

BUY PHILLIPS 66 (PSX) 4.14.2024

INVESTMENT THESIS

I recommend considering an investment in Phillips 66 (PSX) based on its notable performance over the past 6 months, which has yielded a return of 45.41%. The company boasts a highly integrated business model, which has facilitated expanded cash flow contributions from various segments. Notably, Phillips 66 has strategically diversified its cash flows through ventures into the midstream, marketing, and chemical segments, solidifying its position as a leading player in the marketing and refining industry. Phillips 66 consistently demonstrates robust cash generation capabilities, exemplified by its significant cash flow from operating activities, amounting to \$7.029 billion in 2023. With the current upward trajectory of WTI crude prices, hovering around \$90/barrel, the company stands to benefit from potentially higher revenues and improved profit margins. This is particularly noteworthy considering the company's impressive FY2022 EPS of \$23.27. Phillips 66 maintains a sound financial position, underscored by its strong cash generation in the fourth quarter of 2023, totaling \$2.2 billion from operations. Additionally, the company possesses substantial liquidity, with \$3.3 billion in cash and cash equivalents, alongside \$6.4 billion of committed capacity available under credit facilities. In summary, Phillips 66 presents an appealing investment opportunity, supported by its strong performance metrics, diversified business model, and solid financial footing.

DRIVERS OF THESIS

- Strong Momentum
- Economic Landscape
 - Raw product prices
 - Geopolitical tensions
- Financial Positioning
- Steady dividend growth

FIVE YEAR PERFORMANCE



Data Source: Yahoo Finance

COMPANY SUMMARY

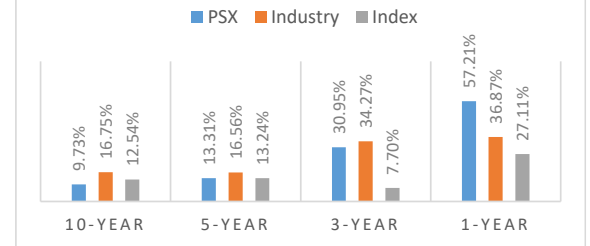
Phillips 66 stands as a prominent American multinational energy corporation headquartered in Houston, boasting an illustrious legacy spanning

nearly 150 years.

Phillips 66

NYSE	PSX
Price	\$ 157.88
Fair Value	\$ 190.10
Sector	Energy
Industry	Oil & Gas Refining & Marketing

TRAILING RETURNS



Proposal

Shares	26
Predicted Weight (Portfolio)	1%
Predicted Weight (Sector)	27%

Key Statistics

Market Cap	\$ 69.02B
Shares Outstanding (M)	427.82M
EBITDA (TTM)	\$ 12.10B
Five Year Beta	1.37
Forward Dividend Yield	2.83%
Price/Earnings	10.38
Price/Sales	0.51
Price/Book	2.32
Price/Cash Flow (TTM)	8.46

Specializing in the downstream sector of the oil and gas industry, the company operates through diversified business segments, including refining, midstream operations encompassing the transportation and storage of oil and gas products, a joint venture with Chevron in chemicals, and PSX does engage in marketing.

BUSINESS MODEL

Phillips 66 employs a multifaceted business model that encompasses diverse revenue streams. This includes the processing of crude oil and other feedstocks to produce refined petroleum products, which are subsequently marketed and distributed to a broad spectrum of customers. These customers encompass wholesalers, retailers, as well as commercial and industrial users, thus ensuring a comprehensive market reach for the company's offerings.

Diversified Operations

Phillips 66 operates a comprehensive business model encompassing multiple segments within the energy sector. Leveraging its rich history and expertise, the company has strategically positioned itself in various facets of the downstream oil and gas industry. Through its refining, midstream, chemicals, and marketing divisions, Phillips 66 ensures a well-rounded approach to meeting the demands of the global energy market.

Refining Excellence

At the core of Phillips 66's business model lies its refining segment, where the company excels in processing crude oil into valuable petroleum products. With a focus on operational efficiency and technological innovation, Phillips 66's refining operations are renowned for their ability to optimize product yields while adhering to stringent

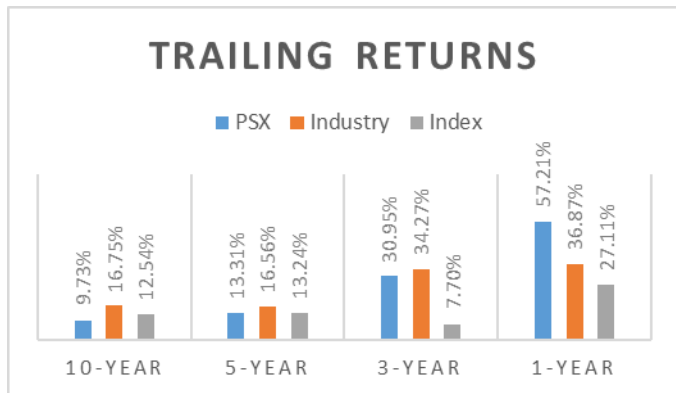
environmental and safety standards. This segment serves as a key revenue generator for the company, providing essential fuels and other refined products to markets worldwide.

