Yale School of Management
Conoco Phillips (COP)

Detailed Research Report
Nov 7, 2018

Recommendation

HOLD

Upside Return

2.41%

Recommendation Factors

Fair Value ($)	71.37
EBIT (TTM) ($MM)	6,603
Market Cap ($ B)	81.08
B/F P/E Ratio	12.49x
B/F P/E Industry	12.05x

Basic Information

Last Trade ($)	69.69
Trade Date	11/02/2018
Market Cap ($ B)	81.08
Trailing P/E	13.95x
Forward P/E	12.49x
P/B	2.55x
EPS	1.36
Dividend/share(S)	0.285
Dividend Yield	1.73%
D/V	0.55
Beta	1.55

Valuation Forecast Analysis

Last Trade	$69.69
High Growth Price	$90.93
Neutral Grwt Price	$71.37
Low Growth Price	$55.09

Industry & Sector

Industry	Oil & Gas
Sector	E&P

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Key takeaways:

- **Diversified Portfolio – geographically and commodities produced**: COP operates in 17 countries and produces Oil, Gas, LNG and Bitumen.

- **Impressive Financials –** In TTM the company reduced debt by 27%, improved EBIT by 40%, increasing dividend yield by 9%, increased EPS by 16%, continued to decrease cost of revenues and maintained best EBITDA margin in class (13.9%).

- **Cash returns prioritized**: COP has been paying out 20-30% of cash from operations back to shareholders. In 2017, dividends worth $1.3B were paid and share re-purchase worth $3B were executed. COP plans to continue this over the next few years.

- **Atypical E&P company** – No major assets being bought as the focus remains on maintaining flat production over the coming years and maintaining only low cost-of-supply assets. The company is depleting its resources and the RP ratio is falling drastically.

- **Great performer on ESG** – COP received an "AA" rating from MSCI ESG, up from an 'A' rating in 2017. COP has consistently reduced total GHG emissions per MMBOE produced, by 8% CAGR over the last 3 years.

- **Valuation**: Great company but the market has already priced COP future cash flows in the current price – therefore a Hold. Our fair value is $71.37. We recommend to wait for the right time for entry i.e. with a minimum upside return of 10% (enter @ <$64.23).

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The Story

Created in 2002 with a merger of *Conoco Inc*. and *Phillips Petroleum Co*. the Oil & Gas exploration and production company – ConocoPhillips (COP) is the world's largest independent exploration and production (E&P) company based on proved reserves and production of liquids and natural gas. The company finds its roots in Continental Oil and Transportation Co. that was founded in 1875. The company has 11,000 employees and operates in 17 countries.

Figure 1

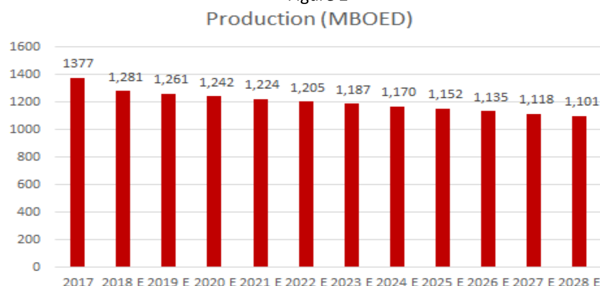
Following the industry trend, in 2012, ConocoPhillips spun off its downstream business as a new separate company – *Phillips 66*. The company is headquartered in Houston, Texas but the legal identity is incorporated in Delaware to reap legal benefits of distancing the management from its shareholders. The company sells crude oil, natural gas, natural gas liquids and bitumen thereby making the portfolio very diverse.

The Strategy

ConocoPhillips changed its strategy in 2016 in order to have predictable performance based on superior return across wide range of commodity such as oil, gas, bitumen and liquid gas. The new strategy focuses on the following:

1. **Maintain flat production**: Unlike many exploration companies, COP does not plan to increase production.

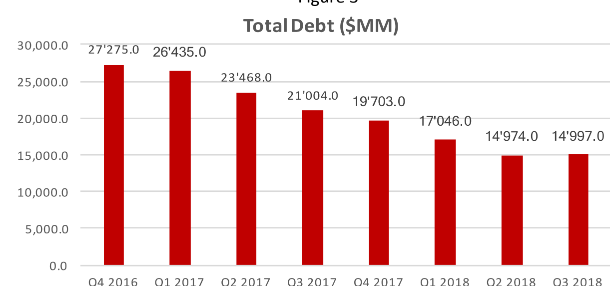
Figure 2



However, due to depleting reserves, we expect that the production will go down by at least 1.5% over the next 10 years as shown by the graph below.

2. **Focus on maximizing financial returns**:
   a. **Reduce Debt** – COP has been reducing its debt by 9.95 % every year for the last 3 years because cash from

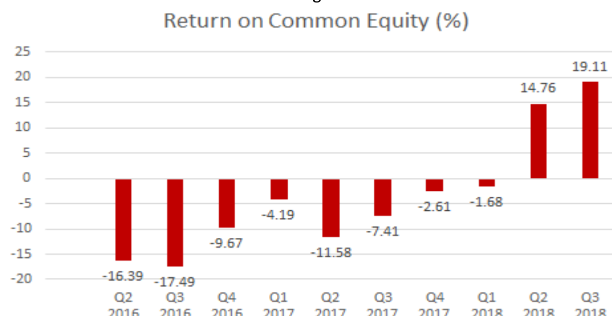
Figure 3



operations is higher than the capital expenditure and the capex is not poised to increase in the coming years while the production is aimed to remain flat. In 2017 alone COP reduced its debt by $7.6B and plans to continue reducing debt to $15 billion by year-end of 2019.

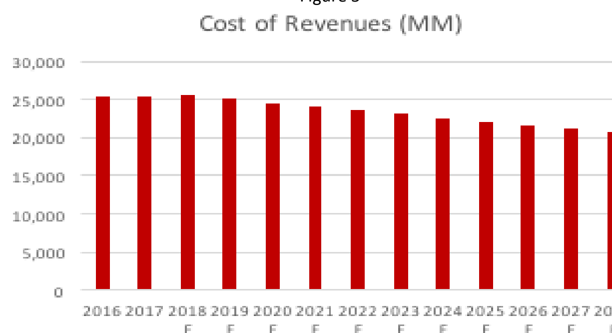
   b. **Increase ROE**: Over the last 8 quarters, COP has consistently improved its ROE. Starting Q2 2018, the company started to achieve positive returns on equity. Prior to Q3 2017, the higher cost-of-supply assets and low oil prices were eating away the earnings.

Figure 4



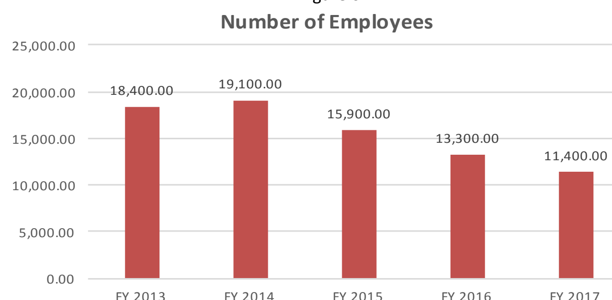
   c. **Control costs and expenses**: COP has been maintaining a competitive position in the industry even through low commodity price environment. This is mainly attributable to reducing the number of employees, making use of the best technology available added with reducing production.

Figure 5



We expect the cost of revenues to go down by 2.10% annually over the next 10 years because of reduced production (-3.5% p.a.), reduced cost of production because of better technology (-1% p.a.) despite the inflation (+2.4% p.a. {IMF estimates}).

Figure 6



COP has reduced its employees by 33% over the last 5 years.

   d. **Maintain low cost-of-supply assets**: COP generated $16B from dispositions of non-core assets including 50% non-operated interest in FCCL Partnership as well as by selling its Canada Gas assets; interests in San Juan Basin and its interests in Panhandle assets. Moreover, COP

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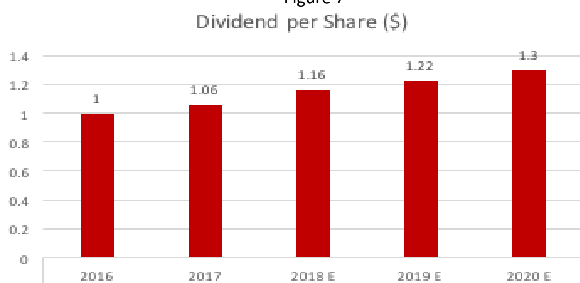
aims to maximize the production from its current asset portfolio especially in Alaska and Lower 48.

