At What Oil Price Will Shale Drillers Stop Drilling?

By Dan Doyle (@dandoyleoil) and Chris Ryan, CPA, President and CFO of Reliance Well Services and Arena Resources - Oct 01, 2024, 7:00 PM CDT

Under the Biden administration, higher oil prices have benefited exploration and production (E&P) companies, but oilfield services revenue has struggled, especially in 2024.

A Trump win in 2024 could lead to deregulation and increased drilling, boosting oilfield services, but low energy prices might still hinder profitability for the services sector.

The industry's shift towards capital discipline and profitability overgrowth means that oil prices must stay above $70 per barrel for meaningful activity to continue.

“I will cut your energy prices in half”

A Trump campaign pledge for sure, but one that has me hanging in my CFO’s doorway, consulting with him and another company CPA, wondering aloud just what in the hell we’re going to do should the pledge hold.

Our predicament is a bit unusual in that we’re both an E&P and a frack company, actively drilling in Wyoming’s Powder River Basin and running frack camps in Appalachia and the Illinois Basin. Under Biden-Harris, our E&P side has done well with higher oil prices, but our frac side revenues have gone to hell in 2024. “Blame it on the election,” I’m told. Nonetheless, should Harris prevail in the election, I’m expecting the services-side slide to continue.

Under Trump—increasingly, it looks to be Trump's race to lose—I’m hoping for some reprieve. A Trump win would be a tailwind for our frac services company. Initially anyways, like in 2017, when Trump came in and the industry turned on after the moribund years of 2015 and 2016. That was back when OPEC went all in on market share and decided to break shale, nearly breaking itself instead.

Trump's appeal back then, his way of getting us to work again, was his stalwart support of an industry that fell out of favour during the Obama years. His regulation-off was an aphrodisiac to my crestfallen crowd. We loosened our wallets and ardently jumped in, borrowing cheap money with no mind paid to the low oil prices at the time. With Trump, breaking the regulatory state was just so much fun. We all wanted a part in it.

But eight years later, in a far different world, Administrative approval will no longer be enough. Ours has become a more restrained industry, no longer the gunslinging cowboys of Trump's first years. These days, we’re driven by profit more than horsepower on the services sides, and elbow room among drillers. The old hell-on-wheels, growth-at-any-cost industry is gone. The headlong rush into debt has been replaced by a more buttoned-down attitude, a more restrained crowd with a watchful, jaded eye on its bottom line. Better put, we’re an industry that got burned, at our own doing. So naturally, our recovery has been driven by caution. If it was an AA meeting, which it was, our “one day at a time” became “don’t forget.” Regrettably, in the aftermath, we’ve become adults, boring and predictably steady. Second mortgages against piss poor cash flow will do that to you.

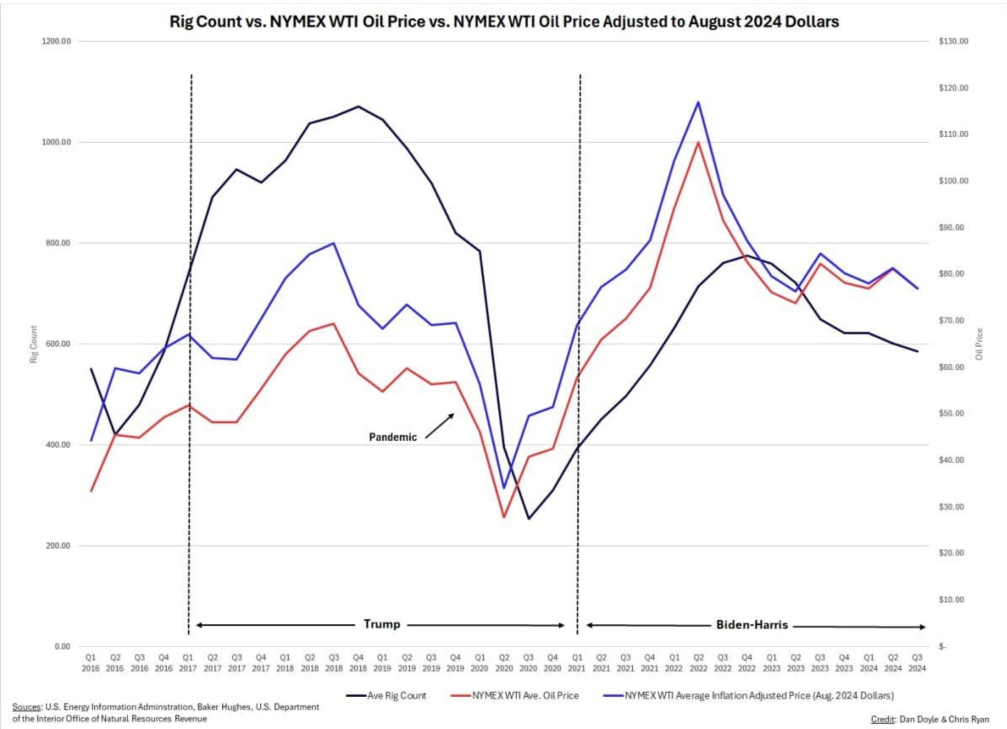
If Harris should win the election, you'll no doubt hear a collective groan from my crowd. Like working under a cold rain, a Harris-Walz administration would be met by my brethren with novel sobriety. We'll work, but only because Harris' policies will support higher oil prices, much the same as her current administration.

