Oil patch likely to remain on debt diet

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Oil executives have spent the last two years promising investors that they are putting their companies on strict debt diets.

It appears they are sticking to them.

Stats show oil-patch debt financings, such as debenture issues, are off 77 per cent in the first nine months of this year versus the same period in 2015.

This does not account for related borrowing such as bank credit lines and other loans, but it's indicative of the weight-loss program the industry was forced into by the downturn.

Now, with oil and gas prices as unpredictable as ever and bond markets going haywire following Donald Trump's election victory, it's looking like the debt purge could extend into next year.

The various pressures will also boost the popularity of alternatives to the traditional financing that the energy sector has tapped for years.

This is a major shift from the old days (say, early 2014), when old-school leverage was an important and popular tool for the financing of buying rival companies and funding development. Booming commodity markets meant few feared that it could be paid off.

Following the collapse in oil prices, high debt levels in the industry sapped corporate financial strength as dwindling cash flows made servicing that debt while spending on operations tougher and tougher.

Healthier producers sought to shore up their finances by selling assets and issuing equity to improve their ratios. Indeed, several companies, including Suncor Energy Inc. and Encana Corp., launched some honking big share issues.

According to Sayer Energy Advisors, the upstream oil and gas industry raised $9.8-billion of equity in the first three quarters of this year, up 6.5 per cent from the same period in 2015. Here's the thinking: What's a bit of dilution when long-term survival is at stake, especially when there's little in the way of earnings to dilute?

For the mostly smaller producers that sank into receivership over the past year and a half, it wasn't equity that put them there but debt and their inability to support it as commodity prices languished.

Hence today's aversion. The industry issued $6.5-billion of debt in the first nine months of 2015. This year, the value tumbled to $1.5-billion, according to the Sayer figures.

Meanwhile, merger and acquisition activity is way up – with deals, including assumed debt, ringing in at $18.3-billion, up from $10.9-billion last year. Suncor has been a big player in the deal flow, both buying and selling. Tourmaline Oil Corp. and Seven Generations Energy Ltd. have also made some pretty big asset acquisitions.

So what does it all mean for energy financing in the months ahead?

The commodity-price trough has dragged on following some midyear optimism. On Tuesday, U.S. benchmark oil jumped nearly 6 per cent as traders wager that last-minute diplomacy among Organization of Petroleum Exporting Countries officials could help the group agree on production quotas at their meeting late this month.

But the market has been disappointed on such bets before. Some forecasters have said the world's oversupply of crude could last through 2017 without an OPEC deal to limit production.

Such an eventuality would keep some oilpatch CEOs well away from debt markets, at least traditional ones. Indeed, the industry has embraced alternative financing ideas, including sales of royalty interests and sales and lease-backs of equipment such as natural gas plants.

All of those industry-specific factors are confusing enough. A new wrinkle that's emerged over the past week has been the blow-out in bond yields following Mr. Trump's victory. How long this will last and how it might affect high-yield debt in the energy sector is an open question. It's already spilling into the country's housing market in the form of rising mortgage rates.

Meanwhile, energy remains a capital-intensive game. Sources of all that money will have to keep diversifying, especially if the downturn persists.