BP (BP)

Updated July 31st, 2018 by Ben Reynolds

Key Metrics

Current Price:	$45	**5 Year CAGR Estimate:**	10.9%	**Volatility Percentile:**	58.1%
Fair Value Price:	$42	**5 Year Growth Estimate:**	7.0%	**Momentum Percentile:**	86.7%
% Fair Value:	108%	**5 Year Valuation Multiple Estimate:**	-1.5%	**Valuation Percentile:**	46.8%
Dividend Yield:	5.4%	**5 Year Price Target**	$59	**Total Return Percentile:**	74.2%

Overview & Current Events

BP is one of the largest oil corporations in the world based on its $149 billion market cap. 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 billion 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 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. Even better, OPEC and Russia seem determined to continue to support it for the foreseeable future, particularly given the upcoming IPO of Saudi Aramco.

BP posted 2nd quarter results for fiscal 2018 on July 31st. BP posted fantastic results thanks in large part to significantly higher oil prices. Adjusted profit per US share increase from $0.21 to in the 2nd quarter of 2017 to $0.85 in the 2nd quarter of 2018. Also, the company announced its *first dividend increase* since 2014, a modest 2.5% bump. Strong growth was expected at BP this quarter, so we are maintaining our fiscal 2018 earnings-per-share (EPS) estimate.

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	***$2.43***	***$2.80***

After years of lackluster performance due to the aforementioned 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, 3 of which are already online. 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.

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.

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. Indeed, BP has some of the strongest growth prospects of the major integrated oil and gas corporations.

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	***13.7***	***12.7***
Avg. Yld.	5.5%	6.9%	1.9%	3.9%	4.7%	5.1%	5.0%	6.4%	7.3%	6.6%	***5.4%***	***4.7%***

BP is now trading at a P/E ratio of 13.7, 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 1.5% 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%	*73.6%*	*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 5.4% 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 very shareholder friendly. Even when BP was forced to suspend its dividend after its Macondo blowout amid public outrage, it resumed its dividend payments after just three quarters. Moreover, even in the last three years, in which the company incurred losses, it continued to pay its dividend, which amounted to about $6 B per year. The dividend appears to be a priority for BP's management team.

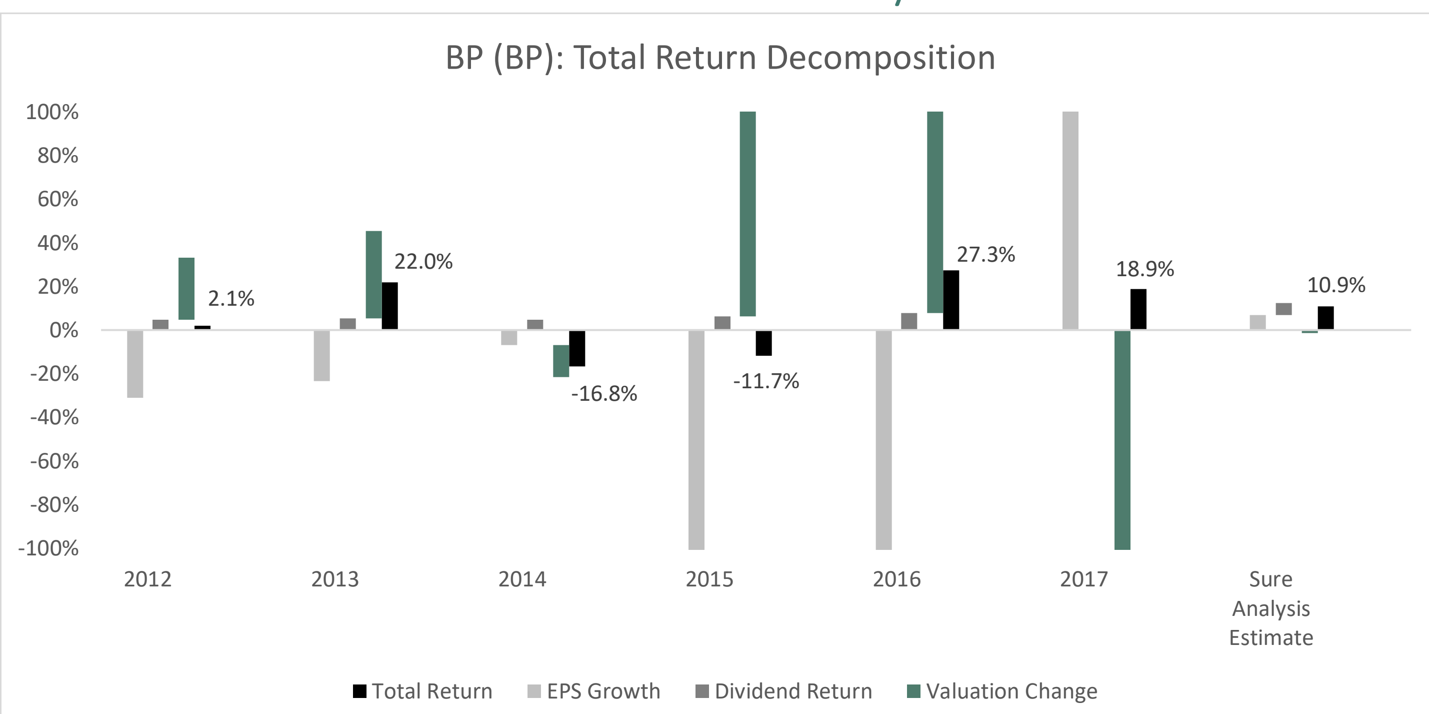
Final Thoughts & Recommendation

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 10.9% average annual return over the next five years thanks to 7% annual EPS growth and its 5.4% dividend yield, which will be partly offset by a -1.5% annualized P/E contraction.

While BP's management will do everything in their power to continue paying dividends, another protracted bout of low oil prices would likely cause a dividend cut for BP shareholders as the company's financial position still has not recovered from the Gulf of Mexico disaster and low oil prices from 2014 onward. In the final analysis, BP is riskier than a high quality non-cyclical, but it has proven how important maintaining its dividend is. It is certainly a hold, and possibly a buy at current prices for income-oriented investors looking for exposure to the energy sector.

Total Return Breakdown by Year



Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.