Seeking Alpha α

EOG Resources: Why Investors Can Expect A Rebound

Feb. 27, 2015 4:58 PM ET
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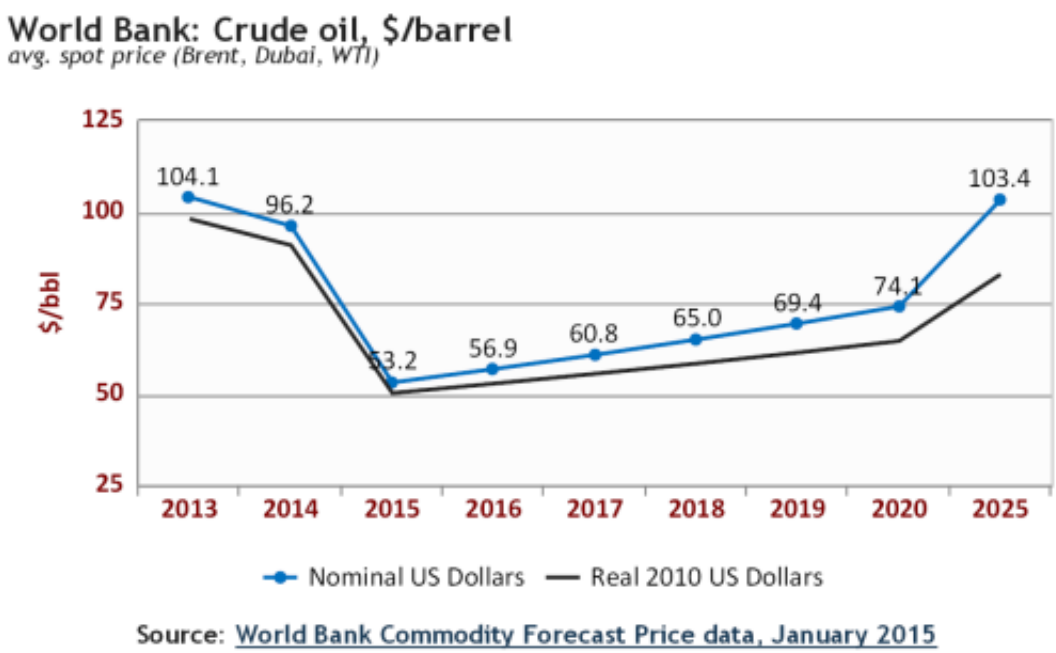
Summary

- EOG Resources will remain profitable even if crude oil prices fall further, as the company has three key assets with low cost and high output.
- Oil prices are expected to gain momentum going forward, as per The World Bank, which means that EOG is capable of delivering a better financial performance.
- The use of hydraulic fracturing has helped shale players such as EOG keep costs under control.

EOG Resources (NYSE:EOG) turned in a woeful performance in the fourth quarter as it missed Wall Street's earnings estimates by a whopping 22%. The stock has already tanked in the last six months due to weak crude oil pricing, and such a big bottom line miss might create more pressure on its performance on the stock market.

The present oil market is extremely volatile, with fears mounting that prices could sink to as low as $20 a barrel. Such low prices were last seen in 2009, when oil bottomed at $35 a barrel. Until recently, OPEC was the controller of the world oil market, with Saudi Arabia being the lead producer. But with the boom in American oil, this monopoly has been broken.

It is high time that the U.S. oil companies take note of this change in power and act immediately to curb further decline in oil prices rather than wait for OPEC to take some action. Moreover, we can be sure that oil will not always remain at such low levels. The following graphic based on the World Bank Commodity Forecast Price data illustrates the same.



Source

Why EOG is well-positioned to capitalize on an increase in oil prices

As oil prices start climbing once again, EOG will be in a good position to bring its financial performance back on track as the company has a strong asset portfolio. Moreover, EOG also has a strong cash flow profile. According to Bloomberg data, it "is the only shale producer expected to generate more cash than it spends both this year and next after oil fell to a three-year low."

Moreover, the company won't curtail its production in spite of falling prices. The reason behind this strong stance is that EOG management believes that it can still generate a 10% return even if oil drops to $40 a barrel. This is a bold statement in an uncertain environment, and once oil prices start picking up, EOG will be able to generate higher returns.

Now, the company has a strong portfolio of assets in the Eagle Ford, the Delaware Basin, the Permian, and others, on the back of which it is confident it can maintain a cash-flow positive production profile. Moreover, EOG is taking steps such as improving well quality with completion enhancements, which will allow it to do well despite uncertainty in the oil industry.

