Oil at $75 Means Patches of Texas Shale Turn Unprofitable

By Isaac Arnsdorf - Nov 20, 2014

With crude at $75 a barrel, the price Goldman Sachs Group Inc. says will be the average in the first three months of next year, 19 U.S. shale regions are no longer profitable, according to data compiled by Bloomberg New Energy Finance.

Those areas, which include parts of the Eaglebine and Eagle Ford in East and South Texas, pumped about 413,000 barrels a day, according to the latest data available from Drillinginfo Inc. and company presentations. That compares with the 1.03 million-barrel gain in daily national output over the past year, government figures show.

The expansion of U.S. oil supply to more than 9 million barrels a day is contributing to a global glut, driving down prices by as much as 32 percent since June. The data compiled by BNEF, which take into account the costs of drilling, royalties and transportation, show that certain shale patches fail to make money at the current price. Companies such as SandRidge Energy Inc. (SD) and Goodrich Petroleum Corp. (GDP) said they expect to pump more oil for less money so they can withstand the rout.

“Everybody is trying to put a very happy spin on their ability to weather $80 oil, but a lot of that is just smoke,” said Daniel Dicker, president of MercBloc Wealth Management Solutions with 25 years’ experience trading crude on the New York Mercantile Exchange. “The shale revolution doesn’t work at $80, period.”

Break Even

West Texas Intermediate crude, the U.S. benchmark, fell to a four-year low of $73.25 a barrel on Nov. 14, from $107.73 on June 20. Goldman Sachs cut its first-quarter forecast to $75 a barrel on Oct. 27 from a previous forecast of $90.

The 12-nation Organization of Petroleum Exporting Countries has increased output by more than 1 million barrels a day since the end of May. OPEC meets Nov. 27 to decide whether to cut output or preserve market share and pressure U.S. drillers.

Estimates of the price that drillers need to break even have varied. The Paris-based International Energy Agency said about 96 percent of U.S. shale production remains profitable at $80 a barrel. Analysts at Sanford C. Bernstein LLC said one-third of the output added in the first three months...
of 2014 is uneconomic with WTI at $80.

Profitability varies depending on the rocks’ depth and density, access to pipelines and the mix of oil and gas that wells pump. Drillers in the Tuscaloosa Marine Shale of Louisiana and Mississippi break even at $79.52 a barrel because they have to bore more than two miles deep, according to data compiled by BNEF. The cheapest field was the Green River basin in Colorado and Wyoming, at $50.10 a barrel.

**Reduce Spending**

At least a dozen companies including Continental Resources Inc. (CLR) and SandRidge, both based in Oklahoma City, said on conference calls in the past month that they would reduce capital spending plans because of lower prices.

Wells in the 19 regions that according to the data are unprofitable pumped a combined 273,745 barrels a day in June, 38 percent more than a year earlier, according to Drillinginfo, an Austin, Texas-based information provider to government and industry.

Data weren’t available for Oklahoma because government record keeping there is limited, according to Drillinginfo. In the state’s seven regions that the data compiled by BNEF say are unprofitable, companies including Continental and SandRidge said they produce at least another 139,360 barrels a day. Together, the two estimates come to about 413,000 barrels a day, which is 40 percent of the growth in daily U.S. production over the last year.

**Higher Returns**

By contrast, the biggest-producing fields -- North Dakota’s Bakken and the Permian and Eagle Ford in Texas -- pump a combined 4.7 million barrels a day, according to the Energy Information Administration. Those regions remain economic at $55 to $65 a barrel, according to Manuj Nikhanj, head of energy research at New York-based Investment Technology Group Inc. What matters more than break-even levels is that lower prices reduce the cash flows companies can use to reinvest in new production, he said.

Continental, led by billionaire Harold Hamm, produces about 10,540 barrels a day in the South Central Oklahoma Oil Province, known as Scoop, according to Warren Henry, vice president of research and policy. The region’s break-evens range from $79.28 to $186.73 a barrel, according to data compiled by BNEF. Shares of Continental have fallen 18 percent to $52.86 since Oct. 1, compared with a 5.3 percent gain in the Standard & Poor’s 500 Index of U.S. equities.

Continental’s returns in the Scoop are higher than in the Bakken and the company is still exploring the region, Henry said. The initial production rates Continental reported are higher than those assumed in the data compiled by BNEF.
Mississippian Formation

“I’d probably be more inclined to drop rigs in the Bakken because I’m getting really good results and I’ve got two to three years of drilling to do in the Scoop,” Henry said.

SandRidge pumps about 23,400 barrels a day of oil and gas from the Mississippian formation on the Kansas-Oklahoma border, the company said Nov. 5. The area is the company’s focus, with more than 1.85 million acres leased, according to its website. Drillers in the area need between $78.56 and $163.51 a barrel to break even, according to data compiled by BNEF.

By reining in drilling costs, SandRidge makes a 40 percent return on a $2.9 million well at $80 a barrel, said Jeff Wilson, a company spokesman. That’s about 14 percent cheaper than the BNEF data’s estimated well cost and doesn’t include other expenses such as leases and transportation. Including infrastructure, the return is 30 percent, Wilson said. SandRidge also hedged the majority of its 2015 production above $90 a barrel, he said. Shares of SandRidge fell 10 percent to $3.73 since Oct. 1.

Tuscaloosa Marine

Goodrich, based in Houston, spends about 80 percent of its capital budget on the Tuscaloosa Marine Shale, its largest acreage position, according to a November presentation. Daniel Jenkins, a company spokesman, declined to comment. Shares dropped 30 percent to $9.34 since Oct. 1.

Some break-even analyses have been wrong because they use improper assumptions, Robert C. Turnham Jr., Goodrich’s president, said on a Nov. 4 conference call. A well that costs $13 million and eventually yields the equivalent of 600,000 barrels of oil returns 13 percent at $70 a barrel, the company said in a Nov. 11 slideshow.

“The first question on every earnings call is, ‘What can you do going into the next year if we really are in a $75 oil price environment?’” said Chad Mabry, an analyst at MLV & Co., an investment bank in Houston. “We’re already starting to see some cracks.”

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