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North American Utilities

Sector Risk Profile

Rating Range

Regulated utilities, which include integrated electric utilities, electric transmission and distribution utilities, regulated electric transmission companies and local gas distribution utilities, have a lower-than-average sector risk profile and can be rated up to the 'A' category. Utility parent companies that own a mix of regulated and nonregulated businesses also tend to be rated up to the 'A' category, while the nonregulated businesses, such as competitive generators, retail electric and gas providers and propane distributors rarely exceed the 'BBB' rating category. North America in this Navigator refers to the U.S. and Canadian market.

Sector-Specific Key Factors

Regulatory Environment

This Key Factor assesses the regulatory framework in which a utility operates. The nature of tariff-setting mechanisms, consistency in rule-making and regulatory outcomes, and the level of political influence exerted on regulations have a significant bearing on the stability of cash flows. State regulatory frameworks do not affect a competitive generator by a similar magnitude, yet regulatory and political interests can still interfere with market mechanisms.

Market Position

This factor considers customer mix, economic health and vibrancy of a service territory, and sensitivity of sales and cash flows to extreme weather or disaster disruptions. Location plays an important role for a competitive generator, since power prices are driven by the demand/supply balance, fuel mix and prices of key fuel inputs in a region.

Asset Base and Operations

This factor assesses a company's physical infrastructure with respect to age, technology, cost competitiveness and reliability of operations that may influence its relative price competitiveness and drive capital reinvestment needs.

Commodity Exposure

This factor measures the insulation provided in regulated tariff mechanisms against variability in commodity costs. For a competitive generator, this factor assesses the hedging practices employed to mitigate the effect of fuel and selling price volatility.

Financial Profile Key Factors

The financial profile factors show midpoints of leverage (based on FFO and EBITDA), FFO interest cover, volatility of profitability and level of FCF within relevant rating categories, potentially reaching the 'A' category.



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North American Utilities

Industry Characteristics

The overall risk profile of the sector is characterized by strong defensive qualities since the demand for electricity and natural gas tends to be relatively noncyclical and inelastic, in particular for residential customers. The sector exhibits high capital intensity. New electricity generation and transmission usually involves significant capital investment, often with long lead times. Electricity and gas distribution services typically require significant maintenance capex to ensure reliability and safety of the service. During investment cycles, these businesses can be significantly FCF negative, thus requiring external financing to fund expansion and replacement capex.

State regulation has a material bearing on the risk profile of the sector as certain states in the U.S. and provinces in Canada have deregulated electricity generation while the rest continue to follow the legacy structure of fully vertically integrated regulated utilities. Companies that provide utility service with monopolistic service territories are typically subject to tariff regulation and regulatory oversight of their service levels and terms of service, and generate relatively stable and predictable cash flow. Competitive generation companies bear the full risk of market competition and can be exposed to significant price and volume risk, although these risks can be substantially mitigated by long-term fuel and power sales agreements and/or effective hedging.

The rated issuers in the North American Utilities sector exhibit a wide range of participants from multi-utility giants to smaller, specialized participants. As such, this sector exhibits both segmentation and diversity of business risk profiles.

Given the sector risk profile described above, the following summary indicates risk characteristics of North American Utilities commensurate with different rating categories for the Issuer Default Ratings (IDRs).

Fully Regulated Utilities: 'A+' to Speculative Grade

These businesses provide electric and/or gas services in natural monopolies and are subject to conducive tariff regulation. There exists significant regulatory oversight regarding costs of service, operating performance, financing and other strategic activities.

These include electric transmission and distribution utilities, vertically integrated electric utilities, regulated transmission companies and local gas distribution companies. These companies bear little or no commodity sensitivity and relatively modest cyclical or volumetric risk, and generate relatively stable and predictable cash flow profiles.

Utility Parent Companies: 'A+' to Speculative Grade

These holding companies by themselves are rated lower than their operating subsidiaries, but when they have varied holdings, as described above, company-specific traits may provide rating uplifts to the 'A' category.

These companies may be passive investors or operationally integrated with their operating subsidiaries, providing centralized treasury activities and operational or administrative services. The overall earnings stream is a function of the underlying business portfolio of utility and/or non-utility activities.

