S&P Global
Ratings

Industry Credit Outlook Midyear 2024

Quietly optimistic

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This report does not constitute a rating action.

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Industry Credit Outlook Midyear 2024: Key Themes

Key Takeaways

- A quiet optimism pervades our industry credit outlook updates, with positive earnings growth expected, financial markets buoyant, and credit and interest rate pressures easing. For weaker credits the picture is bleaker however, with refinancing risks acute.
- High labor costs continue to cause anxiety, and supply-chain fragility is still apparent and vulnerable to escalating geopolitical risks and trade tensions.
- The AI super-cycle continues to power on, absorbing capital investment. And climate-related risks, regulations, and adaptations are increasingly material for credit.

What's changed, what matters, what are the risks?

S&P Global Ratings analysts have published 56 midyear Industry Top Trends updates for North America, Europe, and Asia-Pacific. These one-page updates summarize our evolving views, focusing on what's changed, what to look out for, and what are key risks to our baseline scenarios. They are drawn from our assessments of around 5,000 rated corporate and infrastructure entities. All individual Industry Top Trends reports can be accessed **here**.

A quiet, if fragile, optimism is the predominant theme of the industry credit outlook updates. Resumed earnings growth, resilient economies, receptive capital markets, receding leverage, and the prospect of lower policy rates as we head into 2025, all give reasons to be cheerful. Financial policy is starting to reflect this shift, with M&A and shareholder returns back in focus and deleveraging less of an imperative. Caution is not far from the surface, however, with high labor costs and what they might mean for interest rates a particular concern, inventory levels still relatively high, and supply-chain fragility still apparent. Geopolitical risks loom large, particularly in a year of elections and ongoing conflicts, as does the threat of escalating tariff tensions. Weaker credits face continuing risks and difficulties in refinancing, even as investment-grade and stronger speculative-grade entities demonstrate improving credit quality.

Chart 1

Global median nonfinancial corporate issuers
Median revenue growth by industry and rating

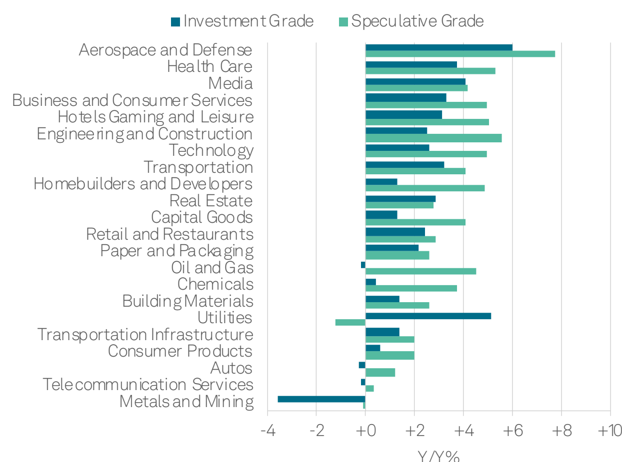
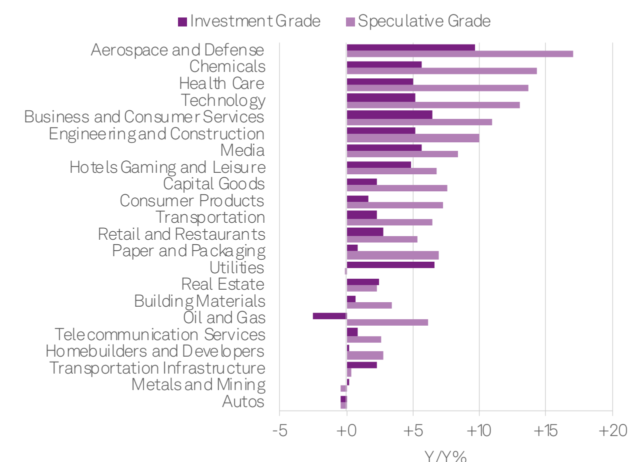


Chart 2

Global median nonfinancial corporate issuers
Median EBITDA growth by industry and rating



Source: S&P Global Ratings. Calculated as of July 29, 2024. All units are USD. Global and regional aggregates exclude utility and real estate entities. Charts are ranked in descending order of the average estimated median industry growth for investment grade and speculative grade.

Operating performance

We continue to expect positive revenue and EBITDA growth for most industries in 2024, both for investment and speculative grade (see charts 1 and 2). The earnings upturn is still patchy, with significant variation by industry and region. While industries such as aerospace and defense, health care, and technology are expected to deliver good growth, the auto and commodity sectors are sluggish at best. Even so, the direction of travel is predominantly positive.

Labor costs and skill shortages remain a concern and a threat to margins. While economic resilience has underpinned demand, it has kept unemployment low and labor markets tight in developed economies, and particularly the U.S. As a result, elevated labor costs remain a concern for many sectors. This is particularly acute for labor-intensive sectors: in retail we expect higher labor costs to be a drag on margins, health care service providers continue to suffer cash flow pressure from labor costs, and staff shortages could impede airlines' path to full capacity. Industries requiring highly skilled labor – capital goods, aerospace and defense – also report labor availability challenges. The emergence of AI also threatens, ironically, a human skills gap, particularly for smaller companies, as companies seek to get to grips with its challenges, potential, and emerging regulation.

Supply-chain problems have eased but not dissipated and are increasingly linked to broader political and trade tensions. The acute phase of pandemic-linked supply-chain disruption is behind us, although the problems caused by attacks on shipping in the Red Sea and the war in Ukraine continue to simmer and a broader escalation of Middle East conflict remains a significant risk to global credit conditions (see Global Credit Conditions Q3 2024: Soft Landing, Fragmenting Trajectories, July 1, 2024). Some industries continue to wrestle with bottlenecks. Surging demand for weight-loss drugs, for example, has led to health-care companies Novo Nordisk and Eli Lilly to acquire production capacity and announce significant additional investments. The broader themes of deglobalization, trade tensions, and supply-chain localization are significant concerns for some sectors. In autos, we expect continued trade tensions to catalyze 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. For technology, 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. The outcome of U.S. elections this year could have a significant impact on these structural supply-chain issues, as will any resulting Chinese and European response to tariff increases.

Working capital pressures from excess inventory levels and destocking have eased for some sectors, while remaining elevated in others. Excess inventory levels in sectors like retail and commodity chemicals appear to have been worked through, with inventory levels normalizing relative to pre-pandemic averages (see charts 3 and 4). For others – notably pharmaceuticals, technology hardware and semiconductors, health care, European aerospace, and autos – inventory-to-sales ratios remain relatively high. These elevated inventories are a consequence of the supply-chain pressures described above and suggest that working capital and capital expenditure needs will continue to weigh on cash flow in these sectors.

Chart 3

LTM median inventory/sales relative to 2015-2019 average for rated North American nonfinancial corporates

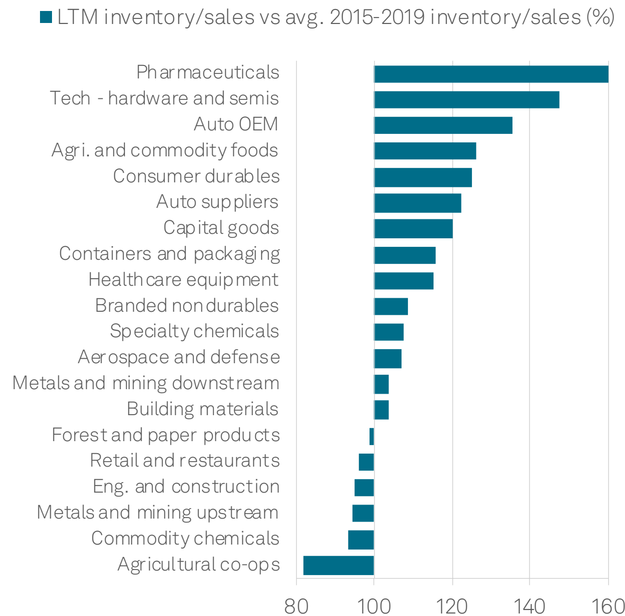
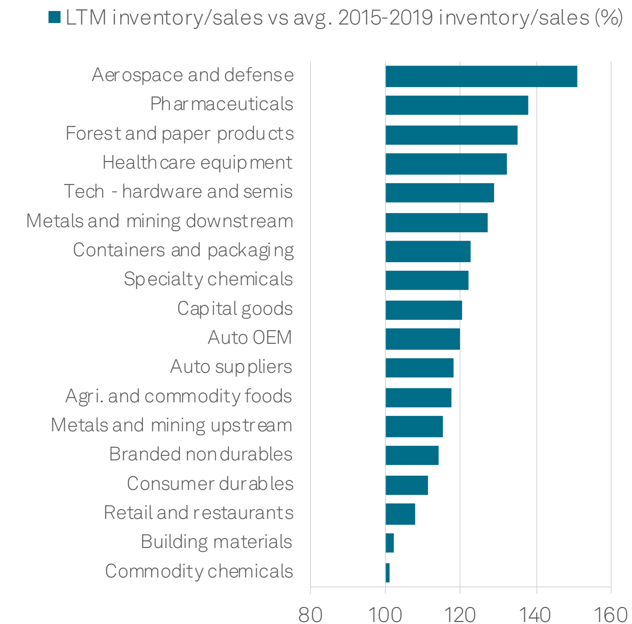


Chart 4

LTM median inventory/sales relative to 2015-2019 average for rated European nonfinancial corporates



Source: S&P Capital IQ, S&P Global Ratings. Shows median inventory sales by sub-industry group for sectors with significant inventory. LTM--last 12 months.

Financial performance and policy

Conducive capital market conditions have brought refinancing relief for many, but not all. Receding recession fears have brought buoyant financial market conditions and tightening spreads, making refinancing possible albeit at higher interest rates. Investment-grade bond issuance increased 16% globally year over year in the first half, and speculative-grade bond issuance rose 71%. More than 75% of U.S. speculative-grade bond issuance and over 60% of leveraged loan issuance was for refinancing (see Global Refinancing Update Q3 2024: Near-Term Risk Eases, July 29, 2024). Even sectors with challenging credit prospects – European REITs for instance, where 29% of entities carry a negative outlook – have been able to borrow, issuing €10.8 billion of debt year-to-date versus €6.1 billion in 2023. Funding remains trickier for weaker credits, however. In U.S. media, companies rated 'B' and lower, especially the local TV broadcasters with high leverage and weak competitive positioning, face significant challenges in refinancing upcoming maturities.

Deleveraging is not a priority for most industries. Deleveraging barely features in the industry credit outlooks that follow. Even where it does - U.S. consumer products, for instance - leverage reduction is anticipated to be limited to companies in subsectors that have underperformed expectations, including durables, apparel, and protein processors. The pressure to reduce leverage has been eased by resilient economic growth, constructive capital markets, and interest rate-cutting cycles underway or expected soon in many economies. In addition, considerable progress is being made in reducing leverage from pandemic-era peaks. We estimate that the median debt-to-EBITDA ratio for global speculative-grade nonfinancial corporates will return to its pre-pandemic (2019) level of 4.7x this year, before falling further in 2025 (see chart 5). This is not the case across all industries. Chart 6 shows the change in median leverage for North American industries from 2019 to 2024. Half of the industries are still projected to have higher

leverage than in 2019, although the gap is less than half a turn of leverage for many of them. Elevated leverage remains a concern for the weakest credits struggling to service debts and with limited recourse to funding, particularly so in industries experiencing broader duress – real estate, media, and retail, for instance.

Chart 5

Global speculative-grade nonfinancial corporates median debt/EBITDA

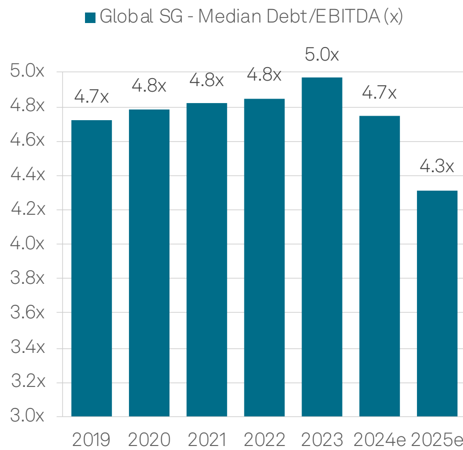
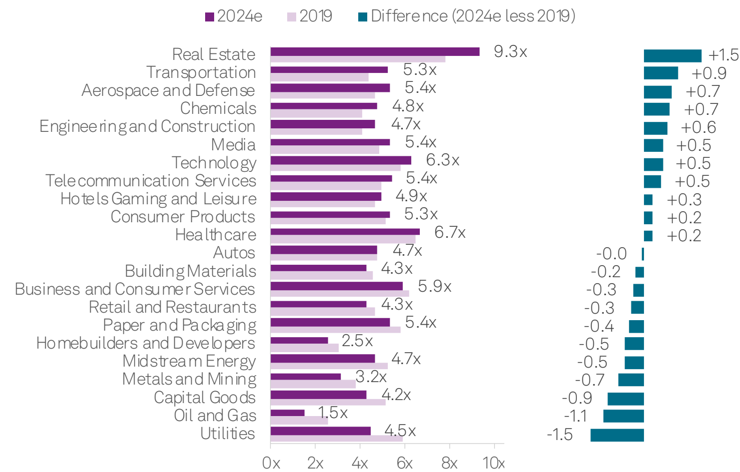


Chart 6

North American speculative-grade nonfinancial corporates median debt/EBITDA by industry



Source: S&P Global Ratings. Calculated as of July 29, 2024. All units are USD. Global aggregates exclude utility and real estate entities.

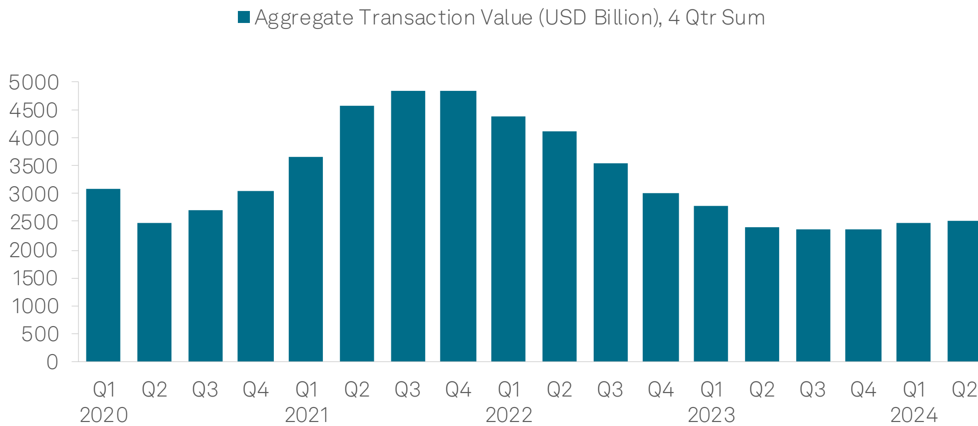
The financial policy discussion is moving towards mergers, takeovers, and shareholder returns. Given resilient cash flows and improved financing conditions, share buybacks are making a comeback in the Q2 earnings results season, and thoughts are also turning again to M&A after a prolonged lull (see chart 7). Some illustrations:

- In health care, M&A is a focus for the pharma and life sciences industries, and we expect private equity will again become more active in health care services.
- Some metals and mining companies are looking at strategic changes to optimize and future-proof their asset portfolios. A few large metals and mining transactions have been proposed, but only a few global-scale deals have been completed.
- We anticipate that European hotels, gaming, and leisure companies will resume M&A activity, although in line with ratings thresholds. In the U.S., M&A may take off in earnest if buyers can look past elevated rates.
- The Paramount/Skydance merger could open the M&A spigot for U.S. media, although an unfriendly regulatory environment and skeptical capital markets could limit such activity.
- Investment-grade building materials companies in Europe are consuming the rating headroom from strong results by spending on M&A and on generous shareholder remuneration.

With cash flow and financial flexibility improving for many entities, the overall credit effect will depend on how management teams prioritize debt reduction, accelerated investment, M&A, and shareholder returns. For M&A, funding choices will be an important consideration, with equity-funded deals still predominant for now. Regulatory constraints may also curtail dealmaking, with the U.S. Federal Trade Commission (FTC) taking a hard line on retail M&A, for example, and European telecoms awaiting a ruling on the Vodafone-Three merger in October.

Chart 7

Global M&A activity is starting to edge higher



Source: S&P Global Market Intelligence.
Announced and completed transactions by announcement date. Includes private equity deals.

Concerns that persistent inflation could keep interest rates higher-for-longer, and that capital markets could become less receptive, are a particular concern for sectors with a significant number of speculative-grade issuers, such as building materials, capital goods, and real estate. The sharp rise in financing costs since 2022 has pushed interest coverage ratios for speculative-grade companies sharply lower (see chart 8), and while we anticipate a gradual improvement in coverage this year onwards, median coverage ratios for most speculative-grade sectors are still expected to be below where they were in 2019 (see chart 9).