On the other hand, should Trump win, I'm expecting something different...

2025 will be better than 2024, but headwinds will persist. High interest rates, low oil and gas prices, takeaway issues in Pennsylvania, LNG terminal delays, a Biden-Harris era hobbled BLM; all of it will be difficult to overcome, even under the rallying cry of "Drill Baby Drill." No doubt, Trump will work to undo Biden's moratoria and ultimately approve more oil and gas infrastructure, but it will take time. And how do you make drilling and completing wells more attractive to my newly stoic crowd, when cutting energy prices in half is a campaign pledge?

Regulation-off will be a welcome Day One relief, but it will take more. Trump will push domestic drilling to keep prices low but incentivizing work by easing regulations won't be enough, not like it was in 2017. If prices go too low, we won't work. Compounding our new discipline will be the Trump Administration's reluctance to allow petrodollars to flow into Iran, as Biden-Harris have done. Sanctioning Russian oil, as expected, will take more barrels off the market as will a return to curtailing Venezuelan production. That leaves most of the heavy lifting to U.S. shale, U.S. offshore, Alaska, and heavy Mayan and Canadian imports; and the big hope that the Saudis will show a willingness to give in to more supply at lower prices, a long shot given their treatment by the shifting tides of American diplomacy.

The net effect is that supplies will come from a combination of adequate price support and from regulation-off. Higher oil and gas prices will trigger E&Ps, and E&P budgets will be what triggers services. To gauge what lies ahead, the best barometer of service activity is a look back at the rig count.

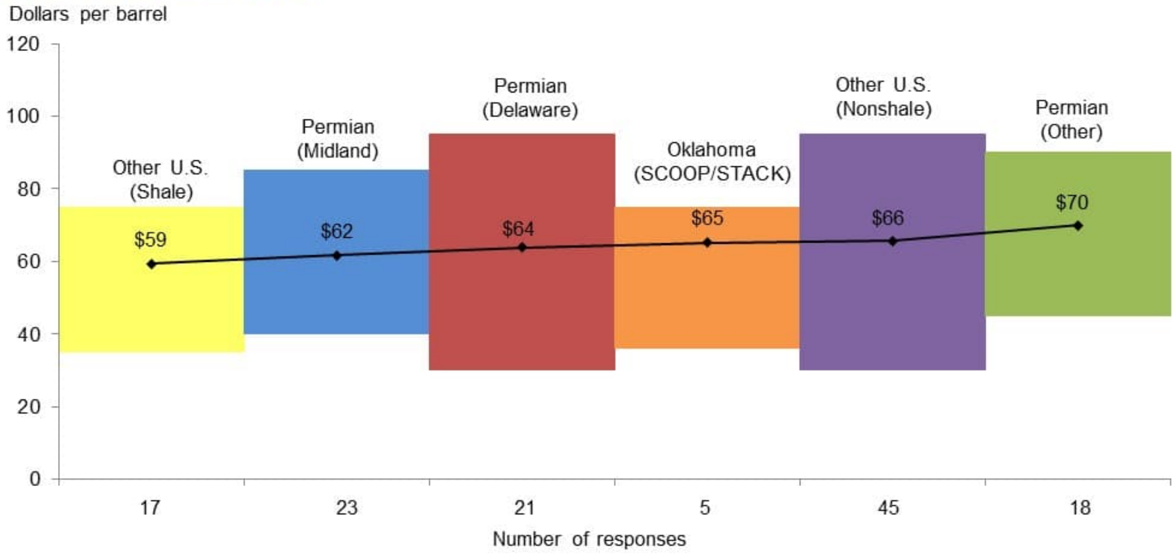


As demonstrated above, activity will track price. When the price of oil rises, so does the rig count. When prices fall, the rig count falls. But also of influence are the differences in the regulatory burden during the Trump vs. Biden years. The Trump administration had lower prices but an increased rig count (until the pandemic) directly due to its regulation-off stance. This wasn't without meddling. Trump inserted himself directly into prices, going so far as to allow Iranian exports for a six-month period when oil prices hit the mid $70 mark. The result was as expected. Prices collapsed back into the low $60's.

