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Capital expenditures cut into energy companies' profits

By: D. Ray Tuttle The Journal Record August 18, 2014 0

Recent earnings reports suggest that oil and gas companies are expanding and as a result seeing higher costs, which have affected profits, said Qian Zhang with Fredric E. Russell Investment Management Co. of Tulsa. (Photo by D. Ray Tuttle)

TULSA – Recent oil and gas company earnings suggest an industry trend of companies boosting capital expenditures. The higher costs cut into second-quarter profits, said market analyst Qian Zhang with Tulsa-based Fredric E. Russell Investment Management Co.

A second market observer noted that there is not one clear reason why energy companies reported mixed financial results, as there are a number of variables to consider when examining quarterly earnings reports.

"The numbers are not always clean as companies report one-time charges and things like the price of oil being up from a year ago," said Gabriele Sorbara with Topeka Capital Markets in New York.

Two examples of companies ramping up expansion plans are Helmerich & Payne and Magellan Midstream Partners, Zhang said.

"Helmerich & Payne disclosed in its last quarterly earnings release that the company had signed new multiyear contracts," Zhang said.

Magellan Midstream Partners announced plans to spend about $1.2 billion through 2016 to complete its current slate of construction projects, Zhang said. Also, the growth rate for energy companies has slowed compared to a year ago, she said.

"Operating costs are the same or higher," Zhang said on Monday. "But the outlook for the market remains good."

Factors that have contributed to a decline in profits include smaller production totals due to smaller acreage, less cash flow and pricing pressure, Sorbara said.

One reason for lower profit compared to last year might be that a company's oil and gas production declined because of having less acreage available for production, Sorbara said.

A number of companies have followed a trend to sell their noncore assets, she said.

For example, SandRidge Energy sold its Permian Basin assets in 2013, said Ben Tsocanos, an analyst with Standard & Poor's.

"It will take them a while to rebuild production to where it was before they sold those properties," Tsocanos said.

The trend of companies shifting focus to core areas, where they think they can add drilling inventory to their portfolios, is growing, Sorbara said. The buyers tend to be small startups taking advantage of the activity, snapping up properties shed by the sellers.

"Companies are redeploying their capital, moving equipment to their core assets and exiting their noncore regions," Sorbara said. "Drilling remains a capital-intensive activity."

Companies are under pressure to raise adequate equity and debt to fund drilling projects, cutting into profits.

"They are putting a lot of energy into the ground, adding more laterals in fracturing, for example, and that is not cheap," Sorbara said.

For example, during Laredo Petroleum Inc.'s conference call, President and Chief Operating Officer Jay Still discussed the higher cost for crews.

"Over the last quarter, we've seen an increase in pricing and greater competition for completions crews," Still said.

The Permian Basin remains one of the hottest plays even a century after its discovery, Tsocanos said.

"So many companies are active there, that it puts upward pressure on service prices," Tsocanos said.

Across the industry, companies are seeing drilling delays, Sorbara said.

"Companies are consolidating their drilling to fewer pads, drilling four, six, eight wells per pad," Sorbara said. "That creates delays."

The result is expected to be higher production totals later in the year once product begins flowing, Sorbara said.

Another factor delaying drilling is how companies create multiple laterals from one site, in the practice called stacking.

"These stacked laterals are targeting a number of zones off one pad," Sorbara said. "It defers production and means longer cycle times."

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