OUTLOOK

Lower 48 E&P Universe Forecast to Shrink, ‘Starved for Capital’ as Liquidity Dries Up

The market disruption from Covid-19 is forecast to unsettle long-term energy consumption patterns and heighten price volatility, with better financed operators ready to pounce on distressed Lower 48 assets, according to Moody’s Investors Service.

An extended oil price slump partly sparked by the pandemic, “will amplify disparities between stronger and weaker” exploration and production (E&P) companies. The well capitalized operators, along with the global majors, “will consolidate U.S. shale assets,” credit ratings analysts said.

The “universe of leveraged E&P companies

Leveraged E&P, OFS Operators Looking for Stronger WTI to Elude Bankruptcy

Barring higher U.S. oil prices, about 150 more energy operators could face Chapter 11 bankruptcy filings through 2022, a new analysis by Rystad Energy indicated.

The pandemic has burdened the upstream industry, hitting debt-ridden operators particularly hard, analysts noted. West Texas Intermediate (WTI) oil has risen above $40/bbl, but exploration and production (E&P) companies and their oilfield services (OFS) brethren may have no alternative than to file for voluntary protection.

“While an improvement in oil prices toward $40/bbl WTI saved a significant number of E&Ps and prevented early Chapter 11 filings in June-July, the current

ANALYSIS

As Election Nears, U.S. Energy Industry Assessing Impacts of Possible Trump Loss

The oil and gas industry is bracing for a possible November victory by Joseph R. Biden Jr., who is leading in the polls and who officially accepted the Democratic nomination last Thursday from Wilmington, DE.

President Trump was officially nominated for a second term on Monday as the Republican convention began.

Although energy policy has taken a backseat to the Covid-19 pandemic and economic hardship facing Americans, climate change has nonetheless garnered more attention this election than in any past cycle.

Biden is calling for aggressive action on climate and an emissions-free power sector by 2035, while President Trump has promised to continue a deregulatory

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Notable:

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- As Election Nears, U.S. Energy Industry Assessing Impacts of Possible Trump Loss

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Notes: Table represents fixed-price delivered-to pipeline transactions in USD/MMBtu. These data are comprised of deals that NGI believe represent trading activity in the respective resource plays and may contain gas that was produced from conventional formations. * Denotes a tight sands formation. Volumes may not total due to rounding. For more information, please see NGI’s Shale Price Methodology.
Argentina Appoints Energy Secretary from Neuquén, Home to Vaca Muerta

Argentina’s government on Monday announced that Dario Martínez would take over from Sergio Lanzian as the Energy Secretary, the top position in the energy sector. Martínez was head of the energy committee in the lower house. He previously worked for state energy firm YPF SA, and he hails from Neuquén Province, where most of the world class Vaca Muerta shale deposit is located.

Energy policy has remained vague under the government of Alberto Fernández, who assumed the presidency at the end of last year, and the industry has been hampered by the coronavirus, leaving the future of Vaca Muerta uncertain.

“I believe that the relevance of Vaca Muerta has been clear for the new administration ever since they took office,” Buenos Aires-based Wood Mackenzie analyst Ignacio Rooney told NGI. The previous secretary “had taken time to name his complete team, and it was contradictory to see this time taken when the energy area was so relevant for the new administration. The expectation is to see more action from the new secretary.”

Natural gas production in Argentina decreased by 10% year/year in June to 126 million cubic meters/day (MMm3/d), or 4.45 Bcf/d, according to the Energy Secretariat.

One of the first matters expected to be addressed by Martínez is the country’s gas tender plan aimed at ramping up natural gas production. The proposed tender system would consist of a four-year block auction mechanism starting in October, which would differentiate offers for the peak winter season and the rest of the year, according to the IAE Argentine Energy Institute.

Prices for offers from gas companies would be set at a limit of around $3.40/MMBtu.

