Energy industry: Top issues for 2024

Transcript

SPEAKER:

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NARRATOR: Welcome to the Industries podcast series, where Grant Thornton shares information through an industry-specific lens about the most important business issues of the day.

BRYAN BENOIT: As 2024 begins, companies in the energy industry have opportunities to make significant progress. Midstream companies, for example, are well positioned. Oil and gas companies are reinvesting profits, and oil is far from over.

I'm Bryan Benoit, Global Head of Energy and Natural Resources for Grant Thornton, and here's what companies in the industry need to watch for in the coming year.

First, I think we should talk about midstream and the fact that it is very well positioned fundamentally. I think they're supported broadly by EBITDA and CapEx guides that are unchanged from the prior year.

This is really driven as I see it by a few things:

- One, strong volumes for pipeline transportation.
- Two, higher fee rates on those pipeline assets.
- And then the third is lower third-party cost.

I might add one other item and that's higher transportation or storage services, so something else to think about.

Those four items really have midstream companies very well positioned for the coming year.

So moving on, next, oil and gas companies are reinvesting profits, another item to call out in a list of observations for 2024. So let's talk about that.

They're reinvesting profits at a very healthy rate. And these profits are, by the way, record profits, and the reinvestment is in finding new reserves.

So for a number of years — going into the pandemic, coming out of the pandemic — there was significant capital discipline around spending. Companies in the oil and

gas industry have enjoyed very high prices for quite a while now.
That has led to these profits, which they can now invest in finding new reserves and exploring for new oil and gas properties, and extracting those and continuing to have more profit. It's exactly what you would expect, given the different economic dynamics going on.
I think this is being driven by the Ukraine war, other world events, what's happening in Israel. There is a number of significant factors that are contributing to these higher prices and these larger profits for oil and gas companies.
The hunt to find these new deposits is happening even despite the climate crisis. There’s obviously pressure to transition to cleaner forms of energy, but there's also incredible pressure from investors to make returns.
For example, returns on oil and gas are typically 15% to 20%, while returns on renewable energy investments are closer to 8%.
And that brings us to our next item on the list, which is, is oil over? Well, no, absolutely not. Oil is not over. There have been some challenges for oil and gas companies in terms of getting access to capital. The bucket of capital available for conventional oil and gas has been smaller and it's going to continue to get smaller in the coming years.
But other sources of capital have stepped up. So for example you can see the rise in, say, the family office channel, for example. This is a phenomenon, it's still in its early stages, but I really believe it's going to continue to evolve as time goes on.
I mean, the family office money really wasn't set up to be a source of capital for oil and gas, but what a family office really seeks to do, it’s to provide a steady, predictable return to its investors, and that's exactly what oil and gas does.
I think the other thing is it's a great hedge against inflation — that is, oil and gas is great hedge against inflation — and that's very attractive, right, to a family office. So I think we're going to see family office step up in a bigger way than it already has, and that'll be around for a while.
Eventually we'll see commercial lending come back as a source of capital, but at this time resource-based lending by commercial banks is falling out of favor because they've had to go through three or four bankruptcy cycles over the last decade. And they’re a little bit fatigued on energy deals.

So with all that said, you only need capital if you need to fund opportunities. But the opportunities are abundant. There’s a significant need for oil and gas, not only in the United States but throughout the world.

It will be continuing for quite some time. We may not see it grow like it had in historical periods, but it's going to be a part of the energy picture for many years to come.

And then that leads us to my fourth point today, which is balancing oil with renewables and really seeing that pivoting on a fulcrum, if you will, of inflation.

So what I mean by that is, there's a transition to renewable energy. It's a theme in most of the conversations that companies are having today. I sit down with executives frequently, and either the conversation begins with renewable energy or it shifts there.

The rate at which it's occurring, that is, the energy transition, is really influenced by development costs and expected returns to investors. So if costs are really expensive to build renewable energy projects, then whether that's wind, solar or whatever the case may be, then they may not provide the return to investors that is needed.

And if that's not capable of happening, then those projects will be delayed or scaled back. The Inflation Reduction Act and a number of other policies that have been put in place by the current administration are very helpful to getting those returns.

But as I said, with the inflation looming, the cost of these projects is maybe higher than people anticipated even just a couple of years ago. And so they may not get built or they may be put on hold or they may be changed.

And so the point here is that inflation is really a fulcrum on which this balance or seesaw, if you will, between oil and renewables, keeps going back and forth.

So oil and gas prices on the other hand, as you know, just the other side of the of the of the balancing act, right, oil and gas prices have been high for the last few years relative to historical levels.

OK, so everybody knows that.

But you know these higher prices, while they've been really great for oil and gas profits, have also contributed to a lot of inflation in the economy because when oil prices are high, then your costs to make steel are higher, for example, and everything else is higher as well. So you see this higher oil price for a sustained period of time being a contributor to inflation.

So what this really all kind of boils down to is that there has to be a balance between higher oil profits, managing inflation, making cost to develop renewable projects more affordable, policies coming out of the government and the administration like the Inflation Reduction Act on how to create incentives for renewable energy and and appropriate returns to investors as a result of that.

And so there is this seesaw effect occurring that is really balanced on the fulcrum of inflation and it's playing a very big role in energy transition.

NARRATOR: Thanks for listening. Find out how Grant Thornton goes beyond expectations at GT.com