An Underfollowed Shale Story That Deserves Your Attention

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With each passing year, oil consumption continues to climb. Total consumption worldwide now exceeds 80 million barrels per day, with Asia responsible for much of the increase over the past decade, a trend likely to continue for the foreseeable future. However, as consumption increases, we are not finding enough super-oilfields from which to produce oil. That means we're increasingly forced to go into unconventional places such as the shales and into the deep waters to continually increase production.

Since it's very expensive to produce from unconventional sources, oil prices have gone up quite a lot as these sources have grown as a percentage of total production. Here in the United States, the shale boom has been in full effect, with places like the Bakken, the Eagle Ford, and other liquids-rich shales getting plenty of attention from energy companies. One of the shale plays that has yet to receive as much fanfare, however, has been the Monterey Shale in California, an area that could potentially hold billions of barrels of recoverable oil.

The top dogs

At this juncture, the main players in the Monterey Shale are Occidental Petroleum and Venoco. The two companies combined forces in a joint venture to shoot 3-D seismic on a 500-square -ile portion of the play. That data is likely to be valuable in guiding the companies as they explore and develop their acreage.

Occidental is the dominant player in this region, with 1.6 million net acres in California, which includes 870,000 net acres of shale plays. The company produced 139,000 BOE per day from this play last year and is currently running 30 drilling rigs. The company's 2011 capital spending plan allocated $1.6 billion to California to drill at least 500 new developmental wells. The $1.6 billion program was 80% more than in 2010. Of those 500 wells planned for 2011, 195 of them were expected to be shale wells.

So far, the company has achieved 30-day initial production rates of 300 to 400 BOE per day. That rate was achieved on wells that cost an average of $3.5 million to drill and complete, a figure that the company expects to come down over time.

All told, Occidental is quite bullish on the play and believes that the "CA shale" could become the company's largest business unit in 10 years, which is a major statement by a global company with a market cap of $76 billion. It's still in its early stages, but it's almost a certainty that the company will continue spending heavily in this area in its 2012 drilling program.

Venoco, the other major player, holds 214,000 net acres in the Monterey Shale and has been leasing acreage since as early as 2006. That's a lot less acreage than is held by Occidental, but Venoco's market cap is a much smaller $391 million, making it much more leveraged to success in the Monterey than Occidental. In 2012, Venoco expects to spend $255 million in total capital expenditures. Of that figure, $100 million has been allocated to the Monterey Shale, where it plans to continue delineating and testing the play.

The other player

Another company with a lot at stake in California is Plains Exploration. Counting both its onshore and offshore assets, the company has 211 million BOE of proven reserves, with a total resource potential of 392 million barrels. This is good for 2,300-plus future drilling locations. The company hasn't disclosed how much of that acreage is conventional versus unconventional, but 1,900 of the drilling locations are in the San Joaquin Valley, the same area where Occidental and Venoco shot its joint 3-D seismic survey.

Going forward, Plains Exploration expects to spend $1.6 billion in capital expenditures next year, with 20% of that figure allocated to its California assets. So far, 116 gross wells have been planned for 2012, with 82 total in the main San Juan Valley area. The company's long-term operational plan in California is to go from about 40,000 BOE per day in 2012 to almost 60,000 BOE per day in 2017.

Foolish bottom line

It's still early in the Monterey Shale play in California, but these companies have made some significant commitments to this play. Venoco offers the most leveraged ways to play the Monterey Shale, but my favorite pick here is Occidental, which believes the play could become the company's biggest-producing area despite its huge size. Plus, Occidental has the strongest balance sheet by far and pays a dividend that has increased 10 times over the past nine years -- hardly a small feat.