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Criteria | Corporates | Industrials:

Key Credit Factors For The Unregulated Power And Gas Industry

March 28, 2014

(***Editor's Note:*** *This article is no longer current after the publication of "Sector-Specific Corporate Methodology," April 4, 2024, except in jurisdictions that require local registration of those criteria.)*

1. This article presents S&P Global Ratings' methodology and assumptions for rating unregulated power and gas companies globally. This article aims to help market participants better understand the key credit factors in this industry. This article relates to our global corporate criteria (see "Corporate Methodology," published Nov. 19, 2013) and to our criteria article "Principles Of Credit Ratings," published Feb. 16, 2011.

SCOPE OF THE CRITERIA

2. These criteria apply to entities that generate and sell electricity, or buy and resell power and/or gas in some combination of energy or capacity, through bilateral agreements with utilities and other intermediaries, or directly to end-consumers or to a market administrator or system operator. Market participants range in complexity from stand-alone power producers or competitive retail suppliers of power and gas to varying degrees of integration both forward from generation to retail and back to upstream fuel supplies such as gas and coal reserves. While ultimately subject to evolving energy policies, most clearly in the case of renewable producers and sellers, these entities are subject to competitive dynamics and market supply and demand in getting their earnings and cash flow. As such, they do not--like regulated utilities--benefit from rate regulation of tariffs that are typically designed at a minimum to ensure cost recovery and some level of profit.

3. These criteria do not apply to project finance structures or to entities that qualify as project developers. We are not addressing power-price and fuel-cost assumptions in this article; we publish these separately, updated as appropriate, for certain markets (see "FAQ: How S&P Global Ratings Formulates, Uses, And Reviews Commodity Price Assumptions," published Sept. 28, 2018). Also, these criteria do not apply to commodity-trading companies.

SUMMARY OF THE CRITERIA

4. This article presents S&P Global Ratings' global criteria for analyzing unregulated power and gas companies, applying its global corporate criteria.

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6. Energy market structures can differ significantly globally because of the degree of market liberalization across the energy value chain and distinctive approaches to unregulated markets. Accordingly, government policies, market design, and the credit quality and number of market participants can significantly influence these issuers' credit risk profiles.

7. In assessing the competitive position of unregulated power and gas companies, we put particular emphasis on the following: market structure/design, relative size of the business, diversity by geography and fuel type, operating efficiency, technological advantage, degree of integration (both forward and backward), and offtake and fuel supply contract structure, including hedging strategy and the extent to which commitments are secured by market contracts or physical generation or by load dispatch to retail customers. In assessing the competitive position of retail supply companies, we emphasize market design, business strategy, product/service quality, market share, diversity of products/services and geography, cost position, and churn rate of customers.

8. When we assess the financial risk profile, we rely on the core ratios set forth in the global corporate criteria, but we emphasize the influence of periodically substantial capital spending requirements on leverage and cash flow coverage ratios. To determine the applicable volatility table, we apply the same principles as for regulated utilities (see "Key Credit Factors For The Regulated Utilities Industry," published Nov. 19, 2013) and base the determination of the applicable volatility table on our assessment of the strength of the regulatory advantage and the share of regulated activities in the business mix, in line with paragraphs 72-73. These paragraphs supersede the "Cash flow/leverage" section of the corporate criteria for the purpose of evaluating unregulated power and gas entities.

9. Generally, the more integrated an entity is from an upstream fuel supply base to providing retail products and services, the stronger its business risk profile. In the most deregulated and competitive markets, without some level of integration, we consider it is unlikely entities could achieve investment-grade ratings, except for those that dominate their sectors.

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METHODOLOGY

Part I--Business Risk Analysis

Industry risk

12. The industry risk is assessed by applying S&P Global Ratings' criteria for assessing industry risk (see "Methodology: Industry Risk," published Nov. 19, 2013). Also see "Industry Risk Assessments Update: Jan. 27, 2021" for the most recent assessments for the unregulated power and gas industry.

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Country risk

25. Country risk plays a critical role in determining all ratings on companies in a given country. Country-related risk factors can substantially affect company creditworthiness, both directly and indirectly. In assessing country risk for an unregulated power and gas company, our analysis uses the same methodology as with other corporate issuers (see global corporate criteria). A key factor in our business risk analysis for corporate issuers is the country risk assessment, which includes the broad range of economic, institutional, financial market, and legal risks that arise from doing business in a specific country.

