# Do Record Profits Change Oil.

**January 13, 2022**

Mike Disabato: 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 Disabato, and this week we discuss after record profits in 2022 whether oil and gas companies are ready to move away from fossil fuels. Thanks as always for joining us. Stay tuned.

2022 has turned out to be a banner year for oil and gas companies. ExxonMobil and Chevron are expected to rake in a record high of a hundred billion US dollars in combined profits as energy prices surge following Russia's invasion of Ukraine. It's a windfall profit that's been borne by volatility, sure, but some of the major oil companies see their profits as a vindication of the resistance to pivot away from fossil fuels toward more renewable energy sources.

For example, it's being reported in the Financial Times and elsewhere that Exxon's chief executive Darren Woods said recently that the company's bumper year was evidence it is quote "on the right course." That course, as told by Exxon's latest long-term outlook, is filled with fossil fuels. Chevron agrees with that statement with its CEO Mike Worth telling the Financial Times that fossil fuels will still quote "run the world 20 years from now."

These very public statements are in contrast with peers who have more ambitious goals for decarbonization. In fact, seven oil and gas majors, Shell, BP, Equinor, Repsol, ENI, Total and OMV, aim to reduce a hundred percent of their emissions footprints, including their Scope 3 emissions by some time in the future like 2030, 2040, or 2050. Yet BP, for example, has continued to increase its investments in fossil fuel extraction in places like the Gulf of Mexico and Texas.

How different are the companies that have made pledges to reduce their emissions from the companies like Exxon and Chevron that publicly state fossil fuels will continue to run the world for decades? What does all this new money mean for the future of oil and gas?

To figure that out, I called up my colleague Antonios Panagiotopoulos, who covers the energy sector for us. What I wanted to know first was what are Exxon and Chevron going to do right away with all those windfall profits?

Antonios Panagi...: Don't forget that we're coming out of a period of underperformance for those companies and shareholders, if you like, have not been getting exactly the return that they wished for. So now it's the time of, in a cyclical industry like oil and gas, it is the time for giving back to shareholders.

Mike Disabato: Specifically, Exxon said it would expand its share buyback program to $50 billion US from 30 billion and would end the program at 2024, instead of 2023. Chevron has been a bit more subdued saying it will buy back around $15 million US worth of shares, a market set in May of 2022 as the profits for the year started to make themselves apparent.

That is the short-term decisions that these companies are making with those profits, though. Buybacks don't go on forever. They are designed to be finite to pump the profits for investors and to be rewarded by the market for it, which is actually happening at the moment for both Exxon and Chevron.

What about the long term? What sort of energy projects will most likely see capital increases due to these profits?

Antonios Panagi...: It's going towards either replacing reserves that have been depleted, so either into new fossil fuel reserves or spend more money into making certain reserves economically recoverable.

Mike Disabato: The way to make reserves more economically recoverable is upping the efficiency of their current process of extraction, such as using different fluid systems to remove hydrocarbons from operating wells.

Now we calculate what's called a patent value score, which establishes a picture of the relative level and quality of patents that are held by companies. If you look at patent value scores of the energy industry, as our colleagues Matthew Lee and Umar Ashfaq did in our 2023 ESG Trends to Watch Report, you see much of the industry's innovation is focused on the traditional activities of fossil fuel extraction and petrochemical development and making those processes more efficient. Aside from TotalEnergies that have a decent amount of solar PV panels patents, most companies don't have many patents and renewables that could signal more aggressive investment toward the energy transition.

Efficiency seems to be where much of the energy industry is continuing to put its innovative agenda, which isn't nothing. Efficiency is good, don't get me wrong, but what we might be seeing in this instance is a focus on incremental, rather than game-changing investments.

Antonios Panagi...: I think efficiency is a big requirement towards the path to the low-carbon future.

Mike Disabato: Let me back up what Antonios is saying there with some data. The International Energy Agency, the IEA, said in their 2018 Energy Outlook, that energy efficiency could provide more than 40% of the abatement required by 2040 to be in line with the Paris Agreement. That's carbon emissions abatement and efficiency gains are much easier to implement than game-changing investments like alternative fuels.

Antonios Panagi...: However, it needs to happen in conjunction with the change in the primary energy source.

Mike Disabato: That combination, the combination of renewable energy and energy efficiency, is indispensable for achieving our climate goals, and that is why we cannot just have incremental investments and not have those game-changing investments that we so need. Incremental efficiency gains are where oil and gas profits and decarbonization efforts align. Increased efficiency means more oil and gas is pumped out of a well using less energy and other inputs, which means the companies have less expenses and thus higher profits with fewer planet-warming emissions associated with each barrel they've extracted.