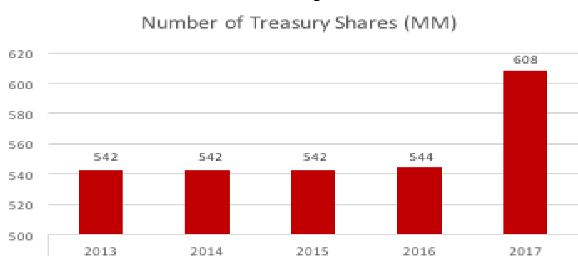
Return capital to shareholders: COP has been paying out 20-30% of cash from operations to shareholders annually through dividend yields and continuous share re-purchase programs. COP has increased dividend yields consistently by 6% over the last few years.

Figure 7



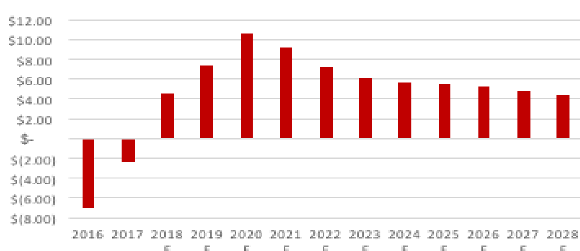
In 2017, COP paid dividends of $1.3B on their common stocks and repurchased stocks worth $3B. COP plans to continue increasing dividend yield annually and to purchase up to $3.5B of common stock evenly through 2018-19. We maintained the same pay-out ratio (26%) for determining the dividend per share in 2019 and we assumed that it will slighltly increase 2020 based on COP's claims.

Figure 8



In addition, share repurchase worth $1.5B is planned through 2020. Given the healthy financial status of the company the share repurchase programs can be easily accomplished.

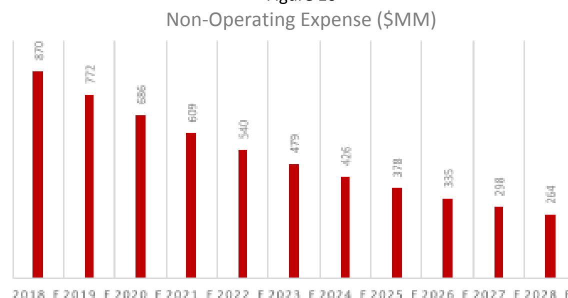
Figure 9



First 2 Quarters' adjusted earnings in 2018 were $2.4 billion or $2.05 per share compared to a net loss ($2.30) in the first 6 months of 2017. Conoco Phillips improved its financial performance tremendously in the last 2 quarters. This increase was primarily due to the increase in commodity price that allowed Conoco to have a more liquids-weighted portfolio. EPS therefore improved this year by 41.67% primarily because of the increase in WTI and Brent prices while the production remained flat in the principal fields such as Alaska and Lower 48. We expect the EPS of COP to go up in the next 10 years.

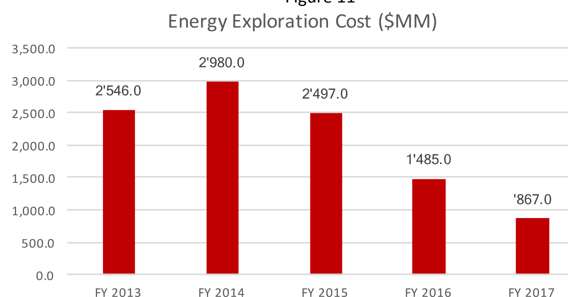
e.Controlling operating and overhead costs and expenses in order to increase its margins. COP aims to strengthen its position to delive improved cash and financial returns even at crude price of $50 per barrel WTI.

Figure 10



3. **Maintain technical advantage**: COP is known to be an industry leader in technology. In recent years, COP was one of the first companies to employ hydraulic fracturing and horizontal drilling in tight oil formations that led to better efficiencies for actual and forecasted crude oil and natural gas production in the US.

Figure 11

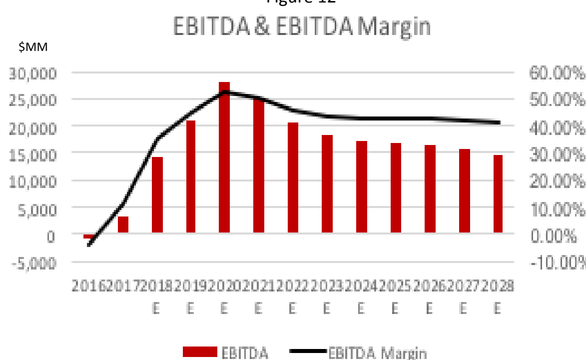


COP has consistently reduced its exploration cost over the last 5 years because it has focussed on exploring in undeveloped acreage within their portfolio, disposed high-cost-of-supply assets, experienced cost containment in dry hole expenses while reducing total production and using better technology.

Financial Performance

EBITDA margin analysis: ConocoPhillips has consistently improved its EBITDA margin over the last 8 quarters and is expected to increase EBITDA margin over the next several years. This increase of the EBITDA was due to an increase in revenues in United States, Canada, UK and Australia.

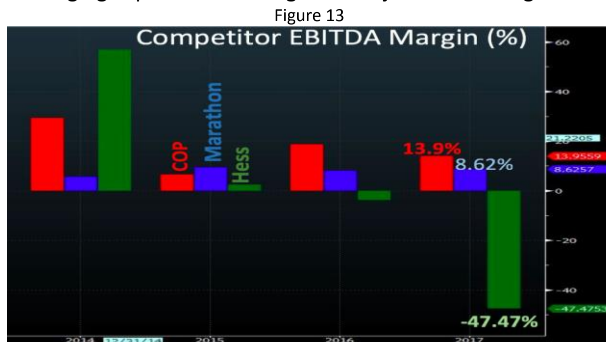
Figure 12



Similarly, the EBITDA Margin had a positive increase from 2015 to 2018. Conoco optimized its capital investment in low cost of supply at $40 BBL sustaining prices while collecting incremental cash from its global portfolio which increased

EBITDA by 20.78% in the last 4 years. The profitability of Conoco increased because of high-margin production by leveraging superior technologies in major shale oil & gas sites.

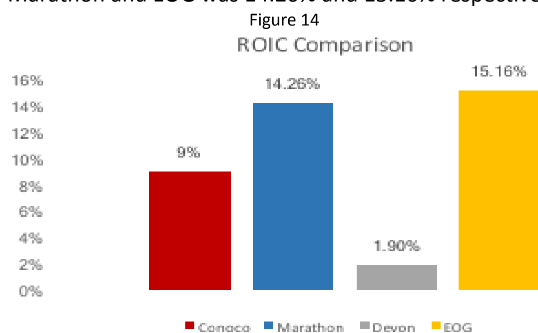
Figure 13



Comparing COP with its competitors i.e. Hess (Analsysts's previous company report) and Marathon (similar ratio analysis) on EBITDA margin informs us that COP's EBITDA margin in 2017 was equal to 13.9% whereas, for Marathon and Hess the EBITDA margin was only 8.62% and -47.47% respectively. Indeed, the company had better returns than its peers because of its global portfolio, technological expertise and strict cost control measures employed.

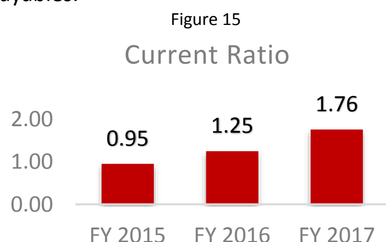
ROIC Peer comparison: ROIC peer analysis among the top performers in the industry shows that in 2018, Marathon Petroleum and EOG outperformed Conoco Phillips. In fact, the Return on Invested Capital of COP was 9% whereas the ROIC of Marathon and EOG was 14.26% and 15.16% respectively.

Figure 14



Current Ratio: In the last 3 years the cash provided by operating activities exceeded capital expenditures by $2.5 billion. Therefore, there has been an increase in the current ratio by 22.16%. The current ratio has improved because there has been an increase by 51.28% in cash from 2015 to 2017 and even because the company collected 16 billion dollars from disposing assets that were no longer profitable. This trend is going to furhter increase in the next years as Conoco continues to exceed its collection of cash from operation because of an increase in the commodity prices and an optimized portfolio allocation. Furthermore the current liabilities has a negative CAGR of 9.08% in the last 3 years mainly due to a reduction in account payables.

