ConocoPhillips' Q4 2023 oil sands production breaches investment exclusion thresholds

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In 2023, ConocoPhillips purchased the remaining 50% of the Surmont oil field from Total.[1] Surmont is an oil sands field located in onshore Canada with production not expected to peak until 2036.[2] Oil extraction from oil (or tar) sands is particularly energy and water-intensive, destructive to local forest environments and pollutive.[3] For this reason, oil sands extraction is one method of unconventional oil and gas production that is often identified in investment exclusion policies.

ConocoPhillips funded the Surmont acquisition with a $2.7bn three-tranche bond deal, which priced in Aug 2023.[4] Our earlier analysis highlighted that some investors subject to investment exclusion policies participated in the deal, essentially financing an acquisition that has since made the issuer uninvestable.[5] Ultimately, this will force a sale of those securities at the point at which the investment exclusion threshold is reported to be breached.

ConocoPhillips released its 2023 results on 8 Feb 2024,[6] which disclosed details of both its production and its average price by source. The Surmont acquisition seems to have been consolidated only for Q4, and bitumen production doubled in the final quarter (see Table 1). **The 2023 report confirms 6.6% of Q4 2023 production and an estimated 5.0% of revenue was from oil sands (see Figure 1 and Figure 2 overleaf), although on a full-year basis the figures are lower, at 4.4% and 3.4% respectively.**

On a forward-looking basis, the Q4 figures are the best representation of the company's production.

When relying on data providers, it will likely be over a year before the annualised production and revenue are reported to have breached this threshold, which will then be subject to investment processes for implementation. **This means investors (such as those identified in Table 3) may find themselves financing undesirable oil sands production for up to two years, before divestment following the confirmation notification of a threshold breach.**

The performance of the bonds in H2 2023 showed an average spread tightening of 12%. Set against a backdrop of a very strong market (for example, the Bloomberg US Agg Corporate tightened 21%) this suggests that benchmarked investors in the ConocoPhillips bonds may have underperformed. **This poor performance will be crystalised at the point of divestment.**

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[1] "ConocoPhillips Completes Purchase of Remaining 50% in Surmont", ConocoPhillips, 4 Oct 2023.
[2] "Surmont Project (ConocoPhillips Company) Oil Sands Field, Canada", Offshore Technology, 2 Dec 2021.
[3] "This is the world's most destructive oil operation – and it's growing", National Geographic, 11 Apr 2019.
[4] Debt consisted of $1bn 10-year (ISIN US20826FBF27), $1bn 31-year (ISIN US20826FBG00) and $0.7bn 40-year (ISIN US20826FBH82) bonds.
[5] Please see "ConocoPhillips crossing oil sands exclusion thresholds", AFII, 16 Aug 2023.
[6] "Fourth-Quarter 2023 Detailed Supplementary Information", ConocoPhillips, 8 Feb 2023.

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ConocoPhillips 2023 production details

The 2023 results announcement gives the following details on production and price.[6]

Production

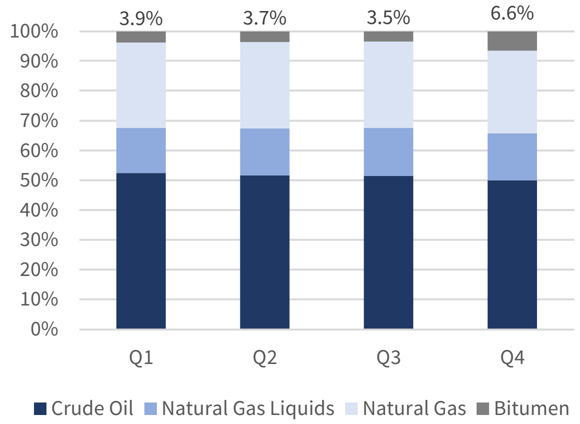
Bitumen is produced exclusively from the Surmont field in Alberta; the full acquisition seems to have been consolidated only in Q4, which explains the near doubling of bitumen production.

Table 1 shows production by product in Thousand Barrels of Oil Equivalent Daily (MBOED), and Figure 1 shows the relative proportion for each quarter. Oil sands production increased from 3.5% in Q3 to 6.4% in Q4, although on a full-year basis it is only 4.4%.

Table 1. ConocoPhillips 2023 production. Source: ConocoPhillips.

Product ion (MBOED)	Q1	Q2	Q3	Q4	FY 2023
Crude Oil	937	931	927	949	936
Natural Gas Liquids	271	283	291	301	287
Natural Gas	514	524	523	526	522
Bitumen	69	66	64	125	81

Figure 1. ConocoPhillips 2023 production as a percentage of total. Source: ConocoPhillips.



