Chesapeake's Loan Exceeds Highest Bond Yield: Corporate Finance
2012-05-15

By Zeke Faux

May 15 (Bloomberg) -- Chesapeake Energy Corp. will offer the highest yield on any of its debt for a $3 billion loan from Goldman Sachs Group Inc. and affiliates of Jefferies Group Inc.
that gives the second-largest U.S. gas producer time to sell assets while maintaining compliance with borrowing agreements.

The company agreed to an initial interest rate of 8.5 percent on the five-year debt, which increases by 3 percentage points if it isn't repaid within a year, in order to pay off a revolving credit line that costs 2.5 percent. That's higher than the yield on the company's similar-maturity bonds even after revelations of Chief Executive Officer Aubrey McClendon's private loans secured by personal stakes in the company's wells.

Chesapeake Energy, facing a cash-flow shortfall that Fitch Ratings estimates will reach $10 billion this year, said in a May 11 regulatory filing that it may delay billions of dollars in asset sales because they might interfere with loan covenants. McClendon said yesterday that it took out the new debt to give the company "enough financial firepower" to complete the plan.

"It's the most expensive financing they have in place,"
Brian Gibbons, an analyst at CreditSights Inc. in New York, said in a telephone interview. "They had to pay up for it."

The revelations of McClendon's private transactions came as profits have been hurt by plunging U.S. natural-gas prices. The cost of gas has dropped 43 percent in the past year as new production from shale formations glutted North American markets.

Average Yields

The company's bonds on average yielded 8.1 percent as of May 14, above the 7.57 percent average for single-B rated companies, according to Bank of America Merrill Lynch index data.

Chesapeake had its credit rating cut to BB by Standard & Poor's last month. Moody's Investors Service said on May 9 that it may lower its Ba3 rating on the company's unsecured debt.

The average yield on Chesapeake’s bonds was 6.1 percent on April 17, the day before Reuters reported on McClendon’s loans.

Shares of Chesapeake Energy, which is smaller only than Irving, Texas-based Exxon Mobil Corp. among U.S. gas producers, rose 4.8 percent to $15.52 yesterday, after the company announced on May 11 that it had obtained the loan. The stock has fallen 14 percent since April 18.

Jim Gipson, a spokesman for Chesapeake, didn’t respond to messages seeking comment.

Chesapeake’s $660.4 million of 6.5 percent notes due in August 2017 fell to 93.3 cents on the dollar yesterday to yield
8.1 percent, down from 106.8 cents and a 5 percent yield on March 26, according to Trace, the bond-price reporting system of the Financial Industry Regulatory Authority.

Loan Discount

The company said it arranged the new loan on May 11 after disclosing the asset-sale and covenant risks in a regulatory filing. The obligation matures December 2017 and has an interest rate of 8.5 percent or 7 percentage points more than the London interbank offered rate, whichever is higher.

The unsecured loan is being offered to investors at 96 cents on the dollar, according to KDP Investment Advisors Inc., the Montpelier, Vermont-based debt researcher. The discount reduces proceeds to Chesapeake and raises the yield for investors.

Taking out a loan allows the company to negotiate financing with a smaller group of lenders rather than tapping a larger group of investors in the bond market, said Craig Orchant, co- founder of investment-banking advisory firm EA Markets LLC in New York.

“You don’t want to go into a more public market in that weakened state,” Orchant, who was previously head of corporate finance at Barclays Plc, said in a telephone interview. “You try to do a private transaction.”

‘Paid Back’

The loan can be paid off early without penalty until 2013, and the rate increases by three percentage points if it isn’t. Chesapeake plans to repay the new borrowing by the end of this year with proceeds from the sale of oilfields in

Texas' Permian Basin and a joint-venture to develop the Mississippi Lime formation that straddles the Oklahoma-Kansas border, McClendon said during a conference call yesterday to discuss corporate developments.

"We don't expect this facility to be out at the end of the year," McClendon said. "We expect to get it paid back in the third quarter."

Proceeds will be used to pay off debt on Chesapeake's revolving credit line, which matures in 2015 and has a current interest rate of about 2.5 percent, according to data compiled by Bloomberg. By paying off the revolver, the company cuts the risk of violating maximum leverage and minimum collateral covenants, CreditSights's Gibbons said.

In February, Chesapeake issued $1.3 billion of 6.775 percent, seven-year notes, Bloomberg data show. The securities have since dropped to 92.5 cents on the dollar to yield 8.23 percent, Trace data show. The rate on the new loan probably was set to be similar to where the outstanding debt is trading, Orchant said.

Asset Sales

"Their credit costs have mushroomed out," Orchant said. "It was reflective of where people are willing to take risk on the name in the current environment."

The company's cash flow will fall $10 billion short of planned spending on new wells and leases, Fitch said in a May 4 note to clients. Chesapeake posted a $71 million first-quarter loss and said on May 1 that it may run out of money next year to fund its drilling program. Chesapeake plans to sell between $9.5 billion and $11 billion of assets this year to make up that shortfall and pay down debt, McClendon said during the conference call.

Cash Shortfall

Chesapeake said in a May 11 regulatory filing that some asset sales may be delayed to maintain production and cash flow required to comply with bank covenants.

Selling the energy properties may raise $14 billion to $16 billion over the next two years, the company said in a May 2 presentation.

Without an asset sale, the company probably will face a cash shortfall in the fourth quarter, Gregg Brody and Jason Homler, analysts at JPMorgan Chase & Co., wrote in a report yesterday.

Chesapeake, co-founded by McClendon in 1989, has outspent cash flow in 19 of the past 21 years, Bloomberg data show.

The board said in a May 1 filing that it will strip McClendon of the chairman’s position and an internal review of his personal transactions is under way. The U.S. Securities and Exchange Commission opened an informal inquiry earlier this month.

“It’s going to take a major asset sale to change the psychology right now,” Phil Adams, senior bond analyst at Gimme Credit LLC, said in a telephone interview. “If it costs them a little bit of extra interest expense in order to get top dollar for the assets, that’s money well spent.”

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