ACCR

Investor Bulletin: Woodside diversifies into ammonia, but is it decarbonisation?

August 9 2024 | WDS

Woodside's acquisition of an ammonia project in Texas, USA, is a welcome departure from deploying shareholder capital to long-duration, low-margin and high-emissions oil and gas projects. But this "new energy" investment won't reduce Woodside's oil and gas emissions.

This week, Woodside Energy Group Ltd announced a US$2.35 billion deal to acquire an ammonia project in the US Gulf Coast from chemicals giant OCI Global. The post-FID project is targeting first ammonia, derived from gas, in 2025; and lower carbon ammonia, derived from gas paired with Carbon Capture and Storage (CCS), in 2026.

This is Woodside's first investment in ammonia and first major investment in "new energy", it is not a new strategy. It is consistent with Woodside's existing "new energy" targets of US$5billion investment and 5MtCO_2e p.a. emissions abatement. A "US Gulf Coast Opportunity" was flagged in Woodside's 2023 Climate Transition Action Plan (CTAP)[1], which the majority of investors rejected at the last AGM.

Using excess free cash flow to diversify into "new energy" projects is better than allocating capex to long-duration and uncompetitive fossil fuel projects, such as the US$900 million purchase of Driftwood LNG, which is more expensive than 76% of other pre-FID US LNG projects.[2] "New energy" is also a good idea if it offers comparable or better risk-adjusted returns to alternatives like share buybacks or dividends. (Though, judging by the share price reaction on the day of the announcement, the jury is still out on if this is the case.)

But Woodside's diversification into "new energy" doesn't address the company's primary problem – its non-competitive and high-emissions pre-FID oil and gas portfolio, and the threat this poses to longer-term shareholder value.

Woodside's "new energy" portfolio is not designed to reduce Woodside's emissions. Investing in an ammonia project forecast to abate 3.2 MtCO_2e p.a., at the same time as investing in Driftwood, which could cause 68 MtCO_2e p.a. of scope 3 emissions, reflects the imbalanced scales of Woodside's strategy. This is a fundamental problem with Woodside's existing climate transition plan.

Key points

- The acquisition of the ammonia project from OCI is consistent with Woodside's "new energy" strategy as articulated in its 2023 CTAP. As Woodside says, it is a "material step" towards delivering its "Scope 3 investment and abatement targets"[3], with Phase 2 of the project having the capacity to meet over 60 percent of the abatement target. However, this should be viewed in the context of a majority of shareholders rejecting the CTAP.

[1] Woodside 2023 CTAP, p37
[2] ACCR, What's next for Woodside?, 2024, slide 15
[3] https://company-announcements.afr.com/asx/wds/53e3cfd6-52f3-11ef-b51d-b681c1fa9655.pdf

- Woodside's "new energy" strategy and associated targets are not intended to decarbonise Woodside's portfolio, since its "new energy" investments are additive, rather than substituting for oil and gas investments.

- The most important role for the oil and gas sector in the energy transition is to reduce hydrocarbon investment rather than increase investment in clean energy. Between 2019 and 2023, the oil and gas sector provided US$75 billion of global clean energy funding, which is just 1% of total clean energy funding. In contrast, global fossil fuel investment over the same period was US$5.1 trillion.[4]

- What looks good about the OCI deal?

  - Unlike oil and gas, ammonia could have a sustained role at scale in a low-carbon economy. The IEA suggests blue ammonia could make up around 20% of the global market by 2050 in its Net Zero Emissions scenario.[5]

  - Woodside estimates this project will exceed its 10% IRR investment hurdle for "new energy" when allowing for a US tax credit for CCS, and Woodside receiving a premium price for lower carbon ammonia sold to Europe.

  - Woodside has moved its capex risk to an experienced ammonia company. This could be wise considering the lack of experience Woodside has in this field.

  - The business model seems dependent on the CCS working, providing a strong incentive for ExxonMobil, Woodside and Linde to make sure the CCS works and is deployed on time.

- What are the risks of the OCI deal?

  - We see a range of technical risks to the project, principally around the reliance on CCS, which has a long and consistent history of underperforming pre-FID guidance. Any emissions abatement hinges on the successful deployment of CCS.

  - Woodside has contractual arrangements with Linde to source some of the required hydrogen feedstock from 2025, whilst Linde has a contractual arrangement with ExxonMobil to sequester some of the associated CO_2 emissions from the hydrogen production using CCS from 2026. However, ExxonMobil does not currently have regulatory approval for the CCS permits in question.

  - It diminishes Woodside's capacity to fund dividends and share buybacks.

