

ConocoPhillips: a Marathon journey towards exclusion

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In Aug 2023 ConocoPhillips (ticker COP) issued $2.7bn debt to buyout the remaining 50% of the Surmont oil facility, a Canadian oil sands field.[1] The deal was completed in Oct 2023, [2] and ConocoPhillips has reported increased production of bitumen since the acquistion.[3]

Extracting bitumen from oil sands is a method of fossil fuel production that is frequently subject to investment exclusions. As reported in our earlier analysis**, we concluded that the Surmont acquisition would put ConocoPhillips at risk of exclusion where investors have policies that bar exposures to firms with a 5% production or revenue threshold for oil sands production.**[4,5] ConocoPhillips' recent H1 2024 reporting confirms the increased production above 5%, and our estimates show an even higher revenue proportion due to increased bitumen prices.

However, due to the typically lengthy process that investment exclusions follow**, it will likely be H1 2025 before the most significant outflows from ConocoPhilips' securities take place.** Data is captured on a full year basis, and so 2024 is the year when the production increases, and a review process will add additional delays. This means that investors with exclusion policies could potentially finance the undesirable activity for nearly two years. However, this time delay also presents an opportunity to anticipate outflows, which should follow a predictable pattern.

In May 2024, ConocoPhillips announced an intention to acquire Marathon Oil, a US shale producer. This transaction has been approved by Marathon's shareholders, and is predicted to complete within the year. M&A activity can affect investment exclusions, as this increases the size of a company and may reduce the proportion of revenues that comes from undersirable activity – even though the absolute amount may be unchanged. **Our analysis concludes that the acquisition of Marathon will not bring ConocoPhillips below the exclusion threshold of 5% for oil sands. We therefore still anticipate future divestment flows.**

The performance of the Aug 2023 ConocoPhillips bonds has been mixed. While there has been overall tightening since issuance, relative to the benchmark they have underperformed**. A future divestment may crystallise these losses for investors.**

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[1] "ConocoPhillips to offer notes to fund $3 billion Surmont oil facility buyout", Reuters, 9 Aug 2023.
[2] "ConocoPhillips Completes Purchase of Remaining 50% in Surmont", ConocoPhillips, 4 Oct 2023.
[3] For our earlier analysis please see "ConocoPhillips crossing oil sands exclusion thresholds", AFII, 16 Aug. 2023 and "ConocoPhillips' Q4 2023 oil sands production breaches investment exclusion threshold", AFII, 13 Feb 2024.
[4] For earlier analysis please see "ConocoPhillips crossing oil sands exclusion threshold", AFII, 16 Aug 2023. and "ConocoPhillips' Q4 2023 oil sands production breaches investment exclusion thresholds", AFII, 13 Feb 2024.
[5] "Conoco Deal Triggers Divestment Alert From Pension Investors", Bloomberg, 23 Aug 2024.

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H1 2024 data

On 1 Aug 2024, ConocoPhillips released its Q2 earnings alongside reporting on production and earnings by segment.[6]

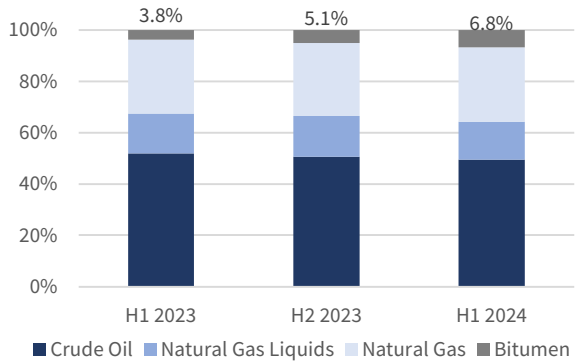
Production

Table 1 gives details of ConocoPhillips production split by product. The full acquisition of Surmont, its only bitumen-producing asset, was consolidated from Q4 2023, which explains the rise in relative production of bitumen. For H2 2024 bitumen was 6.8% of production, and without M&A activity one would expect this to remain constant for the rest of the year.

Table 1. ConocoPhillips production details. Source: ConocoPhillips

Production (MBOED)	H1 2023	H2 2023	H1 2024
Crude Oil	1,868	1,876	1,899
Natural Gas Liquids	554	592	562
Natural Gas	1,038	1,049	1,111
Bitumen	135	189	262

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



Estimated revenue

ConocoPhillips does not release revenue by product. While it does release details on earnings split by operating segment, this is not sufficient, since the Canadian segment also includes revenues from natural gas produced out of the Montney field.[7] It is therefore not possible to isolate earnings from oil sands.

