U.S. Corporate Credit Outlook

Midyear 2021

Trends And Transitions

2 Corporate Credit Outlook Midyear 2021

North American Industry Top Trends Update

15 Aerospace and Defense

16 Autos

17 Building Materials

18 Capital Goods

19 Chemicals

20 Consumer Products

21 Health Care

22 Homebuilders and Developers

23 Hotels, Gaming and Leisure

24 Media and Entertainment

25 Metals and Mining

26 Midstream Energy

27 Oil and Gas

28 Real Estate

29 Regulated Utilities

30 Retail and Restaurants

31 Technology

32 Telecommunications

33 Transportation

34 Transportation Infrastructure

35 Unregulated Power

S&P Global Ratings

U.S. Corporate Credit Outlook Midyear 2021

Trends And Transitions

July 27, 2021

Authors

David Tesher
New York
david.tesher@spglobal.com
+1-212-438-2618

Joe Maguire
joe.maguire@spglobal.com
+1-212-438-7507

Yucheng Zheng
yucheng.zheng@spglobal.com
+1-212-438-4436

Financing Conditions & Ratings Trends
Nick Kraemer
nick.kraemer@spglobal.com
+1-212-438-1698

Evan Gunter
evan.gunter@spglobal.com
+1-212-438-6412

Nicole Serino
nicole.serino@spglobal.com
+1-212-438-1396

Leveraged Finance
Ramki Muthukrishnan
ramki.muthukrishnan@spglobal.com
+1-212-438-1384

Steve Wilkinson
steve.wilkinson@spglobal.com
+1-212-438-5903

Robert Schulz
robert.schulz@spglobal.com
+1-212-438-7808

Stephen Anderberg
stephen.anderberg@spglobal.com
+1-212-438-8991

Daniel Hu
daniel.hu@spglobal.com
+1-212-438-2206

Key Takeaways

- Corporate borrowers in a number of sectors are recovering faster than expected, boosted by the strong economic rebound and reaping the benefits of pent-up consumer demand.
- Still, it could take until well into next year for some sectors to recover to 2019 credit metrics; the outlook is further complicated by the recent resurgence of COVID cases and the potential reinstatement of some social restrictions.
- As the focus turns to corporates' financial policies, we expect increases in M&A and capex in most U.S. sectors as companies reposition their business models to address shifts in consumer and corporate behavior triggered—or accelerated—by the pandemic.
- We continue to believe the jump in inflation will be transitory, but a prolonged period of rising prices would pose downside risks for many borrowers.

As the U.S. economic rebound continues, corporate borrowers across nearly all sectors are enjoying a recovery that, in many cases, has paved the way for a return of business activity to pre-pandemic levels somewhat sooner than we expected. This is especially true for the services sectors, which were hardest hit by the pandemic and related social restrictions but are now reaping the benefits of pent-up consumer demand and a household savings rate that has been swelled by massive government stimulus.

After the world's biggest economy expanded at an annualized pace of 6.4% in the first quarter—the fastest pace since 1984—we revised our expectations for several retail and consumer segments (see "**COVID-19 Heat Map: Pent-Up Demand And Supply Shortages Further Improve Recovery Prospects For Credit Quality**," published June 8).

For the lodging sector, we now believe 2021 revenue per available room (RevPAR) could be slightly better than we assumed earlier in the year—at around 25-35% below 2019—given the recent surge in leisure travel and demand for lower-priced hotels (see Industry Top Trends, starting on Page 15, for sector-specific breakdowns). Higher-priced, full-service hotels are still lagging significantly, but will likely rebound this autumn. Pent-up demand for leisure travel is also accelerating the recovery in the gaming industry—Las Vegas, in particular—and the eventual return of conventions and international visitors should help smooth any pullback in leisure travel next year.

Restaurants, too, have rebounded faster than we expected. Within our rated universe, many dine-in eateries reported demand returning to pre-pandemic levels in the second quarter. While fast-food restaurants fared relatively well during the pandemic due to their takeout and drive-through operations, casual-dining businesses compensated for lost revenue with off-premise offerings, and protected margins by simplifying menus.

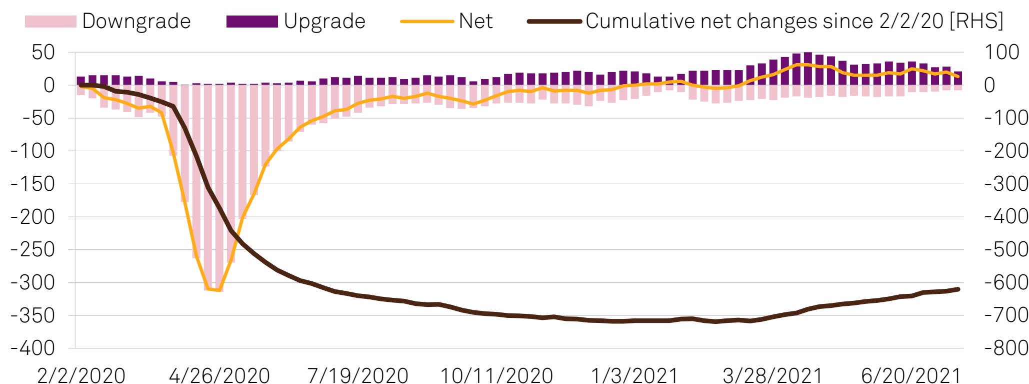
In the tech sector, hardware sales have recovered apace, and the earnings rebound we've seen so far bodes well for 2021 operating performance and credit ratios—even though capacity constraints and component shortages could limit material improvement in the second half.

For apparel and cosmetics makers, we expect continued recovery in 2021 and 2022 as consumer mobility increases. And manufacturers of consumer durables enjoyed substantial growth in the second half of last year and into 2021 because of increased spending on home goods. But we believe that will moderate in the second half. Demand for consumer staples is also waning.

Regarding rating actions, upgrades among U.S. nonfinancial corporates have outpaced downgrades 2-to-1 this year (see chart 1). While the number of upgrades is still only a fraction of the downgrades of 2020, we expect further upgrades in the second half, as the largest percentage of rating actions this year has been due to a positive outlook revision.

Chart 1

U.S. Nonfinancial Ratings Upgrades And Downgrades Since February 2020



Source: S&P Global Ratings. Data as of July 18, 2021. Downgrades, upgrades, and net show the 4-week trailing sum of ratings changes. Cumulative net changes are the absolute sum of net ratings changes since Feb. 2, 2020. This data was selected because on Jan. 30, 2020, the WHO declared the COVID-19 outbreak a global health emergency.

Secular Changes

With the worst of the health crisis in the rearview mirror and the economic recovery seemingly well under way, many corporate borrowers have turned to confront the secular changes that the pandemic merely accelerated rather than caused (see table 1). While the recovery paths for corporate borrowers we rate have, in some instances, surprised on the upside, they depend on many factors—not the least of which is companies' ability to adapt to changes in consumption patterns.

Consumer products makers, especially, are dealing with new consumer behaviors. Through the pandemic, buyers chose brands they trusted, increased e-commerce purchases, worked and ate at home, and focused on health and wellness—while also indulging in premium products—and we believe many of these trends will persist. For **media and entertainment**, secular changes are front and center, as well. As the direct effects of the pandemic diminish, the focus has returned to issues such as the deepening decline in traditional TV, faster shifts in advertising, and increased competition among streaming services.

The pandemic similarly accelerated various shifts in the **health care** industry, such as the use of "telehealth" services, homecare delivery, and value-based care. The permanence/impermanence of these shifts are will have longer-term implications for the industry and individual borrowers.

All told, we still believe it will take until well into next year—and, in some cases, 2023 and beyond—for some sectors to recover to 2019 credit metrics. The outlook is further complicated by the resurgence of COVID cases in many parts of the country, and the more-contagious delta variant, which now accounts for most new infections in the U.S. And while it's not yet clear whether the delta variant increases the likelihood of "breakthrough" infections (affecting those who have been vaccinated), the U.S. has extended travel bans and there are signs that social restrictions may once again be needed. Clearly, a fourth wave of cases in the U.S. would hamper the nascent recovery for sectors reliant on consumer mobility.

Moreover, the massive federal fiscal stimulus that has propped up consumer spending is receding. The stimulus economic effect peaked in March-April, and the draw-down of government support could expose the operational and structural headwinds many borrowers face. All told, if the recovery in companies' income starts to wobble, some issuers may find their debt burdens unbearable and credit quality could weaken.

