



# Occidental Petroleum Corporation (OXY)

Updated March 3<sup>rd</sup>, 2020 by Aristofanis Papadatos

## Key Metrics

<b>Current Price:</b>	\$33	<b>5 Year CAGR Estimate:</b>	8.9%	<b>Market Cap:</b>	\$26.7 B
<b>Fair Value Price:</b>	\$31	<b>5 Year Growth Estimate:</b>	38.0%	<b>Ex-Dividend Date:</b>	3/9/2020
<b>% Fair Value:</b>	106%	<b>5 Year Valuation Multiple Estimate:</b>	-26.9%	<b>Dividend Payment Date:</b>	4/15/2020
<b>Dividend Yield:</b>	9.6%	<b>5 Year Price Target</b>	\$35	<b>Years Of Dividend Growth:</b>	17
<b>Dividend Risk Score:</b>	F	<b>Retirement Suitability Score:</b>	D	<b>Last Dividend Increase:</b>	1.3%

## Overview & Current Events

Occidental Petroleum is an international oil and gas exploration and production company with operations in the U.S., the Middle East, and Latin America. It has a market capitalization of \$26.7 billion. While the company also has a midstream and a chemical segment, it is much more sensitive to the price of oil than the integrated oil majors. That's why Occidental was more severely affected than its integrated peers by the downturn in the oil market which began in mid-2014. Due to that downturn, the company reported negligible earnings in 2015 and posted a loss in 2016.

On August 8<sup>th</sup>, 2019, Occidental closed the acquisition of Anadarko. Occidental pursued this acquisition thanks to the promising asset base of Anadarko in the Permian, which has enhanced the already strong presence of Occidental in the area, and the \$3.5 billion annual synergies it expects to achieve from the integration of the two companies. However, this is a huge acquisition, as the \$38 billion value of the deal exceeds the market cap of Occidental. There are great concerns that Occidental overpaid, which will stretch the balance sheet of the company to the extreme. Occidental has already agreed to sell many non-core assets of Anadarko while it has secured \$10 billion in funding from Berkshire Hathaway (BRK.A) in exchange for preferred shares, which will receive an 8% annual dividend. Due to above concerns, the market has punished the stock harshly, sending it to a 10-year low level, with a -50% plunge in the last 12 months.

In late February, Occidental reported (2/27/20) financial results for the fourth quarter of fiscal 2019. Total production essentially doubled and reached 1.4 million barrels per day thanks to the acquisition of Anadarko. However, Occidental incurred merger transaction costs of \$656 million while its interest expense essentially quadrupled due to the acquisition, from \$99 million in prior year's quarter to \$434 million. As a result, the company switched from a profit of \$1.22 per share in prior year's quarter to a loss of -\$0.30 per share. On the bright side, Occidental has already paid 32% of the debt issued for the acquisition and has captured \$900 million of synergies. In addition, management reiterated its commitment to reduce the debt load. However, we are concerned over the depressed results in the last two quarters and the steep increase in interest expense.

## Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
<b>EPS</b>	\$5.72	\$8.39	\$7.09	\$6.96	\$4.83	\$0.12	-\$1.01	\$0.89	\$5.01	\$1.45	<b>\$0.50</b>	<b>\$2.50</b>
<b>DPS</b>	\$1.42	\$1.76	\$2.07	\$2.45	\$2.80	\$2.94	\$3.01	\$3.05	\$3.10	\$3.14	<b>\$3.16</b>	<b>\$3.26</b>
<b>Shares<sup>1</sup></b>	812.8	811.0	805.5	796.0	770.6	763.7	764.2	766.4	755.4	809.5	<b>810.0</b>	<b>810.0</b>

Due to the pronounced increase in interest expense, we expect poor earnings this year and we have lowered our earnings-per-share estimate for 2025 from \$4.00 to \$2.50, just to be on the safe side. Nevertheless, Occidental has promising growth prospects. It has doubled its output in the Permian in the last three years and expects to double it again over the next five years, from 300,000 to 600,000 barrels per day. Investors should realize that our assumed 38.0% average annual earnings-per-share growth rate mostly results from the suppressed earnings expected this year.

