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# Energy Sector Recommendations

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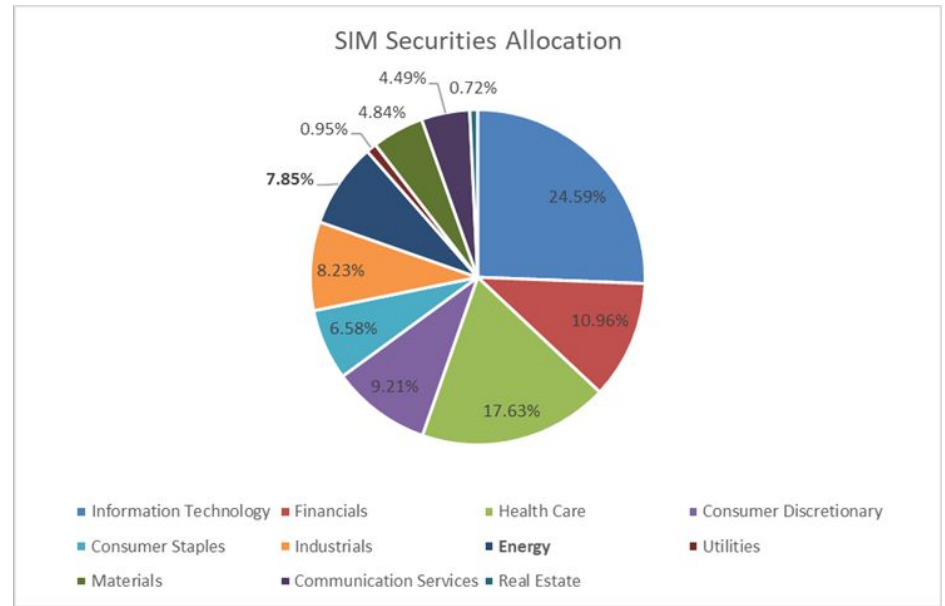
# Current SIM Portfolio

- SIM Portfolio contains
  - Chevron, ConocoPhillips, Magellan, SM Energy, Schlumberger
- Our recommendations
  - Buy Chevron
  - Buy ConocoPhillips after a period of inspection
  - Buy Schlumberger
  - Add PDC Energy to the portfolio



# Recommendation

- The SIM portfolio **should** be overweight energy
  - Positives of our recommendation
    - Largest YTD increase
  - Negatives
    - Susceptible to influence by government
  - Which industry should be overweight?
    - Oil, Gas, and Consumable Fuels
      - Accounts for about 94% of energy sector

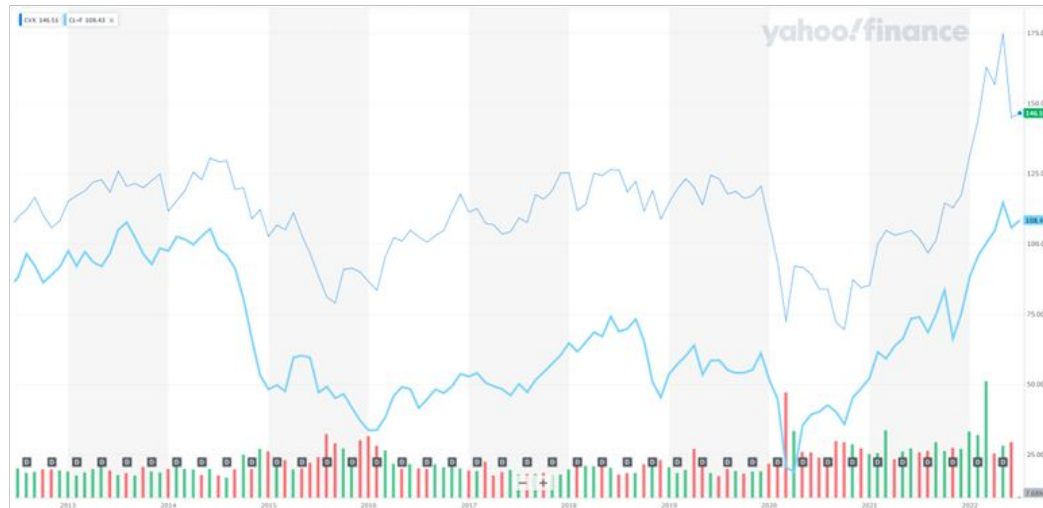


# Chevron Corporation (CVX)

Recommendation	
Current Price (07/15/22)	137.65
Stock Rating	BUY
Price Target	187.29
Implied Upside	36.1%
Dividend Yield	3.92%

