

## Oil and Gas

The industry's overall credit profile remains resilient

January 9, 2024

This report does not constitute a rating action.



### What's changed?

**Oil faces downside risks.** Demand growth is slowing to about 1 million barrels per day (bpd) in 2024 from more than 2 million bpd over 2021-2023.

**Balance sheets are stronger.** Producers and refiners have used two years of strong prices and margins to deleverage.

**Mergers and acquisitions (M&A) increased.** Various deals, mostly in North America, signal a desire for quality reserves and critical mass during the uncertainties of energy transition.

### What are the key assumptions for 2024?

**Oil prices support credit quality.** OPEC+ will continue to support prices through production cuts.

**Global gas prices remain stable.** High inventory levels will keep U.S. gas prices suppressed and we expect the Title Transfer Facility (TTF) to be elevated but range-bound.

**Refining margins remain strong but below the peak levels of 2022.** Credit quality has improved, which will help companies withstand any headwinds in 2024.

### What are the key risks around the baseline?

**OPEC+ supportive policies could change.** If oil prices decline, OPEC could reverse supportive policies to garner market share and attempt to permanently drive out marginal cost producers.

**Government intervention is stepping up.** Producers' strong profits, energy affordability and security, and decarbonization mean risks from regulation, taxation, and policies.

**Financial discipline may worsen.** Producers might increase investments or shareholder returns, only for prices and cash flow to fall further, eroding balance sheet strength built up since 2021.

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# Ratings Trends: Oil and Gas

