IHS Markit Perspectives [Special]

Sentiment on the Energy Sector

IHS Markit's Perception team[1] engages in in-depth discussions with investors and analysts daily. In light of market volatility and economic uncertainty, IHS Markit is speaking to investors and analysts on a regular basis to assess how COVID-19 is impacting their evaluations of and engagement with corporate issuers.

In this special Perspectives report on the energy sector, we explore how investment sentiment has evolved over the course of 2020, which saw demand drop off due to a global pandemic, industry supply disruptions, and historic lows for energy equities. Coupling these near-term challenges with the long-term concerns around climate change, we ask investors and analysts[2] to opine on the current and future outlook for the oil and gas industry.

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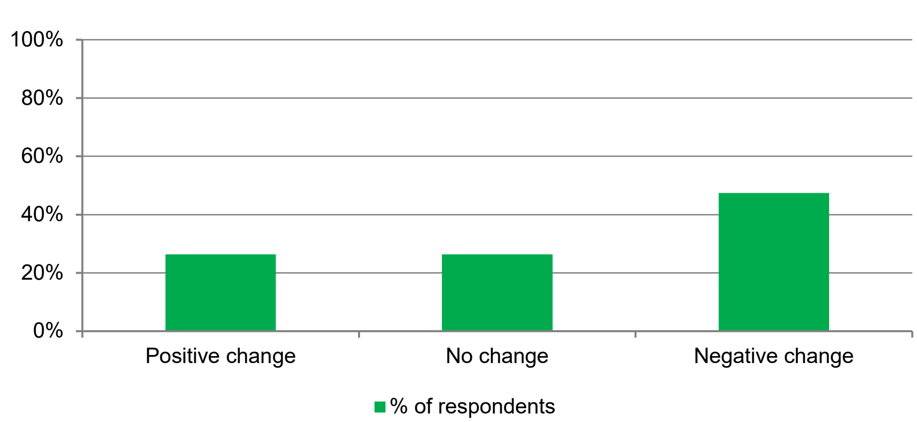
[1]**IHS Markit Issuer Solutions' Perception group** partners with issuers, banks, and exchanges to understand investment community sentiment. Through in-depth interviews and rigorous analysis, our research results in actionable market intelligence. IHS Markit Perspectives is a series of sentiment reports providing issuers with real-time feedback from the capital markets. For more information: Perception group and Perspective series.

[2]**Participant population** includes 28 investment professionals, representing a total EAUM of $700mn and 10 countries.

COVID-19 and other industry forces have had a bifurcated effect on the buy side’s willingness to invest in oil and gas companies.

Has willingness to invest in the oil and gas sector (upstream E&P) changed as a result of the pandemic?



Source: IHS Markit

Investment sentiment toward the energy sector has undoubtedly been impacted this year as a result of COVID-19 and other industry forces. Investors describe that two ‘black swan’ events in the beginning of 2020, in the form of a global pandemic and an oil price war between Russia and Saudi Arabia, have magnified the delicate balance of supply and demand in the oil and gas sector as well as the sensitivity of E&P companies to structural impacts. The ongoing thematic debate surrounding climate change and the energy transition overlay on top of these near-term issues to create an environment where securities are trading at historic lows and investor uncertainty is at all-time highs.

For some, this pullback presents an opportunity from a value investment perspective and they show **stable or increased appetite for investing in energy** names. These respondents believe that although the near-term outlook is challenged, oil prices will normalize over time (and potentially even spike due to capital deprivation and underinvestment) based on their expectations for global energy demand and a gradual and lengthy timeline for the next energy transition. with prudent balance sheets and return-based strategies that can weather the near-term tailwinds.

How do you identify and capture AUM from investors with increased appetite for oil and gas?

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Nevertheless, nearly half of the investors have lower risk appetite. In the short term, they foresee that the sector will remain out of favor as impairments to global demand (e.g. less air travel) will persist into 2022 or 2023. Over the longer term, some believe that the recent disruptions reveal how fragile and structurally challenged the energy industry has become, foreshadowing continued troubles as the world moves toward decarbonization. Investors are less willing to devote time and capital to a sector that they believe faces an existential crisis.

