

Energy Capital Markets:
A Sector in Transition
Nasdaq IPAA Presentation
April, 2019



Agenda

Capital Flows

What's driving recent energy market performance?

Valuation & Fundamentals

Why is deep value money still on the sidelines?

Looking Ahead: 2020-2021

What macro & sector developments can we expect?

Conclusion

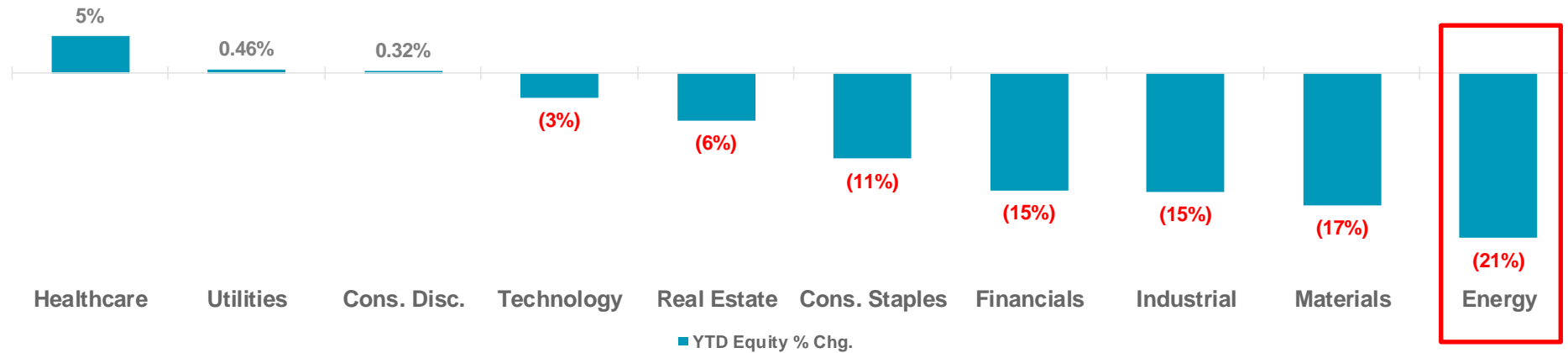
How to craft a winning strategy

Capital Flows

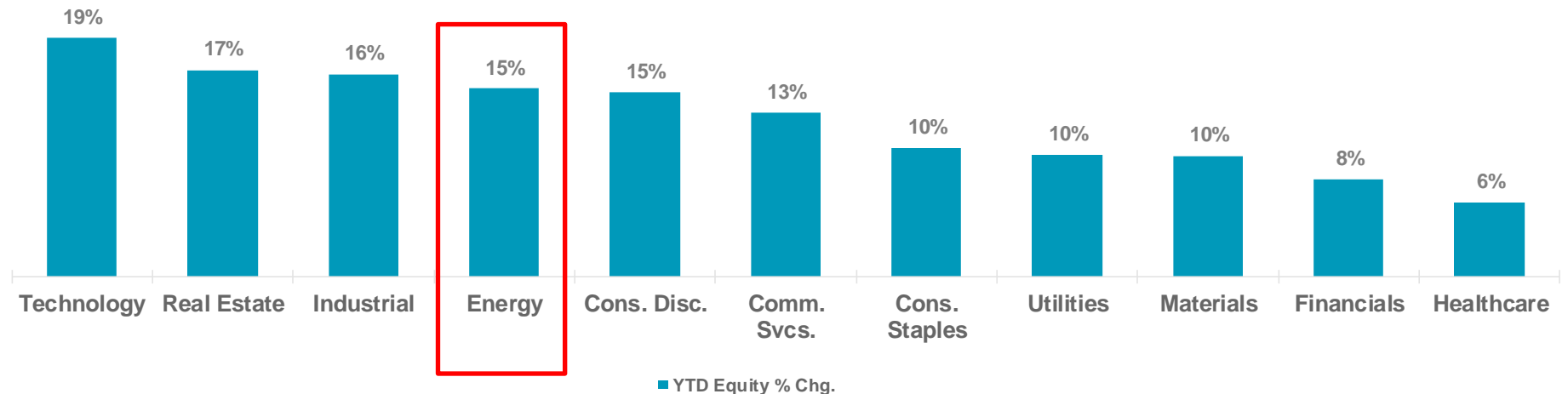
What's Driving Performance &
What Does That Tell Us?

After Being The Worst Performer In 2018, Energy Is One Of The Better Performers In 2019