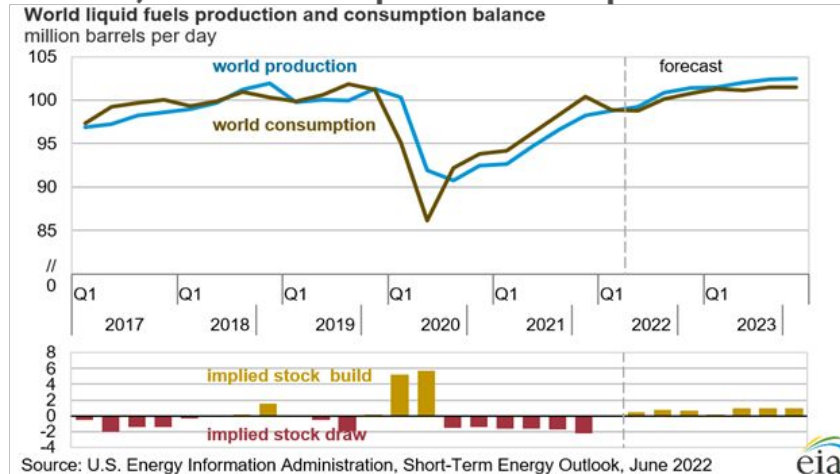
# Fundamental Drivers

- In the past 20 years, the price of crude oil and natural gas is highly correlated to the performance of the Energy Sector as a whole. Figure below identifies an R2 value of 0.724 between Crude Oil and Chevron Corporation stock price



# Crude Oil price

- The Brent crude oil spot price averaged \$113 per barrel (b) in May 2022. EIA expects the Brent price will average \$108/b in the second half of 2022 and then fall to \$97/b in 2023. Current oil inventory levels are low, as shown in figure below, which amplifies the potential for oil price volatility.



# Risks

- **ESG**

- ESG stands for Environmental, Social, and Governance. Investors are increasingly applying these non-financial factors as part of their analysis process to identify material risks and growth opportunities. Chevron is planning \$10 billion in lower carbon capital investment between 2021 and 2028 with the goal of reducing the carbon intensity of our oil, products and gas business and building new lower carbon energy businesses.

- **Russia-Ukraine war**

- God bless the people in Ukraine. The Russia-Ukraine war ends will result Crude Oil price drop.

- **OPEC production increase**

# Key Financial Ratios

- The table below is showing different financial ratios of the companies in S&P 500 Energy sector, with similar size. All the companies had significant growth in quarterly revenue compared to a year earlier, as well as the earnings. Thanks to the high crude oil price in the first quarter of 2022.

Table 4

	Quarterly Revenue Growth (YoY)	Quarterly Earnings Growth (YoY)	Operating Margin	Forward Annual Dividend Yield	ROA (TTM)	ROE (TTM)
CVX	68.30%	354.50%	12.22%	3.98%	5.51%	14.69%
XOM	52.50%	100.70%	10.86%	4.09%	6.10%	15.59%
COP	82.80%	486.50%	33.40%	2.22%	12.95%	27.83%
OXY	57.70%	N/A	25.26%	0.86%	5.96%	34.10%





# Valuation

- Though Chevron Corporation company financial performance was fluctuated a lot in the past 5 years, before the COVID-19 pandemic, the company demonstrated their strength in growing business. Therefore, the terminal growth rate should be stabilized around 3%.
- Considering the interest rate hike of this year, the year end interest rate will fall into a 3.4% to 3.8% according to Wall Street Journal. The terminal discount rate should be higher than normal years, though oil and gas industry carry relatively lower risk premium. With a Beta 1.08, the reasonable terminal discount rate of the DCF model is 11.5%.

