Industry Top Trends Update

Regulated Utilities

Credit quality is on a downward trajectory

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What's changed post-COVID?

Weaker financial measures. We expect the industry's funds from operations to debt will weaken by about 100 basis points in 2020 from COVID-related lower commercial and industrial load, higher bad debt expense, lack of consistent access to the equity markets, delayed rate case filings, and underfunded pensions.

Minimal financial cushion. Credit quality was already weak heading into 2020, with about 25% of the industry's outlooks on negative. This reflected tax reform, record capital spending, and the increasing number of utilities that are strategically managing their credit measures closer to the downgrade threshold.

The industry remains investment-grade. For the year to date, there have been seven downgrades and only one upgrade, which is a departure from prior years when upgrades consistently outpaced downgrades. However, we expect only a modest weakening to the industry's overall credit quality.

What is the likely path to recovery?

Regulatory deferral mechanisms. Utilities are either volunteering or have been mandated not to shut off service for nonpaying customers, and many regulators are approving the deferral of COVID-related costs for future recovery.

Operating and maintenance costs. Permanent cost reductions are being realized through the increasing use of technology and a shrinking real-estate footprint.

Capital spending and dividend levers. The industry consistently operates with annual capital spending of about $150 billion and dividends of about $35 billion. Under financial stress, a utility could pull either of these levers to temporarily restore its credit measures.

What are the key risks around the baseline?

Wildfires. The early Western U.S. 2020 wildfires and the below-average 2020 rainfall in California could potentially signal a longer wildfire season, which, in our view, could increase the possibility of a catastrophic wildfire. COVID presents additional risks because it could challenge emergency response time.

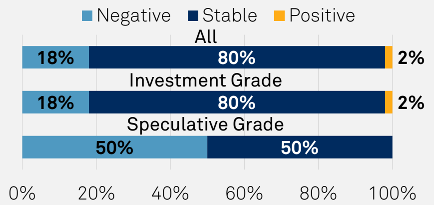
Environmental risks. The cancelation of the Atlantic Coast Pipeline is the latest demonstration that customers want carbon-free energy. High carbon-emitting utilities may need to accelerate the transformation of their generation fleet.

Safe operations. Utilities that cause gas explosions, electrical blackouts, wildfires, water contamination, service interruptions, or have high greenhouse gas emissions are facing increasing political and regulatory scrutiny.

Latest Related Research

- North American Regulated Utilities Face Tough Financial Policy Tradeoffs To Avoid Ratings Pressure Amid The COVID-19 Pandemic, May 11, 2020
- COVID-19: While Most Of The U.S. Is Shut Down, Utilities Are Open For Business, May 4, 2020
- An Old Age Problem? While North American Regulated Utilities' Credit Measures Could Dip On Pension Underfunding, Cost Recovery Ability Supports Credit Quality, April 20, 2020
- COVID-19: The Outlook For North American Regulated Utilities Turns Negative, April 2, 2020

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	280	4	284
Downgrades	7	0	7
Upgrades	1	0	1

Ratings data as of end-June, 2020

COVID-19 Heat Map

Utilities	
COVID-19, Recession, and O&G Impact	Low
Potential Negative Long-Term Industry Disruption	--

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

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