ConocoPhillips (COP)

Updated February 5th, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	$56	**5 Year CAGR Estimate:**	5.1%	**Market Cap:**	$61.6 B
Fair Value Price:	$38	**5 Year Growth Estimate:**	10.0%	**Ex-Dividend Date:**	2/13/2020
% Fair Value:	147%	**5 Year Valuation Multiple Estimate:**	-7.4%	**Dividend Payment Date:**	3/2/2020
Dividend Yield:	3.1%	**5 Year Price Target**	$61	**Years Of Dividend Growth:**	4
Dividend Risk Score:	C	**Retirement Suitability Score:**	D	**Last Dividend Increase:**	37.7%

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 $62 billion. It was founded in 2002 and is headquartered in Houston, Texas.

In early February, ConocoPhillips reported (2/4/20) financial results for the fourth quarter of fiscal 2019. Production (excluding Libya) fell -1.8% over the prior year's quarter due to asset divestments. In addition, the average realized price of the company fell -11% over the prior year's quarter, from $53 to $47 per barrel of oil equivalent. As a result, its adjusted earnings-per-share fell -33%, from $1.13 to $0.76.

Management raised the amount of remaining share repurchases from $5 billion to $15 billion but provided disappointing guidance for 2020, as it expects an approximate -4% decrease in the average production rate, partly due to a pipeline outage in Malaysia. Consequently, the stock fell -5% on the day of its earnings release.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$5.92	$8.76	$5.91	$6.43	$4.96	-$1.39	-$2.52	$0.61	$4.54	$3.59	***$3.20***	***$5.15***
DPS	$2.15	$2.64	$2.64	$2.70	$2.84	$2.94	$1.00	$1.06	$1.16	$1.33	***$1.71***	***$2.40***
Shares[1]	1430	1290	1220	1230	1230	1240	1240	1180	1140	1100	***1060***	***940***

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.

As leverage is a double-edged sword, ConocoPhillips is now one of the best positioned oil producers to benefit in the event of rising oil prices. The company grew its underlying production by 5% in each of the last two years and has promising growth prospects in the long run, despite the disappointing guidance for this year. Moreover, cost-cutting efforts during the oil price slump, which have enhanced the efficiency of ConocoPhillips, are paying off. Due to the expected dip in earnings this year, we have raised our expected earnings-per-share growth from 8% to 10%.

Overall, ConocoPhillips could 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 -54%, from $52.7 billion in 2014 to $24.1 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	9.4	8.2	9.5	10.1	15.0	---	---	---	13.7	17.1	***17.5***	***11.9***
Avg. Yld.	3.9%	3.7%	4.7%	4.2%	3.8%	5.1%	2.4%	2.2%	1.9%	2.2%	***3.1%***	***3.9%***

[1] In millions.

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ConocoPhillips is currently trading at a price-to-earnings ratio of 17.5. 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 11.9 for 2025, which is the average earnings multiple over the last decade. If this proves correct, the stock will incur a -7.4% annualized drag in its returns over the next five years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2025**
Payout	36.3%	30.1%	44.7%	42.0%	57.3%	---	---	174%	25.6%	37.0%	***53.4%***	***46.5%***

