AS YOU SOW REPORT: OIL INDUSTRY FUNDAMENTALS “WEAKENING” UNDER STRUCTURAL PRESSURE

Major Caution to Investors: You’ve Been Here Before; 5 Years After Issuing Report Highlighting the Growing Risks of Investing in Coal, As You Sow Examines the Oil Industry, Finds Cause for Concern.

OAKLAND, CA – July 13, 2016 – *Higher extraction costs. International supply competition. Falling profit margins. Mounting debt. Shrinking cash. Competing technologies. Rising regulatory risk. Social pressure due to climate change.* Indicators are now flashing yellow for the oil industry, which is in danger of “weakening” if major oil companies continue to operate as though they are in a business-as-usual environment, according to a report released today by the nonprofit As You Sow. In 2011, near the height of U.S. coal consumption, As You Sow published a report highlighting the growing financial risks for investors with stakes in the U.S. coal industry, correctly predicting the structural basis for what has become a permanent decline of that once mighty industry.

Available online at http://www.asyousow.org/unconventionalrisks, the new As You Sow report, ***Unconventional Risks: The Growing Uncertainty of Oil Investments***, concludes: **“History is replete with companies that failed to recognize the inevitability of change in their markets. This paper examines the claim, echoed to some degree by all oil majors, that there is little risk to the companies’ ability to conduct business as usual. While acknowledging the importance oil has played in the successful economic development ... over the past century, it is incumbent on investors, markets, and the oil companies themselves, to recognize the growing markers of change that will affect their future. Once dominant players in world markets, oil majors now share problems found at many risky companies, including increasing cost structures, deteriorating financial fundamentals, changing demand for their product, and management that has failed to address key areas of risk.”**

Danielle Fugere, As You Sow President, Chief Counsel and report co-author said: **“We are in a period of accelerating change, which will fundamentally affect the oil industry. It is worth remembering that only a few years ago coal was seen as being able to weather the economic changes that are now dragging it down. That is why investors need to understand the deepening structural risks in the oil industry, which have become more pronounced over the last decade. The future is not set in stone for oil companies, but their failure to acknowledge signs of change and plan appropriate action could be disastrous.”**

Tom Sanzillo, director of finance, Institute for Energy Economic and Financial Analysis, and former first deputy comptroller of New York State, said: **“Over the past 30 years or so, the oil industry has gone from dominating global capital markets with strong returns to becoming a significantly diminished — though still profitable — player. Ten years ago, the industry, bolstered by dramatic spikes in prices, planned a future based on developing high-cost oil sands and hydraulic fracking of natural gas and conventional oil reserves. When prices collapsed, the inherent risks in these initiatives were exposed. The prolonged outlook now for low oil prices throws into question the ability of oil companies to achieve return targets, replenish reserves, pay down debt, build cash reserves and maintain dividend commitments. The coal parallels here are not precise, but they are cause for concern nonetheless.”**

Lou Allstadt, former executive vice president, Mobil Oil, said: **“The oil industry is under pressure to reduce greenhouse gases, from the Paris Agreement, to citizens blockading pipelines, to investigations for failure to disclose material risk to investors. Climate change and the forces for change it is creating won't go away; the oil industry will be best served by addressing the issue instead of trying to maintain an evaporating status quo.”**

Amelia Timbers, As You Sow Energy Program Manager and report co-author said: **“Today, the majority of low-cost reserves are owned by nationally controlled oil companies (NOCs). This forces the majors to pursue higher cost unconventional projects for new reserves. Independent oil companies, including the majors, are thus becoming the world’s high cost producers, making them less competitive. This trend has been broadly masked by the past decade’s record-high oil prices. Yet, the oil majors are caught in a negative feedback loop. Every time oil prices are high enough to allow the majors to breakeven, high oil prices simultaneously create market conditions that accelerate long-term oil demand destruction, ironically reducing the frequency and extent of oil price rebounds in the future.”**

Other financial markers of concern for oil majors are the following:

- **Increasing Capital Expenditure**: Between 2000 and 2014, total capital expenditures of the oil majors grew 308 percent, from $41 billion to $166 billion. Despite these increases in capital investment, the total oil equivalent production from the oil majors decreased 1.7 percent in the same period, reflecting in part, the rising costs of replacing reserves. Reduced access to conventional supplies of crude has required most independent oil companies, including the oil majors, to develop unconventional, higher cost resources (e.g., shale, deep water, Arctic, and tar sands), which are often in extreme and remote locations and require complicated extraction processes, increasing costs of production.

- **Declining Profit Margins**: From 2011-2013, oil prices were at the highest levels in history. Yet, due to spiraling costs of finding and developing new resources, and the burden of servicing growing levels of debt, oil majors’ profit margins have declined. The majors’ average return on equity has been declining since it peaked in 2005, reflecting decreasing profitability over the last decade.

- **Mounting Debt**: From mid-2000 to 2014, debt among oil majors has more than tripled as the oil majors took on debt at unprecedented rates. Debt appears to have supported capex, operations, share buybacks, and dividends, as profit margins declined. Whether this increasing indebtedness is reflective of historically low interest rates, or was necessary to fund the increasing costs of reserve replacement and dividends, the oil majors’ debt positions are structurally distinct from what they were 15 years ago. Recent credit rating downgrades show that rating agencies are starting to take notice.

- **Shrinking Cash**: Also from 2000-2014, several of the oil majors had significant decreases in cash reserves, resulting from increased spending, lower profit margins, maintenance of dividends and/or share repurchases, and debt servicing. In particular, Exxon’s cash reserves have plummeted since 2008, ConocoPhilips’ cash peaked in 2010, and Chevron’s cash peaked in 2012. An eroding end cash position and a weak revenue outlook heightens the potential for credit access and repayment problems.

- **Collapsing oil prices:** The oil majors’ decade-long trend of financial stress has been exacerbated by oil prices collapsing in mid-2014. It is unclear how long the oil majors can weather the low price

market, even with 2015 reductions in capital expenditures and a focus on low cost projects. The majors' balance sheets also face increased pressure as the companies continue to support high dividends to assure investors of the companies' financial strength, even when doing so requires companies to cannibalize earnings and potentially take on more debt.

Added to these key financial indicators is the potential for peaking or even declining demand for oil. The report notes: **"As the world moves to address climate change, and as new regulations and technology slow or reduce demand for oil and other fossil fuels, risk to oil and gas companies escalates. Since even a marginal oversupply of one to three million barrels per day can result in lower global oil prices, slower than projected demand growth could reduce oil majors' profitability. Already, demand for oil has stabilized and even fallen in OECD countries, despite rising gross domestic product, due primarily to the success of fuel efficiency standards and technology innovations."**

What about those balmy industry forecasts about growing demand? The As You Sow report notes**: "Oil majors' projections of significant future demand increases from developing nations must … be measured against an array of global demand-reducing trends, including continuing sustainable development, fuel efficiency mandates, significant air quality problems, competitive alternative technologies, and a globally recognized need to shift away from fossil fuels. In an increasingly low carbon economy marked by declining oil demand, marginal oversupply can sufficiently decrease price so that higher cost producers become unprofitable. This market positioning has created permanent vulnerability for oil majors."**

# # #

ABOUT AS YOU SOW

As You Sow is a nonprofit organization that promotes environmental and social corporate responsibility through shareholder advocacy, coalition building, and innovative legal strategies. For more information, visit http://www.asyousow.org.

MEDIA CONTACTS: Pat Mitchell, (703) 276-3266 and pmitchell@hastingsgroup.com.