

Business report: royal dutch shell vs exxonmobil



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There is a growing tendency for world's demands for reliable, affordable energy supplies in the next following decades (see chart 1. 1), oil and natural gas will remain the world's essential energy sources, meeting nearly 60% of world's needs (ExxonMobil, 2008). Therefore, it is worth focusing on the investment in petroleum industries which are expected to have potential profitability in the long run.

Chart 1. 1

- Source: ExxonMobil Annual Report, 2008

1. 2 Primary comparison between Royal Dutch Shell and ExxonMobil

In the annual rankings of GLOBAL 500 provided by Fortune magazine, Royal Dutch Shell and ExxonMobil ranked the first and second place respectively in the year 2009 (see table 1). Both of them are worldwide group of energy and petrochemical companies, engaging in the exploration and production of oil and natural gas, manufacture of petroleum products and transportation. In the next following years, they all plan to emphasize on the exploration of emerging energy sources and technologies to cater for sustainable development.

Rankings in GLOBAL 500

Company

Year

Rank

Revenues

(\$millions)

Profits

(\$ millions)

Royal Dutch Shell

2009

1

458, 361

26, 277

â€€

2008

3

355, 782

31, 331

ExxonMobil

2009

2

442, 851

45, 220

2008

2

372, 824

40, 610

Table 1. 1

Source: <http://money.cnn.com/magazines/fortune/fortune500/2009/>

As can be discerned from table 1. 2, Shell and ExxonMobil have similarities in terms of revenues, assets structure and staff size. According to companies' annual reports, ExxonMobil is the world's largest publicly traded international oil and gas company, while Shell is the largest oil producers in Europe. Their businesses are active all over the world.

Companies

Countries

Revenues

(\$millions)

Assets

(\$millions)

Equity

(\$millions)

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Employee

Accounting standards

Shell

Netherlands

458, 361

282, 401

127, 285

102, 000

IFRS

ExxonMobil

U. S.

442, 851

228, 052

112, 965

104, 700

US GAAP Table 1. 2

- Sources: Royal Dutch Shell Annual Report, 2008,

ExxonMobil Annual Report, 2008

2. Comparison and analysis of companies' performance

This report will compare and analyze the financial strengths and weaknesses between Shell and ExxonMobil in terms of profitability, efficiency, liquidity and investment over the period from 2004 to 2008. All data adopted is from Thomson DataStream and companies' annual reports, presented in U. S. dollars.

2. 1 Profitability

Chart 2. 1 Chart 2. 2

Chart 2. 3

Chart 2. 1 shows that ROE ratio in ExxonMobil was higher than Shell's over the whole period, which indicates ExxonMobil generated more profit than Shell per dollar invested by shareholders. The difference of ROE between two companies have expanded since 2007, with ExxonMobil's ratio increasing to 39% and Shell's ratio decreasing to 21% in 2008, largely because of the significant drop of Shell's net income, which declined from \$ 31, 331, 100 in 2007 to \$ 26, 277, 040 in 2008.

The tendency in ROCE (chart 2. 2) is very similar to ROE, indicating that ExxonMobil was more efficient and profitable in companies' capital investment, which, to a certain extent, resulted from dramatic increase in upstream earnings of ExxonMobil in 2008, rising by 36%. Furthermore, it can be seen for chart 2. 3 that the ROCE ratio in Shell and ExxonMobil was far higher than gearing ratio during this period, implying that both of these

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companies invested effectively and the increase in borrowing didn't reduce shareholders' earnings. However, it is worth paying attention that gearing ratio in Shell was slightly higher than the corresponding figures in ExxonMobil, indicating Shell was more vulnerable to the recession due to the higher rate of debt it has to pay back.

Chat 2. 4 Charts 2. 5

As for the gross profit margin (see chart 2. 4), there was a slightly decrease tendency in ExxonMobil as well as Shell. However, according to chart 2. 5, during these five years, revenues in ExxonMobil and Shell actually climbed from \$ 263, 989, 000 to \$ 425, 070, 800 and \$265, 188, 600 to \$458, 361, 600, respectively. Therefore, the drop of gross profit margin may be largely attributable to the increase of cost of goods sold. Additionally, as noted by FORTURN magazine (2009), the significant reduction of international oil price, ranging from more than \$146 a barrel to around \$45 a barrel, has also exerted a huge influence on the fall of companies' oil price, ultimately resulting in the decrease of gross profit margin.

Overall, compared to Shell, ExxonMobil is more profitable due to the higher ratio of ROE, ROCE and gross profit margin.

