

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

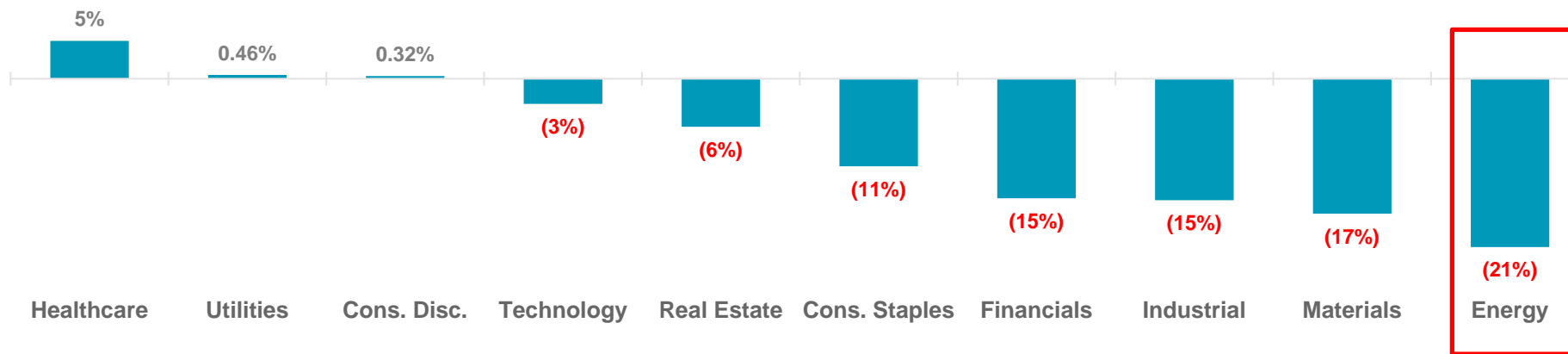
How to craft a winning strategy

Taking Stock

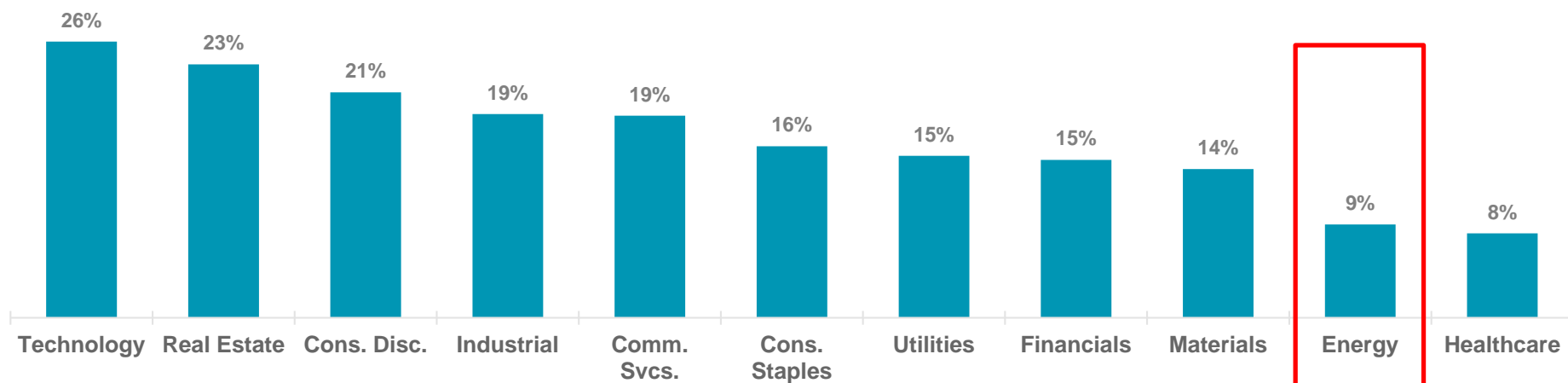
What can we learn from recent market performance?

Most sectors have mean reverted from last year, but Energy continues to underperform

