FROM THE OIL PATCH

Falling oil prices – blessing or curse?

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While walking past the television in the bank lobby in mid-August, a highlighted marquee on CNBC read, "CRUDE NEAR 6 YEAR LOW," with the WTI crude price of 40.76 $/bbl displayed in a corner of the screen. Over the next few days the price went even lower, below $39.00/bbl and has currently moved to around $45/bbl. Upon seeing this, my thoughts were that third quarter revenue for our Oil, Gas & Mineral Management clients will again decrease and there will be continued restructuring in the oil industry. It would sure be nice to see prices rebound.

My thoughts about oil prices were completely different from when I pulled into a filling station near the office recently. Regular unleaded gas was priced at $1.99/gal, and for $30 dollars I filled up my tank! The low price of oil is great!

So, which is it? The price needs to go up, or should the price stay low? You see the dilemma. As a consumer it's nice to see the price at the pump decrease, thereby reducing fuel expenses for the year. Yet, as a person involved with oil and gas or receiving revenue from oil and gas assets, it's difficult to see revenues decline and hear about layoffs and bankruptcy filings within the oil and gas industry.

Since the price fell in late 2014 there have been multiple reports reflecting oil and gas industry cuts. Perhaps the most telling is the number of active drilling rigs in the U.S. In September 2014 the number of active rigs was 1,931 while the most recent rig count for the week ending September 25 was 838.

Shell Oil has reported that the company will cut 6,500 employees and reduce investment by $7 billion, which exhibits the impact that lower prices have on a major integrated oil company. With other major oil companies possibly planning similar reductions, economic growth will be affected.

These budget cuts will limit development, reducing the amount of oil coming on the market. Other reports include bankruptcy filings by independent producers Sabine and Samson, and others may follow. While they will continue operations, this opens the door for the sale of assets or company acquisition. Once in bankruptcy, operations at these companies will continue, however, less money will be spent on routine operations resulting in a further drop in production.

Will prices start to increase?

These three items on their own suggest that prices may start to increase. Other indications that crude prices may begin to increase are production and storage statistics.

While U.S. production did not decrease as expected early in the year, EIA reported average weekly oil production for November 2104 at 9.06 million bbls and at 9.52 million bbls for July 2015. This trend has recently changed with reported production in August at 9.32 million bbls and slipping during the first three weeks in September to 9.13 million bbls. This could be the first indication of the expected drop in production from the shale plays.

The storage report did not have as definitive a change. EIA reported average weekly crude oil stocks for November 2014 at 1,071.4 million bbls, July 2015 at 1,156.1 million bbls, August at 1,149.1 million bbls and the first three weeks of September at 1,151.1 million bbls. These past four months could be considered unchanged or indicate a slight decrease in oil storage.

On the flip side, items that could put pressure on the price to remain low include the lifting of sanctions against Iran. If oil from Iran officially comes back onto the market it will further increase the supply available worldwide. Combine this with Saudi Arabia and OPEC continuing to maintain production and allowing oil prices to be determined by the market, and there is no near-term reason for prices to increase. OPEC has a meeting scheduled on December 4th, however, some members are pressing for an earlier meeting where this strategy will be a hot topic for discussion.

Domestically there are still active areas that are economically attractive to develop at $40/bbl crude. This is due to lower rig costs and improved technology that has reduced the cost to drill and complete wells. Pioneer's 2nd quarter report stated that they have reduced the drilling and completion time of wells in the Sprayberry/Wolfcamp by 25 days due to increased efficiency. These are horizontal wells with 9000' laterals. Technology is leading the way for continued development in this low-price environment.

Additionally, there is no current or near-term projected increase in demand, either domestically or globally. Since the supply is sufficient and the demand is unchanged, there is no upward pressure on prices at this time.

As seen above there are competing factors affecting oil prices; how these may affect one revenue stream may be different from another. If an operator has reduced drilling costs and is still developing an area, then revenues may increase due to the increase in production. Conversely, if an operator has filed for bankruptcy, the revenues might be further reduced due to minimal spending to keep wells at maximum production.

Oil, Gas & Mineral Management – a long-term investment strategy

The price volatility of oil, gas and natural gas liquids and the reservoir characteristics underscores the need to understand and actively manage these assets for a long-term investment strategy. The professional staff of the Oil, Gas and Mineral Management team has over 70 combined years of oil and gas industry experience. They have weathered previous downturns and can advise on and/or manage these assets through this current situation to maximize their return through leasing activity, monitoring revenues/expenses and evaluating future potential.

To answer my earlier question concerning prices, being involved with oil and gas I will anticipate prices increasing, and hopefully soon. However, as a consumer, I will be grateful for the low cost of fuel as long as it lasts.

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