S&P Global Ratings

U.S. Corporate Credit Outlook Midyear 2024

Steering Toward Sunlight

August 1, 2024

This report does not constitute a rating action

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U.S. Corporate Credit Outlook Midyear 2024

Steering Toward Sunlight

Key Takeaways

- With the U.S. economy likely settling into a soft landing and the Federal Reserve poised to lower interest rates, U.S. corporate borrowers could soon see improving credit conditions. But a brighter environment is no guarantee if borrowing costs remain high for longer than we anticipate and uncertainty around the U.S. elections sparks market volatility.
- After a minor earnings recession last year, we expect positive median EBITDA growth this year for most U.S. sectors. However, corporate borrowers continue to battle elevated input costs, uncertain consumer demand, and heavier debt-service burdens.
- The net outlook bias for U.S. corporates hasn't changed much since the beginning of the year and was at negative 11.0% as of June 30. Telecom, chemicals, packaging and environmental services, and health care have the highest net negative bias.

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U.S. corporate borrowers swing into the second half of the year amid the prospect of improving—but still fragile—credit conditions, with the economy seemingly settling into a soft landing and the Fed poised to lower interest rates.

A brighter borrowing environment is anything but assured, and we could see some credit deterioration if the central bank keeps monetary policy tight for longer than we anticipate. This could make the burden of debt service and/or refinancing too heavy for some borrowers—especially those at the lower end of the ratings ladder. Increasing risk-aversion among investors, who have accepted fairly narrow spreads on corporate debt, could exacerbate this.

Uncertainty around the November elections could make financial markets more volatile. With the presidency and 34 Senate seats (as well as all House seats) up for grabs, this risk is growing, especially if the presidential result is in dispute. The consequences for U.S. borrowers will depend on the outcomes—especially if there is a partisan split between the presidency and Congress, which would make passage of any sweeping legislation challenging.

The advanced estimate of second-quarter GDP reflected a controlled deceleration in growth. Even as real GDP growth in the April-June period reached 2.8% (annualized), it slowed in the first half of the year, to 2.1% on average, compared with 4.2% in the second half of last year. Final sales to private domestic purchasers (a good indicator of underlying demand) showed a similar, although less pronounced, moderation, to 2.6% from 3.2%.

Our Business Cycle Barometer suggests that recession risk remains above the historical norm. We see the probability of a U.S. recession starting within the next 12 months at 25%-30%. Even without a downturn, we expect a period of below-potential growth that will lead the pace of job gains to moderate and unemployment to drift higher through next year. We forecast the U.S. economy to expand 2.5% this year and 1.7% in 2025.

The pace of inflation will likely continue to slow, with the Fed seemingly poised to begin rate cuts soon (see "Economic Outlook U.S. Q3 2024: Milder Growth Ahead," published June 24). The possibility is rising that policymakers could use slowing growth momentum and easing inflation to adopt more dovish language during the annual Jackson Hole meeting (in the last week of August) and signal a rate cut in September.

Either way, corporate borrowers continue to battle elevated input costs, uncertain consumer demand, and heavier debt-service burdens (see table 1).

Table 1

Key risks around North American sectors' baseline

Sector	Risk 1	Risk 2	Risk 3
Aerospace and defense	Supply chain constraints	Cost inflation	Share repurchases
Autos	Strategic missteps	Sharper decline in used car prices	CDK's dealer management system software outage
Building materials	Cost inflation amid slowing demand	High interest rates	
Capital goods	High interest rates	Cost pressure	
Chemicals	Persistent destocking	Weaker demand	Cost inflation
Consumer products	Weaker-than-expected demand	High interest rates	Supply chain disruption / geopolitical risk
Healthcare	Cost inflation, high interest rates	Slower revenue growth	Reimbursement concerns
Homebuilders and developers	Higher home inventories	Focus on volumes over profitability	
Hotels, gaming, and leisure	High prices and high interest rates	Casino development projects	Higher shareholder returns
Media and entertainment	Secular trends for legacy media	Slower growth in domestic streaming	Macro weakness / geopolitical shocks
Metals and mining	Lower metal prices	Regulatory changes	
Midstream energy	U.S. elections	Economic slowdown / high interest rates	Energy transition
Oil and gas	Weak natural gas prices	Soft oil field service activity	Lower shale productivity
Real estate	Tighter access to capital	Upcoming debt maturities	A further delay in rate cuts
Regulated utilities	Wildfires	Insurance availability and costs	Insufficient common equity issuance
Retail and restaurants	Weaker demand		
Technology	Escalating trade tensions	Slowdown in AI spending	Funding availability
Telecommunications	Pressure from FWA and FTTH	Lead sheath cable	High interest rates
Transportation	Weaker macro	Stalled freight market recovery	Geopolitical tensions
Transportation Infrastructure	Affordability risks	Counterparty pressure	Geopolitical tensions
Unregulated utilities	Ability to deploy infrastructure	ERCOT's expected demand growth	

Most prevalent themes: Macroeconomic conditions; Interest rates / refinancing; Cost inflation / supply chain; (Geo)politics

FWA—Fixed wireless access. FTTH—Fiber-to-the-home. Note: Risks have been simplified. No rank ordering is implied between the risks. For more information, see Industry Credit Outlook Update 2024. Source: S&P Global Ratings.

Financing Conditions

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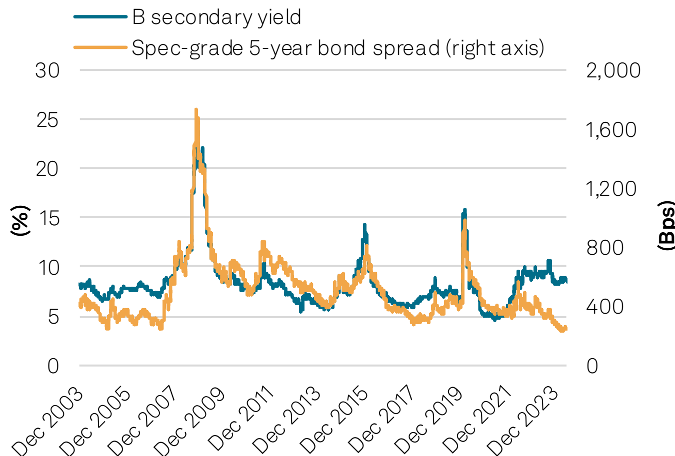
Spreads reached new lows, but yields remain historically high. Even as the aggregate spread on corporate bonds reached an all-time low of 229.6 basis points (bps) on May 7, corporate yields have remained at high levels—particularly for a non-recessionary period (see chart 1). In fact, the gap between speculative-grade spreads and secondary-market yields is arguably at its widest point ever this year.

Borrowers have taken advantage of market demand, with U.S. speculative-grade corporates reducing near-term maturities in the first half. After two years of subdued supply, markets have been ready to take on new debt. Borrowers have capitalized on this, with year-to-date nonfinancial corporate bond issuance in the U.S. up 13% over 2023. The amount of speculative-grade debt maturing in the second half is relatively low at $54 billion, representing about one-fifth of the total maturities (see chart 2). Meanwhile, they look set to increase in the next several years, peaking at $730 billion in 2028.

Chart 1

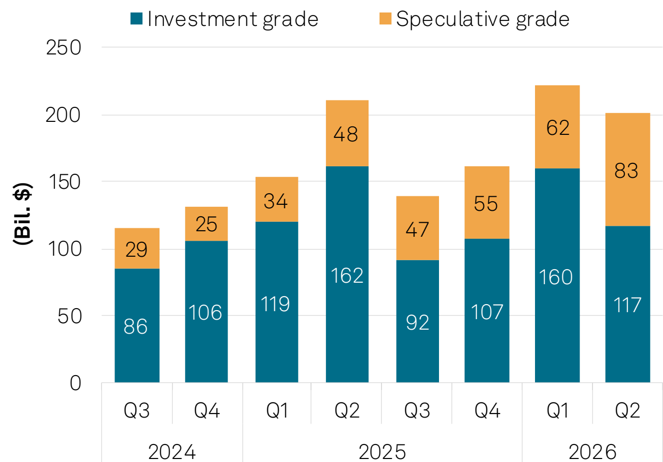
Spreads are low, but yields remain historically high



Source: S&P Global Ratings.

Chart 2

Spec-grade corporate maturities pick up in 2025



Data as of July 1, 2024. Chart shows maturities of U.S. nonfinancial corporate debt, including bonds, loans, and revolving credit facilities that are rated by S&P Global Ratings. Source: S&P Global Ratings.

This is coming at a cost. The average coupon rates in the first half were roughly 1.5% higher for investment-grade bonds and 1% higher for speculative-grade debt compared to the first half of 2019 (see chart 3). And this gap only widens relative to 2020 and, especially, 2021. These higher borrowing costs could prove more burdensome than in the past, particularly if borrowers face flagging demand and slowing top-line growth.

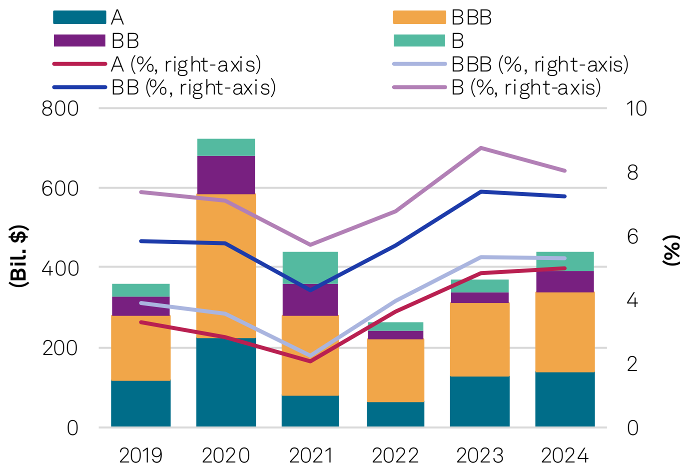
Restrictive yields and general uncertainty are keeping issuance limited to refinancing. Overall bond and loan issuance in the U.S. has been heady so far this year, normally consistent with strong economic and investment growth. But a large majority of this year's issuance has been for refinancing and similar purposes (see chart 4). In fact, M&A has been fairly muted, and much of what has been done has been equity-financed. This, combined with high underlying yields (despite ultra-low spreads), indicates a less robust situation than some headline numbers suggest.

Lower-rated borrowers remain vulnerable to liquidity constraints. Debt maturities rated 'B-' or lower peak in 2028, with leveraged loans and revolvers (which are largely floating-rate) accounting for nearly 73% of the total through 2028 (see chart 5).

Chart 3

Increased issuance at increased costs

Year-to-date issuance totals for U.S. nonfinancial corporates through June 30

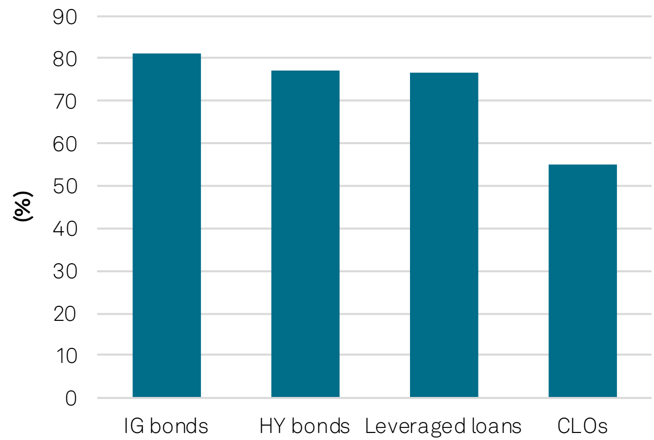


Sources: Refinitiv, S&P Global Ratings.

Chart 4

Issuers remain cautiously prudent

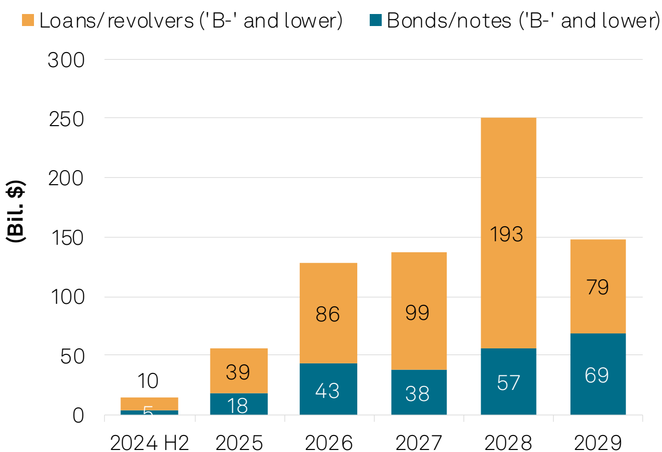
Proportion of 2024 bonds issued for refinancing, resets, repricing, and general corporate purposes



Sources: Leveraged Commentary and Data (LCD) from PitchBook, a Morningstar company, S&P Global Ratings.

Chart 5

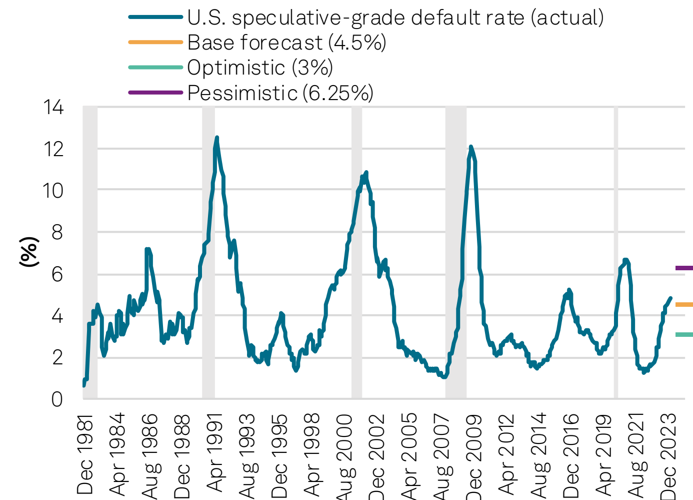
Escalating maturities of debt rated 'B-' and below put pressure on weaker borrowers



Data as of July 1, 2024. Includes U.S. nonfinancial corporate issuers' bonds, loans, and revolving credit facilities that are rated 'B-' and lower by S&P Global Ratings. Source: S&P Global Ratings.

Chart 6

U.S. spec-grade default forecast through March 2024



Shaded areas are periods of recession as defined by the National Bureau of Economic Research. Sources: S&P Global Ratings and S&P Global Market Intelligence's CreditPro®.

Some relief appears to be coming—but only some. This year has been characterized by several conflicting signals, in terms of both soft and hard data. Growth has remained solid, if not strong, but purchasing indexes have remained in contractionary territory. And inflation has remained somewhat sticky, forcing markets to re-evaluate their interest rate expectations this year.

