Executive Summary

The year 2002 began with the world oil market in a state of excess supply. Reflecting this market condition, the earnings of the U.S.-based major energy companies in 2002 declined 45 percent compared to their net income in 2001, after having already dropped 29 percent from the year 2000. Key developments in 2002 included:

- Global petroleum inventories began the year well above normal levels.
- In the United States, petroleum stocks (crude oil plus finished petroleum products) at the beginning of 2002 were over nine percent higher than at the beginning of 2001.
- Natural gas in working storage opened the year at its highest level since 1990.
- The crude oil price (as represented by the U.S. composite refiner acquisition price) climbed over the year, beginning the year at $17.38 per barrel and ending the year close to $27 per barrel, as excess supplies were reduced.
- Also as excess supplies were reduced, estimated natural gas prices at the U.S. wellhead rose from $2.35 per thousand cubic feet in January to $3.84 in December, an increase of over 63 percent.

To see how these and other developments have affected energy industry financial and operating performance, strategies, and industry structure, the Energy Information Administration (EIA) maintains the Financial Reporting System (FRS).

Through Form EIA-28, major U.S. energy companies annually report to the FRS (see the box entitled "The FRS Companies in 2002" in Chapter 1 of this report). Financial and operating information is reported by major lines of business, including oil and gas production ("upstream"), petroleum refining and marketing ("downstream"), other energy operations, and nonenergy businesses.

Major Energy Companies' Profits Decline In 2002 As Income From Both Upstream And Downstream Operations Falls

Net income of the FRS companies totaled $20.6 billion in 2002, a 45-percent decrease from the $37.7-billion result achieved in 2001. (Excluding the effects of unusual items (such as asset writedowns), the decline in 2002 was 36.6 percent.) In addition to the 2002 result being the majors' second net income decline in two years, on a constant-dollar basis, it represented the lowest level of net income achieved since 1998 and the eighth-lowest level over the 1974 through 2002 period of FRS data collection.

Further, 2002 was an unusual year for the FRS companies in that both upstream and downstream earnings were negatively affected relative to prior-year levels. Net income from oil and gas operations was down by over $4 billion, a 21-percent decrease, largely due to a glut of natural gas in the United States in the first half of 2002, which resulted in lower natural gas prices. However, financial results of the FRS companies' refining/marketing operations were significantly worse with overall refining/marketing net income declining in 2002 by $16.8 billion, or 111 percent.

With recession in much of the global economy, the impacts of September 11, 2001, a relatively warm 2001-2002 winter, and world oil supply outpacing demand until mid-2002, domestic refiner margins for the U.S. energy industry were squeezed, as petroleum product prices declined while crude oil prices increased. Although net income from the foreign refining/marketing operations of the FRS companies managed to remain positive, both foreign and domestic operations registered a steep decline, with domestic refining/marketing net income falling to a loss of $0.3 billion, an all-time low for U.S. refining/marketing profitability over the 1977 to 2002 period of FRS line-of-business data collection. Further, these historic losses for domestic refining/marketing are all the more troubling as 2001 was the second-most profitable year for U.S refining/marketing, reflecting this industry's continuing efforts at cost-cutting.

The demise of energy trading activities across the energy industry, driven by the collapse of the Enron Corporation in late 2001, also negatively affected many of the overall financial results in 2002 for the FRS companies. Although only a small minority of FRS companies were significantly involved in energy trading, the drop in cash flow for those FRS companies involved in energy trading exceeded that of all other FRS companies combined. Further, net income from the FRS companies' "other energy" line of business (now largely consisting of electric power and energy trading activities) plunged from a positive $2.0 billion in 2001 to a loss of $1.5 billion in 2002, a $3.5-billion decline.

Despite Lower Profits, Capital Expenditures Remain High Due to Acquisitions

Capital expenditures of the FRS companies (as measured by additions to investment in place) totaled $98 billion in 2002, 11 percent below the all-time high of $110 billion reached in 2001. Among the geographic regions, the U.S. Onshore region continued to be the most popular upstream target of investment, even with an exploration and development cutback of 17 percent. Additionally, while most FRS companies reduced their spending in the U.S. Offshore region, several projects in the Gulf of Mexico moved ahead in 2002, and total U.S. Offshore spending held steady, declining by only one percent between 2001 and 2002. The largest cutback was for projects in the Canadian region, which were down by 37 percent and were concentrated among those majors having made significant acquisitions in recent years. Political turmoil in Venezuela may have affected exploration and development spending in South America (in the Other Western Hemisphere region) as it declined a relatively steep 43 percent. However, spending for Asian Pacific projects (in the Other Eastern Hemisphere region) was up 22 percent in 2002, and spending for European projects (in the OECD Europe region, and mostly in the North Sea) increased by $0.9 billion, or 19 percent, over 2001 levels.

With the exception of the Devon Energy acquisition of Mitchell Energy and the completion of the ConocoPhillips merger, the upstream mergers by the FRS companies that were a prominent feature of the 1998 to 2001 period fell off. Some of the companies previously involved in significant upstream merger activity (other than Devon and ConocoPhillips) may have ceased their merger activity in order to address debt level or stock value problems on their balance sheets. In contrast, the bulk of capital expenditures in 2002 (as in 2001) reported by the FRS companies for U.S. refining and marketing operations involved transactions between FRS companies. Excluding the effects of mergers and acquisitions, the FRS companies' capital expenditures increased by only 5 percent between 2001 and 2002.