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A Conversation with Matt Simmons

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While at the ASPO-USA Denver World Oil Conference, I managed to buttonhole Matt Simmons in a corner for a while. Here's what we talked about.

Matt Simmons receives his M. King Hubbert Award from ASPO-USA cofounder Steve Andrews.

SS: Tell me a little bit about where you grew up.

MS: I grew up in Davis County, Utah which is half way between Salt Lake City and Ogden. My dad had a legendary career coming from a really poor background to become one of the most successful commercial bankers in the Rockies.

SS: What was his name?

MS: Roy Simmons. He's almost 90. When I was in college I was sure I was going to end up a commercial banker.

SS: Where'd you go to college?

MS: University of Utah, where everyone in our family went. One day I had a fraternity brother who came in and said, "I'm so excited today", and I said, "Why?" He said, "I just got into Harvard Business School," and I said, "What's that?" I didn't have any idea. I wasn't thinking about grad school but luckily got into Harvard Business School.

Almost all my classmates were older than me; they were just shutting the door on people who were coming in right out of college. I couldn't believe that all these older friends didn't know what they were going to do! I still thought I was going to be a commercial banker in Utah. But then I had this professor; I reluctantly signed up for a really tough 2nd-year course because my finance professor told me it was the best finance course in the school, even though it was called "Advanced Production Problems", and I hated production.

I loved it, and then, before grades came out, the Professor (who the book is dedicated to, C. Wickham Skinner) his secretary came and said "Professor Skinner wants to see you." So I went over, very timidly, to see Professor Skinner and he asked if I would be interested in staying on and working with him as a research assistant -- a case writer. I said, "Do what?" I didn't know the job existed. He suggested before I do that I really ought to enroll in the doctoral program because I could do both at the same time - and I said, "What?!"

After a year of working for him, he took me to lunch and he told me he'd traded me, because he said it would be fabulous if I stayed on and got my doctoral degree and taught. But I needed a mentor in finance so he'd traded me to Pearson Hunt, who was the senior finance professor. My heart sunk because one professor was really dynamic and the other wasn't. So I wanted to stay but it wasn't on the cards.

SS: He didn't ask you, he just told you?

MS: Well, I mean, first of all he said, "If you'd like to", but he'd already arranged it, and he was doing it for me. So, the first year I wrote fourteen cases, the second year I wrote 3 cases - I just had a ton of extra time, so ended up being in the deal business, while I was with Pearson Hunt. It was the late `60s stock market era, and I thought I was the smartest stock market guy in the world, so I started managing some money for some professors. One of the few cases I did for Pearson Hunt, it was on American Cement of all things. It came from combining with a trip to see my parents who were going to Palm Springs for a banking Mergers and Acquisitions seminar. Dad said, "There's an interesting young guy in our class, that keeps asking all the best questions, he's a deep sea diver." So I hung around the coffee break the next day and introduced myself. He was Laddie Handelman, he was the founder of a company called California Divers.

So I said, "Are you a treasure diver?", and he almost hit me, because he hated them. "No," he said, "we actually dive to assist developing offshore oil and gas." He said they were probably going to sell the company to one of the offshore drilling contractors... I said to myself, growing fast, interesting, "Why don't you raise some venture capital?" and he said, "What's that?" That was my introduction to the energy business.

Laddie was the founder of two New York Stock Exchange subsea services companies. Oceaneering (which he changed the name to). Then once the company got up to $85-100 million a year business, I was one of the directors, thought he was doing a bad job so I helped kick him out of the company. I knew that he would kill me if the company didn't make it. So I thought I'd lost a really close friend and also, a major client of our firm.

SS: So you had a firm by this point?

MS: Yeah, I had a firm by this point. Anyway, then he founded a new company, took the old name back, Caldive, and now on the New York Stock Exchange there's Oceaneering and there's Caldive.

When my two years were up at Harvard, that was sort of a fish-or-cut-bait time. I needed then to either get serious and start my dissertation or move on to something else. This research assistant thing wasn't a perpetual job. I wasn't interested in finishing my doctorate degree and in the meantime I couldn't do anything else because I was so busy doing all these deals. I raised money for this diving company...

SS: Because doing deals is fun. People who like it -- it's a drug almost.

MS: Oh yeah, I was having a lot of fun. I was raising this money for Oceaneering - $250,000 for 40% of the company. What they were doing at the time, which I didn't actually put into perspective for 25 years, was perfecting the mixed gas diving tables so that man could safely go beyond 200 ft. Had that not happened, we wouldn't have had a deep water industry. So I was actually working with the Thomas Edison of deep water. All the robotic stuff started around the same period of time.

