

Inside the Integrations: Drilling Down on Crude Oil

By [Sung Moss](#) 10/29/09 - 12:34 PM EDT

NEW YORK ([TheStreet](#)) -- Integrated oil company earnings are well under way this week, with numbers from the likes of **BP**([BP Quote](#)), **ConocoPhillips**([NWSA Quote](#)), **Hess**([HES Quote](#)), **Royal Dutch Shell**([RDS.A Quote](#)) and **Exxon Mobil**([XOM Quote](#)) already in the books. **Chevron's**([CVX Quote](#)) third-quarter report comes on Friday.

And already, a familiar pattern has emerged: some bettering production output from companies experiencing year-over profit declines, hampered by dour refining margins and down commodity prices compared to last year. Still, major integrated oil operations are Rube Goldberg-esque in their complexity, with everything from geopolitical events to foreign exchanges to commodity prices to technology affecting top and bottom lines.

Given that, we've convened a roundtable of sorts -- a series of excerpts from conversations throughout the week with analysts and experts who follow the integrated sector. While profit figures may garner the headlines, each has their own take on the important items worth keying on during the [earnings](#) season.

With cost reductions all the rage, Phil Weiss, a senior analyst at Argus Research, for one, discussed the importance of examining the type of reductions the integrated [operations](#) are showing:

"It's not just about taking costs out. In the second quarter, when Conoco talked about all the costs it was taking out, a lot of it wasn't sustainable. It was foreign exchange and energy [cost reductions](#), and those are not controllable," Weiss says. "So if you tell me you reduce cost by \$1 billion, but \$800 million of it is not sustainable, that doesn't mean as much to me if you don't take out more sustainable costs."

Sven Del Pozzo, senior research analyst at C.K. Cooper, like many, expected upstream operations to look infinitely better than downstream numbers. But he also notes that petrochemical numbers, among other things, may deserve special attention.

"Petrochemicals are highly integrated with refining operations. To a degree, the two things go hand-in-hand just because the engineering of these facilities feed one another. So the other segment you want to look at is petrochemicals to see what those margins are doing," Pozzo says. "You really want to break down the petrochemical earnings as well to see at how bad things are in the entire downstream sector, which includes both petrochemicals and refining."

"If the retail consumer isn't buying a lot of plastic because they're not building enough homes, they're not buying a lot of durable assets, then you would expect a potential downturn in petrochemical [earnings](#) as well. They're a good indicator of the overall health of the economy."

Alan Brochstein, a senior energy analyst at Management CV, notes the importance of examining management moves and reserve forecasts.

"Bottom line, as we near the end of 2009, the large U.S.-based integrated oil companies have lagged the market significantly, with little differentiation in their returns. We believe that [investors](#) are concerned near-term primarily with the outlook for reserve growth. As we think about the key factors impacting COP, CVX and XOM," notes Brochstein, "we don't expect reported earnings to significantly influence our views on the companies. Again, earnings tell just one aspect of the story, and the management regimes, both good or bad, are driving the bottom line."

Stephen Davis, associate portfolio manager specializing in energy at Alpine Mutual Funds, says that while oil price forecasts and strategy changes were worth noting, it's production numbers that get his attention.

"I'm not sure how important the earnings are for the integrations," Davis says. "What we look for when we own any of these integrations is news flow regarding the exploration side and the development side of their business. Are their projects delayed? Are things moving on schedule? Is production rising or not? The most important number I'm looking at is the production number on these releases, because beating is just a function of oil price."

Not a fan of the integrations, Andy Corn, chief investment officer for equities at Beacon Trust, considers them more value plays as opposed to growth plays. What he keys on most, however, is what they have to say about their futures.

"Another thing to look at is where they predict oil and gas are going and what they're doing on the [hedging](#) side," Corn says. "The whole concept of 'we're going to shrink the company to build the company back up' can [also] make sense as long as they're doing it highly strategically and they have clear vision of where they want to be. It's all a matter of what's the outcome," Corn says. "What are they doing to make sure they're going to have a secure future?" -- *Written by Sung Moss in New York*