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Veröffentlichungsversion / Published Version

Zeitschriftenartikel / journal article

Empfohlene Zitierung / Suggested Citation:

Webber, H. (2017). Gazprom ends ExxonMobil's 12-year Reign at No.1: But The Real Story is Utilities and Pipelines. *IndraStra Global*, 6. <https://nbn-resolving.org/urn:nbn:de:0168-ssoar-53945-1>

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Gazprom ends ExxonMobil's 12-year Reign at No.1, But The Real Story is Utilities and Pipelines

indrastra.com/2017/09/Gazprom-ends-ExxonMobils-12-year-Reign-at-No-1-003-09-2017-0039.html

By Harry Weber



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Commodity price volatility, geopolitical shifts, and industry consolidation made investors seek out safe havens in 2016 in the form of strong returns on invested capital, long-term fixed fees, regulatory stability, and access to regional and world markets.

That helps explain why utilities and pipelines were able to differentiate themselves from other sectors, even as some operators struggled to boost revenue and underwent major transformations that included operational and management changes.

Integrated oil and gas companies continued to be in the mix, especially those that have made big bets on US shale plays in Texas and the Northeast and have streams of customers that are heavily reliant on their services, for power generation, to heat homes and to run trains, buses, and automobiles.

But growing exports of LNG and oil from the US changed the state of play in the energy landscape, giving way to new entrants in the global pecking order.

"Utilities, by their nature, are natural monopolies, because obviously, you don't have competing wires coming into your house. The government agencies allow them to make a profit over their costs," Ed Hirs, an energy economist at the University of Houston, said in an interview. "In an environment like we have had this past year, those companies such as ExxonMobil and Chevron who are exposed to the commodity price environment, you would expect them to fall behind versus those companies that have a government license to make a profit."

This year's S&P Global Top 250 rankings show that European utilities and North American pipeline operators were among the biggest movers upward, beneficiaries of their willingness to stick to what they know best and shy away from more risky enterprises and territories.

The advancement was not even across the sectors, with Asian gas utilities falling in the rankings. And some of the diversified energy majors slipped as the world oil price rout continued amid strong shale drilling in the US and new shipments to overseas markets.

Among the biggest losers in the rankings, by sector, were South American exploration companies and Chinese power providers.

The two dozen biggest movers up included a range of companies from Europe, the Middle East, Asia, and the Americas. The group was heavy with diversified utilities -- which provide electricity and natural gas to residential, commercial and industrial users -- and pipeline companies that carry oil and gas to market. Not surprisingly, both sectors rely on each other for supply and demand.

As a sector, the majority of the electric utilities that dominated the global leader's list serve primarily in regulated or government-sponsored markets. That gives them an advantage because their revenues are largely defined and consistent, and are not as susceptible to swings in oil and gas prices.

Return on invested capital also is more stable for regulated utilities. In the US, for instance, utilities are reimbursed for the billions of dollars in infrastructure they have built over the years by pass-through charges on customers' bills, regardless of whether they are the retail provider of electricity to those users. In Europe, utilities often enjoy large market share or monopolistic power because of their footprints and the market rules in their home countries.

The story is much the same for pipeline operators, which often are guaranteed long-term pre-defined revenue for allowing oil and gas producers and power producers to reserve capacity on their infrastructure. The most sought-after shippers are those that are creditworthy and have consistent demand.

Growing shale output in the US has created that demand for pipeline operators, especially the ones with broad networks that can serve multiple regions. The decline of coal-fired generation and nuclear and the rise of renewables in the US has increased the need for natural gas, both as a direct supply of fuel and as a bridge to address the intermittency of wind and solar.

These trends are expected to continue into the next decade as billions of dollars of new investment pour into pipeline projects in the US, Canada, and Mexico. The growing ties between the US and the Mexico on this front are especially noteworthy. Mexico is heavily reliant on US supplies of gas to feed its power needs, and that demand is forecast to increase over the next five to 10 years, data compiled by Platts Analytics' Bentek Energy show. Mexico also has been a leading importer of US LNG, receiving by far the most shipments through the middle of 2017 from Cheniere Energy's Sabine Pass export terminal in Louisiana.

