

Exploring Opportunities in the Distressed Oil Patch

Recent Developments in Energy Capital Markets,
Restructurings, and Bankruptcies in the Oil Patch

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November 12, 2015

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Introduction

Brian Barnard
Haynes and Boone, Fort Worth

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CURRENT INDUSTRY TRENDS

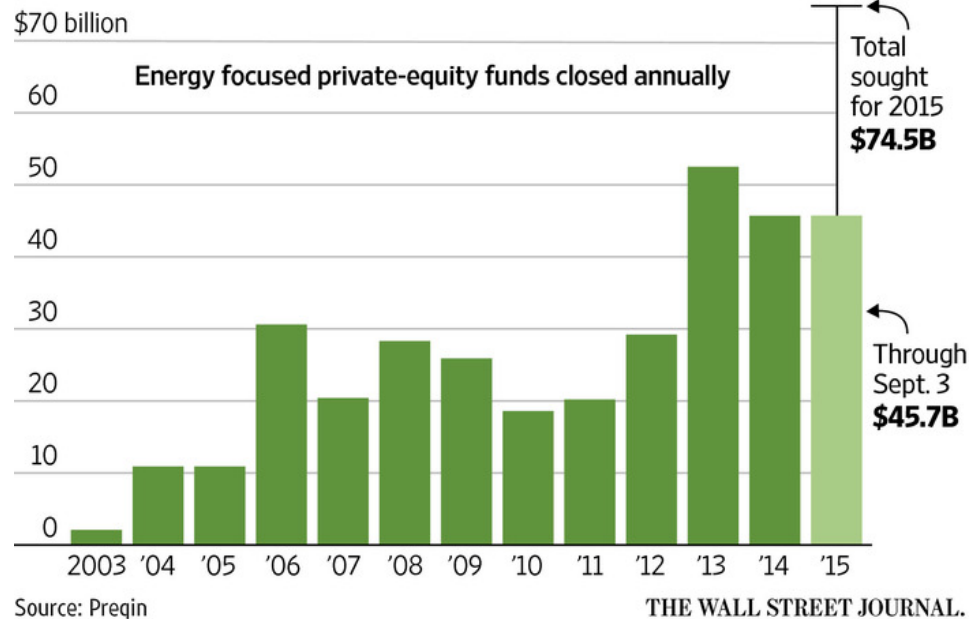
- Growing consensus that commodity prices will stay low for some time
- Bank regulators are pressuring senior energy lenders to redline large parts of their loan portfolio, requiring much larger bank reserves and rendering these loans unprofitable
- Regulators are extending this pressure to traditional second lien lenders who are bank affiliates
- Result: funding gap to be filled by non-bank lenders

CURRENT INDUSTRY TRENDS

- **\$115.6 billion** of PE dedicated to new energy deals and 67 energy focused funds trying to raise \$29 billion more. Including leverage, energy funds have **\$300 billion** to spend*.

Greasing the Skids

Private-equity firms are looking to raise more than \$70 billion for energy investments this year.

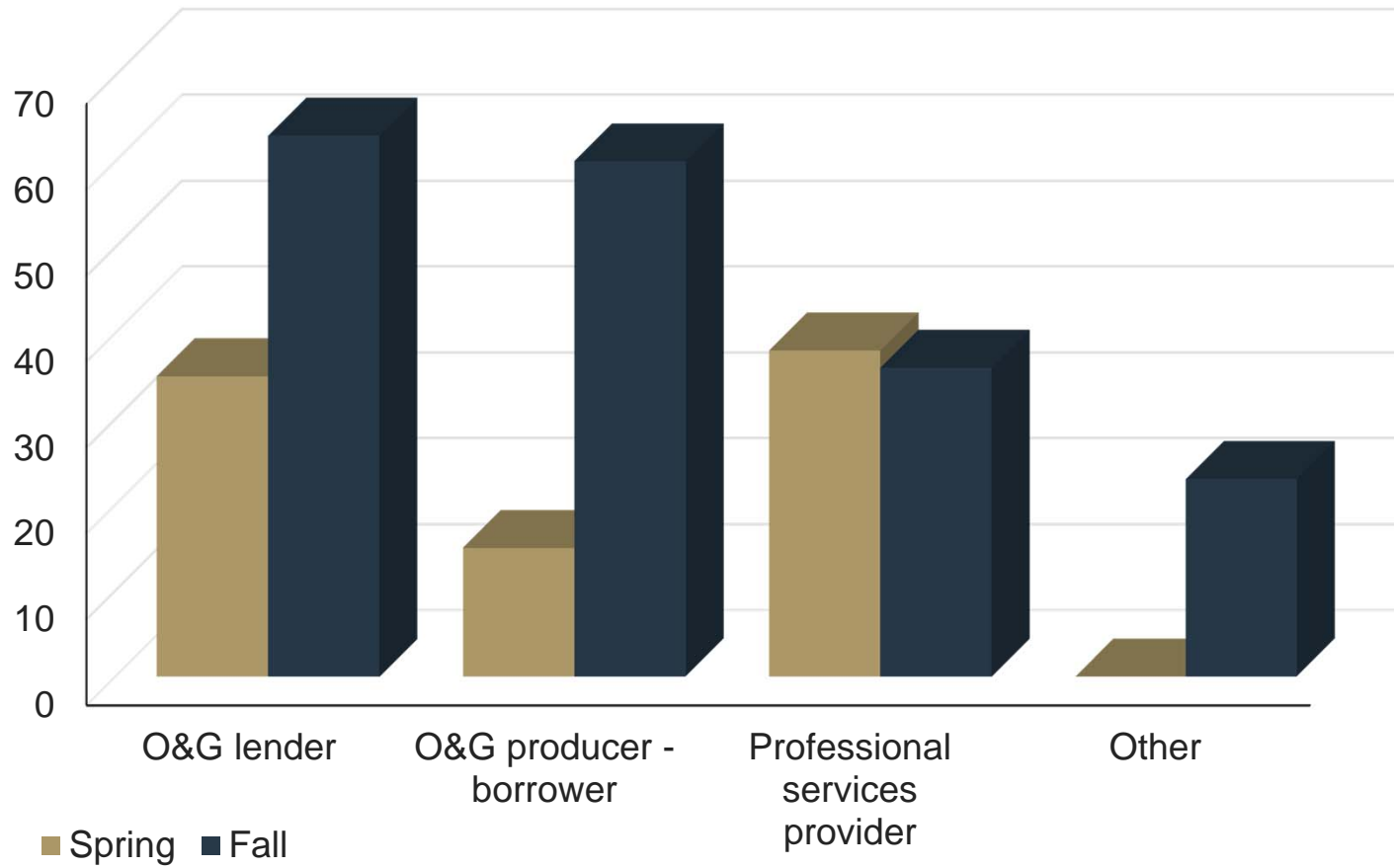


*Private-Equity Firms Plunge Back Into the Oil Patch, *Wall Street Journal*, September 4, 2015.

OBJECTIVES OF OUR BORROWING BASE SURVEY

- Haynes and Boone conducted surveys in April and September 2015 that included executives at:
 - Financial institutions
 - Private equity firms
 - Independent producers
 - Professional services providers
- The objective was to get a clear sense of what lenders, borrowers and others were expecting regarding the spring and fall 2015 borrowing base redeterminations in light of the price uncertainty in the commodity market
- The results that follow include a comparison of responses from the spring and fall surveys

1. Who Responded



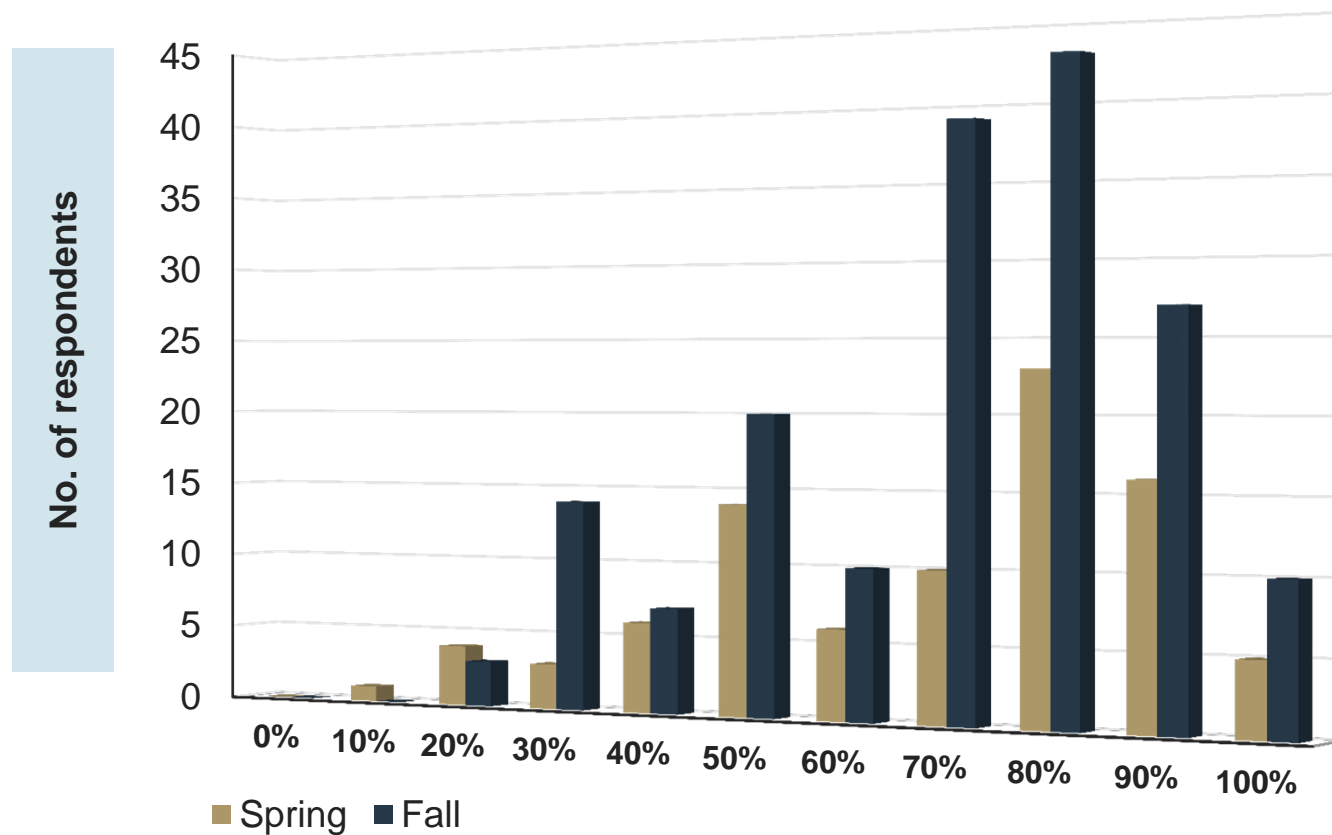
Spring: 88 respondents
Fall: 182 respondents