Utility holding companies may own competitive businesses that do not have a market monopoly position and are thus exposed to market competition.

These include competitive power generators, retail electric and gas providers, and propane distributors. These companies are subject to greater commodity sensitivity, market risk or cyclical variation.

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Sector-Specific Key Factors – North American Utilities

	Regulatory Environment	Market Position	Asset Base and Operations	Commodity Exposure
Rating	**Degree of Transparency and Predictability**	**Market Structure**	**Diversity of Assets**	**Ability to Pass Through Changes in Fuel**
aa	n.a.	n.a.	n.a.	n.a.
a	Record of transparent and predictable regulation.	Well-established market structure with complete transparency in price-setting mechanisms.	High-quality and/or large-scale diversified assets.	Complete pass-through of commodity costs.
bbb	Generally transparent and predictable regulation with limited political interference.	Established market structure but some level of uncertainty in price-setting mechanisms.	Good quality and/or reasonable scale diversified assets.	Limited exposure to changes in commodity costs.
bb	Poor or uncertain record of regulation and high political interference.	Still evolving market structure and uncertain price-setting mechanisms.	Small size and limited diversification.	Inability to pass through all changes in commodity costs.
b	Hostile regulatory or political jurisdiction or frequent regulatory interference in market-based mechanisms.	High risk to market structure from regulatory or political interference.	Low quality, small size and highly concentrated assets.	High exposure to commodity price changes.
ccc	Regulatory framework formally or informally abandoned, with substantial uncertainty around future mechanisms.	Market framework formally or informally abandoned, with substantial uncertainty around future mechanisms.	n.a.	Substantial cash impairments crystallized or about to as a result of the failure of derivative and physical hedging measures.
	Timeliness of Cost Recovery	**Consumption Growth Trend**	**Operations Reliability and Cost Competitiveness**	**Underlying Supply Mix**
aa	n.a.	n.a.	n.a.	n.a.
a	Minimal lag to recover capital and operating costs.	Economically vibrant market or service territory with strong sales growth.	Record of reliable, low-cost operations.	Extremely low cost and flexible supply.
bbb	Moderate lag to recover capital and operating costs.	Customer and usage growth in line with industry averages.	Reliability and cost of operations at par with industry averages.	Low variable costs and moderate flexibility of supply.
bb	Significant lag to recover capital and operating costs.	Exposure to declining usage or volumes or self-generation.	Below-average system reliability and cost structure.	High variable costs and limited flexibility of supply.
b	Material delays in recovering capital and operating costs.	Rapidly shrinking market or service territory and falling unit consumption.	Poor system reliability and disadvantageous cost structure.	Extreme variability in costs and minimal flexibility of supply.
ccc	Regulatory framework formally or informally abandoned, with substantial uncertainty around future mechanisms.	Customer base, key personnel or material operational facilities experiencing a level of flux that significantly impairs cash generation.	Subject to advanced regulatory intervention with material risks for concession ownership/preservation of capital structure.	Substantial cash impairments crystallized or about to as a result of the failure of supply purchasing strategies.
	Trend in Authorized ROEs	**Customer Mix**	**Exposure to Environmental Regulations**	**Hedging Strategy**
aa	n.a.	n.a.	n.a.	n.a.
a	Above-average authorized ROE.	Favorable customer mix.	No exposure to environmental regulations.	Highly captive supply and customer base.
bbb	Average authorized ROE.	Less diversified customer base.	Limited or manageable exposure to environmental regulations.	Long-term supply and sales contracts with creditworthy counterparties.
bb	Significantly below-average authorized ROE.	High concentration of customers in cyclical industries.	Significant exposure to environmental regulations.	Medium-term hedging strategy for supply and sales.
b	Absence of regulatory ROE.	High concentration to risky, less creditworthy customers.	Merchant generator with a material exposure to highly polluting technology.	Minimal hedging of supply and sales or highly speculative trading positions.
ccc	Regulatory framework formally or informally abandoned, with substantial uncertainty around future mechanisms.	Substantial cash impairment crystallized or about to, due to counterparty failures, including systemic collection failures.	Substantial cash impairment crystallized, or about to, due to multiple, punitive environmental cost burdens.	Substantial cash impairments crystallized or about to as a result of the failure of derivative and physical hedging measures.
	Mechanisms Available to Stabilize Cash Flows	**Geographic Location**	**Capital and Technological Intensity of Capex**	
aa	n.a.	n.a.	n.a.	
a	Revenues fully insulated from variability in consumption.	Favorable location or high geographic diversity.	Low levels of reinvestment requirements.	
bbb	Revenues partially insulated from variability in consumption.	Beneficial location or reasonable locational diversity.	Moderate reinvestments requirements in established technologies.	
bb	Revenues fully exposed to variability in consumption.	High sensitivity to extreme weather or disaster disruptions.	Reinvestment concentrated in capital-intensive or unproven technologies.	
b	Revenues fully exposed to declining consumption.	High exposure to event risk.	High exposure to execution risk for projects involving large outlays or unproven technologies.	
ccc	Regulatory framework formally or informally abandoned, with substantial uncertainty around future mechanisms.	Concentration in one location with disruptive economic or logistical characteristics impairing either operation or cash collections	Substantial cash impairment crystallized, or about to, due to the failure or cost over-run of a major project.	
	Mechanisms Supportive of Creditworthiness	**Supply Demand Dynamics**		
aa	n.a.	n.a.		
a	Effective regulatory ring-fencing.	Beneficial outlook for prices/rates.		
bbb	Effective regulatory ring-fencing or minimum creditworthiness requirements.	Moderately favorable outlook for prices/rates.		
bb	Limited regulatory ring-fencing or minimum creditworthiness requirements.	Uncertain outlook for prices/rates.		
b	Absence of minimum creditworthiness requirements.	Extremely unfavorable outlook for prices/rates.		
ccc	Regulatory framework formally or informally abandoned, with substantial uncertainty around future mechanisms.	Direct exposure to failed market structures crystallized or about to, with substantial negative cash flow implications.		