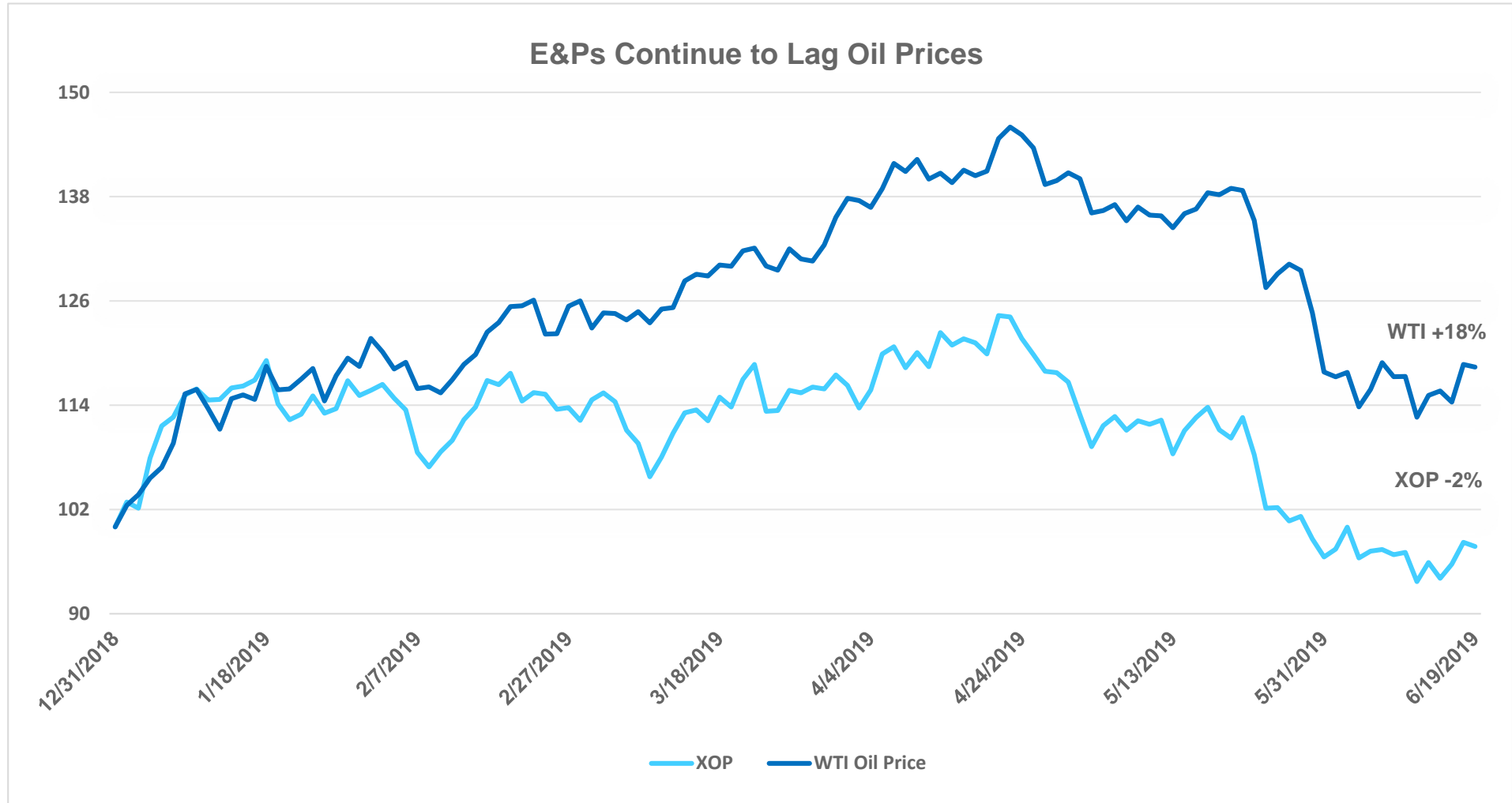
2018 Equity Sector Performance



2019 YTD Equity Sector Performance

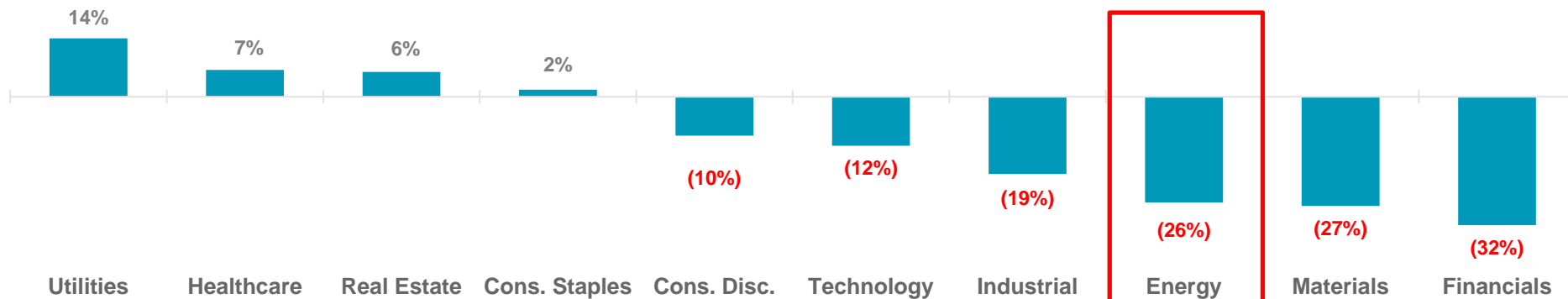


E&Ps vs. Oil Prices YTD

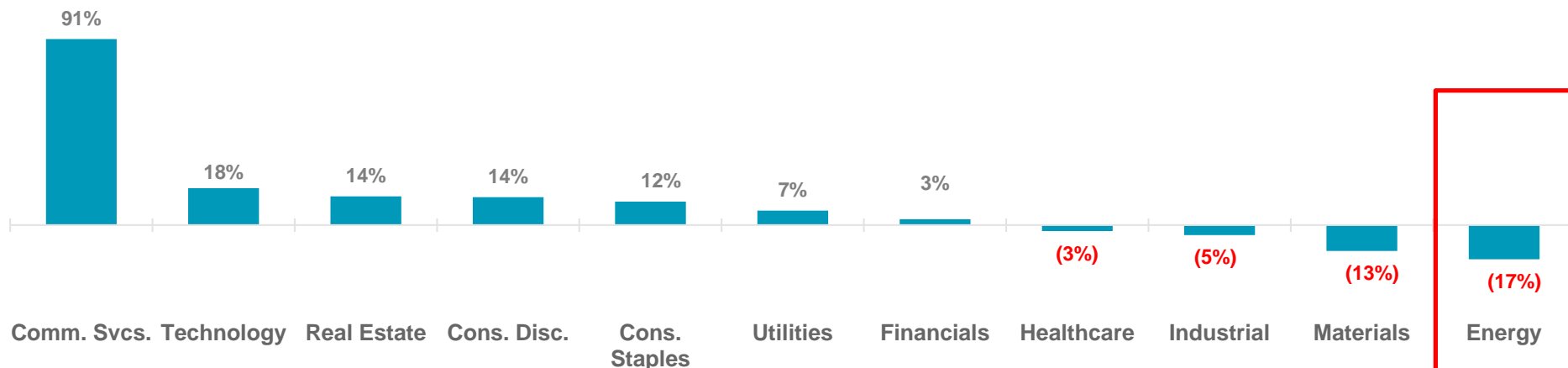


