The evolving landscape of renewable energy production

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Market Update: "On the Money" A Conversation with Vice President & Portfolio Manager Jennifer Stevenson.

What will demand look like as the world emerges from COVID-19 restrictions? What will be the impact of behavior change? Will we completely return to previous habits and will sustainable renewable energy production accelerate? One of the sectors that perhaps inspires answers to these questions more than any other is, of course, energy.

From the heart of the Canadian energy industry, we're joined by Jennifer Stevenson. She is close to the company, she covers and regularly on the ground in other major global energy hubs. Jennifer Stevenson's extensive energy industry experience spans nearly three decades, and she's fostered a global approach to casting a wide net in search of the highest quality companies with solid management teams and sustainable long-term business models.

If I was to look back to the spring and refer to that as a pretty crazy time for oil prices, we've really seen oil prices stabilize over the summer months. That would seem to imply that the market is relatively balanced. Can you walk us through what's been happening in the supply-demand equation that's helped hold this level of price equilibrium in what's been considered a pretty noisy period?

Yes, that's a really pertinent question because *crazy spring* is certainly the understatement of all because we had WTI briefly trade negatively as there was a bunch of speculation in the financial trading of the West Texas Intermediate oil contract. If you are along that contract, you have to take physical delivery when the contract expires. Other oil contracts like Brent in the UK, you don't. Unless you happen to have access to storage in Cushing, Oklahoma, if you're along that contract on expiry date and you don't have storage, you have to sell it.

That gave us a crazy spring and the stability since then is really a combination of material OPEC+, that's OPEC plus Russia, cuts to production, combined with everyone else, non-OPEC, having much lower CapEx, much lower activity in the energy sector, and therefore much lower supply. Then we've seen that initial demand recovery once we came out of the first phase of lockdowns from COVID. We've got all of these supply cuts, OPEC+ in particular, combined with that demand recovery that got us into a more balanced place for oil supply-demand and therefore, oil prices.

Despite the fact that it does seem like the world is opening again and people are out and back to some, I will say, normal habits, but certainly integrating back into work and some limited travel, do you see a permanent result or any changing consumer habits as a result of COVID and did that ultimately having a permanent impact on demand?

Yes, right now, what we're seeing in the numbers as far as demand impacts is really focused on jet fuel. Pre-COVID, we burned globally about eight million barrels a day of jet fuel and that's out of total oil supply of 100 million. That's a lot. We've got about half of that back. That's still a big gap. I think that is a longer-term repair. Just when you look at the data from the airlines and the data from the TSA about how many people are flying, how many planes are flying, we've got the cargo planes flying but not the passenger planes.

I do think that that particular consumer habit is going to be slower and has been so far slower to recover. That's the one area where we're seeing an impact on demand that's more long-term.

It seems like such a long time ago that I'm going to refer to prices being at around $60 to where we are today. Are there any concerns with respect to the producers in the space especially those you're investing in around cash flow impacts or dividends?

Yes, that's always a concern for the market when you've got volatility in prices or when prices stabilize at new levels that are lower. We're really focused on that. We always run really conservative price checks because we don't want to be surprised by free cash flow levels, by dividend payments, that sort of thing. As far as any concerns about cash flows or dividends in the space, there are none whatsoever with any of the companies that we own. We are more weighted to pipelines into producers, and our pipeline companies continue to grow their dividends.

Out of all of our portfolios, we actually only had one producer that cut their dividend and that was Suncor in Canada. Lots of reasons for them to do that because it was enabling them to reduce their breakeven so their dividend included breakeven is now in the $30's We've got lots of cushion for any further price volatility. That was a one-and-done type of cut and their plan over the long-term is to revert back to dividend growth as things continue to improve and stabilize.

Another major concern since all this has started has been the prospect of a potential second wave, and some might argue that we're already seeing it. Unfortunately, there are signs of one emerging in Europe. Have OPEC and other major producers laid out plans for how to adjust supply in a second wave scenario?

Yes, OPEC is super focused on this. They actually just had their monthly meeting yesterday. Every month, a group of OPEC ministers called the JMMC, which is the Joint Ministerial Monitoring Committee, meet. The discussion coming out of that meeting was that they're really focused on compliance. Anybody that's cheated, which means they haven't met their cut obligation, has to make it up. They were working on making it up until the end of September and they've given them an extension, keep making up your cuts to the end of December.

The other thing that came out of that meeting is that they're really focused on what demand is telling them; how demand is looking, how demand is trending with all of the daily data that we get. They said at the meeting yesterday that their plan when they had this big OPEC+ agreement was that they would relax some of the cuts in December, such that more oil would be made available. They were talking yesterday that if demand isn't there, that's going to be a result of something like a COVID second wave. If demand isn't there, we won't do this reduction of the cuts. They're already talking about that, anticipating that this might need to happen.

They also talked about if we need to get the broader, not just the ministers, but more of the members of OPEC involved, they would call an emergency meeting for October to talk about it. They're very, very focused on managing the supply side of oil because they are very focused on needing the pricing to be reasonable for their economic survival. All of that hinges on demand, and that's going to be affected if there's a second wave, so they're definitely on it.

Shifting gears just a little bit. This year, in particular, you've added exposure to renewable energy names in your portfolios. We haven't typically seen many of these names in the portfolio before. What's the thesis here? I know that it's a subject that's talked about a great deal, especially within the media. Is this a tactical move or should we expect to see more of these types of names in the future in the portfolios you're running?

