Performance Comparison and Strategy Selection of Oil Companies under the Normal Environment of Low Oil Price

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Abstract: Under the normal environment of low oil price, the financial performance of most oil companies dropped significantly. Based on the analysis of performance gap of all three kinds of oil companies during low oil price period, it has been disclosed why Chinese oil companies went through low oil price with much worse performance compared with multinational oil companies according to further performance analysis by business sections. Based on the different strategies adopted to deal with low oil price by oil companies, it has been proposed for Chinese national oil companies to accelerate marketization, optimize the structure of upstream production, optimize the layout of midstream，downstream and chemical business , strengthen the development of special technology and carry out strategic management of the budget.

As from the second half of 2014, with the combination impact of slowdown of global economic growth, over supply of crude oil, inflation of US dollar and the numerous geopolitical dispute, the global oil price dropped by more than 50%. It called an end to four years' volatility period of high oil price. The drop of oil price not only showed that world petroleum market was experiencing a new round adjustment, but also indicated the oil supply and demand would maintain loose. As a result, oil price would stay low for the next few years which will be the new normal environment. With the low oil price, the revenue of oil companies dropped significantly and profit margin was narrowed. The whole oil industry is facing a new round of integration.

1 INTRODUCTION

The risk of oil price is one of the major risks that oil companies may face. The impacts on different oil companies by the drop of oil price are totally different. Throughout the oil industry, although the profitability of the upstream related business in all the oil companies is reduced dramatically, the loss of some companies may be compensated by the profit earned through downstream and chemical segment because they had mature and perfect portfolio structure. But for some small companies, it is highly possible that they will go bankruptcy because they can not earn as much as to offset their expense due to small scale and imperfect portfolios.

1.1 Classification and Characteristics of Oil Companies

According to the size of oil companies and the characteristics of the main business, oil companies are generally divided into three major categories of (not including oil service companies):
The first category is International Oil Company (known as IOC) who is mostly engaged in oil and gas exploration, development, production, refining, marketing and trade. IOCs are especially referring to 5 super majors including ExxonMobil, BP, Royal Dutch Shell (Shell), Chevron Corporation (Chevron) and Total. IOCs are implementing diversification and integration strategy(Peng Yuanzheng, 2014) They have strong financial strength and operate globally. Oil refining and marketing are also their main business and have a large share in the whole business. Each sector of their business can be a profit pool. They have strong business flexibility and good anti risk ability. They have a good control of

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the resources and their assets have a wide distribution over the world, especially in resource rich area. They own a large number of core assets and profit centers worldwide. They have a strong sense of brand awareness and profit awareness. Finally, their core competitiveness prevail over other oil companies and they have a great advantage over the cost saving and profit making.

The second category is Independent Oil and Gas Company (known as E&P). Independent Oil and Gas Companies are non-integrated companies which receives nearly all of its revenues from production at the wellhead which includes Conocophillips, Apache Corporation, Devon Energy and so on . They are exclusively in the exploration and production segment of the industry, with no downstream marketing or refining within their operations. Conocophillips has been regarded as E&P instead of IOC since it was broken down into two. Independent Oil and Gas Companies are focused in upstream business and have a short industry chain. Compared with IOC, they are much smaller and are more flexible in operation. They invest in high profitability projects of short-term and mid-term, and build up step by step around the core competitiveness power such as comparable advantage of special advantage. Their assets are more centralized and they are active in capital market. They pay more attention to short term profitability and will dispose their assets as quickly as possible according to their strategy(Wang Zhen, Wang Rulang, Xiao Fei,2009).

The third category is National Oil Company (known as NOC). NOCs are major players in oil industry which include Saudi Aramco, StatoilHydro ASA (Statoil), Petrobras, Petrochina Company Limited (Petrochina), China Petroleum & Chemical Corporation (Sinopec), China National Offshore Oil Company (CNOOC), and so on. A national oil company (NOC) is an oil company fully or in the majority owned by a national government. NOCs are implementing integrating strategy and most of them are only strong in upstream. Although NOCs are also increasingly investing outside their national borders, their major businesses still lie within their own countries. NOCs are given the privilege in carrying out the oil business in their countries by their governments. In some senses, NOCs undertake part of the roles of their governments such as ensuring adequate energy supply and safeguarding oil industry. During previous years, some of the

NOCs have undertaken successful reforms on their systems and are becoming more and more IOCs which include Statoil, Petrobras, Pemex and so on.

