



Phillips 66 (PSX)

Updated August 5th, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	\$62	5 Year CAGR Estimate:	14.7%	Market Cap:	\$27.0 B
Fair Value Price:	\$84	5 Year Growth Estimate:	4.0%	Ex-Dividend Date:	8/17/2020
% Fair Value:	73%	5 Year Valuation Multiple Estimate:	6.4%	Dividend Payment Date:	9/1/2020
Dividend Yield:	5.8%	5 Year Price Target	\$103	Years Of Dividend Growth:	7
Dividend Risk Score:	F	Retirement Suitability Score:	D	Last Dividend Increase:	12.5%

Overview & Current Events

Phillips 66 was spun off from ConocoPhillips in 2012. Phillips 66 has a market capitalization of \$27 billion and operates in four segments: refining, midstream, chemicals, and marketing. It is a diversified company with each of its segments behaving differently under various oil prices, in the absence of a severe recession. When oil prices collapsed in 2014, the refining segment became by far the most profitable segment, as low oil prices improved demand for oil products and boosted refining margins. In 2019, the refining segment generated 48% of the total earnings of Phillips 66.

In late July, Phillips 66 reported (7/31/20) financial results for the second quarter of fiscal 2020. The company was severely affected by the pandemic, which caused a collapse in the demand for refined products and in the margins of all the segments of Phillips 66. The midstream, chemical and marketing segments saw their adjusted profits fall roughly -50% sequentially while the refining segment saw its loss more than double, from -\$401 million to -\$867 million. As a result, Phillips 66 switched from adjusted earnings-per-share of \$1.02 in the first quarter to an adjusted loss per share of -\$0.74. On the bright side, the company has somewhat increased its refinery utilization in the running quarter, from 75% in the second quarter to the low 80s. Nevertheless, due to the sustained impact of the pandemic on the margins of all the divisions of Phillips 66, we have lowered our earnings-per-share forecast for the year from \$2.50 to \$1.30.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	---	---	\$6.48	\$5.92	\$7.10	\$7.73	\$2.92	\$4.58	\$11.85	\$8.05	\$1.30	\$8.55
DPS	---	---	\$0.45	\$1.33	\$1.89	\$2.18	\$2.45	\$2.73	\$3.10	\$3.50	\$3.60	\$4.38
Shares¹	---	---	637	619	571	547	530	519	464	441	442	400

Growth projects in the oil industry take many years to start bearing fruit and hence there is a great lag between capital expenses and their resultant cash flows. Fortunately for the shareholders of Phillips 66, the company is currently in the positive phase of its cycle. While it has greatly reduced its capital expenses in recent years, it has begun to reap the benefits from its huge investments in 2014 and 2015, when it invested a total of \$9.5 billion. In addition, management is well known for its discipline to invest only in high-return projects.

The pandemic will greatly affect the results of Phillips 66 this year but we expect the company to recover from next year, along with the energy market. In order to calculate its future returns, we have used its mid-cycle (5-year average) earnings-per-share of \$7.03 as a base. As soon as the pandemic subsides, Phillips 66 will greatly benefit from the new international marine standard (IMO 2020), which has forced vessels sailing in international waters to burn low-sulfur diesel instead of heavy fuel oil since January 1st, 2020. Diesel is much more expensive than fuel oil and hence refiners will enjoy a boost in their earnings. Phillips 66 also has many ongoing growth projects in its midstream segment. Moreover, while Phillips 66 has suspended share repurchases due to the pandemic, it will resume them when the economy recovers. Overall, we expect Phillips 66 to grow its earnings-per-share by 4.0% per year on average over the next five years off its mid-cycle level.

