U.S. energy:
Black not gold

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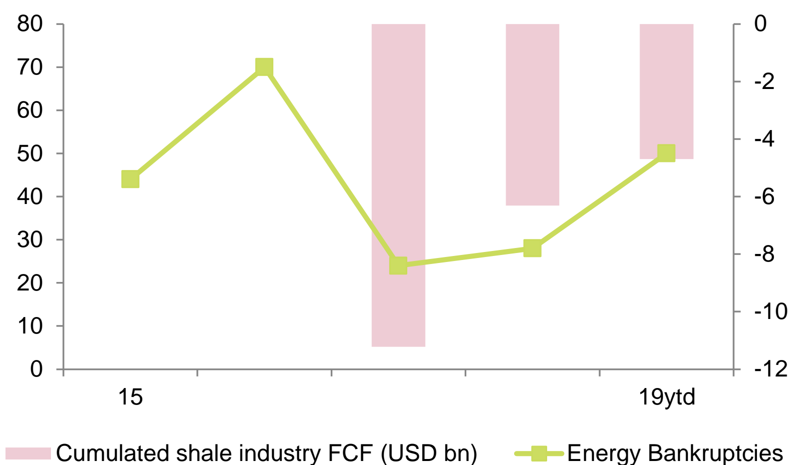
CATHARINA HILLENBRAND SAPONR
Senior Sector Advisor
Catharina.hillenbrand-saponar@eulerhermes.com

The bankruptcy of U.S. oil services provider McDermott, which filed for Chapter 11 this week, is a perfect reminder of the current challenges of the U.S. energy sector. Tight finances and weak growth are pushing up insolvencies since 2019.

Tight finances and weak growth. The U.S. energy sector, particularly shale oil, is highly leveraged, with an averge gearing close to 200% and net debt to Ebitda ratio of 2.8x for our independent/shale basket of quoted companies. That, however, masks ratios at the high end reaching 8x net debt/Ebitda and also the fact that most of these companies have gone through recent fundraisings. We gauge that the smaller and privately held end of the sector presents yet weaker financials. The majority of independent energy companies in the U.S. are cash-burning and thus require incremental fundraising. However, declining investor appetite and patience, as well as a less bullish oil price backdrop, have dried up available liquidity for the sector. Lack of funding deprives companies of growth from new wells, but not only that: Little upside from oil prices means no growth from existing assets and erosion of liquidity. Completing the vicious circle, this not a pattern prone to attracting fresh funds.

Figure 1 – U.S. energy and shale sector financials



Source: Bloomberg, Euler Hermes, Allianz Research

The sector is looking forward to a second year of negative revenue growth, -2.4% flat margins on average and a USD 1.4bn capex decline for our sample. Meanwhile, it is spending a substantial amount of revenues on capex; as a matter of fact, for a great number of companies, annual capex exceeds or at least absorbs most of Ebitda.

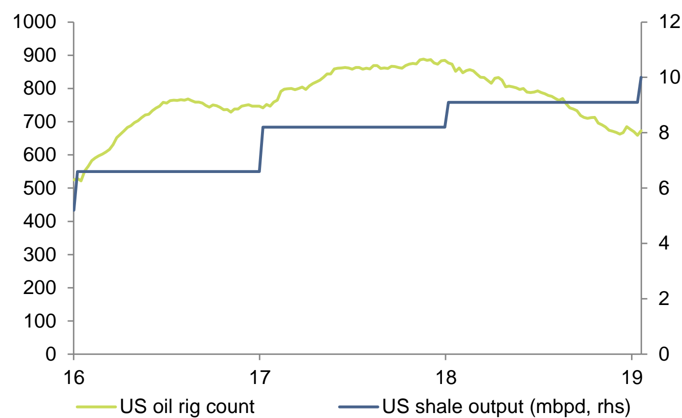
Figure 2 – U.S. independent oil sector earnings and balance sheet metrics

	2016	2017	2018	2019e	2020e
Revenue growth	24%	30%	-6%	-2%	2%
Ebitda margin	40%	39%	49%	51%	50%
Free cash flow growth	-147%	101%	-49%	-147%	-71%
Capex growth (USD m)	1790	3579	-4953	-1390	645
Capex/sales	67%	62%	57%	42%	35%
Net debt/Ebitda	0.7	3.9	2.6	2.8	2.8
Net gearing	466%	85%	185%	n/a	n/a

Source: Bloomberg, Euler Hermes, Allianz Research

Weak oil prices and slowing production growth are the main factors. We forecast U.S. shale production for 2020 to exceed 10mpbd, which is still 10% y/y growth but below past growth rates that exceeded 25%. Total rig count in the U.S. has been slowing persistently and stood at 673 as of January 2020 vs 888 at the peak in 2017 (source: Baker Hughes).We expect the growth that there is to be driven forward by the largest and most efficient producers that benefit from efficient operations, economies of scale and competitive access to infrastructure.

