OIL&GAS FINANCIAL JOURNAL®

Industry struggles with low prices, lack of capital

Capital constraints are crippling parts of the energy industry, as many banks, preferring to reduce their risk exposure to near zero, are declining to lend money. It's a chilling environment. Deals in the private equity and debt markets are at a virtual standstill as well, although some funds have ample cash available.

Don Stowers, *Editor – OGFJ*

With the economy in severe contraction, one mid-sized independent E&P company recently told its shareholders, "We are deferring major capital allocation for drilling our inventory of exploitation and exploration opportunities until drilling costs decline, commodity prices rebound, and/or the ability to access capital economically improves." This is not an uncommon theme these days, and in some cases, cutbacks have been dramatic – amounting to drilling budget reductions of 75% or even more.

"Of the 20-plus banks we talked to recently, I would only characterize about three or four as really being 'open for business.' That's pretty staggering." **– Wil VanLoh, Quantum Energy Partners**

The impact of low commodity prices has been two-fold: cash flow has ebbed and the value of reserves has been reduced. The latter is the basis for an E&P company's credit standing, and a lowered credit rating increases the cost of capital – provided it is available at all.

Although some analysts are hopeful the bottom of the cycle has already happened, others believe it may not come until late in the year or even sometime in 2010. If you put 20 analysts together in a room, you will likely get 20 different opinions as to when the recovery might occur and what is required to bring the energy industry back from the abyss.

In a recent interview with Oil & Gas Financial Journal's Mikaila Adams, Quantum Energy Partners' Wil VanLoh said, "Of the 20-plus banks we talked to recently, I would only characterize about three or four as really being 'open for business.' That's pretty staggering."

VanLoh, a co-founder and CEO of the private equity firm, added, "The second lien and term B markets are completely dead. I don't think you can get a deal done in the private market for that right now. We're telling our portfolio companies that they have to look at everything they're doing right now in terms of passing their return hurdles based on 100% equity financing."

Quantum's $1.3 billion Fund IV is fully committed, but the firm has only "pulled down" $300 million to date, leaving $1 billion available. For now, the private equity firm will continue to "hunker down" while the industry is in turmoil.

Although there have been relatively few distressed sales of assets, VanLoh expects we'll start seeing this happen in the second quarter. **OGFJ**