Our View: Investor Demands and the Hess Capitulation

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Investors have great confidence in AI's future but little trust regarding the future direction of oil prices. They will thus invest trillions in tech stocks while demanding that oil companies return all cash to them in dividends or stock buybacks.

The investors still in oil have good reason to call for their money now. The giant oilfield services company Baker Hughes reported on June 23 that drilling activity in the United States is slowing:

> The number of active drilling rigs in the US fell by six in the week ended Jun. 23 to a total of 546, according to Baker Hughes. It marks the seventh decline in the last eight weeks and puts the domestic rig count at its lowest level in nearly 15 months.[1]

The report explained that domestic drillers were reducing operations in response to "gloomy economic outlooks, drooping commodity prices, and an ongoing focus on fiscal discipline over near-term growth." The quarterly survey by the Dallas Federal Reserve added color.[2] The survey included comments by responders. Two of these highlighted one source of the oil firms' need for fiscal discipline:

> The lack of bank lending to independent producers has drastically reduced our ability to invest in new projects. We are limited to our organic cash flow, and decreased natural gas prices have lowered that cash flow by more than half.
>
> Access to capital for our client base remains a challenge (a comment from a service company).

Two statements by John Hess, CEO of Hess Corp, one offered in 2019 and a second given on June 22, vividly capture the investor shunning of oil and to what lengths the industry will go to win them back.

At Davos in 2019, Hess noted that investors were frustrated with the oil industry. One measure of their frustration was that energy companies accounted for only 5.5 percent of the S&P 500, down from sixteen percent in 2009. At the time, he asked, "How do you get the hearts and minds of investors back? That is a real challenge for our industry."[3] He then added,

> "We will have to compete against other industries in the S&P to create the value proposition that makes us more attractive. A new paradigm is coming up which is to generate free cash and **share some of this cash with investors**" [emphasis added].

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[1] "US Oil Rigs Fall to 15-Month Low: Baker Hughes," *Energy Intelligence*, June 23, 2023 [https://tinyurl.com/2p8w556c].
[2] Dallas Fed Energy Survey, Federal Reserve Bank of Dallas, June 22, 2023 [https://tinyurl.com/3745kdp3].
[3] Dmitry Zhdannikov, "'Under siege', oil industry mulls raising returns and PR game," Reuters, January 24, 2019 [https://tinyurl.com/36tbxrvx].

In June 2023, Hess quantified the word "some."[4] He noted that the firm's cash flow would rise by twenty-five percent per year over the next twenty-five years if prices remained at $74 per barrel and that up to seventy-five percent of the free cash flow would be returned to investors.

The message seems clear. Investors have little faith in the industry's future. They no longer wish to share their money with firms like Hess and are demanding the return of their capital. If Hess is any example, the oil companies appear to be listening.

[4] Sabrina Valle, "Hess expects cash flow to rise 25% per year for the next five years," Reuters, June 22, 2023 [https://tinyurl.com/y9dpdps8].