



Samson Resources

Relative Value

Samson had a vulnerable credit profile even before the current weakness in the commodities market given its high leverage levels and the modest quality of its asset base. Nevertheless, we had a constructive view on the company for two reasons, the company had a good proved asset (or PV-10) coverage (relative to its yield levels) and we expected an equity infusion by the sponsors as part of the restructuring of its business. With the sharp downward shift in the commodity market, the first contention is not valid given the substantial erosion in PV-10 value. As regards the second, the sharp depletion in the value of its net assets largely rules out the possibility of an equity infusion. The \$2.25 billion Senior Notes '20 currently trade in the 30s, which implies the equity value of the business is negative ~\$1.5 billion. Given this it does not make economic sense for the sponsors to invest equity into the business. Therefore, the credit is now basically driven by the outlook for fundamentals, which is clearly precarious. Leverage levels are already at 5.5x and this is set to worsen further over the next two years to 9.4x on earnings weakness. We see EBITDA deteriorating meaningfully from FY 14E levels of \$622 million to \$496 million in FY 16E – based on flat production levels and weaker realization. The lower EBITDA levels are not sufficient to meet its maintenance level capex (excluding capitalized interest) of \$630-\$700 million. Moreover, the company also has a high annual interest burden of ~\$290 million. Overall, we are seeing a FCF burn of close to \$950 million over the next two years – i.e. a business which cannot even sustain maintenance level capex. Also worrying, current liquidity is just \$434 million – the company will run out of cash by 1H 16 unless there is an expansion in the borrowing base (we are assuming a \$500 million addition to its credit facilities in 2016, likely from a second lien loan). Further aggravating the weak outlook, Samson, which has generally been a conservative hedger and protector of cash flow, has fairly modest hedges for FY 15 (40%) and FY 16 (25%) driving further downside risk to our estimates; for example, at \$60/\$3, net leverage could be close to 12x levels by FYE 16 and cumulative FCF burn through FY 16 would be \$1 billion. Even in our base case, we see the company breaching, by a wide margin, the net leverage covenant limit of 4.5x in Q1 16 (the covenant has been relaxed through FYE 15).

Overall, many of the positive ideas we discussed in our 2014 initiation of the credit are being turned on their head given the commodity backdrop especially the deteriorating PV-10 and equity infusion in addition to the difficulty of selling assets in this market. Our initial call was very catalyst driven – positive ones. Further, given that a structure has already been set up to layer in additional second lien debt (\$500 million), we see future layering as highly probable outcome. So, while SAIVST 9.75% Notes '20 bonds are trading in the 36/38 context, we do see further downside. We therefore move to a SELL from a BUY rating on those notes. Upside risks include an equity infusion from the sponsor, assets divestitures and/or distressed debt exchanges.