# FIN 6186.E1 TERM PROJECT

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## Executive Summary

Exxon Mobil's value can be seen in terms of minimum and maximum prices per share, which ranged between $76.14 and $96.12 in the past fifty-two weeks. At first glance, share price can be perceived as Exxon Mobil's value, but the true value of this large corporation goes beyond share price. Exxon Mobil's true worth can be witnessed in its annual revenues, heavy demand for its products, resilience, performance, and future potential growth. The corporation has strong management to guide it through the years. Despite a fall in stock price, Exxon Mobil continues to make billions of dollars every quarter. Its value can also be seen in its dividend growth or its return on equity. In short, Exxon Mobil has great value as an investment.

Exxon Mobil's indicators, including balance sheet, cash flow, and others carry a mostly positive message. Although there may be better alternatives right now in terms of dividend investments, Exxon Mobil has shown its ability for dividend growth. Exxon Mobil has decades of strong performance to show for its track record. There may be some nervousness among investors about Exxon Mobil's ability to meet its long-term obligations, but the company maintains tens of billions in cash reserves. In addition, Exxon Mobil continues to invest heavily in its operations and its future. Further evidence in for Exxon Mobil comes in the form of the Du Pont Identity. This measure indicates that the company has proven itself as a good investment to shareholders for years. Potential investors may be turned away by the recent decline in Exxon Mobil's share price, but analysts believe this downturn is more a sign of the overall bear market than any shortcomings within Exxon Mobil. Finally, like all companies, Exxon Mobil does carry inherent risk. Threats may come from the external environment. They may come from government regulations or fewer customers due to higher gas prices. Exxon Mobil, however, has shown the ability to reward investors for the risks that the investors accept.

## Introduction

The goal of this project is to gain insight into reasons why Exxon Mobil has always been at or near the top of the Fortune 500 list beyond the simple observation that the corporation sells oil. In the nineteenth century, Exxon Mobil was part of the same company, John D. Rockefeller's Standard Oil. After Standard Oil was determined to be monopolistic, in the early twentieth century, it was divided into several companies, two of which became Exxon and Mobil. After decades of earning enormous profits, Exxon and Mobil were brought back together in 1999. Exxon Mobil is in both the Crude Oil and Natural Gas Extraction industry and the Petroleum Refining industry. If the past few years give a glimpse into Exxon Mobil's future, then the company's financial state should continue to be profitable. The annual revenues for Exxon Mobil are the largest in the world, and they continue to grow. In the next three to five years, Exxon Mobil should expect its revenues to grow by at least 5% and possibly much more. If 2008 is an indication of the world's oil demands, then it's very possible that the company could see revenue of more than 20%, as they did in 2005. Exxon Mobil should expect net income to continue to grow in the next three to five years as well, by at least 1.5%. For Exxon Mobil's stock price, the future is not as clear. The price rose by $5 by year-end 2005. However, in 2006 and 2007, the share price rose by an average of $18.73. These numbers would indicate that the price of Exxon Mobil's stock would continue its upward trend. The prediction for the next three to five years, however, is that 2008's bear market will continue to negatively impact the company regardless of how it performs. Most likely, Exxon Mobil's share price will either rise by a few dollars are fall by a few dollars.

## Analysis of Indicators

With a relatively low price/earnings ratio, Exxon Mobil investors pay for shares close to what the company actually earns (see Appendix B). However, indication of the corporation's stock being over-valued can be seen in the price-book ratio. Investors are able to gage Exxon Mobil's past performance by studying its price-sales ratio. Dividend investors may want to consider the competitors of Exxon Mobil prior to selecting shares of a company, as the dividend yield offered by Exxon Mobil is acceptable but low by industry standards. For current Exxon Mobil investors, the value offered to shareholders by the company is continued performance near the top of all businesses, which is also a reflection on past decades. As with all investments, Exxon Mobil presents concerns for investors when the financial strength of the company is examined. Both the quick ratio and the current ratio are fairly low. If Exxon Mobil maintained higher ratios, then investors would feel more secure in the corporation's ability to meet its long-term obligations. The operating margin and profit margin for Exxon Mobil are both very high, which reaffirms Exxon Mobil is very profitable. With cash inflows being very substantial, Exxon Mobil has positive cash flow that is attractive to potential investors and rewarding to shareholders (see Appendix C). The financing and investing activities for Exxon Mobil show that the company is very active in growing the business and not only operating it. For balance sheet indicators, it's evident that Exxon Mobil's assets far outweigh its liabilities (see Appendix D).