<sup>1</sup> In millions

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## Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	14.4	11.4	12.4	12.8	19.5	---	---	---	15.0	36.0	<b>66.0</b>	<b>13.8</b>
Avg. Yld.	1.7%	1.8%	3.0%	2.2%	3.0%	4.0%	4.2%	4.7%	4.1%	6.0%	<b>9.6%</b>	<b>9.4%</b>

In the last 12 months, shares of Occidental have fallen -50%, mostly due to the acquisition of Anadarko. Nevertheless, due to this year's suppressed expected earnings, Occidental is now trading at a P/E ratio of 66.0, which is much higher than its 10-year average P/E ratio of 13.8. If the stock reverts to its average valuation level over the next five years, it will incur a -26.9% annualized drag due to P/E contraction, which will mostly offset the artificially high expected earnings growth rate. In addition, the current dividend yield of 9.6% is twice as much as the average dividend yield of the stock in the last four years (4.8%). Given the unusually high P/E ratio and artificial growth rate, we have estimated fair value by computing the required price to generate 10% annualized returns using the expected dividends and 5-year price target.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

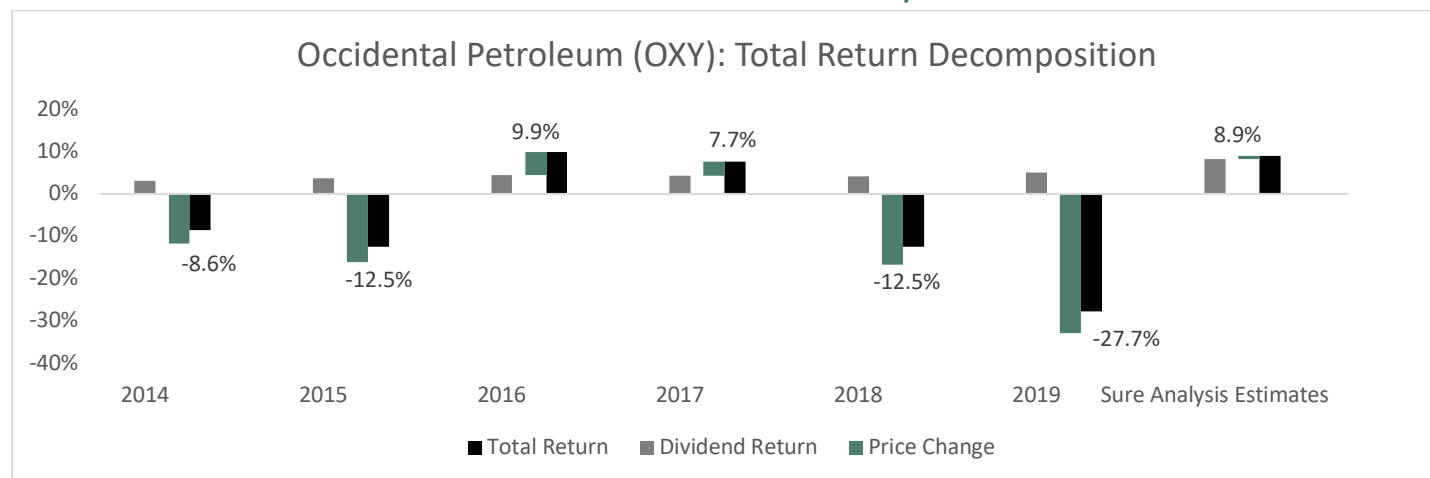
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	24.8%	21.0%	37.0%	27.6%	58.0%	---	---	343%	61.9%	217%	<b>632%</b>	<b>130%</b>

Occidental has raised its dividend for 17 consecutive years at an 11% average annual rate and now offers a generous 9.6% dividend yield. Cash flows are currently insufficient to support capital expenses and dividends, but the company expects to cover its dividend as the deleveraging process continues. However, Occidental has only marginally raised its dividend in each of the last four years and will almost certainly continue to do so for the foreseeable future, given the Anadarko acquisition. Investors should expect minimal dividend growth and a pause in share repurchases for a few years. Moreover, Occidental is very sensitive to the gyrations of oil prices. The company's reliance on oil prices was displayed in the Great Recession, when its earnings-per-share fell -58%, from \$8.98 in 2008 to \$3.79 in 2009. We reiterate that it is much more sensitive to oil prices than its "supermajor" peers like Exxon Mobil (XOM) and Total (TOT).