Integrated Midstream & Logistics

Complementing its refining operations, Phillips 66 maintains a robust midstream segment that encompasses transportation, storage, and logistics services for crude oil, refined products, and natural gas liquids. Through strategic investments in pipelines, terminals, and other infrastructure assets, the company ensures the efficient movement of energy products from production sites to end markets. This integrated midstream network enhances Phillips 66's competitive advantage by providing reliable and cost-effective solutions for transporting and distributing energy resources.

STOCK PERFORMANCE

Phillips 66 (PSX) has consistently demonstrated impressive stock performance, surpassing benchmarks such as the S&P 500 index in every time mark except for the 10-year. Also, compared to the oil and gas refining and marketing industry PSX has performance about as well except for the 1-year PSX outperforms the industry by 20.34% Year-to-date (YTD), Phillips 66 has seen a return of 22.83%. These returns can be characterized by the soaring energy prices, and investor confidence in the sector.



Data Source: Morningstar.com

RECENT DEVELOPMENTS

News & Acquisitions

DCP Midstream:

In June 2023, Phillips 66 (PSX) finalized its acquisition of DCP Midstream, LP (DCP) in an all-cash transaction valued at approximately \$3.8 billion, marking a significant expansion of its presence in the midstream segment of the oil and gas industry. DCP Midstream's extensive network of gathering, processing, logistics, and marketing assets for natural gas liquids (NGLs) presented a compelling rationale for the acquisition, given the growing importance of NGLs in various industrial applications and as petrochemical feedstocks. With Phillips 66 nearly doubling its economic interest in DCP to 86.8%, the acquisition offered increased control over NGL transportation and processing infrastructure, facilitating a more integrated approach to capturing value across the NGL value chain. Anticipated synergies from combining midstream operations and infrastructure were expected to result in annual cost savings and operational enhancements totaling at least \$300 million. The successful integration has positioned Phillips 66 as a leading player in the large-scale NGL business, with projections indicating an annual additional adjusted EBITDA of over \$1 billion.

Looking ahead, the company's sustained success in the midstream sector will hinge on factors such as NGL price dynamics and its adaptability to evolving energy landscapes, including the potential emergence of cleaner energy alternatives.

INVESTMENT THESIS

My investment thesis is based on an analysis of economic drivers such as the current geopolitical events tightening supply and rising crude prices, financial analysis, and the constant growth dividend discount model (Gordon growth model) to calculate fair value.

ECONOMIC DRIVERS

Energy Sector

The current economic landscape within the energy sector is marked by a confluence of significant factors. Foremost among these drivers is the escalation of energy prices, a trend that has been notably pronounced since late 2021. Several factors contribute to this surge, including heightened geopolitical tensions such as the ongoing conflict between Russia and Ukraine, which has disrupted energy supplies from a major producer, consequently impacting global markets. Additionally, the post-pandemic resurgence of economic activity worldwide has spurred a surge in energy demand, particularly for oil. Compounding this situation is the limited growth in global refining capacity in recent years, exacerbating the supply constraints of

refined products like gasoline and diesel. Amidst these dynamics, companies like Phillips 66 stand to gain, leveraging their refining capabilities to capitalize on high oil prices and the tight refining capacity, thereby enabling the sale of refined products at a premium. This advantageous position has bolstered investor confidence in the energy sector, prompting increased interest and investment in companies like Phillips 66.

Despite the energy sector outperforming the S&P 500 in the YTD, the 1-year shows exactly how well the market as a whole has been performing in the last year with a 22.34% return compared to that of the energy sector with a 7.92% return in the same period.



Data Source: Yahoo Finance

The energy sector has historically underperformed the broader market, but YTD has outperformed thus far. Fidelity expresses that the United States is currently in the late expansion phase of the business cycle. During this phase, the sector tends to face double positive returns.

