3 tactical moves for oil and gas companies in 2023

Building a better working world

To successfully navigate the future, companies must define a new core, develop markets further downstream and innovate new business models.

In brief:

01 While the past year has been profitable for oil and gas companies, the medium-term outlook remains uncertain.

02 Companies need plentiful capital, technical expertise, and experience with complex operations and markets to successfully embrace new zero-carbon fuels.

03 Oil and gas companies can take steps today to be leaders in defining the energy system of tomorrow.

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The past year has been one of seemingly good fortune for oil and gas companies. Price increases, spurred higher by geopolitical factors but fundamentally reflecting much stronger global economic activity, allowed companies to fund spending out of earnings and still return capital to shareholders — in part allowing for share prices to decouple in a positive manner from underlying oil and gas prices.

But the medium-term outlook remains uncertain. Buyers of natural gas are reluctant to sign long-term purchase agreements, given the questions about climate change and future demand requirements. Similar questions complicate capital planning or approval for long-term projects where the price and demand uncertainties are seemingly growing, despite current conditions that underscore the viability of oil and gas through the energy transition.

The reality of energy transition is not a stark choice between hydrocarbons today and renewables tomorrow. Instead, the answer to solving tomorrow's energy requirements is understanding how oil and gas companies can be on the leading edge of the transition, embrace decarbonization as a catalyst to innovation, and actively seek opportunity in a lower-carbon world.

"Beyond the current crisis, in which security of supply has become a top priority, the oil and gas sector can, must and will play a role in solving the climate crisis," says Saulius Adomaitis, EY Global Oil & Gas Leader. "It is essential, therefore, that the sector not only survives but thrives."

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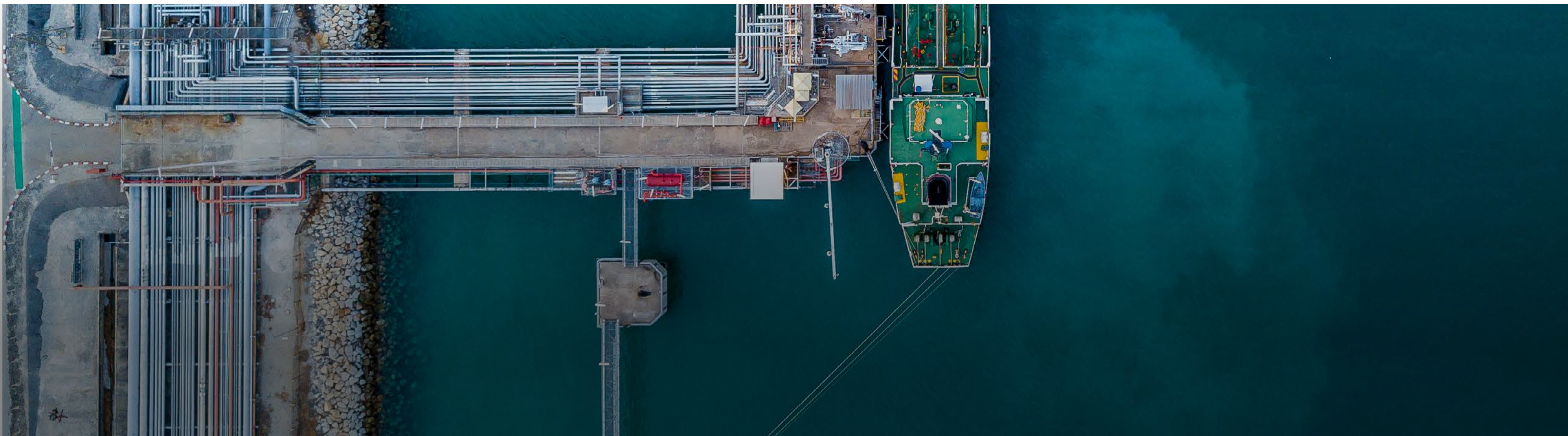
> EY Global Oil & Gas Leader

New technologies, expanded energy sources, innovative business models and collaborative ecosystems will unlock opportunities in the energy transition. Policies like the landmark Inflation Reduction Act further accelerate the commercial possibilities. To successfully embrace new zero-carbon fuels – especially hydrogen – plentiful capital, technical expertise, and experience with complex operations and markets will be critical. Rather than running afoul of the energy transition, can oil and gas companies utilize their expertise and experience to lead it?

Successfully navigating this future will require companies to define a new core, develop markets further downstream and innovate new business models. To this end, there are three tactics US oil and gas companies are anticipated to progress in 2023:

1. Optimize operations: Although arguably at the heart of oil and gas operations for a century, optimization through the energy transition will require thinking in terms of portfolios of energy technologies, rather than a single asset or asset class. In a similar vein, the digitalization efforts underway at most companies will be required to not only broaden to reflect this approach toward providing insights across the enterprise, but also a recognition that digital initiative, rather than an IT service, are becoming a core asset themselves, invaluable to the successful management of an energy company.

"To really embrace the possibilities that energy transition and digital bring, companies need alignment among business units, operating models that support rapid decision-making and change, and a skilled, adaptable workforce," said Tim Haskell, EY US Oil & Gas Leader, People Advisory Services. "In an innovative mindset, it's important to look beyond a technology's capability, and consider how processes, decision-making, teaming or hierarchies should evolve."



Optimizing operations will require a reappraisal of the back office as well. The next-generation back office can be an important lab for incubating some of these commercial and operational innovations, placing those companies that can successfully implement in advantaged positions to capitalize on new market opportunities and win in the ongoing competition for talent.