2. 2 Efficiency

Chart 2. 6 Chart 2. 7

Consistent with the figures in Chart 2. 6, inventories days on hand in Shell was far more than the corresponding figures in ExxonMobil, which went up to 35 days in 2007, followed by a sudden decrease in 2008 with 24 days

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recorded. This swift was attributable to the sharp reduction of total inventories in Shell, which decreased from \$31, 502, 910 in 2007 to \$ 19, 342, 030 in 2008, indicating Shell improved its inventory management in 2008. On the other hand, it takes fewer days for ExxonMobil to sell its products, the figures remained relatively stable at around 15 days, which means ExxonMobil operated more efficiently than Shell during this period.

In the case of receivable days on hand (see chart 2. 7), apparently, it takes fewer days (approximately 30 days) for ExxonMobil's clients to pay. The corresponding figures in Shell almost doubled during the whole period. It is worth paying attention that, the increase rate of revenues in Shell (78. 4 %) is higher than ExxonMobil (70. 6%) (see chart 2. 5), which, to a large extent, is due to Shell's comparatively loose credit policy.

2. 3 Liquidity

Chart 2. 8 Chart 2. 9

According to Chart 2. 8, both ExxonMobil's and Shell's current ratios are higher than one, which means current liabilities could be repaid by current assets. However, as can be seen from chart 2. 9, quick ratio in ExxonMobil maintained the level at 1. 2, Shell, on the other hand, leveled out at around 0. 85 during the same period, this tendency predicts that ExxonMobil has a stronger liquidity than Shell.

2. 4 Investment

Chart 2. 10 Chart 2. 11

Chart 2. 12

Chart 2. 10 shows that there was a dramatic fluctuation in Shell's dividend yield ratio, which fell to 3% in 2005, followed by a boom in the next 3 years, going up to 9.74% in 2008. This tendency, to a certain extent, was caused by the increase in dividend per share (see chart 2. 11) and decrease in market price per share (see chart 2. 12). As noted by Shell annual report (2008), dividend per share in 2008 increased by 11% compared to 2007, however, the market price declined by approximately 38% at the same time, which was partly attributable to the reduction of earnings caused by the effect of lower international oil price and higher operating costs. ExxonMobil, on the other hand, experienced a relatively lower dividend yield ratio, which remained steady at around 2%. Consistent with chart 2. 11 and chart 2. 12, compared to Shell, ExxonMobil represented a lower but more stable level of dividends and higher level of market price, which could explain the lower dividend yield ratio showed in chart 2. 10

In summary, investors may obtain higher payback rate by investing in Shell, however, its unstable dividend policy should not be neglected. Although ExxonMobil showed a lower level of dividend yield, it is worth noticing that, according to ExxonMobil annual report (2008), it plans to invest more than \$125 billion over the next five years for future development. Therefore, investors willing to accept the low dividend yield ratio of ExxonMobil today may expect a higher level of payback in long term.

Chart 2. 13 Chart 2. 14

As can be seen from chart 2. 13, there was a considerable upward trend of EPS in ExxonMobil, which climbed from \$ 4 in 2004 to \$ 8. 8 in 2008. EPS in Shell, on the other hand, rose significantly from \$ 2. 3 in 2005 to \$ 7. 5 in 2007, then drop slightly to \$ 6. 8 (figures in 2004 has been ignored since Shell adopted IFRS from 2005). Therefore, compared to Shell, ExxonMobil generated more profits per share during this period, indicating ExxonMobil is better at using its capital to generate income. However, the possibility of earnings manipulations should be taken into consideration before making decisions.

Chart 2. 14 represents that ExxonMobil's PE ratio was approximately 5 more than Shell's since 2006, which indicates ExxonMobil has a stronger growth potential than Shell from market's view. Nevertheless, there was a gradually decrease tendency in both of the companies from 2007, which, to a certain extent, may be caused by international financial crisis and the international oil price changes.

To conclude, in terms of investment potential, although Shell represents a higher level of dividend yield ratio which indicates higher rates of payback to investors, it seems that ExxonMobil has a stronger growth potential because of the comparatively steady dividend policy, higher EPS ratio and higher PE ratio.

3. Review of the market perception

Chart 3. 1 Shell Chart 3. 2 ExxonMobil

Source: Thomson DataStream

Chart 3. 1 and Chart 3. 2 shows the tendency of stock price of Shell and ExxonMobil over the period from 2004 to 2008, apparently, both of these companies' stock prices outperformed the benchmark with \$48 recorded by Shell and \$78 recorded by ExxonMobil at the end of 2008. However, opinions about the stock performance of these two companies differ among analysis community (See Table 3. 1).

Bulls Say

Bears Say

Royal Dutch Shell

Shell has healthy financial statement and plentiful cash flows;

Shell has the largest retail distribution network which is critical in oil industry;

Shell's size and cost structure contribute to expanding business worldwide.