Sector	Early	Mid	Late	Recession
Financials	+			-
Real Estate	++	-	+	--
Cons. Disc.	++		--	
Info Tech.	+	+	-	--
Industrials	++			--
Materials	+	--		-
Cons. Stap.	--	-	+	++
Health Care	--			++
Energy	--		++	--
Comm. Serv.		+		-
Utilities	--	-	+	++

Data Source: Fidelity.com

Oil & Gas Refining & Marketing

Phillips 66 (PSX) is a prominent player in the Refining and Marketing industry, known for being the only independent refiner with a growing segment of chemicals which sets it apart from others. Despite the challenges faced by the industry such as volatility in the oil prices of both WTI and Brent crude, Phillips 66 has managed to maintain a relatively strong performance. Over the past year, the Refining and Marketing industry has experienced superb growth, with a return of 17.35%, slightly underperforming the broader market's return of 22.34%. However, Phillips 66 has fared better than the industry average, boasting a return of 51.35% during the same period. Year-to-date (YTD), PSX continued to outshine its industry peers, with a remarkable return of 21.1%, while the industry followed closely with a return of 20.4%. In contrast, the S&P 500 saw a more modest YTD return of 5.8%. Despite the industry's challenges, Phillips 66 has been able to continue to stay ahead of its competitors in the industry with strong returns in comparison to the industry and the overall market.



Data Source: Yahoo Finance

To further establish the economic outlook of the United States, it is important to examine the 10-2 Spread.



Source: FRED

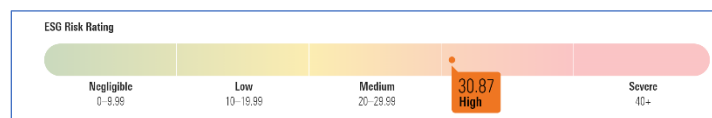
Generally, when these two yields are inverted as they are now, it indicates a recession, however, given the recent performance of the economy, the economy appears to be performing stable.

Company Specific Factors

Tip Rank’s suggests Phillips 66’s next quarter’s earnings estimate stands at \$2.61, with a range spanning from \$2.00 to \$3.66, indicating a slight decrease from the previous quarter’s EPS of \$3.09. Notably, Phillips 66 has consistently outperformed its earnings estimates, achieving a 75.00% success rate over the past 12 months, surpassing its overall industry's performance of 52.05% during the same period. Moreover, in the last calendar year, Crocs has demonstrated a superior performance compared to its industry peers. Looking at the sales forecast, Phillips 66 is projected to generate \$36.57 billion in sales next quarter, with a range of \$26.83 billion to \$54.46 billion, reflecting a small decline from the previous quarter's sales of \$38.05 billion. With the small decline, Phillips 66 has consistently failed to beat its sales estimates, with a 0.00% success rate over the

past 12 months, compared to the overall industry's performance of 50.61%. Sales estimates could be attributed to lower output with smaller net profit margins compared to FY2022.

ESG RATING



Source: Morningstar.com

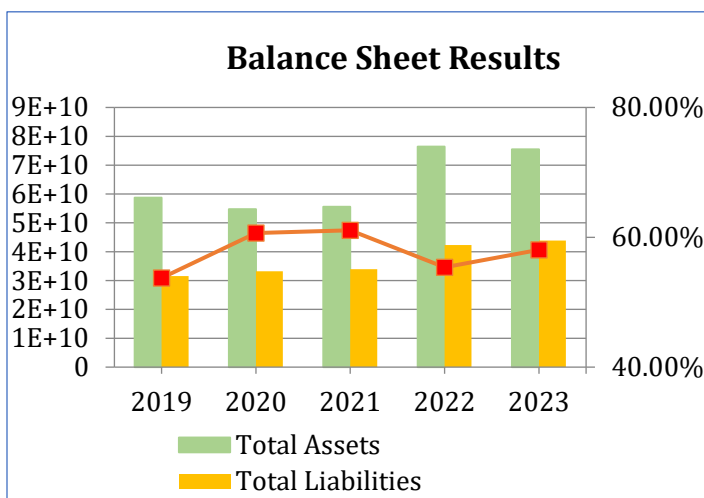
ESG stands for environmental, social, and governance factors. This rating helps investors understand certain nonfinancial aspects of a company that may make it an attractive investment. As of April 14th, 2024, Phillips 66 had an ESG rating of 30.87, which is a high level on the risk scale, but very typical of stocks in the energy sector. The ESG issues are not able to be pinpointed to one single category.

FINANCIAL ANALYSIS

Financial analysis for energy sector companies encompasses a comprehensive evaluation of various key factors tailored to their operations. This analysis typically includes examining revenue and profitability metrics such as revenue growth trends, gross margins, and net profit margins to assess the company's ability to generate profits. Additionally, understanding the company's cash flow position, and balance sheet strength is crucial for evaluating its financial health and liquidity. Assessing capital expenditure plans, regulatory compliance, and market dynamics, including supply and demand trends and commodity prices, helps anticipate potential impacts on the company's performance. Competitive positioning within the energy sector, along with consideration of environmental, social, and governance factors, also plays a significant role in financial analysis to gauge long-term

sustainability and risk management practices. Overall, a comprehensive financial analysis of energy sector companies involves evaluating a wide range of factors to understand their financial performance, risks, and growth prospects.

