www.NEWSBASE.com
UOGM
Unconventional Oil & Gas Monitor

Not So Tough at the Top

The oilfield services industry as a whole has been hit hard by the fall in crude prices, but the largest firms are finding it easier to weather the storm

August 25, 2015

Oilfield services firms' results for the first half of the year are coming in thick and fast. With oil prices having remained low over the period, some had expected a bloodbath. Yet the signs are pointing to an industry – for those at the top at least – that is proving remarkably resilient.

Surprising resilience

During the first six months of 2015, none of the world's largest services companies came through the collapse in crude prices unscathed. Schlumberger, the largest oilfield services firm, posted a fall in second-quarter revenue of 12% to US$9 billion. Halliburton saw profits drop from US$774 million in the second quarter of 2014 to US$54 million in the same period this year and Baker Hughes reported a loss of US$188 million in net income. But all of these companies came in ahead of analysts' expectations, weathering the storm much better than anticipated.

"In the time that I've practised – the last 30 years – I've been through three boom and bust cycles, and many people have been around a lot longer than I have and have seen four or five," BDO's global head of natural resources, Charles Dewhurst, told *NewsBase*. "The big operators are very adept at restructuring and rebalancing when it comes to this sort of price decline. I'm pleased, to be honest, the oilfield services companies are doing a lot better than many people predicted, but it's not entirely surprising."

This stronger than expected performance was not only confined to the big three oilfield services firms. Among the smaller companies, Aberdeenheadquartered Wood Group posted a 13% year-on-year drop in pre-tax profits to GBP102.3 million (US$161.2 million) for the first half of 2015.

As with the industry leaders, these results were largely achieved through restructuring, with cost savings of more than US$40 million made since the start of the year. Wood Group has shed more than 5,000 workers over the past eight months – the equivalent of 13% of its total staff. So far this year, Schlumberger has cut 20,000 jobs. Baker Hughes has lost 10,500 jobs, while Halliburton slashed around 12,800 jobs in the first half.

Speaking to *NewsBase*, SOLIC Capital's managing director, Raoul Nowitz, said this level of reduction in staff was "an indicator that they see the current environment continuing for some time". SOLIC is a capital advisory, distressed asset management and principal investing firm that specialises in energy.

Nowitz added that many firms had been investing in technology and software in a bid to be more efficient and cut waste. "I don't think anyone is immune. We've seen the small independent guys that are most exposed saying that they have to do something very significant very quickly, and then you've got the larger integrated

firms saying that they see this as a long-term structural sector shift and that they have to implement these measures immediately."

Over-exposure

Another crucial part of the services industry's durability seems to be a broad and varied portfolio. Schlumberger, Baker Hughes and Halliburton, all of which are headquartered in Houston, Texas, count on the Middle East and Asia for their highest before-tax profit margins.

These regions have been hit less hard by the downturn than higher-cost areas such the North Sea and the US. The fall in oil prices has had a particularly dramatic impact on the latter.

Maintaining production from US shale plays requires the drilling of many more wells than in conventional fields, which translates into more work for services firms in good times. But the breakeven price for shale drillers varies massively and the downturn has made some shale acreage uneconomic. According to some estimates, the average breakeven price among shale drillers is roughly US$50 per barrel. In some premium acreage, though, this can fall below US$10 per barrel, while, elsewhere, a breakeven price of US$80 per barrel can be expected.

"On a basin-by-basin level, we see the Barnett and Bakken plays being spoken of as some of the hardest hit, and the Barnett rig count has continued to decline from 2008 levels," said Nowitz.

"There's a lot of gas there yet to be drilled but when prices are where they are its unlikely that we'll see a recovery any time soon. In terms of the Bakken, there's still a large amount of activity, and there's an estimate that something like 40% less will be spent on services during 2015. You see a lot of 'mom and pop' services operators in the Bakken simply folding up. Conversely, the Marcellus has seen sustainability and hasn't been as badly hit."

More buoyant

Over in the Middle East, though, the outlook seems to be far more buoyant. While drilling in some areas has slowed, production is soaring and the need for related services remains strong. On average, onshore output has a breakeven cost of US$27 per barrel, falling to below US$10 per barrel in some instances.

"The world will continue to be heavily invested in the oil industry in the Middle East – it will have to be, because that where most of the reserves are," Dewhurst said. "Certainly for the big three oilfield services companies – and many others, for that matter – there are tremendous opportunities in the region, and those will continue."

Under pressure

This is all well and good for the giant, well-funded services providers, but for smaller firms the future is looking distinctly more challenging. The slump is unlikely to pass anytime soon, with all firms regardless of their size remaining under considerable pressure.

"What we're hearing about is that EBITDA [earnings before interest, taxes, depreciation and amortisation] is declining by around 30-35%, and liquidity profiles are being severely adversely impacted," said Nowitz. "Our view is that this is likely to continue into the first half of 2016. We expect this to play out for some time to come," he added.

"There's more and more supply, lightness in demand, while China is not importing as much crude. Companies are trying to recalibrate and regain market share but it's going to take time for all this to happen, and there will be casualties. It's going to at least be into 2016 we think before we see stabilisation on earnings, and then maybe a slow recovery thereafter."

M&A potential

The outlook is not wholly negative, though. There is a consensus in the industry that mergers and acquisitions (M&A) could offer hope to many firms, with the prospect of cutting costs and boosting market share through consolidation becoming increasingly appealing.

In an interview with Bloomberg earlier this year, the head of energy investment banking at Duff & Phelps, Jim Rebello, predicted that a surge in such deals could be around the corner.

“The service-side M&A activity will accelerate as we go through the remainder of the year,” he said. “There’s too much capacity. We don’t think every company will make it through this down cycle.”

This, it seems, could also be prompted by the closing of the deal between Halliburton and Baker Hughes, a US$34.6 billion mega-merger that was announced at the end of 2014 as prices were already falling. Once the transaction is completed, which is anticipated by the end of the year, the combined company will begin to offload overlapping assets, leading to a spate of acquisitions by smaller players. For the market, this could well be a positive step.

“In our opinion, merger and acquisition activity will allow certain parties to weather the storm better than others,” said Nowitz. “There are clearly the benefits of scale, integration bonuses, and synergies and cost reductions,” he added.

“The more that companies fall into financial distress, the more opportunities there’ll be for stronger capitalised operators. It may not be quite here yet, but it is clearly going to be the order of the day over the next 6-12 months. With the tie-up between Halliburton and Baker Hughes – people asked if it was needed as they are such big companies. But you have significant product diversity, exposure to internal markets and economies of scale that can help enormously.”

Again, it seems that the biggest firms are the best placed to benefit.

“There are tremendous opportunities in a market like this,” said Dewhurst. “There’s the prospect of many M&As, and we’ve already seen a tremendous number of those recently, not just on the services side, but with [international oil companies] IOCs being very active and gobbling up medium and smaller-size companies,” he added.

“Any time you have a crisis point like this there are a lot of deals, and it’s going to be the bigger diversified international players that can take the long-term view.”

Hunting for business

Still, the crisis is ongoing. Recently it emerged that both Schlumberger and Halliburton had been broadening their usual contracts in a bid to win business, offering loans to crude producers to pay for drilling campaigns, or offering to take stakes in new wells instead of cash.

With banks unwilling to lend this is a sensible move, and one the industry can expect to see more of over the coming months. For the smaller players, though, it is yet another example of an area in which they cannot compete.

###