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TRANSCRIPT

ESG Now Podcast

“The Future for Oil and Gas Producers”

Transcript, 3 November, 2023

Mike Disabeto:

What's up everyone, and welcome to the weekly edition of ESG Now where we cover how the environment, our society, and corporate governance affects and are affected by our economy. I'm your host Mike Disabeto, and this week, we talk about the different paths the oil and gas industry may take as players are predicting we are running up on peak oil demand. Thanks as always for joining us. Stay tuned.

There's this group called the International Energy Agency, everyone calls them the IEA, and the IEA is this autonomous intergovernmental organization that is a trusted voice on where traditional energy is likely to trend in the future. That voice recently proclaimed loudly and proudly that oil demand was going to peak by 2028. Now, you might be thinking, "Hold up, wait a minute there. Two weeks ago on this very podcast, you talked to me about the fact that oil and gas companies have made some major expansions of the oil reserves." I'm talking about the Exxon purchase of US competitor, Pioneer Natural Resources in an all stock deal valued at $59.5 billion US that made Exxon the biggest producer in the largest oil field.

If oil demand is going to peak in 2028, why would Exxon engage in one of the largest stock mergers in the history of oil and gas? Why would Chevron acquire Hess for $53 billion US the same week the Exxon merger went down? These oil and gas companies must see a different world going forward than the IEA, a world that has China continuing to grow as it has been, and India's oil consumption may be reaching China type levels; a world where the transportation sector has not yet become a majority electrified sector; a world where plastic producers, another massive user of oil, continue to grow at the pace they are now, and don't forget natural gas growth. Peak oil would require each of those factors to reverse.

If they don't, some are arguing you could have oil demand growing by 15% through 2035. You must ask yourself now, do you trust the IEA's predictions on this subject or not? Also, if what this is is uncertainty about how oil will perform in the future, how are oil and gas companies positioning themselves amid an uncertain low carbon transition?

Well, today we're going to answer some of those questions by looking at research published by my colleagues Chris Cote and Gabriela de la Serna. Now, Gabby hosted last week's ESG Now Podcast, so I wanted to give her a break this week, which means I called up Chris Cote and asked him if he could help me through these murky waters. The sort of waters that depending on who you ask, could see oil grow or precipitously decline in the coming decade.

Chris Cote:

We see really two basic options in the market. One option is to totally transform your business. So you squeeze the value of your current assets you currently have, but you spend all of your new investments, or at least a growing share of your investments, toward lower carbon businesses, toward electricity or electricity-related services. You get into building solar farms and wind plants, or you build charging stations that are relevant for electric vehicles. In addition to that, maybe there's technologies like green

hydrogen or carbon capture and storage that are a little bit more relevant to your current business but nevertheless have some future in a low carbon economy.

The second option is to stay an oil and gas company and just be the best at it, even among futures scenarios where there's much lower demand. So the 100 million barrels a day that we can consume globally now, let's say it halves in the next 30 years. By 2050, we're consuming 40 or 50 million barrels a day. That's still a lot of oil in absolute terms. It's much less than today, but it's still a lot, and you just need to be the one to supply it.

Mike Disabeto:

This is like the conversation I pretend to have with myself every new year. Should I change into someone new or lean into what I am and continue to be the best version of the current me that I can be? Now, of course, it will depend on what that version of myself was. If I'm a big disaster that year, I should probably change so I don't remain a big sloppy disaster. But if I was great, maybe I should just be even greater in whatever capacity that is. Still, both those things, a change or staying the same, they require some sort of foresight, which means planning. In a plan it can be seen what the decision was that I decided on: to change or to remain the same.

Chris Cote:

One big way to distinguish between companies that want to transform and companies that want to be efficient is whether they set targets on their scope 3 emissions. That's basically the emissions intensity of the products that they sell, the gasoline, the diesel, but also the electricity and whatever else business they want to get into as the economy continues to shift.

You look at the US companies, and they largely haven't set targets on their downstream emissions on those products. They haven't made any sort of pledge to change the products that they're selling over time. Whereas meanwhile, the European economies, with some caveats here and there, have largely. They're basically saying our emissions intensity is going to decrease. That may come from selling less oil and gas, but it also may come from selling a lot more of something else. Whereas in the US you see companies largely pledging to just reduce their operational emissions intensity. So this is, "We're going to be the most efficient company out there."

Mike Disabeto:

In sum, what European oil majors are saying it seems is they're going to decrease their emissions intensity, which is the amount of carbon emitted per barrel of oil, by lowering their emissions through investments in technology other than fossil fuels. What the US majors are saying is, "We are going to lower our intensity numbers by just being really efficient per barrel sold, but we're going to keep on the same path as we've always been on with regards to our product mix."

Now, that could be the US majors agreeing that oil is going to see peak demand sometime in the future. They may think, well, to deal with that, we just want to become extremely efficient, and we can weather any storm that comes about. Aside from the plans, another distinction is apparent between these two groups, the Euros and the Americans. When you look at who is earning revenue from alternative energy, I mean renewable power generation, or selling products that improve energy efficiency. What Chris and Gabby found was the Euro majors like TotalEnergies, BP, Repsol, Shell, Galp Energia, these were the ones that had the most exposure to greener energy options, which even as I note that I must say, Chris is going to come in with a couple caveats to that reality.

