



## Untimely investments sink Chicago Bridge & Iron into troubled water

by [Budi Andoro HARTANTO](#)

Once touted as one of the companies that would benefit from President Trump's commitment to ramp up US infrastructure and embrace fossil fuel production again, Chicago Bridge & Iron Co NV (CB&I), one of the largest engineering and construction companies in North America, is now painfully deleveraging its balance sheet as it reported a disappointing Q2 2017 operating income result. After a slew of risky investments and cost overruns in recent years (see Table 1), CB&I's poor performance in Q2 2017 led its market capitalization to slide down to almost half of what it used to be at the beginning of the year.

Correspondingly, the RMI-CRI 1-Year Probability of Default (PD) shot to an all-time high of 785.67 bps in August 2017 and has remained high until recently (see Figure 1). Meanwhile, the 1-Year aggregate PD for 42 US energy infrastructure construction companies (excluding CB&I) remained well below 20 bps and stable despite the commodity market downturn. This suggests that company-specific problems may be the main culprits behind the company's current predicament.

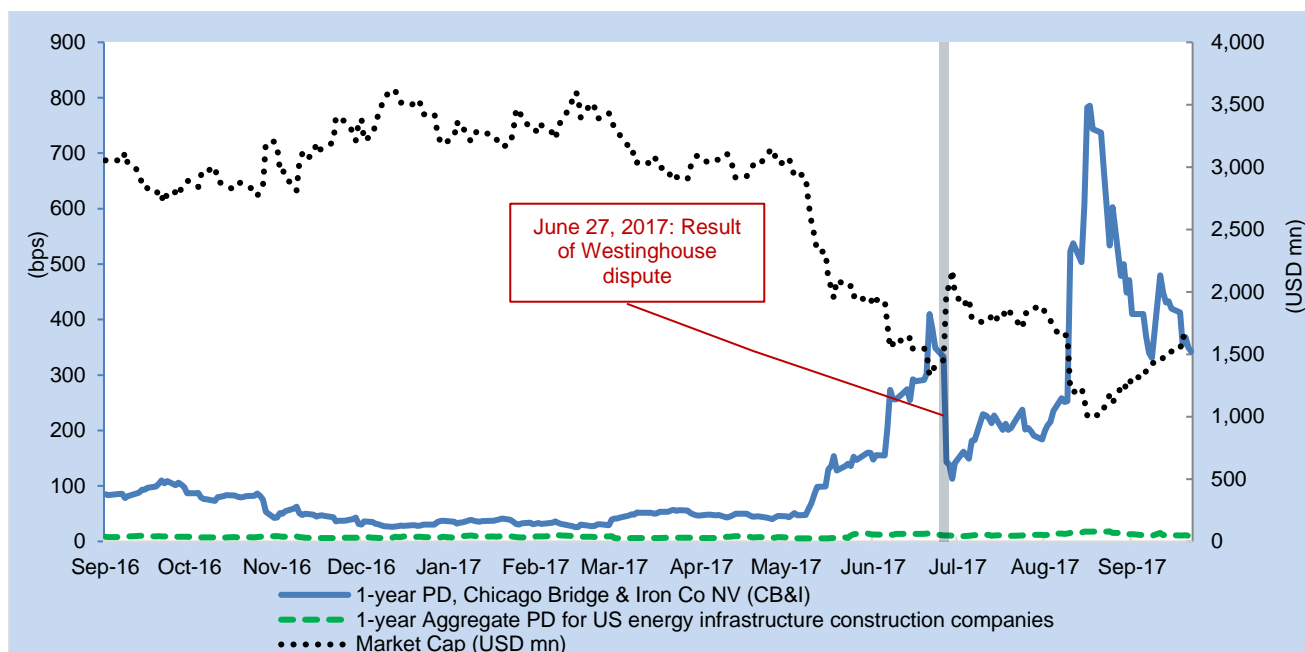


Figure 1: RMI-CRI 1-year PD for Chicago Bridge & Iron Co NV and RMI-CRI 1-Year aggregate PD for US energy infrastructure construction companies vs market capitalization. Source: RMI-CRI, Bloomberg

In July 2012, CB&I which back then focused on the oil and gas infrastructure industry, decided to expand its power plant portfolio by [acquiring Shaw Group at a premium of 72%](#) in a deal worth USD 3bn using its cash reserves and leverage. The acquisition came with a big risk since Shaw Group had been making huge losses and [incurring cost overruns associated with project licensing delays](#), thus, CB&I would expose itself to those problems acquired. Furthermore, the acquisition came not long [after the Fukushima incident](#), which stigmatized the nuclear energy industry and limited growth opportunities for Shaw Group. Since then CB&I would be entrenched in a huge debt-load post-acquisition period.