In recent years, the boundaries between different categories of oil company are becoming more and more vague.

1.2 Performance Analysis on Oil Companies during Low Oil Price Period

To make the analysis on the performance of the oil companies of different categories during the low oil price period, we chose typical companies from each of the three categories. By comparing the performance of the 2015 Q1 with that of 2014 Q1, the impact of oil price plunge on oil companies has been analyzed. The average crude oil price of WTI in 2014 Q1 was 98.7 $/bbl while dropped to 48.5 $/bbl in 2015 Q1, down almost 50.9%, which can explain the impact of oil price on the performance of oil companies very well. The typical companies we chose included ExxonMobil, BP, Shell, Chevron and Total form IOCs, Conocophillips, Apache, Devon Energy form E&Ps, and Statoil, PETROCHINA and Sinopec from NOCs. The indicator for the analysis we chose was the net profit attributable to the shareholders. According to the financial report publicly published by each company, different companies had totally different performances as we can see the change of the net profit attributable to the shareholders caused by oil price plunge from figure 1. The third largest NOC of China CNOOC was not included in the analysis due to no public data obtainable on that indicator.

As we could see from figure 1, the net profit attributable to the shareholders of all chosen companies dropped with the impact of the oil price plunge. The drop ranged from 20% to 119% according to different companies. The impacts of oil price on performance of different companies were totally different. According to performance by different categories of oil companies, we could draw below conclusions:

The performance of IOCs was impacted less by the oil price drop, with net profit attributable to the shareholders falling 20% to 56% and maximum drop keeping the same pace with the drop of the oil price.

The net profit attributable to the shareholders of 3 NOCs fell 43% to 85%, with 2 Chinese NOCs' falling even over 80%.

The performance of E&Ps was impacted most by the oil price drop, with net profit attributable to the shareholders falling 73% to 119% and even 2 of them recorded net loss.

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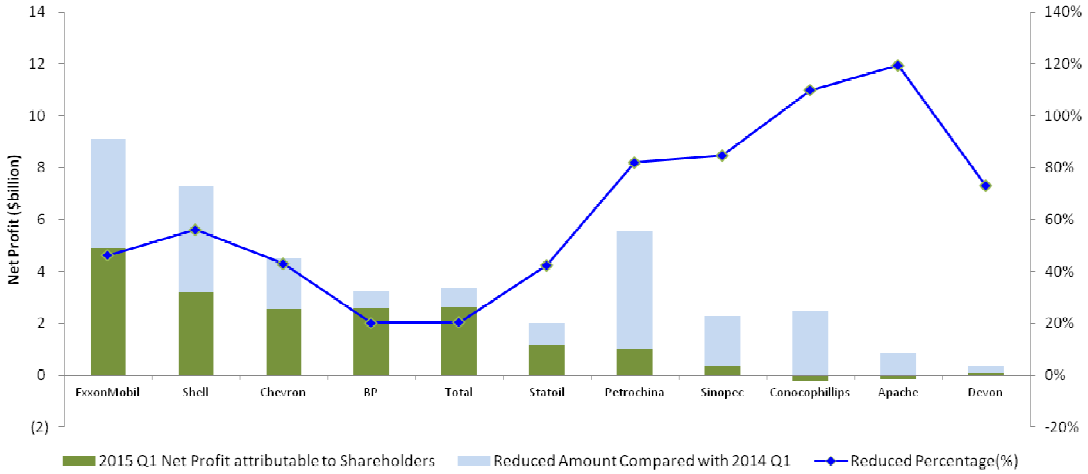

Figure 1: Impact of Oil Price on Performance of Different Oil Companies.

