The Ratings View

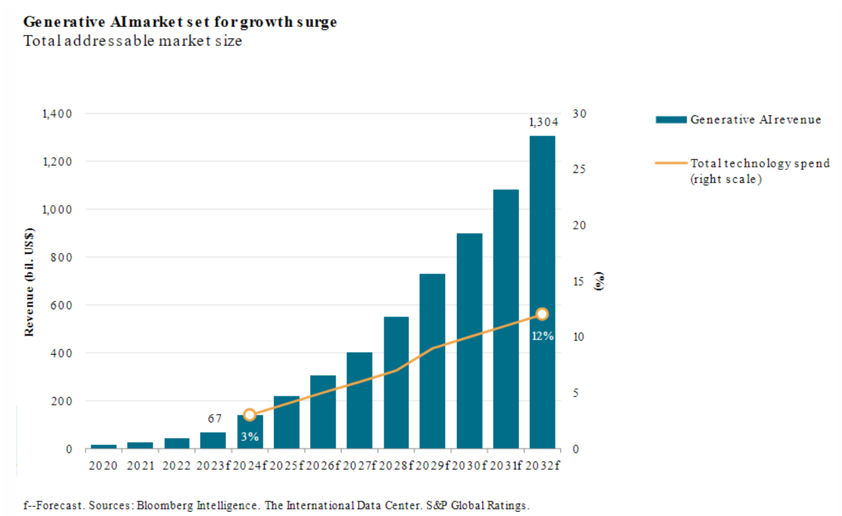
November 15, 2023

This report does not constitute a rating action.

Key Takeaways

- Generative AI will spur heavy investment and boost demand for related tech hardware.
- Lower-rated U.S. borrowers face challenges in refinancing near-term debt maturities.
- Extreme weather events are posing challenges or North American utilities' credit quality.

The popularity and development of generative artificial intelligence (AI) will spur heavy AI investment over the next three years and boost demand for related tech hardware. Foundry leader Taiwan Semiconductor Manufacturing Co., memory chip producer SK Hynix Inc., and chip designer NVIDIA Corp. will be among the chief beneficiaries of the investment boom. To a lesser degree, server vendors should also benefit from AI server sales, which is incremental to conventional server business. The longer-term implications for rated tech firms are less clear and depend on how they can adapt to an evolving AI-induced shift. Accurately pacing, timing, and executing AI-related investments will be key determinants.



[Gen AI Is Writing A New Credit Story For Tech Giants]

Lower-rated U.S. borrowers face challenges in refinancing near-term debt maturities. Factoring in longer-dated maturities by pulling them forward to the first year when a quarter or more of a company's total outstanding debt comes due, about 18% of the debt held at 'B-' rated borrowers comes due in the next two years. Pressure to meet interest payments is mounting among loan-only issuers as tighter financial conditions filter through. That group's median interest coverage fell below 2x as of June 30, from 2.1x at the start of the year. Nearly one-quarter of 'B-' rated borrowers had EBITDA interest coverage of less than 1x in the 12-months-ended on June 30.

[U.S. Leveraged Finance Q3 2023 Update: The Lowdown On High Interest Rates]

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Extreme weather events are posing challenges for North American utilities' credit quality. Climate change is increasing the frequency and severity of storms, hurricanes, wildfires, and other natural disasters, which is escalating infrastructure damage and raising credit risks for North America's investor-owned utilities (IOUs) and publicly owned utilities (POUs). To reduce credit risks, we expect IOUs and POUs will limit damages from physical events by leveraging already developed and in-use technologies. We also expect that IOUs will likely enhance civil litigation strategies and expand their cost-recovery capabilities. Over the past six years, IOU and POU downgrades directly related to physical risks have significantly increased. The credit quality of utilities with physical risk exposure could come under even more pressure if comprehensive risk-reduction strategies are not effectively implemented.

