Phillips 66 (PSX)

Updated May 7th, 2019 by Aristofanis Papadatos

Key Metrics

Current Price:	$87	**5 Year CAGR Estimate:**	12.0%	**Volatility Percentile:**	46.9%
Fair Value Price:	$91	**5 Year Growth Estimate:**	7.0%	**Momentum Percentile:**	10.8%
% Fair Value:	95%	**5 Year Valuation Multiple Estimate:**	1.0%	**Growth Percentile:**	66.1%
Dividend Yield:	4.0%	**5 Year Price Target**	$128	**Valuation Percentile:**	60.0%
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Total Return Percentile:**	68.4%

Overview & Current Events

Phillips 66 was spun off from ConocoPhillips in 2012. Phillips 66 has a market capitalization of $39 billion and 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 oil price began to collapse in 2014, the refining segment became by far the most profitable segment, as low oil prices improved demand for oil products and boosted refining margins.

In late April, Phillips 66 reported (4/30/19) financial results for the first quarter of fiscal 2019. Adjusted earnings plunged 92% over previous quarter, as the refining segment switched from a pre-tax profit of $2.0 billion to a pre-tax loss of $0.2 billion. The reasons were the collapse of the discount of Canadian crude to WTI, which caused the refining margin of the company to plunge 56%, and the major turnaround program in five refineries, which caused the refinery utilization to drop from 99% in previous quarter to 84%.

Notably Phillips 66 exceeded analysts' earnings-per-share estimates for a 7th consecutive quarter. On the other hand, the latest earnings report is a stern reminder of the high cyclicality of this business and the high vulnerability of Phillips 66 to factors beyond its control, namely refining margins. In our last research report, we had noted that the benchmark refining margins plunged but the company posted impressive results thanks to the deep discount of Canadian crude to WTI. Unfortunately, that discount collapsed in the latest quarter and led the company to post poor results. Nevertheless, we expect Phillips 66 to improve its performance in the next two quarters thanks to favorable seasonality.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	---	---	---	$6.48	$5.92	$7.10	$7.73	$2.92	$4.58	$11.85	***$7.60***	***$10.66***
DPS	---	---	---	$0.45	$1.33	$1.89	$2.18	$2.45	$2.73	$3.10	***$3.50***	***$4.50***
Shares	---	---	---	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.

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. The extensive turnaround activity of Phillips 66 in the first quarter may have hurt the results in the short term but it has prepared the refineries of the company to run at full throttle when the new marine rules come into effect. The company is likely to greatly benefit from its prudent strategy.

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. While we have lowered this year's earnings-per-share forecast from $8.90 to $7.60 due to the markedly poor margins in the first quarter, we have kept our long-term forecast essentially intact, implying 7% annual growth, as we are confident in the future growth path of the company.

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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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	***11.4***	***12.0***
Avg. Yld.	---	---	---	1.1%	2.1%	2.4%	2.7%	3.0%	3.2%	2.9%	***4.0%***	***3.5%***

Phillips 66 is now trading at a price-to-earnings ratio of 11.4, which is lower than its 10-year average of 13.3. In order to be conservative, we assume a fair earnings multiple of 12.0 for this stock. If the stock approaches our fair value estimate within the next five years, it will enjoy a 1.0% annualized gain.

