Europe's Big Oil Sees Output Fall

By Alexis Flynn

LONDON—Most European major oil companies posted a surge in quarterly profits last week, but their results were overshadowed by a trend that continues to trouble Wall Street and corporate boardrooms: Nearly every major oil company reported year-to-year oil-and-gas output declines, often in the double-digits.

Big Oil is throwing huge resources at the problem with more open embrace of unconventional petroleum developments, high-risk exploration in frontier areas and corporate restructuring. But even if these strategies work in some cases, there is little doubt that anemic petroleum output signals a long-term challenge.

The particulars varied across the sector. **BP** PLC's 11% output drop was fueled in part by the continued hit from its reduced activity in the U.S. Gulf of Mexico after last year's disastrous spill. Italian giant **Eni** SpA's production fell 15% due to its disproportionate exposure to war-ravaged Libya. Spain's **Repsol YPF** SA, whose output fell 17%, was affected by both Libya and the U.S. Gulf, as well as by labor unrest in Argentina. Norway's **Statoil** ASA saw a 16% output decline largely on production outages and maintenance in its home market in the North Sea. French oil major **Total** SA's output slipped 2% from a year earlier, mostly due the loss of Libyan crude.

Oil giants are more vulnerable to operational problems in part because of their declining dominance over key resources. Whereas in 1973, independent oil firms controlled three quarters of the world's reserves, they hold as little as 10% today, according to some estimates. That has forced oil majors to rely to a greater extent on costly unconventional plays such as shale gas, deepwater exploration, and Arctic exploration.

Investment in conventional assets accounted for 63% of the majors' total capital expenditure between 2001 and 2005, research by Wood Mackenzie showed, with this proportion set to fall to 40% between 2011 and 2015.

Last week's reports showed that the two biggest oil giants, **Royal Dutch Shell** PLC and **Exxon Mobil** Corp., were somewhat better positioned than their smaller peers, in light of their capacity to progress capital-intensive projects. Another standout, Wall Street darling **BG Group** PLC, the only European oil major to report higher year-to-year output, has prospered from recent discoveries in the hot Brazil offshore region.

Yet there are problems even with these templates. Though demand for natural gas remains solid, natural gas prices could see further weakness in light of surging North American shale gas output and economic weakness in Europe and the U.S.

The push for more exploration has ignited interest in Africa following new seismic results and recent discoveries in Ghana and Uganda. But it's a risky and capital-intensive game and one requiring a fleetness of foot to grasp opportunities and adapt quickly to contrary political circumstances. Industry anecdotes abound of how some of the most lucrative recent discoveries on the continent were once passed up by reluctant majors.

Oil giants are vulnerable to operational problems as their dominance over key resources declines.

Consolidation offers another way forward, yet few expect large corporate mergers between integrated oil giants in light of antitrust concerns and today's high oil prices.

More likely is a deal akin to Exxon's purchase of U.S. unconventional-gas specialist XTO, a major factor in Exxon's standout 10% rise in production in the quarter.

Wood Mackenzie's Simon Flowers predicts more such "infill acquisitions," but says "large-scale acquisition is not likely in the near term."

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