A Storm Is Brewing: Extreme Weather Events Pressure North American Utilities' Credit Quality

Investors in China's property bonds can expect very different cash recovery rates than those of the country's non-property bonds. We examined all the defaults since 2015 in China's domestic bond market (717 bonds) and dollar bond market (368). Key findings for U.S. dollar-denominated bonds include the following. This year, four times as many defaulted bonds were resolved by courts than in 2022, while only one-fifth as many were able to settle out of court. 60% of property and 41% of non-property bond defaults remain unresolved, but more are likely to go to court as other options run out. After defaults, unresolved cases typically enter courts in two to nine months and are resolved within two months thereafter. Property bonds tend to be resolved faster than non-property, both out of court and in court. However, property bonds' cash recovery rates are lower than non-property both out of court (36% vs. 47%) and in court (3% vs. 18%).

China Bond Recovery Review 2023: Property And Non-Property Bonds Diverge

North American technology revenue rose a modest 2.6% year over year in the third quarter due to the start of recovery in the PC, smartphone, and memory markets, and slowing but still strong public cloud growth, but it was held back by cautious enterprise spending and a weakening industrial market. Public cloud growth is finding a bottom as a customer spending rationalization cycle is waning. S&P Global Ratings is cautiously optimistic about acceleration in 2024 as cloud migrations resume and AI use cases expand, but a weakening economy could derail this view. AI spending among hyperscale data centers is crowding out spending on central processing units (CPUs), memory, hard disks, and networking. However, we expect hyperscale capital spending (capex) will improve for all areas in 2024 and the AI benefits will be shared more broadly. High interest rates and deteriorating service provider spending keeps speculative-grade ratings under pressure.

U.S. Tech Earnings Q3 2023: Cautious Enterprise Spending And Weakening Industrial Market Hinder Results
Credit FAQ: More Risks Ahead For Global Technology Companies As U.S. Restrictions Tighten

Power demand for Asia-Pacific utilities will expand 4%-5% in 2024-2025, amid resilient economic growth in the region. Softening fuel costs can help protect cash flows, given fossil fuels still dominate the region's overall energy consumption. That said, the trend could change if geopolitical risks further escalate. Spending will be heavy to meet growing user demand and energy-transition targets in the region; this will weigh on already stretched financial metrics. Our rating bias is balanced. The few negative outlooks are due to profitability pressure, governance risks, or financing challenges.

Asia-Pacific Utilities Outlook 2024: Earnings Recovery Should Temper Higher Transition Spending

Asset Class Highlights

Corporates

Notable publications include:

- Gen AI Is Writing A New Credit Story For Tech Giants
- Asia-Pacific Utilities Outlook 2024: Earnings Recovery Should Temper Higher Transition Spending
- A Storm Is Brewing: Extreme Weather Events Pressure North American Utilities' Credit Quality
- Leveraged Finance: U.S. Leveraged Finance Q3 2023 Update: The Lowdown On High Interest Rates
- U.S. Tech Earnings Q3 2023: Cautious Enterprise Spending And Weakening Industrial Market Hinder Results

Financial Institutions

- In Europe, we revised the rating outlook on Germany-based Commerzbank to positive from stable. The positive outlook indicates that we could raise the ratings if Commerzbank delivers on its financial targets and we observe strengthening resilience, while the bank maintains solid balance-sheet metrics.
- In Latin America, we revised the rating outlook on two Panama-based banks, Banco General S.A. and Banco Nacional de Panama to negative from stable and affirmed all ratings on these entities. The outlook revision mirrors the sovereign rating action on Panama.
- We published several commentaries, including:
  - What A Regional Escalation Could Mean For MENA Banks' External Funding
  - GCC Sovereign External Balance Sheets Remain Strong Despite Higher Banking Sector External Debt
  - China's New Capital Rules Will Ease Strain On Banks Ahead Of TLAC Rollout

Sovereign

- Iceland Ratings Raised To 'A+ ' On Strong Growth and Fiscal Consolidation; Outlook Stable

Structured Finance

- **Global ABCP:** S&P Global Ratings published a slide deck examining the changes in issuance volumes and key performance trends in global asset-backed commercial paper (ABCP) amid prevailing economic scenarios, "SLIDES: Inside Global ABCP: 2023 Update," on Nov. 6, 2023.
- **European RMBS and ABS :** S&P Global Ratings published on Nov. 10, 2023 its "European RMBS And ABS Monitor Q3 2023." Rating activity was high during Q3 2023, with 149 rating actions including 112 affirmations, 29 upgrades, and eight downgrades. Most upgrades reflected stable credit performance and transaction deleveraging. There were several rating actions following the upgrades of Barclays Bank PLC and the Governor and Company of the

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Bank of Ireland, and the downgrade of Elavon Financial Services DAC. The ratings on these counterparties constrain the ratings on a number of RMBS transactions we rate. We reviewed five ABS and 49 RMBS transactions through our annual review surveillance process, and rated three new ABS and 14 new RMBS transactions.

