Quarterly analyst themes of oil and gas earnings

Q3 2021

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Overview

The third quarter of 2021 was a good one to be in the oil and gas business. Crude oil, natural gas and LNG prices were at or above where they were before the COVID-19 pandemic and, in the case of LNG, way above. OPEC+ supply discipline continued in the face of demands from government leaders to increase production and give consumers price relief. And as we come to the end of the year, there's a heightened sense of confidence that market strength is sustainable and oil and gas can be profitable in the near and medium term. When earnings came in, returns on capital employed were at levels we haven't seen since the height of the shale boom. One oil company CEO declared his company was a "cash machine."

Brent averaged US$74 in 3Q21, up 7% from the previous year and 71% higher than a year ago, reflecting favorable supply-demand balance and inventories below pre-pandemic levels. Gas prices increased sharply through the quarter. Henry Hub averaged US$4.30/MMBtu, up from US$2.90/MMBtu in the previous quarter as global and domestic demand-side pressures coincided with Hurricane Ida and the resulting production cuts. US producers still seem unwilling or unable make big capital commitments to upstream gas, and US gas producers continued to prioritize capital discipline, limiting gas production growth. International prices rose by 85% compared with the previous quarter, reflecting tight LNG markets driven by growth in Asian demand, wind energy shortfalls in Europe and supply interruptions. Downstream, refining margins benefited from stronger demand and Hurricane Ida-related disruptions.

Improved market conditions, earnings and cash flows changed the tone of the usual flurry of financial questions — 62% of the total in this round of calls. As usual, interest in companies' plans to prioritize between dividends, buybacks, de-leveraging their balance sheet, investing in the legacy business or new energy alternatives was central. Shareholder distributions attracted the most attention from the analyst community (as they did last quarter) accounting for 13% of total. Analysts recognized that companies with a flexible dividend strategy were already providing high yields and delved deeper to find out if companies intend to increase the dividend or shift to buybacks and defer dividend increases. In contrast, companies that kept their dividends flat were questioned on the attractiveness of their dividend and whether they intend to prioritize growing their earnings per share (EPS) as they start their share buyback program.

Cash flows that aren't returned to shareholders or used to reduce debt are put back into the business, and as is customary for this time of year, capital spending plans were in focus. Given market conditions and uncertainties about the long-term future of oil and gas, short-cycle spend was an obvious source of curiosity. The amount of capital allocated to and returns from petroleum alternatives remains an important topic. Inflation continues to be the dominant macroeconomic theme, and analysts probed to understand what cost pressures companies were seeing and, more importantly, their ability to offset them. Expect this theme to continue.

Gas prices impact refining costs for heavy oil, and analysts were keen to get a view of how gas market conditions affected downstream margins. More generally, analysts continued to ask companies for their perspective on current demand recovery and the path forward and its potential impact on margin recovery in 2022. In the LNG business, analysts had several questions on factors that led to high earnings — how much was market driven vs. factors internal to the company such as contract renegotiation, etc. — and the ability to sustain earnings in upcoming quarters.

We live in an era where oil and gas majors' strategic decisions could have existential implications, and the number of questions analysts ask about various strategic options gives us valuable clues about where they think the industry is headed and where it should go. Analysts asked 18 questions about alternative energy businesses, 7 questions about the LNG market, 4 questions about onshore US activities and not a single question about deepwater offshore fields. Analysts raised a point on linkage between the outcome of COP26 and companies' energy transition strategies. Analysts wanted to understand whether companies that have already announced emission reduction commitments would be competitively disadvantaged against those that haven't made any commitments if COP26 fails to reach a meaningful agreement. Some companies were even questioned on how much they were themselves driving their new energy business vs. their dependence on their partners and suitable technologies to drive growth of their new energy business. As long as there is focus on decarbonization, we should expect these types of questions to continue.

Operational matters, as usual, took a back seat. Major project updates, production outlooks and the performance of US onshore projects accounted for over half of analyst questions. Analysts had significant interest in the Permian Basin and whether companies had any plans to accelerate activity levels in the Permian and other short-cycle plays. Analysts also indicated concern around companies' shrinking upstream business and its likely impact on companies' production outlook.