Figure 15



The blended forward P/E: COP has the blended forward P/E closes to the industry average because of its diversified portfolio showing that the market is valuing COP correctly.

Figure 16

Name	BF P/E
ConocoPhillips	12.49
Marathon Oil Corp	15.60
EOG Resources Inc	14.44
Hess Corp	40.01
Devon Energy Corp	13.57
Continental Resources Inc/OK	12.97
Anadarko Petroleum Corp	12.63
Concho Resources Inc	23.06
Pioneer Natural Resources Co	13.69
Cimarex Energy Co	9.75
Diamondback Energy Inc	10.73
Noble Energy Inc	18.69
Apache Corp	16.22
Parsley Energy Inc	10.58
EQT Corp	14.01
Cabot Oil & Gas Corp	15.62
Mean (Including COP US)	***12.05***

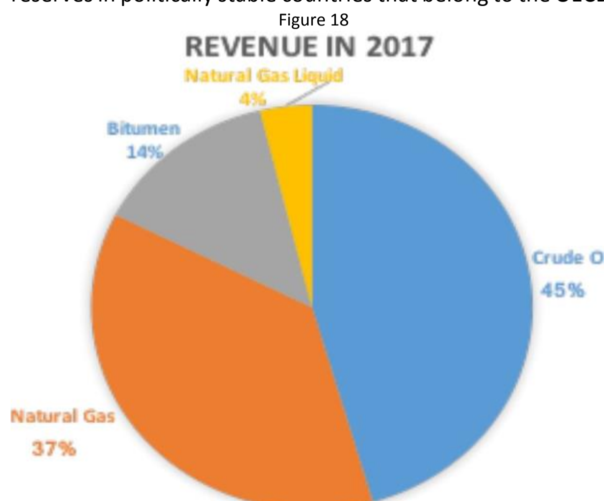
P/B ratio: COP's P/B (2.50x) is lower than P/B of EOG Resources (4.21x) and MPC i.e. Marathon Petroleum (2.53x). Though COP has a lower P/B ratio when compared to its immediate peers but the mean P/B of the industry is 1.20x meaning that the market is already paying a premium for COP.

Figure 17

Diversified World Class Portfolio

The company has world-class portfolio in North America tight oil and oil sand assets (USA and Alaska). Furthermore, it owns lower-risk conventional assets in North America, Europe, Asia and Australia with multiple liquefied natural gas (LNG) developments. ConocoPhillips has 77% percent of proved reserves in politically stable countries that belong to the OECD.

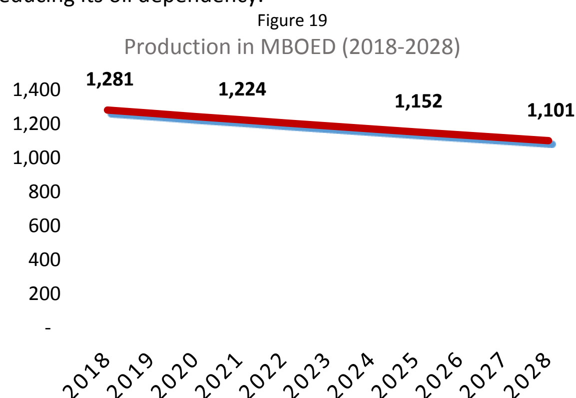
Figure 18



COP presents high diversification in its portfolio. Clearly, the company has reduced its commodity volatility risk by operating in 4 different commodities. ConocoPhillips' revenue by origin shows the level of geographic diversification that COP has built throughout the years that has allowed it to minimize its exposure to one market. 50% of COP's revenues are produced in the United States with Lower 48 and Alaska that

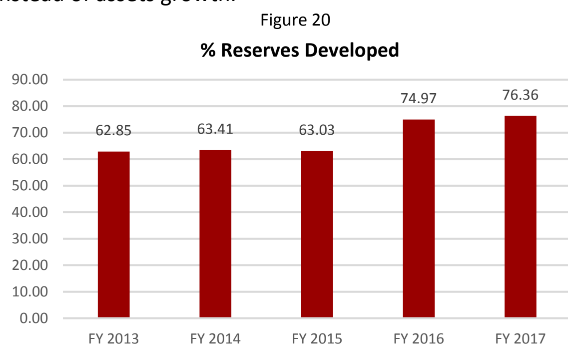
produce oil, gas and bitumen. In Europe, Conoco has major interest in Norway were it produces oil while the company is planning to reduce its interest in the Viking Area. In Britannia (UK off-shore site) the company will increase its production of natural gas and therefore increase its diversification by reducing its oil dependency.

Figure 19



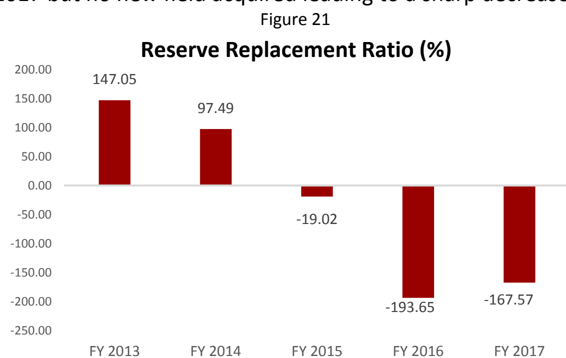
In 2017, Conoco produced 1,356 MBOED per day (excluding Libya) and we expect that the company will maintain relatively flat production in the next ten years. However, there will be a slow decrease in its production because of normal decline of fields such as Panyu and Indonesia Block B. In fact, Conoco will drain its current reserves over the next decade. In the last 5 years, the percentage reserves developed increased by 13.51%. This decrease belongs to Conoco's strategy as the company is currently prioritizing cash return to shareholders instead of assets growth.

Figure 20



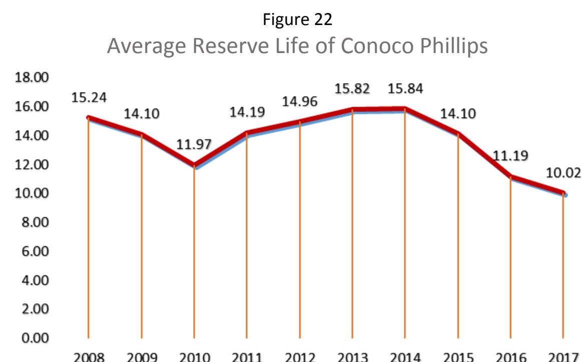
Conoco is not planning to pursue big M&A of offshore sites as it clearly stated that new off-shore reservoirs do not represent low cost-of-supply assets. In fact, the total crude oil proved reserves increased from 2015 to 2017 by only 0.59% CAGR in North America. There has been improved drilling activities in Alaska, Norway and China that have increased production in 2017 but no new field acquired leading to a sharp decrease in

Figure 21



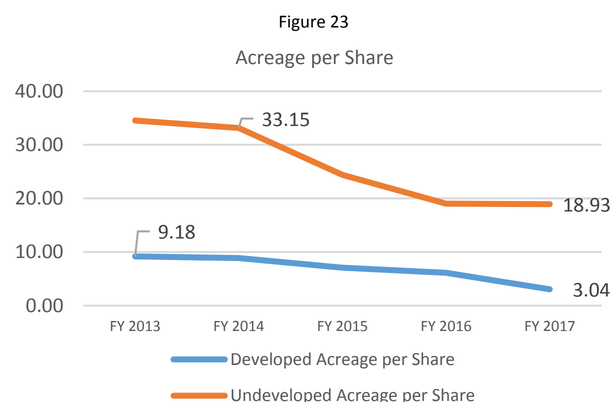
reserve-replacement ratio. Furthermore, Conoco collected cash from non-core asset dispositions in Canada and San Juan.

Figure 22



After initiating its current strategy, Conoco decreased its average reserve life by 10.76% CAGR over the last 4 years and today its reserves have an average life on only 10.02 years. As stated in 10-k (2017), Conoco will add its undeveloped reserve within its current portfolio without acquiring new reserves.

Figure 23



Therefore, we expect Conoco to eventually dispose of all its assets that will not have low cost-of-supply in the coming years. COP will simply develop its reserves in Alaska and Lower 48. Contemporary, improving drilling activities in Alaska, Norway and China in 2017 has allowed the company to maximize its current excellent portfolio.

