



# Phillips 66 (PSX)

Updated August 19<sup>th</sup>, 2021 by Aristofanis Papadatos

## Key Metrics

<b>Current Price:</b>	\$68	<b>5 Year CAGR Estimate:</b>	14.2%	<b>Market Cap:</b>	\$29.9 B
<b>Fair Value Price:</b>	\$84	<b>5 Year Growth Estimate:</b>	6.0%	<b>Ex-Dividend Date:</b>	8/17/2021
<b>% Fair Value:</b>	81%	<b>5 Year Valuation Multiple Estimate:</b>	4.4%	<b>Dividend Payment Date:</b>	9/1/2021
<b>Dividend Yield:</b>	5.3%	<b>5 Year Price Target</b>	\$113	<b>Years Of Dividend Growth:</b>	8
<b>Dividend Risk Score:</b>	F	<b>Retirement Suitability Score:</b>	C	<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 \$29.9 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 early August, Phillips 66 reported (8/3/21) financial results for the second quarter of fiscal 2021. The company began to recover from the pandemic thanks to the rollout of vaccines. Refining margins improved but the benefit was offset by higher RIN costs. On the other hand, the chemical segment posted record earnings thanks to impressive margins and high utilization. As a result, the company switched from an adjusted loss of -\$1.16 per share in the first quarter to an adjusted profit of \$0.74 per share. The pandemic has begun to subside thanks to the distribution of vaccines, though the propagation of the delta variant has raised some concerns for the recovery of the energy sector. Nevertheless, Phillips 66 is more defensive than pure refiners in the adverse scenario. Its minor loss of -\$0.89 per share in 2020 is a testament to the diversified business model of Phillips 66.

## Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
<b>EPS</b>	---	\$6.48	\$5.92	\$7.10	\$7.73	\$2.92	\$4.58	\$11.85	\$8.05	-\$0.89	<b>\$2.50</b>	<b>\$9.41</b>
<b>DPS</b>	---	\$0.45	\$1.33	\$1.89	\$2.18	\$2.45	\$2.73	\$3.10	\$3.50	\$3.60	<b>\$3.60</b>	<b>\$4.00</b>
<b>Shares<sup>1</sup></b>	---	637	619	571	547	530	519	464	441	439	<b>441</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 greatly affected the results of Phillips 66 last year but the company has begun to recover this 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. 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 a strong recovery of Phillips 66 from next year and thus we expect 6.0% average annual earnings-per-share growth over the next five years off mid-cycle level.

<sup>1</sup> 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	---	6.4	10.5	11.1	10.3	27.7	18.5	8.9	12.4	---	9.7	12.0
Avg. Yld.	---	1.1%	2.1%	2.4%	2.7%	3.0%	3.2%	2.9%	3.5%	5.3%	5.3%	3.5%

Phillips 66 is now trading at 9.7 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 trades at our fair value estimate in five years, it will enjoy a 4.4% annualized gain in its returns.

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

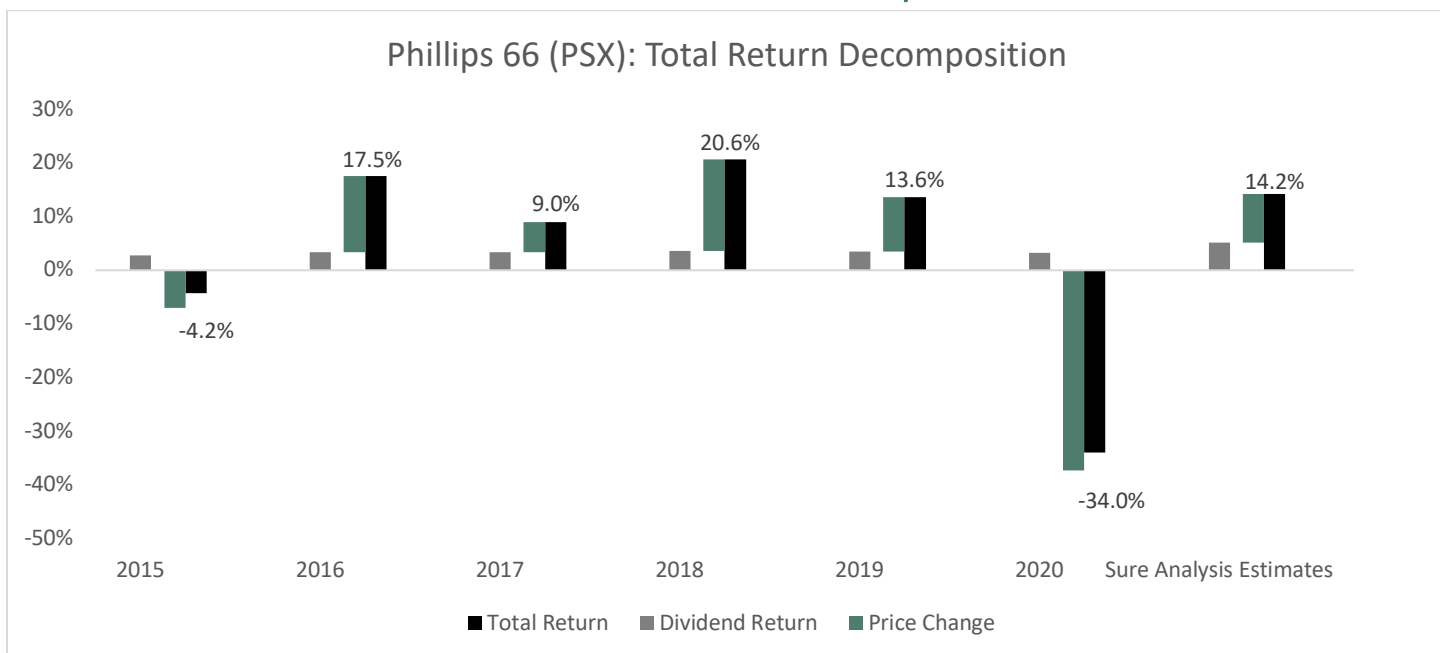
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	---	6.9%	22.5%	26.6%	28.2%	83.9%	59.6%	26.2%	43.5%	---	51.2%	42.6%

