Industry Top Trends Update

Regulated Utilities

Credit quality is weakening

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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.

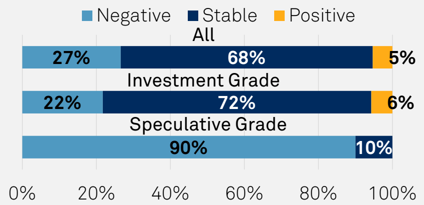
What are the key risks around the baseline?

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.

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**

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