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'Perfect Storm' of Debt, Credit Tightness Looms for Upstream Companies

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The combination of low commodity prices and tightening credit markets may leave small to midsize oil and gas companies facing the prospect of distressed sales or bankruptcy later in 2015, SOLIC Capital Advisors Managing Director Raoul Nowitz told SNL Energy on Jan. 20.

Nowitz said the situation facing oil and gas producers is similar to when the price of natural gas collapsed several years ago, as a number of independent producers are overextended and highly leveraged after tapping open credit and debt markets in an effort to rapidly expand. Now that the price of oil has fallen below $50 per barrel and the credit markets are much less friendly, those companies are in a perilous situation.

"Any environment where you have companies with significant distress, that's a perfect storm," Nowitz said. "In our opinion, significant activity is going to come for smaller and medium-size companies, the independents."

The smaller companies, Nowitz explained, are more likely to find their balance sheets in a negative situation as they are more likely to have added significant debt while failing to protect themselves sufficiently through hedging.

"Companies that haven't had their production hedged for the next couple of years will be coming to the market, and that's problematic," he said. "They are not on the right side for the current environment. Majors can weather the storm better."

Oil and gas producers looking to renegotiate their debt or for additional credit may have a difficult time, Nowitz said, because the lending community is "taking a pause" in the sector to see how companies respond to the more difficult environment.

"They're reassessing the winners and losers," he said. "For some of these lenders, [tight lending] might be the new normal. They might want to restructure their approach for the next couple of years."

Some companies that are desperate for additional funding may look to more exotic sources for capital, even though it may come with substantial risk.

"I think you could see a number of nontraditional lenders being active in this environment, like hedge funds, putting money forth," Nowitz said. "But that money would come with very high yields and very high fees. But if a company is looking at this as their sole option, they may consider it."

The other options could be even more dire: sales or bankruptcies. Those next steps could begin in the next year as the price collapse makes its effects felt on companies' balance sheets.

"It'll probably begin in the latter half of 2015 and into 2016. It's only emerging right now," Nowitz said. "You have some companies that are trying to address the situation themselves first before admitting defeat and going to bankruptcy."

While some companies are looking to asset sales to buy time, majors and other strategic buyers may be waiting to pounce on distressed sales to expand their presence in some high-quality oil and gas plays.

"They're going to look for companies with good operations with bad balance sheets," Nowitz said. "They might be able to pick up good assets at good prices. You're going to see strategic buyers stepping in, and some may even be doing it in bankruptcy."

For some of the smaller to midsize producers who took on significant debt before the price of oil collapsed and the credit markets tightened, the objective will be finding ways to survive. Nowitz said those companies will have to repair their balance sheets as much as they can and hope they are able to ride out a negative environment for some time.

"We think this will continue for next few years. It won't be a quick recovery," he said. "People have got to button up as best they can."

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