Chart 1  
Ratings distribution

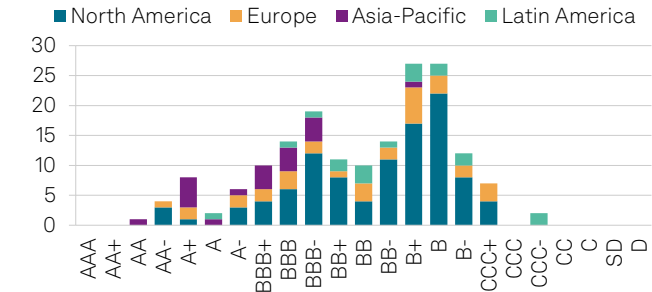


Chart 2  
Ratings distribution by region

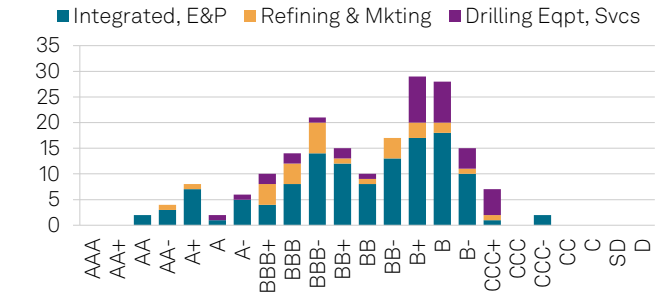


Chart 3  
Ratings outlooks

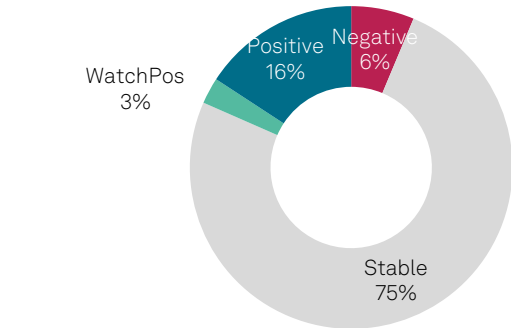


Chart 4  
Ratings outlooks by subsector

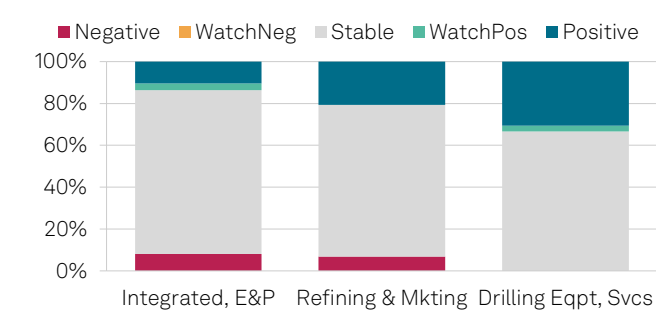


Chart 5  
Ratings outlook net bias

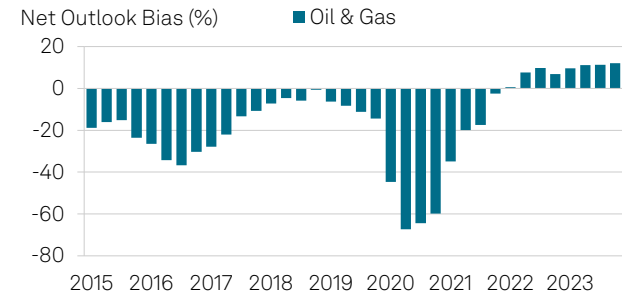
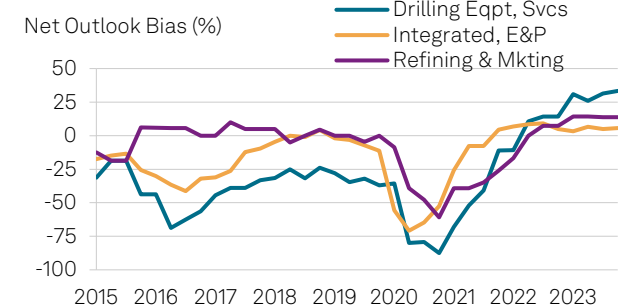


Chart 6  
Ratings net outlook bias by subsector



Source: S&P Global Ratings. Ratings data measured at quarter-end.

# Industry Outlook

## Ratings trends and outlook

The overall positive ratings trends we have seen in previous years continued in 2023. Healthy oil and TTF natural gas prices, robust refining margins, and financial discipline that limited production growth allowed companies to garner strong netbacks and cash flow. Producers remain focused on a financial discipline that targets limiting outspend and capital expenditure (capex) levels. The high levels of M&A activity in 2023, particularly in North America, have largely been credit positive as most acquirors have used equity as a currency. We expect positive momentum to slow in 2024 as issuers allocate more cash flow to equity-friendly initiatives.

Oil field services (OFS) has been slower to join the positive ratings trends due to upstream capital discipline, but recent upgrades and positive outlook revisions reflect improved margins and a focus on the balance sheet. We believe some segments of the OFS space will exhibit less cyclicity during industry troughs owing to improved market dynamics. Over the last several downturns, retired equipment has not returned, and many companies have either filed for bankruptcy or merged, resulting in fewer suppliers and greater discipline with respect to pricing and new builds.

The refining industry had another good year due to above-average refining margins, strong balance sheets, and ample liquidity. In North America, refiners remain well positioned, with lower input costs than most of their global peers and supportive demand. We expect demand for distillates like diesel and jet fuel will support above-average margins for 2024 as gasoline margins begin to normalize. Credit ratios remain strong, and companies will likely continue to focus on returning cash to shareholders after repaying debt borrowed during the pandemic.

Refining capacity is growing globally, with significant capacity additions in Africa, China, and the Middle East coming online in 2024. Net capacity could increase by about 1 million barrels per day, which would keep pace with global demand growth if all this capacity successfully comes online. European refiners will also experience solid margins compared with their Asian peers, which have higher costs and compete with Russian product exports diverted from Western markets. We expect global biofuels and alternative fuel consumption to continue to grow, but this is unlikely to become a meaningful credit driver until the second half of the decade. Lower demand and higher climate-related costs will weigh on European and U.S. West Coast refiners before the broader asset class.

## Main assumptions about 2024 and beyond

### 1. Despite recent softness, oil prices should remain supportive of credit quality.

As of the date of this publication, oil prices have retreated somewhat, reflecting weaker demand from China as the COVID-19 demand rebound loses steam and concerns remain over growing production from non-OPEC countries. However, we assume oil prices will remain supportive for credit because we believe OPEC+ will continue to produce less oil and Saudi Arabia and Russia will remain steadfast with their unilateral production cuts. It's unlikely OPEC will want oil prices sustained below \$70/barrel because this would be insufficient for several OPEC members to balance their budgets.

