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Financial News for Independent Energy Companies

The "Financial News for Independent Energy Companies" is issued several weeks after the close of each quarter to report recent trends in the financial performance of independent energy companies, which are typically smaller than the majors and do not have integrated production/refining operations. Earnings for the 50 independent energy companies included in this report grew 75 percent in the second quarter of 2004 (Q204) over earnings in the second quarter of 2003 (Q203) (Table 1). All three types of energy companies included in this report -- independent oil and natural gas producers, oil field service companies, and refiner/marketers -- had increased income over the year-ago quarter, as crude oil prices, natural gas prices, and the gross refining margin all increased (Table 2).

Energy Price News

Oil prices increase by one-third as natural gas prices increase by one-ninth, relative to prices of a year ago. The world oil price (represented by the U.S. refiner average acquisition cost of imported crude oil) increased 33 percent relative to a year ago, going from $25.58 per barrel in Q203 to $33.97 per barrel in Q204 (Table 2). As indicated in the September *Short-Term Energy Outlook* (*STEO*) of the Energy Information Administration, upward pressure was exerted on crude oil prices by worldwide security concerns. Additionally, several factors also affected the underlying fundamentals of the world crude oil market. In particular, the U.S. economy's 5-percent growth, slightly lower stock levels in the countries of the Organization for Economic Cooperation and Development relative to a year earlier, and a 5-percent increase in world oil demand all placed upward pressure on crude oil prices. The effects of these factors were somewhat offset by a 5-percent increase in world supply and higher U.S. stocks (Figure 1) by 5 percent relative to a year earlier. This was the eighth consecutive quarter in which crude oil prices increased relative to their year-earlier levels, after six consecutive quarters of falling or unchanged crude oil prices (relative to a year earlier).

Meanwhile, the average U.S. natural gas wellhead price increased 11 percent between Q203 and Q204 (Table 2). Contributing to higher natural gas prices was the 3-percent increase in U.S. demand, much of which was offset by a 2-percent growth in total U.S. supply, according to the September *STEO*. The growth in natural gas prices also was dampened by increased U.S. natural gas working storage at the beginning of the period (Figure 2), which was 45-percent higher than a year earlier.

Company Earnings

Crude oil and natural gas price increases boost independent producers' earnings. Net income of the independent oil and gas producers included in this report rose 45 percent between Q203 and Q204, from $354 million in Q203 to $511 million in Q204, as revenues rose 27 percent, from $2.2 billion to $2.8 billion (Table 1). Independent oil and gas producer earnings were boosted by a 33-percent increase in the price of crude oil and an 11-percent increase in the price of natural gas over year-ago prices (Table 2).

- **Oil field companies' revenue and earnings increase with higher drilling rig counts.** Net income of U.S. oil field companies included in this report increased 60 percent, from $388 million in Q203 to $622 million in Q204, as revenues rose 17 percent, from $13.8 billion to $16.1 billion (Table 1). U.S. oil field company earnings were strengthened by an increase in the worldwide rig count of 10 percent from 1,996 in Q203 to 2,203 in Q204, according to Baker Hughes data. Higher rig counts and the resulting higher demand for rig services directly increased the demand for the equipment and services supplied by oil field companies. This increase in demand raised day rates on equipment and margins on overall operations, thereby increasing companies' profits.

The rig count growth rate for the United States was slightly higher at 13 percent, rising from 1,028 in Q203 to 1,164 in Q204 (Figure 3). Decomposing the total U.S. rig count into its natural gas and oil components shows natural gas to be the driver for growth with a 17-percent increase in natural gas rigs, from 857 in Q203 to 1,004 in Q204. The oil rig count decreased 6 percent over the same period, the first decrease in the oil rig count after 5 consecutive quarters of increasing relative to its year-earlier level. The natural gas rig count has now increased for six consecutive quarters relative to its year-earlier level.
Breaking down overall (oil plus natural gas) rig counts on a regional basis shows that while total rig counts grew 10 percent worldwide and 13 percent in the United States from Q203 to Q204, the rig count declined 1 percent in Canada.

- **Refiner earnings up sharply with higher margins.** Earnings of the independent refiners included in this report jumped 271 percent from $83 million in Q203 to $308 million in Q204 (Table 1). All five independent refiners included in this report had earnings increases over the year-ago quarter due to the sharp increase in average refining margins of 49 percent over the period (Table 2). (The average refining margin is the difference between the composite wholesale refined petroleum product price and the composite refiner acquisition cost of crude oil.) Refining margins increased because the increase in refined product prices (calculated from Table 2 by adding the price of crude oil and the gross refining margin) of $13.74 more than offset the $8.39 increase in the price of crude oil.

