Shell plc (SHEL)

Updated November 1st, 2022 by Aristofanis Papadatos

Key Metrics

Current Price:	$56	**5 Year CAGR Estimate:**	8.4%	**Market Cap:**	$196 B
Fair Value Price:	$114	**5 Year Growth Estimate:**	-9.0%	**Ex-Dividend Date:**	11/9/2022
% Fair Value:	49%	**5 Year Valuation Multiple Estimate:**	15.3%	**Dividend Payment Date:**	12/19/2022
Dividend Yield:	3.6%	**5 Year Price Target**	$71	**Years Of Dividend Growth:**	2
Dividend Risk Score:	C	**Retirement Suitability Score:**	C	**Rating:**	Hold

Overview & Current Events

Royal Dutch Shell (RDS.B) changed its name to Shell plc (SHEL) on January 21st, 2022. It is an oil and gas supermajor, the third largest behind Saudi Aramco and Exxon Mobil in terms of production volumes. Shell is currently valued at $196 billion, also ranking third among oil companies by that measure. Shell is headquartered in London (UK).

In late October, Shell reported (10/27/22) financial results for the third quarter of fiscal 2022. Its production decreased sequentially and the price of oil somewhat corrected from its highs in the previous quarter. Therefore, while European gas prices climbed to new all-time highs amid the sanctions of Europe and the U.S. on Russia, Shell saw its adjusted earnings dip -18% sequentially, from an all-time high of $11.5 billion to $9.5 billion. Thanks to exceptionally favorable prices of oil and gas, Shell expects to raise its dividend by 15% in 2023. It also has a share repurchase program of $6.0 billion, which can reduce the share count by 3% around the current stock price.

Due to the sanctions of western countries on Russia, oil and gas prices are likely to remain high in the short run. Shell especially benefits from the record European gas prices. However, we expect oil and gas prices to deflate beyond this year. We also note a bearish signal; the oil price has reverted towards its level at the onset of the war in Ukraine.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$8.48	$5.20	$4.72	$0.60	$1.16	$3.84	$5.16	$4.08	$1.24	$4.98	***$9.50***	***$5.93***
DPS	$3.42	$3.56	$3.72	$3.76	$3.76	$3.76	$3.76	$3.76	$1.91	$1.92	***$2.00***	***$2.93***
Shares[1]	3,150	3,150	3,150	3,200	4,070	4,170	4,170	4,029	3,892	3,872	***3,650***	***3,500***

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 in 2020 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 five years. This is in sharp contrast to the other oil majors, such as Chevron, BP and Total, which have grown their production 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 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 reserves, which have

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[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.

rendered Shell more profitable at a given oil price. Due to the high comparison base formed by the blowout earnings this year, we expect the earnings-per-share of Shell to decline at a -9.0% average annual rate over the next five years.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	8.4	13.3	16.7	52	44	18.6	11.6	15.1	27.7	8.3	***5.9***	***12.0***
Avg. Yld.	5.1%	5.1%	4.7%	6.5%	7.4%	6.4%	6.2%	6.1%	5.6%	4.6%	***3.6%***	***4.1%***

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 nearly 10-year low price-to-earnings ratio of 5.9. This valuation level is lower 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 15.3% annualized gain in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

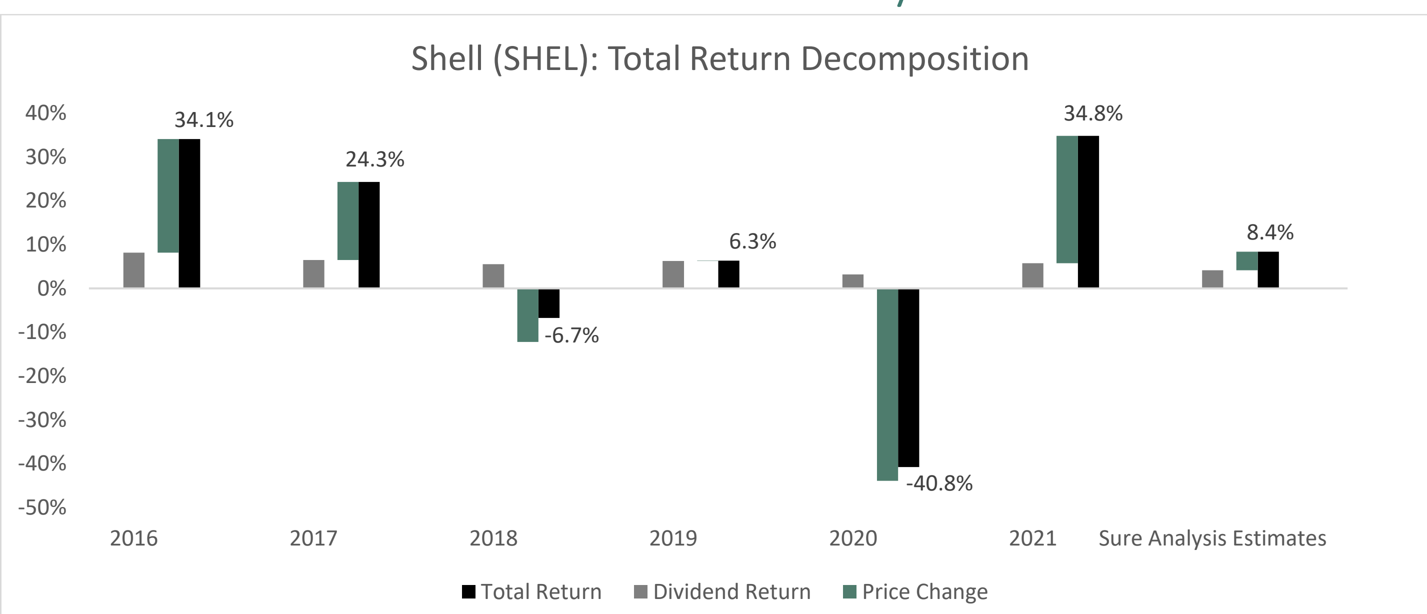
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	40.3%	68.5%	78.8%	627%	324%	97.9%	72.9%	92.2%	154%	38.6%	***21.1%***	***49.3%***

