A more restrained U.S. oil industry among energy predictions for 2018

By

Photo: John Davenport, STAFF

Image 1 of 3

Roughneck Eluid Cervantes pulls up a section of drilling pipe with the help of machinery at the Abraxus Petroleum Shut Eye Unit oil drilling rig in the Eagle Ford Shale in Atascosa County.

U.S. shale drillers appear to have abandoned risky financial strategies that exacerbated the dot-com meltdown and that made the recent oil bust far more painful for Houston companies and their employees.

In recent months, investors have demanded executives focus on delivering investment returns and fueling operations with their own cash, instead of running up large debts or diluting shares in stock sales to pump ever-increasing amounts of oil.

It's a big change for a boom-and-bust industry, but so far, oil companies seem compliant, even restrained: though oil prices have surged toward $60 a barrel in recent weeks, the number of working U.S. oil rigs hasn't skyrocketed. In fact, the oil-rig count has barely budged since early November.

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"The hype is over," said Chris Midgley, global head of analytics at S&P Global Platts. "We're seeing a chance in their behavior and mindset. The dot-com boom mentality has dissipated. Now there's a really strong focus on accountability."

Midgley believes investor pressure will keep the U.S. oil industry in line in 2018 after energy companies under-performed in the S&P 500 Index this year. He also thinks banks will tighten their purse strings for oil producers; that oil field service companies will have to raise prices; and that the world's oil stockpile will decline next year.

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Those are just some of the things Midgley and others predict for 2018, a year that could bring the oil industry further out of its financial straits, as long as crude prices remain elevated.
Another thing that might happen next year is a wave of corporate acquisitions of companies who exited bankruptcy court led by new owners: their former bondholders.

Dallas law firm Haynes & Boone, which tracked the bankruptcy cases of more than 130 debt-laden North American oil companies, said most of the time, bondholders end up as shareholders after a company is reorganized in bankruptcy proceedings.

"They're interested sellers because they never intended to own an oil company," said Buddy Clark, a Houston partner and co-chair of the energy

practice group at Dallas-based law firm Haynes & Boone. "Those bondholders are not oil men. They're bond traders."
Higher oil prices, Clark said, could mean more of these transactions.

Higher prices could also mean oil companies will pursue litigation more often, said Brit Brown, Houston managing partner at the law firm Akerman.

The oil downturn, Brown said, had led companies to cut their in-house legal departments, forcing the departure of experienced personnel that had built relationships with other companies over the years – relationships that were quite useful in heated disputes.

During the downturn, companies were shying away from litigation and arbitration because it not cheap, or quick. But now, oil-company budgets are stabilizing, in-house legal departments are being rebuilt and companies are assessing "their legal docket, what needs to be addressed and what needs to be let go," Brown said.

"There seems to be a greater willingness to pursue a legal right," he said. "Smaller and midlevel commercial disputes are now being raised."

Unless the oil market sinks again, the benefits of higher crude prices will have to spread out across the energy industry. Next year, Midgley said, oil field service companies will have to raise their prices to avoid financial disaster. A majority of both drilling contractors and hydraulic fracturing companies are on negative credit watch at S&P.

"That's unsustainable," Midgley said. "Prices have to go up. That's a very strong indicator costs have to move in one direction only. They have to start earning returns, as well."

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That could make it more expensive to pump oil next year. Investors are expected to keep a closer eye on the economics of wells in the oil patch. They've taken companies to task for advertising high rates of return on wells that don't take into account other factors that reduce the ultimate investment return, such as lease and debt costs. For some of these wells, returns are a tenth as profitable as advertised.

"You're looking at $65 a barrel oil being roughly the breakeven level," Midgley said. "The industry is being held a lot more accountable."