Stubborn yields remain the main stressor for potential defaults. Despite solid economic growth in the past few years, defaults have been on the rise since the Fed's rate-tightening cycle began in 2022. We expect economic growth to slow, with rates coming down to some extent. It's more likely that growth will be slower than what we saw in the second quarter, with rates staying high in the near term, which could make for a slower decline in the default rate than we've seen historically (see chart 6). We anticipate the default rate will come in at 4.5% through next March.

Ratings Trends

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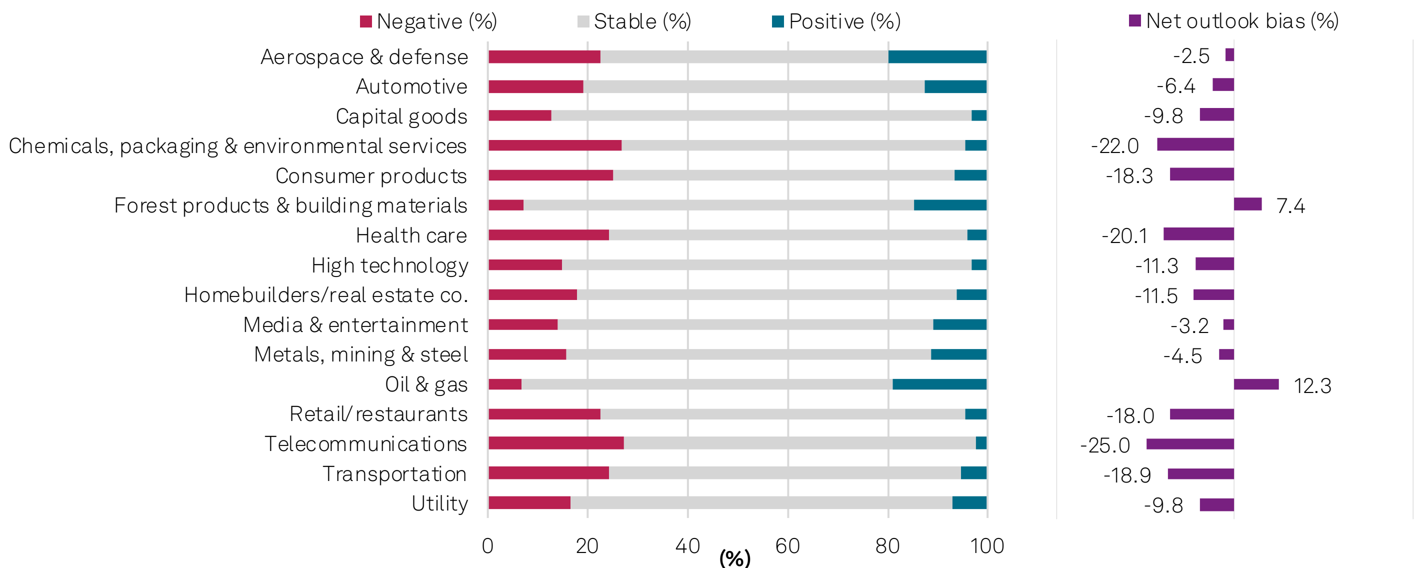
The net outlook bias of U.S. nonfinancial corporate entities, indicating potential ratings trends, has stayed relatively flat since the beginning of the year, and was at negative 11.0% as of June 30. By sector, the progress is mixed with about half of the sectors improving and the other half losing ground. However, the sectors with increasingly optimistic outlooks tended to have minimal to mid-single digit percentage increases in their net outlook bias, whereas those with weakening outlooks had larger drops. Metals, mining, and steel registered the most pronounced absolute change with a double-digit percentage decline out of positive territory.

Telecom, chemicals, packaging and environmental services, and health care have the highest net negative bias (see chart 7). Nearly all of telecom sector's issuers with a negative outlook or on CreditWatch negative are rated speculative-grade, led by cable-TV providers which are facing increasing competition as fiber-to-the-home (FTTH) buildouts continue.

Oil and gas stands out with the highest net positive bias of 12.3%. Optimistic outlooks for the sector are due to supportive oil prices, ongoing capital discipline, healthy balance sheets and largely equity-funded mergers and acquisitions that have typically bolstered the outlook for the acquirers and their potential targets.

Chart 7

U.S. nonfinancial corporate ratings outlook distribution and net outlook bias



Data as of June 30, 2024. Net outlook bias—Percentage of issuers with a positive outlook or CreditWatch placement minus those with a negative outlook or CreditWatch placement. Source: S&P Global Ratings.

The transportation and metals, mining, and steel sectors experienced the largest increase in negative bias since January. For the transportation sector, pressure on cash flows and liquidity is mounting for smaller domestic airlines even as air travel demand remains solid. Meanwhile, logistics and trucking ratings are under pressure with persistent freight weakness, which led to negative rating actions in the second quarter. Metals, mining, and steel's negative bias almost doubled in the face of difficult operating conditions that have led to deteriorating credit metrics.

The number of downgrades and defaults in the health care sector remains a concern. As demand normalizes and inflationary pressures ease, we expect overall ratings deterioration of the health care sector to slow in the second half, though the health care services-heavy lower end of the ratings universe continues to face stubbornly high leverage and weak cash flows.

Key Themes

Operations: earnings recovery on the back of a soft landing

After a minor earnings recession last year, we expect positive median EBITDA growth in 2024 for most U.S. sectors, both investment- and speculative-grade, as the economy likely settles into a soft landing (see table 2). For example, chemicals production rose globally, and we expect the sector's EBITDA to improve this year as destocking challenges ease. In media, advertising growth has returned as the economic landscape normalizes, with the digital portion seeing strong momentum.

Table 2

Median EBITDA growth projections by sector

	Investment grade		Speculative grade	
	2024e	**2025e**	**2024e**	**2025e**
Aerospace and defense	10.1	9.0	15.9	12.1
Autos	3.3	6.2	4.4	6.4
Building materials	8.2	5.6	3.8	3.9
Business and consumer services	10.2	5.1	10.7	8.1
Capital goods	4.2	6.1	6.9	7.8
Chemicals	5.6	10.0	10.2	9.1
Consumer products	3.5	5.2	6.7	5.1
Engineering and construction	8.0	5.3	10.1	7.7
Healthcare	5.3	6.2	12.4	9.4
Homebuilders and developers	0.6	4.6	1.3	13.2
Hotels, gaming and leisure	6.5	3.4	7.6	7.0
Media	10.4	9.0	12.7	6.0
Metals and mining	-11.4	-9.9	-2.1	3.9
Midstream energy	3.1	1.7	7.2	3.6
Oil and gas	0.7	4.3	5.9	4.7
Paper and packaging	9.4	11.4	6.8	6.0
Real estate	3.9	4.3	3.6	2.4
Retail and restaurants	3.8	5.9	5.2	6.1
Technology	7.4	9.4	12.2	9.7
Telecommunication services	2.5	1.6	2.4	3.7
Transportation	2.4	5.7	8.9	11.8
Utilities	10.8	8.3	-0.3	3.7

e—Estimate. Includes current U.S. rated nonfinancial corporates and calculated as of July 29, 2024.
Source: S&P Global Ratings.

Sectors sensitive to consumer discretionary spending and/or interest rates are under pressure. This points to underlying weakness in U.S. consumer financial health—with excess savings largely depleted for all but the highest-income households. Delinquencies of auto loans and credit cards have been rising since 2022. We expect consumer spending to weaken, especially among lower-income cohorts, with high prices and high interest costs biting into purchasing power. Against this backdrop, consumer products companies are facing a negative

mix shift to lower-margin offerings as shoppers seek value, buy closer to consumption, and shop across multiple channels. Leisure demand, which has been resilient, could be tested. Meanwhile, elevated interest rates continue to weigh on sectors such as building materials, homebuilders, real estate, and autos, which depend on rate-sensitive financing to drive demand in end markets.

Companies are increasingly adopting promotional measures to protect revenues, which could hurt margins. For example, homebuilders are offering incentives to help maintain their sales, and we expect the larger, better-capitalized ones to continue competing on price. If such activities remain higher than normal, we could see gross margins fall back to pre-pandemic levels. In the consumer products sector, we also anticipate many companies will reinvest savings from cost-cutting measures into advertising the promotions to drive volume growth.

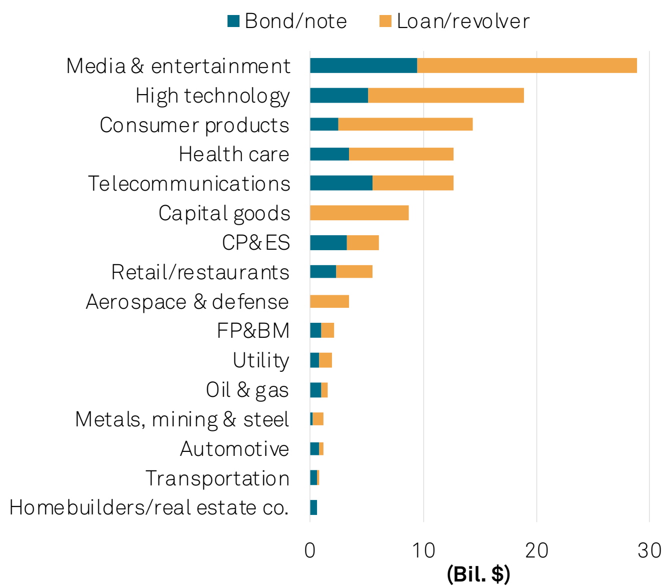
While input-cost inflation and supply-chain bottlenecks have eased somewhat, corporates remain vulnerable to any resurgence of these issues, exacerbated by geopolitical risks. For instance, our baseline expectations for a moderate pace of supply-chain diversification by global tech firms could be challenged if escalating geopolitical tensions lead to sharp cost inflation and the need for higher inventory levels. **Elevated costs and/or shortage of (skilled) labor continue to be a concern** for sectors including building materials, capital goods, health care, leisure, and airlines.

Financing: a bifurcated market

Refinancing activities have been robust this year. This is amid more comfort with “new normal” interest rates, private versus public credit market offerings, and concerns about potential market volatility as the U.S. presidential election approaches toward the end of the year. For example, the retail sector has seen a steady stream of small- to medium-sized refinancings so far this year. Telecom companies facing upcoming maturities and those looking to proactively address their capital structures have been increasingly able to access the capital markets.

Chart 8

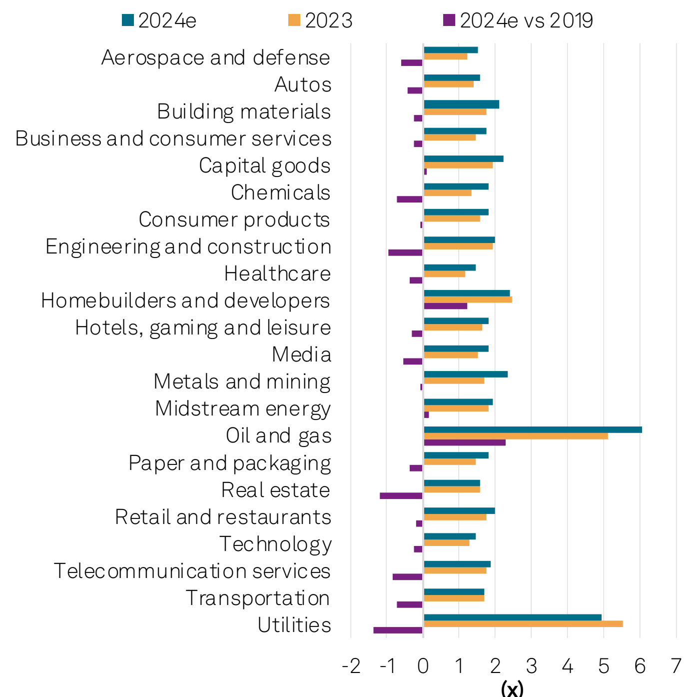
'B-' and lower maturities in next 24 months by sector



Data as of July 1, 2024. Chart shows maturities through June 30, 2026 of U.S. nonfinancial corporate debt, including bonds, loans, and revolving credit facilities that are rated 'B-' or lower by S&P Global Ratings. FP&BM—Forest products and building materials. CP&ES—Chemicals, packaging, and environmental services. Media and entertainment includes leisure. Source: S&P Global Ratings.

Chart 9

Median EBITDA interest coverage, ‘B’ and below, by sector



e—Estimate. Includes current U.S. rated nonfinancial corporates, and calculated as of July 29, 2024. Source: S&P Global Ratings.

However, financing conditions remain challenging for lower-rated entities and certain struggling segments. In the media sector—which has the most debt rated 'B-' or lower due in the next 24 months (see chart 8)—local TV broadcasters with high leverage and weak competitive positioning, face difficulties refinancing upcoming maturities. Commercial real estate borrowers that postponed refinancing with hopes for a rate cut could get squeezed; we continue to see high refinancing risk in the next two years, particularly for struggling segments and properties. Meanwhile, **interest-coverage ratios are still uncomfortably low**, even if improved market risk appetite has helped soothe refinancing worries (see chart 9).

U.S. elections: potential market volatility and policy uncertainties

The elections introduce another dimension of uncertainty and risk, with official policy platforms for both parties remaining loosely defined. Some borrowers have taken the opportunity to refinance earlier than they otherwise would to lock in funding before any pricing volatility that could arise as the elections approach. In midstream energy, for instance, we expect companies to either accelerate major strategic moves or delay them until after November.

We have identified the following key areas that we will continue to monitor as details become available, keeping an eye on those sectors that stand to gain or lose from shifts in policy.

Trade and tariffs: We believe increasingly protectionist trade policies and any international responses will likely result in inflationary pressures (higher input costs for companies, higher costs for consumers, or both). Specifically, higher tariffs on imports from China—and any retaliation from China—could add to margin pressures for some sectors, hamper market access (especially for tech), and accelerate supply-chain diversification away from China. The auto sector, as an example, will likely see continued trade tensions catalyzing more partnerships, joint ventures, and co-investments to develop alternative supply chains, particularly for battery-grade lithium, nickel, graphite, and cobalt outside China to avert higher costs. Certain industries, such as capital goods and chemicals, may benefit from greater onshoring/reshoring opportunities or less competition.

Foreign aid: Conflicts such as those in Ukraine or the Middle East can disrupt supply chains, contributing to rising input prices. Conversely, to the extent the U.S. becomes involved, commitments of human and financial resources would surely filter down to companies that produce the resources demanded or restricted by these conflicts. Material changes in defense policies could affect projected spending levels in the U.S. and reprioritization of defense platforms and projects.