On the bright side, it seems possible that a public infrastructure package of some sort will come to fruition this year, after President Joe Biden and a bipartisan group of senators agreed to a roughly $1 trillion plan on U.S. transportation, water, and broadband. Unlike the American Rescue Plan, which was designed to drive demand and didn't "pay for itself," infrastructure spending would almost certainly return more to the economy than its cost through the so-called multiplier effect.

Table 1

The Key Risks Around Sectors' Baseline Assumptions

Sector	Risk 1	Risk 2	Risk 3
Aerospace and defense	COVID resurgence	Further issues on MAX or 787	Supply chain constraints
Autos	Higher commodity, freight, and labor costs	Economic headwinds	Electrification curbs market positions and cash flows
Building materials	Revenues drops amid high costs	Financial policies	Increase in low-rated debt
Capital goods	Weak recovery in global markets	Weaker ability to pass on cost increases	Financial policies
Chemicals	Financial policies	Macroeconomic setbacks	Oversupply
Consumer products	Higher input, labor, freight, and transportation costs	COVID resurgence	Financial policies
Healthcare	Policy pressure to control health care costs	Legislative changes related to pharmaceuticals	M&A
Homebuilders and developers	Higher mortgage rates	House prices appreciate more than wage growth	Construction pace slows to limit sales
Hotels, gaming and leisure	Financial policies	COVID resurgence	Surviving fitness operators invest
Media and entertainment	Economic slowdown	Secular shifts	Financial policies
Metals and mining	Financial policies	Oversupply	ESG factors
Midstream energy	COVID resurgence	Regulation	Price or capital market shocks
Oil and gas	OPEC	COVID resurgence	Shale production
Real estate	Financial policies	Slower-than-expected recovery	Secular shifts
Regulated utilities	Tax reform	Wildfires	Inflation
Retail and restaurants	COVID resurgence	Supply chain constraints	Secular shifts
Technology	Persistent cost pressure	U.S.-China tension	M&A
Telecommunications	Increasing competition in wireless	--	--
Transportation	Higher fuel costs	COVID resurgence	Higher labor costs
Unregulated power	Slowdown in demand	Power prices decrease	--

COVID-19 / macro
Cost inflation / supply chain
Financial policy / M&A
Other sector-specific issues

Note: Risks have been simplified and standardized. No rank ordering is implied between the risks.
For more information, see Industry Top Trends Update Midyear 2021. Source: S&P Global Ratings.
Copyright © 2021 by Standard & Poor's Financial Services LLC. All rights reserved.

Financial Policies

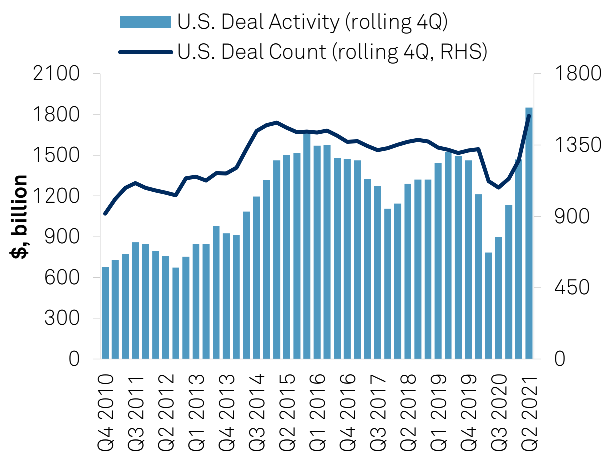
With many sectors recalibrating for the post-COVID world, the focus is turning to financial policies. Recent shifts in consumer and corporate behavior will likely have sustained effects that require a repositioning of business models. Mergers and acquisitions (M&A) and capital expenditures (capex) are the two primary routes to adjusting these, and we expect most U.S. sectors to pursue both routes more substantially this year than in 2020.

M&A has picked up in recent quarters (see chart 2), and the surge will likely continue given the improving economic outlook and attractive financing costs, and continued fuel provided by special-purpose acquisition companies (SPACs) (see "**SPACs And Credit Quality: S&P Global Ratings' Recent Ratings Experience**," published March 12). For example, we've seen a sudden increase in M&A across the **retail REIT** sector, and **consumer staples** issuers, which focused on shoring up liquidity during the peak of the pandemic, have also restarted M&A and shareholder returns. **Health care** consolidation has largely resumed with industry players seeking greater economies of scale with the goal of mitigating competitive and disruptive pressures. In the **media and**

entertainment sector, high-profile transactions, including Discovery/WarnerMedia, Amazon/MGM, and Univision/Televisa's media assets, are pending.

Chart 2

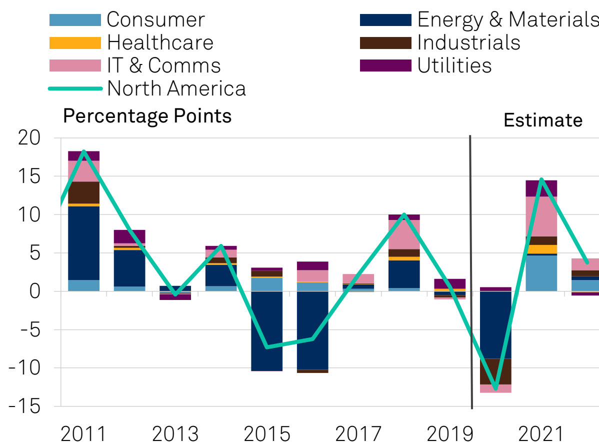
M&A Has Increased In Recent Quarters In the U.S.



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

Chart 3

Sector Contribution Of North American Capex Growth



Source: S&P Global Market Intelligence, S&P Global Ratings. Universe is Global Capex 2000.

In addition, following a 13% slump last year, capex is set to increase 15% this year in North America. This would be the best year since 2011. Consumer, technology, communications, and utility investment lead the way with many of the top spenders set to grow spending rapidly (see chart 3 and "**Global Corporate Capex Survey 2021: Surge Investing**," published July 21).

Conversely, it's important to note that some industries follow more conservative financial policies. Faced with severe headwinds (such as ESG and climate regulation), North American **oil and gas** producers have remained disciplined in their capital spending and maintained healthy balance sheets, while balancing shareholder initiatives. The **midstream energy** sector could be ripe for consolidation given declining organic growth prospects, but large mergers have yet to materialize. **Metals and mining** companies, too, are showing sustained financial and investment prudence.

Nonetheless, while the decision to invest may be welcome in broader economic terms, it does pose credit risks especially in the context of higher leverage. Given high valuations, credit metrics could become stressed, which could translate into ratings pressure.

Inflation

The reopening of the economy isn't without challenges, mainly in the form of sharply rising prices. Inflation as measured by the Consumer Price Index (CPI) jumped 0.9% in June—the most since 2008—and the core reading, which strips out volatile food and energy costs, also rose 0.9%. Year-over-year, CPI rose 5.4%, the sharpest move since September 1991 and well above what most economists expected. Still, much of the annual rise was attributable to the "base effect" increase from pandemic-suppressed prices and to supply-chain problems. For example, prices for used cars (which soared 10.5% and are up a remarkable 45% in the past year), accounted for more than one-third of the increase.

We continue to believe the jump in inflation will be transitory, since "COVID-insensitive" sectors haven't seen the same level of price increases. With stimulus-related household savings likely to boost demand for goods and, especially, services, inflation looks set to stay above the Federal Reserve's target of 2% for this year, but we don't think it will reach "runaway" levels in the near term.

And while corporate borrowers in many sectors are feeling some input-price pressures, we expect this to moderate in the next year or two, as the economic recovery starts to level off and business activities return to more normal levels. For now, industries have largely been able to deal with rising prices via cost savings, productivity gains, or cost pass-throughs (see chart 4).

