

Quarterly analyst themes of oil and gas earnings

Q4 2021

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Overview

2021 saw improvements for the oil and gas business. While the COVID-19 pandemic continued unabated, economies adapted and rebounded, and, as that happened, mobility and oil demand began to approach normal levels. Oil, gas and LNG prices blew through pre-pandemic levels, and oil and gas company earnings followed. Although things look very different just a few short weeks after close and days after the final earnings call of the quarter, the fourth quarter of 2021 marked a continuation of that trend.

During the fourth quarter, Brent crude prices increased by 8% to an average US\$80/bbl, the highest level in seven years. According to OPEC, global oil demand grew 2% between the third and fourth quarters as curbs on international travel and other restrictions on mobility were lifted. At the same time, relentless production discipline kept the market undersupplied and inventories falling. And recent events have moved the globe further toward undersupply. In gas markets, warmer-than-normal weather in the US combined with recovering production interrupted the rally in Henry Hub prices, and they fell by 31% during the quarter. In contrast, uncertain Russian supplies and stressed infrastructure drove prices in Europe to unprecedented levels. The continent went into the fourth quarter heating season with low inventory levels and nagging concerns about supply availability, and LNG prices increased by over 90%. Uncertainty has turned to reality and tightness in LNG markets will be with us for the foreseeable future. In refining, margins remained broadly flat compared with the previous quarter.

Earnings reports for the fourth quarter of 2021 brought uniformly good news. Oil majors reported a combined net income of US\$41.3 billion – more than double the US\$17.3 billion reported in the previous quarter and a phenomenal turnaround from losses of US\$25.8 billion in the fourth quarter of 2020. The majors reported combined cash flows of US\$50.2 billion – 16% lower than the previous quarter but more than double year-ago levels.

As is almost always the case, questions about financial matters dominated earnings calls, accounting for nearly half of the total. The share of questions fell from 62% in the previous quarter, no doubt a result of strong financials. Healthy cash flows also explained analyst interest in shareholder distributions, and those questions accounted for 8% of the total. Analysts were focused on how payout ratios and the pace of share buyback plans might change in the event of stronger-than-expected commodity prices, earnings and cash flows. Analysts mused openly about what companies might do with even more free cash flow.

Not surprisingly, at this time of the year, analysts were curious about companies' capital spending plans for 2022 and the range of possible outcomes. Analysts tried to gauge the amount of flexibility companies had built into the top end of the range of their guidance by asking how they would respond to continued high oil

prices. Given the expectation of tight crude markets for the foreseeable future (an expectation that appears to be realized), analysts were most interested in companies' upstream capex plans, particularly for companies that had already announced spending increases. Given the uncertain long-term outlook for hydrocarbons, analysts were also keen to understand how incremental spend would be allocated between short- and long-cycle projects. Cost inflation was a key point, and the impact of labor and material cost on returns weighed heavily. On a related note, analysts probed to understand whether projected capex increases for 2022 are driven by higher activity levels or inflation. Regarding trading, volatility in international gas markets led to questions about how much impact trading businesses had on companies' bottom lines during the current quarter, whether those results were transitory and how trading businesses might perform in future quarters.

Decarbonization continued to remain the most important strategic theme. As the EU green taxonomy is implemented this year, it may begin to guide the ESG strategies of European investors, and analysts are interested in knowing how companies are likely to score. Companies' response to current geopolitical tensions have highlighted investor focus on non-economic factors. Additionally, analysts pushed for more disclosure of carbon intensity at the asset or region level to get a view of the relationship between asset returns and emissions, particularly for projects not meeting industry benchmarks.

On mergers and acquisitions, analysts checked for companies' appetites to acquire renewable energy companies versus organic growth, perhaps reflecting eagerness for companies to grow those businesses and to understand their capacity to build them from scratch. In parallel, analysts also wanted to know companies' willingness to go beyond the asset disposal plans already announced if high commodity prices are reflected in valuations. On the subject of commodity prices, analysts were, as always, keen to get companies' views.

The production outlook for 2022 emerged as the most important operational theme. Analysts were curious if higher production levels in 2022 would be driven by higher activity levels or more efficient operations. It is unclear how much flexibility companies might have in the short run, but it is likely that long-term investment and production are already being reworked in light of recent events. Reflecting a consensus that gas markets have more long-term upside, they probed to understand the mix of production growth between oil and gas. With high and volatile gas prices, questions naturally arose about companies' strategies for entering into long-term contracts or staying in the spot market. As always, analysts also checked for updates on companies' major projects and the level of maintenance activity expected in 2022.

