ConocoPhillips (COP)

Updated August 7th, 2019 by Aristofanis Papadatos

Key Metrics

Current Price:	$54	**5 Year CAGR Estimate:**	9.8%	**Volatility Percentile:**	59.1%
Fair Value Price:	$50	**5 Year Growth Estimate:**	8.0%	**Momentum Percentile:**	16.0%
% Fair Value:	108%	**5 Year Valuation Multiple Estimate:**	-1.4%	**Growth Percentile:**	77.3%
Dividend Yield:	3.2%	**5 Year Price Target**	$74	**Valuation Percentile:**	38.8%
Dividend Risk Score:	D	**Retirement Suitability Score:**	D	**Total Return Percentile:**	43.7%

Overview & Current Events

ConocoPhillips is the world's largest independent oil and gas producer, with an average production of 1.3 million barrels per day and a market capitalization of $61 billion. It was founded in 2002 and is headquartered in Houston, Texas.

In late July, ConocoPhillips reported (7/30/19) financial results for the second quarter of fiscal 2019. The company grew its production (excluding Libya) by 4% over last year's quarter, thus exceeding the high end of its guidance, primarily thanks to 26% production growth in the big 3 unconventional/shale plays. However, its adjusted earnings-per-share fell 7%, from $1.09 to $1.01, and thus missed analysts' consensus by $0.02. The decrease in earnings-per-share resulted from a 7% decline in the average realized price of oil, from $54.32 to $50.50.

Management expects 0%-3% sequential production growth in the third quarter due to planned maintenance in Alaska, Europe and Asia Pacific. Due to the pressure in the price of oil since mid-April and the high sensitivity of the earnings of ConocoPhillips to the oil price, we have lowered our earnings-per-share forecast for this year from $4.50 to $4.20.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$3.24	$5.92	$8.76	$5.91	$6.43	$4.96	-$1.39	-$2.52	$0.61	$4.54	***$4.20***	***$6.17***
DPS	$1.91	$2.15	$2.64	$2.64	$2.70	$2.84	$2.94	$1.00	$1.06	$1.16	***$1.24***	***$1.70***
Shares	1490	1430	1290	1220	1230	1230	1240	1240	1180	1140	***1110***	***1030***

When oil prices began to collapse in 2014, ConocoPhillips was, among the large oil companies, the producer that suffered the most. The company posted heavy losses in 2015 and 2016 and its stock price fell 60% from its peak. However, the company seems to have learned its lesson. It has focused on high-grading its asset portfolio with the addition of low-cost barrels in order to achieve positive free cash flows even at oil prices below $40. This year, it has directed all its investments on reserves that are profitable even below $40 per barrel.

As leverage is a two-edged sword, ConocoPhillips is now one of the best positioned oil producers to benefit from rising oil prices. The company's results during 2018 show that ConocoPhillips has been able to generate tremendous earnings growth compared to prior years thanks to higher average oil prices. The company grew its production by 5% last year and is poised to grow it by at least 5% this year. In addition, cost-cutting efforts during the oil price slump, which have increased the efficiency of ConocoPhillips' operations, are increasingly paying off.

Overall, ConocoPhillips is likely to grow its earnings-per-share significantly in the upcoming years thanks to four growth drivers: production growth, somewhat higher oil prices, share repurchases, and lower interest expense thanks to debt reduction. ConocoPhillips has reduced its net debt by 50%, from $52.7 billion in 2014 to $26.1 billion. As a result, interest expense has dropped 38% in the last three years and has thus contributed to earnings growth significantly.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	14.0	9.4	8.2	9.5	10.1	15.0	---	---	---	13.7	***12.9***	***12.0***
Avg. Yld.	4.2%	3.9%	3.7%	4.7%	4.2%	3.8%	5.1%	2.4%	2.2%	1.9%	***3.2%***	***2.3%***

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ConocoPhillips is currently trading at a price-to-earnings ratio of 12.9. While this valuation seems fair right now, we expect the earnings multiple to contract over the next five years, as the upcycle of the energy sector unwinds. This is in line with the data of the above table, which shows that the stock had its lowest price-to-earnings ratios in the years it posted its maximum profits (2010-2013). We have thus assumed a fair price-to-earnings ratio of 12.0 for 2024. If this proves correct, the stock will incur a 1.4% annualized valuation drag in its returns over the next five years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2024**
Payout	59.0%	36.3%	30.1%	44.7%	42.0%	57.3%	---	---	174%	25.6%	***29.5%***	***27.6%***