That's a super question because it's not tactical. It's not saying, oh, renewables are great because we've got issues with, say jet fuel demand. Over the last few years, the cost of renewables have really come down. Even in the last 12 months, they've come down another step function. These renewable names now have returns on their projects that are as competitive as the hydrocarbon companies.

It's definitely not a tactical move, it's a structural move so that we can look to add these renewable companies that have that great growth profile because demand for renewable energies is increasing. We can add those into the portfolio along with those solid E&P and pipeline names that are in there and get the best of both worlds.

Then on the topic of renewables, it seems that a number of the major integrated names are increasing their investments in projects to reduce their carbon footprints. BP, for example, recently did a strategy rebrand around this. How does the energy investment community view these steps?

That's fun because BP this week, they have their investor day, but it took them three days and 15 hours of presentations to talk about it. BP way back when three CEO's ago, they did a big branding, yippee yahoo, and BP became beyond petroleum. The renewable stuff they were doing back then didn't make any money. Then they stopped it and went back to departments that did make money.

Now we've got this going from an integrated energy company to an international energy company, and they've done some investments with Ørsted and offshore wind, and they've made a big splash. As far as how the energy investment community views these steps, it's very dependent on what the companies are doing as far as project and returns and how that fits into the strategy and whether it's attainable, because BP is taking a 180-degree shift. They're going to be reducing their hydrocarbon output in their plan over the next several years by 40% and investing all this money in renewables.

Yet I can look across the street at companies like Shell and Total, Shell did have to cut their dividend because their balance sheet is heavier than someone like Total, who hasn't. They've been investing in renewables for years and making money at it for years. The growth outlook from both of them is impressive. They're in a wide range of renewable projects. I think the investment community is discerning enough to give credit where it's due, like say a Total or even a Shell, and be skeptical where it's not yet proven.

I can't tell you that BP knows how to make money in renewables. They made a big splash and we'll watch and see, but I'm not interested at this point in putting capital over there yet. It's very, very company returns and project-specific as far as the view at this point.

Well, certainly, the sustainable and renewable energy conversation is going to be an evolving one. Jenn, when all this started back in April or when things were really evolving back in April, the conversation in the energy space was certainly focused on Russia, the US, and Saudi. It would seem now the Russian and US conversation is more squarely focused on the US election, but we'd like to get your insights on that connection between those three mega producers of energy and what's been happening lately and what your view is going forward.

That is like the triad of intrigue; Russia, US, Saudi, at least as far as oil markets. Going back to your timeframe, we had the Russia, Saudi button fight where Saudi and Russia were arguing about production cuts. Saudi said “watch this” and flooded the market with oil for a couple of months. That was basically brought to a resolution by Trump, getting everybody in a room and getting them to agree to go back to doing the orchestrated cuts. That was a unique triad.

There was concern at that point whether Russia would stay with the OPEC+ group because Saudi played the power card and trumped them using the verb, not the guy. They went from main co-heads to Saudi leading the charge. Was Russia going to stay in? Fast forward to this week and we had the OPEC ministers’ monthly meeting, and Russia at the beginning of that meeting said ‘our policy and our plan is that Russia is going to stay with this group and be participating in these decisions until 2035’. We've never heard Russia say anything long-term like that at all.

That's a pretty strong endorsement because the Russians aren’t one to speak idly of such things. You've got Russia and Saudi aligned on working together as far as oil supply management from the OPEC+ producers. With Saudi, they're holding everyone's feet to the fire making sure that if you say you're going to cut back your production by ‘X’ amount, you better be doing it and they're making these countries that don't, they call them cheaters, retroactively cut more so their numbers are in line.

The Saudi oil minister is Prince Abdulaziz bin Salman. He is in his late 60s and he's a super-experienced oil and gas guy. He knows of what he speaks. This powerful, highly-educated, very experienced gentleman at the closing press conference, and they don't often have a press conference after these ministerial meetings, said, and I'm going to quote him from his speech "Let the market understand that they're serious about the cheaters making up the volumes, is that using tactics to over produce and hide non-compliance have been tried many times in the past and always end in failure. They achieve nothing and bring harm for our reputation and credibility."

If you're UAE, you're sitting up and taking notice. Then he goes in and takes aim at the financial side of the oil market. This is another quote and just remember who's saying this when I read it out, "We will never leave this market unattended. I want the guys in the trading floors to be as jumpy as possible. I'm going to make sure whoever gambles on this market will be ouching like hell." That's a quote from Prince Abdulaziz bin Salman. He is really serious about managing the oil market for inventory and price, which comes from supply and demand.

He's in charge of the demand side for the OPEC+ group, along with Russia. He's putting word out to the financial market that tries to have fun shorting oil prices; his view is that their management is tight enough that that is not going to happen. You've got the whole OPEC+ side being really, really constructive. At the same time, on the supply side, among non-OPEC the biggest portion is the US. There we've got companies who have been told in no uncertain terms by their shareholders, we don't want you adding debt, we don't want you out-spending, you don't need to grow, we want you to make money.

The capital has been rolled way back, the production growth has been way downsized. That part of the supply piece is coming in as well. So, that Russia-Saudi-US triad has changed their relationship for the better and it just gives you a lot more confidence on the supply side. Then the only thing that we're looking at is the demand side, and like we talked about, the only hole in that right now is we've done our V-shape recovery with a flatlining on things like diesel and gasoline. The only little hole in it right now is jet. That is the kind of thing that OPEC can manage, and like we talked about, they can also manage things that happened to demand if we go into impacts from a potential second wave of COVID.