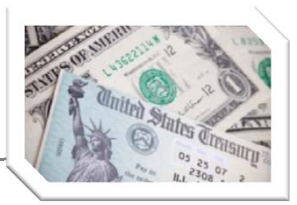
2. What Percentage of Borrowers will Experience a Decrease



Spring: average **68%** expect a decrease.

Fall: average **79%** expect a decrease.

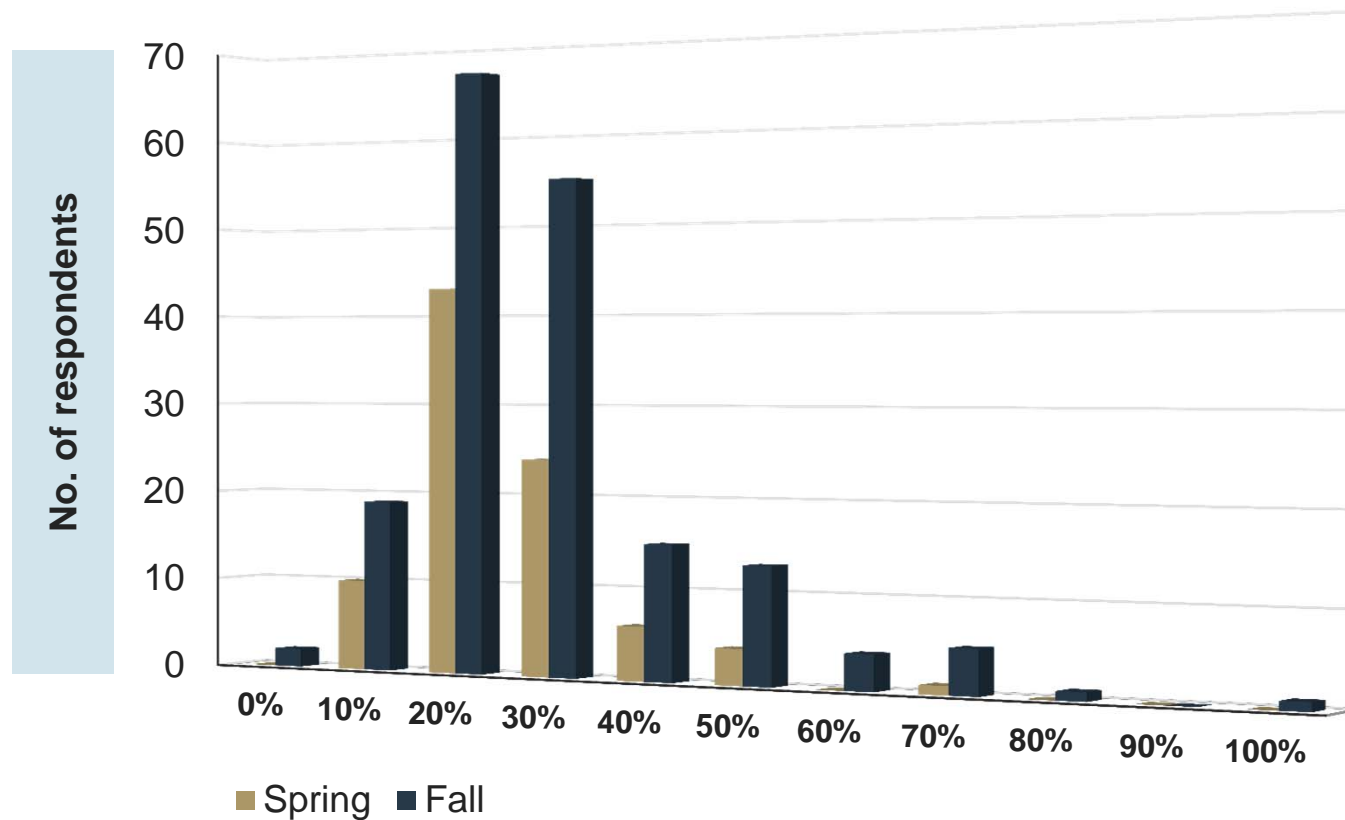




3. Average Percentage Decrease

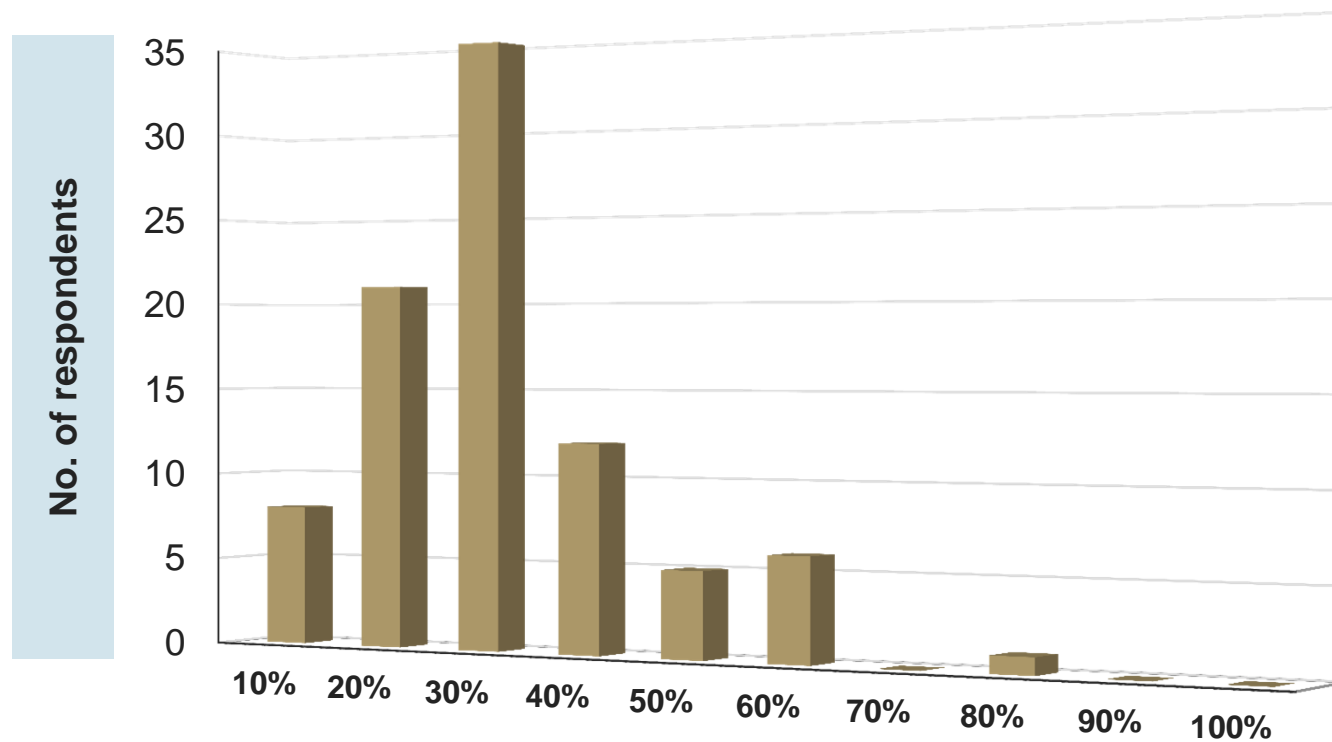
Spring: average of **25%** decrease.

Fall: average of **39%** decrease.









4. RESPONSES (SPRING SURVEY ONLY):

Last Spring, respondents expected that this Fall's borrowing bases would be **31%** lower (compared with **39%** now).



