

Rating: Buy
S&P 500: 1131

ExxonMobil Corporation

Raise Present Value to \$50 a Share

<i>Symbol</i>	XOM	<i>Ebitda Next Twelve Months ending 9/30/05 (US\$m)</i>	56,500
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	10
<i>Price (\$/sh)</i>	48.82	<i>Natural Gas and Oil Production/Ebitda (%)</i>	69
<i>Pricing Date</i>	11/1/04	<i>Adjusted Reserves/Production NTM</i>	11.1
<i>Shares (mm)</i>	6508	<i>EV/Ebitda</i>	6.0
<i>Market Capitalization (\$mm)</i>	317,700	<i>PV/Ebitda</i>	6.2
<i>Debt (\$mm)</i>	23,800	<i>Undeveloped Reserves (%)</i>	38
<i>Enterprise Value (EV) (\$mm)</i>	341,600	<i>Natural Gas and Oil Ebitda (\$/boe)</i>	25.20
<i>Present Value (PV) (\$mm)</i>	349,200	<i>Present Value Proven Reserves(\$/boe)</i>	11.40
<i>Net Present Value (\$/share)</i>	50	<i>Present Value Proven Reserves(\$/mcf)</i>	1.90
<i>Debt/Present Value</i>	0.07	<i>Earnings Next Twelve Months (US\$/sh)</i>	4.53
<i>McDep Ratio - EV/PV</i>	0.98	<i>Price/Earnings Next Twelve Months</i>	11
<i>Dividend Yield (%/year)</i>	2.2	<i>Indicated Annual Dividend (US\$/sh)</i>	1.08

Note: Estimated cash flow and earnings tied to one-year futures prices for oil and natural gas.

Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.

Summary and Recommendation

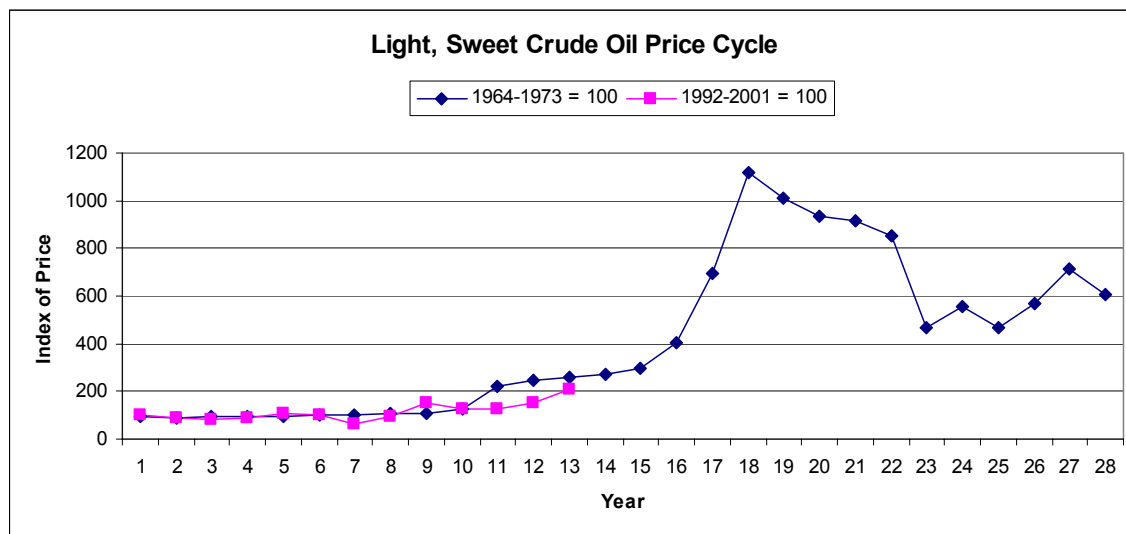
We continue a buy rating on the common shares of **ExxonMobil (XOM)** for low risk mega cap participation in a positive outlook for crude oil and refined products. We raise our present value to \$50 a share from \$43 on the basis of projected cash flow and a multiple in line with mega cap peers. In our opinion, the estimate can be justified by a constant real crude oil price of \$35 a barrel. Next twelve months futures of \$48 a barrel point to record earnings and cash flow well in excess of typical expectations. A continued favorable industry outlook and XOM's favorable long-term historical performance support our current buy rating up to a McDep Ratio of 1.2 that, in turn, relates to a stock price of \$61 a share.

Oil Price Move Possibly Just Starting

To offset any inclination to underestimate further potential for oil and gas price, we compare the relatively stable price period from 1992 to 2001 to the period from 1964 to 1973. Each was a ten year period that immediately preceded a sharply lower stock market in 2002 and in 1974. After quiescence, oil price started moving up in each case. We may be in the early stages of a new historic move (see chart [Light, Sweet Crude Oil Price Cycle](#)).