Chart 8

Global speculative-grade nonfinancial corporates median EBITDA interest coverage

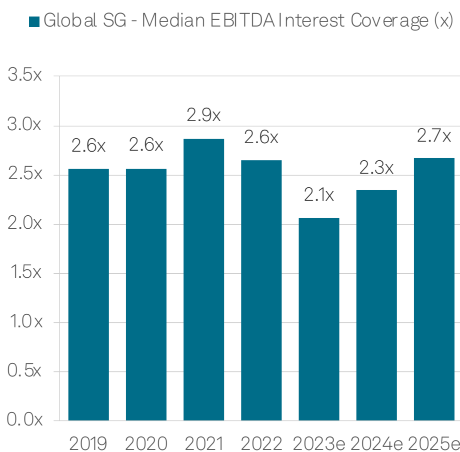
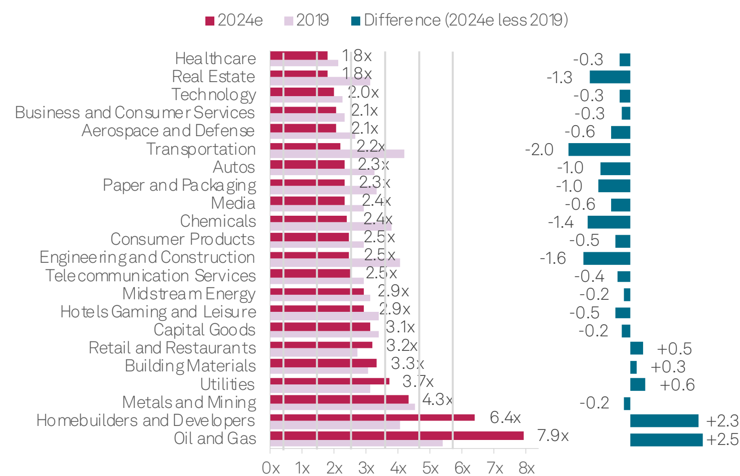


Chart 9

North American speculative-grade nonfinancial corporates median EBITDA interest coverage by industry



Source: S&P Global Ratings. Calculated as of July 29, 2024. All units are USD. Global aggregates exclude utility and real estate entities.

Other trends

The AI super-cycle continues to gather pace. 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% area, up from our prior estimates of about 30% earlier this year. The rise of data centers is one of the reasons why we expect regulated utilities to see positive growth after nearly two decades of flat to negative electricity sales, driven by energy conservation efforts. Whether all this investment pays off is less clear. Specific use cases are starting to emerge. AI has many applications for telecom companies: network optimization and predictive maintenance, customer retention, improved back-office operations, and sales and marketing. In media, many companies are already implementing AI in their products, which allows them to reduce operating and production costs (ad agencies in creative pitches; content producers in distribution, postproduction, and visual effects; and scientific and data publishers in content editing). AI is also not without its risks. We are monitoring the potential risks from AI of increased competition and disruption to media companies' business models, especially for content publishers.

Climate change continues to shape credit prospects through its direct impact and the regulatory and technological response. U.S. utilities across many states are experiencing increasing wildfire risks, raising the industry's credit risks and adding insurance-related costs. The regulatory response is increasingly material in credit terms. For instance, the European airline and shipping sectors face increased costs as a result of the EU's Emissions Trading System, and tighter regulation around buildings' energy performance is an added risk for real estate. The EU's green buildings directive offers opportunities for the building materials sector, but the significant costs associated with its wide-scale implementation, particularly for households, could delay single country enactment and disperse the benefits beyond the current decade. With respect to transition, the economics of power-supply decarbonization remain challenging, and automakers face a complex interplay of tariff policy, the anticipated phaseout of internal combustion engines, and China's battery electric vehicle push.

Related Research

- U.S. Corporate Credit Outlook Midyear 2024: Steering Toward Sunlight, August 1, 2024
- Credit Trends: Global Financing Conditions: Early Issuance Should Support Growth Through Second-Half Slowdown, July 29, 2024
- Credit Trends: Global Refinancing Update Q3 2024: Near-Term Risk Eases, July 29, 2024
- Scenarios Show Potential Ways Climate Change Affects Creditworthiness, July 25, 2024
- Global Credit Conditions Q3 2024: Soft Landing, Fragmenting Trajectories, July 1, 2024
- Global Nonfinancial Corporate Medians History And Outlook Midyear 2024: Return to growth eases financial pressures, but vulnerabilities remain, June 19, 2024
- Corporate Results Roundup Q1 2024: Recovery continues excluding commodity sectors but remains fragile and fragmented, May 22, 2024
- Industry Credit Outlook 2024, January 31, 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?

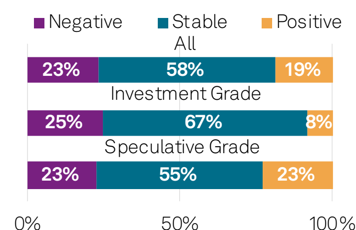
Supply chain and productivity constraints. Parts availability limitations and relatively unseasoned manufacturing workforces could increase costs and impede an increase to production.

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

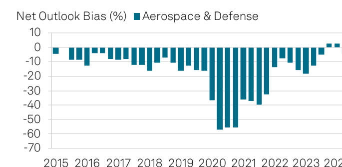
Outlook Distribution



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?

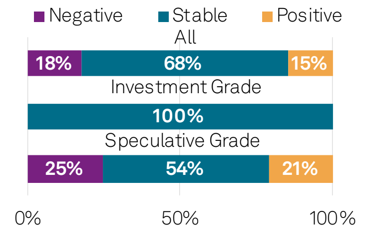
Uncertainty around EV demand could force strategic missteps. Some automakers may not allocate appropriate capital towards hybrid technology, mid-cycle portfolio refreshes on internal combustion engines, or towards material improvements in cockpit experience and charging experience. This would weaken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

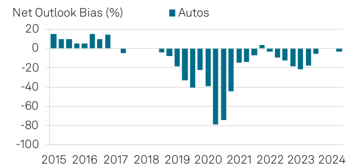
Outlook Distribution



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.

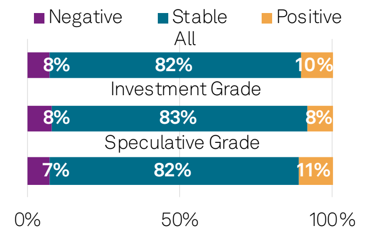
What are the key risks around the baseline?

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?

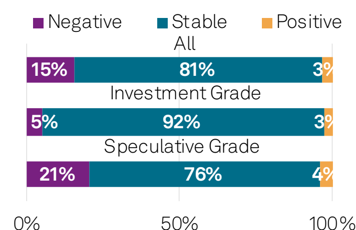
Interest rates slow big investments. Rising interest slows manufacturing activity with nearly every tightening cycle. Fiscal stimulus is counteracting monetary factors in this industry, but tighter funding conditions could throttle the pace of investment.

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

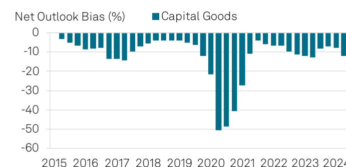
Outlook Distribution



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, Jun 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, Jul 02, 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?

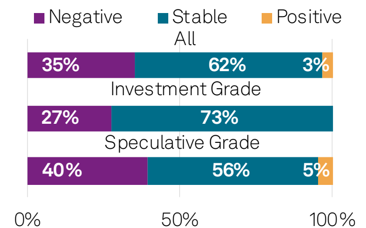
Destocking persists. Delays in our anticipated recovery from destocking or a weaker-than-expected recovery would weaken earnings and credit metrics against our expectation for improvements in many instances.

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

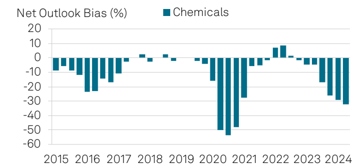
Outlook Distribution



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?

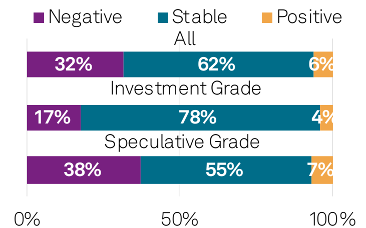
Weaker than expected volumes. Price elasticities may become more pronounced, leading to lower consumption and a higher market share for value products.

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

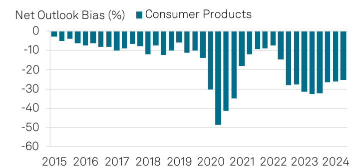
Outlook Distribution



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?

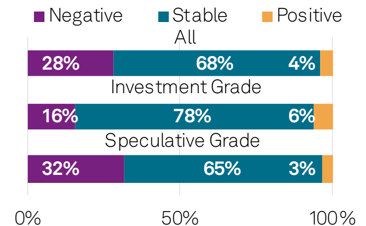
Inflationary/labor pressures, persistent elevated interest rates. Execution risk remains high for leveraged health care service providers, whose margins and cash flows continue struggle against high labor costs and elevated interest expenses.

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

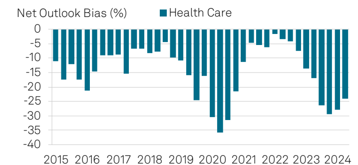
Outlook Distribution



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.

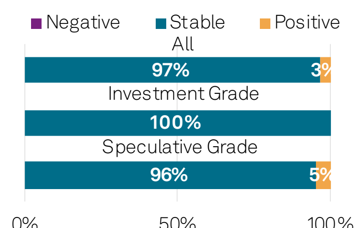
What are the key risks around the baseline?

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

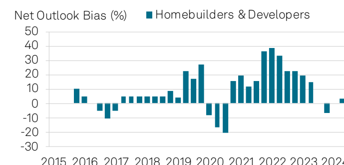
Outlook Distribution



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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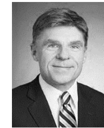

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What's changed?

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?

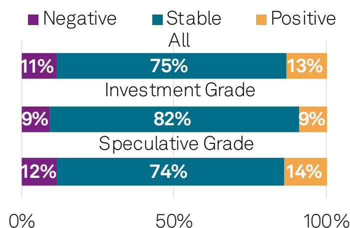
High prices and high rates weaken demand more than we assume. This is particularly true for big ticket discretionary items like timeshare and recreational vehicles.

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

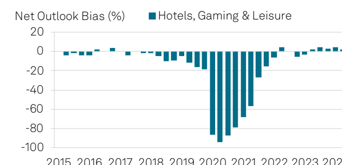
Outlook Distribution



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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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?

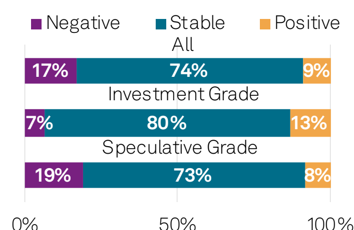
Secular trends for legacy media worsen. Legacy media remains dependent on the deteriorating linear TV ecosystem. Faster deterioration and worsening pay-TV subscriber declines could weaken legacy media companies' credit metrics.

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

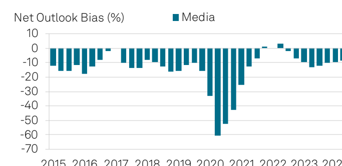
Outlook Distribution



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.

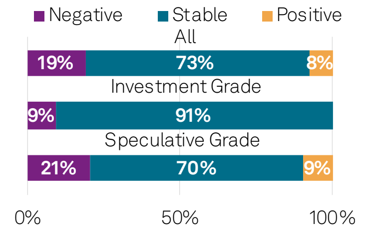
What are the key risks around the baseline?

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

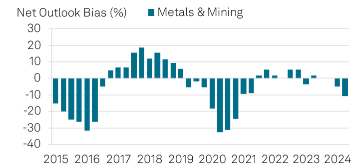
Outlook Distribution



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 02, 2024
- Alliance Resource Partners L.P. Rating Raised To 'BB-' From 'B+' On Refinance, Removed From CreditWatch; Outlook Stable, Jun 28, 2024
- Reliance Inc. Upgraded To 'BBB+' On Strengthened Credit Profile; Outlook Stable, May 02, 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?

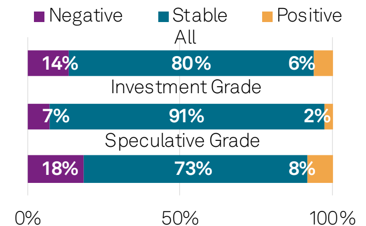
The upcoming election. Uncertainty around the U.S. presidential election could cause companies to accelerate major strategic moves, or delay them until after November.

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

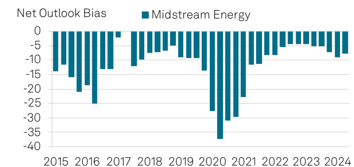
Outlook Distribution



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?

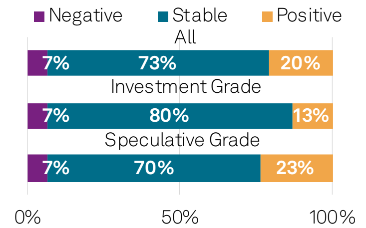
Natural gas prices remaining weak due to high inventory levels, byproduct gas production, and delays on lifting the Biden administration's ruling to pause issuing LNG export permits.

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

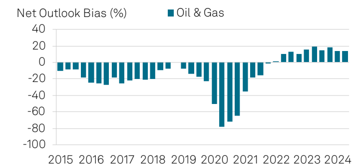
Outlook Distribution



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?

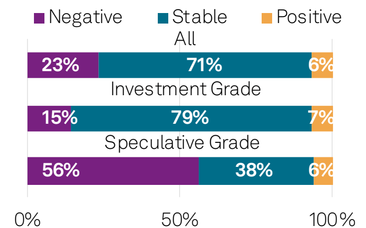
Tighter access to capital could narrow liquidity. Banks tightened lending standards as asset valuations declined and real estate fundamentals slowed, while access to equity remains constrained given the sector trades at a significant discount to net asset value.

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

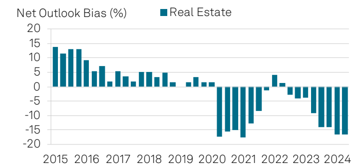
Outlook Distribution



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?

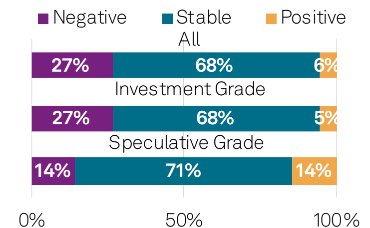
Wildfires. Utilities operating in Alberta, Arizona, California, Colorado, Florida, Idaho, Nevada, New Mexico, Oklahoma, Oregon, South Dakota, Texas, Utah, Washington, and Wyoming are all experiencing increasing wildfire risks, raising the industry's credit risks.

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

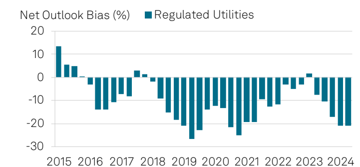
Outlook Distribution



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.

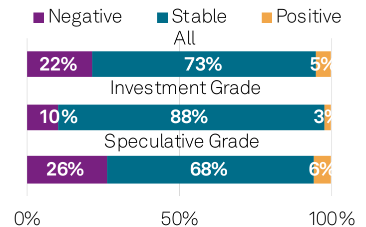
The Federal Trade Commission (FTC) is taking a hard line on retail M&A. We note how difficult it is for big-name deals to get through the regulatory process this year. The FTC is pushing back on The Kroger Co.'s acquisition of Albertsons Cos. Inc. and Tapestry Inc.'s acquisition of Capri Holdings Ltd. 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

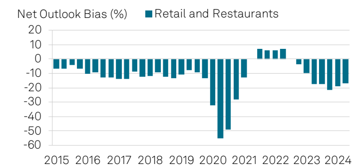
Outlook Distribution



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?

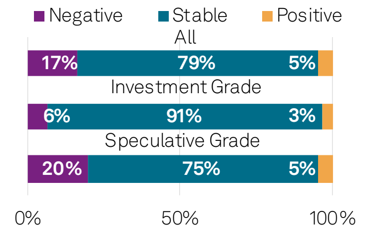
Acceleration of supply chain diversification or expanding scope of trade restrictions. Our baseline expectations for a moderate pace of supply chain diversification by global tech firms could be challenged if escalating geopolitical tensions lead to sharp cost inflation and the need for higher inventory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

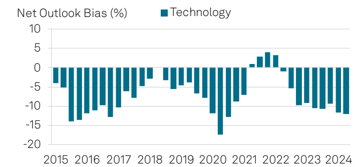
Outlook Distribution



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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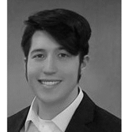


What's changed?

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?

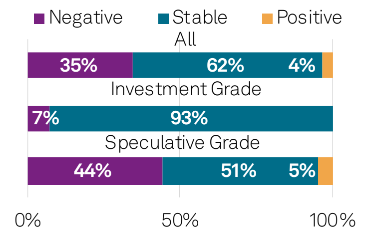
Pressure from FWA and FTTH is greater than expected. If market share losses are greater than our current base-case, cable companies could face pricing pressure and lower EBITDA.

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

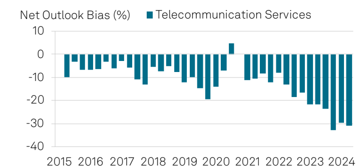
Outlook Distribution



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 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?

