More trouble ahead for U.S. oil industry

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The oil bust of 2015 washed out dozens of small U.S. drillers, and the New Year is expected to bring a wave of additional pain to the oil industry.

At least one in five domestic oil companies are at risk to go through significant corporate reshuffling, downsizing or bankruptcy proceedings in 2016, the biggest shakeout the industry has seen in since the 1980s, according to Talara Capital Management, which specializes in restructuring transactions.

"The industry is sorting itself out," said David Zusman, managing partner and chief investment officer at Talara. "What we learned in 2015 is the industry is all about cost structure, and the downturn is separating those that can produce efficiently and those who can't."

Cost cutting and other survival tactics kept most U.S. drillers pumping crude through last year's oil-market collapse, but the downturn this year is likely to eviscerate straggling companies pushed closer to the financial brink by a year and a half of low oil prices.

"We're going to shrink the population of (companies) who have been hanging in there," said Michelle Foss, chief energy economist at the University of Texas' Bureau of Economic Geology. "For people who managed to get through 2015, this is it. This is the end of the road."

Crude prices, which fell more than 30 percent in 2015, widely are expected to remain low for most of 2016 as global demand ebbs and international markets absorb more oil from the Middle East.

Forty oil producers have filed for bankruptcy protection in the United States and Canada since the downturn began, and toward the end of 2015, the pace of oil-company bankruptcies rose to levels last seen during the financial crisis seven years ago. Houston-based Swift Energy Co. and Magnum Hunter Resources Corp. capped the tumultuous year with separate bankruptcy filings in December.

Another round of corporate reshuffling that clears out the weakest players would only amplify the economic pain and add to the 70,000 U.S. jobs the oil industry lost last year. The energy sector performed worse than any other major segment of the U.S. economy, with the S&P 500's energy index tumbling 24 percent. In recent months, major stock indexes have begun following crude prices both up and down as investors focus on the link between tumbling prices and lower activity in other sectors of the economy, including construction, manufacturing, transportation and trade.

"The tentacles of the energy sector run deeper in the US economy than most understand," Zusman said. "Only in the last few months are people really starting to see that they're in an industrial, manufacturing slowdown in the United States."

For example, some U.S. manufacturing benchmarks have declined alongside the rig count since this summer.

The sharp drop in crude prices last year triggered the biggest retreat from U.S. oil fields in decades and quashed a roaring domestic energy boom that had put the United States, long dependent on crude from overseas, in the same league as top oil producers Russia and Saudi Arabia.

The tumultuous year emptied once-crowded shale oil plays in Texas and North Dakota and forced domestic drilling to fall to levels last seen in 1999. In Houston, center of the U.S. energy industry, the jobless rate rose from 4.3 percent last year to 4.9 percent in November as the price of oil fell below $40 a barrel.

Revenue for the world's biggest publicly traded oil companies - Exxon Mobil Corp., Chevron Corp., Royal Dutch Shell, BP and Total - plummeted by $464 billion, and the top 20 U.S. producers lost $64.3 billion in profits during the first nine months of the year.

On Thursday, the Dow Jones industrial average ended the year down 2.2 percent, marking its first annual loss since the financial crisis in 2008, and the S&P 500 slipped 0.7 percent for the year. The link between the oil sector and the broader economy could be amplified this year as the oil bust becomes more exacting in its toll on the industry.

In the United States, two thirds of the oil hedges that shielded many smaller drillers from low crude prices will expire soon. At today's prices, shale drillers are losing $13 to $18 for each barrel of crude they extract.

"It's definitely going to be a rough first half in 2016," said John Kilduff, a partner at Again Capital, a hedge fund New York. "We're going to see new lows yet again and it'll get ugly toward midyear."

History has not been kind to investors who bet that crude prices would recover quickly in 2015. In the early spring, those financiers poured billions into U.S. oil companies in hopes of rewards if crude prices rose higher. For a few months early in the year, U.S. crude prices did increase, and hovered around $55 to $60 a barrel until late summer, when new fears of slowing economic growth in China jolted markets, and Saudi Arabia and Iraq began throttling up oil output.

U.S. oil sank to an annual low point this month when it dropped to $33.98 a barrel amid worries over the Organization of Petroleum Exporting Countries, which at a meeting this month removed any pretense it is keeping a crude production quota. Saudi Arabia and other core OPEC members are burning through their currency reserves in a bid to carve out a bigger corner of the global oil market.

"It's a market share battle for the ages," Kilduff said. "If they're not going to come together voluntarily to cut production, the market will bring them to their knees."

But an implosion in global oil production may take longer than many expect. Crude production outside of OPEC and U.S. shale plays has steadily risen this year because major oil companies are, all at once, bringing deep-water facilities and other large oil projects into production after years of investing and construction.

Oil-market players are watching for high-cost U.S. shale oil production to sink this year, but it may take more than a U.S. decline to push crude prices back up if the production losses are offset by other energy sources.

"This stuff is going to come into the market because it has to," Foss said. "It doesn't matter what U.S. producers do, they're going to have to adjust. It's going to be a very tough year ahead."

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