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Strategic Decisions and Shareholder Value: An Analysis of ConocoPhillips

By

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**An Honors Thesis in partial fulfillment of the requirements for the degree Bachelor of
Science in Business Administration in
Accounting**

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INTRODUCTION

Through the difficult market volatility for investors in the past few years, corporations never settled for allowing the market to completely dictate the share price of their company. During this time period companies strove to create value for their shareholders through making strategic decisions. Many companies utilized strategic decisions to give more value to shareholders of their stock. Extensive research has been done in the field of market returns, especially with spin-offs and the returns they create for investors. The research from Cusatis, Miles, and Woolridge (1993) shows that investors could outperform the market by investing in spin-offs, in some cases the return was 700% the initial investment. If a common investor knew these kinds of opportunities, they could continue to find new ways to invest their money.

One company that has consistently striven to create shareholder value for its investors is ConocoPhillips. This Fortune 500 Company was created through a merger in 2002, and began aggressively competing against its peers (ExxonMobil, Shell, BP, and Chevron). In 2009 they outlined a detailed asset sale program, and eventually implemented a plan to increase shareholder value in 2010. Their plan included selling \$15-20 billion in assets, repurchasing \$10 billion in stock, and increased dividends. The final step they took towards creating value was beginning the steps toward a spin-off of their refining business that will be completed in the second quarter of 2012. This commitment to increasing shareholder value is the reason that this study will highlight and analyze a few of the strategic decisions that ConocoPhillips made throughout their existence and provide market comparison for how their shareholder value plan compares against the returns of the market and benchmarked companies. The strategic decisions that will be

highlighted will be the merger that created ConocoPhillips, and the upcoming spin-off to create Phillips 66.

In the summer of 2011, I interned for ConocoPhillips in their Lower 48 division in Plans and Budgets, specifically the investment and portfolio group. My main project for the summer was to create a database that compared ConocoPhillips's operations in specific geographic regions to competitors. I analyzed ConocoPhillips and 30 other competitors. This gave me a comprehensive view of the oil and gas industry, ConocoPhillips, and their main competitors. Mid-way through my summer internship, ConocoPhillips announced that it planned to split into two leading energy companies.

I remember reading analyst reports that were forwarded to me by my supervisors on the upcoming spin-off. Analysts worked diligently to show the value that this transaction held for shareholders. One of the common things completed was comparing ConocoPhillips spin-off to Marathon Oil's spin-off of Marathon Petroleum. Marathon Oil was once an integrated oil and gas company, but smaller in size than ConocoPhillips, and spun-off its downstream and midstream parts of the business. Through this thesis, Marathon's spin-off will be used as a comparison for ConocoPhillips and to demonstrate what investors could expect from the spin-off.

METHODOLOGY

The main objective of this study pivots on the idea of being able to create a comparison for strategic decisions and how it might benefit an investor. Utilizing a simple view of finance and investing, a comparison a companies' stock performances on four time dates: day of the decision/implementation, one week afterward, one month afterward, and six months afterward

was completed. A timeframe of longer than six months the stock performance could attribute to normal operations and less of the market reaction to the strategic decision. For the Marathon Oil spin-off, the returns that investors had is shown, by demonstrating the return based on if an investor were to purchase two shares on the announcement, and follow his or her returns through different dates. The comparison was exceedingly important for this research, and the three major market indexes that were chosen are: NASDAQ, S&P 500, and the Dow Jones Industrial Average. These three market indices were chosen because they are the most common market indices, and are referenced most when determining how the market moved on a specific day. The list of benchmark companies are in Table 1: Benchmark Companies located in the Appendix along with a brief description of the business, stock price at the close of market on April 9, 2012, and the market value of the company. The benchmark group was selected based on ConocoPhillips current peer group (major integrated) and their new peer group after their spin-off (major independent); as well as Marathon Petroleum to provide insight into what could be expected for ConocoPhillips upcoming spin-off. Information was gathered on the stock's performance for key dates for ConocoPhillips' strategic plan to create shareholder value. The gain of the stock is compared then to individual companies in the benchmark, and also a simple mean of the return for each group: market indices, integrated oil and gas, and independent oil and gas. The information gathered should provide insight to whether value was actually created for shareholders through the comparison of ConocoPhillips stock performance to the benchmark.

