Congressional
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Memorandum

February 28, 2007

TO: Honorable Ron Wyden
Attention: Brendan Doyle

FROM: Robert Pirog
Specialist in Energy Economics and Policy
Resources, Science, and Industry Division

SUBJECT: Oil Company Financial Data, 2006

This memorandum is written in response to your request for 2006 financial data for selected oil companies. The companies for which you requested data are ExxonMobil, BP, Shell, Valero, Chevron, ConocoPhillips, Sunoco, and Total SA[1]. This memorandum updates the financial data found in my July 5, 2006 memorandum to you.

Profit Rates

The rate of profit for a firm can be calculated in different ways. Profit as a proportion of revenue suggests how well the firm controls costs and transforms sales, and other revenues, into returns. Profit as a proportion of shareholders equity shows how effectively the firm uses its invested capital in generating returns.

Table 1 shows the average return on revenue and the average return on equity for the eight selected oil companies. The profit rates in **Table 1** are simple, not weighted, averages of the eight companies rates of return. The companies differ in size. ExxonMobil is the largest company; its net income and revenues are 55% and 38% larger, in 2006, respectively, than those of the next largest firm, Shell. The smallest firm, Sunoco, had 2006 net income and revenue less than 3% of those of ExxonMobil.

Returns in 2006 were sufficient to raise the average return on revenue from 5.24% through 2005 to 5.71%, and the average return on equity from 18.32% through 2005 to 19.2%. In 2006, returns on revenue exceeded those attained in any year since 1999, while returns on equity were down from the peak values attained in 2005.

[1] Total SA reports its financial data in euros. For this memorandum, the euro/dollar exchange rate of 1.3185 dollars per euro, observed on February 27, 2007 was used.

Table 1. Average Rates of Return for Selected Oil Companies
(percentages)

Year	% Return on Revenue	% Return on Equity
1999	2.88	4.64
2000	5.79	24.85
2001	5.36	16.67
2002	3.89	8.11
2003	5.23	18.47
2004	6.45	26.18
2005	7.10	29.38
2006	9.00	25.40

Source: Security and Exchange Commission Forms 10-K and 20-F, and company financial reports.

For comparison, the American Petroleum Institute reports that the percent return on revenue for the entire U.S. manufacturing sector in 2005 was 7.4%, while the oil and natural gas industry as a whole earned 8.5%.[2] The United States Census Bureau reports that the return on equity for all manufacturing companies was 18.1% through the first two quarters of 2006, and was 16.4% in 2005.[3] Because the industry bases used in calculating these averages are broader than the selected companies used in **Table 1**, the rates of return are not directly comparable.

Cash Reserves

The increase in the price of crude oil that began in the second half of 2003 led to rapid increases in oil company revenues. Investments in increased exploration, refining, and distribution systems may take years to plan and carry out. Mergers, stock buyback programs, and, to a lessor extent, increased dividend payments, may also require planning and development time. In the time between the increase in revenues and expenditure on these and other programs, cash balances may increase.

Table 2 shows the aggregate cash reserve position of the selected oil companies. The growth in the cash reserves of the selected companies slowed to 7.1% in 2006 as the persistent increases in the price of crude oil abated. The growth in cash reserves was 39.9% in 2005, 66.8% in 2004, and 18.4% in 2003.

The cash reserves of the selected oil companies are not equally held. ExxonMobil, with $32.8 billion in cash reserves at the end of 2006 accounted for over 50% of the total. The

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[2] American Petroleum Institute, *Putting Earnings in Perspective,* 2006, p.2.

[3] U.S. Bureau of the Census, *Quarterly Financial Report for Manufacturing, Mining, and Trade Companies 2006, Quarter One,* June 2006, Table D, p.xviii.

cash reserves of the three largest companies, ExxonMobil, Shell, and BP accounted for 71% of the total cash reserves.

