Oil Companies Go Slow On Exploration, Output Despite Spike In Crude

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Thanks to strong prices, oil companies are boosting spending on exploration and production. But not by a lot -- and those increases may not bring more oil to market.Since approaching $50 a barrel on Aug. 20, near-term oil futures have reversed. On Monday, October crude fell 90 cents to $42.28 a barrel, a four-week low.

But long-term futures still point to sustained high prices. Nonetheless, planned E&P spending hikes are much tamer than in years past. Burned by other price spikes, oil companies are more conservative. Yet with oil output nearing capacity, E&P budgets could keep trending upward for several years.

"Oil companies have gotten the message from institutional investors that they need to be more capital disciplined," said James Crandell, oil services analyst for Lehman Bros. "Companies were also unprepared for this surge in commodity prices."

Lehman Bros.' midyear survey says E&P spending will rise 12% to $162 billion this year. In the 1970s, E&P spending rose more than 20% a year, according to Smith Barney. In 1974, E&P spending surged more than 50%.

Crandell recently upped his forecast for E&P spending. Still, "absolutely it's less" compared with prior oil price shocks, he said. "If we had similar gains in energy prices, we'd be looking at gains (in E&P spending) north of 20%. To see only a 12% increase is amazing."

It's a sign of financial discipline. Oil companies have been burned in the past by bringing on projects viable when oil prices are high, only to watch prices plunge later.

"If we learned anything, we can't predict prices," said Tony Lentini, vice president of public affairs at Apache. "People have been burned by volatility."Around 1981, oil companies spent one-third of cash flow on E&P. Crandell says they now spend 11% of cash flow.

Oil companies are looking to reward investors with share buybacks and increased dividends instead of plowing money into E&P.Consumers shouldn't expect higher E&P spending to translate into higher crude and natural gas production.Energy firms will ramp up spending on international projects in the Middle East, Central Asia, Russia and the North Sea.

But oil companies want to make sure projects are profitable. Lehman says surveyed companies are basing E&P budgets on oil at $28 a barrel. Most analysts believe strong demand and tight supply will keep oil above $30 for the foreseeable future.

Oil's boom and bust cycles will remain. But higher-trending prices and E&P budgets suggest cyclicality may be tempered, Crandell said.

"The violent ups and downs have been difficult to manage for oil companies," he said. "It looks like a good long moderate growth cycle."

Smaller independents like Apache are the ones leading the gains in E&P spending while major firms such as Exxon Mobil are showing minimal or flat growth.

Exxon's $12 billion budget is so huge that its percentage gains will be much smaller next to Apache's $2 billion E&P budget.Another reason is there are few large oil fields for a major like Exxon. But companies like Apache can take on much smaller finds."The huge elephant (size fields) are harder to come by," Lentini said.

National oil companies, which don't have as many shareholder constraints, will see some of the biggest gains, Crandell says. Mexico's Pemex, Brazil's Petrobras and Venezuela's PDVSA will see the biggest gains among state-run firms.

Smith Barney's survey found 30% of companies cited the lack of big oil fields as the main reason E&P budgets aren't going up more. Royal Dutch Shell is hiking spending more than most majors, but that's mostly due to cost overruns and finding smaller fields.Smith Barney found production of existing wells, not exploring for new ones, is the focus. Globally, 38% of firms plan to spend more on exploration than production in 2004. That compares with 45% in 2001.

There may be only eight projects across the world that will add at least 200,000 barrels of oil a day, says Matt Simmons, founder of research firm Simmons Company International. Most projects in development now should bring only an extra 50,000 barrels a day.That's paltry, given the world consumes 82 million barrels a day. And since it can take five years for a new field to begin producing, a lack of new fields doesn't bode well for supply through the rest of the decade.

"We won't have big increases in production anytime soon, at least before 2009," Simmons said. "It's a reversal of economics since high prices won't do anything to supply."Simmons says the total projects set to come on stream will add 6 to 8 million barrels of oil a day by 2009. But production declines will mean 11 million barrels a day will likely be gone by then.

The rest of the world's untapped energy is in deep water or under rock formations that are harder to drill in. Bob Gillon, analyst at research firm John S. Herold Inc., says oil companies will need to boost spending to tap these new sources.

"We need to see a step up in spending, not necessarily on traditional drilling," Gillon said. "We need new types of ventures."