Multiple reserve restatements reflect weakness in upstream business and cause risks;

Shell is face with national political risks duo to the business expansion.

ExxonMobil

Exxon has excellent capital allocation and operational performance;

Production diversity and business globalisation protect against regional recession.

Exxon has advantage in exploiting new resources by combining XTO's expertise.

Countries' growing sense of resources protection impede Exxon's production increase;

Exxon's superiority in evaluating investment opportunities could slow growth since less attractive contracts may not be signed.

Table 4. 1

-Source: <http://www.morningstar.com/>

4. Significant changes to the companies and their environment

Year

Royal Dutch Shell

ExxonMobil

2004

—

—

2005

Adopted IFRS;

Became the single parent company of " Royal Dutch" and " Shell".

ARC Resources Ltd acquires ExxonMobil Canada-Oil & Gas.

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2006

—

Start-up upstream projects in West Africa, Azerbaijan, Norway and Canada.

2007

Acquisition of the Shell Canada.

Start-up 7 major upstream projects.

2008

Acquisition of Duvernay Oil Corp.

Galp Energia SGPS SA acquires ExxonMobil Portugal Holdings.

Table 4. 1

-Sources: Royal Dutch Shell annual report (2004-2008)

ExxonMobil annual report (2004-2008)

Table 4. 1 represents the main changes of Shell and ExxonMobil during the period from 2004 to 2008, which tend to exert significant influences on companies' performance, such as profitability, efficiency, liquidity, investment potential as well as stock prices.

Moreover, external factors, such as changes of international crude oil price, war and regional conflicts, unexpected technological development and worldwide economic conditions will also affect companies' performance. The main changes occurred in recent years that may affect earnings and cost of

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Shell and ExxonMobil are as follows (Royal Dutch Shell, 2008 and ExxonMobil, 2008):

Chinese government at Davos announced a target growth rate of 8%, indicating further demands for energy, which may result in an increase of oil and gas prices;

The international financial crisis happened in 2008 has a negative influence on oil companies;

The war in Afghan and the tension situation in Middle East cause the oil price to go up;

Growing demands for fuel-efficient cars pummel petroleum industry.

Global requirement for controlling greenhouse effects forces oil companies to exploit new technology, resulting in huge research and development expenditures.

5. Impact caused by the difference between IFRS and U. S. GAAP

It is worth paying attention to the fact that Shell's financial statements are prepared in accordance with International Financial Reporting Standards (IFRS), while the financial statements of ExxonMobil are in conformity with U. S. Generally Accepted Accounting Principles (GAAP). Therefore, a rational assessment of the two companies needs a proper evaluation of the impact caused by the differences between IFRS and U. S. GAAP.

Firstly, the difference of balance sheet structures between Shell and ExxonMobil may cause inconvenience in analysis. Full flexibility of balance sheet formats is allowed under IFRS, however, which is not allowed by U. S GAAP (Nobes and Parker, 2008, p 185). Therefore, it is difficult for statement users to gain direct information from companies' balance sheet adopted different accounting standards.

More importantly, different options in IFRS and U. S. GAAP may largely affect the results of financial analysis. For example, in terms of inventory valuation, ExxonMobil adopts LIFO to calculate costs, while Shell uses FIFO (ExxonMobil, 2008 and Shell, 2008). Since LIFO will comparatively overestimate costs and underestimate earnings, especially in inflationary period, investors should consider the influence caused by different measures of inventory valuation when they compare profits of Shell and ExxonMobil.

Finally, both Shell and ExxonMobil use fair value to record derivatives (Shell, 2008 and ExxonMobil, 2008), however, the criteria to judge fair value may vary from country to country (Alexander and Jermakowicz, 2006), which tends to reduce the comparability of accounting information of Shell and ExxonMobil.

Part B: Critically evaluate the pressures for convergence between U. S GAAP and IFRS and the extent to which such an exercise will be successful.

1. Introduction

In July 2007, the SEC ruled that it will “ accept from foreign private issuers in their filings with the Commission, financial statements prepared in

accordance with IFRS as issued by the International Accounting Standards Board without reconciliation to GAAP as used in the United States” (SEC Concept Release No. 33-8879, 2007). According to Alexander and Jermakowicz, (2006), the convergence between U. S. GAAP and IFRS is expected to move more towards principle-based standards. However, whether the convergence between those two systems could be successful is controversial. This essay will attempt to discuss the main pressures for convergence, analyze current difficulties during this process and tentatively predict the possibility of success of convergence between U. S. GAAP and IFRS.