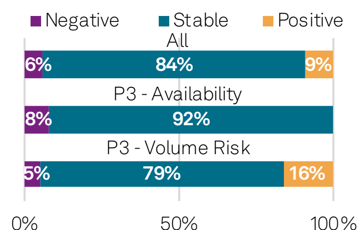
Affordability risks. Rise in unemployment and more-persistent inflation and interest rates than we currently forecast could weaken disposable income and travel demand, as well as activity in transporting goods. This may hamper peak travel demand, which is still lagging due to remote working.

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

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?

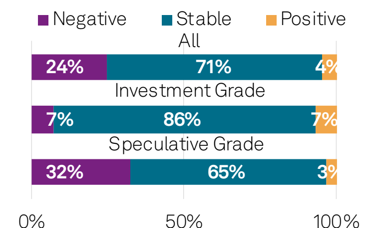
Macroeconomic softening. Slower U.S. economic growth in 2025 could weigh on consumer spending as household savings are eroded. Cash flows within the highly cyclical airline and trucking sectors are most at risk.

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

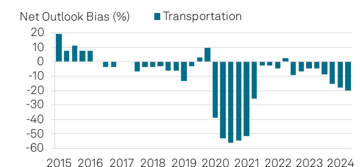
Outlook Distribution



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

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.

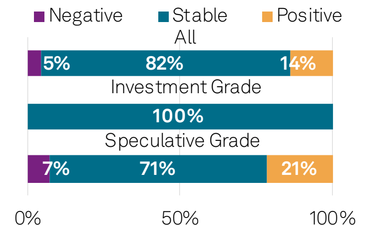
What are the key risks around the baseline?

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

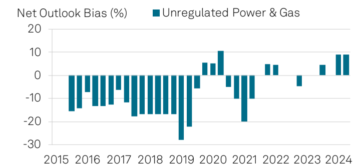
Outlook Distribution



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

Aerospace and Defense

Demand soars while supply chain drags

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What's changed?

Airbus has revised its 2024 guidance but its credit quality remains solid. Despite lowering its guidance on aircraft deliveries and EBIT for 2024, we expect Airbus to maintain healthy cash flows and a comfortable net cash position, leaving solid ratings headroom.

Defense players showcase their platforms and services. Governments are raising their defense budgets and modernizing their militaries in light of the continuation of the Russia-Ukraine and Israel-Hamas wars. S&P Global Ratings-rated defense issuers evidence a clear competitive advantage on many products and services, which improves profitability.

We assigned our public 'BBB+' long-term issuer credit rating on Saab AB, a Sweden-based defense company. This followed shortly after Sweden became a full member of NATO. We consider SAAB to be well placed to benefit from rising defense expenditure in Sweden and by its NATO allies.

What to look out for?

Elections. In 2024 there are elections in more than 60 countries around the world (including the EU). Changing governments could result in a change in defense policy, potentially affecting budget levels and reprioritizing which defense platforms and projects budgets are allocated to.

Escalation or spillover of existing conflicts. Escalation of the Russia-Ukraine or Israel-Hamas wars into their wider respective regions could cause higher demand for certain aerospace and defense products such as munitions, radar, or air defense systems. This would come at a time when stockpiles of some products are exhausted, and production stretched.

The balance between Airbus and Boeing is unlikely to radically shift. While Boeing grapples with well documented quality control challenges and regulatory oversight, Airbus cannot fully capitalize and increase its market share due to supply chain constraints.

What are the key risks around the baseline?

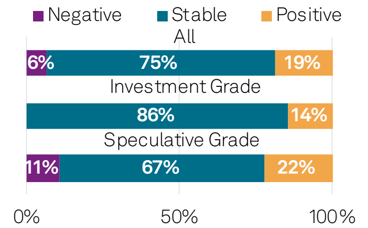
Supply chain. The well documented challenges in the civil aerospace sector are likely to persist but defense supply chains should hold up better.

Financial policy. Any aggressive merger and acquisition activity or share buybacks could weigh on credit metrics.

Quality control. Boeing's challenges mean that many aerospace and defense management teams have focused intently on maintaining or improving quality control, as failure to do so could have significant financial consequences.

Rating Trends

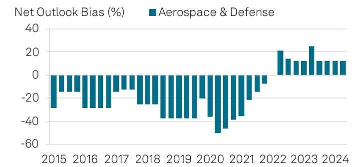
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	7	9	16
Downgrades	0	0	0
Upgrades	1	1	2

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	7.1	21.5
EBITDA growth (Y/Y%)	14.3	51.4
EBITDA margin (%)	14.3	16.9
Capex growth (Y/Y%)	8.2	-6.3
Debt/EBITDA (x)	0.8	5.8
FFO/Debt (%)	71.3	11.2
FOCF/Debt (%)	45.2	2.9

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

Related Research

Airbus Can Accommodate Announced Operating Setbacks, June 26, 2024
Saab AB Assigned 'BBB+' Rating; Outlook Stable, June 4, 2024

Autos

Bracing for the Chinese push

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What's changed?

Protectionist policies to subdue Chinese BEV push. The EU adopted provisional import tariffs of up to 38% on battery electric vehicles (BEVs) made in China, on top of the existing standard 10% tariff on light vehicle (LV) imports. The measure applies to finished BEVs and applies to models produced in China by Chinese and European brands. The provisional tariffs will be in place until Nov. 3, when the EU could impose permanent duties. Among rated original equipment manufacturers (OEMs), Volvo Cars loses the most as its new flagship model, EX30, was meant to be solely produced in China in 2024. Other brands will also be affected, but the volumes as a share of an OEM's total sales are generally small.

Weak economic rationale for a stronger second half of 2024. We expect LVs to increase in line with our annual forecast (sales of 1%-3%) in the first half of 2024. Hybrid powertrains are gaining at the expense of EV and internal combustion engines (ICE). We do not expect a stronger second half of 2024, despite momentum in model changeover because we forecast a stagnating economic environment for 2024 and mounting geopolitical uncertainty.

Regulatory pragmatism in Europe. The U.K. and U.S. have relaxed emission targets and the EU (with more sovereigntists) might delay the phaseout of ICE. The expected EV share of 50% in 2030 in Europe (versus 2025 previously) results in a slower pace of battery co-investments in the region, which might free up capital expenditure and mergers and acquisitions spending over 2024 and 2025. We think OEMs will need to a high research and development spend to invest in a competitive multi-powertrain model line-up.

What to look out for?

Chinese automakers' response to protectionist measures on pricing, market share, model launches, and plans to produce in Europe or in countries tied to the U.S. by a free trade agreement. We expect tariffs to accelerate the onshoring of Chinese production capacity in or close to strategic markets, and market share erosion of legacy OEMs in China if it retaliates with tariff measures (such as increased levies on cars with larger ICE).

Cost pressure is high although the inflationary peak finished. Labor and manufacturing costs remain a challenge for auto manufacturers and suppliers (on top of funding costs for the latter) only partly offset by a favorable raw material cycle.

Pricing headwinds for new and used cars year-to-date, mostly affecting the resale value of used cars. OEMs and suppliers are confident in their ability to defend pricing on new cars thanks to momentum in model changeover. We think new car pricing momentum in Europe and the U.S. will weaken moderately throughout the rest of 2024.

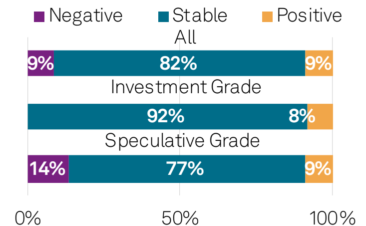
What are the key risks around the baseline?

Chinese OEMs may fuel price-based competition and have the potential to absorb the European tariff and remain competitive.

Supply-side disruption linked to geopolitical tension. This is the main disruptive risk for the industry because the localization of supply chain remains a major challenge whether related to EV not.

Rating Trends

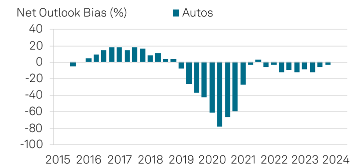
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	12	22	34
Downgrades	0	0	0
Upgrades	1	1	2

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	-1.6	0.2
EBITDA growth (Y/Y%)	-2.5	-2.8
EBITDA margin (%)	12.2	8.2
Capex growth (Y/Y%)	8.0	-0.2
Debt/EBITDA (x)	0.1	3.1
FFO/Debt (%)	49.8	18.6
FOCF/Debt (%)	19.8	3.7

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

Related Research

Autoflash EMEA: Suppliers Feel The Heat Of Low Volumes And Earnings Pressure, July 1, 2024

China Ahead In Delivering Affordable Electric Mobility, May 29, 2024

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

Building Materials

A soft context weakens credit quality in the 'B' category

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What's changed?

Rating pressure has intensified on speculative-grade companies focused on Europe. Outlook bias in the sector has worsened compared with end 2023. We took negative rating actions on companies in the 'B' category, particularly distributors, and with a business focus in weak performing countries such as Germany, the Nordics, and U.K.

Mergers and acquisitions (M&A) have resumed. Across the sector there were increasing debt-funded acquisitions, particularly from large and diversified investment-grade companies that expanded in regions outside Europe, such as North America and Australia; and in adjacent segments that benefit from climate transition, such as the construction chemicals segment.

Margins should moderately decline compared with 2023. The drop in volume across all business segments and current wage inflation are putting companies' aims of matching the margin level reached in 2023 at risk, though we acknowledge companies' discipline in keeping prices unchanged.

What to look out for?

The credit quality in the investment-grade category remains largely stable. Companies' balance sheets still benefit from the solid results from 2021-2023. However, most players are consuming the rating headroom by spending on M&A and on generous shareholder remuneration.

The EU green building directive offers opportunities to the sector, but the significant costs associated with its wide-scale implementation, particularly for households, could delay single country enactment and disperse the benefits beyond the current decade.

Climate transition risk is among the main drivers of capital allocation. Despite weak business confidence, most companies' capital expenditure is unchanged or increases.

What are the key risks around the baseline?

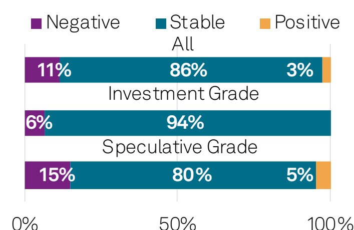
The drop in volume in the residential building segment may last longer. While we assume a progressive and slow volume recovery in 2025 ahead of lower rates, a prolonged decline or volume stationarity would put pressure on the sector credit quality (particularly of companies in the speculative-grade category that display less rating headroom).

Financial policies turn aggressive. The main factor driving negative rating actions is financial policy. More-aggressive behavior than expected would likely stress ratings. However, private equity sponsors' stance in the building material sector has been rather conservative with no appetite for dividend distributions or debt-funded acquisitions.

Structurally higher construction costs could slow the demand for building renovation, particularly from low-income households. Since 2022, most critical building products prices have significantly increased, reflecting both cost inflation and solid price discipline in the market. The presence of consistent government support schemes in single countries in the EU will be key to help low-income households finance the improvement of their homes' energy performance.

Rating Trends

Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	16	20	36
Downgrades	0	1	1
Upgrades	0	2	2

Ratings Outlook Net Bias

Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	1.3	-0.2
EBITDA growth (Y/Y%)	-2.8	-4.0
EBITDA margin (%)	18.6	15.1
Capex growth (Y/Y%)	1.9	-0.5
Debt/EBITDA (x)	1.5	5.6
FFO/Debt (%)	52.1	9.9
FOCF/Debt (%)	34.2	3.7

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

Related Research

Credit FAQ: European Building Materials Firms Display Good Rating Headroom In A Sluggish Environment, March 19, 2024

Global Building Materials Companies: Strongest To Weakest, Feb. 6, 2024

Holcim's Financial Flexibility Could Offset The Loss Of Diversity Caused By Spinning Off Its U.S. Business, Jan. 30, 2024

Industry Credit Outlook 2024: Building Materials, Jan. 9, 2024

Capital Goods

Short cyclical downturn with robust secular trends

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What's changed?

Destocking and macroeconomy weighs on short cycle business. Order intake has declined for short cyclical products in automation, warehouse equipment, and consumables over the last six months. This demonstrates a normalizing after considerable pre-buying in the last two years, when supply chains were constrained. Customers and distributors have reduced inventory levels, while the economic environment has remained soft. Despite this, diversified companies are experiencing revenue growth thanks to high order backlogs for longer cyclical businesses, like energy transition products and equipment. We expect a more supportive environment in the second half of 2024 for short cyclical products.

Easing inflation and normalized supply chains support profit margins. We expect slight margin expansion for the sector in 2024 as end-market demand remains robust providing sound utilization, fixed cost absorption, efficiency measures, and still good pricing. Simultaneously, inflationary dynamics have decreased for raw materials and transportation costs. Supply chains have broadly normalized, underpinning the recovery in profitability and leading to reduced inventory supporting cash flow generation.

The credit quality trend has been positively skewed across the capital goods portfolio. Over the past six months we raised the ratings for about 10% of the companies in the sector, most notably upgrading Siemens AG, Schneider Electric, and ABB. This reflects the sound strategic position of the businesses to secular trends, resulting in a higher margin and more stable cash flow profile but also reflecting a conservative financial policy. Upgrades in the speculative-grade space relate to addressing refinancing risks and less aggressive leverage. Most companies target a more conservative balance sheet to support their credit standing given the higher cost of debt.

What to look out for?

Tight labor market and supply constraints could lead to renewed cost escalation. Skilled labor availability challenges will put pressure on the production costs (directly and indirectly). Supply chains have broadly normalized but could be disrupted by geopolitical tensions or by renewed elevated demand for certain components and raw materials because of the time lag to expand capacity of supply networks.

We expect merger and acquisition activity to pick up because of lower inflation and gradually declining interest rates. The portfolio transformation for most companies is not yet complete and we anticipate sizable bolt-on acquisitions such as Nexans, Prysmian, or Knorr Bremse AG.

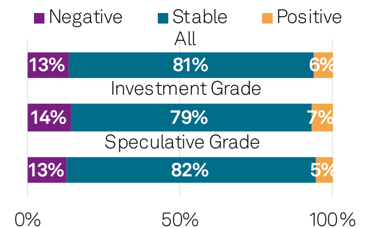
What are the key risks around the baseline?

Longer than expected order intake contraction for short cyclical businesses. This could lead to revenue declines after the order backlog is eaten up, and profit margins are likely to take a strong hit as operating leverage is high.

Demand and earnings could become depressed because of the lasting elevated interest environment. Higher interest rates are slowing demand, with a time lag for the late cyclical capital goods sector. Sticky core inflation in Europe is likely to result in higher-for-longer interest rates, which depresses demand in the medium term.

Rating Trends

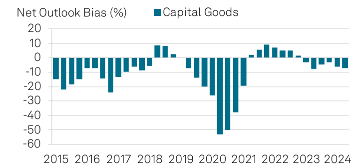
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	28	39	67
Downgrades	0	1	1
Upgrades	4	5	9

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	0.5	4.3
EBITDA growth (Y/Y%)	1.6	13.3
EBITDA margin (%)	18.7	15.1
Capex growth (Y/Y%)	4.8	-6.1
Debt/EBITDA (x)	1.4	5.3
FFO/Debt (%)	51.1	10.5
FOCF/Debt (%)	40.2	3.8

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

Related Research

Research Update: Siemens AG Upgraded To 'AA-' On Successful Portfolio Transformation And Conservative Financial Policy; Outlook Stable, Feb. 13, 2024

Research Update: Schneider Electric Upgraded To ‚A/A-1' On Resilient Business Model; Outlook Stable, April 26, 2024

Research Update: ABB Ltd. Upgraded To 'A/A-1' On Strong Credit Metrics And More Supportive Financial Policy; Outlook Stable, March 28, 2024

Chemicals

Glimmers of light yet no sustained recovery

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What's changed?

Volume recovery. Following the severe downcycle amplified by massive destocking between the second half of 2022 and the end of 2023, global chemical production volumes started to recover in first-half 2024, including for European chemical producers. However, this increase was very modest compared with other regions. At the same time, lower prices caused chemicals sales to decline slightly.

Demand still sluggish. While the significant destocking by chemicals customers ended in first-half 2024, demand trends remain muted, with no solid signs for sustained recovery. Our base case factors in a gradual recovery and a slightly stronger second half of 2024.

Industry sentiment remains cautious. Issuers have noted the pickup in demand, an upturn in stock levels, and somewhat fuller order books, albeit these are still at low levels. At the same time, recovery is burdened by the prolonged economic uncertainty that has kept raw materials and energy prices high.

What to look out for?

Modest sales growth and improved earnings. We forecast 5%-9% growth in EBITDA and flat-to-small rises in EBITDA margins for European chemical producers in 2024. This derives from lower energy and raw material costs compared with the previous year. It also encompasses companies' credit-supportive measures, such as extensive cost cutting.

Capacity rationalization. Many petrochemical chains are oversupplied, resulting in low operating rates and weaker margins. We expect this to last until 2025. In Europe, however, we note early signs of permanent capacity shutdowns, largely due to structural disadvantages for producing commodity chemicals, such as higher regional energy costs.