Immigration: There are pockets of labor shortages across our service-based economy. In recent months, wage growth has declined from previous peaks providing some relief for employers. Nevertheless, finding affordable workers with the right skills constrains certain companies. Industries with labor forces or skill sets that are sensitive to immigration policy will need to be prepared to make adjustments to continue meeting staffing goals if immigration restrictions are implemented.

Fiscal spending and taxation: Fiscal spending related to legislation such as the CHIPS and Science Act and the Inflation Reduction Act remains significant. We believe these policies have bipartisan support and therefore are less likely to be reversed. However, they may be adjusted in ways that change the extent to which various beneficiaries receive support. Certain provisions of the 2017 Tax Cuts and Jobs Act (TCJA) that affect corporations have expired, such as interest deductibility, and certain provisions that affect individuals are set to expire in 2025. While still very fluid, there have been proposals to retroactively reinstate the expired corporate-tax provisions as well as to work on individual-tax provisions.

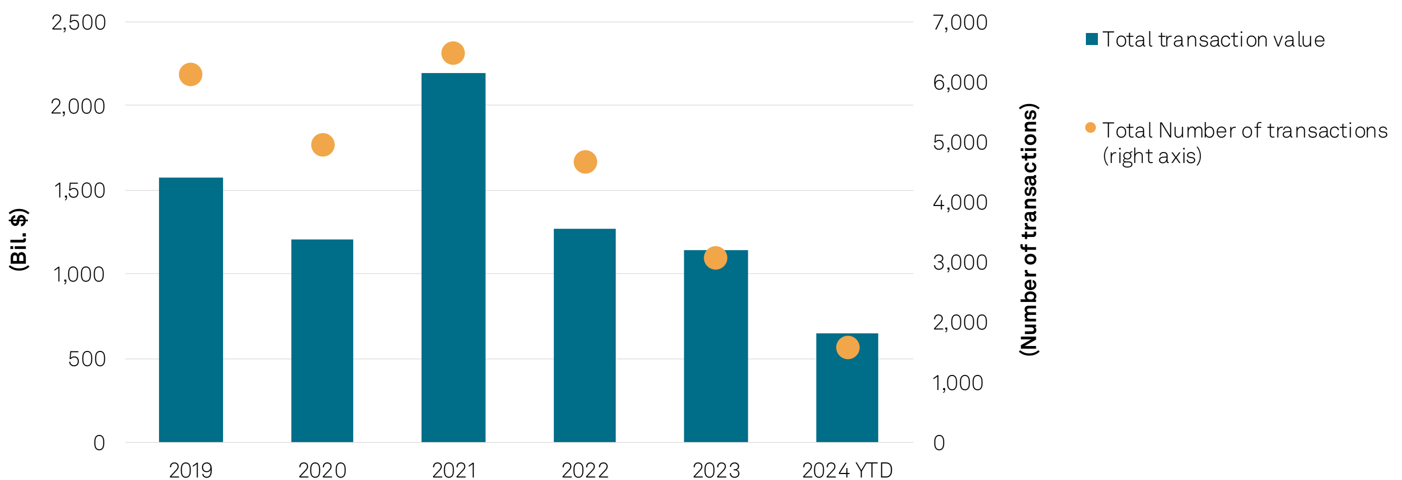
Regulation: A looser environmental stance that might open new lands for mining, or lessen the restrictions or costs associated with transporting natural resources, might benefit certain oil and gas or metals and mining companies. Finally, if regulators are more open to large business combinations, sectors ripe for consolidation such as health care and pharmaceuticals may become more active in M&A.

M&A: more deals could come in the second half

M&A hasn't picked up significantly so far this year (see chart 10), but some sectors were more active than others. In oil and gas, there has been significant ramp-up in consolidation in upstream exploration and production (E&P) due to concerns about medium- to longer-term reserve replacement, productivity, and need for scale. In metals and mining, only a few global-scale deals have been completed, with buyers reluctant to pay large premiums and sellers confident in the scarcity of assets.

Chart 10

U.S. corporate M&A activity remained muted so far this year



Includes U.S. corporate M&A deals announced between Jan. 1, 2019 and July 29, 2024. Only includes announced/effective/closed deals for which transaction value is available. Source: S&P Global Market Intelligence Capital IQ.

Many proposed transactions continue to be heavily scrutinized. For example, in the retail sector, it has been difficult for big-name deals (The Kroger Co.'s acquisition of Albertsons Cos. Inc., Tapestry Inc.'s acquisition of Capri Holdings Ltd., Tempur Sealy International Inc.'s acquisition of Mattress Firm Inc.) to get through the regulatory process.

Nonetheless, consolidation is an important strategy for many sectors. In hotels, gaming, and leisure, M&A may take off in earnest if buyers can look past elevated rates or become flexible on how much debt to use to finance transactions. M&A continues to be a focus for the pharma and life sciences industries, and we expect private equity to again become more active in health care services.

M&A-related debt issuance has been relatively subdued, with most deals equity-funded. If leveraging M&A increases, leverage cushions could decline, and ratings could be pressured.

Megatrends: risks and opportunities

AI is possibly one of the most important industry growth drivers this year. With AI promising to transform many of the most labor-intensive industries, we expect spending on the technology will accelerate in coming years, with private investment in AI startups perhaps approaching $1 trillion by the end of the decade (see "Investment And Talent Are The Keys To Unlocking AI's Potential," published July 9). In this context, AI is proving to be the game changer as cloud service providers are investing ahead of anticipated demand, and enterprises are slowing traditional information technology spending while cautiously exploring AI opportunities (see "Midyear 2024 IT Forecast Update: Robust Cloud Spending Offsets Still-Cautious Enterprise Budgets," published July 17). Besides the direct effects on the technology sector, energy, utilities, and power sectors stand to benefit from the relevant infrastructure buildout such as data centers.

Although we're confident AI will be a catalyst for product refreshes and rising IT spending as a percent of global GDP, we are cognizant that AI spending will be lumpy given the concentrated customer base. This could lead to swings in credit metrics for some semiconductor and hardware providers.

Climate risks are increasingly weighing on certain industries. For instance, utilities operating in Alberta, Arizona, California, Colorado, Florida, Idaho, Nevada, New Mexico, Oklahoma, Oregon, South Dakota, Texas, Utah, Washington, and Wyoming are all experiencing increasing wildfire risks. While we expect helpful mitigation plans to be implemented, the lack of availability and rising costs for wildfire insurance for the industry are a negative for credit quality.

Increased digitalization is inevitable but comes with security and business-continuity risks. Companies continue to store more and more of their information in digital form to ensure that it is accessible and protected. Digitalization takes this a step further and makes information available for processing using advanced technologies, which can lead to fundamental changes in operational processes.

While such changes can mean dramatic efficiency gains, they come with their own set of risks. Remotely accessible proprietary or customer data are vulnerable to cyber-attacks which can cause direct or indirect financial costs. The attack on software service provider CDK Global in June is an example that crippled thousands of its auto dealership customers. Additionally, dependency on complex technologies can bring operations to a standstill when they stop working, as we recently experienced with CrowdStrike outage (see "CrowdStrike Update Issues Highlight The Perils To Global IT Systems From Interdependency And Concentration," published July 19). Even if systems are working, they may promote an opaqueness that complicates the process of auditing or explaining business decisions.

Leveraged Finance

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Despite reduced expectations for interest-rate cuts, the leveraged-finance markets have seen the narrowest institutional loan spreads in more than five years and surging issuance. U.S. leveraged-loan issuance reached roughly $280 billion (excluding repricings) in the first half of the year, a significant rise from $234 billion for all of 2023, according to data from LCD.

However, loan repricings (not included in the above) remained the dominant theme. Many issuers took the opportunity to lower their funding costs, given spread compression. In all, borrowers of a total of $372 billion in loans, or more than a quarter of the LCD index, were able to reduce their cost of funding by more than 50 bps—effectively negotiating the equivalent of two 25-bps rate cuts that brought savings of over $2 billion in interest costs, per LCD.

While the market saw high issuance, loans outstanding remained relatively static, as most activity was refinancing-related, and loan growth from leveraged buyouts and M&A remained lackluster.

Spread tightening has made it attractive for borrowers that had tapped the private credit markets to transition (or return) to the broadly syndicated loan (BSL) market. We expect to see a continued movement of borrowers across the two markets.

Given the strong financing market and steady economic growth, our speculative-grade portfolio has shown resilience, with improved liquidity profiles and steady operating performance this year. Reported median leverage is at a multiyear low of 4.9x, and although reported median interest coverage is also at a multiyear low of 2.6x, it's likely to improve in the next 12 months due to ongoing earnings growth, expected rate cuts, and lower credit spreads.

We estimate 15%-20% of our speculative-grade portfolio remains highly vulnerable to high credit stress (and potential downgrades) if economic growth slows and policy interest rates remain above 4% through 2025, as we expect. About 42% of our borrowers in the 'B-' ratings category and below have reported EBITDA interest-coverage deficits, and 34% have free operating cash flow (FOCF)-to-debt deficits of more than negative 3%.

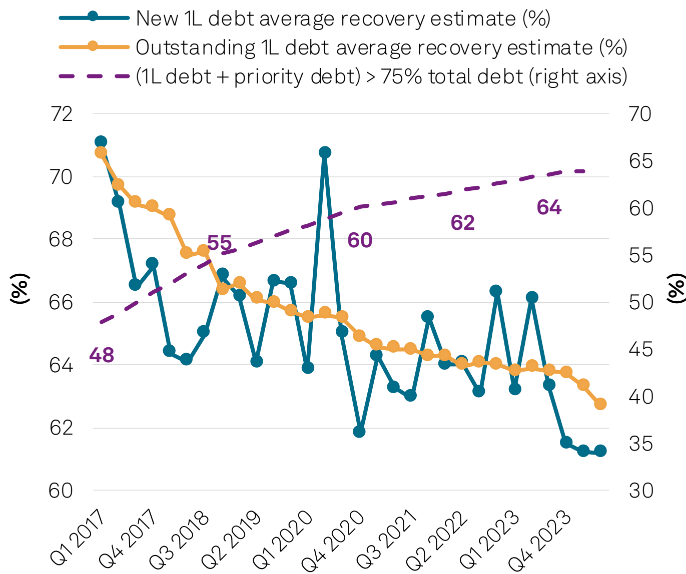
Moreover, there is a wide dispersion in operating performance within and across rating categories. Within our 10 largest industry sectors, we see more than 20% of issuers reporting at least four quarters of continuous EBITDA declines in the oil and gas E&P, miscellaneous retailers, and chemical companies sectors as of the first quarter. Additionally, in sectors with at least five issuers, integrated oil and gas, railroads, leisure equipment, semiconductors, oil and gas exploration and production, and satellite operators have more than 30% of issuers reporting at least four quarters of continuous EBITDA declines.

It's worth noting, however, that the oil and gas and semiconductors sectors are normalizing following peak pandemic-related earnings. From a coverage standpoint, health care continues to be the most challenged. Even in the private credit space, health care services and providers remain the most vulnerable, given the pressures of wage inflation, the pace of repayment, and regulatory challenges.

Prospects for recovery given default on first-lien debt have declined notably since 2017 as debt structures have become more top-heavy, with a notable increase in first-lien-heavy and first-lien-only structures (see chart 11). Average first-lien recovery expectations are now in the low-60% area overall but are even lower for firms rated 'B-' and below, in the mid- to high-50% area (using the rounded point estimates that are part of our recovery ratings). More top-heavy debt structures have also pushed down estimated actual recovery rates on first-lien debt in the five-year period ending in 2022 versus historical levels (see chart 12), as shown in two different recovery studies (see "Are Prospects For Global Debt Recoveries Bleak?" published March 14).

Chart 11

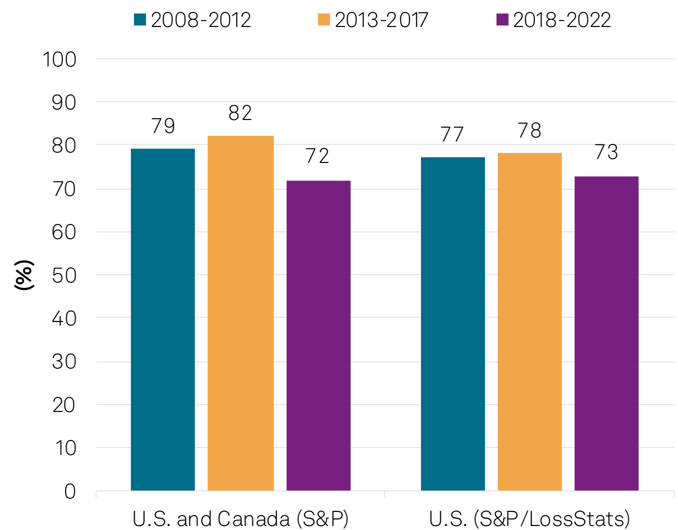
Expected recovery on newly issued and outstanding 1L debt based on S&P Recovery Ratings (U.S. and Canada)



Data through Q2 2024, based on the rounded point-estimates included in our recovery ratings for rated nonfinancial corporate entities in the U.S. and Canada. Source: S&P Global Ratings.

Chart 12

Estimated actual first lien recoveries (% par)



Source: S&P Global Ratings. The actual first-lien recovery estimates are on an ultimate (at the end of the insolvency or restructuring period) and nominal basis. The S&P data represents estimated recoveries from bankruptcy documents while S&P's LossStats data is based on the best available information using one of three calculation approaches (trading prices, settlement prices or liquidity event pricing).

While these trends may be concerning, they don't capture the event risk that first-lien creditors face from the increase in aggressive out-of-court restructurings in recent years. These restructurings spike during periods of economic stress as we saw during the pandemic and more recently in the past two years as interest rates rose sharply. These transactions often materially impair recovery prospects for existing first-lien lenders, although the impact can vary significantly from case to case.

For example, data on 10 collateral transfer loan restructurings we've tracked since 2017, show first-lien recovery expectations were cut by about 40% (roughly 25% of par). Similarly, data on 22 priming loan exchanges show recovery prospects for the first-lien lenders most disadvantaged by the transaction were cut by about 70% (or about 31% of par), with recovery expectations for the most negatively affected lenders wiped out in many cases. Even so, we don't factor this risk into our recovery ratings on a prospective basis because the effect isn't predictable or quantifiable at the issuer or debt-instrument level. The challenge is further complicated with priming loan exchanges that typically create winners and losers among lenders in the same debt instrument. As a result, we capture the impact as part of our ongoing ratings surveillance once the specifics of a restructuring are known.

These restructurings have been facilitated by the weak loan documentation that has proliferated in much of the past decade as credit agreements have become more flexible and bond-like. Sponsor-owned companies were the first to aggressively pursue out-of-court loan restructurings because it enabled them to retain their equity while getting senior lenders make concessions (such as reduced collateral levels, the subordination of their repayment rights, haircuts to par, and/or the extension of existing maturities to distressed borrowers). While documentation provisions designed to combat these risks have existed for many years, they generally don't make it into institutional credit agreements due to the limited negotiating power of individual loan buyers in the BSL market. Further, as aggressive restructurings have increased, the stigma has abated somewhat, and even non-sponsor owned companies now use these tactics.

