Royal Dutch Shell plc (RDS.B)

Updated February 4th, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	$53	**5 Year CAGR Estimate:**	11.6%	**Market Cap:**	$206.2 B
Fair Value Price:	$60	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date:**	2/13/2020
% Fair Value:	88%	**5 Year Valuation Multiple Estimate:**	2.5%	**Dividend Payment Date:**	3/23/2020
Dividend Yield:	7.1%	**5 Year Price Target**	$73	**Years Of Dividend Growth:**	0
Dividend Risk Score:	F	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	N/A

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 $206 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 January, Royal Dutch Shell reported (1/30/20) financial results for the fourth quarter of fiscal 2019. Just like in the last several quarters, total production remained essentially flat, as field ramp-ups in the Permian and the Gulf of Mexico were offset by asset sales and natural decline of oil fields. The adjusted annual earnings of the company fell -48%, from $5.7 billion to $2.9 billion, due to lower oil, gas and LNG prices as well as weaker refining and chemical margins. On the bright side, despite a -33% decrease in annual free cash flows, from $39.4 billion to $26.4 billion, free cash flows were still sufficient to cover the generous dividend and share repurchases of the company.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$6.56	$8.67	$8.48	$5.20	$4.72	$0.60	$1.16	$3.84	$5.16	$4.08	***$5.00***	***$6.08***
DPS	$3.36	$3.36	$3.42	$3.56	$3.72	$3.76	$3.76	$3.76	$3.76	$3.76	***$3.76***	***$3.76***
Shares[1]	3,080	3,110	3,150	3,150	3,150	3,200	4,070	4,170	4,170	4,029	***3,950***	***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 risen 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 deep-water 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.

Management expects new projects to contribute 0.25 million barrels per day this 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. These two factors have also caused the duration of the reserves of Shell to fall for six years in a row and reach 7.9 years, which is much shorter than the average duration of the peer group (~11 years).

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 in 2018 even though Brent was about -40% lower than it was before the downturn. Overall, we expect Shell to grow its earnings-per-share to $6.08 by 2025 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	8.7	8.1	8.4	13.3	16.7	52	44	18.6	11.6	15.1	***10.6***	***12.0***
Avg. Yld.	5.9%	4.8%	5.1%	5.1%	4.7%	6.5%	7.4%	6.4%	6.2%	6.1%	***7.1%***	***5.2%***

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 10.6, which is lower 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 enjoy a 2.5% annualized gain in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

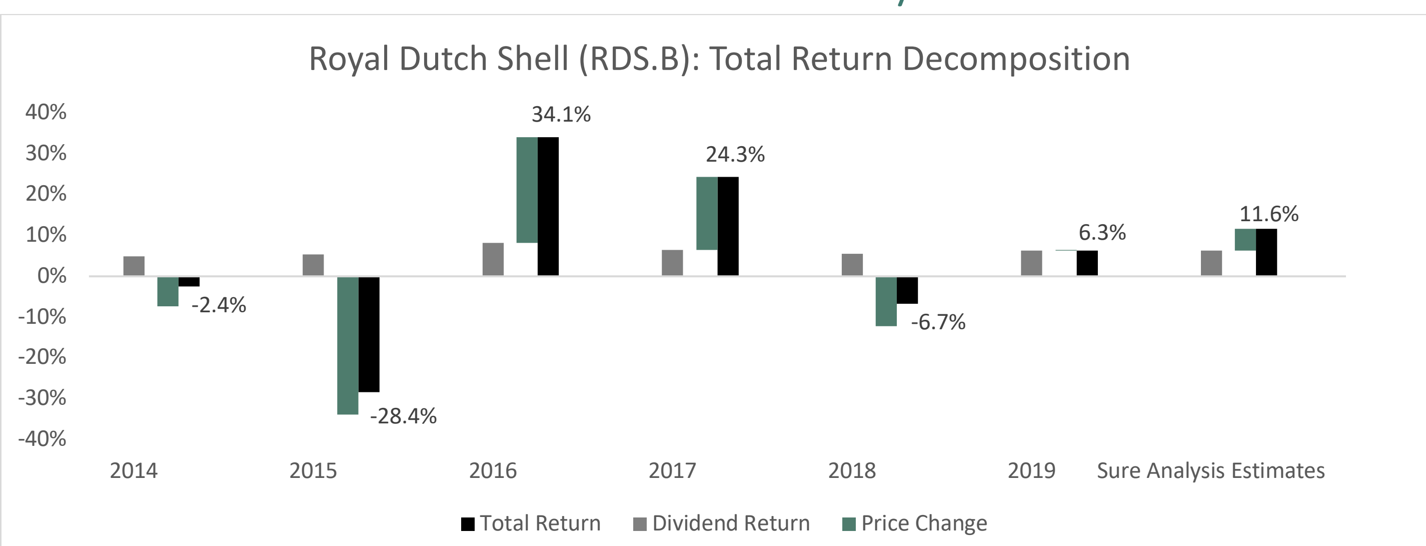
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	51.2%	38.8%	40.3%	68.5%	78.8%	627%	324%	97.9%	72.9%	92.2%	***75.2%***	***61.8%***

