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| Financial Statement Analysis: Chevron Corporation | November 15  2012 | |
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**Company Overview and Business Outlook**

Chevron is one of the world’s largest petroleum companies having exposure in almost every facet of Petroleum Industry. It is a multi-national corporation with operations widely dispersed geographically. Chevron business primarily comprise of Upstream and Downstream operation activities.

*Upstream Operations:* The Upstream operations consists of exploring, developing, and producing crude oil and natural gas and contributed 92.15% towards the net income of the Company in year 2011.The major production areas include Angola, Australia, Azerbaijan, Bangladesh, Brazil, Canada, China, Denmark, Indonesia, Kazakhstan, Nigeria, the Partitioned Zone between Kuwait and Saudi Arabia, the Philippines, South America, Thailand, the United Kingdom, the United States, Venezuela, and Vietnam**.**

*Downstream Operations:* Downstream part of the business includes refining, transporting, marketing and providing fuel to the consumers for transportation and also the manufacturing and selling of petrochemicals. Most significant downstream areas of operations are the west coast of North America, the U.S. Gulf Coast, Southeast Asia, South Korea, Australia and South Africa. Apart from these main activities, Chevron manufactures, produces and sells petrochemical products and geothermal energy. The company also devotes a significant portion of its research into development of alternative energy options, most specifically bio-fuels.

Chevron competes with other leading global as well as domestic energy companies because of intense competition in every sector of petroleum and petrochemical industry. The major area of competition includes acquisition of exploration and production rights, equipment, human resources, labor and other related goods and services. Significant factors that affect the performance of the company, as any other company in this industry, is the fluctuation in the prices of crude oil. It can affect both upstream and downstream part of the business. Though, Chevron does not face cyclical fluctuations in sales but is subject to other factors such as economic, political and regulatory environment in the various countries in which it operates. Also civil unrest, violence, severe weather conditions and government intervention can all affect company performance and hence revenue and profits.

*Expectation of growth*: The Company has major projects to be completed in upcoming years and many more in pipeline. With an expected capital expenditure of USD 32.7 billion including 87% of the budget on upstream activities in year 2012 and primary focus on increasing return on investment and stockholder’s equity, Chevron has a positive growth expectation in the future.

**Accounting Policy**

Due to the nature of Petroleum industry, we believe that Accounting of Properties, Plant and Equipment & Revenue Recognition are two most important accounting policies. Depending on how the company select its practice, these two policies will have significant bearing on the company overall financial statements.

***Accounting of Properties, Plant and Equipment***

*Reserves Assessment*

Company uses Successful Method to assess the cost related to its upstream business activities of crude oil and natural gas exploration and production. Successful Method recognizes:

* Exploratory cost related to successful commercial field is capitalized and cost of unsuccessful results implying dry holes is expensed in the year it incurred.
* Cost related to exploratory wells where it needs to be determined whether well has proved reserve is also capitalized.
* All the cost related to Development Well, Plant &Equipment and proved mineral interest in Crude oil. Natural gas and related ARO assets are also capitalized.
* Cost is capitalized for reserves which are yet to be characterized as Proved or Non Proved, provided company is making notable progress in the assessment of reserve and quantity of reserves is sufficient to categorize it as producing well.

*Impairments*

Chevron recognizes impairment as following:

* Long lived assets including proved crude oil and natural gas are periodically checked for impairment by comparing their carrying value with undiscounted before tax future Cash flow. They are written down to their Fair Value which is discounted future CF before tax.
* For its upstream business in US, reserves impairments assessment is usually on individual field basis. Outside US impairments is based on country, concession or development area.
* For its downstream business impairment reviews are on the basis of refinery, a plant, marketing area and are recorded as Depreciation Depletion and Amortization.
* A periodic valuation provision for impairment of capitalized cost of unproved mineral interest is expensed.

*Depreciation, Depletion and Amortization*

* Depreciation of capitalized cost is expensed using Unit-of-production method, generally done on individual field basis.
* Depletion of capitalized cost is also expensed using Unit of production method.
* For all PPE other than related to E&P, depreciation method used in US is Declining Balance Method and for international plant and equipment –‘Straight Line Method’. Straight line method is used for amortization of capitalized leased asset.
* Gain and losses are not recognized for normal retirements of PPE and come under Group depreciation or amortization. For abnormal retirement Gain and losses are included in other income or expensed respectively. Major replacements and renewals are capitalized.

