Corporate Credit Comment

4 February 2020

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Royal Dutch Shell (RDSALN) 4Q19 earnings miss, solid credit but gearing ticked up

Shell posted slightly disappointing 4Q19 numbers with CCS earnings coming in 36% lower yoy at $17.0bn. Production came in almost identical at 3.7m boe/d, but all business areas reported like for like declines due to lower realised oil and gas prices, with Integrated Gas at $9.0bn, Upstream 4.7bn and Downstream at $6.7bn.

Operating cash flow came in at $42.2bn down from $53.1bn, capital expenditure was held constant at $23.9bn and capital investments came in around $4bn higher at $28.8bn. Free Cash Flow came in at $26.4bn down from $39.4bn. Net debt was $79bn up some $5bn from half year and net gearing came in at 29.3% which partly reflected the increased shareholder distributions that amounted to $25bn in dividends and share buybacks.

Group 2020 outlook is for capital expenditure to be at the lower end of the $24-29bn range, also divestments are to be in excess of $10bn over 2020 which should help drive gearing lower; in this regard management maintained a gearing target of 25% but it's unlikely that it will be met in 2020, even though they remain committed to maintain AA rating metrics. Shell confirmed its intention to finalise the share buyback programme of $25bn, but the pace of execution could be subject to change due to "macro conditions and debt reduction".

Following the BG Energy acquisition which has now been long absorbed and integrated, Shell's scale and diversity of business is second to none, with an added benefit of a strategic presence in LNG giving it a differentiation factor when compared to the rest of its supermajor peer group. Whilst leverage had initial moderated from the BG acquisition, thanks in part to asset sales, we have seen a reversal of this trend with a more expansive shareholder stance that included growing dividends, significant share buybacks and an IFRS 16 adjustments (Gearing would have been 25% had it not been for this.)

The trend in Shell's gearing isn't something that credit investors will like the look of but the credit remains best in class and with secondary levels trading flat to TOTAL we consider bonds fairly value and a decent defensive play given the compression we have seen between core BBB and AA/A energy names.

