



Q is for... Quitting fossil fuels: Is the end nigh?

Appetite for traditional oil and gas is set to slump as the energy transition takes effect, writes Charles Waine

The energy transition can be described as an existential crisis for traditional oil and gas producers. The falling cost of renewables, net-zero government policies, innovations in clean energy technology as well as commodity price risk paint a bleak picture for the future of fossil fuels.

The North Sea in Europe is a prime example. High-cost barrels will likely struggle to stay competitive as the energy transition takes effect, especially given its status as a mature oil and gas province, while decommissioning liabilities and more stringent climate policy could add further pain.

In January, a report from climate think-tank Carbon Tracker assessed 10 private equity-backed companies with licences in the North Sea. All eight firms with existing production were expected to see their cashflows fall by more than 60 percent under a modest energy transition.

For managers, the threat is very real. If fossil fuel demand falls or fails to compete with low-carbon alternatives, then commodity prices will drop. This will impact cashflows and company valuations. For investors, this would result in lower returns, and reputational risk could affect future access to capital.

Moving at different speeds

It is also important to remember that the energy transition will play out over a multi-decade period. Different countries are targeting net zero over different timeframes and have different energy mixes.

In Asia, for example, the immediate priority will be phasing out coal rather than totally abandoning

fossil fuels. Even if governments wanted to shift to renewable energy entirely, it will take time to build up capacity. Balancing grids is another factor.

“The role of natural gas as a bridging fuel to a longer-term energy transition is more prominent than ever in Asia,” says Dave Noakes, senior managing director at Prostar Capital. “According to Shell, global LNG demand is expected to rise more than 50 percent by 2040”, mainly driven by Asia.

The US is particularly looking to fill this demand gap. Financial watchdog Private Equity Stakeholder estimates that nearly 86 percent of the operating LNG terminals in the US have some PE investment.

“Resource-rich geographies such as the US will continue to produce gas for growing global demand,” says Andrew Ward, founder and managing partner at Clearstream Capital. “Private equity appetite for oil and gas has begun to return in the US, but many of the larger institutional investors still have restrictions on how much capital allocation can be deployed in traditional oil and gas strategies.”

The near-term picture for key geographies like the US might be less gloomy, but the long-term trajectory for oil and gas demand is still downwards. In August, a report from US think-tank Public Citizen estimated that taxpayers could be lumped with a bill of \$384 million across eight states to cover decommissioning of wells operated by private equity firms.

Currently, firms are only obliged to cover 1.5 percent of the cleanup bill, but reputational risk and falling fossil fuel demand will no doubt change the situation, especially as we approach net-zero targets. ■