CB&I ventured into the coal energy industry in March 2013 by [acquiring Phillips 66's e-gas technology business](#), which transforms coal into synthetic gas that generates power. However, this purchase too was ill-timed amid a [dying US coal industry](#) as China announced that it is [significantly curbing coal use](#) and the Obama administration [unveiled carbon standards](#) for new coal-fired power plants. This had again put CB&I's financials at further risks as its investments were not yielding meaningful returns.

Among the businesses which CB&I took over from Shaw Group is a company called Stone & Webster (S&W), a construction service company active in the energy, chemical, and infrastructure sectors. In 2015, S&W together with Westinghouse, a nuclear power service company owned by Japan's Toshiba Corp., secured a contract to build two nuclear plants in South Carolina and Georgia jointly with The Southern Co., a Georgia based gas utility company. Unfortunately, the partnership proved to be [burdensome](#) as cost overruns emerged due to delays in the nuclear plant constructions by The Southern Co., leading to a legal litigation. Shortly afterwards, Westinghouse decided [to acquire CB&I's Stone & Webster business](#). However, [disputes](#) over the accounting of S&W unit's handover led both companies to be engaged in another legal litigation. The whole Westinghouse-S&W saga dealt a huge blow to CB&I's bottom line due to the large cost overruns from the failed partnership as well as the hefty legal costs that the company incurred. It was only in June 2017 that a [decision was announced](#) by the Delaware Supreme Court in favor of CB&I, causing CB&I's market cap to increase momentarily (see Figure 1).

CB&I's problem continued in 2016 after its [Q4 2016 earnings call](#) reported a dismal quarterly performance due to low productivity of its labor workforce in unionized areas of the US. The rigid and restrictive nature of the work rules imposed by the labor unions limit the firm's ability to freely train these workers and improve their productivity. In February 2017, [the company sold its Capital Service Business](#) to a private equity firm. CB&I commented that it was in line with the company's new long-term strategy to focus on its core business - a move that was widely anticipated given its failed investments.

This series of events prompted [the retirement of Philip Asherman as CEO](#) of CB&I and the appointment of Patrick Mullen as the new CEO in May 2017. Massive reforms have been proposed by Mullen in CB&I's [Q2 2017 Earnings Call](#), including to maximize the replacement of workforce in the aforementioned unionized areas with specialty contractors to improve labor productivity and the sale of its Technology business to beef up its financials and focus on its core energy infrastructure business under the Engineering & Construction (E&C) segment. Turning to the company's financial performance (see Table 1), the gradual decrease in revenue, operating margin and quick ratio likely show that CB&I's problem started with the Shaw Group acquisition and is not just due to falling commodity prices. Subsequently, its Net Debt/Equity ratio saw a nearly perfect increase, indicating not only the susceptible position CB&I is facing since the acquisition binge, but also an increasing dependence on debt financing to sustain normal operations amid poor revenue performance.

	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017
Revenue (USD mn)	2161.20	2776.20	2540.00	1827.40	1283.50
Operating Margin (%)	8.48	8.41	1.36	4.32	-34.79
Quick Ratio (%)	0.40	0.38	0.27	0.23	0.19
Net Debt/Equity (%)	72.59	75.97	108.51	123.94	121.98

Table 1: Financial Data for Chicago Bridge & Iron Co NV (CB&I). Source: Bloomberg

Looking forward, although the proposed measures are set to restabilize CB&I's balance sheet, numerous challenges are still ahead and the company will most likely not be financially sound anytime soon. [The risky nature of the contracts](#) linked to its joint venture E&C projects, which caused a devastating Q2 2017 net result, could possibly inflict more losses in the future if the company does not play its cards right in the event of an economic slowdown. Furthermore, CB&I's business decision to focus on its energy infrastructure business might be a hit or miss given the still unstable outlook on the commodity market. For now, CB&I should continue operating on the defensive so that it can weather through these periods of uncertainty. At the same time, the company should not engage in excessive cost-cutting measures that might hamper its growth prospects in the long term when business conditions become more conducive again.

