

CHICAGO--( [BUSINESS WIRE](#) )--Fitch Ratings has taken the following ratings actions:

Energy XXI (EXXI) Gulf Coast (Delaware):

--Issuer Default Rating (IDR) affirmed at 'B+';

--Senior secured revolver affirmed at 'BB+/RR1';

--Senior unsecured notes affirmed at 'B+/RR4'.

Energy XXI (Bermuda):

--IDR downgraded to 'B' from 'B+';

--Convertible perpetual preferreds downgraded to 'CCC+/RR6' from 'B-/RR6';

--Convertible notes assigned initial rating of 'B/RR4'(exp).

Approximately \$1.67 billion in debt is impacted by today's rating decision, excluding today's issuance. The Outlooks for both Energy XXI Gulf Coast and Energy XXI Bermuda are Stable.

The senior convertible notes are due Dec. 15, 2018 and may be optionally redeemed by the purchaser prior to maturity under certain conditions. The notes are guaranteed only

by EXXI Bermuda and are therefore structurally subordinated to obligations at EXXI Gulf Coast. Net proceeds from the issuance will be used for general corporate purposes, which may include working capital, capital expenditures, or acquisitions. In addition, concurrent with the offering, the company intends to repurchase up to \$100 million in common stock from revolver borrowings.

## KEY RATINGS DRIVERS

Energy XXI's ratings are supported by the company's increased size and scale following property acquisitions and a robust organic drilling program; high exposure to liquids, composed mostly of higher-value black oil linked to waterborne grade pricing; historically strong production economics and cash generation; balanced acquisition funding; operator status on a majority of its properties; and the short-term cash flow protections of its hedging position.

Ratings issues for bondholders include the notable increase in the company's leverage seen over the last few quarters including the pending notes issuance; the company's status as a small offshore GoM producer; lack of basin diversification; a relatively flat production outlook over the next few years; increasing structural subordination at EXXI Bermuda; and exposure to the riskier ultra-deep shelf exploration program.

## INCREASE IN 2013 RESERVES

EXXI reported a large (50%) increase in audited proven (1p) reserves at June 30, 2013, resulting in a 2013 reserve replacement ratio of 393% on an organic basis, and 475% on an all-in basis, as calculated by Fitch. Total 1p reserves climbed to 179 million boe from 119 million boe the year prior, comprised primarily of extensions and discoveries (62 million boe), and to a lesser degree acquisitions (13 million boe). A significant driver of the increase was the company's horizontal drilling program in the GoM, which consists of short laterals (<1000 feet) drilled in EXXI's mature offshore properties. Fitch would note that there is a sizable backlog of such drilling opportunities across EXXI's portfolio.

## RISING DEBT RESTRICTS HEADROOM

As calculated by Fitch, EXXI's debt with equity credit (which includes a 50% weighting for the company's preferreds) rose to \$1.67 billion at Sept. 30, 2013 versus \$1.49 billion at June 30, 2013, and just \$1.14 billion at June 30, 2012. This is set to rise further with the company's pending issuance. Fitch anticipates total debt with equity credit for the company will reach just over \$2.0 billion, and pro forma debt/EBITDA will climb to over 2.2x. As a result, credit metrics are weak for the current rating category and there is expected to be little headroom at the current rating level. Fitch anticipates the company will be approximately FCF neutral in 2014 as capex is set to drop to \$660 million. Fitch believes the company has reasonable capex flexibility within that number.

### INCREASING SUBORDINATION AT EXXI BERMUDA

The downgrade of EXXI Bermuda's IDR was driven by recognition of the significant legal separations between the stronger EXXI Gulf Coast subsidiary (which houses most of the corporation's assets and cash flows) and the weaker EXXI Bermuda parent (which depends on distributions from EXXI Gulf Coast), and the increased structural subordination that would arise from issuing additional securities at the weaker Bermuda parent.

Fitch would note that despite reasonably strong operational ties, the legal separations between EXXI Gulf coast and Bermuda are significant and include restrictions on dividend payments from Gulf Coast to the parent; a lack of guarantees from the subsidiary up to the parent; and separate legal jurisdictions (Bermuda vs. the US). Fitch would also note that potential future international investments recently identified by management at its Analyst Day are likely to be funded at the Bermuda level for tax efficiency reasons. As a result, if international expansions move ahead, we anticipate that the amount of debt and securities issued at Bermuda is likely to go up, which would further structurally subordinate securities issued at Bermuda.

### LIMITED ULTRA DEEP SHELF COMMITMENT

It is important to note that the company's 2013 reserve and production figures exclude the impacts of the ultra-deep shelf program, which Fitch anticipates should begin to be booked despite ongoing delays at the Davy Jones #1 well. EXXI has participated in eight

ultra-deep shelf wells to date with participation levels of 9 - 20%. The company seeks to limit its total exposure to these projects to less than 10% of expected cash flow in any one year, and EXXI's strategy has been to fund this higher risk exploration drilling with lower risk drilling prospects across the rest of its portfolio. Total investments at June 30, 2013 were limited and included Davy Jones #1 and #2 (\$147 million), Blackbeard East (\$51 million), Lafitte (\$40 million), Blackbeard West #1 and #2 (\$57 million), Lineham Creek (\$17 million), and Lomond North (\$21 million).