But incremental efficiency gains cannot reduce the overall emissions that come from the products these companies sell, the gasoline, the diesel, the jet fuel, and then natural gas. To reduce Scope 3 emissions and, in effect, reduce the world's overall emissions, companies cannot go on selling the same amount of oil and gas. They just can't. They would have to shift their focus towards something else maybe, like electricity, different chemicals or carbon capture services. That's why companies with strong commitments to reduce their Scope 3 targets stand out so much and there are seven I noted at the beginning of this program, Shell, BP, Equinor, Repsol, ENI, Total and OMV, that aim to reduce a hundred percent of their emissions footprint, including their Scope 3 emissions footprint.

When you do a peer comparison between those seven and Exxon and Chevron, we could see that, based on the company's carbon emission intensities and their decarbonization targets, that Chevron and Exxon are completely outside of what is needed to keep our world below two degrees warming, whereas Total, Shell and BP, for example, have proposed plans

and emissions that are only slightly out of line with the Paris Climate Agreements and those company pledges are very important.

But even for those seven, we don't see the sort of long-term project spending that would show they are aggressively moving away from fossil fuels and if we remove those plans, the oil majors sort of all fall into line with each other. For example, if you look at the revenue from wind and solar generation, Total has the most revenue from alternative energy at 8%. Then comes BP and Shell around 6% of their total and then the rest have around 1% less of their total revenue. None of the oil majors have said, "We're going to use these record profits to speed up our globe's transition by investing a lot of that profit into alternative fuel." Some say that they're going to invest some, but not a lot.

Does this all mean that the pressure fossil fuel companies have been under by both governments and investors to cut their emissions are failing? That engagement just no longer works? I asked Antonios what he thought.

Antonios Panagi...: It means a couple of things like, first of all, we need to make clear that all this and the climate, the fight against climate change is not going to be a sprint. It's going to be more likely a marathon. Yes, you will have some first-movers, but eventually, everyone will need to move to a lower carbon future, whether that is primarily gained through efficiencies and later on through the change in energy supply.

With regards to engagement, I would say that engagement, at least in a European, if you like, context has worked. We have seen that a lot of companies, specifically in Europe, are not wholly moving towards renewable energy. I mean, not everyone is an Ørsted. But we have seen companies from the oil and gas slowly, but progressively, making plans on how their future is going to look like and most likely that is aligned to an energy company, rather than an oil and gas company.

Mike Disabato: It also might be that climate engagement has still been a bit too mercurial in a way, where most proposals have either been too lofty for shareholders to get behind, like asking a board to not support any new investments in fossil fuel-adjacent companies or to focus on discussion, rather than action, like asking a board to include emissions from its supply chain in some report at some time in the future.

Antonios thinks there needs to be more of a strategy if an oil and gas company agrees to do something at its annual general meeting, at its AGM, but then nothing happens.

Antonios Panagi...: Like we set like we will engage with Company X in order to get them to switch from, if you like, from an intensity to an absolute emission calculation. Is that feasible? Or do we just actually need to make that intensity target a bit more aggressive? So define the outcome, if you like, or try to define what the outcome needs to be. Discuss with the company, set a timeline that we can engage with them over the period of the next two, three years. We can go through AGMs, we can try to vote on that proposal, we can bring that proposal to AGM. But there needs to be some kind of target in the process of engaging and there needs to be like a resolution if the engagement is not successful.

Mike Disabato: Those decisions would be made on the individual investor level, of course, but it's still one that probably needs to be made.

It also might be that climate proposals are really just getting started. We looked at US proposals calling on a company to adopt a greenhouse gas emissions reduction target and found that in 2020, there were five proposals. In 2021, there were 10, and in 2022, there are 23 proposals on climate, eight of which passed.

Regardless of oil and gas companies continue to commit tens of billions of dollars to projects that are out of step with what government's climate pledges are, there might be a situation in the future when the companies cannot rely on a sharp increase in energy prices to recoup their costs. This basically underlies a lot of our thinking on these type of stories that,

eventually, those assets will be transitioned and those companies that have secured market share in alternative fuels, for example, will be running ahead of the pack and those that have not secured that market share will maybe be more volatile.

That's it for the week. I want to thank you so much for listening. I want to thank Antonios for discussing the news with an ESG twist.

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