STRATEGIC DECISIONS AND CONOCOPHILLIPS

The history of ConocoPhillips has been one of strategic decisions that create value for shareholders and the company. They implemented a plan in 2010 to sell \$15-20 billion in assets,

while simultaneously repurchasing \$10 billion in common stock. They also utilized the extra cash to improve their operations to better serve stockholders. Their continual success on maintaining an edge by providing value for shareholders has served the company well through stock performance. However, there are other large strategic decisions that play a significant role on the value that is created for shareholders. In the following sections, two such strategic decisions will be discussed and their impact on shareholders analyzed; those two strategic decisions are the merger that created ConocoPhillips and the upcoming spin-off to create Phillips 66.

MERGER BETWEEN CONOCO AND PHILLIPS

There are many motives that a firm could have to complete a merger, and in a paper issued by the Federal Trade Commission titled *Evidence on Mergers and Acquisitions* by Pautler (2001), the author lists some motives that a company could have in making this strategic decision. Of them, the most common one is for the competing companies to come together to position themselves for a long term goal. This is the case of ConocoPhillips, whose merger, announced on November 19, 2001, was created to position them to better compete against other leading companies in their peer group consisting of ExxonMobil, Shell, Chevron, and BP. Another large factor in the decision to merge companies is efficiencies, which could involve cost-saving, utilizing less employees to accomplish the same thing, increase output, and combine research efforts of the companies. These efficiencies are difficult to create for a firm, and sometimes a merger is the only way to achieve them. An example of how the efficiencies could be passed onto consumers is found in the press release that announced the merger claimed that

cost savings would be passed onto consumers at the pumps as a result of the merger (CNN Money, 2001).

When ConocoPhillips, then Conoco, Inc. and Phillips Petroleum Company (two separate companies) announced the merger, that day Phillips Petroleum Company (the larger firm) stock rose 2.79% whereas the average gain for the three market indices was 1.36%, the integrated companies dropped 0.69%, and the independent group rose 0.01%. The announcement of the merger between these two companies was received well by the market and the increase in the stock price for the day reflects that. However, a one day gain is not enough to suit an investor. After one week (from November 19, 2001), Phillips shares rose 1.41%, whereas the benchmark gains were 0.32%, 1.77%, and 3.20% for the index, integrated, and independent benchmark, respectively. After one week, the return was not as good as other oil and gas companies, but still beat the market indices. One month from the announcement date, the stock price rose 8.43%, which is much better than before. It also has a better comparison when compared with the 1.11% of the market indices, 2.41% of the integrated group, and 8.76% of the independent group. And finally, after six months Phillips Petroleum Company's stock closed 13.38% above its price from a month before as compared to a loss of 3.36% for the index group, a 12.14% gain for the integrated group, and a 17.83% gain for the independent group. A more detailed breakdown can be found on Table 2: ConocoPhillips Merger Benchmark Analysis in the Appendix.

The returns for shareholders showed that if an investor were to buy the stock on the day of the announcement, the return after 6 months is 13.38% which is a great return for any investor. If an investor were to hold onto the stock until the merger was completed on August 30, 2002, their stock value would have dropped 1.44%. This is minimal when compared to a

loss of 21.87% of the indices, but comparable to a loss of 1.47% for integrated companies, and worse than a gain of 6.74% for the independent group. The time period that these returns fall under was the time of the internet bubble burst and stock market downturn. This demonstrates good value retention for the stock during a time where most of the market was taking huge hits.

CONOCOPHILLIPS SPIN-OFF

On July 14, 2011 ConocoPhillips announced that it was pursuing a plan to separate into two stand-alone publicly traded companies. Their plan was to spin-off the Refining and Marketing business into what would later be named Phillips 66 to create a pure-play independent refiner that would be one of the largest independent refiners in the US. This tax-free transaction was modeled to increase the businesses by allowing the refining and marketing business to be able to solely focus on their operations versus creating cash flow to go toward the \$15 billion capital expenditures that the exploration and production had, while allowing exploration and production to not use its profits to pay for refinery upgrades and operations.

There are many motivations for a company to spin-off their company. Most of the time it is the strategic decision to separate two different businesses that would perform better on their own and the market would better appreciate them separately. Some companies spin-off because they feel their company is undervalued with the extra subsidiary or part of their business that ends up being spun-off. Spinoff Advisors (2000), an independent research site, states that another motivation for a spin-off comes from the desire to separate a poor or underperforming business so that a good business can shine through to investors. ConocoPhillips tried to make the case for both companies being good businesses that would do well on their own, with the

belief that investors would benefit from more focused companies versus a diversified integrated company.