## Final Thoughts & Recommendation

Due to its upstream nature and its takeover of Anadarko, which quadrupled interest expense, Occidental is extremely sensitive to the price of oil. However, we believe that the market has punished Occidental to the extreme due to its high debt load. In the absence of a downturn in the energy sector, we expect Occidental to reduce its debt load and offer an 8.9% average annual return over the next five years. We rate the stock as a hold but note its elevated risk profile.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Revenue</b>	19,045	23,939	20,100	20,170	19,312	12,480	10,090	12,508	17,824	20,393
<b>Gross Profit</b>	9,780	12,963	9,985	9,470	8,248	2,132	633	3,087	7,431	6,696
<b>Gross Margin</b>	51.4%	54.2%	49.7%	47.0%	42.7%	17.1%	6.3%	24.7%	41.7%	32.8%
<b>SG&amp;A Exp.</b>	1,396	1,523	1,366	1,544	1,503	1,270	1,330	546	585	882
<b>Operating Profit</b>	7,638	10,577	7,909	7,222	6,045	483	(1,036)	1,095	5,117	2,815
<b>Op. Margin</b>	40.1%	44.2%	39.3%	35.8%	31.3%	3.9%	-10.3%	8.8%	28.7%	13.8%
<b>Net Profit</b>	4,530	6,771	4,598	5,903	616	(7,829)	(574)	1,311	4,131	(667)
<b>Net Margin</b>	23.8%	28.3%	22.9%	29.3%	3.2%	-62.7%	-5.7%	10.5%	23.2%	-3.3%
<b>Free Cash Flow</b>	5,626	4,763	3,438	5,570	2,680	(2,513)	553	1,262	2,694	738
<b>Income Tax</b>	2,995	4,201	2,659	3,214	1,685	(1,330)	(662)	17	1,477	693

## Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Total Assets</b>	52,432	60,044	64,210	69,443	56,259	43,409	43,109	42,026	43,854	109,330
<b>Cash &amp; Equivalents</b>	2,578	3,781	1,592	3,393	3,789	3,201	2,233	1,672	3,033	3,032
<b>Acc. Receivable</b>	5,032	5,395	4,916	5,674	4,206	2,970	3,989	4,145	4,893	6,373
<b>Inventories</b>	1,041	1,069	1,344	1,200	1,052	986	866	1,246	1,260	1,447
<b>Total Liabilities</b>	19,948	22,424	24,162	26,071	21,300	19,059	21,612	21,454	22,524	75,098
<b>Accounts Payable</b>	4,646	5,304	4,708	5,520	5,229	3,069	3,926	4,408	4,885	7,017
<b>Long-Term Debt</b>	5,111	5,871	7,623	6,939	6,838	8,305	9,819	9,828	10,317	38,241
<b>Total Equity</b>	32,484	37,620	40,016	43,126	34,959	24,350	21,497	20,572	21,330	24,470
<b>D/E Ratio</b>	0.16	0.16	0.19	0.16	0.20	0.34	0.46	0.48	0.48	1.12

## Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Return on Assets</b>	9.4%	12.0%	7.4%	8.8%	1.0%	-15.7%	-1.3%	3.1%	9.6%	-0.9%
<b>Return on Equity</b>	14.7%	19.3%	11.8%	14.2%	1.6%	-26.4%	-2.5%	6.2%	19.7%	-2.9%
<b>ROIC</b>	13.0%	16.7%	10.1%	12.0%	1.3%	-21.0%	-1.8%	4.2%	13.3%	-1.3%
<b>Shares Out.</b>	812.8	811.0	805.5	796.0	770.6	763.7	764.2	766.4	755.4	809.5
<b>Revenue/Share</b>	23.40	29.45	24.81	25.07	24.72	16.30	13.21	16.33	23.35	25.19
<b>FCF/Share</b>	6.91	5.86	4.24	6.92	3.43	(3.28)	0.72	1.65	3.53	0.91

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

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