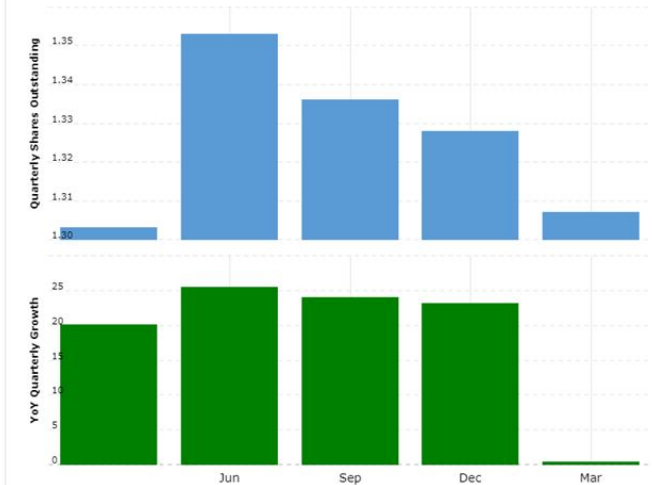
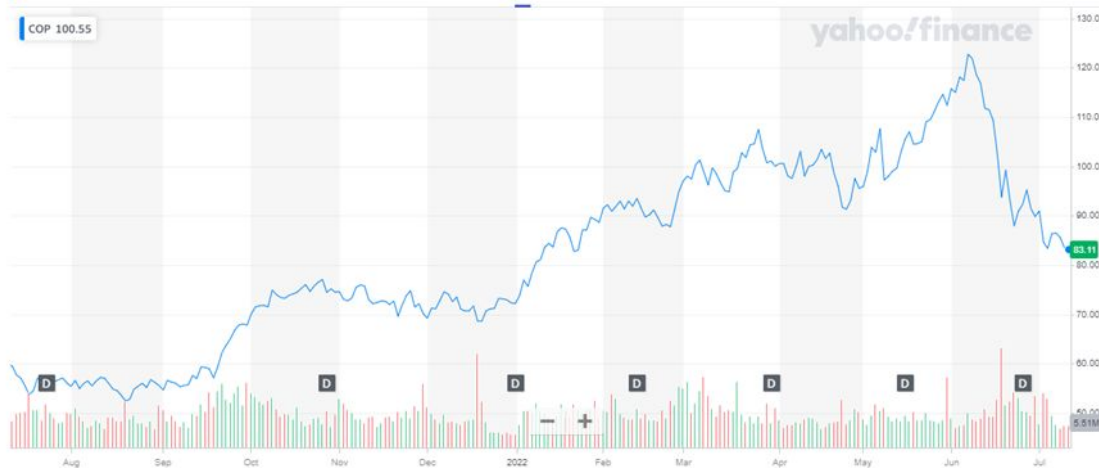
# ConocoPhillips (COP) - Overall Introduction

-ConocoPhillips (COP) is an American multinational corporation engaged in the hydrocarbon exploration and production, and the company is based in the Energy Corridor district of Houston, Texas.

-In 2021, the total earnings of ConocoPhillips are \$8.1 billion, with Crude Oil taking 49.61% of sales, Natural gas liquids 11.09%, Natural gas 35.07% and Bitumen 4.21%.

-Recent major event is the change of essential leadership: Tim Leach, previously executive vice president, has become advisor to the chief executive officer. COP also announced that Jack Harper, previously president, Permian for ConocoPhillips, and former president of Concho Resources, has assumed the role of executive vice president.

-Following is the stock price of COP (left) and stock outstanding (right) in the past 12 months:



# ConocoPhillips (COP) - Systematic & Unsystematic Risks

-Global political uncertainty: The War between Russia and Ukraine caused the profitability of ConocoPhillips to increase over 60% due to increasing oil price. However, as the war began to step into the end phase, we have already seen drop in COP stock price.

-Changing economic pattern: Improved performance of ConocoPhillips may be due to the high U.S inflation rate. Thus, the overall performance may be limited as U.S is lowering the interest rates to control overwhelmingly high inflation rate.

