Royal Dutch Shell plc (RDS.B)

Updated November 12th, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	$30	**5 Year CAGR Estimate:**	15.1%	**Market Cap:**	$117.4 B
Fair Value Price:	$33	**5 Year Growth Estimate:**	10.0%	**Ex-Dividend Date:**	11/12/2020
% Fair Value:	92%	**5 Year Valuation Multiple Estimate:**	1.7%	**Dividend Payment Date:**	12/16/2020
Dividend Yield:	4.4%[1]	**5 Year Price Target**	$53	**Years Of Dividend Growth:**	0
Dividend Risk Score:	F	**Retirement Suitability Score:**	D	**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 $117 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 October, Royal Dutch Shell reported (10/29/20) financial results for the third quarter of fiscal 2020. The company posted record marketing earnings thanks to increased sales of high-margin premium products but its adjusted earnings plunged -80% due to the continuing impact of the pandemic, which resulted in depressed prices of oil, LNG and gas, and poor refining margins. Notably, Shell reduced its production by -14% over last year's quarter.

In late March, Shell stated that its dividend was safe but in late April it cut its quarterly dividend by -66%. It was the first time that Shell cut its dividend since World War II. The misleading stance of the CEO and the new forward dividend yield (4.4%) are certainly disappointing. Notably Shell raised its dividend by 4% in late October, just six months after its dividend cut. We do not applaud the choppy dividend policy of management amid high uncertainty.

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	***$1.30***	***$4.78***
DPS	$3.36	$3.36	$3.42	$3.56	$3.72	$3.76	$3.76	$3.76	$3.76	$3.76	***$1.91***	***$1.84***
Shares[2]	3,080	3,110	3,150	3,150	3,150	3,200	4,070	4,170	4,170	4,029	***3,910***	***3,800***

The earnings-per-share numbers in the above table do not look 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, in 2015, 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 stalled in the last three years.

This is in sharp contrast to the other oil majors, such as Chevron, BP and Total, which have grown 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). Moreover, Shell recently announced a major transformation plan, which involves a transition from oil and gas to renewable energy sources. The company will transform its refining portfolio from 14 sites to 6 energy and chemicals parks and will reduce its upstream portfolio to 9 core positions, which will generate more than 80% of the cash flows of the upstream segment. This historic transition has greatly increased the uncertainty over future results, as the new business will probably have lower margins. On the bright side, Shell has drastically reduced its operating expenses in recent years and has invested in high-quality, low-cost reserves, which have rendered the company more

[1] Forward dividend yield.

[2] 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.

profitable at a given oil price. We expect the pandemic to subside from next year and Shell to grow its earnings-per-share at a 10.0% average annual rate over the next five years off its mid-cycle level (5-year average) of $2.97.

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	***10.1***	***11.0***
Avg. Yld.	5.9%	4.8%	5.1%	5.1%	4.7%	6.5%	7.4%	6.4%	6.2%	6.1%	***4.4%***	***3.5%***

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 10.1 times its mid-cycle earnings. This valuation level is somewhat lower than our assumed fair earnings multiple of 11.0. If the stock reverts to our fair valuation level over the next five years, it will enjoy a 1.7% annualized gain in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

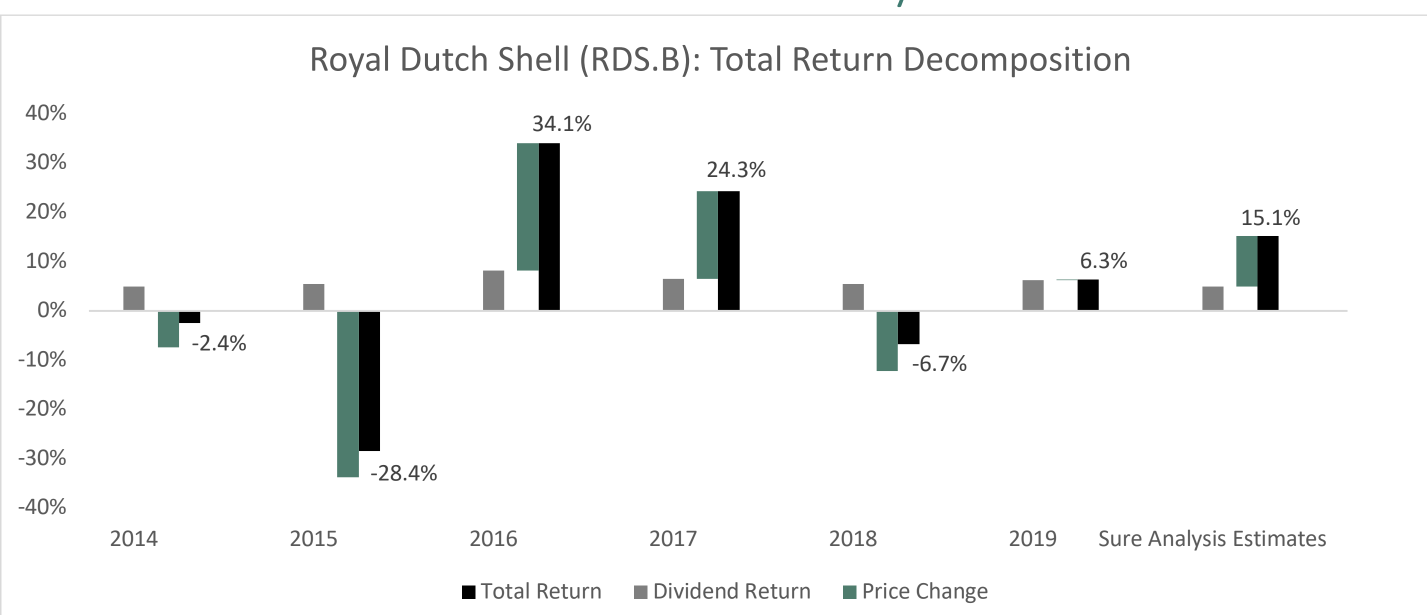
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	51.2%	38.8%	40.3%	68.5%	78.8%	627%	324%	97.9%	72.9%	92.2%	***44.8%***	***38.5%***

In contrast to Exxon Mobil and Chevron, which are Dividend Aristocrats, Shell froze its dividend for the last four years and cut its dividend this year, for the first time since World War II. 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, it can endure the ongoing downturn caused by the pandemic. Its earnings have slumped this year but the oil giant is likely to recover strongly as soon as the pandemic subsides.

Final Thoughts & Recommendation

Shell has plunged -50% this year, near its 20-year lows, primarily due to the pandemic. In addition, the company cut its dividend for the first time in 75 years. While everything looks negative for Shell right now, we believe that the security looks compelling. Shell could offer a 15.1% average annual return over the next five years, mostly thanks to higher oil and gas prices in the future. We rate the stock as a buy.

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.