Quarterly analyst themes of oil and gas earnings

Q3 2020

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Overview

The third quarter of 2020 witnessed mixed signs of global economic recovery. Oil and gas prices have recovered steadily from their lows and are relatively stable, although not yet sustainable levels. The stability is supported by the combination of oil-producing countries cutting production and economic stress on upstream independents. Crude oil prices averaged US$42/bbl in the quarter – significantly above the second quarter average of US$29/bbl. Henry Hub averaged US$2/mmbtu during the quarter, below where it was last year but substantially less depressed than in Q2 as stable domestic demand offset continued weakness in US LNG exports. LNG spreads were substantially higher at the end of Q3 than they were at the beginning of the quarter but are still roughly half of what is generally thought of as sustainable. Refining margins remained weak, reflecting lower demand due to the pandemic and excess capacity.

Oil majors reported a combined net loss of US$3.4b in the third quarter – a dramatic improvement over the write-off driven US$65b net loss reported in 2Q20 but significantly below the 3Q19 earnings of US$13.2b. Oil majors' operating cash flows for the quarter amounted to US$32.2b – nearly three times the previous quarter levels but still 36% lower than previous year levels.

Of course, financial matters remain the top priority for the analyst community. The market environment continues to remain challenging and uncertain, and analysts were keen to get a view of the amount of flexibility companies have built into plans, particularly around capital spending. To stay resilient, companies have been pulling all possible levers to reduce their costs and improve operational efficiency. With this in mind, analysts were very interested in the mix between enhancing efficiency and cutting capital spending. Analysts wanted to know how long companies could sustain their capital spending levels at the lower end of their guidance range amid tough macro conditions without an adverse effect on their medium-term production and cash flow targets while investing in energy transition. With the energy transition accelerating, companies face pressure to allocate capital to alternative energy sources. Some companies were directly asked about the current and likely future allocation of funds to their alternative energy businesses.

Companies' commitment to shareholder returns continues to remain important to analysts and shareholders. Questions about how companies would prioritize between capital spending and shareholder distributions if they generate surplus cash flows were prominent.

As usual, analysts asked questions on the timing of companies' share buyback programs and suggested companies initiate programs earlier than planned to take advantage of low share prices. On gearing, analysts wanted a view of the long-term target leverage if oil prices continue to remain around US$40/bbl.

Despite the fact that the market offered up poor refining margins and lower than usual demand, some companies reported better than expected downstream results, and analysts were curious about the drivers and the sustainability of those results amid growing uncertainty around demand recovery.

On the strategic front, companies' energy transition ambitions and the path to achieve their goals continue to remain a key focus area for the analyst community. Several wanted more visibility into companies' decarbonization plans and applied subtle pressure to companies without targets by comparing them with their peers. From these questions, it is clear analysts want companies that have not yet announced long-term carbon emission reduction targets to do so soon. On the other hand, analysts have questions about companies' ability to execute against those targets while maintaining an acceptable trade-off between growth and returns. Some companies were asked about the extent of their reliance on M&A to achieve their renewable energy targets and the risk posed by that approach.

Most companies are focused on pruning their portfolios by divesting non-core assets to maintain balance sheet strength. Analysts asked several pointed questions related to companies' disposal strategies and the factors that would drive their decision to rationalize or divest refining capacity, given the challenging outlook for the refining sector.

On policy and regulation, analysts wanted to understand the potential impact of a change in the US Government on US acreage. Additionally, analysts were keen to get a view of the possible impact of the approval of the European Climate Law on companies' upstream and downstream operations in the region.

Companies were asked the usual questions on the progress of major projects Project delays and cost overruns usually affect future results. Production outlook, as always, was an important topic for the analyst community. Libyan volumes were of particular interest when discussing 2021 production guidance.

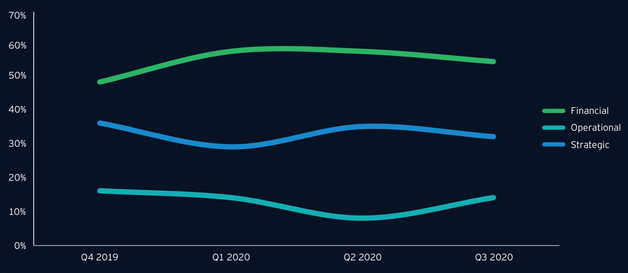
Top three themes | Q3 2020

1 Capital spending

2 Shareholder distributions

3 Investment in alternative energy

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



Financial matters continue to dominate earnings calls, with a focus on sustainability of capital spending and dividends and the impact on medium-term output and cash flow targets if capital spending levels remain unchanged. Energy transition plans remained a strategic area of interest for the analyst community.

Looking forward

The market will be looking closely at how the economy and oil demand respond to new developments with respect to a potential COVID-19 vaccine. While progress is being made in adapting economies and putting people back into the workplace, full recovery is far from here. We expect analyst queries to be tightly focused on uncertainty in how the demand for oil and gas will be impacted in the short, medium and long term and how companies are using their capital. Historically, oil and gas prices have recovered in concert with the drawdown of stocks, but there is significant risk surrounding how quickly that will happen and whether energy transition will be in full bloom when it does.

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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 2020 earnings reporting season among 11 global oil and gas companies. 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:

BP plc	Eni SpA	Repsol SA	Suncor Energy Inc
Chevron Corporation	Exxon Mobil Corporation	Royal Dutch Shell plc	TOTAL SA
ConocoPhillips	Husky Energy Inc	Equinor ASA	

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