Table 2. Cash Reserves of Selected Oil Companies
(millions of dollars)

Year	Cash Reserves
1999	9,495
2000	27,185
2001	23,875
2002	20,908
2003	24,764
2004	41,323
2005	57,828
2006	61,970

Source: Security and Exchange Commission Forms 10-K and 20-F, Company Financial Reports.
Note: Shell, Valero and ConocoPhillips data could not be obtained for 1999. Shell data could not be obtained for 2000.

Exploration and Capital Investment

Exploration and development expenditures can lead to increased reserves and production for the companies. Capital investments can lead to an increased ability to refine, transport, or distribute crude oil and petroleum products. However, exploration expenditures may also lead to dry holes, or reserve finds that replace reserves used during the year. Capital investments may be directed to compliance with environmental regulations on products and sites and not increased capacity, as well as replacing depreciated capital assets, again not increasing capacity.

Table 3 shows aggregate exploration and capital investment expenditures through 2006. In most cases, the selected companies have not released 2006 financial statements, or filed 2006 Securities and Exchange Commission reports with detail sufficient to separate exploration expenditures from capital investments.

The 2006 combined capital investment and exploration level represents an increase of 36% compared to 2005. Growth in capital investment and exploration was 16% in 2005, and 3% in 2004. This increased growth in expenditures could indicate that projects that have been in the planning stage have moved to implementation; the companies' long term, expected, price of crude oil has risen, qualifying more projects for investment; environmental regulations have changed; international partnerships have become more available; or a combination of these and other factors.

Higher oil and petroleum product prices make both upstream and downstream investments more attractive, while high net incomes and cash reserves make their financing easier. These investments can increase supply in the longer term, serving to reduce the price of crude oil and petroleum products.

Table 3. Exploration and Capital Investment Expenditures of Selected Oil Companies
(millions of dollars)

Year	Exploration Expense	Capital Investment
1999	>1,794	>32,835
2000	3,114	36,417
2001	3,843	52,798
2002	4,231	55,577
2003	5,018	56,558
2004	5,318	58,304
2005	4,704	68,884
2006	N/A	100,396

Source: Security and Exchange Commission Forms 10-K and 20-F, Company Financial Reports.
Notes: The Capital Investment entry for 2006 represents capital investments including exploration expenditures. Shell and ConocoPhillips exploration data was not available for 1999. ConocoPhillips capital investment data was not available for 1999.

Other Uses of Financial Resources

Other uses of financial resources include debt reduction, increased dividend payments, share buy-back programs, and increased compensation for company employees.

Debt reduction changes the financial structure of the company, lowering key debt ratios, suggesting that the company is a better credit risk. A reduction in credit risk may qualify the firm to borrow at lower interest rates in the future, should the company need to use the credit markets in the future.

Increased dividend payments represent a payout to the owners of the firm, increasing their over-all rate of return. Increased dividends may be deemed extraordinary, or merely an increase in normal payments.

Share buy-back programs may increase share values because while the asset side of the balance sheet remains intact (except for the cash used in the buy-back) it is divided over fewer shares. Investors may interpret this as an indication of the companies' financial health and bid up share values. From the companies' perspectives, the retired shares can be held as treasury shares and be re-issued should the company need access to capital from equity markets, without undertaking Securities and Exchange Commission registration and authorization procedures.

Increased compensation, to include higher salaries, bonuses, stock option plans, increased benefits, and enhanced retirement packages reward existing employees and can attract new applicants for available positions, potentially enhancing the quality of the companies workforce.

Conclusion

While favorable financial conditions for the selected oil companies continued through 2006, oil industry firms operate in a volatile short-run market where decisions have long-run implications. The market is affected by political trends and events. The upstream portion of the market continues to be largely under the control of national oil companies, and indirectly, the governments of the producing countries, increasing potential volatility.

Private oil companies have the primary responsibility of making decisions that are in the best interests of their shareholders and other investors. However, because their products are important to the functioning of national economies, their decisions are also of interest to the public. The companies face the task of balancing this dual responsibility.