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Oil: Shift in Play

Bakken production expected to shift in response to lower oil prices

December 26, 2014

Crude oil prices have been on a steady march downward since last June, a consequence of a worldwide surplus — largely due to growing production at North American shale plays — and compounded by OPEC's (Organization of the Petroleum Exporting Countries) decision to maintain its production output despite that global oversupply, according to experts.

By Dec. 9, West Texas Intermediate, which traded above $100 per barrel in June, was trading at about $63 per barrel, after an even lower dip earlier in the month. Regionally, Flint Hills Resources, which operates a refinery at Rosemount, Minn., posted a purchase price of just $45.50 per barrel for North Dakota light sweet crude on Dec. 9, down more than $5 per barrel from the beginning of the month. The downturn in pricing has inspired much speculation as to a potential slowdown of domestic oil production as well as what impacts that slowdown could have on North Dakota's prolific Bakken region.

Mike Warren, senior vice president at consulting firm Stratas Advisors, a Hart Energy company, says that while the decline in prices is certainly not positive news for shale plays in general, each play will be impacted differently depending on its stage of development. Stratas divides shale plays into three development stages: delineation, optimization and harvest. Delineation stage represents a period of capital expenditures and exploration, optimization is as the name suggests, a period during which producers apply different completion techniques to extract as much of the resource as possible.

The final stage, harvest, is the stage at which producers begin cutting costs and reach mass production of the play. "The Bakken obviously is in harvest mode," Warren says. He anticipates lower oil prices to have a lessened impact on the Bakken compared to shale plays that are less developed, particularly for producers operating wells with the highest estimated ultimate recovery rates.

"What we see is … the lower oil price will basically impact players or operators that have drilled out their higher value acreage and are moving into the lower-value acreage," he says. Warren expects fewer new wells will be drilled in 2015 than in previous years while producers instead focus on proven high-producing wells.

Continental Resources, for example, which is the biggest producer in the Bakken, announced in its November third quarter earnings report that it will not add new rigs in 2015, thus reducing its 2015 capital expenditures by $600 million. Instead, the company said it will focus the majority of its 2015 Bakken capex in areas where it can improve production levels.

Location, Location

“The pullback in drilling will not be dramatic and quick, however you won’t have an expanding drilling activity in the Bakken [this] year,” Warren says. “On the margin, there will be fewer wells drilled or it might be flat. But overall, it really depends on where you are in the Bakken whether you continue drilling or you just pull back a little bit to see where prices go in the future.”

Ken DeCubellis, CEO of Minnetonka, Minn.-based Black Ridge Oil & Gas Inc., says well location will factor heavily into his company’s investment plans this year, noting the break-even price per barrel varies wildly from well to well. “There are some parts of McKenzie County where you could still get, I wouldn’t say strong returns, but you could still get a return at $40 a barrel,” he says. “But I wouldn’t be drilling in western or southern McKenzie, or northern Williams County or southern Divide County at $70 oil. You can’t get a return at today’s prices in some parts of the [Williston] Basin.”Black Ridge is a publicly traded exploration and production company that is focused solely on Williston Basin activities. It’s a non-operator, meaning that rather than participating in the production aspect, it invests in drilling units.

Black Ridge has been active in the area for the past four years and currently has a stake in more than 300 wells, according to DeCubellis. In late November, the company anticipated its fourth quarter 2014 average production would range between 950 and 1,100 barrels of oil equivalent per day, a nearly 200 percent increase over the same time frame a year prior.

DeCubellis says his company’s disciplined approach toward investments has served it well so far and will continue to do so during this period of lower oil prices, although he notes that his company’s already discerning selection process has tightened even further in recent months. “We have to pass a lot more often than we would have six months ago,” he says. Additionally, Black Ridge has been actively hedging oil prices through 2017, which DeCubellis says provides another layer of protection against the recent drop in oil prices. The company has also worked to maintain strong relationships with its lenders to ensure the continued access to capital Black Ridge needs for future growth, he says.

Travis Kelley, regional vice president of Target Logistics Management, the largest provider of workforce housing in the Bakken, says demand for his company’s services has actually gone up over the past few months and he doesn’t anticipate a slowdown anytime soon. “Our occupancy levels are still up in the 90 percentile at all of our facilities, and that’s actually come on stronger in the last six months,” he says. While the company holds the identities of its clients close, Kelley says demand for housing continues to come from the same clients Target Logistics served at the height of the boom. He also anticipates a shift in where housing is most needed, however. “I think that’s more of what we’ll see,” he says.

“Where we can push things around, we will. We’re seeing more activity south of the river — Watford City, Dunn County — potentially we may look at expanding our facility there.”

Other Impacts

Halliburton Co. and Baker Hughes Inc., the second and third largest U.S. oilfield services companies, made international headlines when Halliburton announced in late November plans to acquire Baker Hughes for about $35 billion. The merger is expected to close in the second half of this year, creating a behemoth-sized company to rival competitor Schlumberger. The deal, spurred by falling oil prices, is a large example of what many believe will be a continued trend of mergers and acquisitions.

“Consolidation is the name of the game,” Warren says. Also, while oil prices may be dropping, the natural gas market outlook is more positive, making it more attractive for companies to capture gas that would otherwise be flared — regardless of regulations. DeCubellis says natural gas, which has accounted for between 8 and 10 percent of Black Ridge’s revenues in the past, could increase to approximately 13 percent of its revenue if oil prices remain low.

“It’s going to become more of the production mix,” he says. And while no one can predict with certainty how long oil prices will remain low, or how low they will fall, Warren is confident they will remain manageable in the coming year before rising again in 2016. In the meantime, companies like Black Ridge intend to continue investing with confidence in Bakken oil. DeCubellis sums up his philosophy on the play as this: “There will be a slowdown in the Bakken, but the Bakken is not going away.”