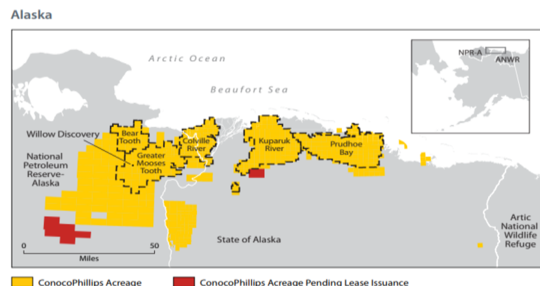
Long story short, the company will basically milk its current assets while returning increased value to its shareholders.

Alaska

This segment contributed to 22% of Conoco's worldwide liquids production (majorly oil (92%) with some NGL) and less than 1% of the company gas production. In 2018, the company continuously explored and installed additional wells because of an appraisal of the Willow Discovery in the National Petroleum Reserve. As the board of directors stated in the Q1 2018 earnings call the production is going to be flat and it will average to approximately 182K BOED.

The chart shows the acquisition of 22% in the Western North Slope asset for $400 million. In the Greater Mooses Tooth Unit (acquired in January 2018) where Conoco has begun construction of two drills site that will produce first oil at the end of 2018 and 2021 respectively is still pending lease issuance and regulatory approval. The company will have 100% interest in approximately 1.2 million acres in the Western North Slope for further exploration and development lands.

Figure 24
The Greater Mooses Tooth Unit



Lower 48: USA and Gulf of Mexico

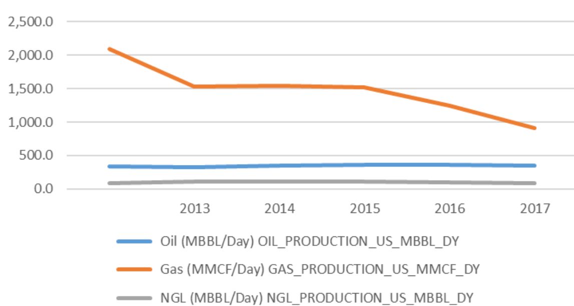
Lower 48 is the second largest business unit for COP, by volume. In 2017, the Lower 48 segment contributed 30% percent of Conoco worldwide liquids production and 27% of gas production. In Bakken, the company achieved exceptional cash returns utilizing new technology that we expect will optimize production in 2018 and 2019 in these fields.

Figure 25

The production mix is 55% oil, 28% natural gas and 17% NGL and we assume it is going to be approximately constant in the next 10 years.

The chart below shows that in the last four years in United States (Alaska & Lower 48) there has been a decrease by 12.94% in the gas production (MMCF) whereas, oil and NGL production remained approximately constant.

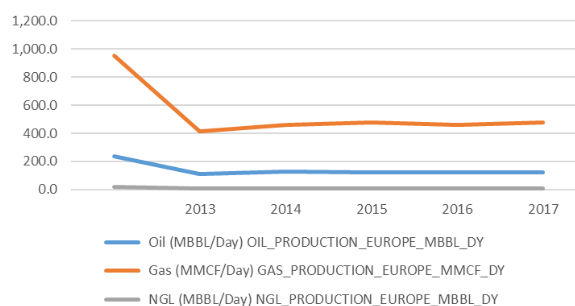
Figure 26
United States Production



Europe and North Africa

Europe and North Africa sites contributed 18% of Conoco liquids production and 15% of natural production. This includes operation and exploration activities in Norway, UK and Libya. Britannia is one of the largest natural gas and condensate fields in the North Sea and this is ownded by COP. Part of production from the Viking Area in Norway already ceased in 2016 and main complex are planned to be removed in the next few years for natural decline of the fields. However, there are existing opportunities in the UK in the North Sea for additional exploration and development activities and Conoco will offset the decrease of oil production from Norway with an increase in gas production in Britannia.

Figure 27
Production in Europe



Earnings in Europe and North Africa increased 40% in 2017 mainly because of higher oil and gas prices.

Asia & Pacific and Middle East

ConocoPhillips' Asia Pacific and Middle East segment forms the company's largest business unit by volume. Operations consist of producing fields in China, Indonesia, Malaysia, Qatar, Australia and Timor-Leste, as well as liquefied natural gas production and export in Australia and Qatar. The Asia & Pacific and Middle East segment contributed 14% of Conoco worldwide liquid production and 52% of natural gas production. The production from Panyu offshore site (4-2 and 5-1) in the South China Sea expired in September 2018 and the production period for Pabyu 11-6 will expire in Sept' 2022.

Risks

1. **Commodity Price volatility**: Oil, gas, NGL and bitumen being a commodity, the prices are volatile. However, since Conoco portfolio is highly diversified we believe that price volatility represents a lower risk for this company
2. **Increase additional resources** is extremely difficult for Conoco as commodity prices and supply costs can make projects uneconomic or unattractive. Furthermore, timing and level at which Conoco will add its reserve base may, or may not, allow the company to replace its production over subsequent years.
3. **Cash return to shareholders' strategy might limit Conoco efforts to increase reserve replacement ratio** and therefore it will affect the capability to further increase the average life of the reserve, as the company will not pursue new opportunities.
4. **Carbon tax and Environmental Risks**: Conoco business is subject to environmental risk and regulation that can increase administrative, civil or criminal penalties because of damages of the environment or noncompliance of existing regulation. However, COP's detailed ESG strategy (discussed later) should help COP to evade these risks in a much better form than most of its competitors.

ESG Analysis

Sale of High Carbon Intensity Assets

COP recognized that facilities located in the western part of the U.S. could have an emissions factor over 25 times greater than an identical unit based in the East. This led to higher estimates for its San Juan, New Mexico operations where, until it sold these assets in 2017, it was the largest producer. The San Juan Basin emissions had accounted for approximately two-thirds

of the company's Lower 48 onshore emissions. The sale of older assets in the U.S. and Canada reduced COP's methane emissions by 64% or 3.4 million tonnes CO_2e. As a result, the percentage of COP's total GHG emissions that methane now represents has been reduced from 20% in 2016 to 9% at the end of 2017.

Reporting

COP is among the leaders in the industry when it comes to understanding and reporting ESG related risks. On the left, the scorecard represents that COP discloses on 11/13 Level 1 GHG leakages from its operations.

- COP has included a **GRI index** as a reference tool to help readers readily locate relevant information across ConocoPhillips' web-based resources.
- COP also reports on **TCFD** (Task Force on Climate-related Financial Disclosures).
- COP received "B" score from **CDP** (Carbon Disclosure Project) for reporting and management of climate issues. The industry average, CDP overall average, and S&P 500 average was a "C". No natural gas and oil companies received an "A".
- COP received an "AA" rating from **MSCI ESG**, up from an 'A' rating in 2017.

Figure 28

2017 SCORECARD

COMPANY	TOTAL
Apache	12
BHP	12
Southwestern	12
Conoco	11
Hess	11
Shell	11
Chesapeake	10
Newfield	10
Range	10
Exxon	9
Noble	9
Pioneer	9
Carrizo	7
CONSOL	7
Devon	7
EOG	6
Anadarko	5
WPX	5
Antero	4
Occidental	4
BP	3
Chevron	2
Continental	1
EQT	1
QEP	1
Cabot	0
Whiting	1
Encana	0

Reducing GHG Emissions

COP is understanding its footprint, managing operations and projects more efficiently to reduce both costs and GHG emissions, managing risk and opportunities to improve further on risks' exposure, developing and investing in latest technology and lowering the cost of supply while shortening the project life cycles.

