Research Update:

The Weir Group Outlook Revised To Positive On Sale Of Oil And Gas Division; 'BB+' Ratings Affirmed

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Rating Action Overview

- U.K.-based engineering equipment producer The Weir Group PLC (Weir) has disposed of its oil and gas division to Caterpillar Inc. for an enterprise value of $405 million, and exhibited a relatively robust operating performance throughout the COVID-19 pandemic thus far.
- The full net proceeds of the sale have been used to pay down debt. Management also plans to use the proceeds of a proposed new benchmark bond issuance to refinance debt maturities falling due within the next 12 months and further deleverage the company.
- Due to improving margins and reducing debt, we forecast an improvement in the company's credit metrics, albeit dependent on management delivering on its clear operational and financial policy targets.
- We revised the outlook on our 'BB+' long-term issuer credit ratings on Weir to positive from stable, and affirmed the rating. The 'B' short-term rating and the rating on the euro CP program have been withdrawn at the issuer's request. We also assigned our 'BB+' issue and '3' recovery ratings to the company's proposed benchmark bond.
- The positive outlook indicates that, following the sale of the oil and gas division, Weir will be able to raise S&P Global Ratings-adjusted margins to about 20%. It also reflects that management intends to reduce debt and deleverage the company. If Weir's management delivers on these expectations and strengthens the company's credit metrics, we could raise the ratings within the next 12 months, subject to clear supporting evidence and industry conditions.

Rating Action Rationale

The sale of the oil and gas division resulted in reduced scale and diversification for Weir, because of its increased focus on mining, but it will help to lessen business volatility. We believe that the transaction will allow the company to continue its strategic transformation focusing on the mining sector. The sale of the oil and gas division represents a further step toward that goal, following the acquisition of ESCO in 2018 and the sale of the flow control division in

2019. In fiscal year (FY) ending Dec. 31, 2019, the oil and gas division's reported revenue was about £600 million (23% of total revenue) and reported operating profit (before exceptional items and intangibles amortization) was about £37 million. Therefore, we believe that the transaction will result in smaller scale and reduced diversification for the group, due to its exit from the division's end-markets. However, in our view, it will also reduce volatility, because Weir Minerals and ESCO are more stable businesses and their performance is strongly reliant on the aftermarkets services (about 70% and 95% of the division revenue, respectively), which we see as more resilient than the original equipment sales business. We have always seen the disposal as positive overall for the company, since Weir is now focused only on mining through its minerals and ESCO divisions. These divisions are global leaders in slurry-handling equipment and the manufacture of products used in metals and mining processing (minerals division) and in ground-engaging tools for the mining and construction markets (ESCO). As a result of the oil and gas disposal, we expect S&P Global Ratings-adjusted EBITDA margins to improve toward 20% in FY2021.

Weir has used the sale's net proceeds to reduce adjusted leverage, and management intends to use proceeds from a proposed new bond issuance to repay term debt maturities falling due in the next 12 months to further deleverage the company. Of the total net proceeds of $405 million (approximately £314 million) from the sale of the oil and gas division, $375 million was received from Caterpillar in February 2021 and a further $30 million is due from AMCO before the end of first-half 2021 . We understand that Weir plans to use the $375 million of proceeds from the sale and proceeds from the proposed benchmark bond issuance to repay its £200 million term loan that matures in February 2022 and the £430 million equivalent U.S. Private Placement (USPP) that matures in March 2022. Once this is done, we expect that Weir's capital structure will comprise a fully undrawn RCF, the new benchmark notes, and about £130 million of remaining USPP, maturing in 2023. In addition, thanks to the sale of the oil and gas division, Weir's overall lease obligations have fallen slightly. At the same time, margin improvement, as mentioned above, coupled with deleveraging and improved cash interest cost on its term debt all result in potentially improved credit metrics. If management adheres to its strategy and does not, for example, use high cash balances for opportunistic mergers and acquisitions (M&A), then we expect that adjusted leverage will decrease to below 2x by the end of 2021, paired with an improved funds from operations (FFO)-to-debt ratio of more than 40% from FY2021. These metrics could improve toward 1.6x and more than 45% respectively through 2022 if management delivers on its targets and end markets are supportive. We view as a positive management's public financial policy of net leverage of between 0.5x and 1.5x, with the upper end/temporary spike of up to 2x tolerated only for bolt-on acquisitions. Management targets a dividend payout ratio of 33% of earnings per share through the cycle is and committed to reattaining an investment-grade rating.