## Du Pont Analysis and Weighted Average Cost of Capital (WACC)

Like all other companies, Exxon Mobil can be evaluated on the basis of Du Pont Identity. By definition, Du Pont Identity simply means that return on equity can be determined by multiplying profit margin by total asset turnover, and then, multiplying the product by the equity multiplier. The profit margin can, in turn, be used to understand Exxon Mobil's operating efficiency. Additionally, total asset turnover is also referred to as asset use efficiency, while the equity multiplier is in reference to the corporation's financial leverage. For Exxon Mobil, profit margin, or the division of net income by sales, has grown each year to generate increasing profitability for the company (see Appendix E). As the years have passed, Exxon Mobil has shown an ability to increasingly get more work out of its working capital. This ability is evident in total asset turnover, which is determined by dividing sales by total assets.

Another component of the Du Pont Identity, the equity multiplier, indicates that Exxon Mobil is continually using less debt to finance its assets. The past several years has seen the equity multiplier fall, an arguably positive sign for the company. For the years between 2002 and 2007, Exxon Mobil's return on equity has steadily improved meaning shareholder investments are being turned into profits more efficiently. Overall, the Du Pont Identity shows that Exxon Mobil has been a sound investment for its shareholders. In Appendix F, the Weighted Average Cost of Capital is over 12%. This means that Exxon Mobil can expect to pay 12% to finance its spending on assets. This knowledge does not necessarily affect Exxon Mobil's value, as it means the company must pay this particular rate for financing to continue to grow.

**Weekly stock prices and NYSE Index**

For the seven weeks between June 13, 2008 and July 25, 2008, Exxon Mobil's stock price ranged between \$81.54 and \$88.36 (see Appendix G). As the weeks passed, the stock price fell. In recent days, the stock price fell even further to less than \$77 per share. As Rob Curran notes in an August 5 article from the *Wall Street Journal*, Exxon Mobil made over \$11 billion in the last quarter but still had its share price fall (see Appendix J). Additional information in this article points out that in recessions, prices of commodities (i.e. oil, gold, etc.) typically decline. Although a recession hasn't been officially declared, many economists have believed for months that signs of a recession are very apparent. For instance, consumer confidence has been lower than normal. Further on in Curran's article, commodities were in demand in the second quarter 2008, but not so much in recent weeks.

For the same seven week period, the NYSE Index ranged from 8,347.24 to 9,063.23. Much like Exxon Mobil's stock, the NYSE Index was on a decline during this time. In his July 9 article for *Business Week*, Ben Steverman, through interviews with market personnel, discusses the recent fall of the NYSE, and how it fits with the current bear market (see Appendix K). The article mentions expensive fuel which is likely impacting Exxon Mobil's stock price as well, despite enormous profits. The NYSE, which is now combined with Euronext, is a business in itself with its own shares traded. Further negative news comes in the form of IPOs being less frequent in this period.

**Riskiness**

According to Standard & Poor's Stock Report of Exxon Mobil, the qualitative risk assessment for investing in the company is low. The Value Line Report on Exxon Mobil suggests that the company is a safe means by which investors can gain from the current oil boom. The riskiness of Exxon Mobil can be considered in several ways. The most obvious risks for Exxon Mobil are witnessed in the news every day. As gas prices have risen, many people have grown increasingly frustrated at oil companies, speculators, OPEC, the federal government, etc. The risk of this frustration to Exxon Mobil is that there are continuous calls to develop alternative fuel sources, including ethanol, electricity, hydro-based fuels, and more. It's a risk to Exxon Mobil's revenues to have alternative fuels become more prevalent at gas stations. In addition, as gas prices rise, some consumers have decided and some will decide to cut back on gasoline consumption by car-pooling or driving less frequently, which is a threat to ExxonMobil.

