Questions That Matter

Oil and Gas | Can Energy Companies Prevail?

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Stubbornly low oil prices and industry challenges will continue to strain creditworthiness, even as demand picks up after plunging during lockdowns.

How this will shape 2021

Ratings downside persists. Potential downgrades can stem from restructuring and defaults of weak oil and gas players. At investment grade ('BBB-' or higher), even if leverage metrics recover in 2021, sustained pressure on profitability, volatile prices, and mounting industry hurdles may weigh on business profiles.

Continued low oil prices will hamper investment and oilfield services. The major international oil companies have already reduced capital expenditure by 25%-30% on average. If prices remain low, investment is unlikely to rebound, resulting in more restructuring for oilfield services companies.

Refining margins have been hit hard. This as COVID-19 pushed down demand and excess capacity resulted in low utilization rates. If consumption and refining margins don't improve in 2021, more plant closures and conversions to bio-refineries in mature economies are likely.

What we think and why

Oil price recovery is tied to demand. Lockdowns have hit the transport sectors, and monthly oil demand is still down year on year after dropping more than 8% for 2020. We assume it will recover in 2021, but still be 2%-3% lower than in 2019, not least because air travel remains weak.

Our $50/bbl Brent crude and $45/bbl WTI assumptions for 2021 and 2022 are underpinned by OPEC+. A gradual adjustment of the current 7.7 million barrel per day cuts is critical for balancing the market and reducing high oil stocks. Depressed consumption means refining margins will likely stay at or below the five-year average.

What could go wrong

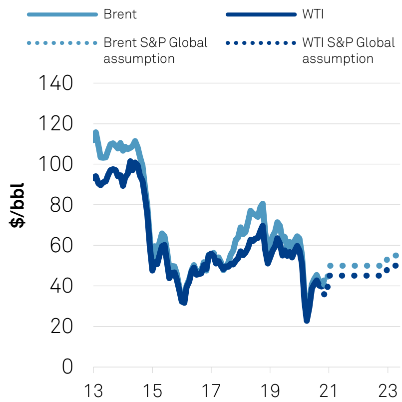
More lockdowns, cracks in OPEC+ compliance, or a warm winter. Oil prices could languish below our $50/bbl Brent assumption if COVID-19 infection rates lead to tighter restrictions, and supply remains higher than demand. In particular for gas companies, a warm winter will again hit revenue and margins.

Overbidding for renewables assets could dilute returns. Many European majors are ramping up non-oil and -gas investment to 20% or more of total capital spending. This comes with execution and other risks, even in growth markets such as renewables.

Moving too fast or too slow. The pace of the energy transition and shape of future energy markets are uncertain. Companies may forego returns by leaving oil behind too soon or building new energy businesses too late.

Oil Prices Will Likely Stay Low

Current prices and S&P Global Ratings assumptions



The energy transition will take decades and means companies face increasing uncertainty, whatever their strategic choices

Robust liquidity keeps a company afloat in a crisis. A solid balance sheet underpins strategy. But it's the resilience and predictability of the business that sustains high ratings

Read more

The Energy Transition: COVID-19 And Peak Oil Demand, Sept. 24, 2020

The Energy Transition: COVID-19 Undermines The Role Of Gas As A Bridge Fuel, Sept. 24, 2020

Write-Downs, While Eye-Catching, Are Not The Largest Issue Facing Oil And Gas Supermajors, Aug. 3, 2020

This report is an extract from the S&P Global Ratings report, "Global Credit Outlook 2021: Back On Track?"

This report does not constitute a rating action

S&P Global Ratings believes there remains a high degree of uncertainty about the evolution of the coronavirus pandemic. Reports that at least one experimental vaccine is highly effective and might gain initial approval by the end of the year are promising, but this is merely the first step toward a return to social and economic normality; equally critical is the widespread availability of effective immunization, which could come by the middle of next year. We use this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

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