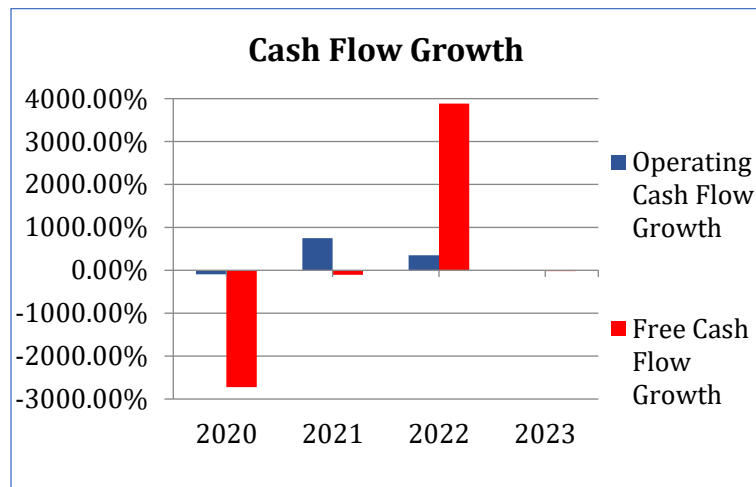
Balance Sheet Analysis



Source: Morningstar.com (Millions)

The balance sheet data indicates a recent trend of major growth in total assets over the five-year period, notably the jump in 2021 to 2022 starting at \$55.594 billion to \$76.442 billion. Concurrently, total liabilities have also jumped slightly, rising from \$33.957 billion to \$42.336 billion. This large jump can be seen oil prices started to rise due to increasing conflicts with Ukraine and Russia decreasing the global supply. The Total Liabilities to Assets ratio provides insights into the company's stability, showing that even when net profit margins are providing steady income the company can handle debt obligations staying around the 60% mark for liabilities to assets. This shows that year over year, when Phillips 66 is increasing their assets their debt levels rise slightly but not at the same rate as their asset growth.

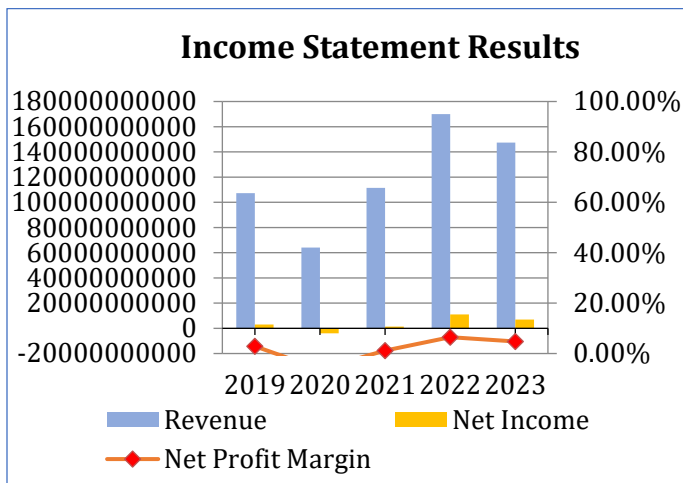
Statement of Cash Flows Analysis



Source: Morningstar.com (Millions)

Analyzing Phillips 66 cash flow growth data from 2019 to 2023 reveals the nature of the sector they are engaged in. The refining and marketing industry is a volatile industry that is sensitive to various factors such as geopolitical events and crude oil prices. The cash flow growth provided by operating activities saw 748.10% growth YoY in 2021 and 348.17% YoY in 2022. However, this would decline in 2023 as the growth dropped to -11.63% YoY. This growth reflects the sector wide run in 2021 and 2022 as energy provided the highest returns in the market for those two years. In terms of free cash flow growth, the pandemic stopped the economy creating an extreme downfall for demand of energy products. As the economy bolstered back into normalcy, we see that in 2022 the FCF growth skyrocketed YoY to an increase of 3883.50% and 2023 followed with a small decrease YoY of -18.55% FCF growth. As discussed earlier, PSX has made strides to improve cash flow steadiness by relying less on their profit margins from refining and diversifying into different aspects of energy production.

