

A valuation of Exxon Mobil: November 2013

Exxon Mobil is not the most interesting company in the world to value, given its status as the largest oil company in the world. The company's operating style is set in stone (little debt, conservative management) and its operating income is closely tied to oil prices. So, why did I value Exxon Mobil? The answer is simple: because Berkshire Hathaway took a \$3.7 billion stake in the company. I don't know whether Warren Buffett is still calling the shots at Berkshire but the assumption still seems to be that if Berkshire makes a call, he is behind it.

Unlike some, I don't believe that Mr. Buffett is infallible but his track record suggests that when he pays attention to a stock, it is worth taking a look at the company. So, start with the company's most recent 10-K (from 2012) and a summary sheet from Bloomberg that provides key numbers for the company going back 30 years.

I started with a discounted cash flow model, using a stable growth model, with normalized values for operating income and tax rates. To get the normalized value, I used the average from 2003 to 2013, generating an operating income of \$45.649 billion for the company, a tax rate of 40.52% and a return on capital of 15.64%. The resulting value is disappointing, with an intrinsic value of \$310 billion for the equity, well below the market capitalization of \$417 billion. There is one big "unknown" in this valuation that may be affecting my estimate: Exxon Mobil has a bunch of cross holdings that it has valued on the balance sheet at about \$18 billion, that may in fact be worth far more, but some of the effect is offset by the minority interest that Exxon Mobil is valuing at just over \$5 billion, which is also probably worth far more.

I considered adding an option pricing premium, since Exxon does have undeveloped reserves of both crude oil and natural gas, but those reserves are just 30% of all proven reserves and are unlikely to provide a large addition to value.

Finally, I looked at Exxon, relative to other oil companies. On almost every multiple, Exxon trades at a premium over the median values for the sector, though it does have above-average returns on equity/capital and expected growth in earnings per share. In fact, the only relative valuation variant that makes Exxon look attractive is a regression of PE versus growth, which yields a predicted PE for Exxon that is about much higher than the actual PE (by about 30%).

There are only two possible explanations that I can come up with for Berkshire's giant bet on Exxon. One is that it is a bet that oil prices will go up, in which case investing in Exxon seems to be an awfully convoluted way to make that bet real. The other is that Berkshire is going along with the analyst estimates of expected growth in earnings per share for Exxon, which are optimistic.