5. RESPONSES (FALL SURVEY ONLY):

		Responses	Response ratio
Negotiate an amendment / extension with the lender		123	37%
Sell non-core assets		117	35%
Seek capital from hedge funds or private equity funds		62	18%
Sell the company		6	2%
Restructure or declare bankruptcy		25	7%
Other		4	1%
	Total	337*	100%

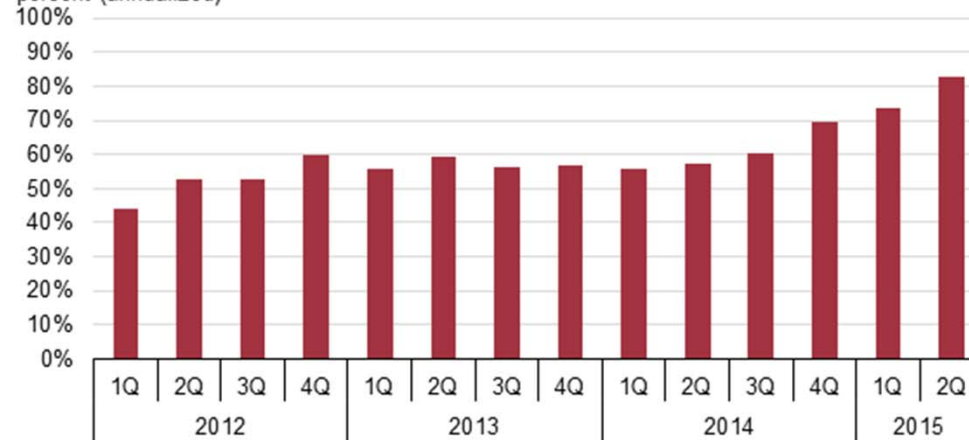
*Although there were 182 respondents, up to two options could be selected.

Record Debt Levels

SEPTEMBER 18, 2015

Debt service uses a rising share of U.S. onshore oil producers' operating cash flow

U.S. onshore oil producers' debt service as a share of operating cash flow percent (annualized)



Source: U.S. Energy Information Administration, based on Evaluate Energy
Note: Each quarter represents a rolling four-quarter sum.

BLACKTOBER???

- Results of Fall borrowing base redeterminations have not been as severe as anticipated (So Far)
- E&P Companies with RBL's have so far reported a net reduction of 4.2%, approximately \$1.23 billion in the aggregate, in their credit lines (through October 28)
- Are Banks kicking the can down the road (again)?
- Several more redetermination announcements yet to come could report more severe borrowing base reductions



April 2015 Senior Loan Officer Opinion Survey



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

DIVISION OF MONETARY AFFAIRS

For release at 2:00 p.m. ET

May 4, 2015

TO: HEADS OF RESEARCH AT ALL FEDERAL RESERVE BANKS

Enclosed for distribution to respondents is a national summary of the April 2015 Senior Loan Officer Opinion Survey on Bank Lending Practices.

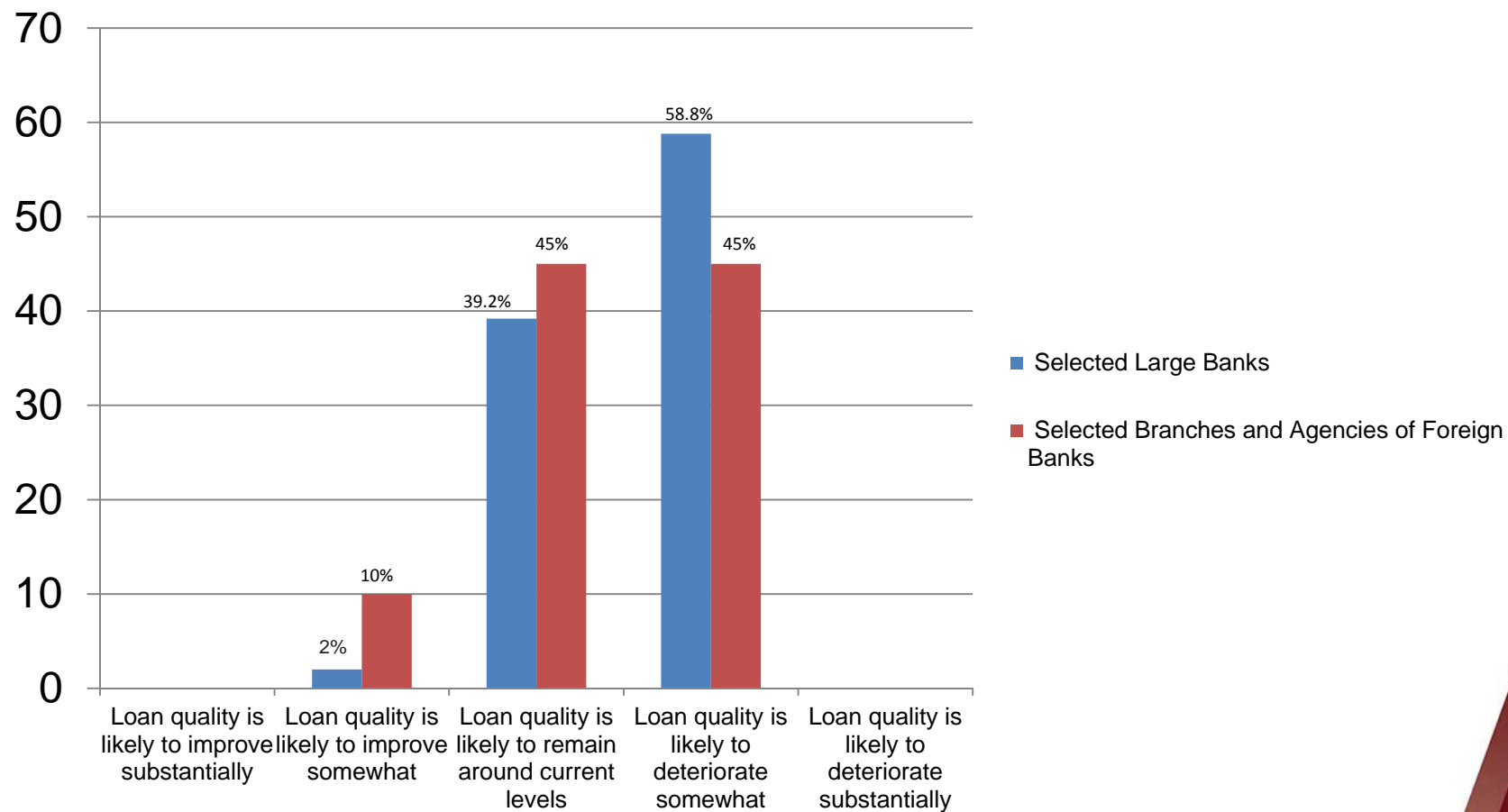
Enclosures:

April 2015 Senior Loan Officer Opinion Survey on Bank Lending Practices

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Assuming that economic activity progress in line with consensus forecasts, and energy commodity prices evolve in line with current future prices, what is your outlook for delinquencies and charge – offs on your bank’s loans to firms in the oil and natural gas drilling/extractions sector over the remainder of 2015?



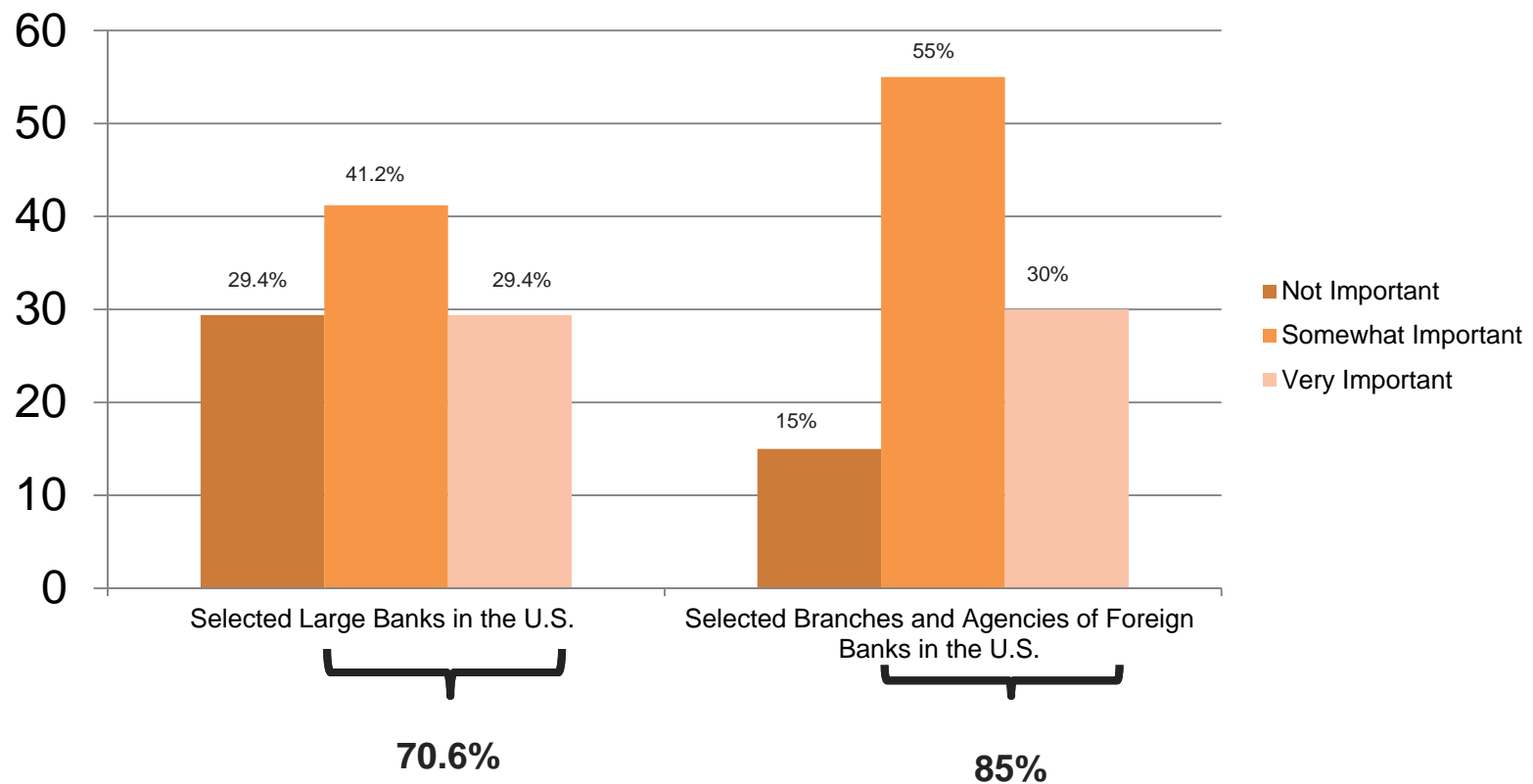
* For this question, 1 respondent from selected branches and agencies of foreign banks and 21 respondents from selected large banks answered, “My bank does not hold loans to firms in the oil and natural gas drilling/extraction sector.”