To do the further analysis to explain why the performances of different companies were impacted differently by oil price, we broke down the performance analysis by segments. Because there was no standard global criterion to split the whole oil industry into different segments, we just simplified the analysis by dividing the whole business into upstream and others (including the mid-stream, downstream, LNG, petrochemical and so on).

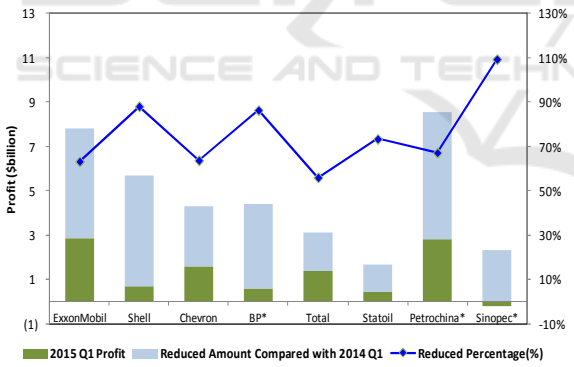

Figure 2: Impact of Oil Price on Upstream.

Figure 2 shows the performance impact on upstream business for different companies that oil price plunge caused. Due to the availability of the data, two different indicators were employed in the analysis such as operating profit and net profit.

As we can see from figure 2, the companies with * indicate the data reported are operating profit, while others without * indicate net profit. The performance of the upstream business of all the oil companies were impacted heavily by the oil price plunge, with the profit falling 56% to 109% which was beyond the falling of oil price of 50.9%. Among them, Total experienced smallest drop while Sinopec biggest. The performance of upstream business of IOCs and NOCs saw the same trend with the impact of the oil price plunge as performance of the E&Ps.

Figure 3 shows the performance impact on the segments without upstream for different companies that oil price plunge caused. As we can see from the chart, the profit of the segments without upstream for all oil companies increased a lot ranging from 43% to 133% except two Chinese oil companies. Among them, Total experienced the biggest increase of133%. On the contrary, two Chinese oil companies PETROCHINA and Sinopec still experienced big drop during the same period with the oil price plunge, falling 56% and 112% separately.

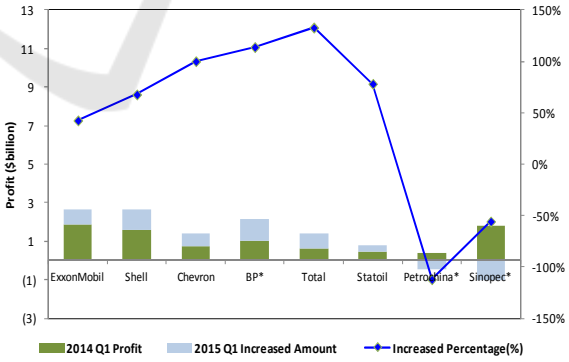

Figure 3: Impact of Oil Price on Segments without Upstream.

According to the above analysis, the oil price plunge had a direct impact on the performance of upstream. Perfect portfolio structure between upstream and other segments can help to lower down the risks arising from the fluctuation of oil price. Although the profitability on the midstream

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and downstream business were also impacted by the oil price plunge, the impact could be relieved by the reduced cost and lengthened industry chain. As a result, the segments other than upstream demonstrated strong performance as compared with loss in the upstream caused by the oil price plunge. Through the integration and diversification strategy, the IOCs can stabilize the crude price internally by supplying oil produced to the midstream and downstream. When the crude oil price increases, part of the profit in the upstream can be transferred to midstream and downstream. Vice versa, the profit of midstream and downstream can be transferred to upstream when the crude oil price drops. The risks can be reduced through internal transfer for IOCs and the profit of the whole company can stay stable. For Chinese oil companies, no profit can be derived from midstream and downstream to offset the loss incurred in upstream because no stable profit center is formed in midstream and downstream business. So with the plunge of the crude oil price, the profit of the two Chinese oil companies fell sharply too. For E&Ps, the fluctuation of crude oil price can have a big impact on the performance of the companies because they operate only in upstream and their business scopes are quite simple. During the low oil price period, it is highly possible that they could go bankruptcy or be merged due to financial disaster caused by oil price drop.