I took a tiny office in downtown Boston, sort of middle of June. June 30th, the Dow Jones peaked at 1000 and luckily no-one told me that it would be 1982 before the Dow went back to 1000. By the next year the over-the-counter market had collapsed and all these stocks that I'd done so well in had gone down by 99%. My nest egg didn't look quite like that, so I was lucky I was putting some deals together. I got more and more involved in working with these companies, and I got fascinated with companies that weren't oil companies but oil service companies. No one in Houston seemed to understand this was a real business. When the Arab embargo of 1973 happened, within two weeks I realized it was a big deal; we've had 30 years of cheap oil and now we're going to have high oil prices, and that will open the door to a lot of projects.

SS: Did you have any recognition of the U.S. peak in production?

MS: Oh, hell no, I didn't know anything about the oil and gas business. But I thought no-one knows anything about the oil service industry, I might know more about the oil service industry, because no-one else knows about it. That's my point.

Every time I'd get back to Boston I'd have to do things in other industries, paper industry, some medical electronics and some land development; this stuff was boring as can be. But the North Sea was opening up and I thought I could set up a firm. A merchant bank in London had been wanting me to work for them and I thought I could get them to become a shareholder, get a couple of guys to join me. My younger brother would be perfect because he'd just graduated from Harvard. So I did my Dad two bad turns. I stayed away from the job, and I kept my brother away from the job. May 1, 1974, we opened our doors to be a dedicated investment bank to the oil service industry. Because we weren't trying to be energy experts, or oil and gas experts, but trying to be oil services experts, we subscribed to all of the best analysis of what was going on in the oil and gas industry. So we saw all these projections about how oil was going to go to $100 or more, and then the industry collapsed.

I thought we were going out of business. It took me about a year to understand all of the people we were subscribing to were idiots. I started looking into the primary data, supply and demand. I thought, God, it was so obvious that we were going to roll over. That's when I became a student of energy statistics. I was never again going to leave my career in the hands of the experts to say what the big picture is, and then we'll take that big picture and adapt it to oil services. I spoke all over in the 1980s about how the depression in the oil industry might go on for decades. If you didn't basically get the costs less than the revenues, then you were going to go out of business. So we did a massive amount of consolidation, jamming companies together, bankruptcy work and so forth.

By the end of the `80s I had convinced myself that the era was coming to an end. The capacity excess was very small. All these awful things were over. You know the Viet Nam general who said in order to save the village we had to destroy it? To save the oil services, we had to destroy it. Some of the projects we worked on, the Nirvana event was when we did a final analysis that said if these three companies come together they can fire 4,000 people and 1,000 people will have sustainable jobs. I learned how to go to industry forums and tell people they all had AIDS. Very unpleasant news that nobody wanted to hear, but people started applauding because I was speaking reality. When people know the truth, even if it's brutal, it's better than being in denial and then going out of business.

When I turned on a dime, and I started talking about growing again, people thought I had lost my marbles. By then I was really intently starting to look at, with low rig count, we're going to have collapsed production, the United States is going to end up in a decade, decade and a half, with half the production we have today without drilling for it. I wasn't involved with things like Hubbert's Peak, I just thought if you don't drill wells, you don't grow production. The excess was drained away. The only place you couldn't measure the excess was the Middle East. Even if they have excess capacity, they don't have the logistics to get there. I started talking about the fact that the gas bubble had disappeared, the oil bubble had disappeared, the rig bubble had disappeared, and unless we started expanding we were going to get into problems, because the low price were stimulating demand much faster than anyone thought - when everyone thought demand wasn't growing, it was actually growing. The big collapse only lasted four years.

Ten years ago I started doing analysis on depletion. All these oil field technologies that we helped save were being hyped as doing things they were not doing, but what they were doing was creating decline rates that we'd never been able to do before. Because you couldn't pull hydrocarbons out as fast before. In the last five years I have become one of the most famous speakers on depletion. It was in almost every talk I gave.

SS: Would you agree that these technologies do increase recovery rate?

MS: No.

SS: Not at all?

MS: Well, once in a great while.

SS: My understanding is that industry recovery rates have gone up from where they were twenty, thirty, years ago...

MS: There are always two or three exceptions: the Troll field in the North Sea, where they discovered, before they started producing, that underneath was a three foot layer of additional oil-bearing sands, they could get them both at the same time. That was one of the few cases. Sure, they could recover another billion and a half barrels of oil, but it doesn't have anything to do with running into decline, it's just managing the tail.

SS: But it has increased the recovery rate somewhat?

MS: No, not much. By 1997, 1998 I was basically having concern that we were heading for a bad landing and then came the oil price collapse, again.

SS: With the Asian flu?

