



Phillips 66 (PSX)

Updated October 30th, 2023 by Aristofanis Papadatos

Key Metrics

Current Price:	\$111	5 Year CAGR Estimate:	4.0%	Market Cap:	\$48.8 B
Fair Value Price:	\$162	5 Year Growth Estimate:	-7.0%	Ex-Dividend Date:	11/16/2023
% Fair Value:	69%	5 Year Valuation Multiple Estimate:	7.9%	Dividend Payment Date:	12/1/2023
Dividend Yield:	3.8%	5 Year Price Target	\$113	Years Of Dividend Growth:	11
Dividend Risk Score:	B	Retirement Suitability Score:	B	Rating:	Hold

Overview & Current Events

Phillips 66 was spun off from ConocoPhillips in 2012. Phillips 66 has a market capitalization of \$48.8 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. 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 October, Phillips 66 reported (10/27/23) financial results for the third quarter of fiscal 2023. Refining margins greatly improved sequentially, from \$15.32 to \$18.96 per barrel, and refinery utilization increased. As a result, the refining segment grew its pre-tax income from \$1.1 billion to \$1.7 billion and the adjusted earnings-per-share of the company grew 20%, from \$3.87 to \$4.63, though they missed the analysts' consensus by \$0.10. Moreover, thanks to the substantial progress of Phillips 66 on some growth projects, the company raised its guidance for its mid-cycle adjusted EBITDA in 2025 from \$3 billion to \$4 billion. 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 and its superior resilience to downturns when compared to most oil companies.

The CEO of Phillips 66 retired in July-2022. 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	\$4.20	\$4.72
Shares¹	619	571	547	530	519	464	441	439	441	466	440	400

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 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 above average 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 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	8.2	12.0
Avg. Yld.	2.1%	2.4%	2.7%	3.0%	3.2%	2.9%	3.5%	5.3%	4.7%	4.2%	3.8%	4.2%

Due to its exceptionally high earnings expected this year, Phillips 66 is now trading at a price-to-earnings ratio of only 8.2. 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 7.9% annualized gain in its returns, which will offset the expected decline in earnings-per-share.

Safety, Quality, Competitive Advantage, & Recession Resiliency

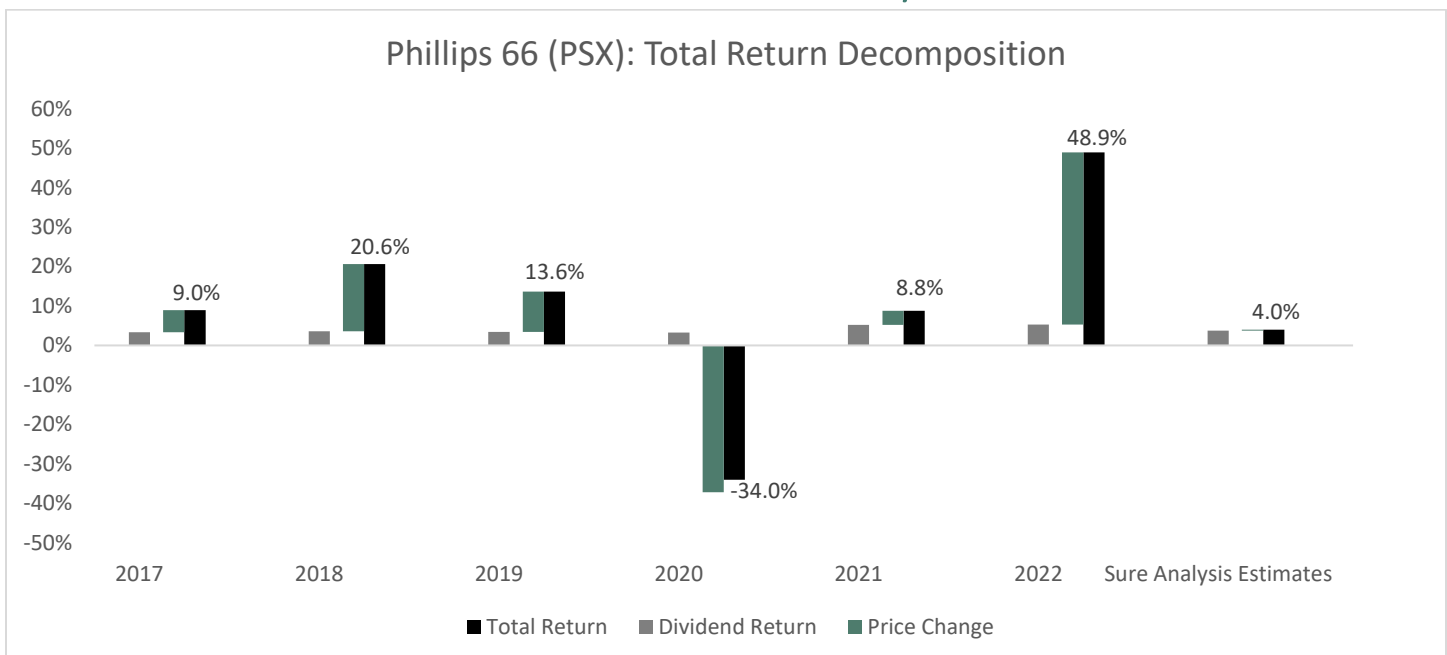
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	22.5%	26.6%	28.2%	83.9%	59.6%	26.2%	43.5%	---	63.5%	20.4%	31.1%	50.2%

