



Phillips 66 (PSX)

Updated October 29th, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	\$99	5 Year CAGR Estimate:	10.6%	Volatility Percentile:	55.8%
Fair Value Price:	\$118	5 Year Growth Estimate:	4.0%	Momentum Percentile:	75.3%
% Fair Value:	84%	5 Year Valuation Multiple Estimate:	3.5%	Growth Percentile:	20.1%
Dividend Yield:	3.1%	5 Year Price Target	\$143	Valuation Percentile:	74.7%
Dividend Risk Score:	C	Retirement Suitability Score:	C	Total Return Percentile:	56.0%

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.

Phillips 66 reported its financial results for the third quarter of fiscal 2018 last week. The company exceeded the analysts' earnings-per-share estimates by 33% (\$3.18 vs. \$2.40), mostly thanks to high realized refining margins in the Central Corridor, where the refineries enjoyed a strong tailwind from the large spread between WTI and WCS. It is remarkable that the company ran its refineries in the region at a 108% utilization rate.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	N/A	N/A	N/A	N/A	\$6.48	\$5.92	\$7.10	\$7.73	\$2.92	\$4.58	\$8.35	\$10.16
DPS	N/A	N/A	N/A	N/A	\$0.45	\$1.33	\$1.89	\$2.18	\$2.45	\$2.73	\$3.10	\$4.20
Shares	N/A	N/A	N/A	N/A	636.76	618.99	571.50	546.98	530.07	518.51	515	500

As Phillips 66 smashed the analysts' estimates in Q3, we have raised our earnings-per-share estimate for this year from \$7.02 to \$8.35. 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 billion.

Phillips 66 will benefit from the new international marine rules, which will force vessels sailing in international waters to burn low-sulfur diesel instead of heavy fuel oil starting January, 2020. Diesel is much more expensive than fuel oil, refiners will enjoy a boost in their margins. The U.S. government was rumored to be attempting a postponement in the implementation of the new rules for the U.S. and thus caused a sell-off of all the domestic refiners.

The oil market has tightened this year thanks to the efforts of OPEC and Russia and supply disruptions in Iran, Libya and Venezuela. Consequently, the oil price has rallied to an almost 4-year high. As high oil prices exert pressure on the demand for refined products, they negatively affect refining margins.

Nevertheless, as Phillips 66 has repurchased its shares at a 5% average annual rate in the last six years and has confirmed its intention to continue to repurchase its shares at a similar pace, it is reasonable to expect at least 4.0% annual earnings-per-share growth over the next five years. We have lowered our assumed long-term growth rate from 6% to 4% due to the exceptional results of this year, which will constitute a high base for the upcoming years.

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	11.9	14.1
Avg. Yld.	----	----	----	----	1.1%	2.1%	2.4%	2.7%	3.0%	3.2%	3.1%	2.9%

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In our last research report, in July, we mentioned that the rally of Phillips 66 had rendered the stock overvalued. Indeed the stock has lost 17% since then. Moreover, Buffett, who is well-known for its value-oriented mindset, slashed his stake in Phillips 66 by 36% in Q3, from 7.5% to 4.8%. Berkshire Hathaway has reduced its stake in the stock in every quarter this year. Nevertheless, thanks to its recent correction, Phillips 66 has become more reasonably valued and is now trading at a P/E ratio of 11.9, which is lower than its 10-year average of 14.1. If the stock reverts to its average valuation level within the next five years, it will enjoy a 3.5% annualized gain thanks to P/E expansion.