### 2. North American gas prices lie in wait for the liquefied natural gas (LNG) tsunami, while European gas prices remain elevated but stable.

Gas prices in North America will remain suppressed throughout 2024. It's hard to find any near-term catalysts that support higher prices as supply looks to outstrip demand and inventory levels remain elevated. If unseasonable weather patterns occur in the winter, the U.S. and European markets could be well oversupplied heading into the winter injection season that begins in April.

### 3. Refining margins will remain robust as demand likely outpaces supply additions over the next year.

Refining margins in North America will likely be above the long-term average in 2024 despite weakness in the gasoline crack since late summer. Growing global demand for diesel and jet fuel will outpace capacity additions in Asia and the Middle East, which will support margins over the next 12 months, albeit down from peak levels in 2022-2023.

**Oil prices will remain supported by OPEC+.** Oil prices are under pressure, primarily from non-OPEC production growth, which we expect will outstrip OPEC+ production cuts and increase inventory levels. Indeed, crude oil inventories have been creeping toward the five-year average. We anticipate much of the non-OPEC growth will come from the U.S. and Canada as well as Brazil and Guyana. Global supply growth is likely to outstrip demand growth in 2024 as the COVID-19 impact on demand growth wanes further, particularly from China.

Recently, OPEC+ announced new voluntary cuts of about 2.2 million bpd, with Saudi Arabia and Russia continuing their voluntary production cuts of 1.3 million bpd through the first quarter of 2024. However, the key question remains how much of the production cuts OPEC members will honor.

**Natural gas prices will remain stable as inventories stay elevated.** Since the beginning of the year, the Henry Hub, despite a record power burn this summer, has been rather lifeless, and we aren't confident about near-term prospects for gas prices. A mild winter, the Freeport LNG outage, and robust production weighed on prices. Although declining prices lowered the gas-directed rig count about 26% since the end of 2022, production continued to rise. This was largely due to improved well productivity, a lag on production from gas drilling last year, and a decline in drilled but uncompleted well count in the Permian.

Natural gas inventories in the U.S. are approximately 3.8 trillion cubic feet as of Dec. 7, 2023, and according to the Energy Information Administration, the Lower 48 will enter the winter heating season, which runs from November 1–March 30, with the most natural gas in storage since 2020. This means the U.S. is well supplied as it heads into the early months of the winter heating season. The panacea for natural gas prices in the U.S. will likely come from the 13 billion cubic feet of LNG growth expected by 2028. We expect natural gas prices will begin responding to LNG

buildout sometime in the back half of 2025 and continue an upward trajectory as the U.S. adds capacity through 2028.

European natural gas prices, particularly the TTF, remain elevated and broadly in line with our assumptions. EU efforts to reduce natural gas consumption, a weak EU economy, and alternative LNG sources to Russian natural gas have proven successful in boosting inventories and kept the TTF from increasing further. Indeed, the EU has reached its 95% target inventory levels as it begins its winter heating season and, barring an excessively cold winter, has alleviated supply concerns for this winter.

**Refining margins will moderate from peak levels but remain healthy globally.** Refiners continue to benefit from above-average refining margins. We believe this trend will continue in 2024 but moderate as more global capacity comes online. Several factors support resilient margins for the next 12 months, including tight inventory levels, growing demand that outpaces globally capacity additions, and market/product disruptions related to Russian sanctions. We anticipate North American refiners will realize some of the highest margins globally due to lower feedstock costs and lower natural gas prices compared with their European and Asia competitors.

North American refiners also have a complexity advantage, which allows them to pivot to higher-value products such as distillates (diesel and jet fuel). We expect these products to have stronger demand than gasoline. In addition, the regulatory framework is supportive for renewable fuel production, which will likely continue to encourage some switching to alternative fuels from traditional and lower companies' overall carbon footprint.