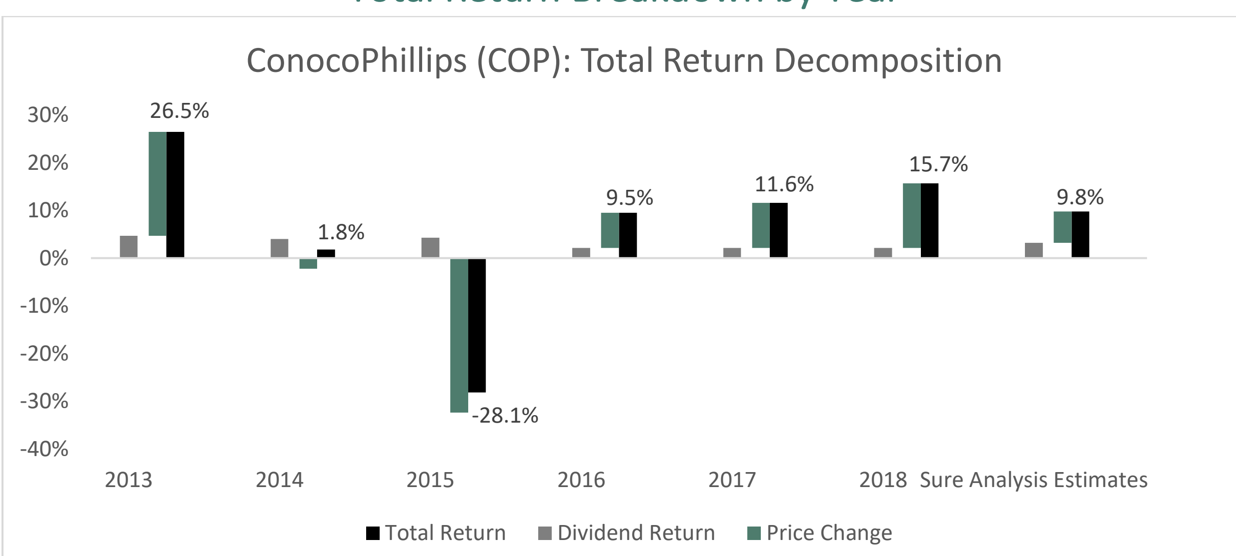
Since ConocoPhillips is a pure upstream company, it is much more leveraged to the price of oil than the well-known supermajors like Exxon Mobil, Chevron, BP, and Total. Those companies remained profitable in the recent downturn of the energy sector (2014-2017) and avoided cutting their dividends. On the contrary, ConocoPhillips incurred heavy losses in 2015-2016 and cut its dividend by 66% in 2016. This unconvincing history, coupled with the high cyclicality of ConocoPhillips' business, makes us believe that the company is not a safe income stock.

ConocoPhillips has made questionable investments in the past, such as its drilling rights in the U.S. Arctic and its deep-water business in Senegal. However, the company seems to have learned its lesson and has thus become much more disciplined, investing only in high-return projects. Nevertheless, investors should be aware of the sensitivity of ConocoPhillips to the oil price. In the event of another decline in oil prices, the company's earnings-per-share would decline substantially. During the last financial crisis, earnings-per-share plunged by 70%.

Final Thoughts & Recommendation

ConocoPhillips is an oil and gas pure upstream play that is highly leveraged to the price of oil. This allows for strong earnings growth during good times but the company is highly vulnerable to downturns in the energy sector and hence the stock is highly cyclical. Since it peaked early this year, the stock has shed 24%. As a result, it can now offer a 9.8% average annual return over the next five years and hence it is on the verge or earning a buy rating. However, due to its high cyclicality and vulnerability, we prefer to wait for a better entry point and thus rate the stock as a hold.

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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	149341	56215	64196	57967	54413	52524	29564	23693	29106	36417
Gross Profit	27274	17130	21146	19362	17098	13187	1009	-1030	4613	10954
Gross Margin	18.3%	30.5%	32.9%	33.4%	31.4%	25.1%	3.4%	-4.3%	15.8%	30.1%
SG&A Exp.	1830	809	865	1106	854	735	953	723	561	401
Operating Profit	8442	12045	14916	13122	11955	8118	-5440	-4634	2360	8956
Op. Margin	5.7%	21.4%	23.2%	22.6%	22.0%	15.5%	-18.4%	-19.6%	8.1%	24.6%
Net Profit	4414	11358	12436	8428	9156	6869	-4428	-3615	-855	6257
Net Margin	3.0%	20.2%	19.4%	14.5%	16.8%	13.1%	-15.0%	-15.3%	-2.9%	17.2%
Free Cash Flow	1618	9510	8432	-250	604	-516	-2478	-466	2486	6184
Income Tax	5090	7570	8208	7942	6409	3583	-2868	-1971	-1822	3668

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets ($B)	152.14	156.31	153.23	117.14	118.06	116.54	97.48	89.77	73.36	69.98
Cash & Equivalents	542	9454	5780	3618	6246	5062	2368	3610	6325	5915
Acc. Receivable	13215	13787	16526	9182	8487	6807	4514	3414	4320	4067
Inventories	4940	5197	4631	965	1194	1331	1124	1018	1060	1007
Goodwill & Int.	4461	4434	4077	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Total Liabilities	89525	87205	87481	68717	65565	64266	57402	54546	42561	37916
Accounts Payable	15485	18399	19653	10013	9314	8026	4933	3653	4030	3895
Long-Term Debt	28653	23592	22623	21725	21662	22565	24880	27275	19703	14968
Total Equity	62023	68562	65239	47987	52090	51911	39762	34974	30607	31939
D/E Ratio	0.46	0.34	0.35	0.45	0.42	0.43	0.63	0.78	0.64	0.47

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	3.0%	7.4%	8.0%	6.2%	7.8%	5.9%	-4.1%	-3.9%	-1.0%	8.7%
Return on Equity	7.5%	17.4%	18.6%	14.9%	18.3%	13.2%	-9.7%	-9.7%	-2.6%	20.0%
ROIC	5.0%	12.3%	13.7%	10.6%	12.7%	9.2%	-6.3%	-5.7%	-1.5%	12.8%
Shares Out.	1490	1430	1290	1220	1230	1230	1240	1240	1180	1140
Revenue/Share	99.72	37.70	46.28	46.26	43.89	42.16	23.81	19.02	23.84	30.98
FCF/Share	1.08	6.38	6.08	-0.20	0.49	-0.41	-2.00	-0.37	2.04	5.26

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