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 67% in about two years and hence it has become less attractive. We expect it to offer a 4.0% average annual return over the next five years thanks to its 3.8% dividend and a 7.9% annualized valuation tailwind, which may be partly offset by a -7.0% annual decline of earnings-per-share. We maintain our hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue (\$B)	171.6	161.2	99.0	84.3	102.4	111.4	107.3	64.1	111.5	170.0
Gross Profit	23,351	25,464	25,576	21,811	22,945	13,531	11,764	5,027	7,769	18,429
Gross Margin	13.6%	15.8%	25.8%	25.9%	22.4%	12.1%	11.0%	7.8%	7.0%	10.8%
SG&A Exp.	1,478	1,663	1,670	1,638	1,695	1,677	1,681	1,544	1,744	2,168
D&A Exp.	947	995	1,078	1,168	1,318	1,356	1,341	1,395	1,605	1,629
Operating Profit	2,666	3,430	4,548	1,098	1,838	5,209	3,335	(1,492)	468	9,620
Op. Margin	1.6%	2.1%	4.6%	1.3%	1.8%	4.7%	3.1%	-2.3%	0.4%	5.7%
Net Profit	3,726	4,762	4,227	1,555	5,106	5,595	3,076	(3,975)	1,315	11,024
Net Margin	2.2%	3.0%	4.3%	1.8%	5.0%	5.0%	2.9%	-6.2%	1.2%	6.5%
Free Cash Flow	4,248	(244)	(51)	119	1,816	4,934	935	(809)	4,157	8,619
Income Tax	1,844	1,654	1,764	547	(1,693)	1,572	801	(1,250)	146	3,248

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	49,798	48,692	48,580	51,653	54,371	54,302	58,720	54,721	55,594	76,442
Cash & Equivalents	5,400	5,207	3,074	2,711	3,119	3,019	1,614	2,514	3,147	6,133
Acc. Receivable	9,632	7,255	5,173	6,397	7,506	6,173	8,510	6,522	7,470	10,985
Inventories	3,354	3,397	3,477	3,150	3,395	3,543	3,776	3,893	3,394	3,276
Goodwill & Int.	3,794	4,174	4,181	4,158	4,146	4,139	4,139	2,268	2,297	2,317
Total Liabilities	27,406	26,655	24,642	27,928	26,943	27,149	31,551	33,198	33,957	42,336
Accounts Payable	11,090	8,064	5,655	7,061	8,027	6,586	8,575	5,549	8,461	11,323
Long-Term Debt	6,155	8,635	8,887	10,138	10,110	11,160	11,763	15,629	14,158	17,190
Total Equity	21,950	21,590	23,100	22,390	25,085	24,653	24,910	18,984	19,166	29,494
D/E Ratio	0.28	0.40	0.38	0.45	0.40	0.45	0.47	0.82	0.74	0.58

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	7.6%	9.7%	8.7%	3.1%	9.6%	10.3%	5.4%	-7.0%	2.4%	16.7%
Return on Equity	17.4%	21.9%	18.9%	6.8%	21.5%	22.5%	12.4%	-18.1%	6.9%	45.3%
ROIC	13.2%	16.1%	13.3%	4.7%	14.3%	14.8%	8.0%	-10.5%	3.6%	25.2%
Shares Out.	619	571	547	530	519	464	441	439	441	474
Revenue/Share	277.22	282.08	180.95	159.00	197.40	235.13	236.39	145.90	253.15	358.83
FCF/Share	6.86	(0.43)	(0.09)	0.22	3.50	10.41	2.06	(1.84)	9.44	18.19

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

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