Source: April 2015 Senior Loan Officer Opinion Survey, published May 4, 2015, by the Board of Governors of the Federal Reserve System of the United States.

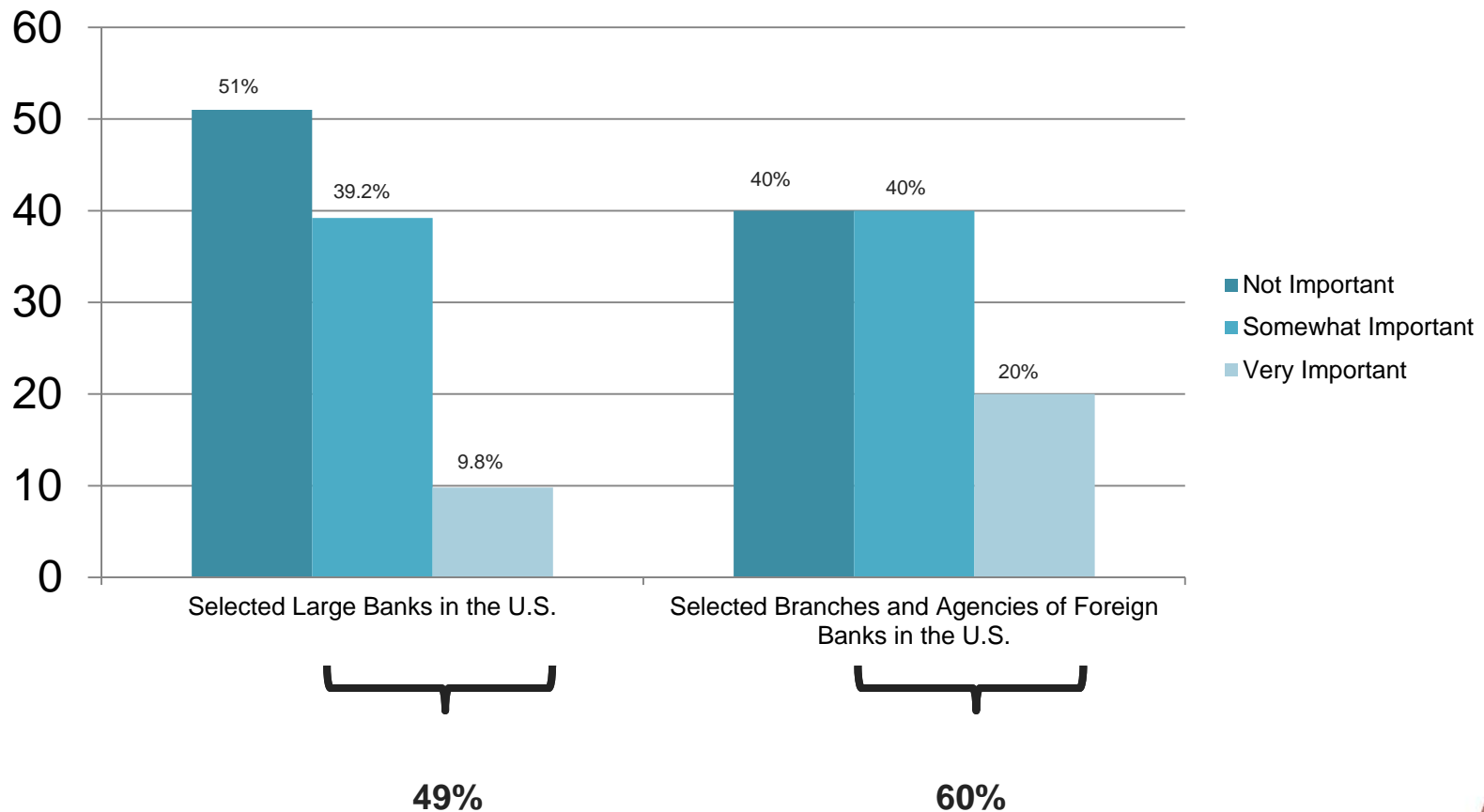
Please indicate how important each of the following actions are in your bank's efforts to mitigate risks of loan losses from loans made to firms in the oil and natural gas drilling/extraction sector. (Please rate each possible action using the following scale: 1 = not important, 2 = somewhat important, 3 = very important).

- Tightening underwriting policies on new loans or lines of credit made to firms in this sector



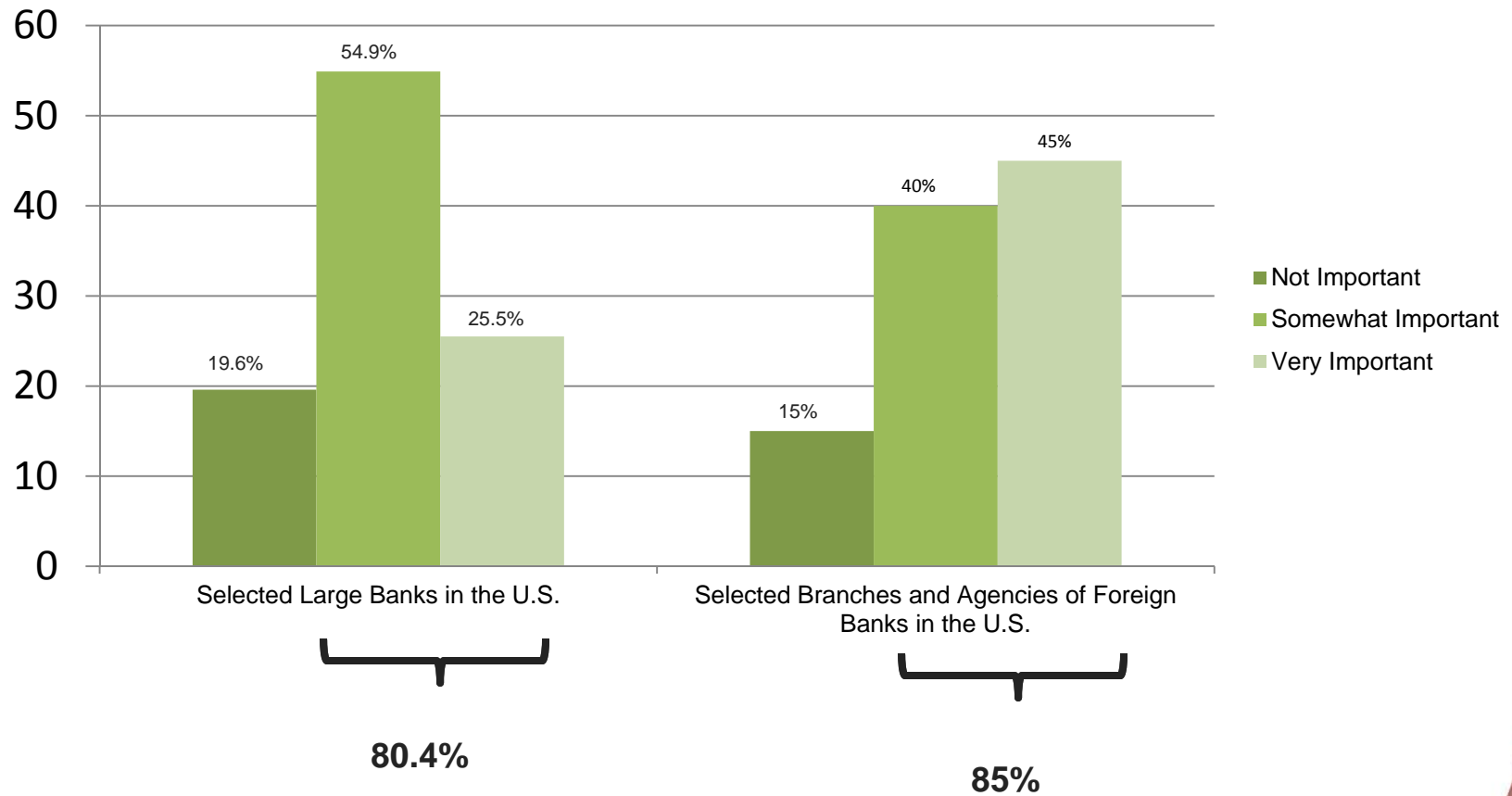
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- Enforcing material adverse change clauses or other covenants to limit draws on existing credit lines to firm in this sector