The day of the announcement for the spin-off, ConocoPhillips stock opened at \$80.11 (up 7.67% from the previous close) before closing the day down at \$75.61 (up 1.51% from previous close). This fluctuation was attributed to much speculation as to what would happen with some of ConocoPhillips assets that were not classified as exploration and production nor refining and marketing. Analysts wondered if ConocoPhillips desire was to cut out a large underperforming section of their portfolio. This belief came from the asset sale program that had put several refineries on the market in the months leading up to the announcement of the spin-off. During this time period, which included my ConocoPhillips internship, the attitude amongst the employees was one of confusion. Considerable time had passed before much was clear about what the spin-off would entail and the full effects of it. Since the spin-off has yet to occur, it is difficult to tell the full impact on shareholders and the value that this strategic decision would create. Table 2: ConocoPhillips Spin-Off Benchmark Analysis is located in the Appendix and shows the different companies and how the stock compared based on the day of the spin-off announcement, a week later, a month later, six months later, and market close April 9, 2012. ConocoPhillips stock underperformed in each of the benchmark groups on all dates except for the day of the announcement, outperformed all three benchmark groups, and on the close of market on April 9 when it outperformed only the integrated group. These results, while they could give an inclination of how the market perceives the spin-off, is also a result of a market downturn that occurred in August of 2011 and created market volatility for the remainder of the year, causing most stocks and indices to have significant decline. While most stocks had this problem, it is evident in the benchmark that some companies were better at maintaining value

during that time than others such as EOG Resources, one of the mid-size integrated exploration and production companies. EOG Resources experienced an 11.10% gain over the six month period that ConocoPhillips lost 0.74% on their stock price.

MARATHON OIL SPIN-OFF

On January 13, 2011 Marathon Oil announced its plans to spin-off its refining and marketing subsidiary, Marathon Petroleum, into a wholly owned independent company. On July 1, 2011 the spin-off was completed only thirteen days before ConocoPhillips announced their plan to spin-off. The close proximity of these two spin-offs, especially located in the same industry, allows for easy comparison for the kind of return ConocoPhillips shareholders could hope to see. Marathon Oil was a smaller company than ConocoPhillips, but the comparison between the two should be just as valid because both claimed its assets were undervalued and that the companies would perform better for shareholders as stand-alone entities.

On the day of the spin-off announcement, Marathon Oil outperformed all of the benchmark groups (ConocoPhillips placed in the integrated group for this analysis) with a gain of 5.53% compared with an indices group gain of 1.36%, while both the integrated and independent group dropped 0.60% and 1.08%, respectively. Similarly to ConocoPhillips's spin-off announcement, Marathon Oil was outperformed by all three benchmark groups for the one week after announcement date. Unlike ConocoPhillips; however, Marathon Oil far outperformed the benchmark groups at the one month mark and six month mark. One cause for the six month mark to be much higher than ConocoPhillips's mark after their announcement could be associated with how closely the date is to Marathon Oil's spin-off date. In the case of this analysis, the next day after the six month analysis point is the separation date. The 22.57%

gain over the January 13, 2011 close price could be attributed to shareholders getting prepared for the spin-off that occurs the next day of trading. More information on the benchmark analysis is located in the appendix under Table 4: Marathon Oil Performance Announcement to Spin-Off.

On the next day, Marathon's stock drops 59.28% to level out to the new price after the spin-off. On the same day, Marathon Petroleum, the spun-off company, gained 1.94%. The set-up of the spin-off was for every two shares of Marathon Oil, you received one share of Marathon Petroleum. Shareholders then have a choice of whether or not they sell one and keep the other, or keep both and see how the stocks perform. *Predictability of Long-Term Spinoff Returns* (McConnell and Ovtchinnikov, 2004), a paper by students at Purdue University, states that the long-term return of parent companies after a spin-off produce largely positive, yet "economically insignificant returns." The main return that McConnell and Ovtchinnikov (2004) assert is from investing in the newly formed company after a spin-off, stating that in the past several decades it has largely outperformed the market and their benchmark tests. It is important then for investors to see how Marathon Oil and Marathon Petroleum produce returns after the spin-off.

