FIRST ALLY
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Restructuring Finance for Energy Asset Portfolio

By

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Introduction

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- The huge decline in global crude oil prices which began mid 2014 has created huge challenges for energy companies.

- Crude oil prices have dropped from over $100/barrel in June 2014 to around $40/barrel presently, and is expected to remain low, at least in the medium term.

- While the international IOCs and the larger well-diversified companies are better equipped to weather the storm, most of the Nigerian, and Nigerian-focused independent exploration and production companies are not so well positioned.

- Notably, the IOCs and the larger well-diversified companies have already taken, and are continuing to take steps to address the critical problems facing them. These include:

    - Rationalizing liquidity by suspending new projects and future expansion,
    - Selling non-core / non-producing assets to raise cash,
    - Divesting from onshore acreages,
    - Rationalizing staff to save costs,
    - Demanding price reductions from services providers etc.

- They also have substantial access to capital both in the bank and global capital markets.

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Introduction

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- On the other hand, Nigerian E & P companies have acquired significant oil and gas assets over the past six years and have borrowed heavily from local and international banks to finance the acquisitions.

- The crash in crude oil prices and the huge exposure of Nigerian banks to the oil and gas industry have heightened asset quality concerns in the Nigerian banking industry.

- Reduced appetite for new oil and gas loans is to be expected.

- In the unfolding scenario, it is only the companies that take proactive and effective steps to manage their debt problems that will survive.

- This presentation examines the growth of Nigerian oil and gas companies, how they funded the acquisition of their assets, the implication of the sharp drop in oil prices on their finances, and what they need to do to survive the raging storm.

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Build-up & Financing of Asset Portfolio

Build-up & Financing of Asset Portfolio

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- The build-up of energy asset portfolio by Nigerian indigenous exploration and production companies has been driven by three principal factors.

1. **The marginal field programme which was launched in 2003, after initial discretionary awards were made in the 1990s.**
2. **The local content programme , which prioritizes the involvement of indigenous oil and gas companies in the award of oil blocks and oil field licences.**
3. **The divestments of International Oil Companies ("IOCs") interests in onshore oil blocks.**

- Local Nigerian companies are reported to own more than 100 oil blocks across the Niger Delta region, at least 30 marginal fields, and account for some 10% of Nigeria's total production.

- IOC divestments have been largely responsible for the steep rise in the participation of Nigerian oil and gas companies in Exploration and Production over the past six years.

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Build-up & Financing of Asset Portfolio

