Quarterly analyst themes of oil and gas earnings

Q2 2020

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Overview

The second quarter of 2020 was the first full quarter since the onset of the COVID-19 crisis, and it was marked by unparalleled demand destruction and weakness in oil and gas prices. The majors booked US$65 billion in losses during Q2. Asset revaluations accounted for over three-quarters of this, as companies came to grips with the long-term ramifications of COVID-19-related demand reduction and the looming energy transition.

Between Q1 and Q2, oil demand fell by about 10 million barrels per day. Crude oil prices dipped below US$20/barrel in April, then moved up steadily, resulting in an average crude oil price of US$29/barrel for the quarter. However, this is still well below the Q1 average of US$48/barrel.

Reduced demand worsened existing oversupply conditions in the gas markets, pushing prices to historic lows. Henry Hub front-month futures averaged US$1.70/MMBtu during the quarter, the lowest in 25 years. The refining environment was also extremely challenging as US and Europe crack spreads fell to nearly 50% of their year-ago levels.

Balance sheet and capital spending outlook

As losses were a given, analysts focused on larger financial matters, including capital spending and balance sheets. Companies reported that capital spending cuts were the tool of choice to manage cash flow, and rig counts are at the lowest level in 15 years.

Analysts also probed on long-term capital needs to sustain the business, expressing concern that companies' current low capex levels would compromise the achievement of their medium-term output and cash flow targets.

Throughout the calls, the macro environment and demand scenarios were overarching themes. Asset write-downs were based on the assumption that oil prices would return to more sustainable levels, but analysts wanted to know how companies would respond if oil continues to remain below US$40/barrel in the medium to long term.

Dividends and impairments

The recent crisis has triggered a wholesale re-examination of dividend policies across the industry, and the subject was front and center again in Q2 analyst calls. Some companies have overhauled dividend policies so that dividends track oil prices instead of remaining fixed, and analysts wanted to understand the factors that led to any changes.

In view of the dividend cuts made by several companies, analysts were skeptical about payouts that would be made over the medium term and whether companies would be able to return to a progressive dividend path. Ironically, companies that have been able to sustain high dividends were asked to defend them given the current market conditions.

On impairments, analysts were curious to get a view of the share of total impairments that were not triggered by COVID-19 and the reason why companies waited until this time to make those impairments.

Strategic concerns

On the strategic front, questions related to portfolio reshaping dominated. Portfolio high-grading was at the top of the agenda, with asset divestment and how to achieve a "fit-for-the-future" asset mix not far behind.

Diversification into alternative energy and the returns on those businesses continue to be areas of focus for analysts. For the first time, analysts asked multiple questions about hydrogen project plans and what role hydrogen is expected to play in company portfolios in the medium to long term.

Additionally, analysts were curious about the potential competition between hydrogen, natural gas and liquid natural gas (LNG). Analysts asked for perspective on the consolidation of low-carbon operations, which could enable companies to provide more visibility around the strength and importance of that business.

Companies were asked about their current M&A appetite and if there were any gaps in their portfolios they were willing to fill with transactions. Companies recently active in the M&A market were asked how well acquired assets meshed with their overall portfolios and the reasons for choosing particular assets.

Operationally, analyst interest was focused on the impact of prolonged capital spending cuts on production. Analysts wanted to understand priorities around final investment decisions (FIDs) and the ability to sustain production in the medium term.

Finally, analysts probed regarding any issues companies were experiencing in ongoing projects, their approach toward remobilization of their workforce and the ongoing risk of project delays.

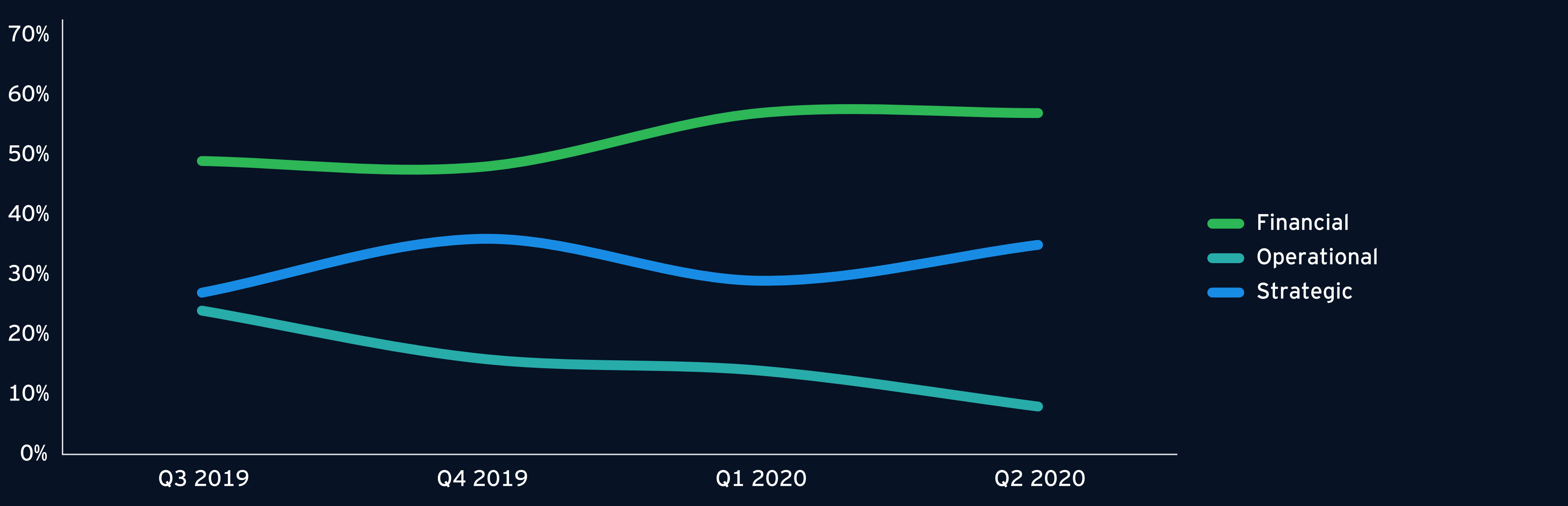
Top 3 themes | Q2 2020

1 Investment in alternative energy

2 Capital spending

3 Shareholder distributions

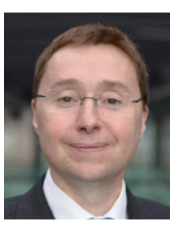
Percentage of analyst questions pertaining to financial, operational and strategic themes



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

No one knows how long oil and gas demand will be affected by the pandemic. And by the time we find out, energy transition may be in high gear. Companies continue to search for a balance between using cash thrown off in their core businesses to keep those businesses alive and using that cash to fund alternatives. Analysts will continue to seek detailed information regarding the return on those ventures, and the answers will be increasingly vital for the industry at large.



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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 2020 earnings reporting season among 12 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	Eni SpA	Repsol SA	Suncor Energy Inc
Chevron Corporation	Exxon Mobil Corporation	Royal Dutch Shell plc	TOTAL SA
ConocoPhillips	Husky Energy Inc	Equinor ASA	Woodside Petroleum Ltd

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