Industry Top Trends Update

Unregulated Power

An unprecedented power price run

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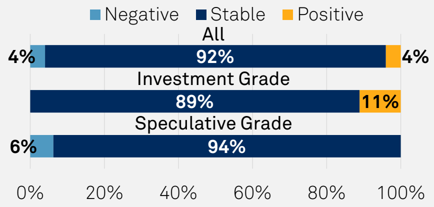
What's changed?

An epic bull run. Prices that had barely touched $40/MWh at the start of 2022 rose to $100/MWh and $85/MWh by April for calendar 2022 and 2023, respectively, and retreated to $60-$70/MWh levels only after a major outage at an LNG unit. Year 2024-2025 forward prices are still above $50/MWh and higher than levels at the end of Q1 2022 in both ERCOT and the PJM Interconnection.

Prices in all capacity markets are at their lowest. The decline is particularly severe in PJM, which recorded a new decade-low in the RTO and ComEd zones. EMAAC also cleared an all-time low. PJM market rule changes, returning nuclear capacity, and modest supply additions contributed to the tepid prices. With no real catalyst to spur bidding behavior, we see no significant improvement in the next auction.

Stronger financial performance. Despite concerns of a slowing economy and a heavily hedged position entering the year, financial performance of independent power producers (IPPs) should improve for 2022 compared to expectations at year-end 2021. Unlike power project financings, which may not have adequate liquidity for margining provisions, most IPPs have hedged their economic generation for 2023 and 2024 during the second quarter.

Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	9	16	25
Downgrades	0	0	0
Upgrades	0	0	0

Ratings data as of end-June 2022. * Year-to-date

What to look out for?

Retail power. The run-up in wholesale power price is the first real test for retail power companies, especially for asset-light providers. Margins could erode as procurement costs increase and contracts come up for renewal.

Grid stability. In California there is a potential for 1.7GW-1.8 GW shortages across 2022-2025, even when factoring the 11.5 GW new resource target. In the Midwest the capacity auction priced at $237/MW-day for Zones 1-7, up from $5 last year, prompting utilities to delay coal plant retirements; and in ERCOT spark spreads have expanded even as the Capacity, Demand and Reserve report tells a story of adequate capacity and reserve margins.

State challenges to EPA rules. We're waiting to see how the implementation of the Cross-State Air Pollution Rule (CSAPR) timeline will proceed after the U.S. Supreme Court limited the Environmental Protection Agency's authority to set standards on climate-changing greenhouse gas emissions for existing power plants.

What if there's a recession?

More resilience than other sectors. With strong performances by Vistra, NRG, and others during the pandemic, we have recent history of how the financials have held up through a brief recession. Typically, power companies experience a 3%-4% overall dip lead by a 10%-15% decline in industrial/commercial volumes, which are recovered in about 18 months. IPPs have become more focused on a net long exposure to natural gas and high cash flow yields play.

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- Power Markets Update: PJM's Capacity Market Auction Lays Another Egg, July 12, 2022
- Hedged U.S. Unregulated Power Generators: No Rest For The Weary, May 11, 2022