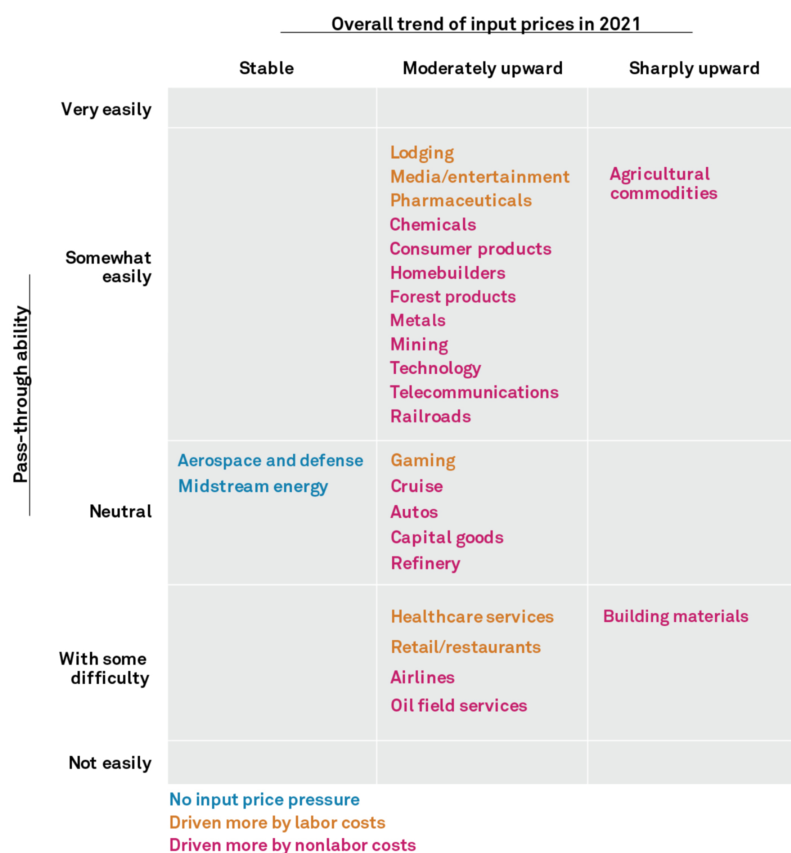
In the near term, cost pressures will shrink profit margins in many sectors, but we expect any erosion to be only moderate and to hit a relatively small percentage of companies. We also don't expect it to weigh too heavily on credit quality. For most, the continuation of the U.S. economic recovery—which will add to revenues—is far more crucial for their bottom lines.

On the other hand, a prolonged period of high inflation would pose downside risks for borrowers in a number of sectors. In the **auto** sector, for example, higher costs for commodities, freight, and labor are squeezing manufacturers. If inflationary pressures linger (say, beyond mid-2022), companies could find it difficult to pass through higher costs to customers—and this could hit ratings and outlooks. The broader **transportation** sector, too, is feeling some heat, and higher fuel costs could slow the ongoing recovery. Airlines, in particular, are highly exposed, and their ability to pass costs through to customers depends on supply-demand balance. And while most freight transporters have fuel surcharges in their contracts, rising labor costs could eat into profit margins.

Other sectors enjoy somewhat more favorable prospects with regard to the pass-through of higher costs. **Homebuilders**, for example, have seen their pricing power outweigh higher input costs so far. Even as lumber prices skyrocketed during the worst of the pandemic—on top of elevated land and labor costs—new home prices largely made up for that. Meanwhile, **building materials** makers have enjoyed strong revenue growth but may face some margin pressures from higher costs because many companies in the sector rely on their ability to pass through volatile commodities costs to bolster earnings. Similarly, **chemicals** producers face rising, but manageable, input prices, as strong demand makes it easier for them to pass on cost increases.

Chart 4

Most U.S. Corporate Sectors Expect Rising Input Prices This Year, While The Pass-through Ability Varies



The assessment reflects an average view based on the U.S. rated entities in each sector. For sectors where the input price trend in 2021 is stable (including aerospace and defense, and midstream energy), the ability to pass-through price pressure is denoted as "neutral".
Source: S&P Global Ratings.
Copyright © 2021 by Standard & Poor's Financial Services LLC. All rights reserved.

Tech/Chip Shortage

Among the supply chain-related issues spurring inflation in some sectors (e.g., autos) is the semiconductor shortage, which we believe will linger into next year (see "**Credit FAQ: Latest Views On Hot Tech Topics--Semiconductor Supply Shortage, Inflation, And Big Tech Regulation**," published July 9). As customers scramble to procure available supplies, normal lead times—the time between when customers place and receive their orders—has lengthened to about 18 weeks from a more typical 13 weeks at the beginning of the year. Increased utilization at existing chip-manufacturing plants (known as fabs) and new manufacturing capacity added since late 2020 are helping to alleviate the pain but still insufficient to meet the rising demand. Large semiconductor manufacturers, such as TSMC, Samsung and Intel, have announced new fab constructions in the tens of billions over the next few years, in anticipation of growing semiconductor demand for years to come.

It's no surprise that the winners of the chip shortage are the semiconductor companies themselves, as they've enjoyed robust demand across a broad range of end markets, an improved pricing environment, and higher factory utilization, which should boost profit margins. In the longer term, we believe semiconductor manufacturers will have better bargaining power over their customers given the growing chip content in virtually all electronics, and relatively high barriers to entry, which should limit competition in the industry.

The primary losers have been auto makers, which have been forced to shutter plants and have estimated losses in the billions of dollars. This could foster more-direct collaboration between the auto industry and semiconductor companies; trade associations in the two industries have already signed a memorandum of understanding to advance collaboration. We could also see auto makers and tier 1 suppliers looking to incentivize chip manufacturers to allocate and guarantee higher capacity to them through committed long-term contracts.

So far, we've seen modest pressure on auto sales forecasts. Despite strong demand, we expect some effect on volume recovery compared with our 2021 base case (a 14%-16% improvement from last year) because of the components shortage and other supply-chain disruptions in 2021.

Top Risks

On top of the pandemic-related risks to the economic recovery, and the possibility that inflationary pressures will push investors to drive up borrowing costs, debt leverage remains at or near record highs. Companies have tapped credit markets at a frenetic pace, not just to survive the crisis but to take advantage of historically low borrowing costs. This has eased near-term maturity pressures at a time when the risks of a bumpy recovery in demand in some sectors remains.

Elsewhere, the U.S.-China strategic confrontation continues to simmer, but the White House has shifted strategy and is enlisting allies (G-7 countries, in particular) in its endeavor, in contrast to the unilateral approach of the previous administration. China is actively pursuing less reliance on markets and technology from foreign countries, and tensions between the countries look set to persist.

The Biden Administration has also accused the Chinese government of the recent hacking of widely used Microsoft email systems, joining with all other NATO countries to condemn Beijing for cyberattacks. President Biden also confronted Russian President Vladimir Putin about cybersecurity at their June summit, seeking an end to ransomware attacks against the U.S.

Either way, cyberattacks continue to pose a systemic threat and significant single-entity risk, and new targets and methods are emerging—as evidenced by the ransomware attacks that shut down the U.S. Colonial Pipeline and some operations at Brazilian meat-processing giant JBS. As almost all public and private organizations are forced to accelerate their digital transformation, the key to resilience is a combination of risk-management, both before and after an attack, followed by swift remediation. Entities lacking well-tested security measures and responses could face more credit risk.

ESG And Policy-Related Risks

As policymakers and investors intensify their focus on ESG, borrowers that are (or are perceived as being) on the wrong side of ESG issues could face increasing policy risks or limited access to capital—with restrictions ranging from having to pay a premium to borrow to being shut out of the capital markets.

In the **metals and mining** industry, ESG factors are influencing investment decisions and credit. Steel producers globally are aiming to reduce their carbon-intensity, which ranks among the highest of any industry. 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.

For **midstream energy** companies, risks related to climate change and the transition to renewable energy have become more pronounced. We think the industry's focus on reducing emissions and seeking alternative, low-carbon opportunities will continue to increase. The Biden Administration has made clear its affinity for renewable energy, and we believe the White House will increase regulation and reduce subsidies/tax deductions for the **oil and gas** industry. The operating environment for domestic shale producers will undoubtedly become more difficult. Along these lines, energy transformation is affecting regulated utilities, with the sector focused on reaching "net zero" by further reducing its greenhouse gas (GHG) emissions. (The industry's GHG emissions are down about 25% in the past 10 years, and we expect a further 40% reduction in the coming decade as renewables displace coal-fired generation.)

On the flip side, the **auto** industry enjoys some upside from the (so far, slow) transition to electric vehicles (EVs). The Biden Administration's announced $174 billion commitment to accelerate EV adoption—including point-of-sale rebates, tax incentives, and the mass installation of charging stations—could boost EV sales above our base-case of 10% of U.S. light vehicle sales by 2025 (versus just 2% in 2020). The president's infrastructure plans would also benefit **building materials** companies, even if the programs are not purely building-related.

