Themes from the Oil Majors' Q2 2019 results

Developing resilience in a volatile macro–environment

Resilience was the dominant theme from the second quarter earnings calls held by the large integrated oil and gas companies: resilience of the balance sheet to volatile oil prices and weak gas prices; resilience of operating assets following some unplanned outages; and resilience of the portfolio to the challenges of the energy transition.

Recent geopolitical events, particularly in the Strait of Hormuz and simmering US-China trade tensions, are creating concerns around supply and demand, driving volatility in prices. Balance sheets are stronger than during the oil price downturn, but companies are remaining disciplined in their **capital spending**. Questions raised by analysts attending the earnings calls probed companies' capital spending plans for the remainder of this year and 2020 and the projects budgeted for.

Companies were also quizzed by analysts on the confidence in their ability to return more cash to shareholders, given the volatile macro backdrop. Questions examined whether companies were prioritising returning cash back to shareholders via buybacks versus higher dividends.

With the large, integrated companies all having the capacity to fund shareholder returns organically without using the balance sheet, the competitiveness of **shareholder distribution** policies was queried.

Despite the industry's continued "value over volume" pledges, analysts attending the earnings calls zeroed in on companies' **production outlook**. The scale of output growth in the Permian was of interest with analysts wanting more detail around exit infrastructure as well as drilling activity. Investment in US shale has pivoted toward longer laterals and higher productivity. The higher capital efficiency makes it more difficult to estimate production solely based on planned levels of capital investment.

There was one clear distinction between the questions asked of companies based in the US and those headquartered in Europe. Analysts covering US-based companies focused their questions almost exclusively on operational and financial performance. Their European peers also fielded questions from analysts on the **energy transition**. Guidance was sought on the expected returns from investments in solar and wind projects. Companies were also questioned investment criteria for low carbon business opportunities and the preferred financing model for these investments.

Oil and gas M&A activity is subdued but companies are continuing to invest in new lower carbon ventures.

There may be scope for some opportunistic acquisitions, but there is limited appetite for large–cale acquisitions. Questions on **portfolio optimisation** have turned to divestments as companies look to ensure their portfolios are fit for a volatile price environment and the energy transition.

Companies that weighted their portfolio more heavily to gas are exposed to some additional challenges. Analysts raised questions on the outlook for **LNG markets** amid a supply surge. The threat of the new LNG capacity sanctioned by companies becoming a drag on prices was under the spotlight. The message from the large, integrated companies has been consistent. Gas is a key pillar of the energy transition. The response is evolving as critics question whether increased use of natural gas is consistent with more ambitious national emissions targets.

Companies' views on the expected impact of the new IMO **regulation** for a lower sulphur cap for marine fuels from 2020 were sought by analysts. The prospects for an uplift to refining margins and widening light-heavy crude spreads were the key areas of analyst questioning.

Patrick Handley
Partner
phandley@brunswickgroup.com
+44 (0) 20 7396 5395

Will Medvei
Director
wmedvei@brunswickgroup.com
+44 (0) 20 7936 1271

The companies included in this review are: BP plc; Chevron Corporation; Eni S.p.A.; Equinor ASA; ExxonMobil Corporation; Repsol S.A.; Royal Dutch Shell plc; and Total S.A.

Bringing the outside world in.