ConocoPhillips (COP)

Updated February 8th, 2021 by Aristofanis Papadatos

Key Metrics

Current Price:	$44	**5 Year CAGR Estimate:**	6.8%	**Market Cap:**	$60 B
Fair Value Price:	$37	**5 Year Growth Estimate:**	7.0%	**Ex-Dividend Date:**	2/11/2021
% Fair Value:	119%	**5 Year Valuation Multiple Estimate:**	-3.5%	**Dividend Payment Date:**	3/1/2021
Dividend Yield:	3.9%	**5 Year Price Target**	$52	**Years Of Dividend Growth:**	5
Dividend Risk Score:	F	**Retirement Suitability Score:**	D	**Last Dividend Increase:**	2.4%

Overview & Current Events

ConocoPhillips is the world's largest independent oil and gas producer, with a pro forma production of 1.5 million barrels per day (after the acquisition of Concho Resources, discussed below) and a market capitalization of $60 billion. It was founded in 2002 and is headquartered in Houston, Texas.

In early February, ConocoPhillips reported (2/5/21) financial results for the fourth quarter of fiscal 2020. As ConocoPhillips is a pure upstream company, it continued to be negatively affected by the pandemic. The average realized oil price plunged -29% over the prior year's quarter, from $47 to $33, while production fell -7%, primarily due to the natural decline of oil fields. As a result, the company switched from a profit of $0.76 per share in the prior year's quarter to an adjusted loss of -$0.19 per share. On the bright side, the oil producer greatly benefits from the aggressive production cuts of OPEC and Russia, which have led to a full recovery of the oil price this year. We thus expect ConocoPhillips to earn $1.60 per share this year.

On January 15th, 2021, ConocoPhillips closed the acquisition of Concho Resources for $9.7 billion in an all-stock deal. This was the largest shale oil deal in 2020 and will boost the output of the new company to 1.5 million barrels per day. ConocoPhillips pursued this deal thanks to the low production cost of Concho and the high rate of return of this deal.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$8.76	$5.91	$6.43	$4.96	-$1.39	-$2.52	$0.61	$4.54	$3.59	-$0.97	***$1.60***	***$4.07***
DPS	$2.64	$2.64	$2.70	$2.84	$2.94	$1.00	$1.06	$1.16	$1.33	$1.69	***$1.72***	***$2.00***
Shares[1]	1290	1220	1230	1230	1240	1240	1180	1140	1100	1074	***1070***	***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 production in recent years but its production fell -8% in 2020 due to the pandemic and the natural decline of its fields. In addition, it posted an organic reserve replacement ratio of only 65% in 2020. Moreover, only $0.4 billion of its $5.5 billion capital expense program will be allocated to growth projects this year.

Nevertheless, we expect the energy market and the company to begin recovering this 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 7.0% 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 -32% in the last four years. We expect a further decrease in interest expense to contribute to earnings growth significantly.

[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	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	8.2	9.5	10.1	15.0	---	---	---	13.7	17.1	---	***15.2***	***12.7***
Avg. Yld.	3.7%	4.7%	4.2%	3.8%	5.1%	2.4%	2.2%	1.9%	2.2%	4.1%	***3.9%***	***3.9%***

ConocoPhillips is now trading at 15.2 times its mid-cycle earnings-per-share. We have assumed a fair price-to-earnings ratio of 12.7 for 2026, which is the average earnings multiple over the last decade. If this proves correct, the stock will incur a -3.5% annualized valuation drag in its returns over the next five years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	30.1%	44.7%	42.0%	57.3%	---	---	174%	25.6%	37.0%	---	***59.3%***	***49.3%***

