Royal Dutch Shell plc (RDS.B)

Updated August 17th, 2021 by Aristofanis Papadatos

Key Metrics

Current Price:	$39	**5 Year CAGR Estimate:**	12.3%	**Market Cap:**	$156.6 B
Fair Value Price:	$62	**5 Year Growth Estimate:**	-1.0%	**Ex-Dividend Date:**	8/12/2021
% Fair Value:	63%	**5 Year Valuation Multiple Estimate:**	9.9%	**Dividend Payment Date:**	9/20/2021
Dividend Yield:	4.2%	**5 Year Price Target**	$59	**Years Of Dividend Growth:**	0
Dividend Risk Score:	D	**Retirement Suitability Score:**	C	**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 $157 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 July, Royal Dutch Shell reported (7/29/21) financial results for the second quarter of fiscal 2021. The company continued to recover at full throttle from the pandemic thanks to the rally of the oil price, which resulted from the massive rollout of vaccines and the aggressive production cuts of OPEC and Russia. Its upstream segment more than doubled its earnings and thus Shell grew its adjusted earnings-per-share 69% sequentially. Given the favorable environment for Shell, we have raised our earnings-per-share forecast for this year from $4.30 to $5.20.

In late March-2020, Shell stated that its dividend was safe but a month later it cut its quarterly dividend by -66%. It was the first time that Shell cut its dividend since World War II. However, Shell has raised its dividend three times since then and thus it is now offering a quarterly dividend that is essentially half of the pre-pandemic dividend ($0.48 vs. $0.94).

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$8.67	$8.48	$5.20	$4.72	$0.60	$1.16	$3.84	$5.16	$4.08	$1.24	***$5.20***	***$4.95***
DPS	$3.36	$3.42	$3.56	$3.72	$3.76	$3.76	$3.76	$3.76	$3.76	$1.91	***$1.64***	***$2.40***
Shares[1]	3,110	3,150	3,150	3,150	3,200	4,070	4,170	4,170	4,029	3,892	***3,890***	***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 they recovered but they plunged again last year due to the pandemic. 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 four 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, a few months ago, Shell 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. It also expects to produce ~75% of its proved reserves until 2030. 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

[1] In millions.

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reserves, which have rendered Shell more profitable at a given oil price. Due to the high comparison base formed this year, we expect the earnings-per-share of Shell to decline at a -1.0% average annual rate over the next five years.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	8.1	8.4	13.3	16.7	52	44	18.6	11.6	15.1	27.7	***7.5***	***12.0***
Avg. Yld.	4.8%	5.1%	5.1%	4.7%	6.5%	7.4%	6.4%	6.2%	6.1%	5.6%	***4.2%***	***4.0%***

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 a price-to-earnings ratio of 7.5. This valuation level is higher than our assumed fair earnings multiple of 12.0. If the stock reverts to our fair valuation level over the next five years, it will enjoy a 9.9% annualized gain in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

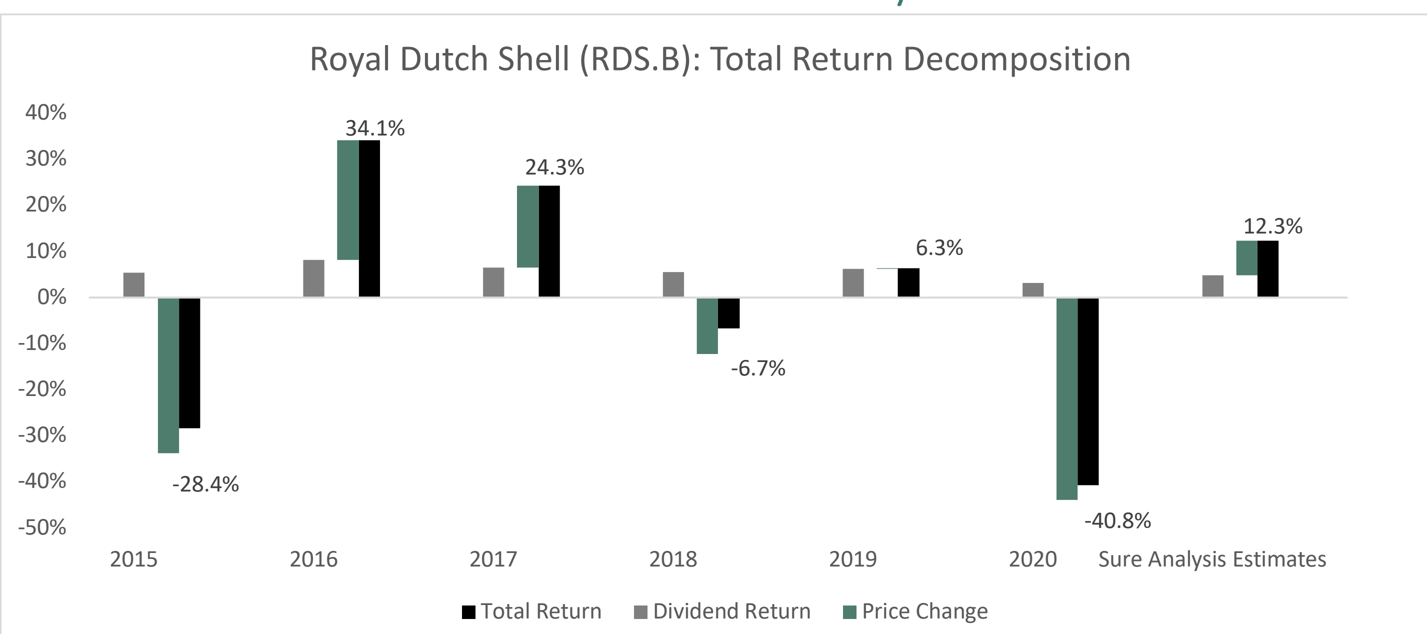
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	38.8%	40.3%	68.5%	78.8%	627%	324%	97.9%	72.9%	92.2%	154%	***31.5%***	***48.5%***

