



# Phillips 66 (PSX)

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

## Key Metrics

<b>Current Price:</b>	\$48	<b>5 Year CAGR Estimate:</b>	19.4%	<b>Market Cap:</b>	\$21.0 B
<b>Fair Value Price:</b>	\$84	<b>5 Year Growth Estimate:</b>	3.0%	<b>Ex-Dividend Date:</b>	11/16/2020
<b>% Fair Value:</b>	57%	<b>5 Year Valuation Multiple Estimate:</b>	11.9%	<b>Dividend Payment Date:</b>	12/1/2020
<b>Dividend Yield:</b>	7.5%	<b>5 Year Price Target</b>	\$98	<b>Years Of Dividend Growth:</b>	7
<b>Dividend Risk Score:</b>	F	<b>Retirement Suitability Score:</b>	D	<b>Last Dividend Increase:</b>	2.9%

## Overview & Current Events

Phillips 66 was spun off from ConocoPhillips in 2012. Phillips 66 has a market capitalization of \$21 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 October, Phillips 66 reported (10/30/20) financial results for the third quarter of fiscal 2020. The company greatly improved its performance thanks to its midstream, chemical and marketing segments, which grew their adjusted profits sequentially by 40%-50% each thanks to the reopening of the economy. On the other hand, the refining segment widened its losses, from -\$867 million to -\$970 million, due to the continued impact of the pandemic on the demand for oil products and on refining margins. Overall, Phillips 66 narrowed its losses, from an adjusted loss per share of -\$0.74 to a marginal loss of -\$0.01 per share and exceeded analysts' consensus by an impressive \$0.74. Due to the sustained impact of the pandemic on the refining margins, we now expect Phillips 66 to post a loss of -\$0.10 per share this year. On the bright side, despite the depressed refining margins, management reaffirmed its commitment to a secure and growing dividend.

## Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
<b>EPS</b>	---	---	\$6.48	\$5.92	\$7.10	\$7.73	\$2.92	\$4.58	\$11.85	\$8.05	<b>-\$0.10</b>	<b>\$8.15</b>
<b>DPS</b>	---	---	\$0.45	\$1.33	\$1.89	\$2.18	\$2.45	\$2.73	\$3.10	\$3.50	<b>\$3.60</b>	<b>\$3.90</b>
<b>Shares<sup>1</sup></b>	---	---	637	619	571	547	530	519	464	441	<b>442</b>	<b>400</b>

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 has greatly affected 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 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 1<sup>st</sup>, 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 3.0% per year on average over the next five years off its mid-cycle level.

<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	---	---	6.4	10.5	11.1	10.3	27.7	18.5	8.9	12.4	<b>6.8</b>	<b>12.0</b>
Avg. Yld.	---	---	1.1%	2.1%	2.4%	2.7%	3.0%	3.2%	2.9%	3.5%	<b>7.5%</b>	<b>4.0%</b>

Phillips 66 is now trading at 6.8 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 an 11.9% annualized gain in its returns.

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

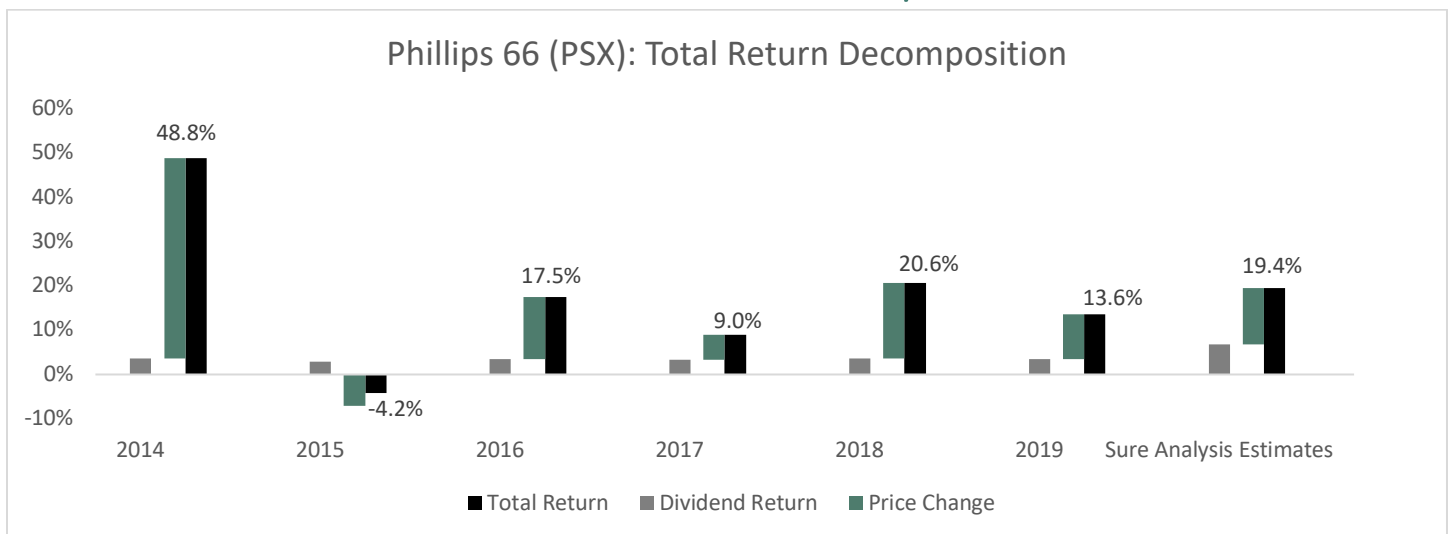
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	---	6.9%	22.5%	26.6%	28.2%	83.9%	59.6%	26.2%	43.5%	<b>51.2%</b>	<b>47.8%</b>

