Net-zero commitments in oil and gas

May roundup

Hi everyone,

As promised, this month I'm taking a good look into what happened during the AGM season. But first, let's appreciate the backdrop: We're in a full blown energy crisis and prices for oil and gas are either at record highs or at their highest levels in a decade. It should, therefore, come as no real surprise that support for climate resolutions dropped across the board. But dig a little deeper and a more interesting picture emerges.

Meanwhile, windfall taxes are in the air, especially as the UK has finally followed through and implemented one (it was a pretty slow and painful process, with the government initially poo pooing the idea). I look into why the narratives pushed by the oil majors about why this tax isn't a good idea don't quite stack up.

Finally, this being predominantly a newsletter about the clean energy investments of the oil majors, I've got some exciting stories on offshore wind (what else?!), hydrogen and solar. Suffice to say, some big things are happening.

As ever, do reach out if you have comments or feedback and forward this newsletter along to any colleagues who might find it useful - the sign up button is just below.

Cheers,
Micky

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Stat of the month:

23%

The average share of investors that voted in favour of more ambitious climate action at the AGMs of Shell, BP, Chevron, ExxonMobil and Occidental.

Decarbonisation strategies

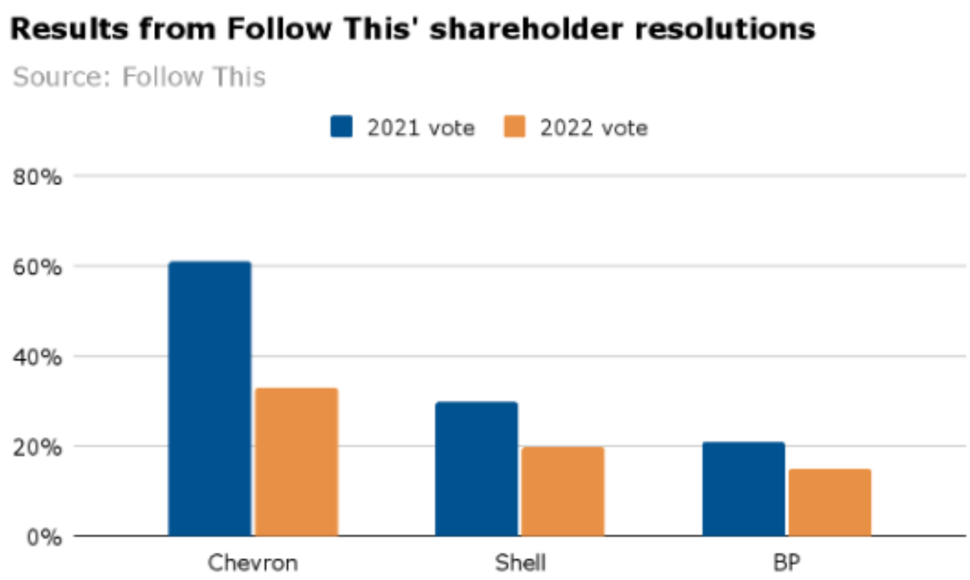
Shareholder resolutions have been a mixed bag

Dutch investor group Follow This has had less success this season. For several years, it has been a persistent thorn in the side of oil companies during their AGMs. It typically submits the same shareholder resolution for each company, asking it to set short, medium and long-term emission reduction targets that align with the Paris Agreement and cover all three scopes of emission.

In 2021, a record number of shareholders backed its proposal. Though that support dropped in 2022, it has far from disappeared.

At BP's AGM, support dropped from over 20% (2021) to just under 15% (2022). At Shell, it fell from 30% to 20%. In fact, a larger number of shareholders backed the investor group's resolutions at the AGMs of the American majors - 33% voted in favour at Chevron's AGM, 28% did so at Exxon's and 17% at Occidental's. It should be mentioned though that Chevron saw the single largest drop in shareholder support. Votes in favour were practically cut in half – falling from 61% to 33%.

I suspect this is largely because the US majors don't have any convincing transition strategies - at least, not yet - while those of the European majors are more sophisticated. As such, shareholders feel less inclined to push for climate action, as many think these companies are already doing a lot.