## Credit News

### Ezion served redemption notice by bond holder

**Sep 25.** A key bondholder of Ezion Holdings has delivered a notice to redeem his bond for full principal sum, after the company suspended trading of its shares in the Singapore Exchange. Ezion has sold seven tranches of bonds since 2013, but the USD 120mn tranche sold in 2015 was unique as it gave bondholders an option to redeem their bonds early. DBS Bank backed the fixed income securities and the lender may have to provide extra financing to the firm if the company has insufficient funding. Ezion is in the midst of restructuring its debt with creditors. ([Straits Times](#))

**Swissport's short-term loans to HNA raise investor concerns**

**Sep 24.** Swissport recently disclosed that it has provided a 90-day EUR 400mn loan to companies linked to its parent company, the HNA Group, and people with knowledge of the matter said that the loans were to a Hong Kong affiliate of HNA. This move has raised investors' concern that HNA is using loans to cover short-term liquidity needs elsewhere. Investors are also concerned over HNA's access to Chinese bank financing, and opaque ownership and financing structure. In the case of Swissport, debt investors are particularly concerned, as HNA triggered a technical default at the Swiss company earlier this year. ([FT](#))

**Debt continues to haunt ailing retailers**

**Sep 22.** Investors and traders are alarmed by the bankruptcy of Toy 'R' Us Inc. and creditors are monitoring several retail companies closely because of their large debt loads, looming maturities, and weakening results. The rise of online shopping in recent years have put US retailers under duress. Apparel-focused stores and traditional grocery stores are struggling. According to a Bloomberg Intelligence, North American retail traffic are down 5.6% so far this month. Moody's Investors Service analyst commented that retail chains with heavy debt have been able to push off a reckoning because a decade of low interest rates and widely opened credit markets. However, with the start of higher interest rates and winding down balance sheet by the Federal Reserve the frothiness won't last. Since a record USD 1tn high-yield debt is maturing over the next five years many companies may need lenders to extend deadlines or take on new debt. ([Bloomberg](#))

**S&P strips Hong Kong of AAA rating after China downgrade**

**Sep 22.** S&P Global Ratings cut Hong Kong's credit rating to AA+ from AAA a day after it lowered China's sovereign rating to A+ from AA-, stating that the downgrade on Hong Kong was to reflect potential spillover risks from China. It is the second time this year for Hong Kong to get a rating cut in response to a China downgrade. Hong Kong Financial Secretary disagreed with the downgrade by S&P, saying that the market has a sound market structure and strong regulations to prevent spillover risks. While S&P responded that even though Hong Kong's credit metrics remain very strong, it faces challenges from surging property prices under the Federal Reserve's plan to increase interest rate. ([Bloomberg](#))

**Banks hire Lazard to solve Turkey's biggest default**

**Sep 19.** Creditors have hired Lazard and Raiffeisen Investment to advise in negotiations over a USD 4.75bn loan taken out by Ojer Telekomunikasyon AS (Otas). The creditors have already been in talks for almost a year after Otas failed to pay a Sep 2016 installment on the loan. Otas has struggled to pay the dollar-denominated bond loan repayments due to a slump in the Turkish lira which reduced the value of the company's earnings. The creditors are considering Saudi Telecom's offer to inject USD 750mn into Otas and restructure the remaining USD 4bn of debt into two new loans. ([Bloomberg](#))

**UK credit rating downgraded by Moody's ([BBC](#))**

**Debt-laden Time seeks breathing room for turnaround ([Bloomberg](#))**

**Brazil seeks to avoid Venezuela default on USD 5bn contracts ([Reuters](#))**

**Regulatory Updates****Saudi Arabia to implement bankruptcy law in early 2018: Al Arabiya**

**Sep 22.** According to Saudi-owned broadcaster Al Arabiya, Saudi Arabia will begin implementing a new bankruptcy law at the end of the first quarter of year 2018. The new bankruptcy law serves to replace current legislation, under which there is no easy way to wind up the activities of indebted companies in Saudi Arabia, and the new law could help with government plans to restructure the economy and attract foreign investment. Besides the new bankruptcy law, Saudi Arabia is working on new laws regarding commercial mortgages and commercial franchising, and these planned laws were lauded by the International Monetary Fund (IMF) as progress towards identifying and reducing obstacles to private sector growth. ([Reuters](#))

**ISDA gives its verdict on Noble Group CDS**

**Sep 19.** The International Swaps and Derivatives Association (ISDA) committee tasked with making a ruling on the tussle over Noble Group's credit-default swaps has issued a verdict that could halt attempts to settle the derivatives contracts bilaterally. The ISDA ruling said that it "deliberately limited" its focus on this issue of guarantees, however, with no ruling on what other elements CDS holders could supply publicly available information on to try and trigger the contracts bilaterally. It also dismissed the request for making a ruling on whether a credit event had occurred. ([FT](#))

**India eases foreign investment rules for corporate debt** ([Economic Times](#))

**Draghi: still too many non-performing loans across eurozone banking system** ([FT](#))

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