Table 1. Revenue and Net Income Summaries for Independent Energy Companies
(Millions of Dollars)

	Q203	Q204	Percent Change	Year to Date 2003	Year to Date 2004	Percent Change
Revenue						
Oil and Gas Producers (20) [a]	2,179	2,762	26.8	4,459	5,383	20.7
Oil Field Companies (25)	13,753	16,148	17.4	26,376	32,384	22.8
Refiners (5)	4,872	6,657	36.6	7,883	10,284	30.5
Total Revenue (50)	20,804	25,568	22.9	38,718	48,051	24.1
Net Income						
Oil and Gas Producers (20)	354	511	44.6	819	983	20.1
Oil Field Companies (25)	388	622	60.4	922	1,140	23.7
Refiners (5)	83	308	270.9	62	313	409.1
Total Net Income (50)	825	1,442	74.8	2,436	1,802	35.2

[a]The number of companies reporting revenue and net income is in parentheses.

Notes: The net income data have been adjusted to exclude the effects of unusual items such as accounting changes. Percentages are calculated from unrounded data.

Sources: Compiled from companies' quarterly reports to stockholders.

Table 2. U.S. Energy Prices and the U.S. Gross Refining Margin

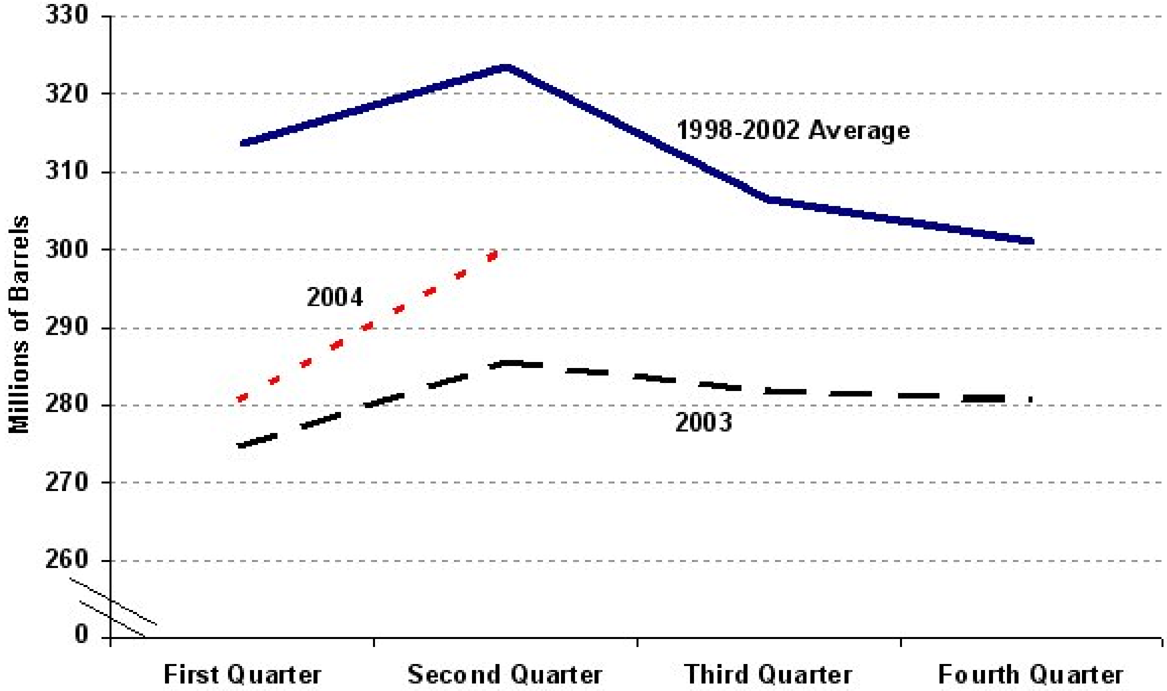
	Q203	Q204	Percent Change
U.S. Energy Prices[a]			
Refiner Acquisition Cost of Imported Crude Oil ($/barrel)	25.58	33.97	32.8
Natural Gas Wellhead ($/thousand cubic feet)	5.01	5.56	11.0
U.S. Gross Refining Margin[b] ($/barrel)	10.87	16.22	49.1

[a]Energy Information Administration, *Short-Term Energy Outlook*, (Washington, DC, September 8, 2004), Table 4.

[b]Compiled from data in Energy Information Administration, *Petroleum Marketing Monthly,* DOE/EIA-380 (Washington, DC), Table 1, Table 4 and Table 5; and Energy Information Administration, *Monthly Energy Review*, DOE/EIA-0035, (Washington, DC) Table 3.2b.