One recent trend is for these restructurings to produce a less-extreme gap between the winners and losers, in part to reduce the risk that disadvantaged lenders will pursue expensive and time-consuming litigation. As a result, participation rates in many restructurings have increased, but the disadvantaged lenders still bear most of the future risks because they generally have a less favorable position in the new capital structure. This incremental risk is significant as redefault risk for these companies is high because these restructurings typically don't resolve the capital-structure problems that triggered the restructurings in the first place.

CLOs: Record issuance, but where are all the loans coming from?

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Issuance of new BSL collateralized loan obligations (CLOs) in the first half reached a record $101.35 billion, per LCD. This surpassed the $83.61 billion in the first half of 2021, which was the busiest year in the U.S. CLO market's history when taking the full year into account. This occurred amid tepid new loan issuance, with most of the activity in the BSL market consisting of loan repricings and refinancings, neither of which provide the loan supply that would normally fuel new CLO issuance. The fact that more than half of loans in the secondary market are trading above par also isn't accretive for new CLO formation.

Optional redemptions of existing CLOs can provide some collateral, but absent an increase in new loan supply from LBOs and M&A, we think the pace of CLO issuance will moderate in the second half. CLO refinancings and resets, however, aren't subject to the same collateral constraints, and we expect a very busy second half. Credit spreads on BSL CLO 'AAA' tranches from the largest, most liquid CLO managers have fallen below 140 bps over SOFR, 30 points tighter than at the end of 2023. Combined with the dearth of CLO resets in 2022 and 2023 and the increase in loan prices, this has left the CLO market with a large volume of transactions that are good candidates for resets and refinancings (see "Calling All CLOs! Or Not? Assessing The Potential Volume Of CLO Refinances And Resets," published Feb. 22). We expect the heavy volume of the first half ($110.77 billion, per LCD) to continue through year end.

Exposure to corporate ratings downgrades in the second quarter kept BSL CLO 'CCC' buckets elevated. Despite the downgrades, there has been an overall improvement in S&P Global Ratings' weighted average rating factor (SPWARF) metrics over the past year, largely driven by the decrease in CLO exposure to obligors we rated 'B-' during this time. This is partly a reflection of trends in the overall loan market, which has become less receptive to 'B-' issuers, some of whom have moved to the private credit market. But it's also the result of de-risking efforts from CLO managers amid a still uncertain economic environment.

As a result, there has been gradual par loss in the past year; and this, plus elevated 'CCC' baskets, have resulted in the average junior overcollateralization (O/C) cushion across the BSL CLO transactions declining modestly, to just below 4% (see "CLO Insights U.S. BSL Index: SPWARF Improves, But 'CCC' Buckets Remain Elevated; CLOs Outperform Loan Market In Exposure To Defaults," published July 2).

CLO ratings have held up well despite elevated corporate downgrades since the second half of 2022, with modest levels of downgrades, mostly to 'BB' tranches of to BSL CLOs issued before the pandemic. With the number of corporate ratings downgrades moderating in recent months (see "U.S. BSL CLO And Leveraged Finance Quarterly: High Capital Costs Limit Broad-Based Improvement," published on May 8), we expect this to continue. For middle-market CLOs, moderation of credit estimate downgrades has been more limited, but we still expect few downgrades to middle-market CLO ratings in the second half given the large amounts of par subordination and rating cushion in place to support the ratings on most middle-market CLO tranches (see "Private Credit And Middle-Market CLO Quarterly: Pick Up In Performance And PIKs," published July 24).

Related Research

- Global Business And Tech Services Outlook: Unveiling Risk And Resilience Across Subsectors, July 31, 2024
- Global Financing Conditions: Early Issuance Should Support Growth Through Second-Half Slowdown, July 29, 2024
- Global Refinancing Update Q3 2024: Near-Term Risk Eases, July 29, 2024
- Risky Credits: U.S. And Canadian Downgrades Into 'CCC' Sharply Rise, July 26, 2024
- Industry Credit Outlook Update 2024, July 18, 2024
- Credit Conditions North America Q3 2024: A Brighter Outlook, Laden With Risks, June 25, 2024
- Economic Outlook U.S. Q3 2024: Milder Growth Ahead, June 24, 2024
- Global Nonfinancial Corporate Medians History And Outlook Midyear 2024, June 19, 2024
- Resilient Growth, Resilient Yields, And Resilient Defaults To Bring The U.S. Speculative-Grade Corporate Default Rate To 4.5% By March 2025, May 16, 2024

Aerospace and Defense

Aircraft delivery uncertainty, steady defense

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What's changed?

Boeing outlook revised to negative. We see a heightened risk for a delayed recovery in Boeing's credit measures while it improves quality control on its 737 MAX aircraft.

Stronger aircraft market fundamentals. Aircraft delivery rates are well below prevailing demand and older commercial aircraft remain in service longer than expected. Companies focused on aftermarket parts and services have been key beneficiaries, and upgrades have followed.

Higher defense spending was formalized. The 2024 budget for the U.S. Department of Defense is $842 billion--a 3% increase over the 2023 budget. The request for 2025 represents a 1% increase, and slowing growth is likely.

What to look out for?

Boeing delivery expectations for 2025. We assume the company's production and deliveries of 737 Max aircraft will increase in the second half of this year from current low levels. A downgrade could result if Boeing does not make progress towards more normalized levels.

Shareholder-friendly initiatives. Strong cash flow but elevated share repurchases that could lead to a reassessment of financial policies and pressure on certain investment grade ratings.

Elections. Roughly 50% of the world's population is subject to elections this year. Material changes in defense policies could impact projected spending levels in the U.S. and reprioritization of defense platforms and projects.

What are the key risks around the baseline?

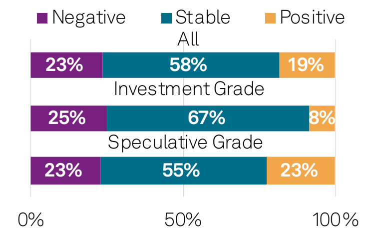
Supply chain and productivity constraints. Parts availability limitations and relatively unseasoned manufacturing workforces could increase costs and impede an increase to production.

Fixed-price contract cost inflation. Delays and cost increases on fixed-priced development contracts and early-stage production for defense programs may result in losses.

Share repurchases. Heightened levels of buybacks could delay (or reverse) projected credit measure improvement among certain higher-rated defense companies.

Rating Trends

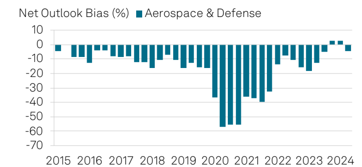
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	12	31	43
Downgrades	0	1	1
Upgrades	0	3	3

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	4.8	6.8
EBITDA growth (Y/Y%)	7.9	14.9
EBITDA margin (%)	15.0	12.6
Capex growth (Y/Y%)	9.2	11.0
Debt/EBITDA (x)	2.5	5.4
FFO/Debt (%)	27.0	9.1
FOCF/Debt (%)	21.7	2.5

All data as of end-June 2024.

* Year-to-date. Current ratings only.

Related Research

Boeing Co.'s Use Of Equity For Spirit AeroSystems Acquisition Is Better For Long-Term Credit Metrics, July 1, 2024

TransDigm Inc. Upgraded To 'BB-' On Strengthening EBITDA; Outlook Stable, June 6, 2024

Autos

Sluggish sales limit ratings upside

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What's changed?

High interest rates will limit sales growth through 2025. As U.S. consumers' excess savings get depleted and delinquency rates on auto loans now exceed pre-pandemic levels, we expect flattish auto sales through 2025.

Rising pricing pressure and ongoing inflation implies lower ratings headroom. With rising inventories, softening fleet demand, and demand shifts to used vehicles, a 10% decline is likely in average new vehicle transaction prices from 2023 levels through the end of 2025 (down 3% through June 2024). Wage inflation will limit margin upside for suppliers, particularly if automakers get tougher on cost pass-throughs.

Further downside for electric vehicle (EV) sales. Recently announced higher tariffs on batteries and critical minerals will likely push up input costs for U.S. EV manufacturers, delaying automakers from hitting profit targets and translating to higher EV prices for end customers until alternative supply options are identified. This, in turn, could disincentivize purchases at a time when U.S. EV sales have become sluggish as pure battery EV (BEV) (excluding plug-in) share fell from 7.5% in 2023 to 6.9% in the first half of 2024.

What to look out for?

Inventory levels at certain outliers. We will monitor if outliers like Stellantis and Ford exercise production discipline to reduce inventory levels towards 50-60 days. This is critical to reducing pressure to raise incentives, hence protecting their margins somewhat, even if consumer demand weakens over the next 18 months.

Tougher financing conditions. Auto loan delinquencies over 90 days have risen to above pre-pandemic levels, with buyers in the age group of 18-29 representing the highest delinquency rate. We believe subprime borrowers are delaying vehicle purchases for now as higher borrowing costs and inflationary pressures affect their overall spending.

Chinese response to protectionist measures. We expect continued trade tensions catalyzing more partnerships, joint ventures, and co-investments to develop alternative supply chains, particularly for battery-grade lithium, nickel, graphite, and cobalt outside China to avert higher costs.

What are the key risks around the baseline?

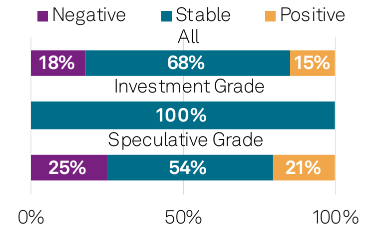
Uncertainty around EV demand could force strategic missteps. Some automakers may not allocate appropriate capital towards hybrid technology, mid-cycle portfolio refreshes on internal combustion engines, or towards material improvements in cockpit experience and charging experience. This would weaken their competitive position.

Used car prices drop beyond our expectations for a 5%-7% fall in 2024. In this scenario, many consumers who paid above MSRP during the pandemic will find themselves in a negative equity position because their trade-in vehicles are the most likely to have suffered significant drops in value.

CDK's dealer management system's software outage. Lack of lost sales recovery in July or further such disruptions pose downside risks to our base-case for U.S. auto sales.

Rating Trends

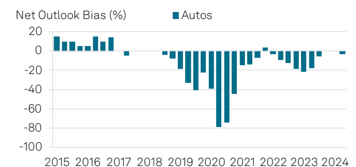
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	10	24	34
Downgrades	0	0	0
Upgrades	0	4	4

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	2.8	1.4
EBITDA growth (Y/Y%)	3.5	4.4
EBITDA margin (%)	12.4	11.6
Capex growth (Y/Y%)	4.1	10.9
Debt/EBITDA (x)	1.0	4.6
FFO/Debt (%)	58.0	10.9
FOCF/Debt (%)	20.8	3.0

All data as of end-June 2024.
* Year-to-date. Current ratings only.

Related Research

Global Auto Sales Forecasts: Slower EV Growth Offers Temporary Relief To Legacy Automakers, April 25, 2024

Credit FAQ: Why China Is At The Center Of Global Auto Conversations, June 11, 2024

Tougher Pricing Conditions In 2024 Could Cramp U.S. Auto Sector Ratings Headroom, Feb. 12, 2024

Building Materials

Credit stability on a weaker foundation

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What's changed?

Slowing revenue growth. We still expect revenue across the sector will remain flat or decline by low single-digits in 2024 due to elevated interest rates and persistent inflation. Furthermore, as interest rates remain higher for longer, we expect repair and remodel spending to decline modestly as consumers delay large projects. However, tailwinds from certain nonresidential and new residential construction activity will persist in 2024, albeit less than in recent years.

Industry consolidation and falling leverage have propelled recent positive rating actions in the sector. Nonetheless, given the concentration of private equity ownership, more aggressive acquisitions or shareholder returns could be forthcoming, pressuring ratings, particularly at the lower-rated credits.

What to look out for?

Lower volumes pressuring margins. We expect softer demand to result in increased competition, which will limit pricing power and pressure margins and earnings. Furthermore, high incentives by homebuilders to maintain volumes could limit building materials companies' ability to pass through price increases. Nonetheless, profitability has remained resilient and companies have kept prices stable.

Slower growth in new construction and pullback in remodel spending. While we believe homebuyers are adjusting to higher mortgage rates and demand for new homes remains resilient, a sharper-than-expected pullback in homebuilding or renovation demand could pressure issuers with higher exposure to these segments.

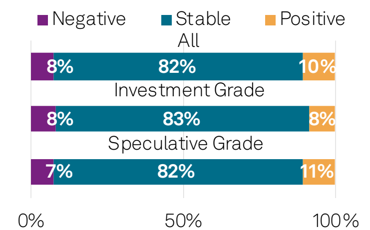
What are the key risks around the baseline?

Cost inflation could strain consumer spending and reduce earnings further. Slowing demand for home repairs and construction coupled with persistent cost pressure within the building materials industry could limit pricing power and increase pressure on margins. Unfavorable price-cost mixes, sticky inflation in commodities, and high labor and delivery costs could result in weaker-than-expected earnings and cash flows.

High interest rates will increase refinancing risks for speculative-grade issuers. The debt of many speculative-grade issuers is priced at historically low interest rates. As the Fed increased its benchmark rates, issuers faced higher refinancing costs, thus a reduction in their interest-coverage metrics. On the plus side, most issuers do not have significant maturities before 2026 and many have refinanced already.

Rating Trends

Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	12	55	67
Downgrades	0	0	0
Upgrades	0	7	7

Ratings Outlook Net Bias

Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	3.8	3.8
EBITDA growth (Y/Y%)	8.2	3.4
EBITDA margin (%)	19.5	15.2
Capex growth (Y/Y%)	9.4	6.2
Debt/EBITDA (x)	1.6	4.2
FFO/Debt (%)	46.8	14.4
FOCF/Debt (%)	24.9	7.3

All data as of end-June 2024.
* Year-to-date. Current ratings only.

Related Research

Signs of Stability Are Emerging Amid Challenging Conditions in Real Estate, July 2, 2024

U.S. Homebuilders Are Building On Improving Credit Quality, June 3, 2024

Capital Goods

All those new factories will need equipment

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What's changed?

Revenue growth takes a pause as customers destock. Industry throughput has slowed, but demand still looks good. Inventories are normalizing but could remain elevated as supply chain risks persist.

Equipment investment should follow a boom in plant construction. Our economists expect a jump in equipment investment in 2025 and 2026, following a surge of factory construction from large U.S. stimulus programs.

