



Phillips 66 (PSX)

Updated November 1st, 2021 by Aristofanis Papadatos

Key Metrics

| | | | | | |
|-----------------------------|------|--|-------|----------------------------------|------------|
| Current Price: | \$75 | 5 Year CAGR Estimate: | 12.1% | Market Cap: | \$32.8 B |
| Fair Value Price: | \$84 | 5 Year Growth Estimate: | 6.0% | Ex-Dividend Date: | 11/16/2021 |
| % Fair Value: | 89% | 5 Year Valuation Multiple Estimate: | 2.4% | Dividend Payment Date: | 12/1/2021 |
| Dividend Yield: | 4.9% | 5 Year Price Target | \$113 | Years Of Dividend Growth: | 9 |
| Dividend Risk Score: | D | Retirement Suitability Score: | B | Last Dividend Increase: | 2.2% |

Overview & Current Events

Phillips 66 was spun off from ConocoPhillips in 2012. Phillips 66 has a market capitalization of \$32.8 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 (10/29/21) financial results for the third quarter of fiscal 2021. The company recovered impressively from the pandemic. Refining margins more than doubled sequentially thanks to improved demand for oil products and thus the refining segment switched from adjusted pre-tax losses of -\$706 million to an adjusted profit of \$184 million. It was the first profitable quarter for this segment since the onset of the pandemic. In addition, midstream, chemicals and marketing segments posted strong earnings. As a result, the company more than quadrupled its earnings-per-share sequentially, from \$0.74 to \$3.18 per share, and beat analysts' consensus by an impressive \$1.26. We have thus raised our annual earnings-per-share forecast from \$2.50 to \$4.00. We reiterate that Phillips 66 is more defensive than pure refiners in the adverse scenario of a prolonged pandemic. Its minor loss of -\$0.89 per share in 2020 is a testament to the diversified business model of Phillips 66.

Phillips 66 also announced that it will buy all the units of Phillips 66 Partners LP (PSXP) it does not own in an all-stock deal valued at \$3.4 billion in order to simplify its structure across its integrated portfolio. The unitholders of PSXP will receive 0.5 shares of Phillips 66 for each unit of PSXP they own. The deal is expected to close in the first quarter of 2022.

Growth on a Per-Share Basis

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2026 |
|---------------------------|------|--------|--------|--------|--------|--------|--------|---------|--------|---------|---------------|---------------|
| EPS | --- | \$6.48 | \$5.92 | \$7.10 | \$7.73 | \$2.92 | \$4.58 | \$11.85 | \$8.05 | -\$0.89 | \$4.00 | \$9.41 |
| DPS | --- | \$0.45 | \$1.33 | \$1.89 | \$2.18 | \$2.45 | \$2.73 | \$3.10 | \$3.50 | \$3.60 | \$3.68 | \$4.10 |
| Shares¹ | --- | 637 | 619 | 571 | 547 | 530 | 519 | 464 | 441 | 439 | 441 | 500 |

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. Phillips 66 also has many ongoing growth projects in its midstream segment. Overall, we expect a strong

¹ In millions.

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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 its mid-cycle level.

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 | --- | 10.7 | 12.0 |
| Avg. Yld. | --- | 1.1% | 2.1% | 2.4% | 2.7% | 3.0% | 3.2% | 2.9% | 3.5% | 5.3% | 4.9% | 3.6% |

Phillips 66 is now trading at 10.7 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 2.4% annualized gain in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

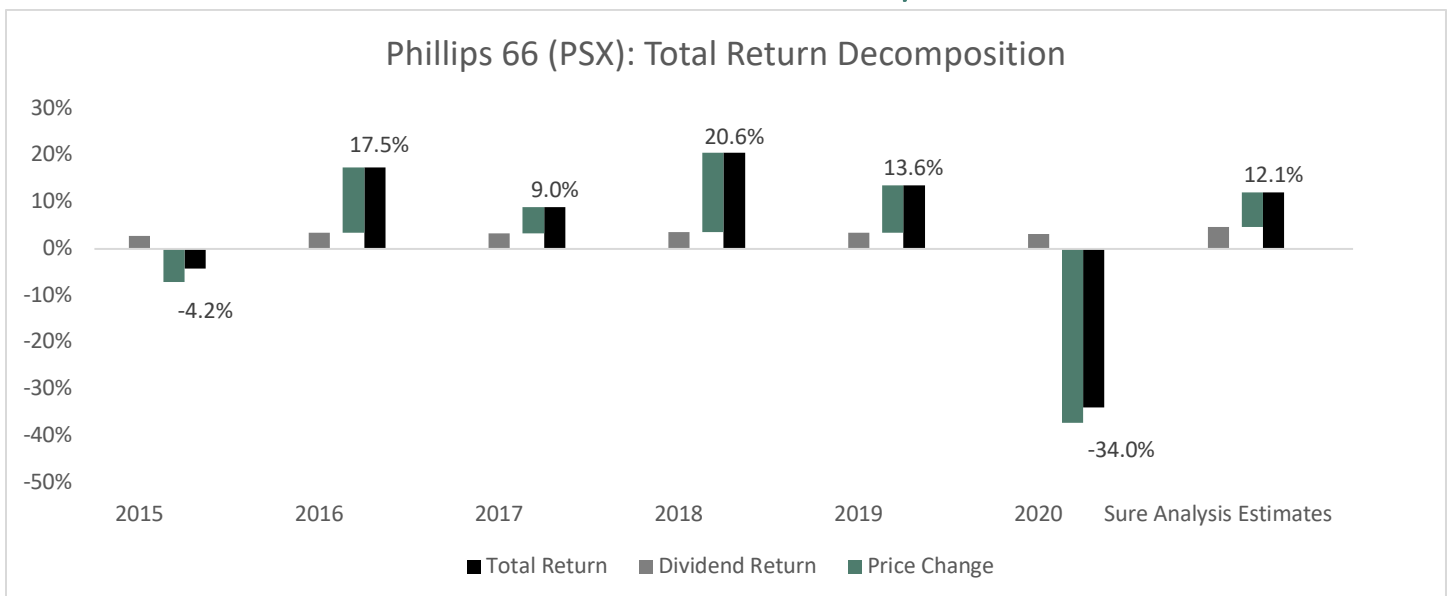
| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2026 |
|--------|------|------|-------|-------|-------|-------|-------|-------|-------|------|--------------|--------------|
| Payout | --- | 6.9% | 22.5% | 26.6% | 28.2% | 83.9% | 59.6% | 26.2% | 43.5% | --- | 52.3% | 43.6% |