“Providing a four-year price signal allows companies to extend their planning horizon and reduce a portion of short-term volatility,” Rooney said. “However, this is a long-term industry, and companies look beyond those four years. The industry also requires commitment after year four, which could be addressed by defining sequences of auctions that could happen on a yearly basis combined with short-term auctions to address demand peaks.”

Another shift in the energy sector in Argentina has been that the Energy Secretariat, once the Energy Ministry, now falls under the domain of the Economy Ministry.

The reasoning has been that the gas plan, along with a previously announced oil scheme, will mean rising government subsidies are needed in the sector. The government would have to pay the difference between what distributors and end users pay and what has been promised to producers.

Accumulated energy subsidies were $2.6 billion in the first half of 2020, double the same period last year, according to the IAE.

“It can be read as a stricter fiscal control,” Rooney said, referring to the change. “The energy sector in Argentina drives a significant portion of subsidies, and these will face higher scrutiny now.” The natural gas plan ...cont’ pg. 3
“is another element of the broad subsidy scheme in the whole energy sector, and the Economy Ministry will be looking at them in greater detail.”

Earlier this month the Argentine government announced it had reached a preliminary agreement with its biggest creditors to restructure $65 billion in foreign debt. The government said the agreement would allow creditor groups to support the debt restructuring proposal and “grant Argentina significant debt relief.”

If the deal goes ahead, along with another debt agreement pending with the International Monetary Fund, Argentina would regain access to foreign capital markets, which is seen as key to lifting an economy that is now in its third straight year of recession.

Lower 48 E&P Universe Forecast to Shrink, ‘Starved for Capital’ as Liquidity Dries Up

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will shrink substantially amid waning bank and investor support as a prolonged downturn further discourages debt investors from the E&P sector.”

Disparities between the E&P “haves and havenots” are amplified by the pandemic.

“All E&Ps are expected to take a hit on output and cash flow” into next year. However, E&Ps that were operating with higher costs and leverage before the...cont’ pg. 4
coronavirus downturn “will shrink considerably, starved for capital, lacking access to market, and will face increasing restructuring risk as hedges and liquidity run out.”

More than half (52%) of the E&Ps rated by Moody’s have a “negative” outlook today “reflecting elevated liquidity and solvency risks.”

The “growth-at-any-cost business model” by the traditional E&Ps “has proved unsustainable in recent years.”

In addition, the push toward decarbonization around the globe “has left some market participants uneasy over oil’s long-term sustainability.”

E&Ps had sold capital inflows between 2010 and 2014, but since then, debt investors have cut their exposures to operators that long have lost money.

Rebalancing the global oil market, meanwhile, is going to require E&Ps to remain disciplined “for at least two years to ensure that demand recovers more quickly than supply,” the analysts said. The natural gas market’s recovery also is forecast to take time, although the overall impacts may be less severe than for oil.

“The U.S. natural gas market will benefit from slower growth in oil production — and by extension less associated gas production in 2020-21,” the Moody’s team said. “But oversupplied global markets for liquefied natural gas will hamper growth in U.S. natural gas exports in the medium term, and will slow the construction of new export facilities.”

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Source: Tallgrass Energy LP, NGI calculations. For more info and daily 10am ET updates of this chart, go to natgasintel.com/rextracker.
Overall, oil and gas prices are likely to remain volatile because of the ongoing adjustment in supply and the significant inventory overhang.

“We expect that oil prices will remain highly volatile but will recover toward our medium-term price range of $45-65/bbl,” the credit ratings analysts said. “We expect that natural gas prices will recover to our medium-term price range of $2.00-3.00/MMBtu.”

Investment activity is likely to rebound from 2020 lows but remain muted because of the higher cost of capital and uncertainty about the pace and trajectory of demand growth.

Meanwhile, decreasing oil and natural gas volumes may lead to an inflection point in the cash flow for the midstream sector, as E&P customers cut capital spending and renew or renegotiate contracts.

“Rising regulatory scrutiny will make it harder to win social licenses to build interstate pipelines and other large projects, slowing investment, and companies will increasingly need to finance themselves as capital access tightens,” the analysts said.

