BP (BP)

Updated May 19th, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	$47	**5 Year CAGR Estimate:**	9.9%	**Quality Percentile:**	N/A
Fair Value Price:	$42	**5 Year Growth Estimate:**	7.0%	**Momentum Percentile:**	N/A
% Fair Value:	112%	**5 Year Valuation Multiple Estimate:**	-2.2%	**Total Return Percentile:**	N/A
Dividend Yield:	5.1%	**5 Year Price Target**	$59	**Valuation Percentile:**	N/A

Overview & Current Events

BP is the fifth-largest oil and gas company in the world, with a market cap of $157 B. It is a fully integrated company and operates in two segments: upstream and downstream (mostly refining). BP has gone through extreme challenges since its major accident in 2010. It has paid $62 B for this accident so far. Even worse, when the oil giant began to recover in 2014, the price of oil collapsed, and oil producers incurred a fierce downturn which persisted until recently.

However, the worse is behind the BP. Thanks to the efforts of OPEC and Russia and the investment cuts of the big oil producers, the supply glut in the oil market has disappeared and the price of oil has enjoyed a strong rally since last summer. As a result, oil prices are now standing at a 3.5-year high. Even better, OPEC and Russia seem determined to continue to support it for the foreseeable future, particularly given the upcoming IPO of Saudi Aramco.

In addition, after years of lackluster performance due to the above headwinds, BP has returned to a solid growth trajectory. It increased its output by 10% last year and expects to grow it by 5% per year for at least the next four years. It launched 7 major oil and gas fields last year, more than in any other year in its history, and also expects to start another 6 major projects this year. In this way, the company expects to restore its output to 4.0 M barrels/day, the same as before its accident in the Gulf of Mexico and much higher than the 3.0 M barrels/day it was producing in the aftermath of the accident due to its unprecedented asset sales.

The great improvement in the prospects of BP was evident in its latest results. BP grew its output by 6% in Q1 over last year. Even better, a 10% increase in the average price of Brent, from $61 in Q4 to $67 in Q1, boosted the operating income of the upstream segment of BP by 45% and its total earnings by 24%, from $2.1 B to $2.6 B. This shows how leveraged to the oil price the company is. Now that Brent has remained in rally mode and has approached $80, the company will enjoy even further growth in its earnings. Moreover, BP drastically reduced its operating expenses in the recent downturn and now invests only in projects that are profitable even below $40 per barrel. As a result, the oil major has reduced its breakeven point to $50 and expects to further reduce it to $35-$40 by 2021. The company is poised to enjoy greater earnings at a given oil price compared to a few years ago.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$8.17	$4.47	-$1.18	$8.06	$5.56	$4.26	$3.96	-$1.22	$0.04	$1.03	***$3.30***	***$4.63***
DPS	$3.30	$3.36	$0.84	$1.68	$1.98	$2.19	$2.34	$2.40	$2.40	$2.40	***$2.40***	***$2.80***

Thanks to the production growth of BP and the rally of oil prices, analysts expect BP's EPS to rise to about $3.00 this year. However, BP has exceeded the analysts' estimates by 14%-17% for four consecutive quarters, as the analysts did not adjust their estimates properly for the rally of the oil price. Moreover, even if the EPS of BP remained flat at $0.78 (their Q1 level) per quarter for the rest of the year, the company would earn $3.04 this year. Therefore, as oil has posted an impressive rally since Q1, it is only natural to expect BP to earn at least $3.30 this year, which would exceed the analysts' current estimate by just 10%.

As BP is likely to grow its output by about 5% per year in the upcoming years and the price of oil is likely to remain strong, the oil major is likely to grow its EPS by at least 7.0% per year over the next five years. If this growth rate materializes, BP will grow its EPS from $3.30 this year to $4.63 in 2023.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	7.3	10.9	---	5.4	7.6	10.1	11.8	---	---	35.5	***14.2***	***12.7***
Avg. Yld.	5.5%	6.9%	1.9%	3.9%	4.7%	5.1%	5.0%	6.4%	7.3%	6.6%	***5.1%***	***4.7%***

BP is now trading at a P/E ratio of 14.2, which is higher than its 10-year average P/E of 12.7. As the current upcycle of its business proceeds, it is only natural to expect the stock to revert towards its average valuation level. If this occurs within the next five years, the stock will incur a 2.2% annualized drag due to the contraction of its P/E ratio over this period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	28.2%	21.5%	-0.4%	15.5%	8.9%	9.6%	7.9%	0.9%	8.0%	12.5%	***17.0%***	***20.0%***
Debt/A	59.6%	56.7%	64.8%	61.6%	60.1%	57.3%	60.4%	62.4%	63.2%	63.7%	***63.6%***	***62.0%***
Int. Cov.	162.9	51.4	-2.2	30.7	17.5	26.1	6.6	-4.8	-0.8	4.3	***8.0***	***12.0***
Payout	40.4%	75.2%	N/A	20.8%	35.6%	51.4%	47.2%	N/A	NMF	233%	***72.7%***	***60.5%***
Std. Dev.	32.8%	30.7%	53.0%	27.3%	18.9%	15.4%	17.8%	29.9%	19.2%	16.1%	***18.2%***	***19.0%***

BP is currently offering a 5.1% dividend yield, which is much higher than the 4.0% yield of Exxon Mobil and the 3.5% yield of Chevron. In addition, its management is one of the most shareholder-friendly managements investors can hope for. Even when BP was forced to suspend its dividend after its Macondo blowout amid public outrage, it resumed its dividend payments just three quarters after the accident. Moreover, even in the last three years, in which the company incurred losses in total, it continued to pay its hefty dividend, which amounted to about $6 B per year. In other words, the management will do its best to maximize its distributions even under the most adverse business conditions. Therefore, income-oriented investors should consider purchasing this stock. It is also worth noting that the company is likely to raise its dividend in the upcoming quarters thanks to its bright prospects, after having paid the same dividend for 15 consecutive quarters.

Final Thoughts & Recommendation

After having incurred two fierce downturns, its accident in the Gulf of Mexico and the collapse of oil prices since 2014, BP has returned to growth. It is growing its output at a fast pace while it greatly benefits from the strength in oil prices. The stock is likely to offer a ~10% average annual return over the next five years thanks to 7% annual EPS growth and its ~5% dividend yield, which will be partly offset by a ~2% annualized P/E contraction. BP is a solid hold at current prices and could still be a buy for income oriented investors. This stock is a buy when trading at or below fair value.

Total Return Breakdown by Year