Permian land rush loses steam

Increasing costs, high land prices and shareholders reining things in mean far fewer deals recently

By Collin Eaton

Rising production costs, high acreage prices and a shareholder push for financial discipline have dramatically slowed the land rush in the Permian Basin, one of the world's most active oil fields.

Drillers spent $35 billion in West Texas over a nine-month period that ended in early spring. By comparison, the collective value of land deals of the last six months is less than $5 billion, energy research firm Wood Mackenzie reports.

Shortly after OPEC announced plans to curb global crude supplies, oil prices rose and drillers made a flurry of acquisitions in the Permian, willing to pay high prices to lease land that sits atop multiple stacked layers of oil-soaked rock that could ultimately yield another 70 billion barrels of crude in coming decades. But that multibillion-dollar push, prodded along by outside investors, couldn't last forever.

"The market was throwing money at them to buy things," said Greig Aitken, head of upstream oil and gas mergers and acquisitions at Wood Mackenzie.

Land prices rose so high that new entrants found it difficult to make returns on their investments, often paying more than $30,000 an acre. As a surge of drilling got underway and companies dispatched more rigs and fracking equipment across the vast plains, labor and equipment costs also began to climb, eating into the industry's bottom line.

Plus, companies faced

Investor continues on B5

FROM THE COVER

'Investor base has become fatigued,' analyst says

Investor from page B1

labor shortages after the oil downturn and much of their functioning equipment had been cannibalized for parts.

Investors, meanwhile, have grown impatient with an industry that has prioritized rapid growth over returns, and some of those groups have begun pushing companies to spend within their means, rather than relying on debt or other outside capital to drill new wells.

"It's just taken the edge off the Permian," Aitken said.

Last week, Anadarko Petroleum Corp., based in The Woodlands, made one of the most pronounced moves yet to appease shareholders, announcing plans to spend $2.5 billion to repurchase shares through the end of next year.

The company, analysts said, may be only the first to shift funds directly away from their investment budgets; most, however, have already signaled they'll spend less than anticipated on developing oil fields this year.

"The investor base has become fatigued" with shale drillers that still can't cover their spending with cash flowing from their oil and gas operations, Mizuho Securities analyst Timothy Rezvan said. "Companies have started to walk back aggressive multi-year production growth guidance."

In the years of $100-a-barrel oil, companies drilled wells at breakneck speed across the country and promised double-digit growth, fueled at different times by a mix of junk-rated bonds and stock sales to Wall Street investors, as technological breakthroughs opened up once-inaccessible sources of oil and natural gas.

This year, oil prices dropped below $50 a barrel, burning investors who had bet on a strong recovery after two brutal years in which the industry axed hundreds of thousands of jobs and scores of U.S. oil companies went bankrupt.

The crude-price decline was, in part, because of forecasts of rising oil production from U.S. oil fields — most prominently, the Permian Basin.

"Hedge funds have been hit hard trying to bet on the oil recovery," said James Sullivan, an analyst at Alembic Global Advisors in New York.

Analysts say the conservative shift in market sentiment could signal the beginning of a new chapter for the U.S. shale oil industry, one in which companies place a greater emphasis on shareholder returns. It takes years to build any kind of business, making investments and sacrificing upfront returns to become profitable over time. The shale industry, analysts said, is no different.

"At some point, the plan was always to harvest this investment," Morningstar analyst David Meat said in Chicago. "We're just seeing the early stages of getting to that point. It's distorted by the fact that we're coming out of a downturn."

collin.eaton@chron.com
twitter.com/CollinEatonHC