- **U.S. ABCP:** Here are a few "Key Takeaways" from a recent article:
  - Auto loans represented 24% ($54.4 billion) of the total dollar amount invested in U.S. ABCP conduits as of June 2023.
  - Growth in auto loan amounts invested in ABCP conduits fell sharply during the first half of 2023, likely due to the inverted yield curve.
  - Auto loan-financed ABCP issuance may decline if the yield curve remains inverted into 2024 and issuers continue to choose ABS over ABCP funding.

See "Perspectives On Auto Loans Financed In U.S. ABCP Conduits" published Nov. 6, 2023.

- **European Auto ABS:** Here are a few "Key Takeaways" from a recent article:
  - In light of challenging macroeconomic conditions, credit performance in Q3 2023 deteriorated year-on-year, but nominal delinquencies and defaults remained low and within our expectations.
  - Year-on-year, 30-60 days delinquencies slightly decreased to 0.30% from 0.31%, 60-90 days increased to 0.15% from 0.13%, and 90+ days to 0.22% from 0.15%.
  - While delinquencies are marginally up year-on-year, net losses remained negligible at 0.02%.
  - Germany (50.3%), the U.K. (31.1%), Italy (5.5%), and Spain (4.5%) form 91.4% of our index. Among the originators' group distribution by volume, the Volkswagen group remained the largest, increasing its share to 66.2% of the securitized assets' current volume.
  - We rated two new transactions in Q3 2023: Citizen Irish Auto Receivables Trust 2023 DAC and Globaldrive Auto Receivables 2023-A B.V.
  - We upgraded eight tranches and affirmed 29.

See "European Auto ABS Index Report Q3 2023" published Nov. 9, 2023.

- **European and U.K. Credit Card ABS:** Here are a few "Key Takeaways" from a recent article:
  - Notwithstanding challenging macroeconomic conditions, credit card performance remained mostly resilient in Q3 2023.
  - Charge-offs increased slightly to 3.2% from 2.9% in our U.K. credit card ABS index quarter-on-quarter, while they increased to 3.3% from 1.8% in our European credit card ABS index. The European increase is due to a one-month charge-off spike for Oban Cards 2021-1 PLC.
  - Delinquencies remained relatively unchanged quarter-on-quarter, with total delinquencies decreasing by 0.1% in both our European and U.K credit card ABS indices. Furthermore, 90+ day delinquencies were stable across both indices.
  - Payment rates increased by 0.10% in our U.K. credit card ABS index quarter-on-quarter but decreased by 2.3% in our European credit card ABS index.

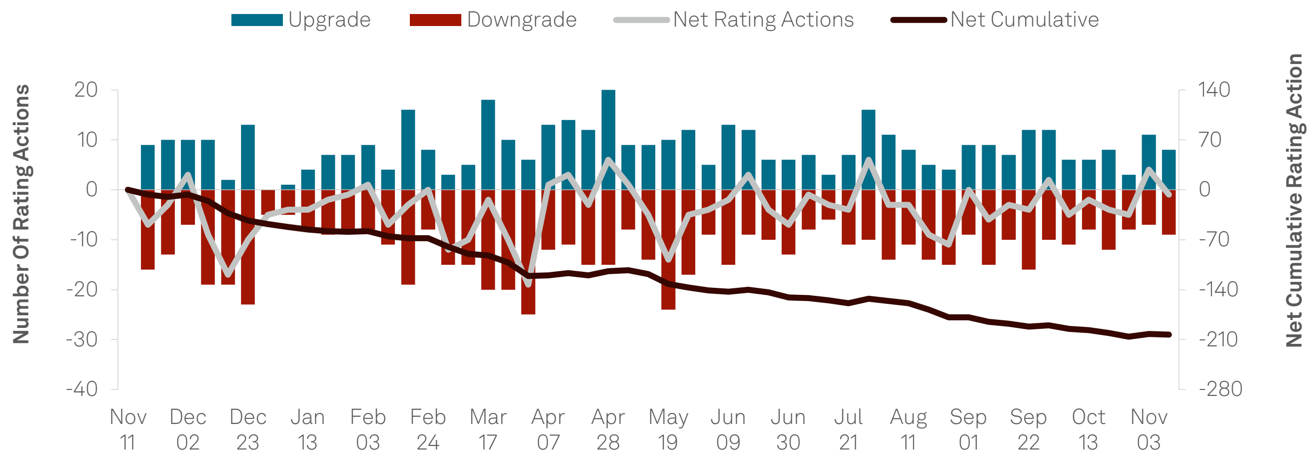
- o Net spread (the difference between the yield rate and charge-off rate) increased quarter-on-quarter in our U.K. credit card ABS index to 12.4% from 12.2%. In our European credit card ABS index, net spread decreased quarter-on-quarter to 14.3% from 15.7%. Again, the latter is due to the one-month charge-offs spike for Oban Cards 2021-1 PLC.