2018 Equity Sector Performance

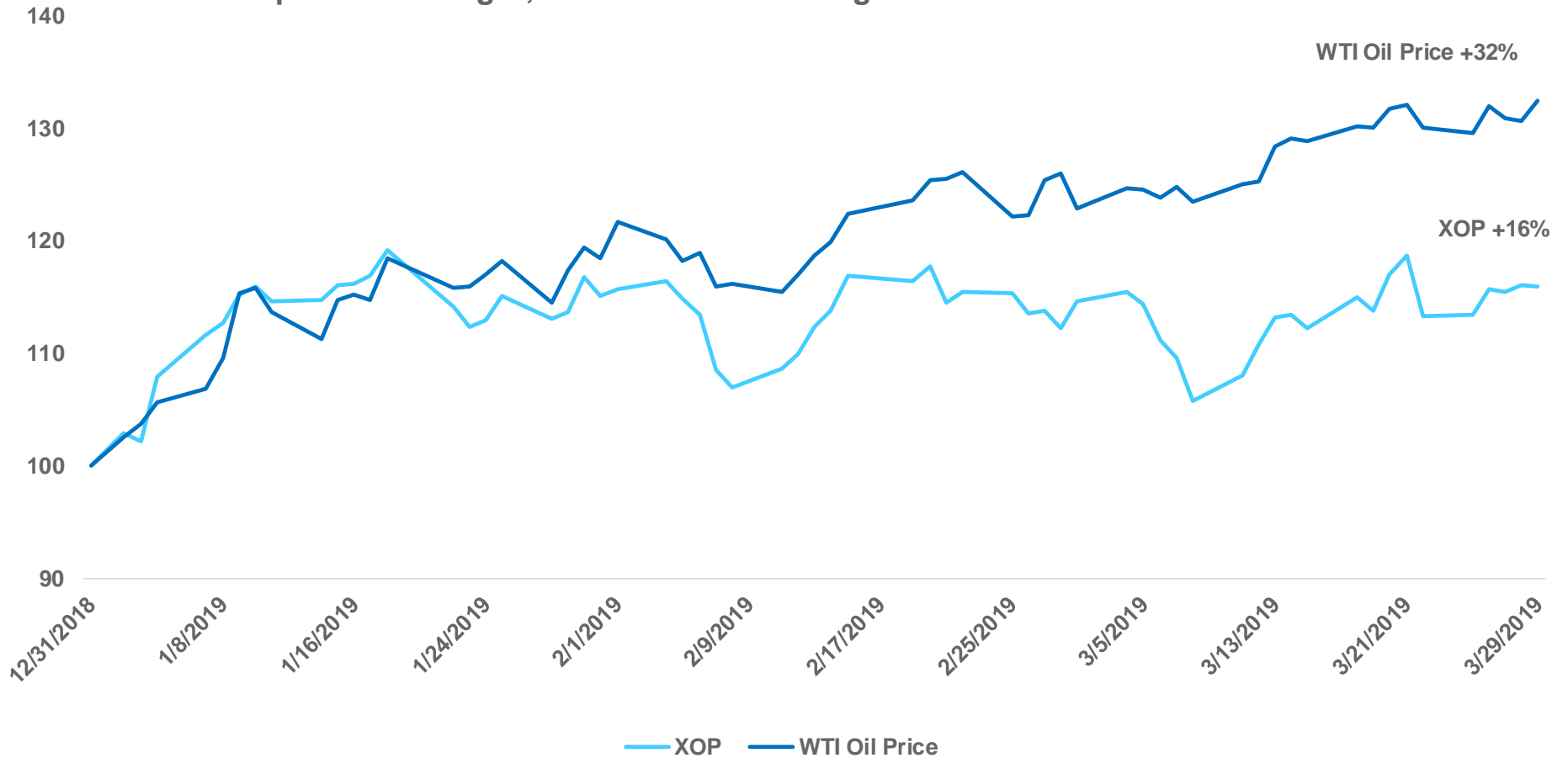


Q1'2019 Equity Sector Performance



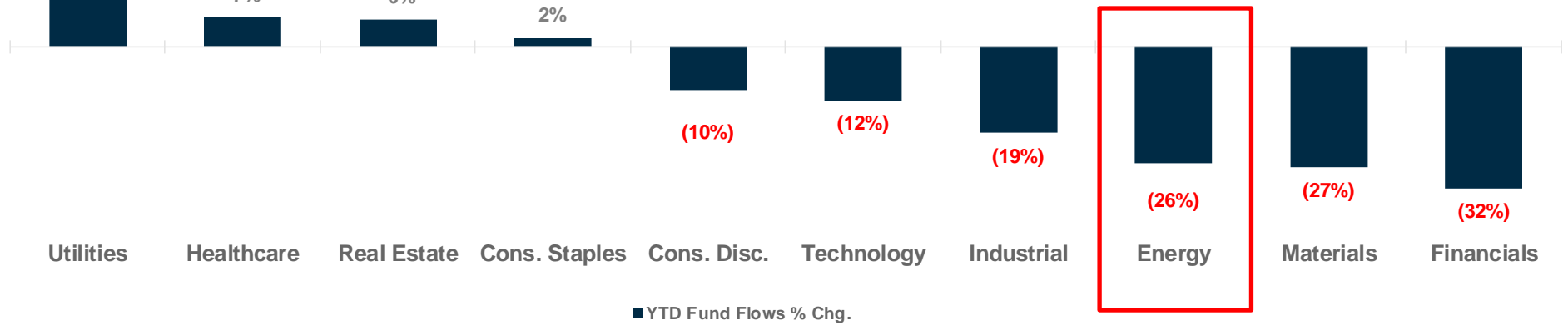
Even With Strong Gains, Energy Stocks Continue to Disappoint

E&P Stocks vs. Oil Prices in Q1'19:
Despite the Strength, E&Ps Continue to Lag Oil Prices