Investors Continue to Withdraw \$ from Energy Funds

2018 Fund Flows by Sector

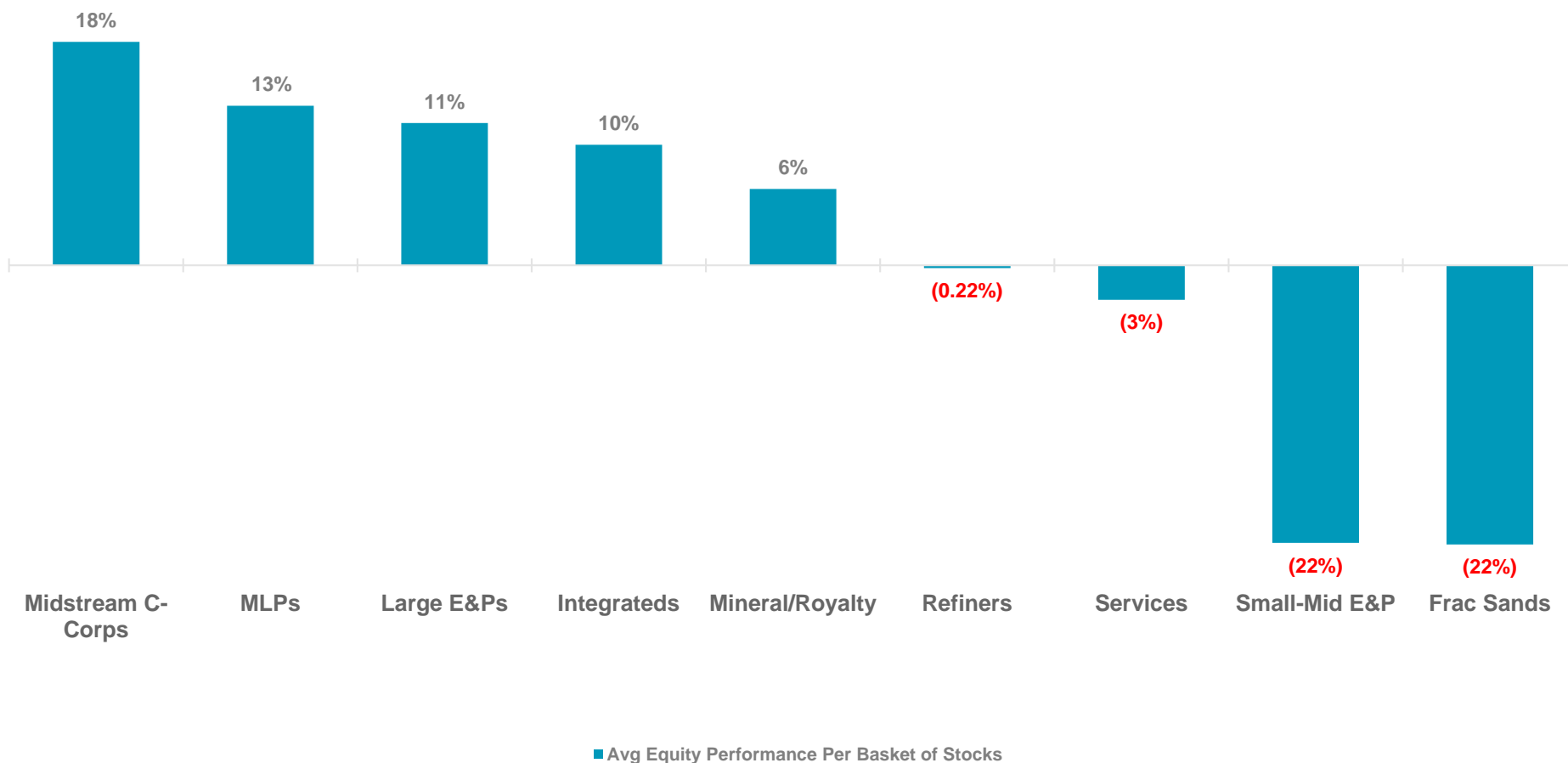


2019 Fund Flows by Sector



2019 YTD Energy Performance by Segment