Demand, profits, and credit hold steady through a cyclical pause. U.S. capital goods companies mostly finished a cautious 2023 with good credit buffer, so any slowdown in 2024 looks manageable.

What to look out for?

Megatrend spending might be lumpy. The race to build factories in the U.S. could also stop quickly. Investment decisions for energy transition, strategic manufacturing, and infrastructure all face starts and stops.

Orders keep slowing while costs stay high. We are assuming that revenue picks up in 2025 and 2026, so more destocking in late 2024 could indicate a deeper downturn. Meanwhile, input costs and labor could be sticky in a moderate downturn.

U.S. capital goods companies go shopping. U.S. capital goods companies have outperformed their global peers in revenue and profit growth for a few years, and the U.S. dollar is strong. The largest transactions in recent years have been spin-offs, so the prospects for international mergers and acquisitions look good.

What are the key risks around the baseline?

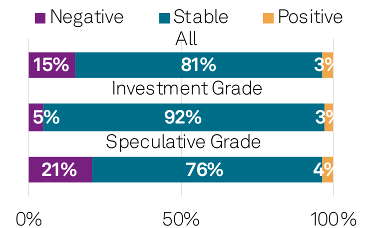
Interest rates slow big investments. Rising interest slows manufacturing activity with nearly every tightening cycle. Fiscal stimulus is counteracting monetary factors in this industry, but tighter funding conditions could throttle the pace of investment.

Costs and capabilities limit growth or eat into margins. Even with robust demand, elevated costs or poor labor productivity could affect earnings amid otherwise good market conditions.

Higher-for-longer interest rates cause more speculative-grade distress. Maturities start rising in 2025 for highly leveraged private equity-owned issuers. Distress is already evident as some companies struggle to fund higher cash interest from earnings while valuations will affect refinancing large debt stacks.

Rating Trends

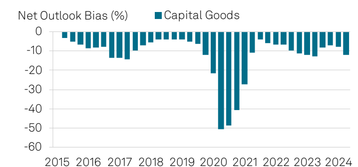
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	39	78	117
Downgrades	2	5	7
Upgrades	2	12	14

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	3.9	4.5
EBITDA growth (Y/Y%)	4.8	6.0
EBITDA margin (%)	21.9	16.8
Capex growth (Y/Y%)	5.2	10.8
Debt/EBITDA (x)	2.0	4.3
FFO/Debt (%)	41.2	13.8
FOCF/Debt (%)	30.9	6.2

All data as of end-June 2024.

* Year-to-date. Current ratings only.

Related Research

Evolving Risks For Credit Quality In U.S. Capital Goods, June 18, 2024

Bulletin: Deere & Co. Maintains Strong Credit Buffer Despite Agricultural Downturn, May 16, 2024

Rockwell Automation Inc. Downgraded To 'A-' From 'A' On More Aggressive Financial Policy; Outlook Stable, July 2, 2024

Chemicals

Signs of recovery but challenges remain

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What's changed?

Chemical output improves. Chemical production volumes rose globally, including in North America for the first quarter. We see indications that the improvement might sustain into the first half of 2025, at least.

Demand is holding up. Underlying demand for many chemicals has support from positive GDP growth and stable to improved demand from key end markets, including housing, auto, and general industrial.

Greater prospects for trade disruptions. Tariffs imposed by the U.S. on certain products produced in China and retaliatory tariffs by China have increased the odds of trade disruptions between them--two of the largest global chemical producers.

What to look out for?

Improvements in earnings. We anticipate EBITDA will improve this year as destocking challenges ease. The improvement is likely to be more pronounced in the second half of this year.

Supply reductions. Although some petrochemical capacity in Europe is shutting down because of the high cost of energy in that part of the world, we expect petrochemicals will remain oversupplied. However, further shutdowns could limit the credit downside for North American petrochemicals.

Economic shocks. Stable to slightly improving demand prospects provide a bedrock of credit quality, offsetting risks of high interest rates, supply additions in some subsectors, and trade disruptions. Still, economic shocks could slow down or reverse our anticipated demand improvement.

What are the key risks around the baseline?

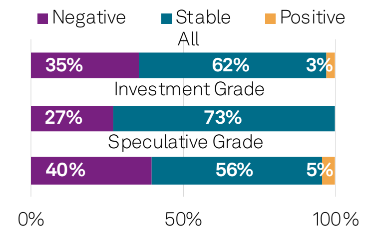
Destocking persists. Delays in our anticipated recovery from destocking or a weaker-than-expected recovery would weaken earnings and credit metrics against our expectation for improvements in many instances.

Demand weakens. Extraneous shocks or weaker consumer spending would deteriorate underlying demand and stall a recovery in the sector. This would likely hurt credit quality, especially for credits at the lower end of the rating scale.

Raw material costs rise sharply. A spike in input costs could offset benefits to earnings from improved demand. However, we do not account for this in our base case because we consider the likelihood of such increases to be low. Shipping challenges in the Red Sea related to the Israel-Hamas war have not had a widespread or deep impact on input costs in general, but such events highlight an ongoing vulnerability of portions of the sector to input cost increases.

Rating Trends

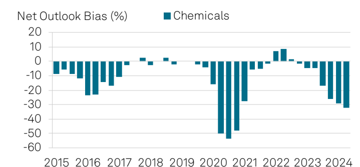
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	22	43	65
Downgrades	1	4	5
Upgrades	1	2	3

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	2.3	4.1
EBITDA growth (Y/Y%)	5.6	10.2
EBITDA margin (%)	19.9	18.3
Capex growth (Y/Y%)	1.7	9.6
Debt/EBITDA (x)	2.4	5.0
FFO/Debt (%)	32.2	12.3
FOCF/Debt (%)	15.9	3.1

All data as of end-June 2024.
* Year-to-date. Current ratings only.

Related Research

CreditWeek: Is The Slumping Chemicals Sector Set For An Earnings Rebound? May 23, 2024

Consumer Products

A pinched consumer and more promotional spending

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What's changed?

Consumer discretionary income further erodes. Higher interest rates and the cumulative effect of inflation have caused U.S. income growth to lag spending since the middle of last year. Excess savings are now depleted. Lower consumer discretionary income, particularly for low-income consumers, will likely lead to less spending.

Aggressive cost savings will support higher brand investment. Many companies expect low-single-digit inflation and limited price increases for the remainder of 2024. Also with fewer supply chain disruptions, they have resumed productivity measures, including cost savings. However, many will reinvest these savings into advertising and promotions to drive volume growth.

Stalled margin recovery from more promotional spending and a negative mix shift. In addition to higher promotional spending to recoup volumes, companies are facing a negative mix shift to lower-margin offerings as shoppers seek value, buy closer to consumption, and shop across multiple channels. More at-home consumption should also pressure margins as higher-margin on-premise sales shift to retail value offerings.

What to look out for?

Market share losses to private label and a pause in premiumization. Private label has gained market share over the past year due to larger price gaps relative to branded competitors and increased availability of products from a normalization of supply chains. Premium priced products are losing share, particularly for spirits companies.

Weak demand for discretionary products, though margins may have bottomed. Demand for household appliances and apparel will remain weak after sales were pulled forward during the pandemic, and discretionary income is now pressured. Moreover, high interest rates will likely constrain durable purchases tied to housing turnover. Although retailers will reorder cautiously, there is no longer a large inventory overhang, so margins could rebound from less discounting.

Less deleveraging with most companies operating within their financial policy targets. Leverage reduction will be limited to companies in subsectors that have underperformed expectations, including durables, apparel, and protein processors. Apart from these, consumer products issuers have largely reduced leverage to their long-term targets and will likely prioritize shareholder returns or bolt-on acquisitions as valuations remain lofty for larger transactions.

What are the key risks around the baseline?

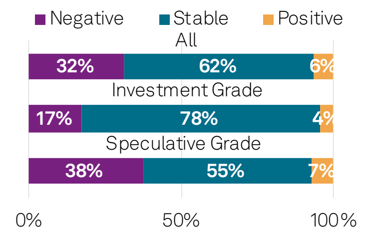
Weaker than expected volumes. Price elasticities may become more pronounced, leading to lower consumption and a higher market share for value products.

Stubbornly high interest rates. If inflation does not fall as expected, rates could stay higher for longer, further pressuring consumer wallets.

Supply chain disruption and heightened geopolitical risk. Geopolitical tensions could escalate and further disrupt supply chains, pressuring margins and cash flow.

Rating Trends

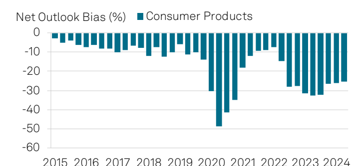
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	46	112	158
Downgrades	3	13	16
Upgrades	0	15	15

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	1.8	2.0
EBITDA growth (Y/Y%)	3.7	6.3
EBITDA margin (%)	19.8	14.7
Capex growth (Y/Y%)	4.9	4.5
Debt/EBITDA (x)	2.3	5.4
FFO/Debt (%)	33.3	10.5
FOCF/Debt (%)	19.7	5.9

All data as of end-June 2024.
* Year-to-date. Current ratings only.

Related Research

What's Next For Protein Processor Ratings After a Grinding 2023?, May 23, 2024

U.S. Beverage Companies Face A Cautious Consumer in 2024 With Slower Topline Growth And Limited Rating Upside, March 19, 2024

Health Care

Ratings deterioration to moderate, but challenges abound

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What's changed?

Credit deterioration has peaked? With the normalization of demand and moderation of inflationary pressures, we expect overall ratings deterioration to slow in second half of 2024, though the health care services-heavy lower end of the ratings universe continues to face stubbornly high leverage and weak cash flows.

Defaults back on record pace. Despite the improving environment, defaults in the sector remain historically high, as recent improved operating performances have not offset high leverage, weak cash flows, and decreasing liquidity for many companies.

Spotlight on pharma pricing getting brighter. Growing GLP-1 demand and newly approved, albeit expensive, Alzheimer's treatments have increased scrutiny of pharma pricing. The Federal Trade Commission (FTC) is also preparing to sue pharmacy benefit managers (PBMs).

What to look out for?

Pace of margin improvement. We are projecting EBITDA margin improvement for all subsectors in 2024. The pace of improvement will be especially critical for the lower-margin, higher-leveraged health care services companies.

M&A pressures. Mergers and acquisitions continue to be a focus, especially for the pharma and life sciences industries, and we expect private equity will again become more active in health care services.

Regulatory and legislative noise increasing. Continued FTC scrutiny on health care mergers and PBM practices and the U.S. Supreme Court overturning Chevron deference are among developments that hold potentially significant impacts to the industry.

What are the key risks around the baseline?

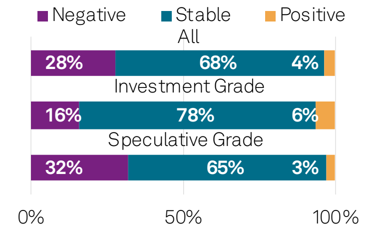
Inflationary/labor pressures, persistent elevated interest rates. Execution risk remains high for leveraged health care service providers, whose margins and cash flows continue struggle against high labor costs and elevated interest expenses.

Topline growth supports ratings. We have limited concern on health care demand/topline growth currently, but EBITDA margins and cash flows remain pressured. Should revenue growth disappoint, we can see more ratings deterioration.

Reimbursement concerns increasing. Health insurers' rising medical cost ratios, due to increased utilization, growing GLP-1 and behavioral health spend, and pressures on Medicare Advantage rates, likely leads to tougher reimbursement rates going forward.

Rating Trends

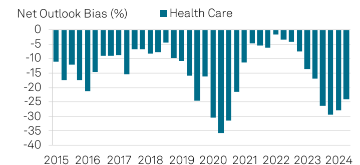
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	32	97	129
Downgrades	1	11	12
Upgrades	0	9	9

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	2.9	5.3
EBITDA growth (Y/Y%)	5.7	12.3
EBITDA margin (%)	29.4	15.4
Capex growth (Y/Y%)	3.9	6.7
Debt/EBITDA (x)	2.4	6.7
FFO/Debt (%)	32.5	6.2
FOCF/Debt (%)	24.2	2.4

All data as of end-June 2024.
* Year-to-date. Current ratings only.

Related Research

AI In Healthcare: A Path to Long-Term Immunity? June 25, 2024

Turbulence at Physician Groups that Provide Services in Hospitals is Weighing on Ratings, May 31, 2024

Despite Some Improvement, Weaker Health Care Services Companies Continue to Struggle, May 2, 2024

Homebuilders and Developers

Credit quality remains solid

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What's changed?

Construction cycle times continue to improve. Better labor and material availability has resulted in shorter cycle times relative to pre-pandemic levels, which should increase cash flow and inventory churn as the builders focus on volumes. This improvement should play out in overall operating performance as we assume financial results improve from 2023, which saw both revenues and EBITDA decline across the sector.

Ratings stability. Given that 97% of sector ratings are on stable outlook, we expect relative rating stability through the remainder of 2024 following several upgrades in 2023. Still, stronger-than-expected performance in 2024 has resulted in eight positive rating actions so far in 2024.

What to look out for?

Higher-than-expected incentives due to higher-for-longer mortgage rates. The level of incentives that builders offer helps them maintain their sales pace but also pressures profitability. If the level remains higher than normal we could see gross margins approach pre-pandemic levels.

Historically elevated cash balances should lead to reinvestment in the business. Homebuilders are maintaining historically high cash balances that we expect they will use to increase gross inventory on their balance sheets over the next 24 months. Reinvesting most of their cash in continuing operations could benefit the sector in the long term.

Timing and pace of rate cuts. We expect the first rate cut in December 2024 and subsequent cuts in 2025. Lower interest rates could ease some affordability concerns and increase demand.

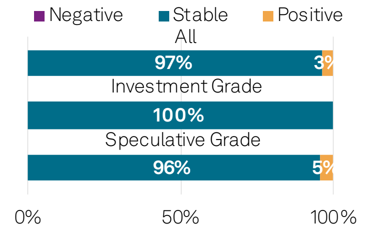
What are the key risks around the baseline?

U.S. existing home inventories increase from low levels. Lower mortgage rates could attract existing homeowners to sell, possibly siphoning sales from prospective new-home buyers.

Continued focus on volumes over profitability. As homebuilders focus on volumes in an environment of worsening affordability, we would expect the larger, better-capitalized homebuilders to maintain their market share by competing on price, either through price reductions or incentives.

Rating Trends

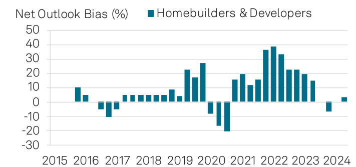
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	7	22	29
Downgrades	0	0	0
Upgrades	1	6	7

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	4.7	8.4
EBITDA growth (Y/Y%)	0.6	0.1
EBITDA margin (%)	17.7	14.5
Capex growth (Y/Y%)	4.7	14.4
Debt/EBITDA (x)	0.3	2.4
FFO/Debt (%)	197.1	28.4
FOCF/Debt (%)	67.0	8.6

All data as of end-June 2024.

