Article | 30 March 2020 Credit | Energy

European oil & gas majors take action

Already suffering from oversupply, the Covid-19 outbreak is pushing the energy sector to revise its business plans for 2020



Bearish oil fundamentals prompt major rethink

At the start of the year, the International Energy Agency (IEA) was expecting that oil demand over 2020 would grow by 1.2MMbbls/d. Clearly, the spread of Covid-19 and the resulting country shutdowns and travel restrictions have changed that projection, with oil demand now expected to contract over 2020. What's less clear is precisely how much demand destruction could be seen, but we are assuming it's something in the region of a 2MMbbls/d year-on-year decline. The demand hit is weighing heavily on oil prices, and European oil & gas majors are responding to the situation by cancelling share buybacks and reducing capital expenditure. These actions, combined with the companies' robust liquidity and leverage positions should limit the extent of negative credit rating actions.

On top of the demand hit due to the Covid-19 pandemic, we also saw a collapse in the OPEC+ deal, which has seen a price war break out between Saudi Arabia and Russia. As a result, both countries plan to increase output from April onwards, which will only increase an already significant surplus over the second quarter of this year. Russia appears to have the advantage in terms of fiscal breakeven levels, with the Russians needing a little over US\$40/bbl to balance their budget, whilst Saudi Arabia needs a price in the region of US\$80/bbl. However, it is the Saudis who have more room to increase output and gain market share, with the Kingdom having a sustainable production

Article | 30 March 2020

capacity of 12MMbbls/d, which is around 2.3MMbbls/d above their February production levels. Russia could potentially increase output in the region of 200-300Mbbls/d in the near term.

In the absence of an emergency OPEC meeting, the market will likely have to wait until the scheduled OPEC meeting in June for some sort of action, which would be too late to deal with the surplus expected over the second quarter. We recently revised lower our oil forecasts, and now expect ICE Brent to average US\$20/bbl over 2Q20, versus our previous forecast of US\$33/bbl for the quarter.

ING oil price forecasts

New Forecasts	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
ICE Brent (US\$/bbl)	53	20	35	45	50	60	60	63
NYMEX WTI (US\$/bbl)	48	17	30	40	44	54	54	57
Previous Forecasts								
ICE Brent (US\$/bbl)	53	33	40	45	50	60	60	63
NYMEX WTI (US\$/bbl)	48	28	35	40	44	54	54	57

Source: ING Research

Capital expenditure reduced

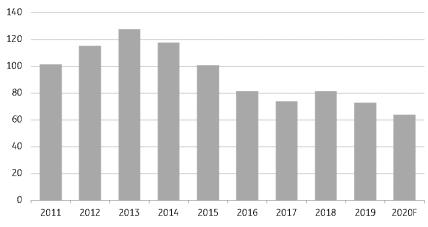
With most European oil & gas majors displaying an average oil breakeven price around US\$40/bbl, the need to review business plans for 2020 has become a requisite for most of them. Our peer group, composed of Royal Dutch Shell, Total SA, BP, ENI, Equinor and Repsol, shows that capital expenditure will continue its descent in 2020.

On an aggregate basis, the top European oil & gas majors have announced an average 18% cut in investments for 2020. According to recent statements, we estimate the peer group capex spending at c.US\$64 billion in 2020 compared with c.US\$78 billion in 2019. Some of these players have announced that they envisage further cuts in 2021. Capital expenditure in 2020 might be reduced further in our view, although the sector's flexibility is limited due to projects already underway which cannot be stopped swiftly.

The oil crisis in 2014-2016 shows that investment reductions tend to be spread over the crisis years and with a certain delay. Plunging oil prices in the period 2014-2016, with a severe dip at the beginning of 2016, pushed oil & gas majors to review their expansion strategy and more importantly their capex and opex efficiencies. As a result, this new crisis sees the Energy sector in a better position this time around with the experience gained a few years ago.

Article | 30 March 2020

Top 5 European oil & gas' investment in US\$bn 2011-2020F



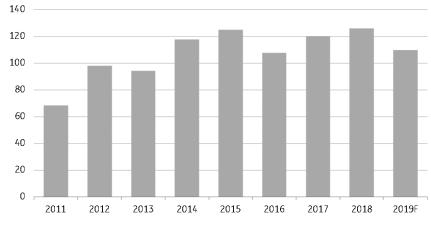
Source: Company reports, ING

Liquidity and leverage relatively robust

On aggregate, Royal Dutch Shell, Total SA, BP, ENI, Equinor and Repsol have strong liquidity with c.\$109bn of cash & cash equivalents on their balance sheets as of end 2019. The peer group's net leverage (net adjusted debt/EBITDA) has seen a small upward peak in 2019, with oil and gas prices already showing some weakness. With an average net adjusted debt/EBITDA at 1.67x in 2019, the European oil & gas majors' leverage still offers some buffer. In 2016, leverage tipped at 3x. Depending on the depth and length of this crisis, leverage may surge to 2016 levels or even beyond.

In 2016, the peer group's deterioration in credit ratios had resulted in a mere one notch downgrade, proving the top European oil & gas majors' resilience and ability to take action during critical times.

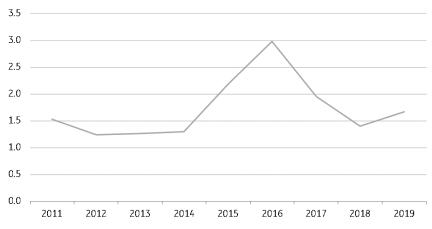
European oil & gas majors' total liquidity (US\$bn)



Source: Company reports, ING

Article | 30 March 2020

European oil & gas majors' net leverage (x)



Source: Company reports, ING

Authors

Nadège Tillier

Head of Corporates Sector Strategy nadege.tillier@ing.com

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@asia.ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies). The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

 $Additional\ information\ is\ available\ on\ request.\ For\ more\ information\ about\ ING\ Group,\ please\ visit\ \underline{http://www.ing.com}.$

Article | 30 March 2020 4