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US Independents Likely Lost Millions on Q3 Hedges

EOG Resources' anticipated hedging loss of $52.1 million during the third quarter may be just a drop in the bucket once the final tally is taken on US independents' earnings for the period.

For the third quarter, the Houston-based tight oil kingpin had locked in a price close to $60 per barrel on 35% of its production — about 134,000 barrels per day. US benchmark West Texas Intermediate (WTI) prices in the quarter average about $69.50/bbl.

"EOG has far fewer hedges than most of its their peers, so you should expect the losses to be significantly higher with other operators," said Trisha Curtis, president and co-founder of Petronerds. "Most of these guys were hedged into the $50s, as opposed to the $70s."

Many tight oil players' hedges will result in "major losses," Curtis told Energy Intelligence.

Among the 41 US producers that Petronerds covers, some companies are shedding $100,000 each day; other contracts are losing even more money, she said.

"I think you'll continue to see the negative impact of hedging and there will be a larger focus on it because oil prices are much higher. People are going to ask if they are capturing this higher oil price and a lot of these operators aren't because they were so aggressively hedged," she said.

With a solid balance sheet and little debt, EOG is one of the independents that generally opts not to rely on hedging for protection. The company can afford to "ride the upside," along with most of the majors.

"They tend to never hedge because they have the financial wherewithal to handle pricing volatility a little better than some of their peers, and they have captured upside in [previous] quarters," Curtis said, adding that companies like Whiting Petroleum and Chesapeake Energy tend to hedge more aggressively.

What's more, these losses could restrain spending. At ESAI Energy, analyst Elisabeth Murphy noted that a significant loss to free cash flow might give pause to those Permian Basin producers who moved rigs to develop other assets while pipelines are debottlenecked in West Texas (OD Jun.5'18).

"Investors want a lot. They want a company to perform while spending within cash flow and they also want to see growth. You usually have to spend money to grow," Murphy told Energy Intelligence. "But when you're losing upside, your free cash flow won't be as high as it could've been, and you're not going to spend as much."

Just past the midpoint of 2018, producer hedging on future volumes is low but in line with previous years, according to data from Goldman Sachs. However, the investment bank's analysts and other energy finance advisers agree that operators tend to add hedging contracts mostly during the fourth quarter, when there is a clearer line of sight on the next year's market activity (OD Apr.19'18).

Where hedging activity may accelerate is in protecting against basis differentials, Murphy said. The debottlenecking in the Permian isn't expected to be in force until late 2019, which means producers will likely hedge on the differentials — a trend that started last year as the Permian's production ramped up, she said (OD Oct.12'18).

Those basis hedges built to protect the differential between the Midland, Texas regional hub and Cushing WTI offered some protection to companies that were losing upside on other hedges, Murphy noted. ■

Deon Daugherty, Houston