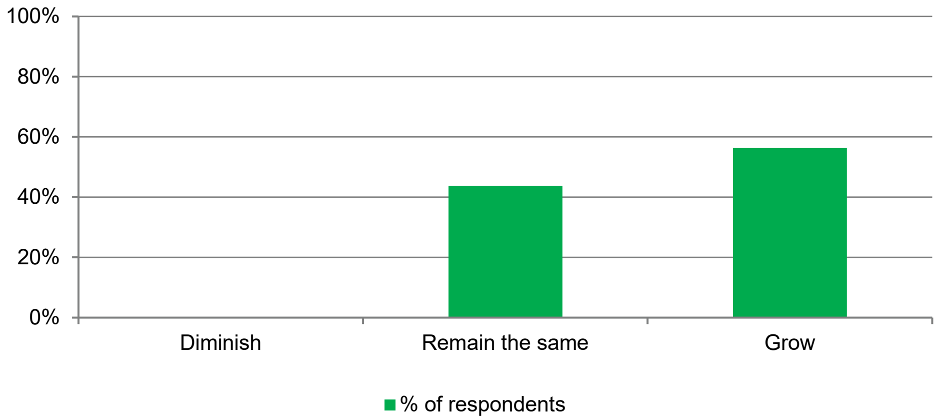
"For the oil and gas industry, COVID-19 is the perfect storm. There is the effect it has had in depressing the economic environment. There are also the OPEC troubles between Russia and Saudi Arabia. Lastly, there is climate change. For the time being, the oil and gas industry is out of fashion. However, we are willing to maintain our investments in the industry because we believe the companies we are involved in are the most responsible players and divestment is not the perfect solution." ***Analyst, European investment manager (>$2B EAUM)***

"Investor appetite in upstream E&P will be impacted by the pandemic because in many cases these stocks are at 20- or 30-year lows. That always attracts investors looking for value in the market. It is going to be tough to get investors to actually pull the trigger because it is still very unclear that a lot of these companies will survive. Many of them have balance sheet problems. There may need to be a little bit more of a shakeout before we see these inflows into the segment. Ultimately, there is the sentiment that the situation cannot get any worse than it already is, which always attracts investors. When there is clarity that energy demand is normalizing to what it was pre-pandemic, the stocks of companies that survive this recessionary period will be extremely good investments. This is because the stocks clearly do not reflect energy demand at pre-pandemic levels, never mind some multi-year high growth rate in demand." ***Research analyst, US sell-side firm***

"The pandemic has highlighted the important efforts and investments that firms are making toward their energy transition. This includes increasing renewable and low-carbon generation capacity as well as a greater deployment of carbon capture technology. With COVID-19 and the climate crises, where the climate aspect is a never-ending story, this will be something we take into account even more seriously. This could lead us, and others globally, to more stringent investment decisions at the corporate and individual security level." ***Analyst, UK investment manager (>$20B EAUM)***

The investment community's concerns about climate change are expected to persist and grow in the post-pandemic period.

Do you anticipate that investor concerns over climate change in relation to the energy sector will diminish or grow in the post-pandemic period?



Source: IHS Markit

The investment community's focus on climate change will continue to grow in the post-pandemic period and most investors do not believe that the recent health crisis has diminished investor concerns in any way. The shift toward low carbon is viewed as a long-term concern impacting investment decisions, one that existed pre-pandemic and will continue to accelerate after.

When probed on any direct effect the pandemic has had on investors' views of climate change, feedback is mixed. Some believe the pandemic will have ripple effects in the way that consumers and investors perceive the energy sector. For example, **the conversation around climate change may evolve** to include more social issues, such as workforce sustainability and job creation in the context of the transition to clean energy.

How do climate concerns influence your shareholders' investment decisions?

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In certain countries, government bodies may enact regulation or incentives to maintain low emissions after the pandemic period is over. Conversely, some economies may become more oil dependent as prices remain low and personal auto use outpaces public transportation. These effects are difficult to predict or quantify but support the belief that ESG concerns will remain in focus.

From a tangible standpoint, several do not perceive that the pandemic has immediately increased the attractiveness of investing in renewables, for example. They see that investment decisions are still ultimately driven by fiduciary motivations (e.g. low valuations), echoing previous IHS Markit research on the topic. Thus, the oil and gas sector may still see inflows in the post-pandemic period, despite the long-term concerns around climate change.

Regardless, investors generally expect **scrutiny of their funds' environmental footprint to increase over time**, which in turn will impact the way they invest in the energy sector, forcing companies to transform and adapt in response.