Outlook bias remains negative. Despite negative rating actions in 2023 and so far in 2024, 24% of the European portfolio remains on a negative outlook. The outlooks for investment-grade names have stabilized, with only 6% on a negative outlook. Negative outlooks are predominantly concentrated on speculative-grade chemicals names, representing 33%, reflecting weak free cash flows in a tough industry environment and still-high interest rates.

What are the key risks around the baseline?

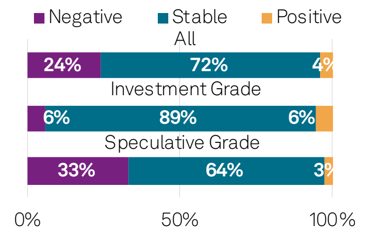
Demand weakened. Ongoing depressed demand for chemical products instead of a gradual recovery could hit credit quality, especially for speculative-grade chemicals issuers.

Geopolitical risks. Challenges to global trade and chemical supply chains, which rely on timely and efficient flow of critical materials, remain a key risk.

Financial policy. A shift to more aggressive financial policies--alongside deviation from well-controlled capital expenditure and disciplined mergers and acquisitions and shareholder remuneration--could reduce already weakened headroom after some challenging years, and pressure the ratings.

Rating Trends

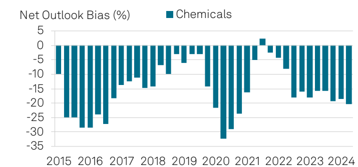
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	18	36	54
Downgrades	0	5	5
Upgrades	0	3	3

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	0.3	4.4
EBITDA growth (Y/Y%)	2.5	19.3
EBITDA margin (%)	16.6	14.0
Capex growth (Y/Y%)	10.5	1.8
Debt/EBITDA (x)	2.1	5.8
FFO/Debt (%)	38.4	7.1
FOCF/Debt (%)	11.2	0.5

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

Related Research

Credit FAQ: Europe's Chemical Sector: Spotting Signs Of Recovery, April 11, 2024

Global Chemical Companies: Strongest To Weakest, Feb. 13, 2024

Consumer Products

Brands look to regain volumes as pricing cools down

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What's changed?

Easing of input, material, and energy cost inflation. This has enabled consumer product companies to moderate pricing and redirect their focus to volume growth.

Carryover pricing will improve gross margins. The previous price increases' carryover effect should help most consumer goods companies to rebuild their gross margin. However, coffee and cocoa are seeing price spikes due to a weak harvest. We expect to see sharp price increases, which will hurt volumes, in the coffee and confectionary segments.

Brands look to regain the market share from private labels. Branded consumer product companies are investing in product innovation and increasing promotions to regain some of the lost ground to private labels.

What to look out for?

Tough negotiations with retailers. Consumer product companies should expect tough price negotiations with retailers, especially grocers and supermarkets, as they seek to restore their price perception compared to discounters.

An increase of advertising and promotional spending. As competition intensifies, gross margin gains from lower input costs and carryover pricing gains will be deployed to strengthen brand equity.

Consumers will cut back on discretionary spending. Lower- and middle-income households remain cautious due to the cumulative effect of higher prices, and they continue to limit purchases of discretionary and big-ticket items.

What are the key risks around the baseline?

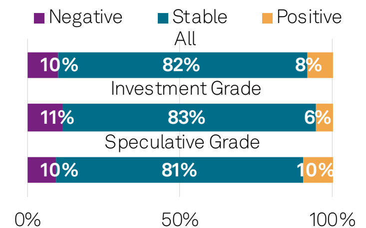
The U.S. and China could remain a challenge. European multinationals (especially those in the personal luxury goods and branded apparel) will experience weaker sales in the major consumer markets of the U.S. and China. In the U.S., cumulative effects of high prices will put pressure on consumer spending, while in China there is a risk of a pronounced slowdown in domestic consumption.

Merger and acquisition activity resuming. In our base-case scenario we expect bolt-on acquisitions; however, multinational investment-grade consumer goods companies, notably in the food and ingredient sectors (who have recovered their credit metrics through strong pricing), may pursue large acquisitions to realign their product portfolio.

Geopolitical risks could hurt trade and supply chains. Spillovers have been lower than we expected but further escalations could induce supply chain bottlenecks and commodity price volatility, negatively influencing global trade and consumer sentiment.

Rating Trends

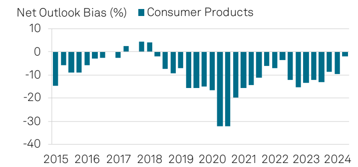
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	36	63	99
Downgrades	1	5	6
Upgrades	3	9	12

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	1.9	2.2
EBITDA growth (Y/Y%)	4.8	8.0
EBITDA margin (%)	17.4	15.2
Capex growth (Y/Y%)	4.9	12.8
Debt/EBITDA (x)	2.5	5.8
FFO/Debt (%)	31.2	9.1
FOCF/Debt (%)	18.1	3.9

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

Related Research

Sector Update: Sportswear: Robust Growth Prospects Amid Intensifying Competition, June 25, 2024

Credit FAQ: Unilever Streamlines Its Portfolio By Separating Its Ice Cream Business, April 16, 2024

SLIDES: Consumer Goods 2024 Outlook: Carryover pricing supports margins, volumes stay subdued, March 11, 2024

Health Care

Increased focus on capacity building

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What's changed?

Supply chain bottlenecks are a key consideration for the pharmaceutical sector. Denmark-based Novo Nordisk acquired three manufacturing sites for $11 billion in February 2024, after its controlling shareholder bought U.S. company Catalent. The Danish drugmaker and its competitor Eli Lilly have announced huge additional investments to increase capacity in their U.S. plants as they race to expand production of the weight loss drugs. Therefore, we anticipate a reallocation of investments toward capacity increase and supply chain strengthening, following a period where growth investments were primarily in mergers and acquisitions (M&A).

The main business trend for pharma is the fantastic growth prospects of GLP-1, a new class of diabetes and obesity drugs, a market which should exceed $40 billion in 2024 and could reach $130 billion by 2030. The runaway success of this asset class is unprecedented since the emergence of immuno-oncology.

A tough pricing environment affects health care services. In France, a price increase cap was set at the beginning of 2024 for the diagnostics segment. This came after a cut of about 5% in 2023, which had already significantly weighed on earnings. Amid tough negotiation with the state, the private clinics sector in France is operating in a blurred tariff's environment.

What to look out for?

For big pharma, we await the new list of drugs that the Inflation Reduction Act in the key U.S. market will affect. In 2023 an initial list of 10 products was released and the drugs will be subject to price renegotiation with Medicare from 2026. However, we do not expect regulations to have a material effect on earnings.

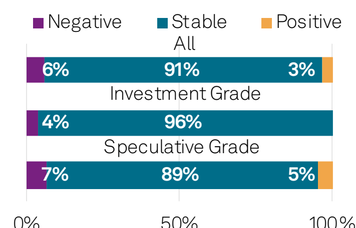
For health care services, we will monitor the ability to cut costs and adjust the operating footprint to the current environment where volumes linked to the COVID-19 pandemic have plummeted. There is a need to optimize costs at a time when inflation is still biting, and tariff increases are a constraint.

What are the key risks around the baseline?

In our view, the key risks for pharma are the ability to expand production and supply chain shortages, ahead of M&A risks. Coping with inflation in an unfavorable pricing environment is the key risk for health care services.

Rating Trends

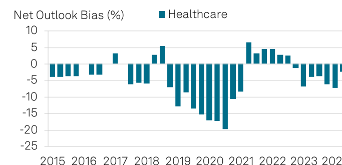
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	27	62	89
Downgrades	0	2	2
Upgrades	1	1	2

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	4.8	5.3
EBITDA growth (Y/Y%)	5.1	14.7
EBITDA margin (%)	27.3	22.0
Capex growth (Y/Y%)	1.9	2.1
Debt/EBITDA (x)	2.3	6.6
FFO/Debt (%)	35.1	8.5
FOCF/Debt (%)	20.8	3.6

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

Related Research

Peer Comparison: Top Pharmaceutical Companies Will See Revenues Soar By 2028, May 1, 2024

Homebuilders and Developers

Bracing for a two-speed recovery

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What's changed?

Demand for newly built residential properties has reached a low point. The number of issued permits in European countries has decreased by 20%-40% in the past two years, particularly in Germany and France.

Construction costs remain elevated. The price of several raw materials, such as metal and timber, has decreased but the price of concrete has only declined marginally. Furthermore, labor costs are increasing.

The European market is two-speed. While the French, German, and U.K. markets struggle, Spanish developers are proving more resilient, supported by a significant increase in the number of permits and orders. This is thanks to the country's lower exposure to mortgage loans and higher demand from international investors, particularly on coastal areas.

What to look out for?

Construction cost pressures should ease. As of the end of 2023, the cost of most building materials has stabilized, and subcontractors have adjusted their prices amid weaker demand. Therefore, developers should see some modest margin recovery in 2024 and 2025.

Demand for newly built residential properties should recover gradually. Increasing real income, a resilient labor market, housing scarcity, and a growing preference for energy efficient assets should progressively revive demand for newly built assets.

Prices could bottom out. After correcting by different degrees (low in Spain and the U.K., and high in Sweden and Germany), we expect the price of existing houses to rise again in most markets in 2025. Newly built residential should follow the same trend.

What are the key risks around the baseline?

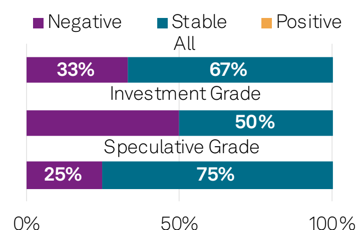
Intensifying regulatory and environmental requirements. While these are fueling demand for newbuilds, the requirements also represent additional costs, administrative hurdles, and technical challenges for developers.

Development of office real estate remains risky. Developers of office commercial real estate should continue to face pre-leasing headwinds and risk aversion from banks.

Political or geopolitical risks could delay the recovery. Although not our base-case scenario, any strong effect on government bond yields from political risks could inflate mortgage loans and hit demand for newly built residentials. It may also take longer to approve building permits in France due to the recent shift in the government.

Rating Trends

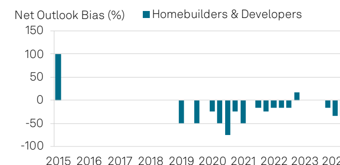
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	2	4	6
Downgrades	0	1	1
Upgrades	0	0	0

Ratings Outlook Net Bias



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

Related Research

Credit FAQ What Does Property Company Signa's Failure Mean For Ratings, Dec. 12, 2023

Bulletin: Tough Year Ahead For U.K. Homebuilders: Costs Will Rise And House Prices Are Likely To Fall, March 1, 2023

When Rates Rise: Softening Demand Threatens European Homebuilders Amid Climbing Costs, Aug. 12, 2022

Hotels, Gaming, and Leisure

Consumer spending supports resilient earnings

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What's changed?

Resilient operating performance for the leisure and travel subsectors. Consumers prefer spending on leisure, as opposed to purchases of discretionary goods, despite the ongoing geopolitical tensions.

Large European gaming players becoming profitable in the U.S. Smaller companies are exiting because of the heavy investment required and high competition.

A high volume of refinancings and capital structure activity. Speculative-grade companies have addressed their refinancing needs on the back of resilient operating performance. Many maturity extensions of pandemic era debt are done via opportunistic amend and extend transactions.

What to look out for?

Financial policy choices. Most issuers demonstrated a sound rebound in operations and built up liquidity headroom after the COVID-19 pandemic. We anticipate that companies will resume merger and acquisition (M&A) activity and shareholder distributions, though we expect it would remain in line with rating thresholds.

Price increases moderating in 2024. We forecast high average daily rates for lodging companies, but further increases should moderate because of elevated prices and declining inflation. Revenue per room should see continued uplift on the back of recovering occupancy rates.

Wage pressure to persist. While energy costs have reduced relatively, wage inflation could hamper EBITDA margins because we expect the ability to pass-through price increases to the final customer will reduce.

What are the key risks around the baseline?

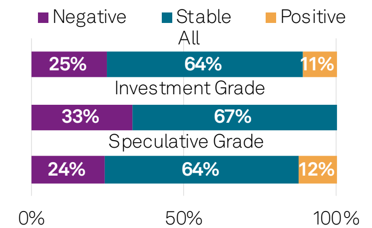
Developments in new gaming regulation, as economies and political choices settle. The focus on tightening gaming restrictions could resume.

Increasing capital expenditure on growth investments could subdue cash flow for 2024, as operating performance improves, and financial flexibility is restored.

Debt-funded M&A could resume. Base rate cuts are expected for the eurozone and the U.K., and we think consolidation across leisure and gaming sectors could resume in Europe because the sector is highly fragmented.

Rating Trends

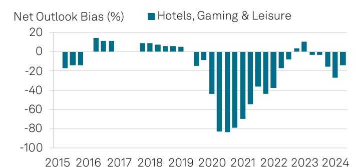
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	3	33	36
Downgrades	0	3	3
Upgrades	0	4	4

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	5.9	4.5
EBITDA growth (Y/Y%)	7.4	4.0
EBITDA margin (%)	20.6	20.8
Capex growth (Y/Y%)	6.5	14.0
Debt/EBITDA (x)	2.6	4.6
FFO/Debt (%)	27.4	12.0
FOCF/Debt (%)	19.3	4.1

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

Related Research

Industry Credit Outlook 2024: Hotels, Gaming, and Leisure: Spending on leisure slows under high prices and rates, Jan. 9, 2024

Media and Entertainment

Faster, higher, stronger: All bets are on the second half

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What's changed?

Advertising revenue, including on TV, is recovering. Advertising growth is robust on the back of a soft macroeconomic landing and reducing inflation. We expect tech companies' ad spending to recover from the second half of 2024, supporting the performance of agencies that rely more heavily on this sector. Linear TV advertising is recovering in the U.K., Germany, and France (after declines in 2023); expanding in Central and Eastern Europe; and declining sharply in the U.S.

Content production is returning to a normal cycle. Hollywood strikes and budget cuts by streamers in 2023 caused delays in production activity; however, production has resumed and demand for content, especially local content, remains robust. This should allow the largest independent producers to increase their revenue by 3%-5% in 2024. Global streaming platforms invest in nonscripted and selected high-quality scripted productions, especially in local non-English languages. In May 2024, RedBird IMI acquired All3Media (which remains an independent producer), while Mediawan increased its scale by merging with Germany-based Leonine.

What to look out for?

Winners and losers in the AI race. Many companies are already implementing AI in their products, which allows them to reduce operating and production costs (ad agencies in creative pitches; content producers in distribution, postproduction, and visual effects; and scientific and data publishers in content editing). Some have reached licensing agreements with tech companies and unlocked additional revenue streams (such as Axel Springer, Informa). However, we are monitoring the potential risks from AI of increased competition and disruption to media companies' business models, especially for content publishers.

Whether the box office picks up. Cinema operators bear high debt and cash interest burdens and rely on the box office to recover in the second half of 2024 and bounce back in 2025 following a light film slate and a lack of blockbuster releases.

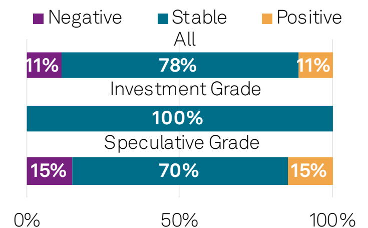
If large mergers and acquisitions (M&A) pick up. Many companies have recently strengthened their balance sheets and have capacity to invest inorganically, but we have seen a limited number of large M&A deals. We think regulatory and competition concerns will constrain consolidation. Businesses that were acquired by private equity sponsors five to seven years ago could also see IPOs and spin offs now that they have fully recovered from the COVID-19 pandemic and have largely completed business turnarounds and cost cutting.

What are the key risks around the baseline?

More restrictive regulation around privacy and AI could hamper growth. In May 2024, the EU passed the AI Act that imposes strict regulation on high-risk AI systems and general-purpose AI models. We think large, diversified companies are well placed to adapt to stringent regulation. Smaller companies could struggle to adjust their business models and remain competitive and may lack the resources needed (financial and employee skills) to address regulatory requirements.

Rating Trends

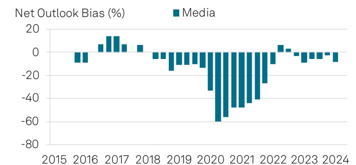
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	9	27	36
Downgrades	0	0	0
Upgrades	2	5	7

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	1.4	4.3
EBITDA growth (Y/Y%)	4.7	8.8
EBITDA margin (%)	21.8	18.9
Capex growth (Y/Y%)	4.6	10.4
Debt/EBITDA (x)	2.0	5.9
FFO/Debt (%)	37.6	9.1
FOCF/Debt (%)	30.2	5.8

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

Related Research

Research Update: Mediawan Holding SAS Assigned Preliminary 'B' Rating; Outlook Stable; Proposed Debt Assigned Preliminary 'B' Rating, June 4, 2024

Research Update: Universal Music Group BV Upgraded To 'BBB+' On Robust Business Performance And Low Leverage; Outlook Stable, May 29, 2024

Research Update: JCDecaux SE Outlook Revised To Stable On Improving Credit Metrics And Travel Recovery; 'BBB-' Ratings Affirmed, May 23, 2024

Metals and Mining

Rising costs meet financial discipline

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What's changed?