Safety, Quality, Competitive Advantage, & Recession Resiliency

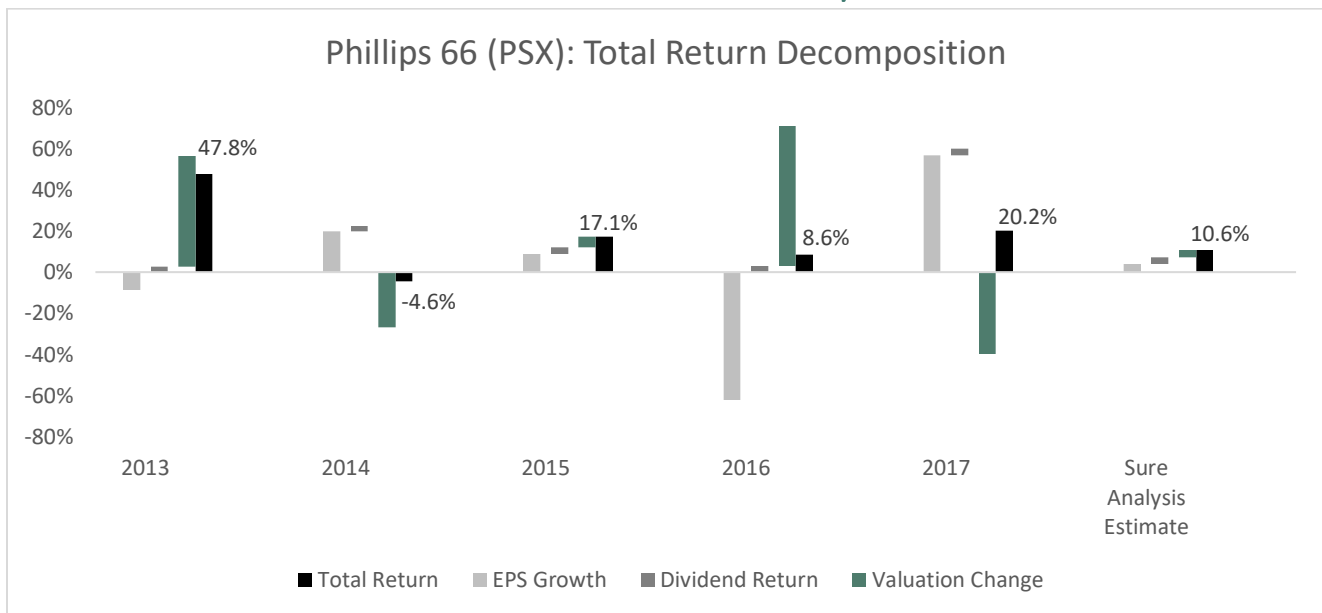
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	----	----	----	----	44.0%	38.7%	44.0%	43.8%	33.9%	33.6%	32.0%	30.0%
Debt/A	----	----	----	----	56.7%	55.0%	54.7%	50.7%	54.1%	49.6%	54.0%	55.0%
Int. Cov.	----	----	----	----	27.7	21.0	22.5	22.5	7.9	9.8	10.0	11.0
Payout	----	----	----	----	6.9%	22.5%	26.6%	28.2%	83.9%	59.6%	37.1%	41.3%
Std. Dev.	----	----	----	----	21.6%	29.3%	20.1%	26.0%	18.9%	15.2%	15.0%	17.0%

In the recent downturn of the oil sector, low oil prices resulted in high refining margins thanks to the healthy underlying economic growth. However, in the Great Recession, 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, Phillips 66 will have significant downside risk in such an event.

Final Thoughts & Recommendation

Phillips 66 is a well-managed company, which is properly positioned for almost any scenario of oil prices. Thanks to its recent correction, the stock can now offer a 10.6% average annual return over the next five years, in the absence of a recession. It thus earns a buy rating, though investors may be better suited to wait for an even lower entry point.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue (\$B)	N/A	112.86	146.56	195.93	179.29	171.60	161.21	98.98	84.28	102.35
Gross Profit	N/A	15606	21469	23163	24877	23351	25464	25576	21811	22945
Gross Margin	N/A	13.8%	14.6%	11.8%	13.9%	13.6%	15.8%	25.8%	25.9%	22.4%
SG&A Exp.	N/A	1314	1384	1394	1703	1478	1663	1670	1638	1695
D&A Exp.	N/A	879	880	902	906	947	995	1078	1168	1318
Operating Profit	N/A	-231	1078	2521	4612	2666	3430	4548	1098	1838
Operating Margin	N/A	-0.2%	0.7%	1.3%	2.6%	1.6%	2.1%	4.6%	1.3%	1.8%
Net Profit	N/A	476	735	4775	4124	3726	4762	4227	1555	5106
Net Margin	N/A	0.4%	0.5%	2.4%	2.3%	2.2%	3.0%	4.3%	1.8%	5.0%
Free Cash Flow	N/A	-1515	942	3990	2595	4248	-244	-51	119	1816
Income Tax	N/A	368	579	1822	2473	1844	1654	1764	547	-1693

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	N/A	42880	44955	43211	48073	49798	48692	48580	51653	54371
Cash & Equivalents	N/A	N/A	N/A	N/A	3474	5400	5207	3074	2711	3119
Accounts Receivable	N/A	6842	8364	8354	8593	7900	6306	4411	5485	6424
Inventories	N/A	3842	4113	3466	3430	3354	3397	3477	3150	3395
Goodwill & Int. Ass.	N/A	4426	4410	4064	4068	3794	4174	4181	4158	4146
Total Liabilities	N/A	15940	18929	19918	27267	27406	26655	24642	27928	26943
Accounts Payable	N/A	7715	9814	10007	9731	9948	7488	5155	6395	7242
Long-Term Debt	N/A	428	417	391	6974	6155	8635	8887	10138	10110
Shareholder's Equity	N/A	26917	26001	23264	20775	21950	21590	23100	22390	25085
D/E Ratio	N/A	0.02	0.02	0.02	0.34	0.28	0.40	0.38	0.45	0.40

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	N/A	N/A	1.7%	10.8%	9.0%	7.6%	9.7%	8.7%	3.1%	9.6%
Return on Equity	N/A	N/A	2.8%	19.4%	18.7%	17.4%	21.9%	18.9%	6.8%	21.5%
ROIC	N/A	N/A	2.7%	19.1%	16.0%	13.2%	16.1%	13.3%	4.7%	14.3%
Shares Out.	N/A	N/A	N/A	N/A	636.76	618.99	571.50	546.98	530.07	518.51
Revenue/Share	N/A	176.34	229.00	306.14	281.56	277.22	282.08	180.95	159.00	197.40
FCF/Share	N/A	-2.37	1.47	6.23	4.08	6.86	-0.43	-0.09	0.22	3.50

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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