



## QEP Resources

### Relative value

QEP Resources (QEP) divested its midstream business in October 2014 for \$2.5 billion, and before it could make any major decisions on rewarding shareholders from the sale proceeds, oil prices cratered. Thanks to this fortuitous timing, QEP is starting off the current commodity cycle on strong financial footing – net leverage levels pro forma for the transaction are 0.6x (the lowest within the peer group along with XEC) and liquidity is an impressive \$3.2 billion including \$1.4 billion in cash (the company paid down ~\$900 million of revolver borrowings and unsecured term loan). While QEP scores over its BB-peers in terms of financial risk, the outlook for business risk is relatively less attractive. Specifically, QEP lacks high quality assets with significant scale (i.e. lower inventory life) comparable to peers like RRC and NFX; its Bakken acreage is only 109K net acres of which the top quality South Antelope acreage is just 27K net acres. The issue was only partially addressed by its minor Permian acquisition in late 2013 (26.5K net acres). Consequently, it is difficult to see any credit catalysts in the horizon for the company driving a meaningful improvement in credit profile from current levels. We acknowledge that, given its strong financial position, management could attempt to remedy the situation via another major acquisition of high quality assets and that, given the current condition of the asset markets, could even get it at an attractive valuation. But, at this stage, it is too early to factor this into the credit outlook. In terms of financial outlook, we see a modest deterioration from current levels over the next two years driven by weakening earnings and modest cash burn. We expect annual capex to be about \$1.4 billion (versus \$1.7 billion in FY 14E) driving production growth in the high single digits. However, EBITDA levels should be in the \$1.2 billion range for both years, below \$1.3 billion in FY 14E (pro forma for divestitures) due to weaker realization. In turn, we see cumulative FCF burn of \$550 million during the next two years and net leverage moving up to 1.3x by FYE 16. The company's hedge program is fairly modest – 25% of FY 15E production and close to 0% for FY 16E - exposing it to downside in commodity prices. Taking all of the above into account, we are moving to a **SELL** from a **HOLD** on all QEP bonds (YTW: 6.3-6.5% on longer-dated bonds). Overall, given their recent outperformance, BB high yield E&P bonds have significantly outperformed – QEP included. Further, given our shorter outlook for oil in 1H 15, we think we will see further weakness in overall E&P bonds before we see any marked improvement; we think this leaves BBs without catalysts as set to underperform, of which QEP is one. Upside risks include using cash on hand to pay down debt while downside risks include potential leveraging acquisitions.