Selective mergers and acquisitions and portfolio changes. Some companies are looking at strategic changes to optimize and future-proof portfolio assets.

Local and global politics. Companies in specific countries have faced material social and regulatory hurdles, and potential disruptions from geopolitical risks loom large. These can add to companies' hesitation to invest, as returns are less certain.

Balanced sector rating prospects. Strong or moderate prices, increasing costs, high investment levels, and modest leverage imply any rating changes would be company-specific while these conditions persist.

What to look out for?

Differing demand dynamics. Major metal consuming economies are diverging, with Europe looking stronger as the U.S. moderates and China's property sector remains subdued. We also consider the impact of downside scenarios to this base case view.

Prices hold up. Notwithstanding some economic clouds, sufficient demand for most metals, alongside rising production costs and some output challenges, mean we have not significantly revised our price assumptions.

Sustainability trade-offs. Steel and aluminum producers in Europe, the Middle East, and Africa face significant spending to remain competitive, even with policy support (see Related Research). Miners will not find it easy to provide sufficient minerals for the energy transition, with challenges including resource availability, economic access, and gaining approvals to develop greenfield or even expand brownfield projects.

What are the key risks around the baseline?

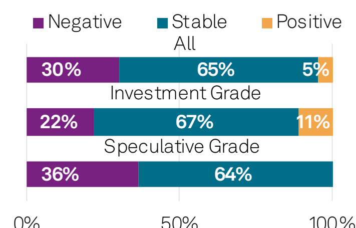
Lower prices and committed spending. Multi-year investments typically can't be rapidly scaled back if prices drop. Some companies may find their access to funding restricted in a weaker market environment.

Responses to public scrutiny. Ratings can evolve due to ownership considerations and government intervention, as well as companies' operating and strategic reactions.

Looser financial policies including capital allocation. Companies in this volatile industry could release more capital to shareholders, potentially eroding rating buffers.

Rating Trends

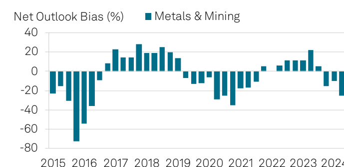
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	9	11	20
Downgrades	0	1	1
Upgrades	0	2	2

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	-3.9	-1.2
EBITDA growth (Y/Y%)	9.7	-0.4
EBITDA margin (%)	22.8	13.1
Capex growth (Y/Y%)	-8.6	-0.1
Debt/EBITDA (x)	1.2	2.2
FFO/Debt (%)	59.7	36.0
FOCF/Debt (%)	25.3	5.0

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

Related Research

Decarbonizing Metals Part Two: Financial Strength Mitigates Rising Credit Risk, June 3, 2024

S&P Global Ratings Metal Price Assumptions: Prices Rise On Tight Supply And Higher Costs, May 2, 2024

Industry Credit Outlook 2024: Metals & Mining, Jan. 9, 2024

Oil and Gas

Prices and policies remain supportive

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What's changed?

Oil market balances underpin prices, for now. Prices in 2024 look supported, with demand for oil modestly ahead of earlier expectations and OPEC+ producers showing ongoing restraint.

Portfolio strategy to the fore. Mergers and acquisitions, especially in North America, show how companies are positioning their assets and capital allocations for the future.

Drilling day rates are up. Global offshore spending and a tighter rig market mean both utilization and day rates for drillers have strengthened, albeit with the Middle East now a softer market.

What to look out for?

How fast OPEC+ increases oil supply. The signaled increase in production from October 2024 could pressure prices, even if restraint continues for now.

Refining margins may soften further. The exceptional profits of recent years are moderating, so fundamental asset quality and investment needs are more important for ratings, although balance sheets have generally been rebuilt.

Capital spending--how much and on what? Most investments still go into oil and gas, but companies continue to tweak and refocus their priorities depending on their opportunity sets.

What are the key risks around the baseline?

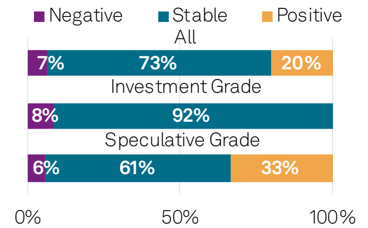
Loss of focus on cost control. Financial and operating discipline have bolstered the sector's overall credit quality in recent years. We see this continuing; however, keeping a tight rein amid solid prices could become increasingly difficult.

Material shifts in prices or prospects. Changes in production profiles due to strategy, regulation, or taxes can change an asset's value dramatically. The specific effects of energy transition trends and imperatives continue to bring uncertainty and surprises.

Companies' financial policy implementation. Many have materially reduced their debt. Balance sheet strength enables companies to make choices about capital allocation and distribution flexibility, so rating headroom could be eroded when the market environment becomes less favorable.

Rating Trends

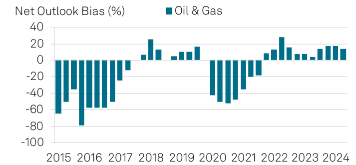
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	12	18	30
Downgrades	0	1	1
Upgrades	1	3	4

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	0.7	5.2
EBITDA growth (Y/Y%)	9.7	6.7
EBITDA margin (%)	20.0	36.4
Capex growth (Y/Y%)	13.2	19.8
Debt/EBITDA (x)	0.8	2.3
FFO/Debt (%)	94.7	31.4
FOCF/Debt (%)	24.7	11.3

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

Net-Zero Targets Leave GCC Oil Companies Unperturbed For Now, April 22, 2024

Industry Credit Outlook 2024: Oil & Gas, Jan. 9, 2024

Real Estate (REITs)

A little worse before it gets better

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What's changed?

The negative rating bias remains high, but it is decreasing. Of European REITs, 29% currently carry a negative outlook, down from 33% in December 2023. We downgraded 18 companies since 2022, however, we have also taken a few positive rating actions recently.

Property valuations have declined by 9% since June 30, 2022. We assume another 4% decline in 2024, which will result in a 13% peak-to-trough average correction (with a maximum of 30%). After a two-year increase, debt-to-debt-plus-equity ratios should peak at about 4 percentage points (pps)-5 pps higher than the level in 2021.

Investor sentiment has improved, easing refinancing pressures. The bond market has reopened to most REITs (€10.8 billion issuances year to date, compared with €6.1 billion in 2023). Equity prices and credit spreads have improved, and recent hybrids' exchange offers were successful.

What to look out for?

Most interest coverage ratios (ICRs) should reach the trough by 2025. Steady revenue growth and debt reductions should allow 52% of S&P Global Ratings rated REITs to see their ICRs bottom out by 2025. For the remaining ICRs, the decline will last longer but will be more gradual.

Nonprime offices show more vulnerabilities. Low economic growth and changing office utilization patterns should weigh on occupancy and rent reversions and depress valuations more than other asset classes.

Rental growth should remain healthy and drive future valuations. Rent growth should exceed inflation for most segments until mid-2025 (longer for German residential) before normalizing. As rates stabilize, cash flow expectations will primarily drive next valuations.

What are the key risks around the baseline?

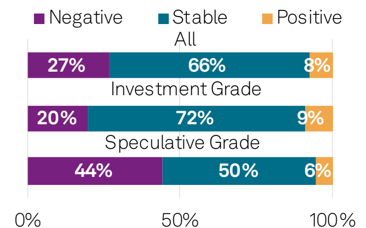
Distressed asset sales. Transaction activity remains subdued, especially in the office segment, and is concentrated on small transactions. Large institutional investors are constrained by allocation limits and refinancing struggles could force some asset sales at price discounts.

Political or geopolitical risks. Although not our base-case scenario, any strong effect on government bond yields or economic forecasts from political risks could potentially derail the recovery of REITs' valuations and hamper tenant demand.

Tighter regulation around properties' energy performance. This would require REITs to further increase renovations capital expenditure while the cost of capital remains high and access to funding has not fully recovered yet. Most REITs are focused on deleveraging.

Rating Trends

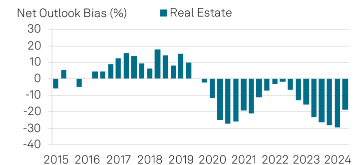
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	46	18	64
Downgrades	0	5	5
Upgrades	1	2	3

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	1.9	2.4
EBITDA growth (Y/Y%)	0.8	3.7
EBITDA margin (%)	75.6	61.8
Capex growth (Y/Y%)	-2.3	-1.0
Debt/EBITDA (x)	11.1	10.2
FFO/Debt (%)	6.5	4.1
FOCF/Debt (%)	0.3	-0.2

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

Related Research

Most European REITs' Valuations Should Bottom Out In 2024, July 10, 2024

Highlights From Our 2024 European Real Estate Conference, June 20, 2024

German Residential REITs Remain Supported By Funding Access And Solid Rent Fundamentals, May 31, 2024

AI In Real Estate: What To Watch As Adoption Accelerates, May 28, 2024

Swedish Real Estate: The End Of The Slump Could Soon Be In Sight, Feb. 29, 2024

Retail and Restaurants

Easing inflation and promotions to boost consumer spending

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What's changed?

Households are regaining their purchasing power. The improving economic conditions, strong wages, and lower energy bills should support domestic demand for goods and services. Therefore, retailers should benefit as consumer demand picks up momentum from the second half of 2024.

Working capital pressures have eased. The greater focus on managing working capital has normalized inventory levels across retailers, although inventories are still elevated.

Retailers with scale and more nimble supply chains have improved their market share. Over the last few quarters, larger and better capitalized retailers (especially in the grocery and apparel segments) have increased their market leadership over smaller competitors. Larger retailers have benefitted significantly from greater scale and more efficient supply chains, distribution, and fulfillment capabilities.

What to look out for?

Higher labor costs will continue to be a drag on margins. Wages typically account for the largest operating cost for retailers. The cost of labor exceeds inflation and this will depress the retailers' and restaurant operators' margins.

Higher levels of promotions to gain market share. Retailers will increase promotions to improve volumes because previous price increases have led to high unit prices. With already low margins, retailers will look to their suppliers of branded consumer goods to contribute a significant portion of those promotions.

The private label opportunity. Because of declining input costs, there are opportunities for retailers with established private labels to increase and cement their market share by providing greater value to their consumers.

What are the key risks around the baseline?

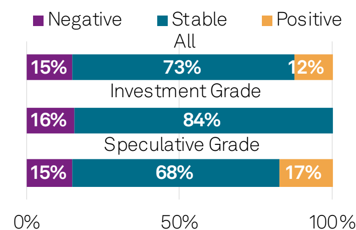
Elevated spend on experiences will hurt sales of discretionary goods. Consumers will continue to prioritize travel and leisure activities while curtailing their spending on discretionary products relating to the home, apparel, and higher value durables.

Weaker free cash flow generation. Retailers, particularly those with leveraged capital structures, will be tested on their ability to protect their free cash generation. Following moderation in capital expenditure (capex) budgets over the last few years, many retailers face higher capex requirements to upgrade their technological platforms, distribution networks, and stores.

Geopolitical risks. There have been lower-than-expected spillovers, but escalations could affect supply chain bottlenecks and commodity price volatility, hurting consumer sentiment.

Rating Trends

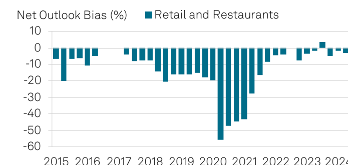
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	19	47	66
Downgrades	0	2	2
Upgrades	0	1	1

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	2.0	2.6
EBITDA growth (Y/Y%)	1.4	5.1
EBITDA margin (%)	8.3	13.6
Capex growth (Y/Y%)	-0.7	9.1
Debt/EBITDA (x)	1.8	4.4
FFO/Debt (%)	44.6	15.2
FOCF/Debt (%)	20.4	9.7

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

Related Research

SLIDES: Global Retail And Restaurants Outlook 2024: Consumers Will Remain Cautious Even As Inflation Eases, Feb. 29, 2024

Peer Comparison: European Food Retailers Resilient Amid Operating Shocks, Feb. 12, 2024

European Retailers' Margins Are Unlikely To Regain Their Pre-Pandemic Strength, Nov. 7, 2023

Telecommunications

Competition could still hamper favorable trends

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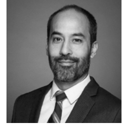


What's changed?

Growth trends have broadly improved on the back of robust data demand, moderate competition, and premium fiber and 5G products. Removing mergers and acquisitions (M&A) distortion, we expect organic topline revenue growth to average 2% annually (up from 1% previously), and a cumulative 2% adjusted EBITDA margin growth through 2026.

Capital expenditure (capex) declines will improve free operating cash flow in markets where fiber rollouts are near completion and initial 5G coverage has been established. We expect capex intensity to decrease by 0.5% annually to average 16% by 2026.

Moderating inflation removes a key tailwind for telecom revenue growth, and some operators in the U.K. are shifting to fixed price hikes. While originally driven by calls for customer price certainty, a successful shift to scheduled contract increases could create a more sustainable impetus for revenue growth, if broadly adopted.

What to look out for?

Competition may recalibrate. M&A activity has completed in Spain (MasOrange), and is pending in Italy (FastWeb-Vodafone), and in the U.K. (Vodafone-Three). Alternative networks are also beginning to rationalize in the U.K. This, combined with eased wholesale regulation and tighter financing for aggressive challengers, could improve competitive structures in three of Europe's largest and two of its toughest markets.

Regulators will set limits. Telecoms have long argued for consolidation and lighter-touch regulation, and recent decisions are incrementally positive for them. The next key ruling will be on the Vodafone-Three merger in October. However, another four-to-three merger could garner regulator pushback in our view, especially given reduced network competition and no obvious recipient of remedies.

Financial policy will be a key credit driver. As cash flow and financial flexibility improve for many operators, the credit effect will depend on how management teams prioritize debt reduction, accelerated investment, M&A, and shareholder returns. These choices will be key for highly leveraged speculative-grade telcos facing refinancing at higher rates.

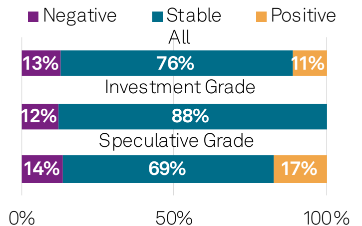
What are the key risks around the baseline?

The intensification of competition remains a key risk. It has eroded more-for-more strategies, and pressured pricing, topline revenue, and return on capital over the last decade. In countries like France, fragmentation and an imbalanced market share could reignite price competition. In markets like Spain, Belgium, and Portugal, new operators could disrupt the market.

Fiber network provider (netco) spinoffs could materially erode our assessment of business strength. The completion of Telecom Italia (TIM)'s netco spinoff (Optics Bidco) marks the first major incumbent's fixed network divestment in Europe, and we lowered TIM's business risk profile by a category. Though not our base-case expectation, other telecoms could also undertake spinoffs to reduce debt, fund shareholder returns, respond to long-term commoditization of fiber, or in the hopes of lightening the regulatory burden that comes with wholesale market power.

Rating Trends

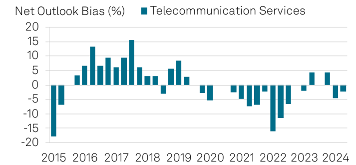
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	17	29	46
Downgrades	0	4	4
Upgrades	1	4	5

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	-0.7	1.8
EBITDA growth (Y/Y%)	-0.3	2.9
EBITDA margin (%)	38.2	40.5
Capex growth (Y/Y%)	-6.7	-0.8
Debt/EBITDA (x)	2.6	5.0
FFO/Debt (%)	30.4	12.5
FOCF/Debt (%)	14.2	3.0

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

Related Research

European Telecoms: Sector Outlook And Hot Topics, July 18, 2024

Rated GCC Telcos Reinvent Themselves As Techcos, March 19, 2024

Shedding Light On Fiber Project Financing In Europe, March 19, 2024

Industry Credit Outlook 2024: Telecoms, Jan. 9, 2024

Transportation Infrastructure

Back to 'business as usual'

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What's changed?

Creditworthiness is stable or slightly improving across our portfolio. The credit recovery after the pandemic is over and our portfolio is mostly stable. All rating actions over the last 12 months (July 2023 to June 2024) were sovereign related, with two downgrades in France (Aeroports de Paris [ADP], SNCF) and one upgrade in Turkiye (Mersin International Port). This compares with five upgrades and one downgrade from July 2022 to June 2023.

Normalized mobility trends, with mid-single-digit growth in land and air traffic. Traffic revival for leisure destinations, coupled with supportive regulations, has underpinned the faster-than-anticipated financial metrics recovery and has stirred the nascent positive rating trend. We revised to positive the outlooks on Zurich and Schiphol airports, and we raised the stand-alone credit profile on Aeroporti di Roma and SNCF by one notch. However, the resurgence of dividend distributions could decelerate rating upside potential for some issuers.

What to look out for?

