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EDITORIAL: BP’s colossal impairment points to seismic shift in energy landscape

[1]

BP today warned the market of eye-watering asset write-downs coming in its Q2’20 results after lowering its long-term price assumptions and reconsidering its intention to develop some exploration prospects, providing a pointed example of how top-level energy bosses are drastically reconfiguring their views around demand for hydrocarbons in a post-pandemic world.

The British oil and gas major will write off between USD 13 billion and USD 17.5 billion – by far the largest single Big Oil impairment warning since this year’s oil price crash. The non-cash, pre-tax impairment charges will be divided between property, plant and equipment for USD 8-10 billion, and exploration intangibles in the same range.

The exploration hit is notable. In its Q1’20 results, BP valued exploration intangibles at USD 14.2 billion. Even if impairments come in at the lower end of the range, the company is saying more than half of its undeveloped acreage is now worthless and might never be exploited.

“This huge dent in BP’s balance sheet suggests it has finally dawned on BP that the climate emergency is going to make oil worth less – something that smart investors have been warning for some time. This is long overdue,” said Charlie Kronick, senior climate adviser for Greenpeace UK.

The impairments were triggered when BP cut its 2021-2050 long-term price assumptions to around USD 55/barrel for Brent crude and USD 2.90 MMBtu for Henry Hub gas, both in 2020 real terms. Previously, BP’s central price assumptions were USD 70/barrel to 2025 and USD 4/MMBtu to 2032, both in 2015 prices. BP also hiked its assumed carbon price from USD 40/tonne to USD 100/tonne of CO_2.

Framing the narrative

BP said today it is "reviewing its intent to develop some of its exploration prospects and consequently is assessing the carrying values of the group's intangible assets", and warned the Covid-19 pandemic will have "an enduring impact on the global economy, with the potential for weaker demand for energy for a sustained period".

Company bosses have a "growing expectation" that the pandemic "aftermath" will "accelerate the pace of transition to a lower carbon economy and energy system", as countries "seek to 'build back better' so that their economies will be more resilient in the future" – using a turn of phrase hitherto reserved for climate pressure groups and NGOs.

There is an open debate about whether countries will "build back better" in a post-pandemic world. The aggregate effect of contagion mitigation measures and the economic downturn they have precipitated has so far been to stymie investment in all energy sources, including renewables.

But there is a growing realisation that the pandemic is simultaneously accelerating structural shifts in societal behaviour and ways of doing business, potentially ushering in an era of lower consumption characterised by fewer flights and car journeys.

"[W]e have reset our price outlook to reflect that impact and the likelihood of greater efforts to 'build back better' towards a Paris-consistent world," BP CEO Bernard Looney said today. "We are also reviewing our development plans."

Looney has made BP's transformation into a "net zero company by 2050" the hallmark of his tenure, and measures taken in response to cratering oil and gas prices have all been framed in this narrative. Only last week, Looney described the decision to cull 15% of the global workforce as a key part of "how we will deliver on our net zero ambition".

Taking a view

BP says it will explain in September how it intends to get to 'net zero' emissions by mid-century. Until that strategy is known, it is easy to dismiss job cuts, asset write-downs and – inevitably – a dividend cut as merely part of the new CEO playbook: front-load bad news and rebase the business to create the best chance for good news in the future, as one market observer told Gas Matters Today.

But these decisions provide meaningful insight into how BP top brass see the world. By the company's own admission, the recoverability of asset carrying values are calculated based upon "significant judgements and estimates" from management on highly uncertain matters such as inflation/deflation, discount rates, production profiles, reserves and resources, and future commodity prices.

Before the pandemic, BP's long-term oil price assumption was higher than the 2019 average of USD 64/barrel "based on the judgement that current price levels would not encourage sufficient investment to meet global oil demand sustainably in the longer term".

The Sars-Cov-2 coronavirus has forced a fundamental rethink, accelerating "how oil and gas companies see the future," according to professor David Elmes, head of the Global Energy Research Network at Warwick Business School.

BP had “hoped for enough time to make an orderly transition to its goal of becoming a Net Zero emissions company. That marathon may have become a sprint,” he added. - SK

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

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