Equity Research; Oil Major revival?

COLLINS SARRI STATHAM INVESTMENTS

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Key Risks to Price Target

Not applicable

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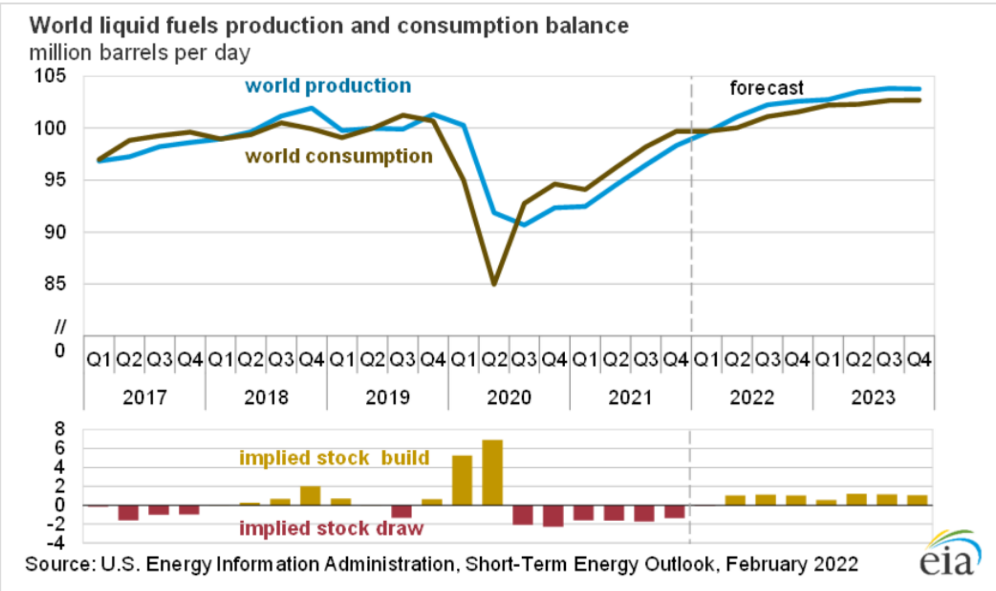
Q4 2021 was a positive scorecard for global oil majors after a long and lean 24 month period. There was tangible earnings improvement over Q4 2021 with particularly encouraging reports from Shell and Total Energies.

Oil Major	Q4 21 adjusted earnings	Q3 21 adjusted earnings	Gain (%)
BP	$2.32BN	-$2.54 BN	>100%
Chevron Corp	$5.1BN	$6.1BN	-16.4%
ExxonMobil	$8.87BN	$6.75BN	+31.4%
Shell	$6.4BN	$4.13BN	+54.9%
Total Energies	$6.8BN	$4.8BN	+41.6%
Total Market Cap	$820BN (30.9.21)	$1,024BN (31.1.2021)	+24.8%

Source: CSS Investments Ltd

The oil sector's valuation at $1.02 tn end January 2022 (prior to Russia/ Ukraine tensions) is up c. 24.8% from Q3 and amounts to a re-appraisal of crude oil fundamentals in the context of a global normalization post pandemic.

