Royal Dutch Shell plc (RDS.B)

Updated November 15th, 2019 by Aristofanis Papadatos

Key Metrics

Current Price:	$60	**5 Year CAGR Estimate:**	8.8%	**Volatility Percentile:**	32.1%
Fair Value Price:	$48	**5 Year Growth Estimate:**	8.5%	**Momentum Percentile:**	25.4%
% Fair Value:	125%	**5 Year Valuation Multiple Estimate:**	-4.4%	**Growth Percentile:**	87.5%
Dividend Yield:	6.3%	**5 Year Price Target**	$72	**Valuation Percentile:**	31.4%
Dividend Risk Score:	F	**Retirement Suitability Score:**	C	**Total Return Percentile:**	70.3%

Overview & Current Events

Royal Dutch Shell is an oil and gas supermajor, the second-largest behind Exxon Mobil in terms of annual production volumes. Shell is currently valued at $237 billion, also ranking second among oil companies behind Exxon Mobil by that measure. Shell is headquartered in London (UK) as well as in Den Haag (Netherlands). There are two types of shares of the company; RDS.A shares, listed in the Netherlands, and RDS.B shares, listed in the United Kingdom.

In late October, Royal Dutch Shell reported (10/31/19) financial results for the third quarter of fiscal 2019. Just like in the last several quarters, production remained essentially flat, at 3.6 million barrels per day. Moreover, the adjusted earnings of the company fell -15%, from $5.8 billion to $4.9 billion, due to lower oil and gas prices as well as weaker refining and chemicals margins. Shell partly offset the effect of adverse commodity prices with profits from trading of LNG and refined products but the company remains highly dependent on commodity prices, like the other oil majors. Due to the adverse commodity prices, we have lowered our earnings-per-share forecast for this year from $4.85 to $4.00.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$4.08	$6.56	$8.67	$8.48	$5.20	$4.72	$0.60	$1.16	$3.84	$5.16	***$4.00***	***$6.00***
DPS	$3.36	$3.36	$3.36	$3.42	$3.56	$3.72	$3.76	$3.76	$3.76	$3.76	***$3.76***	***$4.00***
Shares[1]	3,060	3,080	3,110	3,150	3,150	3,150	3,200	4,070	4,170	4,170	***4,000***	***3,700***

The earnings-per-share numbers in the above table do not look particularly enticing. From 2011's levels, earnings-per-share declined continuously until hitting an inflection point in 2015. Since then per-share profits have been rising, but are still well below the peak levels hit earlier in the decade. When oil prices were around their lows, Shell acquired BG Group, a deepwater oil and natural gas focused upstream company, in a $53 billion deal that was criticized by many at the time. Shell grew its output considerably thanks to that acquisition but its output has remained flat in the last two years, around 3.6-3.7 million barrels per day. Even worse, management expects new projects to contribute 0.25 million barrels per day this and next year and 0.3 million barrels per day after 2021. That output is likely to be offset by the natural decline of existing oil fields and hence we do not expect Shell to grow its output meaningfully in the upcoming years. This is in sharp contrast to the other oil majors, such as Chevron, BP and Total, which have been growing their production at a fast clip in recent years. The stagnation of Shell has resulted from the natural decline of its fields and its extensive asset divestments, which helped fund the expensive acquisition.

On the other hand, the current buyback program of Shell will reduce its share count by ~10% over the next three years and will thus provide earnings-per-share growth. Moreover, during the downturn of the energy sector, Shell drastically reduced its operating expenses and invested in high-quality, low-cost reserves, which have rendered the company more profitable than in the past at a given oil price. Shell posted record organic free cash flows of $31 billion last year even though Brent was about 40% lower than it was before the downturn. Overall, we expect Shell to grow its earnings-per-share to $6.00 by 2024 thanks to buybacks, its high-quality reserves and higher prices of oil and natural gas.

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[1] In millions.

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	12.7	8.7	8.1	8.4	13.3	16.7	52	44	18.6	11.6	***15.0***	***12.0***
Avg. Yld.	6.5%	5.9%	4.8%	5.1%	5.1%	4.7%	6.5%	7.4%	6.4%	6.2%	***6.3%***	***5.6%***

Shell's valuation has moved in a very wide range throughout the last decade, which can be explained by the big movements in the company's net profits. The stock is currently trading at a price-to-earnings ratio of 15.0, which is higher than our assumed fair earnings multiple of 12.0. If the stock reverts to our fair valuation level over the next five years, it will incur a -4.4% annualized drag in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

