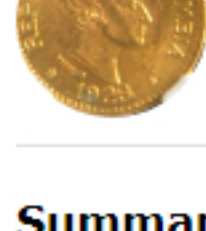


Long Ideas | Basic Materials

Occidental's Sale Of Its Onshore Colombian Oil Assets Makes Sense

Nov. 9, 2020 2:33 PM ET | 2 comments | 6 Likes | About: Occidental Petroleum Corporation (OXY). Includes: EC



Inversiones Apartado
Long Only, Deep Value, Value, long-term horizon

Summary

- Occidental's sale of its onshore Colombian assets makes sense in the current environment.
- Onshore Colombia is becoming a less attractive jurisdiction for upstream oil exploration and production.
- The sale of mature assets in riskier jurisdictions allows Occidental to reduce debt while dialing down the risks associated with its upstream portfolio.

Diversified international oil company **Occidental Petroleum (OXY)** has become something of a pariah among investors since its ill-fated \$55 billion August 2019 acquisition of Anadarko Petroleum. The deal, which was aimed at boosting Occidental's exposure to the burgeoning U.S. shale energy patch, notably the prolific Permian shale, and endow it with the scale to compete against oil super majors like **Chevron (NYSE:CVX)** was one of the worst timed in history. A few months after the deal was completed oil prices crashed because of the impact of the COVID-19 pandemic on energy demand and a looming oil price war between Saudi Arabia and Russia. The acquisition left Occidental heavily leveraged with over \$36 billion in debt costing over \$1 billion annually to maintain.

Struggling to perform

For the second quarter 2020, Occidental reported a worrying \$8.4 billion loss primarily caused by sharply weaker oil prices and \$6.4 billion of impairment charges on its oil assets. That is compared to a \$635 million profit a year earlier. Occidental is struggling to meet its financial obligations and reduce debt to manageable levels. Operating cashflow for the period fell sharply dropping almost 43% year over year to just under \$1.7 billion. As a result, cash and cash equivalents was reduced by almost \$2.4 billion at the end of the second quarter, reducing Occidental's cash pile to \$1.2 billion compared to \$1.75 billion at the end of the same period in 2019.

Poor timing of asset sales

Occidental's monster \$36 billion of net long-term debt forced it to embark on an aggressive divestment strategy, which in the current difficult market awash with oil assets can only be described as a fire sale. Sharply weaker oil prices have forced many deeply indebted energy companies, to raise capital to ensure their survival, to flood the market with oil assets at bargain basement price making it a buyer's market.

Occidental is no different, it is expecting to realize around \$2 billion of asset sales during 2020 so that it can whittle down its extremely high level of debt. During August 2020, the company stated it intended to sell \$1.33 billion of assets in Wyoming, Colorado and Utah to Orion Mine Finance. Occidental's most recent divestment is its sale of all onshore oil acreage in Colombia to private equity firm The Carlyle Group for around \$825 million (consisting of a \$700 million base price and a further \$125 million linked to performance targets). Occidental has had a presence in Colombia for around four decades maintaining a close partnership with national oil company **Ecopetrol (EC)**. Occidental is selling its acreage in the Llanos, Middle Magdalena and Putumayo Basins, including the Caño Limon oil field which is Colombia's second largest oil field which have a combined output of around 33,000 barrels of oil equivalent daily.

Some pundits have balked at the sale, claiming that Occidental is making a mistake selling what are proven producing low-cost oil operations for less than three times their cash flow. While on the surface the sale could be interpreted as another misstep there are several important factors to consider. The Caño Limon oil field, discovered by Occidental in 1983, is Colombia's second largest and includes the smaller Redondo, Cano Rondon, and Jiba oil fields. It is a mature asset which is in decline, meaning that production is progressively falling as decline rates rise. As a result, maintenance spending and the sustaining capital required to maintain production are rising at a steady clip, making the Caño Limon field is a costly asset to own. When those characteristics are considered in conjunction with the oilfield's extremely limited exploration upside because it has been heavily exploited over the last four decades, it is clear the Caño Limon oilfield has a limited lifespan. Furthermore, the Caño Limon field is estimated by the Natural Resource Governance Institute to have average breakeven costs of around \$34 per barrel. Those could be as high as \$45 per barrel on an after-tax basis. That means it could be uneconomic to operate in the current environment where Brent is hovering at around \$40 per barrel, particularly when ever higher maintenance and capital spending is required to sustain production.

The remote region where the Caño Limon field is located has long experienced extensive guerilla activity, which even with the 2016 FARC peace deal has failed to significantly alleviate. That means attacks on energy infrastructure in the region including well-heads and the Caño Limon-Coveñas pipeline remains an ever-present threat. The Caño Limon-Coveñas pipeline is the only means of cost effectively transporting the crude oil produced at the Caño Limon oilfield to the port of Coveñas because of Colombia' rugged terrain and lack of transportation infrastructure. If the pipeline is shut-in because of maintenance or damage, then it is impossible to ship the oil produced in the Caño Limon oil field to global energy markets.

In 2019, there were 42 attacks on the pipeline with another 15 attacks during the first five months of 2020. When the Caño Limon-Coveñas pipeline suffers outages because of bombings and other forms of sabotage operator **Ecopetrol** is forced to store the oil produced at the oilfield onsite. Once maximum storage of 900,000 barrels is reached, production at the Caño Limon field and its smaller satellite fields must be shut-in until the Caño Limon-Coveñas pipeline recommences operations. This creates further costs and additional uncertainty for **Ecopetrol** and Occidental, increasing the costs of operations and making the Caño Limon oilfield an unreliable asset.