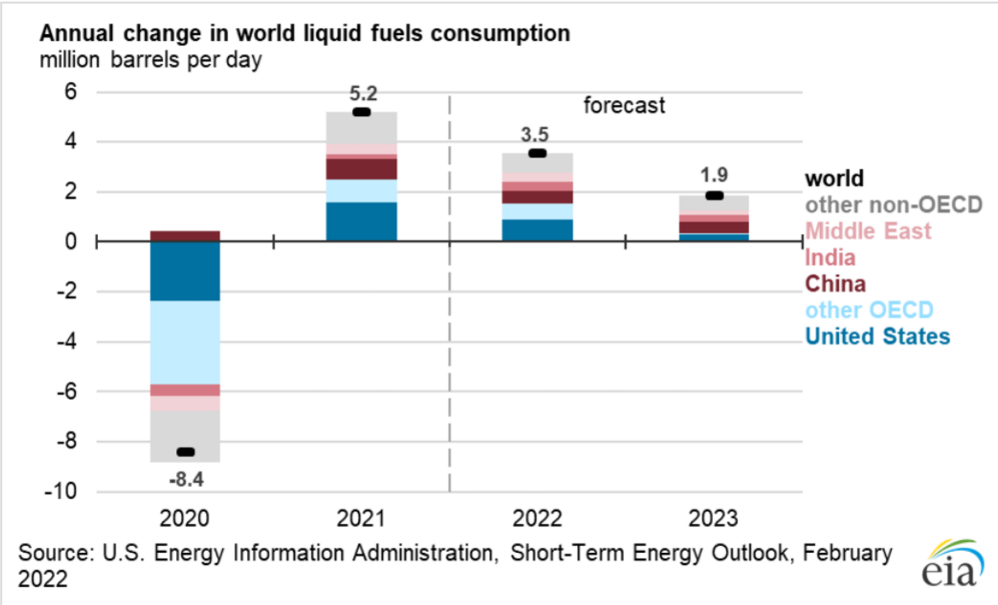
It was tempting during the C-19 pandemic to view crude oil as post 'peak oil' – the theoretical peak in global oil demand that would mark the turning point from oil demand growth to ex-growth. What does the data say?



According to the US Energy Information Administration forecast (3rd February 2022) 99m b/d (barrels/ day) was consumed globally in January 2022 up 6.6m on January 2021. Global demand is expected to rise to an average of 100.6m b/d for 2022 up 3.5m b/d on 2021 and 0.3m b/d above the 2019 peak. Over 2023 global oil demand is expected to rise another 1.9m b/d to 102.5m b/d.

In mid-2020 many observers thought 2019 would mark 'peak oil'. But the data is now suggesting the world has not yet reached 'peak oil'. This is very bad news for environmentalists and for the objectives of the 2016 Paris Climate Agreement.

Furthermore, there is no evidence of oil demand erosion in any single bloc, in 2021, nor is this forecast this year or next.



Crude oil demand has been robust over the post pandemic period, and alternative energy sources have yet to impact the energy mix sufficiently to cause a drop in demand due to substitution. What has happened is new alt energy technologies have reduced the growth and trajectory of oil demand but not replaced current demand. That said, production growth at most oil majors appears to be struggling as well after a few years of lower capital spending.

Looking ahead the short term picture appears positive for oil majors due to:-

i) Re-opening demand/ increased international travel over 2022 (aviation represents c. 7.8% of oil demand)

ii) Possible sanctions on Russian oil if Russia invades Ukraine or undertakes any military incursion into Ukraine – this may work in similar way to previous sanction on Iranian oil exports.

iii) Increased emphasis on debt gearing reduction with a commensurate increase in shareholder returns (Shell $8.5bn dividend in H1 2022/ BP $1.5bn in Q1 2022 – Chevron lifted its Q1 dividend by 6%)

iv) OPEC grip/ discipline on production appears to be holding firm for now.

Conclusion

The valuation of oil majors remains low on a relative basis largely due to their lower index weightings/ ESG considerations/ their slow shift to renewables. As oil companies shift their business models away from fossil fuels to renewable energy, presumably they will become more investable. Investors want to also want to witness more corporate change i.e. how companies like BP fund the transition to renewable energy.

Most important is for oil majors to show how they can be part of the solution to the climate crisis, leveraging their significant infrastructure and replacing petroleum with clean energy. The industry is disrupted and reliant on periodic oil price firmness for significant profits. But even so the demand picture looks very good in the short term.

Oil's rebound still leaves it a poor relation relative to the tech sector whose Top 10 companies have a combined valuation of $12.3trn whilst the entire sector (713 companies) is valued at $23.5trn. The oil major's combined market capitalization at just above $1trn is a telling sign that the industry has lost relevance for investors. Recently some confidence has returned but full rehabilitation will require more consistency and progress on the clean energy transition.

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