Quarterly analyst themes of oil and gas earnings

Q2 2021
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Overview

The recovery of oil and gas commodity markets and improved company performance continued in the second quarter of 2021 with oil demand and OPEC+ discipline resulting in a steady reduction in inventories and an increase in crude oil prices.

Brent crude averaged US$69/bbl in the second quarter, up 13% from the previous quarter and twice the average a year ago. Henry Hub averaged US$2.95/mmBtu, down from US$3.50/mmBtu in the first quarter as prices normalized after the extreme cold, but were up 50% from the beginning to the end of the quarter, a trend that has continued into Q3. International gas markets strengthened with northern Asia LNG prices averaging nearly US$10/mmbtu in 2Q21, driven by strong growth in Chinese power demand, European inventory rebuild and reduced hydroelectric output in Brazil. In the downstream segment, international travel and the demand for aviation fuel continue to be depressed with no end in sight as COVID-19 variants continue to vex public health authorities. Rebound in global GDP, particularly demand for plastic from the automotive industry, boosted petrochemical segment earnings.

Earnings reports for the second quarter of 2021 brought mostly good news. The majors reported a combined net income of US$18.8 billion in Q2, 9% lower than the previous quarter, but a complete turnaround from net losses of US$58 billion in the same quarter of 2020. Companies reported the highest combined cash flows in the last 10 quarters at US$52.1 billion – 27% higher than the previous quarter and more than four times the level of a year ago. A vigorous debate about how to use revived cash flows is sure to ensue as companies face the choice between returning cash to shareholders, investing in the core hydrocarbon business and growing emerging alternative energy ventures.

More than ever, financial questions, which accounted for 65% of the total, dominated earnings calls. Analysts frequently queried management on the trade-off between additional capital returns and new investment in core and emerging businesses. This is a stark contrast to the previous quarters when companies were cutting capital investment and dividends and suspending share buyback programs. Several analysts questioned companies' plans to split the capital return between dividends and buybacks. Some pointed out that the market recognizes more value through dividends than through buybacks and inquired if companies were willing to align their shareholder return strategy with that observation. Recognizing that most companies were able to reduce their net debt levels significantly over the past two quarters, analysts wanted to get a view of how low debt levels might go before companies begin to see themselves as underleveraged and begin to return even more cash to shareholders. As companies grapple with low unlevered returns on renewable energy investments relative to oil and gas projects, the matter of gearing is likely to re-emerge.

On capital spending, analysts were interested in companies' response to the improving macro-environment, specifically whether the companies were considering mobilizing additional upstream investment with commodity prices returning to pre-COVID-19 levels. Supply chain interruptions, labor market shortages and inflation concerns have begun to take center stage in economic news, and oil and gas industry analysts checked for signs of pricing pressure in the market for materials and services upstream and indications of how companies plan to offset the impact. In the wake of consecutive quarters of disappointing downstream results, analysts were looking for confidence in an improving refined product demand outlook and recovery in refining margins. In the companies' emerging renewables businesses, analysts shared a desire for more insight into financial results, capital investment and financial structure. Clearly, skepticism remains regarding the ability of oil and gas companies to compete in a field where they have never played.

From a strategic standpoint, decarbonization and the pipeline of renewable projects across different geographies and technologies were in focus. Analysts recognized that different policy frameworks across geographies could act as a deterrent to growing the renewables business and probed companies to understand how they plan to overcome those challenges. The companies were also questioned on how they intend to balance economic returns of new oil and gas projects with their carbon emission profile. Analysts were also keen to understand how IOCs and NOCs were responding to programs (like EU fit for 55 program and Shareek in Saudi Arabia) to encourage diversification. On portfolio optimization, analysts checked to see if companies were interested in pursuing mergers and acquisitions or reconsidering their upstream asset divestment plans. Apparently, renewed strength in oil and gas prices has triggered re-examination of petroleum's place in these companies' portfolios.

Operational questions were guided by analyst curiosity around companies' production outlook in medium to long run, and the contrast between IOC and NOC upstream capital commitments was apparent. In other matters, analysts showed a typical interest in the pipeline of projects, and several companies were asked on their level of activity in the Gulf of Mexico and their long-term plans for the US shale plays.

