S&P Global Ratings

Oil and Gas

The industry credit profile should remain healthy

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This report does not constitute a rating action.

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What's changed?

M&A. After extremely robust M&A activity last year, particularly in North America, the pace is slower but still relatively high. The main reason is to replace inventory and diversify production.

Global refining capacity additions will be more than offset by announced closures. Additions of about 1 million bbls/d will be mostly offset by closures and renewable fuel conversions.

The new Trump administration will have a limited impact on U.S. oil and gas production. The administration will likely make it easier to drill on federal lands and garner drilling permits, but economics and commodity prices will continue to be the deciding factor.

What are the key assumptions for 2025?

Gas demand in U.S. expected to rebound. Data center buildout and LNG infrastructure spending will lead to demand and price appreciation for natural gas.

North American upstream spending will remain muted. Capex will likely be either flat or slightly lower due to lower oil prices and continued emphasis on generating cash flow.

Refining margins will marginally weaken. We expect global margins to soften due to slower demand growth and new supply from capacity additions.

What are the key risks around the baseline?

OPEC unleashes production. Although recent OPEC announcements have demonstrated support for oil markets, the rhetoric from OPEC members to increase production has intensified.

Shifts away from conservative financial policies. Such a shift and outspending cash flow could lead credit quality to deteriorate.

Refining margins could have more downside risk. Refining margins could be weaker than expected if the Trump administration imposes a 25% tariff on Canadian and Mexican crude oil.