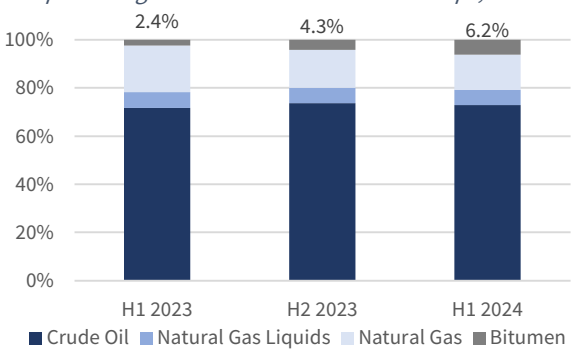
However, as per our earlier analysis, we have used the reported average realised price for each product to estimate revenue share. We note this generates a total revenue of $19.0bn for H1 2024 compared with the actual reported figure of $27.5bn, but our calculation is simply an estimate to show the relative importance of each product.

As shown in Table 2 and Figure 2, we observe an increase in the estimated revenue share attributable to oil sands production from H2 2023 (4.3%) to H1 2024 (6.2%).

*Table 2. ConocoPhillips production * average realised price. Source: ConocoPhillips, AFII.*

Estimated revenue ($bn)	H1 2023	H2 2023	H1 2024
Crude Oil	12.9	14.0	13.9
Natural Gas Liquids	1.2	1.2	1.2
Natural Gas	3.5	3.0	2.8
Bitumen	0.4	0.8	1.2

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



[6] "2Q24 supplemental information", ConocoPhillips, accessed 24 Sep 2024.
[7] "Canada", ConocoPhillips, accessed 25 Sep 2024.

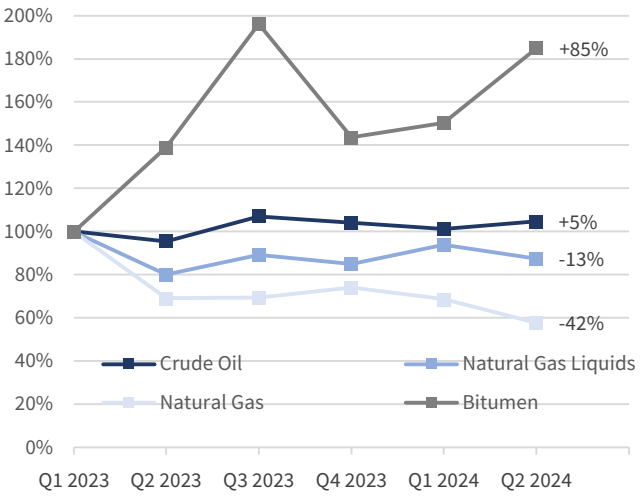
Recent bitumen price movements

The increase in estimated revenues from bitumen shown in Figure 2 is driven both by greater production and higher prices.

Figure 3 shows the evolution of average realised prices as reported by ConocoPhillips. Bitumen prices have increased +85% since Q1 2023, compared to -42% for natural gas.

This has increased the significance of bitumen to ConocoPhillips revenue.

Figure 3. Average realised price by production. Source: ConocoPhillips.



Impact of Marathon acquisition

It was announced in May 2024 that ConocoPhillips would acquire Marathon Oil in an all-stock deal for $22.5bn.[8] This was approved by Marathon shareholders in Aug 2024,[9] and is expected to complete in Q4 2024.[10] As this transaction represents a complete acquisition, we would expect full consolidation in the year it settles.

Marathon Oil is an independent exploration and production company with assets in the US and Equatorial Guinea.[11] It does not currently operate in oil sands regions. This being the case, the acquisition should serve to reduce the proportion of revenue that ConocoPhillips generates from oil sands.

This M&A activity underlines the problems with relative investment exclusion thresholds. Increasing the size of a company's total production does not reduce the environmental impact of a fixed asset. It should not be possible for an acquisition to make an uninvestible company investible again, by virtue of reducing only the relative weight of its undesirable activities. Using an exclusion threshold linked to absolute volume of production would remove this possibility.

Table 3 shows how the production of ConocoPhillips and Marathon compare, and therefore what a combined entity would look like. Including Marathon does serve to

Table 3. ConocoPhillips and Marathon production, and combined. Source: ConocoPhillips, Marathon, AFII.

