Research Update:

Occidental Petroleum Corp. Ratings Lowered To 'BB-' From 'BB+' Due to Unabating High Leverage; Outlook Negative

November 19, 2020

Rating Action Overview

- We expect U.S.-based exploration and production (E&P) company Occidental Petroleum Corp.(OXY) will remain highly leveraged over the next two years amid industry headwinds and a challenging market for divestitures.
- We believe OXY will look to address its approaching debt maturities with a combination of refinancing, asset sales, and internally generated cash flow.
- We lowered our ratings on OXY, including our issuer credit rating and unsecured issue-level ratings, to 'BB-' from 'BB+'. Our '3' recovery rating (50%-70% recovery) on the company's unsecured debt remains unchanged, though we are revising our rounded recovery estimate to 55% from 50%.
- Our negative outlook on OXY reflects our expectation that the company will remain highly leveraged with average debt/EBITDA above 7x and FFO/debt below 12% over the next two years based on our current oil and gas price forecast. We believe improvement in overall leverage will continue to depend on a combination of stronger commodity prices and debt reduction through additional asset sales.

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Rating Action Rationale

The downgrade primarily reflects OXY's highly leveraged capital structure resulting from last year's acquisition of Anadarko Petroleum, which continues to be burdensome amid an increasingly challenging industry environment. Based on our current oil and gas price assumptions, we expect average debt/EBITDA above 7x (on an adjusted basis) for the next two years, with FFO/debt below 12% during that timeframe. Accordingly, we anticipate a slower pace of deleveraging than our prior estimates and believe a meaningful reduction in leverage will require a blend of accretive asset sales and higher commodity prices along with maintenance of a conservative financial policy. Additionally, we expect lower production and the potential loss of cash flow associated with divestitures could constrain EBITDA despite significant savings on overhead and operating costs achieved this year. We acknowledge that OXY's reduced capital budget and common dividends have helped accelerate cash flow generation, and are forecasting positive discretionary cash flow in 2021 while noting the potential for further cost improvements. The company has surpassed its $2 billion divestiture target for 2020, and we expect asset sales to be an ongoing process; albeit in a tough market. As we assess OXY's credit risk and leverage trajectory, we are also mindful of broader industry headwinds including demand uncertainty and investors' growing aversion to the oil and gas industry because of poor returns on investment. We have applied a negative comparable rating analysis modifier to capture some of the aforementioned factors, as well as risk from various contingent liabilities and the company's lack of downside hedges on oil for 2021 and beyond.

We believe the company's cumbersome near-term debt maturity schedule should be manageable with a combination of refinancing, asset sales, and cash flow generation. After refinancing and repaying a substantial share of debt maturing over the next three years, only $1.1 billion is due in 2021, followed by a heavier $4 billion in 2022 and $1.2 billion in 2023. We believe OXY could return to market next year after raising $5 billion of unsecured notes this summer, and the company is already targeting $2 billion-$3 billion of incremental divestitures in 2021--which would also reduce leverage. The company ended the third quarter with approximately $7 billion of total liquidity, which provides a backstop against capital market volatility and uncertainty around the magnitude and timing of various potential legal challenges as well as an annual put option on the company's zero coupon notes due 2036. Furthermore, OXY's current secured debt capacity of up to $11 billion could provide another avenue for liability management, although that could require modifications or redemption of certain debt in order to access the full amount. We anticipate positive discretionary cash flow in 2021, and the company's ability to pay its $200 million quarterly preferred dividend with common shares instead of cash (as it did for two quarters this year) provides yet another lever for cash flow preservation and debt reduction.

OXY's wide breadth of operations in the U.S., Middle East, and Africa provides additional divestiture opportunities with current activity mostly focused on unconventional Permian production. Recent divestitures, highlighted by the sale of its onshore Colombia assets, Wyoming land grant, and the WES note-for-unit exchange, have elevated post-Anadarko total divestitures to approximately $8 billion. However, the company remains shy of its original $10 billion-$15 billion asset sale target. While initially planned sales of assets in Algeria and Ghana were unsuccessful, Ghana still appears to be part of a broader effort expected to net another $2 billion-$3 billion of divestitures in 2021. That could also include a package of WES units since the company intends to pare its stake (which is currently valued at more than $2 billion) in the limited partnership. Furthermore, OXY benefits from the cash flow diversity its chemicals and midstream businesses provide, which helps reduce cyclical volatility. As the company heads into 2021, we expect management to prioritize debt reduction and mitigating production decline with a maintenance capital budget of just under $3 billion. Drilling activity will likely remain concentrated in the Permian Basin, where the company is in the process of adding multiple rigs.

Outlook

Our negative outlook on OXY reflects our expectation that the company will remain highly leveraged with average debt/EBITDA above 7x and FFO/debt below 12% over the next two years based on our current oil and gas price forecast. We believe improvement in overall leverage will continue to depend on a combination of stronger commodity prices and debt reduction through additional asset sales.

Downside scenario

We could downgrade OXY if the company fails to meaningfully reduce debt in the next 12 months. This could occur if the company does not meet our cash flow expectations and is unable to execute accretive asset sales. We could also lower the rating if, contrary to our expectations, we believe OXY has become overly reliant on capital markets, aggressively spends capital, or favors shareholder returns over debt reduction.

Upside scenario

We could revise the outlook to stable if the company's financial metrics improve relative to our base-case scenario, such that debt/EBITDA decreases to comfortably below 7x with FFO/debt closer to 12%. The company would also need to continue addressing near-term debt maturities, maintain at least adequate liquidity, and have a plausible path to further deleveraging. This would most likely occur if commodity prices improve or if asset sales exceed our expectations.