Ratings Trends: Oil and Gas

Chart 1
Ratings distribution by subsector

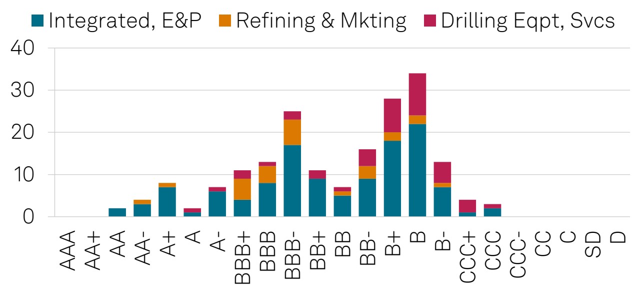


Chart 2
Ratings distribution by region

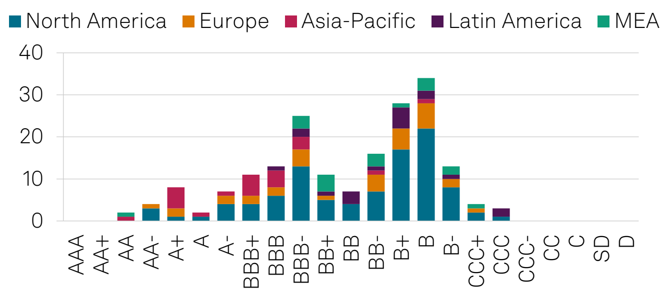


Chart 3
Ratings outlooks by subsector

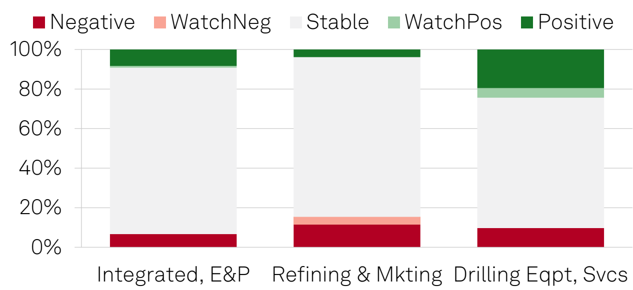


Chart 4
Ratings outlooks by region

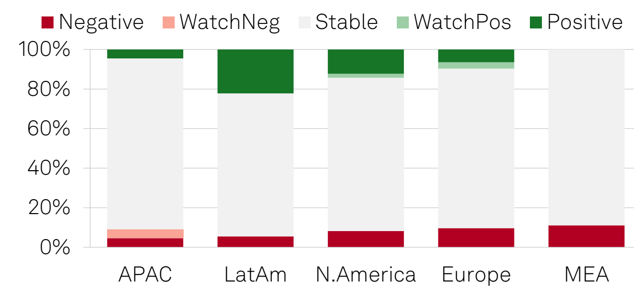


Chart 5
Ratings net outlook bias by subsector

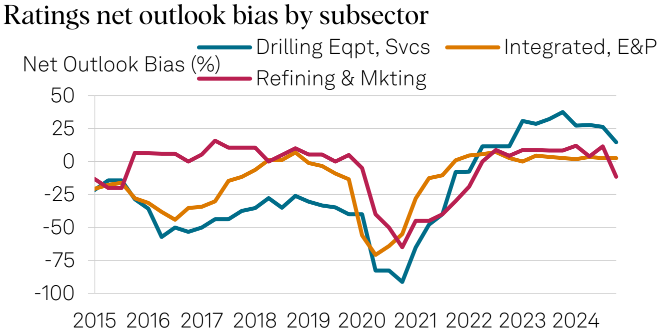


Chart 6
Ratings net outlook bias by region

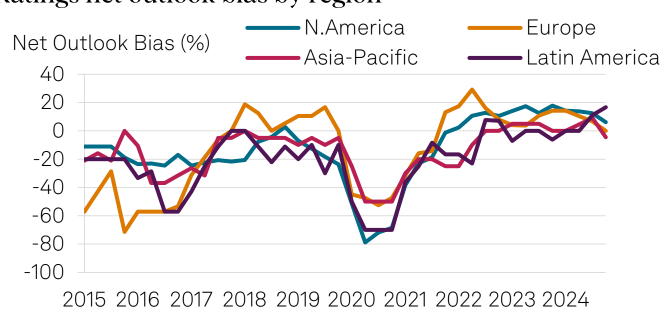


Chart 7
Ratings outlooks

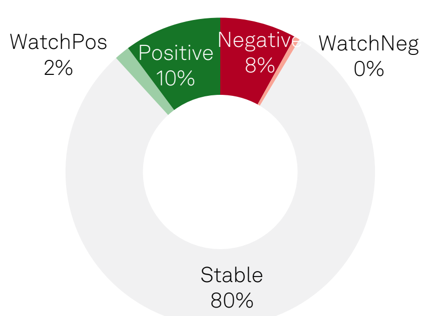
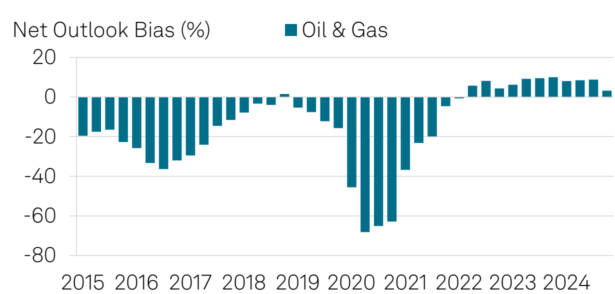


Chart 8
Ratings outlook net bias



Source: S&P Global Ratings. Ratings data measured at quarter-end.

Industry Outlook

Ratings trends and outlook

The overall positive rating trends we have seen in previous years continued in 2024. Healthy oil and Dutch Title Transfer natural gas prices and financial discipline that limited production growth allowed companies to garner strong earnings and cash flow. Producers remain focused on a financial discipline that targets limiting outspends of cash flow. Merger and acquisition (M&A) activity in 2024 has largely been positive for ratings, with companies, similar to 2023, largely using equity and maintaining financial discipline. Oil field services have been slower to join the positive rating trends due to upstream capital discipline and heavy M&A activity, but recent upgrades and positive outlook revisions reflect improved margins and a focus on the balance sheet. Nevertheless, overall leverage in the space remains at higher levels than exploration and production companies. Also, with North American spending expected to be flat to slightly down, service companies' top-line growth will be muted. North American-based service companies that have the capability will look to international markets for growth.

We believe the global refining industry will come under added pressure in 2025 because of weaker demand and the pace of capacity additions that will influence the overall supply of refined products. S&P Commodity Insights (SPCI) expects global gasoline demand to peak in 2025 at approximately 27.14 million bbl/d, mainly due to increased electric vehicle (EV) adoption and fuel efficiency gains. At the same time, capacity additions in Africa, Mexico, and the Middle East will increase gasoline production and shift product flows, which will likely pressure refining margins in the Atlantic Basin, particularly in Europe; the northeastern U.S.; and possibly markets in Asia. While we expect refinery closures to mostly offset the capacity additions, the pace of closures could pressure margins in the near term, which will have different impacts on creditworthiness in 2025. We also believe that margin improvement will be more dependent on a reduction in global capacity than increased demand, as was the case in past refining cycles.

