Energy Capital Markets:
A Sector in Transition
IPAA, June 2019

The Times They are a Changin’
Agenda

Taking Stock
A mid-year review of the energy capital markets

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
Taking Stock

What can we learn from recent market performance?
Most sectors have mean reverted from last year, but Energy continues to underperform.

**2018 Equity Sector Performance**

- Healthcare: 5%
- Utilities: 0.46%
- Cons. Disc.: 0.32%
- Technology: (3%)
- Real Estate: (6%)
- Cons. Staples: (11%)
- Financials: (15%)
- Industrial: (15%)
- Materials: (17%)
- Energy: (21%)

**2019 YTD Equity Sector Performance**

- Technology: 26%
- Real Estate: 23%
- Cons. Disc.: 21%
- Industrial: 19%
- Comm. Svcs.: 19%
- Cons. Staples: 16%
- Utilities: 15%
- Financials: 15%
- Materials: 14%
- Energy: 9%
- Healthcare: 8%

E&Ps vs. Oil Prices YTD

Source: Eikon. 2019 YTD based upon data as of 6/19/2019
Investors Continue to Withdraw $ from Energy Funds

2018 Fund Flows by Sector

Utilities 14%  Healthcare 7%  Real Estate 6%  Cons. Staples 2%  Cons. Disc. (10%)  Technology (12%)  Industrial (19%)  Energy (26%)  Materials (27%)  Financials (32%)

2019 Fund Flows by Sector

Comm. Svcs. 91%  Technology 18%  Real Estate 14%  Cons. Disc. 14%  Cons. Staples 12%  Utilities 7%  Financials 3%  Healthcare (3%)  Industrial (5%)  Materials (13%)  Energy (17%)

Source: Lipper. 2019 Fund Flows based upon data as of 6/12/19
2019 YTD Energy Performance by Segment

Defensive, High Yielding Segments Outperform Higher Beta Segments

- Midstream C-Corps: 18%
- MLPs: 13%
- Large E&Ps: 11%
- Integrateds: 10%
- Mineral/Royalty: 6%
- Refiners: (0.22%)
- Services: (3%)
- Small-Mid E&P: (22%)
- Frac Sands: (22%)

Source: Eikon. 2019 YTD based upon data as of 6/19/2019
Valuation & Fundamentals
Why aren’t investors more excited about the energy sector?
While Energy's Absolute Market Cap Has Gone Up, the Sector's Relative Weighting Has Lost Share To Technology Over Past Decade.
Energy has 5% stock value relative to 5% earnings contribution, suggesting the sector is fairly-valued.

Source: FactSet June 2019
Energy Returns Have Improved But Still Lag Other Sectors

S&P Mid-Cap ROCE by Sector

S&P 500 ROCE by Sector

Source: FactSet. 2019 ROCE Estimates based upon data as of 6/12/2019
Refiners Continue To Outpace All Other Energy Sub-sectors In Returns

Return on Capital Employed By Energy Sub-Sector

ROCE = EBIT / (Total Assets - Current Liabilities)

Source: FactSet April 2019. ROCE Estimates based upon data as of June, 2019
Looking Ahead
What Macro & Sector Developments Can We Expect in 2020 – 2021?
Macro Challenges – Part I
Shifting Market Landscape

**Regulation on Corporate Access: Contraction of Sell-Side**
- Unbundling of research & trading
- Small & Mid-Caps to 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
- Passive assets already hold 35% of S&P 500
- Hard to make nuances of your investment thesis matter in a market with less discretionary capital
Macro Challenges – Part II
Less Exclusive Focus On Energy

Increased Importance of “Generalist Investors”

- Analysts are covering multiple unrelated sectors
- Issuers should simplify investment thesis
- Competition for capital versus other sectors
- More direct engagement with investors
- Less reliance on banks as intermediaries
Sector Themes in 2020-2021

**Tailwinds**
- IMO 2020
- Improved Financial Results
- Consolidation
- Shareholder Activism

**Headwinds**
- Peak Oil Demand Fears
- Saudi Aramco IPO
- Trade War

**Wildcards**
- Oil Prices
- 2020 Election
M&A: A Necessary Catalyst to Excite Investors
But Impediments to Deal Consummation Still Exist

E&P Equity Performance Post Acquisition Date Through 6/19/19:
Markets Have Penalized Companies for Buying Other Public Companies

- ECA: (53%)
- CHK: (51%)
- XEC: (37%)
- CXO: (35%)
- OXY: (25%)
- FANG: (4%)

Source: Eikon
Increased Focus on Environmental, Social & Governance (ESG) Investing:

Institutions embrace responsible investing

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**

![Graph showing growth in assets under management from 2006 to 2018](image-url)
Investors Across All Strategies Are Focusing On ESG

- No longer just a European or small pension fund phenomenon
- Part of US mainstream approach to risk management
Sustainable Investing Rarely Implies Divesting:
Being Best in Class within Oil & Gas Can Help Issuers Attract New Money

$1 of Every $4

$23T

institutional assets are invested sustainably

institutional assets are invested sustainably
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
Successful Strategies for Today’s Energy Market

1. Capital stewardship focused on returns
2. Demonstrate competitiveness relative to other sectors
3. Direct engagement with investors - rely less on intermediaries
4. Run data-dependent IR programs to evaluate successful marketing
5. Be transparent about managing future risk
6. Stress test around carbon tax and reserves write downs
7. Lower carbon intensity & link this to the value proposition
8. ESG disclosure should be included in all investor decks
9. Link compensation to value creation and environmental measures
10. Increase female representation at board and management level
Thank You!

81% Nasdaq IPO Win Rate 2019
87% Nasdaq VC Backed IPO Win Rate 2019
80% Nasdaq PE Backed IPO Win Rate 2019