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	---	---	6.4	10.5	11.1	10.3	27.7	18.5	8.9	12.4	8.8	12.0
Avg. Yld.	---	---	1.1%	2.1%	2.4%	2.7%	3.0%	3.2%	2.9%	3.5%	5.8%	4.3%

Phillips 66 is now trading at 8.8 times its mid-cycle earnings. This valuation level is lower than its 10-year average of 13.2. In order to be conservative, we assume a fair earnings multiple of 12.0 for this stock. If the stock approaches our fair value estimate within the next five years, it will enjoy a 6.4% annualized gain in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

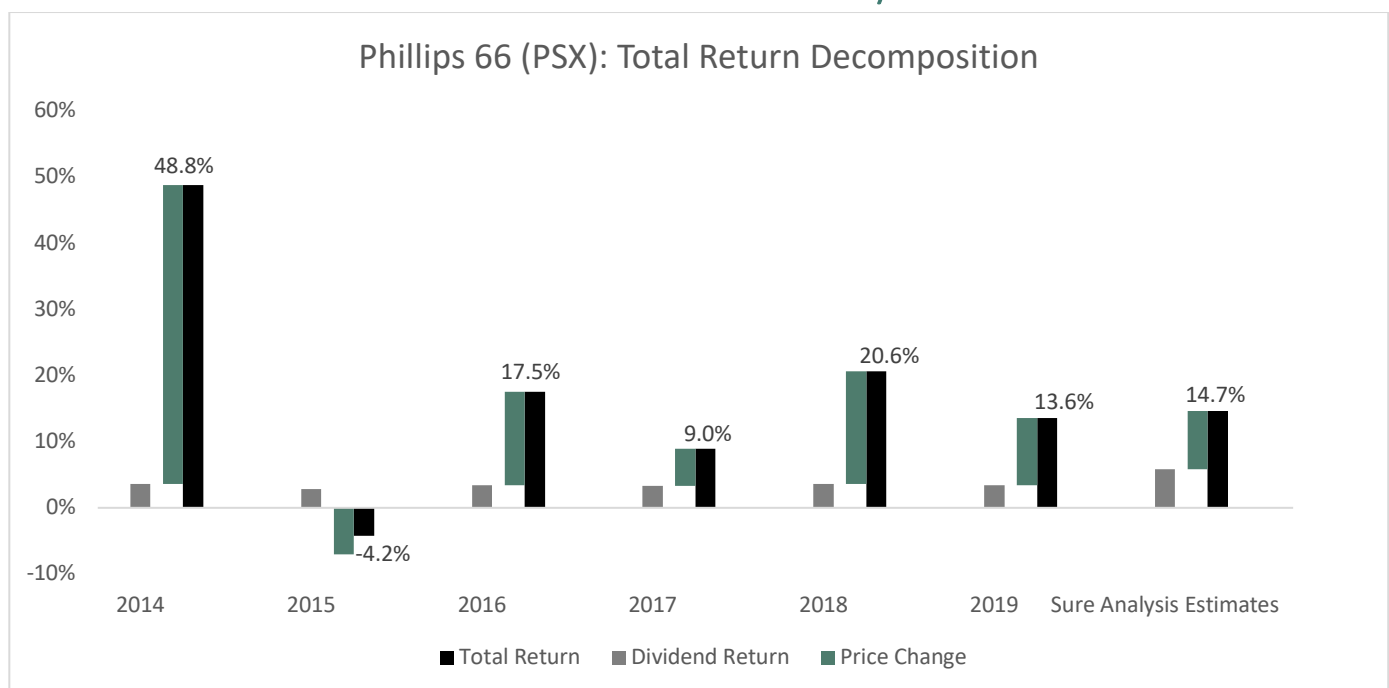
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	---	6.9%	22.5%	26.6%	28.2%	83.9%	59.6%	26.2%	43.5%	51.2%	51.2%

Phillips 66 has a significant competitive advantage, namely the discipline of its management to invest only in high-return projects. However, despite its diversified business, the company is cyclical, just like most oil companies. In the recent downturn of the oil sector, between mid-2014 and 2017, low oil prices resulted in high refining margins thanks to healthy underlying economic growth. However, in the Great Recession, the price of oil products plunged along with the price of oil and resulted in low refining margins. The current downturn is much fiercer than the recent downturn and hence it will greatly affect the results of Phillips 66, at least this year.