In North America, we expect the large, geographically diverse, and more complex refineries to maintain a competitive advantage over their smaller and less diverse and complex peers. These larger investment-grade companies have stronger balance sheets and liquidity than their weaker peers and have more optionality to advantaged feedstocks in most cases. We also believe that gasoline demand destruction will outpace diesel demand, which means the price differential will favor assets that can upgrade to more valuable distillates such as jet fuel and higher-value diesel using lower-value heavy crudes. According to SPCI, U.S. Gulf Coast refining assets will maintain very high utilization until the mid-2030s but may need to rationalize capacity of up to 1.7 million barrels per day (bbls/d) after that due to growing long positions of gasoline and diesel. That said, advantaged access to natural gas and crude oil feedstocks will help maintain the region's competitiveness versus the rest of the world for the foreseeable future, in our view. The West Coast will see more capacity rationalization due to more stringent environmental regulations and costs.

Carbon intensity will increasingly become an important factor for the global refining industry and initially will be more of a driver outside of North America. Exporters will seek the last growing markets in Latin America and Africa, which will become very competitive and likely increasingly difficult for all but the top-tier European refineries. Europe has already announced about 495,000 bbls/d of refining capacity closures in 2024, and SPCI estimates that another 1.1 million bbls/d will need to be rationalized by 2030 to keep the supply-demand balance in the region in check.

Main assumptions about 2025 and beyond

1. Oil is range bound, mostly trading within a $60-$70 band.

Oil prices over the past several months have retreated due to lower global demand and the reconciliation among warring factions in Libya that would return approximately 700,000 bbls/d of offline oil production. We believe this trading range reflects current supply/demand fundamentals and the assumption that OPEC will not in any meaningful way resume the 2.2 million bbls/d of offline production it is considering returning next April.

2. OPEC continues its support of oil prices.

Due to weakening demand and global markets likely to be in surplus in 2025, we believe OPEC will continue to support the oil markets. OPEC's recent announcements have demonstrated its willingness to delay reintroducing surplus capacity until global demand improves.

3. U.S. natural gas demand and prices begin to recover.

After a couple of years of weak fundamentals, we expect natural gas demand and prices are expected to recover through the end of the decade. Liquefied natural gas (LNG) and data center buildout will drive the demand side of the equation and lead to robust growth and price appreciation. Underlying this assumption is the expectation that the Trump administration will unwind the LNG export pause enacted by the Biden administration.

We are expecting that after two years of global oil demand growth outstripping global oil supply growth, oil markets will be in surplus in 2025. Estimates of supply increasing by approximately one million bbls/d from non-OPEC+ nations, such as the U.S., Canada, Brazil, and Guyana, will outstrip global demand growth estimates of 600,000-700,000 bbls/d. Demand growth continues to weaken largely due to China. Chinese domestic oil demand has been slowing, largely a result of China becoming the leader in EV penetration, and has rapidly been converting its fleet of diesel truck engines to compressed natural gas (CNG). Indeed, SPCI believes Chinese demand for diesel and gasoline recently peaked due to the rate of EV penetration.

Although supply is expected to outstrip growth, global inventories remain low and could support some additional supply. A key assumption around this base line is that OPEC remains supportive and keeps its estimated surplus of 5.2 million bbls/d of production offline. Since its June 2024 announcement that it would return 2.2 million bbls/d of production, it has delayed doing so three times, with the latest announcement in early December, stipulating it would consider reintroducing these barrels next April over an 18-month period. In our base case, we believe OPEC+ remains supportive of oil markets and would like to see oil demand improve and support oil prices above $80. However, global inventory levels are low and remain supportive for some moderate level of OPEC+ resuming production. Nevertheless, if OPEC+ were to move forward and reintroduce the full 2.2 million bbls/d of production, we believe oil prices would collapse and be hard to sustain at levels over $50/bbl.