Production (MBOED)	H1 2023	H2 2023	H1 2024
ConocoPhillips Bitumen	135	189	262
ConocoPhillips Total	3,597	3,708	3,847
Marathon Oil Total	697	721	677
% Bitumen ConocoPhillips	3.8%	5.1%	6.8%
% Bitumen Consolidated Entity	3.1%	4.3%	5.8%

[8] "ConocoPhillips to buy Marathon Oil in $22.5 bln deal in latest energy merger", Reuters, 29 May 2024.
[9] "Marathon Oil Received Stockholder Approval for Proposed Merger with ConocoPhillips", Marathon Oil, 29 Aug 2024.
[10] "ConocoPhillips to acquire Marathon Oil Corporation in all-stock transaction; provides shareholder distribution update", ConocoPhillips, 29 May 2024.
[11] "Marathon Oil at a Glance", Marathon Oil, accessed 25 Sep 2024.

increase total production and so reduce the percentage coming from oil sands, however annualised production in 2024 would still have been above the 5% threshold.

Investor exclusion policies

As previously reported, several investors do have exclusion policies linked to oil sands, often with a 5% production or revenue threshold. For a (non-exhaustive) list of investors with oil sands exclusions that have not yet publicly excluded ConocoPhillips, please see Appendix 1.

ConocoPhillips investor exclusions

There are investors with 5% oil sands thresholds who have already excluded ConocoPhillips from their investment universe.

Nordea Asset Management, a Nordic investor with €264bn under management,[12] has a 5% threshold for oil sands revenue.[13] Nordea excludes ConocoPhillips for oil sands involvement.[14]

PensionDanmark, a Danish pension fund managing €42bn, also excludes companies that have 5% or more of their revenue coming from oil sands. It currently excludes ConocoPhillips under this criteria.[15]

Danske Bank, a Danish manager with €103bn under management,[16] has an exclusion threshold for companies generating over 5% of revenue from tar sands.[17] ConocoPhillips is not on the tar sands exclusion list, however Danske does exclude it on the basis of a proprietary "harmful environmental practices" screen, the full details of which are not publicly disclosed.[18]

PGGM, a Dutch pension investor managing over €240bn in assets,[19] excluded ConocoPhillips for tar sands involvement at the end of 2021.[20] The threshold it uses is not definitively disclosed; the announcement around exclusion suggests a 10% of revenue cutoff,[20] while an earlier paper from 2020 suggests a 10% of production limit.[21] The company's responsible investment policy merely states it does "not wish to invest in […] tar sands".[22] In 2022, after ConocoPhillips was already excluded by PGGM, its largest client PFZW tightened its threshold to 1% of revenue.[23] What is interesting about this example is that ConocoPhillips was excluded in 2021, prior to fully acquiring the Surmont field, when oil sands accounted for 4.4% of production.[24] Therefore it is unlikely revenue was over the 10% thereshold at this time. Still, PGGM appears to have interpreted the exclusion policy as more than a black-and-white hard limit and accounted for the expansionary strategy of this company, too.

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[12] "About Nordea Asset Management", Nordea, 9 Sep 2024.
[13] "Exclusion", Nordea, accessed 25 Sep 2024.
[14] "Exclusion list", Nordea, Sep 2024.
[15] "Exclusion list", PensionDanmark, Feb 2024.
[16] "New growth strategy will further strengthen our strong investment products", Danske Bank, 2 Feb 2024.
[17] "Exclusion Instruction", Danske Bank, Mar 2024.
[18] "Excluded Investments", Danske Bank, Jun 2024.
[19] "2023 Annual Report", PGGM, accessed 25 Sep 2024.
[20] "Dealing with climate risk as financial risk", PGGM, accessed 25 Sep 2024.
[21] "Policy Paper Climate Change, Pollution and Emissions", PGGM, 28 Oct 2020.
[22] "Compliance", PGGM, accessed 25 Sep 2024.
[23] "PFZW to divest fossil fuel companies unless they align with Paris Agreement", Responsible Investor, 16 Feb 2022.
[24] "2021 Annual Report", ConocoPhillips, accessed 25 Sep 2024.