Figure 29

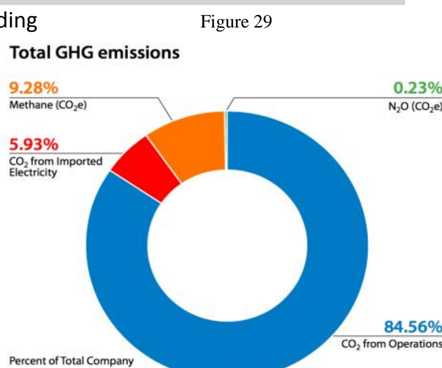
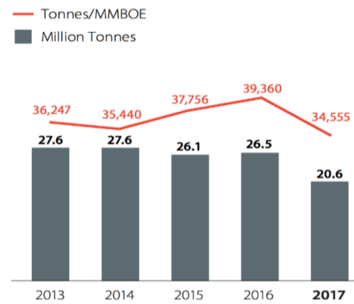
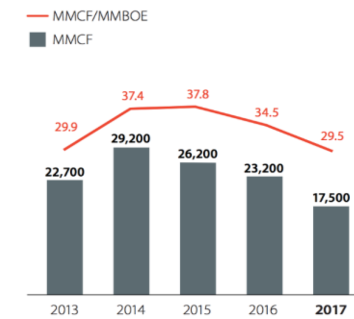


Figure 30

Total GHG emissions (CO_2 equivalent)



Total flaring volume



COP has a long-term target to reduce its GHG emissions intensity between 5 and 15% by 2030, from a January 1, 2017 baseline. In 2017, COP reduced 51,000 $TeCO_2$ while emitting approximately 20.6 million tonnes, a decrease of about 22 percent, or 5.9 million tonnes, from 2016. Emissions intensity decreased by 12.2 percent in 2017.

COP has been reducing its flaring volumes and thereby reducing losses. This became possible because COP uses FLIR and LDAR cameras to tap methane leakages.

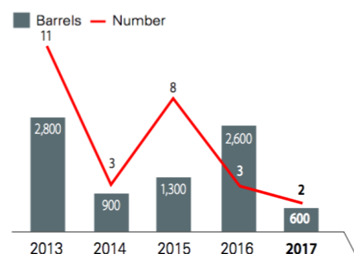
Understanding Ecosystems

Impact of Oil Spills on Ecosystems: COP is also engaging on innovative projects to protect the ecosystems, particularly marine wildlife. externally on learning from key stakeholders like models to simulate marine ecosystem to assess the effects of hypothetical oil spills on the Northeast Arctic cod stock including the development of cod early life stages (eggs and larvae), and a multi-species population model.

Reducing Environmental Risks and Costs

Figure 31

Volume of spills >100 BBL



COP has focused on recycling, re-using and renewing inputs, such as water and heat. This helped reduce costs and improve environmental benefits. COP has reduced its spills' volumes too.

Figure 32

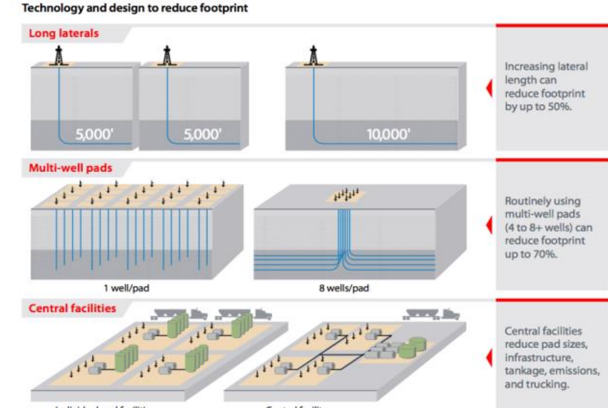
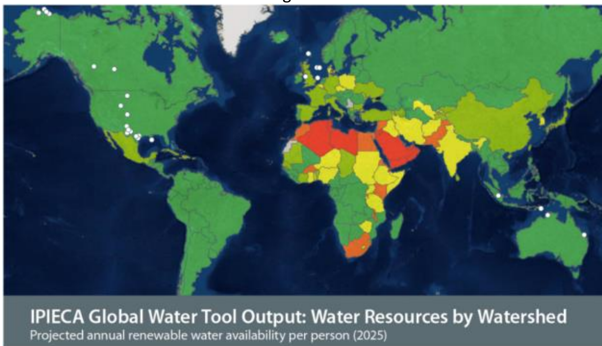


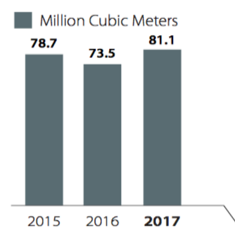
Figure 33



No data | Extreme Scarcity | Scarcity | Stress | Sufficient | Abundant | ConocoPhillips operated asset

37% of total the company's production is Natural Gas and that requires a lot of water. Therefore, COP has considered water scarcity risks, especially in its countries of operations. More importantly, COP is already recycling and reusing water in its operations.

Figure 34



Ownership & Insider Trades

Both the CEO and CFO among other board members have been disposing their shares in the calendar year of 2018. However, the Shareholding Pattern (Nov 2018) of the company is healthy as the management's control is minimum.

Figure 35

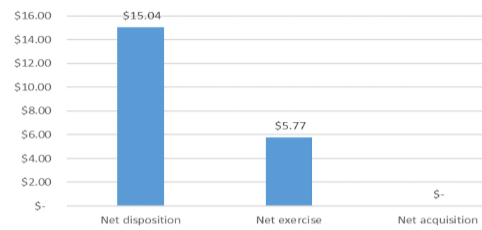


Figure 36

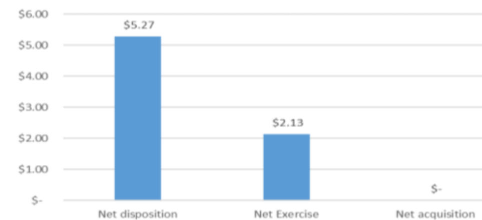
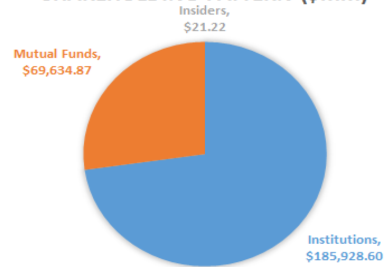


Figure 37



Top Institutional Funds' holdings of COP over the last 2 years:

Figure 38

Vanguard – Held in 2018

Figure 39

Blackrock Asset Management – Held in 2018

Figure 40

JP Morgan Chase – Held in 2018

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Figure 41

Norges Bank – Held in 2018

Figure 42

Capital Group Inc – Held in 2018

Valuation

Neutral Scenario

Revenue assumptions:

1. **Escalating Oil, Gas, Bitumen and NGL Price**: The revenues are based on an escalating oil, gas, bitumen and NGL price from 2018 to 2020 (based on analysts' industry report) and for 2021 to 2028 price estimates, the other commodity prices will be based on the estimates of the Canada Energy Board and EIA. Thus:
   a. The weighted average price of oil price per barrel from 2018 to 2028 is considered to be $80.55
   b. The weighted average price of Natural Gas (MCFD) from 2018 to 2028 is considered to be $4.19
   c. The weighted average price of Natural Gas Liquid Gas per barrel of oil equivalent from 2018 to 2028 is considered to be $23.15
   d. The weighted average price of Bitumen from 2018 to 2028 is considered to be $18.88
2. **Portfolio Composition:** COP operates in 17 countries and it produced 1,377 MBOED in 2017. As the company is committed to maintain production flat, we assumed that it will maintain its portfolio composition ratios between every commodity. The table below shows the quantity produced last year and the weight of every commodity over the total production. Therefore, in our model oil accounts for 44% of the revenue, NGL 6%, Bitumen 9% and Gas accounts for 40% of the revenue.

Figure 43

Revenue Assumptions	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Weighted Average Oil Price WTI (per barrel)	61.00	75.00	91.00	87.50	80.50	77.65	77.90	79.00	80.00	80.00	80.00
Canada Energy Board Oil Price Estimation WTI & Analyst Estimate	67.00	90.00	92.00	83.00	78.00	77.30	78.50	79.50	80.00	80.00	80.00
Weighted Average Price Natural Gas (MCFD) in last 5 years	4.188	4.188	4.188	4.188	4.188	4.188	4.188	4.188	4.188	4.188	4.188
Weighted Average Price Natural Gas Liquids (per barrel) project as per EIA	25.71	24.20	25.15	24.59	24.05	23.98	23.36	22.79	21.83	21.61	21.51
Weighter Average Price Bitumen (per barrel) as per Company's last 3 year Avg	18.88	18.88	18.88	18.88	18.88	18.88	18.88	18.88	18.88	18.88	18.88
Total Production in MBOED (adjusted annually by -3.5% CAGR)	1,281	1,236	1,193	1,151	1,111	1,072	1,034	998	963	929	897

3. **Decreased in Production by 3.5% CAGR:** In the last 3 years, Conoco decreased its production by 7% CAGR. However, we considered these 3 years were extraordinary as the company initiated its cash return strategy in 2016 and it has sold high cost-of-supply assets in Canada, San Juan and Block B in Indonesia. Therefore, the company is not going to decrease production in the next decade at the same rate it did in the last 3 years. However, being realistic given the fact that the company is not investing in new exploration, we consider the reduction of the Viking Area in Norway and Panyu in Asia & Middle East will stop producing in the next five years. In Alaska, Conoco purchased 100% interest in Western North Slope that will add first oil production in 2018 and 2021 and we have calculated the variation among these sites, which will decease the production by 3.5% CAGR in the next decade.