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 7.1% yield, which is much higher than the yield of its peers. 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 75 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 three 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 11.6% average annual return over the next five years, assisted by its exceptional 7.1% dividend yield and its cheap valuation, which has resulted from the recent sell-off of the energy sector due to the coronavirus. 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue ($B)	368.06	470.17	467.15	451.24	421.11	264.96	233.59	305.18	388.38	344.9
Gross Profit	44827	60346	56598	48141	39290	15507	17590	28857	44875	36,755
Gross Margin	12.2%	12.8%	12.1%	10.7%	9.3%	5.9%	7.5%	9.5%	11.6%	10.7%
SG&A Exp.	15528	14359	14465	14675	13965	11956	12101	10509	11360	10,493
D&A Exp.	15595	13228	14615	21509	24499	26714	24993	26223	22135	28,701
Operating Profit	26244	42598	37722	26870	19879	-3261	2367	15481	31189	22,946
Op. Margin	7.1%	9.1%	8.1%	6.0%	4.7%	-1.2%	1.0%	5.1%	8.0%	6.7%
Net Profit	20127	30826	26712	16371	14874	1939	4575	12977	23352	15,843
Net Margin	5.5%	6.6%	5.7%	3.6%	3.5%	0.7%	2.0%	4.3%	6.0%	4.6%
Free Cash Flow	410	10470	13564	465	13368	3679	-1501	14805	30074	19,208
Income Tax	14870	24450	23552	17066	13584	-153	829	4695	11715	9,053

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets ($B)	322.56	337.47	350.29	357.51	353.12	340.16	411.28	407.10	399.19	404.3
Cash & Equivalents	13444	11292	18550	9696	21607	31752	19130	20312	26741	18,054
Acc. Receivable	N/A	79509	40210	39094	28393	20607	25766	30721	42431	43,414
Inventories	29348	28976	30781	30009	19701	15822	21775	25223	21117	24,071
Goodwill & Int.	5039	4521	4470	4394	7076	6283	23967	24180	23586	23,486
Total Liab. ($B)	172.78	177.51	174.11	176.36	180.33	176.04	222.76	209.29	196.66	213.9
Accounts Payable	76550	81846	42448	41927	32131	23795	28069	33196	48888	49,208
Long-Term Debt	44332	37175	33560	39417	38838	52194	77617	70141	76824	96,424
Total Equity ($B)	148.01	158.48	174.75	180.05	171.97	162.88	186.65	194.36	198.65	186.5
D/E Ratio	0.30	0.23	0.19	0.22	0.23	0.32	0.42	0.36	0.32	0.52

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	6.5%	9.3%	7.8%	4.6%	4.2%	0.6%	1.2%	3.2%	5.8%	3.9%
Return on Equity	14.2%	20.1%	16.0%	9.2%	8.5%	1.2%	2.6%	6.8%	11.9%	8.2%
ROIC	11.0%	15.8%	13.1%	7.6%	6.9%	0.9%	1.9%	4.9%	8.8%	5.7%
Shares Out.	3080	3110	3150	3150	3150	3200	4070	4170	4170	4029
Revenue/Share	119.90	151.14	149.06	143.40	133.44	82.40	59.20	73.55	93.04	85.02
FCF/Share	0.13	3.37	4.33	0.15	4.24	1.14	-0.38	3.57	7.20	4.74

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