See “European And U.K. Credit Card ABS Index Report Q3 2023" published Nov. 9, 2023.

- **Australian RMBS:** Australian prime home loan arrears were unchanged in September and nonconforming home loan arrears rose. That's according to S&P Global Ratings' recently published "RMBS Arrears Statistics: Australia." The Standard & Poor's Performance Index (SPIN) for Australian prime mortgages loans excluding noncapital market issuance remained at 0.92% in September. Nonconforming arrears rose to 3.86% from 3.70% the same month, influenced by a contraction in outstanding loan balances in the sector that increased the SPIN in percentage terms. A pause in rate rises in recent months will have contributed to the sideway movements in RMBS arrears since June, providing borrowers with a reprieve in regular mortgage repayment increases. But this reprieve will be short lived, with many lenders passing on the Nov. 7 rise in the official cash rate target to 4.35%.
  Arrears increases have been tempered by low unemployment, competitive refinancing conditions, household savings buffers, and, more recently, a rebound in property prices, which supports refinancing options for borrowers. Higher rates will add to debt-serviceability pressures for some borrowers. Robust labor markets have kept advanced arrears low to date, but rising unemployment would increase migration from early arrears to more advanced arrears categories.

Chart 1

Global Rating Actions (Rolling 52-Weeks)



Source: S&P Global Ratings. Net rating actions means downgrades minus upgrades. Net cumulative means total net rating actions. Data as of Nov. 10, 2023. Global rating actions include actions on both financial and non-financial corporates and sovereign issuers.

Table 1

Recent Rating Actions

Date	Action	Issuer	Industry	Country	To	From	Debt vol (mil. $)
8-Nov	Upgrade	Plains All American Pipeline L.P.	Utilities	U.S.	BBB	BBB-	15,400
9-Nov	Downgrade	Team Health Holdings Inc.,	Health Care	U.S.	CCC	CCC+	9,849
7-Nov	Upgrade	Republic of El Salvador	Sovereign	El Salvador	B-	CCC+	6,738
9-Nov	Upgrade	EXOR N.V.	NonBank Financial Institutions (ex. Insurance)	Netherlands	A-	BBB+	3,870
7-Nov	Upgrade	Apollo Global Management Inc.,	NonBank Financial Institutions (ex. Insurance)	U.S.	A	A-	3,575
6-Nov	Upgrade	Weatherford International plc	Oil & Gas	Ireland	B+	B	2,390
6-Nov	Downgrade	Corus Entertainment Inc.	Media & Entertainment	Canada	B+	BB-	2,231
7-Nov	Downgrade	Meituan	Consumer Products	Cayman Islands	BBB	BBB-	2,000
8-Nov	Downgrade	Worldline SA	High Technology	France	BBB-	BBB	1,719
9-Nov	Downgrade	CWT Travel Group Inc.,	Media & Entertainment	U.S.	SD	CCC+	715

Source: S&P Global Ratings Credit Research & Insights. Data as of Nov. 10, 2023. U.S. means United States, U.K. means United Kingdom and U.A.E. means United Arab Emirates. NBFI - NonBank Financial Institutions (ex. Insurance)

For further credit market insights, please see our **This Week In Credit** newsletter**.**