PORTLAND MARKET REPORT

MAY IN VIEW

THE MAJOR QUESTION – TO GREEN OR NOT TO GREEN?

The death knell of the oil majors has been sounded many times. In the 70s it was feared that Exxon, Shell, BP et al would be eclipsed by OPEC (Organisation of Oil Exporting Countries). Then the 90s brought 'Peak Oil' and the exhaustion of oil stocks. Since 2000, focus has switched to the incompatibility of oil exploration with pressing environmental needs, whilst 2020 brought Covid and oil prices plunging into negative territory. Yet the majors have always survived and, invariably, bounce back to post enormous profits and generate the kind of debates we are having today in the UK, which is whether extra-ordinary (windfall) taxes should be levied to punish them for being so successful.

The post-pandemic / pre-renewable major oil companies of 2022 are at a crossroads that represent two very different routes to the future and highlight the difference between North American and European outlooks. The first route is to stick with – and possibly increase – oil and gas exploration.

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It looks likely that this path will largely be followed by the American majors (Exxon, Chevron), faced with significant shareholder scepticism as to the merits of 'going green' as well as having, traditionally, been the most efficient operators in the exploration sector. In their mindset, the Russian invasion of Ukraine has highlighted the fact that oil and gas still dominate the global economy and, moreover, it has sent western governments into apoplexy over boosting domestic oil and gas production (in an attempt to avoid dependence on imports from unfriendly nations). These US companies are also making the accurate calculation that, whilst transport looks likely to decarbonise (thus reducing oil demand), that still leaves up to 50% of oil demand wrapped up in everything from concrete to contact lenses and clothes that have colour. In these sectors, demand for oil will stay robust and consistent.

Taking a very different approach are the European oil majors (BP, Shell, Total, ENI) who have to deal with a very different public and a more environmentally conscious shareholder base. These companies are now falling over themselves to show their alignment with the decarbonisation project and both BP and Shell have announced their intention to achieve 'net zero' by 2050. There has been a slew of acquisitions of everything from wind and solar companies through to battery manufacture and roadside electrical charging. The CEO of BP has even called on the UK Government to speed up the proposed 2030 ban on petrol and diesel cars – an inconceivable standpoint prior to 2020.

There is no legal mandate for the Euro oil companies to follow this 'progressive' path and the danger is that shareholders may conclude that going green will not generate sufficient returns. Traditionally oil majors have generated between 15-20% returns in upstream investments (oil and gas exploration), whereas, to date, large scale renewable projects are only generating around 5-10%. Most, if not all shareholders, are keen on immediate profits and dividends and this 'profitability gap' may drive mercenary investors back to the more traditional modus operandi of the US industry (which they understand) and leave the European majors lacking sufficient funding for the huge capital investments required for renewable energy projects.

Two factors do support the 'European' approach though and the first is that historical returns of 15-20% do not guarantee the same level of profit in the future. In fact, traditional energy projects seem unlikely to perform at these high levels in the face of tightened regulation and increased competition from ubiquitous renewable energy plays. The second, more cynical, reality is that the European oil companies are clearly hedging their bets in the short-term. No-one is shutting down, or even reducing, hydrocarbon production, so revenues from oil and gas will continue for at least another 10 years. The logic here is that only the handsome returns from traditional energy projects can generate the kind of revenues required for massive re-investment in renewable energy. And it will help pacify nervous investors to boot!

Which approach will win the day then? The truth is that energy is rarely as binary as having absolute winners and losers and both pathways represent a gamble of sorts. If decarbonisation turns out to be a triumph of wishful thinking over reality, then the European oil majors will be guilty of disposing of their 'crown jewels' (oil exploration) unnecessarily.

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At the same time, if the growth opportunities of decarbonisation turn out to be material, then the 'old-school' fossil fuel companies will be seen as outdated and sitting on a whole load of assets (oil reserves) that nobody wants in a cleaner and greener world. One thing is for sure though, and that is that oil may be in decline, but it is not disappearing – so the dire predictions for the future of the oil majors are as misplaced today as they always have been. And the invasion of Ukraine has only strengthened the hand of the oilcos because, for all the current courtship of the likes of Saudi Arabia and Qatar, governments around the world (even the Chinese) would still far rather deal with independent oil majors than the state oil companies.

The latter ultimately act with political – rather than commercial – interests at heart.

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