Cost of revenues assumptions:

1. **Inflation and rise in costs**: The cost of revenue will increase because of US inflation rate of 2.4% (as per IMF estimates) so the costs will grow at the same rate as inflation.
2. **Reduction in Cost because of technological advancements:** Conoco has a clear competitive advantage in technology compared to its peers. Indeed, Conoco prioritizes low cost-of-supply assets, which will contribute to the decrease in the operating costs. In fact, in Bakken the company achieved strong economic performance due to implementation of new technology which will optimize production in 2018 and 2019. Furthermore, pipelines in Alaska and Asia have helped reduce the transportation costs by 3% in the last 3 years. By aggregating all these elements together, we forecast a reduction in Cost of Revenue because of technology by 1.00% which will lead to an overall reduction in the Cost of Revenue of 2.10%.

Figure 44

Cost of Revenue Assumptions	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Reduction in cost because of technological advancements		1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%
Reduction in Production		3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%
US Inflation rate (IMF World)		2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%
Net reduction in cost annually		-2.10%	-2.10%	-2.10%	-2.10%	-2.10%	-2.10%	-2.10%	-2.10%	-2.10%	-2.10%

Capex, DD&A and Net Working Capital assumptions

1. **Inflation and rise in costs:** DD&A and Capex will also depend on the U.S inflation rate (IMF estimates) from 2018-2028.
2. **Capex correlated to production:** We assumed that the company will maintain the same proportion for *Capex : Production* as it did in the last several years. Therefore, Capex and DD&A should decrease 3.5% per year adjusted by inflation.
3. **Net working Capital** will decrease at the same production rate mentioned in the revenue assumptions.

Figure 45

Capex & DD&A	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
US Inflation rate (IMF)		2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%
Capex (correlated to production)	6190	5973	5764	5563	5368	5180	4999	4824	4655	4492	4335
Capex decrease (annually)		-3.5%	-3.5%	-3.5%	-3.5%	-3.5%	-3.5%	-3.5%	-3.5%	-3.5%	-3.5%

Non-Operating Expenses assumptions:

SG&A median per BOE decreased by 13.64% in the last 5 years: Overhead costs tremendously decreased in the last five years as finance, HR, Legal and business departments did. This was because of a substantial change in the organizational structure at Conoco. We assume that in the future too, Conoco will continue to drive down the overhead rate per barrel thereby decreasing the non-operating costs per boe. In the Neutral scenario, we assume that non-operating expenses will decrease at the same rate as that of the last 5 years (13.64% CAGR). Furthermore, Conoco gained cash flows from sources not related to its core business especially in investment, property and asset sales.

Figure 46

Non Operating Expenses	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
US Inflation rate (IMF)		2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%
Reduction in non-operating expense over the last 6 years	-13.64%	-13.64%	-13.64%	-13.64%	-13.64%	-13.64%	-13.64%	-13.64%	-13.64%	-13.64%	-13.64%
Non-operating expense (-13.64% CAGR for the last 6 years)	-870	-772	-686	-609	-540	-479	-426	-378	-335	-298	-264

WACC assumptions:

1. The **corporate tax** is equal to 27.90% in Delaware State where Conoco is legally incorporated.

Figure 47

U.S Corporate Tax Rate for Delaware State	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
U.S Corporate Tax Rate for Delaware State	27.90%	27.90%	27.90%	27.90%	27.90%	27.90%	27.90%	27.90%	27.90%	27.90%	27.90%

2. Conoco' **Beta** is equal to 1.55.
3. **Market Premium Risk** is equal to 6.5% (*source: Damodaran*).
4. **Risk free rate** is the US Treasury bond yield 10 years with a rate of 3.05%.
5. **Conoco Phillips has been assumed to have constant 8.21% WACC.**
6. The WACC perfectly reflects the stability and the solvency of Conoco compared to its industry peers. The average WACC in the Oil E&P sector in the U.S is equal to 10% meaning that Conoco has a lower WACC compared to its industry peers.

Figure 48

WACC	
Cost of equity	8.68%
Cost of debt	6.95%
Corporate Tax Rate	27.90%
WACC	**8.21%**

Terminal Value assumption:

Conoco determined in its strategy to maintain flat production and avoid in the short-term big purchases in its current portfolio. Therefore, after analysing the average reserves life ratio (10.2) and the undeveloped acres ratio (70%), we assume that the company will be able to maintain flat production at least until 2038. In this scenario, the growth for the terminal value is equal to 0.25% as it represents the residual value of the free-cash-flow of the undeveloped reserves.

DCF Analysis:

Figure 49

In Millions of USD except Per Share	FY 2016	FY 2017	FY 2018 Est	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
Revenue	23,693	29,106	40,900	46,844	53,596	49,916	44,740	41,839	40,435	39,451	38,416	37,054	35,750
Cost of revenues	25,462	25,302	25,652	25,114	24,586	24,070	23,564	23,070	22,585	22,111	21,646	21,192	20,747
Gross profit	**-1,769**	**3,804**	**15,248**	**21,730**	**29,010**	**25,846**	**21,175**	**18,770**	**17,850**	**17,340**	**16,769**	**15,863**	**15,003**
% margin	**-7%**	**13%**	**37%**	**46%**	**54%**	**52%**	**47%**	**45%**	**44%**	**44%**	**44%**	**43%**	**42%**
DDA	9,062	6,845	5,778	5,714	5,651	5,589	5,527	5,467	5,407	5,347	5,288	5,230	5,173
Non Operating Expenses	919	-470	-870	-772	-686	-609	-540	-479	-426	-378	-335	-298	-264
EBIT	**-11,750**	**-2,571**	**10,340**	**16,789**	**24,045**	**20,866**	**16,188**	**13,782**	**12,869**	**12,371**	**11,816**	**10,930**	**10,095**
% margin	**-50%**	**-9%**	**25%**	**36%**	**45%**	**42%**	**36%**	**33%**	**32%**	**31%**	**31%**	**29%**	**28%**
Income Tax Expense (cash paid in 2016 & 2017)	-318	1,168	2,885	4,684	6,708	5,822	4,516	3,845	3,591	3,452	3,297	3,049	2,817
NOPLAT	**-11,432**	**-3,739**	**7,455**	**12,105**	**17,336**	**15,044**	**11,671**	**9,937**	**9,279**	**8,920**	**8,519**	**7,881**	**7,279**
%margin	**-48%**	**-13%**	**18%**	**26%**	**32%**	**30%**	**26%**	**24%**	**23%**	**23%**	**22%**	**21%**	**20%**
NOPLAT	-11,432	-3,739	7,455	12,105	17,336	15,044	11,671	9,937	9,279	8,920	8,519	7,881	7,279
DDA	9,062	6,845	5,778	5,714	5,651	5,589	5,527	5,467	5,407	5,347	5,288	5,230	5,173
CAPEX	4,870	4,590	6,190	5,973	5,764	5,563	5,368	5,180	4,999	4,824	4,655	4,492	4,335
Δ Net Working Capital	1,700	7,115	1,641	1,583	1,528	1,474	1,423	1,373	1,325	1,278	1,234	1,190	1,149
Free Cash Flow	**-8,940**	**-8,599**	**5,402**	**10,262**	**15,695**	**13,597**	**10,408**	**8,851**	**8,362**	**8,164**	**7,919**	**7,428**	**6,968**
Present Value FCF			**5,402**	**9,474**	**13,377**	**10,698**	**7,561**	**5,935**	**5,177**	**4,666**	**4,178**	**3,618**	**32,058**

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Figure 50

Enterprise Value FCF (MM)	**102,145**
Terminal Value = FCFn * (1+g)/ (wacc-g)	**64,322**
Wacc	8.32%
g	0.26%
Market Value of Debt (MM)	**14,997**
Number of Share(MM)	1,221.038
Equity Value	87,148
Share Price	**$ 71.37**

The Stock Price in Neutral growth scenario has a fair value of $71.37.

