BP (BP)

Updated May 5th, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	$23	**5 Year CAGR Estimate:**	16.6%	**Market Cap:**	$75.2 B
Fair Value Price:	$24	**5 Year Growth Estimate:**	9.0%	**Ex-Dividend Date:**	5/8/2020
% Fair Value:	96%	**5 Year Valuation Multiple Estimate:**	0.9%	**Dividend Payment Date:**	6/19/2020
Dividend Yield:	11.0%	**5 Year Price Target**	$37	**Years Of Dividend Growth:**	3
Dividend Risk Score:	F	**Retirement Suitability Score:**	D	**Last Dividend Increase:**	2.4%

Overview & Current Events

BP is one of the largest oil and gas corporations in the world based on its $75.2 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 $67 billion for this accident so far. This amount is almost equal to all its earnings since. Even in 2019, nine years after the accident, BP paid $2.4 billion (24% of its earnings) for it. The company expects to pay less than $1.0 billion for that accident this year. 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 2017.

BP has greatly improved its portfolio via the addition of low-cost reserves and has markedly increased its production in recent years. However, the oil major is now facing a perfect storm due to the coronavirus, which has caused a collapse in the global demand for oil and refined products.

In late April, BP reported (4/28/20) financial results for the first quarter of fiscal 2020. BP incurred a -67% plunge in its earnings over last year's quarter due to a steep decrease in the prices of oil and gas, lower profits from trading and lower refining margins. Investors should note that benchmark European refining margins are currently negative and hence they are much worse than U.S. refining margins due to the wide discount of WTI to Brent. Due to the collapse in commodity prices, we now expect BP to earn only $0.40 per share this year.

In contrast to Royal Dutch Shell, which cut its dividend by -66%, BP maintained its dividend in this quarter. However, as BP has paid much higher dividends than its earnings in the last five years and has been caught with high debt load in the fierce downturn, it will cut its dividend if the pandemic lasts longer than expected. On the bright side, BP intends to reduce the cash breakeven point below a Brent price of $35 by next year via fine grading of portfolio and cost-cutting.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	-$1.18	$8.06	$5.56	$4.26	$3.96	-$1.22	$0.04	$1.03	$3.71	$2.95	***$0.40***	***$3.08***
DPS	$0.84	$1.68	$1.98	$2.19	$2.34	$2.40	$2.40	$2.40	$2.43	$2.46	***$2.52***	***$2.52***
Shares[1]	3132.8	3162.9	3186.6	3101.9	3033.3	3068.7	3239.2	3302.9	3350.3	3392	***3390***	***3400***

We view the collapse in the demand for oil as temporary and expect the energy market to begin to recover from next year. BP has solid long-term growth prospects. It grew its output by 10% in 2017, 8% in 2018 and 4% in 2019. Since 2016, it has brought 23 major projects online and has another 12 major projects in its pipeline. Thanks to the ramp-up in projects, the company can add 0.9 million barrels per day to its production base from 2018 when the energy market recovers. The new reserves have 35% greater cash margins and 20% lower development cost than base reserves.

Moreover, BP drastically reduced its operating expenses in the previous downturn and now invests only in projects that are profitable below $40 per barrel. To estimate its 5-year return potential, we have used mid-cycle earnings-per-share of $2.00, which is almost equal to the 4-year average. As we expect the oil price to rebound from next year, we expect BP to grow its earnings-per-share at a 9.0% average annual rate over the next five years off its mid-cycle level.

[1] In millions.

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Avg. P/E	---	5.4	7.6	10.1	11.8	---	---	35.5	11.5	13.6	***11.5***	***12.0***
Avg. Yld.	1.9%	3.9%	4.7%	5.1%	5.0%	6.4%	7.3%	6.6%	5.7%	6.1%	***11.0%***	***6.8%***

Excluding the outlier year 2017, in which the depressed earnings resulted in an abnormally high price-to-earnings ratio, BP has traded at an average price-to-earnings ratio of 10.0 during the last decade. The stock has traded at such a cheap valuation mostly due to the excessive liabilities that resulted from its accident in 2010. We believe that a fair earnings multiple for the stock is around 12.0. BP is now trading at 11.5 times its mid-cycle earnings. If the stock reaches our assumed fair price-to-earnings of 12.0, it will enjoy a mild 0.9% annualized gain thanks to the expansion of its valuation.