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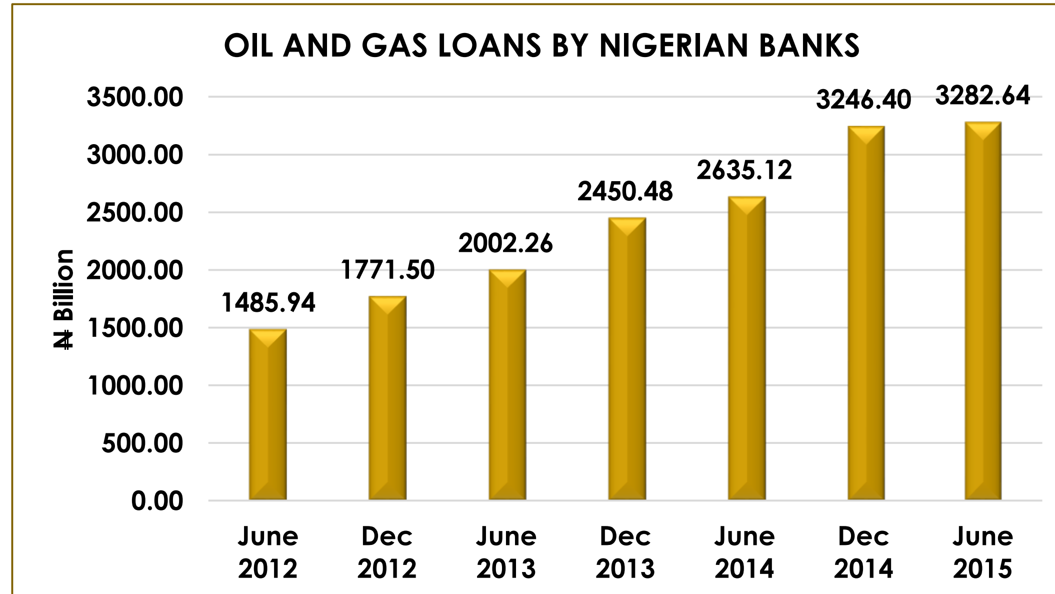
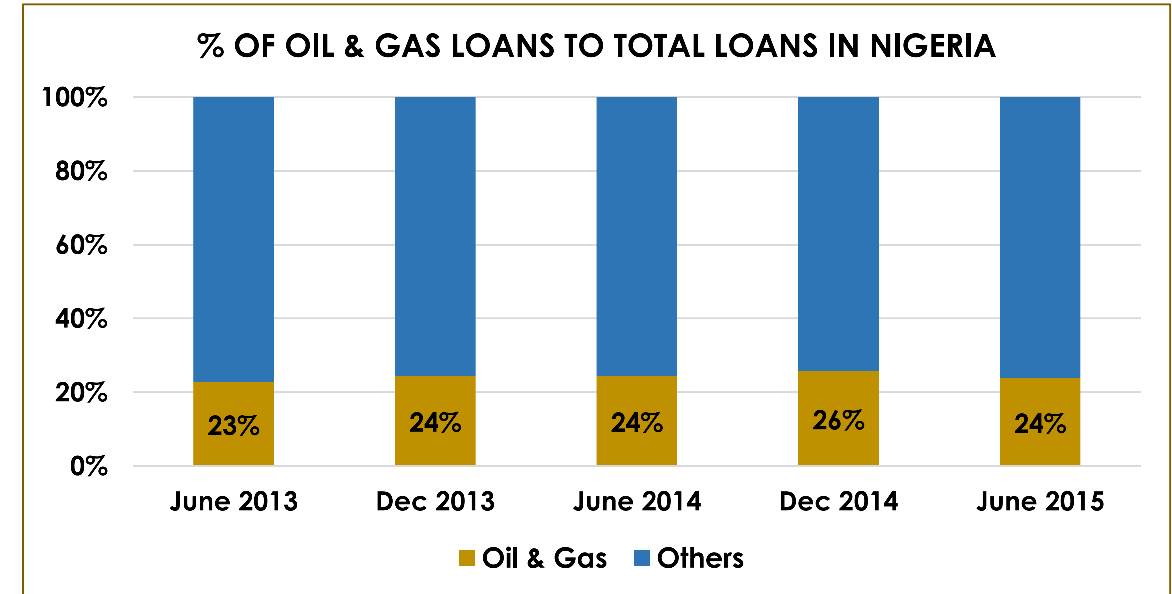
- A number of factors have accounted for a rush in capital into the Nigerian oil and gas industry since 2010. These include:
  - ✓ stable high oil prices,
  - ✓ new opportunities to acquire assets being divested by IOCs, and
  - ✓ readily available debt financing from Nigerian commercial banks.
- Nigerian banks have been especially active in lending to oil and gas firms operating in Nigeria often on the back of their growing foreign currency deposit books while leveraging on-lending facilities from international Development Finance Institutions ("DFIs").





Source: CBN Financial Stability Report, Ecobank, FACL Research

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Build-up & Financing of Asset Portfolio

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- Funding of Assets acquisition under the IOC divestment Programmes have been mainly via revolving Reserve Based Lending ("RBL") typically with tenors of five to seven years. In certain cases, these were preceded by bridge loans (often of a one year tenor).
- Other major sources of funding were Owners' Equity and unsecured bonds / loans which are usually subordinated to RBLs.
- RBLs are mostly suitable for financing pre-producing assets with development CapEx.
- Facilities are secured by the value of the borrower's reserves. As a borrower increases its reserves and drills more producing wells, available borrowings under its RBL increases.
- Also, borrowers cannot draw beyond the value of the "borrowing base" which is based on the value of the reserves.
- RBL Covenants typically require a borrower to have sufficient earnings to cover a multiple of their annual interest and / or their total debt.

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Why Restructure?

Why Restructure?

