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BUSINESS

Banks Cut Shale Drillers' Lifelines as Losses Mount

Lenders are pulling back on reserve-backed loans as the shale industry faces a liquidity crunch

Many banks could suffer sizable losses from souring shale loans and are trying to sell off their portfolios to reduce exposure.

PHOTO: SUE OGROCKI/ASSOCIATED PRESS

By Christopher M. Matthews and Andrew Scurria
June 15, 2020 6:30 am ET

Banks are slashing credit lines to shale drillers, as an oil-price crash and wells that have failed to produce as much as predicted force a painful reassessment of companies' assets.

The cuts vary from company to company, but Moody's Corp. and JP Morgan Chase & Co. forecast a total reduction of as much as 30% to the asset-backed loans, or tens of billions of dollars. At current prices, that will be enough to tip some weaker players into bankruptcy as capital for the beleaguered industry dries up, say bankers, lawyers and energy executives.

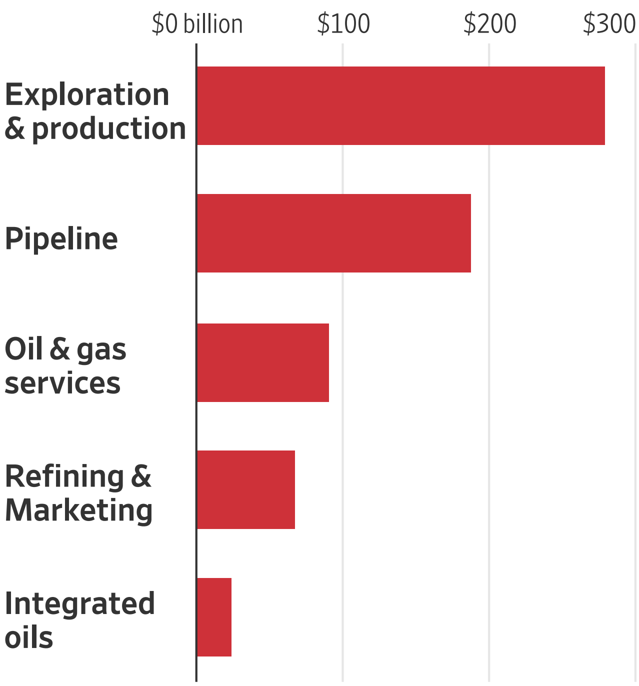
"It's an unavoidable reckoning," said Todd Dittmann, head of energy at alternative investment manager Angelo Gordon & Co., which manages about $33 billion. "A decade of bubbling public and private debt and equity capital delayed this day, but no more."

The loans aren't large enough to pose a systemic risk to banks, whose exposure to U.S. energy companies totals around $650 billion, or about 3.5% of U.S. bank assets, according to JPMorgan Chase. But many banks could suffer sizable losses from souring shale loans and are trying to sell off their portfolios to reduce exposure, people familiar with the matter say.

Energy Exposure

Banks have lent hundreds of billions to the U.S. energy industry, but the loans represent a relatively small amount of the banks' assets.

Bank exposure to U.S energy companies by sector



Source: J.P. Morgan

Banks regularly reconsider reserve-backed loans, part of a normal review that takes place every spring and fall, but industry veterans say the current cuts are among the most severe they can recall.

Some are concerned they could signal a permanent contraction in oil-and-gas lending, as financial institutions, already facing pressure from activists and governments to pull back from fossil fuels, retreat from a sector that has delivered underwhelming profits for most of the past decade.

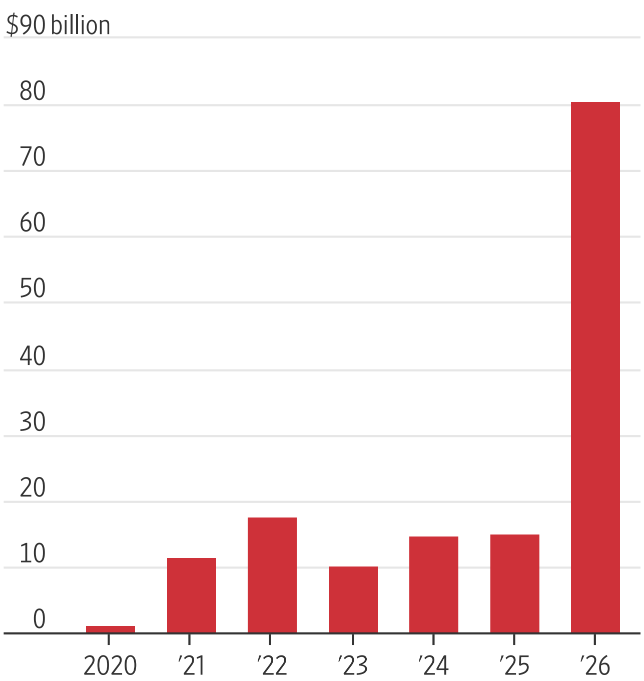
“It’s a different order of magnitude,” said Buddy Clark, co-chair of the energy practice at law firm Haynes and Boone LP. “Historically, you don’t have reductions of borrowing bases across the board. This is different than any other cycle we’ve seen.”