Case in point: Platts Analytics expects that total US to Mexico border crossing capacity will grow to nearly 14.2 Bcf/d by mid-2019 based on currently announced pipeline expansions. Total US exports to Mexico are expected to grow to 5.3 Bcf/d by 2019, a 1.6 Bcf/d build over 2016 levels, reaching average annual flows of 6.0 Bcf/d by 2022.

Meanwhile, the expected growth in LNG export volumes prompted Intercontinental Exchange in March to announce that it would begin trading the first-ever US LNG futures contract, to be cash settled against the Platts LNG Gulf Coast Marker price assessment. A statement at the time said ICE would use Platts-derived US GCM LNG forward curves for daily settlement purposes, and the curves would have an initial term of 48 months.

All that is good news for pipelines that provide feed gas to LNG terminals.

TOP 10

This year top 10 shows a changing of the guard is underway, albeit slowly.

Since the rankings were first released in 2002, IOGs have led the list every year, and that is true again for 2017.

But, ExxonMobil, which had led the rankings for 12 consecutive years, fell to No. 9 and was replaced at the top by Russia's Public Joint Stock Company Gazprom, which benefits from being majority-owned by the Moscow government and from European countries being heavily dependent on Gazprom's gas supplies. European companies have invested in Russia's Nord Stream 2 pipeline expansion opposed by some of the countries. And while there has been a lot of talk about the potential for a coming gas price war between Gazprom and LNG suppliers, that has not crystallized as of yet. ExxonMobil, for its part, has been hit hard by the drop in oil prices.

The bigger story this year is not who is at No. 1, however.

Germany's E.ON shooting up 112 places to No. 2 from No. 114 for last year is something that reveals the broader trend for

utilities making further inroads due to stable cash flows and strong returns on invested capital. In the US, cheap gas has made utility investments even healthier because it is a key feedstock for power plants. While they didn't crack the top 10, British utility Centrica jumped to No. 15 from No. 156 last year, Brazil's Centrais Elétricas Brasileiras, also known as Eletrobras, shot up to No. 47 from No. 193 and Houston-based CenterPoint Energy surged to No. 105 from No. 220 a year earlier.

In E.ON's latest annual report, the company talked about how 2016 was a transformative year.

It separated its fossil fuel assets into a separate company last year, in an effort to boost value for both sets of operations that would exceed the value of all the operations under one roof. That meant that E.ON would focus on renewables, energy networks, and customer solutions, while the other company that was formed through the spinoff, Uniper, would consist of conventional power generation such as hydro, natural gas and coal, and global energy trading.

"From E.ON's perspective, our core businesses are no longer burdened by the risks of the old energy world, such as the uncertainties of commodity markets," CEO Johannes Teysen said in a letter to shareholders in the annual report. "The spinoff relieved your company and its balance sheet of most of the burdens of the past."

While E.ON's 2016 revenue rank fell to 28th on this year's list from 7th on last year's list, its return on invested capital, or ROIC, jumped to 35%, ranking it No. 1 in that category on this year's list, up from 246th in 2015.

There were some familiar names rounding out the top 10, such as No. 4 South Korea's Korea Electric Power, which debuted in the top 10 just last year; China Petroleum & Chemical at No. 5; Russia's PJSC Lukoil at No. 6; Indian Oil Corp. at No. 7; and US refiner Valero Energy at No. 8.

But it was India's Reliance Industries rising to No. 3 from No. 8 last year and France's Total rising to No. 10 from No. 12 last year -- returning to the top 10 after a two-year absence -- that showed the strength of pipelines as the other sector that was among those that surged up this time around. Both have been making investments in the US that benefit from increasing supplies of natural gas and the new pipeline infrastructure that is being built to carry those resources to the Gulf Coast for regional use and for exports to overseas hubs.