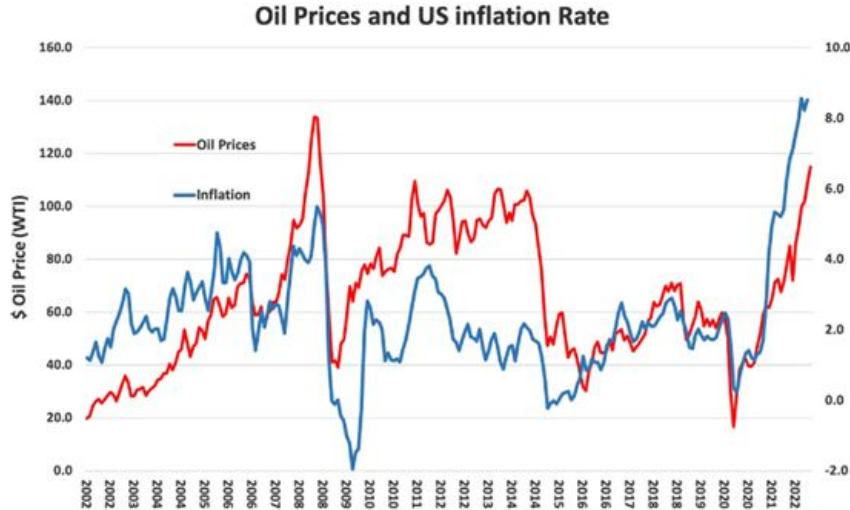
-Risks within COP: As the major leaderships has changed on May 2 this year, ConocoPhillips may face uncertainty when going through large business decisions, especially uncertainty with company structures.

-ESG and environmental policies: As mindset of social and environmental responsibilities suddenly gain popularity around United State, ESG has already become a political correctness. Thus, the traditional energy companies, such as ConocoPhillips, will have hard time finding investments from public because of its conflict with ESG standard.



# ConocoPhillips (COP) - Investment Strategy

- Do not recommend investment right now as stock is still overpriced.
- Invest after the regional conflict stabilized and U.S inflation come down.
- Energy sector is still overvalued compare to the other sectors in S&P 500.
- Wait until the change of leadership stabilized the organization of companies.



Sector	Last 12 months	Last 3 months	Last 1 month
S&P500 (SPX <Index> <Go>)	-5.18%	-5.84%	-4.91%
Energy (S5ENRS <Index> <Go>)	67.12%	27.05%	14.33%
Material (S5MATR <Index> <Go>)	-3.34%	2.63%	-1.94%
Industrials (S5INDU <Index> <Go>)	-12.30%	-4.90%	-6.02%
Cons Discr (S5COND <Index> <Go>)	-5.18%	-5.84%	-4.91%
Cons Stap (S5CONS <Index> <Go>)	3.00%	3.00%	0.00%
Healthcare (S5HLTH <Index> <Go>)	5.45%	2.86%	-2.61%
Financials (S5FINL <Index> <Go>)	-9.59%	-11.62%	-4.01%
Info Tech (S5INFT <Index> <Go>)	-3.89%	-9.37%	1.32%
Telecom (S5TELS <Index> <Go>)	-4.43%	-13.11%	-7.89%
Real Estate (S5RLST <Index> <Go>)	0.37%	-4.02%	-12.73%
Utilities (S5UTIL <Index> <Go>)	13.36%	13.72%	1.45%

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# About Schlumberger

Premier oilfield service provider (ahead of Halliburton and Baker-Hughes)

Divisions include: Digital & Integration, Reservoir Performance, Well Construction, Production Systems

Operates in 120 countries and employs 160 nationalities

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# Why the Portfolio Should Have More Schlumberger

