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Energy Pipeline: DJ Basin a shelter from the storm

Even amid a downturn, oil and gas exploration companies plan to stick to their Niobrara acreage in Weld County.

A fracking rig stands behind a grove of trees in east Greeley. Oil and gas companies plan to stick to their Niobrara drilling programs while waiting out the downturn.

An oil worker climbs up the derrick at a rig off of 4th Street n west Greeley. Oil and gas company officials plan to stick to their Niobrara drilling programs in Weld County while cutting programs elsewhere in the country.

The top oil and natural gas companies operating in the Denver-Julesburg Basin have each responded to the year-long slump in oil prices with intent and innovation.

The optimism that is ever present in the oil industry may have tarnished from the relentless pressure of a commodity market under siege, companies here still see the DJ Basin as the economic choice for shelter from the storm.

And it is a storm that is expected to continue for months to come. “The oversupply of oil has to correct before prices can recover,” said Sarp Ozkan, a senior energy analyst at Ponderosa Advisors in Denver.

“These are troubling times in terms of prices,” Ozkan said. “We don’t expect to see $50 oil before the second quarter of 2017.”

Under other conditions, global events such as political disputes in the Middle East or a drop in domestic oil stocks would cause prices to rally. This time around, the response is different as oil markets continued to hammer prices the first week of the New Year.

Escalating tension between Saudi Arabia and Iran and a sell-off in the Chinese stock market were seen as driving forces pushing oil prices lower through Jan. 7.

The rift between the two Middle East nations could further drive down oil prices “as both countries increase production to cause the other more economic pain,” according published comments by market analyst Darin Newsom, of DTN/The Progressive Farmer. “More production by either or both means larger global supplies.”

Domestic production remains north of 9 million barrels per day, a level market analysts see as exceeding demand when global production is considered. While current production is off the peak of 9.6 million b/d reached in June 2015, oil producers were still pumping 9.2 million b/d through the end of December.

In Colorado, oil production has slid off its August peak. The federal Energy Information Administration reported production in the state slipped to 334,000 b/d in October from a high of 342,000 b/d in August.

Even with a decline in oil production, jobs were still available in northern Colorado.

As 2015 wound down, Weld County continued to maintain one of the highest employment rates in the nation even as job growth slowed. The Colorado Department of Labor and Employment noted that November unemployment held steady at 3.6 percent compared to a national unemployment rate of 5.0 percent. Job growth in Weld County slid from a 5.2 percent gain in new jobs in early 2015 to a gain of 1.1 percent by the end of first half.

Still the One?

Now that companies operating in the DJ Basin have had a full year to respond to the dictates of a slow market, how are they faring? After a half-decade of rapid growth, is the DJ still a good place to make oil?

We started our review of the top operators in the DJ Basin with a look at Anadarko, producer of the most barrels in Colorado.

In December, Anadarko reported an increase in overall production that was driven by its two primary fields, the Wattenberg, in the eastern DJ Basin, and the Delaware Basin in west Texas.

Anadarko stated that increased production in those two fields will drive an increase of more than 15,000 barrels of oil equivalent per day, boosting the company’s overall production to between 314,000 and 319,000 boe/d, up more than 7 percent from third quarter figures.

The company also noted improvements in drilling and completions allowed it to reduce capital expenses while lower operating costs cushioned the impact of lower prices.

Anadarko has been drilling in the Wattenberg “for so long that the results we’re seeing are expected,” said John Christiansen, vice president of corporate communications at Anadarko. “As development continues to evolve, I wouldn't call the results shocking, but this is certainly a field that continues to get better. We know the reservoirs and we continue to refine and improve the completion process and how much oil we ultimately recover."

The company reports it has invested $9 billion in Colorado since 2007 and currently employs 1,450 people here.

"Our people and our investments have dramatically increased the amount of locally produced oil and natural gas Anadarko delivers to our customers," noted Robin Olsen, public affairs manager for the company's Rocky Mountain division.

Ponderosa's Ozkan noted that Anadarko holds acreage in other basins, including the Eagle Ford, Powder River and Marcellus.

"Not all acreage is treated equally," Ozkan said. "The economics Anadarko sees in Colorado are preferable to those other basins. At today's prices, it can still produce in the Wattenberg and earn the rate of return investors are looking for."

Ponderosa estimates that Anadarko could sustain a 20 percent return on investment from its core assets in Colorado even if crude oil prices were to fall to $30 per barrel. "To reach that level of return," Ozkan said, "they need at least $37 per barrel in the Eagle Ford and $45 in the Powder River. Their DJ Basin acreage is the best one-third of the company's total leasehold."

Why does Anadarko see DJ Basin acreage as the crown jewels? "It is a combination of factors," Ozkan said. Since most of the company's local acreage is in "the heart of Wattenberg," it is tremendously productive. Also, initial production rates on newly completed wells and subsequent decline curves favor development here over other locations.

Contributing factors are the company's consolidated land position and outright ownership of mineral interests in the Wattenberg.

In October 2013, the company solidified its position in eastern Weld County with a 100,000-acre land swap with Noble Energy. And, on much of its DJ Basin acreage, Anadarko owns the mineral rights and so, does not have to pay a royalty on that production. Royalty-free production is within the former Union Pacific Railroad Land Grant acreage that Anadarko acquired from UP in 2000.

"The Wattenberg continues to be one of the best U.S. onshore assets in the industry," Olsen declared. "Al Walker, our CEO, stated in November he expects many of the efficiencies that we achieved here over the past year to continue and be further enhanced in the future."

