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Carrizo Oil & Gas: Improving Production Volumes, Recovery In Oil Pricing, Lower Costs Are Catalysts

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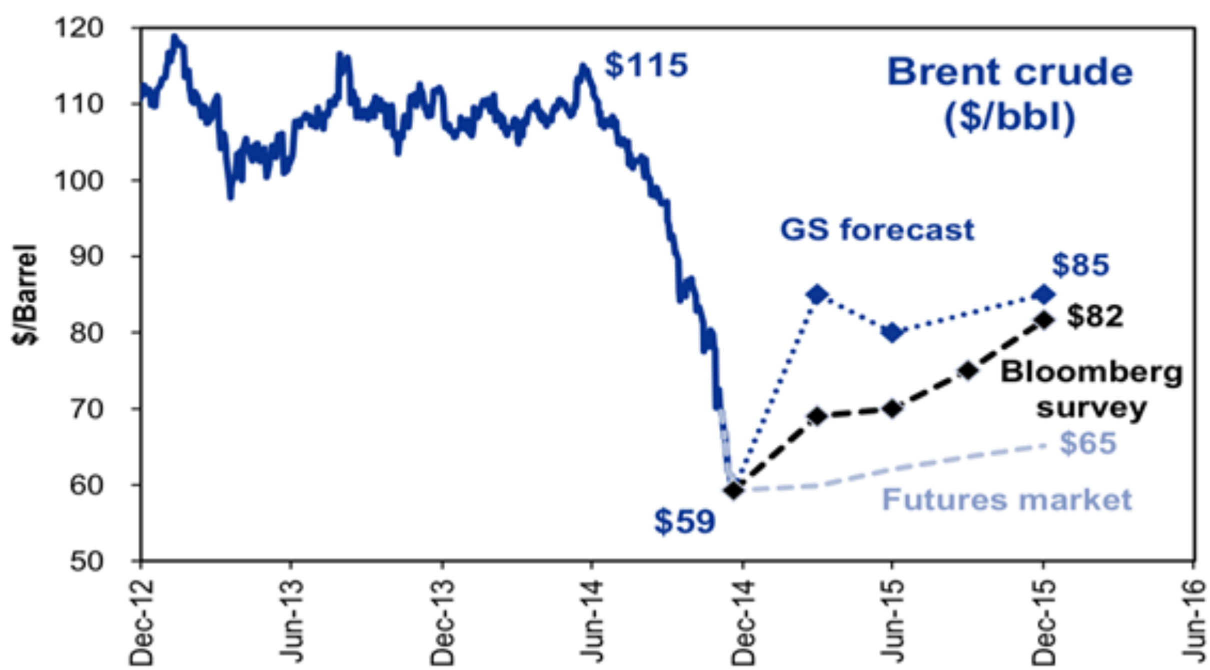
Summary

- Carrizo Oil & Gas will incur 42% less on capital expenses this year, but its production will still increase.
- Carrizo will continue drilling for more oil as over 80% of its Eagle Ford locations will be economical even if crude oil prices are below $44 per barrel.
- An improvement in completion costs and drilling activities will lead to a lower cost structure, and improve Carrizo's bottom line performance.

Carrizo Oil & Gas (NASDAQ:CRZO) recently posted impressive operational results for the fourth quarter. Its production volume for the quarter improved 52% year-over-year on the back of a robust performance by its flagship Eagle Ford Shale assets. However, due to a drop in oil pricing, its results missed Wall Street's forecasts despite a strong rise in revenue.

