Trends & Oil & Gas Recap

December 7, 2018 - On December 6th, the LSTA hosted a webinar on “Trends in Oil and Gas Syndicated Loans” presented by members of the Houston-based Haynes and Boone team – Jeff Nichols, Austin Elam, Brent Schultz, and Katy Shurin. By 3Q18, the US became the largest crude oil producer in the world and, as recently as September 2018, there were predictions that crude prices would reach around $100 barrel by year end. But how quickly things change, and with a market sell-off in October and demand concerns, prices declined rapidly from $75 barrel all the way down to the high 40s. Furthermore, it was thought that the sanctions on Iran would curtail global supply but waivers granted to a few countries to allow them to continue to buy Iranian oil meant that the anticipated global supply restriction never panned out. However, it was noted that it was only in mid-March of this year, that prices were predicted to be in the mid-50s, so how bad are things really today?

When prices are volatile or declining, many producers are required to (or elect to) enter into hedges to smooth out commodity prices and provide uplift on their borrowing base. However, the majority of production for 2019 is not hedged, and with prices much lower today than earlier in the year, producers who are not hedged are now exposed to such price volatility. With prices declining and hedges not providing support to borrowing bases, what are the other sources of capital available, especially because $70B of upstream debt (mostly bonds) will be due in the first half of 2019? The equity markets are not open to upstream producers, and ability to tap the bond market has also declined. Because producers need to continue drilling wells, their capital requirements simply will not disappear, and so alternatives must be explored. The “Drill Co Structure” could be one option, and the panel reviewed the pros and cons of this structure.

The panel then explored the trends in syndicated oil and gas credit facilities for investment grade and near investment grade energy companies, and noted that since 2015 there has been a reduction of the number of (publicly traded) Master Limited Partnerships. Since 1995, this structure has been attractive to capital intensive energy companies for several reasons -- the general partner is incentivized to distribute as much cash as possible to the limited partners and the pass-through taxation structure eliminates the double taxation issue. Nevertheless, there are drawbacks to this structure, including the more complicated taxation issues for investors, the inability to list on a number of indexes, and issues with UBTI which limit the shareholder base. Some of the energy MLPs have converted to a C Corp structure or have bought back all their partnership units, citing larger dividend growth, lower corporate tax rates, increased investor base, and access to capital markets as reasons for doing so.

In the mid-cap and small-cap energy credit facilities, the market remains strong for midstream and E&P companies and a number of banks have re-entered the market causing competition on pricing and covenants as banks compete to win deals. Documentation, especially for E&P companies, has seen a number of provisions that were included in 2015/2016 agreements now being removed. For example, defensive draw and cash hoarding provisions have not mostly come out the documents, but requirements for DACAs have remained in the documents.

Finally, the panelists concluded with a detailed discussion on the opportunities and obstacles of oil and gas hedging for lenders. Two years ago, the OCC issued new guidelines for the examination of oil and gas E&P lending, thereby effectively limiting the availability of commercial bank credit to E&P companies and creating opportunities for alternative capital sources to fill the capital gap. Third party hedge providers, that are unaffiliated with the lenders in the syndicate, have been stepping into that void and providing hedges. The critical issues for third party hedge providers were reviewed and the common hedge provider points of negotiation highlighted.

Please click here for the Haynes and Boone Energy Roundup Fall 2018 and here for the webinar replay.