LEADING THE EQUITY CHARGE

At year-end, as crude prices fell, Eclipse Resources Corp. did a private investment in public equity with the support of its main private-equity sponsor, EnCap Investments, to give it breathing room through 2015.

ARTICLE BY CHRIS SHEEHAN, CFA

When the bottom fell out of the high yield market last year, E&Ps had to adjust—and act—quickly. As crude oil prices moved lower, spreads in high yield widened dramatically for potential E&P issuers. And once the Saudi-led OPEC decision resulted in market forces setting the price of crude last Thanksgiving, the high yield window was shut for E&Ps for the next two and a half months.

For Eclipse Resources Corp., a fast-growing E&P that had gone public in late June of last year on the strength of its Utica/ Marcellus play economics, losing access to the debt capital market meant going back to the financial drawing board.

"The thought process was that we would be looking to the high yield market toward the end of the year to continue to fund our drilling program as we moved into 2015," recalled Eclipse's executive vice president and CFO, Matt DeNezza. "But as we went into the fourth quarter, the market started moving away from us as commodity prices began dropping, and the OPEC announcement took any prospect of doing a deal on reasonable terms away from us."

In executing its late-December PIPE transaction, in conjunction with EnCap Investments LP, Eclipse entered 2015 essentially net debt free. EnCap saw value not being recognized by the market, said Matt DeNezza, Eclipse executive vice president and CFO.

While Eclipse had other options available to it—the company could have taken on further private debt, and it also considered convertible debt or convertible preferred issues—these alternatives had become measurably more expensive, too. And the backdrop of falling commodity prices and widening Northeast gas differentials urged caution.

"When we looked at those options in a period when the commodity price was rapidly declining, the thought of layering on incremental financial risk amidst significant commodity price volatility did not strike us as a prudent strategy for ensuring the long-term viability of the company," DeNezza said. "Did we really want to add another $400 million plus of incremental debt to the balance sheet when facing significant headwinds from a commodity perspective? That didn't make sense to us."

The strategy ultimately selected by Eclipse—and garnering for it *Oil and Gas Investor's* Financing of the Year Award—was an all-equity offering in the form of a PIPE transaction (Private Investment in Public Equity) raising $440 million in gross proceeds.

In executing the late-December transaction, in conjunction with its key private-equity sponsor, EnCap Investments LP, Eclipse positioned itself to enter the current year essentially net debt free and having an estimated $600 million in liquidity, including a $25 million increase in its borrowing base. The offering, albeit with inherent dilution, helped Eclipse maintain a rapid growth trajectory and marked the first of several equity offerings by E&Ps anchored by key investors and institutional accounts.

The process of building a book of orders, anchored by EnCap, began in mid-December.

"It was a private placement, so people were brought over the wall before they left on vacation," DeNezza said. "Certainly, there were some logistical challenges in pricing the offering around Christmas, but to the extent investors were interested in coming over the wall, they knew what the game plan and the timeframe would be, so they were able to set up their internal logistics to meet the timeline."

The order book was built around EnCap's indication of interest that it would add to its existing Eclipse position to the tune of $325 million to $350 million—a figure which was trimmed back to a $315 million allotment as the offering was broadened to bring in other institutional accounts and accredited investors.

"We've had EnCap as a large shareholder and a major supporter of the company since the beginning," observed DeNezza. "They looked at the stock price and saw a lot of value, considering the long-term strategy and growth in the asset base, which was not being recognized by the market."

"Adding additional debt in a collapsing commodity price environment did not make sense," said EnCap managing director Mark Burroughs, noting that Eclipse was the first public E&P to issue equity following the OPEC meeting. "The goal was to strengthen the balance sheet, focus on liquidity and be in a strong position when prices recover.

"Although valuations were down significantly across the sector, we have a lot of confi-

"Adding additional debt in a collapsing commodity price environment did not make sense," said EnCap managing director Mark Burroughs. Eclipse was the first public E&P to issue equity following the OPEC meeting in November.

dence in the management team and the economics of our acreage position in the core of the Utica," he continued. "The PIPE transaction gave us the ability to make an additional investment in the company at a compelling valuation. EnCap investors owned roughly 80% of the company before the offering and wanted to participate at that level to eliminate dilution."