We believe European refineries' margins will benefit from growing global demand for refined products in the coming year and the absence of Russian refined products due to sanctions, which will likely find markets in Asia and India, to the detriment of refining assets in those regions. Longer term, we expect capacity additions from mega-refineries such as Nigeria's 650,000 bpd Dangote refinery in late 2024 and another two million bpd of capacity scheduled to come online by 2025 could pressure margins globally and ultimately lead to some capacity rationalization.

### Credit metrics and financial policy

Our hydrocarbon price deck remains supportive of credit quality. We have flat West Texas Intermediate and Brent oil prices for the next three years of \$80 and \$85 per barrel, respectively. Although we expect companies to allocate more cash flow toward shareholder rewards rather than credit-friendly initiatives, we do forecast credit ratios to improve as they retain some cash flow for debt retirement. We anticipate global capex growth of low-single-digit percent. We believe companies will continue to conduct most M&A in a credit-friendly manner.

## Key risks or opportunities around the baseline

### 1. Insufficient supply restraint from OPEC+ or expectations of weaker demand growth.

Oil market balances hinge on OPEC+ continuing to hold back supply. Demand growth is likely to moderate in our 2024 base case but could soften further with China and India as key drivers.

### 2. Government interventions.

2022-2023 saw a remarkable step up in government involvement in the energy sector. We believe there are ongoing and increasing risks of impacts on industry players from regulation, taxation, and policy implementation.

### 3. A reversal of companies' trend to strengthen financial discipline and resilience.

Debt reduction and limiting capital spending and shareholder distributions to internally generated cash flows have been key drivers of recent rating upgrades. Companies could start unwinding these credit benefits if organic or inorganic investments step up materially. This would be exacerbated if operating cash flows fell at the same time.

### 4. Intensifying environmental risks could potentially affect our ratings.

Oil and gas activities are typically the most exposed to uncertainties of the energy transition.

**Insufficient supply restraint and tepid demand.** The strong recovery in demand for oil products after the COVID-19 lockdowns and collapse in 2020 is coming to an end. S&P Global Commodity Insights forecasts demand closer to 1 million bpd from 2024 from about 2.4 million bpd in 2023 and an average of 1.9 million bpd in the decade before 2019. With flattish demand in developed markets, China and India are likely to be significant contributors. If higher interest rates or other challenges start to weaken global economic activity further, oil demand might soften more. The anticipated summer recovery from the seasonal quarter-on-quarter dip in early 2024 could then be muted.

This underlines the importance of the continued supply restraint by OPEC+ countries, especially the ongoing 1 million bpd cuts by Saudi Arabia and the 0.5 million bpd announced by Russia. These cuts look necessary to balance the market in 2024, even assuming baseline demand growth of 1 million bpd. Even with Brazil joining the exporter group, production growth from the Americas--with the U.S. producing more than ever before--will more than cover estimated demand growth in 2024.

We note that natural gas markets in the U.S. decreased in first half 2023, as moderate demand after milder winter weather wasn't offset by lower supply. This pattern might recur, which would limit any rating upside for gas-focused producers. With European gas storage at the top of historical levels, the risk of supply disruptions is unlikely to result in price volatility rather than interventions to limit usage further.

**Government interventions.** Confronted by gas supply shortages in Europe with the Russia-Ukraine war and decarbonization policies elsewhere, global energy markets have seen a step up in government involvement. The supernormal profits of many primary energy producers as a result of actual and potential supply concerns have drawn both politicians' and consumers' criticism and additional taxation, especially on domestic European activities.

We believe there's risk that higher taxation will not reduce when commodity prices fall. Even with lower debt and cost discipline, this could mean lower funds from operations and credit metrics and potentially tighter liquidity for lower-rated names, particularly if reserve-based facility availabilities decline.

**Loss of financial discipline.** Most companies have used the bonus of sustained high prices to deleverage and term out/pay down debt maturities. Capital investment has also been controlled and contained well within operating cash flows, especially for publicly listed companies.

Nonetheless, not all companies have set out financial frameworks to guide their capital allocation and distributions to shareholders. Even for those that have, it remains to be seen how much they will cut back distributions as and when markets fall back. Producers might also step up investments significantly or commit to higher shareholder returns, which could pose risks, potentially for ratings, if prices trend or settle at lower levels for some years.

