IOC Strategy After Coronavirus and Suggestions for Chinese Oil Companies

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Abstract. Affected by Coronavirus and low oil price, global oil and gas M &A has been in a downturn in 2020. Countries with oil and gas resource intended to revise fiscal terms, enhancing the economics of producing assets and new developments. Many oil companies have faced severe challenges with impact on Coronavirus and oil price crash. According to IHS expectation, the same tightness will continue into 2021. Learned from international oil companies experience, Chinese oil companies should pay more attention to cost reduction, seize opportunities of the M&A market to get high quality projects, and focus more on energy transition.

1. Introduction

After the Coronavirus negative impact and oil price crash, the global oil market is tightening in 2020. The initially strong recovery in global oil demand is now showing signs of slowing down. On the basis of Wood Mackenzie data, Sinopec Corp's half-year loss was US$3.2 billion, while PetroChina posted a US$4.4 billion net loss. Performance was generally weak across all business units. IHS expected that the same tightness will continue into 2021. Many Chinese oil companies have faced severe challenges after impact on Coronavirus.

2. Coronavirus impact on global oil and gas market

The outbreak of coronavirus was an unexpected surprise for everyone in the market and the biggest "Black Swan" event in 2020. The oil and gas industry were facing an unprecedented crisis with a steep decline in demand from the coronavirus pandemic. There are alternative sources of world oil supply, but no alternative sources of world oil demand growth. The coronavirus has upended the natural rhythm of the global oil and gas market. The recovery in global oil demand is uncertain. Depending on the progress of the vaccine development, crude oil price will return to its previous level. There is a significant correlation between the oil price and the global oil and gas assets trade, especially in the period of oil price fluctuation. In the past 20 years, the oil price has experienced three rounds of sharp drops. After the two oil price collapses in 2008 and 2014, global oil and gas asset trading volume decreased rapidly, and gradually rebounded quickly with the recovery of the oil price [1]. Since 2020, the global oil and gas asset trading activity has almost ceased due to the combination of coronavirus pandemic and the collapse of the oil price. In 2020, the coronavirus has spread all over the world. More and more countries have strengthened the immigration control, and many potential transactions have been interrupted or cancelled.
2.1. The bidding activities have been postponed or cancelled.
For example, the 2020 exploration tender was postponed in Lebanon and the exploration tender in Brazil was cancelled. [2]

2.2. Some deals announced in 2019 were cancelled in 2020.
According to Wood Mackenzie data, Neptune Energy terminated its North Sea and Norway deals with Energean On May 20. Neptune Energy will pay a $5 million default fee as a condition of termination.

2.3. A large number of trades have been delayed.
By the end of April 2020, almost $20 billion-$25 billion of announced deals had not been delivered on the basis of Wood Mackenzie's analysis. These transactions are likely to revise terms or Deferred delivery. Hilcorp announced $5.6 billion to purchase of BP's Alaska assets in August 2019. The terms have been revised in April 2020 to reduce Hilcorp's losses. Without coronavirus vaccine, Global business activity is unlikely to resume in 2020. [3]
3. Coronavirus impact on fiscal terms
When the global oil & gas market recovery is uncertain, governments will develop policies to help their economies out of recession. Countries with oil and gas resource face many challenges of fiscal terms revision. There are two key factors in the fiscal term reform, including government tax revenue resource and decarbonization objection [4]. First, the country tax revenue relies on the petroleum production heavily, who want to attract more investments and adopt more flexible fiscal terms to encourage their petroleum sector. According to Wood Mackenzie data, governments have several options to enhance the economics of producing assets and new developments, including tax payments deferral, temporary reduction in royalty rates, investment allowances and remove ring fencing. At the same time, trade war was popular after coronavirus. Some NOC will pursue national company profit by petroleum policy. Petrobras is a typical example of the NOC on domestic opportunities. Foreign companies that have no plans to develop existing discoveries could be forced to relinquish these fields to the NOC.

