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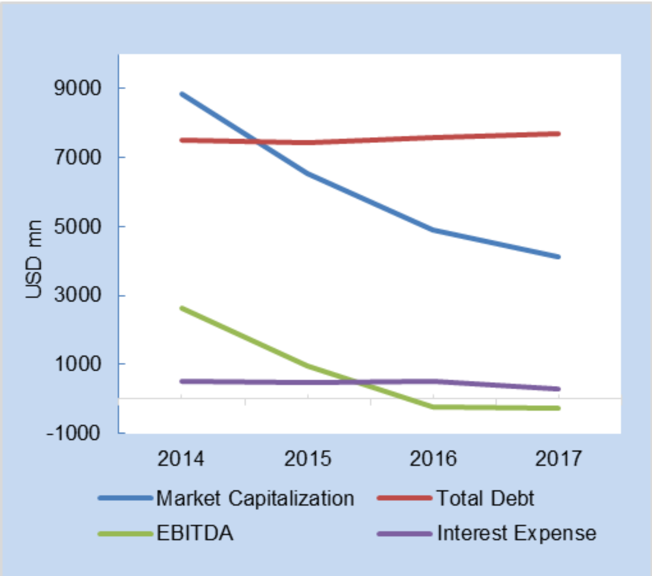
Weekly Credit Brief Mar 27 - Apr 02

Weatherford International PLC struggles amid high debt burden

By [Lin Li]

Weatherford International PLC (Weatherford), one of the world's leading providers of equipment and services in the oil and gas drilling industry, is challenged by the continued volatility in oil prices and severe market contraction for its products and services. The low oil price has reduced capital spending by Weatherford's customers, which has reduced the firm's pricing ability and revenue, resulting in an 87% fall in market capitalization from July 2014 to March 2018. The RMI-CRI 1-year Probability of Default (PD) for the company increased to 342.6bps on 30 March 2018. Given its elevated total debt/capital ratio and falling free cash flow, the credit outlook for Weatherford is negative.

Weatherford's debt-fueled acquisition growth strategy has been proved unsustainable. The decline in oil prices and a highly leveraged balance sheet led the company to sell valuable assets to raise cash for debt repayment and liquidity needs. Early this year, Weatherford failed to form a joint venture with Schlumberger which could have generated USD 535mn of synergies and created one of the largest hydraulic fracturing fleets in the industry. Weatherford instead sold assets directly to Schlumberger, for only USD 430mn in cash, resulting in a lower deal value and loss of potential income from the joint venture.



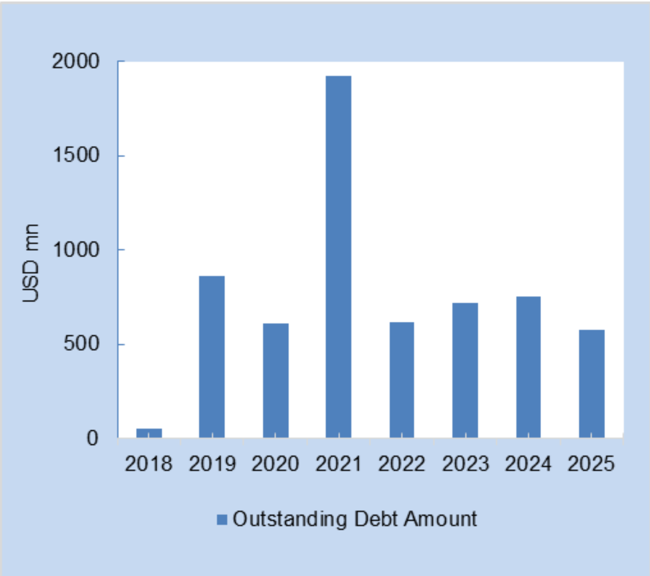


Figure 1: Financial data for Weatherford International PLC. (LHS) & Figure 2: Estimated debt repayment distribution for Weatherford International PLC. (RHS) *Source: Bloomberg*

The company has been selling assets for cash to pay its debt. In 2008, Weatherford sold its oil and gas development and production business to raise cash. In 2014, the company sold its engineered chemistry and integrity drilling fluids businesses to Berkshire for USD 750mn. However, according to Figure 1, Weatherford's total debt remained at a high level of USD 7.6bn. The company's total debt also exceeded its market value since 2015. Weatherford's debt to capital ratio of 108% is considerably higher than the industry average of 45%. The interest expense has exceeded the downward EBITDA after 2016, showing that the company is making losses and cannot cover interest expense by what it earns.

According to Weatherford's 10K filing, the firm's operating and profit margins did not improve during the last 4 quarters, indicating a weak profit profile. The firm's EBITDA/Interest ratio stayed less than one during the first three quarters of 2017 and deteriorated to -14.92X in Q4. The free cash flow (operating cash flows excluding capital expenditure) stayed negative and kept deteriorating. Weatherford's debt burden may be a concern to bondholders as earnings are lower than interest costs.