Natural gas demand and prices are set to rebound. Natural gas prices, especially in North America, have been very weak, largely due to a warm winter last year, record production, the Freeport LNG terminal being offline, and uncontrolled biproduct natural gas production from the Permian basin that does not abide by the laws of economics. Inventory levels in North America are at five-year highs, acting as a cap on prices. However, we believe that is about to change. The Biden administration's pause on LNG export permits, which has delayed LNG build out and caused confusion in the energy and capital markets, is likely to be revoked once the Trump administration takes office in January. Over the next four to five years, we expect LNG capacity buildout will likely result in LNG U.S. gas feedstock more than doubling (approximately 14 billion cubic feet per day [bcf/d]) from current levels. We expect the Permian and Haynesville basins to mostly benefit given their proximity to the Gulf of Mexico.   Some producers in the Marcellus basin will not garner higher realizations at the Henry Hub due to a lack of take-out capacity. Given the difficulties of gaining approval of the Mountain Valley Pipeline, it is unlikely additional pipeline capacity from the Northeast to the Gulf will be approved and constructed. It's unlikely the Trump administration will repeal Inflation Reduction Act tax credits related to solar and wind. However, early expiration of the credits could be on the table, which would increase power supply uncertainty. This could present an opportunity for natural gas to address any supply concerns and shortfalls.

Another tail wind for natural gas is the significant amount of datacenter build out that is occurring. The power markets, after experiencing 0% growth over the last 10 years thanks to energy efficiency and reduced power usage, are about to undergo a generational growth phase. Several market reports have put the compound annual growth rate of U.S. power demand at an average of 2.5%-3% through the end of the decade.

What this ultimately means for natural gas demand is difficult to quantify because a lot of this growth likely will be met through renewables. However, various estimates of gas demand increasing range anywhere from 3 bcf/d to potentially 12 bcf/d. We estimate that U.S. data centers' increasing energy demands will lead to additional gas demand of between 3 bcf/d and 6 bcf/d by 2030. Our model of data center energy demand growth (see "Data Centers: Surging Power Demand Will Benefit And Test The U.S. Power Sector," Oct. 22, 2024) concludes that if 50% of incremental capacity comes from natural gas-fired units (including baseload and peak suppliers), the grid would require up to 50 gigawatts of incremental generation supply. Up to 3 bcf/d of this demand could be met with natural gas. That estimate may change depending on the energy mix that serves data centers, with a greater share of natural gas potentially increasing incremental demand from data centers by as much as 6 bcf/d by 2030. Total natural gas demand in the U.S. in 2023 averaged about 89.1 bcf/d, of which the power sector was the largest consumer at about 35.4 bcf/d, according to the U.S. Energy Information Administration—a 7% increase over 2022.

Credit metrics and financial policy

Although we have lowered our hydrocarbon price decks on several occasions during the year, they remain supportive of credit quality. We have flat West Texas Intermediate and Brent oil prices for the next three years at $70 and $75 per barrel, respectively. Our Henry Hub and Canadian Alberta Energy Co. (AECO) natural gas decks increase along with the expected demand pull from LNG and datacenter build out. Our Henry Hub and AECO price decks for the next three years are at $3.25, $4.00, and $4.25 and $2.25, $3.00, and $3.25, respectively. We expect companies to allocate more cash flow toward shareholder rewards rather than debt retirement given the lack of maturities and balance sheet targets being met. We anticipate global capital expenditure (capex) growth in the low-single-digit percent area, largely driven by international spending. We believe companies will continue to conduct most M&A in a credit-friendly manner.

Key risks or opportunities around the baseline

1. New U.S. administration could impose tariffs.

Tariffs could result in slightly higher gasoline prices in some part of the U.S. and lower realizations for Canadian producers.

2. Refining margins could have more downside risk in the next few years.

The key drivers that could affect weaker margins include weaker demand growth than expected, higher EV penetration, and slower capacity rationalization to rebalance supply and demand. However, carbon costs in certain regions will also come into play, which could affect the pace of structural changes that could have an outsized influence on margins and profitability.