If one were to purchase two shares of Marathon Oil on the day of the announcement of the spin-off, one would have \$85.96 invested. If one held onto these stocks until the spin-off was completed, one would have \$108.10 (32.95×2 original shares + 42.20 new share of MPC); this would be a 25.76% return for the investment over a six month time frame. If one held onto the stock for another six months, the return would have been \$91.83 ($58.54 + 33.29$) for a return of 6.83% for the year. If one were to continue holding onto the stock until April 9, 2012, one could sell the shares for \$102.74 ($60.28 + 42.46$) for a gain of 19.52%, which is a good gain for investors. Looking through this information; however, if one is only investing to get a quick reward from the spin-off, then selling shortly after the spin-off would provide a good return, or

holding onto the stocks for the long term and enjoying the returns over the course of several years. The full results of how Marathon Oil and Marathon Petroleum performed against the benchmark groups can be found in Table 5: Marathon Oil Performance After Spinoff in the Appendix.

ConocoPhillips shareholders are hoping for a 20% return from their upcoming spin-off, and if theirs is to perform anything near Marathon Oil's spin-off, they are justly expecting such a payoff. Marathon Oil started a trend among oil companies that allowed ConocoPhillips to follow suit in their plans to create shareholder value and maintain their long-term strategic course. Since ConocoPhillips's spin-off announcement, BP discussed the possibility of spinning off, and analysts enjoyed the opportunity to see how much value could be unlocked for BP through their spin-off. If ConocoPhillips's spin-off proves to be as successful as Marathon's, then we could see more large integrated companies choose this option as a way to unlock value for their shareholders, and maximize the capabilities of their business through being more specialized.

CONCLUSION

ConocoPhillips's strategic decisions continue to create value for shareholders, some of their strategic decisions in the past few years include stock repurchase, acquisitions, asset disposition, re-financing debt, and ultimately their spin-off into two leading energy companies. ConocoPhillips dedication to creating value for their shareholders should pay off for those who hold ConocoPhillips stock when the spin-off is expected to occur in the second quarter of 2012, sometime around May 1. Until that time, investors can analyze the returns that Marathon Oil had for their spin-off and hope that theirs will be able to compare when the spin-off occurs.

APPENDIX

Table 1: List of Benchmark Companies

Company	Stock Ticker	Category	Stock Price*	Market Value*
ConocoPhillips	COP	Focus Company	75.05	96.04B
ExxonMobil	XOM	Integrated	83.88	395.34B
Royal Dutch Shell	RDS-B	Integrated	69.28	215.46B
BP	BP	Integrated	43.26	136.83B
Chevron	CVX	Integrated	103.49	204.60B
Marathon Oil	MRO	Independent	30.14	21.22B
Marathon Petroleum	MPC	Independent Refining Company	42.46	14.76B
Occidental Petroleum	OXY	Independent	91.38	74.11B
Apache	APA	Independent	94.58	36.35B
EOG Resources	EOG	Independent	107.44	28.91B
Anadarko Petroleum	APC	Independent	75.83	37.80B

*Based on close of market on April 9, 2012 from Yahoo! Finance

Table 2: ConocoPhillips Merger Benchmark Analysis

Benchmark	19-Nov-01	26-Nov-01	19-Dec-01	17-May-02	30-Aug-02
ConocoPhillips	2.79%	1.41%	8.43%	13.38%	-1.44%
NASDAQ	1.87%	0.35%	2.51%	-9.98%	-32.03%
S&P500	1.09%	0.55%	-0.13%	-3.86%	-20.42%
DJIA	1.11%	0.06%	0.94%	3.78%	-13.16%
Indice Mean	1.36%	0.32%	1.11%	-3.36%	-21.87%
ExxonMobil	-1.42%	2.05%	3.62%	8.62%	-4.22%
Shell	-0.37%	1.76%	-2.37%	13.46%	-1.02%
BP	-0.32%	0.50%	2.83%	18.94%	6.95%
Chevron	-0.65%	2.76%	5.54%	7.53%	-7.57%
Integrated Mean	-0.69%	1.77%	2.41%	12.14%	-1.47%
Marathon Oil	-0.38%	4.88%	8.58%	9.31%	-4.81%
Occidental	-0.58%	3.65%	6.83%	25.31%	24.48%
Apache	0.16%	1.13%	11.89%	23.62%	21.87%
EOG Resources	0.06%	5.65%	14.78%	29.47%	6.38%
Anadarko	0.77%	0.67%	1.73%	1.42%	-14.24%
Independent Mean	0.01%	3.20%	8.76%	17.83%	6.74%