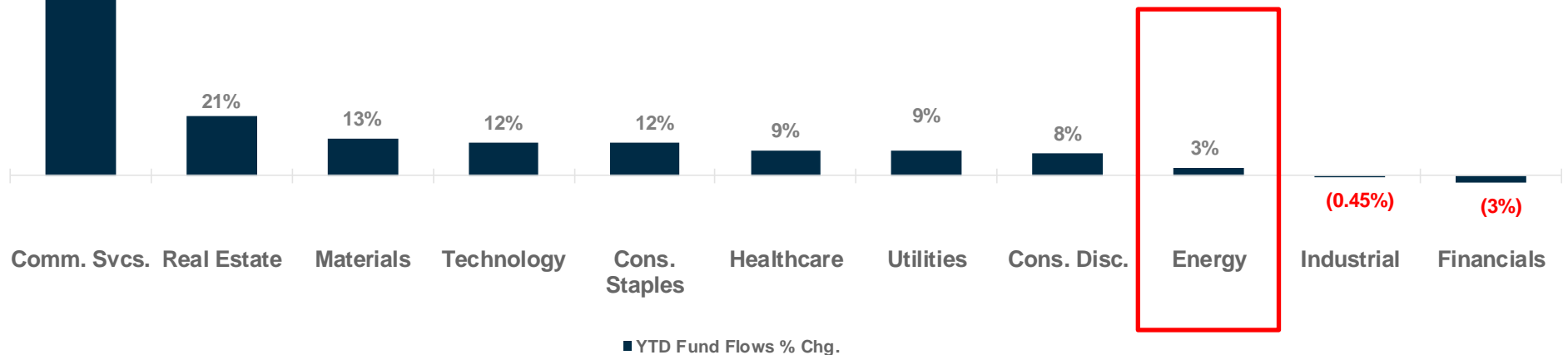


Energy Continues to Lag Other Sectors in Fund Flows

2018 Fund Flows by Sector: Energy's Equity Losses Corresponded with the Exodus of Invested Capital

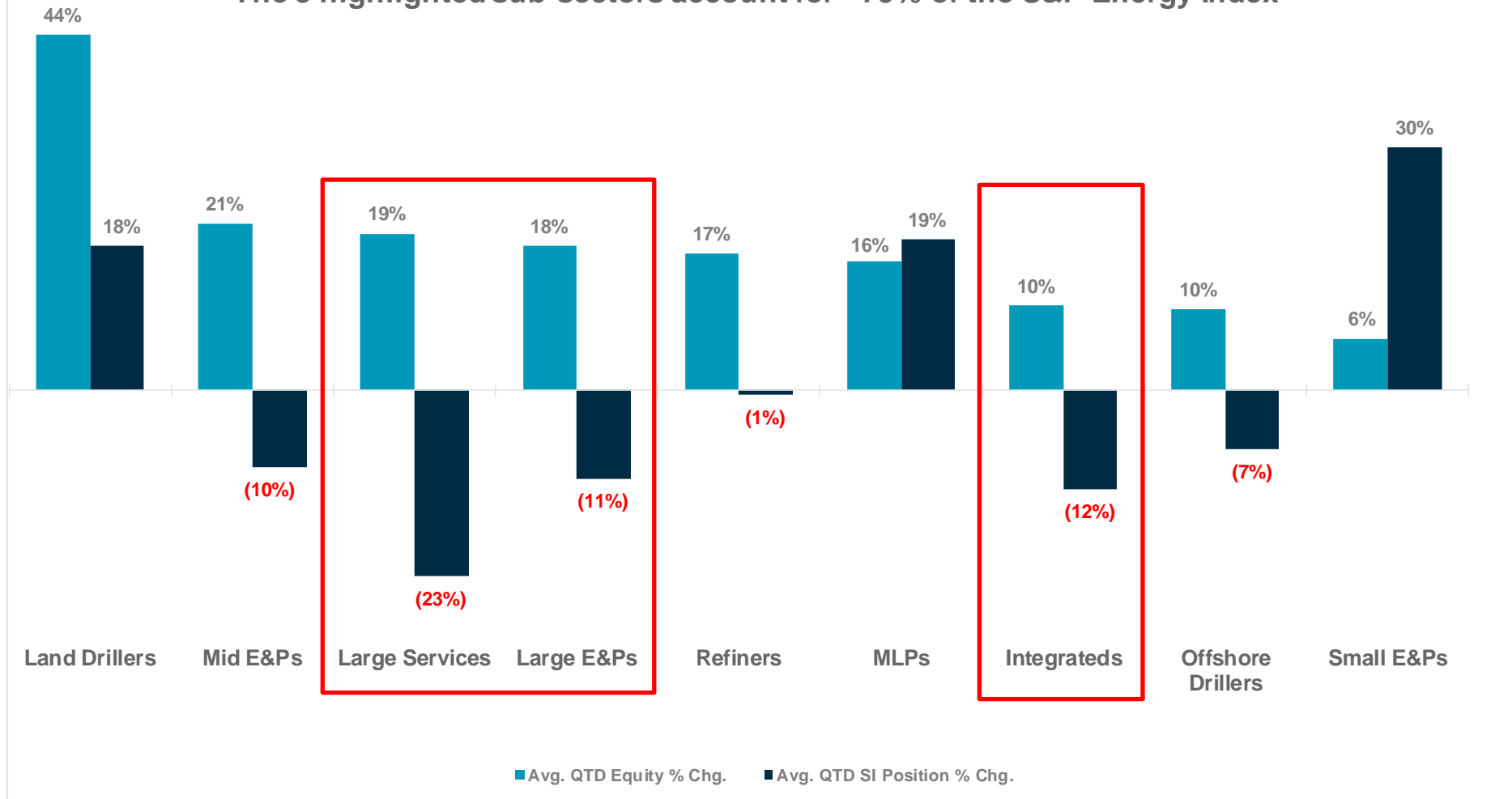


2019 Fund Flows by Sector: Despite Energy's Solid Equity Gains, Fund Flows Trail Other Sectors



Q1'19 Energy Performance vs. Short Interest Positioning

Short covering played a role in the Q1 gains of the Energy sector
The 3 highlighted sub-sectors account for ~75% of the S&P Energy Index