MS: With that, and OPEC's overproduction, we had the biggest oil glut we've ever had - 3.5 million barrels a day. The only problem is that we couldn't find it. I had been a very harsh critic of the IEA's data for the previous 4 years because it was always wrong data, always -- by the time you got good data with the revisions it had all changed. When they started talking about the missing barrels, if you couldn't find the missing barrels then we didn't have a glut. But if the barrels were missing, you could still have a glut. For a year and a half, with the biggest oil collapse in fifty years, there were missing barrels, missing barrels, missing barrels, and at the apex they were looking for 700 million barrels of oil they couldn't find. And I was thinking, this is just awful, we're going to destroy the oil industry with bad data. We can't be missing barrels, we either have demand higher than we think or supply is lower. If you have a glut it will manifest itself in inventory. What we're looking for now is about ten times more than the excess tankers and tank farms in the world, so it would have to be stored on the moon. Or it's actually stored in the reservoirs; it was never produced.

The bottom of the oil collapse, February of 1999, the industry had believed the price collapse was permanent. The Economist had this unbelievable cover story that they admitted was the biggest blooper in their history: "Drowning in Oil." There was a thesis that oil prices wouldn't stay at ten, they would go to five. They would stay there from half a decade to a decade because Saudi Arabia was about to flood the world with cheap oil. They had this hundred-billion dollar war chest and I thought, "That's the dumbest thing I've ever heard." Problem is, everyone believes this. I talked to CEO's of all the major oil companies, talked to Dan Yergin, and I said this is stupid - Saudi Arabia is insolvent, there's not going to be any hundred billion dollars. What was funny was the cover story came out on Tuesday and on Friday the petroleum ministers of Venezuela, Mexico, and Saudi Arabia announced that they'd agreed that collectively they were going to take two million barrels a day off the market to get this scourge off their backs and oil prices then went from $10 to $37 18 months later. They cut into a balanced market.

So by this time I'm really intensely going after the data issues. Then I was asked by the Petroleum Council if I would be one of the taskforce chairmen of this big study being done on natural gas. In that study, I realized that - I was the Demand Taskforce chair - that I didn't know anything about electricity. I thought that power generation was power, turbines or something, pistons. No, it was just electricity. I did a quick study for about three months and ended up learning more about electricity than almost anyone else. It's only when you can finally connect all the energy dots that you start understanding the whole thing. You go back and forth between the electricity markets, the natural gas markets, the oil markets, that you start understanding the whole thing - anchored with a very good knowledge of the mechanics through the oil service industry.

I became more and more outspoken about how this isn't going to end well. I did this world giant oil field study, what the top ten, twenty, oil fields are, no one seemed to know. And that was an eye-opener, that in the Middle East there were only a handful of fields that produced really well, and they were all really old. These people that say the Middle East can produce everything - why did they never produce any more? Because all these fields are old. Look at the Iranian fields. There are four or five fields that used to be a million barrels a day and are now way less.

Somewhere around there I got roped in with this peak oil group of people. I never tried to understand reserves. If you would basically go a decade adding 125% more than you produce then you'd be doubling your production. Maybe they are doubling their reserves, but the decline curve is so steep that it doesn't matter. I finally realized that no they aren't real reserves.

And I'm also working very hard, in 1990 the firm had made it through the worst industrial collapse in the only area were were in; we didn't have any diversification. I thought that was the only risk we'd face, if we can do that, we can survive forever. And by then we're the absolute oil-service specialists in the world, we're known around the world for that. So then I've got to develop a second generation management so the firm actually survives me. Doing that allowed me more time to do analysis, which I have always loved doing. I'm basically an educator at heart, or a teacher at heart, or an analyst at heart. I'd rather do that than work on deals. And for thirty-odd years, I was a really good deal person.

I finally get into this odd thing asked by this friend in Austin to be on this 9-person delegation to Saudi Arabia and I'm really excited about it until the trip gets postponed about eight times, and I'm getting so busy. It's 2003 and one of the VPs calls and says they want to pin down a date in late January or early February and I say I really can't do it. Was a great idea last spring and summer, but I've lost my window. I'm going to Paris to speak and two weeks later I'm going to China. He says, what if we plan our trip and get you back that Thursday in Paris. I said, "Ok, that's fine", thinking, "This will fall apart again." The week before we're supposed to go, my assistant keeps asking shouldn't we call? And I said, "No, let sleeping dogs lie." And seven days before we're supposed to leave she gets this call from Dallas saying they Federal Expressed seven passports, can we walk them all over to the Saudi Consulate? We're going next Thursday and our visas are approved.

SS: So you almost didn't go?