Environmental regulations pose another risk to Exxon Mobil. Many people remember the Exxon Valdez oil spill catastrophe that happened in Alaska in 1989. Exxon Mobil has taken considerable (and arguably deserved) criticism for the disaster. Regulations and lawsuits stemmed from this incident. Exxon Mobil could use risk imposed by future regulations to become more competent at managing its oil operations. According to Forbes, Exxon Mobil faces risk in terms of litigation and organizational structure among other things. The risk of litigation stems from the costs of lawsuits that Exxon Mobil faces. For instance, in 2007 lawsuits were filed against Exxon Mobil for incidents that happened decades ago (Going Coastal). Any press that mentions oil spills is a risk to ExxonMobil's future profitability.

Risk can be measured in terms of business risk, which is also equity risk that is part of the daily operations of Exxon Mobil. Determined by the systematic risks, business risk for Exxon Mobil is very influential on assets (Fundamentals of Corporate Finance). If business strategy is focused on only oil operations, then Exxon Mobil sacrifices operations that could be focused on developing alternative fuel sources. Such a strategy could impact the corporation on a wide scale, including hurting it in the market. Another way risk can be measured is in terms of financial risk, which for Exxon Mobil is attributable to the corporation's capital structure. For financial risk, Exxon Mobil would be pursuing a risky strategy if the company took on too much debt. This strategy could cause a snowball effect that would see investors afraid to invest in Exxon Mobil for the long run.

The different sources that pose risks to Exxon Mobil can be managed by the company. Management of these risks can help shape Exxon Mobil's strategy. Instead of fighting alternative fuel sources, Exxon Mobil can embrace the movement and develop its own alternative fuel sources. To alleviate risks posed by environmental regulations, Exxon Mobil can become more efficient at eliminating its waste and more careful in its oil operations. Research and development has always been an area that companies could invest in order to avoid risk. Discoveries of alternative fuel sources or better ways to turn oil into profits can eliminate some risk. Of course, if Exxon Mobil invests in research and development that does not bring as much benefit then risk could increase especially if competitors become more profitable from research and development.

**Exxon Mobil's Worth**

If I had the opportunity to purchase a share of Exxon Mobil or my company had the opportunity to acquire Exxon Mobil, it is a transaction that would merit serious consideration. In terms of revenue and profit, Exxon Mobil is worth a lot. In fact, the company has more revenues than any other company in the world. In the past few years, Exxon Mobil's price per share has risen from under $60 to over $90. As the share price has fallen back under $80, it is still considered a strong buy (see Appendix I). Considering that for the foreseeable future, the world's energy needs are very dependent on oil, Exxon Mobil, the largest oil company, is also a sanctuary, if there ever was one, in the stock market. Riskaverse investors can rest assured that their money is very safe in Exxon Mobil. The company caused the most infamous oil spill in 1989 and still survived to prosper. Future growth can always be used as a forecast for how Exxon Mobil might perform. The one-year growth rate for revenue should be about 10%. In terms of total earnings, Exxon Mobil should expect a 1% growth rate. The one-year growth rate of Exxon Mobil's stock price should be about 6%.

The real question is: can Exxon Mobil's true worth be measured? Simply mentioning this year's stock price decline does not accurately portray the corporation's worth. As mentioned in Appendix K, Exxon Mobil is affected by the bear market despite making tremendous revenues. As the price falls to the right level, many investors will start buying Exxon Mobil and inevitably drive the price back up. With a very reasonable price/earnings ratio under ten, Exxon Mobil might even be considered undervalued. As pointed out numerous times in the Standard & Poor's Stock Report (Appendix I), Exxon Mobil is an above average performer. The company's cash reserves far outweigh its debt. In terms of earnings, dividend growth, stability, and return on equity, Exxon Mobil is an excellent investment. For a solid, long-term stock investment, Exxon Mobil would be on my short list of companies to strongly consider.