26. We generally determine exposure to country risk for unregulated power and gas companies using revenues, since this information is consistently available. However, this may not capture country risks beyond those affecting demand potential and can, in some cases, be distorted by material trading operations that inflate revenues. Therefore, if country exposure by EBITDA or assets is available and indicative of a materially different country exposure profile, we may use EBITDA or assets to inform our country risk exposure assessment.

Competitive position (including profitability)

27. Under our global corporate criteria, competitive position is assessed as (1) excellent, (2) strong, (3) satisfactory, (4) fair, (5) weak, or (6) vulnerable.

28. The analysis of competitive position includes reviewing:

- Competitive advantage;
- Scale, scope, and diversity;
- Operating efficiency; and
- Profitability.

29. The first three components are independently assessed as either: (1) strong, (2) strong/adequate, (3) adequate, (4) adequate/weak, or (5) weak. Profitability is assessed by combining two subcomponents, level of profitability and the volatility of profitability.

30. After evaluating separately competitive advantage, scale, scope, and diversity, and operating efficiency, we determine the preliminary competitive position assessment by ascribing a specific weight to each component. The applicable weightings will depend on the company's Competitive Position Group Profile (CPGP). The CPGP assigned to most unregulated power and gas companies is "Capital or Asset Focus" with a weighting of the three components as follows: competitive advantage (30%), scale, scope, and diversity (30%), and operating efficiency (40%). Unregulated power and gas companies exhibit some differentiation in terms of market location, scale, and fuel diversity, and regularly require moderate to significant capital investments to sustain their operating efficiency and expansion strategy, or to comply with various statutes or regulations. For

vertically integrated companies we typically use the "Capital or Asset Focus" group profile given the large investment requirements in merchant plant(s) and/or upstream assets.

31. We may assign the "National Industries and Utilities" CPGP to a few unregulated power and gas companies in countries where the influence of government policy, control, and taxation significantly alter competitive dynamics and reduce merchant risk exposure (but where energy markets are not fully regulated). The "National Industries and Utilities" classification may also be appropriate for unregulated entities that have certain monopolistic characteristics, such as a strong incumbent retail position in the markets they serve. "National Industries and Utilities" CPGP sub-factors are weighted as follows: competitive advantage (60%), scale, scope and diversity (20%), and operating efficiency (20%).

32. The CPGP for pure retail supply companies or divisions can be either:

- "Commodity Focus/Scale Driven" (with respective component weightings of 10%, 55%, and 35%), if the level of price competition is very high in the market owing to high fragmentation and customer churn. Brand differentiation is low. Economies of scale and cost efficiency are vital factors.
- "Service and product focus" (with respective component weightings of 45%, 30%, and 25%), if markets are dominated by a few participants and price competition and customer churn is modest. Brand differentiation is important, especially for the incumbent provider. Economies of scale and cost efficiency are of moderate importance.
- "National industries and utilities" (with respective component weightings of 60%, 20%, and 20%), if the relevant market is dominated by one participant (most likely the incumbent provider) with monopolistic characteristics, leading to little price pressure or customer churn. Such high barriers to entry typically support stable revenues, EBITDA margins, and cash flows.

Competitive advantage

33. In assessing the competitive advantage of unregulated power and gas entities, we consider

- Market structure and attractiveness,
- Earnings structure and stability, and
- Asset mix and quality/technological advantage.

34. The risk level of an unregulated power and gas company is heavily influenced by the market(s) in which it operates. Specifically, we assess how public policies (such as energy and environmental) and the market structure in the relevant jurisdiction (national, regional, or state) impact an unregulated power and gas company's operating stability. The relative supportiveness and effectiveness of public policies, degree of market liberalization, generation asset mix and age, weather impact, interconnectors, pricing structure, demand and supply balance, market liquidity, transparency, growth rates, etc., all influence our view of market attractiveness. For example, many European markets have been fully liberalized and are influenced not only by national energy policies (such as the hard turn by Germany away from nuclear energy), but also by EU-wide initiatives. One example for the EU is the "20-20-20" targets (20% reduction in greenhouse gas emissions from 1990 levels, increased energy consumption produced from renewable resources to 20%, and improved energy efficiency by 20% by 2020), which have dramatically reduced profitability for Europe's traditional power and gas companies.