## LIQUIDITY

EXXI's liquidity was good at September 30, 2013, and included availability on its main revolver of approximately \$841 million after borrowings of \$21 million and LoCs of \$225 million. The revolver, which expires in April 2018, is secured by a borrowing base linked to at least 85% of the company's proven properties. Similar to other borrowing-based revolvers, the base periodically resizes in line with the underlying value of the collateral.

Key revolver covenants include maximum leverage of 3.5x; minimum interest coverage of 3.0x; and a minimum current ratio of 1.0x, as well as change of control provisions and restricted payments. The company had ample headroom on all covenants at September 30, 2013. Restrictions on dividends from EXXI gulf coast to its Bermuda parent were recently loosened to include \$350 million per year, subject to liquidity and minimum cumulative consolidated net income tests. EXXI's other maturities are light, with the no major bonds maturities due over the next three years.

## RECOVERY RATING

Fitch's Recovery Rating (RR) of '1' on EXXI's secured revolving credit facility indicates outstanding recovery prospects (91% -100%) for holders of this debt. The revolver is secured by at least 85% of the total value of proven reserves of the company and its subsidiaries. The RR for EXXI's senior unsecured notes of '4' indicates average recovery prospects for holders of these issues, while the RR of EXXI's junior securities of '6' indicates poor recovery prospects for these securities.

## OTHER LIABILITIES

EXXI's other liabilities are manageable. The company's Asset Retirement Obligation (ARO) dropped to \$287.8 million at June 30, 2013 from \$301.4 million the year prior. EXXI recently provided a guarantee to its 20% joint venture M21k for the payment of that company's ARO (\$65 million) and other liabilities (\$1.8 million) in exchange for a \$6.3 million payment from M21k. EXXI hedges a significant portion of its expected output using a range of instruments; including swaps, collars, 3-way collars, and puts. At June 30, 2013, the company had no collateral posted with counterparties and had a net derivative asset of approximately \$60.28 million. Other obligations were limited at June 30, 2013, and included undiscounted operating lease payments of \$16.04 million, and rig commitments of \$107.6 million.

## RATINGS SENSITIVITIES

Positive: Future developments that may lead to positive rating actions include:

--Increased size, scale and portfolio diversification, accompanied by sustained improvement in debt/boe metrics;

--A demonstrated managerial commitment to lower debt levels.

Negative: Future developments that could lead to negative rating action include:

--Increase in debt/boe metrics from current elevated levels;

--A change in philosophy on the use of balance sheet;

--A major operational issue such as a well blowout or extensive facility damage not covered by existing insurance;

--A sustained collapse in oil prices without other adjustments to capex.

Additional information is available at '[www.fitchratings.com](http://www.fitchratings.com)'

Applicable Criteria and Relevant Research:

--'Corporate Rating Methodology Including Short-Term Ratings and Parent and Subsidiary Linkage' (Aug. 5, 2013);

--Parent and Subsidiary Rating Linkage: Fitch's Approach to Rating Entities Within a Corporate Group Structure, (Aug. 5, 2013);

--Treatment and Notching of Hybrids in Nonfinancial Corporate and REIT Credit Analysis (December 13, 2012);

--'Full Cycle Cost Survey for E&P Producers-2012 Numbers Up, but Adjustments Tell a Different Story' (May 28, 2013);

--Investor FAQs--Recent Questions on E&P, Refining, and Drilling and Services Sectors (Aug 12, 2013)

--Updating Fitch's Oil & Gas Price Deck (July 29, 2013)

--Energy Handbook--Upstream Oil & Gas (June 28, 2013)

Applicable Criteria and Related Research:

Investor FAQs: Recent Questions on the E&P, Refining, and Drilling and Services Sectors

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=715859](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=715859)

Full Cycle Cost Survey for E&P Companies (2012 Numbers Up, but Adjustments Tell a Different Story)

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=708783](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=708783)

Treatment and Notching of Hybrids in Nonfinancial Corporate and REIT Credit Analysis

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=696670](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=696670)

Parent and Subsidiary Rating Linkage Fitch's Approach to Rating Entities within a Corporate Group Structure

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=714476](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=714476)

Corporate Rating Methodology: Including Short-Term Ratings and Parent and Subsidiary Linkage

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=715139](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=715139)

Updating Fitch's Oil & Gas Price Deck -- Midyear Update

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=648586](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=648586)

Energy Handbook -- Upstream Oil & Gas

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=706481](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=706481)

Additional Disclosure

Solicitation Status

[http://www.fitchratings.com/gws/en/disclosure/solicitation?pr\\_id=808416](http://www.fitchratings.com/gws/en/disclosure/solicitation?pr_id=808416)

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: <HTTP://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS>. IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEBSITE '

<WWW.FITCHRATINGS.COM>

' PUBLISHED RATINGS, CRITERIA AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE 'CODE OF CONDUCT' SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

# Fitch Affirms EXXI Gulf Coast at 'B+'; Downgrades EXXI Bermuda to 'B'; Rates Convertible Notes 'B'

Written by Australian Business

---