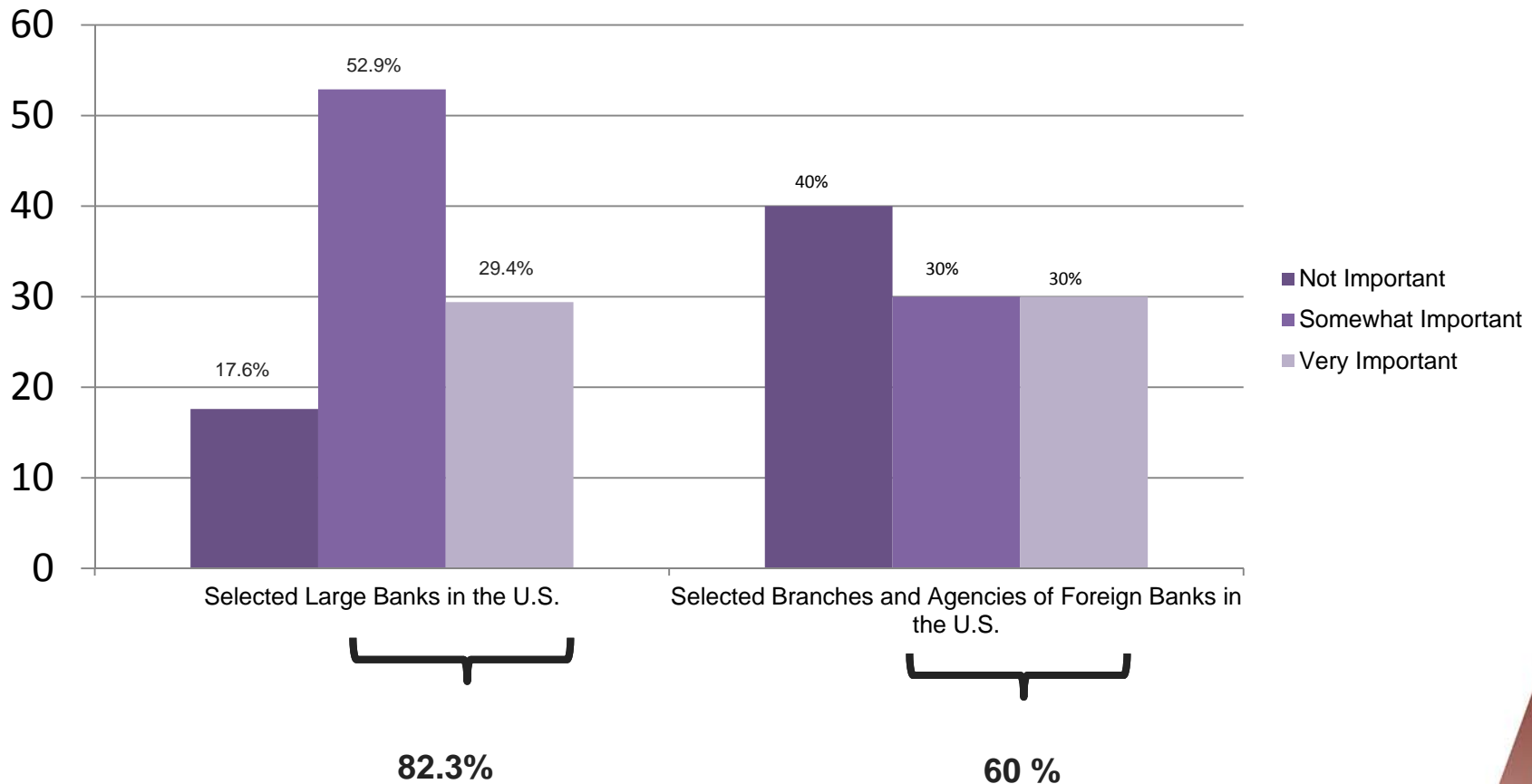
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- Reducing the size of existing credit lines to firms in this sector



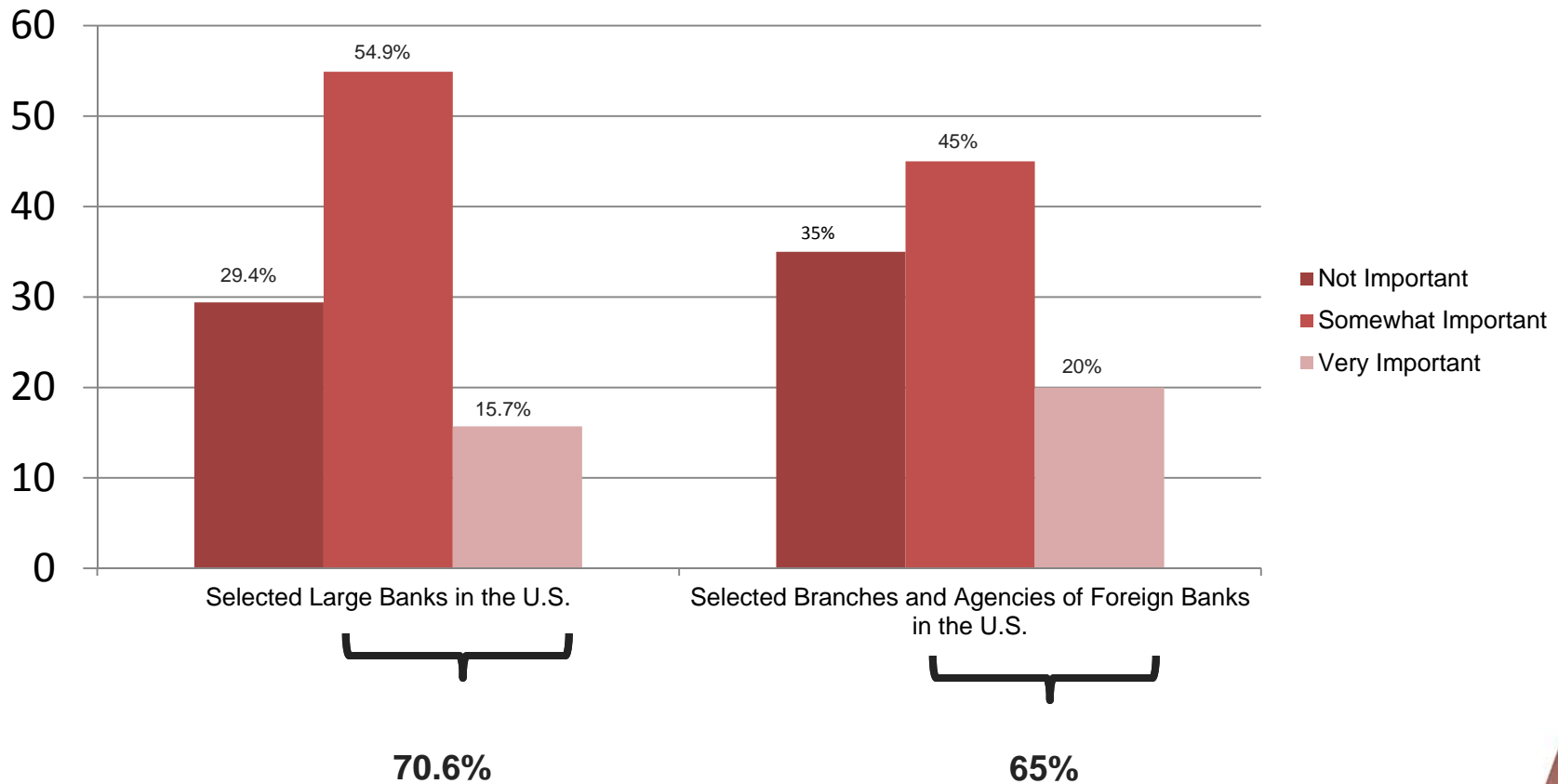
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- Restructuring outstanding loans to make them more robust to the revised outlook for energy prices