There's a lot to unpack here, and I don't think the answer is as simple as support for climate action is waning. I suspect that turbulence in global energy markets and much higher prices for oil and gas have had a significant impact on shareholder sentiment. Bloomberg does regular surveys of investors to gauge when they think we will hit peak oil and, surprise, surprise, the higher the price of oil, the later they think it will be. That, and we're currently living through an energy crisis. It's likely that investors think now is not the time to push for more ambitious climate action.

But this means investors are failing to see the forest for the trees, or so Mark van Baal, CEO of Follow This, insists. They're so focused on addressing the energy crisis that they fail to see that solving it requires many of the same tools as tackling the climate crisis, he says. In other words, just because we're living through an energy crisis, doesn't mean investors can't and shouldn't push for more ambitious climate action.

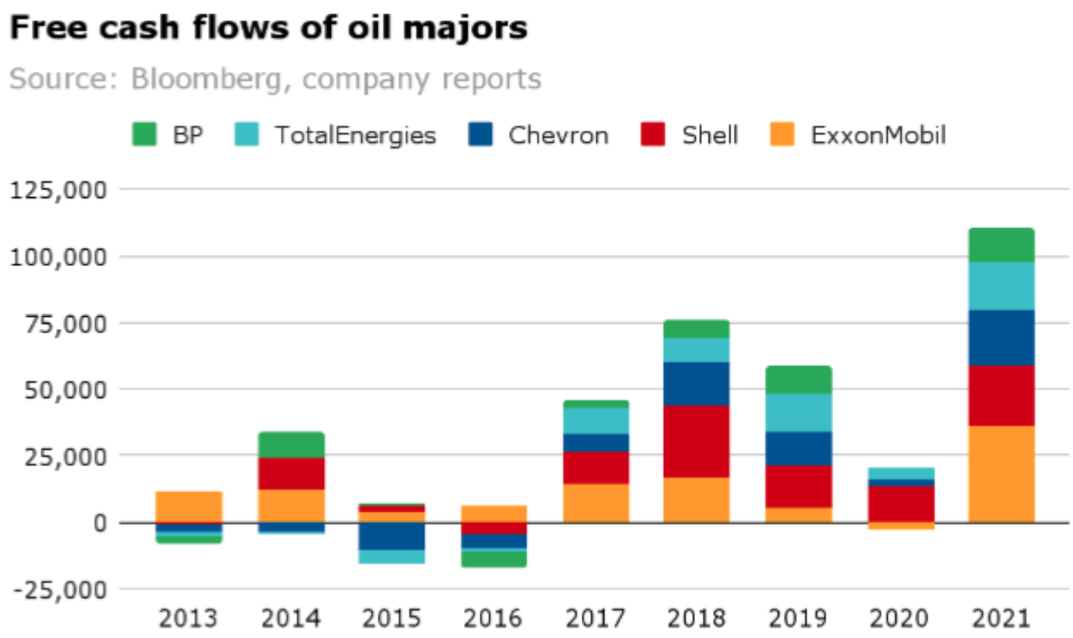
"There is another, equally compelling reason for this lack of investment - the oil majors aren't sure how long the good times will last."

But that doesn't mean shareholder concern for climate change is disappearing. Sizable minorities still backed Follow This' resolutions and there were other signs that shareholders want the oil majors to take climate more seriously. Around 52% of Exxon's investors backed a resolution tabled by Christian Brothers Investment Services demanding the company release an audited report on the impact that the IEA's net-zero by 2050 scenario would have on its bottom-line. They want to know how much of the money they put into the juggernaut might be at risk if the world decarbonises rapidly. They're no longer buying the company line that we're in for a 'gradual transition'.

Moreover, the number of shareholders that voted against Shell's corporate decarbonisation strategy doubled – again, it's becoming ever more difficult to push the narrative that it's an industry leader. Investors want to see more concrete proof of action. And all of this is happening at a time when these companies are making massive profits. A quick return clearly isn't the only thing on investors' minds.

What to do with those record earnings?

