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Sanchez Energy waits for higher oil price to realize profit

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The mounting pressure on Sanchez Energy Corporation (Sanchez), the third largest Eagle Ford acreage holder, reflects the challenge faced by drilling companies that the low crude oil price is threatening the profitability of the companies. As the price of crude oil remained low in the first half of 2017 many drilling companies planned to reduce spending and trimmed back drilling plans for at least a year. Creditors are worried about the profitability and liquidity of drillers like Sanchez Energy.

After its initial public offering in 2011, Sanchez focused on the acquisition and development of US onshore unconventional oil and natural gas resources. In 2014, it acquired a 100,000-acre block from Royal Dutch Shell. In January 2017, Sanchez partnered with Blackstone to acquire 155,000 net acres in the Western Eagle Ford from Anadarko. With the purchase of Anadarko's Comanche acreage, Sanchez Energy became the third largest Eagle Ford acreage holder. Sanchez financed the USD 2.3bn deal with a combination of cash, commercial bank and preferred equity commitments, expecting the new acreages to produce over 100,000 barrels of oil equivalent per day (Boe/d) by 2018. According to the firm’s guidance, Sanchez would be profitable if WTI Crude oil remained above USD 56 per barrel.

	Q1 2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017
Cash & Cash Equivalents (USD mn)	362.2	324.4	328.5	501.9	124.0
Net Debt (USD mn)	1344.1	1384.1	1382.1	1210.9	1757.0
Revenue (USD mn)	133.0	145.7	142.9	145.3	133.8
EBITDA (USD mn)	42.8	-16.8	13.5	64.1	19.6
EBITDA to Interest Expense (X)	1.35	-0.53	0.42	2.02	0.59

Table 1: Financial Data (GAAP) for Sanchez Energy Corp. *Source: Bloomberg*

After the acquisition, the market capitalization of Sanchez increased to more than USD 1bn in the beginning of 2017. In April, the company announced lower Q1 profit due to costs related to the acquisition. Together with the debt to acquire Shell’s assets the new acquisition increased the debt of the company to over USD 1.7bn.(See Table 1 above) Despite the decrease in profitability and liquidity, Sanchez announced an increased production rate of 51,800 Boe/d 4.7% more than the previous quarter. Sanchez was very confident to hit its full year 2017 production target of 78,000 to 82,000 Boe/d.

In June oil prices dropped to below USD 43 per barrel, the lowest level since mid-November 2016, falling below the breakeven point of USD 56 per barrel for Sanchez Energy. The RMI-CRI 1-year aggregate Probability of Default (PD), a median of the PDs for 13 US public drilling companies rose to over 100bps in June from about 40bps in the beginning of the year and the RMI-CRI 1-year PD for Sanchez shot to around 400bps (see Figure1 below). The increasing PDs imply higher credit risks for US drilling companies. The prolonged price slump worried investor that the low oil price together with its financial situation would push Sanchez to default. In August the market cap of Sanchez decreased to below USD 400mn coinciding with a RMI-CRI 1-year PD rose over 800 bps.