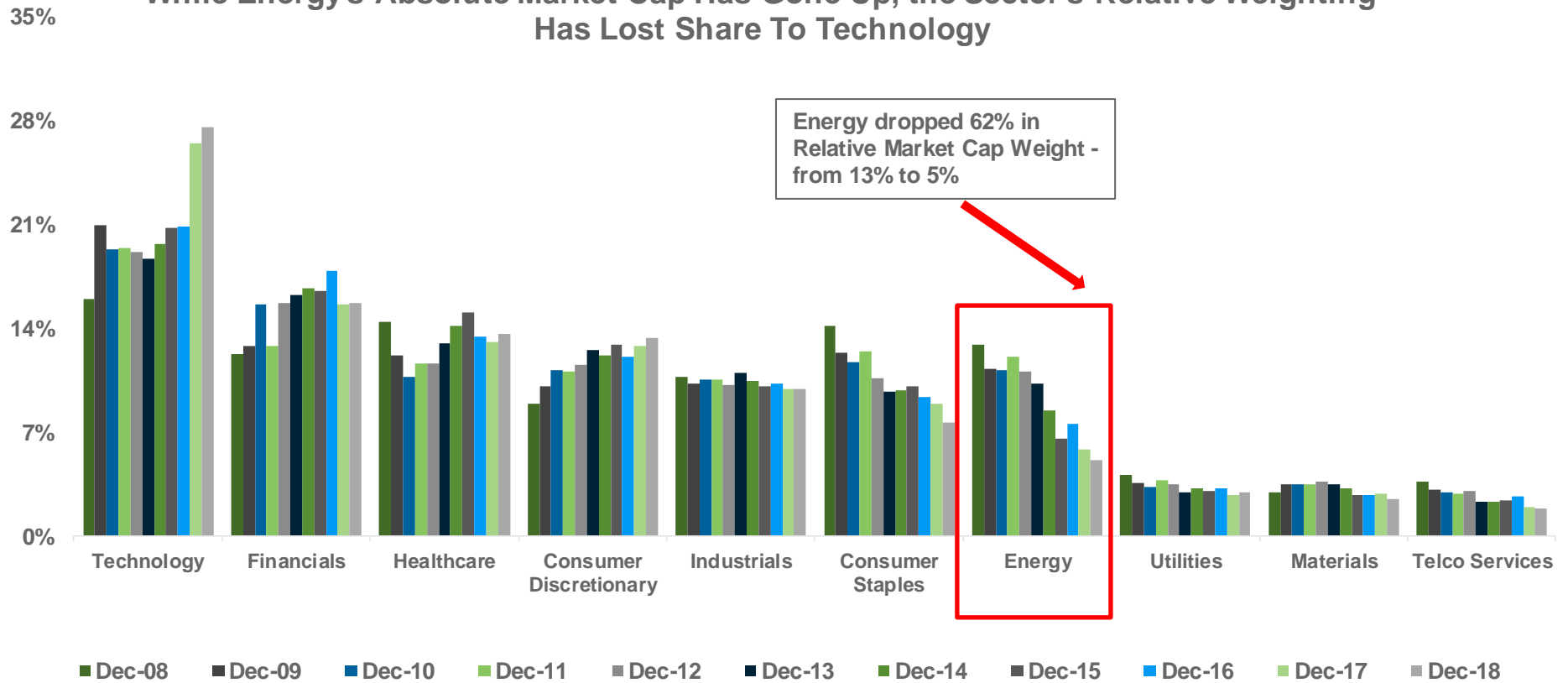


Valuation & Fundamentals

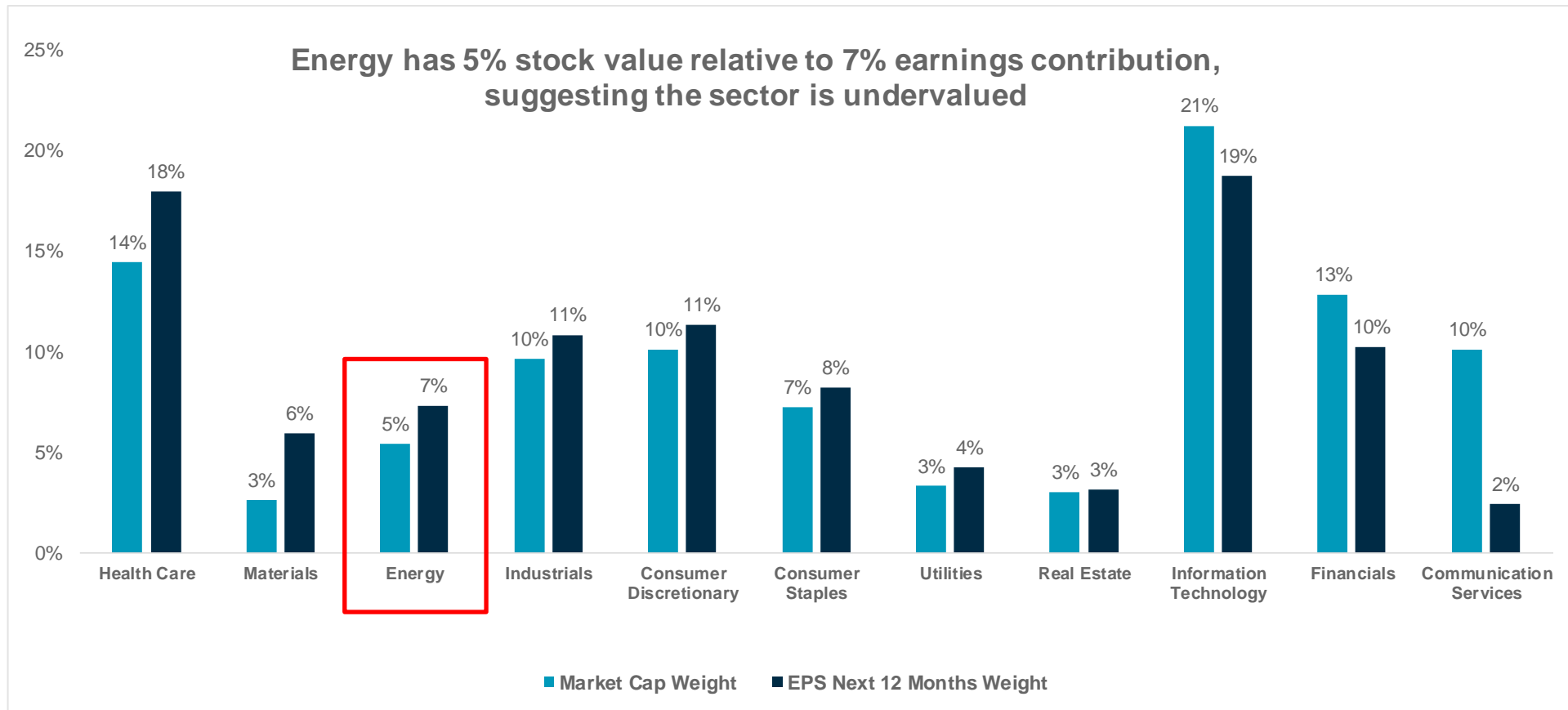
What Is Keeping The Long/Value Money On The Sidelines?

Putting the Market into Perspective by Size

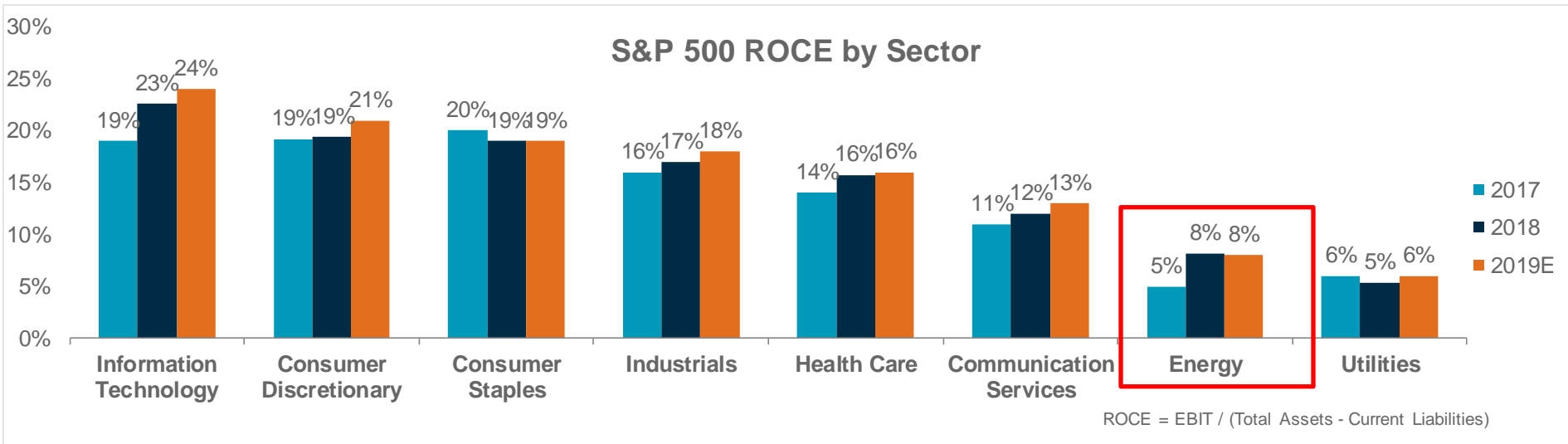