Political changes and the implications for infrastructure. The political changes at the European Parliament and across several European countries (such as the U.K. and France) could affect the direction of public infrastructure plannings, including using public-private partnership and public spending on mobility transition. Many European countries may focus on strengthening the rail sector to achieve their decarbonization goals. The implied massive capital expenditure (capex) needs could boost companies' leverage unless mitigated by government support or favorable regulation.

Geopolitical risk and trade fragmentation. The protracted Russia-Ukraine war and a widening Middle Eastern conflict could affect mobility patterns and investment flows. However, infrastructure issuers' exposure to this risk depends on the asset location and refinancing needs, making it secondary for most of our rated issuers in Western Europe. Growing protectionism and the fragmentation of international trade and logistics flows could increasingly weigh on maintenance, life cycle, and capex.

Acquisitions and growth investments. The narrowing valuation gap throughout 2024 may fuel acquisition activity, as illustrated by Vinci's purchase of 50.01% in Edinburg airport. Acquisitions are also on the agenda for toll road operators aiming at extending the life of their portfolios (Abertis and some single-asset concessionaires). As growth opportunities are limited in Europe, issuers will look to the U.S. (Abertis, Vinci) or emerging markets (ADP, Zurich), where country risk is a factor. We will monitor each company's specific headroom, acquisition funding, and any effect on business risk.

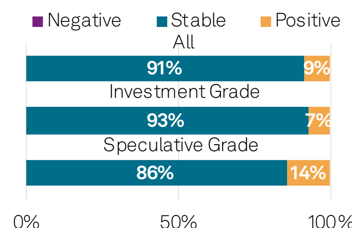
What are the key risks around the baseline?

A sharper economic slowdown. A deterioration in the economic prospects or labor markets may move mobility growth from mid-single digit to low-single digit.

Higher-for-longer interest rates. In our base case, we expect central banks to cut rates over the next 12 months, but only gradually. Higher interest compared to markets' expectations may delay further refinancings or increase the use of short-term facilities, potentially adding pressure on liquidity.

Rating Trends

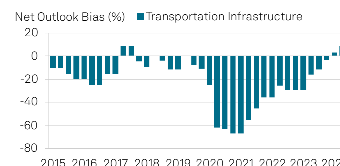
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	27	7	34
Downgrades	2	0	2
Upgrades	0	1	1

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	1.9	1.7
EBITDA growth (Y/Y%)	3.4	6.8
EBITDA margin (%)	33.3	44.8
Capex growth (Y/Y%)	5.3	44.2
Debt/EBITDA (x)	3.4	5.5
FFO/Debt (%)	22.4	12.3
FOCF/Debt (%)	1.3	3.8

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

Related Research

European Airports Trundle Along, May 13, 2024

Transportation

On the right course with potential for rough seas

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What's changed?

Robust demand for air passenger travel continues. Airlines benefit from elevated ticket prices, supported by constrained aircraft supply. Pre-bookings point to a good summer for European air travel. However, wage inflation persists across the aviation network and fuel costs remain high. Catch-up on capital expenditure and investments in new, more fuel-efficient aircraft will weigh on cash flows, despite potential delivery delays. The rated European airlines portfolio has recovered remarkably after the COVID-19 pandemic. However, higher debt levels are keeping ratings on average one notch lower than in February 2020.

Freight rates have improved compared with late 2023. Almost all container ships are rerouting away from the Red Sea and around the Cape of Good Hope, following Yemen-based Houthi rebels attacking ships in the region. Interruption to the shipping network, longer journey times, the recent rise in global trade volumes, and port congestion (notably in Asia and the Middle East) support freight rates. Uncertainty prevails, but the ongoing disruption could cushion the impact from new tonnage deliveries into the fourth quarter of 2024.

Credit conditions are easing. Inflation is receding and interest rates are falling. However, financing costs remain high, particularly for lower-rated issuers.

What to look out for?

Any softening in air fares. We assume flat to slightly higher air passenger ticket prices in our base-case forecasts for 2024 for most European airlines. Travel demand has so far appeared largely resilient to macroeconomic headwinds. However, increased capacity in the sector, due to the delivery of additional aircraft over the next few years, could pressure the current supply-and-demand dynamics.

Red Sea disruption easing. It is unclear when ships will safely navigate the Suez Canal again. However, once disruption eases, we think a widening supply/demand imbalance will decrease freight rates in the container shipping industry. We forecast that decent demand growth will compete with faster ship supply growth in the next few years because substantial deliveries of new ships--particularly ultralarge container ships--will come online. We expect the Asia-Europe and Asia-U.S. lanes, where mega-container ships tend to operate, will be hit hardest.

Environmental regulations will increase costs. Particularly as costs rise in relation to the EU's Emissions Trading System in the airline and shipping sectors.

What are the key risks around the baseline?

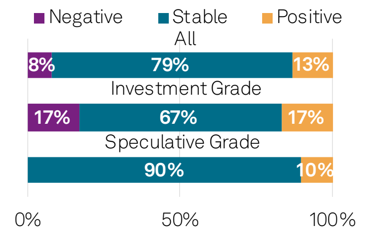
Prolonged period of weak economic growth. This could weigh on consumer spending as household savings are eroded.

Geopolitical and political risks. Jet fuel prices will remain unpredictable, but if the two regional wars in Europe and the Middle East escalate further they could become even more volatile. Demand for travel could also decrease.

A rebound in inflation. Although inflation is receding, labor and fuel costs remain high.

Rating Trends

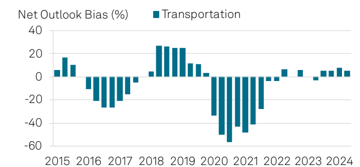
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	18	20	38
Downgrades	0	0	0
Upgrades	1	3	4

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	1.5	2.1
EBITDA growth (Y/Y%)	-0.3	3.5
EBITDA margin (%)	18.2	24.2
Capex growth (Y/Y%)	13.5	12.0
Debt/EBITDA (x)	2.0	3.9
FFO/Debt (%)	40.4	17.6
FOCF/Debt (%)	9.8	8.6

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

Related Research

Global Airlines Outlook: Clear Skies, For Now, April 30, 2024

E-fuels: A Challenging Journey To A Low-Carbon Future, March 25, 2024

CreditWeek: How Will The Red Light In The Red Sea Affect Supply Chains And Inflation?, Jan. 18, 2024

Utilities

Possibility for political risk to add to price risk

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What's changed?

A steady state could be reached on gas and power prices after last winter's fall. Europe's low gas supply buffer will keep prices somewhat elevated and volatile.

The economics of power supply decarbonization are challenging for offshore wind and power grids. This makes the transition less affordable and slower but is relatively credit neutral as long as capital expenditure (capex) discipline offsets lower EBITDA growth.

Higher-for-longer interest rates, high inflation on renewables, and grid capex test energy transition economics, including for nuclear. Most Western European grids benefit from supportive regulatory updates.

What to look out for?

Political risk may have several angles. Several national elections in Europe and in the U.S. may affect energy and trade policies and test energy affordability amid tepid GDP growth.

Exposed generation and grid investments. We expect prudent financing with higher capex.

Thin ratings headroom. Balance sheets, while typically solid, are eroded by high and growing capex, interest rates, and dividends.

What are the key risks around the baseline?

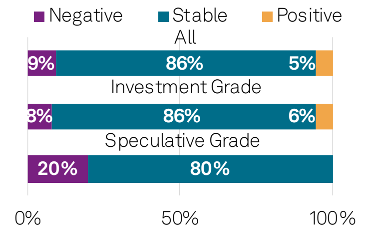
Supply chain issues, interest rates, inflation, and regulatory and fiscal setbacks aggravate energy transition economics. Changes in assumptions or weak contracting could impair the economics of large projects and a utility's business risk or financial risk profile.

Financing a speedier energy transition. Pressures to accelerate the energy transition and measures to make energy more affordable could weigh on ratings via higher debt and lower earnings.

Cyber risk, physical sabotage, or the weather could weigh on issuers with thin liquidity.

Rating Trends

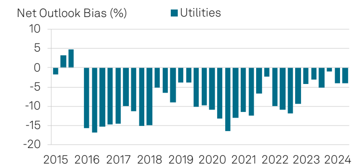
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	88	10	98
Downgrades	2	0	2
Upgrades	4	2	6

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	0.9	1.5
EBITDA growth (Y/Y%)	-0.6	3.0
EBITDA margin (%)	28.2	15.6
Capex growth (Y/Y%)	18.6	15.0
Debt/EBITDA (x)	3.7	4.1
FFO/Debt (%)	19.2	16.8
FOCF/Debt (%)	-0.5	5.3

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

Related Research

Europe's Power Producers Continue Their Balancing Act As Electricity Prices Stay Low, July 10, 2024

European Electricity Producers' Credit Quality And Revenue-Support Contracts: It's Complicated, July 10, 2024

European Utilities' Net-Zero Ambitions Face Myriad Hurdles, May 2, 2024

European Utilities: The Rating Relevance Of Net-Zero Commitments, May 2, 2024

Autos

Slower growth amid strains

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What do we expect over the next 12 months?

Softer demand momentum, intensifying pricing pressure and rising electric vehicle sales will weigh on auto makers' profitability and cashflows.

That said, modest volume growth, product mix adjustment, tightened cost control, and low leverage will anchor steady credit quality for most rated Asia-Pacific auto companies.

Our net rating outlook bias for the sector turned neutral from positive, after recent rating actions on two electric vehicle (EV) battery makers.

What are the key risks around the baseline?

Challenging macro outlook. Economic growth prospects remain clouded in China given weakness in consumption and in the property market. In the U.S, further delays in the timing of rate cuts will further crimp consumer purchasing power. In Europe, higher refinancing costs and less disinflation than we previously expected could squeeze growth and derail a soft landing.

Increasing trade restrictions. Rising trade hurdles in Europe and the U.S. on China-made EVs have limited impact on rated Chinese issuers given their small exposure to those markets. Yet, trade barriers from other markets could arise amid growing Chinese exports, as countries aim to build and expand EV value chains locally.

Slower electrification. We believe electrification will remain the long-term trend globally. However, less aggressive emission reduction targets and a lack of affordable models could slow the EV transition progress.

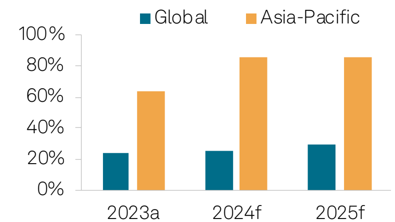
What do they mean for the sector?

Weaker demand. Sales growth of global light vehicles will likely fall below our expected 1%-3% range in 2024, if macro conditions worsen. Price cuts and auto trade-in subsidies can still support modest growth in China. However, volume in U.S. and Europe will see pressure as inflation and high interest rates hurt affordability.

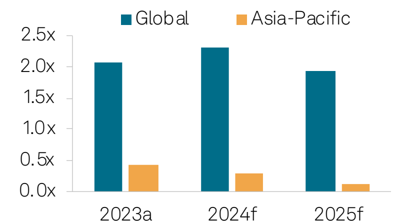
Margin pressure varies. A softer pricing environment, a greater emphasis on lower-margin EV sales, and potentially lower exports will dampen profitability of Chinese auto makers. Cost control and product-mix optimization are vital for margin protection. For Japanese and Korean auto makers, modest volume growth, continuous mix adjustment, more diversified geographical exposure, and strong demand for hybrid vehicles in ex-China markets will be key to the resilience of their profitability over the next 12 months. Nonetheless, there is growing pressure for Japanese auto OEMs to catch up in EVs, given their weakening performance in China.

Rating Metrics

FFO to debt (median, adjusted)



Debt to EBITDA (median, adjusted)



Source: S&P Global Ratings.

All figures are converted into U.S. dollars using historical exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO--Funds from operations. a--Actual. f--Forecast.

Building Materials

Divergence widens among Asia-Pacific producers

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What do we expect over the next 12 months?

The satisfactory competitive position and sufficient financial headroom of most rated Asia-Pacific building material companies will help them manage demand uncertainty.

A further deterioration in the Chinese property sector continues to weigh on the building material sector, with fewer new housing starts and construction areas. Similarly, Korean producers' operating performance is under pressure with weak demand. Construction project orders are declining and housing-market sentiment remains weak amid high interest rates.

The Australian market will stay healthy, with a strong pipeline in the residential sector as growth in net overseas migration supports housing demand, and public sector investment improves.

What are the key risks around the baseline?

Sharper downturn in the Chinese property sector, and high interest rates outside of China. China's challenging property market underlines still-weak momentum for new construction, hitting demand for building materials. Furthermore, China's infrastructure investment growth will also moderate in 2024 due to more disciplined local government spending. Outside China, prolonged high interest rates continue to weaken housing market sentiment.

Still-high input costs and supply-chain challenges. High raw material and labor costs stemming from inflation, supply constraints, and geopolitical risks outside China are keeping input costs high. Meanwhile, extreme weather risks supply-chain bottlenecks and delays in construction.

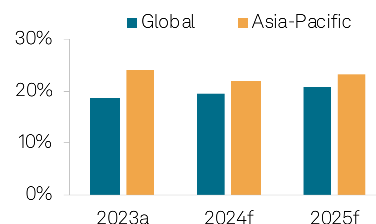
What do they mean for the sector?

Ongoing drag on demand. Weak homebuyer confidence and slower economic growth in China would dampen investment into new properties, hitting construction and demand for building materials, especially for basic building materials (cement). Other building materials, such as waterproofing material, may fare better with support from rising renovation needs. Weak housing market sentiment outside China due to high interest rates will have the same impact.

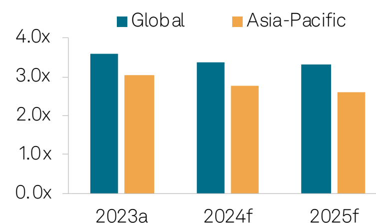
Margin squeeze. While the price of coal--a key energy source--continues to moderate, still-high raw material and labor costs will likely constrain building material companies' profitability. Chinese players may face greater strains on profitability among regional peers because of limits on their ability to raise prices amid sluggish demand.

Rating Metrics

FFO to debt (median, adjusted)



Debt to EBITDA (median, adjusted)



Source: S&P Global Ratings.

All figures are converted into U.S. dollars using historical exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO--Funds from operations. a--Actual. f--Forecast.

Capital Goods

Slow recovery in China weighs on earnings outlook

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What do we expect over the next 12 months?

A slow recovery in China and some end-markets continues to weigh on the earnings outlook in Asia-Pacific.

Key risks include persistently high interest rates and uncertainty around a soft global economic landing. The factors may hurt corporate customer sentiment in terms of capital spending, in turn impeding the recovery of key leverage measures.

The demand outlook and degree of margin protection, as well as cash flow management, will be key drivers of credit quality.

What are the key risks around the baseline?

Slower recovery in China and some end-markets. The weak property sector as well as slow consumption and investment in China will continue to weigh on demand within the Chinese corporate sector for capital goods, despite stimulus by the government. Stagnant demand recovery in some end-markets, such as factory automations for manufacturing, means slower capital expenditure by corporate customers.

Global economic slowdown. Although the demand outlook in the U.S. still looks solid, it continues to be curbed among European economies. Persistently high interest rates should cool capital spending by corporate customers and the construction sector. Some Asia-Pacific capital goods companies--especially Japanese ones--have exposure to the European market. A weaker macroeconomy will erode EBITDA and cash flow, potentially hurting credit metrics.

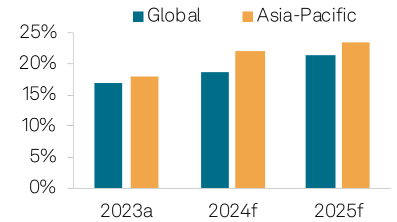
What do they mean for the sector?

Margin pressure. Weaker demand and soft sales, together with a tough competition, would prevent Asia-Pacific companies from achieving a meaningful improvement in EBITDA and margins.

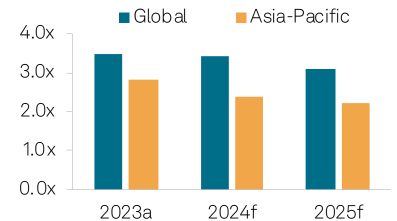
Delayed improvement in cash flow metrics. Given our continued expectation for cautious economic conditions, we assume capital goods companies will carefully manage growth investment and shareholder returns. However, if the economic outlook weakens further, cash flow ratios could deteriorate.

Rating Metrics

FFO to debt (median, adjusted)



Debt to EBITDA (median, adjusted)



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Chemicals

Chronic overcapacity raises credit risk

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What do we expect over the next 12 months?

Profitability is likely to stay weak beyond 2024, for longer than we previously anticipated, because of tepid demand growth and high oil prices.

It could take longer for excess capacity to be absorbed, despite slowing capacity additions.

Leverage should stay high amid weak cash flows.

What are the key risks around the baseline?

Stalling market demand. Ongoing weakness in China's property market could prevent a significant rebound in demand growth, despite recovering exports from the region.

A weaker ability to pass through costs. High crude oil prices could constrain the ability of commodity chemical companies to pass through product costs if demand does not pick up sufficiently to support higher chemical prices.