**Environmental risk factors.** We believe our ratings on producers will depend on their oil and gas activities amid a changing environment for years to come. These businesses will continue to generate most of the operating and free cash flow for at least the next five years in our base cases, underpinning ratings. Oil and gas activities are also typically the most exposed to uncertainties of the energy transition.

Companies are implementing different strategies to underpin credit strength and sustainability for future decades. Carbon capture is likely to play a part, but given the global magnitude, we don't see it as a solution for Scope 3 emissions, which is when fuels are burnt (see "[Carbon Capture, Removal, And Credits Pose Challenges For Companies](#)", published June 8, 2023).

Activities in parallel energy markets or other sectors will generally have to grow materially before they can supplement or replace lower oil and gas cash flows to a meaningful extent. We view many low-carbon activities as cash flow negative after capital investment. Nonetheless, we generally believe these investments are affordable, not least in the prevailing price environment.

In our methodology, a different division ordinarily needs to have an ongoing 20% contribution to the group for it to have a significant weight in our ratings. Diversifying into power generation would not necessarily transform our view of a company's overall industry risk exposure because we see the intrinsic risk of unregulated power and gas as broadly comparable to oil and gas production, refining, and oilfield services.

This said, financial resilience is one commonality across issuers, as is a focus on production with low costs as well as low methane and other emissions for most.

## Related Research

- [S&P Global Report Examines External Funding Outlook For North American and European Oil And Gas Producers](#), Nov. 16, 2023
- [S&P Global Ratings Has Raised Its Henry Hub Natural Gas Price Assumptions For 2024 And 2025](#), Nov. 7, 2023
- [Global Offshore Energy Sector Is On The Road To Recovery](#), Nov. 7, 2023
- [What's Driving The New Wave Of U.S. E&P Consolidation?](#), Oct. 19, 2023
- [Clear LNG Outlook Could Turn Murky Near End Of Decade](#), June 27, 2023
- [Carbon Capture, Removal, And Credits Pose Challenges For Companies](#), June 8, 2023
- [Credit FAQ: How S&P Global Ratings Formulates, Uses, And Reviews Commodity Price Assumptions](#), April 20, 2023