MS: My wife that weekend was so mad at me, that I had basically agreed to do this trip. She said, "We're about to go to war, you have five daughters." I was mad at myself because I was about to waste a week. So I said, "Who are we going to see?" Well, we don't know that, we're going to be told that when we arrive there. Why did I do this?

So we arrive there and Herbert Hunt says we all meet up in Paris and we take the Air France flight to Riyadh and I'm thinking we're going to hang around some government guest house, maybe have three appointments, and I'm so busy. We arrive and I'm told get ready for about two hours of getting through customs. But they said, "Would Mr. Hunt and his delegation please come to the front of the plane?" and we get to the front of the plane and there are two guys in robes and who say, "Gentlemen, welcome to Saudi Arabia, let's just go through the side door here." We have a VIP trip, it was just unbelievably interesting, six days. I'm taking copious notes and every time we get close to anything to do with oil I keep asking innocent questions. We finally tour the Abqaiq processing plant. I'd never seen a GOSP [Gas Oil Separating Plant] before. I ask, basically, what's going on. They say, when the oil comes in there will be all this water. and we have to strip the water out then take the water and recycle it. "Why is there water in it, is there a river?" No, that's our primary drive. I'm looking at these water pipes and thinking, that's an awful lot of water. I'm taking notes and thinking, if there's this much water...I know what water does. We've done all these projects in water handling. The next day we're having all these presentations and sitting there thinking something isn't right. On the plane going back to Paris, and Herbert Hunt is this really good oil guy, I say Herbert, look at all these dots. Could these fields be on the brink of finally running into decline? What would the world do? So I go home and said I'm going to wrestle this to the ground because now I know what to look for. I discovered this unbelievable treasure trove of technical papers at the Society for Petroleum Engineers, and by the time I got thirty-nine of them that I randomly downloaded, I realized this is a far more serious problem, and I'm going to write a really serious white paper this summer. I decided to go back and systematically go through more papers. By the end of the summer I had gone through about 150 papers and stacked them by their individual field and read them chronologically, and thought, I'm going to write a book and self publish, get this thing out to the public because this is a myth.

But it wasn't just the two-and-a-half years, it was actually thirty years and a great deal of intellectual curiosity and becoming a real skeptic of all these energy myths. Even in the early `70s when we'd go into these companies, our modus operandi was put a memorandum together so that you know more about the company than the owner of the company does. Because if you go into it half-baked, that's how deals fall apart.

SS: Because surprises come up in the middle?

MS: Yeah, so you'd say "You have ten drilling rigs, how many wells do you drill each?" And they'd say, "Oh, about 10", and I'd say, "No you don't, you drill about five, and here's the data." Amazing how many people just fake stuff. At any rate, that's the whole background.

SS: You have read the CERA report...

MS: Yeah, yeah, sure.

SS: What's your critique of it? Obviously you disagree radically.

MS: Well, if it is a detailed bottoms up field-by-field they only name about 30 fields, ten a year...

SS: This is true in the full report as well?

MS: Yeah, I read the full report - it's 51 pages

SS: They don't have an appendix with all the fields?

MS: No, not in the one they give to their private clients, that people pay for. They list 10 fields coming on in 2005, 10 coming on 2006, 10 in 2007...

SS: There's about 2 million barrels a day in each year...

MS: 2 million barrels a day, and they have names. The thing that's wrong with them is that they assume that they all happen. And they assume they all happen that year. And they assume that none of them decline. Their biggest one for 2005 unfortunately won't happen until next year. Thunderhorse. It's not their fault. [...] But the thing is, a lot of the fields don't have names.

SS: Let me get this clear, are you saying you don't think there's 16 million barrels a day of new capacity, or are you saying there may well be 16 million barrels a day, but you don't think they're taking into account the decline?

MS: I don't think they can possibly do 16 million barrels a day with this list of projects without naming them. I think they're notional projects.

SS: Chris Skrebowski is claiming 16 in new projects.

MS: I don't think so; he's got quite a different list. He really takes issue with the list.

SS: The totals are similar, for new capacity.

MS: We won't bring on that new capacity, we're out of drilling rigs. It's too bad people didn't realize we're running out of rigs and we won't resolve the rig problem until well after 2010. But to call it a field-by-field bottoms up and then just have a notional idea... if a field does not have a name today, it won't be done by the end of 2009. We just would not have time. The whole thing is typical of the analysis they did when they assured all of their clients that we had abundant robust natural gas, all these pessimists about natural gas are just flat wrong. And they did a bottom-up study then too. And they did the bottoms up story then, too. And they turned out, unfortunately, to be as wrong as me promising that there is a Santa Claus, and you finding that there wasn't.

And with that, Matt had to rush off to be on TV again.

My thanks to Tamsen Merrill for transcribing the tape.