



Phillips 66 (PSX)

Updated February 2nd, 2023 by Aristofanis Papadatos

Key Metrics

Current Price:	\$98	5 Year CAGR Estimate:	6.4%	Market Cap:	\$47.4 B
Fair Value Price:	\$162	5 Year Growth Estimate:	-7.0%	Ex-Dividend Date:	2/17/2023 ¹
% Fair Value:	60%	5 Year Valuation Multiple Estimate:	10.6%	Dividend Payment Date:	2/28/2023
Dividend Yield:	4.0%	5 Year Price Target	\$113	Years Of Dividend Growth:	10
Dividend Risk Score:	B	Retirement Suitability Score:	A	Rating:	Hold

Overview & Current Events

Phillips 66 was spun off from ConocoPhillips in 2012. Phillips 66 has a market capitalization of \$47.4 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. In 2022, the refining segment was by far the most profitable segment, generating 66% of total earnings, as the sanctions of western countries on Russia resulted in extremely tight global supply of oil products and hence in sky-high refining margins.

In late January, Phillips 66 reported (1/31/23) financial results for the fourth quarter of fiscal 2022. The realized refining margins of the company decreased sequentially from \$26.87 to \$19.73 and thus the operating income of the refining segment plunged from \$2.9 billion to \$1.6 billion. As a result, adjusted earnings-per-share slumped from \$6.46 to \$4.00 and missed the analysts' consensus by \$0.35. Given the almost record benchmark refining margins that prevailed during the fourth quarter, the results of Phillips 66 were markedly disappointing. Nevertheless, a disappointing quarter is not enough to hurt the long-term prospects of this high-quality oil company. We praise management for reducing debt and redeeming preferred stock amid record profits. We also reiterate that the minor loss of -\$0.89 per share in 2020 is a testament to the diversified business model of Phillips 66.

The CEO of Phillips 66 retired in July. Given the exceptional quality of the management of Phillips 66, the change in the CEO position is a potential risk factor. However, this is a long-term concern and the odds favor that the new CEO will maintain the discipline of his predecessor.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$5.92	\$7.10	\$7.73	\$2.92	\$4.58	\$11.85	\$8.05	-\$0.89	\$5.70	\$18.79	\$13.50	\$9.39
DPS	\$1.33	\$1.89	\$2.18	\$2.45	\$2.73	\$3.10	\$3.50	\$3.60	\$3.62	\$3.83	\$3.88	\$4.36
Shares²	619	571	547	530	519	464	441	439	441	466	460	450

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 reduced its capital expenses in recent years, it has begun to reap the benefits from past investments. In addition, the record earnings of the midstream, chemicals and marketing segments in 2021 are additional testaments to the widely recognized discipline of management to invest only in high-return projects.

The pandemic greatly affected the results of Phillips 66 in 2020 but the company has fully recovered from that crisis. Moreover, Phillips 66 has many ongoing growth projects in its midstream segment. Furthermore, it is thriving right now thanks to the blowout refining margins, which have resulted from the Ukrainian crisis. However, investors should be aware of the highly cyclical nature of refining margins. Given the exceptionally high earnings expected this year, we expect a -7.0% average annual decline of earnings-per-share over the next five years.

¹ Estimated date.

² 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	10.5	11.1	10.3	27.7	18.5	8.9	12.4	---	13.6	4.8	7.3	12.0
Avg. Yld.	2.1%	2.4%	2.7%	3.0%	3.2%	2.9%	3.5%	5.3%	4.7%	4.2%	4.0%	3.9%

Due to its exceptionally high earnings expected this year, Phillips 66 is now trading at a price-to-earnings ratio of only 7.3. This valuation level is much lower than its 10-year average of 13.1. 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 10.6% annualized gain in its returns, which will offset the expected decline in earnings-per-share.