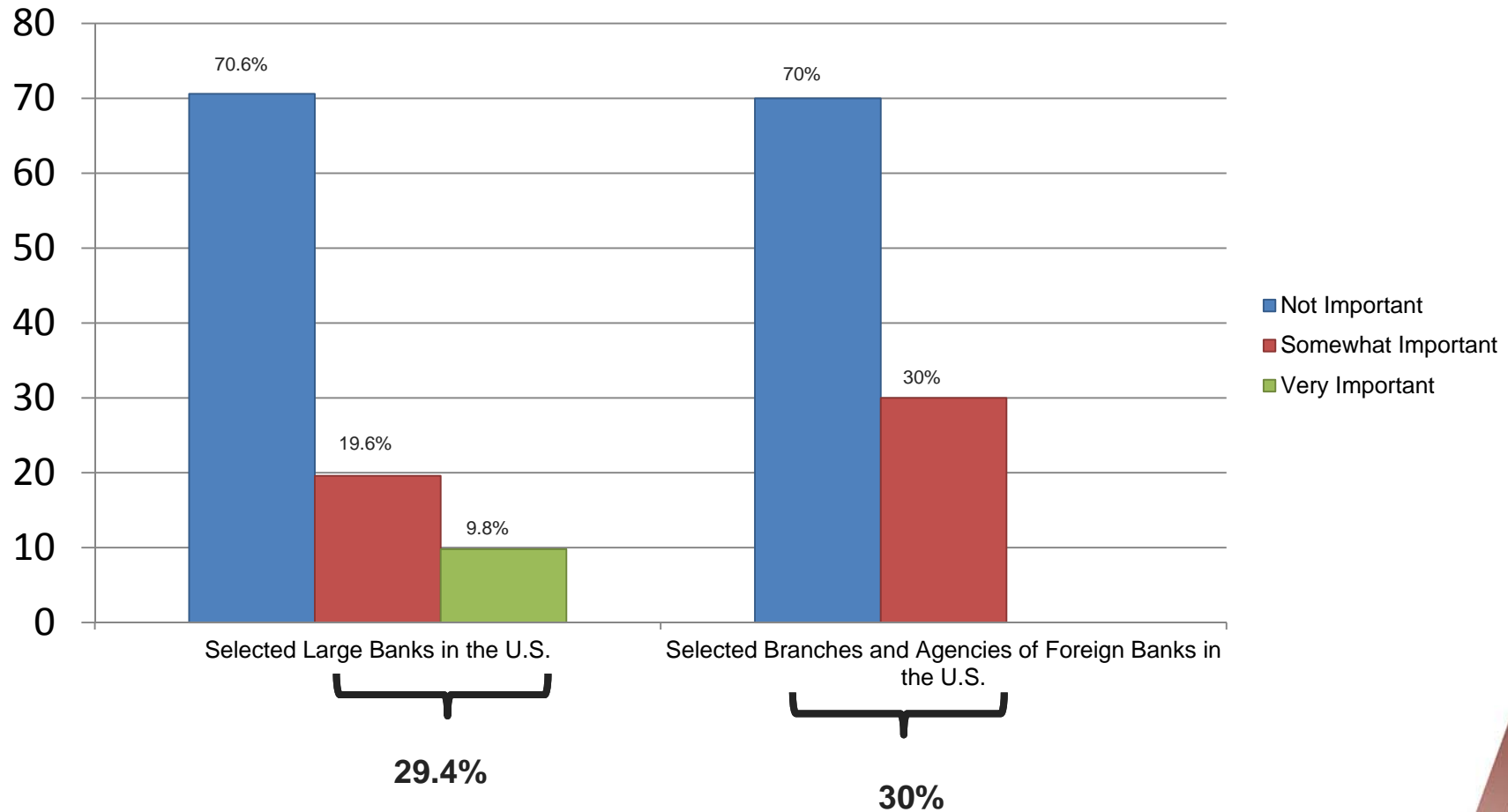
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- Requiring additional collateral to better secure loans or credit lines to firms in this sector



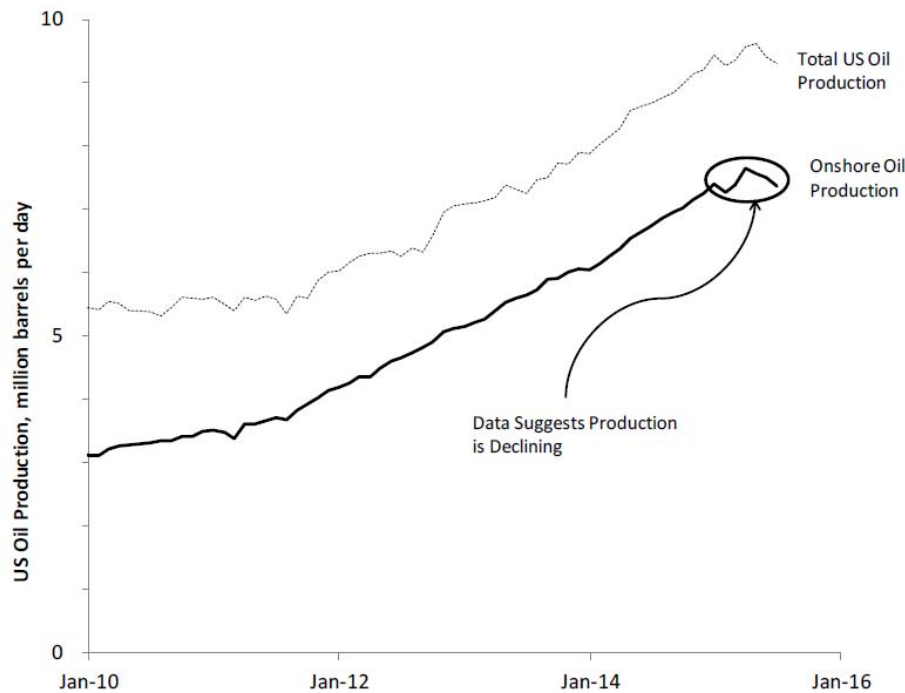
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- Tightening underwriting policies on new loans or credit lines made to firms in other sectors



WELLS ARE RESPONDING- DECREASED PRODUCTION

US Oil Production – Declines are Happening



Less volatile onshore oil production declined in April, May and June '15...an average of 83kbopd per month

Sources: EIA, TPH Research

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Bankruptcy/Restructuring Landscape for Energy Companies