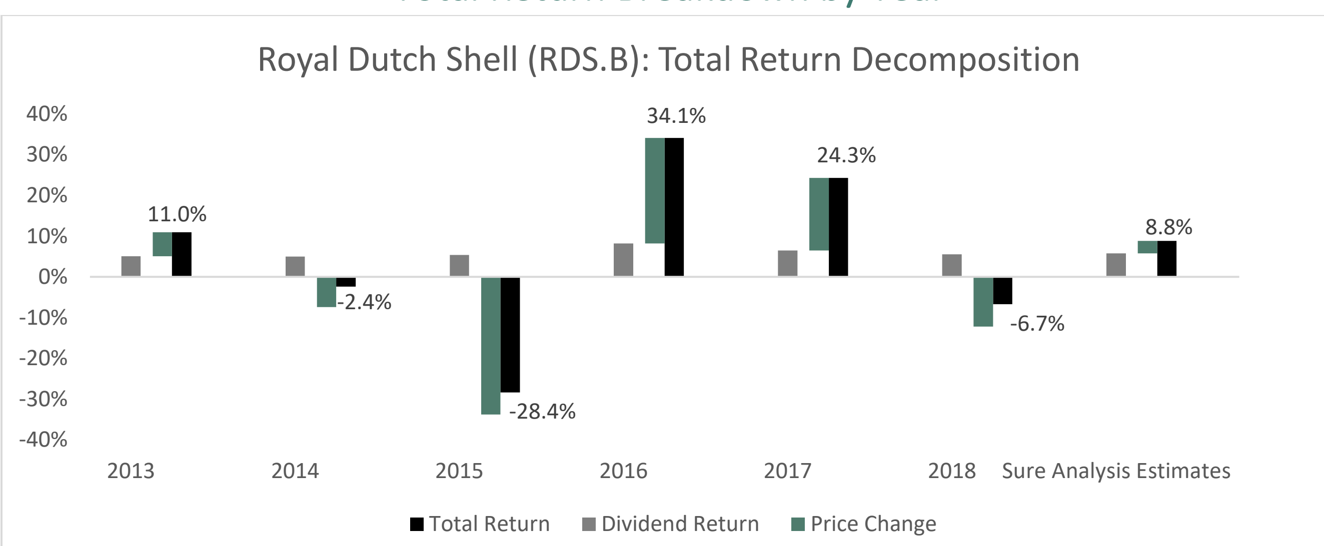
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	82.4%	51.2%	38.8%	40.3%	68.5%	78.8%	627%	324%	97.9%	72.9%	***94.0%***	***66.7%***

In contrast to Exxon Mobil and Chevron, which are Dividend Aristocrats, Shell has frozen its dividend for the last four years. Nevertheless, it has an excellent long-term track record, as it has not cut its dividend since World War II, and it currently offers an attractive 6.3% yield, which is much higher than the yield of its peers except for BP. Shell's dividend payout ratio is not what we call consistent, as the payout ratio has varied significantly throughout the last decade. Even though the dividend was not covered by profits during some of those years, the risk of a dividend cut was not high, given the excessive free cash flows of the company and the absence of a dividend cut during the last 70 years. Shell exceeded Exxon in annual operating cash flows in 2017 for the first time in about 20 years and has maintained its top position in the last two years. Moreover, Shell expects its annual free cash flows to remain around $30 billion in 2019-2021. As this amount is twice as much as the dividend, the dividend seems safe for the foreseeable future.

Final Thoughts & Recommendation

Despite stagnant production, Shell can offer an 8.8% average annual return over the next five years, assisted by its exceptional 6.3% dividend yield. We thus maintain our buy rating. Even if the stock price performs below our expectations, investors can remain patient thanks to the generous dividend, which appears safe for the next several years.

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)	285.13	368.06	470.17	467.15	451.24	421.11	264.96	233.59	305.18	388.38
Gross Profit	56753	44827	60346	56598	48141	39290	15507	17590	28857	44875
Gross Margin	19.9%	12.2%	12.8%	12.1%	10.7%	9.3%	5.9%	7.5%	9.5%	11.6%
SG&A Exp.	17430	15528	14359	14465	14675	13965	11956	12101	10509	11360
D&A Exp.	14458	15595	13228	14615	21509	24499	26714	24993	26223	22135
Operating Profit	21562	26244	42598	37722	26870	19879	-3261	2367	15481	31189
Op. Margin	7.6%	7.1%	9.1%	8.1%	6.0%	4.7%	-1.2%	1.0%	5.1%	8.0%
Net Profit	12518	20127	30826	26712	16371	14874	1939	4575	12977	23352
Net Margin	4.4%	5.5%	6.6%	5.7%	3.6%	3.5%	0.7%	2.0%	4.3%	6.0%
Free Cash Flow	-5028	410	10470	13564	465	13368	3679	-1501	14805	30074
Income Tax	8302	14870	24450	23552	17066	13584	-153	829	4695	11715

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets ($B)	292.18	322.56	337.47	350.29	357.51	353.12	340.16	411.28	407.10	399.19
Cash & Equivalents	9719	13444	11292	18550	9696	21607	31752	19130	20312	26741
Acc. Receivable	59328	N/A	79509	40210	39094	28393	20607	25766	30721	42431
Inventories	27410	29348	28976	30781	30009	19701	15822	21775	25223	21117
Goodwill & Int.	5356	5039	4521	4470	4394	7076	6283	23967	24180	23586
Total Liab. ($B)	154.05	172.78	177.51	174.11	176.36	180.33	176.04	222.76	209.29	196.66
Accounts Payable	67161	76550	81846	42448	41927	32131	23795	28069	33196	48888
Long-Term Debt	35033	44332	37175	33560	39417	38838	52194	77617	70141	76824
Total Equity ($B)	136.43	148.01	158.48	174.75	180.05	171.97	162.88	186.65	194.36	198.65
D/E Ratio	0.26	0.30	0.23	0.19	0.22	0.23	0.32	0.42	0.36	0.39

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	4.4%	6.5%	9.3%	7.8%	4.6%	4.2%	0.6%	1.2%	3.2%	5.8%
Return on Equity	9.5%	14.2%	20.1%	16.0%	9.2%	8.5%	1.2%	2.6%	6.8%	11.9%
ROIC	7.7%	11.0%	15.8%	13.1%	7.6%	6.9%	0.9%	1.9%	4.9%	8.5%
Shares Out.	3060	3080	3110	3150	3150	3150	3200	4070	4170	4170
Revenue/Share	93.04	119.90	151.14	149.06	143.40	133.44	82.40	59.20	73.55	93.04
FCF/Share	-1.64	0.13	3.37	4.33	0.15	4.24	1.14	-0.38	3.57	7.20

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