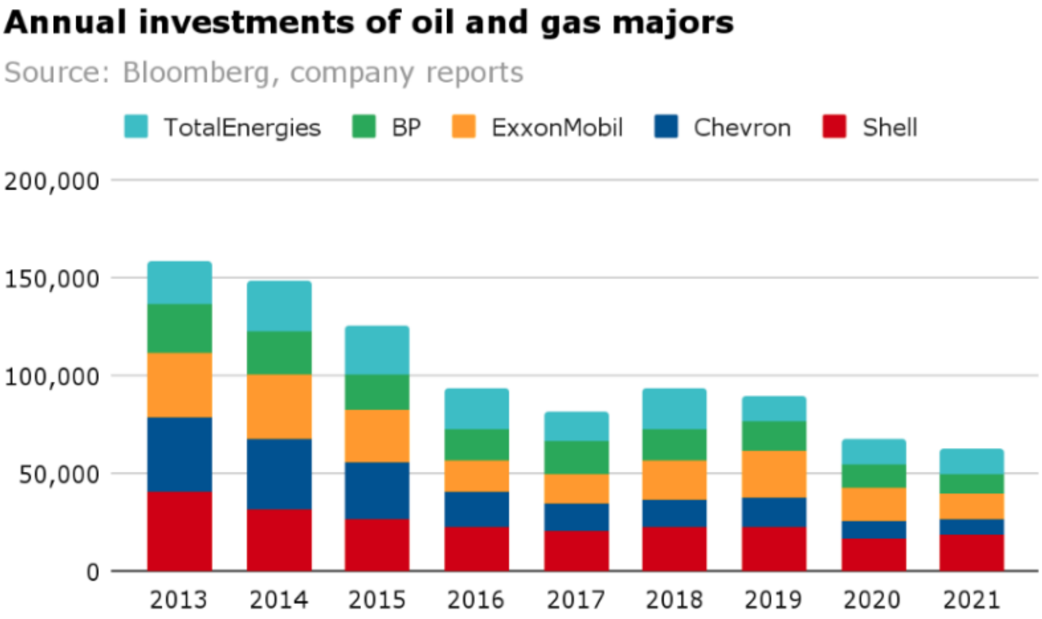
Despite doing well commercially, the oil majors find themselves in an awkward position. Last month, I wrote about how all the majors have benefited significantly from turbulence in energy markets exacerbated by the war in Ukraine. Shell's adjusted earnings jumped to USD 9.1 billion, a threefold year-on-year increase. Meanwhile, BP reported that adjusted earnings more than doubled to USD 6.2 billion. For both companies, their secretive trading divisions drove these mammoth profits, but they do not openly disclose how much money these units make. Collectively, some of the largest Western oil majors have posted their largest jump in free cash flows – an indicator of profitability – since 2013.



In normal times, this would look like good business. But these aren't normal times. Inflation is at its highest rate in decades, energy and food prices are shooting up and people are struggling to get by. The optics aren't great and politicians have taken note. Across Europe, there's been active discussion of a windfall tax – taxing the inflated profits these companies are making due to high energy prices. This debate has been particularly active in the UK, which has actually imposed such a tax after much political debate.

The oil majors tried to push back. They insisted this tax would dampen investment. BP stressed it would invest USD 18 billion in the UK's energy system by 2030, both to boost energy security and reach net-zero. Similarly, Shell has outlined plans to spend between USD 20 to 25 billion, 75% of which would go to low carbon projects (which is likely t include some gas as well).

There are two issues with these narratives. First, these plans weren't really new and so have done little to placate policymakers. Second, and more importantly, the majors haven't actually been investing much at all, which is surprising given the current price environment. Collective investments were down 60% in 2021 from 2013. In the past, when energy prices rose, these companies would pump money into new projects. It's partially for this reason that the oil majors have traditionally been bad stewards of investors' money. Now, the name of the game is to maintain capital discipline and return money to shareholders, either via share buybacks or dividends. That means not increasing annual investments, even when you're recording huge free cash flows.



