Not So Great Expectations for Oil’s 1st Quarter 2015 Earnings Calls

While oil prices continue to slide amid oversupply and shifts in expected demand growth, production continues to rise despite reduced rig counts. The dramatic drop in oil prices changed the tone of 4th Quarter earnings calls and resulted in CapEx slashing. Earnings results weren't as dire as feared because they were pegged to fairly high average prices per barrel, ranging from $71/bbl and $72/bbl for ConocoPhillips and Shell to roughly $69/bbl and $63/bbl in the case of BP and Exxon.

Investors should expect far more pain in this round of quarterly earnings calls as average prices are closer to $50 and reserve valuations may crater as Bloomberg’s Asjylyn Loder pointed out in “The Price of Oil is About to Blow a Hole in Corporate Accounting.” Shell’s Ben van Beurden explained that a $10/bbl drop in Brent represents a loss of roughly $3.3B in CFFO/earnings. For the first quarter of 2015, the average spot price was $52.83/bbl. Even production increases aren’t likely to offset earnings losses.

The oil majors could use this as an opportunity to pump the brakes and consider shifting some of that deferred CapEx into low-carbon projects like solar, wind, or energy storage to diversify their portfolios and mitigate carbon asset risk. Some are already moving towards this trend: Statoil’s choice of the former head of its renewable division as its new CEO is promising, and Sinopec announced it would shift some of its business to clean energy. However, none of the other majors have signaled any return to the dedicated renewable energy programs they once pursued. Instead, they seem content to bet on an energy future that looks much the same as the present, except for far warmer temperatures.

Have We Hit Peak Demand?

Sinopec’s Chairman says he expects demand in China for diesel to peak by 2017 and for gasoline by 2025.
MEET THE NEW OIL BUST. IT’S NOT THE SAME AS THE OLD BUST

Talk to just about any oil industry executive, and they’ll tell you that booms and busts just go with the territory. They’ve survived them before and they’ll survive them again, because they know the oil markets better than anyone else.

It’s true, we’ve seen oil busts come and go. Clinging to the idea that low prices will spur demand and lead the way to the next boom could, however, prove fatal to oil majors who fail to see the new trends affecting demand.

A recent Wall Street Journal article highlighted the widely varying views among investment banks on when and how far oil prices will rebound. Perhaps a more important question is, where do executives expect prices to go and how quickly?

There are four trends that warrant a departure from ‘business as usual’ thinking:

1) **Demand destruction is real.** As a recent article in Bloomberg pointed out, GDP is less dependent on oil than it was – and it is getting less so.

2) **Finding and producing new reserves is getting ever more expensive.** According to Kepler Cheuvreux, CapEx costs more than tripled between 2000-2013, but oil production only increased by 14%.

3) **Innovation in renewable energy technologies is driving down prices at an unprecedented rate.** Solar and wind have already reached grid parity in some markets. For developing countries that don’t have antiquated energy grids built on concepts from the late 1800s, like the U.S., developing more renewable energy is an attractive way to electrify rural communities with no access to transmission lines and to electrify cities without creating the smog and soot that comes with central power stations fired by coal and oil.

4) **Investors are demanding change.** On April 16, 2015, at BP’s annual general meeting, a carbon asset risk shareholder resolution was passed by a vote of 98.28%. That means that almost all shares were voted in favor of a resolution that demanded BP take action on climate by changing its reporting to include Carbon Asset Risk. A day later, dozens of investors called on the Securities & Exchange Commission to improve oil & gas companies’ responses to climate-related material risks, which – they wrote – directly affect the profitability and valuation of companies.
4 CRITICAL QUESTIONS FOR OIL & GAS EARNINGS CALLS:

1. What range of oil prices are you currently using to screen projects for economic viability, and for how many years would those prices need to persist in order to make the project profitable?

2. In March, the Chairman of Sinopec predicted peak demand in China for diesel in 2017 and for gasoline in 2025. The state bank of India is funding 15 GW of solar by 2020. Costs for solar have dropped. A March 2015 report by Pricewaterhousecoopers found that the bid for Dubai Electricity and Water Authority’s 200MW solar PV plant was cheaper even with oil at US$10/bbl and gas at US$5/MMbtu. Have you revised your demand forecasts and cost-of-electricity comparisons to reflect these significant changes in the landscape?

3. Have you calculated the impacts to earnings for any divergence from your demand forecasts for 2035 or 2040? For example, what would it mean for your earnings if your demand forecast overestimated demand growth by 1%, 5% or 10%?

4. As you consider which projects to defer or cancel due to reductions in capital expenditures, are you considering some measure of carbon pricing or regulation over the life of the project in addition to the break-even figures for a project?

HIGHLIGHTED SHAREHOLDER RESOLUTIONS

**Tri-State Coalition resolutions to reduce greenhouse gas emissions:** Shareholders request that the Board of Directors adopt long-term, quantitative, company-wide targets for reducing greenhouse gas emissions in products and operations that take into consideration the global commitment (as embodied in the Copenhagen Accord) to limit warming to 2 degrees C and issue a report by November 30, 2015, at reasonable cost and omitting proprietary information, on its plans to achieve these targets.

| Chevron, ExxonMobil |

**New York City Office of the Comptroller Proxy Access:** Motivated by the risks associated with climate change, The New York City Comptroller’s Office filed the resolution below with 33 fossil fuel companies during the 2015 proxy season stating, “business-as-usual by fossil fuel firms raises board concerns.” For more details see the New York City Comptroller’s Boardroom Accountability Project website.


**Aiming for A Coalition:** Christian Brothers, ICCR, VTPIC, CT Retirement Fund Carbon Asset Risk resolution calling on the company to report on whether it’s portfolio is resilient to climate change and IEA Scenarios including one that achieves no more than 2 degrees of global temperature rise.

| Shell |

About the Carbon Asset Risk (CAR) Initiative: Through the CAR Initiative, 75 investors managing more than $4 trillion in assets have called on 45 of the world’s largest fossil fuel companies to assess and disclose how their business plans fare in a world turned upside down by unchecked climate change. The CAR initiative is coordinated by Ceres and Carbon Tracker, with support from IIGCC and IGCC. For more information, visit [www.ceres.org/issues/carbon-asset-risk](http://www.ceres.org/issues/carbon-asset-risk) or contact Shanna Cleveland at cleveland@ceres.org.