's ambitions to be more self-reliant will challenge U.S. tech firms.

M&A valuations for tech companies have risen significantly. Excessive exuberance on business outlook and aggressive M&As could impair credit profiles even if acquisition rationales are sound. We see more M&As in the hardware and software sectors than in semiconductors.

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	54	200	254
Downgrades	2	4	6
Upgrades	5	14	19

Ratings data as of end-June, 2021

COVID-19 Heat Map

Technology - Software	
Estimated Recovery To 2019 Credit Metrics	No decline
Potential Negative Long-Term Industry Disruption	--

2020 v. 2019		
Revenue Decline	EBITDA Decline	Incremental Borrowings
No decline	No decline	No increase

2021 Estimates v. 2019	
Revenue Decline	EBITDA Decline
≥2019	≥2019

Technology - Hardware/Semiconductors	
Estimated Recovery To 2019 Credit Metrics	1H 2021
Potential Negative Long-Term Industry Disruption	--

2020 v. 2019		
Revenue Decline	EBITDA Decline	Incremental Borrowings
0% to 5%	0% to 10%	<5%

2021 Estimates v. 2019	
Revenue Decline	EBITDA Decline
>2019	>2019

Latest Related Research

- Latest Views On Hot Tech Topics--Semiconductor Supply Shortage, Inflation, And Big Tech Regulation, July 9, 2021
- Stronger For Longer: Good Demand, Capacity Constraints, And Low Inventory To Bolster U.S. Tech Into 2022, May 7, 2021

Industry Top Trends Update North America

Telecommunications

Challenges ahead for U.S. telcos

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What's changed?

Proceeds from the C-band spectrum auction were greater than expected. The $95 billion in proceeds pushed up leverage for wireless telcos, resulting in some negative rating actions. Because spectrum deployment will take time, initial returns on investment will be low.

Remote working/learning benefits will subside this year. While we still expect solid broadband revenue growth for the cable providers, the pace could moderate in 2021 as workers return to offices and students go back to schools. Longer-term trends are favorable given the growing demand for bandwidth from both residential and business customers. Incremental competition from fiber to the home (FTTH) deployments and 5G fixed wireless is still a longer-term threat, though we don't expect any material impact on cable providers in 2021.

M&A activity has picked up, but so have asset sales. AT&T announced sales of a 30% stake in its TV distribution business and its Warner Media business. Similarly, Verizon plans to sell its media business. These transactions will enable some leverage reduction and provide incremental financial flexibility. At the same time, low interest rates and high equity prices should drive some M&A activity in cable, fiber, and data centers. Already, Cogeco Communications USA has announced property acquisitions from WideOpenWest for about $1.1 billion.

How is recovery taking shape?

Revenue from business customers is rebounding. As the economy opens up, we expect some improvement in top-line trends from the small/medium business segment, especially for cable providers that have a dominant market share. Similarly, IT projects that enterprise customers delayed during the pandemic should resume. However, the impact on the top line could be muted, as many customers are migrating to cloud-based networking technologies, which carry lower price points than multiprotocol label switching (MPLS).

Credit-metric trends should be mixed. We expect leverage for the wireless operators to be higher than in 2020 due to the C-band auction spending. We also expect leverage for U.S. wireline companies to deteriorate as they deploy FTTH to better compete with cable. For U.S. cable providers, credit-metric improvement will depend on M&A activity and distributions to shareholders.

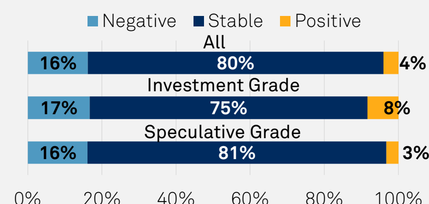
Rating trends should be more balanced. Downgrades outpaced upgrades by more than 2 to 1 in 2020, with most negative actions at the lower end of the rating scale. We expect trends to be more balanced in 2021 as economic conditions improve and low interest rates enable the refinancing of capital structures.