Figure 1: ConocoPhillips Merger Graph

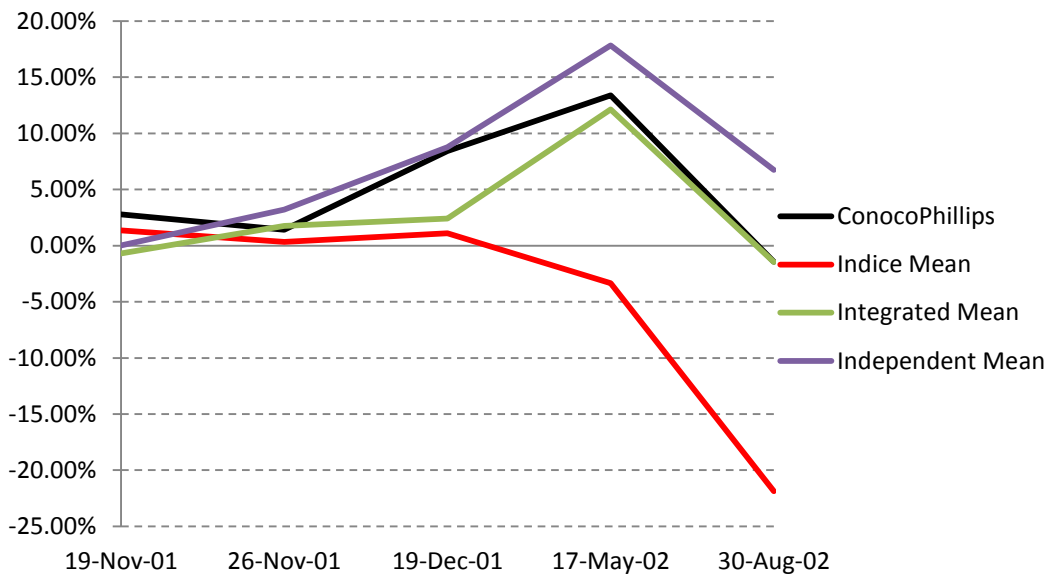


Table 3: ConocoPhillips Spin-off Benchmark Analysis

Benchmark	7/14/2011	7/21/2011	8/12/2011	1/13/2012	4/10/2012
ConocoPhillips	1.51%	0.26%	-12.64%	-6.97%	-0.74%
NASDAQ	1.87%	2.60%	-9.22%	-1.88%	10.29%
S&P 500	1.09%	2.67%	-9.94%	-1.51%	5.60%
DJIA	1.11%	2.31%	-9.39%	-0.12%	3.96%
Indice Mean	1.36%	2.53%	-9.52%	-1.17%	6.62%
ExxonMobil	-0.29%	3.38%	-12.45%	3.21%	1.99%
Shell	0.10%	4.19%	-8.33%	0.18%	-3.64%
BP	1.34%	3.83%	-9.40%	-1.29%	-2.44%
Chevron	-0.40%	4.55%	-8.42%	1.36%	-1.13%
Integrated Mean	0.19%	3.99%	-9.65%	0.87%	-1.30%
Marathon Oil	-1.29%	2.20%	-14.86%	-2.65%	32.46%
Occidental	0.38%	4.57%	-17.65%	-5.55%	-11.59%
Apache	-1.16%	6.93%	-13.94%	-22.57%	-21.12%
EOG Resources	-2.24%	9.15%	-2.65%	6.55%	11.10%
Anadarko	-0.08%	8.49%	-6.51%	1.71%	-1.13%
Independent Mean	-0.88%	6.27%	-11.12%	-4.50%	1.94%

