EMERALD
WEALTH PARTNERS

Letter from the Field

TotalEnergies: Strategic Insights from management in Paris **March 2025**

Dear client,

We initiated a position in TotalEnergies in the Focus Equity Strategy in 2023. Recently we met with the management in Paris and attended the company investors' day virtually. That enriched our knowledge of the 100-year-old oil major, especially its approach to capital allocation under the current CEO.

A 100-year-old oil major combining deep-rooted stability with vitality

Patrick Pouyanné's journey as CEO of TotalEnergies began under extraordinary circumstances on October 21, 2014. His predecessor, Christophe de Margerie, tragically perished in a plane crash at Moscow's Vnukovo International Airport, leaving the company in shock. Such a dramatic event would throw most companies into disarray—but not TotalEnergies. Following company tradition, Pouyanné had undergone a long vetting process meant to prepare him for the CEO role and ensure a seamless transition. In an industry where projects require planning decades ahead, such smooth leadership change reflects a deep-rooted commitment to stability at the top and is a testament to the company's strong management and corporate culture. Remarkably, he is only the ninth CEO in the company's 100-year history.

TotalEnergies demonstrates a **strong corporate culture**, **leadership continuity** and strategic consistency with Patrick Pouyanné. The company's tradition of long-term planning and stable leadership is evident, with Pouyanné being only the ninth CEO in its 100-year history.

Pouyanné stepped in to lead the company amidst significant turmoil in the energy market. Oil prices had just plummeted from $115 to $60 per barrel, a result of years of overinvestment that flooded the market with supply and triggered a severe market downturn. During our visit to the company's HQ, the management explained how that period of excess spending left a deep mark on Pouyanné, shaping his strategic thinking as the newly appointed CEO, and how that influence has permeated all subsequent important decisions.

Pouyanné has led TotalEnergies with **consistent principles**, guiding it through global upheavals and aligning closely with key tenets of our investment philosophy and capital deployment.

Since taking the helm, Pouyanné has steered the company with unwavering adherence to key guiding principles, even amidst transformative global events such as the rise of shale oil, the prominence of global warming in politics, the COVID pandemic, Ukraine war, and escalating Sino-American tensions.

These guiding principles include:

- Be early or **contracyclical when deploying capital** or stay away.
- Operate and own only the **lowest cost assets**.
- Maintain a **fortress-like balance sheet**.

Such principles are not only foundational to the company's success but align well with important tenets of our investment philosophy and the way we deploy capital ourselves.

Consistent adherence to this capital allocation framework has put it in an enviable position among its peers. Its oil and gas portfolio is among the most profitable in the industry—on par with Exxon—and is poised for continued production growth. Additionally, its integrated liquefied natural gas (LNG) business is now the second largest globally, trailing only Shell. As the world searches for more stable, lower-carbon energy sources, LNG is becoming an increasingly important in the global energy mix.

TotalEnergies enjoys a position of strength with **best-in-class assets and a favorable growth profile ...**

At the same time, TotalEnergies is building a vertically integrated power business that will produce and distribute clean and reliable electricity. The company's strategy blends green but intermittent energy sources—such as solar and wind—with natural gas, which offers a more stable alternative to coal. To enhance grid reliability, it is also expanding its battery storage capacity. This pragmatic approach to adapting its business to the evolution of the world makes sense.

... as it advances in a vertically-integrated power business, combining renewables with natural gas for reliability and expanding battery storage to ensure stable, clean energy distribution, particularly for merchants.

An essential industry prematurely written off

Mentioning our investment in TotalEnergies (and Shell) is often, if not always, greeted with scepticism by people wondering why we would want to deploy capital in an industry some see as destined to die soon. The narrative of an oil industry in decline is persistently echoed in the media. However, facts and figures tell a different story. Oil demand may grow at a slower rate than in the past, but it is set to endure even as the world transitions to cleaner energy and efficiency gains—ensuring the industry will remain a pivotal force in global development for the foreseeable future.

Despite scepticism about the oil industry's future, demand endures, driven by global development and resilient entrenched energy sources.

Misunderstandings regarding energy transitions are nothing new. History shows we tend to underestimate the staying power of entrenched efficient energy sources as we embrace alternatives. Back in the 1970s, experts forecasted an imminent decline in coal consumption—yet consumption continued to grow and hit a record high in 2023. Similarly, today's forecasts often reflect wishful thinking,

Historical trends, like coal's persistence, highlight the challenges of rapidly replacing efficient systems, with oil's **role expected to remain significant for decades.**

notably that the shift to electric vehicles will significantly dent oil consumption over the next decade.

Powerful factors will make reductions in the coming decade hard though.

The sheer scale of global consumption makes it difficult to replace fossil fuels quickly. Fossil carbon use now exceeds 10 billion tons a year—five times the total annual harvest of staple grains and double the amount of water consumed by the planet's eight billion people.

Oil is **so efficient** it is now embedded in our production system and **day-to-day life.** Its high energy density and versatility make it incredibly efficient, **with every drop refined into diverse products meeting specific needs.**

The difficulty in replacing oil also resides in its incredible efficiency as an energy source. The amount of energy generated per kilogram of fuel (its energy density) is exceptionally high. Oil is also very versatile. Each drop of crude is refined into many end products from the lightest fuel to the heaviest, each serving a specific need.