* Year-to-date. Current ratings only.

Related Research

Signs Of Stability Are Emerging Amid Challenging Conditions In Real Estate, July 2, 2024

U.S. Homebuilders Are Building On Improving Credit Quality, June 3, 2024

Real Estate Monitor: Higher-For-Longer Interest Rates Will Continue To Weigh On The Sector, March 20, 2024

Hotels, Gaming, and Leisure

Leisure demand will be tested amid high prices

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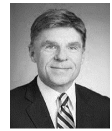

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What's changed?

Not much. Our view that resilient leisure spending will be tested this year holds. With prices and rates high, consumers may look for bargains, causing travel and leisure spending growth to moderate.

Open capital markets and ratings stability contributed to a high level of debt refinancings, extending maturities for all who tapped the markets, although these conditions were not available to the most challenged low-rated issuers.

We keep raising our cruise baseline expectations, floating all ratings in the sector upward. If the late-blooming cruise recovery has a multiyear arc like other leisure sectors did post-COVID, it is plausible cruise vacationers continue to spend freely and credit measures improve to an even better place than we currently assume.

What to look out for?

M&A may take off in earnest if buyers can look past elevated rates or become flexible on how much debt to use to finance transactions. Still, if leveraging mergers and acquisitions increase, leverage cushions could decline, and ratings could be pressured.

Elevated labor and other costs will pressure margin in gaming and hotel sectors where revenue is moderating.

Upgrades so far this year have meaningfully exceeded downgrades, yet the extent of this upward bias to ratings is not likely to continue much longer with moderating revenue, elevated costs pressuring margin, and M&A risk across much of the sector.

What are the key risks around the baseline?

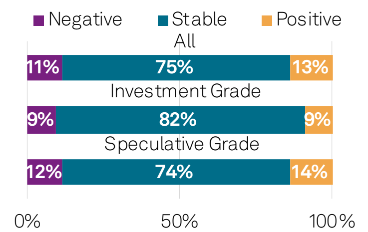
High prices and high rates weaken demand more than we assume. This is particularly true for big ticket discretionary items like timeshare and recreational vehicles.

Large scale casino development projects in New York remain a longer-term leveraging risk for companies that win their license bids, but the timing of these awards has shifted by at least a year to 2025.

Higher shareholder returns than we expect in a slowing revenue environment could weaken credit measures more than we anticipate.

Rating Trends

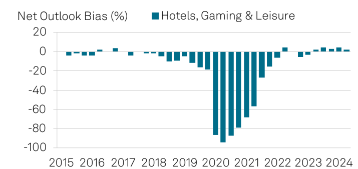
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	11	86	97
Downgrades	0	5	5
Upgrades	1	12	13

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	2.4	5.1
EBITDA growth (Y/Y%)	6.5	7.7
EBITDA margin (%)	29.5	27.2
Capex growth (Y/Y%)	7.5	-3.2
Debt/EBITDA (x)	2.2	4.9
FFO/Debt (%)	34.9	12.7
FOCF/Debt (%)	19.6	5.9

All data as of end-June 2024.
* Year-to-date. Current ratings only.

Related Research

Carnival Corp. Upgraded To 'BB' On Favorable Bookings And Pricing, Expected Deleveraging; Outlook Stable, June 25, 2024

U.S. Lodging Sector RevPAR Growth Will Moderate In 2024, March 13, 2024

Industry Credit Outlook 2024: Hotels, Gaming and Leisure, Jan. 9, 2024

Media and Entertainment

Still trying to navigate secular pressures

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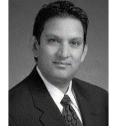

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What's changed?

Diverging trends for advertising. Overall advertising growth has returned as the macroeconomic landscape normalizes. Digital advertising, in particular, has stormed back to low-teens percentage growth. Still, legacy media, especially TV, continues to bleed advertising as secular challenges show no signs of abating.

Content is coming back but at lower levels. The dual Hollywood strikes stopped content production for much of 2023, and it has gradually resumed. But the streamers rationalized their content pipelines during the strikes, so while spending growth will return it will be lower overall.

Bifurcated capital markets don't help those in need. Capital markets are easily accessible for higher rated issuers with lower leverage, healthy cash flow, and a solid business plan. Meanwhile companies rated 'B' and lower, especially the local TV broadcasters with high leverage and weak competitive positioning, face significant challenges in refinancing upcoming maturities.

What to look out for?

The ability to grow streaming advertising. Successful media companies will be those that can deliver sustained net advertising growth (digital and linear TV). Streaming services don't have enough advertising-tier subscribers to deliver scaled audiences to advertisers, except Amazon, who moved all Prime subscribers to an ad-tier.

Is the Paramount/Skydance merger a harbinger for more M&A? Mergers and acquisitions have been muted this decade despite the belief that scale is a key differentiator. The Paramount/Skydance merger could open the M&A spigot, though an unfriendly regulatory environment and skeptical capital markets could limit such activity.

A streaming profitability inflection point. Legacy media companies have made strides in improving streaming profitability recently by increasing prices, adding advertising, and reassessing content spending. These actions have stanched losses and could lead some companies to sustained profitability as early as this year.

What are the key risks around the baseline?

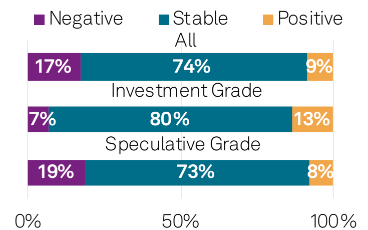
Secular trends for legacy media worsen. Legacy media remains dependent on the deteriorating linear TV ecosystem. Faster deterioration and worsening pay-TV subscriber declines could weaken legacy media companies' credit metrics.

Domestic streaming has matured. Subscriber growth has slowed as the video streaming providers have increased prices and cut content budgets. While this is helping profitability in the near term, sustainable subscriber and ARPU (average revenue per user) growth are needed to offset declines in linear TV.

Macroeconomic weakness/geopolitical shocks. While not in our base case, an economic recession or geopolitical shock could hurt consumer spending and advertising. Sticky inflation and higher interest rates for longer could also weaken consumer discretionary spending, especially for media.

Rating Trends

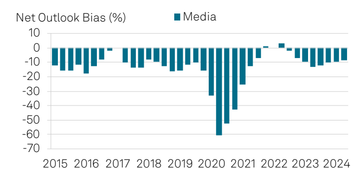
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	15	89	104
Downgrades	0	6	6
Upgrades	1	11	12

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	5.3	4.7
EBITDA growth (Y/Y%)	9.7	11.6
EBITDA margin (%)	24.3	22.8
Capex growth (Y/Y%)	14.8	0.3
Debt/EBITDA (x)	1.4	5.3
FFO/Debt (%)	50.4	8.8
FOCF/Debt (%)	49.0	6.2

All data as of end-June 2024.

* Year-to-date. Current ratings only.

Related Research

- Sports Rights: The Jump Ball In The Streaming Ecosystem, June 18, 2024
- Outlooks Diverge For U.S. Local TV Broadcasters As Industry Faces Secular Challenges, April 15, 2024
- U.S. Speculative-Grade Media Outlook 2024: A Mixed Story, Feb 2, 2024

Metals and Mining

Credit holds steady as big deals take shape

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What's changed?

High-profile mergers and acquisitions (M&A) get rolling...slowly. A few large transactions have been proposed, but only a few global-scale deals have been completed. Buyers are reluctant to pay large premiums, and sellers seem confident in the scarcity of assets.

Political and social pressure constrains output and increases costs. Production from several mines around the world has been disrupted by factors like social opposition or government intervention. The risk of profit disruption plays into investment decisions in this capital-intensive industry.

Prices, profits, and credit hold steady. Prices for most metals have been relatively stable for about a year, with a bounce for copper and gold offset by weaker iron ore and nickel. Cash flow is down, as are shareholder returns and debt reduction.

What to look out for?

Capital deployment affects funding choices. The calls on operating cash flow are relentless from high maintenance spending or large expansion projects. Shareholder returns are often variable, and M&A is disciplined and controllable. But large multiyear project commitments could force choices between debt and equity.

Debt reduction is mostly done. Many metals companies have reduced debt since before rates started rising, so any fixed-rate debt issued before 2022 looks attractive today. And now, companies face pressure for more investment and continued equity returns.

Cost profiles drive competitive position and financial firepower. The companies that own the most efficient, profitable assets are best positioned to acquire and prune less robust competitors. Industry cost curves have moved a lot in the past few years because of general inflation and currency movements, which alters the landscape for M&A.

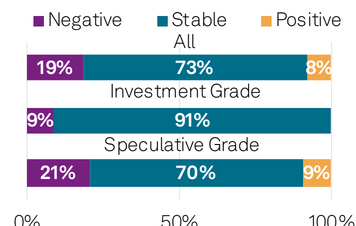
What are the key risks around the baseline?

Big spending and debt issuance coincide with lower prices. Metals prices have dropped substantially from record levels in 2022, but they remain elevated historically. Higher production costs support higher prices, but we still believe an economic downturn and modest overcapacity can drive prices below the cash costs of high-cost producers.

Public scrutiny strands production or adds costs. Unique mining assets attract attention and economic demands at local and state levels. Sometimes regulatory changes compel production changes, higher operating costs, or different economic benefits for stakeholders.

Rating Trends

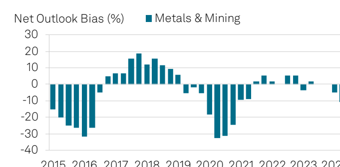
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	11	53	64
Downgrades	0	6	6
Upgrades	2	5	7

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	-1.6	-1.3
EBITDA growth (Y/Y%)	-4.5	-5.1
EBITDA margin (%)	34.5	20.8
Capex growth (Y/Y%)	4.8	-7.1
Debt/EBITDA (x)	0.9	3.0
FFO/Debt (%)	71.7	23.6
FOCF/Debt (%)	20.3	8.5

All data as of end-June 2024.

* Year-to-date. Current ratings only.

Related Research

- S&P Global Ratings Metal Price Assumptions: Prices Rise On Tight Supply And Higher Costs, May 2, 2024
- Alliance Resource Partners L.P. Rating Raised To 'BB-' From 'B+' On Refinance, Removed From CreditWatch; Outlook Stable, June 28, 2024
- Reliance Inc. Upgraded To 'BBB+' On Strengthened Credit Profile; Outlook Stable, May 2, 2024

Midstream Energy

Industry resilient on strong credit fundamentals

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What's changed?

The rise of data centers and the need to power them is a positive for the midstream industry over the next 3-5 years. But the supply mix (renewables vs. natural gas) and infrastructure constraints may offset some of the most optimistic forecasts.

Geopolitical uncertainty/climate factors intensify. Conflicts in the Middle East and Asia tend to have an indirect influence on industry creditworthiness through commodity price volatility and shifting commodity flows, which will influence future capital allocation decisions. Focus on permitting and greenhouse gas emissions will remain an overhang.

Positive discretionary cash flow shrinking. While balance sheets are strong and companies generally have healthy cushions in their credit measures, discretionary cash flow has shifted from positive to negative, or breakeven at best. Higher capital expenditures and shareholder rewards are the cause, but EBITDA growth should offset any harmful credit effects.

What to look out for?

Increased mergers and acquisitions. We expect more industry consolidation, mainly driven by diversified investment-grade companies that will acquire smaller speculative-grade peers. This is unlikely to cause any harm to the acquirer's credit profile.

Infrastructure development. Now that the Mountain Valley Pipeline is in commercial operation, the focus shifts to the need for Permian egress and the next asset to reach final investment decision.

Regulatory changes. Recent Supreme Court decisions are generally positive for the industry but actions by the states, environmental groups, and the presidential election will be an overhang.

What are the key risks around the baseline?

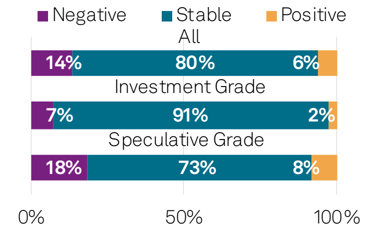
The upcoming election. Uncertainty around the U.S. presidential election could cause companies to accelerate major strategic moves, or delay them until after November.

Economic slowdown/interest rates. Lower inflationary pressure is positive for the industry and could spur refinancing activity. However, the industry's resiliency could be tested if economic growth slows considerably.

Energy transition/secular changes. The growth in renewable energy will continue to slowly make inroads at the expense of hydrocarbon demand, but the supply of renewables will likely not have a meaningful impact for several years.

Rating Trends

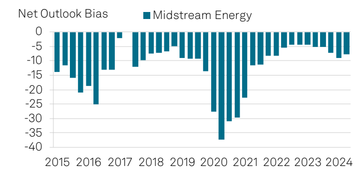
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	42	60	102
Downgrades	1	2	3
Upgrades	2	7	9

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	2.9	4.4
EBITDA growth (Y/Y%)	1.8	6.7
EBITDA margin (%)	59.2	48.9
Capex growth (Y/Y%)	6.5	-6.2
Debt/EBITDA (x)	3.4	4.6
FFO/Debt (%)	23.6	15.0
FOCF/Debt (%)	15.0	6.3

All data as of end-June 2024.
* Year-to-date. Current ratings only.

Related Research

Credit FAQ: Will The TMX Expansion Project Move The Needle On U.S. Refiner's Credit Quality?, April 18, 2024
Key Credit Drivers For North American Midstream Energy Companies In Q2 2024, March 20, 2024
Issuer Ranking: North And South American Midstream Energy Companies, Strongest To Weakest, Feb. 15, 2024

Oil and Gas

Steady as she goes?

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What's changed?

Merger mania. Significant ramp-up in merger and acquisition (M&A) volume in upstream exploration and production (E&P) due to concerns about medium- to longer-term reserve replacement, productivity, and need for scale.

The reemergence of deepwater. Rig retirements, limited new rig supply, and increases in offshore spending have led to vastly improved rig utilization and day rates.

Shifting focus back to core. Some majors announced a shift of focus back to hydrocarbon development vs. energy transition projects due to concerns about generating shareholder value and energy security.

What to look out for?

M&A to slow but stay active as producers continue to look to replace production, add to their reserves, and look for synergies.

Capital spending remains disciplined as producers continue to focus on returning cash to shareholders.

Hydrocarbon prices to remain supportive. OPEC continues to support oil prices while gas prices begin rebounding by year end due to liquid natural gas (LNG) export growth and data center build out.

What are the key risks around the baseline?