Wireless service revenue trends should improve. While industry service revenue growth was essentially flat in 2020, we expect overall service revenue to grow about 2%-3% in 2021 due to increased roaming revenue as consumers travel again and higher ARPU as carriers migrate their customer bases to higher-rate 5G plans.

What are the key risks around the baseline?

Increasing competition in wireless. Incumbent cable providers are offering wireless service through wholesale agreements. So far, the impact on U.S. wireless providers has been muted. However, with aggressive discounting and bundling, cable companies are taking an increasing share of gross subscriber additions. At the same time, the wireless carriers are offering aggressive promotions to differentiate their 5G network capabilities, which could hurt margins.

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	12	62	74
Downgrades	0	3	3
Upgrades	1	3	4

Ratings data as of end-June, 2021

COVID-19 Heat Map

Telecom	
Estimated Recovery To 2019 Credit Metrics	1H 2021
Potential Negative Long-Term Industry Disruption	--

2020 v. 2019		
Revenue Decline	**EBITDA Decline**	**Incremental Borrowings**
No decline	No decline	5% to 10%

2021 Estimates v. 2019	
Revenue Decline	**EBITDA Decline**
≥2019	≥2019

Industry Top Trends Update North America

Transportation

The road to recovery is clearing, could encounter curves

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What's changed?

Airlines see some blue sky–at last. Demand is surging for domestic leisure travel in the U.S. as the COVID-19 pandemic recedes, though Canada lags. Business and international travel, important to big network airlines, will be slower to return.

Freight transportation remains strong. Railroads, trucking, logistics, and parcel carriers weren't hit as hard as the passenger travel industry and are benefiting from federal stimulus to the U.S. economy. Indeed, demand exceeds supply in some markets, boosting pricing (but also labor and fuel costs).

Transportation equipment leasing is less affected than the industries they serve. Car renters were hard hit, especially those that rely on airport business, but they are raising rates and booking gains on used car sales. Aircraft lessor outlooks are mostly back to stable, though ratios will take time to rebound.

How is recovery taking shape?

Airlines are at different altitudes. We revised our outlooks to positive and even raised one rating on low-cost airlines that cater to domestic U.S. leisure travel. The runway to recovery for Air Canada, American, Delta, and United will be longer, but downside risk is easing and liquidity is strong, because of government aid.

Freight transportation approaches pre-pandemic performance. Credit measures are approaching 2019 comps, though further gains will be more gradual. Higher labor and fuel costs (some passed on to customers) and consumer shifts to spending on services as economies reopen will partly offset still solid demand.

Lessor recoveries vary. Equipment leasing companies' lease terms range from very short (car renters) to multiyear (aircraft lessors). The former's revenues and earnings fall sharply but recover faster. The global oversupply of aircraft (particularly widebody aircraft) will take years to work its way out fully, resulting in a shallower but prolonged downturn.

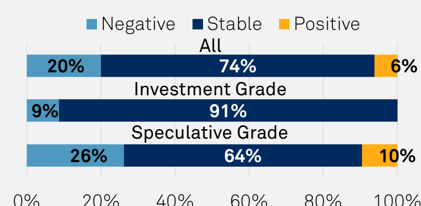
What are the key risks around the baseline?

Higher fuel costs could slow recovery. Airlines are highly exposed, and their ability to pass cost through to customers depends on supply-and-demand balance. Most freight transporters have fuel surcharges in their contracts.

New COVID-19 virus waves could set back progress. Available vaccines appear to protect against new variants, but mutations could change that and trigger another wave of infections. Airlines are most at risk.

Higher labor costs could trim margins. The tight labor market is pushing up labor costs for companies that rely wholly or in part on short-term employees, such as nonunion trucking and sorting for parcel express carriers. Depending on how long this persists, it could affect contracts with unions as well.