But, Carrizo can expect an improvement in its earnings performance going forward as oil prices are expected to gain positive momentum. Crude oil prices are expected to stabilize in the first six months of this year, and then improve in the latter half. Also, a consensus of Bloomberg and Goldman Sachs (NYSE:GS) analysts expect an increase in crude oil pricing this year as the following graphic indicates:

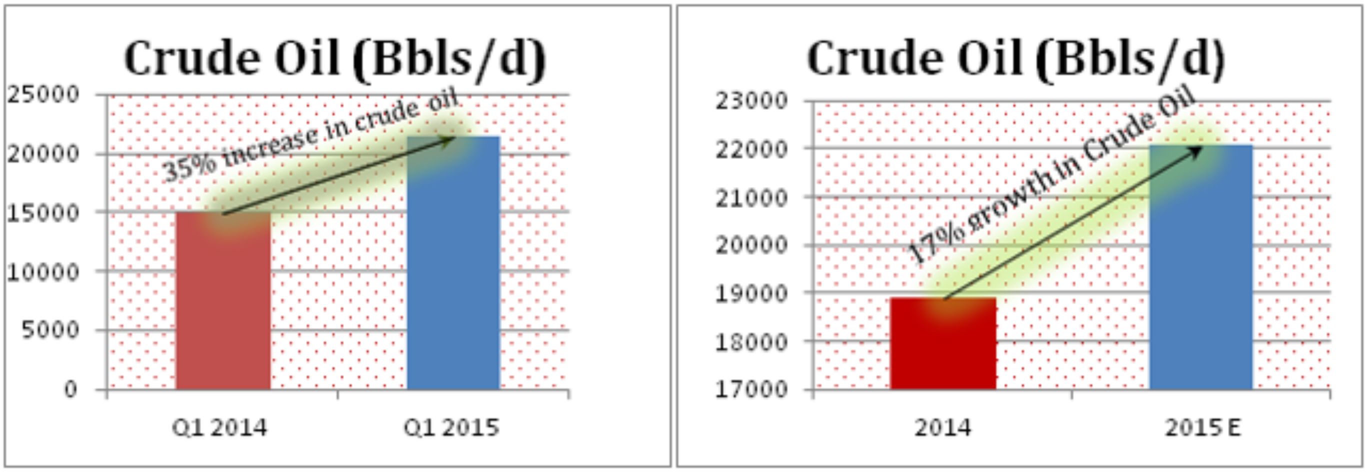
Exhibit 2: Forecasters expect more of a rebound in oil than the market does
as of December 18, 2014



Source: Bloomberg, FactSet, and Goldman Sachs Global Investment Research.

In such circumstances, Carrizo's improving oil production will allow it to improve its revenue and earnings going forward. The company is expected to produce about 20,300 to 20,700 barrels per day in the first quarter of 2015. This will result in production growth of more than 35% as compared to last year, considering the lower end of its guidance. Also, Carrizo's full year oil production is forecasted to be in the range of 21,800 to 22,400 barrels of oil per day. This represents approximately 17% oil production growth over 2014. The following graphic demonstrates its production growth.

(click to enlarge)



Source: Author's representation

Eagle Ford production will drive growth

Carrizo's production growth will be driven by its assets in its flagship Eagle Ford shale, which are expected to deliver profitability despite short-term weakness in crude oil prices. The company estimates that more than 80% of its Eagle Ford drilling locations will prove to be economical even if crude oil prices are below $44 per barrel.

Hence, the company is expanding its production in the Eagle Ford despite the recent weakness in crude oil pricing. As a result, it has recently drilled 21 gross operated wells and completed 12 gross wells in the Eagle Ford Shale. Also, it has another 25 gross operated wells at Eagle Ford that are nearing completion. These wells have the potential of producing more than 8,400 bbl/d of crude oil.

At present, Carrizo is running one rig in the Eagle Ford shale. Looking ahead, it expects to run a three-rig program at Eagle Ford. Moreover, Carrizo currently has four two-well pads online in this area. It plans to bring two additional wells online by the end of the first half of the year. On the other hand, the company has successfully drilled 8 gross operated wells and completed 5 gross wells at Niobrara Foundation. Carrizo is currently operating one rig at its Niobrara assets, and it plans to drill 4 gross operated wells this year.