Activity has been markedly less in the Biden-Harris administration even though prices have been higher. The Day One killing of pipelines and moratoriums on BLM leasing signalled regulation-on and producers pulled back. Services continued, but less so. Production did come up, building on a solid base, and with all the DUCs established in the Trump years. There were also improvements made in drilling longer laterals and in completions. As a shout-out to the services community, we got a lot better at shale and tight sands extraction. However the services industry never reached the same level of profitability as large E&Ps did under the Biden Administration. Should Harris win, the oilfield services sector is unlikely to see a marked increase in activity.

Capital discipline is a third factor playing out in the graph above. There was less of it during the Trump years, back when the industry was still burning cash by figuring out shale and chasing rich land deals. Post-pandemic, and during the Biden years, the new normal became capital discipline, an evolved standard that will not abate, not with stockholders looking for returns in an out-of-favour industry challenged by lender aversion. ROI requirements will keep rigs and frack spreads idle, even with regulation-off—unless oil and gas prices hold up. Interestingly, both the Dallas Fed, in March 2024, and Statista Research, in April 2024, came to the same conclusion. Oil prices need to be in the mid $60's for work to continue.

In the top two areas in which your firm is active, what WTI oil price does your firm need to profitably drill a new well?



NOTES: Lines show the mean, and bars show the range of responses. Executives from 87 exploration and production firms answered this question during the survey collection period, March 13–21, 2024.
SOURCE: Federal Reserve Bank of Dallas.

If $66 oil is the activity cutoff, then we are more or less there. Oddly enough, and unaware of the Dallas Fed's work, I began considering postponing an upcoming 40-stage frack job for our E&P when prices dipped into the $60's. If prices remain there, we may still frack but will let the well stew until prices improve. We will continue permitting, and may even undertake road and pad building, but if the expectation is more of the same, we won't drill.

Another way to look at price-to-activity comparisons is to look back at inflation-adjusted prices. The high $58 oil price that predominated during the Trump years (pre-pandemic) is today's equivalent of $72. That puts the current $66 model for activity underwater relative to the Trump years. The difference is the current Biden-Harris regulation-on vs the Trump regulation-off. That adds something to the willingness to work, that is, until you subtract out today's capital discipline and tighter budgets.

A final factor to consider is percentages. Hamstringing our E&P is the net revenue realized after the government's big grab, particularly under the heel of the Biden-Harris Administration's absurdly named Inflation Reduction Act of 2022. With Vice President Harris' tie-breaking vote, the federal royalty rate on oil and gas leases jumped 33%. Chalk that up to another of Ms. Harris' pro-fracking stances, after her and President Biden's Day One moratorium on federal lands leasing and pipeline takeaway.

		Net Realization per bbl
Gross Oil Price/bbl	$	66.00
Less: 16.67% Fed Royalties		(11.00)
Less: Severance Taxes		(3.30)
Less: Ad Valoerm Taxes		(3.80)
Less: Conservation Taxes		(0.28)
Less: Tranportation		(3.50)
Net Revenue Realized/bbl	**$**	**44.13**
Percent Realized of Gross		**67%**

From $66 to $44 is a 33% loss of revenue, nearly all of it taken by the government. Subsequently, another net-down of revenues follows for lease operating and G&A expenses. Our number is about 12% of the gross, leaving $36/bbl in the basket for drilling—not very accretive when our business plan requires old wells to pay for new wells without seeking the intervention of irritable, burned-before bankers. Not to disagree with the Dallas Fed's results, but independents without the benefits of legacy acreage and lower lifting costs like those of the majors, may just sit out $66, forgoing the "Drill Baby Drill" call to arms.

So where does that put us? My guess is in the mid to high $70's, plus regulation-off, before any meaningful activity is realized; enough to make up for what Trump will likely look to sanction.
Should Trump win, the game becomes one of regulation-off and maintaining an oil price that satisfies both producers and consumers. Needed will be moves like restoring lower federal royalty rates, easing regulation and permitting, keeping accelerated depreciation in place on tangible assets, assisting in natural gas take-away, and anything else that will spur activity, especially in the lower price environment that Trump will seek. The risk is letting prices get too low. If that happens, we're back to importing crude from America's adversaries.

By Dan Doyle & Chris Ryan for Oilprice.com