Defensive, High Yielding Segments Outperform Higher Beta Segments

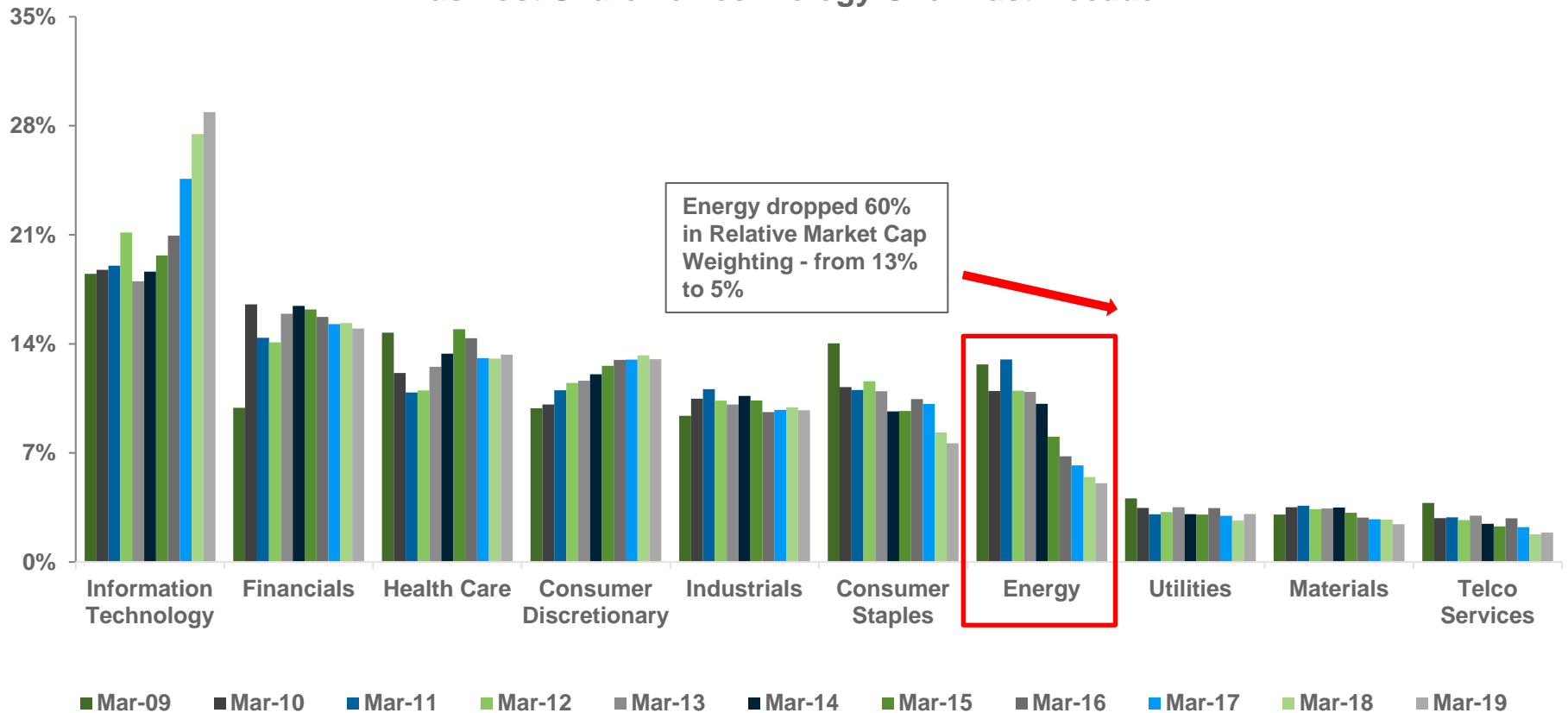


Valuation & Fundamentals

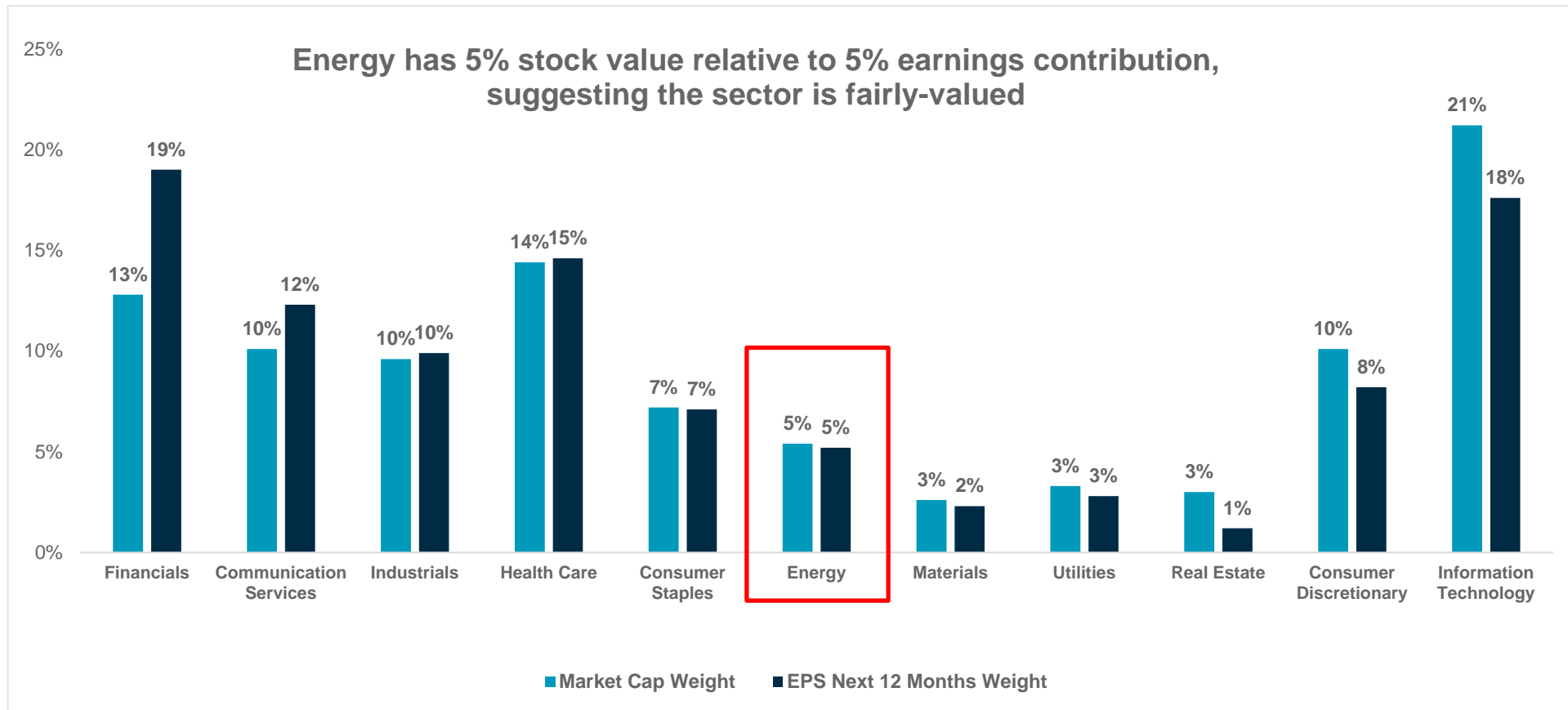
Why aren't investors more excited about the energy sector?

Sector Breakdown of S&P 500 by Market Cap

While Energy's Absolute Market Cap Has Gone Up, the Sector's Relative Weighting Has Lost Share To Technology Over Past Decade

