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News : E&Ps may see borrowing base increases during upcoming reevaluations

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- Higher oil prices put producers in a 'good position'
- **Gas** operators may see flat status or slight decline
- RBLs focusing more on cash flows than reserves

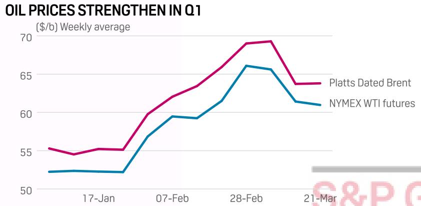
April's round of bank borrowing redeterminations for **North American** upstream companies is expected to be much improved from its gruesome counterpart six months ago, financial specialists say, with industry fundamentals that were just starting to show promise a half-year ago now much improved.

A substantially higher average oil price, continued spending discipline by upstream producers, generous cash flows reaped from lofty **crude** prices and less indebted balance sheets all position E&P companies for better creditworthiness in lenders' eyes, if not also slightly more access to capital.

"You'll probably see increases in borrowing bases, especially when [oil] prices are where they are" at around $60/b **WTI** , said Thomas Watters, managing director for oil and **gas** at S&P Global Ratings. "Clearly, [producers are] in a good position when it comes to pricing. Companies make money at these prices."

That price improvement is due to the current industry fundamentals compared to the round of late-2020 borrowing base redeterminations. Oil prices have averaged $58.20/b in Q1 2021, up from $40.92/b in Q3 2020, the quarter just prior to reevaluations six months ago.

OIL PRICES STRENGTHEN IN Q1



Source: S&P Global Platts

'Going sideways'

On the other hand, certain companies might see bank credit lines slightly lower this season, including, for example, producers with a higher proportion of natural **gas** output.

Gas was "stressed" in Q1 2021, Jonathan Harms, managing director of the restructuring group at Opportune, noted. "I think banks are more about maintaining where levels are already instead of taking aggressive actions in this price environment."

"Overall, I probably characterize this year as going sideways on borrowing bases," Harms said. "No one will step out (lenders) and make a bold increase but they're not overtly looking to cause a problem in companies' liquidity either."

Operators' access to bank credit lines may also depend on the amount of drilling companies have done over the past year, Harms said.

"Sometimes the upside in commodity prices doesn't offset the amount of production roll-off that's occurred" over a given time span, he said.

A focus on cash flow

While banks constantly review upstream companies' financials, they issue formal creditworthiness "report cards" to producer-borrowers twice a year, around April and again around October.

A big factor in E&P companies' financial health has been reserves, since they serve as a gauge of future cash generation. Reserve-based lending, or RBL, has been the **gold** standard in banks' determinations of how much access to cash they will grant producers.

However, in the current environment of less focus on production and more on reaping cash in the here and now, cash may play an increasing role in the evaluations, experts said.

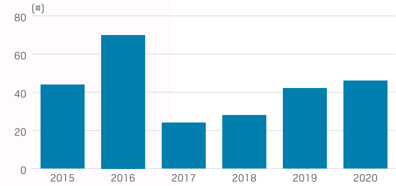
"RBL can be just an asset-backed loan where they aren't looking at cash flows, but it can also have financial covenants that look at cash flows the assets are actually generating," said Jeff Nichols, co-chair of the energy practice group at international law firm Haynes and Boone. Going forward, "there might be less emphasis on the asset-backed nature of it and more on cash flows."

Lending guidelines that came out in 2015, which marked the first year of a major multiyear oil price downturn, reflected a growing shift from an asset focus to more of a cash flow focus.

Now, six years later, public markets are "very focused" on cash flows, Nichols said.

The 2015 lending guidelines also suggested E&P operators keep their debt levels at less than 3.5 times debt/EBITDA, at a time when indebtedness could sometimes be 5x or even higher. Given today's climate of fiscal austerity, many operators have set a goal of 1.5x-2x, and some are even 1x or less.

NORTH AMERICAN E&P BANKRUPTCIES ROSE IN 2020



Source: Haynes and Boone

Bankruptcies to slow

Haynes and Boone is currently conducting its twice-year survey of bank borrowing base redeterminations, which will likely be released early in April.

The firm is also compiling a new quarterly updated Oil Bankruptcy **Monitor** to include Q1 upstream bankruptcies. In 2020, there were 46 upstream bankruptcies, but that should drop this year with higher oil prices, Nichols said.

Consultancy Rystad Energy, which a year ago projected 170 bankruptcies this year, in an update from January 2021 lowered that to around 26 E&P bankruptcies this year and 22 in 2022, roughly in line with 2017-18 levels.

As the year progresses a lot of what happens for the October 2021 redeterminations round will depend on the stability of oil prices and how operators perform according to certain metrics like living within cash flow, paying down debt and controlling cost in the field.

For a lot of companies, it's a "prove-it year," Harms said.