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 forced Phillips 66 to post its first annual loss in its 9-year history.

## Final Thoughts & Recommendation

Phillips 66 is a well-managed company, properly positioned for most scenarios of oil prices. The pandemic has begun to subside but the delta variant of the coronavirus has raised concerns over the recovery of the energy sector. As a result, Phillips 66 has corrected -25% off its recent peak. We view this correction as an opportunity and expect the stock to offer a 14.2% average annual return over the next five years. We thus rate the stock as a buy but we note that the stock is suitable only for patient, long-term investors.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
<b>Revenue (\$B)</b>	195.9	179.3	171.6	161.2	99.0	84.3	102.4	111.4	107.3	64.1
<b>Gross Profit</b>	23,163	24,877	23,351	25,464	25,576	21,811	22,945	13,531	11,764	5,027
<b>Gross Margin</b>	11.8%	13.9%	13.6%	15.8%	25.8%	25.9%	22.4%	12.1%	11.0%	7.8%
<b>SG&amp;A Exp.</b>	1,394	1,703	1,478	1,663	1,670	1,638	1,695	1,677	1,681	1,544
<b>D&amp;A Exp.</b>	902	906	947	995	1,078	1,168	1,318	1,356	1,341	1,395
<b>Operating Profit</b>	2,521	4,612	2,666	3,430	4,548	1,098	1,838	5,209	3,335	(1,492)
<b>Op. Margin</b>	1.3%	2.6%	1.6%	2.1%	4.6%	1.3%	1.8%	4.7%	3.1%	-2.3%
<b>Net Profit</b>	4,775	4,124	3,726	4,762	4,227	1,555	5,106	5,595	3,076	(3,975)
<b>Net Margin</b>	2.4%	2.3%	2.2%	3.0%	4.3%	1.8%	5.0%	5.0%	2.9%	-6.2%
<b>Free Cash Flow</b>	3,990	2,595	4,248	(244)	(51)	119	1,816	4,934	935	(809)
<b>Income Tax</b>	1,822	2,473	1,844	1,654	1,764	547	(1,693)	1,572	801	(1,250)

## Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
<b>Total Assets</b>	43,211	48,073	49,798	48,692	48,580	51,653	54,371	54,302	58,720	54,721
<b>Cash &amp; Equivalents</b>	-	3,474	5,400	5,207	3,074	2,711	3,119	3,019	1,614	2,514
<b>Acc. Receivable</b>	10,025	10,403	9,632	7,255	5,173	6,397	7,506	6,173	8,510	6,522
<b>Inventories</b>	3,466	3,430	3,354	3,397	3,477	3,150	3,395	3,543	3,776	3,893
<b>Goodwill &amp; Int.</b>	4,064	4,068	3,794	4,174	4,181	4,158	4,146	4,139	4,139	2,268
<b>Total Liabilities</b>	19,918	27,267	27,406	26,655	24,642	27,928	26,943	27,149	31,551	33,198
<b>Accounts Payable</b>	10,792	10,710	11,090	8,064	5,655	7,061	8,027	6,586	8,575	5,549
<b>Long-Term Debt</b>	391	6,974	6,155	8,635	8,887	10,138	10,110	11,160	11,763	15,629
<b>Total Equity</b>	23,264	20,775	21,950	21,590	23,100	22,390	25,085	24,653	24,910	18,984
<b>D/E Ratio</b>	0.02	0.34	0.28	0.40	0.38	0.45	0.40	0.45	0.47	0.82

## Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
<b>Return on Assets</b>	10.8%	9.0%	7.6%	9.7%	8.7%	3.1%	9.6%	10.3%	5.4%	-7.0%
<b>Return on Equity</b>	19.4%	18.7%	17.4%	21.9%	18.9%	6.8%	21.5%	22.5%	12.4%	-18.1%
<b>ROIC</b>	19.1%	16.0%	13.2%	16.1%	13.3%	4.7%	14.3%	14.8%	8.0%	-10.5%
<b>Shares Out.</b>	---	637	619	571	547	530	519	464	441	439
<b>Revenue/Share</b>	306.14	281.56	277.22	282.08	180.95	159.00	197.40	235.13	236.39	145.90
<b>FCF/Share</b>	6.23	4.08	6.86	(0.43)	(0.09)	0.22	3.50	10.41	2.06	(1.84)

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

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