More oil, less money

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Ben van Beurden

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Ben van Beurden Address at Oil & Money Conference

Ben van Beurden became Chief Executive Officer (CEO) with effect from January 1, 2014.

He joined Shell in 1983, after graduating with a Master's Degree in Chemical Engineering from Delft University of Technology in the Netherlands.

Ben's career in Shell spans both Upstream and Downstream activities. He has held a number of operational and commercial roles, including some 10 years in the LNG business, and a variety of positions in Downstream.

In January 2005, he became Vice President, Manufacturing Excellence, based in Houston, USA. In this role he was responsible for standards in operational excellence and high-performance initiatives in refining and chemicals manufacturing.

In December 2006, he was appointed Executive Vice President, Chemicals, based in London, UK.

During his tenure in the role, Ben was appointed to the boards of a number of leading industry associations including the International Council of Chemicals Associations and the European Chemical Industry Council.

From January to September 2013, he was Downstream Director and had regional responsibility for Europe and Turkey. He has been a member of the Executive Committee since January 2013.

Ben, a Dutch citizen, is married and has three daughters and a son.

Shell is planning for a longer period of low oil prices. But in the longer term, argues Ben van Beurden, there will be no change to fundamental drivers such as rising demand and the need for new supplies. Moreover, the industry should not be blinded by low oil prices. Even more than prices, the transition to a low-carbon energy future will shape its destiny over the coming decades. Carbon pricing systems are crucial in that transition. They encourage the quickest and most efficient ways of reducing emissions widely.

Today, ladies and gentlemen, I would like to discuss two major topics concerning our industry, and the connection between them. These two issues are oil prices and, on another longer-term level, the transition to a low-carbon future.

Oil prices

Let's start with prices. The way I see it, there are four major signposts for oil prices in the short term: the global economy in relation to oil demand, OPEC, US shale oil, and capital cost. What do they tell us?

The first signpost is the global economy. Forecasts of global growth are lower than expected, but demand for oil appears to remain robust. Low oil prices have stimulated demand in developed economies. Elsewhere, however, governments have seized the opportunity to reduce or abolish subsidies, which tends to dampen demand growth. For this and next year the International Energy Agency predicts overall demand to be relatively strong. But, again, it looks like the underlying global economic growth will be weaker than expected.

So, the first signpost gives a mixed signal. On to the second signpost, OPEC. It remains to be seen whether its strategy of defending market share to maximise export revenues will be successful in the longer term. But despite calls of some members, there are no signs that its leading producer Saudi Arabia will change its policy anytime soon.

Here too, no clear hints of higher prices just yet. So what about the third signpost: US shale oil? American shale oil production has so far been more resilient financially and more competitive technically than expected. But because a large chunk of loans needs to be refinanced this month, producers are now looking for new cash flow to survive. And with West Texas Intermediate (WTI) prices between $40 and $50 a barrel, they'll possibly struggle to get it. Moreover, in May and June we saw the first signs of reduced production. This could entail higher prices, if OPEC at the same time can agree on how to accommodate the aspirations of Iraq and Iran in particular to grow their oil production.

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The fourth and key signpost is capital cost. Since the fourth quarter of last year, capital cost has come down significantly across the industry. This makes it likely that upstream margins will recover over time. Or, to put it another way, that the industry will reset itself.

To conclude this point, ladies and gentlemen, I see the first mixed signs for a recovery in oil prices. But with US shale oil being more resilient than we originally thought and a lot of oil still in stock, it will take some more time to rebalance demand and supply. After this happens, Saudi Arabia's strategy and cohesion within OPEC will remain key uncertainties. If OPEC gets it right and finds a new balance, prices will recover – although it remains uncertain how quickly prices will recover and at what level they will settle.

But what if OPEC doesn't get it right and prices remain low for much longer? Then, the world may find itself in a tight corner at some stage when stocks are rebalanced… growth of US shale oil is stalled… oil production outside OPEC and the US is starting to decline due to cuts in capital expenditure… and when - by that time - there is unlikely to be any significant spare capacity left in the system. This could cause prices to spike upwards, starting a new cycle of strong production growth in US shale oil and subsequent volatility.

Shell's response

Either way, companies like Shell can thrive in a "lower for longer" world. Since low oil prices are great for many consumers and many importers, our integrated business model eases a lot of the pain. And Shell is pulling out all the stops to safeguard our dividends and buy-back programme, and to keep our investment programme steady for the future. To achieve this, Shell is taking a number of steps.

The first step we take concerns our balance sheet, which compares what we own to what we owe. Despite lower oil prices, our gearing ratio - debt related to equity capital - is essentially unchanged since the end of 2014 and stands at 12.7%. This reflects good operational performance, which in turn leads to cash generation and re-introduction of the scrip dividend. And this in turn brings more short-term flexibility to Shell and ultimately protects dividends.

The second step we take is to reduce operating costs. Operating costs fell in the first half of this year and we expect them to fall by more than $4 billion, or around 10% over the full year. Costs are now back at the levels that we saw in 2011. And cost will go down further next year as we continue to work on the supply chain, on our overheads, and on targeted programmes in certain areas.

The third step we take is to reduce capital investment. We expect capital investment in 2015 to be around $30 billion. That's 20% lower than last year. And it's 35% lower than in 2013.

Portfolio restructuring is the fourth step we take. Some parts of our company have not been performing to their full potential. In order to improve their performance, we have specific targets to improve - for example - costs and unit margins. We're also taking portfolio actions in these areas. This is now beginning to show through in the bottom line.