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	23	44	67
Downgrades	0	2	2
Upgrades	2	4	6

Ratings data as of end-June, 2021

COVID-19 Heat Map

Airlines	
Estimated Recovery To 2019 Credit Metrics	>2023
Potential Negative Long-Term Industry Disruption	Yes

2020 v. 2019		
Revenue Decline	EBITDA Decline	Incremental Borrowings
25% to 50%	>60%	>25%

2021 Estimates v. 2019	
Revenue Decline	EBITDA Decline
40% to 50%	>50%

Latest Related Research

- Southwest Airlines Co. Outlook Revised To Positive From Negative, 'BBB' Rating Affirmed On Improving Demand, July 7, 2021
- FedEx Corp. Outlook Revised To Stable From Negative On Improving Credit Measures; 'BBB' Rating Affirmed, April 14, 2021
- Avis Budget Group Outlook Revised To Stable From Negative On Expectation For Improving Credit Quality, Ratings Affirmed, Feb. 17, 2021

Industry Top Trends Update North America

Transportation Infrastructure

The new normal is yet to be defined

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What's changed?

Loosening government restrictions lead recovery. As lockdown measures have eased, usage and volume have generally increased, with some volume-based public-private partnership (P3) toll roads recovering very close to pre-COVID levels.

Is COVID-19 a force majeure? COVID-related force majeure claims are beginning to be resolved. For example, the recent ruling by the Ontario Supreme Court could be significant for P3 credit quality if it leads to more successful force majeure claims.

Toll road resiliency. All but one rated volume-based transportation project remains investment grade thanks to robust debt service coverage, hybrid revenue streams (availability payments with some traffic risk), capital structure, and liquidity.

How is recovery taking shape?

The new normal is still being defined. Shifts in travel patterns/modes and commuter behavior, specifically business travel and work-from-home policies, will drive and vary the recovery across transportation assets.

Different routes of recovery across assets and sectors. Domestic toll road travel has recovered for many operators. Commercial trucks performed particularly well given the shift in consumer behavior toward e-commerce. U.S. airport domestic travel—80% of all flights—has also seen an uptick. That said, congestion-relieving toll roads, international air travel, mass transit, and parking are lagging.

Cash is king. Liquidity and equity injections continue to offset slow recovery for certain assets and sectors. Some have reduced expenses and some have sought waivers for financial covenants.

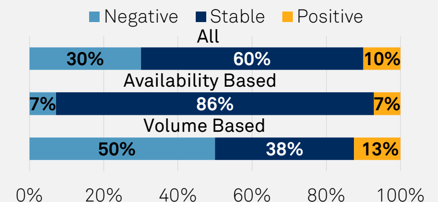
What are the key risks around the baseline?

Structural change to mobility trends. Remote working, virtual business meetings, online shopping, and blended teaching could affect the usage of transportation infrastructure. For example, if commuters work remotely for two days a week it could translate to about a 20% permanent weekday demand loss for toll roads and downtown parking garages.

A third wave of infections or inefficacy of vaccine against variants could lead to additional government lockdown measures that either delay or reverse the recovery in volumes from pre-pandemic levels.

Cash flow pressures on counterparties. A more pronounced downside could also put pressure on availability projects should counterparty risk rise and/or the burden of risk transfer become intolerable.

Outlook Distribution



Ratings Statistics (Last 12 Months)

	Availability based	Volume based	All
Ratings	14	16	30
Downgrades	0	3	3
Upgrades	1	0	1

Ratings data as of end-June, 2021

Toll Road Rating Resiliency Under Demand Loss Scenarios

	5%	10%	15%	20%
407	Minimal	Minimal	Minimal	Moderate
95	Minimal	Minimal	Significant	Significant
PR22	Minimal	Minimal	Minimal	Moderate
ERC	Minimal	Minimal	Moderate	Significant
ITR	Minimal	Minimal	Minimal	Minimal
A30	Minimal	Moderate	Significant	Significant
TRIP II	Moderate	Significant	Significant	Significant
Project A	Minimal	Minimal	Minimal	Minimal
Project B	Minimal	Minimal	Moderate	Significant
Project C	Minimal	Minimal	Moderate	Significant

Possibility of Ratings Pressure
Minimal Moderate Significant

407—407 International Inc. 95—95 Express Lanes LLC. PR22—Autopistas Metropolitanas de Puerto Rico, LLC. ERC—Elizabeth River Crossings Opco, LLC. ITR—ITR Concession Company LLC. A30—Nouvelle Autoroute 30 S.E.N.C. TRIP II—Toll Road Investors Partnership II, LP. Source: S&P Global Ratings.

