



E&P Credit Screens and Analysis

E&P Credit & Operational Metric Screen

When looking at trying to help investors wade through the extremely fragmented E&P sector in US HY, we looked across six main credit and operational metrics including 2016 net leverage, current PV-10 to 2016 net debt, 2016 liquidity assuming a flat borrowing base, 2015 hedges, 2016 adjusted cash margin per unit, and 2016 production mix. We felt this range of metrics would give a wide and varied insight into the path that certain E&Ps might take over the medium term commodity cycle (three years). We first lay out all six of the metrics, which we have ranked into quartiles, and go through the results of the analysis. We then walk through each of the metrics and why they were chosen.

E&P Universe Screening Methodology

2015: For covered companies, in our analysis, we used our updated estimates. For non-covered companies, if 2015 guidance has been provided since Q3 14 earnings, we use that. Otherwise, we used the street consensus with adjustments to both capex and production based on credit rating. With that in mind, in 2015, we assume all BB-rated credits follow the consensus estimates as given; street consensus for BBs is generally +/- 10% YoY capex growth with corresponding production growth rates in the 20-30% YoY area. For B-rated credits, we assume a decrease in capex of 25% YoY with a 5 percentage point decline in the corresponding expected consensus production growth. For CCC-rated credits, we again assume a decrease in capex of 25% YoY but this time with a 15 percentage point decline in the corresponding expected consensus production growth. The difference in the production declines in B vs CCC reflects trends we have seen between the two groups so far from companies that had provided actual 2015 guidance. If bonds are split rated, we assume the lower rating of the two ratings. For example, Midstates Petroleum (MPO) bonds are rated Caa1/B-; we therefore applied our assumption for a CCC credit.

2016: For covered companies, in our analysis, we used our newly initiated 2016 estimates. For non-covered companies, we use a similar methodology to what we did in 2015. We assume all BB-rated credits follow the consensus estimates as given. For B-rated credits, we assume a decrease in capex of 50% YoY with no production growth (ie so-called maintenance capex). For CCC-rated credits, we assume a decrease in capex of 35% YoY with no production growth (ie again maintenance capex). The difference in the expected capex declines needed to reach flat production growth YoY in 2016 favors B-rated assets that are assumed to have a relatively better asset base than CCC-rated companies, and would therefore need less capital to simply maintain production.