

The 'Big Oil' Change – Green Shoots

Since the 2015 Paris Climate Agreement, governments and large institutional shareholders have been putting a massive amount of pressure on Big Oil to do more to reduce greenhouse emissions.

BIG OIL WASN'T MOVING FAST ENOUGH

On the shareholder front, many of the largest pension, endowment, and sovereign wealth funds have decided to reduce or eliminate the energy sector from their portfolios since Big Oil was not moving fast enough.

'Big Oil' also known as the 'supermajors' consists of the six largest independent publicly traded energy companies by market capitalization. This exclusive club includes Chevron (US\$172 billion), ExxonMobil (US\$170 billion), Royal Dutch Shell (US\$140 billion), Total (US\$117 billion), BP (US\$72 billion), and ENI (US\$36 billion).

BIG OIL'S INITIAL RESPONSE

Big Oil initially responded to this external pressure by announcing projects for carbon capture storage and biofuels, reducing methane gases, making small investments into renewables and hydrogen, reducing waste in current operations, and providing more disclosure on their ESG (environmental, social, corporate governance) footprint. They planned to continue growing their traditional exploration and production business since they saw themselves, at their core, to be oil and gas companies only.

BIG OIL IS CHANGING

However, over the last year, the four European companies have changed their tune and now see themselves as energy companies rather than oil and gas companies. They want to be part of the solution, not just the problem. As a result, they have announced a seismic shift (green shoots) in their future energy operations by significantly growing their renewable energy portfolio and more customer-centric businesses. The renewable portfolio assets include wind, solar, hydro, biofuels, hydrogen fuelling stations, and electric vehicle charging stations. The customer-centric companies would include traditional utilities (such as water, gas, electricity) involved in energy transmission, distribution, and servicing.

Sample key highlights:

ROYAL DUTCH SHELL

- Committed to net zero emissions by 2050 or sooner
- By 2030 to provide reliable electricity supply to 100 million people in the developing world
- Investing US\$2 billion per year in cleaner energy solutions
- Announced a major offshore wind project

BP

- Committed to net zero emissions by 2050 or sooner
- Recently announced a major offshore wind project
- Within ten years
 - Increasing low carbon investments to US\$5 billion/year or ten times the current investment
 - Providing 70,000 electric vehicle charging points up from 7,500 today
 - Reducing oil & gas production by over 40% with no exploration in new countries
 - Reduce BP's operations emissions by 30-35%

TOTAL

- Committed to net-zero emission by 2050
- Focused on growing its energy production led by LNG and electricity
- Increase annual spending on renewables from US\$2.9 billion to US\$3.6 billion or 20% of capital investments
- Targeting to have 150,000 electric vehicle charging stations by 2025

Since President Trump's 2017 decision to pull the U.S. out of the Paris Agreement, ExxonMobil and Chevron have not been as aggressive in re-shifting their energy portfolios. Instead, they have continued acquiring and re-investing in their traditional oil and gas assets. With President-elect Biden's promise to have the U.S. re-join the Paris Agreement in January 2021, and given his clean energy agenda, we could see both companies follow their European counterparts.

The pressure continues to mount on Big Oil. On December 7th, Engine No. 1, an activist investment firm, and the California State Teachers' Retirement System (CalSTRS) have teamed together to force strategic changes at ExxonMobil. Together both firms own US\$350 million of ExxonMobil shares. They are seeking to replace board members and move the company into renewables and clean energy.

The Bottom Line

THE FUTURE OF OIL AND GAS

We believe oil and gas will continue to be the primary energy source globally for at least the next two to three decades. Big Oil has woken to the new reality that governments and shareholders are committed to starting the transition to cleaner energy sources. Although this transition will not be easy, Big Oil has several positives on its side: direct access to key policymakers, strong balance sheets (meaning they can afford to make mistakes in their transition), excess free cash flow generation, global scale to create large joint ventures or acquisitions in the renewable and customer-focused businesses, global capital allocation discipline, and most importantly the time (30 years) to reach their targets.

BIG OIL'S TRANSITION As stewards of capital, we see Big Oil's transition having potentially wide-ranging investment implications:

- Despite higher global oil prices, heavy oil assets (such as oilsands) may not be valued as highly as in the past
- Big Oil will continue their departure from the Canadian energy patch due to high operating costs and regulatory uncertainty
- Canadian energy mergers and acquisitions will accelerate as foreign buyers disappear and cost reduction is key
- Private & publicly held renewable assets and traditional utilities will be permanently valued higher, as Big Oil looks for acquisitions to transition their portfolios
- Big Oil's return on invested capital is set to decline as they move to become more like utilities over the next decade; as a result, their stock prices may be range-bound with attractive dividends

RENEWABLE ENERGY We see the period of 2010-2020 as the top of the first inning for renewables globally. During this decade, governments (led by the European governments) provided massive subsidies to kick start creating solar, wind, and hydro projects and bring them into production. After the Great Recession of 2008-2009, governments wound down the subsidies. The renewable industry had to deal with falling demand prices and lower returns – resulting in an industry consolidation between renewable equipment manufacturers and a re-thinking of the business model.

Over the last decade, technological advances, competitive supply chains, growing developer experience, and economies of scale have reduced the cost of solar power by 82% and wind power by 35%. These options are now more economical than new coal power plants. With Big Oil moving aggressively into renewables, we would consider this the bottom of the 1st inning for renewables in a long-term secular uptrend. There is an old saying in the investment business – ‘the trend is your friend,’ and this is currently appropriate for renewables, cleantech, and energy distribution/transmission businesses.

Anil Tahiliani, MBA, CFA
Vice President & Portfolio Manager



Matco Financial Inc.
350, 440 – 2nd Ave SW, Calgary, Alberta
T2P 5E9

Email: info@matcofinancial.ca
Local: +1-403-539-5740
Toll-Free: +1-877-539-5743

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