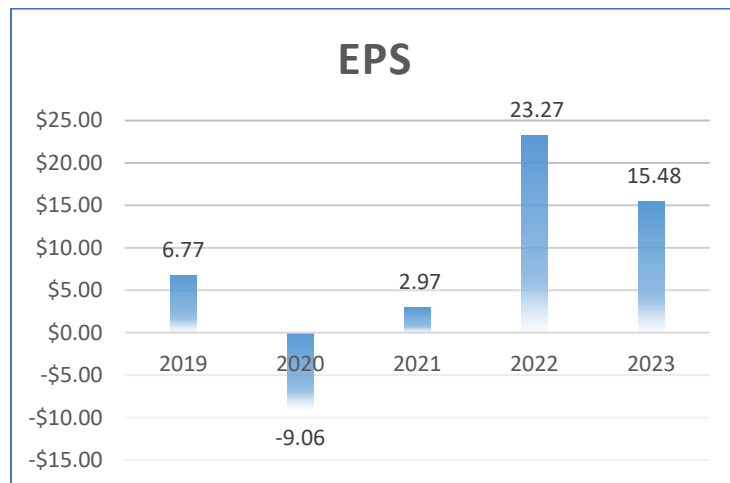
Income Statement Analysis



Source: Morningstar.com

The income statement data for Phillips 66 demonstrates the headwinds and tailwinds that come with the industry over the five-year period, with revenues falling from \$107.29 billion in 2019 to \$64.13 billion in 2020, a decrease of 40.23%. Despite this negative growth from 2019 to 2020, the company rebounded and has increased revenues in 2023 to \$147.40 billion which marks an increase of 37.38%. PSX’s net income experienced fluctuations throughout the period as 2020 was the only year the company recorded negative net income. 2021 the company was able to be profitable again as it recorded \$1.306 billion in net income and a profit margin of 1.17%. The following year, oil prices began to soar, helping PSX record a net income of \$11.014 billion with a 6.48% net profit margin. In 2023, margins declined to 4.75% and net income dropped to \$7.004 billion marking a -36.41% decrease in net income YoY from 2022 to 2023.

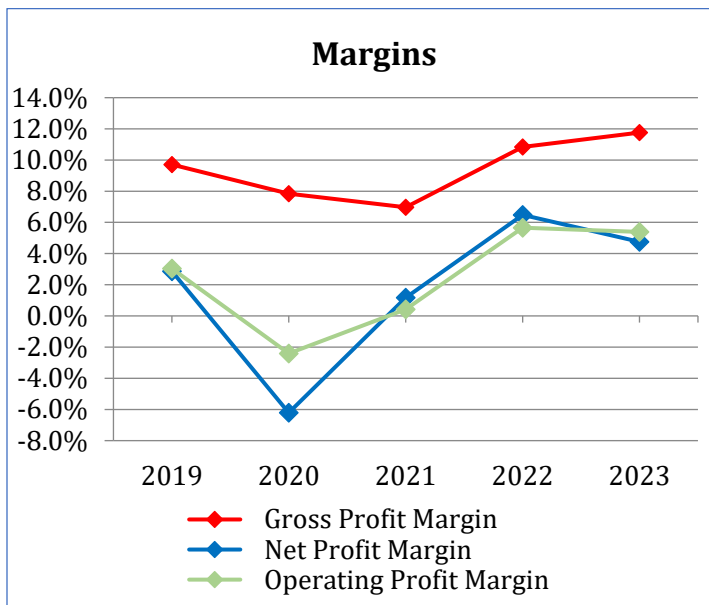
EPS Analysis



Source: Morningstar.com

Phillips 66’s earnings per share (EPS) trajectory over the past five years illustrates the volatile nature of the energy sector, influenced by fluctuating market conditions. Beginning in 2019 with an EPS of \$6.77, the company experienced a significant decline to -\$9.06 in 2020 due to the global economic slowdown induced by the COVID-19 pandemic, which markedly reduced energy demand. However, a rebound ensued in 2021 with an EPS of \$2.97, followed by sharp increases in 2022 and 2023 to \$23.27 and \$15.48, respectively, correlating with the recent surge in global oil and gas prices. This growth aligns with the positive economic drivers currently impacting the energy sector, where high oil prices afford Phillips 66 the opportunity to sell refined products at a premium, bolstering profitability. Moreover, the company benefits from limited global refining capacity, allowing it to capitalize on heightened demand for these products.