Safety, Quality, Competitive Advantage, & Recession Resiliency

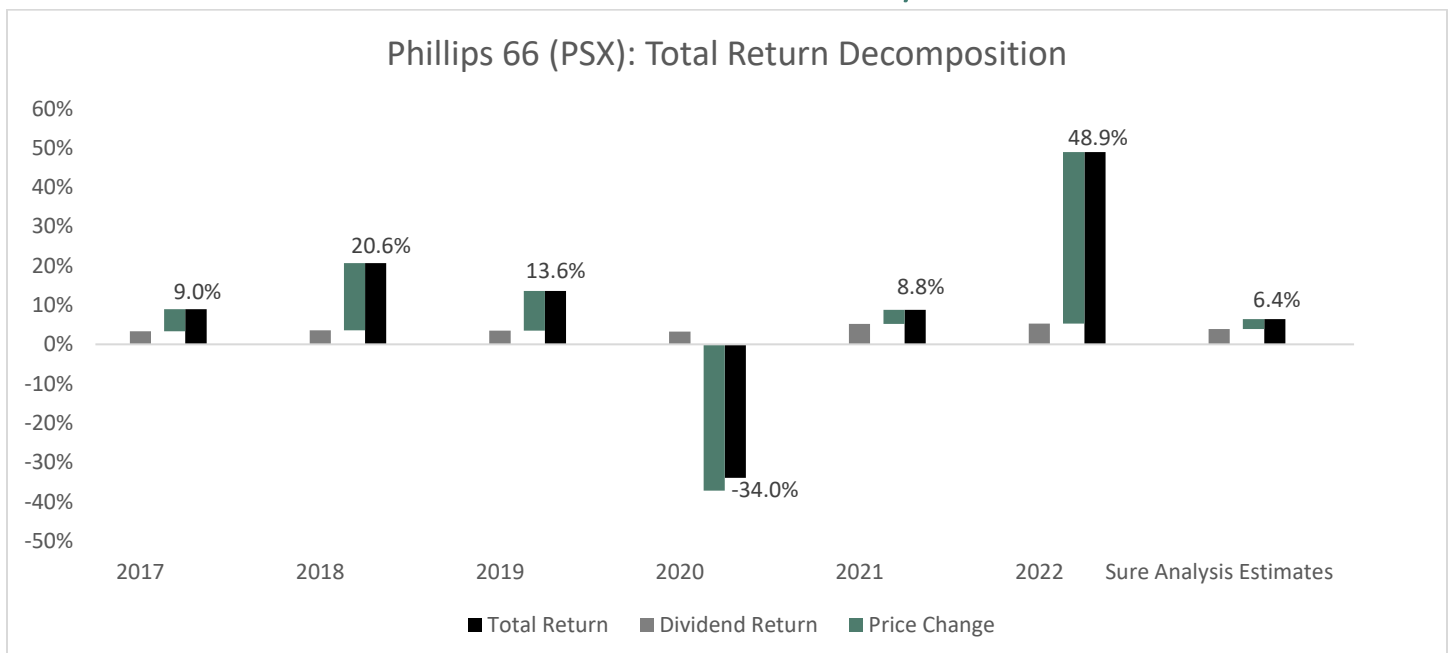
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	22.5%	26.6%	28.2%	83.9%	59.6%	26.2%	43.5%	---	63.5%	20.4%	28.7%	46.4%

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 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 10-year history.

Final Thoughts & Recommendation

Phillips 66 is a well-managed company, properly positioned for most scenarios of oil prices. However, the stock has rallied 50% in about 18 months and hence it has become less attractive. We expect it to offer a 6.4% average annual return over the next five years thanks to its 4.0% dividend and a 10.6% annualized valuation tailwind, which may be partly offset by a -7.0% annual decline of earnings-per-share. We thus 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)	179.3	171.6	161.2	99.0	84.3	102.4	111.4	107.3	64.1	111.5
Gross Profit	24,877	23,351	25,464	25,576	21,811	22,945	13,531	11,764	5,027	7,769
Gross Margin	13.9%	13.6%	15.8%	25.8%	25.9%	22.4%	12.1%	11.0%	7.8%	7.0%
SG&A Exp.	1,703	1,478	1,663	1,670	1,638	1,695	1,677	1,681	1,544	1,744
D&A Exp.	906	947	995	1,078	1,168	1,318	1,356	1,341	1,395	1,605
Operating Profit	4,612	2,666	3,430	4,548	1,098	1,838	5,209	3,335	(1,492)	468
Op. Margin	2.6%	1.6%	2.1%	4.6%	1.3%	1.8%	4.7%	3.1%	-2.3%	0.4%
Net Profit	4,124	3,726	4,762	4,227	1,555	5,106	5,595	3,076	(3,975)	1,315
Net Margin	2.3%	2.2%	3.0%	4.3%	1.8%	5.0%	5.0%	2.9%	-6.2%	1.2%
Free Cash Flow	2,595	4,248	(244)	(51)	119	1,816	4,934	935	(809)	4,157
Income Tax	2,473	1,844	1,654	1,764	547	(1,693)	1,572	801	(1,250)	146

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	48,073	49,798	48,692	48,580	51,653	54,371	54,302	58,720	54,721	55,594
Cash & Equivalents	3,474	5,400	5,207	3,074	2,711	3,119	3,019	1,614	2,514	3,147
Acc. Receivable	10,403	9,632	7,255	5,173	6,397	7,506	6,173	8,510	6,522	7,470
Inventories	3,430	3,354	3,397	3,477	3,150	3,395	3,543	3,776	3,893	3,394
Goodwill & Int.	4,068	3,794	4,174	4,181	4,158	4,146	4,139	4,139	2,268	2,297
Total Liabilities	27,267	27,406	26,655	24,642	27,928	26,943	27,149	31,551	33,198	33,957
Accounts Payable	10,710	11,090	8,064	5,655	7,061	8,027	6,586	8,575	5,549	8,461
Long-Term Debt	6,974	6,155	8,635	8,887	10,138	10,110	11,160	11,763	15,629	14,158
Total Equity	20,775	21,950	21,590	23,100	22,390	25,085	24,653	24,910	18,984	19,166
D/E Ratio	0.34	0.28	0.40	0.38	0.45	0.40	0.45	0.47	0.82	0.74

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	9.0%	7.6%	9.7%	8.7%	3.1%	9.6%	10.3%	5.4%	-7.0%	2.4%
Return on Equity	18.7%	17.4%	21.9%	18.9%	6.8%	21.5%	22.5%	12.4%	-18.1%	6.9%
ROIC	16.0%	13.2%	16.1%	13.3%	4.7%	14.3%	14.8%	8.0%	-10.5%	3.6%
Shares Out.	637	619	571	547	530	519	464	441	439	441
Revenue/Share	281.56	277.22	282.08	180.95	159.00	197.40	235.13	236.39	145.90	253.15
FCF/Share	4.08	6.86	(0.43)	(0.09)	0.22	3.50	10.41	2.06	(1.84)	9.44

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

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