**Appendix A**

Exxon Mobil General Information

| **Category** | **Description** |
|---|---|
| | |
| **Company Name** | Exxon Mobil Corporation |
| **Headquarters** | Irving, Texas |
| **Industry SIC** | 1311 Crude Oil and Natural Gas Extraction<br>2911 Petroleum Refining |
| **NAICS** | 221111 Oil and Gas Extraction<br>324110 Petroleum Refineries |
| **Products and services** | Crude oil and natural gas, petroleum products, petrochemicals, olefins, aromatics, polyethylene, polypropylene plastics |
| **Stock exchange** | NYSE |
| **Ticker symbol** | XOM |
| **Current price** | $86.55 |
| **Date** | 6/27/2008 |
| **12 month high** | $96.12 |
| **12 month low** | $77.55 |
| **Volume of sales per day** | $1.069 Billion |
| **Volume of sales per week** | $7.506 Billon |
| **Earnings per share**<br>**(for trailing 12 months TTM)** | 7.69 |
| **Dividends per share**<br>**(for TTM)** | 1.60 |
| **Beta** | 1.18 |
| | |
| | |

**Appendix B**

Exxon Mobil Key Indicators

| **Valuation Ratios** | **Units** | **2007** | **2006** | **2005** |
|---|---|---|---|---|
| PE (TTM) | None | 12.4 | 11.1 | 9.5 |
| Price to Sales (TTM) | None | 1.29 | 1.20 | 0.96 |
| Price to Book (MRQ) | None | 3.92 | 3.44 | 2.91 |
| Price to Cash Flow (TTM) | None | 8.97 | 8.38 | 6.37 |

| **Stock** | **Units** | **End 2007** | **End 2006** | **End 2005** |
|---|---|---|---|---|
| Stock Price | $ | 93.69 | 76.63 | 56.24 |

| **Dividends** | **Units** | **2007** | **2006** | **2005** |
|---|---|---|---|---|
| Dividend Yield | % | 1.46 | 1.67 | 2.03 |
| Payout Ratio | % | 18.2 | 18.6 | 19.3 |

| **Financial Strength** | **Units** | **2007** | **2006** | **2005** |
|---|---|---|---|---|
| Quick Ratio (MRQ) | None | 1.28 | 1.33 | 1.38 |
| Current Ratio (MRQ) | None | 1.47 | 1.55 | 1.58 |
| LT Debt To Equity (MRQ) | None | 5.9 | 5.8 | 5.6 |

| **Profitability** | **Units** | **2007** | **2006** | **2005** |
|---|---|---|---|---|
| Gross Margin (TTM) | % | 33.3 | 34.6 | 33.8 |

| **Management Effectiveness** | **Units** | **Company** | | |
|---|---|---|---|---|
| Return on Assets (TTM) | % | 16.63 | | |
| Return on Equity (TTM) | % | 35.59 | | |

**Appendix C**

Exxon Mobil Cash Flow Indicators

| Cash Flow Indicators | 12/31/07 | 12/31/06 | 12/31/05 | 12/31/04 |
|---|---|---|---|---|
| Revenue | 390,328 | 365,467 | 358,955 | 291,252 |
| % change from 1 yr ago | 6.8 | 1.8 | 23.2 | |
| Net Income | 40,610 million | 39,500 million | 36,130 million | 25,330 million |
| % change from 1 yr ago | 1.03 | 1.09 | 1.43 | |
| Depreciation | 12,250 million | 11,416 million | 10,253 million | 9,767 million |
| % change from 1 yr ago | 1.07 | 1.11 | 1.05 | |
| Operating Activities | 52,002 million | 49,286 million | 38138 million | 40,551 million |
| % change from 1 yr ago | 1.06 | 1.29 | 0.94 | |
| Investing Activities | (9,728) million | (14,230) million | (10,270) million | (14,910) million |
| % change from 1 yr ago | 0.68 | (1.39) | 0.69 | |
| Financing Activities | (38,345) million | (36,210) million | (26,941) million | (18,268) million |
| % change from 1 yr ago | 1.06 | 1.34 | 1.47 | |
| Dividends Paid | 7,621 million | 7,628 million | 7,185 million | 6,896 million |