Financing Conditions And Ratings Trends

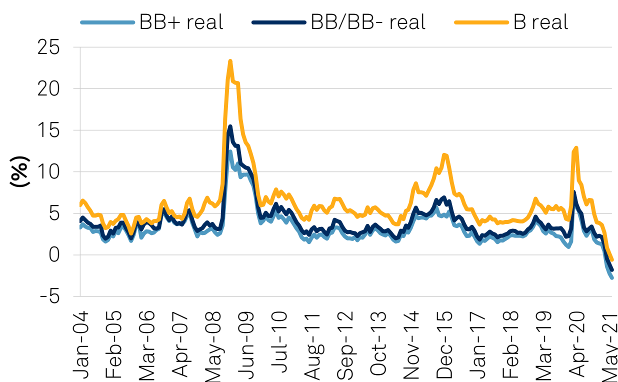
After financing conditions generally reached their most favorable levels ever in late-2020—with yields on Treasuries reaching all-time lows and corporate yields following suit—borrowing costs have risen but financing conditions on the whole have rarely been this good across so many asset classes and levels of credit quality. We expect this to continue for the next several months, barring any unforeseen shock. Even if borrowing costs rise, they have some way to go before returning even to the still-favorable levels through much of the 2011-2019 period. Many issuers have already refinanced debt at better terms, leaving a smaller amount coming due in the short-term—especially among speculative-grade firms.

Combined with higher inflation, these conditions have led to a first in the U.S.: "real" yields (defined here as secondary-market corporate bond yields minus year-over-year changes in headline CPI) have fallen into negative territory, even for 'B' credits (see chart 5).

A second market anomaly has come in the form of speculative-grade debt issuance, which has been massive this year. Through June, combined leveraged loan and spec-grade bond issuance hit $648 billion—a total normally not seen until autumn—and, for the first time, exceeding year-to-date (YTD) investment-grade bond issuance (see chart 6). What makes this even more impressive is that YTD investment-grade issuance is well ahead of the typical levels of recent years.

Chart 5

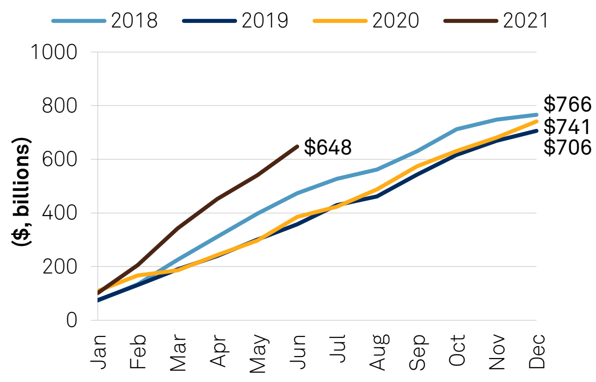
"Real" U.S. Corporate Yields



Source: S&P Global Ratings.

Chart 6

2021 Combined Spec-Grade Issuance Sets A Record



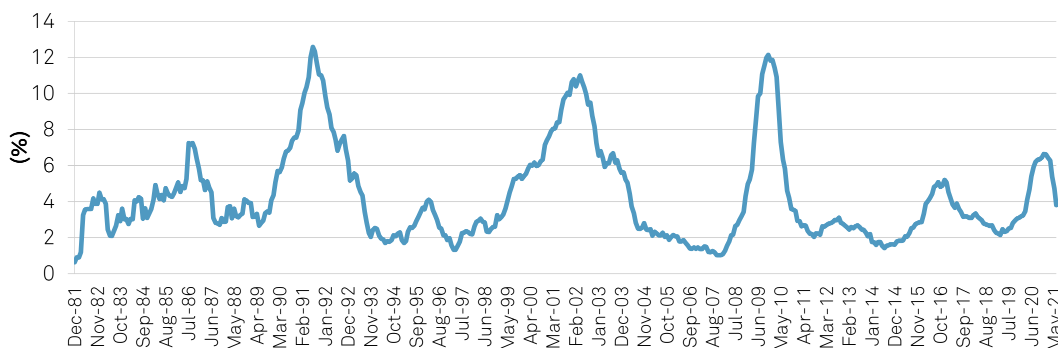
Combined spec-grade bond and leveraged loan issuance. Sources: Refinitiv; LCD, an offering of S&P Global Market Intelligence; S&P Global Ratings.

All of this comes amid a pronounced drop-off in defaults. We estimate that the trailing-12-month speculative-grade default rate through June fell to just 3.8%, down from 6.65% in 2020 and 6.3% through March and representing one of the quickest declines of the default rate (see chart 7).

We now expect the pace of defaults to continue to decline in the months ahead, given such favorable financing conditions, the small amount of upcoming maturities, and strong economic growth (underpinned by expectations for inflation to be transitory).

Chart 7

U.S. Speculative-Grade Default Rate



Data through May 31, 2021. Sources: S&P Global Market Intelligence's CreditPro®; S&P Global Ratings.

Corporate Maturities Rise Through 2025

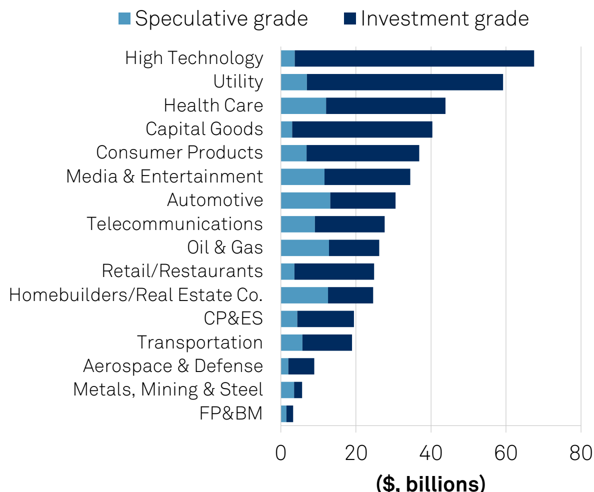
Upcoming debt maturities for U.S. corporates appear to be broadly manageable. The maturity wall for these borrowers doesn't peak until 2025, offering companies several years in which to refinance or pay down debt. U.S. corporates have $209.2 billion in rated debt (including bonds, notes, loans, and revolving credit facilities) due in the second half of this year, and $472.5 billion maturing in the next 12 months (see chart 8).

Chart 8

U.S. Nonfinancial Corporate Maturities Through 1H 2022

Chart 9

U.S. Corporate Maturities Over Next 12 Months By Sector



CP&ES—Chemicals, Packaging and Environmental Services. FP&BM—Forest Products and Building Materials. Data as of July 1, 2021. Chart shows maturities of nonfinancial corporate debt, including bonds, loans, and revolving credit facilities that are rated by S&P Global Ratings. Source: S&P Global Ratings.

Most of the debt maturing over the next 12 months is investment-grade. Upcoming speculative-grade maturities over the next 12 months total $112.7 billion. However, speculative-grade maturities are scheduled to rise steeply over the next several years, reaching a peak of $526 billion in 2025. While financing conditions have been very welcoming of lower-rated debt, investor sentiment can shift quickly. In such a scenario, individual issuers, particularly those at the lowest rating levels and those viewed as distressed by the market, could face higher funding costs and limited options to refinance maturing debt.

By sector, technology has the most debt due in the next 12 months, with $67.5 billion—94% of which is investment-grade (see chart 9). Utilities follows with $59 billion (88% investment grade). Sectors with the most speculative-grade debt set to mature in the next 12 months include autos (with $13 billion), and oil and gas (with $12.9 billion).

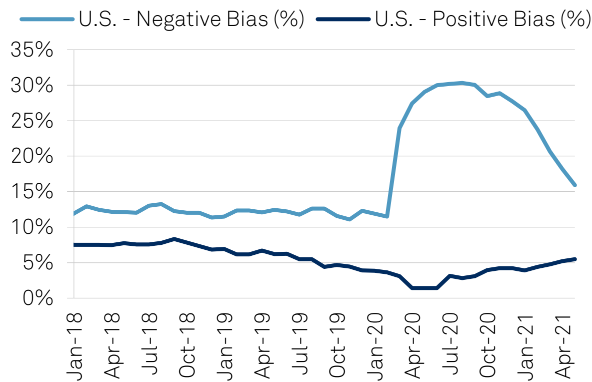
'BBB' Stabilizing

With the economic rebound, credit quality is stabilizing for 'BBB' category companies in the U.S. As a result, fallen angels (issuers downgraded to speculative-grade from investment-grade) have steeply declined this year; through May, there have been just two fallen angels among U.S. nonfinancial corporates, with only $5.4 billion in associated debt. By contrast, for full-year 2020, 24 issuers in the U.S. fell to speculative-grade, with close to $285 billion in debt.