Overall, thanks to the new entrants buoyed by utilities and pipelines, revenues of the Top 10 global energy companies surged more than 30% to \$1.1 trillion from \$830.2 billion in the 2016 rankings.

Collectively, the world's top 10 companies posted combined profits of \$63.7 billion last year, 14% lower than the \$74.3 billion posted the year before. The Top 250 profit figures are adjusted for preferred dividends and exclude discontinued operations and extraordinary operations.

Notable absentees in the top spots this year include US refiners Phillips 66, which fell to No. 20 from No. 4 and Marathon Petroleum, which slipped to No. 34 from No. 10, and Russian oil major PJSC Rosneft, which slid to No. 22 from No. 7. Some US refiners' margins were battered in 2016 because of an oversupply of gasoline and diesel, while some oil majors were negatively affected by the continuation of cheap crude prices.

Average spot crude prices for Brent, the global benchmark, slid to \$43.73/b in 2016 from \$52.39/b in 2015, while WTI crude, the US benchmark, fell to \$43.34/b from \$48.71/b, BP's statistical review of world energy released in June said. The spread between the two benchmarks also narrowed. On the gas side, Henry Hub prices were 5% lower than in 2015, and European and Asian gas markers were down 20-30% as prices continued to adjust to increased LNG supplies, BP said.

"Much of the lackluster performance can be traced back to the US, particularly on the supply side, where falls in gas (and oil) prices caused US gas production to fall for the first time since the US shale gas revolution started in earnest in the mid-2000s," the statistical review said.

REGIONAL BREAKDOWN

Refiners and midstream companies are making inroads in parts of the world where oil majors used to be the most promising growth engines, and Europe, the Middle East, and Africa, as a region, is clawing back previously lost share in the rankings.

In the Americas, Valero, a refiner, tops the rankings, followed by ExxonMobil.

Most noteworthy, in terms of the trend in the rankings, is that for the region, utilities hold five of the top 10 spots and pipeline operators or transportation companies that hold pipeline interests hold three of the top 10 spots. Among those is Houston-based

Enterprise Products Partners, an operator of crude and gas pipelines as well as NGL storage facilities and gas processing plants. Chief Financial Officer Bryan Bulawa said at an industry conference in March that Enterprise has been able to manage the low commodity price environment with investments in fee-based pipelines, fractionators and export facilities, which have provided more stable returns.

Refiners hold five of the top 10 spots in the Asia/Pacific Rim region, but only one utility is in the top 10 there, as some Asian utilities have been hit by high fuel costs. Asia is the biggest importer of LNG in the world, and LNG is converted back to dry gas and used to heat homes and as a power plant fuel.

In the EMEA, IOGs and utilities collectively hold nine of the top 10 spots in the regional rankings. No. 5 is Russia's PJSC Transneft, a pipeline operator.

Also noteworthy for the EMEA is that there are 68 companies from the region in this year's Top 250, compared with 61 in 2016. The Americas slipped, with 94 companies from the region on this year's list, down from 98 last year. Asia/Pacific Rim also lost share, with 88 companies in the Top 250 this year, versus 91 in 2016.

FASTEST GROWING

Compound growth rates analyzed in the latest rankings showed again the strength of utilities and pipelines.

Colombia's Interconexión Eléctrica posted the top three-year CGR at 49.9%, followed by Brazil's Eletrobras at 36.6%. Crude oil transportation and logistics provider National Shipping Co. of Saudi Arabia, or Bahri, was the third fastest growing, with a three-year CGR of 33.6%.

Hong Kong's Kunlun Energy posted a three-year CGR of 23.5%, ranking it No. 10 in the fastest growing segment. The storage and transportation company owes that growth in part to its expansion in the natural gas pipeline arena. The company said in a profile on its website that prior to 2008, it was primarily involved in domestic and overseas oil and gas exploration and development.

In the years after a strategic transformation that began in 2009, Kunlun, through acquisitions and other initiatives, moved into gas pipelines, receiving, processing, storage, and transportation of LNG. It has made growth in its natural gas operations a priority.