Conclusion: The Market has already priced-in the fair value of the company. Fundamentally, investors in Conoco will receive gains from increased dividends yields and share re-purchase programs.

We suggest to HOLD Conoco Phillips stock.

High Growth Scenario

Revenue assumptions:

1. **Everything remains the same except for the production that now decreases by 1.5% CAGR:** In the high growth scenario, the company is not going to decrease production at the same rate as that of the last 3 years. However, being realistic given the fact that the company is not investing in new exploration, we consider the reduction of the Viking Area in Norway, Panyu in Asia & Middle East. However, we assume that in Alaska, Conoco will increase its production in the Moose field sites and in its on-shore site in the Lower 48, with Bakken and the Eagle Ford site that will lead the production to decrease only by 1.5% CAGR in the next decade.

Figure 51

Revenue Assumptions	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Weighted Average Oil Price WTI (per barrel)	61.00	75.00	91.00	87.50	80.50	77.65	77.90	79.00	80.00	80.00	80.00
Canada Energy Board Oil Price Estimation WTI & Analyst Estimate	67.00	90.00	92.00	83.00	78.00	77.30	78.50	79.50	80.00	80.00	80.00
Weighted Average Price Natural Gas (MCFD) in last 5 years	4.188	4.188	4.188	4.188	4.188	4.188	4.188	4.188	4.188	4.188	4.188
Weighted Average Price Natural Gas Liquids (per barrel) project as per EIA	25.71	24.20	25.15	24.59	24.05	23.98	23.36	22.79	21.83	21.61	21.51
Weighter Average Price Bitumen (per barrel) as per Company's last 3 year Avg	18.88	18.88	18.88	18.88	18.88	18.88	18.88	18.88	18.88	18.88	18.88
Total Production in MBOED (adjusted annually by -1.5% CAGR)	1,281	1,261	1,242	1,224	1,205	1,187	1,170	1,152	1,135	1,118	1,101

Cost of revenues assumptions:

1. **Reduction in Cost because of technological advancements:** Due to reduced decrease in production, the cost of revenue also decreases proportionally by only 1.5% in this scenario when we compare it to the neutral growth scenario. Therefore, we forecast a reduction in Cost of Revenue because of technology by 1.00% which will lead to an overall reduction in the Cost of Revenue of 1.90% as the technological advancements reduce costs by 2% in this scenario.

Figure 52

Cost of Revenue Assumptions	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Reduction in cost because of technological advancements		2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
Reduction in Production		1.50%	1.50%	1.50%	1.50%	1.50%	1.50%	1.50%	1.50%	1.50%	1.50%
US Inflation rate (IMF World)		2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%
Net reduction in cost annually		-1.90%	-1.90%	-1.90%	-1.90%	-1.90%	-1.90%	-1.90%	-1.90%	-1.90%	-1.90%

Capex, DD&A and Net Working Capital assumptions

1. **Capex correlated to production:** We assumed that the company will maintain the same proportion for *Capex : Production* as it did in the last several years. Therefore, Capex and DD&A should decrease 1.5% per year adjusted by inflation.

Figure 53

Capex & DD&A	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
US Inflation rate (IMF)		2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%
Capex (correlated to production)	6190	6097	6006	5916	5827	5739	5653	5569	5485	5403	5322
Capex decrease (annually)		-1.5%	-1.5%	-1.5%	-1.5%	-1.5%	-1.5%	-1.5%	-1.5%	-1.5%	-1.5%

Non-operating expense assumption

SG&A will decrease by 20.68% as Conoco: Conoco gained from sources not related to its core business especially in investment, property or asset sales. As the company will try to limit reduction in production by only 1.5% in the high growth scenario we expect to have an increase in the overheads thereby we reduce the negative non-operating income in the next decade by 1.5 times the historical rate of reduction in non-operating expense (-13.64*1.5 = 20.46). There will be 20.46% reduction of non-operating income from CAGR from 2018 to 2028.

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Figure 54

Non Operating Expenses	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
US Inflation rate (IMF)		2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%
Reduction in non-operating expense over the last 6 years	-13.64%	-20.46%	-20.46%	-20.46%	-20.46%	-20.46%	-20.46%	-20.46%	-20.46%	-20.46%	-20.46%
Non-operating expense (-20.46% CAGR for the last 6 years)	-870	-713	-584	-479	-392	-321	-263	-216	-177	-145	-119

We assume to use the same WACC for all our scenarios i.e. 8.21%.

Figure 55

WACC	
Cost of equity	8.68%
Cost of debt	6.95%
Corporate Tax Rate	27.90%
WACC	**8.21%**

DCF Analysis:

Figure 56

In Millions of USD except Per Share	FY 2016	FY 2017	FY 2018 Est	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
Revenue	23,693	29,106	40,900	47,815	55,841	53,085	48,565	46,358	45,731	45,543	45,267	44,568	43,890
Cost of revenues	25,462	25,302	25,652	25,165	24,687	24,218	23,758	23,306	22,863	22,429	22,003	21,585	21,175
Gross profit	**-1,769**	**3,804**	**15,248**	**22,650**	**31,154**	**28,867**	**24,808**	**23,052**	**22,868**	**23,114**	**23,264**	**22,983**	**22,716**
% margin	**-7%**	**13%**	**37%**	**47%**	**56%**	**54%**	**51%**	**50%**	**50%**	**51%**	**51%**	**52%**	**52%**
DDA	9,062	6,845	5,778	5,830	5,882	5,935	5,988	6,042	6,097	6,151	6,207	6,263	6,319
Non Operating Expenses	919	-470	-870	-713	-584	-479	-392	-321	-263	-216	-177	-145	-119
EBIT	**-11,750**	**-2,571**	**10,340**	**17,534**	**25,857**	**23,411**	**19,212**	**17,331**	**17,035**	**17,179**	**17,234**	**16,865**	**16,515**
% margin	**-50%**	**-9%**	**25%**	**37%**	**46%**	**44%**	**40%**	**37%**	**37%**	**38%**	**38%**	**38%**	**38%**
Income Tax Expense (cash paid in 2016 & 2017)	-318	1,168	2,885	4,892	7,214	6,532	5,360	4,835	4,753	4,793	4,808	4,705	4,608
NOPLAT	**-11,432**	**-3,739**	**7,455**	**12,642**	**18,643**	**16,879**	**13,852**	**12,496**	**12,282**	**12,386**	**12,426**	**12,160**	**11,908**
%margin	**-48%**	**-13%**	**18%**	**26%**	**33%**	**32%**	**29%**	**27%**	**27%**	**27%**	**27%**	**27%**	**27%**
NOPLAT	-11,432	-3,739	7,455	12,642	18,643	16,879	13,852	12,496	12,282	12,386	12,426	12,160	11,908
DDA	9,062	6,845	5,778	5,830	5,882	5,935	5,988	6,042	6,097	6,151	6,207	6,263	6,319
CAPEX	4,870	4,590	6,190	6,097	6,006	5,916	5,827	5,739	5,653	5,569	5,485	5,403	5,322
Δ Net Working Capital	1,700	7,115	1,675	1,649	1,625	1,600	1,576	1,553	1,529	1,506	1,484	1,462	1,440
Free Cash Flow	**-8,940**	**-8,599**	**5,368**	**10,725**	**16,894**	**15,298**	**12,437**	**11,246**	**11,196**	**11,462**	**11,664**	**11,558**	**11,465**
Present Value FCF			**5,368**	**9,901**	**14,399**	**12,037**	**9,034**	**7,541**	**6,931**	**6,551**	**6,154**	**5,630**	**42,482**

Terminal Value assumption:

We assume that the company will be able to maintain flat production until 2028. However, technological advancement such as 3D seismic monitoring already used in Conoco sites will allow the company to increase the undeveloped acres ratio and therefore increase the free cash flow under this scenario. In the High growth, the growth for the terminal value is equal to 0.66% as it represents the residual value of the free-cash-flow of the undeveloped reserves.

