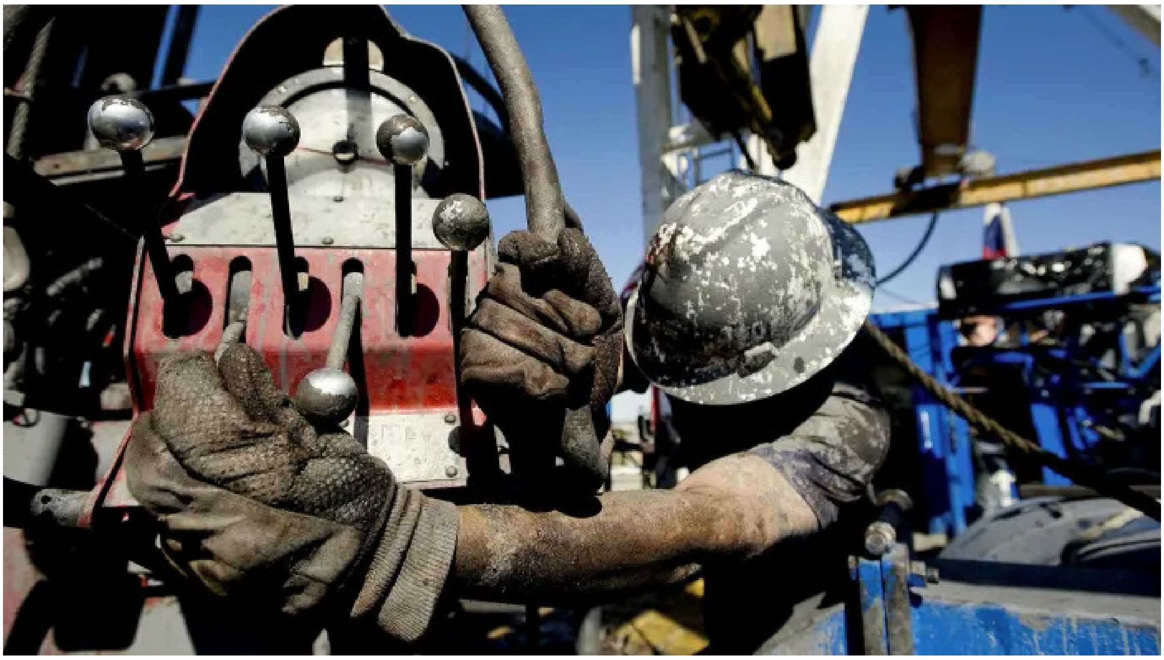
Oil & Gas industry

US shale companies face $300bn in writedowns in Q2

Deloitte says impairments could trigger insolvencies as sector accounts for oil price fall



By the end of May, 18 exploration and production companies had declared bankruptcy this year © Bloomberg

Derek Brower, US energy editor AN HOUR AGO

US shale companies could be forced to write down at least $300bn of their assets in the second quarter, as operators begin to account for the oil-price collapse on their balance sheets, according to a new study.

The huge impairments — about half the net value of the companies' property, plant and equipment — would increase the sector's leverage from 40 per cent to 54 per cent, triggering insolvencies and restructuring, says the study by Deloitte, an accountancy.

"As Covid-19 impacts amplify pressures on shale companies through 2020, a wave of impairments may prompt the deepest consolidation the industry has ever seen over the next six to 12 months," said Duan Dickson, vice-chairman of Deloitte's US oil and gas business.

The writedowns, based on an oil price of $35 a barrel, would be another blow to a sector that has been hammered by the worst oil-price crash in decades. US crude output has plummeted as operators shut wells, idle rigs and sack oilfield workers.

Rystad Energy, a consultancy, calculated that shale producers' impairments in the first quarter were about $38bn.

By the end of May, 18 exploration and production companies had declared bankruptcy this year, according to Haynes and Boone, a law firm. Denver-based Extraction Oil & Gas recently joined the list. Chesapeake Energy, an early shale pioneer, is likely to follow soon.

At a US oil price of $35 a barrel, almost a third of shale producers are insolvent, reckons Deloitte — unable to meet longer-term liabilities from free cash flow.

The US oil benchmark was trading at about $40 on Friday, but has averaged less than $27 this quarter. In April, it briefly traded below zero, sending shockwaves through a shale patch that, on average, needs about $45 to turn a profit.

Consolidation is likely. But Deloitte thinks only 27 per cent of shale companies would offer enough value for buyers. And only large independents or supermajors such as Chevron and ExxonMobil still have the financial strength to make acquisitions.

The sector's vulnerability stems from the fast rate at which shale production declines, meaning new wells must constantly be drilled to replace fast-falling output at other ones.

"You're on a capital treadmill just to maintain your production and that treadmill moves very fast," said Scott Sanderson, a principal in Deloitte's Houston office.

Soaring output in recent years depended on Wall Street's willingness to keep funding that treadmill with new capital.

"The boom in fracking was largely financed by debt," said Mohsin Meghji, head of M-III Partners, a restructuring adviser working with some bankrupt shale producers.

But investors have now soured on shale. Wall Street is unlikely to fund a new recovery or pay for the consolidation analysts say the sector needs.

"There was a sense that capital markets were going to dry up," even before the crash, said Mr Sanderson. "Now the window is completely closed."