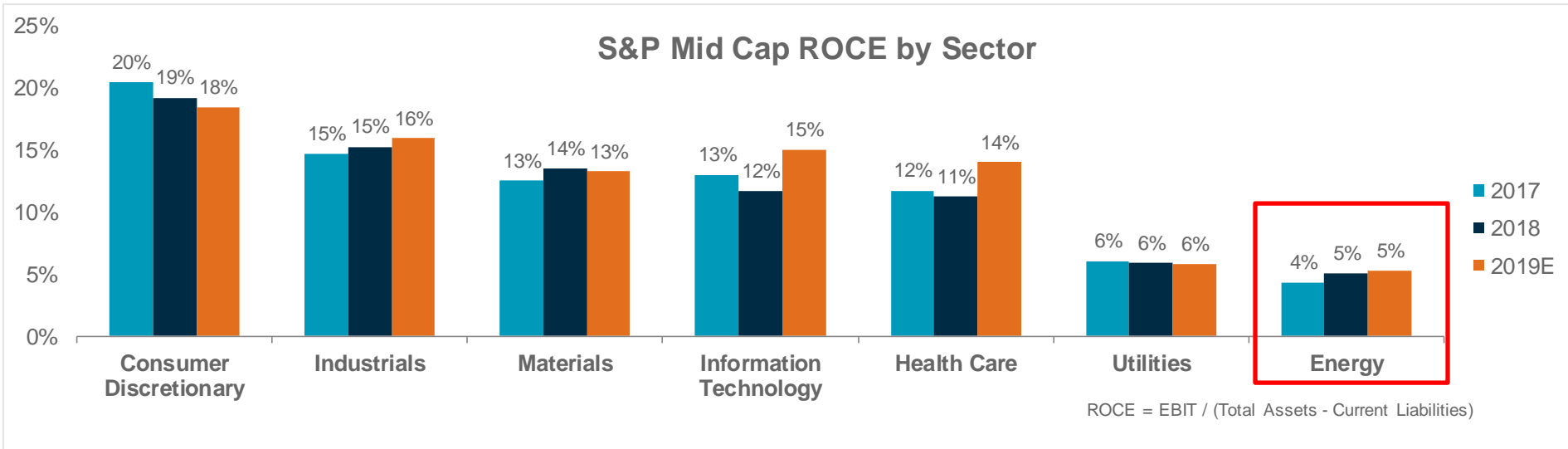
**Sector Breakdown of S&P 500 by Market Cap Over Past Decade:
While Energy's Absolute Market Cap Has Gone Up, the Sector's Relative Weighting
Has Lost Share To Technology**