Additionally, the negative bias (the proportion of issuers with negative outlooks or ratings on CreditWatch with negative implications) suggests that downgrades of 'BBB' companies will continue to decline; the negative bias for 'BBB' U.S. nonfinancial corporates has fallen to 16% (as of May 31) from 28% at of the beginning of the year, while the positive bias has increased by a percentage point, to 5% (see chart 10).

Chart 10

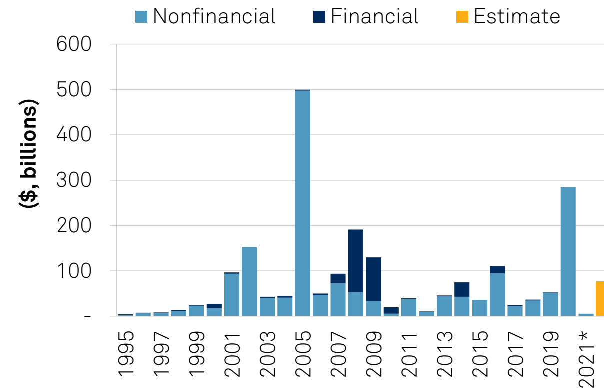
'BBB' Outlooks Are Improving



Source: S&P Global Ratings.

Chart 11

2021 On Track For Lower Fallen Angel Debt In The U.S.



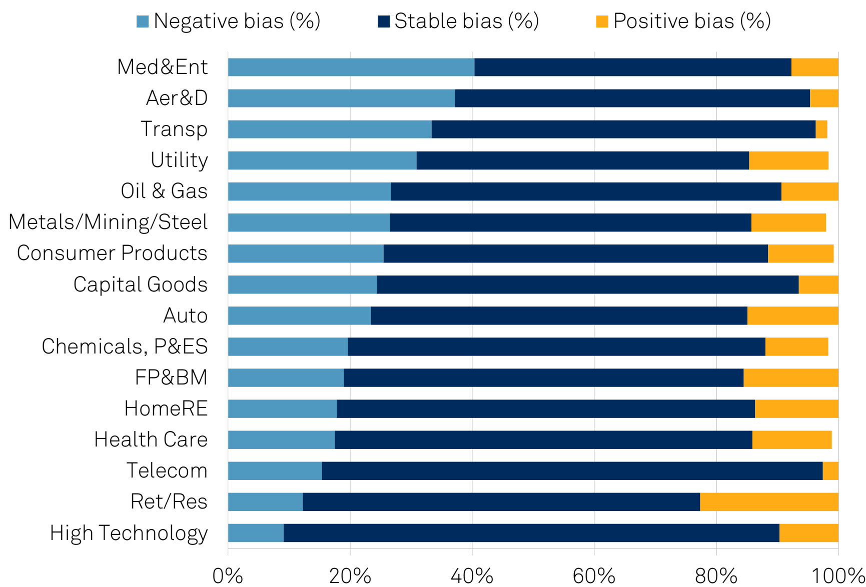
* 2021 through May. The estimate column shows nonfinancial projection from June 1, 2021 through May 31, 2022 for the U.S. and tax havens. Source: S&P Global Ratings.

We estimate about $77 billion in 'BBB' category debt from nonfinancial companies in the U.S. could fall to spec-grade in the next 12 months. This would represent about 2.4% of total 'BBB' nonfinancial debt—a sharp decline from the volume of fallen angels in 2020 (see chart 11).

The negative bias (issuers with a negative outlook or CreditWatch placement with negative implications) among spec-grade nonfinancial corporate issuers has come down to 20% in June, from a record high of 52% in May 2020. Nonetheless, sectors such as media and entertainment, aerospace and defense, and transportation still reflect high downgrade potential (see chart 12).

Chart 12

Outlook Distribution By Sector



Data as of June 30, 2021. S&P Global Ratings. Aer&D--Aerospace & Defense. Auto—Automotive, Chemicals, P&ES—Chemicals, Packaging and Environmental Services, HomeRE—Homebuilders/Real Estate Co. Med&Ent—Media & Entertainment. Ret/Res—Retail/Restaurants. Transp—Transportation, Telecom—Telecommunications, FP&BM—Forest Products & Building Materials, Metals/Mining/Steel- Metals, Mining & Steel.

Leveraged Finance

Leverage across sectors has begun to decline from the pandemic peaks but remains above 2019 levels for most sectors—in several cases, meaningfully above. For example, leverage in the transportation, metals and mining, autos, oil and gas, and media and entertainment sectors is still well above pre-pandemic levels. We expect some further progress in deleveraging, but how companies deploy cash balances remains a factor in the pace of debt reduction and improvements in credit ratios (see table 2).

Table 2

Median Leverage By Industry: Year-end 2019 – Q1 2021

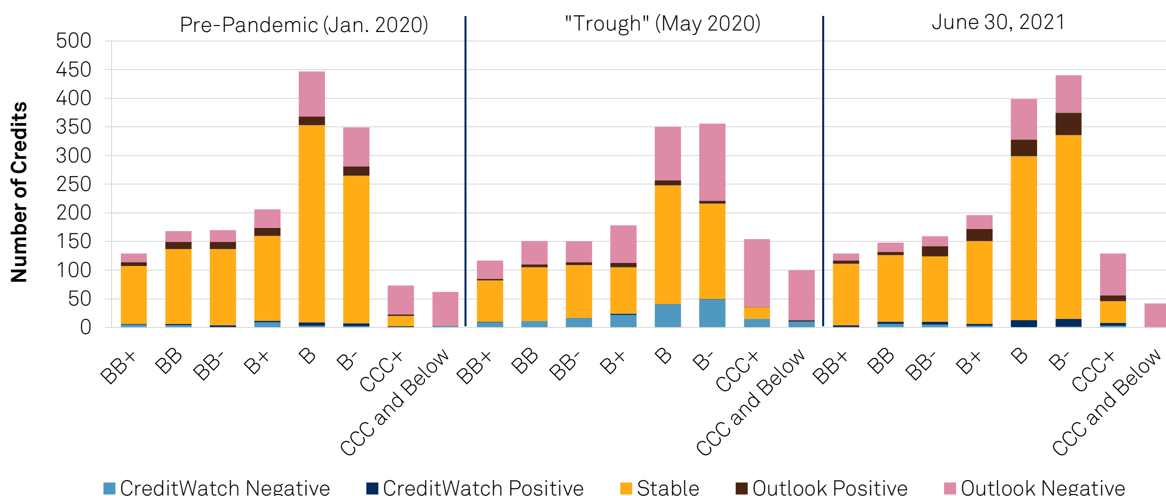
		Median Leverage (x)						
Industry	**Entity Count**	**2019Q3 LTM**	**2019**	**2020Q1 LTM**	**2020Q2 LTM**	**2020Q3 LTM**	**2020**	**2021Q1 LTM**
Aerospace/defense	27	5.2	4.8	5.0	6.2	5.5	5.6	6.1
Auto/trucks	32	3.7	3.7	4.2	6.6	6.3	5.3	5.0
Business and consumer services	89	6.6	7.1	7.3	7.5	7.5	7.0	6.8
Capital goods/machine & equipment	128	5.7	5.8	6.2	6.3	6.3	5.5	5.8
Chemicals	47	5.2	5.3	5.5	6.6	6.0	6.0	5.2
Consumer Products	106	6.0	6.1	6.6	6.4	5.8	6.1	5.5
Forest products/building materials/packaging	42	4.4	4.4	4.6	4.0	3.9	3.6	3.8
Healthcare	98	6.9	6.9	7.8	7.9	7.5	7.5	6.8
Media, entertainment & leisure	148	5.5	5.3	6.2	8.0	8.1	7.5	7.4
Mining & minerals	48	3.0	2.9	3.3	4.0	4.3	4.5	4.1
Oil & gas	67	2.5	2.9	3.0	4.2	5.4	5.1	5.5
Restaurants/retailing	81	4.0	4.4	4.9	6.9	6.0	6.1	5.9
Real estate	32	7.1	6.9	7.7	7.7	8.2	7.9	7.5
Technology	101	7.3	7.6	8.0	7.9	7.4	7.4	7.7
Telecommunications	44	5.0	5.2	5.3	5.1	5.1	4.9	4.6
Transportation	31	4.7	4.6	5.0	6.9	8.5	7.2	7.5
Total	**1,121**	**5.5**	**5.4**	**6.1**	**6.7**	**6.5**	**6.3**	**6.1**

LTM—Last 12 months. Leverage—Debt-to-EBITDA (x). Source: S&P Global Ratings.

