ConocoPhillips (COP)

Updated August 13th, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	$42	**5 Year CAGR Estimate:**	8.1%	**Market Cap:**	$45.3 B
Fair Value Price:	$35	**5 Year Growth Estimate:**	9.0%	**Ex-Dividend Date:**	7/17/2020
% Fair Value:	122%	**5 Year Valuation Multiple Estimate:**	-3.9%	**Dividend Payment Date:**	9/1/2020
Dividend Yield:	4.0%	**5 Year Price Target**	$53	**Years Of Dividend Growth:**	4
Dividend Risk Score:	F	**Retirement Suitability Score:**	F	**Last Dividend Increase:**	37.7%

Overview & Current Events

ConocoPhillips is the world's largest independent oil and gas producer, with a normal production of 1.3 million barrels per day and a market capitalization of $45.3 billion. It was founded in 2002 and is headquartered in Houston, Texas.

In late July, ConocoPhillips reported (7/30/20) financial results for the second quarter of fiscal 2020. As ConocoPhillips is a pure upstream company, it was severely affected by the pandemic. The average realized oil price plunged -54% over last year's quarter, from $50.5 to $23.1. As a result, the company drastically cut its production, by 225,000 barrels per day or -20%, and switched from a profit of $1.01 per share in last year's quarter to an adjusted loss of -$0.92 per share.

The eye-opening 20% production cut of ConocoPhillips is in sharp contrast to the single-digit production decline of all the other oil majors. However, we applaud this strategic decision, which proves that management is focused on enhancing long-term shareholder value by selling oil at much higher prices than those that prevailed in the second quarter. As the price of oil has recovered in the last two months, ConocoPhillips has begun to ramp up its production. Thanks to higher oil prices and increased output, we expect improved results in the second half of the year.

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	***-$0.90***	***$4.46***
DPS	$2.15	$2.64	$2.64	$2.70	$2.84	$2.94	$1.00	$1.06	$1.16	$1.33	***$1.68***	***$1.80***
Shares[1]	1430	1290	1220	1230	1230	1240	1240	1180	1140	1100	***1078***	***1000***

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.

The company grew its underlying production by 5% in each of the last two years but it is now facing the headwind of the pandemic. Nevertheless, we expect the energy market and the company to begin recovering from next year. Moreover, cost-cutting efforts during the oil price slump have enhanced the efficiency of ConocoPhillips. We thus expect ConocoPhillips to grow its earnings-per-share at a 9.0% average annual rate off its mid-cycle (3-year average) earnings-per-share of $2.90. It is also worth noting that ConocoPhillips has reduced its net debt by -58%, from $52.7 billion in 2014 to $22.2 billion. As a result, interest expense has dropped -37% in the last three years. We expect a further decrease in interest expense to contribute 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	***14.5***	***11.9***
Avg. Yld.	3.9%	3.7%	4.7%	4.2%	3.8%	5.1%	2.4%	2.2%	1.9%	2.2%	***4.0%***	***3.4%***

[1] In millions.

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ConocoPhillips is now trading at 14.5 times its mid-cycle earnings-per-share. We expect the earnings multiple to contract over the next five years, as the energy sector recovers. 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 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 -3.9% 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%	***57.9%***	***40.4%***

