Despite the spill, stock-picking professor sees winners as well as losers among small-cap energy firms in Gulf area

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NEW ORLEANS - The likely effect of the Gulf oil spill on the future stock performance of energy companies in the region may be less dire than one might imagine, suggests a Tulane business professor who is a leading expert on the area's economy, particularly small-cap firms that he calls "stocks under rocks." While the six-month moratorium on deep-water drilling may play havoc with the prospects of many firms in the energy sector, which dominates the region, it may actually benefit others.

This assessment comes from Peter Ricchiuti, a clinical professor of finance at Tulane's A. B. Freeman School of Business and director of its Burkenroad Reports program, in which business students analyze stocks of 40 small-cap companies in Louisiana and nearby states (www.burkenroad.org). A mutual fund based in large part on Burkenroad Reports has outperformed 99 percent of U.S. mutual funds since its inception in 2001.

image file

Clinical professor of finance Peter Ricchiuti says some of the companies followed by the Freeman School's Burkenroad Reports program may actually benefit from a moratorium on deep-water drilling.

According to Prof. Ricchiuti, there are four major energy initiatives in Louisiana and the Gulf area in general, "and they're all spectacular." The first initiative is based on the massive natural gas deposits of the Haynesville Shale, near Shreveport, which "in two or three years," he says, "will be the biggest natural gas field in the world"; the second exploits old land wells and gives them a new lease on life; the third focuses on potentially major natural gas deposits 25,000 or more feet below shallow-water portions of the Gulf; and the fourth involves wells in deep water, where a six-month moratorium on further drilling has been instituted by the Obama administration.

That moratorium in deep water, the professor thinks, could work to the benefit of Burkenroad-covered companies in the three other exploration sectors, as they get more attention and money.

One such company is Denbury Resources (DNR/NYSE), a Houston-based company that pumps carbon dioxide into old land wells that were thought to be depleted and thereby gives them a new life. The technique, called CO2 flooding, is so effective that it is has been dubbed the "Viagra of the oil fields." Ricchiuti says that ample supplies of both CO2 and old land wells ripe for rejuvenation make Denbury a likely play for investors.

Another promising firm is Houston-based CARBO Ceramics Inc. (CRR/NYSE), a small-cap that is the world's largest manufacturer of ceramic proppants, tiny beads that are vital to the hydraulic fracturing process used in the extraction of natural gas from shale formations. As Ricchiuti explains, "What you're doing is fracturing the earth so that gas escapes from the shale, but, since the gas has been trapped underground for millions of years, Mother Nature wants to push the formation back together again. The ceramic beads keep the frac open so that the gas can keep rising to the surface."

A third Burkenroad company that could benefit from the deep-water moratorium is McMoRan Exploration Co. (MMR/NYSE), based in New Orleans, which Ricchiuti says is "the most amazing story I've seen here in 10 years." Although it is a relatively small firm, spun off in 1994 from Freeport McMoRan, the company is one of the largest acreage holders on the shelf of the Gulf of Mexico. As Prof. Ricchiuti puts it, "They are finding a whole new layer of dead dinosaurs that are well below the traditional depths for drilling in the US of 10,00-12,000 feet. The majors either didn't believe the story or thought it was too complicated, and McMoRan has become the biggest player out there."

A curiosity about the company's wells, says Ricchiuti, is that they are all named after pirates. "The first was Davy Jones, and in the next few months they're going to drill the Lafitte and Blackbeard wells. These could turn out to be the biggest gas wells offshore in decades; in a short time we'll know."

Still another potential small-cap winner is Superior Energy Services (SPN/NYSE), with headquarters in New Orleans. Superior is not only involved in trying to cap Deepwater Horizon through its 'wild well' subsidiary, Ricchiuti points out, but could benefit tremendously from an increase in the abandonment of retired offshore wells.

When an offshore well stops producing, federal regulations require a P&A -- plug and abandon. Says Ricchiuti: "P&A's are very expensive, and companies look for any way they can to avoid them -- for example, by keeping a well going even when it's dribbling out not much more than a barrel a week. Now that everybody is spooked by offshore wells, the government may crack down, and, with 3,500 offshore old-production platforms in the Gulf, the pace for capping may pick up dramatically. That could be a boon for Superior, because there are only a few outfits in this business, and it is the biggest."

One Burkenroad company unlikely to benefit from the deep-water moratorium is Hornbeck Offshore Services Inc. (HOS/NYSE) of Covington, La. According to Ricchiuti, larger offshore supplier companies, like Tidewater, have vessels of all sizes, but Hornbeck, which has joined another company in suing to overturn the six-month drilling ban, has developed a fleet that is exclusively for deep water. "It's incredibly valuable," he says, "the best deep-water fleet in the world -- but the question is, what is going to happen to it now that all drilling in deep water has been stopped. Hornbeck may have to move it outside the country -- to Brazil, perhaps, or Nigeria -- which may not turn out to be so bad for Hornbeck but would be terrible for their local crews."

Of course, the same would be true, he adds, for the local crews of other deep-water vessels and all the people who work for outfits that service and supply them. Says Ricchiuti: "The companies that own the fleets may be fine in the long run, but the local people are less likely to be. That's the big worry down here now." Offshore oil jobs, he observes, are some of the best-paying in the area.

Named after a family that provided an endowment gift, Burkenroad Reports started out modestly enough in 1993, when Ricchiuti, then director of Freeman/Tulane's career management center, created a new program to give students an edge in the job market. A Boston native and former Wall Streeter who gave it up to become assistant treasurer and chief investment officer of the State of Louisiana before being recruited to Freeman/Tulane, Ricchiuti won a state grant to buy Bloomberg terminals that students could use to prepare investment reports about Louisiana-based public companies. He reasoned that, by publishing the reports and distributing them to investment professionals around the country, the program would give students unique real-world experiences as equity analysts while highlighting traditionally under-followed Louisiana companies -- "stocks under rocks," as he called them. Over the years more than 400 graduates of the course have gone on to careers on Wall Street.

Meanwhile, the Burkenroad Mutual Fund (ticker symbol: HYBUX), established in 2001, is managed by a leading Mississippi bank which uses, among other sources, Tulane's student-produced research reports. The fund has more than $50 million in assets and has about doubled in price since its inception while outperforming 99 percent of the 4,348 equity mutual funds in the U.S..