Big Oil: *Difficult conditions, breathtaking prospects*

by Mathijs van Gool

It can't be easy working for Big Oil these days. The news on the energy front is dominated by electric cars, transition pathways, carbon dioxide emissions and so on. Big Oil is busy every day supplying the world with energy, but the public doesn't seem to notice.

That's not all. The projected demand for oil is continually being re-adjusted downwards by Opec, the International Energy Agency (IEA) and other market analysts. The possibility that we've already quietly hit Peak Oil consumption can't be ruled out. The oil price continues to hover around $65 a barrel and that puts a brake on revenues at a time when extra investments are just what's needed. Profit margins are under pressure and restructuring has become the order of the day in order to retain some semblance of profitability.

Let's take a quick look at Big Oil's principal activities:

1: In the most profitable division, 'exploration and production', margins are still considerable, but downward pressure is increasing. High costs for services and lower revenues due to lower oil and gas prices are increasingly becoming a problem. In addition Big Oil is forced to exploit ever more difficult and therefore expensive catchment areas.

2: In refinery – as always – it's all doom and gloom. This activity has never managed to meet its return on investment target of 15 percent. The only positive factor is its global retail network, giving Big Oil a monopoly on sales of oil products so that it's still able to book reasonable margins.

3: (Petro)chemicals are strategically a good choice, but offer little succour for the wallet.

4: Power and alternative energy are too marginal and subject to such narrow profit margins that they don't warrant major capital allocation.

But although Big Oil is eagerly seeking cost cuts and tackling the last historical weak points in its organisation to finally build an efficient, smoothly functioning structure, the powers that be at BP, Exxon Mobil and Shell don't seem to be losing any sleep. What do they know that the general public doesn't?

Here are some considerations that serve as reminders that Big Oil's role on the world stage is far from over.

1. For the foreseeable future a society powered by renewables remains a utopian dream. The goal of 20 percent renewables by 2020 set by the EU already signifies a major step, and would represent a major achievement if it were realised. But that's far from certain. The EU goal requires significant subsidies from government. However, governments have had to pump their money into propping up the banks and into keeping the real economy ticking over. A return to normal levels of national debt may well take five to ten years. And all that time there will be less capital available for investments in sustainable energy. Added to that is the fact that governments have still not found a way of persuading cash-rich players like pension funds to participate in the energy transition. Some type of guaranteed return would be enough to get them on board, but at the moment governments can't afford to load their balance sheets with any extra liabilities. As such the 2020 target is probably unfeasible. Despite all the aspirations and necessities, the energy transition process looks set to take a lot longer.

But maybe the switch to new electric vehicles will go far more quickly than envisaged. And maybe then the global drop in oil consumption will become fact. A disaster for Big Oil? It certainly won't help oil prices. But maintaining current production levels in order to supply the volumes needed to keep up with demand already requires enormous effort. That means that even if demand does decline, Big Oil is still in a position to gain market share in a sector where returns are highest: exploration and production.

2. Gas. Big Oil is lord and master in 'free' gas. It has the financial clout, the know-how in the areas of exploration, production and transport, and the gas processing plants. It owns the technology to liquefy gas and to transport it. Big Oil is an indispensable

Has Big Oil reached the end of the line now that renewables look to be taking over? The answer is simple: not by a long shot. The transition to a renewable economy will take decades to realise. In the meantime Big Oil has plenty of opportunities to keep treating its shareholders to attractive returns.

partner for countries seeking to secure their gas needs via long-term supply contracts. And gas is also needed in the transition to an electric economy. The gas industry demands enormous investment and the dash for gas by governments all over the world can't be stopped. Shell and ExxonMobil have huge gas reserves, distribution networks and in-house expertise and reap attractive returns on these activities. This new era of gas has only just begun and is set to last another 50 to 80 years.

3. Big Oil dominates global fuel sales. The returns on these activities are jealously guarded and they don't feature as such in annual reports. In part they are used to offset the poor returns on refining. Although turnover volumes are currently down a hefty 5 percent or more as a result of the global recession, Big Oil's global sales network will continue to be of great value over the coming 10 to 20 years. Even if the demand for oil products continues to decline, this network will enable Big Oil to boost its market share and to keep raking in a hefty cashflow.

4. Residual demand. Even if the transition to renewables continues, there will always be a substantial residual demand for oil and gas driven by electricity generation, countless industrial processes and various transport activities. Big Oil has an excellent network and reputation for supplying raw materials. In this area, too, its market share is set to increase.

5. Expertise in offshore and deep-water exploration and production. No major new geological oil and gas fields remain to be discovered. But the likelihood is very great that a great many large-scale reservoirs will still be found in the existing oil and gas fields, particularly in the more difficult offshore areas. Thanks to its high levels of expertise and investment capacity, Big Oil is almost always involved in such complex offshore exploration.

6. Technical and financial capability. Big Oil still has the know-how and the financial clout to initiate major, complex projects. What's more, Big Oil is still prepared to commit to investments with a payback time of more than ten years. As such it remains the obvious partner for governments and other market players seeking to realise and/or secure long-term targets and for this Big Oil can continue to demand a suitable remuneration.

The scenario outlined above is only feasible for the biggest of the oil majors. In fact one could go a step further and cautiously conclude that the challenges posed are even a touch too ambitious for corporate giants such as ExxonMobil, Shell, BP and Total. Viewed from this perspective it becomes clear that Big Oil can only survive as BIG OIL. For example if the biggest oil companies were to merge, or if the five oil giants were to merge with the next five biggest. But no-one knows that better than Big Oil itself. For long-term investors, the major oil multinationals still offer sufficient investment potential. Investors convinced of the need for mergers in the sector would do best to look to the most likely takeover candidates. And for employees of Big Oil: they are charged with an important social task over the coming decades. The prospects are breathtaking. ■

Mathijs van Gool is a financial analyst who contributes regularly to European Energy Review on the financial aspects of the energy market.

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