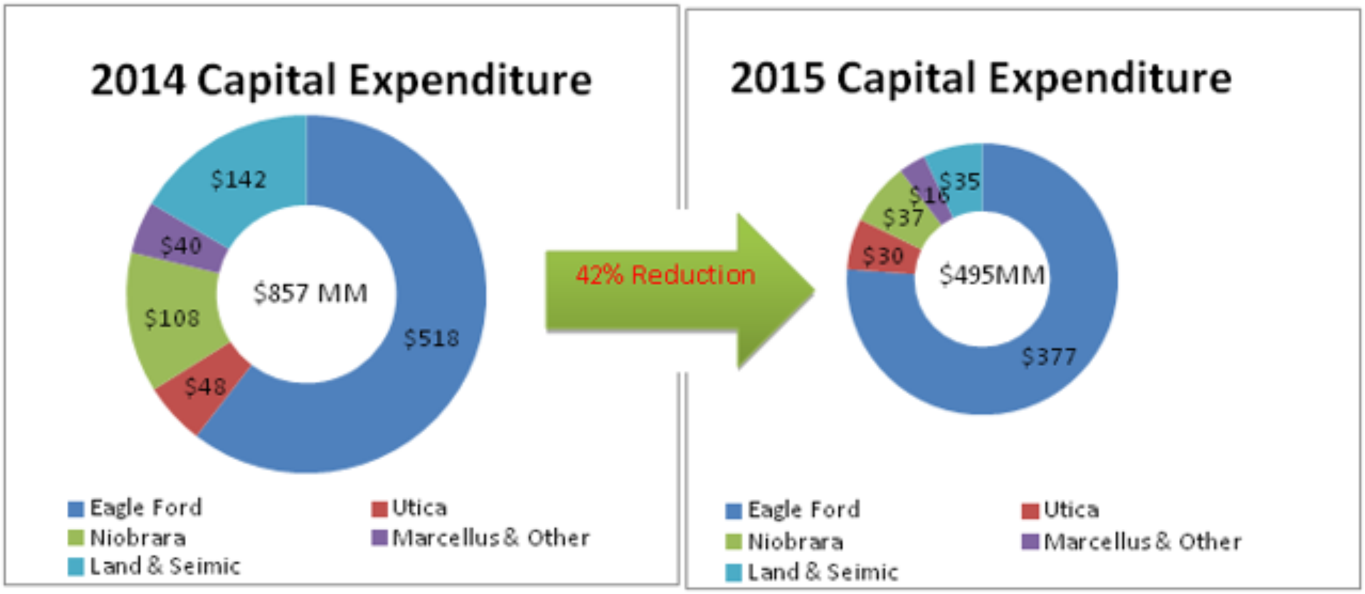
Looking beyond 2015, Carrizo plans to develop its Utica Shale wells. It is currently working at the ground level to ramp up its activities in 2016 as crude oil prices improve.

Lower capital expenses will aid bottom line growth

Thus, Carrizo is intent on improving its production figures, and this will enable the company to improve its earnings performance on the back of an increase in crude pricing. Another factor that will allow Carrizo to get better is its focus on cost-cutting. Carrizo has achieved 8% in cost reduction in its drilling activities this year as compared to the end of 2014, along with a 19% improvement in completion costs. As a result, the company has been able to slash its capital expenditure by approximately $255 million in 2015.

This represents a 42% decrease from its capital expenditure in 2014. Even then, its production is expected to rise this year, which means that Carrizo will be able to produce more oil at lower costs.

(click to enlarge)



[Source](#)

Conclusion

Despite weakness in crude oil prices, Carrizo's margins are strong. It has a strong profit margin of 31.9% and a stronger operating margin of 57.1%, primarily due to its presence in the Eagle Ford shale. As its capital expenses come down and oil prices start recovering, the company's margins should improve further. On the other hand, Carrizo's strong margins will allow it to overcome further weaknesses in oil pricing. As such, even after gaining 14% this year, Carrizo might still be able to deliver more upside going forward.