Fourteen of the top 20 fastest growing energy companies on this year's list are tied to the power and utility industries. That's a trend that should continue, as more countries eye LNG as a cost-effective power plant fuel.

The US is now a key supplier of that LNG, with Cheniere Energy exporting from its Sabine Pass terminal in Louisiana and Dominion Energy expected to begin shipping cargoes from its Cove Point terminal in Maryland later this year. Several other export terminals in the US are under construction, while another two dozen are being proposed.

That supply will have an impact on the compound growth rates of end users such as gas and electric utilities, as well as storage and transportation providers.

COAL'S CHALLENGE

While US President Donald Trump was elected in part based on his 2016 campaign promise to spark a resurgence in coal's fortunes, that is going to be difficult, if not impossible, based on the most recent trends.

Global coal consumption fell last year by 53 million tonnes of oil equivalent (mtoe), or 1.7%, the second consecutive annual decline, with its share within primary energy falling to its lowest level since 2004, according to BP's latest statistical review of world energy.

The largest declines in coal consumption were seen in the US (down 8.8%, or 33 mtoe) and China (down 1.6% or 26 mtoe). Coal consumption in the UK more than halved (down 52.5%, or 12 mtoe) to its lowest level in BP's records.

"Indeed, coal production and consumption in the UK completed an entire cycle, falling back to levels last seen almost 200 years

ago around the time of the Industrial Revolution, with the UK power sector recording its first ever coal-free day in April of this year,” the review found. “In contrast, renewable energy globally led by wind and solar power grew strongly, helped by continuing technological advances. Although the share of renewable energy within total energy remains small, at around 4%, it accounted for almost a third of the increase in primary energy last year.”

Coal's troubles were especially acute in Asia, with China's production falling by 7.9% or 140 mtoe, a record decline, the review found.

Those headwinds translated into swings in this year's Platts rankings for coal interests.

Coal India, for instance, slipped in the rankings to No. 45 from No. 38 last year. On a bright note, producer China Shenhua Energy rose to No. 13 from No. 25 last year as the price of coal there rose sharply following government output cuts.

POLITICS AND ECONOMY

From a trend toward government-mandated price reductions in Romania and Hungary, to Sweden's efforts to enhance consumers' rights in the energy marketplace, to South Korea's participation in combating global climate change, to project permitting delays in the US amid a lack of a voting quorum at the Federal Energy Regulatory Commission, politics played a key role in how the world's top companies fared in the rankings.

Equally important were economic changes in many countries and the winds of change that drove new market rules to spur growth.

At ExxonMobil's analyst day meeting March 1, executives were asked, with global oil prices under pressure over the last 2-1/2 years, how have governments with which the IOG does business responded to the new market realities and have they have been willing to offer better terms to drive further investment in their countries.

That's been difficult in some of the countries where ExxonMobil did business in 2016, impacting its results.

“Obviously every government is wrestling with these low prices and how that's affecting their budgets,” Mark Albers, a senior vice president at ExxonMobil, said in the presentation. “As part of the conversation around making things work in this price environment, we're going to governments and having candid conversations as we speak around this is how far we can take it with development concepts and planning but we need this to get something going in your country.”

In terms of the macroeconomic environment, E.ON noted in its annual report that global growth was again weak in 2016, registering 3.1% according to an OECD estimate.

That meant a reduction in private and public investment activity worldwide, marked by declines in China, only moderate improvement in domestic demand in the euro zone, and weaker economic expansion than in the previous year in the Czech Republic and Turkey, the report said.

China's Guangdong Electric Power Development Co. fell 96 spots to No. 230 in this year's rankings and Beijing Jingneng Power Co. slid 61 spots to No. 233. Datang International Power Generation Co., also based in China, moved down to No. 202 in the Top 250 from No. 95 in 2016.

