Quarterly analyst themes of oil and gas earnings

Q4 2020

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Overview

2020 may have been the most challenging year the world has faced since the beginning of the oil age. The pandemic, the resulting restrictions on mobility and the impact on economies (and oil demand) dominated for almost the entire year. In the fourth quarter, the reset process continued. Demand grew, albeit at a slower rate than producers would have liked, and production cuts continued to keep the market in rough balance. Crude oil prices rose continuously throughout the quarter, with WTI futures trading 20% higher at the end of the quarter than at the beginning. Gas prices were mixed, with Henry Hub futures flat on warmer-than-normal weather in the US, but Asian LNG prices soared due to cold weather there and a shortage of shipping capacity.

Oil majors reported a combined net loss of US$25 billion in Q4 – three times the loss reported in Q3 but less than half the loss reported in Q2. Oil majors' cash flow from operations during Q4 stood at US$20.6 billion – 36% lower than the previous quarter but 81% higher than Q2. The equity markets looked forward though, and share prices followed the commodity markets. IOC stocks finished the quarter 20% higher than they began it. Independents rose by more than 30%, and service companies by 60%.

During the end of year earnings calls, as is almost always the case, financial matters dominated the conversation with analysts. Cash flow, capital spending guidance and shareholder distributions garnered the most attention. Knowing oil prices were higher, analysts were looking for specific guidance as to how much cash flow would be expected to improve and whether cash would be directed toward shareholders, the core businesses or expanding alternative energy businesses. Flexibility was a common theme, with analysts wanting to know if and how capital spending plans might be geared up in the second half of the year if oil prices were to stabilize at current levels or improve.

Analysts highlighted shareholder distribution by reminding companies that the market tends to reward companies that provide stable dividends, even when oil prices are low. Analysts asked direct questions on the level at which crude oil prices need to stabilize before companies can start to raise shareholder payouts. They further asked if capital return will take the form of share buybacks or dividends.

The emerging interest in the balance between core and alternative businesses was notable. Companies were asked more than once whether incremental capital spending would be allocated to the upstream business to capitalize on the potential uplift in oil prices or the renewables business. While analysts acknowledged companies' aspirations, they tried hard to evaluate the companies' competitiveness through both the financial and strategic lens. Analysts questioned the feasibility of renewable business plans laid down by the companies by asking about core capabilities and comparing returns on their upstream assets with potential returns expected from their renewable projects.

Analysts posed several questions to companies on their current and targeted gearing levels. The trade-off between keeping debt levels low and preserving credit ratings vs. growing non-oil businesses that operate with lower returns and therefore need higher leverage was evident. Recent announcements from credit rating agencies on potential downgrades were clearly on analysts' minds.

On the strategic front, oil majors' commitment to low-carbon businesses was a key focus area. Several questions about how far into the future companies expect the renewable business to become material were raised. US companies, lagging in their ambitions relative to peers, were asked how the intense external pressure (from peers, shareholders, credit agencies, etc.) to reduce carbon footprint was influencing board discussions and if they had any long-term plans to operate as diversified energy companies, such as their European peers.

Companies continued to high-grade their portfolios by divesting less-strategic assets and focusing investment on projects with higher margins. Questions were sure to ensue. Shifting capital priorities and the optimum size of their upstream businesses in the long term was a focal point. On policy and regulation, analysts were keen to understand how the change in the US Administration and proposed changes in federal regulation may impact companies' strategies for their US Gulf of Mexico assets and the level of risk this could pose.

From an operational standpoint, analysts asked several pointed questions on production guidance. The underlying message from analysts to companies was to maintain the ability to quickly reactivate capital projects and ramp up output when or if oil demand picks up and (potentially) prices spike. As always, analysts wanted visibility into the progress of companies' major capital projects. With capital scarce and oil and gas projects competing with growing alternative energy projects, analysts were keen to understand capital efficiency, returns, commercial prospects and the link between capital deployment and production guidance.

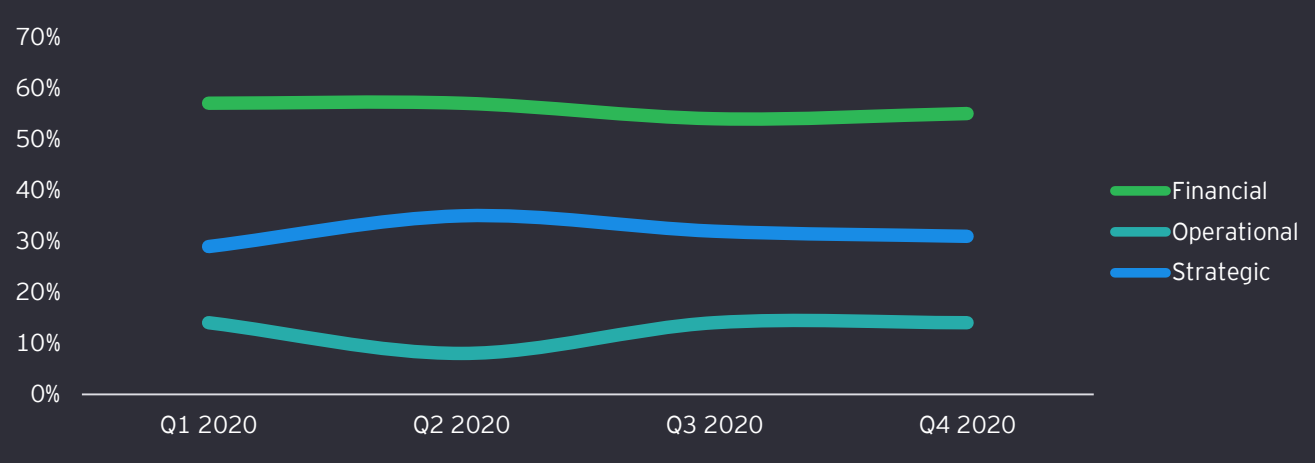
Top 3 themes | Q4 2020

1 Investment in alternative energy

2 Portfolio optimization

3 Capital spending

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



Financial matters continue to dominate earnings calls with a focus on flexibility to increase capital spending and the shift in the capital spending mix from upstream to low-carbon business. Portfolio high-grading and oil majors' commitment to low-carbon business remained strategic areas of interest for the analyst community.

Looking forward:

The COVID-19 pandemic will continue to hang over the market until vaccine accessibility is widespread and oil demand returns to normal. When that happens, analysts will continue to be focused on the long-term value of oil and gas investments and the trade between investing in businesses with reliable cash flows but an uncertain future. Look for increasing pressure on companies to lower their carbon footprint while maintaining current results. Analysts will constantly look for evidence of companies' ability to execute on renewable energy growth and return targets.

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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 Q4 2020 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
- Exxon Mobil Corporation
- Woodside Petroleum Ltd
- Repsol SA
- Royal Dutch Shell plc
- Equinor ASA
- Suncor Energy Inc
- TOTAL SA

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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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