35. For entities that buy and resell power and gas, we analyze competitive pressures such as barriers to entry, customer base stability, ability to pass on cost increases to customers, price structure

and flexibility with end-consumers, brand reputation, hedging and procurement risk, the range of products they offer, and levels of customer satisfaction, customer churn rates, market pricing structure, market liquidity, policy interference in market rates, and demographic trends.

36. Some markets provide greater earnings stability for unregulated power and gas companies. We regard more favorably well-balanced systems that provide long-term and attractive pricing certainty for electricity generators and supply companies than systems that by their nature foster volatility of pricing and input costs. That said, even in volatile energy markets, entities can mitigate pricing volatility either by entering into flexible long-term off-take agreements (sometimes referred to as power purchase agreements, or PPAs) with creditworthy counterparties or through hedging (depending on market liquidity and depth). An effectively structured PPA can transfer all volume and market pricing risk to the off-taker, while assuring a return on investments for the generator. Often such contracts lock in pricing but leave volume (i.e., operational performance) at risk. In addition, renewables-based generation has typically been compensated via subsidy schemes, which tend to provide more cash flow certainty, depending on the remuneration structure. Nevertheless, subsidy schemes are sometimes subject to retroactive government interference, which may quickly erode earnings capacity for renewables' operators.

37. The technological advantage, in particular quality and attractiveness of a company's generation portfolio, is key to ensuring long-term profitability for merchant generators. For example, technological displacement is a factor that has led to much reduced profitability in Europe in recent years, as low marginal cost and subsidized wind and solar capacity displaces incumbent thermal generation capacity. We assess the company's asset base on several factors. These include generation type and fuel mix (thermal, hydro, renewables, nuclear), merit order position, age profile, location, dispatching profile (base, mid-merit, or peak load), carbon intensiveness, reinvestment needs (related to retrofits or replacement), and proximity to raw material input (such as integrated coal mines, near a gas hub, or major transmission line). Retail businesses that have superior customer service platforms that allow for customer profiling and segmentation are expected to achieve better penetration of the more profitable customers. Importantly, companies can use this data to shed low-profitability customers. The importance of on-line channels for gaining new customers also implies a reasonable level of technological competence for growth and customer retention.

38. An unregulated power and gas company with a 'strong' or 'strong/adequate' competitive advantage assessment typically has a combination of:

- High barriers to entry, low market volatility, low competitive pressures, no foreseeable structural changes, favorable medium and long-term growth prospects, and supply-demand balance characteristics. Participation in a market or region with well-established and predictable market rules, including transparent and reasonably predictable environmental rule-making processes.
- Off-take agreements (with creditworthy counterparties) that are long-term, generally longer than five years, or a high confidence of renewal on similar terms if of shorter duration) favorable and flexible (with little volume and price risk) or very high and demonstrated pricing and earnings stability (at attractive levels) that is expected to continue, either owing to a stable and favorable market pricing structure or through long-term and effective hedging with little counterparty risk.
- Technological advantage through an attractive asset mix and well-invested asset base in favorable locations that aids dispatch of generation load or ability to favorably hedge procurement requirements.
- Retail business models that benefit from substantial and generally stable market share, with limited competition that may be underpinned by contract, facilitating the passing through of

costs. Typically, the market resembles a monopoly/oligopoly structure.

- Businesses with strong market shares across a largely integrated generation-to-retail spectrum, that benefit from generation dispatch, though load may be mismatched to some degree, which increases reliance on selling into or procuring from a competitive market.