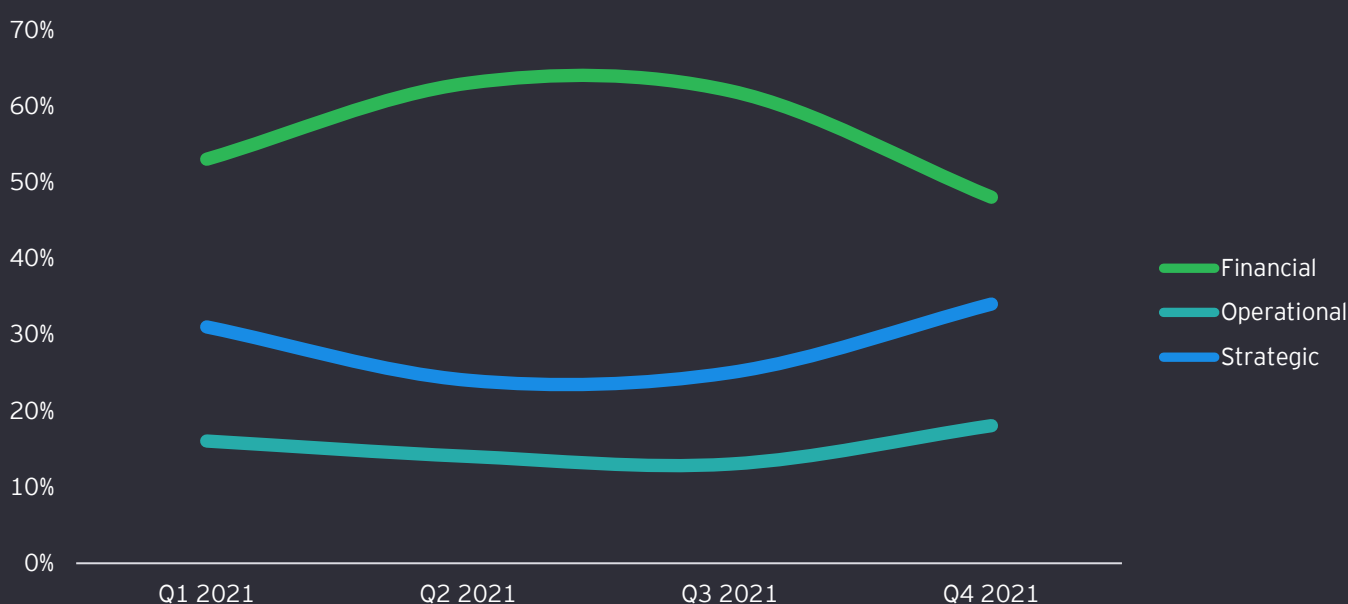
Top three themes | Q4 2021

1
Shareholder distribution

2
Production outlook

3
Decarbonization

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' distribution policies and capital spending frameworks in a strong oil and LNG price environment. Questions on decarbonization strategy and portfolio optimization continued to remain important. Analysts also evaluated companies' appetites and readiness to undertake acquisitions as they generate earnings and cash at levels that are in line with the industry's best times.

Looking forward: Oil and gas markets are facing continued volatility in the face of geopolitical risk and lean inventories. Upside risks that were present at the end of Q4 have already been realized, turmoil has accelerated and expectations have never been more in flux. In light of all of the uncertainty, allocation of cash between legacy businesses, alternatives, dividends and buybacks, return on capital and progress on decarbonization will continue to be a focal point.



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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 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

Suncor Energy Inc
TotalEnergies SE
Woodside Petroleum

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How EY's Global Oil & Gas Sector can help your business

The oil and gas sector is constantly changing. Increasingly uncertain energy policies, geopolitical complexities, cost management and climate change all present significant challenges. EY's Global Oil & Gas Sector supports a global network of more than 10,000 oil and gas professionals with extensive experience in providing assurance, tax, transaction and advisory services across the upstream, midstream, downstream and oil field subsectors. The Sector team works to anticipate market trends, execute the mobility of our global resources and articulate points of view on relevant sector issues. With our deep sector focus, we can help your organization drive down costs and compete more effectively.

As changing energy and pricing volatility transform 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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