Phillips 66 (PSX)

Updated February 12th, 2019 by Aristofanis Papadatos

Key Metrics

Current Price:	$94	**5 Year CAGR Estimate:**	10.2%	**Volatility Percentile:**	52.5%
Fair Value Price:	$106	**5 Year Growth Estimate:**	4.0%	**Momentum Percentile:**	50.3%
% Fair Value:	88%	**5 Year Valuation Multiple Estimate:**	2.5%	**Growth Percentile:**	22.3%
Dividend Yield:	3.7%	**5 Year Price Target**	$130	**Valuation Percentile:**	71.4%
Dividend Risk Score:	B	**Retirement Suitability Score:**	B	**Total Return Percentile:**	54.0%

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 boosted refining margins.

In early February, Phillips 66 reported (2/8/19) financial results for the fourth quarter of fiscal 2018. Although benchmark U.S. refining margins plunged almost 50% in the quarter from $13 to $7 per barrel, Phillips 66 smashed analysts' earnings-per-share estimates ($4.87 vs. $2.86). The impressive performance resulted from purchases of crude oil grades, such as Bakken and Canadian, at a deep discount to WTI. The refining segment generated 64% of total earnings even though the company posted record earnings in its midstream and marketing segments. The midstream segment benefited from high-return capital projects completed in the last two years. Remarkably, Phillips 66 has exceeded the analysts' earnings-per-share estimates for 6 consecutive quarters. In fiscal 2018, Phillips 66 achieved record earnings ($5.6 billion), raised its quarterly dividend by 14%, and repurchased 10% of its outstanding shares.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	N/A	N/A	N/A	$6.48	$5.92	$7.10	$7.73	$2.92	$4.58	$11.85	***$8.90***	***$10.83***
DPS	N/A	N/A	N/A	$0.45	$1.33	$1.89	$2.18	$2.45	$2.73	$3.10	***$3.50***	***$4.50***
Shares	N/A	N/A	N/A	636.76	618.99	571.50	546.98	530.07	518.51	464.4	***430.0***	***350.0***

Growth projects in the oil industry take many years to start bearing fruit and hence 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. In addition, management is well known for its discipline to invest only in high-return projects. This is the primary reason behind the past investment of Berkshire Hathaway in Phillips 66.

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 and hence refiners will enjoy a boost in their earnings. In October, the U.S. government was rumored to be attempting a postponement the implementation of the new rules for the U.S. and thus caused a sell-off of all the domestic refiners. However, this is not likely to postpone the new rules for more than one or two years if at all.

The only point of concern is the 50% plunge of benchmark U.S. refining margins, from $13 per barrel in early October to ~$6.50 per barrel now. While adverse seasonality is a factor, refining margins are still half of what they were last winter. However, Phillips 66 performed impressively in the fourth quarter thanks to the deep discount of Bakken and Canadian crude to WTI, which is used in the calculation of benchmark margins. Moreover, 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 thus reasonable to expect at least 4.0% annual earnings-per-share growth over the next five years.

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	----	----	----	6.4	10.5	11.1	10.3	27.7	18.5	8.9	***10.6***	***12.0***
Avg. Yld.	----	----	----	1.1%	2.1%	2.4%	2.7%	3.0%	3.2%	2.9%	***3.7%***	***3.5%***

Warren Buffett, who is well-known for his value-oriented mindset, slashed his stake in Phillips 66 by 36% in Q3, from 7.5% to 4.8%. Berkshire Hathaway reduced its stake in the stock in each of the first three quarters last year. Nevertheless, thanks to its 24% correction off its summer peak, Phillips 66 has become reasonably valued and is now trading at a P/E ratio of 10.6, which is lower than its 10-year average of 13.3. In order to be somewhat conservative, we assume a fair P/E ratio of 12.0 for this stock. If the stock approaches our fair value estimate within the next five years, it will enjoy a 2.5% annualized gain thanks to P/E expansion.

Safety, Quality, Competitive Advantage, & Recession Resiliency

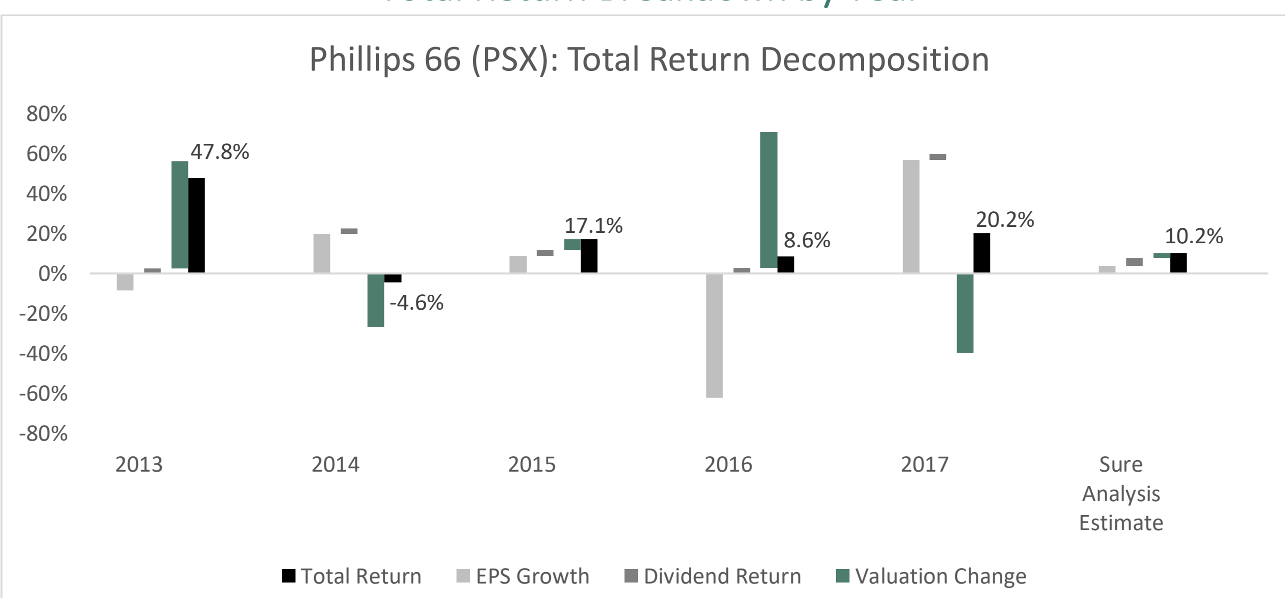
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	----	----	----	6.9%	22.5%	26.6%	28.2%	83.9%	59.6%	26.2%	***39.3%***	***41.6%***

Phillips 66 has a significant competitive advantage, namely the discipline of its management to invest only in high-return projects. On the other hand, despite its diversified business, the company is cyclical, just like most oil companies. In the recent downturn of the oil sector, between mid-2014 and 2017, low oil prices resulted in high refining margins thanks to 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. 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 24% correction off its summer peak, the stock can offer a 10.2% 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 a lower entry point.

Total Return Breakdown by Year



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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.

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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.