**Appendix D**

Exxon Mobil Balance Sheet Indicators

| Balance Sheet Indicators | 12/31/07 | 12/31/06 | 12/31/05 | 12/31/04 |
|---|---|---|---|---|
| Current Assets | 85,963 million | 75,777 million | 73,342 million | 60,377 million |
| % change from 1 yr ago | 13.4 | 3.3 | 21.5 | |
| Lt Investments | 28,194 million | 23,237 million | 20,592 million | 18,404 million |
| % change from 1 yr ago | 2.1 | 12.8 | 11.9 | |
| Property, Plant & Equipment | 120,869 million | 113,687 million | 107,010 million | 108,639 million |
| % change from 1 yr ago | 6.3 | 6.2 | -1.5 | |
| Goodwill & Intangible Assets | 7,056 million | 6,314 million | 7,391 million | 7,836 million |
| % change from 1 yr ago | 11.8 | -14.6 | -5.7 | |
| Total Assets | 242,082 million | 219,015 million | 208,335 million | 195,256 million |
| % change from 1 yr ago | 10.5 | 5.1 | 6.7 | |
| Current Liabilities | 58,312 million | 48,817 million | 46,307 million | 42,981 million |
| % change from 1 yr ago | 19.5 | 5.4 | 7.7 | |
| Long Term Debt | 7,183 million | 6,645 million | 6,220 million | 5,013 million |
| % change from 1 yr ago | 8.1 | 6.8 | 24.1 | |
| Postretirement benefits reserves | 13,278 million | 13,931 million | 10,220 million | 10,850 million |
| % change from 1 yr ago | -4.7 | 36.3 | -5.8 | |
| Other Liabilities | 14,366 million | 11,123 million | 9,997 million | 9,612 million |
| % change from 1 yr ago | 29.2 | 11.3 | 4.0 | |
| Deferred income tax liability | 22,899 million | 20,851 million | 20,878 million | 21,092 million |
| % change from 1 yr ago | 9.8 | -0.1 | -1.0 | |
| Total Liabilities | 120,320 million | 105,171 million | 97,149 million | 93,500 million |
| % change from 1 yr ago | 14.4 | 8.3 | 3.9 | |
| Common Stock | 4,933 million | 4,786 million | 4,477 million | 4,053 million |
| % change from 1 yr ago | 3.1 | 6.9 | 10.5 | |
| Earnings reinvested | 228,518 million | 195,207 million | 163,335 million | 134,390 million |
| % change from 1 yr ago | 17.1 | 19.5 | 21.5 | |
| Treasury Stock | (113,678) million | (83,387) million | (55,347) million | (38,214) million |
| % change from 1 yr ago | 36.3 | 50.7 | 44.8 | |
| Total Stockholder Equity | 121,762 million | 113,844 million | 111,186 million | 101,756 million |
| % change from 1 yr ago | 7.0 | 2.4 | 9.3 | |
| Total Liabilities & Stockholder Equity | 242,082 million | 219,015 million | 208,335 million | 195,256 million |
| % change from 1 yr ago | 10.5 | 5.1 | 6.7 | |

**Appendix E**

Du Pont Identity Components

| Year | ROE | NI/Sales | Sales/TA | TA/EQ |
|---|---|---|---|---|
| | | | | |
| 2007 | 33% | 0.104 | 1.61 | 1.99 |
| 2006 | 35% | 0.108 | 1.67 | 1.92 |
| 2005 | 32% | 0.100 | 1.72 | 1.87 |
| 2004 | 25% | 0.087 | 1.49 | 1.92 |
| 2003 | 24% | 0.091 | 1.36 | 1.94 |
| 2002 | 15% | 0.057 | 1.32 | 2.05 |
| 2001 | 21% | 0.073 | 1.46 | 1.96 |
| 2000 | 25% | 0.078 | 1.53 | 2.11 |
| 1999 | 12% | 0.044 | 1.26 | 2.28 |