The Lion's Share

Over at Noble Energy, the second largest producer of oil in Colorado, "the lion's share of our investment is directed to the DJ Basin," said Ken Fisher, executive vice president and chief financial officer, in early December. "We continue to be very happy with our performance there."

Like Anadarko, Noble holds acreage in other onshore U.S. basins, but continues investing in the DJ, Ozkan said. “No other basin in the company’s portfolio compares.”

Not only is Noble’s 400,000 net acreage position north and northeast of Greeley the largest field in the company’s U.S. holdings, much of the oil produced is heavier, benchmark crude that can be sold at a premium over light crude produced elsewhere in the basin, Ozkan noted.

“When it comes to who is the most economical operator of the two, I would have to say Noble,” Ozkan observed. “Noble has gotten so good at managing drilling and completions costs, that without Anadarko’s mineral ownership advantage, Noble would have the lowest break-even rate in the DJ.”

Noble’s drive to be the lowest cost producer is seeing results, Ozkan said. “We estimate that Noble has a 10 percent advantage in drilling and completions costs over Anadarko.”

For many companies, costs can be reduced by squeezing lower rates from oilfield service companies. How much savings a company can wring from its suppliers varies by company, Ozkan said. “Across the US, service companies cut prices by 20 to 30 percent in 2015; that’s significant and part of the reason domestic producers can maintain production levels. However, we don’t expect service companies to agree to further reductions this year.”

If additional cuts in drilling and completions costs, which are the biggest portion of an oil company’s capital expense, are to be realized, advances in technology must continue, Ozkan said. “Companies are drilling better wells that make more oil over a longer time. As a result, they can drill fewer wells and get the same or better results,” he said.

Noble reports that in parts of the DJ Basin, it has reduced drilling and completions costs to $3 million per well, the lowest of most companies operating there.

Highly Efficient

Synergy Resources is another DJ Basin operator that Ponderosa Advisors see as weathering the low-price storm. “Overall, their break-evens are comparable to the two bigger companies and much of that is due to Synergy’s management and its leasehold,” Ozkan said.

According to CEO Lynn Peterson, Synergy operates 75 horizontal wells and has interest 407 net producing wells. The company reports that it nearly doubled production to 9,524 b/d at the end of August 2015 from 5,020 b/d one year earlier.

In a December presentation to analysts, Synergy management stated its core acreage in western Weld County includes 41,000 net acres with an extension area of 51,000 net acres straddling the Weld and Morgan county lines. In its core area, it operates 75 horizontal wells on 11 wellpads.

The Synergy report notes the company is increasing the number of mid- and extended-length laterals. Extended laterals wells can be drilled and completed for $4.5 million, it says, and provide break-even returns with oil in the low $40s.

An experienced management team, productive acreage and very low debt provide the impetus for Synergy's success in the DJ, Ozkan noted.

"Everything we see about Synergy says they will be successful," Ozkan said. "Although not nearly the size of Anadarko or Noble, Synergy operates at about the same level of efficiency."

Strength in Reserve

For PDC Energy, the third largest producer in the DJ Basin both in oil production and acreage, the Wattenberg field remains "one of the top-rate-of-return horizontal oil plays in the US."

Described by stock market analysis firm Seeking Alpha as "a very well-capitalized and fast growing E&P business," PDC is said to be leaning on a hedge position and strong capitalization to increase production. However, the company is said to need oil in the mid-$50s to reach break-even.

"At today's prices, they are not economic in the DJ," Ozkan noted. "Their acreage here is likely the best in their portfolio but they may need to keep drilling to maintain cash flow."

Meanwhile, the company has earned the respect of regulators and the communities in which it operates.

"We work in close cooperation with government regulators, communities, industry groups and others to protect public health, the environment and safety," said Susan Fakharzadeh, community relations manager at PDC. "We are also exceptionally active in the Weld County communities in which we live, work and operate."

Better Over There

EOG Resources is another DJ Basin operator whose efficiency has allowed it to withstand the headwinds the industry is facing.

The company claims it has the "most productive, lowest cost horizontal wells in the U.S." and that such innovations as producing its own sand, chemicals and drilling fluids allow it to see the lowest operating costs and highest productivity of oil companies its size.

"They really are among the best operators anywhere," Ozkan noted. "It's just that they are not developing their acreage in the DJ Basin at this time. Unlike Anadarko and Noble, they prefer to develop their acreage in the Eagle Ford, Permian and Williston basins rather than here."

Question Mark

Of the other leading operators in the DJ Basin, a question mark is now attached to the acreage held by Encana in western Weld and Boulder counties.

In October, Encana announced it would sell its entire 51,000 net acre position in the DJ Basin for $900 million to a business owned mostly by the Canadian Pension Plan Investment Board with a 5 percent stake owned by The Broe Group out of Denver.

At the time, Encana stated it intended to direct the bulk of its investments to the Permian and Eagle Ford oil plays and a pair of gas plays in western Canada.

The deal stalled in late December when the companies announced closing had been pushed back to sometime in the second quarter of this year.

Encana is reported to have produced more than 880,000 barrels of oil in the two counties in July. Its acreage is considered favorably but there is concern it can be further developed in the current price environment, Ozkan noted.

"It is a good bet for the longer term," he said of Encana's acreage. And the company has shown itself adept at developing good community relations. "It will be interesting to see if the new operator will continue in the same direction."