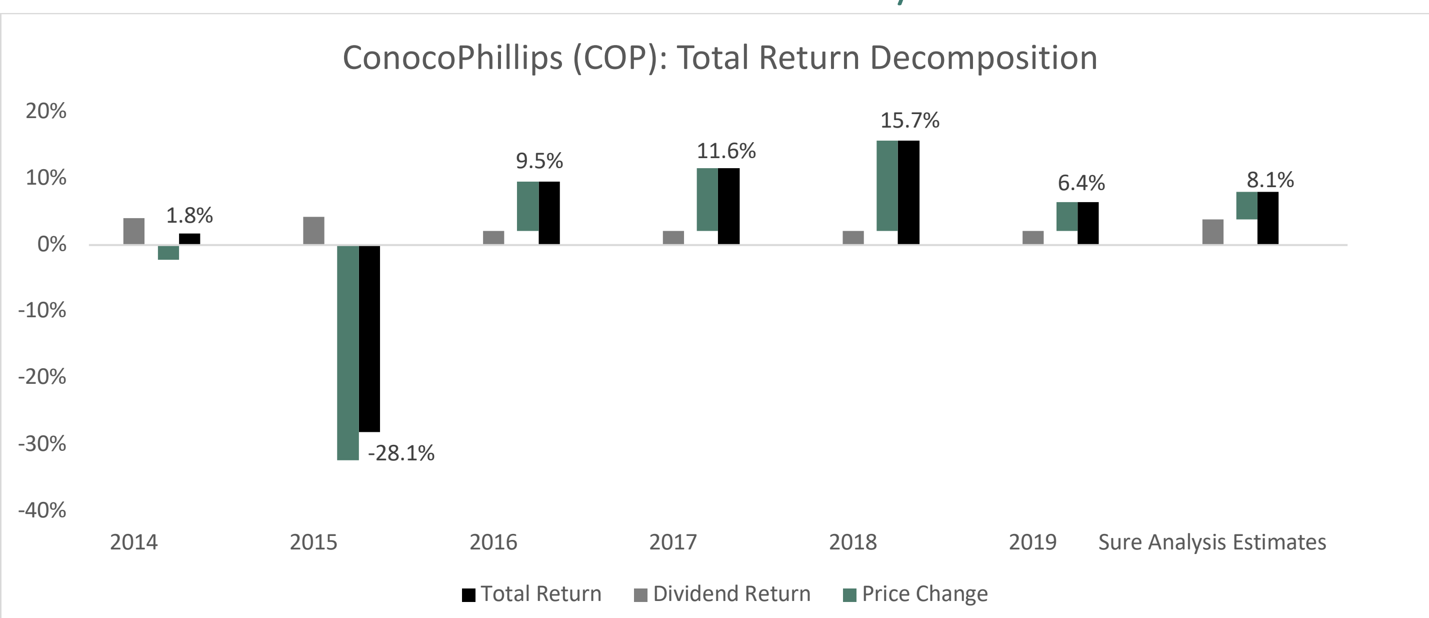
Since ConocoPhillips is a pure upstream company, it is much more leveraged to the price of oil than the well-known supermajors like Exxon Mobil, Chevron, and Total. Those companies remained profitable in the previous downturn of the energy sector (2014-2017) and avoided cutting their dividends. On the 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 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. During the last financial crisis, earnings-per-share plunged -70%. In the ongoing downturn, the company is likely to post losses and may cut its dividend once again.

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 doubled off its bottom in March. As a result, it may offer just an 8.1% average annual return over the next five years. The stock will reward investors even more in the event of a strong recovery of the oil price but its return potential does not compensate adequately for its risk. 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	32567
Gross Profit	17130	21146	19362	17098	13187	1009	-1030	4613	10954	9313
Gross Margin	30.5%	32.9%	33.4%	31.4%	25.1%	3.4%	-4.3%	15.8%	30.1%	28.6%
SG&A Exp.	809	865	1106	854	735	953	723	561	401	556
Operating Profit	12,454	15,338	13,516	12,389	8,602	(4,957)	(3,932)	2,871	9,649	7,604
Op. Margin	22.2%	23.9%	23.3%	22.8%	16.4%	-16.8%	-16.6%	9.9%	26.5%	23.3%
Net Profit	11,358	12,436	8,428	9,156	6,869	(4,428)	(3,615)	(855)	6,257	7,189
Net Margin	20.2%	19.4%	14.5%	16.8%	13.1%	-15.0%	-15.3%	-2.9%	17.2%	22.1%
Free Cash Flow	9,510	8,432	(250)	604	(516)	(2,478)	(466)	2,486	6,184	4,468
Income Tax	7,570	8,208	7,942	6,409	3,583	(2,868)	(1,971)	(1,822)	3,668	2,267

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	70.51
Cash & Equivalents	9454	5780	3618	6246	5062	2368	3610	6325	5915	5088
Acc. Receivable	13787	16526	9182	8487	6807	4514	3414	4320	4067	3401
Inventories	5197	4631	965	1194	1331	1124	1018	1060	1007	1026
Goodwill & Int.	4434	4077	N/A	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	35,464
Accounts Payable	18399	19653	10013	9314	8026	4933	3653	4030	3895	3,200
Long-Term Debt	23592	22623	21725	21662	22565	24880	27275	19703	14968	14,895
Total Equity	68562	65239	47987	52090	51911	39762	34974	30607	31939	34,981
D/E Ratio	0.34	0.35	0.45	0.42	0.43	0.63	0.78	0.64	0.47	0.43

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%	10.2%
Return on Equity	17.4%	18.6%	14.9%	18.3%	13.2%	-9.7%	-9.7%	-2.6%	20.0%	21.5%
ROIC	12.3%	13.7%	10.6%	12.7%	9.2%	-6.3%	-5.7%	-1.5%	12.8%	14.8%
Shares Out.	1430	1290	1220	1230	1230	1240	1240	1180	1140	1100
Revenue/Share	37.70	46.28	46.26	43.89	42.16	23.81	19.02	23.84	30.98	28.99
FCF/Share	6.38	6.08	-0.20	0.49	-0.41	-2.00	-0.37	2.04	5.26	3.98

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