One of the challenges for adopting solar and wind energy lies precisely in their much lower energy density—just 1/100th to 1/10th that of oil. This disparity presents significant physical constraints. The land, logistical, and environmental requirements to bridge this gap limit the scale and speed at which renewables can realistically replace oil in the developed world. Moreover, such a transition to lower-density energy sources is unprecedented in human history.

Solar and wind energy have much lower energy density than oil, **meaning they produce far less energy for the same amount of space**. This makes it **harder and slower to replace oil with renewables**, especially in developed countries. Plus this kind of energy shift has never happened before.

Hydrocarbons are deeply woven into our production systems and daily lives, and have become indispensable. They not only fuel ships and airplanes but serve as the foundation for essential non-energy applications such as lubricants, plastics, asphalt and chemicals. Oil derivatives are vital for industrial processes, supporting the production of fertilizers, manufacturing materials, and key chemicals that drive entire sectors of the global economy.

Even when buying a brand-new electric vehicle you remain very much an oil consumer. Without oil, the world would simply starve. It takes 80 mg of diesel fuel to make 1 kg of sourdough bread, 650 mg for a kg of tomatoes and anywhere between 200 mg to 1 kg of diesel to produce, process and distribute a kg of chicken.[1]

The Developing World Will Support Oil Demand

Also, while Europe and North America are working towards decarbonization, more than 85% of the world's population lives in developing regions, where energy demand is rising rapidly.

6 billion people aspire to a better material life, **which will underpin sustained demand for oil and gas.**

[1] *How The World Really Works, Vaclav Smil*

As billions of people strive for a better standard of living, their demand for energy—including oil and gas—will continue to increase. The average American consumes 150 gigajoules of energy per year while the average global citizen consumes only 35 GJ (China is at 50 GJ and growing fast). These numbers help understand that even aggressive decarbonization efforts in the West will struggle to offset this growing demand.

Favorable long-term supply and demand dynamics

Meanwhile, every year we consume 4% to 6% of global oil reserves, a gap that requires constant replenishment through development of new resources. That underscores the enduring importance of the oil and gas industry and of TotalEnergies' core business: the exploration, production, and distribution of these essential commodities.

Oil reserves need **constant replenishment**, sustaining the importance of TotalEnergies.

Mainstream views that dismiss the oil industry, combined with environmental policies discouraging investment in new capacity and self-imposed ESG restrictions, are depriving the sector of the capital needed to replenish reserves. This scarcity creates a favorable long-term supply/demand outlook for TotalEnergies' products.

Environmental policies and ESG **restrictions are limiting investment in the oil sector**, creating a supportive **supply/demand** picture for TotalEnergies.

It also forces oil companies to be more disciplined in their capital allocation—a notable change for an industry known for its obsession for production growth irrespective of the basic laws of economics, bankrolled by shareholders who did not pay much attention to the return on invested capital.

The industry has shifted towards a more **disciplined capital allocation**, a departure from its past focus on unchecked production growth.

Stick with best-in-class assets

At Emerald, we favour businesses with pricing power rooted in unique, hard-to-replicate products, processes, or technologies. In commodity sectors like oil and gas, successful investment relies on selectivity—favouring low-cost producers and robust balance sheets is crucial to sustaining profitability through market cycles. Our investment in TotalEnergies exemplifies this approach. It offers high-quality assets, operating costs around $5 per barrel, a total breakeven cost of $20-30, and a debt-free balance sheet.

At Emerald, when we consider commodity businesses, we are extremely selective and would only go for low-cost producers with **strong balance sheets**.

Beyond asset quality, we seek investments that are attractively priced to offer potential for both safety and an adequate return on investment. The current backdrop sidelined many investors, creating appealing valuations.

TotalEnergies stands out with high-quality assets, attractive pricing, and strong leadership.

A stock at bargain price, a high-quality assets portfolio and value accretive capital allocation articulated by a capable management represent a good alignment of stars, making TotalEnergies a

compelling investment. We believe that will lead to heavy excess capital redistribution to shareholders: in addition to the large dividend distribution (5% yield), TotalEnergies should be able to buy back a quarter of its outstanding shares within five years at current oil prices.

This unique combination promises significant returns, including a 5% dividend yield and potential for 25% share buybacks within five years.

Meanwhile, in addition to returning so much to its shareholders, TotalEnergies is investing $5 billion per year into its low-carbon electricity business—an initiative that aligns with global energy trends. While the return on invested capital in this segment remains unproven, we see it as an optionality that investors are not currently paying for.

In sum, we think such a combination of a high-quality assets, purchased at a discount, with strong leadership and a strategic vision for the future, provide us with a compelling long-term opportunity.

Sincerely yours,

Cedric Jacque, CFA

Senior Portfolio Manager

Disclaimer

This material is intended for information and marketing purposes only.

This document and the information within it do not in any form constitute Investment Advice or the basis for any Investment Decision. This document is an internal working document which has not been vetted for official purposes. It is provided to you for information purposes only. Emerald Wealth Partners AG assumes no liability whatsoever for the correctness, accuracy and completeness of the information. None of the material, nor its content, nor any copy of it, may be altered in any way, transmitted to, copied or distributed to any other party, without the prior express written permission of Emerald Wealth Partners.

Copyright © 2025 Emerald Wealth Partners AG. All rights reserved.