BREAKING Energy

Oil Industry Shakes Off Bane of Gluttony by End of 2015

April 3, 2015

To paint a clear picture of what the oil and gas industry will look like by the end of 2015 would be an exercise in futility. The only thing we can discern from what we're experiencing today with supply gluts, low global prices and U.S. producer debt burdens is that the environment could become more challenging, before it becomes opportune. And opportunity means consolidation.

Basic economic principles dictate that excess supply and limited demand of oil leads to lower prices. These low prices can lead to periods when the large exploration and production players feast on those who are smaller. On this much we can rely, usually.

This glut caused by years of over spending among E&Ps during boom times, coupled with slower-than-expected economic growth, are the primary reasons there won't be any notable consolidation in the oil and gas industry until the second half of the year. For now, the conversation happening among management teams is about ensuring their own solvency.

Perhaps the story of Whiting Petroleum is one bi-product of this trend. Last year, the Denver-based Whiting bought Kodiak Oil & Gas Corp. in a strategic move to accelerate its growth. That purchase came with more than $2 billion in additional debt and it was when oil was about $100 per barrel. According to reports, Whiting then put itself up for sale, following a 50 percent drop in oil prices. There have been no reports of anyone expressing an interest in purchasing Whiting, which could be why recently, the company issued more debt and announced plans to sell more common stock. (Source: Wall Street Journal)

According to Capital IQ, U.S. oil and gas companies borrowed heavily starting in the middle of the last decade when U.S. oil drillers learned to tap crude from shale. With U.S. producers desperate to get a competitive advantage in what continues to be seen as the next frontier, borrowing increased to almost $200 billion by the third quarter 2014.

While U.S. producers have cut capital expenditures drastically, resulting in reduction in oil rig count (as of March 20, 2015, the U.S. oil rig count totaled 825, compared with 1,473 a year ago, a decline of 648), production hasn't slowed from existing wells. It's about time this gets on a course to stabilization on rig count, but there are headwinds.

Economic improvement, a primary driver of oil consumption, in the U.S. and Europe could lift prices sooner than later, though some forecasters say we're far from the bottom. Dennis Gartman, publisher of the Gartman Letter, said he wouldn't be surprised if oil prices went as low as $15 per barrel. (Source: CNBC.com)

It's likely that crude inventory will continue to build in the next two-to-four months, applying even more pressure on the price. That takes us to the end of second quarter or middle of the third quarter before we will start seeing a decline in production and a stabilization in crude stock inventory. By the fourth quarter, if the price of crude (WTI) is not in the range of $55 – $65 per barrel, you're going to see many more E&P companies start to hit panic buttons.

Kim J. Brady is a senior managing director at SOLIC Capital, a restructuring firm specializing in energy. SOLIC has worked on a variety of energy deals, and is currently serving as financial advisors to EFH Chairman of the Board and Disinterested Directors.

###