Estimated Revenue

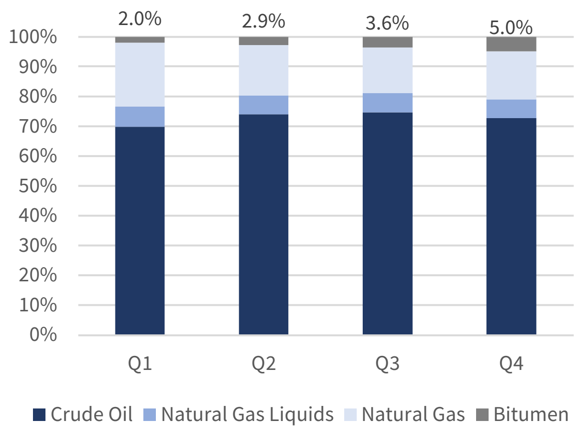
ConocoPhillips 2022 annual report did show revenue split by operating segment, but the update provided on 8 Feb 2024 does not include this specific data. The average realised price for each product is shown, so we have calculated estimated revenue by product shown in Table 2. We note that the total is $37.1bn compared to reported total of $56.1bn. Our calculation is therefore an estimate, to show the relative importance of each product.

For revenue, we observe a similar dynamic to the production figures; there is an increase in the relative weight of estimated bitumen revenue in Q4 to 5.0% associated with the Surmont acquisition. However, on an annualised basis the figure is only 3.4%.

*Table 2. ConocoPhillips 2023 production * average realised price. Source: ConocoPhillips.*

Estimated revenue ($bn)	Q1	Q2	Q3	Q4	FY 2023
Crude Oil	6.6	6.3	7.0	7.0	27.0
Natural Gas Liquids	0.6	0.5	0.6	0.6	2.4
Natural Gas	2.0	1.4	1.4	1.6	6.5
Bitumen	0.2	0.2	0.3	0.5	1.3

*Figure 2. ConocoPhillips 2023 production * average realised price as a percentage of total. Source: ConocoPhillips.*



Production or revenue thresholds

Revenue attribution is inherently more complex than production figures. Oil and gas move between segments for processing and so revenue cannot always be directly attributed to the source. Also, it is often the case (especially in bitumen processing) that additional oil products are purchased to blend with extracted products in order to be sold, which can result in a lower portion of revenue attributed directly to the extractions. ConocoPhillips is up upstream operator, after spinning off its midstream and downstream operations into Phillips 66. Focusing on production allows the emissions threshold to be directly linked to the emissions and environmental destruction caused by the extracted product.[7]

We will analyse revenue attribution estimations from data providers where possible, to ensure they reflect the economic dynamics of this upstream business.

Timing of exclusion implementation

In the absence of any meaningful change to ConocoPhillips' business, full-year figures for 2024 will show a production split similar to Q4, which will result in a production proportion above 5%, and probably a revenue proportion breaching that threshold as well. These figures will be confirmed in 2024 ConocoPhillips reporting, likely in Feb 2025.

Investment exclusions are generally linked to data from external providers, often MSCI and ISS ESG. According to our understanding, new calculations are released in real-time when new information is available, and so we would expect updated figures in Q2/Q3 of 2025.

Even when a threshold breach is confirmed by a data provider, a typical investment process would require a review, and another delay of a few months before any divestment is implemented.

This means investors could be financing ConocoPhillips for up to two years after the on-going production split of the company breached the threshold.

Q4 data shows the current split of operations, and those figures are the truest representation of the issuer going forward. Latest data should be used to judge exclusion thresholds and manage divestment decisions.

[7] Data available from the Global Oil & Gas Exit List.

Investor exclusion policies

Here is a summary of exclusion policies that have a 5% threshold for oil sands that we are aware of. The Assets-under-Management (AUM) shown are for all asset classes, and so do not only represent corporate bonds. There are some significant investors on the list, so the size of a potential divestment would be material.

Table 3. Oil sands exclusion policies. Source: various.

Asset owner/manager/fund	Total AUM (all asset classes estimated)	Threshold	Date last published	Source
Aegon Asset Management	€293 bn	5% of production	Oct-23	Link
Axa	€900 bn	5% of production OR 5% of total oil sands production	Sep-23	Link
BlackRock's iShares ESG Aware USD Corporate Bond ETF	€1 bn	5% of revenue	Jan-24	Link
Coutts	€40 bn	5% of revenue	Nov-23	Link
Danske Bank AM	€100 bn	5% of revenue	Jul-23	Link
Fidelity Sustainable Family Funds	€0.2 bn	5% of revenue	Feb-24	Link
KLP	€72 bn	5% of revenue	Aug-23	Link
Norges Bank Investment Management	$1 trn	No set threshold, but four oil sands producers already excluded	May-20	Link
Oddo BHF	€125 bn	5% of revenue	Oct-23	Link
PensionDanmark	€40 bn	5% of revenue	Dec-23	Link
Vanguard Sustainable Life/WaMU	€0.5 bn	5% of revenue	Dec-21	Link
Wellington AM	€1.3 trn (exclusion applied only where client requests)	5% of revenue	Oct-21	Link

Investor divestment

Bondholder disclosure is not complete; however, Bloomberg shows some investors depending on available information.