39. An unregulated power and gas company with a 'weak' or 'adequate/weak' competitive advantage assessment typically has a combination of:

- Participation in a market or region with poorly defined and unpredictable/transitory market rules, low barriers to entry, high market volatility or uncertainty, weak medium and long-term growth prospects, or often unbalanced supply-demand characteristics. This assessment can also apply if a market is undergoing significant structural changes with high uncertainty.
- An earnings profile that is generally subject to significant short- or medium-term volatility, with volumes sold in the spot markets with only a modest level of hedging or at unfavorable prices.
- Poor asset mix and quality, and/or assets located in unfavorable locations.
- Retail business models that have limited and often unstable market shares and are typically subject to high competitive pressures that impede the ability to pass along costs to end-consumers.
- Businesses that have a relatively small market share, have modestly integrated operations, and/or are pure price takers, thereby mitigating some of the benefits from generation dispatch. Load is typically mismatched, exposing the business to increased market risks given their need to procure from the market. The small size means these entities may have difficulty entering into long-dated hedge agreements to protect against volatile market pricing.

Scale, scope, and diversity

40. In assessing the scale, scope, and diversity of an unregulated power and gas company, we consider:

- The relative size of operations, earnings, and cash flow,
- The degree of market diversity,
- The breadth of the asset mix (including fuel type and plant diversity),
- The degree of supplier or customer concentration, and
- The degree of vertical integration both forward (retail) and backwards (generation and/or fuel).

41. We generally consider that large-scale operations (as measured by power generation or distribution capacity, but also by earnings and cash flows) support stronger competitive positions with more operating flexibility and economies of scale than small companies.

42. The broader the asset mix, whether by fuel type or by dispatchability, as well as by geography and markets, the greater the protection against risk factors that may affect one region and its market dynamics more than another, such as demand and supply and price fluctuations.

43. A diverse customer base reduces the potential for operational disruptions and cash flow volatility that customer concentration may cause. Likewise, a diverse supplier base, such as multiple natural gas pipeline alternatives for a gas-fired power plant, reduces the potential for swings in cash flow and operational disruptions.

44. We generally consider a greater degree of vertical integration as enhancing credit due to the

greater of a company's ability to withstand unexpected operational or market disruptions to any one aspect of the business.

45. For retail supply participants, we consider market position and size, which create economies of scale, and diversity of the supplier and customer base (residential, commercial, industrial), as well as weather influences.

46. An unregulated power and gas company that warrants a 'strong' or 'strong/adequate' assessment of scale, scope, and diversity typically is characterized by a combination of:

- Large scale relative to competition and strong market position in its relevant market(s).
- Participation in a variety of attractive geographic and/or organized markets.
- Fuel and plant diversity/flexibility that compares favorably to peers (when considering number of plants, base/mid-merit/peak load, etc.).
- No meaningful supplier or customer concentrations or counterparty or procurement risk.
- Significant levels of forward (retail) and backwards (generation and/or fuel) integration, reducing volatility in operating earnings.

47. An unregulated power and gas company that warrants a 'weak'' or 'adequate/weak' assessment of scale, scope, and diversity typically has a combination of:

- Small market participant with little pricing power in a market with low growth prospects.
- Concentration in one market that exhibits high volatility and/or risk.
- Little fuel and plant diversity/flexibility (number of plants, base/mid-merit/peak load, etc.). This exposes the entity to operating availability risks at key plants.
- Meaningful supplier or customer concentration or procurement risk that could lead to uncertain operational availability or cost risk.
- Pure merchant or retail risk with little meaningful hedging that mitigate price and volume volatility.

Operating efficiency

48. In assessing operating efficiency for an unregulated power and gas company, we consider:

- Its cost competitiveness,
- Asset efficiency,
- The flexibility of its cost structure in absorbing demand declines (operating leverage) or input cost pressures, and
- Its cost management.

49. To the extent that an unregulated power and gas company has a high degree of operating efficiency, it should be able to generate better profit margins than its peers that compete in the same markets, whatever the prevailing market conditions.

50. We review the cost competitiveness of a company's asset mix, focusing on economies of scale, access to important commodity inputs (including through direct ownership or attractively priced contracts) or by location, and the fixed-cost profile.

51. In reviewing asset efficiency, we focus on the nature and age of the technology deployed, its

relative productive efficiency, availability and capacity factors, and placement in the dispatch merit order, as appropriate.

52. In our review of cost structure flexibility, we focus on overall sensitivity to raw material cost fluctuations and commodity prices, the relative proportion of fixed costs to variable costs which, when elevated, could dampen cash flow if utilization rates decline, and cash flow dependence on actual asset utilization.

