Supermajors Need to Invest Nearly $30 Billion in Permian Basin through 2020 to Meet Volume Targets, Further Exacerbating Service Shortages, IHS Markit Says

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Execution risk may be too great for smaller E&Ps vulnerable to cost escalation and now-likely candidates for sales or mergers

HOUSTON--(BUSINESS WIRE)--A new energy report from business information provider IHS Markit (Nasdaq: INFO) says that the three supermajors active in the Permian Basin -- Exxon Mobil (XOM), Royal Dutch Shell (RDS) and Chevron (CVX) -- will need to invest nearly $30 billion in the oil and gas play through 2020 to achieve growth targets. These investments will catalyze cost inflation and will gradually force consolidation in the basin, the report says.

“If truly committed to the Permian Basin, the traditionally return-focused supermajors will have to grow accustomed to a rising cost-basis in order to build their core, operated-acreage positions that currently do not suffice to meet medium- to long-term growth plans,” said Sven del Pozzo, CFA, director of energy equity research and analysis at IHS Markit. “IHS Markit estimates that the supermajors will need to collectively invest nearly $30 billion in new investments—effectively adding three companies the size of Pioneer Resources to the Permian, to achieve their production growth targets by year-end 2020.”

Del Pozzo is author of the IHS Markit report entitled: “Company Play Analysis—Permian: Supermajors are a disruptive force, catalyzing cost inflation and forcing gradual consolidation.”

However, while there is great optimism about this level of investment in the play, the supermajors’ growth plans will naturally enhance execution risk and cause financial stress for smaller E&P (exploration and production) companies, the IHS Markit report says.

“Many of these smaller Permian independents issued strong growth projections after going on equity-financed acquisition binges in 2016 and early 2017, facilitated by share prices that reflected high expectations for growth,” del Pozzo said. “The supermajors will further stress the Permian service sector, and as costs escalate, the increased execution risk may be too great for these smaller companies to overcome, possibly forcing them into mergers or sales.”

This theme, del Pozzo said, was more recently exemplified by Concho Resources’ acquisition of RSP Permian. RSP had been one of the smallest pure-play Permian independents before making itself a much bigger, and much more appetizing, target for a big company.

IHS Markit believes Concho was willing to pay a premium for RSP, whose assets were nearly all core, and therefore deserved a scarcity premium, del Pozzo said.

“Notwithstanding what we estimate was a premium price paid for RSP’s assets, Concho’s move might have been strategically prescient,” del Pozzo said. “Prior to the deal, industry service-cost inflation was already apparent, as was the benefit of scale.”

Since 2017, the Permian well performance of the three big supermajors has been catching up to that of the E&Ps, IHS Markit said. Exxon Mobil has recently drilled a few ‘monster’ wells in southeast New Mexico, del Pozzo said.

“What may be most exciting for service companies active in the Permian Basin is the concept that the supermajors could source funds from their non-U.S. cash flow,” del Pozzo said. “All the supermajors have a relatively low Permian cost-basis, which was provided by cheap acquisitions of assets prior to the boom in Permian unconventional development. If the return-focused supermajors are to remain committed to the Permian, they must accept the reality of a rapid escalation of their cost-basis that will accompany their medium-to long-term growth plans.”

These growth plans come as IHS Markit foresees a doubling of production growth in the Permian by 2023, as noted in the research released June 13, 2018: New IHS Markit Outlook--“Stunning” Permian Basin Oil Production to More than Double from 2017-2023, Exceeding Expectations.
To speak with Sven del Pozzo, please contact Melissa Manning at melissa.manning@ihsmarkit.com. For more information on the IHS Markit report, entitled: “Company Play Analysis: Permian: Supermajors are a disruptive force, catalyzing cost inflation and forcing gradual consolidation,” contact clare.fletcher@ihsmarkit.com.

About IHS Markit (www.ihsmarkit.com)

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