**Appendix F**

Weighted Average Cost of Capital (WACC)

WACC = (E/V) x Re + (D/V) x Rd x (1 – Tc)

E/V = 121,762 million / 128,945 million = .944

D/V = 7,183 million / 128,945 million = .0557

Re = 0.0461 + 1(0.085) = 0.1311 = 13.11%

Rd = 7.7%

Tc = 35%

WACC = .944 x 13.11% + 0.557 x 7.7% x (1 - .35)

WACC = 12.37584 + 0.1458226

WACC = 12.52%

**Appendix G**

Weekly Exxon Mobil stock prices and NYSE Index

Weekly Exxon Mobil stock prices (6/13/2008 – 7/25/2008)

| Date | Price |
|---|---|
| 6/13/2008 | 88.36 |
| 6/20/2008 | 84.91 |
| 6/27/2008 | 86.55 |
| 7/3/2008 | 88.27 |
| 7/11/2008 | 85.48 |
| 7/18/2008 | 81.54 |
| 7/25/2008 | 81.70 |

Weekly NYSE Index (6/13/2008 – 7/25/2008)

| Date | Price |
|---|---|
| 6/13/2008 | 9,063.23 |
| 6/20/2008 | 8,829.25 |
| 6/27/2008 | 8,623.51 |
| 7/3/2008 | 8,481.54 |
| 7/11/2008 | 8,347.24 |
| 7/18/2008 | 8,453.85 |
| 7/25/2008 | 8,395.58 |

**Appendix H**

Exxon Mobil Value Line Report

The attached Value Line Report is in PDF format:

Exxon Mobil Value
Line Report

**Appendix I**

Exxon Mobil S&P Report

The attached S&P report is in PDF format:

Exxon Mobil S&P Report

**Appendix J**

Exxon Mobil Leads Commodities Bust

Rob Curran

*Wall Street Journal*

August 5, 2008

The commodities boom turned bust Monday as a selloff for such 2008 stock stars as Exxon Mobil, Range Resources, Consol Energy and Mosaic weighed down the market.

If there was a speculative bubble in commodities, it's rapidly deflating. Oil prices are now about 16% from their closing high on July 3, and natural-gas prices have fallen at almost twice that rate.

"Commodity prices fall during recessions," said Tobias Levkovich, chief U.S. equity strategist for Citigroup, in a note to clients. Mr. Levkovich said the boundless optimism about commodities prices recently reminded him of the euphoria around dot-com stocks and home prices earlier in the decade.

"'China and India will continue to grow regardless of other global economic developments' is the most common refrain for industrial commodity price strength even as Indian industrial production slows to a crawl, and China thinks hard about curbing inflation," Mr. Levkovich wrote.

On Monday, Exxon Mobil was the biggest loser on the Dow Jones Industrial Average, falling $3.12, or 3.9%, to $76.60. A few days after logging $11.56 billion in quarterly earnings, shares of Exxon hit their lowest mark in more than a year. Yet, just as it enjoyed less of the gain on the way up, Exxon's losses were muted compared with some of the more-volatile commodities issues.

Oil-and-natural gas driller Range Resources fell 6.41, or 13%, to 42.60, and is now about 45% from its peak in late May. Shares of coal miner Consol Energy fell 4.41, or 6.5%, to 63.44, almost cutting its value in two from its intraday peak of 119.10 on June 27.

Similarly, fertilizer maker Mosaic, which logged robust earnings growth last week and projected further growth in the coming fiscal year, fell 13.40, or 11%, to 109.29. Corn and wheat futures also tumbled with oil, a sign that broad speculation on commodities may have played a role in the spike in food prices.