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Financial Profile Key Factors – North American Utilities

	Profitability	Financial Structure	Financial Flexibility
Rating	**Free Cash Flow**	**EBITDA Leverage**	**Financial Discipline**
aa	n.a.	n.a.	Publicly announced conservative financial policy. Record of strict compliance.
a	Structurally neutral to positive FCF across the investment cycle.	3.25x	Clear commitment to maintain a conservative policy with only modest deviations allowed.
bbb	Structurally neutral to negative FCF across the investment cycle.	3.75x	Less conservative policy, but generally applied consistently.
bb	Structurally negative FCF across the investment cycle.	4.75x	Financial policies in place but flexibility in applying them could lead to temporarily exceeding downgrade guidelines.
b	Structurally heavily negative FCF across the investment cycle.	6.0x	No financial policy or record of ignoring it. Opportunistic behavior.
ccc	Negative FCF burden greater than all projected regulatory parameters, and negative operational cash flow the norm.	>8.0x	Financial management has lost much of its discipline, and subject to frequent, sudden changes consistent with a crisis environment.
	Volatility of Profitability	**FFO Leverage**	**Liquidity**
aa	n.a.	n.a.	No need to use external funding beyond committed facilities in the next 24 months even under a severe stress scenario. Well-spread maturities. Diversified funding.
a	Higher stability and predictability of profits relative to utility peers.	3.5x	No need for external funding beyond committed facilities in the next 12 months even under a severe stress scenario. Well-spread maturities. Diversified funding.
bbb	Stability and predictability of profits in line with utility peers.	5.0x	One-year liquidity ratio above 1.25x. Well-spread maturity schedule of debt but funding may be less diversified.
bb	Lower stability and predictability of profits relative to utility peers.	6.5x	Liquidity ratio around 1.0x. Less smooth debt maturity or concentrated funding.
b	Stability and predictability of profits viewed as negative outliers relative to utility peers.	7.0x	Liquidity ratio below 1.0x. Overly reliant on one funding source.
ccc	Volatility of profits greater than normal bounds of volatility for corporate sector as a whole.	>9.0x	No near-term prospect of recovery in liquidity score above 1.0x. All/most funding sources subject to material execution risk.
			FFO Interest Coverage
aa			n.a.
a			5.5x
bbb			4.5x
bb			3.5x
b			2.0x
ccc			≤ 1.0x