Strong future consensus in both sales and EPS

Sales supposed to grow by 14% in 2022, 12% in 2023, and 5% in 2024

EPS expected to be 1.87 in 2022, 2.66 in 2023, and 3.10 in 2024

Transnational corporation

Profitable as long as oil remains above \$40 per barrel

Each division has increased sales and earnings YoY

Currently no competition from Russia

OPEC and OPEC+ operating at capacity



# About PDC Energy

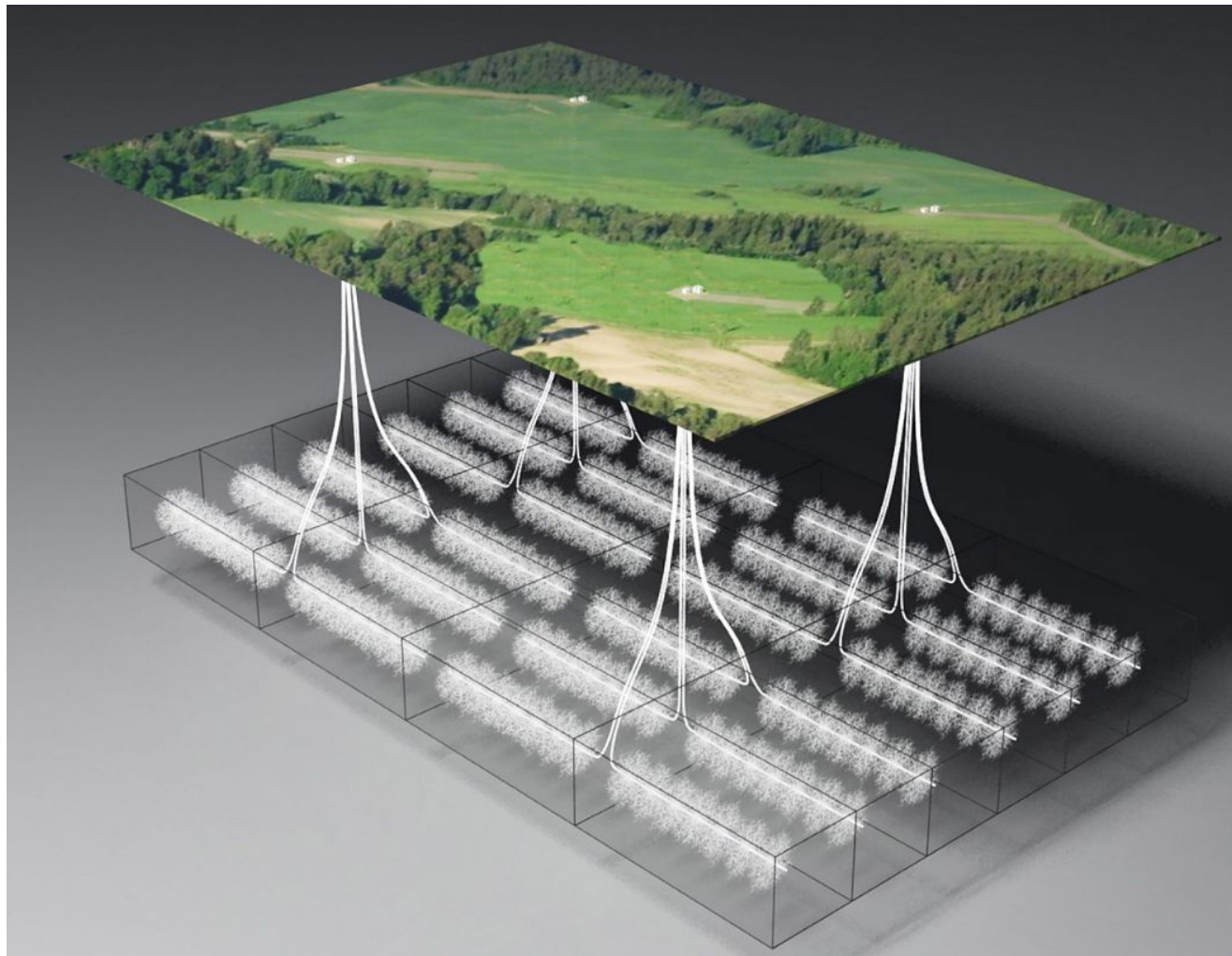
In the S&P MidCap 400

Operate in the Wattenberg Field and Delaware Basin

Focus on oil and natural gas liquids (NGL)

Committed to a strong balance sheet

Their core values emphasize integrity and respect for the environment and for the health, safety and well-being of their employees and the communities where they live and work





