THE WALL STREET JOURNAL.

hUp:/lwww.wsj.comlarticlesldeep-debt«eeps-oil-firms-pumping-1420594436

BUSINESS

Deep Debt Keeps Oil Firms Pumping

Producers Have Increased Their Borrowings by 55% Since 2010

By ERIN AILWORTH, RUSSELL GOLD and TIMOTHY PUKO
Jan. 6, 2015 8:33p.m. ET

American oil and gas companies have gone heavily into debt during the energy boom, increasing their borrowings by 55% since 2010, to almost $200 billion.

Their need to service that debt helps explain why U.S. producers plan to continue pumping oil even as crude trades for less than $50 a barrel, down 55% since last June.

But signs of strain are building in the oil patch, where revenue growth hasn't kept pace with borrowing. On Sunday, a private company that drills in Texas, WBH Energy LP, and its partners, filed for bankruptcy protection, saying a lender refused to advance more money and citing debt of between $10 million and $50 million. Neither the Austin-based company nor its lawyers responded to requests for comment.

Energy analysts warn defaults could be coming. "The group is not positioned for this downturn," said Daniel Katzenberg, an analyst at Robert W. Baird & Co. "There are too many ugly balance sheets."

PHOTO:

The industry is also expecting a wave of asset sales and consolidations, though it may not gain momentum until the price of oil stabilizes and values become clearer. Bankers say companies are reluctant to get acquired with their stock prices under pressure, as they fear they could be selling low, and buyers don't want to overpay if prices fall further.

And mergers aren't a panacea.

"To be a consolidator of a company that has a large cash-flow hole, you have to have the ability to fulfill that cash-flow need," said Dennis Cornell, managing director and head of energy investment banking for the Americas at Morgan Stanley. "You can't expect two companies with big problems with their cash flows to come together and mitigate that problem."

Instead, the investment bank is "thinking of more creative ways of getting capital to clients," he said, for example through private injections of capital.

Before crude prices began falling, U.S. oil and gas producers were able to acquire leases and drill wells even if that meant outspending their incomes. Debt was used to bridge the cash shortfall so that companies could develop oil fields in Texas, North Dakota and newer locations including Colorado.

In 2010, U.S. companies focused on producing oil and gas had $128 billion in combined total debt, according to financial data collected by S&P Capital IQ.

As of their latest quarter, such companies had $199 billion of combined total debt. The group doesn't include Exxon Mobil Corp. and Chevron Corp., which also make money from refining, chemicals and pipelines.

Oil and gas producers' revenues grew more slowly-rising 36% to $239.4 billion in the 12 months ended September 2014 versus $175.8 billion in 2010.

But oil is languishing at five-year lows-the U.S. benchmark fell to $47.93 on Tuesday-and natural-gas prices have fallen by 40% since June from about $4.70 per million British thermal units to less than $3.

Despite the cold winter, companies in the U.S. have been pumping enough gas to fill up storage around the country to high levels not seen in nearly five years.

RELATED

- U.S.Steel Idles Plants on Oil Impact (http:llwww.wsj.com/articles/u-s-stael-to-cut-jobs-amid-low-oil-prices-1420556069)
- Brent Crude Briefly Falls Below $50 a Barrel (http://www.wsj.com/articleslbrent-crude-falls-below-50-a-barrel-1420609392?tesla=y&mg=reno64-wsj)

Companies are focusing on cash conservation, balance sheet mending and meeting lending covenants.

"Having control of your debt and ensuring you have a good level of liquidity going into this commodity cycle is obviously important to us," said Harold Hickey, president and chief operating officer of EXCO Resources Inc. of Dallas. He said the company had been working to shore up its balance sheet since before the crude price collapse.

The company, which produces mostly natural gas, had revenue of $713 million for the 12 months ended September. It has long carried a heavy debt load, which hit nearly $1.9 billion at the end of 2013. Mr. Hickey said the company cut its long-term debt to $1.35 billion by September 2014, in part by selling some assets, and in December suspended its dividend. Even so, the company's shares have cratered, plunging from over $6 apiece last spring to under $2 on Tuesday.

While no energy company has defaulted on its bonds or other debt, CreditSights Inc. has identified about 25 at risk, because of small asset bases, high debt and low cash flow.

The list is headed by Sabine Oil & Gas LLC and Forest Oil Corp. -which merged last month into Sabine Oil & Gas Corp.-and closely held Venoco Inc., which focuses on California. None responded to requests for comment.

Quicksilver Resources Inc. would also be on the list except that it was already trying to restructure its debt out of court, said Brian Gibbons, the research firm's senior oil and gas analyst. Moody's downgraded Quicksilver deeper into junk status in September, noting the company had been failing at its attempts to sell assets in order to help it refinance and cut outstanding debt. Quicksilver didn't reply to a message seeking comment.

Lenders are already doling out tough love to companies, said Chad Mabry, an analyst who follows small and midsize producers for investment bank MLV & Co. Some lenders are asking producers to provide plans for how they will handle further drops in the price of crude, he said, while others are pressing for asset sales.

"The bear call has been right so far," Mr. Mabry said. "Without being able to really call a bottom yet, it's hard to have much conviction to the long side, to the bull case."

The upshot of cash conservation and higher borrowing costs will be less money spent on producing oil and natural gas. However, it is unclear whether overall U.S. output will decline, since some larger producers still expect to produce more oil and natural gas in 2015 than last year by focusing on their best drilling prospects.

Concho Resources Inc. said late Monday that it was cutting its capital spending budget by a third, to $2 billion. But the Midland, Texas, company estimates production will rise 16% to 20% over 2014's level.

-Dana Mattioli and Dan Malinski contributed to this article.

Write to Erin Ailworth at Erin.Ailworth@wsj.com and Russell Gold at russell.gold@wsj.com