Shareholder value looks to be main guide as major oil companies reset their goals after two years of upheaval

As oil companies reap unprecedented profits from the recent highs in oil price, Andrew McBarnet takes at look what oil industry leaders are saying in public about the future of their business

Competitive they may be, but there is a remarkable unanimity among the major oil companies about their view of the business which they dominate and the world in which they operate. At the moment companies are basking in the glow of financial results which can only be described as a spectacular rebound from the oil price and restructuring turbulence of 1998–99, but the company chairmen confess there is a lot of work ahead to satisfy 'shareholder value', the touchstone of all undertakings.

First, those results. ExxonMobil, the biggest of them all, reported first quarter earnings for 2000 of $3350 million excluding the merger expenses and gains on regulatory divestitures, an improvement of 108%. Net income of $3480 million was a quarterly record and improvement of 135% from the equivalent period the period before. The story at the other supermajors Shell and BP Amoco was much the same. The Shell Group's adjusted earnings were an all time record of $3129 million, double the previous year, and reported net income for the quarter at $3335 million was also record. BP Amoco registered a first quarter replacement cost profit before exceptional items of $2707 million, which was a record increase over the first quarter of 1999 of a staggering 256%.

Looking just a little down the food chain, much the same success has been achieved. Chevron reported a first quarter net income of $1044 million, more than three times the equivalent figure in 1999 and the record operating earnings of $1106 million were nearly four times last year's figure. Texaco's normalized earnings for the first quarter were $602 million, the highest quarter since 1981. Earnings at aspiring supermajor TotalFinaElf are harder to decipher and compare, because consolidation has been so recent, but the group's first quarter report suggests a 71.6% increase in consolidated sales over the same period last year.

All these major conglomerations recognize that their exceptional performances have been facilitated mainly by the extraordinary turnaround in the price of oil. Brent crude was ticking along nicely at $19 per barrel in early 1997 before dropping, at one point to less than $10 per barrel last year. Earlier this year Brent had vaulted to over $30 per barrel for a short period. A clear concern for industry leaders is whether the volatility of the past two years will continue. The consensus seems to be that we are in for a period of greater stability although, given that the price lows of 1998/99 were not predicted by the majors, this may not be totally reassuring.

The current view, for what it's worth, is that the oil price shambles was basically the fault of the OPEC nations, who may have learnt a lesson. OPEC is responsible for producing around one-third of the world's oil, which is currently consumed at some 77 million b/day. Two years ago, OPEC allowed a surge in their output just as the Asian economies were on a downward spiral. Apart from wreaking havoc in the oil industry from which oilfield services companies have still to recover, OPEC found its members looking at a loss of some $50 billion in oil revenue compared with their normal annual revenue. David O'Reilly, chairman and CEO of Chevron, remarked recently that it was ironic that the timing of OPEC's response of cutting output levels couldn't have been more unfortunate. The March 1999 production cuts agreed by OPEC coincided with the beginnings of recovery in the Asian markets which quickly drained world oil inventories and stimulated demand to such an extent that the $30 barrel became a reality. Hence the action in March this year by OPEC to raise output by 1.7 million b/day and the decisions by Norway and Mexico to follow suit.

The question for the big oil companies is how much influence OPEC will have in the future. Chevron's David O'Reilly concludes that OPEC will not be in the driver's seat as it was in 1973, even though four-fifths of the world's known reserves and most excess world capacity is in its control. His reasoning is that OPEC itself is not cohesive, does not control the production rates in non-

OPEC countries which currently produce two-thirds of the world's daily oil supply and, most importantly, realizes that volatile oil prices affect the ambitions of its member countries to diversify their economies.

O'Reilly did not discuss the challenge of alternative forms of energy, which has certainly been one of the driving forces behind BP Amoco's aggressive takeover strategy. Sir John Browne, CEO of BP Amoco, noted in a speech at the Offshore Technology Conference (OTC), Houston two months ago, that the pattern of demand is moving in favour of natural gas, which has become the fuel of choice for power generation projects around the world. He said that on one recent calculation, over 50% of all new power capacity commissioned over the last two years is gas fired. No coincidence, then, that natural gas now accounts for 40% of BP Amoco's production and the proportion is set to increase.

Although all the majors pay lip service to their investments in other forms of energy, such as solar, wave, etc, these are not seen as realistic alternatives to oil and gas. One blunt assessment of the state of play came from Lee R. Raymond, chairman, Exxon/Mobil in an address to the Institute of Petroleum earlier this year. He said that his company looked seriously at the options including solar and nuclear but decided that 'it made better sense for us to concentrate on our core energy and petrochemical business.' He conceded that renewable forms of energy could be players in niche markets; photovoltaics also had potential if the costs could be brought down and the performance improved. He discounted any great advance in battery and fuel cell cars in the next 20 years if the free market is left to decide. We need attractive alternatives, Raymond said, but 'excluding a major technological breakthrough with significant short-to-medium impact, oil and natural gas appear to be the energy sources the world will depend on for the foreseeable future.'