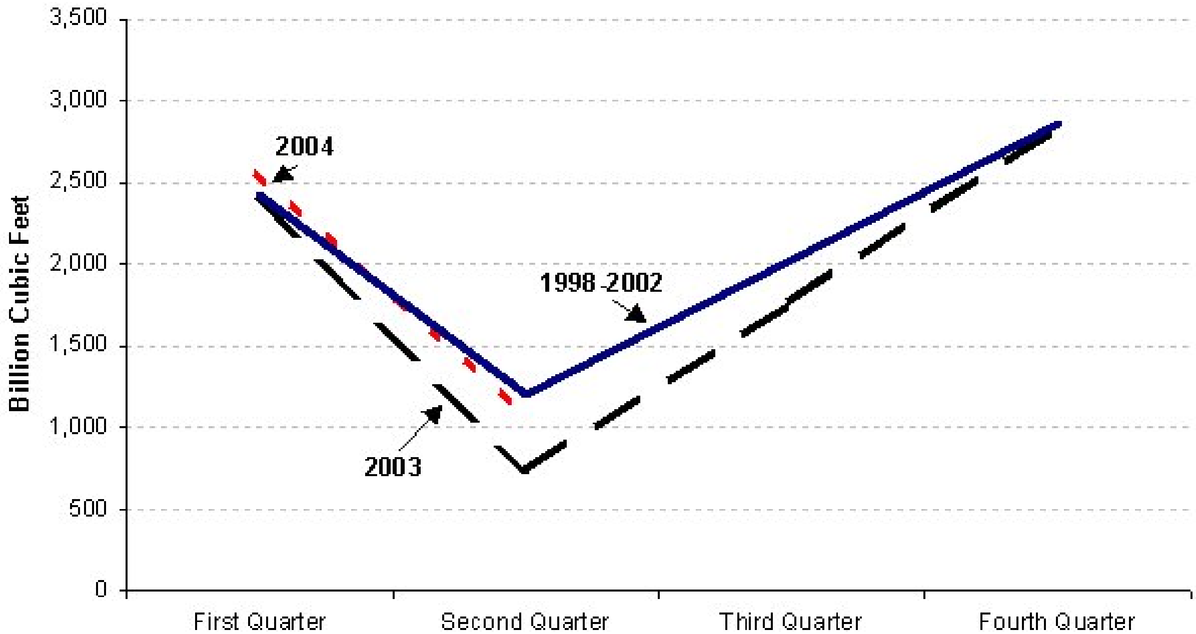
Note: The U.S. Gross Refining Margin is the difference between the composite wholesale product price and the composite refiner acquisition cost of crude oil.

Figure 1. Quarterly U.S. Crude Oil Stocks, 1998-2002, 2003, and 2004



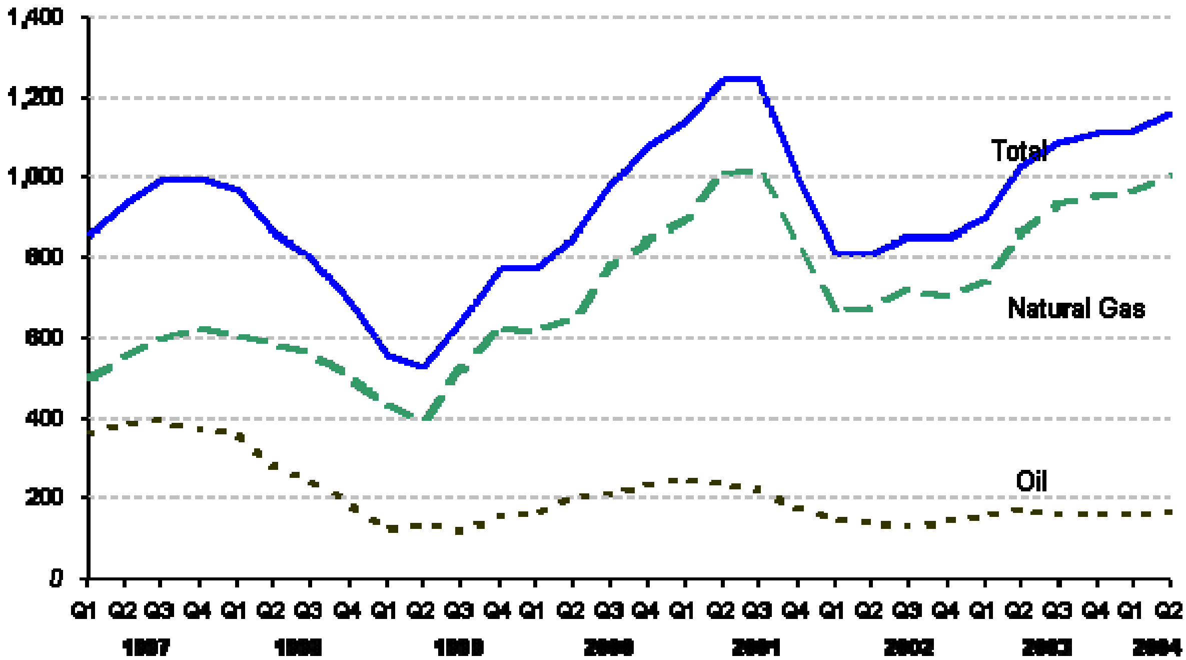
Source: Energy Information Administration, *Petroleum Supply Monthly*, DOE/EIA-0109 (Washington, DC), Table 51.

Figure 2. Quarterly U.S. Opening Level of Working Gas in Storage, 1998-2002, 2003, and 2004



Source: Energy Information Administration (EIA), *Monthly Energy Review*, DOE/EIA-0035 (Washington, DC), Table 4.5; and EIA, *Short-Term Energy Outlook* (Washington, DC, September 8, 2004), Table 8.

Figure 3. U.S. Quarterly Rig Counts: Oil, Gas & Total, 1997-2004



Source: Baker Hughes.

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