



Occidental Petroleum Corporation (OXY)

Updated August 11th, 2018 by Aristofanis Papadatos

Key Metrics

Current Price: \$79	5 Year CAGR Estimate: 5.1%	Volatility Percentile: 55.4%
Fair Value Price: \$65	5 Year Growth Estimate: 5.0%	Momentum Percentile: 81.2%
% Fair Value: 122%	5 Year Valuation Multiple Estimate: -3.9%	Valuation Percentile: 27.7%
Dividend Yield: 4.0%	5 Year Price Target \$83	Total Return Percentile: 29.1%

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 is now trading just 10% off its 3.5-year high. Occidental Petroleum has greatly benefited from this rally. The company reported (8/8/18) its financial results for the second quarter of fiscal 2018 last week. It reported a 7% increase in its average realized crude oil price vs. Q1, which resulted in a 20% increase in its earnings. This shows how leveraged the oil producer is to the oil price. Moreover, the company posted record pre-tax earnings of \$317 million in its chemical segment, above its own expectations, thanks to favorable margins and high volumes. Furthermore, it grew its Permian output by 46% vs. last year to 201 K barrels/day and its total output by 7.5% to 639 K barrels/day. Thanks to the strong underlying trends in its business and the bright outlook, management announced that it was resuming share repurchases. It intends to repurchase more than \$2 billion of shares in the next 12-18 months and will thus reduce the share count by at least 3%.

The free cash flow of the company has increased to a level that is sufficient to cover its capital expenses and its dividend. 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. Occidental Petroleum has built inventory in the Permian Basin that is sufficient for production for 17 years at a breakeven oil price below \$50. Management provided guidance for approximate 3% total output growth for next year.

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	\$4.70	\$6.00
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

Thanks to the strength in the oil price and the markedly high leverage of Occidental Petroleum to the oil price, analysts have pronouncedly raised their EPS estimates for this year since our last research report, from \$3.14 to \$4.89. However, in our last report, we stated that the market had already priced most of the growth potential in the stock. This has proven correct, as the stock has gained just 2.5% since then whereas the broad market has rallied 7.8% over the same period. This case shows why investors should always pay great attention to valuation.

As the oil price has corrected 10% in the last month and analysts have not adjusted their estimates, we expect EPS around \$4.70 this year. Moreover, as a great portion of our previous growth expectations has already materialized thanks to the strength in the oil price, we have lowered our expected 5-year annual EPS growth rate from 10% to 5%.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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	16.8	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%	4.0%

Occidental Petroleum is currently trading at a P/E of 16.8, which is higher than its 10-year average P/E of 13.8. As the company will continue to recover in the years ahead, it is reasonable to expect the stock to revert towards its average valuation level. If this occurs, the stock will incur a 3.9% annualized 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	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%	52.5%	45.0%
Int. Cov.	89.1	38.9	66.8	36.1	51.9	55.5	80.2	4.1	-3.2	3.5	9.5	15.0
Payout	12.7%	34.3%	24.8%	21.0%	37.0%	27.6%	58.0%	2450%	----	343%	66.0%	55.0%
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%

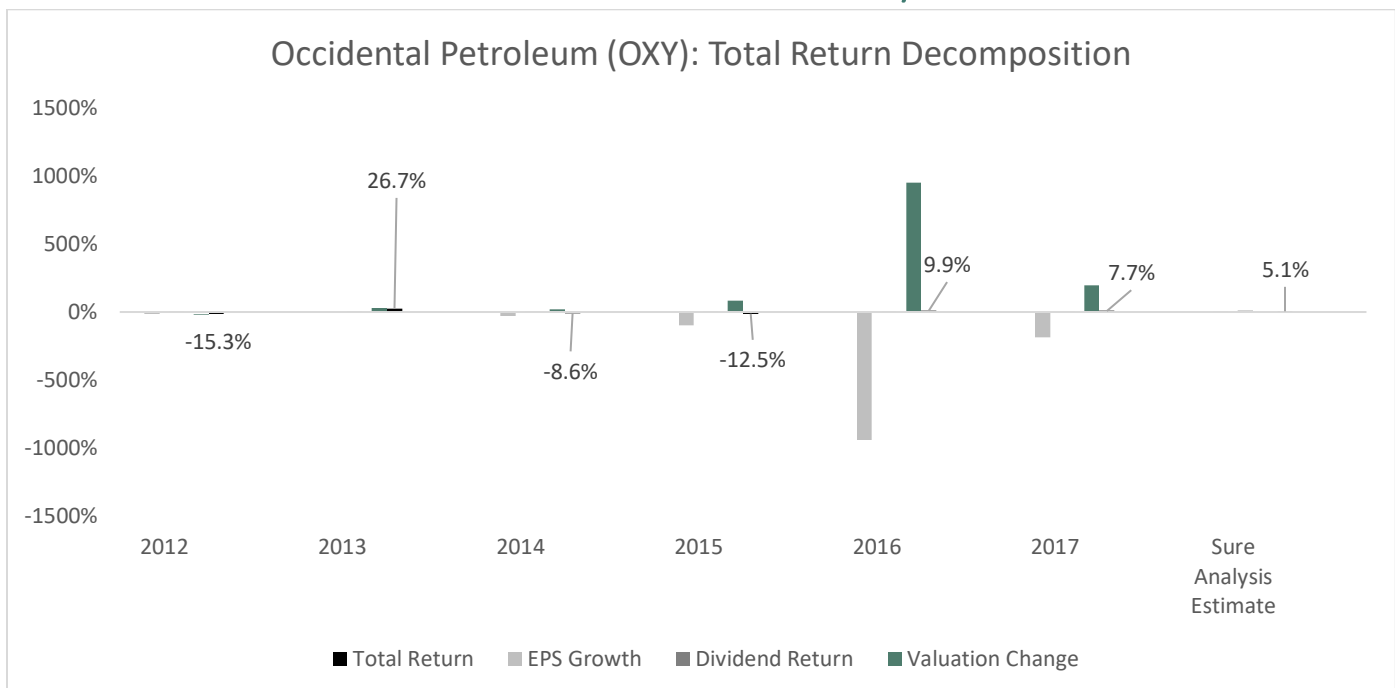
Occidental has raised its dividend for 16 consecutive years at a 12% average annual rate and currently offers a generous 4.0% dividend yield. While some investors are afraid that the dividend will be cut, cash flows are sufficient to support capital expenses and dividends. Moreover, thanks to the continuing strength in the price of oil, the company is resuming share repurchases. Therefore, the dividend can be considered safe for the foreseeable future.

Occidental Petroleum's reliance on oil prices was prominent in the Great Recession, when its EPS plunged 58%, from \$8.98 in 2008 to \$3.79 in 2009. We reiterate that it is more sensitive to oil prices than the energy supermajors.

Final Thoughts & Recommendation

Occidental Petroleum has rallied 34% since last summer. 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 5.1% average annual return over the next five years, thanks to 5.0% EPS growth and a 4.0% dividend, which will be offset by a 3.9% annualized P/E contraction. Because of this mid-single-digit total return expectation, Occidental earns a hold recommendation today.

Total Return Breakdown by Year



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