3. Financial policies relax in the face of softer prices and margins.

Financial discipline has been a sector watch phrase for most public companies. We see a risk that some seek to sustain both capex and meaningful returns to shareholders in spite of lower cash generation

Higher trade tariffs could reduce global oil demand. President-elect Trump, during his campaign, said he will impose tariffs on imported goods, especially on Chinese products. If they are to be implemented, the level and duration are unknown at this point. But anything significant would have the effect of lowering global oil demand, which, given the current weakened demand picture, could affect oil prices. A tax on Canadian and Mexican oil and oil products could raise the cost of gasoline for U.S. consumers, something we believe Trump is against. Across regions, diesel is more vulnerable to higher tariffs than gasoline or jet fuel. The impact of a tax on Canadian oil would likely be shared by Canadian producers and U.S. refiners, with most of the brunt shared by Canadian producers who have limited ability to import elsewhere and will be competing at the margin with untariffed heavy barrels. PADD 3 refineries would however bear the brunt of tariffs because of a lack of alternative heavy crude sources.

Mexico has the ability to reroute its largely waterborne exports to the U.S. and can thus circumvent U.S. tariffs.

While the pace of refining rationalization will be an important factor in future refining margins, carbon costs could put some regions at a disadvantage in the next few years. SPCI assumes that the EU, Singapore, California, and Northeast Asia will have carbon policies in place while the rest of the world does not. These carbon policies will likely drive the refining industry to invest in more decarbonization, such as producing lower emitting biofuels and renewables, and possibly a move into petrochemicals. However, the cost to decarbonize will also likely drive refining companies to avoid such regions because of the lower profitability and investments required to be compliant. We have already seen this occur in the California market and expect more rationalization in Europe. It remains to be seen how competitive refiners burdened with a carbon regime will be in the global market and if certain compensation mechanisms or subsidies will be put in place to allow products produced in these regions to compete with barrels that do not have the same cost structure. At a minimum, we think refining margins could at times have significant volatility and downward pressure depending on the pace of such changes.

Since 2020, reducing debt and bolstering balance sheets have been themes across the sector but especially for largest integrated companies. As both oil prices and refining margins continue to decrease from 2022 levels into 2025, we may see some differentiation between companies. The way management teams elect to deploy likely significant but lower cash flows and the extent to which balance sheets are used to maintain shareholder distributions could result in companies' financial profiles diverging from their typically strong year-end 2023 positions. Most companies have some—or even significant—financial headroom at their ratings, with reported credit metrics comfortably above our cash flow coverage thresholds. We are alert to this headroom being eroded in our forecasts for 2025 and beyond, by both lower prices and cash flows, as well as the incremental year-on-year consequences of net debt increases, if internally generated cash flows don't cover net investments and shareholder returns on a consistent basis.

Related Research

- Energy Brief: Energy Supermajors' Share Buybacks May Strain Their Credit Profiles, Dec. 17, 2024
- Commodities: Could Oil Prices Shock The Global Economy?, Dec. 4, 2024
- Data Centers: More Gas Will Be Needed To Feed U.S. Growth, Oct. 22, 2024
- S&P Global Ratings Revises Its Oil Price Assumptions; North American And Dutch Title Transfer Natural Gas Price Assumptions Unchanged, Oct. 1, 2024
- Occidental Petroleum Corp.'s CrownRock Acquisition Delays Potential Return To Investment Grade, Aug. 19, 2024

Industry Forecasts: Oil and Gas

Chart 9

Revenue growth (local currency)

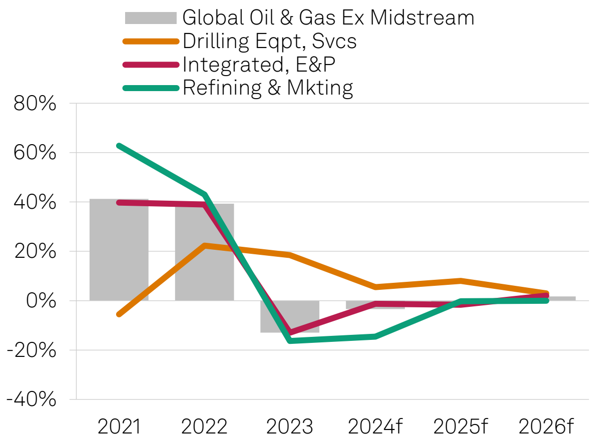


Chart 10

Capex Growth (USD, adjusted)