2. Pressures for convergence

2. 1 Pressures from improving accounting information quality

One of the main pressures for the convergence between U. S. GAAP and IFRS is the global demand for improving comparability and reliability of accounting information. According to Bradshaw and Miller (2007), the standardization between U. S. GAAP and IFRS will result in an increase of comparability of accounting information among countries with various economic and political circumstances. International accounting systems can be used to test the economic outcomes of financial reporting in different countries, potentially causing a decrease of information asymmetry (Soderstrom et al., 2007). Moreover, the harmonization of two systems tends to achieve higher accounting information quality due to more value relevance of earnings and timely loss recognition (Barth et al., 2006). As noted by Liang et al. (2003), the convergence of U. S. GAAP and IFRS can

serve as an accelerator for the process of standardization of interpretations of TFV in different countries, which is considered as a leading indicator of the promotion of reliability of accounting information.

2. 2 Pressures from international companies and individual investors

With the rapid development of economic globalisation, there is a growing need from international companies and individual investors to build a harmonious accounting system achieved by convergence between U. S. GAAP and IFRS. Significant differences between U. S GAAP and IFRS, such as measurement of the negative goodwill' increase, LIFO method, capitalization of development costs and etc., tend to discourage international companies to entry U. S market (Nobes and Parker, 2008, P185), partly because companies with healthy financial statement may turn out to be reported a huge loss under U. S. GAAP, and the case of Daimler Benz AG which planed to list on NYSE in 1993 could properly exemplify this point (Carmona and Trombetta, 2008, p. 455). Therefore, it is necessary to reduce the discrepancy between U. S GAAP and IFRS to improve capital markets efficiency (Bhimani, 2008). Quoting SEC concept release, Bhimani (2008) claims that there will be more chances for investors to obtain investment opportunities outside the U. S. by the assistant of harmonious accounting standards.

3. Difficulties for convergence

3. 1 Difficulties from regulators, accountants and commentators

The convergence between US GAAP and IFRS “ could lead to the most significant change to US accounting and public company reporting since the genesis of the accounting profession in the United States in the late 19th century”(Williams and Carcello, 2007), therefore, the process of the convergence is unlikely to be smooth. Cangemi (2008) argues that the convergence will take huge expenditures for institutional adjustments and training for accountants. Additionally, a sizable number of scholars keep suspicion on the vital role played by IFRS in business globalisation (Bhimani, 2008), and several US regulators and commentators insist on the superiority of U. S. GAAP over IFRS, therefore, they have little incentive to support convergence between these two systems (Schwartz, 2001).

3. 2 Difficulties from diversity

The differences between business, accounting and regulatory cultures among different countries have been considered as influential factors that may hinder the development of convergence. “ Business transactions are often designed differently in different countries” (Zeff, 2006). For example, in terms of determination of consolidation, US GAAP requires majority-voting interest criterion while IFRS method is based on control which needs professional judgment (Alexander and Jermakowicz, 2006). Moreover, it is not infrequent to see that firms in the USA, such as United Airlines and US Airways, tend to raise financing via long-term leases on tax purposes, according to data provided by Reuters Research, a large proportion of US companies in S&P 500 have been found that off-balance obligations are far more than debts reported in financial statement (Weil, 2004). In addition, the study provided by Ernst & Young shows that many European companies tend

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to report smoother yearly income by using ‘ alternative earnings per share’, which is called ‘ pro-forma earnings’ in the USA, this novel measures of profitability may dilute the convergence between US GAAP and IFRS (Zeff, 2006).

4. Possibility for the success of convergence

Although the difficulties of convergence between US GAAP and IFRS cannot be neglected, the truth remains that the inner flexibility of principles-based standards tends to guarantee the further development of convergence, regardless of various accounting and institutional circumstances (Carmona and Trombetta, 2008). It seems that the exercise of convergence have gained tremendous supports for companies, according to PwC, nearly 66 % companies in Fortune 1000 support full convergence between those two systems (Bhimani, 2008). Furthermore, the continuing endeavor by the SEC to reduce the disparity between the accounting and disclosure practices of US GAAP and IFRS will strongly support the future development of convergence (Alexander and Jermakowicz, 2006).

5. Conclusion

In conclusion, pressures from requirements of improving the quality of accounting information, cross-listing firms and individual investors drive the convergence between U. S. GAAP and IFRS. In spite of the fact that difficulties from the regulators, accountants, commentators and various conditions in different countries may impede the development of convergence, the flexibility of principles-based standards and the supports from the SEC can properly guarantee the further convergence between U. S. <https://assignbuster.com/business-report-royal-dutch-shell-vs-exxonmobil/>

GAAP and IFRS. However, there is still a long way to go to achieve genuine convergence, and problems such as how to resolve consolidation policy and the measurement of fair value during the process need further negotiations and studies by regulators and scholars.