

Commentary

Global Utilities & Independent Power Producers 2024 Outlook: A Steady Track to Electrification

Morningstar DBRS

January 9, 2024

Key Highlights

- Our outlook for the industry is neutral despite the significant capital expenditures needed for the electrification of the economy – which could pressure balance sheets for the next few years.
- We expect customer bills to remain a top concern but anticipate electricity prices to be more stable this year relative to the past few year.
- Overall, we expect credit ratings to remain stable.

Tom Li
Senior Vice President
Energy & Natural Resources
+1 416 597-7378
tom.li@morningstar.com

Adam Provencher
Vice President
Infrastructure, Power & Utilities
+1 416 597-7476
adam.provencher@morningstar.com

Steven Lin
Assistant Vice President
Energy & Natural Resources
+1 416 597-7596
steven.lin@morningstar.com

2024 Outlook: Neutral

We view the 2024 outlook for utilities and independent power producers (IPP) to be neutral. While we believe the sector continues to face challenges driven by climate change and general affordability concerns, these have been tempered somewhat by interest rates that appear to be stabilizing and lower inflationary pressures (see our Commentary *2024 Sovereign Outlook: Higher Rates and Slowing Economies, but Stable Credit Ratings*, published December 8, 2023). We expect the general trend this year and in the next few years to revolve around electrification and decarbonization of the economy, with the pace of investment likely to quicken in order for the industry to meet government targets to reduce fossil fuel-based power generation.

Credit Ratings to Remain Stable

Overall, we expect rating changes (if any) to be event based and issuer specific, driven by possible mergers, acquisitions, or poor performance. Our sector ratings have been resilient largely because of the stable regulatory frameworks in place for utilities and the high level of contracted or hedged output for IPPs. The significant capital needs for the electrification of the economy could pressure some balance sheets though, so medium-term capital expenditures (capex) plans will be a particular focus for us for the year.

Significant Capital Spending for Electrification

Government-imposed deadlines on climate change-related targets are quickly approaching. These include targets for phasing out coal-fired generation plants or achieving minimum renewable power generation.

Exhibit 1 Coal Phase-Out Targets

Country	Coal Phase-Out Target Year
Canada	2030
Finland	2029
France	2027
Germany	2038
Great Britain	2024
Norway	2025
Spain	2030
U.S.	2035

Significant capital is being invested by sector participants in order to build replacement renewable and clean energy power generation. Additionally, as wind and solar are intermittent sources of energy, new baseload units (such as nuclear) and peaking units (such as natural gas-fired plants) may need to be

built—at least until battery storage technology is more advanced. Furthermore, to accommodate the new plants as well as the transition to electric vehicles and electric heating, transmission and distribution networks will also need to be upgraded and extended to handle the expected greater capacity and demand.

We expect the pace of investment to hasten in 2024 as government-mandated deadlines approach. While many of these projects present opportunities for utilities to increase their rate bases and for IPPs to grow their portfolios, their pace and scale could pressure some companies' financial risk profiles. This financial risk is partly offset by government initiatives and subsidies to support electrification and grid upgrades, but there will be a need to closely observe how IPPs and utilities tap these available funds. The higher interest rate environment has also made debt financing of these projects more expensive and, in some cases, has even made some uneconomic. Also, we note that some issuers held off issuing debt with longer-dated maturities in 2023. However, we expect more activity in 2024 as the interest rate environment appears to have stabilized. Nonetheless, we expect utilities and IPPs to be prudent in financing capex plans in order to maintain overall key credit metrics within their current rating thresholds.

Customer Bills Remain Top of Mind

Utility spending for the electrification of the economy will ultimately be borne by ratepayers, which could translate to higher bills for customers. This challenge is compounded by the ongoing cost of living pressures from the high inflationary environment in 2023. While interest rates seem to have stabilized and the rate of inflation has slowed, our macroeconomic outlook for 2024 remains cautious with growth expected to be subdued. Moreover, a mild recession in North America and throughout Europe remains a possibility. We expect pocketbook issues, including utility bills, to remain top of mind in 2024. While we have not seen further material political interference in the regulatory process for utilities in 2023, this will remain a heightened risk at least over the short term.

Wholesale Prices Expected To Be Less Volatile

On the other hand, we generally expect natural gas prices to be less volatile in 2024 because of higher storage in both the U.S. and Europe (see our commentaries [North American Natural Gas Market Outlook: Price Pressures Through Early 2024 Followed by a Recovery](#) published December 18, 2023, and [European Gas Outlook: Cautious Optimism for the Winter Heating Season But with Prices Subject to Possible High Volatility](#) published December 21, 2023) although a colder-than-average winter could lead to some price swings.

We cautiously anticipate wholesale electricity prices to be more stable this year relative to the past few years. We note, however, that given the increasing amount of intermittent renewable generation coming into service, there could be additional price volatility in the future. Furthermore, as noted in our commentary [North American Merchant Wholesale Electricity Prices: Overall Subdued, but No Escape From Price Volatility](#) published December 6, 2023, unpredictable weather patterns as a result of climate change will increasingly lead to electricity price spikes. We expect our issuers to mitigate this risk through their hedging strategies and contracting their generation portfolios.

About Morningstar DBRS

Morningstar DBRS is a full-service global credit ratings business with approximately 700 employees around the world. We're a market leader in Canada, and in multiple asset classes across the U.S. and Europe.