Safety, Quality, Competitive Advantage, & Recession Resiliency

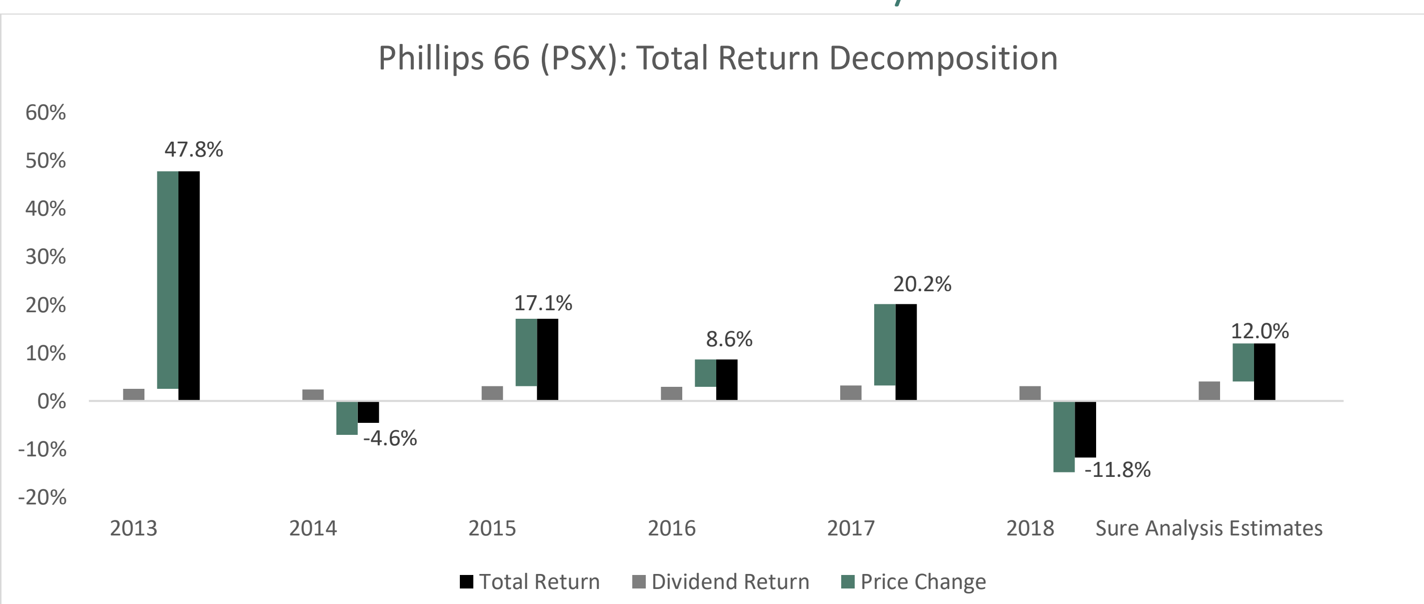
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	---	---	---	6.9%	22.5%	26.6%	28.2%	83.9%	59.6%	26.2%	***46.1%***	***42.2%***

Phillips 66 has a significant competitive advantage, namely the discipline of its management to invest only in high-return projects. However, 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. 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 most scenarios of oil prices. Investors should ignore the poor short-term results and focus on the promising growth prospects of the company. Thanks to its 30% correction off its summer peak, the stock can offer a 12.0% average annual return over the next five years, in the absence of a recession. It thus earns a buy rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue ($B)	112.9	146.6	195.9	179.3	171.6	161.2	99.0	84.3	102.4	111.5
Gross Profit	15606	21469	23163	24877	23351	25464	25576	21811	22945	13531
Gross Margin	13.8%	14.6%	11.8%	13.9%	13.6%	15.8%	25.8%	25.9%	22.4%	12.1%
SG&A Exp.	1314	1384	1394	1703	1478	1663	1670	1638	1695	1677
D&A Exp.	879	880	902	906	947	995	1078	1168	1318	1356
Operating Profit	-231	1078	2521	4612	2666	3430	4548	1098	1838	5209
Op. Margin	-0.2%	0.7%	1.3%	2.6%	1.6%	2.1%	4.6%	1.3%	1.8%	4.7%
Net Profit	476	735	4775	4124	3726	4762	4227	1555	5106	5595
Net Margin	0.4%	0.5%	2.4%	2.3%	2.2%	3.0%	4.3%	1.8%	5.0%	5.0%
Free Cash Flow	-1515	942	3990	2595	4248	-244	-51	119	1816	4934
Income Tax	368	579	1822	2473	1844	1654	1764	547	-1693	1572

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	42880	44955	43211	48073	49798	48692	48580	51653	54371	54302
Cash & Equivalents	0	0	0	3474	5400	5207	3074	2711	3119	3019
Acc. Receivable	6842	8364	10025	10403	9632	7255	5173	6397	7506	6173
Inventories	3842	4113	3466	3430	3354	3397	3477	3150	3395	3543
Goodwill & Int.	4426	4410	4064	4068	3794	4174	4181	4158	4146	4139
Total Liabilities	15940	18929	19918	27267	27406	26655	24642	27928	26943	27149
Accounts Payable	7715	9814	10792	10710	11090	8064	5655	7061	8027	6586
Long-Term Debt	428	417	391	6974	6155	8635	8887	10138	10110	11160
Total Equity	26917	26001	23264	20775	21950	21590	23100	22390	25085	24653
D/E Ratio	0.02	0.02	0.02	0.34	0.28	0.40	0.38	0.45	0.40	0.45

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	N/A	1.7%	10.8%	9.0%	7.6%	9.7%	8.7%	3.1%	9.6%	10.3%
Return on Equity	N/A	2.8%	19.4%	18.7%	17.4%	21.9%	18.9%	6.8%	21.5%	22.5%
ROIC	N/A	2.7%	19.1%	16.0%	13.2%	16.1%	13.3%	4.7%	14.3%	14.8%
Shares Out.	---	---	---	636.76	618.99	571.50	546.98	530.07	518.51	464.4
Revenue/Share	176.3	229.00	306.14	281.56	277.22	282.08	180.95	159.00	197.40	235.13
FCF/Share	-2.37	1.47	6.23	4.08	6.86	-0.43	-0.09	0.22	3.50	10.41

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