The demand and cash flow deterioration seen in the first half of this year also imply “significant trouble” for the global oilfield services (OFS) sector.

“While the handful of investment-grade OFS majors can weather some prolonged industry stress, most speculative-grade OFS companies face an extreme liquidity crunch.”

As Election Nears, U.S. Energy Industry Assessing Impacts of Possible Trump Loss

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agenda to promote oil and gas infrastructure, and exploration and production (E&P).

While Biden did not mention oil and gas in his acceptance speech to close out the Democratic National Convention, he stressed the urgency of addressing climate change. He framed the environmental crisis as “an opportunity for America to lead the world in clean energy and create millions of new, good paying jobs in the process.”

The Democratic standard bearer has pledged to ban new drilling on federal acreage both onshore and offshore, block the Keystone XL crude oil pipeline, and...cont'pg. 6
end fossil fuel subsidies.

With the clock winding down on President Trump’s first term, recent days have seen his administration lift methane regulations for the oil and gas industry, advance lease sales in the Alaska National Wildlife Refuge, and modify the Clean Water Act to expedite environmental review of infrastructure projects.

Pipeline projects in particular face more uncertainty than ever amid a barrage of legal challenges from increasingly savvy and determined environmental groups.

Republicans and the industry, meanwhile, have taken the fight to the crucial swing state of Pennsylvania, Biden’s birthplace and the country’s No. 2 natural gas producer behind Texas.

No Fossil Fuels?

Speaking earlier on Thursday in Old Forge, PA, near Biden’s birthplace of Scranton, the president warned that Biden would ban hydraulic fracturing and “basically get rid of all fossil fuels.” Biden’s energy platform makes no mention of fracturing, which when conducted on privately owned land would be unaffected by a federal drilling moratorium.

Environmental Protection Agency (EPA) Administrator Andrew R. Wheeler also chose Pittsburgh as the site to unveil the sweeping methane rollbacks. He emphasized the role of small independent producers in the Marcellus Shale in providing cheap and abundant gas through horizontal drilling and fracturing, aka fracking.

In a Friday note to clients, analysts at ClearView Energy Partners LLC noted that President Trump’s margin of victory in 2016 in Pennsylvania in the battle against Hillary Clinton “roughly corresponds to direct employment in the energy sectors and energy-intensive metallurgical sectors,” which the president “has sought to preserve with his policies.” Pennsylvania is also the nation’s No. 3 coal producer.

Poll averages on Friday compiled by RealClearPolitics.com showed Biden leading by 5.7 points in Pennsylvania. Modeling by FiveThirtyEight.com indicated a Biden victory in 73 out of 100 sample scenarios as of Friday.

‘Epicenter Of Energy’

The American Petroleum Institute (API) used a bit of public relations jiu jitsu on Thursday, releasing a video collage of past Biden speeches touting the economic and geopolitical benefits of surging domestic natural gas and oil production.

“North America will remain through this century the epicenter of energy,” said then Vice President Biden in 2016. “And by the way, the reason why all these companies are coming home is because to build a plant, natural gas is three times cheaper here than Europe and seven times cheaper than it is in Asia.”

In another speech from 2014 in Oakdale, PA, Biden said, “You all know about the Marcellus Shale, I think you’ve heard of that, right? There’s an energy boom that’s changed the paradigm of manufacturing. It’s cheaper to manufacture in the United States than it is in Europe and/or in Asia.”

The Obama-Biden administration, while unpopular among some domestic fossil energy companies, presided over the resurgence in U.S. oil and gas production, as well as the lifting of a ban on crude oil exports that had been in place since 1975.

In a 2015 speech, Biden hailed “the ascendancy of the Americas as the epicenter of energy production in the world. We have more oil and gas rigs running in the United States than all the rest of the world combined.

“Mexico, Canada and the United States is the new epicenter of energy — not the Arabian Peninsula.”

Energy Execs Weighing In

The election was also a hot topic in second quarter earnings calls held by the country’s leading publicly traded energy names.