## Industry Forecasts: Oil and Gas

Chart 7

### Revenue growth (local currency)

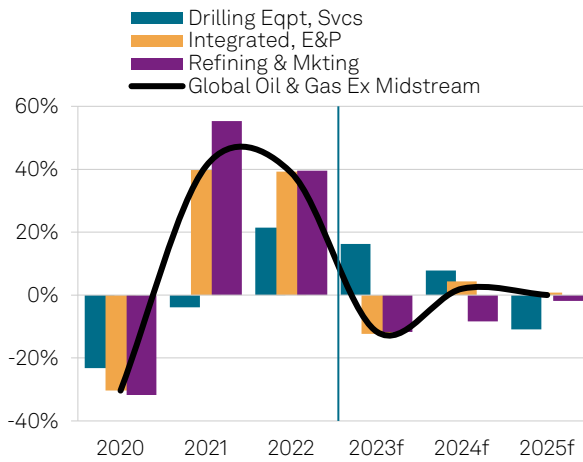


Chart 8

### Capex Growth (USD, adjusted)

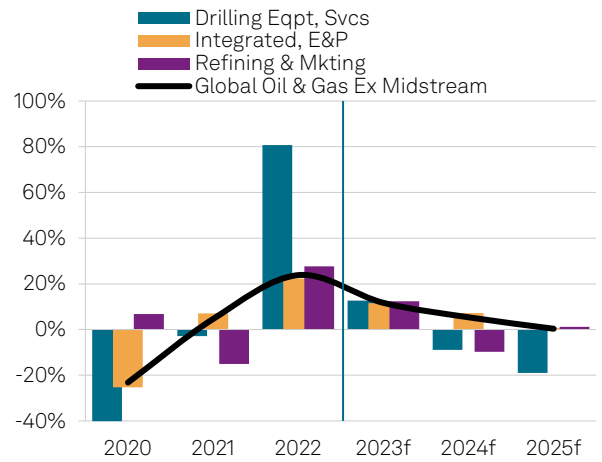


Chart 9

### Debt / EBITDA (median, adjusted)

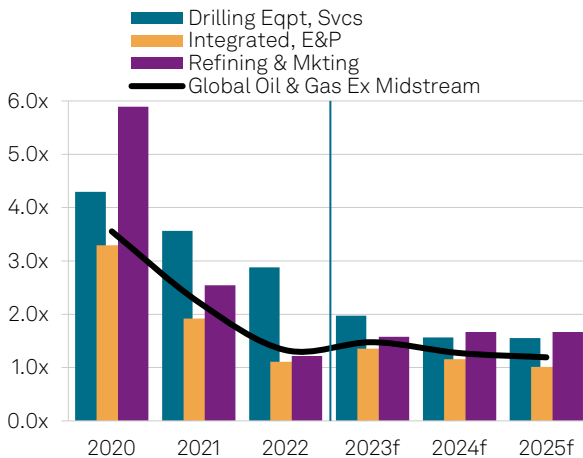
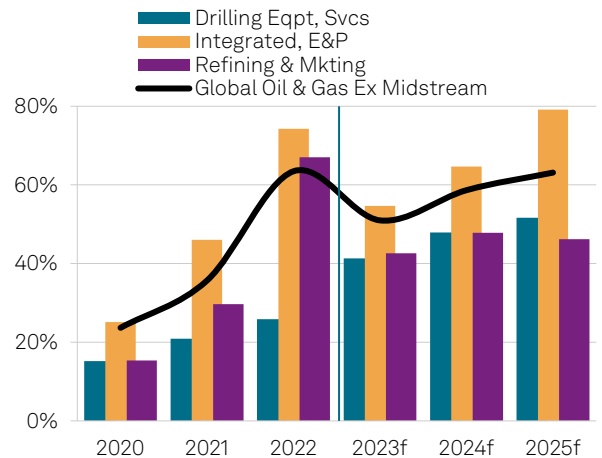


Chart 10

### FFO / Debt (median, adjusted)



Source: S&P Global Ratings. f = Forecast.

Revenue growth shows local currency growth weighted by prior-year common-currency revenue share. All other figures are converted into U.S. dollars using historic exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO—Funds from operations.



