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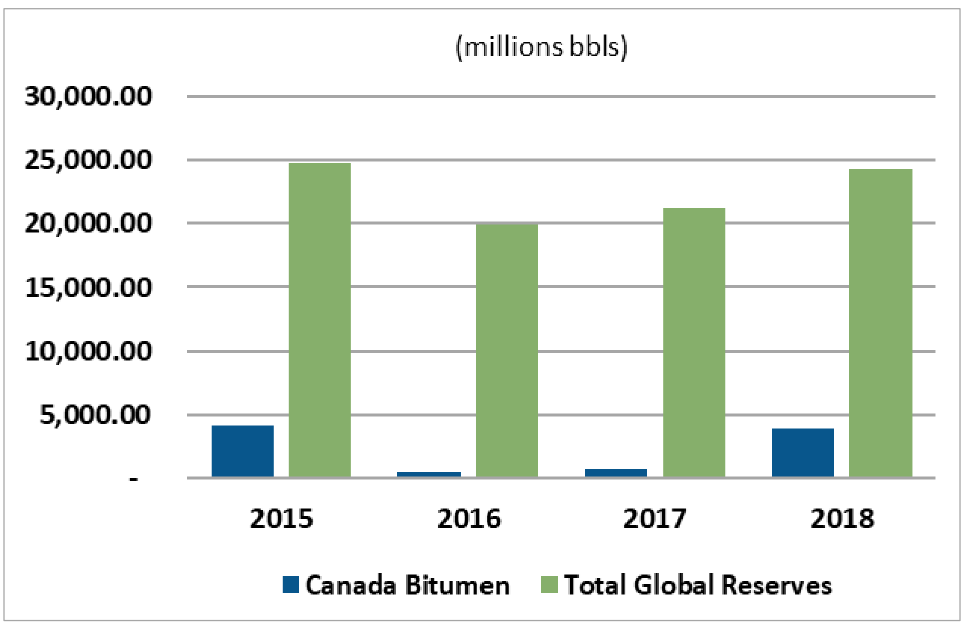
ExxonMobil's Prodigal Reserves Return: Company Rebooks 3.2 Billion Barrels of Previously De-Booked Canadian Oil Sands Reserves

How Can the Oil Giant Declare New Reserves as the Canadian Oil Sands Market Declines?

ExxonMobil's recent 10K filing for 2018 shows it has rebooked 3.2 billion barrels of Canadian oil sands reserves. This action increases the company's worldwide reserves from 21.2 billion barrels in 2017 to 24.3 billion barrels in 2018, a 13% increase. We are skeptical of this action, given its history.

ExxonMobil: Canadian Bitumen as Part of Total Worldwide Proven Reserves (2015-2018)



Just over two years ago, ExxonMobil de-booked 3.3 billion barrels of oil sands reserves.[1] The write-off came in the wake of a two-year oil price collapse, declining

[1] Press Release. ExxonMobil. ExxonMobil announces 2016 reserves. 2/22/17.

profits and a weak outlook, particularly for high-cost oil reserves like Canada's oil sands.

At the time of the write down, the company was under pressure to acknowledge the impact of the oil price decline on its Canadian oil sands reserves.[2] Many companies were acknowledging the value-destroying impact of the low-price environment. Conoco Phillips, Shell, CNOOC[3] (China's biggest offshore oil and gas producer)[4] and Statoil wrote off its assets in the region.

Up to that point, ExxonMobil had been making the general claim that it did not take impairments[5] based on its view that its investments were structured to take into account wide fluctuations in value during the full life cycle of its product. ExxonMobil, claimed the company, had assumed the worst. So, either ExxonMobil managers were the smartest guys in the industry, or they had adopted an accounting system that was an outlier and could not withstand scrutiny.

By late 2016, the company changed direction and was discussing the likelihood of the de-booking[6] and then, by early 2017, it became official, announced in the company's 10K. ExxonMobil's oil sands reserves went from 4.11 billion barrels in 2015 to 436 million in 2016. This action and several other reserve actions during the year brought ExxonMobil's worldwide total proven reserves from 24.76 billion barrels in 2015 to 19.97 billion barrels in 2016, a 20% decline.

At that time, the company stated the move was a means of complying with the SEC's technical rules, which required it to acknowledge the low-price environment, while noting it still believed the reserves were economically extractable and thus subject to rebooking.[7]

No Hint of Rebooking Seen in Earlier Filings

A review of the 4Q 2018 and yearend earnings releases for both ExxonMobil and Imperial Oil (which is majority-owned by ExxonMobil) offer no hint that the company anticipated this move. And, unlike its 2016 write-off, ExxonMobil and Imperial gave no hint of the action as part of their 3Q 2018 earnings releases in October.

In one short sentence in its recently-filed 10K filing, the company declared that, based on a calculation regarding oil prices during 2018, the addition to its proven reserves met SEC standards. "At year-end 2018, an additional 3.4 billion barrels of bitumen at Kearl qualified as proved reserves under the SEC definition requiring calculations based on the average of the first-day-of-the-month price during the last

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[2] Smith. Geoffrey. Fortune. Exxon's big oil sands write-off could help it dodge SEC troubles. 2/23/17.
[3] Financial Post. CNOOC warns of huge loss as it writes down Canadian oilsands assets. 7/28/16.
[4] Cook, Lynn. Wall Street Journal. Exxon lowers proved reserve estimates. 32/22/17.
[5] Olson, Bradley. Wall Street Journal. Exxon's accounting practices are investigated. 3/16/16.
[6] Krauss, Clifford. New York Times. Exxon concedes it may need to declare lower value for oil in ground. 10/28/16.
[7] Addison, Velda. Hart Energy. ExxonMobil cuts costs, endures low oil-price woes. 10/28/16.