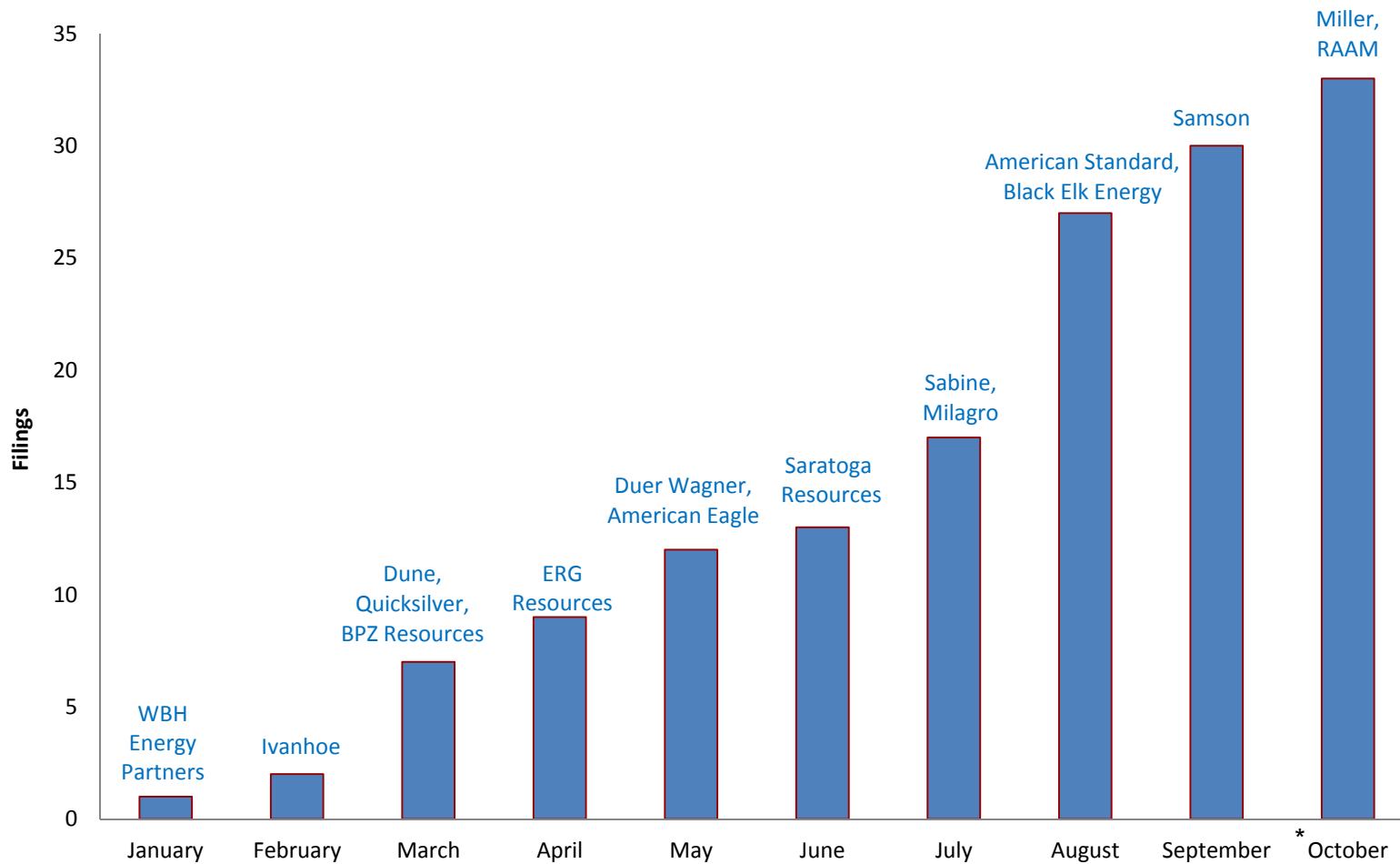
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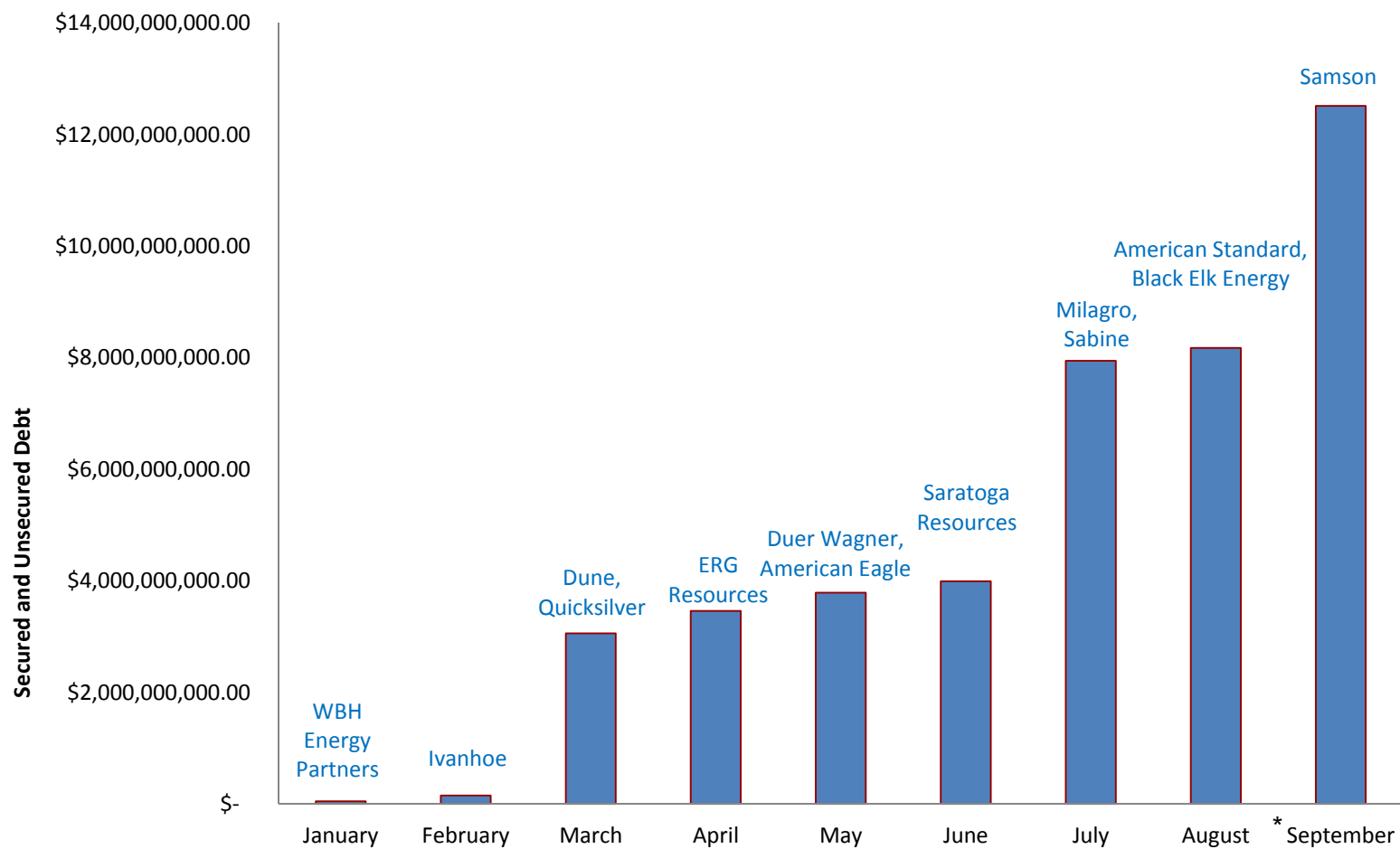
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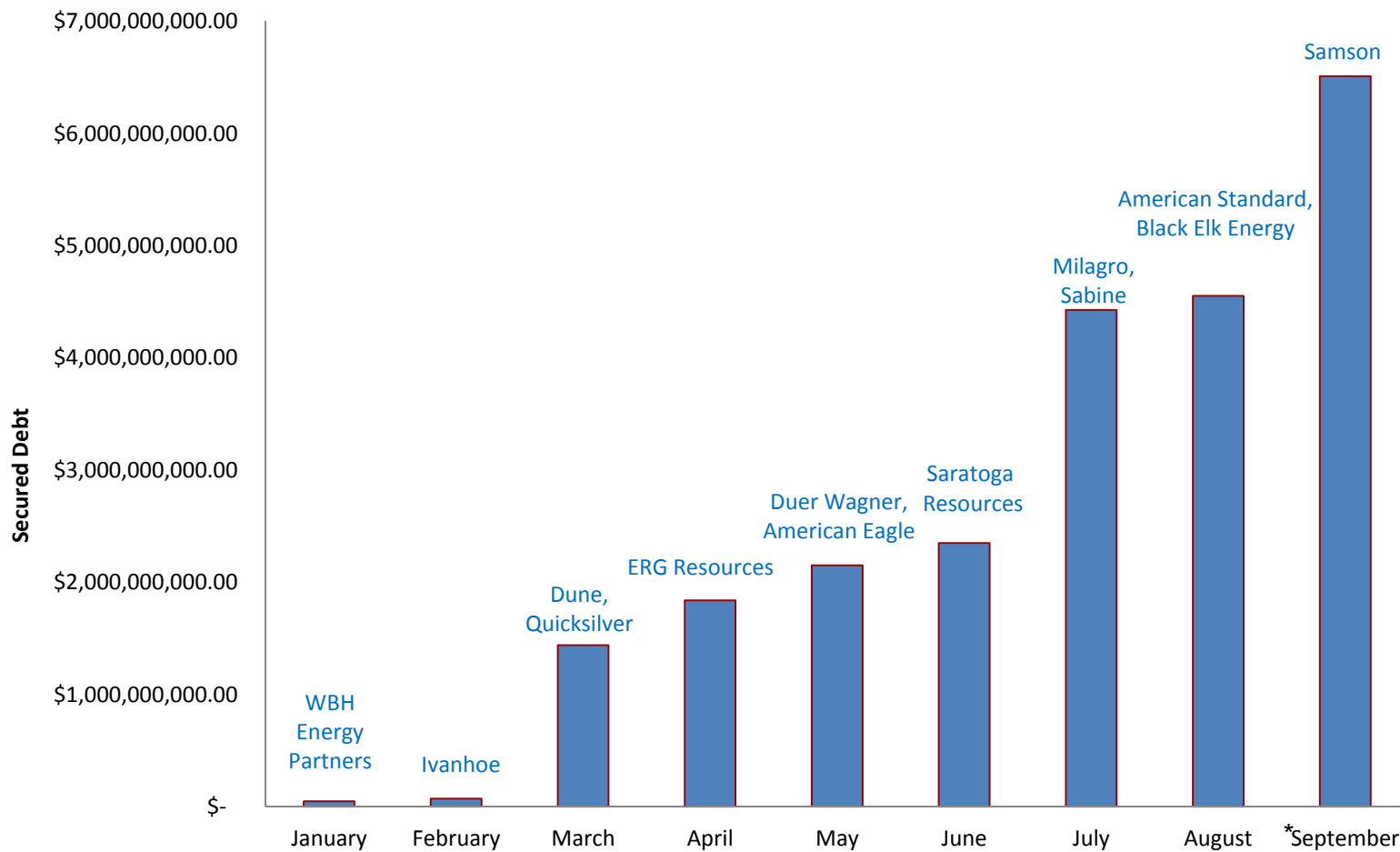
2015 Cumulative U.S. Energy Bankruptcy Filings



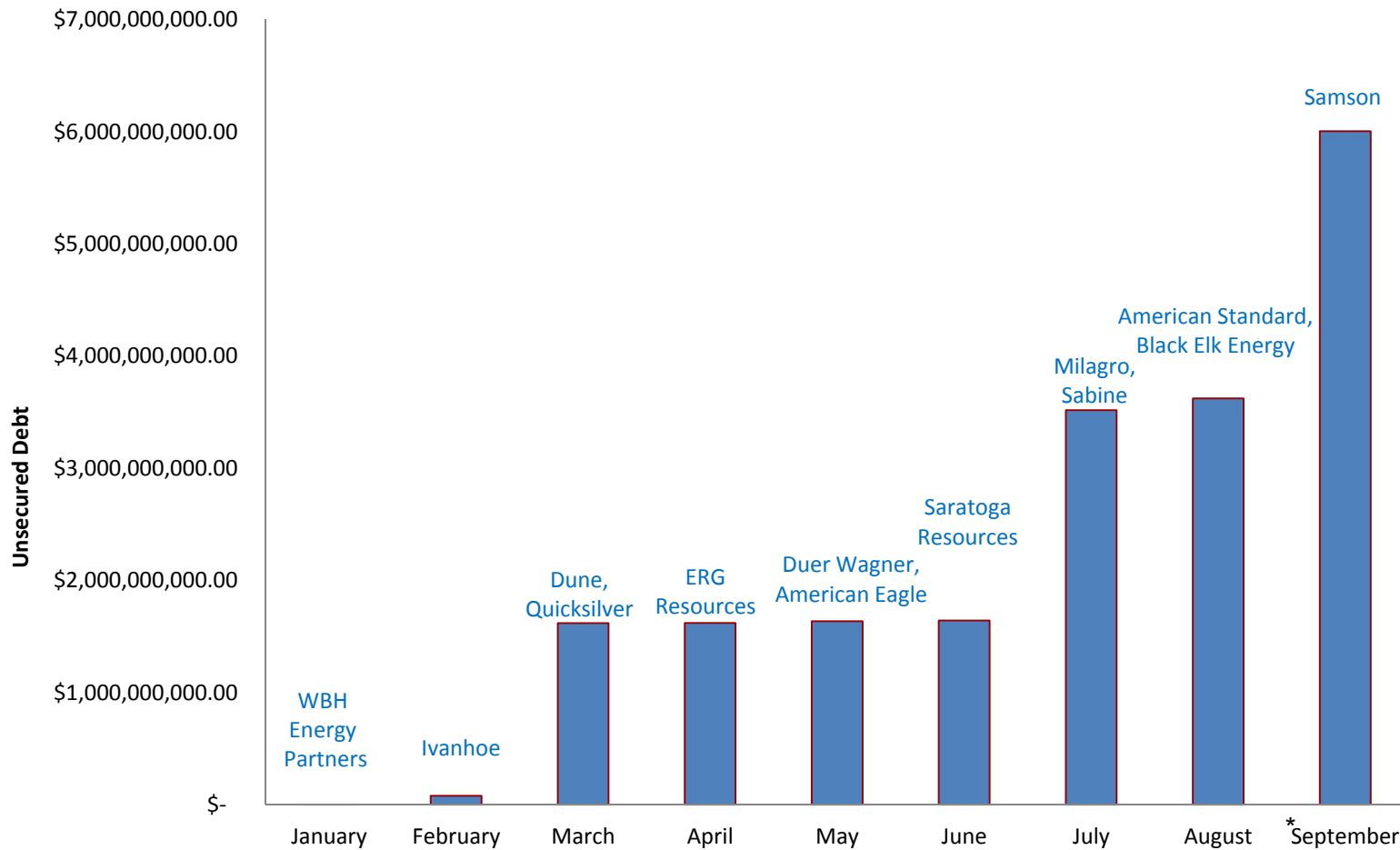
2015 Cumulative E&P Secured and Unsecured Debt - \$12.5 Billion