Profit Margin Analysis

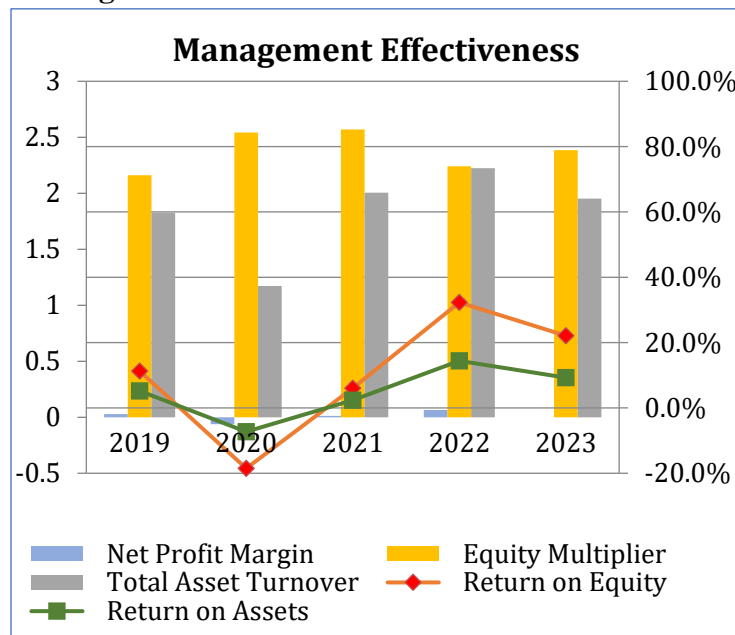


Source: Morningstar.com

Phillips 66's margins from 2019 to 2023 exhibit a mixed trajectory, reflecting fluctuations and recent positive developments in profitability. The gross profit margin, indicating profitability after accounting for the cost of goods sold, fluctuated between 7.0% and 11.8% over the period, peaking in 2023 at 11.8%. This increase suggests improved profitability, likely attributable to favorable market conditions, particularly high oil prices. In contrast, the operating profit margin, reflecting profitability after accounting for operating expenses, ranged from -2.4% to 5.7% during the same period. While exhibiting variability, it displayed a steady increase from 2021 to 2023, reaching 5.7% in 2023. Similarly, the net profit margin, representing the proportion of revenue retained as profit after all expenses are deducted, demonstrated volatility, ranging from -6.2% to 6.5% over the period. Despite fluctuations, it showed an upward trend from 2020 onwards, peaking at 6.5% in 2023. These trends suggest that while Phillips 66 faced

challenges in maintaining profitability, recent years have seen improvements, driven by strategic adjustments to diversify their product mix and favorable market conditions.

Management Effectiveness



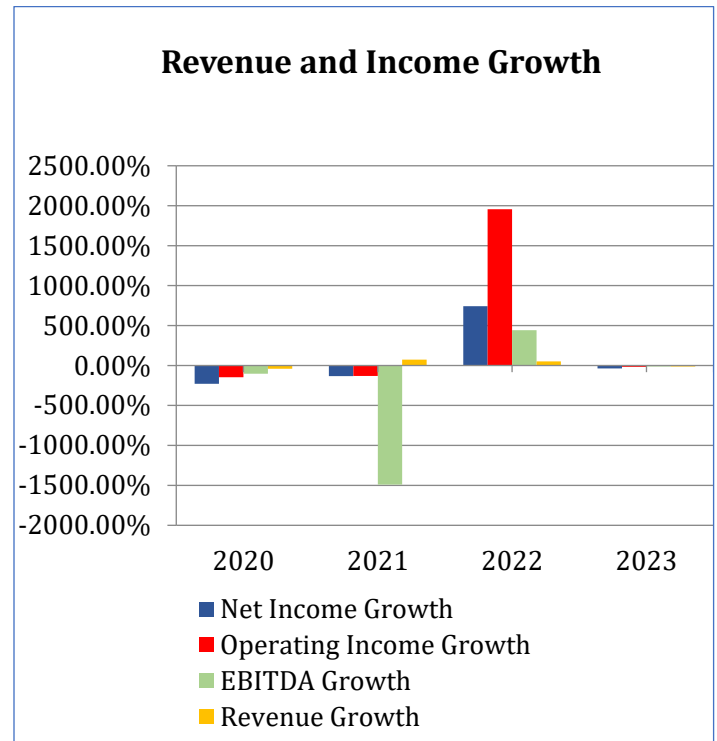
Source: Morningstar.com

The management effectiveness, also known as profitability ratios, provides insights into the company's operational and financial performance over the five-year period. The net profit margin reflects the company's ability to convert revenue into profit, showing fluctuations over the 5-year span. The worst year being 2020 with a -6.2% net profit margin compared to their best year in 2022 with a 6.5% net profit margin. The company over the last three years has been relatively stable with room for improvement in their net profit margins. Total asset turnover has been relatively stable around the 2.0 market for years where the pandemic has not slowed the economy down with a range from 1.17 in 2020 to 2.22 in 2022 with a 5-year average of 1.84, and 3-year average of 2.06. PSX's equity multiplier is a bit higher meaning the company has higher leverage and relies more on

debt financing to fund their operations. The return on equity (ROE) and return on assets (ROA) metrics for the years 2019 to 2023 reveal significant fluctuations in performance for the company. ROE, which signifies the percentage return on shareholders' equity, exhibits notable volatility throughout the period. The negative ROE in 2020 underscores the severe financial repercussions of the pandemic, while subsequent years depict a rebound, with ROE surging to 22.10% in 2023. Similarly, ROA, which measures the efficiency of asset utilization in generating profit, also displays volatility, with a negative figure in 2020 due to the pandemic's impact. However, ROA has shown marked improvement in recent years, reaching 9.30% in 2023. These trends highlight the company's resilience in navigating challenging circumstances and its ability to recover and deliver stronger financial performance in subsequent years.