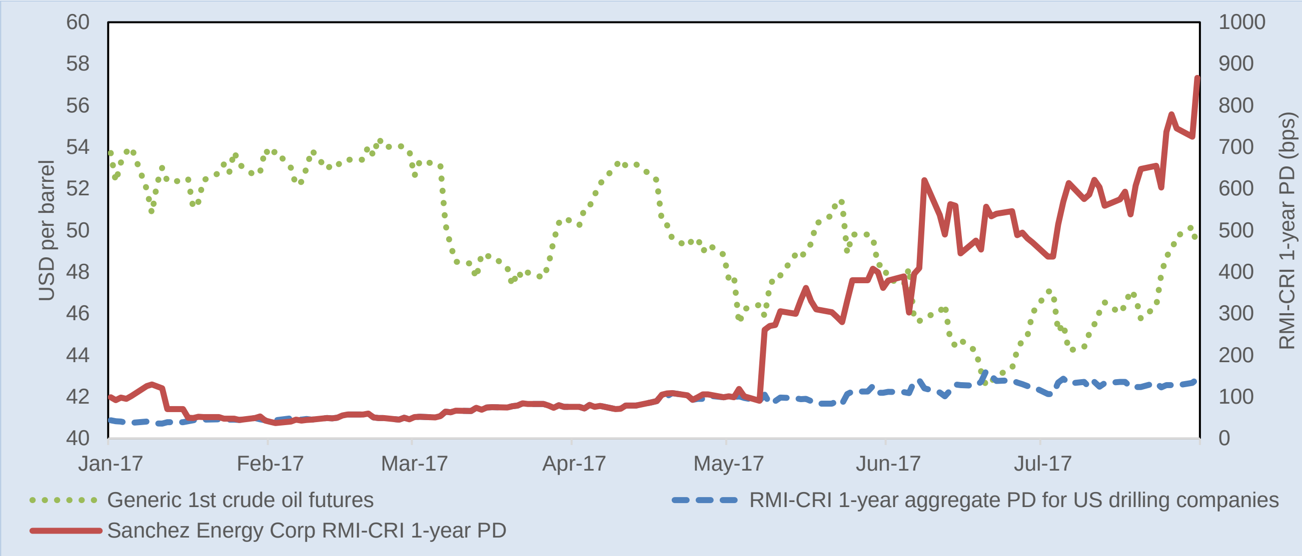

Figure 1: Generic 1st WTI crude oil futures price (LHS), RMI-CRI 1-year PD for Sanchez and RMI-CRI aggregate 1-year PD for US drilling companies (RHS) *Source: Bloomberg, RMI-CRI*

In June Sanchez managed to raise USD 50mn through an asset sale in the Eagle Ford shale. In response to the low oil price, Sanchez said they would reduce its 2018 capital budget by USD 75mn to 100mn and reduce the current eight drilling rigs to five by September this year. The earliest bond principal maturity of the company is in 2021 at USD 600mn and until the end of the Q1 2017 the company had approximately USD 565mn in liquidity which means the company still has a chance to improve its credit position. However, given the high debt and low cash in hand the company may need to focus on cutting costs in order to break even. Whether Sanchez will realize its profit goal largely depends on the future price of crude oil.

Credit News

World Bank Group issues its biggest-ever catastrophe bond

Aug 4. The World Bank Group plans to issue USD 360mn of three year catastrophe bonds on behalf of Mexico, paying bondholders 4.12 to 8.92 percent above the US Libor rate annually. These bonds typically reward investors with higher returns than other World Bank bonds as investors may lose part or all of their capital in the event of a catastrophe. Investors who bought the USD 100mn Class C tranche issue in 2012 lost 50% of their principal after Hurricane Patricia hit the Mexican coast. Demand for the catastrophe bond is expected to be healthy, even though Mexico is among countries that are most vulnerable to natural disasters in the world. (Bloomberg)

Singapore 'can help set standards' for the jungle of green bonds

Aug 3. China is the world leading bond issuer in terms of green bonds, a type of bond used to fund projects that have a positive impact on the environment. However, the standards of issuances in green bonds vary. An economist suggested that Singapore can play a key role in green bonds by formulating the standards through a policy design. The Monetary Authority of Singapore has made initiatives by offering grants to green-bond issuers to cover expenses relating to external verification, a key step in bond issuance. The call for standards is amidst the increasing number of green bonds being issued over the years. It is projected that green bond issuances will amount to at least USD 130bn in 2017. (Business Times)

South African Airways 'is on the verge of bankruptcy'

Aug 3. South Africa's national carrier is on the brink of bankruptcy as it is running out fast on cash to continue operating. The company has been making consecutive losses in the past seven years and its cash-flow statement, presented in the South Africa's parliament, revealed the dire status of the airline. South African Airways (SAA) believes that the situation will improve if it receives a GBP 45mn bailout from the government by October. However, a forecasted cash outflow of GBP 38mn by the company in December indicates the opposite. The Treasury paid out GBP 125mn in July to settle a loan between SAA and Standard Chartered

