



of year 3 – could single-handedly result in positive IRRs. Consider: only three months after the end previous two credit cycles in 2002 and 2009, an average CCC jumped in price from low 50-ies to low 70-ies (measured in June 2003 and June 2009). If we were to plug in a \$70 year 3 price assumption for surviving CCCs in Figure 10, non-annualized IRR jumps to +10%. For a more detailed explanation of assumptions to reach these conclusions, please see DB's US Credit Strategy: What is Priced in Energy Bonds Here? (December 18, 2014).

Despite a dearth of examples around a crisis in HY energy, or more specifically the E&P sub-sector, we do have some examples of where other distressed HY sectors traded at crisis levels (right). If these restructured sectors hold any weight, it seems by this metric, we still have downside on a spread-basis before we reach the bottom for HY E&P bonds. Despite somewhat conflicting answers from the above two analyses, we think the takeaway for HY credit is that we are getting there but not be at the optimal entry point for bonds. Further, investors need to consider time horizons as they relate to various investing strategies and whether or not funds are locked-in. Lastly, with a significant level of default (blended rate of 30% for B/CCC), there will be clear winners and losers, outcomes will be very binary outside of buying a diversified basket of lower-quality HY E&P credits.

Figure 11: Widest Levels of Each Crisis

		BBs	Bs	CCCs
Real Estate	12/31/2008	1,573	2,006	4,702
Media	11/30/2008	1,128	2,029	3,508
Autos	12/31/2008	1,546	2,036	2,473
Telecoms	07/31/2002	1,398	1,014	3,966
Gaming	11/30/2008	1,895	1,870	2,485
Average		1,508	1,791	3,427
Energy	01/08/2015	465	960	1,896
	% of other crisis levels	30.9%	53.6%	55.3%

Source: Deutsche Bank

What can we expect in terms default rates and recovery should there be a full-scale restructuring of energy names?

As we have not seen a full scale restructuring of the sector is hard to pinpoint exact figures here. Moodys reported that during the last two credit cycles for E&Ps (1998-1999, 2001-2002), a majority of unsecured creditors received a range of 35-50% recoveries with an average recovery of 40%. This is better than the average industrial recovery of 29%. Fitch has reported similar numbers. From 2000-2013, the average recovery rate for energy was 45%; compared to a 37% for the total market. However, the spread on recoveries in any given year was relatively wide with a low of 8% in 2001 and a high of 76% in 2011 looking at the Fitch data. Important to note that per Fitch, the comparative default rates for energy have been relatively mild at 2.0% from 1980-2012, this compares to a 4.6% default rate for the overall market during the same period.

What other major catalysts need to play out to trigger defaults for HY E&Ps?

As we look at maturities due in HY energy over the next couple of years (Figure 12), it is clear that most energy companies including E&Ps have termed out debt. This is not surprising given the historically low rates issuers have achieved in the HY market over the last several years. One can see that there is a little less than \$4 billion in overall energy HY bonds coming due in the next two years. In Figure 13, we lay out the specific energy bonds that are coming due in 2015 and 2016. After those years, we see a relatively larger maturity wall of \$18 billion in 2017.