Oil & Gas industry

Shale oil drillers left exposed after pulling back price hedges

Producer 'optimistic we'll see $100 a barrel' shuns insurance despite market wobbles

Listed shale producers have locked in prices for about 27% of their output for 2023, down from 40% last year © Reuters

Justin Jacobs in Houston 4 HOURS AGO

US oil producers cut back on price hedges this year in a bet that energy markets would rally again, a move that has left them suddenly vulnerable after turmoil in the banking sector knocked down the price of crude.

The collapse of Silicon Valley Bank triggered a sell-off in US oil markets this month from recent highs of $80 a barrel. Prices have recovered to about $73 a barrel but remain at a level that could force producers to curtail plans to grow output or reduce payouts to shareholders, analysts say.

Many producers were left more exposed after they had rolled back hedges, a form of insurance against commodity market downturns. They were emboldened to do so after a surge in oil and natural gas prices gave them record profits last year.

“The fall in prices has been a wake-up call,” said Matt Bernstein, an analyst at Rystad Energy.

Top publicly listed shale producers have locked in prices for only about 27 per cent of their output for 2023 at an average of approximately $66 a barrel, down from the more than 40 per cent of output that they hedged last year, according to data from Rystad.

Some of the largest US producers, including Pioneer Natural Resources, EOG Resources and ConocoPhillips, have little to no price hedges in place for this year.

Scott Sheffield, chief executive of Pioneer, defended the positions, saying the recent dip in crude markets “had nothing to do with the lack of oil demand” and that he was still “optimistic that we’ll see $100 a barrel before the end of the year”.

“We’re not going to hedge,” he said in an interview.

Producers pulled back on hedges to avoid a repeat of last year, when they left billions of dollars on the table by locking in prices at an average of about $55 a barrel before Russia’s full-scale invasion of Ukraine sent crude soaring well above $100.

“It’s a very psychological thing when oil is at $90 and you think it’s on the way to $130 and you don’t want to miss out on all this upside,” said Alex Beeker, an analyst at Wood Mackenzie.

Oil producers hedge prices in futures and other derivatives markets to guard against price drops and ensure they have cash to fund drilling, debt payments and other expenses.

Hedging has become less attractive as the oil futures curve has slumped along with the spot price. Producers can currently execute contracts for delivery in September 2023 at approximately $72 barrel, compared to about $90 if they had entered into the contract last summer when markets were more worried about adequate supplies.

Analysts warn that current oil prices could start to put financial pressure on some producers, especially after oilfield services inflation raised their so-called “break-even” price, the level they need to cover expenses and shareholder payouts.

Daan Struyven, an analyst at Goldman Sachs, said in a note that the “cost of US shale projects is now significantly higher than five years ago” and that rig counts, a proxy for drilling activity, were already falling.

Current prices are unsustainable “in a market that still needs shale to grow”, he added.

Analysts at Energy Aspects, a consultancy, said there was “downside risk to US production if current prices last” after the sector “entered 2023 with record-low levels of production hedged”.