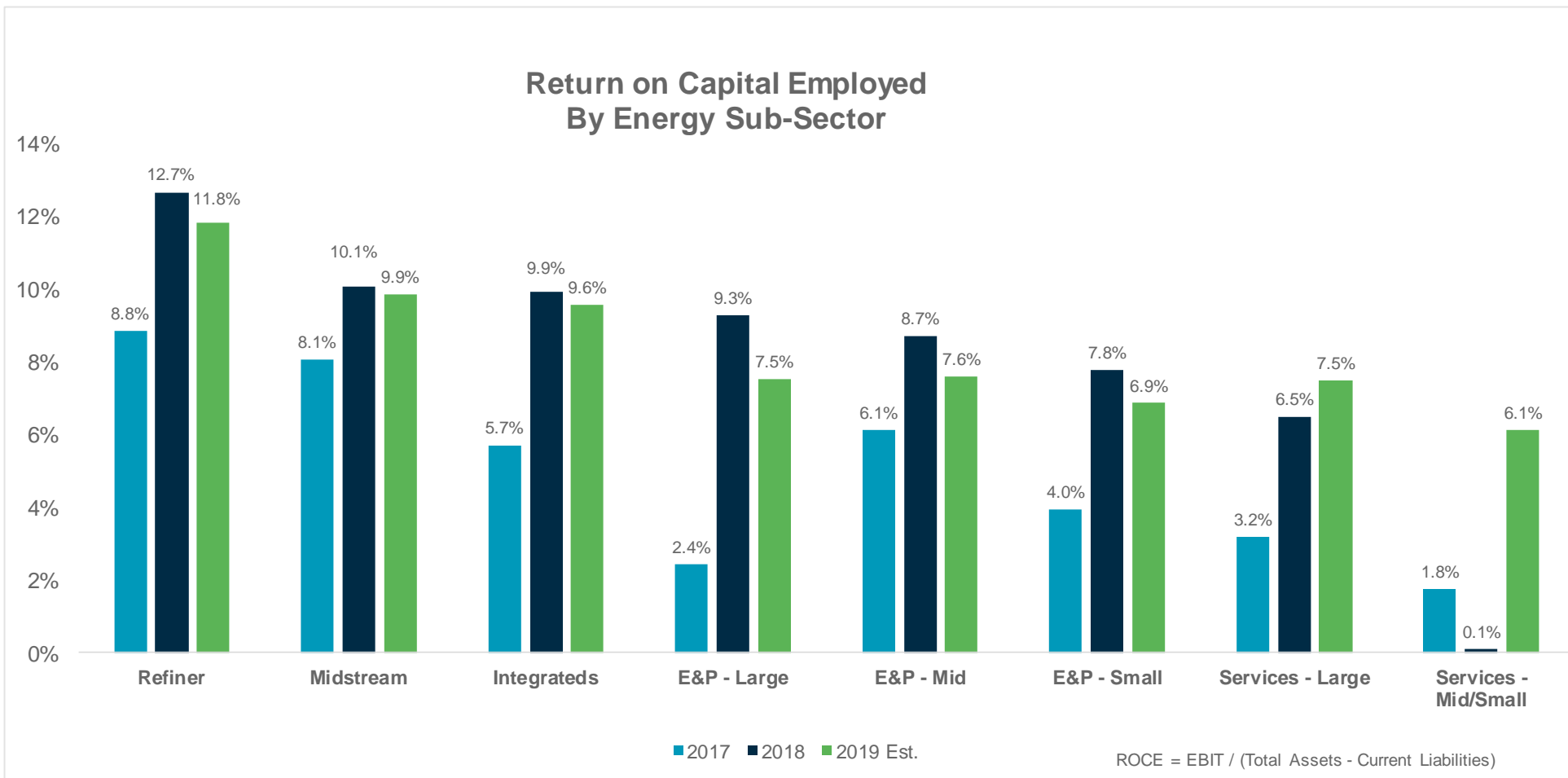
S&P 500 Sector View: Market Cap Weightings vs. Percentage of Earnings