53. Our review of cost management is particularly relevant to retail suppliers where narrow profit margins benefit from superior cash management systems that support more rapid cash conversion cycles.

54. For retailers, we consider the relative cost to serve their customer base, and their ability to manage collections, particularly how this affects working capital management; and the proficiency of managing billing system upgrades or introduction of new systems, given the adverse effect on cost, customer base management of a poorly implemented process.

55. An unregulated power and gas company that warrants a 'strong' or 'strong/adequate' assessment of operating efficiency typically has a combination of:

- Sustainable leading cost position due to economies of scale, fuel flexibility or integration, and production efficiencies that support plant positioning at the low end of the merit order; high and stable capacity (load) factors through the cycle; high availability and capacity factors and state-of-the-art technology.
- Limited or effectively mitigated profit/margin sensitivity to raw material cost fluctuations, commodity prices, or supply chain risks, and a relatively low fixed-cost structure.
- If relevant, sustainable leading cost-to-serve position in retail supply, supported by a track record of stable above market average operating margins.
- Efficient working capital management, supported by a track record of shorter-than-average cash conversion cycles. For retail companies, working capital management can be aided by platforms superior to those of peers, measured by unbilled customers and often underpinned by a single system with proven technology.

56. An unregulated power and gas company that warrants a 'weak or 'adequate/weak' assessment of operating efficiency typically has a combination of:

- Relatively uncompetitive cost position due to high fuel cost and/or concentration risk with key plants at the average-to-weak end of the merit order curve.
- Weak availability and capacity factors influenced perhaps by aging technology.
- Higher-than-average profit/margin sensitivity to raw material cost fluctuations, commodity prices, or supply chain risks.
- If relevant, below-average cost-to-serve position in retail supply, supported by a track record of below-average operating margins and stability.
- Inefficient working capital management, supported by a track record of longer-than-average cash conversion cycles. For retail suppliers, unbilled customers are worse than those of peers and this may have a quantifiable material adverse effect cash collection.

Profitability

57. The profitability assessment can confirm or modify the preliminary Competitive Position

assessment. The profitability assessment consists of two components 1) level of profitability and 2) the volatility of profitability. The two components are combined into the final Profitability assessment using a matrix (see global corporate criteria).

Level of profitability.

58. The level of profitability is calculated on a three-point scale: "above average", "average" and "below average".

59. The two main benchmark measures we use in determining profitability are EBITDA margin (adjusted for nonrecurring items) and return on capital (ROC). The choice as to which is the more appropriate primary measure in our analysis is subject to a number of factors. These include the particular geographic market, position on the value chain, capital cycle, and even type of asset.

60. For example, a hydro or nuclear player is likely to have reasonably high margins, reflecting its low variable cost profile, but could have low ROC because of the significant capital-intensive nature of the asset with the inherent high construction costs. In these cases, ROC will generally be the more representative measure. Even wind farms may be analogous to hydro facilities given their capital intensiveness, particularly those located offshore. In contrast, an entity with mainly thermal generation may have weaker margins, reflecting the significance of fuel costs compared with fixed costs, but a better return on capital due to lower upfront investment costs. In these cases, EBITDA margins will generally be the more representative measure.

61. At the other end of the value spectrum, a retailer is likely to have low margins but high ROC given the limited capital commitment required in its business (excluding any liquidity buffer required to meet hedging needs) and hence we rely primarily on EBITDA margins. For integrated players, depending on the degree of vertical and horizontal integration, either measure may be appropriate. That said, for entities in the midst of a large capital spending program that will lag in earnings until completion (which can be years later), we will generally use EBITDA margin as the primary measure. However, for measuring the level of profitability for companies engaged in trading activity or more frequent event-driven activity such as asset acquisitions or divestitures as part of their business strategy--which can distort margins--we generally use ROC. In accordance with our corporate methodology, we typically calculate the five years average EBITDA margin and ROC using the last two years of historical, and our forecast for the current year and the following two years; we may put more emphasis on forecast years if historical data is not deemed as representative, or to take into account deteriorating or improving profiles where prospective ratios meaningfully differ from average ratios.

62. We derive the benchmarks below for each measure from the full range of rated unregulated power and gas companies. There are meaningful differences across regions, defined principally by distinctions among market structure and design.