So far, more than two dozen publicly traded shale producers have had their borrowing bases cut, according to regulatory filings and other documents.

Centennial Resource Development Inc. had its revolving loan cut from $1.2 billion to $700 million in May, days after U.S. oil prices fell into negative territory. Later that month, Moody’s downgraded the company’s credit outlook, saying its risk of default had increased, citing the borrowing base cut. Oasis Petroleum Inc. had its borrowing base cut from $1.3 billion to $625 million in April and agreed to subsequent cuts that will lower it to $600 million. Antero Resources Corp. ’s base was cut from $4.5 billion to $2.85 billion in March.

The companies didn’t respond to requests for comment.

Debt maturities for exploration and production companies



Source: J.P. Morgan

During the last oil-market downturn in 2015 and 2016, banks came out largely unscathed as producers sold off their assets or handed control over to bondholders. Bank loans, which had priority over high-yield bonds and other corporate debts, were largely repaid in full.

This time around, some bank lenders are finding out their collateral in the form of oil and gas assets isn't worth enough to cover their debts as oil prices have decreased.

"That is a very material development in this sector," with potentially long-lasting impacts on how banks lend into the oil industry, said Kevin Cofsky, a partner at financial adviser Perella Weinberg Partners LP.

Banks are also discovering that estimates they relied on for how much oil borrowers' wells would produce are proving overly optimistic.

Templar Energy LLC, a private equity-backed producer that filed for bankruptcy June 1 after having its borrowing base cut last year, has said it expects lenders to recover at most 21 cents on the dollar. Alta Mesa Resources Inc., a Houston-based shale driller that sold its assets out of bankruptcy in April, expects its bank lenders will get roughly 51.3 cents on the dollar on $316.5 million they are owed, according to court papers.

Lenders are increasing interest rates and tightening loan covenants on shale drillers, say people briefed on the changes, including provisions meant to stop companies from drawing their revolving loan facilities in full and stockpiling the cash. Some bankers expect that lenders will also tighten limits on borrowers' leverage.

The current talks with shale companies have proved so thorny that the banks' traditional spring redeterminations still aren't complete, bankers and lawyers involved say. Many expect the fall reviews to be even worse as drillers' revenues decline due to decreased production.

For some shale companies, the revolving loans are one of their few remaining sources of cash. Even before the coronavirus sapped global oil demand, equity and credit investors had fled the industry after years of poor returns, leaving drillers with few options for inexpensive financing.

That financial crunch has only worsened this year, as scores of companies were forced to sharply curtail new drilling and turn off existing wells due to a collapse in prices, which is going to reduce their future production and cash flow.

Drillers whose debt isn't considered investment grade are most at risk of bankruptcy. Primarily small- and medium-size shale producers, those companies make up about one-quarter of U.S. oil production.

If U.S. oil prices average about $30 this year, around 73 oil and gas producers in the U.S. may have to file for bankruptcy protection, with 170 more following in 2021, data analytics firm Rystad Energy estimates.

While the current bust isn't expected to cause the type of pain lenders saw in the 1980s, when a crash helped trigger the savings-and-loan crisis, some banks are seeking to get out of reserve-backed loans entirely. At its peak, around 60 banks extended reserve-backed loans, according to one lender, who said the number is closer to 30 now.

Regional lenders Huntington Bancshares Inc. and Texas Capital Bancshares Inc. are actively marketing portfolios of such loans to hedge funds, private-equity firms and others, say people familiar with the matter, while Capital One Financial Corp. has had early conversations with prospective buyers.

The banks didn't respond to requests for comment.

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