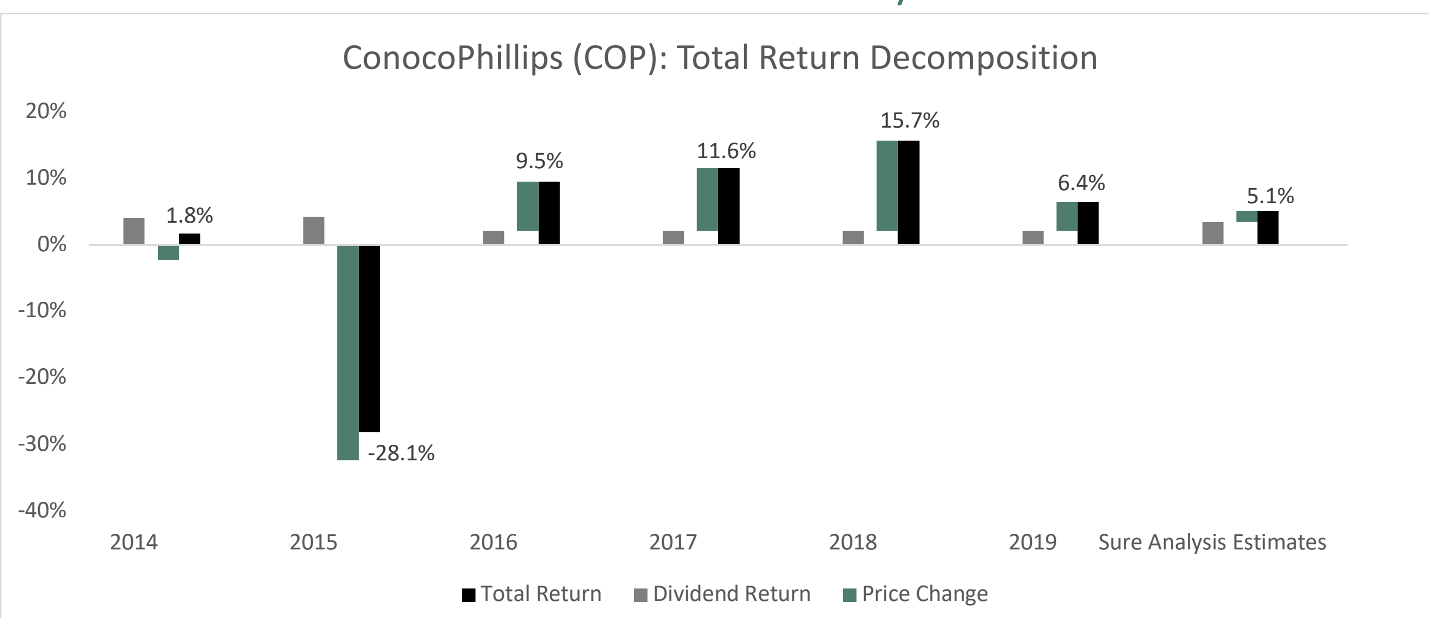
Since ConocoPhillips is a pure upstream company, it is much more leveraged to the price of oil than the well-known supermajors like Exxon Mobil, Chevron, BP, and Total. Those companies remained profitable in the recent downturn of the energy sector (2014-2017) and avoided cutting their dividends. On 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 price of oil. In the event of another decline in oil prices, the company's earnings-per-share would likely 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. The stock has shed -25% in the last 12 months but it is still far from attractive, as it may offer just a 5.1% average annual return over the next five years. Due to its high cyclicality and vulnerability, the stock maintains its hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	56215	64196	57967	54413	52524	29564	23693	29106	36417	
Gross Profit	17130	21146	19362	17098	13187	1009	-1030	4613	10954	
Gross Margin	30.5%	32.9%	33.4%	31.4%	25.1%	3.4%	-4.3%	15.8%	30.1%	
SG&A Exp.	809	865	1106	854	735	953	723	561	401	
Operating Profit	12045	14916	13122	11955	8118	-5440	-4634	2360	8956	
Op. Margin	21.4%	23.2%	22.6%	22.0%	15.5%	-18.4%	-19.6%	8.1%	24.6%	
Net Profit	11358	12436	8428	9156	6869	-4428	-3615	-855	6257	
Net Margin	20.2%	19.4%	14.5%	16.8%	13.1%	-15.0%	-15.3%	-2.9%	17.2%	
Free Cash Flow	9510	8432	-250	604	-516	-2478	-466	2486	6184	
Income Tax	7570	8208	7942	6409	3583	-2868	-1971	-1822	3668	

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets ($B)	156.31	153.23	117.14	118.06	116.54	97.48	89.77	73.36	69.98	
Cash & Equivalents	9454	5780	3618	6246	5062	2368	3610	6325	5915	
Acc. Receivable	13787	16526	9182	8487	6807	4514	3414	4320	4067	
Inventories	5197	4631	965	1194	1331	1124	1018	1060	1007	
Goodwill & Int.	4434	4077	N/A	N/A	N/A	N/A	N/A	N/A	N/A	
Total Liabilities	87205	87481	68717	65565	64266	57402	54546	42561	37916	
Accounts Payable	18399	19653	10013	9314	8026	4933	3653	4030	3895	
Long-Term Debt	23592	22623	21725	21662	22565	24880	27275	19703	14968	
Total Equity	68562	65239	47987	52090	51911	39762	34974	30607	31939	
D/E Ratio	0.34	0.35	0.45	0.42	0.43	0.63	0.78	0.64	0.47	

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	7.4%	8.0%	6.2%	7.8%	5.9%	-4.1%	-3.9%	-1.0%	8.7%	
Return on Equity	17.4%	18.6%	14.9%	18.3%	13.2%	-9.7%	-9.7%	-2.6%	20.0%	
ROIC	12.3%	13.7%	10.6%	12.7%	9.2%	-6.3%	-5.7%	-1.5%	12.8%	
Shares Out.	1430	1290	1220	1230	1230	1240	1240	1180	1140	
Revenue/Share	37.70	46.28	46.26	43.89	42.16	23.81	19.02	23.84	30.98	
FCF/Share	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.