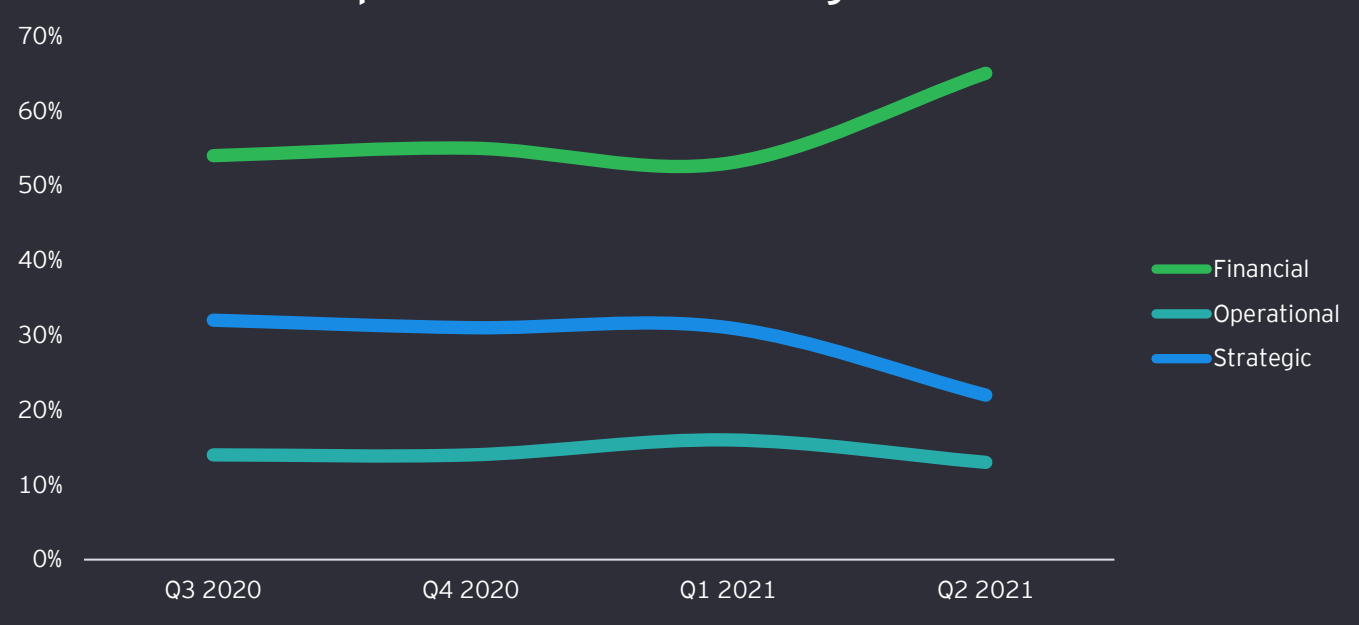
Top 3 themes | Q2 2021

1 Shareholder distribution

2 Decarbonization

3 Investment in alternative energy

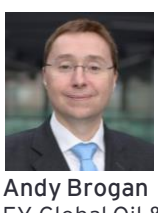
Percentage of analyst questions pertaining to financial, operational and strategic themes



Financial questions continued to attract the most attention of the analyst community with major focus on how companies intend to split their shareholder returns between dividends and buybacks. With increasing pressure on companies to reduce emissions, questions on decarbonization strategy and investment in alternative energy continued to remain important.

Looking forward:

Demand recovery remains a question mark, but OPEC+ discipline continues to hold. Oil prices are expected to remain firm, and excess supply in global gas markets is a low risk. Refining margins will face offsetting pressures as an improved demand outlook is offset by growth in refining capacity. Cash distribution, decarbonization strategy, the performance of renewable projects and the lifespan of the core business will continue to remain focus areas for investors.



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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 Q2 2021 earnings reporting season among 11 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
- Saudi Aramco
- Suncor Energy Inc.
- TotalEnergies SE

How EY's Global Oil & Gas team can help you
As changing demand and pricing volatility transforms the oil and gas industry, companies must reshape to thrive in this new energy world. But how do you balance the immediate cost and regulatory pressures of "now" with investment in what comes "next?" EY's Global Oil & Gas team brings together the breadth of experience and talent needed to approach the entire transformation process. By considering four key pillars of change – structure and culture, customers, technology, and skills and capabilities – we can help you adapt for today and reap the opportunities of tomorrow. And together we can build a better working world.

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