But can the oil industry meet the likely demand for oil and gas, which on the consensus of published projections is likely to reach 90 million b/day of oil and 300 billion ft^3/day of gas in 10 years' time? Sir John Browne who brought up the statistic in his OTC address echoed the belief of all the majors when he replied 'yes, we can' citing technology as one of the most important factors. He said that of the extra oil and gas needed by 2010, a quarter will come from offshore fields, a high proportion in deep water, and that the track record of advances in technology would make this kind of output possible although not easy.

Technology has not only been the route to improving exploration and production, including the optimization of reservoir recovery. It has also been, in the words of David O'Reilly, 'a driving force for controlling costs in the energy industry.' For all oil companies, reducing costs has become a major preoccupation in the bid to provide better value to shareholders. As a result, company leaders make a point of heralding the extent to which costs have been driven down (although, as *First Break* readers have pointed out in the past, the human and community cost of such actions tends to be glossed over).

Lee R. Raymond, chairman, Exxon/Mobil

In his address to Shell's annual general meetings, company Mark Moody-Stewart, referred to the $4 billion in cost savings per year being targeted by his company.

Dr John Buchanan, BP Amoco managing director and chief financial officer, in a speech last month to the European CEO and Investors Forum in Edinburgh wondered aloud whether the mega-mergers and consolidations in the oil industry added value. His first answer was to explain the cost savings that were possible. Some $4 billion was due to come out of BP Amoco in three years, of which $2 billion of the target had been achieved in one year. The Arco and Burmah Castrol acquisitions would yield $1–1.5 billion. 'Those are just the cost savings,' Buchanan said, 'The market has rewarded progress to date with the price/earning multiple of the savings going straight to a market capitalization increase.'

Buchanan then went on to discuss how global scale would be a platform for BP Amoco growth, another central theme of the oil companies.

Corporate restructuring, globalisation and technological advances, according to Peter I. Bijur, chairman and CEO of Texaco in his report to stockholders, constitute the three forces in play which have converged to create the 'new economy.' Part of that technology is massive investment in the internet which oil leaders seems to have adopted with a vengeance, characteristically looking to the Web principally as the vehicle for substantial economies. In the case of Texaco, the company has formed an e-business unit and invested in three online trading platforms. It is also a founding member of petrocosm.com, one of a number of global market initiatives, in which Chevron is also a participant. It is hoped that the B-2-B company can deliver 5–15% savings through the online procurement of oil and gas hardware and services, which could mean billions of dollars.

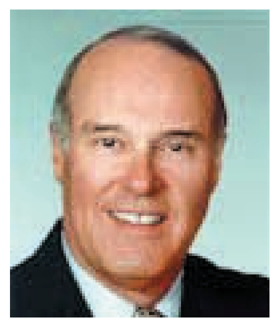
Mark Moody-Stuart, Shell

Likewise, Mark Moody-Stuart of Shell and Sir John Browne of BP Amoco speak of e-commerce in terms of great new potential for savings in a procurement marketplace worth $125 billion annually.

As far as new opportunities are concerned, company leaders this year are far more upbeat than last year about potential growth, citing mainly upstream developments and rationalization of downstream activities. There only a small variation in the target for return on investment to the shareholder – 12% for Shell, 14% for BP Amoco and Exxon, and 15% for Chevron, where chairman David O'Reilly says he is determined that the company is No. 1 in total stockholder return for 2000 to 2004, a goal which he admits is aggressive. A disappointment for providers of equipment and services to the oil majors looking to see increased spending on exploration and development is the open talk by some of using new found cash reserves to buy back shares to please stockholders.

The annual report season is also the time for oil companies to show their sensitive side, recognizing their need to be model citizens in the global community and promoters of health, safety and good environmental practice. As a result of criticism of its activities in Nigeria and the negative publicity over the disposal of the Brent Spar (justified or not), of the major companies Shell goes furthest in demonstrating its ethical business philosophy. The company has now published its third Shell Report: *How do we stand?* In which it and others judge its performance against the principles it has laid down. Mark Moody-Stuart says 'Shell business principles commit us to contributing to sustainable development – integrating economic, social and environmental considerations, balancing short and long term priorities. We are working hard to realize that pledge in everything we do.'

Others are not far behind in listing their responsibilities. David O'Reilly refers to the 'Chevron Way' and the company's mission 'To create superior value for our stockholders, customers, partners and employees.' But, he says, the 'Chevron Way' is more than this: 'it's our respect for people, diversity, and concern for our neighbours and environment.' Peter Bijur at Texaco states 'People most vital to our business success – from employees and stockholders to customers, business partners and governments – all want to know that we treat the communities and environment in which we operate with deep respect and care.'



Peter Bijur, Texaco

The philosopher king in this regard is perhaps Sir John Browne who invited his oil industry colleagues in Houston to consider the limits to power of companies like his which have a market capitalization greater than the 160 of the 180 or so members of the United Nations. 'There is another form of investment,' he said, 'in the process of learning what people expect from us so that we can better understand how large and apparently very powerful companies should behave in all the many varied circumstances they face.'