63. An unregulated power and gas entity with "above-average" profitability would, relative to its peers in a similar market, be able to sustain a higher rate of return because of the composition of its customer and asset portfolio, including competitive position (merit order) within its markets. At the same time the entity would have a history of managing its costs well. In mature markets where demand growth is declining or even flat, the flexibility of asset portfolios can be an important determinant of the sustainability of profitability for traditional incumbents. For merchant power and integrated companies fuel is a key input cost, while for those with retail exposure energy costs and operating costs are important. An entity with long-term contractual arrangements providing stability to earnings might earn a lower return than a more commodity-exposed issuer, but still be assessed as 'above average'. Conversely, a company with 'below average' profitability would generally have higher input costs, less predictable asset performance and higher related maintenance expense, or uneven experience in managing capital projects.

Table 1

Unregulated Power And Gas Profitability

(%)	Below average	Average	Above average
EBITDA margin	< 15	15-30	> 30
Return on capital	< 6	6-12	> 12

Table 2

Retail Supplier Profitability

(%)	Below average	Average	Above average
EBITDA margin	< 5	5-10	> 10
Return on capital	< 6	6-12	> 12

64. **Volatility of profitability.** We calculate the volatility of profitability on a six-point scale, from "1" (least volatile) to "6" (most volatile).

65. In accordance with our general corporate criteria, we generally calculate the volatility of profitability assessment using the standard error of regression (SER), subject to having at least seven years of historical annual data. We apply an SER of EBITDA margin or ROC to companies depending on the companies' characteristics, as more fully described in paragraph 59. In accordance with the general corporate criteria, we may--subject to certain conditions being met--adjust the SER assessment by up to two categories worse (more volatile) or better (less volatile).

Part II--Financial Risk Analysis

Accounting and analytical adjustments

66. In assessing the accounting characteristics of unregulated power and gas companies, the analysis generally uses the same methodology as with other corporate issuers. Our analysis of a company's financial statements begins by reviewing the accounting to determine whether the statements accurately measure a company's performance and position relative to its peers and the larger universe of corporate entities. To allow for globally consistent and comparable financial analyses, our rating analysis may include quantitative adjustments to a company's reported results. These adjustments also enable better alignment of a company's reported figures with our view of underlying economic conditions. Moreover, they allow a more accurate portrayal of a company's ongoing business. Adjustments that pertain broadly to all corporate sectors, including this sector, are discussed in "Corporate Methodology: Ratios And Adjustments".

67. For unregulated power and gas companies that enter into long-term power purchase obligations, we make related adjustments to account for those obligations, as outlined in paragraphs 57-66 of "Key Credit Factors For The Regulated Utility Industry," published Nov. 19, 2013.

Cash flow/leverage analysis

68. In assessing the cash flow adequacy of an unregulated power or gas company, our analysis uses the same methodology as other corporate issuers (see global corporate criteria). We assess cash

flow/leverage analysis on a six-point scale ranging from (1) minimal to (6) highly leveraged. These assessments are determined by aggregating the assessments of a range of credit ratios, predominantly cash flow based, which complement each other by focusing attention on the different levels of a company's cash flow in relation to its obligations.

69. Our corporate methodology provides benchmark ranges for various cash flow ratios we associate with different cash flow leverage assessments for standard volatility, medial volatility, and low volatility. The tables of benchmark ratios differ for a given ratio and cash flow leverage assessment along two dimensions: the starting point for the ratio range and the width of the ratio range.

70. We view companies in the unregulated power and gas industry as demonstrating standard or medial volatility. The threshold levels for the applicable ratios to achieve a given cash flow leverage assessment in the medial volatility table are less stringent relative to those of the standard volatility table, but with a narrower range of values.

71. The applicable volatility table depends on a company's Corporate Industry and Country Risk Assessment (CICRA) and on certain additional business risk profile characteristics. Given the industry risk assessment of '4' for the unregulated power and gas industry, only for companies with a significant proportion of business activities derived from lower risk industries (typically these are regulated utility activities) will we use the medial volatility table, further subject to those lower risk regulated utility activities meeting certain characteristics as defined below.