Among metals processors, Alcoa fell 1.10, or 3.4%, to 31.04; United States Steel fell 11.56, or 7.6%, to 139.87.

In all, the Dow fell 42.17 points, or 0.37%, to 11284.15. The broad Standard & Poor's 500 shed 11.3, or 0.9%, to 1249.01. The technology-heavy Nasdaq Composite fell 25.4, or 1.1%, to 2285.56.

Mr. Levkovich says he was "berated recently by a consultant for expressing doubts in the commodities super cycle, as if rendering a differing opinion was some sort of treasonous act."

While commodities stocks drew a lot of buyers in the second quarter, many observers agree that the financial sector remains the stock market's center of gravity.

On Monday, some of the recent gains in that area faded. Shares of mortgage lender Washington Mutual fell 45 cents, or 8.5%, to 4.87.

Wachovia declined 1.87, or 10%, to 17.11 after broker Morgan Keegan said the recent rally was premature.

Freddie Mac fell 46 cents, or 5.8%, to 7.52; and Fannie Mae tacked on a penny to 11.83. The Wall Street Journal reported the mortgage-finance giants are redoubling efforts to forestall foreclosures.

Motorola rose 1.01, or 11%, to 9.82. The mobile-phone manufacturer hired Qualcomm Chief Operating Officer Sanjay Jha as a co-chief executive officer. Shares of Qualcomm (Nasdaq) fell 2.60, or 4.7%, to 52.87.

Humana tacked on 2.17, or 4.9%, to 46.81 after the health insurer boosted its 2008 profit outlook. That helped peers like Cigna, which rose 1.87, or 5.3%, to 37.48; UnitedHealth Group, which added 83 cents, or 3%, to 28.96; and Aetna, up 2.01, or 5%, to 41.97.

Detroit's twin engines went in opposite directions, even as their plans came to an apparent intersection. After the Detroit News reported that General Motors and Ford Motor may pool resources on engine development, shares of GM fell 13 cents, or 1.3%, to 10.10, while Ford rose 16 cents, or 3.4%, to 4.81.

American depositary shares of Elan rose 1.09, or 11%, to 11.02. Canaccord Adams raised its rating on the Irish biotechnology concern, saying a selloff on the heels of safety worries on two of its drugs may be a chance for a "high risk" investment in Elan.

**Appendix K**

Exchanges Get the Bear Market Blues
Ben Steverman
*Business Week*
July 9, 2008

Shares of Nasdaq and the NYSE have been pummeled as the current grim environment puts the brakes on trading. Are the worries overblown?

Is this bear market different? That's the key question for Nasdaq OMX (NDAQ) and NYSE Euronext (NYX), the operators of the two major U.S. equity exchanges.

Nasdaq and the New York Stock Exchange don't just facilitate trading in other stocks; they also list their own shares. And it has been a cruel year. The value of both exchanges' equities have been cut roughly in half since the start of the year.

The main worry is that the relentless gloom hanging over the stock market is making the Nasdaq and NYSE's U.S. equity platforms less busy, and thus less profitable. With major indexes 20% off their peaks (the official definition of a "bear market"), investors justifiably start the summer with little enthusiasm for shares.

True, "an exchange can profit regardless of which way the markets are moving," says Bill Cline of the Cline Group, a capital markets training and consulting firm. However, in bear markets—particularly when the market funk lingers—"investors do tend to trade less."

**Volatility Dies Down**

At first, in late 2007 and especially early in 2008, trading volume was strong amid the turmoil of the financial crisis. A bear market with a lot of volatility can benefit exchanges, says Raymond James (RJF) analyst Patrick O'Shaughnessy. The big danger for Nasdaq and the NYSE is that the volatility is subsiding, and the stock market is facing many months in the doldrums.

Among the worries dampening investors' willingness to make trades: inflation and expensive fuel, the housing slowdown, continuing credit troubles, and falling corporate earnings (BusinessWeek.com, 7/2/08).

