

# Frontiers

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**Oil's "last cycle"  
means tough  
choices for energy  
company leaders**

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## In a world where prices remain low and consumers have options, where will your company play?

The conventional wisdom following 2014's commodities slide was that oil prices would go back up – someday. After all, the “boom” is a necessary element in “boom and bust” cycles.

But there's no guarantee that a commodity industry will always cycle, just because it has in the past – especially when there are significant market forces at play. In fact, there is a compelling argument to be made that this might just be the oil industry's last cycle, due to abundant supply and an overall – and seemingly permanent – slowing of global demand.

Oil and gas executives who remain convinced that the traditional price cycle is alive and well may believe that their companies once again will be rescued by rising prices. They likely see no need to change direction or innovate; hanging on until crude prices increase has always been the secret to success during a downturn.

But what is the strategy if our abundance of crude lasts until the next energy revolution – be it the fuel cell, the ability to efficiently store electricity or some other technological breakthrough that changes the landscape forever?

### A new world for oil and gas

Most importantly, for many companies, the last cycle theory means that crunch time may come even before there is a game-changing revolution.

Consider: throughout the history of the oil industry, price cycles have typically repeated themselves every 20-30 years. If that holds true to form, crude prices wouldn't even begin to rebound until sometime in the late 2020s or early 2030s, and likely wouldn't reach pre-2014 levels until the late 2030s.

But given where we are today from a technology standpoint – and taking into account the pace of change – there is little doubt that the global energy market will look vastly different by then.

Solar power will be readily available and inexpensive. Electric vehicles and hybrids will dominate new car sales. On-demand transportation services, perhaps with driverless vehicles, will reduce total miles driven.

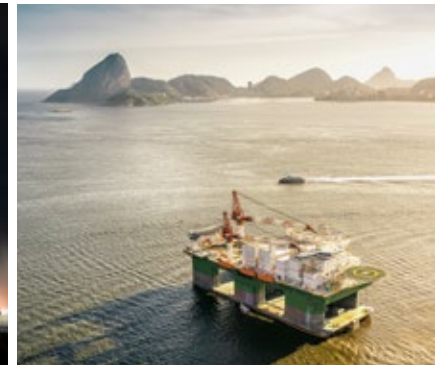
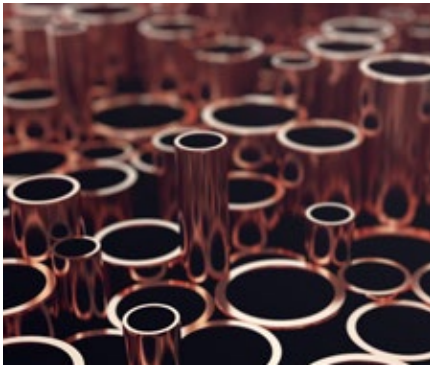
In a carbon-conscious world, consumers faced with numerous energy options will make choices that further reduce demand. Crude will still be a part of the energy mix, especially in some markets and for some applications, but demand will likely be flat or falling year-over-year, keeping prices low – forever.

That's not science fiction. It's a likely reality. And in that scenario, where would oil companies play?

### Who thrives in the “last cycle?”

For the majors, the uncertainty around oil's long-term future is more of an opportunity than a challenge, because they have the resources and scale to identify and exploit areas of constraint to create value. We already see some evidence of this in recent strategic decisions to invest more in chemicals than in new exploration and production. We also see majors and national oil companies investing in less traditional, and lower carbon, energy sources.





Smaller, nimble companies – especially those with low overhead and significant shale reserves – can also thrive. Responding quickly to price signals, they can quickly ramp up or shut in shale production as needed to maximize revenues. And with lean, capable staff and smart use of digital technology, automation and contingent workers, they can effectively manage costs when prices are at their lowest. These companies will also have plenty of capital available to them as needed, especially from private equity.

It is the mid-size and large independents that the “last cycle” will put at most risk. Do they start taking money off the table now, and stop sinking capital into new reserves, knowing future prices will make their development unprofitable? Or do they take risks now to begin transforming their business models into something more sustainable over the long term? Each company must make its own decision on a strategic direction, and possibly sooner than many anticipate.

**In the years ahead, we could see:**

- ▶ Majors continue to invest more in higher value downstream applications, as well as ramp up research and expand into renewables themselves.
- ▶ Mid-size independents look to mergers and acquisitions as a way to capture value today for their reserves and prepare themselves for a more competitive marketplace.
- ▶ Smaller independents, especially those that are privately held, begin to consider exit strategies.

Of course, no one can predict the future with 100% accuracy. But it is clear that the industry will undergo wrenching change in the years ahead as technology speeds the adoption of renewable energy. Smart companies will at least begin talking through their options today so they are prepared. **E**

**About *Frontiers*:** In order not just to survive, but thrive, oil and gas companies and their executives must look around every corner, into the distance, to forecast the industry's next frontier. There are many weak signals that, if they gain velocity, could have major implications on the industry. But what happens when companies are too busy managing the current environment, especially in today's lower-for-longer landscape, to focus on the horizon? And how can companies prepare for those weak signals with an eye on the present and toward the future? Please follow along as we analyze different energy futures and weak signals impacting the industry regularly through our *Frontiers* series. If you are interested in receiving future *Frontiers* editions, please contact [usenenergy@ey.com](mailto:usenenergy@ey.com).

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