Despite the pandemic, the group's performance remains relatively robust, and we expect this to continue through FY2021. Weir posted a relatively strong set of FY2020 results and the trend has carried on through the first quarter (Q1) of 2021, with stable revenue and margins. Weir reports that end market conditions in mining and commodity prices remained supportive. In terms of geographic performance, North America, Central Asia, and Africa are exhibiting the strongest demand, while the Asia-Pacific region and South America are more subdued. In the minerals division, Q1 orders were up 15%, and revenue was slightly up year-on-year. ESCO orders were slightly up with revenues flat. Both divisions' aftermarket orders were down 1%-2% year-on-year, but up sequentially. We expect that Weir's top line will grow by low-to-mid single digit percentage in both core divisions through 2021 and 2%-4% overall at the group level, with stable margins of about 20% resulting in an uptick in adjusted EBITDA. We expect that exceptional restructuring-related costs will gradually drop to about £10 million for this fiscal year.

S&P Global Ratings believes there remains high, albeit moderating, uncertainty about the evolution of the coronavirus pandemic and its economic effects. Vaccine production is ramping up and rollouts are gathering pace around the world. Widespread immunization, which will help pave the way for a return to more normal levels of social and economic activity, looks to be achievable by most developed economies by the end of the third quarter. However, some emerging markets may only be able to achieve widespread immunization by year-end or later. We use these assumptions about vaccine timing in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Outlook

The positive outlook reflects our expectation that, following the sale of the oil and gas division, Weir will be able to raise adjusted margins to about 20%. It also indicates that management intends to reduce debt and deleverage the company. If Weir's management delivers on these expectations and strengthens the company's credit metrics, we could raise the ratings within the next 12 months, subject to clear supporting evidence and industry conditions.

Upside scenario

We could consider a positive rating action over the next 12 months if:

- The group's adjusted EBITDA margin were to improve such that it remained consistently at about 20%, as a result of increasing market share, organic growth, and tight cost control, supported by the stability of its aftermarket services; and
- Weir adheres to a conservative financial policy and reduces debt, translating into adjusted leverage consistently below 2.0x and FFO to debt of sustainably more than 45%.

Downside scenario

We would consider returning the outlook to stable if:

- Management were unable to maintain adjusted margins of about 20%, or decided to pursue opportunistic M&A that weakened the prospects of debt reduction and deleverage;
- Weir's credit metrics did not improve as expected, specifically if FFO to debt did not reach 45% and remain there comfortably through the cycle and debt to EBITDA increased above 2.0x on a sustained basis; or
- There were delays to or challenges in the refinancing of the group's next debt maturities at the beginning of 2022.

Company Description

Weir is a premium mining technology business that designs, manufactures and services highly engineered and mission-critical equipment for its customers.

It is the global leader in three areas of the mining equipment value chain. The company delivers products and related aftermarket service to a large number of customers in those markets, with a broad global geographic exposure. The group's revenue in 2020 was about £2 billion, stemming from two core business lines. Around 80% of revenue comes from aftermarket sales and services. The group has about 11,000 employees operating in over 60 countries, with a presence in every major mining region of the world.

Divisional overview

Weir Minerals (about 75% of 2020 revenue) is the group's largest division. It is the global market leader in slurry-handling equipment and manufactures products that are used in metals and mining processing. The main markets are mining processing, slurry transportation, and mine dewatering.

Weir ESCO (about 25% of 2020 revenue) is the global leader in ground-engaging tools for the mining and construction markets.

Our Base-Case Scenario

Assumptions

- The global macro outlook has improved markedly in recent weeks, reflecting accelerating vaccine rollouts and the substantial U.S. stimulus plan. Orderly reflation will be a positive development but is threatened by the still-uneven nature of the rebound.
- S&P Global Ratings recently raised its price assumptions for most metals for the second time since September 2020 (see "Metal Price Assumptions: Demand Surges But COVID-19, Trade, And ESG Concerns Flatten Output," published March 30, 2021). We believe this will support favorable credit momentum for metals producers, which have benefited from two to three years of financial restraint before prices began to rise sharply in mid-2020.
- Pandemic- and market-induced production cutbacks, as well as trade friction, have coincided with a surge in demand after a significant period of destocking. For example, spot prices for copper have hit their highest level in a decade only a year after dropping to near decade lows, highlighting the metal's fundamentally tight supply-demand balance amid improving economic fundamentals and long-term demand tailwinds stemming from the shift toward greater electrification.
- Production discipline and trade barriers are causing steel prices to reach all-time highs in the U.S. and Europe. Meanwhile, the resilience of demand in China remains critical for the sector. S&P Global Economics raised its assumptions for Chinese and U.S. GDP growth to 8% from 7% and to 6.5% from 4.2%, respectively (see "Economic Outlook Asia-Pacific Q2 2021: Three-Speed Recovery Will Benefit From Faster Global Growth" and "Economic Outlook U.S. Q2 2021: Let The Good Times Roll," published March 24, 2021, on RatingsDirect).
- We forecast that Weir will grow revenue in both of its core divisions by low-to-mid single-digit percentages in FY2021, with total group revenues growing by 2%-4%, supported by a good order book and contract wins.
- Adjusted EBITDA margins are forecast to improve to about 20% as a result of the sale of the lower-margins oil and gas division and the fact that the new perimeter only includes the higher-margins minerals and ESCO divisions, which are mostly reliant on their aftermarket

services.