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 is likely to force Phillips 66 to post its first annual loss in its 9-year history.

## 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 pandemic. However, the market has punished the stock to the extreme, with a -57% plunge this year, to a nearly 8-year low level. We view Phillips 66 as deeply undervalued and expect it to offer a 19.4% average annual return over the next five years, stemming from the 7.5% yield, 3% growth and a significant valuation tailwind. We thus rate it as a strong buy for those 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
<b>Revenue (\$B)</b>	146.6	195.9	179.3	171.6	161.2	99.0	84.3	102.4	111.4	107.3
<b>Gross Profit</b>	21,469	23,163	24,877	23,351	25,464	25,576	21,811	22,945	13,531	11,764
<b>Gross Margin</b>	14.6%	11.8%	13.9%	13.6%	15.8%	25.8%	25.9%	22.4%	12.1%	11.0%
<b>SG&amp;A Exp.</b>	1,384	1,394	1,703	1,478	1,663	1,670	1,638	1,695	1,677	1,681
<b>D&amp;A Exp.</b>	880	902	906	947	995	1,078	1,168	1,318	1,356	1,341
<b>Operating Profit</b>	1,078	2,521	4,612	2,666	3,430	4,548	1,098	1,838	5,209	3,335
<b>Op. Margin</b>	0.7%	1.3%	2.6%	1.6%	2.1%	4.6%	1.3%	1.8%	4.7%	3.1%
<b>Net Profit</b>	735	4,775	4,124	3,726	4,762	4,227	1,555	5,106	5,595	3,076
<b>Net Margin</b>	0.5%	2.4%	2.3%	2.2%	3.0%	4.3%	1.8%	5.0%	5.0%	2.9%
<b>Free Cash Flow</b>	942	3,990	2,595	4,248	(244)	(51)	119	1,816	4,934	935
<b>Income Tax</b>	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
<b>Total Assets</b>	44,955	43,211	48,073	49,798	48,692	48,580	51,653	54,371	54,302	58,720
<b>Cash &amp; Equivalents</b>	-	-	3,474	5,400	5,207	3,074	2,711	3,119	3,019	1,614
<b>Acc. Receivable</b>	8,364	10,025	10,403	9,632	7,255	5,173	6,397	7,506	6,173	8,510
<b>Inventories</b>	4,113	3,466	3,430	3,354	3,397	3,477	3,150	3,395	3,543	3,776
<b>Goodwill &amp; Int.</b>	4,410	4,064	4,068	3,794	4,174	4,181	4,158	4,146	4,139	4,139
<b>Total Liabilities</b>	18,929	19,918	27,267	27,406	26,655	24,642	27,928	26,943	27,149	31,551
<b>Accounts Payable</b>	9,814	10,792	10,710	11,090	8,064	5,655	7,061	8,027	6,586	8,575
<b>Long-Term Debt</b>	417	391	6,974	6,155	8,635	8,887	10,138	10,110	11,160	11,763
<b>Total Equity</b>	26,001	23,264	20,775	21,950	21,590	23,100	22,390	25,085	24,653	24,910
<b>D/E Ratio</b>	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
<b>Return on Assets</b>	1.7%	10.8%	9.0%	7.6%	9.7%	8.7%	3.1%	9.6%	10.3%	5.4%
<b>Return on Equity</b>	2.8%	19.4%	18.7%	17.4%	21.9%	18.9%	6.8%	21.5%	22.5%	12.4%
<b>ROIC</b>	2.7%	19.1%	16.0%	13.2%	16.1%	13.3%	4.7%	14.3%	14.8%	8.0%
<b>Shares Out.</b>	---	---	637	619	571	547	530	519	464	441
<b>Revenue/Share</b>	229.00	306.14	281.56	277.22	282.08	180.95	159.00	197.40	235.13	236.39
<b>FCF/Share</b>	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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