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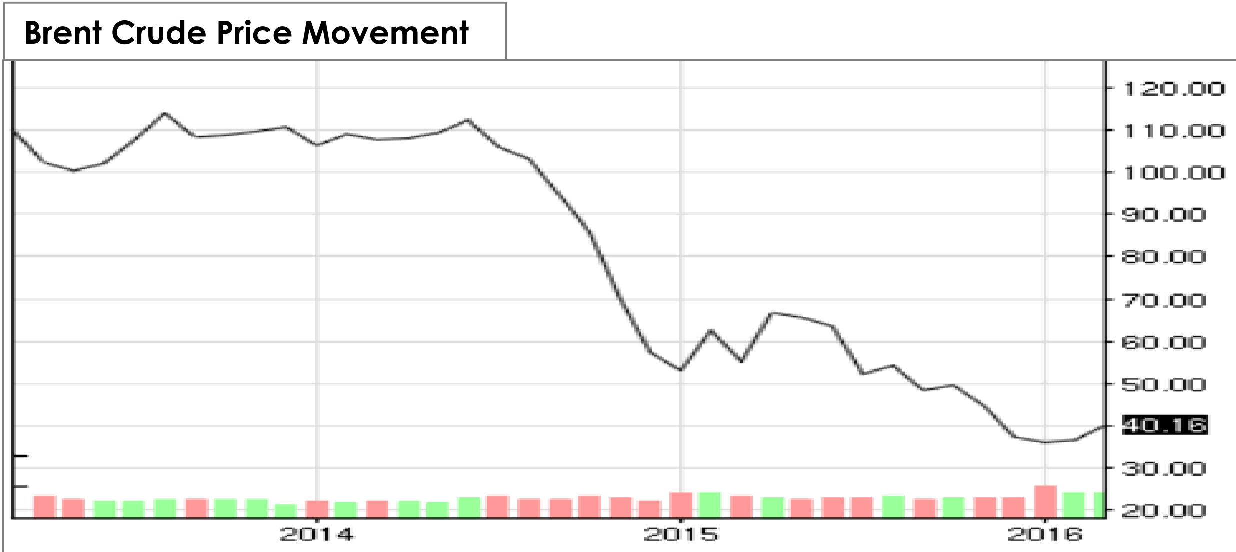
- **Waning banking sector appetite**
  - ✓ Excessive leverage and debt challenges
  - ✓ Caution around risk management (adverse impact of energy exposure on bank's books)
  - ✓ Pressure on banks to deliver appropriate returns (cutbacks on energy exposures)

- **Excessive Debt consolidation on E & P companies balance sheet;** need to diversify funding base to achieve better pricings, longer tenors and minimize covenant restrictions.

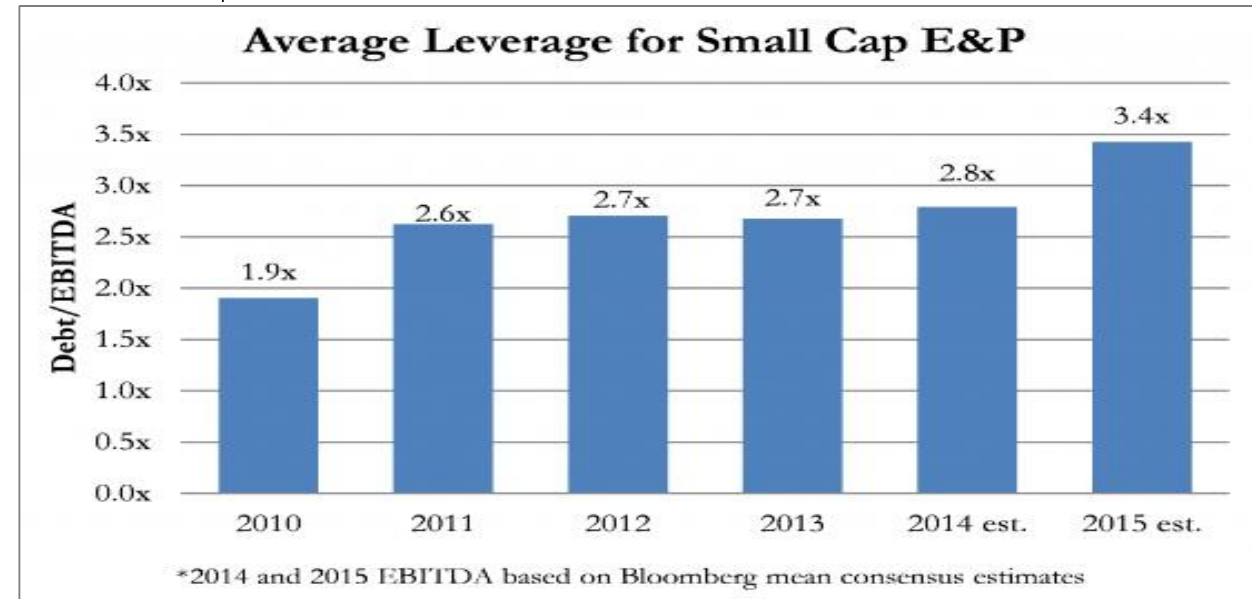
- **Need for fresh capital to meet maturing obligations and continue drilling obligations that are necessary to capture and hold lease acreage positions.**

- **Need to strengthen balance sheets to be able to absorb shocks.**

Brent Crude Price Movement



Source: Nasdaq.com, FACL Research



Source: Oilgasmonitor.com, FACL Research

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Restructuring Finance Options

Restructuring Finance Options

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- During the past year, several E & P companies, including IOCs, have taken steps to reduce costs.
- In a survey published by PwC in August 2015, some sampled players indicated the following actions being taken by them to reduce costs.

