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### **Gas Strategies Group**

10 Saint Bride Street  
London UK  
EC4A 4AD

ISSN: 0964-8496

T: +44(0) 20 7332 9900  
W: [www.gasstrategies.com](http://www.gasstrategies.com)  
Twitter @GSInfoServices



### **Editorials**

+44(0) 20 7332 9957  
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# EDITORIAL: Crestfallen ExxonMobil stops digging, starts acknowledging reality

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[1]

ExxonMobil took another step towards fully acknowledging the reality of structural decline facing the oil market by warning of a gargantuan writedown of American dry gas assets that could be the industry's largest impairment charge in a decade. The US supermajor – which has limped to three consecutive quarterly losses even as rivals returned to profit in Q3'20 – also unveiled plans to cull 15% of its global workforce as it seeks to haul its finances onto a more sustainable footing.

ExxonMobil, which has gone from being the world's most valuable company in 2013 to crashing out of the Dow Jones Industrial Average this year, yesterday unveiled a series of painful measures intended to return the company to profitability.

Chief among these is removing “less strategic assets” from its development plan. These are mostly dry gas resources in the Appalachian and Rocky Mountains, Oklahoma, Texas, Louisiana and Arkansas in the US, and others in western Canada and Argentina, which will result in a non-cash after-tax Q4'20 impairment charge of around USD 17-20 billion.

These assets will be sold “contingent on buyer valuations”, i.e. at a steep loss. Exxon paid USD 41 billion in 2010 to acquire natural gas producer XTO in a deal that even former CEO Rex Tillerson has acknowledged was over-priced.

Exxon tried to spin the charges as a positive move made “as a result of the growing strength of its portfolio”. But the fact remains that the oil and gas industry has not seen an impairment charge of this size since BP's Deepwater Horizon legal settlement of more than USD 40 billion in 2010. The only

genuinely positive for Exxon is that the impairment won't be as deep as the USD 30 billion it had previously warned about [2].

That is about the only silver lining visible in yesterday's announcement. ExxonMobil will reduce its global workforce by 15% next year, and has limited 2021 exploration expenditure to USD 16-19 billion. The company's total capex will be capped in the range of USD 20-25 billion annually through 2025, a big reduction on the USD 33 billion envisaged prior to Covid-19.

### **It's the dividend, stupid**

Exxon is taking these measures after completing a review of its forward business plans. It will now prioritise near-term capital spending on assets with the "highest potential future value" including developments in Guyana and the US Permian Basin, targeted exploration in Brazil and chemicals projects "to grow high-value performance products".

A major motivation for the cost reductions is the perceived need to preserve the dividend, which the company listed as one of its core commitments going forwards. Exxon recently maintained the dividend flat at USD 0.87/share for Q4'20, marking the first time it has not risen since 1982.

Exxon is now borrowing ever-larger sums to bridge the gap between free cash flow (FCF) and its bloated dividend. FCF has failed to cover dividends for seven consecutive quarters, and the shortfall is now more than USD 2.5 billion. In Q3'20, Exxon generated FCF of USD 1.1 billion but paid out USD 3.7 billion in dividends, according to the Institute for Energy Economics and Financial Analysis (IEEFA).

In response to yesterday's impairment announcement, credit ratings agency Moody's warned that Exxon's debt-to-capital ratio is poised to deteriorate rapidly, from around 20% at the start of the year to nearly 30% in the near future.

The USD 20 billion impairment "further worsens the company's already substantial jump in financial leverage," Moody's senior vice president Peet Speer was quoted as saying. "While the charge is non-cash and reflects the already known weak fundamentals for natural gas assets, it just makes the deterioration in this key leverage metric harder to reverse over the next few years."

### **Fingers still in ears**

Exxon CEO Darren Woods remains defiantly optimistic. "Continued emphasis on high-grading the asset base – through exploration, divestment and prioritization of advantaged development opportunities – will improve earnings power and cash generation, and rebuild balance sheet capacity to manage future commodity price cycles while working to maintain a reliable dividend," he said in a statement.

Exxon now claims it will "double earnings by 2027, when viewed on the same price and margin assumptions used in the 2020 Investor Day materials". The market is already turning the corner despite the resurgence in Covid-19 cases and accompanying economic restrictions, according to Woods.

"Prices and margins for many of our businesses have improved from the third quarter and when coupled with continuing efforts to reduce spending and capture additional efficiencies, quarter-to-date cash flow has improved versus our plan assumptions," he said.

The oil market is braced for a rebound in 2021, as promising Sars-Cov-2 vaccines are fast-tracked through the regulatory clearance process and distributed to public health institutions around the world in a bid to quell the pandemic and lift travel restrictions.

But the outlook beyond that is anything but rosy for oil and gas majors. There is a growing chorus of analysts forecasting oil demand will peak this side of 2030, including some who believe crude consumption might never return to 2019 levels. British major BP sits in this camp, while Rystad sees the peak arriving in 2028. Even OPEC now expects global demand to tail off, albeit not until 2040.

While Exxon has not divulged the supply and demand assumptions that underpin its asset valuations, the company cut its future oil prices for the next seven years by 11-17% as part of the recent review, according to a report last week in the Wall Street Journal. The WSJ said it saw internal documents that reveal the company expects the fallout from the pandemic to linger for much of this decade. Shareholders should brace themselves for more write-downs and losses spun as good news. - SK

**Sebastian Kennedy**  
**Editor, Gas Matters Today**

*The views contained in this Editorial are solely those of the editor and do not necessarily reflect those of Gas Strategies.*



### **Consulting**

+44 (0) 20 7332 9900  
[consult@gasstrategies.com](mailto:consult@gasstrategies.com)



### **Alphatania Training**

+44 (0) 20 7332 9910  
[training@gasstrategies.com](mailto:training@gasstrategies.com)



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