Private companies investing in Gulf as Wall Street turns its back

By Collin Eaton  Updated 2:41 pm, Friday, May 4, 2018

Matt McCarroll's oil company recently emerged from bankruptcy with one of the largest positions in the Gulf of Mexico and plans to invest $750 million dispatching rigs over the next two years in its first drilling campaign since the oil bust.

But McCarroll, CEO of Houston's Fieldwood Energy, knows Wall Street investors have largely turned their back on the Gulf, and that his private equity-backed firm is among a dwindling number of independent drillers there, as rivals flee to dry land in West Texas.

“We've seen a lot of good people leave,” McCarroll said in a recent interview.

Once the envy of the oil industry, the Gulf of Mexico has become a lower priority in the energy pecking order. Public companies, including Houston's Noble Energy, Marathon Oil and Apache Corp., jettison properties and pour cash into U.S. shale plays, prodded by shareholders to make faster returns on investments that take far less time to develop than offshore fields.

That has provided an opening for Gulf operators like Fieldwood, which last month paid $480 million in cash for Noble Energy's deep-water Gulf assets that McCarroll expects will generate $300 million in cash this year even if oil prices sink back to around $50 a barrel.

But it's not easy going it alone. Fieldwood raised wages for contractors last month to keep them from moving to Texas boomtowns. McCarrf there's not enough business for oilfield services companies in the Gulf, they'll go somewhere else. And though the daily cost of renting offshore rigs has been cut by more than half, they're operated by less experienced crews that take longer to do the job, which offsets any savings.
But after a career spent developing the Gulf — he began as an intern in 1978 on an offshore platform his company now owns — McCarroll isn't going anywhere. "It's the area I know," he said.

In the sprawling exhibit hall of the Offshore Technology Conference this week, as oil prices cruised above $65 a barrel, the outlook for the Gulf and other offshore fields was grim. Oil industry professionals hawking valves, seals and automated sensors at Houston's NRG Park said the offshore industry has shown few signs of life so far, even as demand for oil equipment and workers has surged since October among drillers operating near Midland and Odessa.

"Offshore has been pretty quiet," said Steve Sharp, a national salesman at Sugar Land titanium pipe supplier Titanium Engineers. "It's expensive to get the oil out of there."

Sixty-three drilling rigs probed the Gulf of Mexico back in the summer of 2014, when oil prices still hovered above $100 a barrel, according to Baker Hughes. The region's latest rig count: 18. And that's down from the 24 that operated there during the worst of the oil downturn in 2016.

U.S. drillers in the Gulf of Mexico produced 1.72 million barrels of oil a day in February, up from 1.41 million barrels in 2014. Meanwhile, the Permian Basin's daily output grew five times faster during that period, expanding from 1.5 million barrels to about 3 million in that same time, according to the Energy Department.

For investors in independent U.S. oil companies, the decision to divest from the Gulf comes down to time and money. It takes six to seven years for oil companies to make their money back on offshore drilling, and though costs have come down, it still takes $52 a barrel to break even on a new well in the Gulf of Mexico.

In the Permian Basin, drillers can get break even on a new well with $42 a barrel oil - and it only takes one year to recover the costs, according to Norwegian research firm Rystad Energy.

The shift to projects with shorter life spans also suggests investors could be worried about the world's thirst for oil will decline in coming years as electric cars take bigger market shares and global climate rules restrict fossil fuels.

"If they believe oil demand will need (offshore projects) to come online in 2023 to 2025, then they should be confident enough to develop these offshore fields," said Maierdan Halifu, senior analyst at Rystad in Houston. "But if they're skeptical, then shale can be a source for them to turn profits quickly."

ConocoPhillips last year stopped exploring deep water fields. Analysts expect Marathon Oil to divest more Gulf holdings. Freeport-McMoRan sold deep-water assets in 2016 to Anadarko Petroleum Corp. for $2 billion.

Houston's Apache Corp. sold its assets in the shallow waters of the Gulf to Fieldwood in 2013. Oklahoma's SandRidge struck a similar deal with Fieldwood in 2014.

Investors see the oil industry's conventional business model, in which companies spend billions of collars upfront for prospects that could turn out to be dry hole sas too risky. And they're keen on drilling into rich oil reservoirs of the Permian Basin.

But some industry experts envision a day when the Gulf and other offshore regions will attract Wall Street money again. Major oil companies are still investing in the Gulf, analysts note.. Royal Dutch Shell in April approved the multibillion-dollar Vito project in the deep Gulf, and this month it will christen the voyage of its massive Appomattox oil platform from Ingleside to the eastern Gulf.

And in coming years, analysts said, independent oil companies will need a more stable source of oil production to offset the fast-declining wells in U.S. shale plays. After severe cost-cutting on the exploration side of the oil business, oil companies haven't replaced the oil reserves they pumped during the two-year downturn. As global oil demand begins to outpace supply, companies will increasingly need to draw on stable oil fields in the Gulf and elsewhere.

"The potential volumes in the deep-water frontier areas are huge," said Michelle Foss, an energy economist for the Bureau of Economic Geology at the University of Texas.

Rystad believes oil companies will approve some 130 offshore projects around the world this year, up from 67 in 2017 and 38 in 2016. Globally, the break-even price for deep-water projects has fallen from around $80 a barrel in 2014 to $45 a barrel this year,
the firm estimates.

Though it's lonelier in the Gulf for independents like Fieldwood, the company is not alone.

Houston's W&T Offshore on Monday announced a deal with Baker Hughes to develop 14 drilling projects in the Gulf. The week before, LL0G Exploration Offshore, a private Louisiana company, said it would take over the operations of the deep-water Shenandoah discovery in the Gulf from Anadarko Petroleum Corp.

Navitas Petroleum and two private companies based in Houston, Beacon Offshore Energy and Venari Resources, also increased stakes in the Shenandoah project, originally led by Anadarko, ConocoPhillips and Marathon Oil.

For now, the Gulf exodus by much of the oil industry doesn't bother Fieldwood's McCarroll. It means fewer rivals elbowing for the billions of barrels of oil locked under the ocean floor. If Noble's holdings, which produce 25,000 barrels a day, had been in the Permian, Fieldwood would likely have faced scores of companies bidding up the price.

McCarroll's company has two Gulf rigs working today and will deploy another two in coming months. Deep-water has higher barriers to entry, he acknowledged, with more stringent regulatory and operational challenges than on land, where companies can cobble together leases and capital and quickly develop a $5 billion enterprise.

“That doesn't mean we can't make as much money as the shale guys,” McCarroll said. “Time will tell.”

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