	Q1 2017	Q2 2017	Q3 2017	Q4 2017
Operating Margin (%)	-17.03	-15.64	-8.33	-17.48
Profit Margin (%)	-31.05	-29.49	-19.55	-29.75
Net Income	-1,723.3	-1,625.3	-1,097.8	-1,695.5
Free Cash Flow	-481.0	-413.0	-553.0	-613.0
EBITDA/Cash Interest Paid (X)	0.08	0.72	0.74	-14.92

Table 1: Financial Data for Weatherford. Information in USD mn, unless indicated otherwise. *Source: Bloomberg*

As shown in Figure 2, Weatherford's debt liabilities will continue to increase in the coming years. On March 1, 2018, Weatherford issued USD 600mn of 7-year bonds with a yield north of 9.85% to refinance its debt maturing through 2019. The bonds were rated B- and Caa1 by S&P and Moody's, respectively. The company's USD 900mn credit line expires in July 2019 and the firm may need to address USD 2.7bn in debt that's scheduled to mature from 2020-21 before extending the 2019 credit facility. Refinancing could be difficult given Weatherford's high financial leverage and poor cash flows.

The credit outlook of an oil service company tends to be closely correlated with the oil and gas prices. However, when West Texas Intermediate crude oil prices reached a high of USD 60.42 per barrel last December, Weatherford did not reverse its negative cash flow trend. In 2018, gains in oil and gas prices look less probable as US output ramps up and OPEC agreements expire. An oversupplied market and lower price could lead to less oil and gas exploration and production activities, thus less demand for Weatherford's services. Making a profit in 2018 could be much harder for Weatherford.

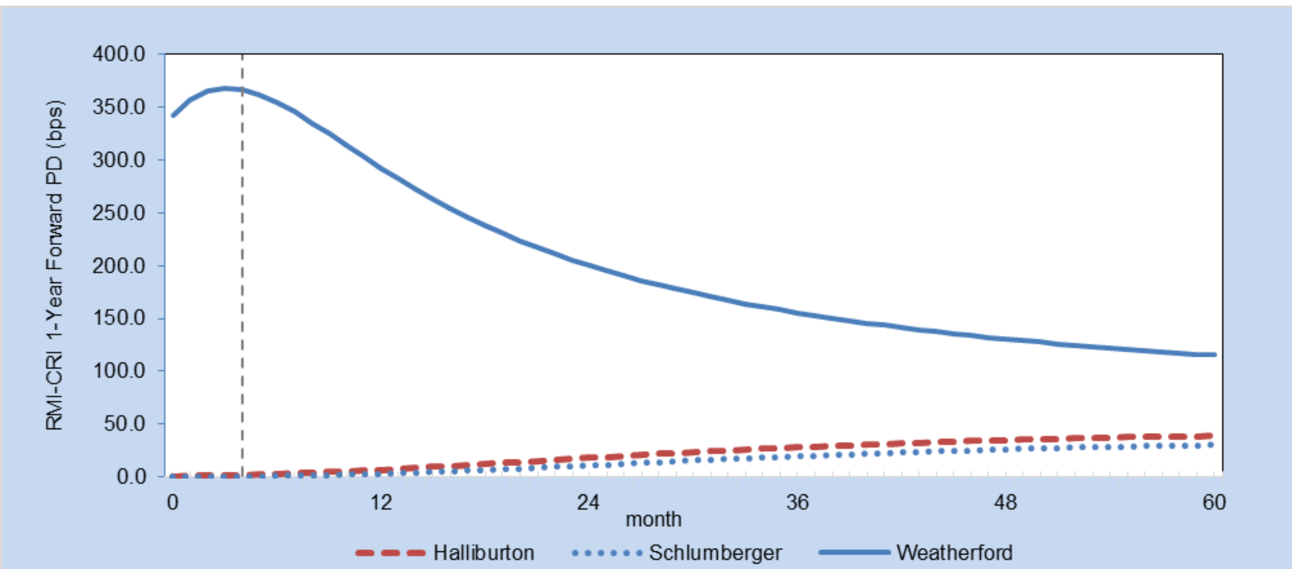


Figure 3: RMI-CRI Forward 1-year PD term structures for the largest oilfield services companies on March 30, 2018. *Source: RMI-CRI*

The RMI-CRI Forward 1-year Probability of Default (Forward PD) term structure for Weatherford steepens with time to peak at 4 months and then decreases, suggesting that based on the market information available as of March 30, 2018, Weatherford's default risk is likely to continue increasing in the short term. Intuitively, the forward PD computes the credit risk of the firm on a future period, which works like a forward interest rate. For instance, the 3-month forward 1-Year PD is the probability that the firm defaults during the period from 3 months onwards to 1 year plus 3 months, conditional on the firm surviving the next 3 months. The term structures for the largest oilfield services companies - Halliburton, Schlumberger and Baker Hughes plotted in Figure 3, exhibit a lower Forward PD than Weatherford. If Weatherford can recover the balance sheet and grow through oil price pressures in the year to come, its credit profile could marginally improve.