Safety, Quality, Competitive Advantage, & Recession Resiliency

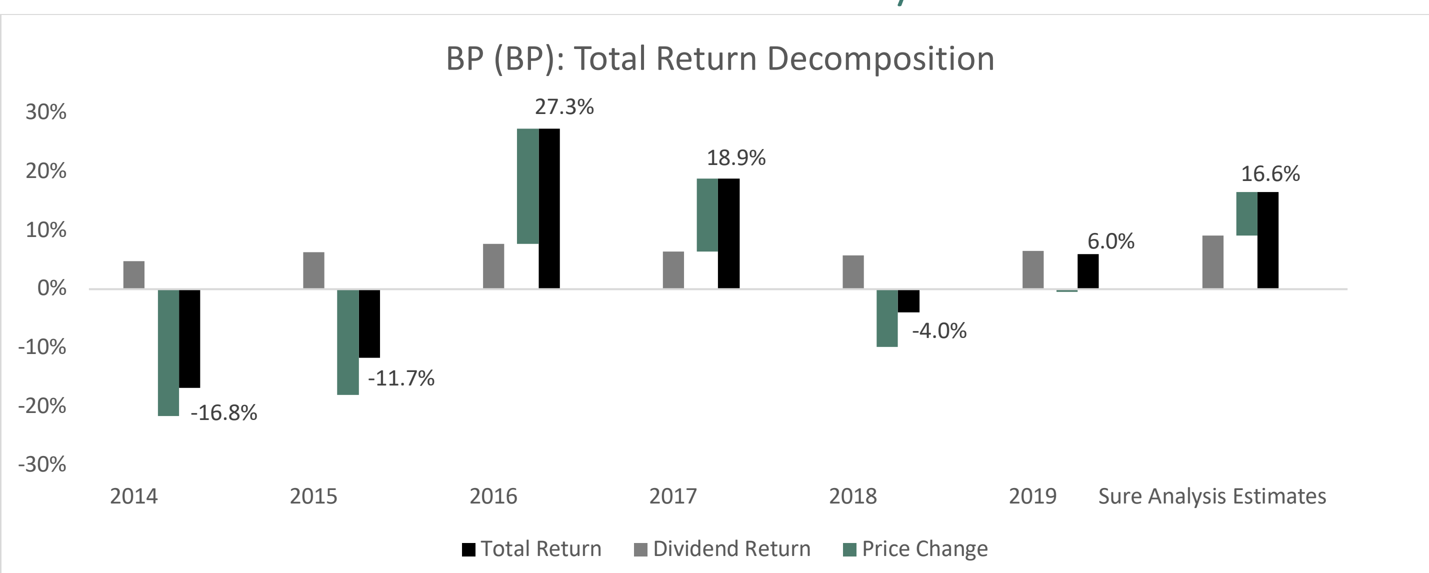
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	20.8%	35.6%	51.4%	47.2%	---	---	233%	65.5%	83.4%	***126%***	***81.9%***

BP is currently offering an 11.0% dividend yield, which is much higher than the 7.8% yield of Exxon Mobil and the 5.6% 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 during 2015-2017, when the company incurred aggregate losses, it continued to pay its dividend, which amounted to about $6 billion per year. The dividend is clearly a top priority for BP's management team. On the other hand, if the energy market does not begin to recover from next quarter, the dividend is likely to come under pressure.

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 is now facing the fiercest downturn in the energy market history due to the pandemic. As a result, the stock is trading near a 20-year low. As BP has greatly improved its portfolio with low-cost reserves and we expect the energy market to begin to recover from next year, BP has become markedly attractive. We expect BP to offer a 16.6% average annual return over the next five years and thus we rate it as a buy but investors should note that patience is required.

Total Return Breakdown by Year



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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.

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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue ($B)	297.11	375.52	375.77	379.14	353.57	222.89	183.01	240.21	298.76	278.4
Gross Profit	-127	46339	28220	32701	26165	4809	6524	18904	28880	27,583
Gross Margin	0.0%	12.3%	7.5%	8.6%	7.4%	2.2%	3.6%	7.9%	9.7%	9.9%
SG&A Exp.	12555	13958	13357	13070	12266	11553	10495	10508	12179	11,057
D&A Exp.	11164	11135	12687	13510	15163	15219	14505	15584	16542	18,411
Operating Profit	-12744	32285	15491	18900	13881	-6883	-4095	8288	15256	15,562
Op. Margin	-4.3%	8.6%	4.1%	5.0%	3.9%	-3.1%	-2.2%	3.5%	5.1%	5.6%
Net Profit	-3719	25700	11017	23451	3780	-6482	115	3389	9383	4,026
Net Margin	-1.3%	6.8%	2.9%	6.2%	1.1%	-2.9%	0.1%	1.4%	3.1%	1.4%
Free Cash Flow	-4805	4309	-2743	-3420	10208	485	-6010	2369	6166	10,352
Income Tax	-1501	12737	6880	6463	947	-3171	-2467	3712	7145	3,964

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets ($B)	272.26	293.07	300.47	305.69	284.31	261.83	263.32	276.52	282.18	295.2
Cash & Equivalents	18556	14067	18091	20894	27499	26389	23484	25586	22468	22,472
Acc. Receivable	36549	27929	26485	28868	19671	13682	13393	18912	24478	24,442
Inventories	26218	25661	28203	29231	18373	14142	17655	19011	17988	20,880
Goodwill & Int.	22896	13315	13388	13355	13431	13001	12417	12880	29488	27,407
Total Liab. ($B)	176.37	180.59	180.71	175.28	171.66	163.45	166.47	176.11	180.63	194.5
Accounts Payable	46329	29830	29920	28926	23074	16838	21575	26983	46265	46,829
Long-Term Debt	45336	43521	48416	47657	52071	52465	57666	62574	65799	67,724
Total Equity ($B)	94.99	111.47	118.53	129.28	111.42	97.20	95.27	98.47	99.44	98,412
D/E Ratio	0.48	0.39	0.41	0.37	0.47	0.54	0.61	0.64	0.66	0.69

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	-1.5%	9.1%	3.7%	7.7%	1.3%	-2.4%	0.0%	1.3%	3.4%	1.4%
Return on Equity	-3.8%	24.9%	9.6%	18.9%	3.1%	-6.2%	0.1%	3.5%	9.5%	4.1%
ROIC	-2.7%	17.3%	6.8%	13.5%	2.2%	-4.1%	0.1%	2.1%	5.7%	2.4%
Shares Out.	3132.8	3162.9	3186.6	3101.9	3033.3	3068.7	3239.2	3302.9	3350.3	3392
Revenue/Share	93.83	117.74	117.68	119.44	114.69	72.99	58.24	72.73	89.17	81.88
FCF/Share	-1.52	1.35	-0.86	-1.08	3.31	0.16	-1.91	0.72	1.84	3.04

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.