Investment U Research Report

Conoco Phillips:

Big Oil's Cash-Flow King Is the Fastest-Growing "Crude Chip"

Here's How To Tap $2.2 Billion of Petro-Profits... And Another 9 Years of 37%-Plus Growth

by the *Investment U* Research Team

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Dear Reader,

When it comes to the price of crude, Mr. Market's changed his tune four times in the last six months… triggering double-digit reversals on each occasion.

From September to November of 2006, oil dropped 19%. It climbed 14% into December, slumped 22% into the New Year, and reversed course yet again in February, rising more than 16% to $58 a barrel.

The volatile price action has analysts stumped… and firing off rounds of speculation about what to expect over the next six months.

But while the talking heads on CNBC debate $100 versus $30 oil, we're taking a more realistic approach…

Market timing in general is a dangerous exercise, and doesn't fit our philosophy at *Investment U*. Instead, we accept that in every market – energy or otherwise – uncertainty will always be our companion.

As Investment Director Alexander Green says, "You can guess what the market is going to do and be right. You can guess and be wrong. Or you can let some self-styled 'expert' do the guessing for you. But no one guesses right consistently, so we don't waste time here."

We can, however, look at the financial strength of the oil industry's biggest players – one of the stock market's most reliable sectors in the last couple of years, when it comes to increasing shareholder value.

And despite some recent warnings from "Big Oil" itself, one cash-rich company is looking to extend its annual double-digit growth rate… at rock-bottom prices.

Expectations for Oil's Top 5

If you were a shareholder of any of the top five "Big Oil" companies in 2006 – **Exxon Mobil** (NYSE: XOM), **Chevron** (NYSE: CVX), **ConocoPhillips** (NYSE: COP), **BP** (NYSE: BP) and **Royal Dutch Shell** (NYSE: RDS-B) – you've had a nice run, thanks to higher oil prices and record profits.

Shares of Exxon Mobil swelled 34% last year, to more than $76.

Chevron, fetching 10 times estimated 2007 profits, earned shareholders a slightly higher 29% in growth and yielded 3%.

ConocoPhillips also had a strong 2006, up 22%. And Royal Dutch Shell finished the year up 19%, while BP – pressured by environmental, safety, and infrastructure concerns – ended higher by 7.9%.

Several of these companies, however, are warning investors not to expect a repeat performance.

- ✔ BP's share of production from the jointly held TNK-BP project in Russia was 930,000 barrels a day, down from 950,000 in the third quarter.
- ✔ Chevron Corp., the #2 U.S. oil company behind Exxon Mobil, said its average selling price for a barrel of oil fell almost $11 in the last three months of 2006 and that maintenance work at its refineries and Gulf of Mexico platforms whittled down product sales.
- ✔ Chevron's U.S. liquid and natural gas production fell almost 1% from the third quarter. Internationally, production fell 3.4%, a move that cost Chevron about 90,000 barrels a day.
- ✔ Finally, if oil continues to trade in the current trading range throughout 2007, Exxon Mobil. would lose nearly $3 billion in profit – about $540 million for every dollar off the price of oil per barrel.

But of the group, one company is best positioned to shake short-term setbacks…

The Industry's Most Improved Balance Sheet

Energy companies generated 15% of the operating cash flow of S&P 500 last year, second only to the 21% chipped in by financials. And **ConocoPhillips** should continue to be one of the best cash-generators of the lot…

Through shrewd acquisitions, the company has grown to become the third-largest U.S. energy company behind **ExxonMobil** and **Chevron**. And it's efficient…

Management has steadily increased the company's cash flow over the past five years. And right now, with more than $2.2 billion on the books, **Conoco has more cash on hand than at any other time in the company's history**.

And they're putting it good use.

Management has trimmed Conoco's long-term debt obligations every single year since 1998. In that time, the company's debt, as a percentage of its market capitalization, has dropped from 46.2% to a mere 14.1%.

The company is increasing value for shareholders, too. Return on equity, over the last decade, is averaging 17.2% a year.

And the board of directors just bumped up the company's dividend, to 2.5% a year.

Conoco's cash infusion is a result of spectacular revenue growth *and* revenue consistency. <u>It has the highest rate of sales growth among the top five oil companies, averaging 37.78%… *over the past 9 years*</u>.

What about the stock?

Shares trade for just seven times estimated 2006 earnings of $10.10, and less than eight times projected 2007 earnings of $9.40 a share, below those of ExxonMobil, Chevron, Royal Dutch Shell and BP.

In fact, it has the lowest price-to-earnings ratio among the Dow Jones Global Titans – the 50 largest companies worldwide, ranked by market capitalization.

In short, Conoco's balance sheet is in top-notch shape. Management is making good decisions with company cash. And the stock, on a relative basis, is cheap.

Where oil will be in the next six months is, literally, anybody's guess. But stick with high-quality companies generating loads of cash – in any industry – and you generously tilt the odds in your favor.

Here are 11 more companies generating unusual amounts of cash… and using it to fuel future earnings growth that is substantially higher than their peers.

Return to the .html version of ConocoPhillips: Big Oil's Cash-Flow King Is the Fastest-Growing "Crude Chip"

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