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Energy Investments in 2022: How to Leverage New Opportunities?

Whitepaper

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The identity of energy markets is being dramatically redrawn by the global transition to a lower carbon future. Fossil fuels and renewables must be part of the same fast-growing energy basket in the near-term – a simple concept and perhaps complex reality, but also one with huge opportunity across both established and new energy markets.

One example is the fast-emerging blue and green hydrogen market – coined the 'new oil' of the 21st century – expected to be valued at $300bn by 2027.[1] Solar PV is expected to generate $182bn investment in the renewables market in the Middle East by 2025[2] – an 18-fold growth in current capacity, and the petrochemical market is expected to grow from $365.01bn in 2020 to $429.11bn this year – a compound annual growth rate of 17.6%.[3]

Following a disruptive two years for global energy markets on the back of the Covid pandemic, declining GDP, supply chain issues and, most recently, an energy supply crunch, the region and the world must now look forward and leverage new opportunities in the energy space to ensure security, environmental protection and commercial success.

PACE THE GREEN AGENDA

Oil and gas are limited resources and so require investment in new exploration. The countries that can offer additional conventional energy today are often constrained by sanctions or political disarray, so without new capital the world will suffer, roundtable participants agreed.

Interestingly, since COP26, the discussion has turned to one about energy transition versus energy security. The average consumer wants electricity at a fair price – that requires more upstream oil and gas investment. Supply security and affordability is key. Countries and companies should still work to expand their green portfolios, but it cannot be a direct switch and we should avoid squeezing out the oil and gas business in the interim. Global capex investment in 2021 was about $350 billion, 50% below 2015 levels before the oil price crash.[4]

"We would need 15 ACWAs in Saudi Arabia in order to achieve real transition and to not have to invest any more in oil and gas."

Securing a Competitive Advantage in the Energy Transition:

- ✓ Invest in low-cost & low-carbon assets
- ✓ Evolve business model to be more efficient & integrated
- ✓ Invest in technology & big data
- ✓ Sustain access to private & public capital

1/Global Market Insights; 2/ Frost & Sullivan; 3/ ResearchandMarkets.com; 4/ Roundtable participant

"The public and private sector need to look forward 50 years, as Tesla has, and innovate accordingly."

Asia in particular – the region with the world's biggest emerging economies – cannot do without oil and gas security. It needs the whole spectrum of energy supply – electric cars for the wealthy and coal, cooking gas and LPG for its poorer communities, many of whom don't have access to electricity.

Oil will be an investment opportunity for the next 20 to 30 years so today's energy businesses need to be sustained – terminals, logistics, downstream and retail – while investing in the energy transition. Time is needed to leverage existing infrastructures towards electric or hybrid systems. A battery vehicle that still takes 8 hours to charge cannot yet compete with a combustion engine.

UNREALISED VALUE CANNOT BE IGNORED

The narrative of net zero by 2050 is undoubtedly gathering momentum and National Oil Companies (NOCs) are fully aware and concerned about the risk of having stranded assets as a result. It is warranted that these, mostly developing economies, will need a sustained GDP to provide their populations with required national infrastructure, resources and diversified economies going forward.

Oil and gas must remain a key contributor to GDP for the good of social and economic benefit. Worldwide, oil producing countries risk collectively losing $13 trillion revenue by 2040 due to the energy transition.[5] Most untapped reserves today are in NOC hands and governments are going to want to capitalize on that revenue.

The Middle East needs funds to finance its ambitious plans for economic development beyond the oil sector. Oil exporters in the Middle East saw their budget deficits balloon to 10.8% of GDP in 2020, from barely 3%, according to the IMF.[6]

Other less wealthy developing economies in Africa and Latin America have no choice but to develop their assets, and many are re-visiting investment legislation and fiscal terms to attract the capital. Even OECD countries, which already have diversified revenues, benefit tremendously from taxes paid by companies on oil operations and oil products; they will feel the pinch of those funds disappearing as they move further into the transition.

5/ Carbon Tracker; 6/ Al Jazeera

"It is too simplistic to only look at investments as pure oil & gas plays – the bigger picture shows that many governments depend on these investments for revenue, employment and contributions to GDP."