Growth Rates

Revenue & Income:

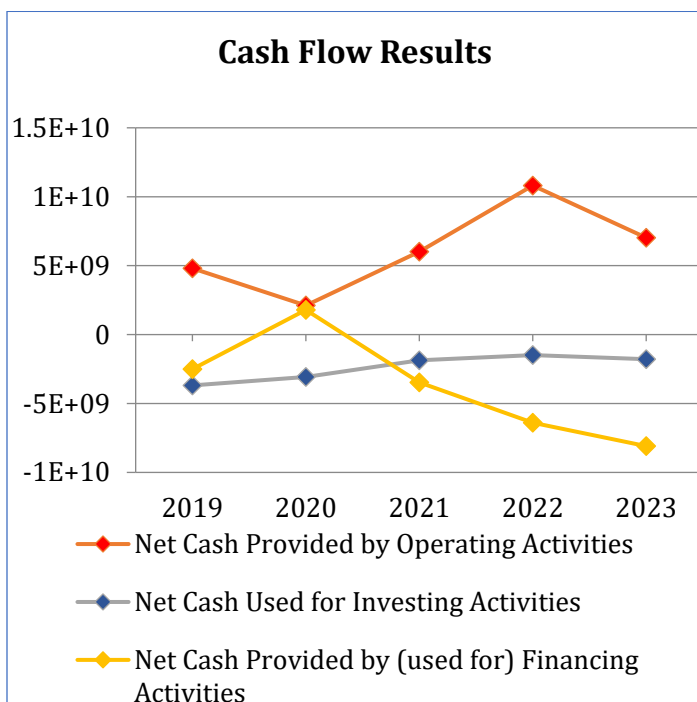


Source: Morningstar.com

Phillips 66's growth trajectory from 2019 to 2023, as depicted by key metrics such as revenue growth, operating income growth, EBITDA growth, and net income growth, reflects a story of significant variability and notable fluctuations. Revenue growth experienced a sharp decline of -40.23% in 2019, followed by impressive rebounds of 73.83% and 52.49% in 2021 and 2022, respectively, indicating robust recovery and expansion. However, growth faltered in 2023 with a decline of -13.29%, potentially reflecting challenges or external factors impacting revenue generation. Similarly, operating income growth and EBITDA growth registered stark declines in 2020 and 2021, reflecting adverse market conditions and a poor economy. However, both metrics rebounded dramatically in 2022, with operating income growth soaring by 1955.56% and

EBITDA growth surging by 442.64%, suggesting significant operational improvements and economic growth post-pandemic. Nevertheless, YoY growth tapered off in 2023, with operating income and EBITDA growth declining by -17.36% and -11.75%, respectively, potentially indicating renewed challenges and not as strong of a market for crude and crude products. Net income growth mirrored the trends seen in revenue and operating income, experiencing sharp declines in 2020 and 2021 followed by substantial rebounds in 2022. However, growth turned negative once again in 2023, declining by -36.41%.

Cash Flow Results:



Source: Morningstar.com

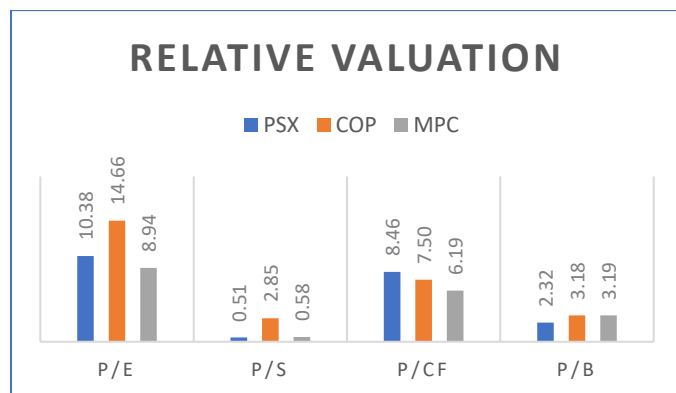
Phillips 66's cash flow from operating activities exhibited fluctuating trends from 2019 to 2023. Starting at \$4.808 billion in 2019, it experienced a decline to \$2.111 billion in 2020 before rebounding significantly to \$6.017 billion in 2021. This upward trajectory continued in 2022, reaching \$10.813

billion, indicative of robust operational performance and strong cash generation. However, there was a slight decrease in 2023, with net cash provided by operating activities totaling \$7.029 billion.