And while upgrades continue, companies rated 'B-' now represent the largest cohort in the spec-grade universe, accounting for 27% of the total (see chart 13). Before the crisis, companies rated 'B' were the most represented. In addition to the downgrades carried out during the pandemic-induced shutdowns, there was also an increase in new issuers at 'B-' (see "**Leveraged Finance: Insights About First-Quarter 2021 New Issuers**," published May 12). At the same time, the number of companies rated 'CCC+' remains high, even as the total declines as companies refinance and enjoy economic tailwinds.

Chart 13

North America Speculative Grade Ratings Distribution



Source: S&P Global Ratings.

About 37% of U.S. spec-grade issuers are rated 'B-' or below (as of July 15). This compares to a total of around 30% at the beginning of 2020, before the pandemic. The general downward trend in ratings reflects the leverage that U.S. corporates have amassed amid low interest rates, high valuation multiples, and accommodative debt markets even for highly leveraged credits. Our default forecast for the 12 months ending March 2022 is 4% for overall speculative-grade (on an issuer count basis and including selective defaults) and 1.75% for leveraged loans (also on an issuer count basis but excluding selective defaults).

Recovery Prospects

The swings in economic conditions and credit quality in the past year and a half highlight that our recovery ratings and recovery point estimates are generally much more stable than issue ratings during periods of stress. This is because our recovery analysis already considers a default scenario, so they don't necessarily need to change when credit stress hits. The same is true in reverse.

Rather, recovery expectations primarily change when companies materially modify their capital structures by changing debt amounts or revising relative priorities. Further, recovery expectations are generally more volatile and sensitive for junior debt instruments (first-lien last-out, second-lien, unsecured, etc.)—unless our recovery expectations are already nominal—and for debt of companies with low-speculative-grade rating that may have already maxed out debt capacity. Conversely, recovery rates for first-lien debt are generally more stable.

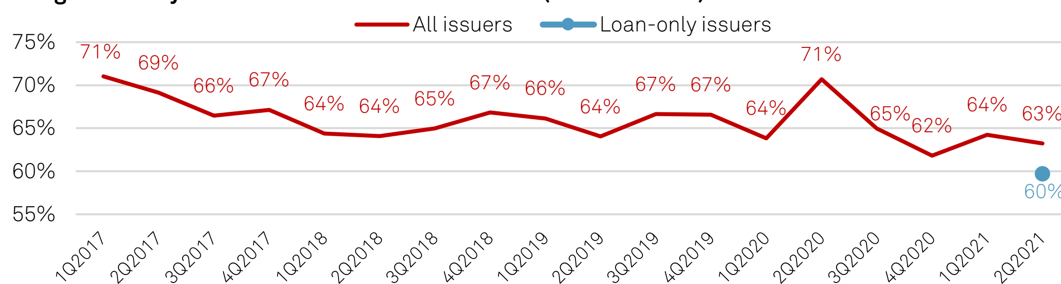
While the number of downgrades of spec-grade companies last year were quite high—with roughly one-third of the more than 1,500 issuers with loans held by U.S. CLOs suffering at least one downgrade of a notch or more—negative actions on the recovery ratings for the debt of these companies were limited: Only about 12% of the roughly 2,100 debt issues held by U.S. CLOs had a negative recovery change. And more than half of those changes (133 of 244) represented declines in our recovery point estimates not large enough to change the recovery ratings themselves. Further, of the 111 recovery ratings that did change, 89% were of just one category.

Unsurprisingly, most of the changes were in response to modifications in debt structure as corporate issuers were quite active in borrowing to boost liquidity and push out debt maturities. Debt issues with more significant changes in recovery ratings predominantly reflected changes to junior debt instruments (such as second-lien and structurally junior holding company debt) as well as some of the more aggressive debt restructurings we saw last year.

In the first half of this year, changes in recovery ratings were balanced to slightly positive, with 92 upgrades and 75 downgrades. The primary driver of positive changes were debt repayments from excess liquidity or equity offerings, as well as the refinancing of secured debt with unsecured debt. Negative changes largely reflected the effects of debt-financed dividends and debt-funded M&A. To put the year-to-date changes in perspective, they represent just a small proportion of the more than 2,800 rated debt instruments and don't fundamentally change the recovery prospects of any debt class. Our expectations for recovery rates remain below historical averages, given that total debt leverage and first-lien debt leverage levels have increased in recent years. Our recovery ratings indicate average recoveries on first-lien debt in the mid-60% area (compared with 75%-80% historically) (see chart 14). The thickening of the senior layer of first-lien debt also often pushes down recovery prospects for more junior debt classes.

Chart 14

Average Recovery Estimate of First Lien New Issues (U.S. & Canada)



Source: S&P Global Ratings.

We caution that our recovery estimates don't include potential event risk related to significant erosion in debt protections in loan documents, which give companies considerable leeway to take actions that may compromise recovery prospects (through loose restrictions around adding debt, selling or transferring assets/collateral, etc.). We don't prospectively factor this risk into our recovery ratings because they aren't predictable or quantifiable, in our view. Instead, we capture these risks as part of our ongoing ratings surveillance.

CLOs: The Great Rebound

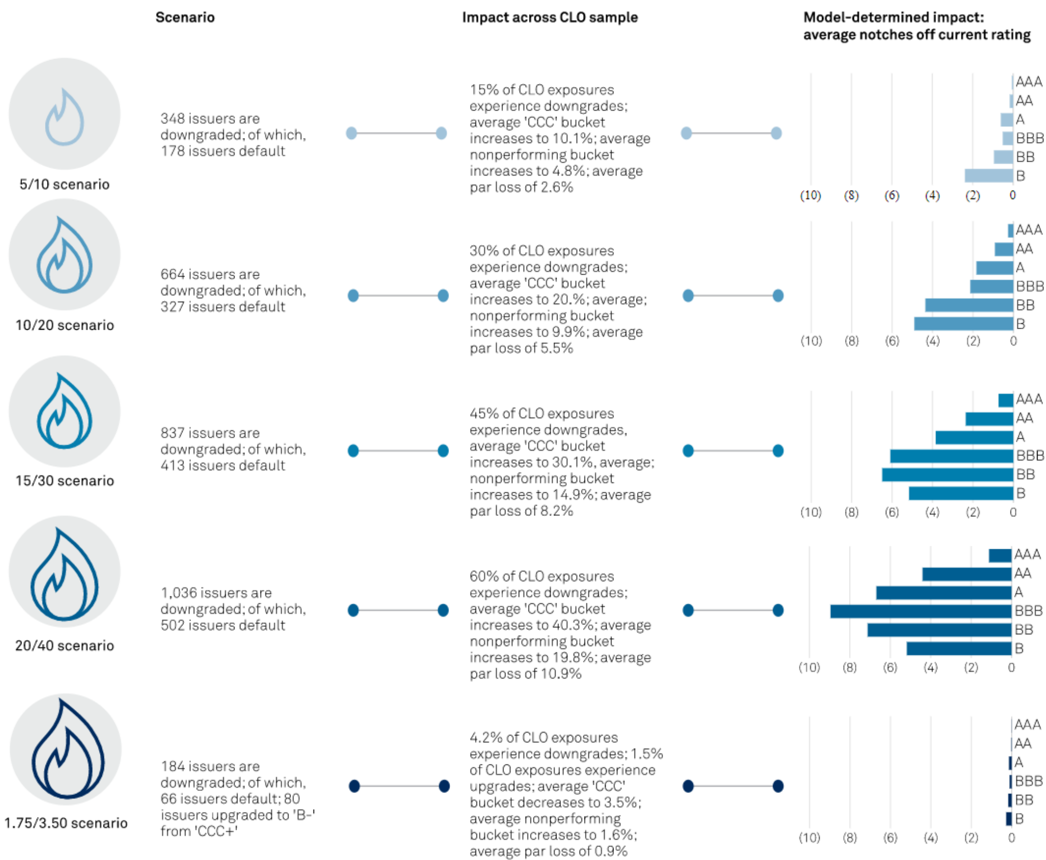
Given the prospect for rising interest rates, there has been more issuance of loans than bonds. A main driver of this has been collateralized loan obligations (CLOs), which came roaring back in the first half with record-setting issuance along with gradual improvement in credit quality for transactions that came through the pandemic. Investors searching for yield see floating-rate assets as a potential hedge against rising rates; CLO issuance has also benefitted from new entrants into the market, as CLO ratings held up relatively well amid the economic turmoil last year.