Türkiye Petrol Rafinerileri fell to No. 103 in this year's rankings from No. 66 in 2016. The Turkish company is involved in the refining of crude oil and petroleum products. Also hit was the Czech Republic's CEZ, an energy company involved in electricity generation, natural gas sales and coal extraction. It slipped to No. 97 in the Top 250 from No. 72 in 2016.

The US was a bright spot in 2016, attracting new investment from domestic and multinational energy companies.

“Growth was supported by private consumption and private investment, which was bolstered by a labor market almost at full employment,” the E.ON report said.

In particular, shale plays such as the Permian, which spans parts of Texas and New Mexico, and the Marcellus in the US Northeast were hotbeds of activity, especially on the midstream oil and gas side, helping explain the uplift for pipelines. Kinder Morgan, for instance, moved up to No. 93 in this year's Top 250 from No. 103 last year. It is a growing Permian player, with plans for a 430-mile natural gas pipeline from the shale basin to the Corpus Christi, Texas, area.

“Ironically, the only constant within 2016 midstream markets was incessant pivoting from one strategic/investment theme to the next,” Jefferies analyst Christopher Sighinolfi said in an April 19 research note to clients.

While some investment advisers encouraged the US midstream sector as the year ended to become more diversified to limit the risk of focusing too heavily on one area, there was a continued appetite heading into 2017 for deals in areas that are hot.

The SCOOP and STACK in Oklahoma and the Eagle Ford in South Texas also were in the mix. Translation: Oneok, a big pipeline player in the SCOOP and STACK, advanced to No. 92 in the Top 250 from No. 158 last year. Oneok also is well-positioned in the Permian’s Midland and Delaware sub-basins.

THE FUTURE

While the Permian is largely an oil play, there is a lot of associated gas being lifted there, and that has been a big lure for IOG’s as well as midstream infrastructure companies.

That could re-order the rankings the next time around, which may be good news for ExxonMobil after falling in stature this year.

In January, it decided to spend up to \$6.6 billion to more than double its position in the Permian, giving it the opportunity to play a bigger role in producing the growing volume of natural gas that is flowing from the region to Mexico for power generation and to the US Gulf Coast for LNG exports.

About 25% of the resource that ExxonMobil said it expected to capture through a series of purchases from the Bass family of Fort Worth is non-liquid — and firms need a home for that product to make their investments more worthwhile. Increasing exports give them the markets for the gas, and midstream operators are building infrastructure to provide the delivery link to those markets.

An analysis issued by PricewaterhouseCoopers in late July found that the first half of 2017 set a record for oil and gas mergers and acquisitions despite oil prices declining by 16% during the period. It said that 14 of the 20 megadeals were all-cash deals, reflecting acquirers’ access to cash and their willingness to spend it.

While 2016 was the first year the US exported LNG produced from shale, 2017 brought new entrants and increased competition.

The industry has been closely watching to see at what point the market becomes too saturated to support further development. Some final investment decisions that were expected this year have been pushed off to 2018 and beyond. A number of developers with proposals in the permitting queue have announced preliminary offtake agreements with buyers, but firm final agreements have so far been fleeting.

Finding the right business model to deal with changes in market trends will be a key to determining how many of the second wave of LNG export projects that are currently being planned get off the ground, developers said.

Meanwhile, energy companies in many sectors have been overhauling their portfolios to focus on their core operations. That has seen some traditional gas pipeline companies get out of petrochemicals and some traditional producers and generators think twice about getting into building LNG terminals.

Williams, a pipeline operator based in Oklahoma, is hoping such a transformation will help it grow in the future, much like E.ON’s moves helped it this year. And LNG demand growth may be the driver that pushes Williams up in next year’s rankings, after falling to No. 197 this year from No. 173 in 2016. Williams’ pipelines provide feeds for LNG production at US export facilities.

“It is blocking and tackling first, and we are focused on that,” Williams CEO Alan Armstrong said in an Aug. 3 investor call. “There’s a pretty intense focus right now on delivering on what we have.”

Source: [The Gulf Intelligence](#)