***Revenue Recognition***

* Revenue related to sale of crude oil, natural gas , coal , petroleum and chemical products and other sources are recorded only when title passes to customer. It is recorded net of royalties, discounts and allowances
* Revenue from natural gas production from properties which Chevron shares with other producers is recognized by entitlement method. As per this method net revenue is based on net share of production of each producer irrespective of the fact who actually sold it. This anomaly is corrected over the life of the field such that each party has sold an amount equivalent to its entitled volume.
* Purchases and sale of inventory with same counterparty are combined and recorded on net basis as’ Purchased crude oil and products’

**Ratio Analysis:**

**Profitability**

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| --- | --- | --- | --- |
|  | **2011** | **2010** | **2009** |
| ROE (%) | 23.75 | 19.31 | 11.74 |
| ROA (%) | 13.64 | 10.88 | 6.43 |
| ROFL (%) | 10.11 | 8.43 | 5.31 |
| Profit Margin (%) | 11.01 | 9.59 | 6.26 |
| Asset Turnover (Times) | 1.24 | 1.13 | 1.03 |
| ROA (%) | 13.64 | 10.88 | 6.43 |
| RNOA (%) | 22.48 | 18.15 | 11.23 |
| NOPM (%) | 10.97 | 9.58 | 6.24 |
| NOAT (Times) | 2.05 | 1.9 | 1.8 |
| RNOA (%) | 22.48 | 18.15 | 11.23 |
| RNOA/ROE (%) | 94.63 | 93.98 | 95.67 |

*Return on Equity (ROE)* : ROE is a primary measure of a company’s profitability. It reflects the percentage of net income generated by every dollar of investment in the company. Over the last three years, Chevron's ROE has grown dramatically, from 11.74% in 2009 to 23.75% in 2011. The progressive increase in ROE suggests the company effective use of investor's equity to generate profit.

*Disaggregation of ROE*: ROE can be further scrutinized by splitting it into two components, Return on Net Operating Assets (RNOA) and non operating returns. Operating assets generate day to day operations of a company which generate revenue. Investors desire high operating returns as they are likely to persist, whereas non operating returns are transitory and very likely to fluctuate. Hence it is desirable to have a high RNOA. Chevron has had increasing RNOA over the past three years which compose of over 93% of ROE, which is very favorable for the company. RNOA, like ROA, can also be disaggregated into two components.

*Return on Assets (ROA)*: One other important metric that needs to be scrutinized is the Return on Assets (ROA). This ratio allows us to glimpse into the company’s earnings without considering the impact of debt financing activities. The ROA figures of Chevron are very impressive and have inclined along with ROE and have maintained a higher percentage of ROE as compared to ROFL, hence we can conclude that Chevron’s net income is more heavily dependent on its operations and sound investments rather than debt financing.

*Disaggregation of ROA:* ROA can be disaggregated into Profit Margin (PM) and Asset Turnover (AT) for further scrutiny. PM captures the profitability performance of a company. Chevron’s PM is an impressive 11.01% as of 2011 and has shown a steady incline in the past three years. AT reveals insight into a company’s efficiency and productivity by measuring the level of sales generated by each dollar that company invests in assets. This ratio is more than one for Chevron for the past three years, and has also been increasing during this time, hence we can conclude that this company generated more in revenue as compared to its investments in Assets and hence is quite productive. These figures also correspond with the industry average for a company such as Chevron which has a high composition of fixed assets.

*Net Operating Profit Margin (NOPM) and Net Operating Asset Turnover (NOAT)*: NOPM and NOAT measure the operating profitability and the productivity of net operating assets of a company respectively. These are very important as we’d like these ratios to stand their ground after investing and financing activities have been removed from the picture, since operating activities are what persists in the future. Both these ratios are sufficiently high for Chevron and have shown steady improvement over the past three years, NOPM increased from 6.24% to 10.97% from 2009 to 2011 and NOAT increased from 1.8 to 2.05 from 2009 to 2011. Hence we can conclude that Chevron is very secure and quite capable of being productive and profitable on the merit of its business operations and has minimum reliance on investing and financing activities to generate profits.