- Cash proceeds from the sale of the entire oil and gas division of £314 million, which were received in February 2021 and a further $30 million to be received by the end of first-half 2021 and which will be used to repay outstanding debt.
- Capital expenditure (capex) of about £100 million per year from 2021.
- No dividends in 2020, with the expectation of dividend payments of 33.3% of earnings in 2021.
- Working capital outflows of about £30 million-£40 million per year.

Based on these assumptions, we derive the following credit metrics:

- Adjusted debt to EBITDA to decrease to less than 2x in 2021 and toward 1.6x in 2022;
- FFO to debt to increase to more than 40% in 2021 and more than 45% in 2022; and
- Strongly positive FOCF.

Liquidity

We continue to assess Weir's liquidity as adequate. Excluding the proceeds of the proposed benchmark bond, we still expect sources of liquidity to exceed uses by at least 1.2x over the 12 months starting from Dec. 31, 2020. Weir has sufficient liquidity to cover operational needs and upcoming maturities. However, we see limited room to absorb additional shocks that might be caused by uncertainty in the global economy.

Excluding the proposed benchmark bond issuance, principal liquidity sources over the 12 months, from Dec. 31, 2021, include:

- About £226 million undrawn under the $950 million RCF (due June 2023, with the option to extend for up to a further two years);
- Unrestricted cash balances of about £351.7 million; and
- Positive cash FFO after lease payments of about £250 million-£260 million.

Principal liquidity uses over the same period include the following:

- We note that Weir plans to use proceeds from the disposal of oil and gas assets and the proposed notes issuance to fully repay its £200 million term loan and £430 million in USPP debt;
- Capex of about £100 million over the next 12 months; and
- Working capital outflows of about £30 million-£40 million. The company also experiences intra-year swings of up to £80 million-£100 million, mainly in the first half of the year.

Issue Ratings - Recovery Analysis

Key analytical factors

- We are assigning a recovery rating of '3' and an issue rating of 'BB+' to $700 million bonds, based on a recovery prospect of 50%-70% (rounded estimate: 65%).

- The recovery rating is supported by our valuation of the business as a going concern.
- The recovery rating is constrained by the presence of pari passu debt facilities; however, it benefits from a lack of priority debt.
- Our hypothetical default scenario assumes severe economic downturn, and rise in competition, leading to drop in revenue and inability to repay interest and debt payments.

Simulated default assumptions

- Year of default: 2026
- Jurisdiction: U.K. (Jurisdiction Ranking A)

Simplified waterfall

- Emergence EBITDA: £152 million
- --Maintenance capex is assumed to be 3.0% of revenue
- --5% cyclicality adjustment; standard for the sector
- --+5% operational adjustment
- Multiple: 6.0x
- Gross recovery value: £914 million
- Net recovery value for waterfall after admin. expenses (5%): £869 million
- Estimated priority debt claims: Nil
- Estimated unsecured claims (excluding priority debt): £1,282 million
- Recovery range: 50%-70% (rounded estimate: 65%)*

*All debt amounts include six months' prepetition interest.

Ratings Score Snapshot

Issuer Credit Rating: BB+/Positive/--

Business risk: Fair

- Country risk: Intermediate
- Industry risk: Intermediate
- Competitive position: Fair

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bb+

Modifiers

- Diversification/Portfolio Effect: Neutral (No impact)
- Capital Structure: Neutral (No impact)
- Financial Policy: Neutral (No impact)
- Liquidity: Adequate (No impact)
- Management and Governance: Fair (No impact)
- Comparable Ratings Analysis: Neutral (No impact)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Metal Price Assumptions: Demand Surges But COVID-19, Trade, And ESG Concerns Flatten Output, March 30, 2021
- Economic Outlook Asia-Pacific Q2 2021: Three-Speed Recovery Will Benefit From Faster Global Growth, March 25, 2021
- Economic Outlook U.S. Q2 2021: Let The Good Times Roll, March 24, 2021
- The Weir Group Ratings Affirmed At 'BB+' On Proposed Oil And Gas Division Sale; Outlook Stable, Oct. 14, 2020
- The Weir Group Ratings Lowered To 'BB+'; Outlook Remains Stable, April 7, 2020

Ratings List

	To	From
Ratings Affirmed; Outlook Action		
Weir Group PLC (The)		
Issuer Credit Rating	BB+/Positive/NR	BB+/Stable/B
Ratings Withdrawn		
Commercial Paper	NR	B
New Rating		
Weir Group PLC (The)		
Senior Unsecured	BB+	
Recovery Rating	3(65%)	