Occidental Petroleum (OXY)

Updated May 4th, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	$77	**5 Year CAGR Estimate:**	3.2%	**Quality Percentile:**	N/A
Fair Value Price:	$43	**5 Year Growth Estimate:**	10.0 %	**Momentum Percentile:**	N/A
% Fair Value:	178%	**5 Year Valuation Multiple Estimate:**	-10.8%	**Total Return Percentile:**	N/A
Dividend Yield:	4.0%	**5 Year Price Target**	$70	**Valuation Percentile:**	N/A

Overview & Current Events

Occidental Petroleum is an international oil and gas exploration and production company, with operations in the U.S., Middle East and Latin America. While the company also has a midstream and a chemical segment, the vast majority of its earnings comes from its upstream segment. Consequently, it is much more sensitive to the price of oil than the integrated oil majors. That's why Occidental Petroleum was more severely affected than its integrated peers by the downturn in the oil market, which began almost four years ago. Due to the downturn in the oil market, the company reported negligible earnings in 2015 and posted losses in 2016.

However, the price of oil has enjoyed a strong rally since last summer and has now reached a 3-year high. In addition, thanks to the sustained efforts of OPEC and Russia, the price of oil is likely to remain strong for the foreseeable future, particularly given the upcoming IPO of Saudi Aramco. Therefore, Occidental Petroleum is poised to enjoy a strong tailwind going forward.

Its free cash flow has already increased to a level that is sufficient to cover the capital expenses and the dividend of the company. Thanks to its cost-cutting initiatives and its discipline to invest only in fields with a low breakeven oil price, the company now generates sufficient cash flows to cover its expenses and its dividend at an oil price of $50. Moreover, as the oil price has rallied above $60, the management has stated that it will resume share repurchases.

In its last earnings report, the company reported an impressive 187% reserve replacement ratio, mostly thanks to the 318% replacement ratio it achieved in the Permian Basin. It added 750 horizontal locations with a breakeven point below $50 and thus extended the lifetime of its reserves in the Permian to 17 years. Moreover, it expects to increase its Permian output by 45% by the end of this year and its overall output by about 5% compared to Q4.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$8.98	$3.79	$5.72	$8.39	$7.09	$6.96	$4.83	$0.12	-$1.01	$0.89	***$3.14***	***$5.06***
DPS	$1.14	$1.30	$1.42	$1.76	$2.62	$1.92	$2.80	$2.94	$3.01	$3.05	***$3.10***	***$3.30***

Given the impressive production growth and the strength in the oil price, Occidental Petroleum has great earnings growth potential from its current depressed level. Thanks to the above tailwinds, the analysts expect its EPS to climb to $3.14 this year. Going forward, it is reasonable to assume 10.0% average annual EPS growth thanks to at least 4.0% annual output growth, a slow rise in the price of oil and 1%-2% reduction in the share count per year. If this growth materializes, the company will grow its EPS from $3.14 this year to $5.06 in 2023.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	8.0	17.8	14.4	11.4	12.4	12.8	19.5	NMF	----	NMF	***24.5***	***13.8***
Avg. Yld.	1.6%	1.9%	1.7%	1.8%	3.0%	2.2%	3.0%	4.0%	4.2%	4.7%	***4.0%***	***4.7%***

As Occidental Petroleum just began to recover off the bottom of its business cycle, it is now trading at a markedly rich P/E of 24.5, which is much higher than its 10-year average P/E of 13.8. As the company is poised to continue to recover in the upcoming years, it is reasonable to expect the stock to revert towards its average valuation level. If this occurs, the stock will incur a 10.8% annualized drag due to P/E contraction over the next five years. In other words, the market has already priced a great portion of the future EPS growth in the stock.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	40.3%	21.7%	24.2%	27.1%	20.8%	19.5%	22.0%	15.3%	11.2%	16.3%	***20.0%***	***22.0%***
Debt/A	34.2%	34.1%	38.0%	37.3%	37.6%	37.5%	37.9%	43.9%	50.1%	51.0%	***50.0%***	***45.0%***
Int. Cov.	89.1	38.9	66.8	36.1	51.9	55.5	80.2	4.1	-3.2	3.5	***7.0***	***15.0***
Payout	12.7%	34.3%	24.8%	21.0%	37.0%	27.6%	58.0%	2450%	----	343%	***98.7%***	***65.2%***
Std. Dev.	49.2%	27.1%	20.6%	35.0%	22.1%	18.8%	18.2%	22.6%	19.4%	15.5%	***17.0%***	***20.0%***

Despite the depressed earnings during the last three years, Occidental Petroleum has continued raising its dividend. As a result, it currently offers a generous 4.0% dividend yield. While some investors are afraid that the dividend will be cut, cash flows are sufficient to support capital expenses and dividends. Moreover, thanks to the continuing strength in the price of oil, the company will even be able to resume share repurchases. Therefore, the dividend can be considered safe for the foreseeable future.

On the other hand, investors should keep in mind that Occidental Petroleum will always be vulnerable to declining oil prices. This was prominent in the Great Recession, when its EPS plunged 58%, from $8.98 in 2008 to $3.79 in 2009. As it is an almost pure upstream company, it is much more sensitive to the price of oil and natural gas than the well-known oil majors.

Final Thoughts & Recommendation

Occidental Petroleum has rallied 33% since last summer. Thus the market has already priced a great portion of the future EPS growth in the stock. Consequently, the stock is likely to offer a modest 3.2% average annual return over the next five years, thanks to 10.0% EPS growth and a 4.0% dividend, which will be partly offset by a 10.8% annualized P/E contraction.

Total Return Breakdown by Year