Company	Reduction in 2015 CapEx	Pay freeze	Reduction in headcount	Reduction in contractors	Renegotiate OFS rates	Investment deferred/abandoned	Change in business model
Apache			✓				
Baker Hughes	✓		✓				
BP	✓	✓	✓				
ConocoPhilips	✓		✓				
Halliburton			✓				
Petronas	✓					✓	
Premier				✓	✓	✓	
Santos	✓			✓			
SBM Offshore			✓				
Schlumberger	✓		✓			✓	
Shell	✓					✓	
Statoil						✓	
Talisman Sinopec			✓				
Total	✓					✓	
Weatherford							✓

Source: PwC Report on current developments in the oil and gas industry, August 2015

Given the likely prolonged period of low oil prices, more fundamental actions need to be taken by smaller cap E & P companies to improve liquidity and reduce leverage and position themselves to better absorb future shocks.

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Restructuring Finance Options

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- Before examining specific restructuring finance options, it is necessary to consider the broad range of financing sources available to oil and gas companies

Typical Sources of Oil & Gas funding

Exploration and Appraisal	Development and Production	Portfolio Expansion
✓ Owners Equity	✓ Reserve Based Lending	✓ Cashflow from operations
✓ Private Equity	✓ Public bonds	✓ Bank loans
	✓ Project finance	✓ Public bonds
	✓ Private Placement	✓ Infrastructure funds
	✓ Multilateral Development Banks	✓ Proceeds from Divestment
	✓ Mezzanine finance	

Increased predictability of cashflows and business maturities

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Restructuring Finance Options

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		Objectives	Appraisal of Option
1	**Restructuring of Existing Facilities (including renegotiation of covenants)**	✓ Ensure liquidity ✓ Extend tenor of maturing obligations ✓ Improve pricing ✓ Avoid default	➢ Most practical short-term approach to avoid default ➢ Imperative for lenders to manage provisioning / write-offs
2	**Debt-for-Equity Exchange** ▪ **Non-bank debtors exchange debt claims for equity** ▪ **Lenders provide new money debt**	✓ Manage leverage ✓ Fresh liquidity	➢ RBL lenders normally frown at new debt in a workout situation ➢ The conversion of non-bank debt to equity provides incentives for lenders to provide new debt to avoid disruption of operations

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Restructuring Finance Options

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		Objectives	Appraisal of Option
3	**Private Equity / Mezzanine Investments**	✓ Raise fresh equity / junior debt (second lien debt) funding	➢ Open to private equity and other financial investors who see value in the current market downturn
4	**Drilling Partnerships** (An arrangement with private sector investors e.g. oil and gas investment funds, to finance the development of specific assets)	✓ Enable incremental drilling work without affecting capital structure ✓ Does not dilute existing shareholders	➢ Lower cost of capital ➢ Enables E & P companies to monetize undeveloped plots ➢ Helps to bridge financing gap ➢ Impacts only selected wells rather than entire company assets

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Restructuring Finance Options

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		Objectives	Appraisal of Option
5	**Fresh IPOs / Further issues of Equity**	✓ Reduce leverage ✓ Raise fresh capital to fund continuous operation	➢ A number of Nigerian and Nigerian-focused E & P companies are listed on the Nigerian and international Stock Exchanges. ➢ Although, public market reception may be weak, the platform exists for a further capital raise. ➢ Stocks are currently trading at historical lows. With forecast oil price starting to rise, value seeking investors can start to invest again.
6	**Debt-for-Debt Exchange** Raising bonds (private or public bond) and applying part of proceeds to reduce bank debt	✓ Maximize tenor / leverage ✓ Minimize lenders restrictions ✓ Hopefully, achieve better pricing	➢ Desirable, particularly for companies already listed on international Stock Exchanges

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Restructuring Finance Options

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		Objectives	Appraisal of Option
7	**Sale of Non-core Assets**	✓ Realise cash from sale of non-core assets for deployment in core E & P operations	➢ IOCs have been divesting their onshore assets. Independent producers with non-core assets cover consider divesting from them.
8	**Mergers & Acquisitions**	✓ Survival strategy for highly leveraged small-cap companies	➢ Opportunistic investments in distressed assets ➢ Improved efficiency / scale benefits ➢ Inorganic growth

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  - ✓ financial advisory, and
  - ✓ project and structured finance advisory services.

- Its asset management subsidiary, First Ally Asset Management Limited, provides a range of bespoke financial solutions including:
  - ✓ Portfolio Management Services,
  - ✓ Private Investment Opportunities,
  - ✓ Pooled Investment Products, and
  - ✓ Structured Products

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