Secondly, the energy transition is unstoppable, and many countries may choose new project to accelerate the decarbonization objection. They will revise some fiscal terms to support the renewable energy projects. For example, new energy capex and petroleum capex can be deducted by income tax or petroleum tax. The oil company can recover their renewable energy capex on the producing assets. But fossil fuel subsidies hinder energy transition goals. [5] Government has the opportunity to reduce this schedule on the low oil and gas price. Based on Wood Mackenzie statistics, the IEA estimates that fossil fuel subsidies could reduce from US$320 billion in 2019 to US$180 billion in 2020. Finally, decommission of oil and gas facilities will be fraught with difficulties and also very expensive. Governments will focus on this issue and seek for ‘fair share’ of these costs.

4. IOC strategy after Coronavirus

4.1. Deep cut in investment and production option
According to IHS statistics, international oil companies has adjusted the 2020 budget of oil price to $35 / barrel. Since the sharp fall of oil prices in early March, major international oil companies have acted quickly and reduced the investment plans over 10 days. IHS expects global capital spending on exploration and production will reach $450 billion this year, falling $100 billion from a year earlier which is the lowest point in 13 years. Major international oil companies generally cut their capital expenditure by 20%-30%. For instance, Shell, Total and Chevron announced 20% cuts in 2020. BP planned to slash capital expenditure by 25% to $12 billion. Exxon intended to cut capital spending by 30% to $23 billion and $10 billion by 2020.

To survive in the low price, companies have deferred and abandoned investment in large capital-intensive projects. In response to low oil prices, large international oil companies generally focus on short-term, low-risk and high return projects. ExxonMobil has been considering delaying the LNG project in Mozambique. shell has planned to postpone the LNG project in Canada, abandoned the Russian Arctic oil joint venture project. Chevron has planned to postpone a number of unconventional and deep-water projects. Based on IHS data, 85% of the large projects that have passed FID this year may be delayed. Operators has avoided committing to new project investment, and FIDs of new projects has been fallen back to 2014-2016 levels. Most new projects will be deferred in southeast Asia, Africa and the North Sea, even though many projects have attractive full-cycle economics at US $50/bbl.

Table 1. Corporate Service cuts to 2020 capital budgets post price crash

| Company name | Peer group                  | Change to budget (%) |
|--------------|-----------------------------|----------------------|
| CNRL         | Focused Canadian            | -2%                  |
| EQT          | Focused US                  | -6%                  |
| Ovintiv      | Focused US                  | -11%                 |
| Marathon     | Diversified Independent     | -21%                 |
| Premier Oil  | Focused International       | -21%                 |
| Concho       | Focused US                  | -25%                 |
| Company        | Focus Type            | Percentage |
|---------------|-----------------------|------------|
| Cenovus       | Focused Canadian      | -26%       |
| Devon         | Focused US            | -27%       |
| Hess          | Diversified Independent | -27%     |
| Noble Energy  | Diversified Independent | -29%     |
| Kosmos        | Focused International | -30%       |
| EOG           | Focused US            | -31%       |
| Occidental    | Diversified Independent | -32%     |
| Husky         | Focused Canadian      | -33%       |
| Murphy        | Diversified Independent | -34%     |
| Apache        | Diversified Independent | -37%     |
| Pioneer       | Focused US            | -45%       |

Source: Wood Mackenzie

4.2. Multiple profit growth by the energy transformation

In the era of low oil prices, the value chain of petroleum industry has been gradually transferred from the production end to the sales end. At the same time, technological progress has rapidly reduced the cost of renewable energy projects and improved the profitability. In contrast to the last two oil price plunders, major oil companies have taken the development of terminal service business and renewable energy business as an important measure to resist the risk of low oil price. Major international oil companies have slashed investment in response to low oil prices, but investment in renewable energy has remained basically [6]. European oil companies have maintained US$1 billion to US$2 billion in low-carbon power and renewable energy projects accounting for about 5% of total investment. R&D budgets of Total's renewable energy business accounts for 20% of the company's total R&D budget.

BP has established a new customer and product business segment which has elevated customer service to the strategic level of the company, focused on customer experience to grasp the new trend of energy consumption in the future and provide better comprehensive energy services. Total has intended to transform gas stations into community centers or one-stop shops and increased more non-oil services. Shell has stepped up efforts to promote hydrogen applications, with hydrogen refueling stations in Europe and North America.