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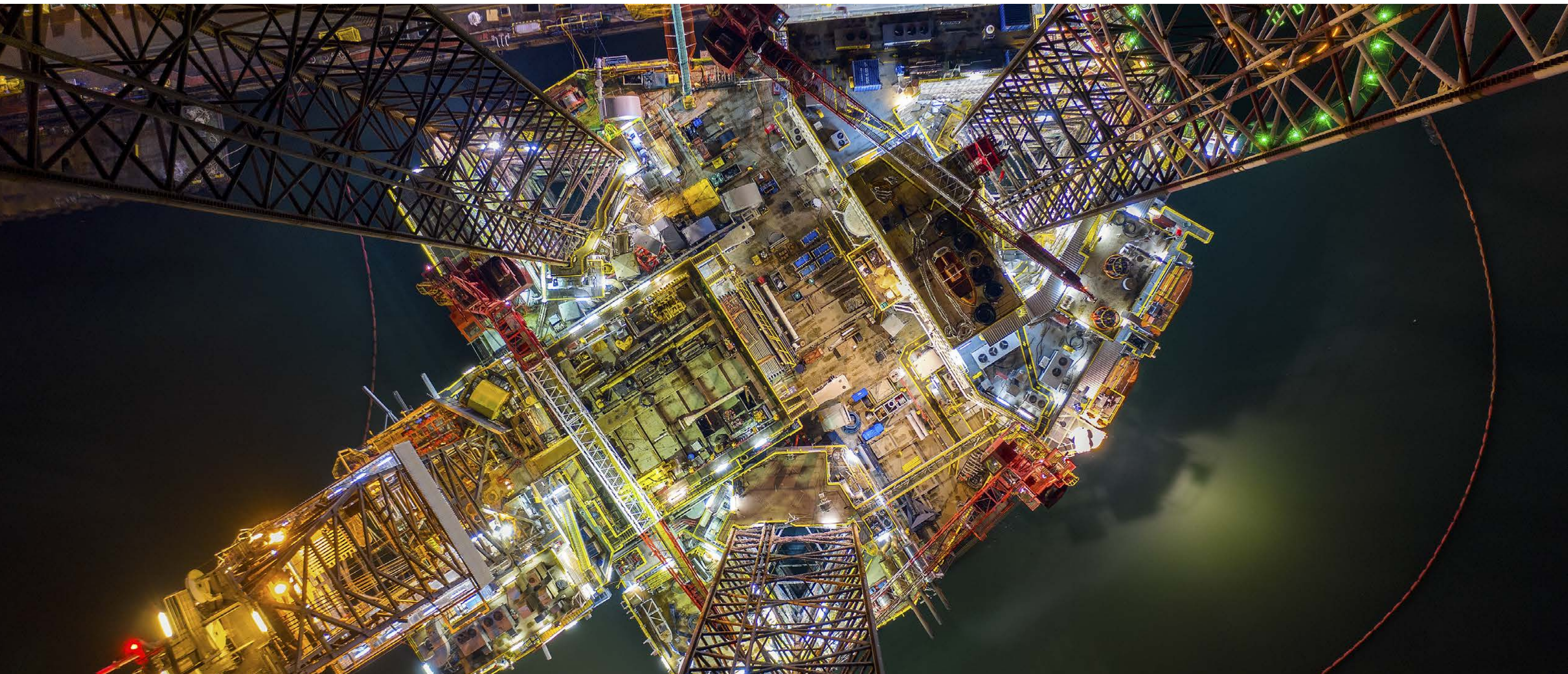
2. Manage emissions: Oil and gas cannot completely decarbonize, but customers and regulators will increasingly seek progress on various emissions metrics, such as carbon intensity of production. Coupling emissions management strategies with digital technology provides an enterprise-wide and full-lifecycle view of the emissions portfolio, and allows management teams to execute growth strategies aligned with customer needs in a future energy system.

"In a recent project for a global integrated energy company, we assessed which technology could best create an integrated carbon tracking system," said Ben Williams, EY Americas Oil & Gas Technology Consulting Leader. "As a result, the client is on the verge of making its carbon footprint transparent and has the perspective to unleash revenue, and business-model opportunities create value during the transition to a lower-carbon future."



3. Execute capital strategy: The two metrics EY professionals are watching are the forward price strip and the cost of capital, specifically borrowing costs to inform the velocity of these estimates. Driving this trend is a continued high grading of portfolios among energy producers. For example, in Q3 2022, oil and gas had 101 deals with US$53b, according to EY analysis.

"As commodity prices hold, we expect assets will continue to shift with both high volumes and deal value through 2023," said David Johnston, EY Americas Oil & Gas Strategy and Transactions Leader. "Over the next two to three years, we estimate those shifts at north of $150b. Specifically, in a climate of higher interest rates, we expect corporates to be key buyers and private equity largely on the sell side."

The expanded investor focus on energy security and the energy transition will maintain private equity appetite for renewed opportunities, however. Corporates are anticipated to leverage a capital allocation strategy via oil and gas assets with low-carbon solutions. Low-carbon businesses like carbon capture, utilization and storage, or carbon capture, utilization and sequestration allow producers to gather Inflation Reduction Act capital to scale solutions with existing assets and offer a differentiated proposition to both customers and investors. Ecosystem strategies, where tech and energy form partnerships and joint ventures, will increase as well.

A shorter version of this article was originally published by Hart Energy on December 20, 2022

Summary

Current outlooks support a healthy attention to these three areas in 2023 and beyond, allowing US oil and gas companies to not only continue to reap the benefits of efficiency improvements realized in the recent past and an improved price environment, but also to take those steps today to realize a robust future and a leadership position in defining the energy system of tomorrow.

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