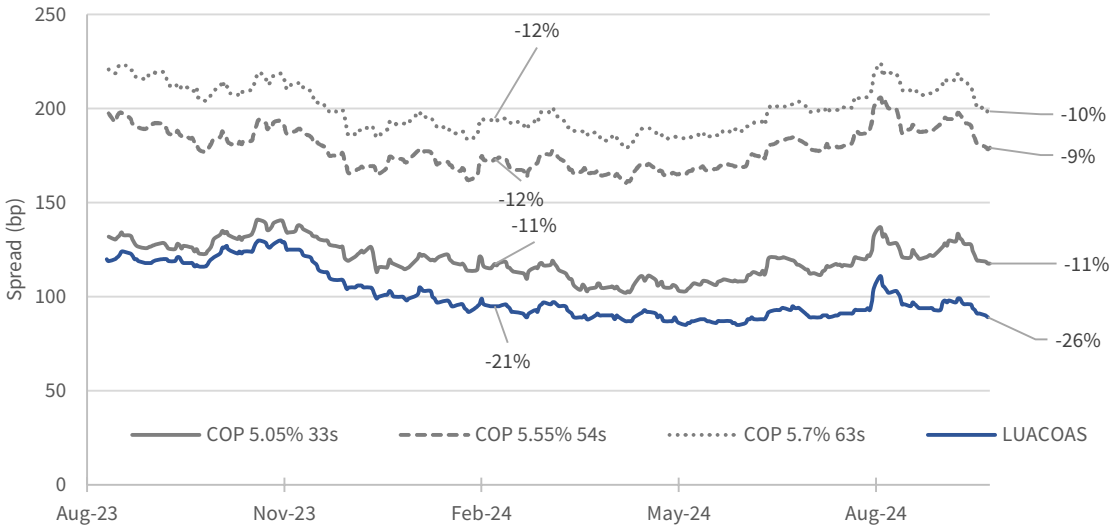
Bond performance

Figure 4 shows the performance of the Aug 2023 issued ConocoPhillips bonds since issuance. Each has tightened between 9 and 11% in terms of spreads, but is slightly wider since our last analysis in Feb 2024, when the tightening was between 11 and 12%.

For comparison the Bloomberg US Agg Corporate Average OAS is shown, designed to represent a benchmark US investment-grade bond index. This has outperformed the ConocoPhillips bonds over both periods, tightening 26% since Aug 2023, and 5% since Feb 2024.

Therefore, while ConocoPhillips investors have been rewarded with positive performance since issuance, they have underperformed this benchmark, and seen a slight widening since Feb 2024. This may have contributed to poor benchmarked returns for investors that have held the bonds over this period.

Figure 4. ConocoPhillips bond z-spreads since issuance, compared to Bloomberg US Agg OAS. Source: Bloomberg, accessed 25 Sep 2024.



Conclusions

ConocoPhillips H1 2024 reporting suggests it generates over 5% of its revenue from oil sands production, even if on a full-year basis this will not be confirmed until early 2025. Some investors with this exclusion threshold appear to have divested, though there are several that have yet to publicly do so.

ConocoPhillips' planned acquisition of Marathon Oil highlights one potential fallacy of revenue limits. Namely, that acquisitions can increase a company's overall revenue and therefore reduce the proportion that comes from undesirable activities. In this context, however, our analysis suggests ConocoPhillips will still be comfortably above the 5% threshold.

The three ConocoPhillips bonds issued in Aug 2023 to finance the acquisition have underperformed the Bloomberg Global Agg index since issuance, and widened further since the start of the year. Investors who wait until full-year 2024 reporting to confirm a potential exclusion may have experienced poor performance.

Appendix – Exclusion policy summary

Table 4 contains a (non-exhaustive) list of investor exclusion policies that feature oil sands production. We have included arctic production where relevant, as ConocoPhillips is also likely to be in-scope of such an exclusion.[25]

Table 4. Oil sands exclusion policies. Source: Various.

Asset owner/manager/fund	Total AUM (all asset classes estimated)	Oil Sands threshold	Arctic threshold	Policy Source	Exclusions
Norges Bank Investment Management	$1.5 trn	No set threshold, but four oil sands producers already excluded		Announcement May-20	Not excluded as Sep-24
Axa	€945 bn	5% of production OR 5% of total oil sands production		Policy Sep-23	No public list
Generali	€618 bn	5% of revenue	10% of revenue	Policy undated	No public list
Aegon Asset Management	€293 bn	5% of production	5% of production	Policy Oct-23	Not excluded as Jan-23
Robecco	€200 bn	10% of revenue	5% of revenue	Policy Jul -24	Not excluded as Jul-24
Oddo BHF	€125 bn	5% of revenue		Policy undated	No public list
KLP	€70 bn	5% of revenue		Policy Aug-23	Not excluded as Jun-24
Coutts	€46 bn	5% of revenue		Policy Apr-24	No public list
BlackRock's iShares ESG Aware USD Corporate Bond ETF	€1 bn	5% of revenue		Policy accessed Sep-24	Not excluded as Sep-24

[25] For analysis please see "Arctic oil & gas: left out in the cold", AFII, 26 Apr 2023.

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