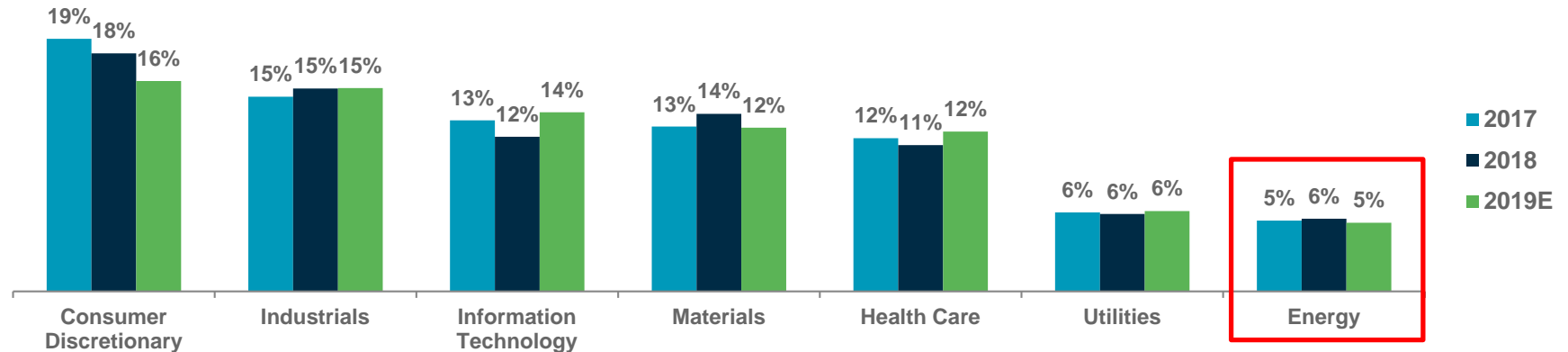


S&P 500 Sector View: Market Cap Weightings vs. Percentage of Earnings



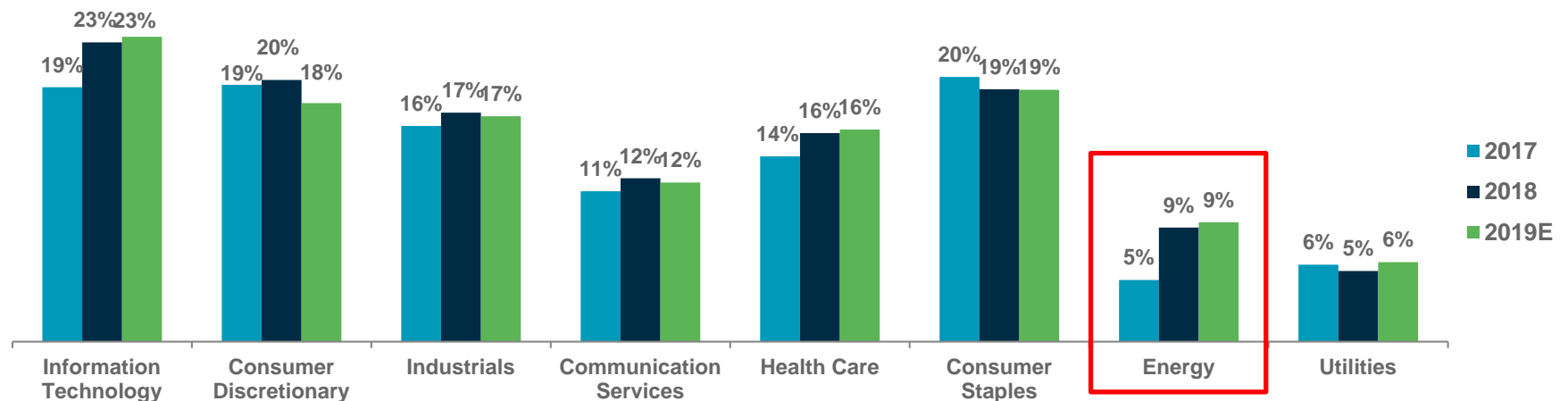
Energy Returns Have Improved But Still Lag Other Sectors