72. We apply the "medial volatility" table to companies with either of the following characteristics:

- Most operating cash flows comes from regulated utility activities with an "adequate" or better regulatory advantage assessment (as defined in "Key Credit Factors For The Regulated Utility Industry"); or
- About one-third or more of consolidated operating cash flow comes from regulated utility activities with a "strong" regulatory advantage assessment and where the average of its remaining activities have a competitive position of '3' or better.

73. We apply the "standard volatility" table to unregulated power and gas companies in all other cases, including when:

- About one-third or less of their cash flow comes from regulated utility activities, regardless of the regulatory advantage assessment; or
- Regulated utility activities, regardless of their significance, have a regulatory advantage assessment of "adequate/weak" or "weak".

Core ratios

74. For each company, we calculate in accordance with S&P Global Ratings' Ratios and Adjustment criteria two core credit ratios: FFO/debt and debt/EBITDA.

Supplemental ratios

75. In addition to our analysis of a company's core ratios, we also consider supplemental ratios to develop a fuller understanding of a company's credit risk profile and refine our cash flow analysis.

76. For unregulated power and gas companies with a preliminary cash flow and leverage assessment of intermediate (3) or better, we typically use free operating cash flow (FOCF) to debt primarily because companies in the unregulated power and gas industry often have elevated capital

spending requirements. When capital spending is low, we would typically expect the more creditworthy companies to be FOCF positive after factoring in maintenance spending, so the core ratios are considered to be strongly representative of the financial risk profile of the business.

77. For unregulated power and gas companies with a preliminary cash flow and leverage assessment of significant (4) or worse, we would typically use debt service coverage ratios ([FFO + interest] to cash interest, or EBITDA to interest) as supplemental ratios. This often applies to unregulated power and gas companies with material adjusted debt amounts resulting from pensions, other retirement obligations, asset-retirement obligations, or leases.

Part III--Rating Modifiers

Diversification/portfolio effect

78. In assessing the Diversification/Portfolio Effect on an unregulated power and gas company, our analysis uses the same methodology as with other corporate issuers (see global corporate criteria).

Capital structure

79. In assessing the capital structure for an unregulated power and gas company we use the same methodology as with other corporate issuers (see global corporate criteria).

Financial policy

80. In assessing the financial policy of an unregulated power and gas company, our analysis uses the same methodology as other corporate issuers (see global corporate criteria).

Liquidity

81. In assessing the liquidity of an unregulated power and gas company, we use the same methodology as with other corporate issuers (see global corporate criteria and "Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers," Dec. 16, 2014).

Management and governance

82. In assessing management and governance of an unregulated power and gas company, our analysis uses the same methodology as other corporate issuers (see global corporate criteria).

Comparable ratings analysis

83. In assessing the Comparable ratings analysis of an unregulated power and gas company, our analysis uses the same methodology as other corporate issuers (see global corporate criteria).

REVISIONS AND UPDATES

This article was originally published on March 28, 2014. These criteria became effective on March 28, 2014.

Changes introduced after original publication:

- Following our periodic review completed on March 25, 2016, we updated the contact information and criteria references. We also deleted paragraphs 10 and 11, which were related to the initial publication of our criteria and no longer relevant.
- Following our periodic review completed on March 27, 2017, we updated the contact information.
- We republished this article on June 19, 2017, to clarify how we determine the applicable volatility tables as part of our cash flow/leverage analysis.
- Following our periodic review completed on March 26, 2018, we updated the contact information and criteria references and renamed the "Revision History" section to "Revisions And Updates."
- On June 4, 2019, we republished this criteria article to make nonmaterial changes to update criteria references.
- On Jan. 27, 2021, we republished this criteria article to replace the Industry Risk Assessment section (paragraphs 5 and 12-24) with a reference to "Industry Risk Assessments Update: Jan. 27, 2021," which contains the most recent assessments of the unregulated power and gas industry, along with a rationale of recent changes.

RELATED CRITERIA AND RESEARCH

Related Criteria

- Industry Risk Assessments Update: Jan. 27, 2021
- Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Methodology: Jurisdiction Ranking Assessments, Jan. 21, 2016
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Corporate Methodology, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Key Credit Factors For The Regulated Utility Industry, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Methodology And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- FAQ: How S&P Global Ratings Formulates, Uses, And Reviews Commodity Price Assumptions, Sept. 28, 2018

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