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The Coal Industry Collapsed—Is Oil Next?

The major oil companies don't seem at all prepared for what's about to hit them. Investors should be worried.

Adele Peters l July 21, 2016

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Five years ago, if you had asked someone in the coal industry about the future, they would have predicted growth—and ignored a nonprofit report arguing that the industry was likely to decline. Since then, dozens of coal companies filed for bankruptcy, including the largest coal company in the Western world.

Now, a new report from the same nonprofit warns that the oil industry faces similar risks of decline.

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"One of the biggest drivers right now is the potential for decreasing demand," says Danielle Fugere, president and chief counsel of As You Sow, the nonprofit that wrote both reports. "And that's driven by climate change… We're in a decarbonizing economy. That's one of the flags for companies—are they adjusting to that?"

Countries like Norway and Denmark have proposed banning the sale of gas cars. China hopes to have 5 million electric cars on the road by 2020; India wants to add another 5 million to 7 million electric cars in the same time. In Paris last December, 195 countries agreed to limit global warming to two degrees, meaning more sweeping cuts in oil use are coming.

Saudi Arabia, one of the world's largest oil producers, plans to transition to a post-oil economy by 2030. In the past, Saudi Arabia carefully regulated the production of oil to keep prices high, but more recently, the country has been overproducing—and though the reasons are unclear, it might be because it wants to sell as much oil as it can while it's still possible, even if it has to take a financial loss to do it.

Since the turn of the century, the major oil companies in the U.S. have taken on record levels of debt to fund more expensive projects, like ultra-deepwater drilling. Shell's debt went up 686%. Incomes have dropped; between 2010 and 2014, oil companies spent more than they were making, while they continued to hand out dividends to investors. The S&P started to downgrade oil companies' credit ratings this year—first Chevron, then Shell, then Exxon (for the first time in 86 years).

While the "majors" once controlled most of the oil market, now 90% of proved reserves are run by countries like Saudi Arabia, China, Russia, and Iran, all of which have national companies bigger than Exxon. National oil companies can often produce oil more cheaply. And a tiny surplus in supply can trigger a collapse in prices, as happened in 2014.

Some analysts still think that the slump is temporary, but their analyses don't consider the effect of climate regulations. Others, like the International Energy Agency, have been far off in their predictions in the past; the IEA thought it would take four times as long for solar to reach the capacity it reached in 2012. It's similar to what many were saying about coal when the first report came out.

"There was absolutely denial about the growing risk," says Fugere. "I think that was both from the coal companies and also, for the most part, the market didn't see any risk. It's kind of like there's a blindness that goes on."

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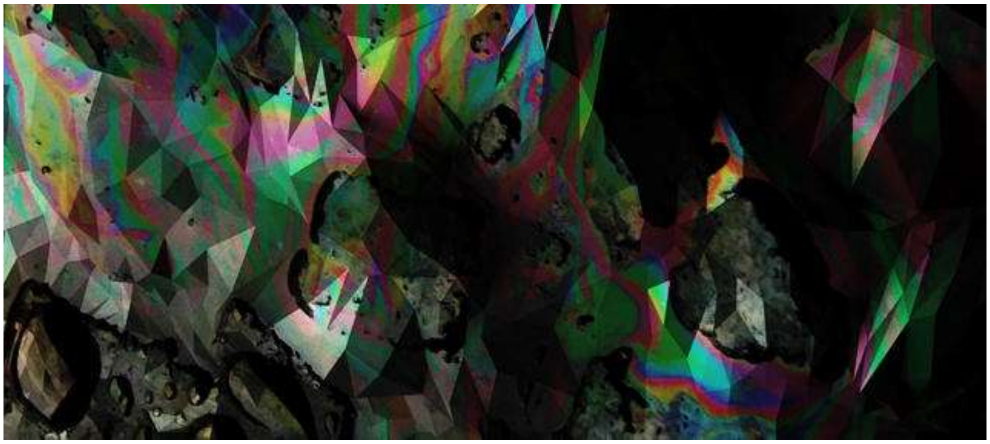
The bottom can fall out of Industries very suddenly as technology changes. Wood was the main fuel source in the U.S. until the mid-1800s, and then was fully replaced by coal for power. Whale oil that once dominated the lighting market was quickly replaced by kerosene (just in time to save whales). Renewables could replace oil; the report argues that one of the ways that oil companies should adapt is to diversify into renewables.

It's something that some companies experimented with in the past, but the time may be right now. France-based Total now owns a majority of the massive solar company SunPower, and might buy a battery company.

Companies like Exxon and BP, with deep expertise in offshore oil, could consider shifting to offshore wind if they recognized the opportunity.



"I want to make sure that people aren't reading our report to say that the oil industry will be gone in five years," says Fugere. "That's not what we're saying. Our goal is to help policymakers, investors, the public, oil companies, understand that changes have to be made, and they have to be made quickly."

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The report points to the example of Polaroid, which was a Fortune 100 company in the early 1990s. When the transition to digital cameras happened, Polaroid fell apart in five years. Near the end, the CEO was still saying that anyone 'who says instant photography is dying has his head in the sand.'"

Investors should be asking oil companies for analyses of risk, says Fugere, and then asking how the companies plan to adapt and change over the next five, 10, and 20 years. "I think they should be demanding that companies show them that they will be one of the companies that remains standing," she says.

"We see structural changes and we believe that this market will look different in five years and 10 years down the line. We want people to recognize those changes. In the end, what we all want to avoid is a large crash that nobody expected."

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