BRACEWELL

INSIGHTS

Distressed Opportunity?

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They say "A pessimist finds a problem in every opportunity and an optimist finds an opportunity in every problem". The recent sharp downturn in the oil price has certainly hurt many parts of the oil and gas sector - and some of the sectors that go with it - and, let's be honest, there has been no dearth of pessimists. But with every situation of rapid change there will be winners and losers and in the E&P space now the situation will be no different. One of the intriguing things when you examine the debt markets for independent in the US and EMEA is how little they have in common. Some of you may have read our magnum opus "***Reserve Based Finance: A tale of two markets***" which looks, some would say in excruciating detail, at the differences between the US and International RBL markets. Those differences are playing out very clearly in the current downturn and we think there are currently some unseen opportunities for US credit investors in EMEA. When one compares the landscape for independents operating in EMEA with that of their US counterparts a number of points loom large:

- EMEA companies are significantly less levered than their US counterparts
- Those EMEA companies that have debt have relied predominantly on bank RBLs and few have issued bonds. A very small subset have both bonds and bank debt
- EMEA RBLs are often fully drawn rather than used as a working capital line (as is not uncommon in the US) so when an RBL contracts it may trigger an immediate debt repayment
- The problem with RBLs is that in a time of low oil price the company faces a " double whammy" - reduced cash flow from the sale of its production and a contraction of its debt facilities at the very point it needs more debt capacity
- Second lien (or "Junior Debt" to use the UK terminology) is a vital part of the debt armoury in the US but it is all but not existent in EMEA
- EMEA companies are generally less hedged than their US counterparts so the oil price downturn will hit them more quickly and harder

- EMEA "plays" that have been debt financed are conventional fields not shale plays, so there may be little practical option of scaling back CAPEX to mitigate a short term funding shortfall.

In short, there are E&P companies in EMEA who have great assets, low leverage, a looming funding gap and, with the debt capital markets all but closed for the independents, no source of debt funding other than their (contracting) RBL facilities. So where are you second lien investors? In the EMEA arena your hour has come!