

Exxon cap structure arbitrage/impact trade idea

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With current equity holder activism around Exxon Mobil,¹ we believe it could be opportune to take an advantage of the pricing dislocations in equity vs debt of the company while also trying to reduce the company's capital expenditure in hydrocarbons.

Trade idea – trade weightings designed to make the package carry neutral:

- Buy USD1mn of Exxon equity (XOM US) @ 58.84, indicated dividend yield of 5.91%.
- Buy USD15mn EXXON 5y CDS protection @ 38bp.

This should be in parallel with the following engagement commitments:

- Field/support proposals for significantly reduced cap-ex spending (currently around USD20bn per annum)² and use resulting positive cash flow for dividend payments and/or stock buybacks. Equity neutral, credit negative.
- Field/support proposals for leveraging up and targeting a BBB rating (currently AA-) through additional debt issuance for purposes of enhanced equity dividend payments and/or stock buybacks. Equity positive, credit negative.

Trade dynamics:

- Indicative dividend income = negative CDS carry => carry-neutral trade.
- Estimated capital requirement is USD1.75mn, assuming a 5% collateral on the CDS.
- We estimate that a downgrade of Exxon to the BBB level would generate at least 50bp spread widening on the 5y CDS (cf. Suncor 5y CDS @88bp, BBB+ rated). With an exit DV01 estimated at 4.1 in 1yr, the expected nominal CDS return would be 1.3%.³
- A 50bp CDS widening with no move in the equity price over a 1yr horizon would imply a return on capital of approximately 11.5%, assuming a crystallization of the indicated dividend yield.

The equity leg provides no more capital to Exxon but gives a right to engage for the orderly unwind of the company's hydrocarbon business model and to avoid further capital expenditure on soon-to-be stranded assets. The short CDS position raises cost-of-capital for existing production, incentivizing earlier closures and dissuading from further explorations. As such, both legs are climate impact positive.

¹ See "[Exxon: a rebellion investors should back](#)", Financial Times Lex column, 20 May, 2021.

² We opine that the company will be unable to readjust capex spending to renewables or carbon-capture technology to a significant degree, given the company's inertia on topics of climate change.

³ We assume a linear roll-down, in this case 88bp/5yr=17.5bp/yr.

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