Industry Top Trends Update

Unregulated Power

Surprisingly resilient

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What's changed post-COVID?

Impact has been muted compared to other energy sectors. Especially compared to energy sectors such as oil and gas, midstream, and refining, the impact of COVID-19 and economic recession on independent power producers (IPPs) has been mild. Even in an unprecedented shutdown such as this, it takes time for the energy juggernaut to slow. Having a big balance sheet, operational diversity, and countercyclical retail operations make a significant difference to credit quality.

We plan to maintain the positive outlooks on the leading players. Delayed upgrades are possible given the broader market uncertainty and volatility. However, AES Corp., NRG Energy, Vistra Energy, and Calpine Corp. all generate free operating cash flow under our base case scenario even after the COVID-related sensitivities. Arguably, the cash flow will be lower and the financial ratios a trifle weaker than what we had earlier estimated for 2020. Still, that may not influence the credit profile of these companies.

Accelerated erosion in credit quality of smaller term loan B project financed assets. Many financings were hindered by milder winter weather in 2019-2020; the impact of COVID-19 put many transactions at risk of breaching their financial covenants soon. We expect to see more negative rating actions.

What is the likely path to recovery?

Recovery is underway but measured. There are indications that industrial activity is improving from the lows of April and will recover significantly through December 2020. We expect commercial and industrial (C&I) power demand to remain down 15% through July, 10% through September, and 5% through December.

Full recovery will take a few quarters. Demand could return to 2019 levels in 2022, although a second pandemic wave would push this outwards.

Residential retail demand across the country has held up and, in most regions, has risen. The ERCOT (Texas) market has been buoyed by weather and shows the least demand weakness. Importantly, the forward power curve has remained robust and most markets still show secular strength in 2021 prices. We expect power companies to be hedging their expected 2021 generation aggressively.

What are the key risks around the baseline?

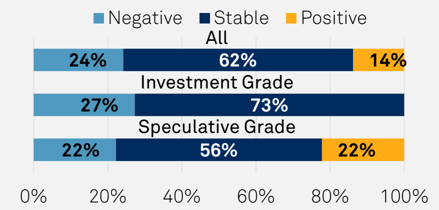
Demand could still be irreparably harmed. Declining loads could have a secular slant, which could hurt power prices over the long run. ERCOT continues to show backwardation in the forward curve, suggesting a possible 5%-10% decline in wholesale EBITDA of IPPs in 2021.

Uncertainty in PJM Interconnections' capacity market construct. Further delay in the timing of PJM's reliability pricing mechanism auction as well as the risk of fixed resource requirement based pullout could influence credit quality of the sector.

Latest Related Research

- Refining Our Views On Independent Power Producers, June 8, 2020
- Independent Power Producers Navigate Falling Demand And Credit Risks In Wake Of Economic Shock, May 6, 2020
- S&P Global Ratings Updates Its Capacity Price Assumptions, April 13, 2020

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	11	19	30
Downgrades	1	2	3
Upgrades	0	1	1

Ratings data as of end-June, 2020

COVID-19 Heat Map

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

2020 Estimates 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%