**Activity/Turnover Ratios:**

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| --- | --- | --- | --- |
| **Activity Ratio/ Turnover Ratio** | **2011** | **2010** | **2009** |
| Receivable Turnover (Times) | 11.38 | 10.18 | 9.86 |
| Days Outstanding (Days) | 32.09 | 35.85 | 37.03 |
| Inventory Turnover (Times) | 27.17 | 21.13 | 16.10 |
| Days Inventory (Times) | 13.43 | 17.27 | 22.68 |
| Account Payable Turnover (Times) | 7.24 | 6.53 | 6.04 |
| Days payables(Days) | 50.40 | 55.93 | 60.47 |
| PPE Turnover (Times) | 2.15 | 1.97 | 1.78 |

Turnover Ratios are essentially the ratios which show the efficiency with which the firm utilizes its assets and resources to generate revenue.

The turnover ratio of Chevron indicates that it has been using its resources in a very effective way .The turnover ratio are very consistent and show a improving trend over the last three years which is very much in line with the overall performance of the Company.

The company is turning its inventory every 14 days which is fast and better than its competitor .The ratio has improved from 23 days in 2009 to 14 days in 2011.This indicates excellent demand of the Company’s product portfolio. Moreover, as evident from the receivable turnover ratio, the Company is managing its receivables effectively and is able to collect the receivable timely .Whereas, at the same time it is utilizing the accounts payable as short term credit by paying its supplier later (approximately 15 days) than the period for which it offers credit to its customer. The PPE turnover ratio of 2.25 for fiscal year 2011 is very healthy, indicating that as a highly capital intensive company Chevron has been using its fixed assets efficiently to generate revenues and assets are being utilized up to the capacity as indicated by the increasing PPE turnover ratio over the past three years.

**Statement of Cash Flow**:

Chevron is a cash rich company with approximately 10% of its assets as cash, cash equivalent and highly liquid assets. The primary source and use of cash is operating activity and capital expenditure respectively. It generates operating cash, sufficient not only to fund its huge capital expenditure budget($26.5 billion for year 2011) but also provides sufficient cash for paying annual cash dividends to its shareholder, besides funding of acquisition of strategically important companies and repayment of other financial obligations. The Company generated $41.10 billion of cash from operating activities in year 2011 a growth of 31% over operating cash flow of year 2010 .With long term outstanding debts less than 5% of total assets in year 2011, past trend of decreasing leverage, enough cash at disposal; Chevron is a highly solvent company at present and looks promising for the future

**Peer Comparison:**

Exxon Mobil is one of the major competitors of Chevron in oil & gas industry. Both Exxon Mobil and Chevron are engaged in massive and geographically diverse upstream operations, downstream and chemicals operations.

***Business Risk Profile: Chevron Corp & Exxon Mobil Corp***

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In 2011, ExxonMobilhad reported higher revenue, around twice than that of Chevron. However, the net profit margin of Chevron was 11.01% greater than that ofExxonMobil’s net profit margin of 8.8%. This reflects the effective cost management exhibited by Chevron in 2011.The energy and petrochemical industries are highly competitive. Cost leadership is highly critical in the energy and petrochemical industry, where thereis little or no product differentiation. With relatively higher net profit margin in 2011, Chevron has proved cost leadership as its competitive advantage. Upstream production forms the important business segment for Chevron and ExxonMobil. In 2011, the capital &exploratoryexpenditure for Chevron and ExxonMobil were approximately $29.1 billion and 36.8billion respectively.

***Financial Risk Profile: Chevron Corp & Exxon Mobil Corp***

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| **Financial Ratios 2011** | | |
| **Profitability** | **Chevron Corp** | **ExxonMobil Corp** |
| Return on Equity (%) | 23.75 | 27.26 |
| Return on Assets (%) | 13.64 | 12.96 |
| RNOA (%) | 27.22 | 29.88 |
| NOPM (%) | 11.01 | 8.82 |
| NOAT (Times) | 2.47 | 3.39 |
| **Liquidity** |  |  |
| Current Ratio (Times) | 1.58 | 0.94 |
| Quick Ratio (Times) | 1.25 | 0.67 |
| OCF/CL (Times) | 1.31 | 0.79 |
| **Solvency/Leverage** |  |  |
| Debt/Equity (Times) | 0.72 | 1.10 |
| Times interest Earned (Times) | 165.4 | 297.59 |
| **Activity/Efficiency** |  |  |
| Receivable Turnover (Times) | 11.38 | 13.03 |
| Days Receivable Outstanding (Days) | 32.09 | 28.01 |
| Inventory Turnover (Times) | 27.17 | 19.04 |
| Days Inventory (Days) | 13.43 | 19.17 |
| Accounts Payable Turnover (Times) | 7.24 | 4.98 |
| Days Payables | 50.40 | 73.33 |
| Net Working Capital (CA-CL) (in million $) | 19,634 | -4,542 |
| PPE Turnover (Times) | 2.15 | 2.26 |

Both Exxon Mobil and Chevron have a strong financial risk profile.