We rate more than 4,000 issuers and nearly 60,000 securities worldwide, providing independent credit ratings for financial institutions, corporate and sovereign entities, and structured finance products and instruments. Market innovators choose to work with us because of our agility, transparency, and tech-forward approach.

Morningstar DBRS is empowering investor success as the go-to source for independent credit ratings. And we are bringing transparency, responsiveness, and leading-edge technology to the industry.

That's why Morningstar DBRS is the next generation of credit ratings.

Learn more at dbrs.morningstar.com.



The Morningstar DBRS group of companies consists of DBRS, Inc. (Delaware, U.S.)(NRSRO, DRO affiliate); DBRS Limited (Ontario, Canada)(DRO, NRSRO affiliate); DBRS Ratings GmbH (Frankfurt, Germany) (EU CRA, NRSRO affiliate, DRO affiliate); and DBRS Ratings Limited (England and Wales)(UK CRA, NRSRO affiliate, DRO affiliate). Morningstar DBRS does not hold an Australian financial services license. Morningstar DBRS credit ratings, and other types of credit opinions and reports, are not intended for Australian residents or entities. Morningstar DBRS does not authorize their distribution to Australian resident individuals or entities and accepts no responsibility or liability whatsoever for the actions of third parties in this respect. For more information on regulatory registrations, recognitions and approvals of the Morningstar DBRS group of companies please see: <https://dbrs.morningstar.com/research/highlights.pdf>.

The Morningstar DBRS Group of companies are wholly-owned subsidiaries of Morningstar, Inc.

© 2024 Morningstar DBRS. All Rights Reserved. The information upon which Morningstar DBRS credit ratings and other types of credit opinions and reports are based is obtained by Morningstar DBRS from sources Morningstar DBRS believes to be reliable. Morningstar DBRS does not audit the information it receives in connection with the analytical process, and it does not and cannot independently verify that information in every instance. The extent of any factual investigation or independent verification depends on facts and circumstances. Morningstar DBRS credit ratings, other types of credit opinions, reports and any other information provided by Morningstar DBRS are provided "as is" and without representation or warranty of any kind and Morningstar DBRS assumes no obligation to update any such credit ratings, opinions, reports or other information. Morningstar DBRS hereby disclaims any representation or warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability, fitness for any particular purpose or non-infringement of any of such information. In no event shall Morningstar DBRS or its directors, officers, employees, independent contractors, agents, affiliates and representatives (collectively, Morningstar DBRS Representatives) be liable (1) for any inaccuracy, delay, loss of data, interruption in service, error or omission or for any damages resulting therefrom, or (2) for any direct, indirect, incidental, special, compensatory or consequential damages arising from any use of credit ratings, other types of credit opinions and reports or arising from any error (negligent or otherwise) or other circumstance or contingency within or outside the control of Morningstar DBRS or any Morningstar DBRS Representative, in connection with or related to obtaining, collecting, compiling, analyzing, interpreting, communicating, publishing or delivering any such information. IN ANY EVENT, TO THE EXTENT PERMITTED BY LAW, THE AGGREGATE LIABILITY OF MORNINGSTAR DBRS AND THE MORNINGSTAR DBRS REPRESENTATIVES FOR ANY REASON WHATSOEVER SHALL NOT EXCEED THE GREATER OF (A) THE TOTAL AMOUNT PAID BY THE USER FOR SERVICES PROVIDED BY MORNINGSTAR DBRS DURING THE TWELVE (12) MONTHS IMMEDIATELY PRECEDING THE EVENT GIVING RISE TO LIABILITY, AND (B) U.S. \$100. Morningstar DBRS does not act as a fiduciary or an investment advisor. Morningstar DBRS does not provide investment, financial or other advice.

Credit ratings, other types of credit opinions and other analysis and research issued by Morningstar DBRS (a) are, and must be construed solely as, statements of opinion and not statements of fact as to credit worthiness, investment, financial or other advice or recommendations to purchase, sell or hold any securities; (b) do not take into account your personal objectives, financial situations or needs; (c) should be weighed, if at all, solely as one factor in any investment or credit decision; (d) are not intended for use by retail investors; and (e) address only credit risk and do not address other investment risks, such as liquidity risk or market volatility risk. Accordingly, credit ratings, other types of credit opinions and other analysis and research issued by Morningstar DBRS are not a substitute for due care and the study and evaluation of each investment decision, security or credit that one may consider making, purchasing, holding, selling, or providing, as applicable.

A report with respect to a Morningstar DBRS credit rating or other credit opinion is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities.

Morningstar DBRS may receive compensation for its credit ratings and other credit opinions from, among others, issuers, insurers, guarantors and/or underwriters of debt securities.

This publication may not be reproduced, retransmitted or distributed in any form without the prior written consent of Morningstar DBRS. ALL MORNINGSTAR DBRS CREDIT RATINGS AND OTHER TYPES OF CREDIT OPINIONS ARE SUBJECT TO DEFINITIONS, LIMITATIONS, POLICIES AND METHODOLOGIES THAT ARE AVAILABLE ON [HTTPS://DBRS.MORNINGSTAR.COM](https://dbrs.morningstar.com). Users may, through hypertext or other computer links, gain access to or from websites operated by persons other than Morningstar DBRS. Such hyperlinks or other computer links are provided for convenience only. Morningstar DBRS does not endorse the content, the operator or operations of third party websites. Morningstar DBRS is not responsible for the content or operation of such third party websites and Morningstar DBRS shall have no liability to you or any other person or entity for the use of third party websites.