“Right now it looks like Biden is leading,” said Pioneer Natural Resources Co. CEO Scott Sheffield during the quarterly earnings call. “It’s obvious, and ...cont' pg. 7
unless something happens...this country could elect Biden and there will be some significant changes.”

Sheffield continued, “I think most of that will be on federal lands. There is discussion about banning on fracking. I don’t know what the end result will be. But as we have noted, we have zero lands on federal lands, and so should be unaffected.

“I would expect pipeline infrastructure will be significantly delayed crossing state lines. Again, all of our acreage is in Texas and we move our oil and our gas through the Gulf Coast. So anticipate no issues there.”

Said Diamondback Energy Inc. CEO Travis Stice, “We don’t have a lot of clarity on what the regulatory environment’s going to look like if we fast-forward to an administration change, but what we do know is that it won’t speed up.”

DCP Midstream Partners LP CEO Wouter van Kempen said the firm’s exposure to a federal drilling ban would mainly be in southeastern New Mexico, epicenter of the state’s Permian Basin holdings.

“I think it has been very clear for everyone that if something would happen and you would get a moratorium on fracking on federal lands, you can’t put that in on a retroactive basis,” he said. Therefore, “there is no scenario in which” DCP’s New Mexico customers “cannot continue to develop that for the next 10-plus years or so.”

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**Leveraged E&P, OFS Operators Looking for Stronger WTI to Elude Bankruptcy**

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price environment is in no way sufficient for a large number of E&Ps in the medium-term,” said Rystad’s Artem Abramov, head of Shale Research.

“As hedging programs set at WTI $50/bbl-plus expire in the second half of this year, we anticipate greater financial pressure on the industry unless WTI prices recover further.”

To date this year, nearly three dozen E&Ps have filed for Chapter 11, with cumulative debt of about $40 billion, according to Haynes and Boone LLP. At least 25 OFS operators also have sought voluntary bankruptcy protection.

Rystad’s E&P Chapter 11 model is based on a cash flow analysis that covers about 10,000 active North American oil and gas explorers. The model was designed as a macro-level outlook rather than individual company insights.

If WTI were to remain at around $40, Rystad’s team estimated “29 more E&P Chapter 11 filings this year, adding another $26 billion of debt at risk.”

With WTI hovering at around $40 into 2022, there could be another 68 E&P bankruptcy filings in 2021, adding $58 billion in debt. In 2022, there could be 57 more E&P filings, with debt of around $44 billion.

“That would bring the total amount of E&P debt at risk from now until the end of 2022 to $128 billion,” analysts noted.

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**North American E&P Chapter 11 Case and Debt Scenarios by Year and WTI Price**

*Source: Rystad Energy*
If WTI were to remain “largely unchanged” from current levels, the total number of North American E&P filings for 2020-2022 could rise to almost 190. Between 2015 and 2019, there were almost 190 E&P filings.

The total debt for North American E&Ps between 2020 and 2022 could reach about $168 billion, “36% higher than the $122 billion recorded in 2015-2019,” analysts noted.

The number of bankruptcies year-to-date is below the total recorded in the previous downturn, particularly filings made 2016. However, total debt combined for E&Ps and the OFS sector through the first seven months of 2020 already matches full-year 2016 at $70 billion.

“Looking at the average debt per company, 2020 seems to be a clear outlier, at $1.2 billion,” analysts said.

“This is 160% higher than the average debt of $460 million recorded in the 2015-2019 period and twice as much as the 2017 level, which was the second highest in terms of average debt in a year.”

The E&P and OFS bankruptcy cases share some of the same dynamics this year, according to Rystad. Average E&P debt is $1.25 billion, with average OFS debt of $1.19 billion. The OFS sector usually carries lower debt than E&Ps, because there are many small OFS suppliers/providers. The capital structure of smaller E&Ps often is controlled by families.

However, the average debt for the OFS sector is higher this year because of several large bankruptcies, analysts noted.