Conversely, the company's cash flow from investing activities fluctuated moderately over the same period, with net cash used for investing activities ranging from \$-3.688 billion in 2019 to \$-1.790 billion in 2023. Additionally, Phillips 66's cash flow from financing activities demonstrated more pronounced fluctuations, with net cash provided by (or used for) financing activities ranging from \$-2.511 billion in 2019 to \$-8,092 billion in 2023.

Relative Valuation Analysis

A relative valuation model is different from an absolute valuation model in that it refers to other companies and benchmarks. Relative valuation looks at valuation ratios like price-to-earnings (P/E), price-to-sales (P/S), price-to-cash flow (P/CF), and price-to-book (P/B). P/S, for example, shows a company's share price as a multiple of its sales, P/E shows a company's share price as a multiple of its earnings, and so on at multiple points in time. The ratios shown in the graph are the current valuation ratios for Phillips 66 (PSX), ConocoPhillips (COP), and Marathon Petroleum (MPC), which MPC is currently held in the Wisman Fund.



Source: Morningstar.com

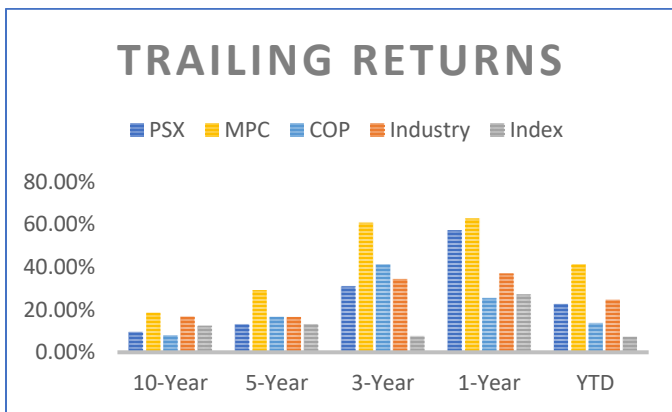
This chart compares the returns of Phillips 66 to ConocoPhillips and Marathon Petroleum Corp, two popular stocks in the industry. The below graph shows the returns of the same companies over the past year. MPC leads the way with a return of 58.3%, followed by PSX with a 51.35% return and COP with a yearly return of 20.05%.



Source: Yahoo Finance

Phillips 66 (Blue), ConocoPhillips (Red), Marathon Petroleum Corp. (Green)

Trailing Returns



In terms of trailing returns, Phillips 66 has demonstrated an excellent performance compared to its counterparts in the industry. Over the past 10 years, PSX has underperformed the market slightly with a trailing return of 9.73%. The narrative changes when looking at the 3-year period as PSX falls in line with the industry return of 30.95% compared to 34.27% of the industry. Looking at the 1-year trailing return the only competitor outpacing PSX is MPC where PSX has a return of 57.21% compared to

MPC's return of 62.74%. Both of these companies have substantially outperformed the industry as well as the index as a whole. Finishing with YTD returns, PSX outperformed the industry by 9.12% as it only trails Marathon Petroleum, a company thriving in the recent economic conditions.

FAIR VALUE

Absolute Stock Valuation

Using data from Morningstar, the current EPS and yearly dividend is \$15.48 and \$4.20 respectively. Using the 2-Stage Dividend Discount Model, with the Cost of Equity, 10.75%, the Beta, 1.38, the risk-free rate, 4.40%, the market risk premium, 5.6%, and the expected growth rate, 18%, and retention ratio of 72.85%. This suggests that, based on the current EPS, payout ratio, and market parameters, the stock has an anticipated fair value of \$190.05 (Lower: \$161.54 Upper: \$218.56).

RECOMMENDATION

I recommend a buy on Phillips 66 (PSX). My recommendation is based on an analysis of economic drivers such as current geopolitical events tightening the global supply of oil, financial analysis of the company with strong financials given the tough environment of the industry, and the 2-stage growth dividend discount (Gordon growth) model, which generated a fair value of \$190.05. Buying Phillips 66 aligns with the Wisman Fund's objectives to buy securities that are deemed undervalued by the fund's analysts.

REFERENCES

1. Yahoo Finance
2. Morningstar
3. Phillips 66
4. Tip Ranks
5. FRED
6. Value Investing
7. Zacks

DISCLOSURES

The author of this report is not a licensed investment advisor, broker or officially licensed financial professional. The opinion presented in this report does not serve as a recommendation or offer to sell or buy shares of Phillips 66. This report was created for academic purposes only.