4.3. Adjustment of the organizational structure

Since 2019, companies have restructured business organization, including BP and Exxon Mobil. Exxon Mobil restructured upstream business. For example, Exxon Mobil integrated one company from five different types of resources which included conventional and unconventional, LNG, deep water and heavy oil. Planning and strategy of three companies have been centralized management by one company, which included the upstream and downstream and Refinery [7]. The problem of low efficiency of decision making and separation of support functions were solved by the two projects integration. Focused on integrated and agile service goals, BP has reframed company organizational structure and established eleven new sections. Four business sectors include operations, customers and products, natural gas and low carbon energy, innovation and engineering sectors, particularly concentrated on operations, customer four core functions, low carbon and innovation. To identify new opportunities and maximizing their value, three integrated departments were set up, including strategic and sustainable development department, regional affairs and urban de carbonization department and trade and navigation department. The four core departments were designed to be more agile and efficient in supporting business operations, such as finance department, legal department, culture department, and public service department.

5. Suggestions for Chinese oil companies after coronavirus

5.1. Cost reduction by Big data analysis and decision-making technology
According to the regular pattern of global business, the rapidly gathering pace of the cost reduction and tight finances exacerbated by low prices. First of all, companies should tighten criteria for investment during periods of low oil prices. Based on the big data, it provided a good method for cost reduction and making scientific decision by modeling the technical factors and construction factors of fracturing operation, optimizing the design and equipping with reasonable productivity and evaluation mechanism. Secondly, many companies changed the original "output first" model, including closing marginal wells, developing sweet spot and integrating the entire industry. In addition, Chinese company should pay more attention to the mature oilfields and focus on the investment-income ratio with capital reduction. Third, Chinese company should improve the budget management system and internal control system to unify the financial report information and improve the investments efficiency [8] [9]. Finally, they should optimize existing assets and divest inferior assets. Chinese company will play the important roll on the market allocation resources and decrease related transactions by business process integration.

5.2. Seize the opportunity of the global assets transaction to amplify M&A of new projects
On the impact of the coronavirus epidemic, the oil and gas industry has come through the toughest year in its recent history. Revenues have collapsed and Investment is at the lowest level in the past 15 years. The sale of oil and gas assets is an urgent need for oil companies to relieve financial pressure. Once the outbreak has eased, international oil prices rose, while the global oil and gas assets trades may increase dramatically. Many countries with oil and gas reserve intended to revise fiscal terms to attract more investment. Chinese companies should identify overseas key target resource countries and focus on the selection and evaluation of high-quality oil and gas assets in the target area.

On the other hand, it is necessary to track existing targets in the market and take actions in an appropriate period to acquire high-quality assets before the current round of oil and gas asset trading market resumes. Chinese company will avoid the external competition and meet the needs of the complex international environment in this way. According to statistics data, innovative transactions has accounted for 40% of oil and gas upstream transactions in 2016. Chinese companies should adapt to the new situation and strengthen research on innovative transactions to avoid related risks. First, they should explore more innovative deal structure. on the basis of cash complete payment, new payment methods rose with the oil price crashed, such as contingent payment, deferred payment and paying for assets with equity, vendor loans, retention of decommissioning liabilities ("clean assets"), swaps and so on.

5.3. Energy transformation to improve the energy security
The current global crisis has revealed deep-rooted loopholes in the current global system. It will lead to a more resilient future for all nations by accelerating renewable energy development and energy transformation. At present, the global oil price fluctuates violently and the fossil energy market is in an unstable state. It is the renewable energy power generation that will improve the energy security. According to Wood Mackenzie news, PetroChina becomes the first NOC to announce carbon neutrality ambitions. during PetroChina H1 2020 results Q&A. PetroChina president Dai Liangwei announced that the company will aim for ‘near-zero’ carbon emissions by 2050. Although no further detail information was disclosed, Mr. Dai comments are still illuminating. Over the past year, CNOOC Ltd, PTT and Petronas have taken first steps. In order to revive their economies at a time of global pandemic, Chinese companies should vigorously promote energy transformation and take the opportunity to promote the development of emerging technologies in order to achieve the 2050 climate target.

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