Figure 2: ConocoPhillips Spin-off Graph

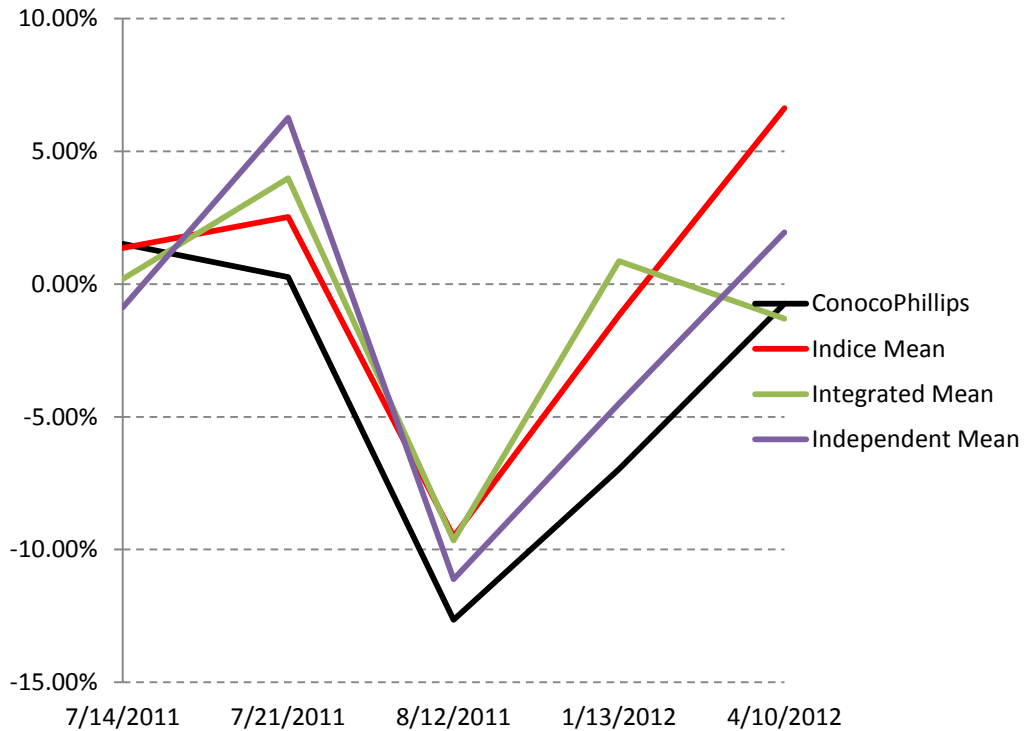


Table 4: Marathon Oil Performance Announcement to Spin-Off

Benchmark	1/13/2011	1/20/2011	2/11/2011	6/30/2011
Marathon Oil	5.53%	-2.63%	8.14%	22.57%
NASDAQ	1.87%	-1.13%	2.71%	1.40%
S&P 500	1.09%	-0.27%	3.54%	2.87%
DJIA	1.11%	0.77%	4.61%	5.82%
Indice Mean	1.36%	-0.21%	3.62%	3.36%
ConocoPhillips	-2.09%	-0.07%	6.42%	11.79%
ExxonMobil	0.17%	1.36%	7.97%	6.09%
Shell	-0.46%	0.64%	1.56%	6.42%
BP	-0.31%	0.06%	-3.66%	-6.84%
Chevron	-0.29%	0.57%	4.63%	11.56%
Integrated Mean	-0.60%	0.51%	3.38%	5.81%
Occidental	-1.10%	-0.01%	3.44%	7.90%
Apache	-0.80%	-0.81%	-4.35%	-1.43%
EOG Resources	-0.64%	3.58%	5.56%	6.84%
Anadarko	-1.76%	-1.05%	1.75%	-0.49%
Independent Mean	-1.08%	0.43%	1.60%	3.20%