Figure 57

Enterprise Value FCF (MM)	**126,028**
Terminal Value = FCFn * (1+g)/ (wacc-g)	**83,003**
WACC	8.32%
g	0.66%
Market Value of Debt (MM)	**14,997**
Number of Share(MM)	1,221.038
Equity Value	111,031
Share Price	**$ 90.93**

The Stock Price in High growth scenario has a fair value of $90.93

Low Growth Scenario

Revenue assumptions:

1. **Everything remains the same except for the production that now decreases by 7% CAGR:** In the last three years, Conoco decreased its production by 7% CAGR and in the low growth scenario, we assume that it will continue to maintain this decrease in the next decade.

Figure 58

Revenue Assumptions	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Weighted Average Oil Price WTI (per barrel)	61.00	75.00	91.00	87.50	80.50	77.65	77.90	79.00	80.00	80.00	80.00
Canada Energy Board Oil Price Estimation WTI & Analyst Estimate	67.00	90.00	92.00	83.00	78.00	77.30	78.50	79.50	80.00	80.00	80.00
Weighted Average Price Natural Gas (MCFD) in last 5 years	4.188	4.188	4.188	4.188	4.188	4.188	4.188	4.188	4.188	4.188	4.188
Weighted Average Price Natural Gas Liquids (per barrel) project as per EIA	25.71	24.20	25.15	24.59	24.05	23.98	23.36	22.79	21.83	21.61	21.51
Weighter Average Price Bitumen (per barrel) as per Company's last 3 year Avg	18.88	18.88	18.88	18.88	18.88	18.88	18.88	18.88	18.88	18.88	18.88
Total Production in MBOED (adjusted annually by -7% CAGR)	1,281	1,191	1,108	1,030	958	891	829	771	717	666	620

Cost of revenues assumptions:

1. **Reduction in Cost because of technological advancements:** In the low growth scenario, we assume that Conoco will be able to decrease its operating costs by only 0.50%.

Capex, DD&A and Net Working Capital assumptions

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1. **Capex correlated to production:** We assumed that the company will maintain the same weight of Capex to production. Therefore, Capex and DD&A should decrease 7.00% per year adjusted per inflation.

Figure 59

Capex & DD&A											
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
US Inflation rate (IMF)		2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%
Capex (correlated to production)	6190	5757	5354	4979	4630	4306	4005	3725	3464	3221	2996
Capex decrease (annually)		-7.0%	-7.0%	-7.0%	-7.0%	-7.0%	-7.0%	-7.0%	-7.0%	-7.0%	-7.0%

Non-operating expenses assumption:

G&A will decrease by 20.68% as Conoco will extremely decrease its OH costs: Conoco gained from sources not related to its core business especially in investment, property or asset sales. As the company will maintain production flat, we expect that Conoco will maintain these gains in the next years and improve its OH allocations. However, we expect in the low growth scenario to decrease production and therefore under this strategy Conoco will continue to sell its asset and gaining non-operating income. There will be 6.82% reduction of non-operating income from CAGR from 2018 to 2028.

Figure 60

Non Operating Expenses											
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
US Inflation rate (IMF)		2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%
Reduction in non-operating expense over the last 6 years	-13.64%	-6.82%	-6.82%	-6.82%	-6.82%	-6.82%	-6.82%	-6.82%	-6.82%	-6.82%	-6.82%
Non-operating expense (-6.82% CAGR for the last 6 years)	-870	-832	-795	-760	-726	-694	-664	-634	-606	-579	-554

We assume to use the same WACC for all our scenarios i.e. 8.21%.

Figure 61

WACC	
Cost of equity	8.68%
Cost of debt	6.95%
Corporate Tax Rate	27.90%
WACC	**8.21%**

DCF Analysis:

Figure 62

In Millions of USD except Per Share	FY 2016	FY 2017	FY 2018 Est	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
Revenue	23,693	29,106	40,900	45,145	49,779	44,680	38,594	34,782	32,396	30,461	28,586	26,573	24,708
Cost of revenues	25,462	25,302	25,652	24,344	23,102	21,924	20,806	19,745	18,738	17,782	16,875	16,015	15,198
Gross profit	**-1,769**	**3,804**	**15,248**	**20,801**	**26,677**	**22,755**	**17,787**	**15,038**	**13,658**	**12,679**	**11,710**	**10,558**	**9,510**
% margin	**-7%**	**13%**	**37%**	**46%**	**54%**	**51%**	**46%**	**43%**	**42%**	**42%**	**41%**	**40%**	**38%**
DDA	9,062	6,845	5,778	5,512	5,258	5,016	4,786	4,565	4,355	4,155	3,964	3,782	3,608
Non Operating Expenses	919	-470	-870	-832	-795	-760	-726	-694	-664	-634	-606	-579	-554
EBIT	**-11,750**	**-2,571**	**10,340**	**16,121**	**22,213**	**18,499**	**13,728**	**11,166**	**9,966**	**9,158**	**8,353**	**7,356**	**6,456**
% margin	**-50%**	**-9%**	**25%**	**36%**	**45%**	**41%**	**36%**	**32%**	**31%**	**30%**	**29%**	**28%**	**26%**
Income Tax Expense (cash paid in 2016 & 2017)	-318	1,168	2,885	4,498	6,198	5,161	3,830	3,115	2,781	2,555	2,330	2,052	1,801
NOPLAT	**-11,432**	**-3,739**	**7,455**	**11,623**	**16,016**	**13,338**	**9,898**	**8,051**	**7,186**	**6,603**	**6,022**	**5,304**	**4,655**
%margin	**-48%**	**-13%**	**18%**	**26%**	**32%**	**30%**	**26%**	**23%**	**22%**	**22%**	**21%**	**20%**	**19%**
NOPLAT	-11,432	-3,739	7,455	11,623	16,016	13,338	9,898	8,051	7,186	6,603	6,022	5,304	4,655
DDA	9,062	6,845	5,778	5,512	5,258	5,016	4,786	4,565	4,355	4,155	3,964	3,782	3,608
CAPEX	4,870	4,590	6,190	5,757	5,354	4,979	4,630	4,306	4,005	3,725	3,464	3,221	2,996
Δ Net Working Capital	1,700	7,115	1,581	1,470	1,367	1,272	1,183	1,100	1,023	951	885	823	782
Free Cash Flow	**-8,940**	**-8,599**	**5,462**	**9,908**	**14,553**	**12,103**	**8,871**	**7,210**	**6,513**	**6,082**	**5,638**	**5,041**	**4,485**
Present Value FCF			**5,462**	**9,147**	**12,403**	**9,523**	**6,443**	**4,835**	**4,032**	**3,476**	**2,975**	**2,456**	**21,516**

Terminal Value assumption: In the Low growth, the growth for the terminal value is equal to 0.00% as it represents the residual value of the free-cash-flow of the undeveloped reserves as of today.

Figure 63

Enterprise Value FCF (MM)	**82,269**
Terminal Value = FCFn * (1+g)/ (wacc-g)	**43,361**
WACC	8.32%
g	0.00%
Market Value of Debt (MM)	**14,997**
Number of Share(MM)	1,221.038
Equity Value	67,272
Share Price	**$ 55.09**

The Stock Price in Low growth scenario has a fair value of $55.09

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Weighted Average Annual Oil Price from 2019-28 to break-even Current Share Price

In our analysis, we did not perform a sensitivity analysis regarding the WTI oil price and that is why we decided to analyse the break-even weighted average oil price for the current market price. In Conoco Phillips, oil represents 44% revenue and it is the commodity that it is most volatile. Therefore, we have performed a break-even analysis of the three scenarios.

Figure 64

The Chart perfectly explains the relation for the three scenarios:

1. In the **Neutral growth,** the weighted annual average oil price should **be equal to $84.02** to break even the current market price of the equity**. Any price above $84.02 is a buy for Conoco stock.**
2. For **Low growth,** the weighted annual average oil price should **be equal to $85.37** to break even the current market price of the equity**. Any price above $85.37 is a buy for Conoco stock.**
3. For **High growth,** the weighted annual average oil price should **be equal to $68.31** to break even the current market price of the equity. **Any price below $68.31 Conoco is a sell for Conoco Stock.**

However, in the last 6 years, the weighted annual average WTI price was $66.26 and in the entire history the weighted annual average WTI price has never been above $88. For Conoco even in the High Growth Scenario production will reduce because assets are not being replaced at the same rate and the least price to sell (in the sensitivity analysis) is higher than the average of the last 6 years. Therefore, we recommend a HOLD on ConocoPhillips stock.

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