In contrast to Exxon Mobil and Chevron, which are Dividend Aristocrats, Shell froze its dividend for five years and cut its dividend in 2020, 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 four years. It is now offering a 10-year low dividend yield of 3.6% but its dividend has a wide margin of safety.

Final Thoughts & Recommendation

Shell plunged near its 20-year lows in 2020, primarily due to the pandemic, and cut its dividend for the first time in 75 years. However, it is thriving now thanks to high oil and gas prices, which have resulted from the war in Ukraine. It is also more cheaply valued than its American peers, Exxon and Chevron. We expect Shell to offer an 8.4% average annual return over the next five years thanks to its 3.6% dividend and a 15.3% valuation tailwind, which may be partly offset by a -9.0% decline of earnings-per-share. We rate the stock as a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue ($B)	467.15	451.24	421.11	264.96	233.59	305.18	388.38	344.9	180.5	261.5
Gross Profit	56598	48141	39290	15507	17590	28857	44875	36,755	-12,995	35,848
Gross Margin	12.1%	10.7%	9.3%	5.9%	7.5%	9.5%	11.6%	10.7%	-7.2%	13.7%
SG&A Exp.	14465	14675	13965	11956	12101	10509	11360	10,493	9,881	11,328
D&A Exp.	14615	21509	24499	26714	24993	26223	22135	28,701	52,444	26,921
Operating Profit	37722	26870	19879	-3261	2367	15481	31189	22,946	-25,530	22,282
Op. Margin	8.1%	6.0%	4.7%	-1.2%	1.0%	5.1%	8.0%	6.7%	-14.1%	8.5%
Net Profit	26712	16371	14874	1939	4575	12977	23352	15,843	-21,680	20,101
Net Margin	5.7%	3.6%	3.5%	0.7%	2.0%	4.3%	6.0%	4.6%	-12.0%	7.7%
Free Cash Flow	13564	465	13368	3679	-1501	14805	30074	19,208	17,520	26,105
Income Tax	23552	17066	13584	-153	829	4695	11715	9,053	-5,433	9,199

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets ($B)	350.29	357.51	353.12	340.16	411.28	407.10	399.19	404.3	379.3	404.4
Cash & Equivalents	18550	9696	21607	31752	19130	20312	26741	18,054	31,830	36,971
Acc. Receivable	40210	39094	28393	20607	25766	30721	42431	43,414	33,625	53,208
Inventories	30781	30009	19701	15822	21775	25223	21117	24,071	19,457	25,258
Goodwill & Int.	4470	4394	7076	6283	23967	24180	23586	23,486	22,822	24,693
Total Liab. ($B)	174.11	176.36	180.33	176.04	222.76	209.29	196.66	213.9	220.7	229.1
Accounts Payable	42,448	41,927	32,131	23,795	28,069	33,196	30,351	29,497	22,664	63,173
Long-Term Debt	33,560	39,417	38,838	52,194	77,617	70,141	62,798	65,887	79,594	89,086
Total Equity ($B)	174.75	180.05	171.97	162.88	186.65	194.36	198.65	186.5	155.3	172.0
LTD/E Ratio	0.19	0.22	0.23	0.32	0.42	0.36	0.32	0.35	0.51	0.52

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	7.8%	4.6%	4.2%	0.6%	1.2%	3.2%	5.8%	3.9%	-5.5%	5.1%
Return on Equity	16.0%	9.2%	8.5%	1.2%	2.6%	6.8%	11.9%	8.2%	-12.7%	12.3%
ROIC	13.1%	7.6%	6.9%	0.9%	1.9%	4.9%	8.8%	5.7%	-8.3%	8.0%
Shares Out.	3150	3150	3150	3200	4070	4170	4170	4029	3892	3872
Revenue/Share	149.06	143.40	133.44	82.40	59.20	73.55	93.04	85.02	46.32	66.99
FCF/Share	4.33	0.15	4.24	1.14	-0.38	3.57	7.20	4.74	4.49	6.69

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