Final Thoughts & Recommendation

Phillips 66 is a well-managed company, which is properly positioned for most scenarios of oil prices, but it is now facing a severe downturn due to the coronavirus. Given the -33% correction of the stock in the last two months and our expectations for a recovery of the company from next year, we expect the stock to offer a 14.7% average annual return over the next five years. We thus rate it as a buy for investors who can wait for the recovery of the energy market.

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)	146.6	195.9	179.3	171.6	161.2	99.0	84.3	102.4	111.4	107.3
Gross Profit	21,469	23,163	24,877	23,351	25,464	25,576	21,811	22,945	13,531	11,764
Gross Margin	14.6%	11.8%	13.9%	13.6%	15.8%	25.8%	25.9%	22.4%	12.1%	11.0%
SG&A Exp.	1,384	1,394	1,703	1,478	1,663	1,670	1,638	1,695	1,677	1,681
D&A Exp.	880	902	906	947	995	1,078	1,168	1,318	1,356	1,341
Operating Profit	1,078	2,521	4,612	2,666	3,430	4,548	1,098	1,838	5,209	3,335
Op. Margin	0.7%	1.3%	2.6%	1.6%	2.1%	4.6%	1.3%	1.8%	4.7%	3.1%
Net Profit	735	4,775	4,124	3,726	4,762	4,227	1,555	5,106	5,595	3,076
Net Margin	0.5%	2.4%	2.3%	2.2%	3.0%	4.3%	1.8%	5.0%	5.0%	2.9%
Free Cash Flow	942	3,990	2,595	4,248	(244)	(51)	119	1,816	4,934	935
Income Tax	579	1,822	2,473	1,844	1,654	1,764	547	(1,693)	1,572	801

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	44,955	43,211	48,073	49,798	48,692	48,580	51,653	54,371	54,302	58,720
Cash & Equivalents	-	-	3,474	5,400	5,207	3,074	2,711	3,119	3,019	1,614
Acc. Receivable	8,364	10,025	10,403	9,632	7,255	5,173	6,397	7,506	6,173	8,510
Inventories	4,113	3,466	3,430	3,354	3,397	3,477	3,150	3,395	3,543	3,776
Goodwill & Int.	4,410	4,064	4,068	3,794	4,174	4,181	4,158	4,146	4,139	4,139
Total Liabilities	18,929	19,918	27,267	27,406	26,655	24,642	27,928	26,943	27,149	31,551
Accounts Payable	9,814	10,792	10,710	11,090	8,064	5,655	7,061	8,027	6,586	8,575
Long-Term Debt	417	391	6,974	6,155	8,635	8,887	10,138	10,110	11,160	11,763
Total Equity	26,001	23,264	20,775	21,950	21,590	23,100	22,390	25,085	24,653	24,910
D/E Ratio	0.02	0.02	0.34	0.28	0.40	0.38	0.45	0.40	0.45	0.47

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	1.7%	10.8%	9.0%	7.6%	9.7%	8.7%	3.1%	9.6%	10.3%	5.4%
Return on Equity	2.8%	19.4%	18.7%	17.4%	21.9%	18.9%	6.8%	21.5%	22.5%	12.4%
ROIC	2.7%	19.1%	16.0%	13.2%	16.1%	13.3%	4.7%	14.3%	14.8%	8.0%
Shares Out.	---	---	637	619	571	547	530	519	464	441
Revenue/Share	229.00	306.14	281.56	277.22	282.08	180.95	159.00	197.40	235.13	236.39
FCF/Share	1.47	6.23	4.08	6.86	(0.43)	(0.09)	0.22	3.50	10.41	2.06

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

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