Latest Related Research

- What Is The Next Stop For U.S. Mass Transit In A Post-COVID Era?, July 1, 2021
- The Ontario Supreme Court's Emergency-Relief Ruling Is A Shot In The Arm For The P3 Industry, June 2, 2021
- Infrastructure: Why Design Build Contracts Can Be A Double-Edged Sword For U.S./Canadian P3 Projects, May 17, 2021
- Infrastructure: Ten Roads, Ten Routes Ahead, April 7, 2021
- Infrastructure: Ten Roads, Ten Different Stories, April 7, 2021

Industry Top Trends Update North America

Unregulated Power

Capacity markets disappoint more than expected

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What's changed?

Prices in all capacity markets turned out lower than expected. The decline is particularly severe in PJM's RTO and ComEd zones. A combination of demand loss, reentering nuclear capacity, natural gas and solar supply, and fixed resource requirement-based withdrawals all contributed. With ~2.7 GW of incremental gas-fired capacity likely going into the next auction, capacity prices could remain low.

Conversely, energy prices have taken off. Compared with power prices at year end 2020, 7x24 prices in PJM West for 2021 through 2024 are up 18% (to 5%), while ERCOT (Texas) prices between 2022 and 2024 are up 50% (to 20%). We expect IPPs to engage in aggressive forward hedging of generation.

Winter Storm Uri. The sever winter storm drove commodity prices higher and exposed systemic risks that need to be addressed.

Nuclear units could find federal support. Legislation in both the House (Pascrell) and Senate (Cardin) could provide nuclear production tax credits through 2030.

Continuing erosion in credit quality of smaller term loan B project financed assets. Many financings were hindered by milder winter weather in the past two years, and COVID-19 put many transactions at risk. Despite higher power prices, we expect more negative rating actions.

How is recovery taking shape?

Full recovery will take a few quarters. Demand appears to be reverting to 2019 levels in 2022, and the growth varies widely across the country.

Large scale coal-fired retirements. We've seen 5 GW of coal-fired capacity announce retirement in the PJM. A wave of coal-fired retirements could mitigate the decline in capacity prices as demand builds post-COVID. Similarly, the implementation of peaker rules in New York should buttress capacity prices.

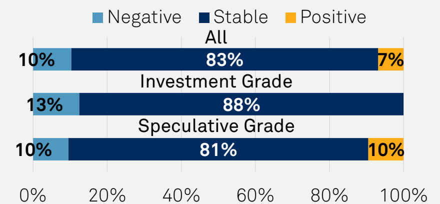
Residential retail demand across the country has held up and, in most regions, has risen. ERCOT has been buoyed by weather and shows the least demand weakness.

What are the key risks around the baseline?

Demand could still be irreparably harmed. Declining loads could have a secular slant, which could hurt power prices over the long run.

Power price climb driven by natural gas prices. A combination of hot weather, pipeline constrains, demand for LNG, and lower storage levels has resulted in significantly higher gas prices. Spark spreads have also expanded. Moderating temperatures and a slowdown in demand from a third wave could break this rally.

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	8	21	29
Downgrades	1	2	3
Upgrades	0	0	0

Ratings data as of end-June, 2021

COVID-19 Heat Map

Power	
Estimated Recovery To 2019 Credit Metrics	2022
Potential Negative Long-Term Industry Disruption	--

2020 v. 2019		
Revenue Decline	**EBITDA Decline**	**Incremental Borrowings**
10% to 15%	0% to 10%	No increase

2021 Estimates v. 2019	
Revenue Decline	**EBITDA Decline**
0% to 10%	0% to 10%

Latest Related Research

- Unregulated Power: S&P Global Ratings Updates Its Capacity Price Assumptions, May 3, 2021
- Industry Report Card: The Outlook On The U.S. Merchant Power Sector Is Negative, April 16, 2021
- Without Firm Power, U.S. Independent Power Producers' Credit Could Soften, April 5, 2021

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