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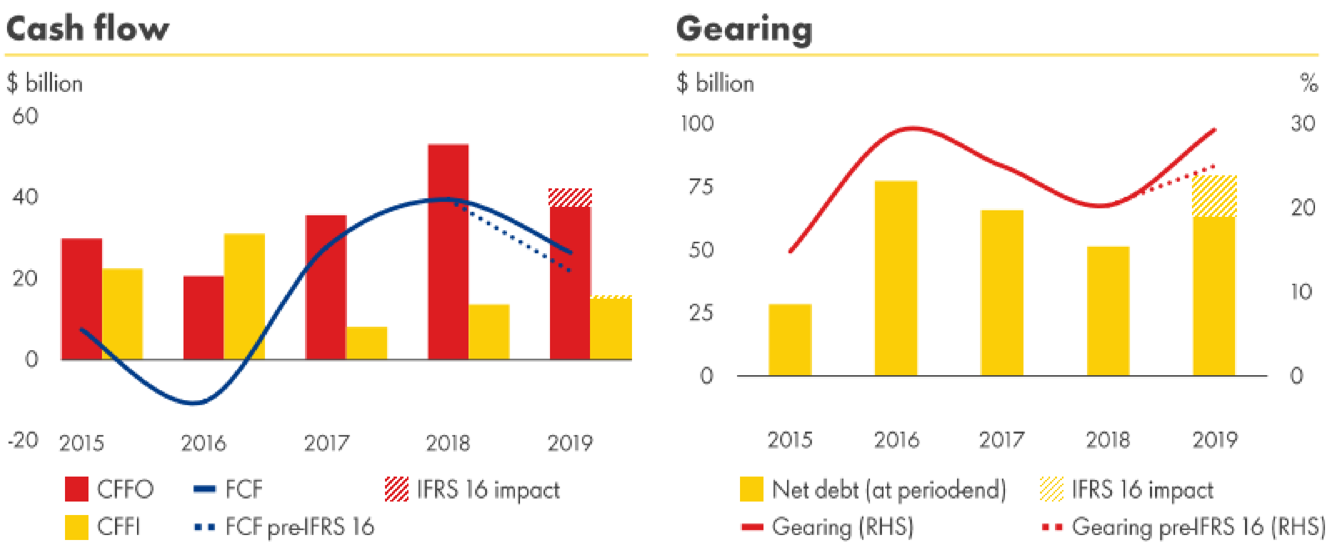
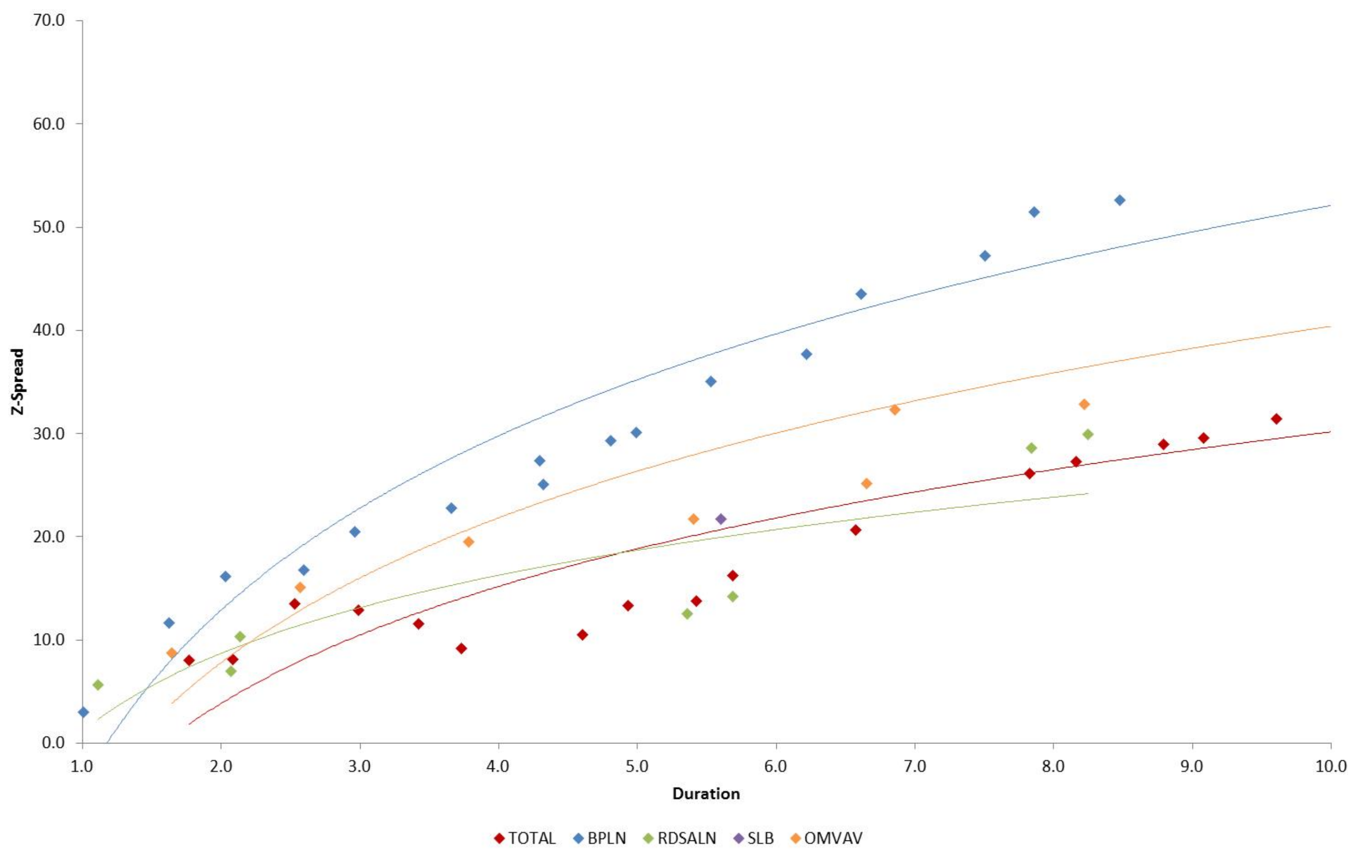
CHART 1: LEVERAGE TICKING UP AGAIN AS BUYBACKS AND IFRS 16 FILTER TRHOUGH



Source: Company disclosure

CHART 2: SOLID NAME BUT VALUATIONS REPRESENT THIS



Source: Bloomberg, MUFG

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