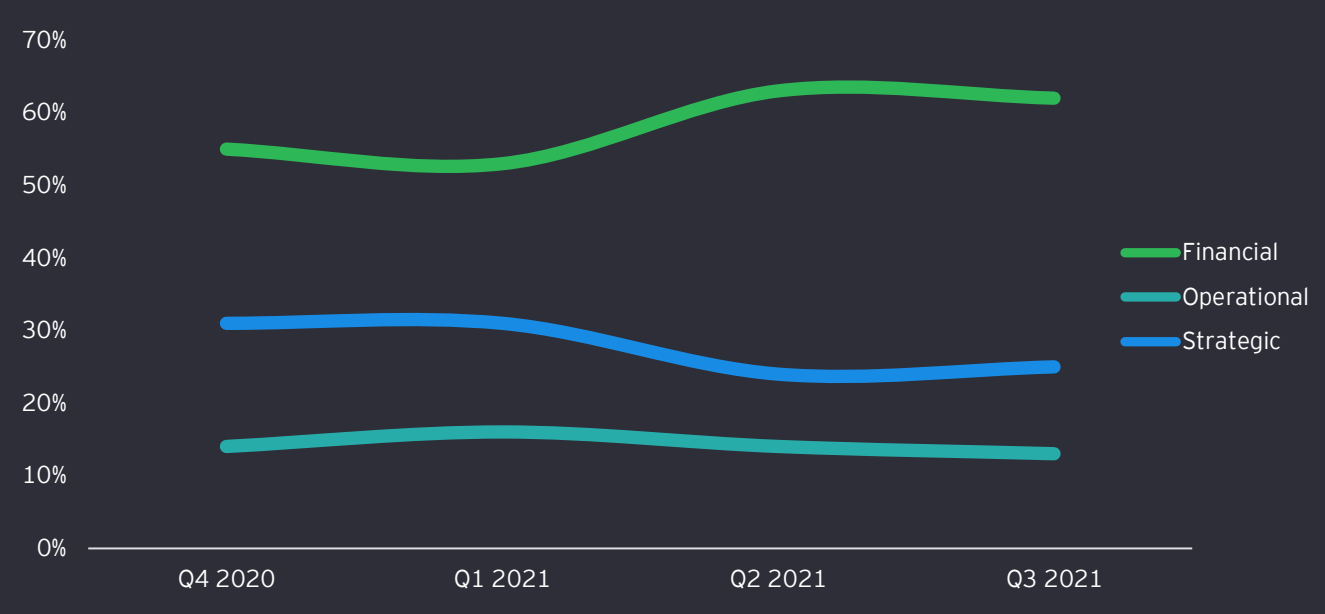
Top three themes | Q3 2021

1 Shareholder distribution

2 Cash flow

3 Investment in alternative energy

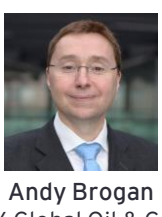
Percentage of analyst questions pertaining to financial, operational and strategic themes



Financial questions continued to attract the most attention of the analyst community, with a major focus on companies' dividend and buyback strategy and prioritization of cash flows. With growing shareholder activism, questions on decarbonization strategy and investment in alternative energy continued to remain important.

Looking forward

Looking at the remainder of this year, oil prices should continue to be supported by lean inventories. Europe went into the heating season with gas inventories below levels of recent years, and LNG markets are likely to remain tight. All of this means that companies will have good choices to make when it comes to how to use cash. Decarbonization strategy, alternative energy projects and the use of capital to support the legacy business will continue to remain focus areas for equity analysts.



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Scope, limitations and methodology

The purpose of this review is to examine the key themes arising from the questions asked by analysts during the Q3 2021 earnings reporting season among 10 global oil and gas companies. The identification of the top three themes is based solely on an examination of the transcripts of the earnings conference calls. For this analysis, the following companies were included:

- BP plc
- Chevron Corporation
- ConocoPhillips
- Eni SpA
- Equinor ASA
- Exxon Mobil Corporation
- Repsol SA
- Royal Dutch Shell plc
- Suncor Energy Inc
- TotalEnergies SE

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