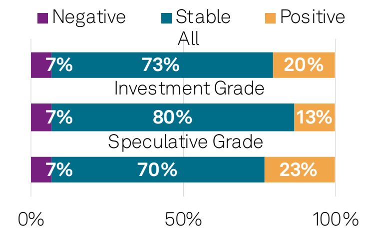
Natural gas prices remaining weak due to high inventory levels, byproduct gas production, and delays on lifting the Biden administration's ruling to pause issuing LNG export permits.

Oil field service activity to remain soft. Ongoing capital discipline among E&P companies, producer consolidation, improving efficiencies, and low natural gas prices will continue to pressure service demand and prices.

Shale productivity. Some plays, particularly the Bakken, Eagle Ford, and Anadarko basin, are experiencing declining productivity as core acreage depletes and costs increase. This could impact medium- to longer-term credit ratings for less diversified producers.

Rating Trends

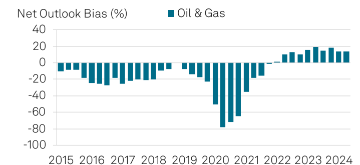
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	30	73	103
Downgrades	0	3	3
Upgrades	2	6	8

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	1.2	3.8
EBITDA growth (Y/Y%)	1.2	6.0
EBITDA margin (%)	28.6	50.9
Capex growth (Y/Y%)	0.8	4.9
Debt/EBITDA (x)	0.9	1.5
FFO/Debt (%)	85.1	54.8
FOCF/Debt (%)	46.8	19.1

All data as of end-June 2024.

* Year-to-date. Current ratings only.

Related Research

S&P Global Ratings Makes Modest Change To AECO Natural Gas Price Assumption; Other Prices Unchanged, June 11, 2024

The Permian Basin's Dominance Continues--But For How Long, May 31, 2024

North American Upstream Capex Growth To Decelerate In 2024 Amid Greater Capital Efficiency Gains, May 1, 2024

Real Estate

Hopeful signs amid challenging conditions

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What's changed?

Delay in rate cut heightened refinancing risk. Commercial real estate borrowers that postponed refinancing with hopes for a rate cut could get squeezed. As such, refinancing risk for debt maturities in the next two years remains high, particularly for struggling property types and properties.

Negative rating bias for office REITs increased. More than 80% of our rated office REITs have a negative outlook compared to 50% in early 2024. While leasing velocity has improved year-over-year, it remains below pre-pandemic levels. Meanwhile, office utilization remains subdued and tenant retention is relatively weak, suggesting further downside to occupancy levels.

Some rebound in debt issuance. Benchmark rates have stabilized and will eventually decrease. To that end, there has been a pickup in debt issuance in recent months as bond spreads tightened.

What to look out for?

Timing and pace of rate cuts. We expect the first rate cut in December and further cuts in 2025. Lower interest rates and narrowing bond spreads should support a recovery in credit metrics and improve access to capital.

Recovery in transaction activity. More certainty on future interest rates could bring greater transaction volume and price transparency (and losses). A more robust recovery may take more time, though the pace of decline in transaction activity is decelerating.

Stabilizing operating metrics. Demand for residential, retail, and industrial real estate remains resilient, and we continue to project cash flow stability in those sub-industries.

What are the key risks around the baseline?

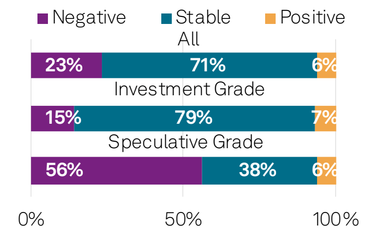
Tighter access to capital could narrow liquidity. Banks tightened lending standards as asset valuations declined and real estate fundamentals slowed, while access to equity remains constrained given the sector trades at a significant discount to net asset value.

Shorter weighted average maturity. Upcoming debt maturities are pressuring liquidity and financial flexibility for some office REITs and speculative grade credits, as the weighted average maturity of debt has narrowed over the prior year.

A further delay in rate cuts could keep valuation depressed. Asset valuations have dropped significantly and may not recover if the rate outlook worsens.

Rating Trends

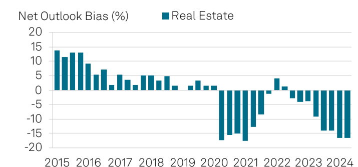
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	62	16	78
Downgrades	2	7	9
Upgrades	2	1	3

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	4.5	1.0
EBITDA growth (Y/Y%)	4.1	3.6
EBITDA margin (%)	64.6	59.6
Capex growth (Y/Y%)	4.6	0.0
Debt/EBITDA (x)	5.6	9.3
FFO/Debt (%)	13.6	6.0
FOCF/Debt (%)	11.3	3.5

All data as of end-June 2024.
* Year-to-date. Current ratings only.

Related Research

Signs of Stability Are Emerging Amid Challenging Conditions in Real Estate, July 2, 2024

CRE Debtholders Are Confronting Increasing Refinancing Risk and Charge Offs in 2024, June 3, 2024

Regulated Utilities

Credit risks are rising

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What's changed?

Industry outlook. In February we revised our industry outlook to negative, reflecting the industry's high percentage of companies with negative outlooks and that operate with only minimal financial cushion from their downgrade threshold; record-breaking capital spending that is leading to high cash flow deficits, which are not sufficiently funded in a credit-supportive manner; and rising wildfire risks.

Growth. Following nearly two decades of flat to negative electricity sales because of conservation, we expect the industry will likely grow at 1%-2% annually, primarily from data centers, the onshoring of manufacturing, and electric vehicles. We assess this development as supportive of credit quality, allowing the industry to spread its fixed costs across a wider base.

Hybrid security issuance at about $12 billion this year is on pace to set a record. We assess hybrids as supporting the industry's financial performance by funding a portion of its large cash flow deficits in a more credit-supportive manner than senior debt.

What to look out for?

Management of regulatory risk. The industry has filed more than 130 rate cases, requesting revenue increases of more than $22 billion to recover its record-breaking $200 billion in annual capital spending.

Wildfire mitigation plans. We expect the industry will implement plans that significantly reduce the likelihood of a utility causing/contributing to a wildfire and that allow for the recovery of wildfire costs should the utility be obligated to pay them. Recent legislation in Utah that addressed liability caps and a wildfire fund is supportive of credit quality.

Downgrades again outpacing upgrades modestly. However, given that more than a quarter of the industry has a negative outlook and that about 35% of the industry operates with only minimal financial cushion from their downgrade threshold, 2024 will likely be the fifth consecutive year that the industry's downgrades outpace upgrades.

What are the key risks around the baseline?

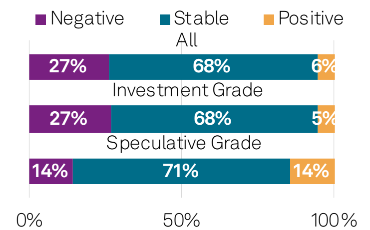
Wildfires. Utilities operating in Alberta, Arizona, California, Colorado, Florida, Idaho, Nevada, New Mexico, Oklahoma, Oregon, South Dakota, Texas, Utah, Washington, and Wyoming are all experiencing increasing wildfire risks, raising the industry's credit risks.

Insurance. The industry's wildfire insurance availability and rising costs have forced some California utilities to move to a self-insurance model. We asses this trend as negative for the industry's credit quality.

Common equity. To date, common equity issuance has only been at about $1 billion, a level likely to be insufficient to the fund the industry's cash flow deficits ($80 billion-$100 billion) in a credit supportive manner.

Rating Trends

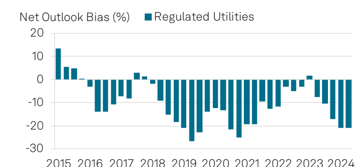
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	227	7	234
Downgrades	18	0	18
Upgrades	17	2	19

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	7.3	3.3
EBITDA growth (Y/Y%)	9.6	2.6
EBITDA margin (%)	35.9	26.4
Capex growth (Y/Y%)	9.5	11.6
Debt/EBITDA (x)	4.5	5.7
FFO/Debt (%)	17.2	12.5
FOCF/Debt (%)	-4.0	-5.1

All data as of end-June 2024.

* Year-to-date. Current ratings only.

Related Research

Will The Issuance Of Hybrid Securities Protect The Credit Quality Of North American Investor-Owner Regulated Utilities?, July 1, 2024

North American Utility Regulatory Jurisdictions Update: Ontario Remains Unchanged, March 11, 2024

Rising Risks: Outlook For North American Investor-Owned Regulated Utilities Weakens, Feb. 14, 2024

Retail and Restaurants

Soft-landing key to containing the pressure on retail

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What's changed?

A steady stream of small to medium-sized refinancings ahead of the U.S. election. Speculative-grade issuers have come to market to push out maturities, reprice, and add on debt at a higher clip than last year in retail. This is amid more comfort with "new normal" interest rates, private vs. public credit market offerings, and concerns about potential market volatility towards the end of this year around the U.S. presidential election. This year we've assigned ratings to SSH Holdings Inc.'s (d/b/a Spencer Spirit) $350 million proposed term loan and United Natural Food's proposed $500 million first-lien term loan. We also commented on Whatabrands LLC's (Whataburger) proposed term loan repricing and $140 million fungible add-on to its 2028 repriced first-lien term loan. We expect more transactions of this size in coming months.

Discretionary retail categories including apparel are under pressure in 2024. Department stores Kohl's Corp. and Nordstrom Inc. have negative outlooks and Macy's Inc. has grappled with a proxy fight and buyout bid turmoil this year. Amazon.com Inc. and other online and fast-fashion players are taking material market share amid consumers' value focus. Now it is a matter of individual management teams executing to win discerning shoppers. For instance, we revised the outlook on Victoria's Secret & Co. to negative this year, and upgraded Abercrombie & Fitch Co. one notch. Saks' owner is buying Neiman Marcus as even high-end customers have pulled back.

What to look out for?

Store closing announcements to continue or accelerate. Family Dollar Stores Inc. will close 600 stores this year and 370 over the next few years as leases expire. 99 Cents Only Stores LLC filed for bankruptcy in April. CVS Health Corp. has closed about 600 stores since 2022 and could close another 300 this year. Walgreens Boots Alliance Inc. recently said as much as 25% of its 8,600 stores are underperforming and could be closed. We note that after years of mall-based closures, the newest closures are off mall.

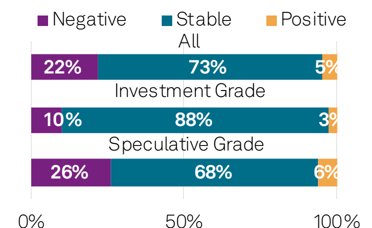
The Federal Trade Commission (FTC) is taking a hard line on retail M&A. We note how difficult it is for big-name deals to get through the regulatory process this year. The FTC is pushing back on The Kroger Co.'s acquisition of Albertsons Cos. Inc. and Tapestry Inc.'s acquisition of Capri Holdings Ltd. It recently blocked Tempur Sealy International Inc.'s acquisition of Mattress Firm Inc. Consolidation is an important go-forward strategy for the sector, and companies are watching closely to see how these transactions play out.

What are the key risks around the baseline?

Slow progress in lowering inflation continuing to weigh on U.S. shoppers. Supply chain snafus abated in the U.S. in 2024. However, slower monetary easing and lower economic growth could result in higher unemployment and even less demand for both retail and restaurant purchases in the coming year. A soft landing will be crucial in keeping more players from distress and default. Already we have downgraded names like The Container Store Group Inc. and Fossil Group Inc. one notch to 'CCC+' and 'CCC', respectively.

Rating Trends

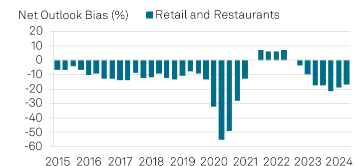
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	40	103	143
Downgrades	0	5	5
Upgrades	2	5	7

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	3.0	2.3
EBITDA growth (Y/Y%)	3.3	5.6
EBITDA margin (%)	11.2	14.7
Capex growth (Y/Y%)	5.4	4.7
Debt/EBITDA (x)	2.4	4.3
FFO/Debt (%)	30.4	13.6
FOCF/Debt (%)	18.6	8.5

All data as of end-June 2024.

* Year-to-date. Current ratings only.

Related Research

Whatabrands LLC's Proposed Term Loan Repricing And $140 Million Fungible Add-On Are Leverage Neutral, May 6, 2024

Industry Credit Outlook 2024: Retail and Restaurants, Jan. 9, 2024

Technology

IT spending and rating expectations remain intact

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What's changed?

Not our information technology (IT) spending growth expectation of about 8% for 2024. We see stronger spending growth in data center infrastructure (fueled by AI-related growth themes) offsetting a modest slowdown in enterprise software and non-AI hardware spending as tech companies exercise cost controls.

AI spending is higher than the highs we expected. Hyperscale data centers have been ramping up their AI investments ahead of an anticipated surge in AI workload. We now expect U.S. hyperscalers' data center spending to increase in the mid-40% areas, up from our prior estimates of about 30% earlier this year.

Negative rating actions outnumbered positive ones in 1H24. Issuers experiencing weak operating performance and having significant debt outstanding continue to be vulnerable to high interest burden, leading to an uptick in downgrades and outlook revisions to negative. Most positive rating actions were on issuers in the 'BB' category or better.

What to look out for?

High growth expectations for the second half of this year. Non-AI enterprise spending was weak across storage, servers, and PCs, but tech companies anticipate improvement as the year progresses, citing inventory correction no longer being a headwind and catalysts such as PC refresh and AI adoption.

Software growth decelerated in the first half, but will it last? Software companies attribute the weaker-than-expected growth to AI spending and customer cost-consciousness as hiring slowed.

Payment defaults/distressed exchanges for a small cohort of tech companies. The higher likelihood of interest rates remaining high adds to the need for companies to take aggressive restructuring actions, operationally and financially. Especially vulnerable are those facing secular business declines, near-term debt maturities, or dwindling liquidity.

What are the key risks around the baseline?

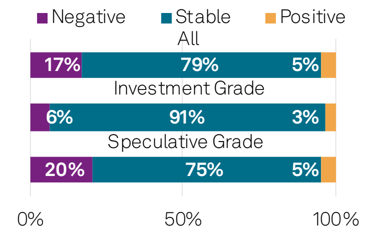
Acceleration of supply chain diversification or expanding scope of trade restrictions. Our baseline expectations for a moderate pace of supply chain diversification by global tech firms could be challenged if escalating geopolitical tensions lead to sharp cost inflation and the need for higher inventory levels.

What will an AI spending slowdown look like? Although we're confident that AI will be a catalyst for product refreshes and rising IT spending as a percent of global GDP, we are cognizant that AI spending will be lumpy given the concentrated customer base. This could lead to swings in credit metrics for some semiconductor and hardware providers.