The risks associated with onshore Colombian oil assets are rising because of a deteriorating security environment. The volume of FARC dissidents, which are those combatants who refused to recognize or have renounced the peace treaty, is growing. It is estimated that since demobilization was completed in 2017 around 1,500 former combatants have rearmed. This along with the last remaining guerilla group the ELN and various neo-right-wing militias and organized crime groups vying for control of lucrative coca growing territory and trafficking routes has triggered an uptick in violence. Civil dissent against the administration of President Iván Duque sparked nationwide protest during 2019 which unnerved foreign investors, especially offshore oil companies. That is evident from the National Hydrocarbon Regulator's (ANH) June 2019 auction where only 15 bids were received for 59 blocks, and those came from existing operators in Colombia. The protest organizers have promised to restart the campaign against Duque, including national strikes, once the COVID-19 national health emergency ends. Those events make onshore Colombia an unattractive location for investment by international energy companies, highlighting that the upside for Occidental's onshore Colombian oil assets is limited. That is further magnified by growing signs that onshore oil production in the Andean country has a limited lifespan. There have been no major oil discoveries since 2009 and Colombia's Ministry of Mines and Energy in April 2020 announced that the Andean country only had proven oil reserves of 2 billion barrels with a limited 6-year lifespan.

There are growing pricing pressures on the crude oil produced in onshore Colombia. The country's main crude oil blends are Castilla and Vasconia which with API gravities of 17.7 degrees and 23 degrees and high sulfur contents of 1.83% and 1.09% respectively are heavy very sour crude oil oils. That means they trade at a discount to the international Brent benchmark which will widen further because of the growing global demand for lighter sweeter crude oil varieties in response to every stricter sulfur content regulation for fuels. This is highlighted by **IMO 2020**, which commenced on 1 January 2020 and restricts the sulfur content of maritime bunker fuel to 0.5% mass for mass. That saw demand from Asian refiners for sweet medium and light crude oil soar since mid-2019. It will cause the popularity of Colombia's heavier very sour crude oil blends to wane.

For those reasons Occidental's onshore Colombian assets are unreliable, costly to operate, have extremely limited upside and there is considerable potential for their value to decline sharply even if oil rebounds. This underscores why management's decision to sell Occidental's Colombian onshore assets makes sense. The company, however, has retained its interests in Colombian offshore assets which are believed to hold tremendous oil potential and are anticipated to be a **game changer** for a country which has limited proven reserves. Occidental is also pushing ahead with its partnership with Colombian national oil company **Ecopetrol** to drill 100 wells in the Permian basin by the end of 2021.

What does the future hold?

The big question for investors after seeing Occidental lose a whopping 81% since closing the Anadarko deal is whether the company can recover. Sentiment surrounding Occidental remains negative and it is difficult to see how it can recover from the missteps relating to the overprice Anadarko deal for as long as oil prices remain sharply lower. A significant factor weighing on Occidental's outlook and the price of crude oil is the COVID-19 pandemic. Cases are mounting which has caused the North American benchmark to slide under \$40 per barrel which is below the breakeven cost for many U.S. oil operations. Whether Occidental is a speculative buy is highly dependent on the outlook for crude oil, which at this moment is not particularly positive.

Occidental does appear particularly cheap with it trading at under \$9 per share. Its attractiveness as a levered speculative play on higher oil is amplified by its low breakeven cost which is estimated to be in the low \$30s or less than WTI's current price of \$38 a barrel. The company owns an impressive array of assets spanning key parts of the petroleum value chain, including upstream production and midstream operations. The petroleum company is the number one producer in the Permian Basin, which has the lowest breakeven costs of any of the U.S. shale oil basins. That means once oil recovers Occidental is ideally positioned to ramp-up what is highly profitable oil production. There are predictions that Brent will rebound, possibly to as high as \$65 per barrel, during 2021 and settle at around \$58 by the year end, which will see the North American WTI benchmark price follow suit. That bodes well for a leaner Occidental with a significantly lower debt load focused on higher margin core operations. The divestment of costly potentially uneconomic assets like those sold by Occidental in onshore Colombia allows it to reduce debt and the risk profile of its operations while focusing on higher margin core operations. For those reasons Occidental is shaping up to be a highly speculative play on an oil recovery, which is making the right moves by aggressively reducing debt and selling mature oil assets so that it is positioned to rebound strongly once oil firms.

Disclosure: I/we have no positions in any stocks mentioned, but may initiate a long position in OXY over the next 72 hours. I wrote this article myself, and it expresses my own opinions. I am not receiving compensation for it (other than from Seeking Alpha). I have no business relationship with any company whose stock is mentioned in this article.

Like this article 6 Likes

Comments (2)

+ Track comments Sort by Newest

Add Your Comment

Daddy_Bernanke
Comments (8) | + Follow

Fantastic article! Very thorough and it presents multiple counter arguments against bearish investors.

09 Nov 2020, 02:58 PM Like 1

Erik Poole
Comments (131) | + Follow

Best piece I have ever read on Oxy and the Colombian assets. Cannot recommend enough as required background reading for serious Colombian resource sector investors.

09 Nov 2020, 02:57 PM Like 1

Disagree with this article? [Submit your own.](#)
To report a factual error in this article, [click here.](#)
Your feedback matters to us!

You are not logged in.

Create a free account and get customized news, alerts, and analysis about the stocks you follow.

Already have an account? [Sign in](#)

Email Address

I agree to [Terms of Use](#) & [Privacy Policy](#).