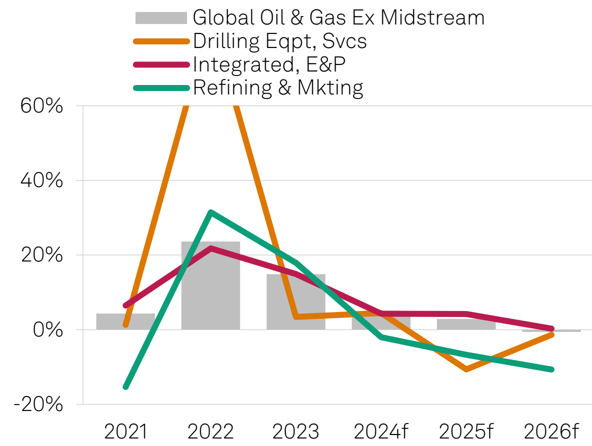


Chart 11

Debt / EBITDA (median, adjusted)

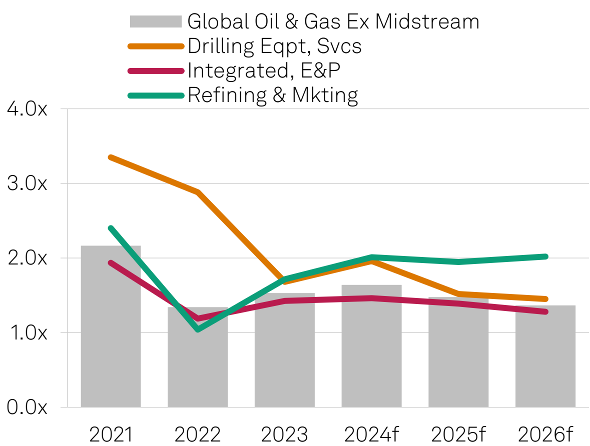
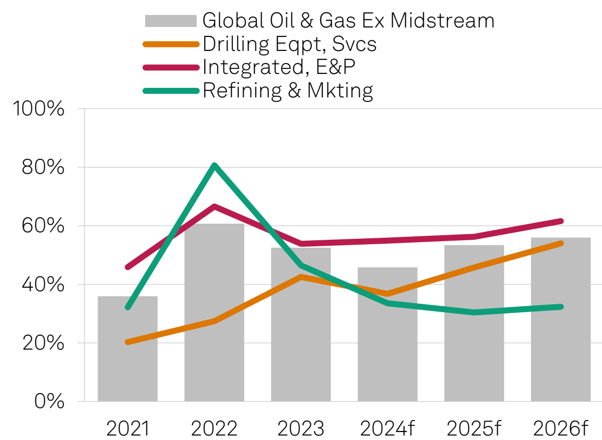


Chart 12

FFO / Debt (median, adjusted)



Source: S&P Global Ratings. f = Forecast.
Revenue growth shows local currency growth weighted by prior-year common-currency revenue share. All other figures are converted into U.S. dollars using historic exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO—Funds from operations.

