Quarterly analyst themes of oil and gas earnings

Q2 2019

ey.com/oilandgas

EY
Building a better working world

Overview

As it almost always is, oil and gas profitability was driven by crude oil, refined product and natural gas market conditions in Q2 2019. Oil prices seesawed, rising steadily during the first half of the quarter, falling during most of the second half of the quarter, before rising again at the end. North American supplies (which continue to grow), worries about world economic growth and OPEC production discipline are driving markets up and down as the story of the day changes. LNG markets continued to search for a sustainable equilibrium as demand and supply grow unevenly. Refining and petrochemical margins held steady through the quarter, albeit at levels below what the industry had come to expect in previous years. Market conditions were reflected in companies' financial results. Returns on capital held steady as cost control continues to be a focal point and higher oil prices are a hope, but not an expectation. Cash flow has been and continues to be strong.

Analysts are always interested in what companies intend to do with that cash, and financial matters will always be a primary focus of the analyst community. Q2 was no exception. Tax rates were a point of inquiry, along with the usual questions about plans for dividend increases, share buybacks, capital expenditure and asset disposal. Investors seem to be keen to see more return of capital. That may mean that they see less opportunity for profitable reinvestment. Gearing was also on the radar for several analysts. The price of more capital returns may be increased leverage and analysts are understandably interested in learning more about companies' intentions about where to get and how to use cash.

From an operational standpoint, equity analysts are intensely focused on LNG, an important strategic priority for oil and gas companies, but investors are understandably skeptical in the face of disappointing results. The LNG markets are increasingly crowded as players scramble to secure resources, regulatory approvals, financing and customers in expectation of slowing liquids demand and an increasingly important role for gas in the energy complex. Time will tell if those investments will bear fruit. Today, investors are asking hard questions about operational performance, progress on major capital projects and LNG pricing. LNG pricing was a particularly active topic. The split between spot sales and contract sales was queried repeatedly.

In recent quarters, oil majors have increased their interest and investment in North American unconventional oil. Those resources are short cycle, readily scalable and concentrated in part of the world with little or no political risk. Uncertainty abounds about the long-term future of oil, which makes those assets ideal. In this round of conference calls, analysts were focused on the performance of those assets and the progress made in relieving takeaway constraints from the Permian Basin and its impact on wellhead pricing. Analysts are watching carefully for expansion or contraction of each company's activity, especially capital expenditure and rig counts.

Refining and chemical performance also had analysts' attention this quarter. Several questions were asked about margins in those businesses, downtime and preparations for the implementation of International Maritime Organization (IMO) 2020. Companies haven't talked in much detail about their plans and there may be a sense of increased risk.

On the strategic front, North American shale, LNG, geographic risk and the energy transition made the top of the list of issues. LNG pricing has been persistently disappointing as well as the financial results. Companies continue to explore and commit to major projects and significant capital investment. While analysts certainly recognize the importance of gas and LNG to oil companies' future, they ask probing questions about the development costs and the general market environment and companies' ability to get long-term contracts and favorable pricing. We'll be looking carefully in future quarters for signs that the economics of these projects are improving, companies' commitment is wavering or investors' patience is running out.

Operational performance, cost, expansion or contraction of activity levels in North America are high on analysts' minds. The economics of unconventional oil have been questionable while those resources were in the hands of independents. As the majors take a bigger role, analysts will be increasingly interested in learning whether they are able to unlock more value.

Geographic risk and its impact on strategy was also on analysts' minds. The situation in Venezuela continues to be problematic, both at the macro level and the micro level for individual companies. Every company has a unique set of country exposures and analysts are keen to explore when issues pop up.

Most interesting is the analyst community's heighted interest in oil companies' interest in alternative, reduced carbon and renewable energy. While returns are and will always be central to oil companies' strategies, they continue to explore their options in those arenas. In the latest round of earnings calls, analysts asked several questions about the performance of those businesses and their growth prospects, and the size of the commitment to those businesses. There's a proven link between equity performance and a company's perceived readiness for what almost everyone believes will be a sea change in the energy landscape, and analysts will continue to be on the lookout for signs that companies are at least keeping their options open and are able to compete effectively.

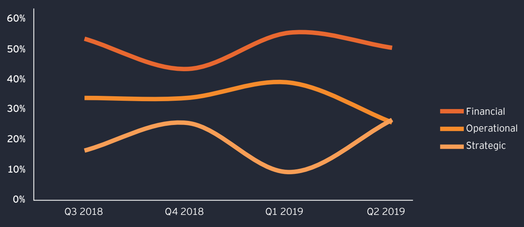
Top three themes Q2 2019

1 **Project updates**

2 **Capital spending**

3 **Cash flow**

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



The financial position of the companies with respect to their capital discipline and cash flows dominated Q2 2019 earnings calls. Project updates and increasing momentum toward inorganic growth were also some areas of interest.

Looking forward

We expect to see more response to macro developments, especially LNG pricing and IMO 2020. Gas's growing importance in the portfolio could be a headwind in the short term with pricing pressures. Crude price volatility will constantly govern operational decisions and cost control momentum will continue as margins continue to be under pressure. North American shale consolidation will continue and interest in alternative energy will grow.

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 Transactions Leader
+1 713 751 2114
john.hartung@parthenon.ey.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 Q2 2019 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 S.A.
ConocoPhillips	Husky Energy Inc	Equinor ASA	Woodside Petroleum Ltd

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 is available via ey.com/privacy. For more information about our organization, please visit 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.

EYG no. XXXX Gbl
BMC Agency
GA 1013071
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.

ey.com/oilandgas