

Tuesday, August 14, 2007

## **Disappointing 1H Douses Hope for '07 Big Oil Output Gains**

Source: Dow Jones Newswires Author: Isabel Ordonez

HOUSTON, (Dow Jones Newswires), Aug 14, 2007

Halfway through the year, hopes for 2007 output growth from the major energy companies have been extinguished.

This year is forecast to be the latest in a long string of disappointments, as governments tighten their grip on hydrocarbons resources and rising costs make it increasingly difficult to shore up oil and gas production in mature, declining fields around the world.

Over the past four years, surging energy prices contributed to quarter after quarter of record profits for the large integrated energy companies, overriding investor concerns about weakening output. The worry: Big Oil is experiencing difficulties in tapping resources amid political upheaval and more stringent contract terms from key producers. Now that crude-oil and natural-gas prices have stabilized, prospects for profit growth have dimmed, and attention has refocused on production.

"These companies continue to disappoint in terms of value growth, particularly for oil," said Rod Oster, an analyst at A.G. Edwards in St. Louis, Mo. "The industry worldwide is having difficulty growing production."

Crude-oil futures are trading at about the same levels they were this time last year. While the front-month benchmark contract on the New York Mercantile Exchange hit an all-time high Aug. 1, futures have since retreated. Recently, they were trading around \$72 a barrel. Natural gas hasn't yet recovered from the selloff in 2006 that followed prices exceeding \$15 a million British thermal units in December 2005. Prices now hover around \$6.80.

### Trying To Hold Steady

With the exception of Exxon Mobil Corp. (XOM), the largest publicly traded energy company in terms of market capitalization, companies are expected to post year-on-year decreases in output this year. Analysts forecast that ExxonMobil will keep hydrocarbons output steady at 4.23 million barrels a day. Chevron Corp. (CVX) and ConocoPhillips are expected to post declines.

Exxon's output for the first half of 2007 was down 2%, largely on a drop in natural-gas volumes due to mild weather in Europe. Chevron's output decreased 0.7% to 2.637 million barrels of oil equivalent a day due to new contracts in Venezuela that allocate less crude to the company and due to lower U.S. output.

"We're focused on making quality investments to maximize long-term shareholder value, not meeting an arbitrary production target," said Gantt Walton, an ExxonMobil spokesman.

ConocoPhillips' output for the first half of 2007 was up almost 5% on strong natural-gas output, but this increase included output of the Burlington Resources'

acquisition, which was not included in the first half of 2006. Due to its exit from Venezuela, the company says its third-quarter output will be lower, dragging down entire year's performance.

A.G. Edwards estimates that Chevron's oil and gas output for the whole of 2007 will drop by 1% to 2.64 million barrels of oil equivalent a day. ConocoPhillips is seen down by 2% to 1.91 million barrels a day. Chevron said it expected production in the second half of this year to be similar to that of the first.

"Right now, our long-range forecast of 3% growth per year from 2005 to 2010 has not changed," Chevron spokesman Mickey Driver said.

ConocoPhillips said the company is positioned to both grow production over the next five years and replace at least 100% of the hydrocarbons it extracts, company spokesman Charlie Rowton said. Production growth will come from 12 major projects that will come on line in the next three years.

### Big Oil's 'Reality'

The three U.S. oil giants had forecast average annual growth of more than 3% between 2005 and 2010, but various factors have cast a shadow on this outlook.

As they encounter persistent declines in mature legacy assets, especially in industrialized countries, the western oil majors have undertaken a multiyear, multibillion-dollar investment campaign to build new capacity. The struggles of 2007 show that while the capital costs of this campaign continue to soar, most of the companies haven't managed to maintain, let alone increase, output.

Flat or declining annual production for 2007 is widely accepted by the industry and is just a "reality" for Big Oil, said Michelle Foss, chief energy economist at the University of Texas at Austin.

Output of these companies' European peers is also expected to be modest or even below forecasts. Royal Dutch Shell PLC (RSDB.LN) foresees output at the lower end of the company's guidance of 3.3 million-3.5 million barrels of oil equivalent a day compared with about 3.47 million in 2006. BP PLC (BP) is also toeing the line between holding output steady and seeing a slight slip. Total SA's (TOT) prospects are brighter. The French giant recently said it wouldn't meet its original forecast of a 6% rise due to persistent disruptions in Nigeria and lower contributions from Azerbaijan and Venezuela. It has yet to provide new guidance.

### Unrelenting Pressure

Shares in the U.S. oil majors grew steadily earlier this year - ExxonMobil was up 21% year-to-date in July - but they slumped in August, and it's unclear whether they'll be able to match their performance posted in the years of the commodity price boom.

In a note to investors, J.P. Morgan attributed the sharp selloff of ExxonMobil's stock at the end of July to the second-quarter earnings miss the company reported in its exploration and production segment.

However, major oil companies have done relatively well compared to the broader stock market, said Fadel Gheit, an analyst at Oppenheimer & Co.

"Going forward, it will depend on oil and gas prices," Gheit said. "If prices go down,

these stocks go down."

With refining margins also declining, Gheit predicts energy companies' profit will "fall sharply" in the second half.

"The magnitude will depend on the magnitude of the margin drop," he said.

There's no sign that the pressure on energy companies is letting up, so they're being forced to adjust to remain attractive for investors and Wall Street.

"If you are an investor in a super major then you want to look at what they are doing with their portfolio," said Bob Fryklund, vice president of industry relations at IHS, a Denver-based energy consultancy. "You have to be chasing what is their vision of the future."

Oil and gas producers lately have been emphasizing their project-management prowess over their reserve base, pointing out that they've been able to keep profitability buoyant despite output declines. Historically strong margins in refining and marketing have helped, but those are also weakening.

"People are going to look for how well these companies are able to manage their cost and their margins in the future," Foss said. "If you have a flat outlook for production but you are a very good manager for cost, you can still produce value that the market will appreciate."

Copyright (c) 2007 Dow Jones & Company, Inc.