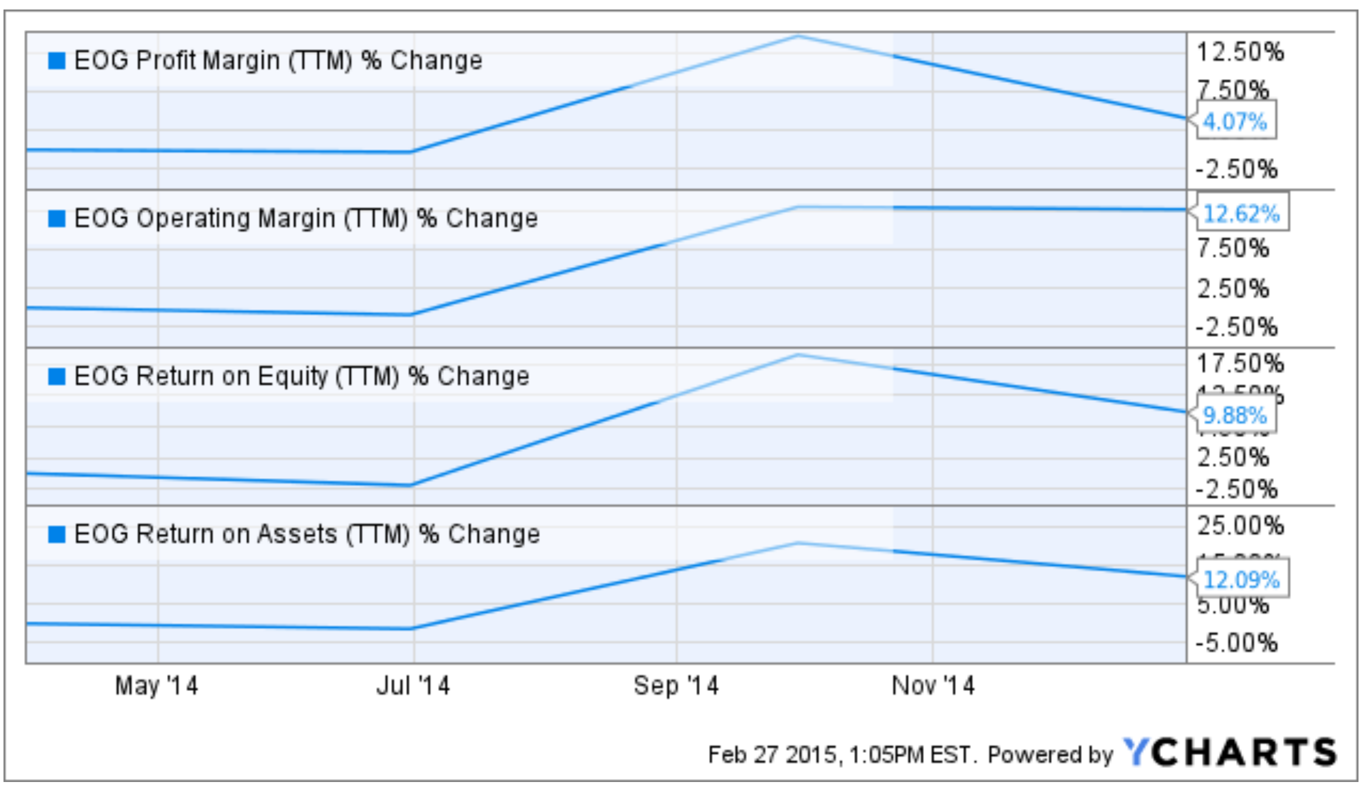
As a result, EOG is focused on improving its operational capability in shale oil. For example, in the Northern Delaware Basin, the company expects its wells to be 50% crude oil. After doing a geological and geophysical survey, it found that 90,000 net acres of its hydrated 140,000 net acres in the Delaware Wolfcamp are in a highly over-pressured crude oil window. Hence, it will increase its drilling activity in the region in anticipation of a good return on investment. Apart from this, it is successfully continuing with its projects like the Bakken Core, Powder River Basin, and others.

Profitable assets have helped EOG maintain impressive margins and returns

Another factor that might drive EOG's performance is its focus on hydraulic fracturing technology, which has helped companies operating in shale formations to increase productivity. According to *The Wall Street Journal*:

> The federal Energy Information Administration's director of energy markets and financial analysis, Lynn Westfall, recently noted that the rig count in South Texas' Eagle Ford Shale 'has not changed since 2012, but the production per new well has doubled.'

Hence, EOG has been able to improve oil production without having to invest in new rigs. As a result, its margins and returns on equity and assets is still strong despite a massive drop in oil prices in recent times. The following chart illustrates the same.



EOG Profit Margin (NYSE:TTM) data by YCharts

Thus, the company has been able to do well in a difficult environment. Going forward, EOG's performance looks set to improve on the back of an expected increase in oil pricing and its focus on low-cost assets that will help it improve production in an economical way. As a result, investors should consider capitalizing on the stock's weak performance in the last six months as can make a comeback going forward.