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Defaults Mount in Beleaguered Energy Industry

Default rate accelerates among U.S. oil and gas companies

A SandRidge Energy oil field *PHOTO: ASSOCIATED PRESS*

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The well is running dry for deeply indebted energy companies.

Samson Resources Corp. became the latest, and largest, victim of an industry downturn, as it filed for chapter 11 protection late Wednesday. Industry experts say more oil-and-gas companies are poised to follow the Tulsa, Okla., company into bankruptcy as oil prices remain low following a steep drop that began last year.

The default rate among U.S. energy companies has accelerated in recent months to 4.8%, the highest level since 1999 and up from 3.3% in August, according to Fitch Ratings.

Within that group, exploration and production companies like Samson are defaulting at an even higher rate, 8.5%, Fitch said. Default volume for such companies is the highest it has been in five years, at $10.4 billion in debt.

The broader U.S. corporate default rate is 2.9%, according to Fitch.

Meanwhile, the yield on a basket of U.S. junk-rated energy bonds has risen to 11%, just off its highest level since July 2009 and up from 5.9% a year ago, according to Barclays PLC. The increase indicates a lack of investor confidence that the bonds will be repaid in full. Yields on debt rise as prices fall.

"Everything has been turned upside down," said Marc Lasry, head of hedge- fund firm Avenue Capital Group, which recently raised $1.3 billion for an energy-focused fund. "If you're equity it's been total devastation. If you're the high-yield guys you're in total shock and you have no idea what to do," he said, referring to investors in stocks and risky debt.

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Jefferies Group LLC said Thursday its debt-trading business lost $90 million on more than 25 distressed energy positions in the nine months through September.

Energy producers pressed for cash largely managed to stay afloat after oil prices began falling last summer, as investors continued to provide funding to allow them to ride out lower prices. But now, some of the most debt-laden companies are running out of money as their lenders turn off the funding spigot.

Last month, rig operator Hercules Offshore Inc. entered bankruptcy to complete its own billion-dollar debt-for-equity swap. Samson and Hercules are among six energy companies to default in the past six weeks, according to Fitch.

More defaults may occur after October, when banks are expected to reduce the amount of credit they provide to these companies.

U.S. banking regulators told banks earlier this year that a large number of loans they have issued to energy producers are substandard, a move that could force lenders to tighten the purse strings.

Still, many large energy companies will be able to ride out low prices for years, though some have scaled back shareholder-friendly measures like dividends and stock buybacks.

But about a quarter of the oil-and-gas producers tracked by Moody's Investors Service are rated B3 or lower, deep in junk territory.

Andrew Calder, a partner in Kirkland & Ellis LLP's Houston office, said producers are starting to conclude they have few options left for riding out the downturn.

"It's a lot easier to get management teams to meet with your restructuring partners or financial advisers," he said.

The energy slump also is stinging investors that extended lifelines to troubled energy companies.

Starved for investing opportunities during a long period of low corporate defaults, distressed-debt buyers earlier this year rushed to buy bonds issued by cash-strapped energy companies in a bet that prices would remain stable or rebound.

Instead, the value of the new debt fell along with oil prices. Billions of dollars worth of bonds issued by Energy XXI Ltd., SandRidge Energy Inc. and Midstates Petroleum Co. and others have sold off since they were issued this year.

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Funds managed by Franklin Resources Inc., Blackstone Group LP and Oaktree Capital Group LLC, among others, have faced big paper losses on investments in oil-and-gas producers and explorers this year, The Wall Street Journal has reported.

Samson's bankruptcy filing, meanwhile, will wipe out the roughly $4.1 billion in cash KKR and its partners invested in the company. The private-equity firm led a $7.2 billion leveraged buyout of Samson in 2011, the biggest-ever such deal for an oil-and-gas producer.

The company's junior lenders, a group that includes distressed-debt investors Silver Point Capital LP, Cerberus Capital Management LP and Anschutz Investment Co., are in line to take control of Samson when it emerges from chapter 11 protection.

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