Capital markets remaining conducive to debt refinancing is not a given. Funding availability has not been a major concern for most of our rated tech issuers thus far in 2024. Macroeconomic growth or geopolitical risk concerns could suppress the risk appetite of market participants.

Rating Trends

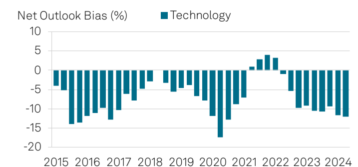
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	63	184	247
Downgrades	2	6	8
Upgrades	2	13	15

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	3.7	5.0
EBITDA growth (Y/Y%)	6.9	11.3
EBITDA margin (%)	31.8	27.1
Capex growth (Y/Y%)	6.3	4.7
Debt/EBITDA (x)	0.8	6.3
FFO/Debt (%)	56.9	6.0
FOCF/Debt (%)	40.8	4.1

All data as of end-June 2024.

* Year-to-date. Current ratings only.

Related Research

Midyear 2024 IT Forecast Update: Robust Cloud Spending Offsets Still-Cautious Enterprise Budgets, July 17, 2024

U.S. Tech M&A, Investments, And Shareholder Returns Compete For Healthy Cash Generation In 2024, May 17, 2024

U.S. Tech's AI-wakening: Enterprises Tread Cautiously, Hyperscalers Charge Ahead, May 9, 2024

AI Will Gradually Reshape U.S. Tech Companies' Credit Quality, April 8, 2024

Telecommunications

Cable is squeezed but capital is accessible

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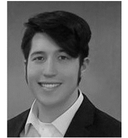


What's changed?

Increasing competition in the cable industry. We expect fiber-based competition will increase as fiber-to-the-home (FTTH) buildouts continue. Fixed wireless access (FWA) also continues to take broadband market share, and we have raised our forecast for FWA subscribers. Our view on cable is now more cautious, meaning tighter rating thresholds and lower ratings for some issuers.

Wireline companies have found alternative sources of funding. Gaining access to third-party capital and utilizing asset-backed security transactions has enabled the wirelines to continue their fiber buildouts with lower funding costs.

Debt issuance has increased. Despite continued high interest rates, companies facing upcoming maturities and those looking to proactively address their capital structure have been increasingly able to access the capital markets.

What to look out for?

Artificial intelligence has many applications for telecom companies: network optimization and predictive maintenance, customer retention, improved back-office operations, and sales and marketing. While AI could lead to cost reductions and margin expansion, investment in AI could also contribute to higher capital expenditures (capex) and lower cash flow.

Cable earning trends. We forecast only slight earnings growth for cable in 2024 and 2025, driven by modestly higher broadband average revenue per user (ARPU), wireless margin growth, and footprint expansion, partly offset by market share losses. Risks around our forecast include churn due to the end of the FCC's affordability program (ACP) and potential for more price-based competition with FWA.

Disruption from low-Earth-orbit (LEO) satellite operators. Uncertainty around earnings trends and competitive position in the satellite industry grows as new LEO entrants impact most end markets.

What are the key risks around the baseline?

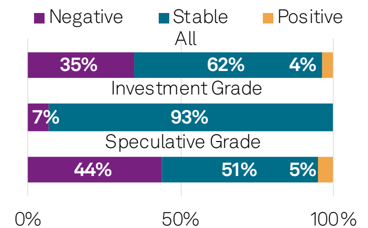
Pressure from FWA and FTTH is greater than expected. If market share losses are greater than our current base-case, cable companies could face pricing pressure and lower EBITDA.

Repercussions from lead sheath cable. Telecom companies could face remediation as well as potential litigation from a wide variety of impacted parties, which could curtail credit metric improvement.

Weaker cash flow if interest rates remain high. Companies with upcoming maturities or significant exposure to floating rates debt could experience a prolonged period of weaker cash flow metrics.

Rating Trends

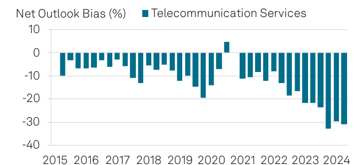
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	14	41	55
Downgrades	0	8	8
Upgrades	1	2	3

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	1.9	0.1
EBITDA growth (Y/Y%)	5.0	2.5
EBITDA margin (%)	44.4	38.3
Capex growth (Y/Y%)	-4.3	-3.5
Debt/EBITDA (x)	3.5	5.4
FFO/Debt (%)	21.3	11.6
FOCF/Debt (%)	10.5	0.9

All data as of end-June 2024.

* Year-to-date. Current ratings only.

Related Research

Cable Industry Intertwining With Wireless, June 3, 2024

Credit FAQ: Calculating Leverage For Selected U.S. Telecommunications And Cable Companies (2024 Update), May 7, 2024

U.S. Cable Operators Face Heightened Competition – And A More Cautious View, April 29, 2024

Transportation

Airline growth normalizes, freight remains subdued

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What's changed?

A tempered outlook for airlines. Passenger air travel demand remains solid and capacity expansion is likely to be subdued this year, but labor and maintenance expenses are appreciably higher and jet fuel prices remain elevated. The network carriers are best positioned to mitigate cost headwinds and pockets of market overcapacity, led by higher-margin premium and loyalty revenues and positive free cash flow generation. However, earnings growth will prove challenging. Smaller domestic airlines have endured negative rating actions, and pressure on cash flows and liquidity is mounting.

Logistics and trucking ratings are under pressure. Persistent freight market weakness has underpinned several negative rating actions. Demand remains subdued and excess truckload capacity has yet to be resolved, culminating in near-trough prices. Acquisitions within these sectors have not led to credit profile improvement.

Railroad financial policies have been tested. Certain Class 1 railroads scaled back or ceased share repurchases to preserve credit metrics amid a weaker outlook for cash flow. Doing so has provided credence to long-held financial policies and rating support.

What to look out for?

Potential downside to airline fares. Average ticket prices have remained relatively stable (albeit well above pre-pandemic levels) despite strong demand fundamentals and unprecedented supply constraints. We assume this will continue through this year, as airlines limit growth in capacity (in some cases by necessity due to aircraft delivery delays and engine issues) and travel demand remains robust. However, a modest decline in average prices could impact cash flow generation and credit measures.

Signs of a freight market recovery. We continue to wait for clear signs of improving freight demand, which has lagged services sector growth. Carriers continuing to exit the market and higher goods demand would presumably stimulate higher trucking prices. We continue to expect low growth in rail shipment volumes this year.

Fuel price volatility. Fuel prices are typically passed on to customers (with a lag), but this could pose a challenge for those without well-established surcharge programs.

What are the key risks around the baseline?

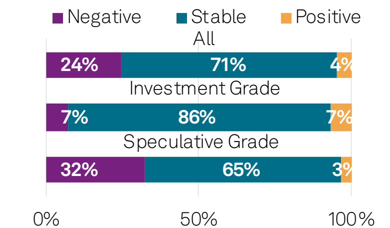
Macroeconomic softening. Slower U.S. economic growth in 2025 could weigh on consumer spending as household savings are eroded. Cash flows within the highly cyclical airline and trucking sectors are most at risk.

Stalled freight market recovery. Intermodal volumes would presumably remain near weak levels, and limit growth in our currently tepid shipment volume expectations.

Geopolitical risk. Further turmoil could lead to economic and financial market instability and weaken credit profiles (particularly lower-rated issuers dependent on capital and facing higher interest costs).

Rating Trends

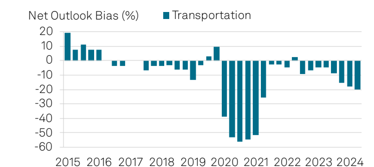
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	14	31	45
Downgrades	1	4	5
Upgrades	1	2	3

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	2.7	6.2
EBITDA growth (Y/Y%)	3.3	10.0
EBITDA margin (%)	17.8	13.9
Capex growth (Y/Y%)	6.3	-6.1
Debt/EBITDA (x)	2.2	5.3
FFO/Debt (%)	31.5	10.6
FOCF/Debt (%)	17.3	2.7

All data as of end-June 2024.
* Year-to-date. Current ratings only.

Related Research

American Airlines Group Inc. 'B+' Rating Affirmed, May 31, 2024
United Airlines Holdings, Inc. Rating Affirmed at 'BB-', April 25, 2024
Global Airlines Outlook: Clear Skies, For Now, April 30, 2024

Transportation Infrastructure

A generally stable outlook with rising megaprojects

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What's changed?

First-of-its-kind private rail project financing. We assigned an investment-grade rating on the first private railway project in North America in over 100 years; a 235-mile, high speed rail system that runs from Miami to Orlando with full ridership risk.

Re-leveraging despite higher interest rates. Transportation infrastructure entities typically maintain their credit quality by re-leveraging on the back of improvement in credit metrics (based on large inflation-linked toll increases and unfettered demand response). Despite the high interest rates, infrastructure sponsors continued to take debt-funded distributions driven by substantial toll revenue growth. Additionally, revenue growth has supported refinancing at higher interest rates.

Force majeure settlements have stabilized construction ratings or mitigated concerns.

What to look out for?

Mega project financing. Sectors such as rail/transit are seeing significant capital spending leading to multi-level financings, such as Brightline East issuing $1.3 billion in holdco financing in addition to $2.2 billion in opco financing. Inflation has added to these costs and is causing a greater capital spending and debt quantum for both greenfield and monetization of existing transportation assets.

Upcoming federal elections. While electoral uncertainty could delay public funding and private capital expenditures, we don't expect the election to affect existing ratings.

Physical climate risk. More frequent and severe natural disasters increase the physical risks that transportation entities face, adding to operational complexity and negative cashflow impact.

What are the key risks around the baseline?

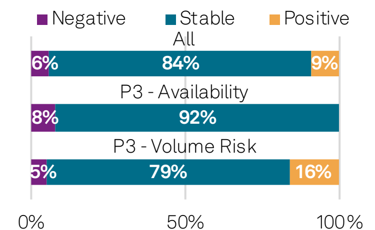
Affordability risks. Rise in unemployment and more-persistent inflation and interest rates than we currently forecast could weaken disposable income and travel demand, as well as activity in transporting goods. This may hamper peak travel demand, which is still lagging due to remote working.

Counterparty pressure. Weakened creditworthiness and liquidity pressures could hinder contractors' construction progress or acceleration efforts, leading to project delays or, where there is linkage to the contractor, a deterioration in project credit quality.

Geopolitical tensions. Although the impact of geopolitical risks on macroeconomic outcomes is elevated, the impact has been minimal to date in most regions. However, escalation is a possibility and can have an outsized impact on the economy, directly or indirectly. This could weigh on global trade, commodity prices, and consumer sentiment around travel.

Rating Trends

Outlook Distribution



Ratings Statistics (YTD)*

	P3 Availability	P3 Vol. risk	All
Ratings	13	19	32
Downgrades	0	0	0
Upgrades	0	1	1

Ratings data as of end-June 2024. * Year-to-date

Related Research

- U.S. Public Finance 2024 Midyear Outlook: A Cooldown Ahead, July 15, 2024
- Credit FAQ: Financing And Rating Recent U.S. Megaprojects, June 24, 2024
- U.S. Transportation Infrastructure Airport Update: Air Travel Rides The Jetstream, For Now, June 24, 2024
- Record U.S. Infrastructure Spending Is Colliding With Higher Construction Costs And Other Hurdles, May 14, 2024
- Research Update: Brightline Trains Florida LLC's $2.219 Billion Senior Secured Debt Assigned 'BBB-' Rating; Outlook Stable, May 8, 2024
- U.S. Transportation Infrastructure 2024 Activity Estimates Indicate A Return To Pre-Pandemic Levels And Growth, With Transit Ridership Still Recovering, March 21, 2024

Unregulated Power

Now comes the demand deluge

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What's changed?

We expect a few IPPs to incorporate in 2024. Market consultants believe power demand could increase at a 15% compound annual growth rate over 2023-2030. This surge, and the ensuing confidence in longer asset lives, is driving a favorable sentiment and should provide credit tailwinds for the entire sector, including the formation of several IPPs, some by the aggregation of project financed assets by sponsors.

Our views on California-ISO and ERCOT. Dispatchable generation is a growing need. We expect resource adequacy payments in California to remain high because of concerns about retirement of base-load generation. But we think California's deployment of long-duration batteries is the right intermittency solution. In contrast, we see ERCOT's hitherto reliance on 1-2 hour batteries as a butterknife in the intermittency gunfight. The greater price volatility in ERCOT should benefit generators.

What to look out for?

More datacenter transactions. As 'large loads' have experienced infrastructure constraints, hyperscalers have looked elsewhere for data center sites. Recently, Talen Corp announced a data center transaction with Amazon Web Services (AWS). We will be surprised if more nuclear power generators do not announce similar transactions by year-end 2024.

Sponsors to monetize their assets. This will be a time for many to hold, but equally for many to fold. As is typical in any upcycle, we expect some sponsors to monetize their investments. Some portfolios are already being offered for sale.

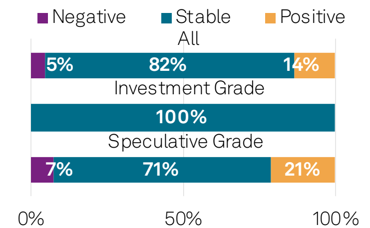
What are the key risks around the baseline?

Demand surge narrative could be oversold. While electrification, onshoring of manufacturing, and large load datacenter needs are real, the ability to deploy concomitant infrastructure is a significant concern.

ERCOT's expected demand growth and warmer summer. ERCOT's higher anticipated load growth also raises concerns about summer dispatchable generation shortages. The Texas Energy Fund's (TEF) 10 GW loan program will not add generation until 2027-2028. We are monitoring summer demand/supply dynamics. Also, given recent extreme weather, load loss in the winter is a possibility. Expansion of the TEF to include more gas-fired generation is a credit risk for generators as it will curb higher power prices.

Rating Trends

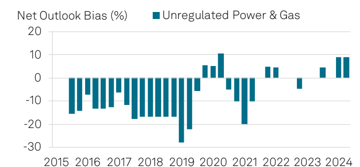
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	8	14	22
Downgrades	0	0	0
Upgrades	1	0	1

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	9.4	-6.6
EBITDA growth (Y/Y%)	-0.5	-5.3
EBITDA margin (%)	30.7	51.8
Capex growth (Y/Y%)	47.4	-16.3
Debt/EBITDA (x)	2.0	4.3
FFO/Debt (%)	38.5	16.3
FOCF/Debt (%)	7.8	10.2

All data as of end-June 2024.

* Year-to-date. Current ratings only.

Related Research

Power Sector Update: The Piper At The Gates Of Dawn, April 1, 2024

Power Sector Update: Credit Drivers In The California And Texas Power Markets, June 18, 2024

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