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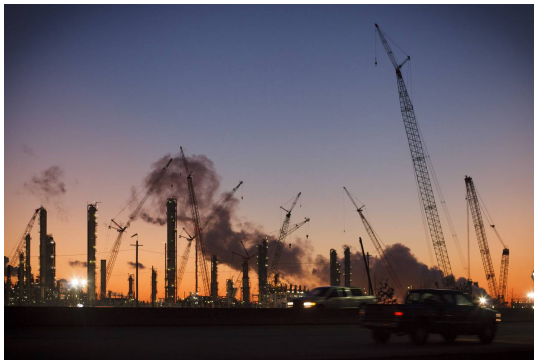
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BUSINESS

Oil Companies Take to Thrifty Bets

Energy producers like Exxon and BP are avoiding expensive engineering forays in favor of cheaper, quicker projects



An Exxon Mobil refinery in Baytown, Texas. PHOTO: MICHAEL STRAVATO FOR THE WALL STREET JOURNAL

By Sarah Kent and Bradley Olson

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The world's biggest oil companies are getting thrifty.

Oil prices have made a modest comeback from the lows hit a little over a year ago, but energy companies such as Exxon Mobil Corp. [XOM 0.03% ▲](#) and BP [BP -0.55% ▼](#) PLC aren't pursuing the extravagant bets they made at \$100 a barrel—like commissioning multibillion-dollar projects in Arctic waters and Kazakhstan's Caspian Sea.

These companies, including Exxon, BP, Royal Dutch Shell PLC and Chevron Corp. [CVX 0.13% ▲](#), are putting their money into cheaper, quicker ventures in Texas shale country, the Middle East and Brazil and squeezing more from existing projects world-wide.

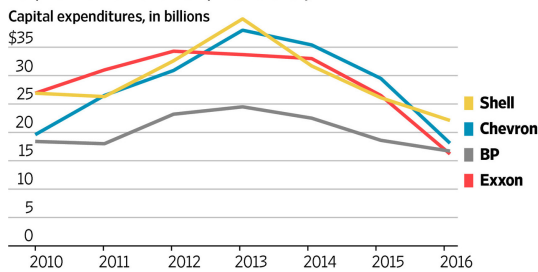
Exxon last week unveiled an ambitious plan to put its U.S. drilling opportunities in Texas, New Mexico and North Dakota at the heart of its future. By 2025, the company said, its production from these areas could more than triple to the equivalent of 750,000 barrels a day. Together with other shale production, that would amount to about a third of Exxon's current output.

It is a shift away from the business model long-employed by the world's largest oil companies, favoring technologically challenging projects that had huge upfront costs that would be paid off over 20 or 30 years.

To drive down costs, big oil companies are abandoning such developments in favor of standardization and bolt-on models that take advantage of existing infrastructure. They are returning to old basins to see what they can extract with new technologies and focusing on the lowest-cost prospects.

Lowering the Stakes

Big energy companies are holding off on new, expensive projects, despite the start of an oil-price recovery.



The appeal of cheaper projects that can bring oil or gas to market within a few years is that it allows big companies to avoid being locked in to multibillion investments over as much as a decade, said Ryan Lance, the chief executive of ConocoPhillips, at the annual CERAWeek conference in Houston on Tuesday.

“They’re not just paying lip service to this,” said Luke Parker, vice president of corporate

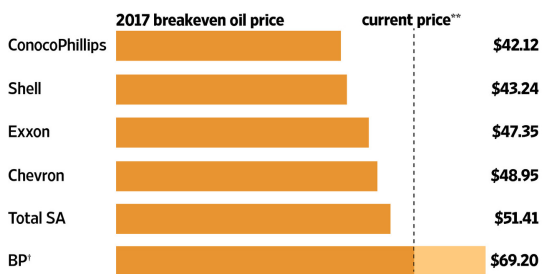
analysis at Wood Mackenzie, a Scottish energy consultancy. “They want to be in a position to future proof themselves against peak oil demand when it comes.”

The challenge of the strategy is that many of the big Western companies have yet to prove that they can consistently turn a profit in a time of lower prices, especially in U.S. shale fields. Increasing production may prove even more daunting since the companies have to spend billions just to replace the barrels they pump every year.

Last week, BP announced plans to drive down its break-even oil price to between \$35 and \$40 a barrel by 2021, all while increasing production. It is a feat the British oil giant says it can pull off by maintaining strict cash discipline, driving down costs and focusing on projects that generate strong returns even at current prices.

Cost Control

The world’s biggest oil companies have scrambled to reduce the price they need to break even, as the world of \$100 a barrel fades.



*Oil price required to generate enough cash from operations to cover capex and dividends

†Includes Macondo liabilities **Brent crude-oil futures as of Friday’s market close.

Source: Jefferies

BP recently abandoned ambitious plans to explore in the Great Australian Bight—a potentially huge source of new supply that still couldn’t compete economically with other project opportunities. Instead, it invested \$2 billion for a 10% stake in oil fields in the United Arab Emirates, which has some of the world’s lowest oil-extraction costs.

Going forward, the company is focusing on “long-lived cash bricks” of low cost oil and

natural gas, said BP Chief Executive Bob Dudley during an interview at CERAWeek.

Others are pursuing a similar agenda. Chevron CEO John Watson told analysts Tuesday that the company intends to invest more of its capital budget in projects that start up quickly and generate higher returns. About three-fourths of the company’s \$20 billion capital budget in 2017 will generate cash within two years, Mr. Watson said.

Shell is focusing the bulk of its new investment on deep water projects offshore Brazil that it says break even at less than \$40 a barrel. France’s Total SA says reducing the break-even level

on its projects is “a top priority.” Last week, Italy’s Eni SpA said new projects out to 2020 will have an average break-even of \$30 a barrel.

The focus on frugality is a departure from the 10-year period from 2005 to 2014, when concerns that supply could run out and soaring oil prices sent energy companies on a grand, often wildly expensive, chase for new production.

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They took on projects like Kashagan, a giant oil field in Kazakhstan that took Exxon, Shell and others over a decade and \$50 billion to develop. It will produce oil for decades but has become a cautionary tale, especially after oil prices began falling in 2014.

According to Sanford C. Bernstein, Europe’s biggest oil companies have slashed capital budgets by \$51 billion since their 2013 peak and are expected to keep spending at current levels of around \$90 billion a year through to 2020, but production volumes are on the rise.

A similar pattern also is emerging at Exxon and Chevron, both of which have roughly halved spending since 2013, but production is still seen increasing, according to estimates from S&P Global Market Intelligence.

Fatih Birol, executive director of the International Energy Agency in Paris, warned Monday that shorter cycle investment plans could create an oil price shock. The IEA estimates oil and gas investment dropped to \$450 billion annually during the two-year energy downturn, 25% less than it needs to be to meet future global demand growth and offset declines in existing fields.

Mr. Birol said investments globally need to rise at least 20% to avoid oil price spikes in the coming years.

Another challenge for these companies will be to prove that they can pivot successfully.

Even as Exxon plans to boost its U.S. focus—including with a \$20 billion spending plan on American refinery and processing operations—the company lost \$4.2 billion in its American oil-and-gas drilling business last year and more than \$500 million in 2015. While many of the companies are moving ahead with investments on what now appear to be profitable projects from South America to Papua New Guinea, they face a major risk of surging costs that would erode returns.

“Our job is to compete and succeed in any market, irrespective of conditions or price,” said Exxon’s new CEO Darren Woods last week.

Write to Sarah Kent at sarah.kent@wsj.com and Bradley Olson at Bradley.Olson@wsj.com

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