Credit News

Saudi Arabia closes USD 16bn loan

Apr 2. On Mar 19, Saudi Arabia closed an expanded USD 16bn syndicated loan deal to refinance a USD 10bn debt raised in 2016. Aside from extending the existing loan maturity from 2021 to 2023, the deal lowers the load rate from 120bps over LIBOR to 84bps over LIBOR. Saudi Arabia has been issuing a series of bonds since two years ago to help implement the kingdom's 2030 vision plan. (Business Times)

Air India offered with no state interference but much debt

Mar 29. India has taken the first big step towards the privatization of its burdensome lossmaking national carrier, Air India, unveiling formal plans to sell a 76% stake in the airline. According to India's minister of state for civil aviation, the new owner will have full management control and be able to operate in its own way to maximize revenues, profitability and value creation. IndiGo, India's largest private carrier, had previously expressed interest in buying Air India's international operations. (FT)

Barclays pays USD 2bn to settle mortgage securities suit

Mar 29. Barclays Plc (Barclays) agreed to pay USD 2bn in civil penalties to settle a US investigation into its marketing of residential mortgage-backed securities (MBS) between 2005 and 2007. The probe targeted 36 Residential MBS deals involving USD 31bn worth of loans, more than half of which defaulted during the crisis, resulting in enormous losses to the investors. The Justice Department claimed that backed loans were significantly less creditworthy than Barclays represented, with Barclays denying the allegations. The suit also targeted two former executives of Barclays who agreed to pay USD 2mn to resolve claims without admitting wrongdoing. Barclays Chief Executive Officer welcomed the deal in a statement and called it a fair and proportionate settlement. (Business Times)

Growth bounces back for year at China's largest banks

Mar 29. Boosted by higher interest rates, a strengthening economy and a campaign to rein in risky lending, China's largest banks saw profits rebound in 2017. Bank of China, Industrial & Commercial Bank of China, China Construction Bank, Agricultural Bank of China and Bank of Communications all reported a rise in net profits. Bad-loan ratios were lowered in 2017, which was the first across-the-board decrease since 2011. Regulators are also encouraging Chinese banks to recognize and make provisions for soured debts. A recent regulatory ruling allows for banks that step up recognition of nonperforming loans to be eligible to put aside less money to cover potential losses. (WSJ)

Tesla cut by Moody's on production Issues, liquidity concerns

Mar 28. On Mar 27, 2018, Moody's cut Tesla Inc.'s credit rating to B3 from B2, citing that a negative outlook with the company's high cash expenditures, failures to meet production expectations and an impending action of raising more than USD 2bn. Tesla also faces liquidity pressures due to its large negative free cash flow and upcoming maturities. Tesla's USD 1.8bn of senior unsecured notes, issued in August, was downgraded to Caa1 from B3. Correspondingly, its unsecured bonds dropped 3.5 cents to an all-time low of 89 cents. Even though Tesla continues to benefit from strong market acceptance of its cars and a growing regulatory support, there is a risk that the company needs to undertake a large, near-term capital raise to refund maturing obligations and avoid a liquidity shortfall. (Bloomberg)

FirstEnergy nuclear, coal plant units file for bankruptcy protection (Reuters)

Gulf General Investment Company in talks to restructure debt (Reuters)

NCLT asks Binani Cement creditors to consider out-of-court settlement (Economic Times)

Regulatory Updates

US Treasury plans talks on more debt transparency

Apr 1. The US Treasury is planning a Treasury market transparency talk with high-speed traders in April. The talk will discuss options to increase the government bond transparency, particularly on disclosing the trade records of its USD 14tn Treasury market to the public. In order to enhance the liquidity in the Treasury market to cope with a growing deficit, Treasury officials are seeking for partnership with high-frequency-traders in shifting the power from banks to technology-savvy market that thrives on data-driven algorithms. The talk will gather viewpoints and feedback from a wide range of market participants to ensure the data dissemination will not harm the market. **(**FT**)**

China presses state lenders to curb local government debt risk

Mar 30. China's Finance Ministry announced on Mar 30, 2018 that state-owned financial firms could no longer provide any sort of funding for local government, other than through the purchase of their bonds, as the government tries to curb local government debt risk. Lenders were forbidden from requiring or accepting any form of guarantee from local government for financing. Officials indicated that the over-reliance of financial institutions on the local governments' creditworthiness was leading to an increase in fiscal and financial risks. Currently, authorities are in their second year of intensified campaigning to reduce risks in the financial system. Actions included a crackdown on shadow banking and investigations into hidden debt obligations by local government. (Reuters)

SEBI seeks to introduce disclosure guidelines for companies undergoing insolvency resolution (Bloomberg)

Defying Fed, Egypt cuts rates again as inflation falls (Bloomberg)

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