Energy Returns Have Improved But Still Lag Other Sectors



Refiners Continue To Outpace All Other Energy Sub-sectors In Returns



Looking Ahead

What Developments Can We Expect in 2020 – 2021?

What Can We Expect in 2019-2020?

Challenges from the Macro Environment

Regulation on Corporate Access → Unbundling of Research & Trading

- Contraction of sell-side
- Small & Mid-caps will receive less research coverage
- Decrease in conference & meeting quality
- International marketing particularly difficult
- Issuers will need to set up their own investor meetings



Increased Dominance of ETFs and Index Funds

- Passive assets are poised to surpass actively managed assets in the U.S. in 2021 according to Moody's Investor Services
- Passive assets already hold 35% of S&P 500
- How to make the nuances of your investment thesis matter in a market with less discretionary capital?



BLACKROCK



More Macro Headwinds

Less Exclusive Focus On Energy

Increased Importance of Generalist Investors

- Analysts covering multiple unrelated sectors
- Issuers need to simplify the investment thesis
- Think in investment themes vs. sectors
- How do you compete outside of your sector?



Sector Trends & Developments in 2020-2021

Tailwinds

- US Becomes Net Energy Exporter On Consistent Basis
- IMO 2020
- Improved Financial Results
- Uptick in Reverse Mergers
 - IPO Market & Pipeline
 - Public M&A

Headwinds

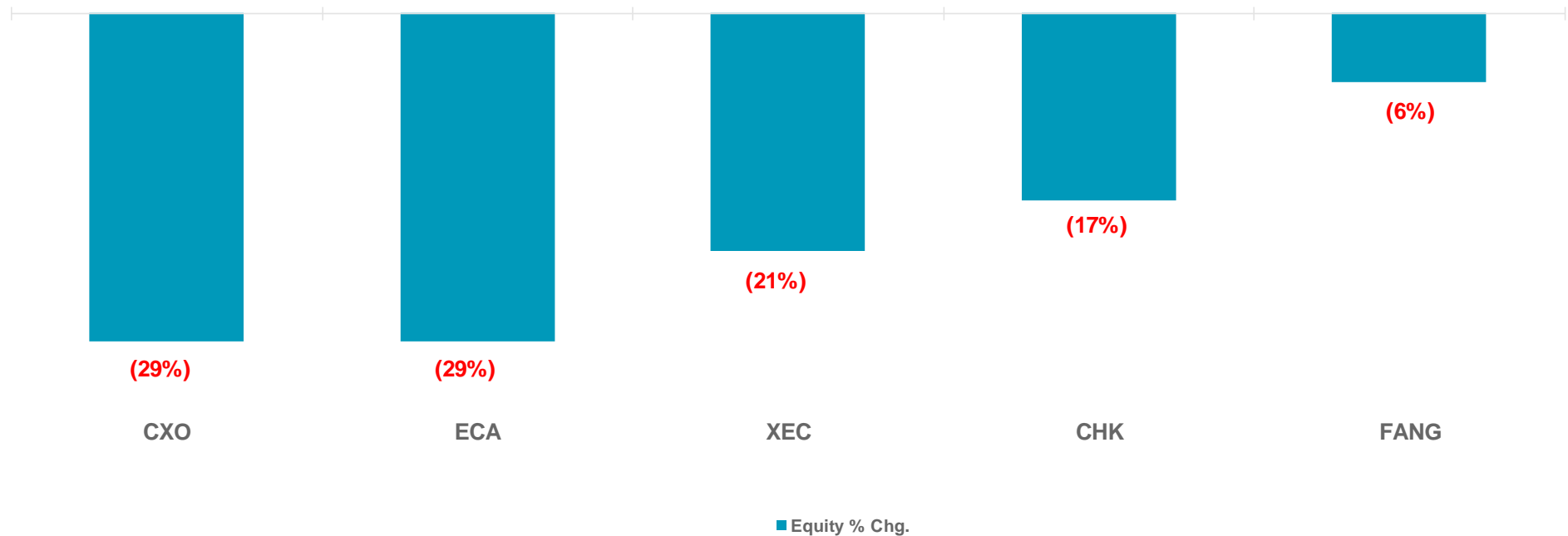
- No Conviction On Sustainability Of Oil Prices +\$60
- Perception That Energy Is The New Tobacco
- Aramco IPO Planned For 2021

- 2020 Election Year

M&A: A Necessary Catalyst to Excite Investors

But Impediments to Deal Consummation Still Exist

E&P Equity Performance Post Acquisition Announcement Date Through Q1'19:
Markets Have Penalized Companies for Buying Other Public Companies