There is another, equally compelling reason for this lack of investment - the oil majors aren't sure how long the good times will last. Upstream projects have long lead times and while in the past high prices might've incentivised more investment, this time there's a growing sense that fossil fuels are "on the way out". Investors and executives are therefore wary of putting too much money in a shrinking part of their business.

Of course, this begs the obvious question: Surely there's some financial wiggle room to spend more on the energy transition? Currently, that's not what's happening. As this newsletter has tried to show, there is serious money going into clean energy, but it remains a fraction of what these companies actually spend. Stepping up those investments would be a good way of showing commitment to what is a growing part of these companies' future businesses.

Speaking of clean energy investments, below are a few of the highlights of the past month.

Clean energy investments

Offshore wind

TotalEnergies emerges victorious in the Carolinas' auction. TotalEnergies and US utility Duke Energy have both secured rights to develop approximately 1 GW each of offshore wind off North and South Carolina's coast. The pair paid USD 315 million for two zones – TotalEnergies doled out USD 160 million while Duke paid USD 155 million. Though this sounds like a large investment, it is significantly lower than recent auctions elsewhere along the US East Coast. In February, the New York Bright lease sale secured USD 4.4 billion in investments. The main reason for this is a poorly articulated or incomplete policy framework, which creates uncertainty in developing projects, according to BNEF.

The industry now fixes its gaze on the Netherlands. The lowlands are poised to become a major hub for offshore wind. The country aims to install 21 GW by the end of the decade and was a co-signatory of a major plan to turn the North Sea into an energy power house by using 150 GW of offshore wind and hydrogen. The Netherlands has a set of auctions coming up, the most immediate of which will see Shell, BP and TotalEnergies going up against each other for the Hollandse Kust West 6 and 7 lots. These zones can host up to 1.4 GW of offshore wind.

A key aim of the Dutch auction is to integrate the offshore wind farms into the wider Dutch energy system. To that end, BP's bid outlines a plan to connect it with 500 MW of electrolysers to generate 50,000 tonnes a year of green hydrogen at BP's refinery in Rotterdam.

Hydrogen

BP goes big, while Shell hints at significant announcements to come. BP will purchase a 30% stake in the Asian Renewable Energy Hub (AREH), one the largest green hydrogen projects in the world, media report. Situated in Western Australia, AREH would tap 16 GW of onshore wind and 10 GW of solar PV to generate hydrogen and ammonia. The project is valued at USD 36 billion. It could produce about 1.8 million tonnes of hydrogen and ammonia a year and could start exporting as soon as 2027.

Additionally, BP and hydrogen producer Linde have announced plans to construct CCS facilities for blue hydrogen production on the US Gulf Coast. The project will have the capacity to capture 15 million tonnes of CO2. Linde is a world-leading hydrogen producer and this project would enable it to 'decarbonise' its production. Evidently, this will be blue hydrogen production. The Gulf Coast appears to be shaping up to be a blue hydrogen hub.

Meanwhile, Shell CEO Ben van Beurden said that the group could potentially quadruple its hydrogen portfolio in the coming months. He did not specify whether these projects would be green or blue, but claimed that the British oil major was "making most progress on the ground".

Solar

BP's solar arm continues to expand its operations. BP's solar joint venture, Lightshore BP, has set up shop in France and intends to build out a 1 GW utility-scale solar pipeline by 2026. Additionally, the group has partnered with Green Rock Energy to build a 150 MW solar PV plant co-located with aquaculture in Taiwan. The Budai project will be among the largest such projects in Taiwan.

TotalEnergies helps kick start Libya's solar sector. The French major has signed a preliminary agreement to develop 500 MW of solar with the General Electric Company of Libya. It will be the first of a series of renewable energy projects in the country. More than the other majors, TotalEnergies has been willing to step into small renewable energy markets, typically in countries that are traditional producers of oil and gas.

In order to help gauge how oil and gas companies are positioning themselves in the energy transition, this newsletter specifically focuses on how they are moving into renewables and clean energy. To offer up-to-date analysis, it uses insight from media sources and subscription-based databases, like Bloomberg and Rystad Energy.

Feel free to forward this newsletter on to colleagues!

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