The Deal

Chesapeake Will Repay Near-Term Bonds

February 24, 2016

Shares of Chesapeake Energy Corp. (CHK) rose Wednesday, Feb. 24, on the news that it does, in fact, plan to make good on $500 million in 3.25% senior unsecured notes due March 15.

The Oklahoma City natural gas and oil producer on Wednesday announced its earnings for the quarter ended Dec. 31. It noted it is prioritizing dealing with near-term debt maturities in its deleveraging effort and will repay the 2016 notes next month.

Kim Brady, a senior managing director at advisory firm SOLIC Capital LLC, said there had been concerns in the market that Chesapeake would elect not to pay the 3.25% bonds.

Brady, who follows Chesapeake but isn't involved in its restructuring, said this is a "positive sign," but Chesapeake still has a "pretty tough road ahead" as it works to manage a staggering debt load.

Chesapeake had $10.35 billion in long-term debt, net of discounts, as of Dec. 31, the company said.

Brady pointed out that Chesapeake's equity investor base is unusually concentrated, with 60% of the company owned by six investors including heavy-hitters Carl Icahn, Capital Research Global Investors and Southeastern Asset Management Inc. Given that circumstance, he believes the company's board, which includes representatives from those shareholders, would strongly resist a bankruptcy filing, which would wipe out equity holders.

Still, with short positions accounting for about 44% of Chesapeake's equity float, "the market is essentially saying they'll have to file, but management is working hard to prove otherwise," with asset sales, cost cuts and debt reduction, Brady concluded.

"We see [Chesapeake's] financial distress as becoming even more clear and more dire," Jefferies LLC analysts said in a Wednesday report. The firm criticized the company's "alarming" cash burn and "sky-high" capital expenditure budget.

Chesapeake does plan to cut its capital expenditures by 57% in 2016 compared with 2015.

On Wednesday's earnings call, Chesapeake president, CEO and director Robert Douglas Lawler emphasized $2.2 billion in debt reduction since the third quarter of 2015 through a bond exchange and open-market purchases at below-par values.

"It's also no secret that we're looking forward to reducing our debt load even further in 2016," he said on the call.

Chesapeake CFO Domenic Dell'Osso said on the call that the company's top priority would be to remove its 2017 and 2018 debt maturities, which were among the bonds subject to the exchange offers. (Three series of bonds totaling more than $1.7 billion due 2017 and 2018 were outstanding as of Sept. 30, before the exchange offers.) He said the company was looking into issuing additional secured debt, privately negotiating with bondholders, and commencing debt exchange and tender offers, in addition to continuing its practice of open-market purchases.

Dell'Osso pointed to Chesapeake's $4 billion in availability on its revolving credit facility due Dec. 15, 2019, as an important resource.

Jefferies analysts said in their Wednesday report, though, that liquidity is a concern because, "We believe that the borrowing base is likely to be cut (possibly harshly) in the spring redetermination period" and noted that is something to watch because of the $500 million note maturity in March.

On the earnings call, Dell'Osso said his company could "maintain robust liquidity" even as its borrowing base is redetermined in April by potentially pledging unencumbered assets previously used to secure a recently terminated hedging facility as security for the revolver.

Lawler also noted that Chesapeake has agreed to sell $700 million in assets in 2016, even more than the $200 million to $300 million the company had forecasted for the first quarter.

Furthermore, he said the company has received several sales inquiries about smaller noncore properties worth about $10 million to $500 million, although there has been "very low" interest in assets valued at $1 billion or more.

"We expect to continue to make progress on several smaller asset divestitures, which when taken together can add up to meaningful amounts until we can evaluate the possibility of divesting a larger asset," Lawler explained, adding that the goal is to raise an additional $500 million to $1 billion from divestitures in 2016.

FourPoint Energy LLC announced Wednesday that it has agreed to pay $385 million for all of Chesapeake's remaining western Anadarko Basin oil and gas assets. The deal includes 3,500 producing wells primarily in the Granite Wash, Missourian Wash, Upper and Lower Cleveland and Tonkawa formations, containing 67% natural gas and 33% oil and natural gas liquids. FourPoint anticipated it would close the purchase on April 29.

Chesapeake reported adjusted Ebitda of $298 million and a $2.06 billion net loss during the fourth quarter, mostly due to impairments of the carrying value of its oil and gas properties. In the same quarter in 2014, the company posted $916 million in adjusted Ebitda and $34 million in adjusted net income available to common stockholders.

Chesapeake had $825 million in cash and cash equivalents as of Dec. 31, down from $4.11 billion a year earlier.

Its New York Stock Exchange-listed shares closed at $2.67 on Wednesday, up 22.2% from Tuesday's close. Nevertheless, the stock is down nearly 87% over the past 12 months. Chesapeake has a market capitalization of $1.78 billion.

The 3.25% bonds due March 15 jumped on the news that they will be repaid. They were trading above 99 cents on the dollar Wednesday, according to Bloomberg Finance data. On Feb. 9, the day after Chesapeake announced it had retained Kirkland & Ellis LLP as legal counsel to strengthen its balance sheet, those bonds were trading around 80 cents on the dollar, but the price crept up into the 90s afterward.

The bonds due in 2017 and 2018, however, are all trading at serious discounts.

Some €302 million ($332.9 million) in senior unsecured notes due Jan. 15, 2017, had a bid value of 43.25 and asking price of 48.75 on Wednesday, the data provider said, while Chesapeake's $453.67 million in 6.5% senior unsecured notes due Aug. 25, 2017, last traded at 42 and its $537.63 million in senior unsecured notes due Feb. 15, 2018, last traded Tuesday at 26.63.

Evercore Group LLC senior managing director Daniel M. Aronson is Chesapeake's financial adviser.

###