2 STRATEGY ADOPTED BY OIL COMPANIES TO DEAL WITH LOW OIL PRICE

With the extended period of low oil price, most of the worldwide oil companies entered ‘cold winter’ due to the financial stress. Oil companies adjusted their strategies correspondingly to cut their loss to the minimum and save themselves. According to the publicly announced information, strategies adopted by different companies are listed in the table 1.

Based on the above mentioned analysis, the oil companies of different categories adopted different strategies to cope with the low oil price based on their characteristics:

- Strategy adopted by IOCs: Streamline the portfolio to maintain steady growth; Focus on the value creation of exiting assets; Explore the opportunity to acquire new assets that align with its strategy; Optimize capital allocation and cut the spending
- Strategy adopted by E&Ps: Divest non-core assets to maintain financial stability; Hedge part of its production to relieve the risks arising from fluctuation of oil price; Explore the new opportunity in adverse environment for transformation
- Strategy adopted by NOCs: Focus more on strategy adjustment and divert from resource driving to efficiency driving; Strengthen the optimization of the portfolio; Cut the spending but not as much as IOCs

3 CONCLUSIONS

The prevailing view is that oil price may stay at low level for a while. The loss experienced by Chinese oil companies exposes the big gap between them and IOCs. It is now the critical period for the three Chinese NOCs to reform. Under the normal environment of low oil price, it is very important for them to develop their own strategies by pooling experiences from both IOCs and other successful NOCs. Below listed are some proposals for them:

i Seize the opportunity of the mixed ownership reform to introduce more social and private capital. Accelerate marketization of NOCs, divest the government role and improve operational efficiency. Norway national oil company Statoil and Brazil national oil company Petrobras provide good for successful reform. Ministry of Petroleum and Energy (MPE) is responsible for the block bidding process, evaluation of the company involved in the bidding and making decisions of home country's share in each block. Two NOCs run parallel to manage oil and gas business in Norway. Statoil which is a pure economic organization is 66.7% owned by MPE and is mainly responsible for operations. Another company, Petoro, is wholly owned by MPE and manages government’s portfolio of exploration and production licenses on the Norwegian continental shelf. Petoro is not an operator of any fields and does not directly own the licenses. In Brazil, National Agency of Petroleum (ANP) was established and takes over thegovernment role played by Petrobras before. Petrobras, as a company, no longer enjoys any privileges, and competes with other participants in the market. The successful reforms of the two oil companies loose tie for them and achieve the market operation in open environment of the oil industry. Their performances were greatly improved. At present, Chinese oil companies has launched the reform of mixed ownership. Through introduction of

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Table 1: Strategies Adopted by Different Oil Companies to Deal with Low Oil Price.