Cash, Debt, And Returns: Oil and Gas

Chart 13

Cash flow and primary uses

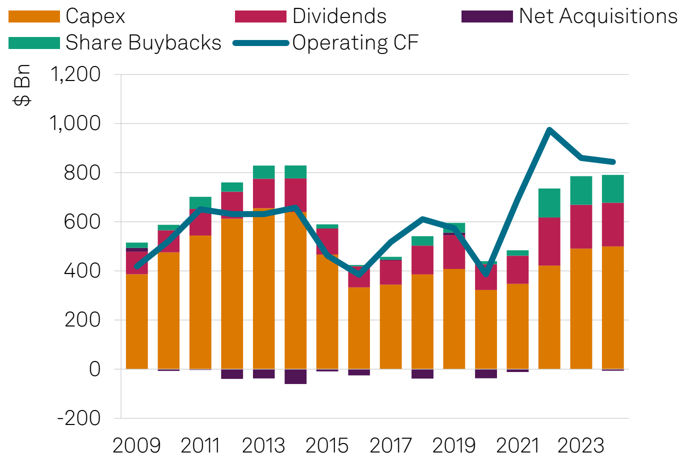


Chart 14

Return on capital employed

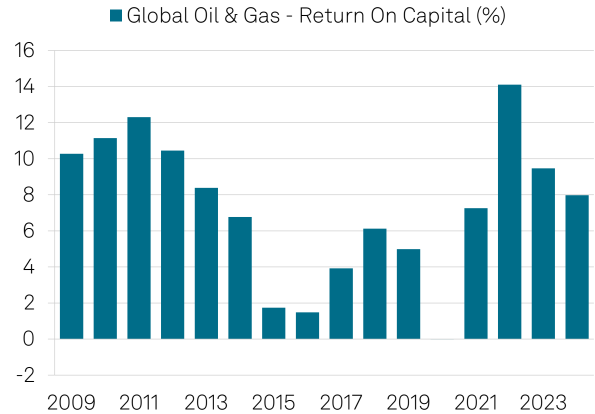


Chart 15

Fixed- versus variable-rate exposure

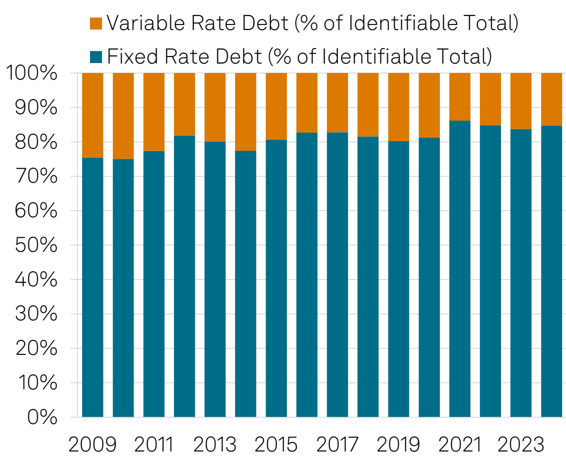


Chart 16

Long-term debt term structure

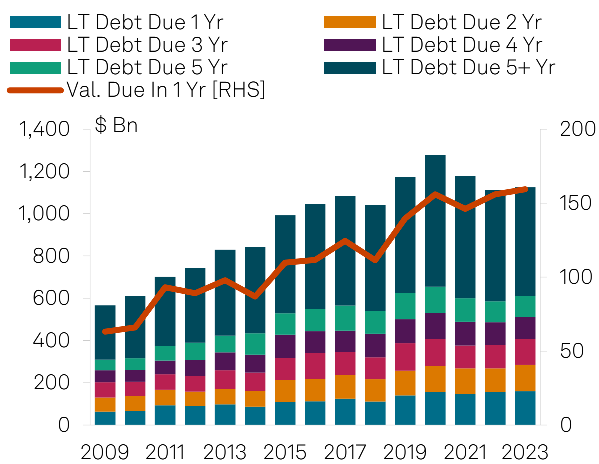


Chart 17

Cash and equivalents / Total assets

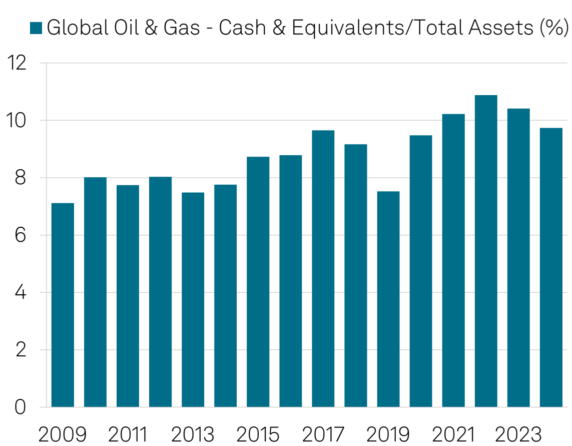
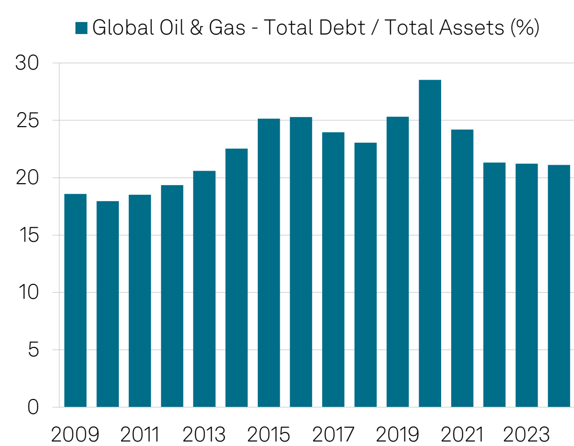


Chart 18

Total debt / Total assets



Source: S&P Capital IQ, S&P Global Ratings calculations. Most recent (2024) figures use the last 12 months' data.