Key stewardship considerations for investors

The OCI acquisition should not divert investors' attention from the problems with Woodside's current strategy of pursuing hydrocarbon growth which is neither Paris-aligned nor value-accretive to shareholders. The key stewardship considerations should include questioning Woodside's allocation of capital to:

[4] IEA, World Energy Investment 2024 p4 & p98
[5] IEA, Ammonia Technology Roadmap, 2021, p11

    - pre-FID, long-duration, high-cost, high-emissions and low-value projects, specifically Browse, Sunrise, Calypso and Driftwood
    - oil and gas exploration, especially considering Woodside's poor track record.

Unless these points are addressed, it is not possible for Woodside to produce a credible climate transition plan.

Questions investors may want to ask the company about the OCI acquisition include:

- When compared with the other Paris-aligned alternative options (e.g. buybacks), does this project provide comparable risk-adjusted returns?
- Will this project meet Woodside's investment hurdles if the CCS is not delivered, or not delivered on time?

Disclaimer

This document has been prepared by the Australasian Centre for Corporate Responsibility Inc. (ACCR).

No distribution where licence would be required

This document is for distribution only as may be permitted by law. It is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or would subject ACCR to any registration or licensing requirement within such jurisdiction. By accepting this document, the recipient will be deemed to represent that they possess, either individually or through their advisers, sufficient investment expertise to understand the risks involved in any purchase or sale of any financial instruments discussed herein.

Nature of information

None of ACCR, its officers, agents, representatives or and employees holds an Australian Financial Services Licence (AFSL), and none of them purports to give advice or operate in any way in contravention of the relevant financial services laws. ACCR, its officers, agents, representatives and employees exclude liability whatsoever in negligence or otherwise, for any loss or damage relating to this document or its publications to the full extent permitted by law.

This document has been prepared as information or education only without consideration of any user's specific investment objectives, personal financial situation or needs. It is not professional advice or recommendations (including financial, legal or other professional advice); it is not an advertisement nor is it a solicitation or an offer to buy or sell any financial instruments or to participate in any particular trading strategy. Because of this, no reader should rely upon the information and/or recommendations contained in this document. Users should, before acting on any information contained herein, consider the appropriateness of the information, having regard to their objectives, financial situation and needs. It is your responsibility to obtain appropriate advice suitable to your particular circumstances from a qualified professional before acting or omitting to act based on any information obtained on or through the report. By receiving this document, the recipient acknowledges and agrees with the intended purpose described above and further disclaims any expectation or belief that the information constitutes investment advice to the recipient or otherwise purports to meet the investment objectives of the recipient.

No representation is made that any estimated returns in this document will be achieved, or that all (or any) assumptions in achieving these returns have been considered or stated. It should not be assumed that any of the securities transactions or holdings referenced in this document were, or will prove to be, profitable, or that any future investment decisions will be profitable, or will be comparable to the investment performance of the securities or strategies discussed in this document. Past performance of any investment is not indicative, or a guarantee, of future results.

Forward looking statements

Certain information constitutes “forward-looking statements”, which can be identified by the use of forward-looking terminology such as “may”, “will”, “should”, “expect”, “anticipate”, “target”, “project”, “estimate”, “intend”, “continue” or “believe”, or the negatives thereof or other variations thereon or comparable terminology. The projected results and statements contained in this document that are not historical facts are based on current expectations and assumptions and involve risks, uncertainties and other factors that may cause actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such projected results and statements. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond the control of ACCR.

Information not complete or accurate

The information contained in this report has been prepared based on material gathered through a detailed industry analysis and other sources and although the findings in this report are based on a qualitative study no warranty is made as to completeness, accuracy or reliability of fact in relation to the statements and representations made by or the information and documentation provided by parties consulted as part of the process.

The sources of the information provided are indicated in the report and ACCR has not sought to independently verify these sources unless it has stated that it has done so. ACCR is not under any obligation in any circumstance to update this report in either oral or written form for events occurring after the report has been issued. The report is intended to provide an overview of the current state of the relevant industry or practice.

This report focuses on climate related matters and does not purport to consider other or all relevant environmental, social and governance issues.

Any prices stated in this document are for information purposes only and do not represent valuations for individual securities or other financial instruments. ACCR does not represent that any transaction can or could have been affected at those prices, and any prices do not necessarily reflect ACCR's internal books and records or theoretical model-based valuations and may be based on certain assumptions. Different assumptions by ACCR or any other source may yield substantially different results.

Conflicts of Interest

ACCR provides independent reports on companies' environmental, social and governance practices. ACCR, its members, employees and affiliates may have a long position in securities discussed in this document. ACCR intend to continue trading in these securities and may at any time be long these securities (or any other securities of the same issuer) or any related investments, regardless of the position or views expressed in this document.

Links to Other Websites

This document may contain links to other websites not owned or controlled by the ACCR and ACCR assumes no responsibility for the content or general practices of any of these third party websites and/or services whose terms and conditions and privacy policy should be read should you access a website as a result of following a link cited in this report.