In a test of the ratings resiliency of U.S. broadly syndicated loan (BSL) CLOs for the next possible downturn, we note that between transactions originated before COVID and those after, there's a difference in ratings outcomes within a given scenario, especially at lower ratings (see "**How The Next Downturn Could Affect U.S. BSL CLO Ratings**," published June 17). This is because the newer transactions, having not experienced the credit effects of the pandemic, generally have cleaner portfolios and larger ratings cushions in place than.

However, our recent analysis shows the fundamentals of CLO structures protecting senior noteholders, with more than 90% of the 'AAA' CLO notes seeing no more than a one-notch downgrade even in the harshest of scenarios, where defaults and 'CCC' buckets across CLOs reach 20% and 40%, respectively (see chart 15). None of the 'AAA' CLO ratings move below 'A+' in any scenario.

Chart 15

Summary Of Scenarios And Ratings Impact



Source: S&P Global Ratings.

Copyright © 2021 by Standard & Poor's Financial Services LLC. All rights reserved.

Related Research

- Global Corporate Capex Survey 2021: Surge Investing, July 21, 2021
- Industry Top Trends Midyear 2021: Resilience, Recovery, Risks, July 20, 2021
- Credit FAQ: Latest Views On Hot Tech Topics--Semiconductor Supply Shortage, Inflation, And Big Tech Regulation, July 9, 2021
- Credit Conditions North America Q3 2021: Looking Ahead, It's Looking Up, June 29, 2021
- How The Next Downturn Could Affect U.S. BSL CLO Ratings, June 17, 2021
- The S&P/LSTA Leveraged Loan Index Default Rate Is Expected To Fall To 1.75% By March 2022, June 15, 2021
- COVID-19 Heat Map: Pent-Up Demand And Supply Shortages Further Improve Recovery Prospects For Credit Quality, June 8, 2021
- The U.S. Speculative-Grade Corporate Default Rate Could Fall To 4% By March 2022, May 26, 2021
- Leveraged Finance: Insights About First-Quarter 2021 New Issuers, May 12, 2021
- U.S. Corporate Cost Pressures May Hit Profit Margins In The Near Term, April 27, 2021
- SPACs And Credit Quality: S&P Global Ratings' Recent Ratings Experience, March 12, 2021

This report does not constitute a rating action.

North American Industry Top Trends Update

Aerospace and Defense

Commercial aerospace no longer losing altitude

Christopher DeNicolo, CFA
Washington, D.C.
christopher.denicolo@spglobal.com
+1 202 383 2398

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.

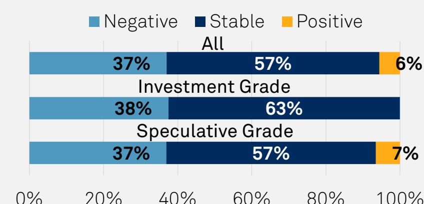
What are the key risks around the baseline?

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	

North American Industry Top Trends Update

Autos

Pent-up demand, strong pricing will limit downside risks

Nishit Madlani
New York
nishit.madlani@
spglobal.com
+1 212 438 4070

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.

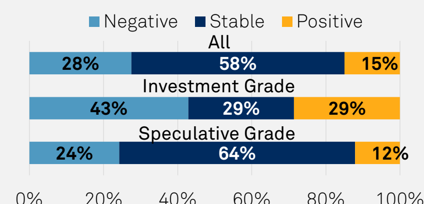
Economic headwinds. New virus strains, rising gas prices, or slowing housing starts could keep consumers cautious and curtail automotive demand recovery.

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.

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

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%

North American Industry Top Trends Update

Building Materials

A revenue boom faces higher costs

Don Marleau, CFA
Toronto
donald.marleau@
spglobal.com
+1 416 507 2526

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.

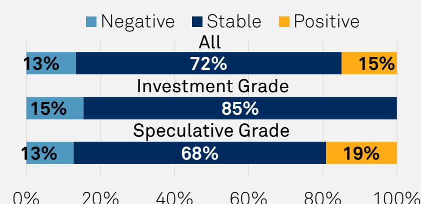
What are the key risks around the baseline?

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**	

North American Industry Top Trends Update

Capital Goods

As end markets recover, cost inflation risk rises

Ana Lai, CFA
New York
ana.lai@
spglobal.com
+1 212 438 6895

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.

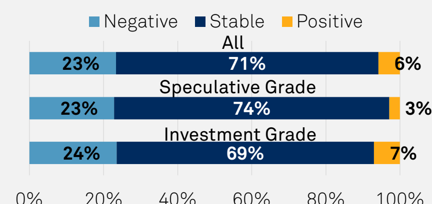
Weaker ability to pass on cost increases. Persistent inflation and lingering cost increases into 2022, coupled with weaker demand, could lead to meaningful margin pressure, particularly if supply chain disruption is prolonged.

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%

North American Industry Top Trends Update

Chemicals

Credit quality rebounds

Paul Kurias
New York
paul.kurias@
spglobal.com
+1 212 438 3486

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.

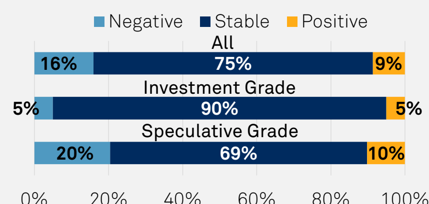
What are the key risks around the baseline?

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.

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%	

North American Industry Top Trends Update

Consumer Products

A gradual return to normalcy

Bea Chiem
San Francisco
bea.chiem@
spglobal.com
+1 415 371 5070

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.

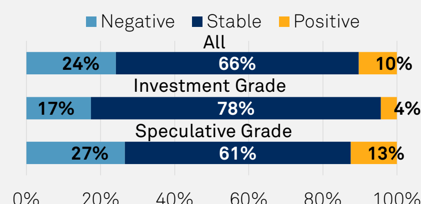
What are the key risks around the baseline?

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%	

North American Industry Top Trends Update

Health Care

Positive rating actions likely to outpace negative ones in 2H

Arthur Wong
Toronto
arthur.wong@
spglobal.com
+1 416 507 2561

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.

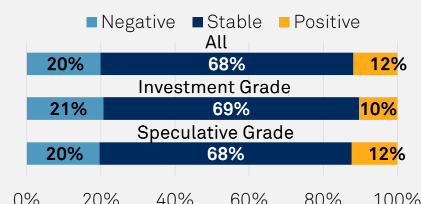
Pharma will receive increased focus. Despite the political divide in Washington, pharmaceutical pricing reform continues to have bipartisan support. Legislative moves could have an impact on the industry.

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.

Latest Related Research

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

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%

North American Industry Top Trends Update

Homebuilders and Developers

U.S. homebuilders use boom to improve credit quality

Maurice Austin
New York
maurice.austin@
spglobal.com
+1 212 438 2077

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.

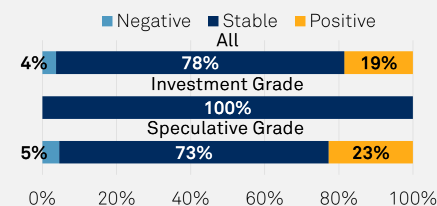
House prices appreciate more than wage growth. The supply/demand imbalance has caused greater home price appreciation than expected. As this occurs, first-time/entry-level homebuyers could get priced out of the market.

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.

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

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**

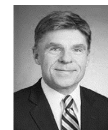
2021 Estimates v. 2019	
Revenue Decline	**EBITDA Decline**
>2019	**>2019**

North American Industry Top Trends Update

Hotels, Gaming, and Leisure

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

Emile Courtney
New York
emile.courtney@
spglobal.com
+1 212 438 7824



Melissa Long
New York
melissa.long@
spglobal.com
+1 212 438 3886

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.