There has been limited divestment during the period between the bonds' issuance and the Q4 2023 reporting date. Table 4 shows investors whose positions have gone down to zero. In the context of the size of the bonds, these moves are very small, and in our opinion do not represent significant divestment.

Table 4. ConocoPhillips bond divestments. Source: Bloomberg, accessed 6 Feb 2024.

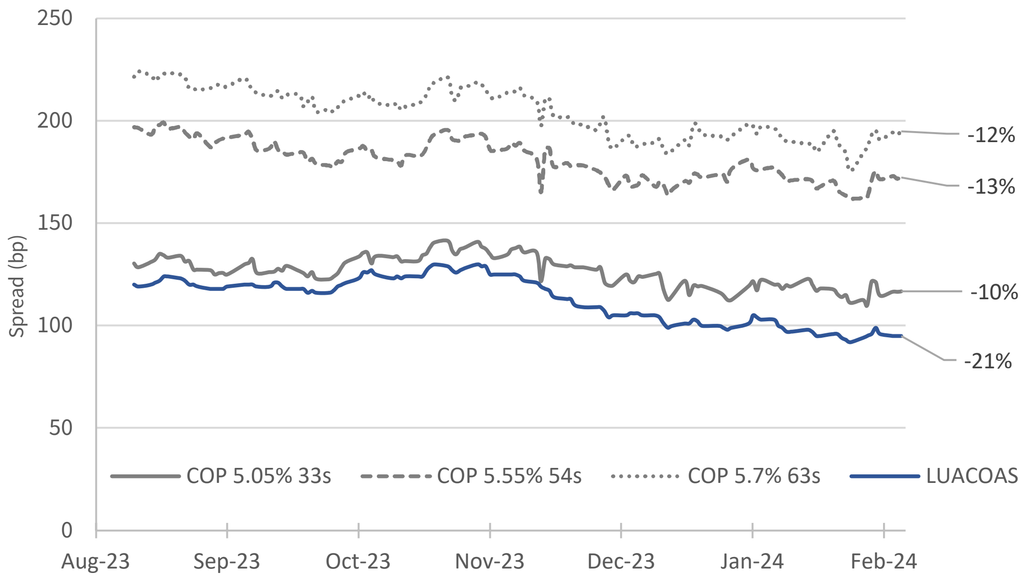
Bond	ISIN	Total Size	Divestments
COP 5.05% 33s	US20826FBF27	$1bn	Cathay Securities (5mm), Muzinich (1mm), Schroders (0.7mm), Loomis Sayles (0.4mm)
COP 5.55% 54s	US20826FBG00	$1bn	Fisher Asset Management (0.3mm)
COP 5.7% 63s	US20826FBH82	$0.7bn	Schroders (2.5mm)

Bond performance

Figure 3 shows the performance of the ConocoPhillips bonds issued in Aug 2023. Each has tightened, between 10-13% in terms of spread. For comparison, the Bloomberg US Agg Corporate Average OAS index is shown, designed to represent a benchmark US investment-grade bond index. This has outperformed the ConocoPhillips bonds, tightening 21%.

While investors have been rewarded with positive performance over this period, the bonds have likely underperformed versus indices. This may have led to poor benchmarked returns for investors that have held the bonds since issuance.

Figure 3. ConocoPhillips bond z-spreads since issuance, compared to Bloomberg US Agg OAS. Source: Bloomberg, accessed 8 Feb 2024.



Conclusions

Oil sands is an environmentally destructive, unconventional method of oil extraction. For that reason, **it features in several investment exclusion policies, often with a threshold of 5% of production or revenue.**

ConocoPhillips' 2023 results confirms that it breaches this threshold in Q4 reporting, due to its 2023 acquisition of the remaining half of the Surmont oil field. Q4 operations are the truest representation of the business going forward, and so are appropriate to be used in divestment decisions.

When relying on data providers, it will likely be over a year before the annualised production and revenue are reported to have broken the threshold. Reporting would then have to be incorporated by data providers, and likely go through investor ESG committees, prior to any exclusion decisions. **This means investors may finance oil sands production for up to two years, in contravention of their investment intentions.**

The bonds have performed well since issuance in absolute terms, but not when compared to indices. **This makes it likely that benchmarked investors have underperformed with these holdings, which will be crystalised upon any divestment.**

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