Persistent overcapacity. Aggressive capacity additions in China in combination with weak demand could keep utilization low for longer, adding additional pricing and cost pressures to Asia's chemical companies.

What do they mean for the sector?

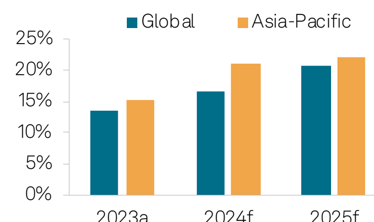
Depressed profitability. A recovery in chemical companies' profitability could stall in 2024, keeping the level of profitability below the average of past cycles.

Higher leverage. Leverage could stay elevated without significant improvement in profitability over the next 12 months.

Rising credit risk. Chronic oversupply and low profitability could raise business risk and erode financial buffers for commodity chemical makers. Credit risk rises without a quick fix to significant supply and demand imbalances in sight.

Rating Metrics

FFO to debt (median, adjusted)



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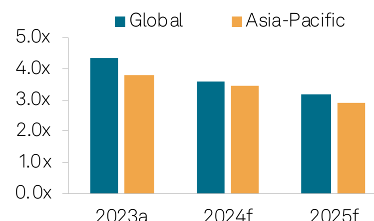

Source: S&P Global Ratings.

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Consumer Products

Stable input costs to support performance

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What do we expect over the next 12 months?

Subdued real income weighs on consumer confidence across the major economies.

Profitability remains stable thanks to past markup efforts by consumer goods companies and lower input cost inflation.

Prudent financial policies will support the credit profiles of consumer-product companies.

What are the key risks around the baseline?

Price competition intensifies. Lower input costs, when combined with weak consumer confidence, could constrain markup behavior by consumer goods companies. This adds to consumers' tendency to trade down to cheaper, no-brand goods in such circumstances, which could benefit private-label brands.

Subdued spending in China. Continued uncertainties in the real estate sector sap consumers' spending appetite. Tight household budgets and higher propensity to save will drive consumers toward value with their daily purchases, leaving profitability of consumer goods companies under pressure.

Souring financing conditions. Growing refinancing costs stemming from unfavorable exchange rates, along with high interest rates, weigh on companies with a highly leveraged capital structure.

What do they mean for the sector?

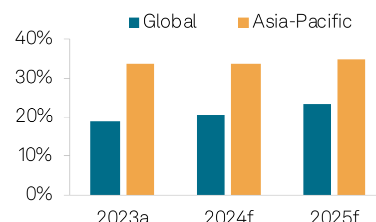
Brand equity matters. High value-add and a differentiated offering enable a firm to protect its profitability in an environment of intensified price competition. Companies without solid brand equity will face fewer opportunities to mark up, thus constraining their ability to drive up profits.

Sluggish recovery in performance. Consumer goods companies operating in China could face a slower recovery in profitability than others due to intensified competitions amid macro headwinds. A further reduction in household spending, depending on the extent of the property crisis' hit to consumer confidence, could hamper their credit headroom.

Slower debt growth. Higher funding costs push highly leveraged companies toward prudent financial policies. Tough economic conditions also encourage companies to focus more on their core businesses, rather than engaging in large M&A transactions.

Rating Metrics

FFO to debt (median, adjusted)



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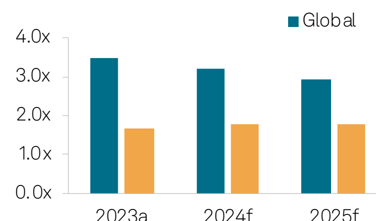

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Gaming

Better prospects of a revenue recovery across the region

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What do we expect over the next 12 months?

In Macao, we forecast mass gross gaming revenue (GGR) in 2024 to be 5%-15% stronger than in the pre-COVID year of 2019. Higher visitation and expanded hotel capacity should fuel the growth. Based on trends so far this year, the 2024 mass GGR is likely to be at the upper end of our forecast range.

Gaming revenue in Singapore and Malaysia should continue to improve, benefiting partly from higher visitations thanks to the visa free arrangement with China.

In Australia and New Zealand, soft economic conditions will continue to take a toll on mass GGR.

What are the key risks around the baseline?

Higher capital expenditures for development projects. Global operators such as Las Vegas Sands, Wynn Resorts Ltd., MGM Resorts International, and Genting Bhd. will likely bid for three full-scale casino licenses available in New York. Many of them also have development projects underway in other regions of the U.S., and also around the world in Singapore, the United Arab Emirates, and Japan.

Economic headwinds. Subdued economic conditions and cost of living pressures are weighing on gaming revenues in Australia and New Zealand. For example, electronic gaming machine revenue at SkyCity Entertainment Group Ltd.'s flagship Auckland casino has softened considerably since the start of 2024. We expect this trend to persist for the remainder of the year.

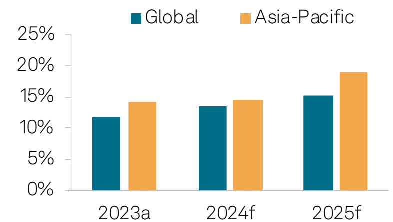
What do they mean for the sector?

The outcome of New York gaming licenses will be a watchpoint for multiple rated issuers this year. The scale of the project could add leverage compared with our base-case forecasts and slow improvement in operators' credit measures or eat into the leverage cushion of others.

Casino operators could expand into Southeast Asian markets. Macao operator Melco Resorts & Entertainment Ltd. is partnering with a local conglomerate in their integrated resort development in central Colombo in Sri Lanka. Thailand is also in the process of legalizing casinos. These markets could be attractive to smaller casino operators with less financial flexibility with their low investment costs, compared with developed markets.

Rating Metrics

FFO to debt (median, adjusted)



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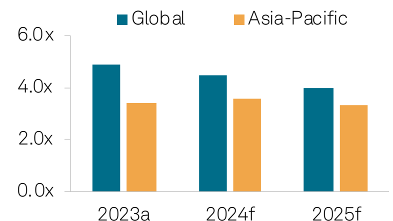

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Media And Entertainment

Tepid growth outlook for 2024

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What do we expect over the next 12 months?

China advertising spending growth to remain stable in 2024, following a recovery in 2023.

Intense competition, particularly in e-commerce, will somewhat offset the effects of stable economic growth in Asia-Pacific. This could erode margins for some issuers.

Large internet companies have plenty of financial buffer to withstand slowing growth and investments to remain competitive.

What are the key risks around the baseline?

Challenging macroeconomic environment remains a burden to incumbent Chinese online retail platforms. Consumers spending remains geared toward services and value-for-money products. This trend can be a challenge for some online retailers as they adapt their platforms to focus more on bargain products and cost reduction. This could result in further shifts in the share of online retail spending for incumbent platforms. However, revenues and profits for such platforms should remain stable so long as online retail spending continues to grow.

Emerging platforms will continue to pressure ad pricing. Short-form video platforms and other emerging platforms are accelerating efforts to monetize their growing user base. This will pressure ad pricing for at least the next 12 months, particularly in China. Such efforts include building up e-commerce capabilities on social media platforms or increasing ad load. Growing ad supply and monetization of e-commerce opportunities on social media will spread advertisers' spending across more channels. This could reduce ad prices and allocation to more established social media platforms and other online ad platforms.

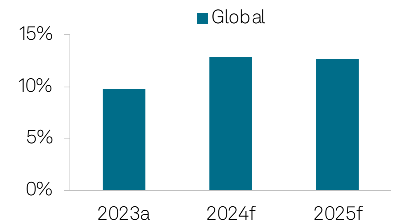
What do they mean for the sector?

Stiff competition and evolving user preferences will push online platforms to scale up investments. Companies are under pressure to increase spending on marketing, user experience, and content. Advances in artificial intelligence are creating opportunities for internet companies to invest. Together, they will weigh on profitability and increase capital investments.

Most Asia-Pacific media and entertainment companies have sufficient financial buffers. Most of our rated media and entertainment issuers in Asia-Pacific have dominant market positions and large financial buffers to absorb rising investments, margin pressure, and rising regulatory costs.

Rating Metrics

FFO to debt (median, adjusted)



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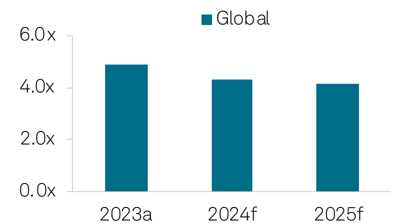

Source: S&P Global Ratings.

All figures are converted into U.S. dollars using historical exchange rates. Forecasts are converted at the last financial year-end spot rate. *Metrics for Asian issuers are not included in the chart, as more than half of the Asia-Pacific media & entertainment rated portfolio are net cash on an adjusted basis. FFO--Funds from operations. a--Actual. f--Forecast.

Metals and Mining

Uncertainty lingers over demand recovery

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What do we expect over the next 12 months?

Demand for industrial metals to remain lackluster given the weak growth of base metals consumption in the U.S. and Europe, and still-subdued property construction in China.

Supply tightness, upbeat demand outlook for critical minerals due to the energy transition and Russia metal sanctions are supportive to some metals, such as copper and aluminum. Supply surplus will persist for some other industrial metals and downstream industries, such as China's steel and Indonesia's nickel.

Macroeconomic signals from different economies will determine the direction of metals markets.

What are the key risks around the baseline?

Economic pressure looms. We have made some modest upward adjustments to our base-case price assumptions for most base metals on tighter supply and higher cost. Overall global macroeconomic outlook remains mixed with muted demand in Europe and China. Risks of a harsher downside persist.

Geopolitical risks escalate. The uncertainty of how these risks unfold further limits price visibility. The Israel-Hamas and Red Sea conflicts have a limited impact on the metals market for now as they are not the main transportation routes. But coupled with Russia sanctions, these could cause supply disruptions.

Pressure on metal downstream players. China's steel companies' profitability remains under pressure, with low product prices; coking coal and iron ore prices remain resilient. China is expected to curb steel production in 2024 and clean out inefficient players in the industry.

What do they mean for the sector?

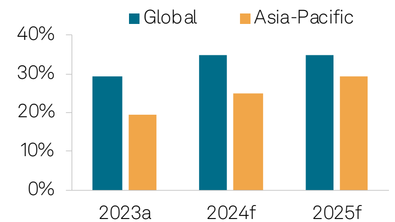
Credit quality of upstream companies has levelled off after a long run of improvement. Credit quality for upstream mining companies has stabilized. Most issuers can withstand further price pressures before testing our downside credit threshold.

Downstream players' profitability is volatile amid macroeconomic uncertainties. Soft end-use demand is limiting pass through of high material cost. Meanwhile, upstream materials' prices are volatile, though they remain at a high level despite the moderating macroeconomic trend.

Less earnings visibility amid high volatility in prices for commodities and energy. This is the result of different catalysts, including economic uncertainty, currency swings, and geopolitical risks.

Rating Metrics

FFO to debt (median, adjusted)



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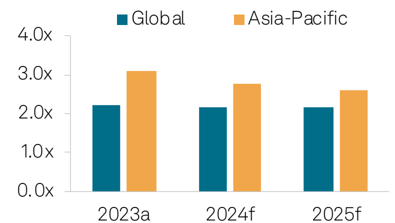

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Oil and Gas

Global demand slows as supply is turning to a deficit

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What do we expect over the next 12 months?

Full-year 2024 global oil demand growth to lose steam amid trade tensions, geopolitical conflicts, and uncertainty in inflation and policy interest rates.

Supply to turn to a deficit in the latter half of 2024 given extended production cuts. We assume Brent oil price to stay unchanged at US$85 per barrel in 2024, and US$80 in 2025 and 2026.

Geopolitical tensions have increased concerns over energy security, potentially hindering the region's effort to address the energy transition.

What are the key risks around the baseline?

Global demand growth losing steam. China, India, and Brazil will remain the key growth drivers, as growth prospects are lackluster for Europe, Japan, Canada, and the U.K. Still, uncertainties around trade tensions, geopolitical conflict, inflation, and policy interest rates are hindering demand expansion for the remainder of 2024, with demand expected at 1.7 million barrels per day, compared with 2.1 million barrels per day recorded in 2023.

Oversupply situation to subside. The extension of crude oil production cuts through the end of 2025, led by the OPEC+, has reduced oversupply pressure on oil prices. The 2.2 million barrels per day of production cuts have been extended until the end of September and will be phased out over the following 12 months. Our Brent oil price assumption in 2025 and 2026 remains US$80 per barrel.

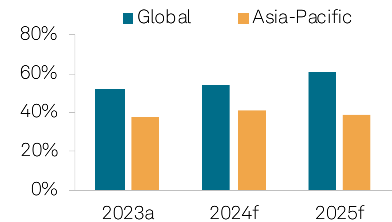
Geopolitical unrest adds to the volatility. Ongoing geopolitical tensions will continue to fuel unease about oil supply and energy security. Adding to the volatility are uncertainties on inflation and policy interest rates..

What do they mean for the sector?

Persistent volatility and earnings headwinds. High volatility will pose potential downside risks that depress earnings. Geopolitical turbulence and the uplift this gives to energy prices, while positive to earnings, could lead to large swings in producers' inventory gains and losses. Given most rated Asia-Pacific producers are national oil companies, they will likely face more pressure to direct investment toward securing energy supplies, rather than for energy transitioning, for their respective countries. Balancing investment needs and maintaining prudent financial policy will also be crucial amid likely volatility over the next 12 months.

Rating Metrics

FFO to debt (median, adjusted)



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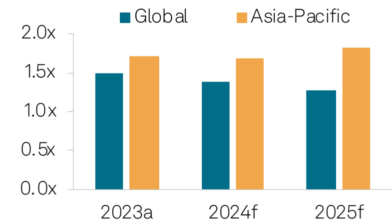

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Real Estate Development

China's primary property market is searching for a bottom

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What do we expect over the next 12 months?

China's primary property sales may stabilize at RMB10 trillion, and then follow an extended L-shaped recovery path.

Hong Kong's home prices will continue to fall in 2024 before stabilizing in 2025 when interest rates ease.

Indonesia residential property sales growth is likely to be flat over the next 12 months. Sales will be front-loaded in 2024, driven by the value-added tax reduction that will expire by the end of the year.

What are the key risks around the baseline?

Structural factors could dampen China's primary property sales. This is because homebuyers are increasingly purchasing in the secondary market, as they might want to avoid the uncertainties of not being able to receive completed units from liquidity-strained developers. Furthermore, social housing for sale offered by the government could cannibalize the sales of rated developers.

Hong Kong's home prices could continue to fall. Recent easing in property-cooling measures will stimulate demand somewhat. However, a high level of inventory, a slew of new supply in 2024, and elevated interest rates will add pressure to price recovery.

Access to funding for Indonesian developers remains selective. This will increase the refinancing risk for the sector again, due to the offshore maturity wall in 2025 of about US$710 million.

What do they mean for the sector?

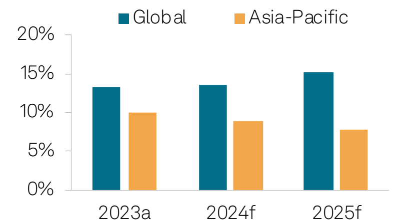
Chinese developers will be competing for a slice of a smaller primary market. Rated developers who focus on higher-end projects in higher-tier cities, and offer better quality products and value-added services, will fare better in the still tough operating environment.

Hong Kong developers will approach land acquisitions with prudence. Rated developers will likely attempt to control their leverage amid a market downturn. We estimate most of our rated developers have over five years of land reserves, and they therefore have no immediate need to replenish their land banks.

Indonesian developers will restructure most of the notes that are due to mature before the end of 2025. Most developers have limited surplus cash to address the upcoming maturities. For developers with weak credit quality, obtaining bank loans could be an uphill task even if they have sufficient unpledged assets. The likelihood for such developers conducting notes restructuring is high.

Rating Metrics

FFO to debt (median, adjusted)



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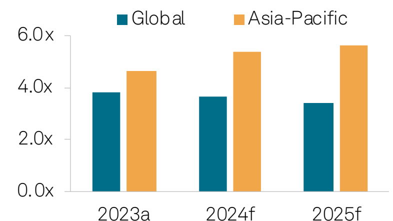

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Real Estate Investment Trusts

Higher-for-longer interest rates are hurting landlords

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What do we expect over the next 12 months?

Asia-Pacific office landlords will continue to bear the brunt of structural and cyclical challenges. Valuation pressures remain for major Australian cities and Hong Kong.

Credit metric and covenant headroom diminishes as higher interest rates persist.

Logistics, hospitality, and retail (nondiscretionary) assets remain well supported.

What are the key risks around the baseline?

Higher-for-longer interest rates will crimp credit metric headroom. Landlords will be more exposed to elevated interest rates as their fixed-rate debt and interest-rate hedges roll off. This will weaken their interest coverage ratio and pressure covenant headroom.

Landlords' ability to monetize assets to deleverage will be constrained. Elevated interest rates will keep purchasers on the sideline, stymying landlords' efforts to deleverage. Sales of office assets at depressed prices will exert further downward pressure on office valuations. These could further erode gearing covenant headroom and funding avenues for our rated landlords.

What do they mean for the sector?