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 downturn from the pandemic was 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 stock has rallied 10% since our last research report, in August, but it remains attractive. We expect the stock to offer a 12.1% 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 |
|-------------------------|--------|--------|--------|--------|--------|--------|---------|--------|--------|---------|
| Revenue (\$B) | 195.9 | 179.3 | 171.6 | 161.2 | 99.0 | 84.3 | 102.4 | 111.4 | 107.3 | 64.1 |
| Gross Profit | 23,163 | 24,877 | 23,351 | 25,464 | 25,576 | 21,811 | 22,945 | 13,531 | 11,764 | 5,027 |
| Gross Margin | 11.8% | 13.9% | 13.6% | 15.8% | 25.8% | 25.9% | 22.4% | 12.1% | 11.0% | 7.8% |
| SG&A Exp. | 1,394 | 1,703 | 1,478 | 1,663 | 1,670 | 1,638 | 1,695 | 1,677 | 1,681 | 1,544 |
| D&A Exp. | 902 | 906 | 947 | 995 | 1,078 | 1,168 | 1,318 | 1,356 | 1,341 | 1,395 |
| Operating Profit | 2,521 | 4,612 | 2,666 | 3,430 | 4,548 | 1,098 | 1,838 | 5,209 | 3,335 | (1,492) |
| Op. Margin | 1.3% | 2.6% | 1.6% | 2.1% | 4.6% | 1.3% | 1.8% | 4.7% | 3.1% | -2.3% |
| Net Profit | 4,775 | 4,124 | 3,726 | 4,762 | 4,227 | 1,555 | 5,106 | 5,595 | 3,076 | (3,975) |
| Net Margin | 2.4% | 2.3% | 2.2% | 3.0% | 4.3% | 1.8% | 5.0% | 5.0% | 2.9% | -6.2% |
| Free Cash Flow | 3,990 | 2,595 | 4,248 | (244) | (51) | 119 | 1,816 | 4,934 | 935 | (809) |
| Income Tax | 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 |
|-------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Total Assets | 43,211 | 48,073 | 49,798 | 48,692 | 48,580 | 51,653 | 54,371 | 54,302 | 58,720 | 54,721 |
| Cash & Equivalents | - | 3,474 | 5,400 | 5,207 | 3,074 | 2,711 | 3,119 | 3,019 | 1,614 | 2,514 |
| Acc. Receivable | 10,025 | 10,403 | 9,632 | 7,255 | 5,173 | 6,397 | 7,506 | 6,173 | 8,510 | 6,522 |
| Inventories | 3,466 | 3,430 | 3,354 | 3,397 | 3,477 | 3,150 | 3,395 | 3,543 | 3,776 | 3,893 |
| Goodwill & Int. | 4,064 | 4,068 | 3,794 | 4,174 | 4,181 | 4,158 | 4,146 | 4,139 | 4,139 | 2,268 |
| Total Liabilities | 19,918 | 27,267 | 27,406 | 26,655 | 24,642 | 27,928 | 26,943 | 27,149 | 31,551 | 33,198 |
| Accounts Payable | 10,792 | 10,710 | 11,090 | 8,064 | 5,655 | 7,061 | 8,027 | 6,586 | 8,575 | 5,549 |
| Long-Term Debt | 391 | 6,974 | 6,155 | 8,635 | 8,887 | 10,138 | 10,110 | 11,160 | 11,763 | 15,629 |
| Total Equity | 23,264 | 20,775 | 21,950 | 21,590 | 23,100 | 22,390 | 25,085 | 24,653 | 24,910 | 18,984 |
| D/E Ratio | 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 |
|-------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Return on Assets | 10.8% | 9.0% | 7.6% | 9.7% | 8.7% | 3.1% | 9.6% | 10.3% | 5.4% | -7.0% |
| Return on Equity | 19.4% | 18.7% | 17.4% | 21.9% | 18.9% | 6.8% | 21.5% | 22.5% | 12.4% | -18.1% |
| ROIC | 19.1% | 16.0% | 13.2% | 16.1% | 13.3% | 4.7% | 14.3% | 14.8% | 8.0% | -10.5% |
| Shares Out. | --- | 637 | 619 | 571 | 547 | 530 | 519 | 464 | 441 | 439 |
| Revenue/Share | 306.14 | 281.56 | 277.22 | 282.08 | 180.95 | 159.00 | 197.40 | 235.13 | 236.39 | 145.90 |
| FCF/Share | 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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