12-month period." When ExxonMobil carried 4.1 billion barrels of proven reserves on its books in 2014, Imperial Oil reported a bitumen price of $67.20 per barrel.[8] In 2018, Imperial Oil reported an average realized price of $37.56 per barrel.[9]

Rebooking assets was an extraordinary step, but fits with the company's current aggressive approach. In 2018, it announced a new oil sands investment, doubled down on its drilling strategy in its capital expenditure plans, and pushed the story that it has mastered low-cost production in this low-price environment.[10] But investors might want to question the basis for the rationale.

- During 2018, no other company doing business in the oil sands has rebooked oil sands assets, according to our research.
- Cenovus, Imperial, Suncor and Teck Resources all posted weak upstream oil sands results for 2018. Imperial's upstream operation posted losses. Teck's new oil sands venture at Fort Hills posted losses. Total has backed away from its interest in the Fort Hills venture.
- During 2018, the price of Canadian oil sank to historic lows due to a confluence of factors. The decline was so great that Alberta officials announced an unprecedented cap on oil sands production in order to force prices back up. Imperial Oil objected to the action and has recently cancelled new investments.[11]
- All of the major oil companies doing business in Canadian oil sands industry lagged the S&P 500 during 2018, including Imperial Oil. This has been true for the last two-year and five-year periods.
- Since the beginning of 2019, as oil prices have begun to rebound, the stock prices of Suncor and Cenovus (and the rest of the oil and gas industry globally) have picked up. Imperial, however, continues to lag the S&P 500.

SEC Drops its Probe into ExxonMobil's Reserves-Related Accounting Practices

During 2018, the Securities and Exchange Commission (SEC) dropped its probe into the accounting practices of ExxonMobil's reserves,[12] which some viewed as a response to the company's Canadian oil sands write-off. The SEC closed out this case, but acknowledged in standard language that it could reopen the investigation if something changes. Well, something *has* changed. The company has rebooked 3.2

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[8] Q4 News Release. Imperial. Imperial earns $1.1 billion in 2015; $102 million in fourth quarter. 2/26/16.
[9] Q4 News Release. Imperial. Imperial announces 2018 financial and operating results. 2/1/19.
[10] Tuttle, Robert. Bloomberg. Exxon's $2 billion Canadian move shows confidence when others flee. 11/8/2018.
[11] Williams, Nia. Reuters. Canada's Alberta increases crude output limit for May and June. 3/18/19.
[12] DiChristopher, Tom. CNBC. Exxon Mobil says it may write down assets after SEC probe into its reserves. 10/28/16.

billion barrels of oil sands reserves in a market that is not exactly robust, with an outlook that is not exactly rosy.

We share ExxonMobil's implicit assumption that the SEC is unlikely to take future action on this matter.

Investors do not pay attention to the validity of company claims regarding proven reserves. Instead, investor behavior is often governed by the seeming stability of the dividend and the white noise of production increases.

ExxonMobil's competitors will probably not complain, despite the obvious advantage the company gains from its recent rebooking. ExxonMobil and Teck Resources are nearly the only bulls left in the oil sands.[13] So, while most other companies project a weak future for oil sands, all companies benefit when some companies are still willing to hype the market with upbeat outlooks.

But saying there is a future is one thing; putting money into that future now is another thing altogether. Late last year, Imperial enthusiastically announced its support for a new investment, the Aspen oilsands project.[14] This action was touted as a long-term bullish move. The recent announcement by the company, to delay the project until 2023, suggests uncertainty. The company blamed the delay on the government of Alberta's cap on oil sands production,[15] which is, by all accounts, a short-term maneuver. Imperial's action—a reverse course on its long-term commitment to oil sands development based on this short-term political blip—reveals that its long-term bullish view is more mirage than oasis.

We are skeptical about the quiet return of these prodigal oil sands reserves. Absent additional disclosures by Imperial Oil or ExxonMobil, we see this rebooking as another red flag. We continue to view such actions as casting a pall on the oil and gas industry as a whole regarding how proven reserves are actually calculated. Either ExxonMobil possesses a trade secret with significant implications for other companies—or the industry is not really served by a system of uniform accounting of reserves that allows investors to confidently compare company disclosures.

The oil and gas industry justly deserves its reputation for technological advances. Its achievements, which include horizontal drilling, hydraulic fracturing (fracking) and artificial intelligence (AI)—have turned what was once considered science fiction into new driving technologies. We are less impressed by the phantasmagorical financial musings of CEOs and oil company managers, who conjure proven oil reserves out of whole cloth.

The spell of these wizards may put regulators in a trance. But some of us prefer facts.

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[13] Oil & Gas 360. Imperial Oil, Teck double down on Canadian oil sands after others flee. 11/7/18.
[14] Healing, Dan. Global News. Imperial Oil going ahead with construction of $2.6B Aspen oilsands project. 11/7/18.
[15] Williams, Nia. Reuters. Canada's Alberta increases crude output limit for May and June. 3/18/19.

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