Financial buffers are thinning. While financial headroom is likely to diminish, we expect most rated Asia-Pacific REITs can still withstand the challenging operating and financial conditions. Cities with stronger return-to-office adoption or a continued increase in tourist arrivals will temper those strains.

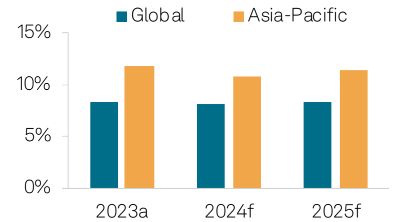
Office asset valuations remain under the spotlight. Further deterioration in valuations will increase gearing. As a result, some REITs' articulated targeted gearing ranges will be tested. Covenant headroom will decline but remain manageable for most.

Shorter debt maturity profiles to challenge liquidity. We may see a further reduction in debt maturity profiles as landlords opt for bank loans over bonds. A shorter-dated funding profile could weigh on the entities' liquidity and capital structure. That said, rated REITs' refinancing risk remains largely manageable.

Multiple capital management levers to be pulled. Asset divestments, distribution payout reduction, deferral of non-essential capital expenditure, and equity raisings are some capital initiatives deployed by Asia-Pacific REITs under rating pressure. Capitalization rate stabilization should encourage capital inflows to the sector.

Rating Metrics

FFO to debt (median, adjusted)



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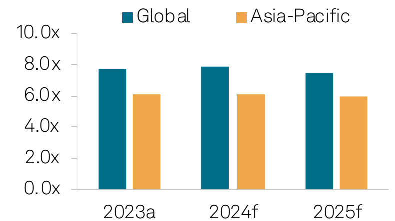

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Retail

Revenue growth to slow amid weak spending

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What do we expect over the next 12 months?

Topline stays weak with low consumer confidence. China retail is seeing a small boost from policy support, while Australian grocers enter a period of heightened political scrutiny over grocery pricing.

EBITDA margins to broadly weaken across our coverage. Companies generally need to spend more on promotion to stimulate demand. Cost pressures are elevated in the Pacific region.

Credit ratios for China and Japan should improve, but Pacific companies will see relatively weaker metrics.

What are the key risks around the baseline?

Cautious spending continues. Consumers are cautious with shrinking real disposal income (in Japan and Pacific) or low confidence (in China). Spending is disciplined and biased toward downtrading and necessities. We expect growth to slow but remain positive.

Regional drivers diverge. In Australia, allegations of price gouging could potentially lead to a shift in market share among supermarket operators. In China, the government is deploying subsidies to encourage upgrades to new, energy-efficient products driving sales of larger-ticket items. In Japan, a weaker yen lifts tourists' inflow but not enough to offset softening trends domestically.

Diminishing returns. Pacific issuers experience most margin pressures as cost inflation persists. Japan issuers are relatively shielded from slowing domestic consumption given most of their earnings comes from overseas, and this level is growing.

What do they mean for the sector?

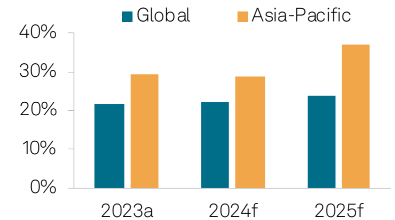
Low confidence. It would take time to rebuild consumer confidence. COVID savings have largely been used up in Japan and the Pacific, while the recent wage hikes could slow the pace of real wage declines.

Tighter corporate spending. Corporations are taking a cautious stance on capital spending, focusing more on maintenance than expansion. Reorganization of companies in Japan's retail market is accelerating as the population shrinks, which could prompt further consolidation locally and abroad.

Credit metrics to diverge. A growing EBITDA base in China and Japan along with measured spendings should support cash flows and low leverage ratio trends. Weaker EBITDA generation in the Pacific would weaken credit metrics such as leverage and discounted cash flows.

Rating Metrics

FFO to debt (median, adjusted)



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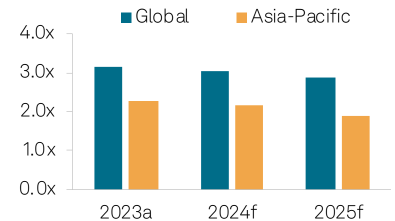

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Technology

An uneven recovery comes with challenges

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What do we expect over the next 12 months?

Uneven recovery across sub-sectors. An AI super cycle could continue, propelling sales of product categories such as high-bandwidth memory and AI servers. The recovery in consumer electronics could be lukewarm. Demand from industrials and auto end markets could stay subdued.

Higher capital expenditure (capex) among certain tech firms, due to production diversification or new business development. Firms more dependent on non-AI end markets could face rising profitability pressure from competition or growth in new capacity.

Most rated tech issuers have sufficient rating buffer. Yet the rating headroom could narrow for selected Japanese firms. Refinancing remains a challenge for lower-rated issuers.

What are the key risks around the baseline?

Macro strains. This could derail a likely recovery of the export-oriented Asia-Pacific tech sector, as both corporate and consumer demand--particularly in the U.S. and the eurozone--could be dampened.

Rising geopolitical tensions and a further tightening of U.S. tech export controls. The risk is compounded by the proposed tariff hike by the U.S. on China's semiconductor exports. The development could hit global tech trade, create supply bottlenecks, and prompt duplicated capacity buildout across geographies.

Overcapacity of mature semiconductors. Sizable new capacity using mature process nodes at 28 nanometers or above will be added in 2024, outpacing IT spending growth. Most of the addition will come from China. Asia-Pacific foundries specializing in mature chips face low utilization and profitability.

What do they mean for the sector?

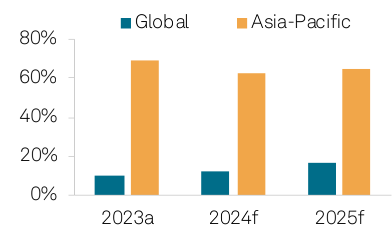
Margin pressure diverges by sub-sectors. Profitability upside expected for memory producers supplying high-bandwidth memory for AI applications and firms debuting other AI-enabled new products. Yet margin pressure is high for players dependent on other end markets.

Cash flow volatility remains high. This is due to a confluence of factors: working capital swings; investment in capacity; new technology and relocation of production facilities; and macro and geopolitical uncertainties.

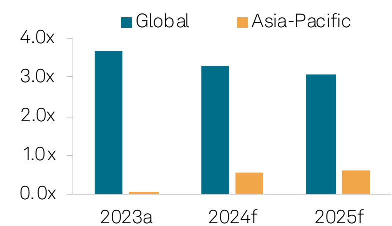
Sufficient rating buffers for most Asia-Pacific tech issuers. Most rated tech firms can maintain market position and financial metrics commensurate with current ratings, despite working capital swings and other investments. Rating headroom of some Japanese firms could narrow on soft customer demand, M&A or investment in new business. High funding costs and weak capital structures weigh on lower-rated issuers.

Rating Metrics

FFO to debt (median, adjusted)



Debt to EBITDA (median, adjusted)



Source: S&P Global Ratings.
All figures are converted into U.S. dollars using historical exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO--Funds from operations. a--Actual. f--Forecast.

Telecommunications

More network sharing, less capex allow telcos to invest in growth

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What do we expect over the next 12 months?

Telecom operators' earnings will, on average, rise by a mid-single digit in 2024 from increased mobile data traffic and fixed broadband adoption. Cost cutting, supported by AI adoption and simplified business structures, will mitigate the effect of inflation on margins.

Average capex intensity should ease as 5G investment declines, even as telcos pivot spending to other digital infrastructure such as fiber, cloud and data centers.

Moderating competition in Asia-Pacific, such as Indonesia and Taiwan, because of market consolidation.

What are the key risks around the baseline?

A need for more 5G capex. Telcos that rolled out non-standalone 5G may need to fund another investment wave as they move toward standalone 5G. Sporadic spectrum buys could also exacerbate leverage.

Inflation and currency risks. Inflation strains could slow upgrades to pricier plans and 5G-enabled handsets and weigh on telcos' ability to execute on price increases. Macroeconomic pressures could weaken demand from enterprise customers. Input cost inflation could undermine telcos' cost cutting. Axiata Group Bhd. and Bharti Airtel Ltd. are more exposed to currency risk. A sizable proportion of Axiata's debt is denominated in U.S. dollars; domestic currencies have weakened substantially in Bharti Airtel's African operations.

Rising investment in growth engines. Telcos have been investing in high-growth segments such as fiber, cloud, and data centers. Such investments, if debt-funded, can erode rating headroom, as new earnings streams take time to ramp up. Execution risks could also lead to higher-than-expected capital intensity.

What do they mean for the sector?

Telcos will be more open to infrastructure sharing. We expect to see more active and passive network sharing, subject to regulatory and competition considerations. Players in markets such as Australia, the Philippines and Malaysia have proposed or entered network sharing agreements. Tower sharing in the region is also set to rise after the spate of tower sales in the past three to five years.

Timely and strategic divestments will be the key leverage management tool. With rated Asia-Pacific telcos mostly at investment grade, the focus is on financial policy. We believe telcos will consider selling non-core businesses and passive infrastructure assets to fund investments in new growth engines. We see signs of this as some telcos restructure their businesses, which could facilitate subsequent divestments. There is also some initial momentum in bringing in strategic partners for new growth engines such as data centers.

Rating Metrics

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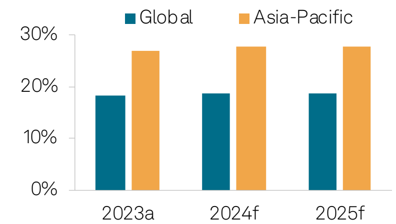

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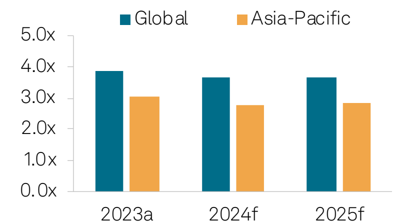

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Transportation Cyclical

Focus on cost management as demand growth slows

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What do we expect over the next 12 months?

Asia-Pacific airlines turn their focus to cost management as air traffic growth decelerates.

Freight rates correction continues, although Red Sea disruptions provide some temporary respite.

Push towards decarbonization will drive costs higher.

What are the key risks around the baseline?

Slowing economy, geopolitical shocks. Slower growth and geopolitical escalations could derail the recovery in aviation and weigh on global trade. While prolonged Red Sea disruptions could ease shipping supply-demand imbalances, it may increase demand for air freight, and stoke inflation.

Elevated interest rates and costs. Persistent high rates, labor cost inflation, and volatile oil prices pose risks to earnings recovery, debt reduction and interest serviceability. These could gradually moderate the improvement in airlines' credit metrics. Lower-rated entities could face elevated liquidity and refinancing risks. Decarbonization targets further add to costs.

Supply-side constraints linger for aviation, ease for freight. Delayed aircraft deliveries, maintenance backlogs, engine problems and staff shortages could impede airlines' path to full capacity, and aviation growth prospects generally. But a surge in new-build ship deliveries will lead to a freight correction.

What do they mean for the sector?

Airlines need to manage costs more tightly. Passenger traffic growth, load factors and yields will moderate as the post-pandemic recovery plateaus, amid intensifying competition. Airlines' ability to maintain their competitive advantage and implement cost savings will be crucial to preserving profit margins.

Capacity management and cash buffers are key for freight operators. Container liners could continue offloading tonnage and carrying out blank/slower sailings to reduce capacity. Freight operators will rely on strong cash flows built up in 2021/2022 to counter disruptions in the Red Sea and to weather weaker margins. They will also remain nimble in their supply-chain logistics strategies.

Renewed focus on growth and green initiatives may mean higher capital expenditure. Entities could invest in more fuel-efficient fleets after spending reductions during the pandemic, and to meet growth aspirations. This could limit meaningful deleveraging. But supply-chain constraints in aviation could slow fleet renewal.

Rating Metrics

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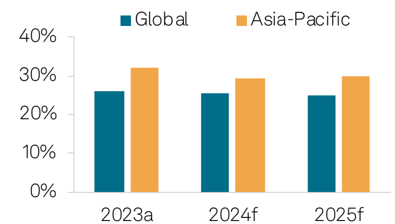

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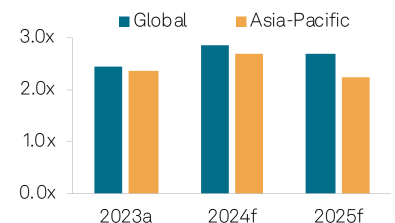

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Transportation Infrastructure

Growth normalizes, inflation lingers, and interest rates stay high

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What do we expect over the next 12 months?

Growth of passenger traffic will further decelerate from the first quarter of 2024 (mainly due to a low base in the first quarter of 2023). Freight demand growth will stay resilient underpinned by capacity additions.

Capital expenditure (capex) will be increasingly demand-oriented. We see tapering capex appetite and a prioritization of key projects under central oversight in China, due to a pressing need for debt resolution.

Our overall rating bias is largely balanced. A few negative outlooks are due to weakening external support amid heightened debt burden, positive outlooks reflect likely cash flow improvement by higher tariffs.

What are the key risks around the baseline?

Global trade tensions and supply chain risks. This is despite the region's export resilience seen so far. The sustainability of traffic/volume growth hinges on demand from buying countries. Continued shipping disruptions in the Red Sea imply supply chain uncertainties.

Inflation continues to affect some markets. Inflation is easing but may not come down as much, or as quickly, as we had expected, and will remain uneven across the region. This may constrain trade demand and travel needs.

High interest rates in some markets may pressure borrowers. This is particularly true for issuers more reliant on dollar funding, those with lower interest rate hedging, or those with large refinancing or capex needs.

What do they mean for the sector?

Demand growth could be lower than expected. Tariff hikes by the U.S. on electric vehicles, semiconductors and batteries from China, if followed suit by the EU and other regions, could hurt demand from exports. Supply chain disruptions may affect operating efficiency.

Still, domestic funding costs are helping issuers across parts of the region. Indian issuers experience continued access to cheaper costs from domestic banks and the onshore bond market. Chinese issuers also have access to favorable funding costs. Some countries' issuers are benefiting from inflation-linked tariff/toll increases.

Leverage will stay elevated, higher than the global level. This is mainly due to continued large capex to improve efficiency or to meet demand growth.

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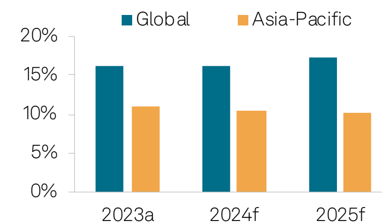

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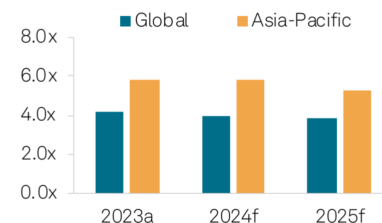

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Utilities

Renewables facing higher volatility in pricing and volume

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What do we expect over the next 12 months?

Demand will grow at mid-single-digit in line with economic growth; declining fuel costs will support earnings and margins.

Large spending on renewables (including grid and storage) and coal-fired capacity (for energy security) will keep leverage high.

The rating bias remains positive reflecting a recovery in volumes, accelerated capacity expansion, and declining fuel cost pressures.

What are the key risks around the baseline?

Geopolitical conflicts continue. This may lead to spikes in fuel costs, reversing the trend of margin recovery. As such, the effectiveness of cost passthroughs will be key to support cash flows. Companies may still have to factor in supply-chain risks in budgeting and capital expenditure (capex) delivery processes.

Inflation and high interest rates to bite. Fuel cost passthrough is in place in some markets but may not be even across all entities. High interest rates in most markets could alter funding options and costs for most entities, except in a few countries (such as China) that face less pressure on this front.

Accelerated new investments and funding needs. We view excessive debt funding of new developments, adverse regulatory reforms or interventions, and grid constraints as risks. Capex will focus mainly on renewables, integrated hybrid projects, grid and energy storage, and the acquisition of renewables.

What do they mean for the sector?

Rapid new capacity addition could weigh on utilization. Accelerated expansion of renewables without sufficient grid or storage facilities could heighten the risk of curtailment and increase volatility of contract pricing and volume. This risk is rising in China and is apparent in some Asia-Pacific markets such as Australia, due to a lack of contractual protection.

High working capital needs due to electricity-price volatility in some markets. In China, power tariffs will moderate as marketized reform continues. Any fuel cost spike due to the disruption of energy supply could hurt profitability in some markets.

Constrains in funding could increase interest costs and lead to capex reviews. Higher funding costs will require closer capex reviews, except for Chinese SOEs benefiting from robust domestic financing support.

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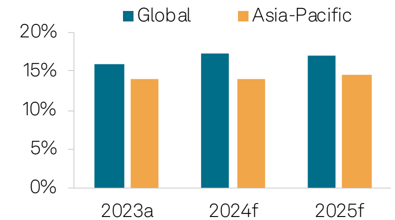

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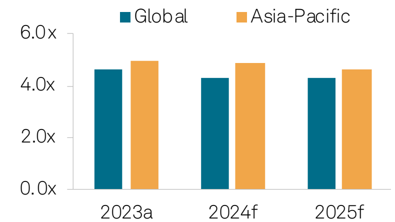

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