The fifth step we take is to sell assets. Typically, these assets are being sold to crystallise value or because they're not critical to our business. This is basically normal business, and it's not something we do only when we really need to. The total of asset sales for 2014 and 2015 together is worth some $20 billion.

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The sixth and final step is to continue delivering new projects and safeguard free cash flow. Our core business model is built around developing new oil and gas resources. Our project portfolio is geared to increase production. And more importantly, it's geared to generate cash flow from operations and free cash flow in 2017 and beyond.

Energy transition

So Shell is planning for a longer period of low prices. But for the longer term, as I've said on several occasions in the recent past, I see no change to fundamental drivers of oil markets. There will be more people on this planet; more people living in cities; and more people buying their first car or refrigerator. As a result, demand for energy - including demand for oil - is likely to grow.

In turn, higher demand will need new supplies. These supplies won't be cheap to produce. New projects are often smaller and technically more challenging. They may carry more non-technical risk, and are more regulated by governments than they were before. These factors are driving up costs that need to be covered by prices.

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Now, one may think that low oil prices are a real challenge. And they are, although our industry is used to dealing with them. But the challenge of low oil prices may pale in the face of the challenge of moving towards a low-carbon future.

As I said, global energy demand is growing. So the challenge is how to balance growing demand with the need to make a transition to a cleaner energy future. To achieve this, we will still need hydrocarbons for decades to come.

I know that some people would like fossil fuels to be replaced by renewables as we speak. But for technical and economic reasons, this can only happen step by step. And it will not happen across the board. Sectors like heavy industry, heavy duty transport and chemicals need carbon to operate. And the resource base of the other large source for carbon - biomass - is insufficient to meet their demand… if we consider only that portion of biomass that doesn't compete with food. This means that sectors like these will continue to need hydrocarbons. The upshot of all of this, by the way, is that hydrocarbon assets will keep their value.

Other people think technology will solve the problem in the end. I agree that technological solutions play a crucial role. In our industry, this will also be about efficiency. Technologies like carbon capture and storage (CCS) are required to clean up the use of fossil fuels. Unfortunately, however, we can no longer wait for CCS technologies to mature slowly. The world needs to start applying them widely and without delay.

In my view, the issue is essentially about finding economic ways to invest in an energy transition. This is why governments should take the opportunity to put a price on carbon. By taking the costs of tackling climate change and air pollution into account, carbon pricing systems will drive the right behaviour of consumers and producers.

Effective carbon pricing systems would boost technologies like CCS, although more is needed to make CCS a success. Carbon pricing systems would also level the playing field for renewables. And they would level the playing field for natural gas against coal. Gas is a fossil fuel, yes, but a crucial one for building a low-carbon future. When burnt for power, gas produces around half the CO_2 and one-tenth of air pollutants that coal does. A switch from coal to gas in power plants improves air quality today and helps deliver a sustainable energy system tomorrow - together with renewables.

In short, carbon pricing systems encourage the quickest and most efficient ways of reducing emissions widely. Unfortunately, there are concerns that overall energy costs would increase. These worries suggest a risk that emerging economies will not take part in them. Eventually, this would be bad news for everybody – including our industry. Managing costs for energy users is crucial in making carbon pricing systems work.

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Here, policymakers have an important role to play. They need to design carbon pricing systems that address concerns about cost and competitiveness. This isn't impossible. In fact, there are some policies being tested to help tackle this problem.

The tax that British Columbia in Canada puts on carbon, for example, is revenue neutral - revenues must be used to reduce other taxes. This basically means that the government compensates carbon taxpayers by lowering other taxes they have to pay.

The second example is from the European Union. Its emissions trading system involves a risk of "carbon leakage". This occurs when companies move production to places with fewer carbon constraints, potentially leading to more emissions worldwide. So the EU initially gives sectors and sub-sectors with a significant risk of "carbon leakage" more allowances to emit CO_2 than others, to keep them within the emissions trading system.

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Conclusion

Ladies and gentlemen, now is a very good time to promote carbon pricing systems. In only two months, the UN's Climate Change Conference - also known as COP21 - will be held in Paris.

In cooperation with five other energy companies, Shell has sent an open letter to the parties at COP21 and has established a Paying For Carbon initiative. We ask governments - at COP21 and beyond - to introduce carbon pricing systems where they do not yet exist. We also ask them to create a framework along the lines proposed by

the International Emissions Trading Association, that could connect all the national systems.

Because if we get them right, carbon pricing systems could really reinforce the transition to a low-carbon future. Just recently, China announced a national scheme setting a price on carbon. The momentum is here. I hope we will all help seize it.

I know that this is a tough time for many of us. The abundance of oil on the market today is putting pressure on our industry. Although the future looks brighter than the present, we could even consider calling this year's gathering the "More Oil & Less Money Conference".

But we shouldn't let today's oil prices blind us. Even more than prices, the transition to a low-carbon energy future will shape the destiny of our industry over the coming decades. This demands our undivided attention.

"I'm not Alice in Wonderland", the UN's lead on climate change, Christiana Figueres, recently said to a reporter. "You and I are sitting here, in this gorgeous apartment, enjoying this fantastic privilege, because of fossil fuels". In other words: for so long, through times of high and low prices, our industry has been a partner in progress.

Let's keep it that way in the future. Let's help create… with a nod to the theme of this great event… "a brave new world of energy". Thank you.

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