



## Oil and Gas Drillers May Face Wave of Bankruptcies This Year

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Oil and gas firms face a crucial test of their health at the end of summer, making the next two months crucial for some drillers on the brink.

Heading into the end of the year, experts say stubbornly high crude production, coupled with eroding revenue, could start to force exploration and production companies to enter bankruptcy, sell assets or embark on mergers—especially if oil prices don't move higher.



A potential catalyst arrives in September, when banks will make one of their periodic reassessments of drillers' reserves. If the companies' assets are found to be less valuable than their outstanding debt, drillers will be forced to come up with a way to cover the gap between their reserve value and debt load. That could mean asset sales, restructurings and the like—or bankruptcies.

Capital from debt and new equity has been relatively easy to come by in the year's first half, but a variety of factors indicate that may not last. Moreover, banks have made accommodations to help drillers stave off default, said Omar Samji, a partner in law firm Jones Day's energy practice.

Samji said banks had so far taken a "reasonable," short-term view of oil and gas companies and commodity prices. "They'll have another bite of the apple in a couple of months and will get to gauge whether they were right or wrong," he said.

In the first quarter of 2015, upstream oil companies raised \$10.9 billion through new equity offerings, according to data from Dealogic. In the previous five years, total first-quarter equity issuances averaged only about \$4 billion.

Meanwhile, oil and gas companies have raised \$97 billion so far this year in U.S. dollar-denominated bond markets, according to Dealogic data compiled by Citigroup. At this time last year, that total stood at \$86 billion.

**Kim Brady, Senior Managing Director at SOLIC Capital, said he expects between five and 13 publicly traded, independent oil and gas exploration and production companies with revenues in excess of \$100 million to file for bankruptcy between July this year and June of next year. In the following year, he predicts another three to seven bankruptcies.**

**Brady's forecast is based in part on his belief that oil prices are headed lower in the third and fourth quarter, while production remains high.**

Though producers have slashed the number of rigs drilling in U.S. oilfields over the last seven months, American oil production hit a nearly 43-year high of 9.5 million barrels per day in March, 2015, according to the U.S. Energy Information Administration.

**"If production doesn't drop meaningfully, I think the oil price will have to go back to the lower 50s and even high 40s," Brady said. "Clearly we see demand increasing. There's no question about that. But production has been keeping up, and it's growing faster than demand."**

U.S. crude has consolidated around \$60 since early May. That's off a low of \$43.46, but it's still 40 percent below the peak a year ago. In September, energy firms will have four straight quarters of depressed prices on their books.

David Bianco, chief U.S. equity strategist Deutsche Bank, said investors are trying to convince themselves that \$60 a barrel is a "sweet spot." But he said \$80 is a more realistic comfort zone.

"I think what you're seeing in energy is not a mere cyclical adjustment. It's a big, structural adjustment. There's a lot to be celebrated here. We figured out how to make cheaper oil, but the whole space has to get accustomed to a lower level of profitability," he told CNBC's "Squawk Box."

With high production keeping commodity prices low, drillers won't be able to increase capital expenditures or will cut even further, he said. That means fewer new wells and less revenue growth, which will in turn exacerbate their debt-to-earnings ratio, making it harder to access capital.

Not everyone sees bankruptcies or consolidation in the near future, however. Michael Rowe, vice president of exploration and production research at energy investment bank Tudor Pickering Holt & Co., said he doesn't expect a major shakeup in September.

Of the 50 companies Tudor Pickering Holt covers, Rowe only foresees a few companies running into problems during the re-rating period. In those cases, banks will likely negotiate a grace period during which drillers are given the opportunity to "get their house in order," pushing out potential restructurings and asset sales another few months.

"The last thing a bank wants to do, honestly, is have their E&P companies that are borrowing from them default," he said, citing the example of Sabine Oil and Gas, which entered into a forbearance agreement with its lenders last month as it sought to sort out its debt and capital structure.

So far, merger activity has been muted. The most noteworthy deal in the exploration and production space was Noble Energy's purchase of Rosetta Resources last month for about \$2 billion, said Rowe.

But that deal was fairly small, he noted, especially considering that Whiting Petroleum, which has a \$6.2 billion market capitalization, was rumored to be up for purchase earlier this year. Instead, Whiting raised \$1 billion in new equity and \$1.25 billion in convertible debt in March.

Jones Day had anticipated a wave of mergers following the April re-rating period, but it never came to pass.

In recent months, Jones Day's energy practice was involved in \$43 billion worth of acquisition discussions. When the dust cleared, none of the transactions went through.

"The majority of those deals did not get done because no one got to a price...the sellers were willing to accept," said Jeff Schlegel, co-lead of Jones Day's energy practice. "There's a lot of poking around going on, but the bargain hunters don't see the bargains yet."

Whether sentiment among buyers and sellers will align after the next re-determination period remains to be seen, but Schlegel said there's pent up money waiting to be deployed in the energy sector.

"It's always hard to guess where this is going turn out, but overall, it looks like there should be a lot more M&A coming out," he said.

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