***Profitability***

The Return on Equity (ROE) of Chevron is 23.75%, lower than that of Exxon Mobil with ROE of 27.26%. This is mainly because of higher leverage of Exxon Mobil 1.1 times as against that of 0.72x of Chevron.

***Liquidity***

Chevron is highly solvent reflected by its liquidity ratios. The total cash and cash equivalents was $20.1 billion as on December 2011.In 2011, Chevron’s cash flow provided by the operating activities was $41.1 billion, which was more than adequate to fund $27.4 billion of company’s capital and exploratory program and to make dividend payments of $6.1 billion to shareholders. Net working capital was positive with current assets of $53.23 billion and current liabilities of $33.6 billion.Exxon Mobil is also highly liquid with cash and cash equivalent of $13.1 billion as on December 2011.Cash provided by operating activities totaled $55.3 billion in 2011, $6.9 billion higher than 2010. The internally generated cash flow is more than adequate to meet majority of Exxon Mobil’s financial requirements. The net working capital of Exxon Mobil was negative due to higher current liabilities of $77.5 billion exceeded total current assets of $73.0 billion at year-end 2011. The higher current liability is due to the company’s ability to stretch itspayment days to its suppliers. This is evident from Days payable ratios of 73 days and 28 days respectively for the year ended December 2011.

***Leverage:***

In 2011, the total debt of Chevron is $10.02 billion and that of ExxonMobil was $17.03 billion. The total debt to Equity ratio is higher for ExxonMobil is primarily due to its higher current liabilities, which comprises around 46% of its total liabilities.

**Summary**

Common to other commodity dependence companies, Chevron financial suffered as the world economy slowed down and demand for energy consumption lessen during the 2008 Financial Crisis. However, within the last 3 year (2011, 2010, and 2009), we see a progressive improvement in all measuring-metrics of the company financial health. These continuous improvements suggest the company ability to weather difficult economy condition as well as managing cost. Hence, we believe Chevron will continue to experience steady growth and increase in profit through 2012.

**2011 2010 2009**

Net Oil Production (million/day) 2.673 2.763 2.704

International Price ($/Bbl) 101.53 72.68 55.97

As the world economies continue to recover, the energy demand and consumption will further boast Chevron revenue and profitability. As discussed in the company 10-K filing, the increase in profitability and revenue were primarily the result of the rise in average price per barrel of oil. In 2011, the company’s worldwide net oil-equivalent production averaged 2.673 million barrels per day at the average Brent price of $101.53 per barrel. We expect the upward trend to continue through 2012 as the world increase its appetite for energy consumption. Thus further strengthen Chevron financial outlook.

Furthermore, in 2011, Chevron made a strategic purchase of Atlas Energy, Inc. This purchase provides Chevron a position in the Marcellus and Utica Shale Gas Field. The acquisition also provided a 49% interest in Laurel Mountain Midstream, LLC, an affiliate that owns more than 1,000 miles of natural gas gathering lines servicing the Marcellus field. We believe this purchase will give Chevron a significant advantage and well-position the company to take advantage in the U.S growing Shale Gas production/export market.

However, the company might experience some minor setbacks due to the impending lawsuits, MTBe& Ecuador. The most significant out of the two is in Ecuador, where Chevron is the defendant in a 18.9 billion dollars Civil lawsuit in LagoAgrio, Ecuador. This lawsuit was an inheritance when Chevron bought Texaco in 2001. While Chevron deny of any wrong doing in the case, the court in Ecuador ruled against the company. Though Chevron countersue the plaintiffs and secure an injunction, staying the enforcement of the verdict. It is unclear, however, the extent of damage to the company or when alleged damages materialize.

While there are setbacks, the company long-term growth and profitability remain promising.We certainly recommend investment in Chevron.

Profitability Ratio Graph