## Cash, Debt, And Returns: Oil and Gas

Chart 11

### Cash flow and primary uses

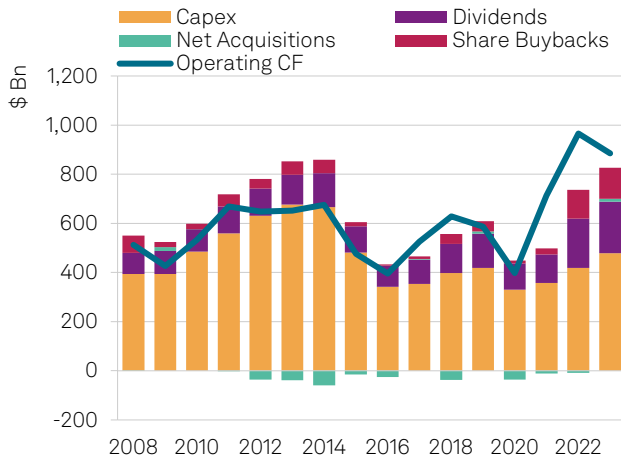


Chart 12

### Return on capital employed

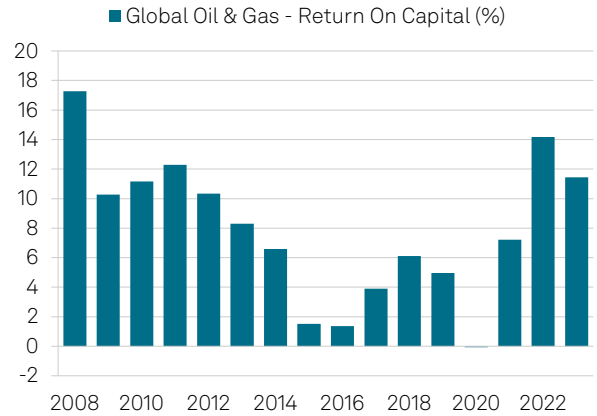


Chart 13

### Fixed- versus variable-rate exposure

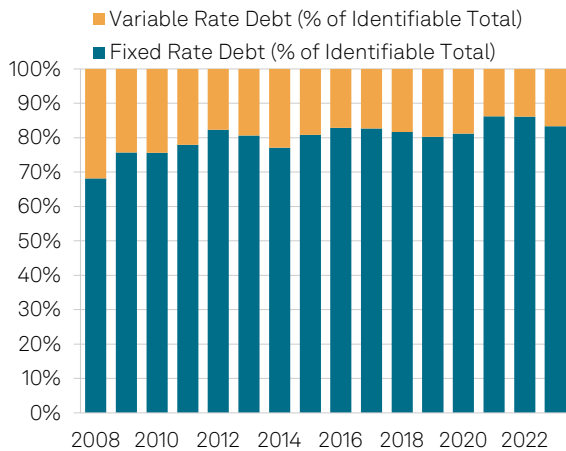


Chart 14

### Long-term debt term structure

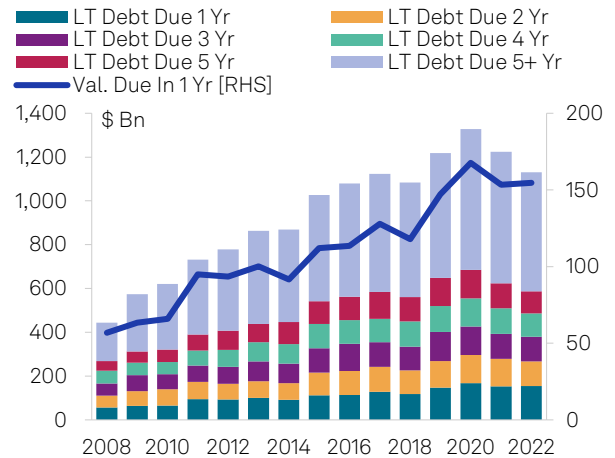


Chart 15

### Cash and equivalents / Total assets

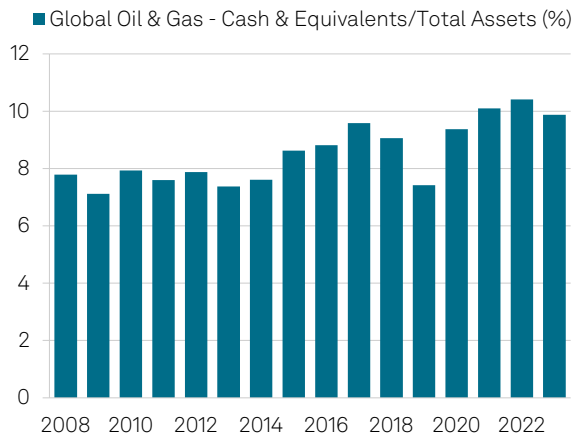
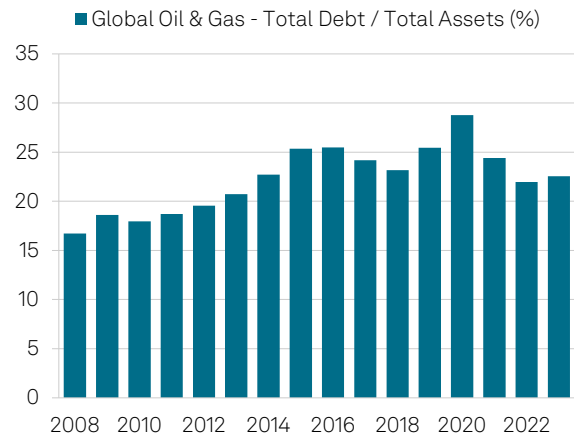


Chart 16

### Total debt / Total assets



Source: S&P Capital IQ, S&P Global Ratings calculations. Most recent (2023) figures use the last 12 months' data.

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