Eclipse's recent investor presentation suggests that the company's "core of the core" Utica position, comprising some 128,000 net acres with stacked-pay Marcellus upside, offers a total resource potential of 6.6 trillion cubic feet equivalent (Tcfe). Proved reserves at end-2014 were 356 billion cubic feet (Bcfe).

Other institutional accounts that added to positions on the private placement included Luxor Capital Partners and Fir Tree Value Master Fund. New investors included GSO Capital Opportunities Fund and KKR subsidiary Buckeye Investors LP. Sole placement agent for the offering was KeyBanc Capital Markets.

Adjusting for the downcycle

With an initial capex budget—subsequently revised lower—of $640 million for 2015, Eclipse guided to production growth in 2015 of more than 200% versus last year, when output averaged 72.7 million cubic feet equivalent per day (MMcfe/d) for the full year and 130.7 MMcfe/d for the fourth quarter.

"We assumed about a 200% growth rate, and under that scenario we would have utilized funds from the offering and drawn slightly on some of our revolver capacity by the end of 2015," said DeNezza. "The plan was to continue to rapidly grow the company, focusing activity primarily around our dry gas assets, while still having some rich gas activity as well."

However, with the continued slide in commodity prices, Eclipse has signaled new steps designed to further preserve liquidity, notably by potentially bringing in a joint venture partner on a promoted basis on its Utica/Marcellus acreage. In the interim, the company has said it will lower activity levels from three rigs to a single rig, focused on its Utica dry gas operation, with capex coming down by as much as 50%. Production growth in 2015 is targeted at more than 100%.

"Since the equity offering, we've slowed more aggressively, and we've begun looking at potential JV options on the drilling side to further reduce our capital spend," said DeNezza. "Our thinking changed a little from the time of the offering. We said: 'Let's get through this year—whether we have a JV partner or not—with some cash from the equity transaction still on the balance sheet so that, if the commodity downcycle continues into 2016, we're not revisiting the equity market at the end of 2015.'"

In addition to paring back capex, Eclipse is taking action to defer completions on 26 gross/19 net wells located in the liquids portion of the Utica Shale until commodity prices recover and/or completion costs fall further. The company has achieved well cost savings this year on the order of 15% to 20% and expects further reductions.

DeNezza described the combined program as a "prudent approach" that is designed to leave Eclipse with "options on the table as we get towards the end of the year. Additionally, we still have the ability, given this completion backlog we've put in place, to accelerate activity to the degree the commodity market rebounds more quickly."

Managing options for maintaining liquidity currently takes precedence over pumping up production, according to DeNezza. He points to an annual production growth rate of about 1,200% from fourth-quarter 2013 to the fourth quarter of last year.

"Production growth is not an issue; we'll grow easily by 100% year-over-year in 2015," he continued. "It becomes much more a matter of managing liquidity and the balance sheet, and keeping options open to fund the business, as we get later in the year."

KeyBanc Capital Markets E&P analyst David Deckelbaum models 150% growth for Eclipse in 2015, based on a budget of $345 million. Under this scenario he estimates Eclipse would likely not need to tap into its revolver until almost the final quarter of 2016. The company's borrowing base, raised to $125 million from a previous $100 million at the latest redetermination, would also "likely go meaningfully higher with another year of robust reserve growth," he noted.

In a hypothetical joint venture, in which Eclipse would sell a 25% working interest for a $300 million accelerated carry on 25,000 acres, Deckelbaum projects production growth of roughly 200% and 125% in 2015 and 2016, respectively, with Eclipse's ratio of net debt to 2016 EBITDAX ending up at around 1.8 times. The company prefers keeping net debt to EBITDAX below 2.0x, according to DeNezza.

On KeyBanc Capital Markets' investment banking side, director Chris Malik described the Eclipse private placement as "one of the most exciting deals" for him in the past 15 years. Although the private placement involved clearing compliance hurdles to reach portfolio managers during a notoriously difficult period to price deals, KeyBanc Capital Markets contacted more than 20 accounts in late December, building an order book totaling some $500 million in demand.

While the pricing of PIPE deals can in many cases involve double-digit discounts to the publicly traded security, the strong support from existing shareholders resulted in less price sensitivity. To achieve a happy medium with new shareholders, the offering was priced at $7.04 per share. This represented a 4.2% discount to the last trade on Friday, December 26, but also coincided with the average closing price of Eclipse's stock for the prior five-day period. □

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