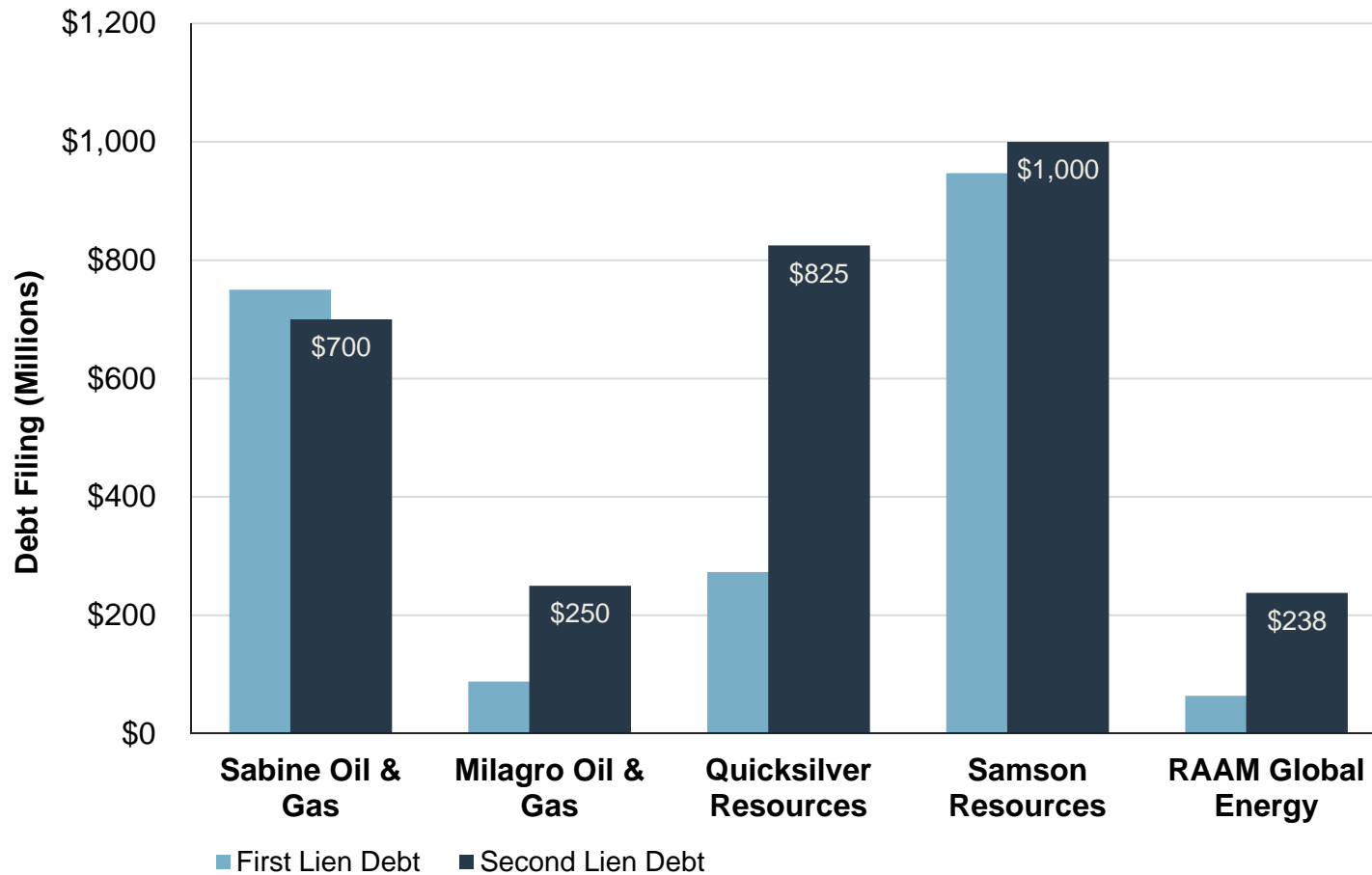
2015 Cumulative E&P Secured Debt - \$6.5 Billion



2015 Cumulative E&P Unsecured Debt - \$6 Billion



SECOND LIEN DEBT PROMINENCE IN RECENT FILINGS



HYPOTHETICAL E&P CASE STUDY

- Capital Structure

First Lien Debt	\$50 MM
<u>Second Lien Debt</u>	<u>\$20 MM</u>
Total Secured Debt	\$70 MM
Unsecured/Trade Debt	\$15 MM

- Collateral Coverage After BB Re-Set

Value of Oil and Gas Assets	\$50 MM
Collateral Coverage (90% of value)	\$45 MM

- Starting point for Chapter 11
 - First Lien adequately covered
 - Second Lien and Trade Debt underwater

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HYPOTHETICAL E&P CASE STUDY

- **Company Loses Borrowing Availability Under RBL**
 - Lender Declares Covenant Default
 - PANIC!!!
 - Short-term Forbearance While Company Seeks New Capital

- **Company Seeks to Raise New Capital**
 - Engages Investment Banker
 - Looks for Re-Financing or New Equity
 - Terms are VERY EXPENSIVE!
 - Looks to Sell Non-Core Assets
 - Prices are TOO LOW!

HYPOTHETICAL E&P CASE STUDY

- **Company in Denial**
 - Refuses to Consider Realistic Options
 - Mind Set Stuck in 2014
 - Liquidity Tightens
 - Trade Debt Gets Stretched
 - M&M Liens Filed
 - Proceeds Suspended
- **Lender Loses Patience**
 - Forbearance Expires
 - Company Forced Into Chapter 11
 - Lender Forces Company into Sale Process

HYPOTHETICAL E&P CASE STUDY

- **WHERE ARE YOU IN THIS EQUATION?**
 - Distressed Company / Old Equity?
 - Buyer of Distressed Assets?
 - Equity Investor?
 - Mezzanine Lender?
 - Debt Trader?

DISTRESSED ASSET SALES

- **VERY Difficult Market for Raising New Equity or Debt**
 - New equity investors would rather just buy assets
 - New debt is difficult because collateral values are depressed

- **Distressed Asset Sales have become the norm**

THE DIFFERENCES IN ENERGY COMPANY BANKRUPTCIES

- Oilfield Service Bankruptcies -- Equipment Intensive
 - Liquidation Value vs. Enterprise Value
 - Worth more dead than alive??
 - Highly Dependent on E&P Market Recovery – 6-12 months after \$60 oil
 - Can business sustain itself from cash perspective?
 - EBITDA levels
 - Cap Ex Needs
 - Balance Sheet Needs (interest and principle)
 - ABL Lenders and Equipment Lessors Have Big Stick
 - What do Lenders Want to Do?
 - PIK interest
 - Debt for Equity Conversion
 - Liquidate
 - What Can Old Equity Do?
 - What Can Management Do?

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THE DIFFERENCES IN ENERGY COMPANY BANKRUPTCIES

- E&P Bankruptcies are a Different Breed
 - Not All Assets Subject to Senior Lender’s Liens (too cumbersome)
 - Gives other creditors a seat at the table
 - Second Liens Sandwiched Between RBL and Unsecured/Trade
 - In declining price market, second lien maybe out of the money
 - Creates costly, litigious relationship between second liens and trade debt
- E&P Companies have Unconventional Assets
 - Oil and Gas Lease is not a “Lease” (in some jurisdictions)
 - State Laws Vary Materially on Key Issues
 - Operating agreements
 - Stakeholder rights – royalty, vendors, operator, VPP
 - Early Stage Liquidity Requirements
 - Unproven Reserves Given Little or No Value

BANKRUPTCY SALES

- **Why Implement Sales / Acquisitions in Chapter 11?**
 - Section 363 Sales -- Timeline and Process
 - Stalking Horse Protections
 - Credit Bidding
 - Assignment of Contracts in Bankruptcy
 - Treatment of O&G Contracts in Bankruptcy
 - Diligence Issues
 - Purchase Agreement Negotiation
 - Post-Acquisition Issues

LIGHTNING ROUND: CURRENT CASE STATUS

- Quicksilver Resources (filed March, Del.)
- Sabine Oil & Gas (filed July, S.D.N.Y.)
- Milagro Oil & Gas (filed July, Del.)
- Samson Resources (filed September, Del.)
- RAAM Global Energy (filed October, S.D. Tex.)

Questions?

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