Bank. In March, SAA asked the Treasury for a recapitalization of GBP 560mn, but the finance minister has yet to give a reply. (BBC)

Shunned from bond market, US Virgin Islands faces cash crisis

Aug 2. Traditionally, US Virgin Islands looked to the Wall Street for the funding of its essential public services. Its triple-tax-exempt bonds attracted investors to pour cash into the territory. However, this source of borrowing was shut off after the bankruptcy of neighboring Puerto Rico and investors fear that Virgin Islands will be next on the list to default. The islands have the biggest per capita debt load in any US territory at USD 19,000 per person and a combined debt amount of over USD 2bn. Rating agencies have downgraded the islands' credit rating to junk range and the Islands' government responded with proposals to slash public spending and impose tax rate hikes. Like Puerto Rico, Virgin Islands' debt load exceeded 50% of its GDP after running on years of budget deficit. (Reuters)

Sunac to sell bonds to refinance debt from its shopping spree for assets

Aug 2. Sunac China, a large Chinese real estate developer, is planning to sell up to USD 1bn in bonds to raise funds to refinance its debt. The move came after a six-month, USD 14.9bn shopping spree for theme parks, a video streaming company and a carmaker. Although Moody's believes the refinancing would improve its debt maturity profile, all three major credit ratings agencies have warned of Sunac's rising liquidity risks caused by its purchase of assets from Wanda. (SCMP)

Investors rush to buy Iraq's first independent bond (FT)

Noble group 'sinking in perfect storm,' says foe after trader profit warning (Bloomberg)

Congo misses Eurobond payment as government contractor chases unpaid bills (Bloomberg)

Regulatory Updates

Mifid II drives US investment industry frantic

Aug 7. Mifid II, a set of rules coming into force in 2018 to regulate Europe's financial system, will change the way the investment industry interact. Asset managers will have to set clear budgets for research from banks and brokerages which is currently bundled into trading fees. This European regulation will affect the US investment industry as brokers in US are not allowed to receive direct payments for research unless they are registered as investment advisers. The US broking community has thus lobbied to the Securities and Exchange Commission to allow brokers to receive direct payments. Some US fund managers are also concerned as their US and European teams may not be able to share research freely while other fund managers are considering to pay for research from their own profit and loss accounts to ease complying with the regulation. The US investment industry will be seeking further clarity regarding Mifid II in the coming months. (FT)

US haul from credit crisis bank fines hits USD 150bn

Aug 7. Financial institutions have largely recovered from the global financial crisis, but the crisis has profoundly reshaped economies and markets, and its effects on politics and society remain. The public outcry for accountability ushered in an era where the US government was willing to penalize financial institutions sharply, yet most crisis-related actions were civil rather than criminal. Financial institutions have paid more than USD 150bn in fines in the US relating to the credit crisis; however, much of the public remained unsatisfied because few bankers went to prison. (FT)

US regulator moves to loosen Volcker rule

Aug 3. The Office of the Comptroller of the Currency (OCC) has taken the lead in amending the Volcker Rule which was conceived by former Fed chairman Paul Volcker and passed by the Obama Administration in 2010. Market liquidity levels have dropped significantly since the Volcker Rule came into effect as it is difficult for banks to differentiate trading situations that is in violation of the existing law. The Trump administration has announced bank deregulation and tasked the OCC to work with the Federal Reserve and Financial Stability Oversight Council to simplify the Volcker Rule. Any revision to the law would require an agreement by all five regulators but there has been little progress in a common consensus so far. (FT)

US regulators issue warning over 'aggressive lending' (FT)

UK regulator targets every single individual in finance (FT)

US financial regulation burdensome for small banks (Xinhua)

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