FINANCIAL FLUIDITY IS KEY

The green agenda and narrative are placing pressure on conventional banks on where they put their money. Companies and societies are today held accountable to contribute towards the energy transition and so the energy sector needs to make its journey towards the transition more visible so that financial institutions can, in turn, retain the capital made available to them.

There is no doubt that financial fluidity is key to the security and continuity of energy projects. Restricting access to capital could work against the global environmental agenda and without the provision of full alternatives, there will be more energy shortages and price spikes.

Hydrocarbons are also still the only energy that is exportable and so critical for developing economies in South-East Asia, Africa and elsewhere. At the same time, it's important to make the 'green' narrative visible to investors and not be penalised for falling behind on innovation.

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Fund managers, controlling $35tn of assets with 2,910 gigatons of potential CO_2 emissions, have signed the Climate Action 100+ Initiative.[1]

$900 bn
Stranded assets – one-third of current value of big oil and gas companies — would evaporate if governments succeeded in their 1.5˚C rising temperature target for the rest of this century.[1]

$805 bn
Estimated committed energy investments in MENA in the next 5 years, $250bn of it in power, of which 40% will be renewables.[2]

5%
Estimated increase in global power investment in 2021 – renewables accounting for 70%.[3]

10%
Estimated rise in upstream investment in 2021 – 30% below 2019 levels.[3]

4.5%
Share of capex by oil and gas companies in clean energy projects this year – up from 3.8% in 2020.[3]

$101 bn
Saudi Arabia's planned spend on renewables projects by 2030, plus $38 bn on energy distribution.[4]

1/ FT Lex In-Depth
2/ APICORP: Energy Investment Outlook 2021
3/ IEA: World Energy Investment Report 2021
4/ Reuters

Climate Fund Eligibility Defined:

Global agreement must be reached on what is eligible to be financed through climate funds in order to attract new private sector funding. Is Blue Hydrogen 100% clean? Some say YES, some say NO.

PRIVATE SECTOR INVESTMENT GETS A REGIONAL BOOST

International Oil Companies (IOCs) have been restructuring their portfolios and beginning to move away from oil, adding more renewables and gas projects. That is starting to be replicated by NOCs in the Gulf, a region with natural cost advantages – whether in blue or green hydrogen, wind or solar power. The Middle East has an opportunity to capture a first-mover advantage here but will need funds for R&D, talent development and infrastructure refits. Enter the private sector.

One roundtable member highlighted Saudi Arabia as an example. Its recently announced National Investment Strategy sets out to double the level of private investment in the oil sector this year. Previously relatively dormant development funds in the Kingdom, sitting on huge amounts of cash and capital such as the Saudi Industrial Fund for Development, are also now being more actively allocated to private projects, alongside the Public Investment Fund (PIF – the Kingdom's Sovereign Wealth Fund). The PIF is effectively becoming both a development and investment bank in that it is encouraging private sector participation into new economic sectors and local supply chains.

"Remaining oil and gas assets in the ground today, at an oil price of only $50, have been estimated at a value of more than $13 trillion."

In tandem, regulatory reform in Saudi Arabia, such as allowing arbitration on an international level rather than following local Saudi law, are considered huge changes that will have profound implications for the Saudi economy. The Kingdom is targeting financial direct investment of $100 billion by 2030 and so needs to make international investors aware of such changes on the ground.

CONCLUSION

Energy Security Through Financing All of the Above:

While not so evident in the Middle East, globally there's much environmental pressure to restrict financing to the oil and gas sector. Whether it is valid or not, it is a real threat to energy security across the world. Restricting hydrocarbons access to capital even goes against the global environmental agenda. If we get ahead of ourselves by restricting the energy sources of the world today, while not providing full alternatives, we will have shortages, similar to what we've seen in recent months, with natural gas prices spiking to unprecedented levels and triggering blackouts in many parts of the world. Developing developed economies are having to switch back to coal, which is totally counterproductive for the environment. The transition steps towards a low-carbon world need to be down a slope and not off a cliff edge.

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