Frankly, few investors would give much weight to the likelihood of continued oil price strength. Contrast that with the growing chorus for a weaker dollar. It may just be that oil price is not high, but the real value of the dollar is low. That, too, is a parallel to historical experience.

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Let us imagine how the cycle might unfold. By the way we chose to draw the chart Year 13 corresponds to 1976 and 2004. Once the move got going in the previous cycle, the annual average oil price did not decline until Year 19 (1982). The annual peak of 1100, or 11 times the first ten year average, was too high to be sustained. It might be less disruptive economically if the peak ahead of us were lower and the decline shallower. The end point in Year 28 at 600 implies a tripling over the next 15 years. If higher oil price unfolded gradually it would give everyone time to adjust.

The World's Safest Energy Income Stock

Considering no one knows the future, how can an investor have any confidence in an oil stock now? Alternatively how can one be so confident that oil price will return to previous lower levels?

Doubters might hedge their uncertainty with XOM stock. Our analysis indicates that the company is in a strong position today to participate in the upside. Perhaps just as important to a doubter, XOM stock does not seem to go down as much in energy downturns.

How much financial risk is there in XOM? Debt is almost nil at the ratio of 0.07 to estimated present value. XOM will still be standing after higher debt stocks are unable to withstand unforeseen economic adversity.

The relative safety of XOM seems to be reflected in a relatively stable stock price. Yet when one adds all the advances over the years and subtracts the modest declines, the total return performance is favorable. No energy giant has a better long-long-term record.

Value XOM as Four Businesses

The internationally and functionally diversified industry leader has its value concentrated on oil production, perhaps to no surprise (see table Functional Cash Flow and Present Value). Of course that value is directly sensitive to oil price.

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Exxon Mobil Corporation
Functional Cash Flow and Present Value

	<i>NTM</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Present</i>
	<u><i>Ebitda</i></u>	<u><i>R/P</i></u>	<u><i>Ebitda</i></u>	<u><i>Value</i></u>
North American Natural Gas	5,500	11.6	6.3	34,700
Overseas Natural Gas	6,910	13.0	6.7	46,500
Oil	26,590	10.2	5.9	156,900
Downstream	17,540		6.1	107,000
	56,540	11.1	6.1	345,100
Debt				23,800
Net Present Value (\$mm)				325,400
Shares				6,508
Net Present Value (\$/sh)				50

The downstream refining/marketing and chemicals business is a natural hedge. When oil price is low and economic activity strong, the downstream business does well. When oil price is too high (not yet), and economic activity is weak the downstream might not do well. A plus for XOM's refining business is its capacity to process less desirable crude oil, the incremental world supply, and turn it into light products, the incremental world demand.

The two natural gas businesses have distinct characteristics. North American natural gas is the premium energy business where competition is limited and the quality of the product high. Aside from valuable conventional resources, XOM has differentiated incremental potential in both the Canadian Arctic through 70% owned Imperial Oil and in the gas resources of the Prudhoe Bay oil field in Alaska.

The overseas natural gas business is growing faster than oil and has contractual pricing that responds only slowly to change. Among XOM's projects is a venture that liquefies natural gas in Qatar and delivers it to consuming countries now in Asia, but ultimately in North America. Not welcome in Saudi Arabia, the U.S. military established its regional headquarters in Qatar.

Track Quarterly Cash Flow and Project It

Quarterly reports are interesting to us not for the bottom line earnings number, but for the operating and cost details that give us a basis for anticipating future performance (see table Next Twelve Months Operating and Financial Estimates). Exxon's trend is solid with steady volume and price that fully responds to industry conditions except for overseas natural gas. If that continues and current futures prices hold, quarterly cash flow already at a record \$12 billion may jump to near \$15 billion. That could pay a lot of dividends and repurchase a lot of stock.

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Exxon Mobil Corporation
Next Twelve Months Operating and Financial Estimates

