Oil Prices Down, Oil Bankruptcies Up, Industry Safe

Just before Christmas Bruce Richards, CEO of Marathon Asset Management, predicted that not only would the price of a barrel of crude oil drop into the $20s but that it would take a third of America's energy companies with it. As head of a vulture capitalist fund, described as "focused on opportunistic investing," he was expressing more hope than despair.

Managing more than $13 billion, Richards is waiting for those bankruptcies to take place in order to clean up the balance sheets of faltering energy companies and allow him and his investors to move in, buy up the remaining assets, and put them back to work. Without the debt burdens, those companies will be able to produce crude profitably at much lower prices.

The implications of such a strategy are profound. OPEC will be the primary victim, including Saudi Arabia itself, the largest member of the foundering cartel. The Saudis have been deficit financing their welfare state since early last year, raiding their cash reserves and borrowing to pay their bills. Other members of OPEC are in even worse shape, needing oil above $100 a barrel to fund their governments and their military adventures.

The impact state-side has been severe but not life-threatening. Jobs in the oil patch have been lost, and investors have seen the market value of their energy-sector high-yield bonds decline sharply, some by more than 30 percent over the last several months.

According to at least three major banks, it's going to get worse before it gets better, but it is going to get better. Goldman Sachs made a seemingly outrageous prediction late last year that crude could crater to $20 a barrel. With Morgan Stanley and Citigroup just now joining the chorus, Goldman's prediction isn't so outrageous. With crude touching $30 a barrel and threatening to drop into the high $20s, Goldman's call could prove to be prescient if not providential.

As of last July, nine oil field companies had already gone bankrupt, including Quicksilver Resources, PBZ Resources, Dune Energy, Sabine Energy, WBH Energy, and American Eagle Energy. At the time another nine were teetering on the edge.

In December many of those shuttered their operations under Chapter 11, while survivors have cut their budgets and their staffs sharply while continuing to produce in order to service their debt loads. Three companies — Energy, Inc., Energy XXXI Ltd., and Halcon Resources — all paid out more than 40 percent of their total revenues in the third quarter last year just to service their debts.

But not every energy company is on the ropes. Some of the strongest ones saw what was coming and hedged the decline in oil prices in the futures markets, essentially buying insurance against $20 oil.

Two companies in particular, ConocoPhillips and Pioneer Resources, are planning to expand their production this year. Pioneer's CEO Scott Sheffield told the *Wall Street Journal* on Monday that his company is still making profits from the company's most efficient and low cost wells.

And investors seeking a bottom are willing to invest in companies such as Pioneer even as its competitors struggle. Last week's public offering by Pioneer of $1.4 billion of new stock was oversubscribed.

American crude oil production has scarcely faltered, despite the bankruptcies. Government officials estimate that U.S. crude oil production will stay at 9.2 million barrels a day, one percent higher than a year ago when oil was trading 40 percent higher.

Oil prices are likely to remain low, and the oil industry profitable, thanks not only to technological improvements and cost cutting but also to opportunists such as Marathon. The oil belonging to marginal producers being squeezed out of business remains in the ground. Vulture funds such as Marathon will restart those newly minted debt-free companies, producing oil at a profit even as the price of oil continues its slide.

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