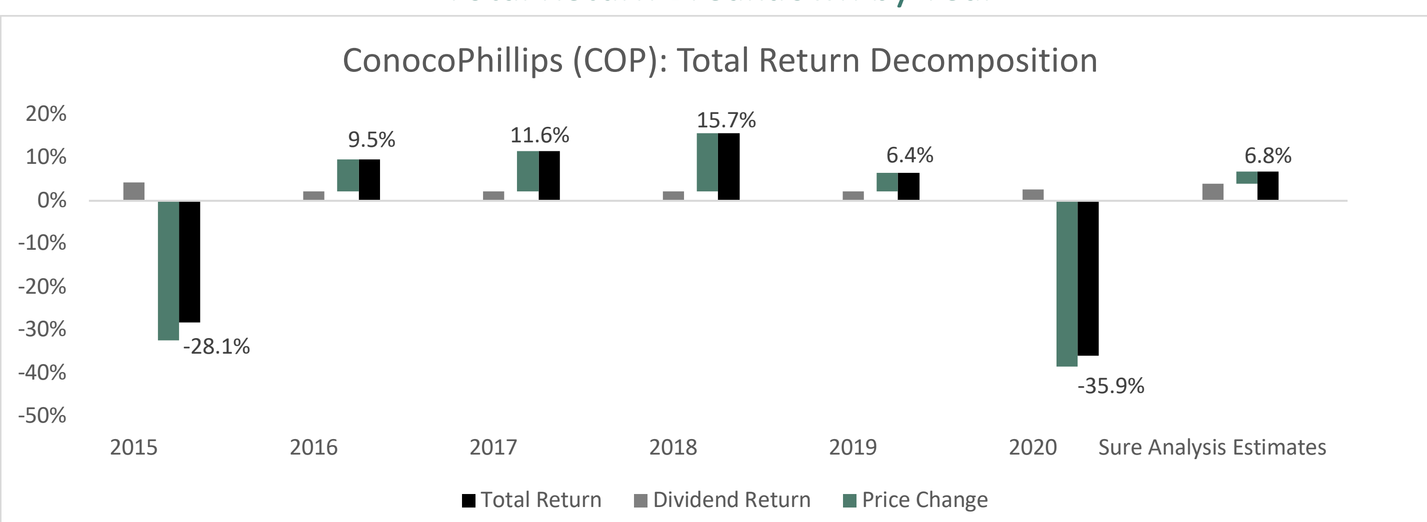
Since ConocoPhillips is a pure upstream company, it is much more leveraged to the price of oil than the well-known supermajors like Exxon Mobil, Chevron, and Total. Those companies remained profitable in the previous downturn of the energy sector (2014-2017) and avoided cutting their dividends. On the 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 posted losses in 2020 and may cut its dividend once again if the downturn persists.

Final Thoughts & Recommendation

ConocoPhillips is an oil and gas pure upstream play that is highly leveraged to the price of oil. Thanks to the aggressive production cuts of OPEC and Russia and the expected recovery from the pandemic late this year, ConocoPhillips will begin to recover this year. However, the stock has rallied 55% in the last three months and hence it can now offer just a 6.8% average annual return over the next five years. We thus lower its rating from "buy" to "hold".

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	64196	57967	54413	52524	29564	23693	29106	36417	32567	18,784
Gross Profit	21146	19362	17098	13187	1009	-1030	4613	10954	9313	841
Gross Margin	32.9%	33.4%	31.4%	25.1%	3.4%	-4.3%	15.8%	30.1%	28.6%	4.5%
SG&A Exp.	865	1106	854	735	953	723	561	401	556	430
Operating Profit	15,338	13,516	12,389	8,602	(4,957)	(3,932)	2,871	9,649	7,604	(1,800)
Op. Margin	23.9%	23.3%	22.8%	16.4%	-16.8%	-16.6%	9.9%	26.5%	23.3%	-9.6%
Net Profit	12,436	8,428	9,156	6,869	(4,428)	(3,615)	(855)	6,257	7,189	(2,701)
Net Margin	19.4%	14.5%	16.8%	13.1%	-15.0%	-15.3%	-2.9%	17.2%	22.1%	-14.4%
Free Cash Flow	8,432	(250)	604	(516)	(2,478)	(466)	2,486	6,184	4,468	87
Income Tax	8,208	7,942	6,409	3,583	(2,868)	(1,971)	(1,822)	3,668	2,267	(485)

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets ($B)	153.23	117.14	118.06	116.54	97.48	89.77	73.36	69.98	70.51	62.62
Cash & Equivalents	5780	3618	6246	5062	2368	3610	6325	5915	5088	2,991
Acc. Receivable	16526	9182	8487	6807	4514	3414	4320	4067	3401	2,754
Inventories	4631	965	1194	1331	1124	1018	1060	1007	1026	1,002
Goodwill & Int.	4077	---	---	---	---	---	---	---	---	---
Total Liabilities	87481	68717	65565	64266	57402	54546	42561	37916	35,464	32,769
Accounts Payable	19653	10013	9314	8026	4933	3653	4030	3895	3,200	2,698
Long-Term Debt	22623	21725	21662	22565	24880	27275	19703	14968	14,895	15,369
Total Equity	65239	47987	52090	51911	39762	34974	30607	31939	34,981	29,849
D/E Ratio	0.35	0.45	0.42	0.43	0.63	0.78	0.64	0.47	0.43	0.51

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	8.0%	6.2%	7.8%	5.9%	-4.1%	-3.9%	-1.0%	8.7%	10.2%	-4.1%
Return on Equity	18.6%	14.9%	18.3%	13.2%	-9.7%	-9.7%	-2.6%	20.0%	21.5%	-8.3%
ROIC	13.7%	10.6%	12.7%	9.2%	-6.3%	-5.7%	-1.5%	12.8%	14.8%	-5.7%
Shares Out.	1290	1220	1230	1230	1240	1240	1180	1140	1100	1074
Revenue/Share	46.28	46.26	43.89	42.16	23.81	19.02	23.84	30.98	28.99	17.42
FCF/Share	6.08	-0.20	0.49	-0.41	-2.00	-0.37	2.04	5.26	3.98	0.08

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