In contrast to Exxon Mobil and Chevron, which are Dividend Aristocrats, Shell froze its dividend for five years and cut its dividend last 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 slumped last year but the oil giant is recovering this year.

Final Thoughts & Recommendation

Shell plunged near its 20-year lows last year, primarily due to the pandemic. In addition, Shell cut its dividend for the first time in 75 years. The stock has rallied 77% in about ten months thanks to the enthusiasm of the market over the massive vaccination program underway, but we believe that the stock could still offer a 12.3% average annual return over the next five years, mostly thanks to its still cheap valuation. We thus maintain our buy rating.

Total Return Breakdown by Year



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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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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue ($B)	470.17	467.15	451.24	421.11	264.96	233.59	305.18	388.38	344.9	180.5
Gross Profit	60346	56598	48141	39290	15507	17590	28857	44875	36,755	-12,995
Gross Margin	12.8%	12.1%	10.7%	9.3%	5.9%	7.5%	9.5%	11.6%	10.7%	-7.2%
SG&A Exp.	14359	14465	14675	13965	11956	12101	10509	11360	10,493	9,881
D&A Exp.	13228	14615	21509	24499	26714	24993	26223	22135	28,701	52,444
Operating Profit	42598	37722	26870	19879	-3261	2367	15481	31189	22,946	-25,530
Op. Margin	9.1%	8.1%	6.0%	4.7%	-1.2%	1.0%	5.1%	8.0%	6.7%	-14.1%
Net Profit	30826	26712	16371	14874	1939	4575	12977	23352	15,843	-21,680
Net Margin	6.6%	5.7%	3.6%	3.5%	0.7%	2.0%	4.3%	6.0%	4.6%	-12.0%
Free Cash Flow	10470	13564	465	13368	3679	-1501	14805	30074	19,208	17,520
Income Tax	24450	23552	17066	13584	-153	829	4695	11715	9,053	-5,433

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets ($B)	337.47	350.29	357.51	353.12	340.16	411.28	407.10	399.19	404.3	379.3
Cash & Equivalents	11292	18550	9696	21607	31752	19130	20312	26741	18,054	31,830
Acc. Receivable	79509	40210	39094	28393	20607	25766	30721	42431	43,414	33,625
Inventories	28976	30781	30009	19701	15822	21775	25223	21117	24,071	19,457
Goodwill & Int.	4521	4470	4394	7076	6283	23967	24180	23586	23,486	22,822
Total Liab. ($B)	177.51	174.11	176.36	180.33	176.04	222.76	209.29	196.66	213.9	220.7
Accounts Payable	81846	42448	41927	32131	23795	28069	33196	48888	49,208	41,677
Long-Term Debt	37175	33560	39417	38838	52194	77617	70141	76824	96,424	108,014
Total Equity ($B)	158.48	174.75	180.05	171.97	162.88	186.65	194.36	198.65	186.5	155.3
D/E Ratio	0.23	0.19	0.22	0.23	0.32	0.42	0.36	0.32	0.52	0.70

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	9.3%	7.8%	4.6%	4.2%	0.6%	1.2%	3.2%	5.8%	3.9%	-5.5%
Return on Equity	20.1%	16.0%	9.2%	8.5%	1.2%	2.6%	6.8%	11.9%	8.2%	-12.7%
ROIC	15.8%	13.1%	7.6%	6.9%	0.9%	1.9%	4.9%	8.8%	5.7%	-8.3%
Shares Out.	3110	3150	3150	3150	3200	4070	4170	4170	4029	3892
Revenue/Share	151.14	149.06	143.40	133.44	82.40	59.20	73.55	93.04	85.02	46.32
FCF/Share	3.37	4.33	0.15	4.24	1.14	-0.38	3.57	7.20	4.74	4.49

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