Figure 3 – U.S. oil rig count and shale output



Source: Baker Hughes, BP, Euler Hermes, Allianz Research

Insolvencies on the rise since 2019

Major insolvencies for companies with revenues in excess of USD 50m in the energy sector in the U.S. have increased to a total of 19 cases, more than twice the number in 2018. With this, the U.S. accounted for 52% of global energy insolvencies, while energy made up 23% of U.S. bankruptcies (source: Bloomberg) and represented the single most important sector in terms of insolvencies over the past year. Turnover of insolvent companies has increased fourfold, to USD 16bn. Total insolvencies for all company sizes comprised amounted to 50 cases in the first nine months of 2019, of which 33 were in the E&P sector (source: Haynes & Boone).

At the same time, in excess of USD 130bn of debt comes to maturity for the U.S. independent energy sector as a whole to 2025, of which USD 3bn is in 2020 and USD 24.4bn in 2023/24 (source: Bloomberg).

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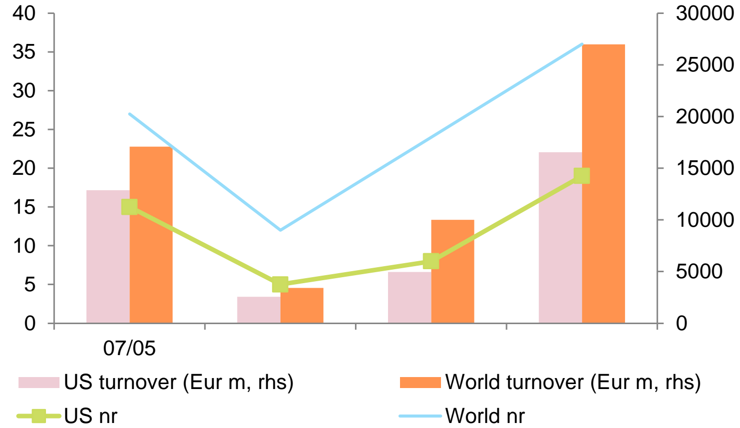
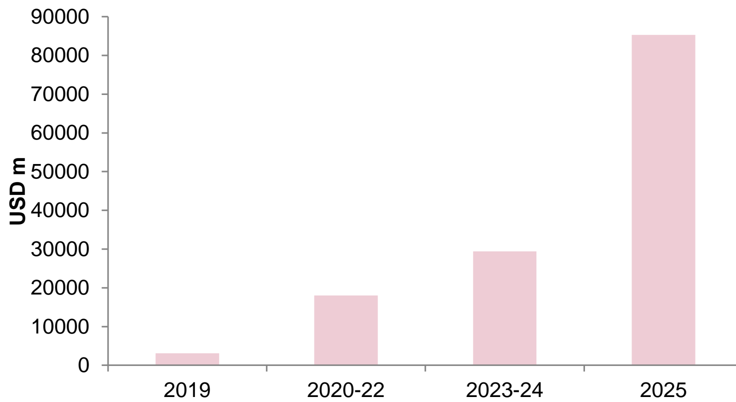
Figure 4 – Insolvencies in U.S. energy



Source: Euler Hermes, Allianz Research

Figure 5 – Debt maturities in U.S. independent energy

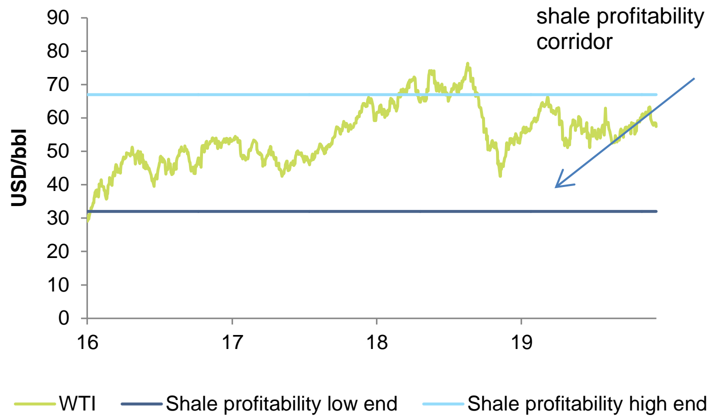


Source: Bloomberg

Weak oil price environment leaves low end uncompetitive

Our central oil price scenario suggests an average Brent price of USD 66/bbl for 2020, compared to an average of USD 65/bbl in 2019. While the most efficient U.S. shale assets with a break-even point around USD 30/bbl, the high end cannot as break even costs can be as high as USD 70/bbl.

Figure 5 – Oil price and shale profitability



Source: Bloomberg, Euler Hermes, Allianz Research

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