Figure 3: Marathon Oil Spin-Off After Announcement

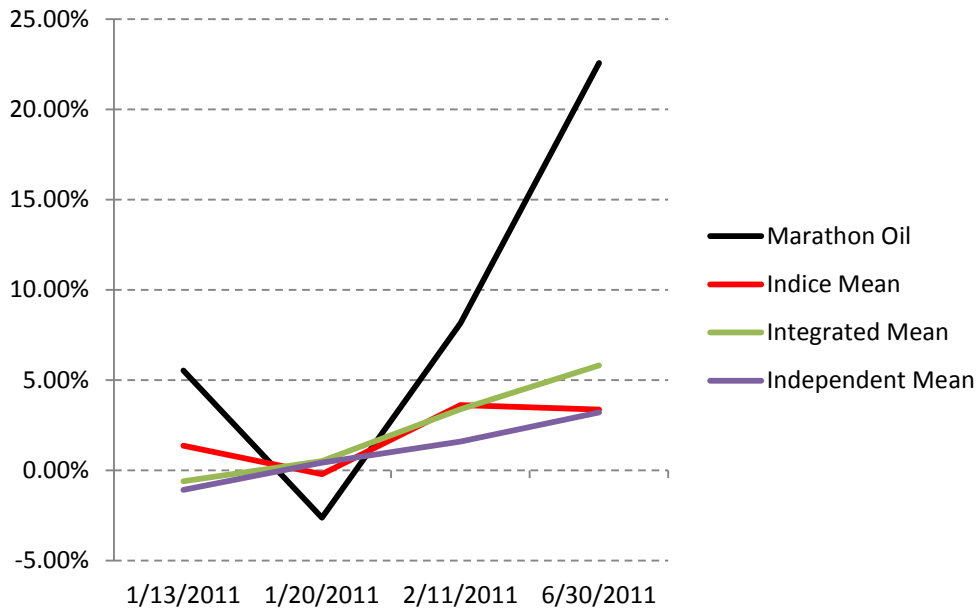
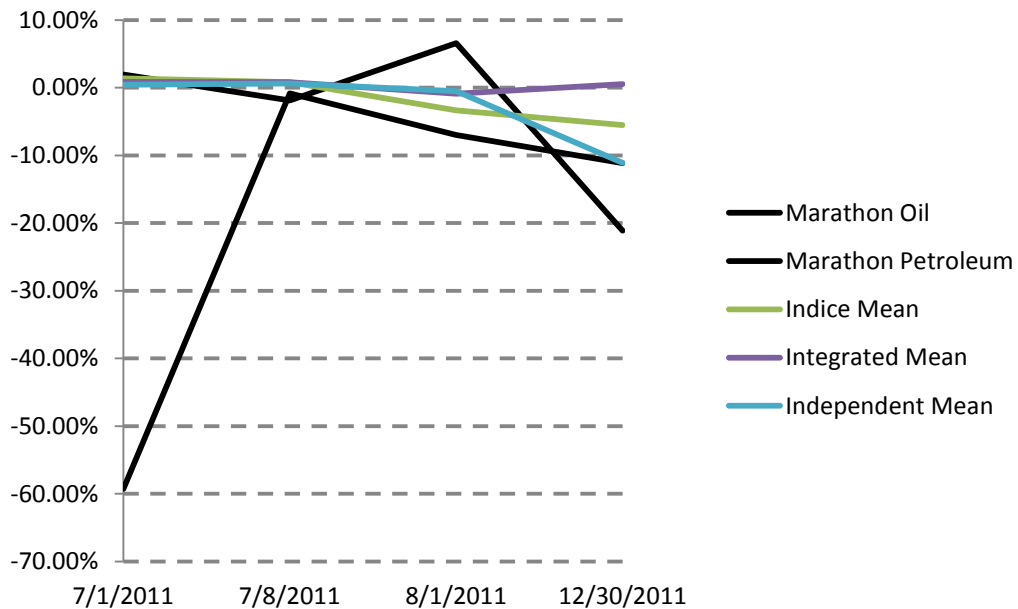


Table 5: Marathon Oil Performance After Spin-Off

Benchmark	7/1/2011	7/8/2011	8/1/2011	12/30/2011
Marathon Oil	-59.28%	-0.85%	-7.01%	-11.17%
Marathon Petroleum	1.94%	-1.87%	6.56%	-21.11%
NASDAQ	1.87%	1.55%	-2.54%	-7.49%
S&P 500	1.09%	0.31%	-3.94%	-6.13%
DJIA	1.11%	0.59%	-3.58%	-2.90%
Indice Mean	1.36%	0.82%	-3.35%	-5.51%
ConocoPhillips	0.92%	0.04%	-5.13%	-3.97%
ExxonMobil	0.78%	0.50%	-2.94%	3.35%
Shell	0.61%	2.09%	1.15%	5.29%
BP	0.75%	-0.25%	1.14%	-4.21%
Chevron	1.22%	1.73%	1.24%	2.22%
Integrated Mean	0.86%	0.82%	-0.91%	0.54%
Occidental	1.42%	0.71%	-7.34%	-11.20%
Apache	0.28%	1.12%	0.26%	-26.80%
EOG Resources	-1.41%	-1.13%	-1.42%	-4.43%
Anadarko	1.50%	1.84%	6.35%	-2.03%
Independent Mean	0.45%	0.64%	-0.53%	-11.12%

Figure 4: MRO and MPC Performance After Spin-Off



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