Chris Cote:

One is a lot of them are betting their strategies in the meantime on natural gas having a longer life than oil, and that could definitely be true. It has a lower emissions intensity than oil. It, more importantly has a lower emissions intensity than coal, what it's replacing in at least Asian economies. But it's becoming increasingly known that with a small leakage rate in the transportation of gas or in the production of it, methane has a much higher warming potential as we recently discussed. If this increasingly comes to the public consciousness, to policymakers, then natural gas could have a different future than is currently expected. Then all these new low carbon businesses, especially electricity production, they have lower rates of return than oil and gas does traditionally. That involves getting comfortable with having a lower return on your investments and having your investors get comfortable with that too.

Mike Disabeto:

At this moment, better efficiency seems to be what US majors like Exxon and Chevron think will make their shareholders more comfortable. We see this with Exxon's acquisition of Pioneer and Chevron's acquisition of Hess. According to our data, Pioneer was a very efficient oil and gas company, and that is largely because it was operating in the Permian Basin, which is a very large North American shale play. Shale is efficient relative to other methods of production if you have economies of scale. Otherwise, shale is famously inefficient. But Pioneer did have economies of scale, so in this instance, it was an efficient method of extracting oil.

Hess owned a lot of assets in the deep water offshore oil area in Latin America, specifically Guyana. Offshore drilling is another very efficient oil extraction method relative to other methods, and Chevron didn't really have a lot of investments in that area until now so they're becoming more efficient. But as with the Euro's green picture, there's a caveat with these US super majors. It's not that they are just completely going away from any carbon abatement technology in favor of only fossil fuels and traditional oil and gas.

Chris Cote:

It's not that the US companies aren't thinking about how to win and compete in a low carbon environment either, they're just making maybe different types of bets. These companies have said that they're going to expand their carbon capture businesses, and they well could be the leaders there. I mean, the US has strong policy incentives for carbon capture and storage through the 45Q legislation, and you also have these companies looking at a wide array of things. We see potential investments in green hydrogen, but also electrification. It's just at a smaller scale than the European companies.

I think the bottom line is that all of these companies are finding ways to make bets on the future, and that's largely where European or US or otherwise, that's largely where a lot of these companies still stand. Their investments in non-oil and gas are still relatively small compared to their oil and gas investments and the revenues that they generate from these types of businesses. But the Europeans are beginning to explore other options at a faster rate than the American counterparts.

Mike Disabeto:

By the way, the 45Q legislation that Chris mentions is the name of the US tax credit for carbon capture and storage that was increased with the Inflation Reduction Act. Chris and Gabby also show in their paper that although European companies stand out above American integrated oil and gas companies, the super majors like Exxon and Chevron are still investing much more in low carbon innovation than straight-up oil and gas producers like Pioneer who didn't refine or market any of those type of products. Their acquisition could be seen as an industry that is consolidating toward the players with the capital to invest in a low carbon transition, a line that is often repeated by oil majors that they are the ones with the capital

to push this transition forward. But it's still uncertain. That's what this is really all about. It's the continued uncertainty.

Our economies are still reliant on fossil fuels, and emissions continue to rise, and oil and gas companies continue to pump and extract oil at high rates. There are more targets being set to reduce emissions, which would have to mean that there's lower consumption of oil and gas in the future, but that may depend more on the priorities of governments rather than a vast shift in the oil and gas industry. Those targets do remain on the lower end for the all-important scope 3 emissions for oil and gas producers. What I mean by that is Gabby and Chris found that only 24% of companies in the peer set that they looked at had set targets that included any scope 3 emissions. Of those, only two were exploration and production companies.

Now, I said this all to Chris, noting that it doesn't seem like that many new things are happening in the industry aside from those acquisitions that seem pretty run-of-the-mill to me, but that is where he corrected me.

Chris Cote:

You might want to also think about the flip side of those deals. Pioneer and Hess are iconic oil and gas companies in the US. They have long histories, they have storied managers, and they both decided now was the right time to sell.

Mike Disabeto:

Fair enough. We obviously don't know how the future of oil and gas demand will unfold, and we don't know which of these strategies is going to work best for the long-term health of the company. We might have an idea of which strategy might work best for the long-term health of the world though.

But funny enough, even in a future scenario with much lower demand in 10 to 20 years, both of these strategies could work for companies. The US companies could succeed in becoming some of the lowest cost producers and manage to grow their market share while companies that transition away from oil and gas could succeed in other business lines. Maybe it's a company that's caught in the middle that face the most trouble, or maybe not. Like I said, we're dealing with uncertainty here.

That's it for the week. I want to thank Chris for talking to me about the news with an ESG twist, and I want to thank you so much for listening. If you like what you heard, don't forget to rate, then review us. It really helps us on moving up in the podcast lists, and subscribe wherever you get your podcasts. Thanks again. Talk to you soon.

Speaker 3:

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