

# Quarterly analyst themes of oil and gas earnings

Q1 2020

[ey.com/oilandgas](http://ey.com/oilandgas)

## Overview

The first quarter of 2020 was one of extraordinary events as the oil and gas industry faced a dramatic downturn in demand from the COVID-19 outbreak, the virtual shutdown in many sectors of the economy, and a collapse in local and global mobility. The average oil price in Q1 2020 was 20% lower than in Q4 2019.

During Q1 2020, oil prices were extremely volatile - the price at the end of the quarter was one-third of the price at the start. On the day before the WTI May futures contract expired, prices went significantly negative as traders realized how difficult it might be to deliver into those contracts with little or no storage capacity available.

### Industry-wide impact

Every segment of the industry was impacted, including the refining sector, which provided refuge to oil majors during previous downturns. As refining spreads fell by 27%, refineries were left idle by the operators. LNG prices, which were at unsustainable levels prior to the current crisis, declined further, and the spread between Henry Hub feedstock prices and the landed price of European and Asian LNG narrowed to essentially zero. Furthermore, deep upstream capital spending cuts pose an existential threat to oilfield services players.

Not surprisingly, company results reflected these unfavorable market dynamics. Combined net income was down 38% from Q4 2019 and down 148% from Q1 2019. Operating cash flows were also weak: 24% below Q4 2019 levels and 13% down from a year ago.

### Return on capital or capital spending?

Most analyst questions were, of course, tied to the current crisis. With deep spending cuts announced, analysts were concerned about the timing of recovery in capital spending to pre-crisis levels. They also wanted to understand if companies foresee a structural shift in long-term oil and gas demand patterns and how that might influence capital allocation.

Companies were asked several probing questions on their dividend strategy and how they would prioritize capital spending and dividend growth, with some specifically asked if it was financially prudent to cut capital spending while sustaining dividends. They were also asked about their ability to sustain dividends over the long term if oil prices continue to remain low. For some companies, analysts questioned whether there would ever be a return to growing dividends.

This quarter, there were several direct questions about the confidence companies had in the strength of their balance sheets. They were asked about their current gearing levels and flexibility to increase debt to meet their capital spending or dividend commitments. Unlike previous quarters when the subject never arose, analyst interest in companies' credit ratings and the importance of maintaining those ratings was evident.

### Assessing structural damage and long-term strategies

The most popular operational questions were about involuntary and voluntary shut-ins that companies are undertaking, and if they would cause any structural damage to assets and hinder a return to pre-crisis volumes when prices recover. Further, analysts wanted to understand how companies arrived at their production curtailment estimates and how they identified the assets where they would cut production.

Analysts were keen to get a view of the impact of upstream capital spending cuts on production capacity for 2020 and beyond, and which part of the portfolio is expected to be impacted. Analysts tried to get a granular view by asking specific questions around the progress of major capital projects and whether their ramp-up schedule would be impacted due to capital spending cuts.

At the strategic level, analysts wanted a view of the impact of the current crisis on the companies' long-term strategy and positioning vis-à-vis their peer group. Companies were asked how their portfolio is expected to evolve in the long term and the subsequent impact on their oil-to-gas ratios.

Beyond hydrocarbons, there was interest among the analyst community to understand where companies stood with respect to their energy transition ambitions, and whether they have any plans to accelerate energy transition initiatives after experiencing the current downturn in prices and spike in oil volatility. Analysts were keen to understand changes in the risk-reward profile between investments in fossil fuels and renewables, and how companies would alter their capital allocation plans between the two businesses.

Analysts are signaling their strong conviction that results for Q2 2020 will be worse than those for Q1. They had many questions related to companies' views on upcoming Q2 results based on the visibility they already have around the pace of demand recovery in Asia. Analysts wanted the companies to share their observations around the incremental impact on Q2 earnings and the key factors that could impact earnings. Skepticism regarding the timing of oil price recovery was evident.

## Top 3 themes | Q1 2020



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



Financial matters took on increased urgency for the analyst community. This quarter, however, the lens moved from the ability of companies to return capital toward their resilience and capacity to survive in market conditions that none had ever contemplated.

## Looking forward

The investor community will remain on edge, with rampant speculation regarding how quickly demand will recover and inventory will be drawn down. Production cuts are occurring, and nervousness about the status of storage seems to have abated. Attention will increasingly focus on the pace

of economic reopening, the extent to which long-term damage has been done to economic confidence and investment appetite. Consolidation is inevitable as the market determines how much capacity it can absorb and who can manage it best.



**Andy Brogan**  
EY Global Oil & Gas Leader  
+44 20 7951 7009  
abrogan@uk.ey.com



**Derek Leith**  
EY Global Oil & Gas Tax Leader  
+44 12 2465 3246  
dleith@uk.ey.com



**Gary Donald**  
EY Global Oil & Gas Assurance Leader  
+44 20 7951 7518  
gdonald@uk.ey.com



**Jeff Williams**  
EY Global Oil & Gas Advisory Leader  
+1 713 750 5916  
jeff.williams@ey.com



**John Hartung**  
EY Global Oil & Gas TAS Leader  
+1 713 751 2114  
john.hartung@parthenon.com

## Scope, limitations and methodology

The purpose of this review is to examine the key themes arising from the questions asked by analysts during the Q1 2020 earnings reporting season among 12 global oil and gas companies.

BP plc	Eni SpA	Repsol SA	Suncor Energy Inc
Chevron Corporation	Exxon Mobil Corporation	Royal Dutch Shell plc	TOTAL S.A.
ConocoPhillips	Husky Energy Inc	Equinor ASA	Woodside Petroleum Ltd

The identification of the top 3 themes is based solely on an examination of the transcripts of the earnings conference calls. For this analysis, the following companies were included:

EY | Assurance | Tax | Transactions | Advisory

### About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity, Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via [ey.com/privacy](http://ey.com/privacy). For more information about our organization, please visit [ey.com](http://ey.com).

### 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.

© 2020 EYGM Limited.  
All Rights Reserved.

EYG no. 003412-20Gbl  
BMC Agency  
GA 1015007  
ED None



In line with EY's commitment to minimize its impact on the environment, this document has been printed on paper with a high recycled content.

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax or other professional advice. Please refer to your advisors for specific advice.

[ey.com/oilandgas](http://ey.com/oilandgas)