Oil Giant Shell’s Pivot to Electricity Could Bring Investors Less Sizzle

By
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Oil giant Royal Dutch Shell RDS.B -0.93% PLC aims to become the world’s largest electricity company without necessarily generating very much power. The Anglo-Dutch company last month detailed its plans to transform into a cleaner business centered on selling electricity. Hoping to capture the most profitable part of the business, Shell’s power strategy will be light on assets and focus on trading electricity generated by others.
“Trading will sit at the heart of the integrated approach as a very important source of value,” Shell Chief Executive Ben van Beurden said at the company’s management day last month. “Of

course we will be involved in generating electricity […] but we have a preference for being asset-light and balance our supply by providing electricity from other producers.” Oil and gas will remain Shell’s core business, the company says, but it is aiming to be the world’s largest electric power company by the early 2030s.

Income attributable to Royal Dutch ShellshareholdersSource: the company

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The shift presents challenges. Sizable companies already exist in the power industry, and generating power has historically produced smaller profits than oil-and-gas production, because utilities often carry more debt and are heavily regulated. “The oil companies have always been used to high rates of returns with the production of crude oil,” said Paul Stevens, senior research fellow at Chatham House, a London-based think tank. “Those rates are just not available in power generation.” Shell says it hopes to achieve equity returns of between 8% and 12% from its power business, lower than the 12% to 15% target for its traditional oil-and-gas business. The company currently is the second-biggest power trader in the U.S., with a trading desk that predominantly buys and sells electricity that other companies generate. Shell, however, doesn’t disclose its trading profits or profit margin on its power-trading business. “Many utilities are hopeless at trading and marketing their power, so it makes sense to let them operate the power plants and have Shell market their power more efficiently,” said Craig Pirrong, a professor of finance at the University of Houston. Shell’s pivot is part of a broad movement among European oil giants to show they can help meet global goals to reduce fossil-fuel emissions while continuing to churn out profits. It also is an acknowledgment that demand for oil, its chief moneymaker, is expected to peak sometime in the early 2030s, according to a host of studies. The company’s recent interest in Dutch energy provider Eneco could serve as an asset-light model for where Shell’s power business might be heading. Earlier this year, Shell announced a joint bid with Dutch pension-fund manager PGGM for Eneco, a firm that sold around three times more power than it produced last year. The size of the bid wasn't disclosed but analysts have estimated the company to be worth about $3.4 billion. As electricity rapidly makes its way into domestic heating, transportation and industrial processes, more than a quarter of global energy demand by 2030 will be for electric power, according to Shell forecasts. That compares with 18% today and Shell's forecast of as much as 50% by 2060. Shell could play a leading role in new businesses such as electric charging points in fuel stations, said Nick Stansbury, head of commodity research at Legal & General Investment Management, a shareholder in Shell. "What I am not yet convinced by is whether—in order to be good at power-market trading, be good at making money—they necessarily need to own and have on the balance sheet the renewable assets," Mr. Stansbury said.

A London taxi plugged into a charging station at a Shell gasoline station in London in 2017, not long after Shell agreed to buy electric-vehicle charging firm NewMotion. PHOTO: TIM IRELAND/ASSOCIATED PRESS

Many of the oil industry's biggest companies are investing in clean energy projects. France’s Total SA owns a majority share in U.S. solar-system maker SunPower and acquired French battery manufacturer Saft Groupe. In the U.K., BP PLC acquired electric-vehicle charging company Chargemaster last year for about $170 million and invested over $20 million in fast-charging battery company StoreDot. Norway’s state-backed oil company Equinor and Italy’s ENI also have committed to large investments. Overall, European major oil companies are allocating a fraction of their budgets to low-carbon investments, which accounted for a combined 7% of capital expenditures last year, according to investment research firm CDP. Shell’s acquisitions in power include German battery company Sonnen, retail energy providers First Utility and MP2 Energy, electric-vehicle charging companies NewMotion and Greenlots, and U.K. energy technology company Limejump Ltd. Shell also has outlined an ambitious plan to share profits with investors, with a plan to pay at least $125 billion in dividends and share buybacks between 2021 and 2025. Mr. van Beurden has told The Wall Street Journal that the payouts will come from returns on investments the company already has made.

In the long term, those generous dividends could be at risk if the world’s switch to cleaner forms of energy changes pace. Oil giants’ ability to make high profits remains dependent on their core industries, and failing to embrace the change means they’ll eventually be forced out of the business, according to Chatham House’s Mr. Stevens.

“The energy establishment is grossly underestimating the speed and depth of the energy transition,” he said. “I think it’s going to happen a lot faster and be a lot deeper.” https://www.wsj.com/articles/oil-giant-shells-pivot-to-electricity-could-bring-investors-less-sizzle-11563015600?redirect=amp#click=https://t.co/wqT12UoCEc