Company	Strategy Adopted
ExxonMobil	●Take steady growth strategy with strict control over the scale of investment and optimizing investment structure, with investment prioritized in upstream ●Temporarily suspend the M&A and wait for good opportunities ●Divest some of the unconventional oil and gas assets and focus on the growth of shale oil ●Cut 2015 CAPEX by 12% to $34 billion
Cheveron	●Implement the downsizing plan and improve the strategic layout of the assets ●Accelerate the divestiture of non-core assets, with the plan to strip $15 billion between 2015 – 2017 ●Optimize the capital allocation, with priority given to key projects under construction including West Texas Permian and Australia's LNG projects ●Cut 2015 CAPEX by 12% to $35 billion
Shell	●Strategy diverted to control investment, optimize the allocation of resources and develop spetial technology ●Divest part of the North American shale oil and gas assets suffering big loss ●Look for the opportunity for acquisition and purchased BG Group with $70 billion ●Suspend part of the high investment projects and plan to cut the expenditure of $15 billion for the next 3 years
Total	●Optimize the asset portfolio around the technological advantages and divest the non-core assets of $5 billion which do not meet the strategic objectives ●Look for opportunity to acquire large scale projects with long term growth and to acquire LNG or offshore project to utilize its technological advantages ●Suspend investment in the U.S. shale oil and gas and cut 2015 CAPEX by 10% to $24 billion
BP	●Implement strategy diversion, take measures to strictly control the investment scale and numbers of big projects ●Explore intrinsic potential and optimize the portfolio structure ●Announce the plan to freeze the salary of 80,000 staffs and divest non-core assets to raise fund ●Suspend part of the upstream and downstream projects and announce the plan to cut the 2015 CAPEX to $20 billion from $25 billion
Statoil	●Focus on the medium and long term growth and continue to invest in long term project with high potential including some exploration and offshore projects ●Take a moderate control over the spending and cut 2015 CAPEX by 20% to $18 billion
PETROCHINA	●Focus diverted to quality and efficiency from scale. Improve the operation efficiency and take the "revolutionary" measures to reduce the cost and increase the efficiency ●Optimize overseas portfolio structure and slow down the development of non-conventional resources in Canada and Australia ●Cut 2015 CAPEX by 7% to $43 billion
Sinopec	●Focus on efficiency, reform and innovation to achieve transformation ●Organize the operation based on the fluctuation of the oil price ●Cut 2015 CAPEX by 12% to $22 billion
CNOOC	●Implement diversification strategy, foster the ability to survive the oil price cycle and explore the new potential in midstream and downstream business ●Plan to sell the shares owned in Bridas Energy to lower down the risk ●Cut 2015 CAPEX by 26%-35% to $11-$13 billion
Conocophillips	●Completed $14 billion in non-core asset sales to focus on core area ●Capital allocation shifted to the North American unconventional and announce the plan to cut the spending especially on Australia LNG

private capital, not only can they obtain strong financial support and reduce the investment risk in low oil price period, but more importantly, it will guide the companies to grow in a healthy way and achieve the goal of market-oriented management through continuous optimization of capital structure.

ii Optimize business structure and industrial chain. The oil companies which run with the strategy of integration of upstream and downstream have special advantage to deal with low oil price. Integrated business structure can make the company to optimize resource allocation and enhance the company's ability to deal with the risks of low oil

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price. The biggest issue that Chinese NOCs have is that the profitability of downstream segment has always been far lower than the profitability of the upstream segment. Although the government roles to guarantee the fuel supply and protect the consumers' interests are part of the reason to prevent them from profiting, excess capacity and low efficiency of management caused by previous expansion without proper planning is another major driver behind that. Adjusting of the structure between different segments and optimizing the layout of the downstream business to match the level of its total capacity is crucial to enhance the profitability and buffer low oil prices impact.

iii Focus more on efficiency instead of fast pace and large scale during the process of expansion. The philosophy of achieving the production target without consideration of efficiency has been adopted by Chinese NOCs for a long time. Some oil fields, including Shengli oilfield and Liaohe oilfield, have been over exploited. The water cut is so high (over 85% or even up to 90%) that it can never make profits to produce for some wells. Even so, those wells are still producing without shut in. Although Chinese NOCs have launched concept transition from scale-driving to efficiency –driving, the deep-rooted traditional idea is still major force behind the production organizing. It is extremely important for Chinese NOCs to arrange production and make the decision based on benefit instead of output.

iv Explore the potential and strengthen the integration of existing assets. Optimize the layout of global asset. Through internationalization, Chinese NOCs has acquired lots of assets abroad and expanded very fast in these years. It will take time for them to digest and integrate according to the strategic layout. They must play an active role the M&A market. It is important to improve the capital efficiency by way of divesting, exchange, purchase, merger and sale. Purchase only mode has to be reversed and some assets which do not meet the efficiency criteria must be stripped off or sold. M&A is the main way for the Chinese NOCs to obtain overseas assets. The falling of oil price demonstrates good opportunity for M&A. Although facing financial stress, it is still critical for Chinese NOCs to buy some big assets with high quality to improve the structure and layout. Perfect structure has to be formed which includes good ratio between exploration and development, oil and gas, conventional and non-conventional.

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