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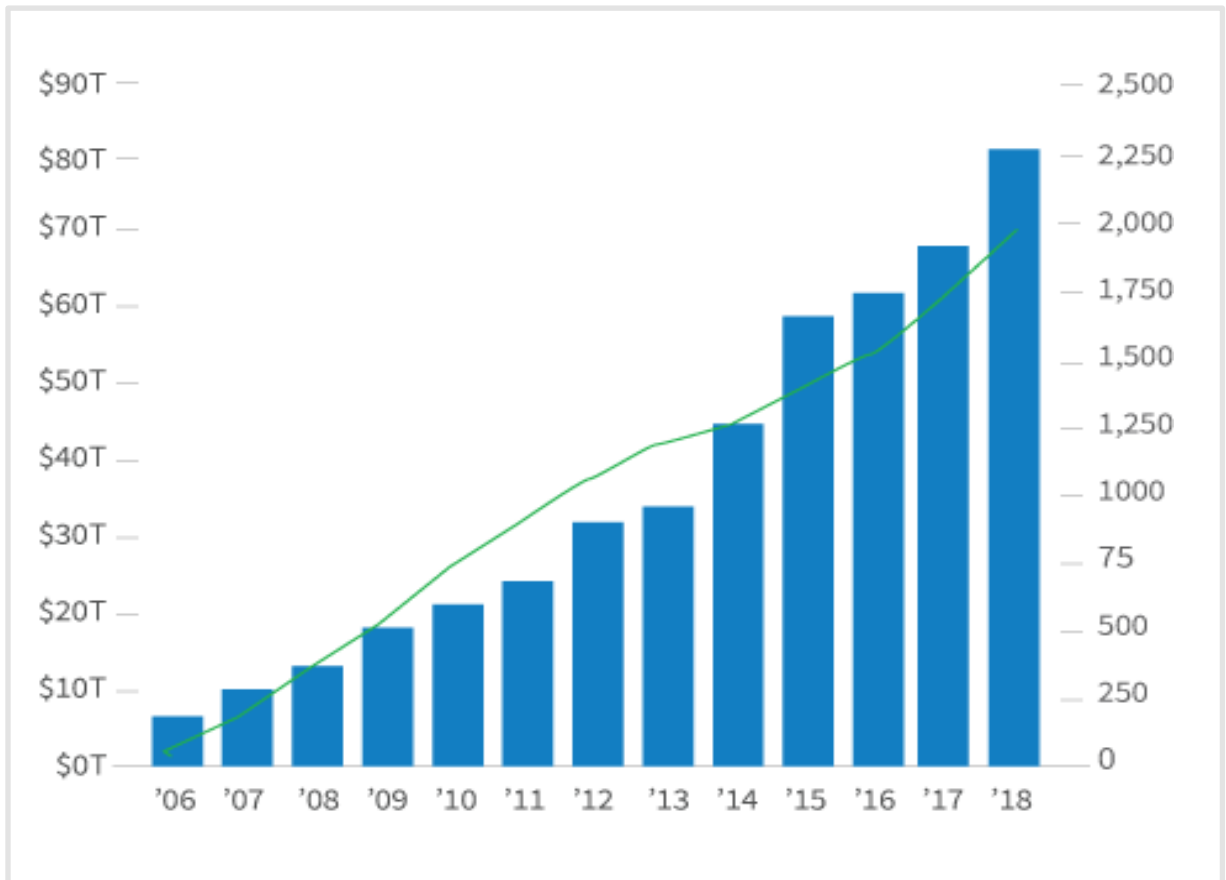
Other trends for 2020-2021

Increased Focus on Environmental, Social & Governance (ESG):
A Challenge → Opportunity

Institutions embrace responsible investing

grows ranks of investment managers that have signed the UN Principles of Responsible Investing, committing to consider ESG issues in portfolio decisions.

- Assets under management (U.S. \$ trillion)
- ✓ Number of signatories



Investors Across All Strategies Are Focusing On ESG

- No longer just a European phenomenon
- No longer only the domain of small pension funds/religious endowments

Index



Long-Only



Activist



Sustainable Investing Rarely Implies Divesting:

Being Best in Class within Oil & Gas Can Help Issuers Attract New Money

\$1 of Every \$4

institutional assets are invested
sustainably

\$23T

institutional assets are invested
sustainably

GLOBAL SUSTAINABLE
INVESTMENT ALLIANCE



The “G” is the Most Important Part of ESG: Top Governance Priorities for Investors

1

Board Composition, with a particular focus on enhanced diversity

2

Board-level expertise that is more aligned with business goals

3

Increased attention to climate risk and the environment

4

Enhanced attention to talent and human capital management

5

Compensation that is more aligned with performance and strategy

In Conclusion

How To Craft A Winning Strategy

In Conclusion: How Should Issuers Position Themselves to Win?

- Acknowledge past performance as a steward of capital
- Simplify the investment case
- Demonstrate competitiveness relative to stocks in other sectors
- Focus on returns rather than growth
- Cut costs, reduce debt & compensate shareholders
- Be transparent about managing risk for the future
 - Stress test around carbon tax and reserves write downs
- Focus on lowering carbon intensity
- Institute incentive metrics that align with long-term strategy
- Increase female representation at board and management level



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