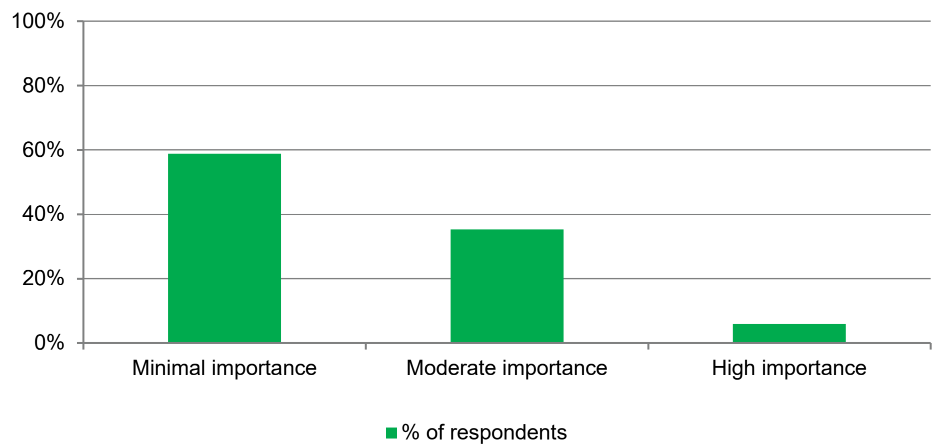
"Overall, I would say ESG is still an important consideration when making investment decisions. We are really focused on enhancing our climate change strategies. When the pandemic hit, we saw the oil prices plunging and how the pandemic influenced the oil market. That was an alert for investors to focus more on the energy transition commitments of companies." ***Analyst, European investment manager (>$40B EAUM)***

"There are many institutional investors who understand their responsibility and know that they would be held accountable if it becomes public that they invested in companies with bad ratings. This scrutiny is not something that is going to vanish in the short term. As we are going to be rated on our Scope 3 emissions, it is quite clear that we will have to reduce our shares in companies with high emissions, so there will be a clear effect from the regulations on our investment flows into the sector." ***Analyst, UK investment manager (>$85B EAUM)***

"I think investor concerns around climate change will remain, and we may see it wrapped a bit more with the social aspect. For example, the idea of how to have a green transition that is also sustainable from a workforce perspective. The unemployment piece was almost ignored in past discussions and public media-grabbing headlines. Those discussions were mostly just about the environmental piece. I think the environmental side will continue, but it will be more of acknowledging that it is important and asking how that transition is building a sustainable economy to job creation." ***Analyst, US investment manager (>$15B EAUM)***

The outcome of the 2020 US presidential elections serves as a minor to moderate influence on the priorities that investors set for energy investment.

How important is the outcome of the US elections to the priorities that you set for energy investment?



Source: IHS Markit

Many investors state that the outcome of the US presidential elections is one of the considerations when developing a strategy for energy investment, but does not feature as a top priority, especially now that the race is between President Trump and apparent Democratic nominee Joe Biden.
Respondents expect that the former will maintain a pro-oil and gas status quo and the latter will take a moderate approach to energy policy. Former Democratic candidates, Elizabeth Warren and Bernie Sanders, whose platforms included a ban on fracking, were considered bigger drivers of a potential industry upheaval.

How is your company positioned for potential regulations and various climate scenarios?

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When considering their priorities for energy investment, current macro risks take precedence as investors are focused on oil prices, a recovery in demand, OPEC policy, and the capital structure of energy companies (e.g. access to capital and debt burdens).

Some respondents anticipate that a Democratic presidency would introduce more regulation around fracking, a bigger push for renewable energy, and a headwind for the oil and gas industry. A few perceive that **renewables and CleanTech are already increasingly relevant** and that a Biden win might drive increased exposure to the space. One respondent remarks that oil may come under more pressure from both supply-demand and environmental perspectives, which could drive investors to prioritize gas-focused companies.

"People put way too much importance on elections. They never really seem to matter that much. Looking at the past 20 years, there has not really been a president that has influenced energy investment that much or caused a paradigm shift. There has been some impact around the edges, but there has not been a wholesale shift in policy, taxation, or legalization." ***Research analyst, US sell-side firm***

"The outcome of the US elections will have an impact on the direction of travel of the oil and gas sector. The oil and gas industry can change quite quickly, so whether it will be a four-year impact, or a long-term impact is hard to tell. From a higher-level perspective, if its Democratic over Republican then you would expect there to be a much bigger push on decarbonization and renewable." ***Analyst, UK investment manager ($100B EAUM)***

"The 2020 election is definitely an issue on the minds of energy investors. If Biden wins, it is going to be tough. It is another headwind for the industry. People are going to think twice before putting their money in there. It will absolutely have an impact on investor appetite for renewables. If Biden wins and ramps up the pressure on oil and gas companies, then people are going to look for where energy is going to come from instead. That could be solar panels or wind or some other form." ***Research analyst, US sell-side firm***