	<i>Q1</i>	<i>Q2</i>	<i>Q3</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Next Twelve Months</i>
	<i>3/31/04</i>	<i>6/30/04</i>	<i>9/30/04</i>	<i>12/31/04</i>	<i>2004E</i>	<i>3/31/05</i>	<i>6/30/05</i>	<i>9/30/05</i>	<i>9/30/05</i>
Volume									
Natural Gas (mmcf)									
U.S. (or North America)	3,060	2,961	2,831	3,032	2,971	3,060	2,961	2,831	2,971
Overseas (or Int'l)	8,407	6,040	5,597	7,836	6,965	8,358	6,129	5,572	6,968
Total	11,467	9,001	8,428	10,868	9,935	11,418	9,090	8,403	9,939
Oil (mmb)	237	235	237	237	947	232	235	237	942
Oil (mbd)	2,635	2,581	2,581	2,581	2,594	2,581	2,581	2,581	2,581
Total gas & oil (mmb)	409	371	367	404	1,551	404	373	366	1,547
Price									
Natural gas (\$/mcf)									
Henry Hub (\$/mmbtu)	5.64	6.10	5.49	7.49	6.18	8.62	7.16	7.20	7.62
U.S. (or North America)	5.51	5.96	5.70	7.77	6.25	8.95	7.44	7.48	7.92
Overseas (or Int'l)	4.43	4.03	4.24	4.24	4.25	4.24	4.24	4.24	4.24
Total	4.72	4.66	4.73	5.22	4.85	5.50	5.28	5.33	5.34
Oil (\$/bbl)									
WTI Cushing	35.23	38.34	43.89	51.67	42.28	49.68	48.36	46.96	49.17
Worldwide	30.65	33.71	39.34	46.31	37.51	44.53	43.34	42.09	44.06
Total gas & oil (\$/bbl)	29.66	31.61	35.48	40.14	34.23	39.64	39.03	38.53	39.36
NY Harbor 3-2-1 (\$/bbl)	6.98	12.73	7.83	5.70	8.31	6.57	8.70	8.70	7.42
Revenue (\$mm)									
Natural Gas									
U.S. (or North America)	1,517	1,606	1,485	2,167	6,775	2,465	2,004	1,947	8,583
Overseas (or Int'l)	3,352	2,215	2,183	3,057	10,807	3,189	2,365	2,173	10,784
Total	4,869	3,821	3,668	5,224	17,582	5,654	4,368	4,121	19,367
Oil	7,268	7,917	9,341	10,995	35,521	10,343	10,180	9,994	41,512
Other	55,465	58,955	63,366	63,366	241,152	63,366	63,366	63,366	253,464
Total	67,602	70,693	76,375	79,585	294,255	79,363	77,914	77,480	314,342
Expense									
Production	4,240	4,077	5,030	5,672	19,020	5,627	5,338	5,251	21,888
Other	52,362	55,142	58,932	59,535	225,971	59,243	58,575	58,575	235,927
Ebitda (\$mm)									
Exploration and Production	7,896	7,660	7,979	10,547	34,083	10,369	9,210	8,863	38,990
Other	3,103	3,813	4,434	3,831	15,181	4,123	4,791	4,791	17,537
Total Ebitda	11,000	11,474	12,413	14,379	49,265	14,493	14,001	13,654	56,527
Exploration	174	210	401	401	1,186	401	401	401	1,604
Deprec., Deplet., & Amort.	2,373	2,350	2,350	2,350	9,423	2,350	2,350	2,350	9,400
Ebit	8,453	8,914	9,662	11,628	38,656	11,742	11,250	10,903	45,523
Interest	48	50	50	50	198	50	50	50	200
Ebt	8,405	8,864	9,612	11,578	38,458	11,692	11,200	10,853	45,323
Income Tax	2,942	3,102	3,364	4,052	13,460	4,092	3,920	3,799	15,863
Net Income (\$mm)									
Exploration and Production	4,013	3,846	3,929						
Other	1,568	2,114	2,410						
Unallocated	(118)	(199)	(91)						
Total	5,463	5,761	6,248	7,525	24,998	7,600	7,280	7,055	29,460
Shares (millions)									
Total	6,582	6,547	6,508	6,508	6,533	6,508	6,508	6,508	6,508
Per share (\$)	0.83	0.88	0.96	1.16	3.83	1.17	1.12	1.08	4.53
Ebitda Margin (E&P)	65%	65%	61%	65%	64%	65%	63%	63%	64%
Tax Rate	35%	35%	35%	35%	35%	35%	35%	35%	35%

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Additional Ideas for a Low Risk Stock

Although our first job in the oil industry was with Exxon, throughout our analyst career we have had subdued interest in the company's apparent premium valuation much of the time. We attributed that partly to a refusal by well-rewarded long-time holders to sell only to pay taxes and be faced with finding an alternative investment. In fact the stock has done well while seemingly exhibiting low volatility or risk. Thus, while XOM may not appear to be our most undervalued recommendation its risk characteristics suggest special potential uses.

One idea is to use XOM stock in the place of cash reserves. There might still be some surprise fluctuation, but it may not be much. The dividend return beats money market rates. The long term return should beat inflation and Treasury Inflation Protected Securities. The stock is easy to buy and sell at low transaction costs.

Another idea is to use XOM stock as an income fund. Instead of taking high risk for the promised income of some highly leveraged energy partnerships, put the same amount of money in XOM stock. Then when it is time to make a withdrawal, sell a few shares of stock. There is even some theoretical justification for that as XOM has been a long-term leader in repurchasing its own shares as an indirect way to distribute value to holders. The income fund holder would be turning an indirect distribution into a more direct distribution.

Kurt H. Wulff, CFA

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