In this year's second quarter, trading volume was still high compared with a year earlier, but average daily trading in the U.S. fell 11% from the tumultuous first quarter. Keefe, Bruyette & Woods (KBW) analyst Niamh Alexander says she expects light trading volume in the third quarter, which will hurt profits. "The relentless bear market pressure…appears to be slowing equity trading volume at last," she wrote on July 2.

In an interview, David Warren, Nasdaq's chief financial officer, says volume on his exchange remains "quite robust."

**Other Revenue Sources**

But he argues that investors are putting too much emphasis on the exchanges' trading business. For Nasdaq, only about 16% of revenue comes from U.S. equity trading. Nasdaq also makes money on the sale of market data, fees to connect to its trading systems, services for companies that list on the exchanges, and technology sold to other exchanges around the world.

"To think about us as a trading company really misses the point," Warren says.

Executives at NYSE Euronext weren't available for interviews. But since the NYSE's merger last year with the European exchange Euronext, the company relies less on stock trading than Nasdaq, analysts say. Nasdaq completed its own European merger earlier this year, to Swedish-Finnish exchange OMX.

Industry experts insist, however, that trading volume is a key determinant of the big exchanges' profits—hence their diversification into new trading products, such as futures contracts or exchange-traded funds. "Trading is still very important for these companies," O'Shaughnessy says.

**IPOs Dry Up**

Exchanges spend heavily on trading technology and, in the NYSE's case, maintaining a trading floor. But once those fixed costs are covered, each additional trade can be extremely profitable. Still, another lucrative business for exchanges—initial public offerings, or IPOs—has slowed to a trickle as a result of weak market conditions.

Recent mergers have diversified exchanges' revenues, but they also give Nasdaq and NYSE a chance to cut expenses deeply. Both have promised hundreds of millions of dollars in cost savings from their mergers.

In recent years, trading volume on equity exchanges has spiked as new regulations encouraged electronic trading. The NYSE opened the human traders on its Wall Street trading floor to direct competition from computers that can execute trades in nanoseconds. So far, the computers, including NYSE's own computerized platform, NYSE Arca, have won.

With so much trading happening so quickly, NYSE's volume has increased even as its market share has plummeted. Nasdaq has won some of that market share, but both exchanges face cutthroat competition from new, smaller exchanges. "The 'electronification' of the industry has been a blessing and curse for these exchanges," O'Shaughnessy says.

**Retail Investors Lose Interest**

As hedge funds and other institutions embrace electronic trading, "the individual investor [accounts for] a smaller and smaller portion of overall trading," says Larry Tabb, chief executive of the Tabb Group, a specialized consultant to financial companies. The exchanges worry that the return of the bear will make individuals even warier of the market.

For institutions, the current angst is over "deleveraging." Because of recent credit troubles, investment banks and hedge funds aren't able to borrow as much money, which leaves them less to trade with.

That's the theory, anyway. But analysts point out that many hedge funds don't need a lot of capital to trade quickly during the day, and those funds rarely hold large positions overnight.

Also, Tabb says, problems in credit markets have pushed many institutions toward stock investments and away from complicated, structured-credit instruments that are hard to value. "A significant number of investors have moved from mortgage-backed and asset-backed products to markets [whose instruments] are much easier to price," Tabb says. Those investors could ultimately turn their backs on equities, however, if the bear market drags on, Tabb says.

**A Tough Group to Figure Out**

Through July 8, NYSE Euronext shares were off 46% for the year so far, while Nasdaq stock was down 49%. But the prices have been volatile lately, perhaps reflecting uncertainty about how market conditions will affect their earnings.

The way exchanges operate has changed rapidly in the past few years, and the overlapping trends do make it difficult to evaluate their stocks. "It's a tough sector to keep up with," says Nasdaq's Warren. Investors may be "cautious because they can't figure out all the factors they need to be thinking about."

But investors' immediate concern is whether trading volume is slipping into a long, bear-market lull. In an industry that thrives on risk-taking and volatility, the last thing Nasdaq and the NYSE want is an extended period of peace and quiet.

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