Company Description

OXY is one of the largest independent oil and gas companies, with forecast 2020 production of about 1.3 million barrels of oil equivalent (mboe) per day. It operates in three segments: oil and gas E&P, chemical (OxyChem), and marketing and midstream, with the largest being E&P. At year-end 2019, the company had proved reserves of 3,827 mmboe, of which 52% were oil, 29% were natural gas, and 19% were natural gas liquids (NGLs).

Our Base-Case Scenario

- West Texas Intermediate (WTI) price assumptions of $35 per barrel (bbl) for the remainder of 2020, $45/bbl in 2021 and 2022, and $50/bbl in 2023 and thereafter;
- Henry Hub natural gas price assumptions of $2.75 per million Btu (mmBtu) for the remainder of 2020, $2.75/mmBtu in 2021, and $2.50/mmBtu in 2022 and therafter;
- Average daily production of about 1.3 million boe in 2020, decreasing 10-15% in 2021.
- Significant working capital outlays.
- Capital spending of approximately $2.5 billion-$3.0 billion per year.
- Common dividends of about $1.4 billion in 2020, falling to around $40 million in 2021.
- We conservatively assume the company will cash pay its preferred stock dividends in 2021.
- We are no longer consolidating WES in our projections since OXY lacks control and intends to reduce its stake in the limited partnership to below 50%.
- We only incorporate asset sales that we expect will close in 2020.

Based on these assumptions, we arrive at the following (adjusted) credit measures:

- FFO to debt below 12% over the next two years;

- Debt to EBITDA averaging above 7x over the same timeframe; and
- We expect the company will generate positive discretionary cash flow in 2021.

Liquidity

We assess OXY's liquidity as adequate and expect liquidity sources will exceed uses by more than 1.5x over the next 24 months. We also expect that sources would exceed uses even if EBITDA declines by 30%. However, our liquidity assessment is limited by qualitative factors including the company's ability to absorb high-impact, low-probability events without refinancing, its current standing in the credit markets and recent covenant amendment.

Principal liquidity sources:

- OXY had approximately $1.9 billion of unrestricted cash at the end of third-quarter 2020.
- Full availability under its $5 billion revolver credit facility.
- FFO of about $4.5 billion-$5.0 billion in the next 12 months.
- More than $1.5 billion of net cash proceeds from asset sales expected to close in fourth quarter 2020.

Principal liquidity uses:

- $2.1 billion of debt maturities coming up in the next 12 months (including zero coupon notes that could be put to the company for up to $1 billion next year).
- Potential working capital outflows.
- Capital expenditures of $2.5 billion-$3 billion.
- Minimal common dividend payments.
- $800 million of annual cash dividends on preferred stock.

Covenants

OXY's credit facility has a maximum debt-to-total capitalization covenant of 65%. We expect the company to remain under this threshold. In March, OXY amended the covenant to exclude impairments and other noncash write downs occurring after Sept. 30, 2019.

Issue Ratings - Recovery Analysis

Key analytical factors

- S&P Global Ratings' simulated default scenario for OXY assumes a sustained period of low commodity prices, consistent with the conditions of past defaults in this sector.
- We base our recovery analysis on OXY's reported year-end 2019 PV-10 valuation and our recovery price assumptions of $50/bbl WTI crude and $2.50 per mmBtu Henry Hub natural gas.
- We limit the value of proved undeveloped reserves (PUDs) to 25% of the total valuation.

- Our analysis assumes that the $5 billion unsecured revolving credit facility would be fully drawn at default.
- We assume the parent company's unsecured revolver debt and senior unsecured notes are structurally subordinated to approximately $400 million of debt outstanding at OXY subsidiaries and the company's limited recourse guarantee on roughly $240 million of debt at equity method investee Dolphin Energy.
- We exclude WES from the recovery analysis since the debt is non-recourse to OXY.
- Recovery ratings on unsecured debt issued by companies rated 'BB-' or higher are generally capped at '3' (50%-70% recovery expectations) to account for the greater risk of recovery prospects being impaired due to incremental debt issuance prior to default.

Simulated default assumptions

- Simulated year of default: 2024

Simplified waterfall

- Net enterprise value (after 7% bankruptcy administrative costs): $23.95 billion
- Priority claims: $640 million
- --Recovery expectations: Not applicable
- Total value available to unsecured debt claims: $23.31 billion
- Senior unsecured debt claims: $41.84 billion
- --Recovery expectations: 50%-70% (rounded estimate: 55%)

Note: All debt amounts include six months of prepetition interest.

Ratings Score Snapshot

Issuer Credit Rating: BB-/Negative/B

Business risk: Strong

- Country risk: Low
- Industry risk: Intermediate
- Competitive position: Strong

Financial risk: Highly leveraged

- Cash flow/Leverage: Highly leveraged

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 rating analysis: Negative (-1 notch)

Stand-alone credit profile: bb-

Related Criteria

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- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- Criteria | Corporates | Industrials: Revised Assumptions For Assigning Recovery Ratings To The Debt Of Oil And Gas Exploration And Production Companies, Sept. 14, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
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Ratings List

Downgraded; CreditWatch/Outlook Action; Ratings Affirmed

	To	From
Occidental Petroleum Corp.		
Anadarko Petroleum Corp.		
Issuer Credit Rating	BB-/Negative/B	BB+/Watch Neg/B
Kerr-McGee Corp.		
Issuer Credit Rating	BB-/Negative	BB+/Watch Neg

Ratings Lowered; Recovery Expectations Revised

	To	From
Occidental Petroleum Corp.		
Anadarko Finance Co.		
Anadarko Holding Co.		
Kerr-McGee Corp.		
Senior Unsecured	BB-	BB+/Watch Neg
Recovery Rating	3(55%)	3(50%)

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.