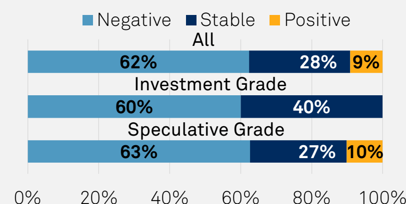
Virus variants. A virus strain that renders vaccines less effective or causes a significant spike in cases among the unvaccinated could slow the travel recovery by diminishing consumers' confidence in leisure travel, delaying the resumption of business and group travel, and possibly leading to additional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

North American Industry Top Trends Update

Media and Entertainment

Pandemic in the rearview mirror, secular trends in focus

Rose Oberman, CFA
New York
rose.oberman@
spglobal.com
+1 212 438 0354

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.

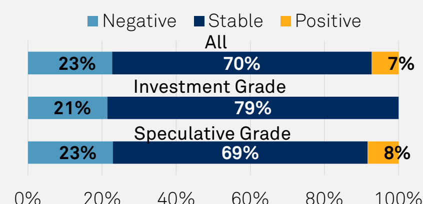
What are the key risks around the baseline?

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

North American Industry Top Trends Update

Metals and Mining

Surging metals prices power windfall profits

Don Marleau, CFA
Toronto
donald.marleau@
spglobal.com
+1 416 507 2526

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.

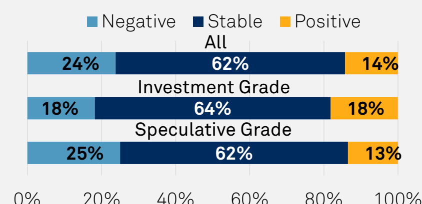
What are the key risks around the baseline?

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

North American Industry Top Trends Update

Midstream Energy

Sector stable, but future presents challenges

Michael Grande
New York
michael.grande@
spglobal.com
+1 212 438 2242

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.

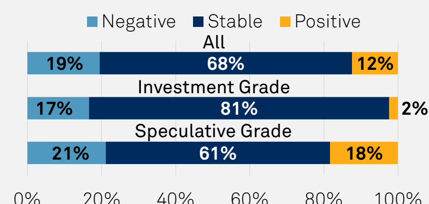
Regulation. The Biden Administration continues to promote its clean-energy plan and has rolled back more favorable Trump-era industry policies. The recovery could falter if climate regulation increases or drilling limits are enacted.

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.

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

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%

North American Industry Top Trends Update

Oil and Gas

Improved credit quality but industry still faces headwinds

Thomas Watters
New York
thomas.watters@
spglobal.com
+1 212 438 7818

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.

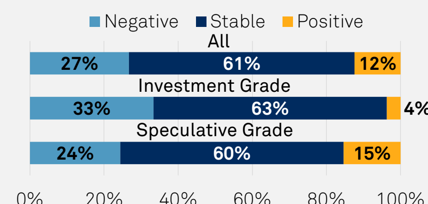
What are the key risks around the baseline?

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%

North American Industry Top Trends Update

Real Estate

Fundamentals on track to recover

Ana Lai, CFA
New York
ana.lai@
spglobal.com
+1 212 438 6895

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.

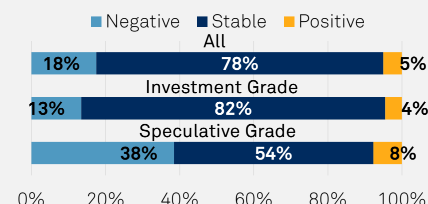
Slower-than-expected recovery. Lack of rebound in leasing activity could delay recovery. Leasing activity is starting to pick up after depressed levels in 2020. Still, re-leasing spreads are negative for malls and flat for strip centers, as tenant quality remains challenged. For office, a slow return 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%

North American Industry Top Trends Update

Regulated Utilities

Credit quality is weakening

Gabe Grosberg
New York
gabe.grosberg@
spglobal.com
+1 212 438 6043

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.

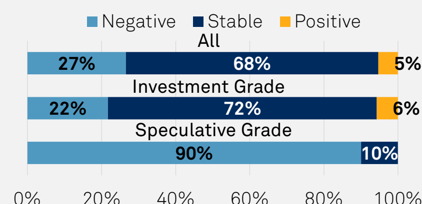
Wildfires. California again received below-average rainfall, remaining susceptible to catastrophic wildfires. However, the utilities have invested billions in wildfire mitigation that they believe will offset the rising environmental risks.

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.

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

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

North American Industry Top Trends Update

Retail and Restaurants

The road to recovery starts with a spending spree

Sarah Wyeth
New York
sarah.wyeth@
spglobal.com
+1 212 438 5658

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.

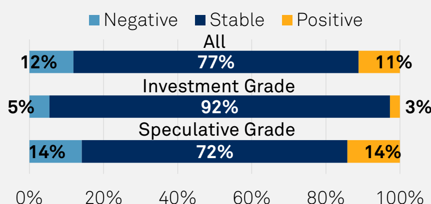
What are the key risks around the baseline?

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%

North American Industry Top Trends Update

Technology

Positive rating actions bias for 12 months and counting

David Tsui
San Francisco
david.tsui@
spglobal.com
+1 415 371 5063

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.

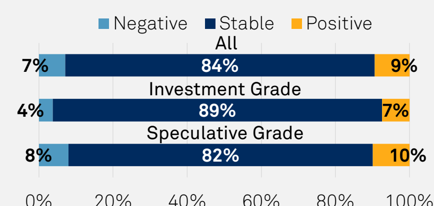
What are the key risks around the baseline?

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

North American Industry Top Trends Update

Telecommunications

Challenges ahead for U.S. telcos

Allyn Arden, CFA
New York
allyn.arden@
spglobal.com
+1 212 438 7832

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.

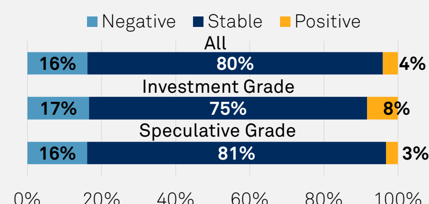
Rating trends should be more balanced. Downgrades outpaced upgrades by more than 2 to 1 in 2020, with most negative actions at the lower end of the rating scale. We expect trends to be more balanced in 2021 as economic conditions improve and low interest rates enable the refinancing of capital structures.

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

North American Industry Top Trends Update

Transportation

The road to recovery is clearing, could encounter curves

Philip Baggaley
New York
philip.baggaley@
spglobal.com
+1 646 285 4615

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.

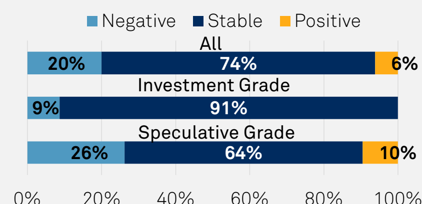
What are the key risks around the baseline?

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

North American Industry Top Trends Update

Transportation Infrastructure

The new normal is yet to be defined

Dhaval Shah
Toronto
dhaval.shah@
spglobal.com
+1 416 507 3272

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.

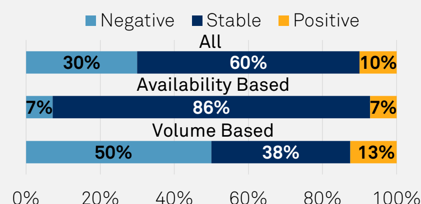
A third wave of infections or inefficacy of vaccine against variants could lead to additional government lockdown measures that either delay or reverse the recovery in volumes from pre-pandemic levels.

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.

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

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.

North American Industry Top Trends Update

Unregulated Power

Capacity markets disappoint more than expected

Aneesh Prabhu
New York
aneesh.prabhu@
spglobal.com
+1 212 438 1285

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?

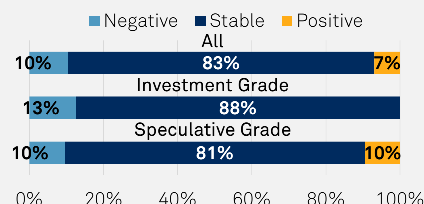
Demand could still be irreparably harmed. Declining loads could have a secular slant, which could hurt power prices over the long run.

Power prices climb has been 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.

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

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%

Copyright © 2021 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.spcapitaliq.com (subscription) and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.

spglobal.com/ratings