Phillips 66 (PSX)

Updated May 3rd, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	$115	**5 Year CAGR Estimate:**	5.4%	**Quality Percentile:**	N/A
Fair Value Price:	$99	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	N/A
% Fair Value:	116%	**5 Year Valuation Multiple Estimate:**	-3.0%	**Total Return Percentile:**	N/A
Dividend Yield:	2.4%	**5 Year Price Target**	$132	**Valuation Percentile:**	N/A

Overview & Current Events

Phillips 66 was spun off from ConocoPhillips in 2012. Phillips 66 operates in four segments; refining, midstream, chemicals and marketing. It is a diversified company, with each of its segments behaving differently under various oil prices. When the price of oil began to collapse in 2014, the refining segment became by far the most profitable segment, as low oil prices improved the demand for oil products and thus boosted refining margins. Despite the rally of the oil price since last summer, oil is still much cheaper than it was four years ago. As a result, the refining segment of Phillips 66 still earned as much as the other three segments combined last year. Nevertheless, as oil now stands at a 3-year high, the earnings of this segment have decreased. On the other hand, higher oil prices favor the results of the midstream segment and the chemicals segment. That's why these two segments almost doubled their earnings in Q1.

As growth projects in the oil industry tend to take many years to start bearing fruit, there is a great lag between capital expenses and their resultant cash flows. Fortunately for the shareholders of Phillips 66, the company is currently in the positive phase of its cycle. While it has greatly reduced its capital expenses in recent years, it has begun to reap the benefits from its huge investments in 2014 and 2015, when it invested a total of $9.5 B. This year, the company intends to invest only $2.3 B, from which about half will be directed to growth and the other half to maintenance.

It is also critical to note the importance of the quality of the management. Buffett has repeatedly stated that the primary reason for his high stake in the company is the quality of the management, which is disciplined and thus invests only in high-return projects.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	----	----	----	----	$6.48	$5.92	$7.10	$7.73	$2.92	$4.58	***$7.02***	***$9.39***
DPS	----	----	----	----	$0.45	$1.33	$1.89	$2.18	$2.45	$2.73	***$3.01***	***$4.20***

Thanks to the determination of OPEC and Russia, oil prices are likely to remain strong for the foreseeable future, particularly given the upcoming IPO of Saudi Aramco next year. This will benefit the midstream and the chemicals segment. Moreover, the crude oil from Canada and the Permian Basin are trading at a discount to WTI thanks to the rising output in these areas while the discount of WTI to Brent is widening for a similar reason. As a result, domestic refiners are enjoying much higher margins than their international peers. Thanks to these positive factors and the recent tax reform, the analysts expect Phillips 66 to grow its EPS to $7.02 this year.

On the other hand, while Phillips 66 is highly diversified, it still operates in a cyclical sector. Consequently, it is hard to make long-term predictions. Nevertheless, as the company has repurchased its shares at a 4% average annual rate in the last five years and has confirmed its intention to continue to repurchase its shares at a similar pace, it is reasonable to expect at least 6.0% average annual EPS growth over the next five years. If this growth rate materializes, the EPS will grow to $9.39 in 2023.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	----	----	----	----	6.4	10.5	11.1	10.3	27.7	18.5	***16.4***	***14.1***
Avg. Yld.	----	----	----	----	1.1%	2.1%	2.4%	2.7%	3.0%	3.2%	***2.4%***	***3.2%***

Phillips 66 has rallied 50% during the last 11 months. As a result, it is now trading at a P/E of 16.4, which is significantly higher than its 10-year average P/E of 14.1. As it is reasonable to expect the stock to revert towards its average valuation level over the next five years, the stock is likely to incur a 3.0% annualized drag due to P/E contraction until 2023.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	----	----	----	----	44.0%	38.7%	44.0%	43.8%	33.9%	33.6%	***32.0%***	***30.0%***
Debt/A	----	----	----	----	56.7%	55.0%	54.7%	50.7%	54.1%	49.6%	***53.0%***	***55.0%***
Int. Cov.	----	----	----	----	27.7	21.0	22.5	22.5	7.9	9.8	***10.0***	***11.0***
Payout	----	----	----	----	6.9%	22.5%	26.6%	28.2%	83.9%	59.6%	***42.9%***	***44.7%***
Std. Dev.	----	----	----	----	21.6%	29.3%	20.1%	26.0%	18.9%	15.2%	***15.0%***	***17.0%***

The management of Phillips 66 has repeatedly confirmed its shareholder-friendly character. It has more than doubled the dividend in the last four years while it has reduced the share count by 25% since the spin-off of the stock. Thanks to its strong balance sheet, the company will easily remain shareholder-friendly for the foreseeable future.

As low oil prices result in excessive refining margins, some investors may think that Phillips 66 is recession-proof. However, this is not the case. In the recent downturn of the oil sector, the low oil prices resulted in high refining margins thanks to the healthy underlying economic growth. During the Great Recession however, the price of oil products plunged along with the price of oil and resulted in low refining margins. Even worse, whenever the next recession shows up, U.S. refiners will not be protected by the ban on oil exports, which pressured domestic oil prices in the last recession. Therefore, as the next recession is likely to exert pressure on all the segments of Phillips 66, the stock will have significant downside risk in such an event, particularly given its breathless rally this year.

Final Thoughts & Recommendation

Phillips 66 is a well-managed and properly positioned for almost any scenario of oil prices. However, its 50% rally last year has significantly reduced its potential future returns. Over the next five years, the stock is likely to offer a 5.4% average annual return thanks to 6.0% EPS growth and a 2.4% dividend, which will be partly offset by a 3.0% annualized P/E contraction. This stock is a strong buy when trading at a discount to fair value but is a hold at current prices.

Total Return Breakdown by Year