ConocoPhillips (COP)

Updated May 4th, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	$66	**5 Year CAGR Estimate:**	7.3%	**Quality Percentile:**	N/A
Fair Value Price:	$58	**5 Year Growth Estimate:**	8.0%	**Momentum Percentile:**	N/A
% Fair Value:	113%	**5 Year Valuation Multiple Estimate:**	-2.4%	**Total Return Percentile:**	N/A
Dividend Yield:	1.7%	**5 Year Price Target**	$86	**Valuation Percentile:**	N/A

Overview & Current Events

ConocoPhillips is the world's largest independent oil and gas producer, with an average daily production of 1.2 M barrels/day. As it is a pure upstream company, it is much more leveraged to the price of oil than its well-known peers like Exxon Mobil, Chevron, BP and Total. When oil prices began to collapse in 2014, ConocoPhillips was the producer that suffered the most; it posted heavy losses in 2015 and 2016 and its stock price plunged 60% from its peak.

However, as leverage is a two-edged sword, ConocoPhillips is now one of the best positioned oil producer to benefit from rising oil prices. The average realized price per barrel of oil for the company increased from $46 in Q4-2017 to $51 in Q1-2018 and its EPS more than doubled, from $0.45 to $0.96. In other words, a ~10% rise in the price of oil in three months boosted EPS by 113%. While investors should not expect these exact proportions to repeat in the future, they should keep this extraordinary sensitivity in mind.

ConocoPhillips grew its comparable (excluding asset sales) production 4% in Q1 over last year and expects it to grow 5% this year thanks to the ramp-up in the output of its unconventional assets. In addition, due to the aforementioned downturn in the oil sector, the company has reduced its operating costs and sold several assets that did not offer high returns. As a result, the company is well positioned to benefit from rising oil prices. Oil prices have enjoyed a strong rally since last summer and are now trading at a 3-year high. Moreover, thanks to the sustained efforts of OPEC and Russia, the oil price is likely to remain strong for the foreseeable future, particularly given the upcoming IPO of Saudi Aramco. Therefore, ConocoPhillips is in a strong recovery mode, with exciting growth prospects ahead.

While the oil majors did not cut their dividends during the severe downturn of the oil sector, ConocoPhillips cut it by almost 2/3, after 25 consecutive years without a cut. That move has greatly helped the stock and will continue to provide a tailwind, as the company has begun to reduce its debt load and its interest expense at a fast pace.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$10.66	$3.24	$5.92	$8.76	$5.91	$6.43	$4.96	-$1.39	-$2.52	$0.61	***$3.90***	***$5.73***
DPS	$1.88	$1.91	$2.15	$2.64	$2.64	$2.70	$2.84	$2.94	$1.00	$1.06	***$1.14***	***$1.74***

Thanks to its promising growth prospects and the rally of the oil price to a 3-year high, the analysts expect ConocoPhillips to grow its EPS to $3.90 this year, which is in line with its adjusted Q1 EPS of $0.96. As the company operates in a commodity business, it is hard to make long-term predictions. Nevertheless, given the unprecedented investment cuts of all the oil producers in recent years and the support from OPEC and Russia, the fundamentals of the oil market are likely to remain strong for years. Moreover, ConocoPhillips is expected to repurchase its shares at an annual rate around 2%. Furthermore, thanks to the reduction of its dividend, the company is drastically reducing its debt load. It recently paid down $2.7 B of debt and has reduced its interest expense by 42% in the last four quarters. As it will continue to reduce its interest expense, this will provide an additional boost to its EPS. Overall, taking into account a modest 2% average output growth and a slow rise of the oil price from its current level, it is reasonable to expect the company to grow its EPS by about 8.0% per year on average, from $3.90 this year to $5.73 in 2023.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	7.0	14.0	9.4	8.2	9.5	10.1	15.0	N/A	N/A	N/A	***16.9***	***15.0***
Avg. Yld.	2.5%	4.2%	3.9%	3.7%	4.7%	4.2%	3.8%	5.1%	2.4%	2.2%	***1.7%***	***2.0%***

ConocoPhillips is currently trading at a P/E of 16.9 whereas it has traded at an average P/E of 10.5 during the last decade. However, it was trading at markedly low P/E ratios before the spin-off of its downstream business. Therefore, it is reasonable to expect the stock to trade at a P/E around 15.0 in five years. If this happens, the stock will incur a 2.4% average annual drag due to P/E contraction over the next five years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	46.0%	26.0%	31.4%	18.7%	24.0%	22.1%	18.9%	-3.3%	-3.3%	5.0%	***14.0%***	***20.0%***
Debt/A	60.6%	58.8%	55.8%	57.1%	58.7%	55.5%	55.1%	58.9%	60.8%	58.0%	***57.0%***	***56.0%***
Int. Cov.	----	8.4	17.6	17.1	22.8	24.3	15.5	-7.2	-3.6	-1.5	***12.5***	***17.0***
Payout	17.6%	59.0%	36.3%	30.1%	44.7%	42.0%	57.3%	N/A	N/A	174%	***29.2%***	***30.3%***
Std. Dev.	40.3%	33.6%	23.7%	24.9%	15.4%	14.5%	22.5%	30.3%	40.2%	20.5%	***20.0%***	***20.0%***

The above metrics have greatly deteriorated in recent years but are poised to revert to normal levels as the recovery continues. During the previous boom of the oil sector, when oil was around $100, ConocoPhillips made frivolous investments, such as its drilling rights in U.S. Arctic and its deep-water business in Senegal. When the price of oil plunged, the company sold its rights and incurred more than $1 B in impairment losses. However, the company seems to have learned its lesson and has thus become much more disciplined, investing only in high-return projects.

Nevertheless, investors should be aware of the extreme sensitivity of ConocoPhillips to the oil price. In the event of a recession, the EPS of the company will slump, just like they did in the Great Recession, when they plunged 70%.

Final Thoughts & Recommendation

Despite the 55% rally of ConocoPhillips since last summer, the stock can still reward its shareholders. Over the next five years, it can offer a 7.3% average annual return thanks to 8.0% EPS growth and a 1.7% dividend, which will be partly offset by a 2.4% annualized P/E contraction. The company is a hold based on its expected total returns.

Total Return Breakdown by Year