# Why PDCE should be added to the portfolio

Added diversity of a midcap

Strong balance sheet

Committed to health, safety, and environment

Geographically diverse

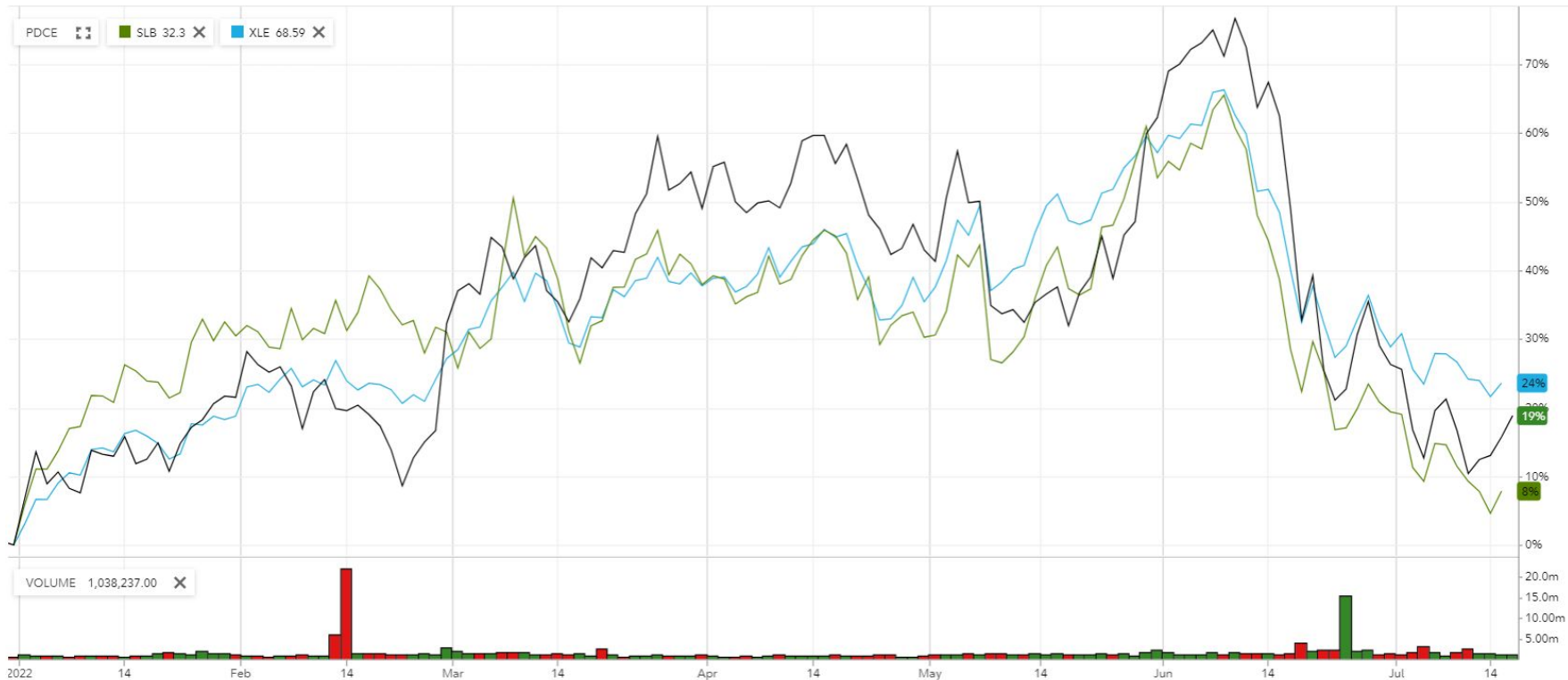
Consensus sales growth of 93% in 2022 and 10% in 2023

Supposed to shrink by 1% in 2024

EPS consensus of \$14.19 in 2022, \$16.58 in 2023, and \$20.34 in 2024

# Overlay comparing XLE, SLB, PDCE

07/15/2022 O: 56.22 H: 56.50 L: 54.83 C: 56.46 V: 1.04 M



# Conclusion

Company	Current Price	Current Weighting (Sector)	Current Weighting (Portfolio)	Recommendation	Weight After Buy (Sector)	Weight After Buy (Portfolio)	Target Price	Expected Return
Chevron	\$146.51	16.96%	1.17%	Buy	12.71%	1.74%	\$161.16	10%
Conoco	\$83.11	37.43%	2.57%	Buy After Waiting	28.04%	3.15%	\$91.42	10%
Schlumberger	\$32.73	30.64%	2.11%	Buy	22.96%	2.68%	\$36.00	10%
PDC Energy	\$57.57	0.00%	0.00%	Buy	6.27%	0.58%	\$63.33	10%

# Sources

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