Oil Industry May See Cash Tighten as Banks Face Pressure

April is a big month for energy companies when it comes to lines of credit many of them depend on.

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U.S. oil and gas companies have been hammered by collapsing crude prices, and now the banks that provide their lifeblood are under pressure to curb their lending to them.

This month, the energy industry has entered a regular, twice-annual review period that will determine whether banks reduce their access to credit. The current period comes at a time when only the healthiest drillers are able to tap equity and bond markets.

Banks and syndicates of lenders typically extend loans to drillers in the form of a revolving line of credit. That is the go-to financing option for day-to-day expenses. When exploration and production firms need more funding, they typically take out a second lien loan or issue new equity or bonds.

Those credit lines are tied to the value of drillers' proved oil and gas reserves. Since those asset values fluctuate with commodity prices, banks re-evaluate their energy customers' creditworthiness twice a year in a process the industry calls the borrowing base redetermination.

On average, lenders, borrowers and other stakeholders expect a 38 percent decrease in borrowing bases, according to a survey by Houston-based law firm Haynes and Boone.

With U.S. crude futures down 62 percent from their 2014 high, the best most drillers can hope for is to have their existing borrowing ability left intact. In the worst-case scenario, the borrowing ceiling is slashed below the outstanding balance, and the company can't make interest payments, triggering bond covenants that lead to bankruptcy.

Redeterminations were "pretty benign" last year as lenders mostly remained accommodating, said Andrew Brett, a real assets research consultant at investment consulting firm NEPC. But banks now face internal issues as the assets that back energy loans look more distressed, he said.

Banks have been increasing their provisions for bad loans. Earlier this year, JPMorgan announced it was adding $500 million to an $815 million reserve to cover potential losses in its energy loan portfolio.

Banks simply do not want to lend to oil and gas customers at this point, and they see an opportunity to reduce their exposure to unfunded energy loans by cutting borrowing bases, said Kim Brady, a restructuring specialist and partner at financial advisory firm SOLIC Capital.

"To the extent that the borrowing base can be lowered without the company going out of business ... I think their goal is going to be to reduce their exposure as much as they can," he told CNBC.

If a bank lowers a driller's borrowing base too much, it can push the company into bankruptcy and leave the lender holding depressed assets. Banks have already cut the borrowing bases of more than a dozen oil and gas companies by a total of $3.5 billion, or roughly a fifth of available credit, according to data compiled by Reuters.

But it could be some time before investors get a full picture of things. Banks typically process the easy cases first and put off the tough ones as they work to reach solutions with borrowers, according to Buddy Clark, head of the energy practice at Haynes and Boone.

'Anti-hoarding' measures

With more producers in distress, banks have recently begun committing drillers to "anti-hoarding" agreements that require them to spend a portion of the money they draw from their credit facility on expenses like payment to vendors or new production. That discourages borrowers from maxing out their revolving credit to build a war chest for bankruptcy, Clark said.

After fully drawing its revolving line earlier this year, SandRidge Energy said last month that it engaged advisors to explore its options, including private restructuring or reorganization under Chapter 11. The company said its ability to continue as a going concern was in doubt.

But maxing out a line of credit is not always a sign that companies are raising the white flag, Clark said. It may be prudent — and in keeping with fiduciary duty to shareholders — to shore up cash if a driller anticipates it will not pass tests built into its public bonds.

Indeed, about two-thirds of the respondents in the Haynes and Boone survey expect drillers facing a borrowing base deficiency to either negotiate an amendment or extension with the lender, or to sell noncore assets. Only 13 percent expected to declare bankruptcy.

A separate review of some syndicated loans conducted in February could have spillover effects on bank redeterminations. The Office of the Comptroller of the Currency recently released new guidelines for examiners who carry out its Shared National Credit program, which reviews loans of $20 million or more that are shared by three or more institutions under OCC supervision.

Clark said that until banks have more clarity on how the new guidelines will be enforced, banks are likely to be conservative in their redeterminations out of concern that the OCC will later flag a revolving credit line as at risk of not being repaid. In that case, a bank would have to set aside reserves to cover potential losses.

'If you don't need money, you can have it'

With the loan market getting tighter, some drillers have returned to equity and debt markets.

U.S. energy exploration and development companies raised about $10.5 billion in equity in the first quarter of 2016, slightly less than in the same period last year, according to Dealogic. The sector raised an additional $9.7 billion in debt.

But it's largely the healthy companies that are able to tap equity markets, analysts said.

"It seems like if you don't need money, you can have it," said Brian Velie, equity analyst at Capital One. Many drillers who borrowed in the first quarter of 2015 "have gone right back to the well in the spring of 2016 with the same kind of relatively warm reception."

Capital One recently surveyed drillers to find out how they planned to use the proceeds, and found a range of plans.

According to that survey, Cabot Oil & Gas said it raised cash to reduce its debt ratio, a key measure of health that can trigger default if it goes too high. Marathon Oil and PDC Energy said their issuance was insurance against the threat of lower oil prices. Conversely, QEP Resources said its $380 million in follow-on proceeds positioned it to add rigs if prices rebound.

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