S&P Mid-Cap ROCE by Sector



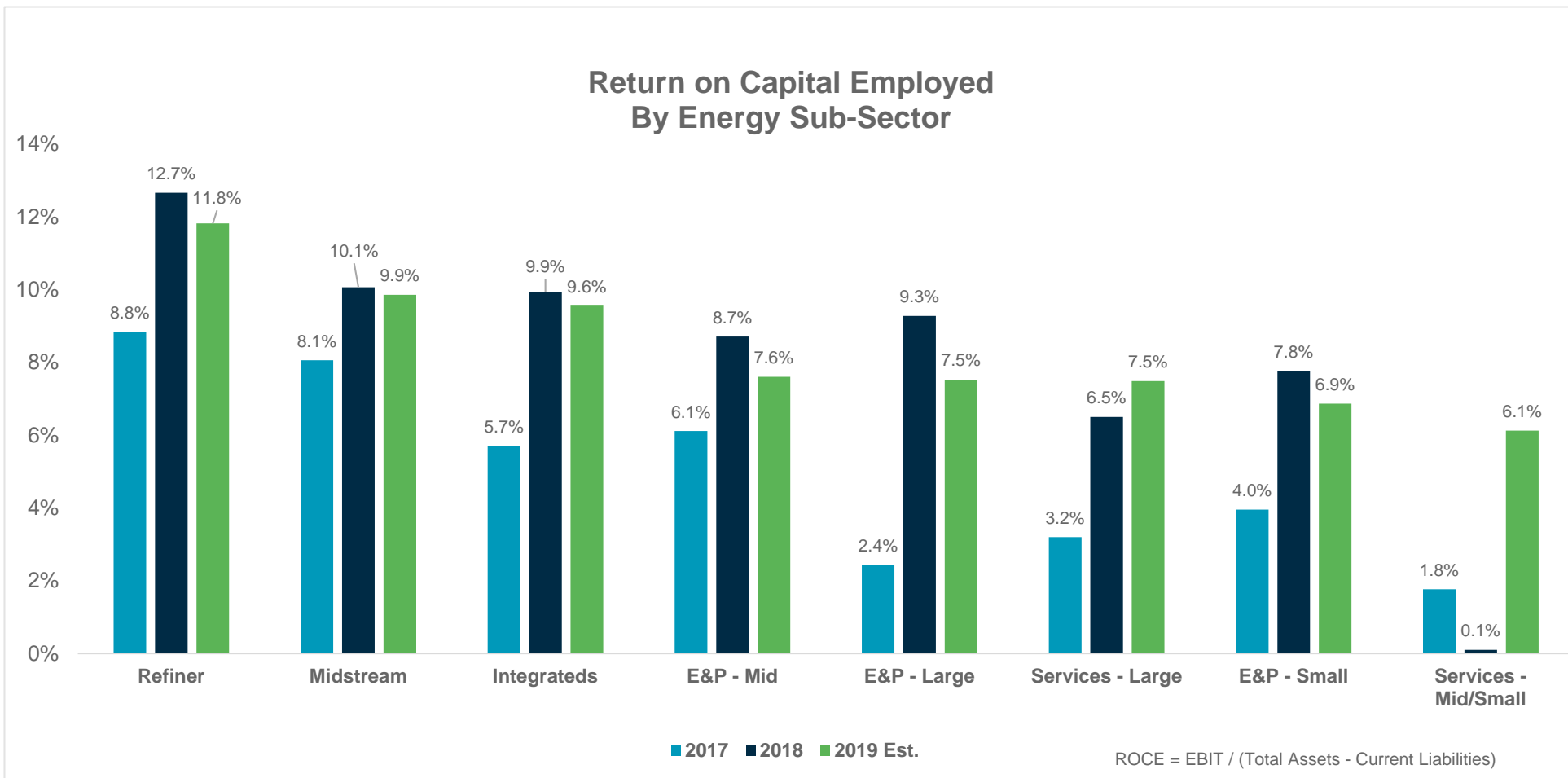
ROCE = EBIT / (Total Assets - Current Liabilities)

S&P 500 ROCE by Sector



ROCE = EBIT / (Total Assets - Current Liabilities)

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



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



BLACKROCK



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

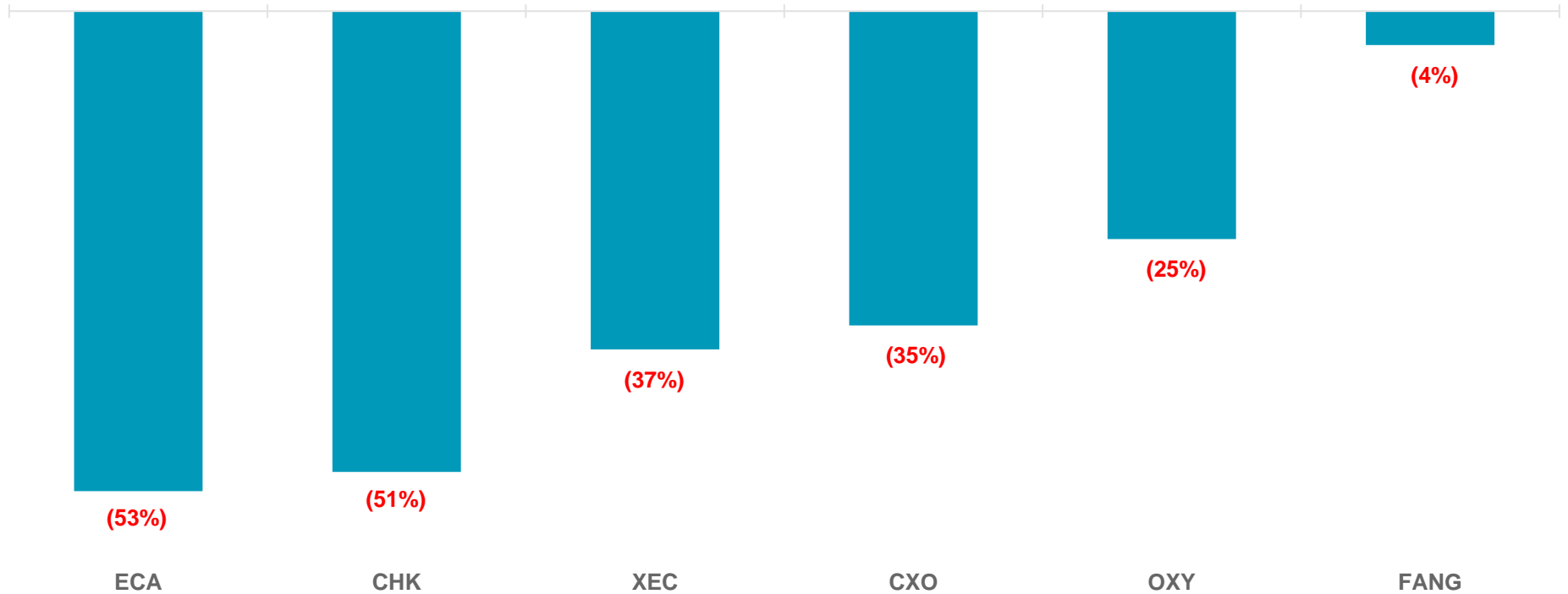
Wildcards

- 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

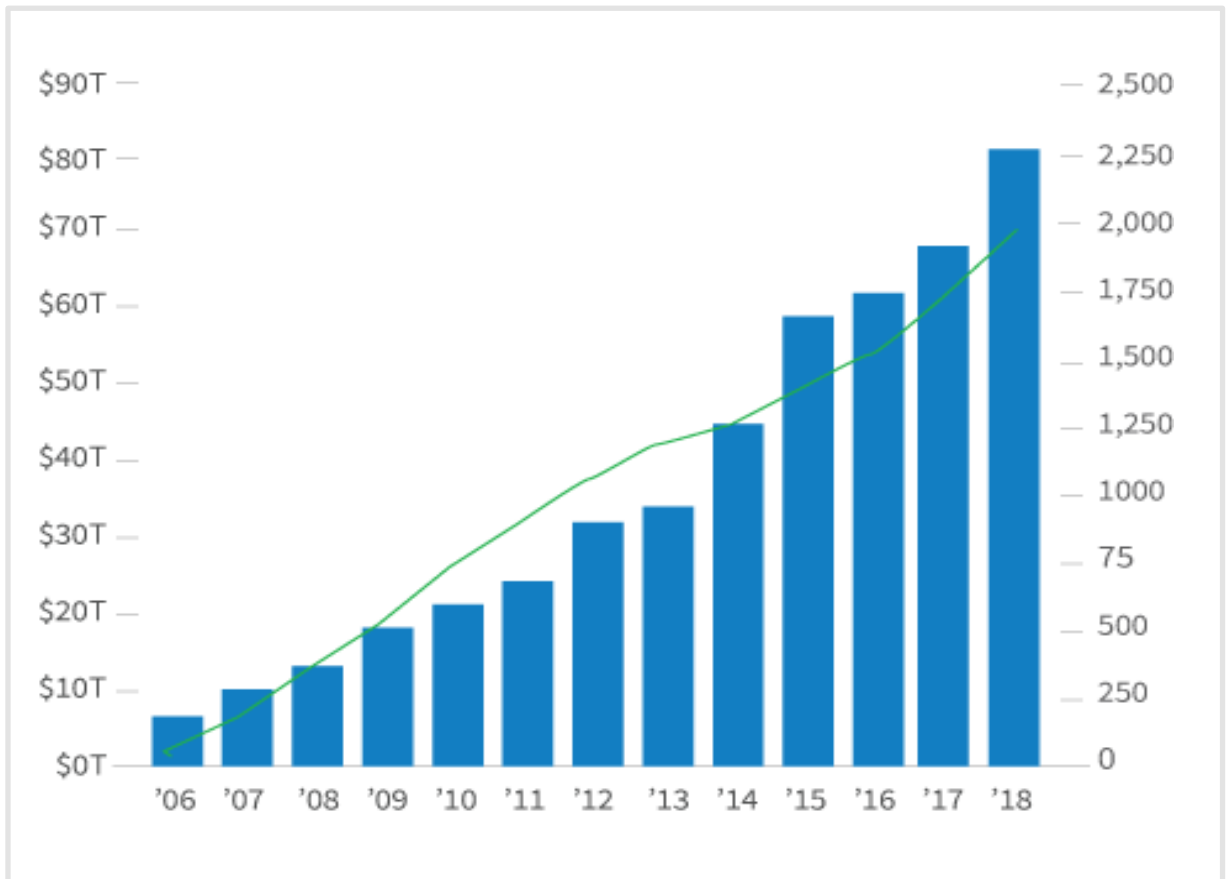


Increased Focus on Environmental, Social & Governance (ESG) Investing:

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



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

Index



Long-Only



Activist/Hedge Fund



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

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



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Thank You!

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