BP (BP)

Updated October 29th, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	$15	**5 Year CAGR Estimate:**	19.2%	**Market Cap:**	$51.7 B
Fair Value Price:	$24	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date:**	11/5/2020
% Fair Value:	63%	**5 Year Valuation Multiple Estimate:**	9.9%	**Dividend Payment Date:**	12/18/2020
Dividend Yield:	8.4%[1]	**5 Year Price Target**	$29	**Years Of Dividend Growth:**	0
Dividend Risk Score:	F	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	N/A

Overview & Current Events

BP is one of the largest oil and gas corporations in the world based on its $51.7 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 about $70 billion for that 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 $1.5 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 pandemic, which has caused a collapse in the global demand for oil and refined products.

In late October, BP reported (10/27/20) financial results for the third quarter of fiscal 2020. Due to the collapse in the demand for oil products, BP reduced its production by -6.4% over last year's quarter. Oil prices remained suppressed but improved sequentially while refining margins remained at historical lows but the fuels marketing segment improved its performance. As a result, BP switched from a loss of -$6.7 billion in the previous quarter to a marginal profit of $0.1 billion. Due to the downturn in its business and its weak balance sheet, BP cut its quarterly dividend by -50% this year. The demand for oil products has recovered since the second quarter but it has stalled lately, primarily due to partial lockdowns worldwide that have resulted from a second wave of the pandemic.

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	***-$1.00***	***$2.43***
DPS	$0.84	$1.68	$1.98	$2.19	$2.34	$2.40	$2.40	$2.40	$2.43	$2.46	***$1.89***	***$1.46***
Shares[2]	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 products as temporary and expect the energy market to begin to recover from next year. BP 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. However, it recently announced a major shift in its strategy. BP will boost its investment in renewable energy sources 10-fold and it will simultaneously reduce its investment in oil and gas projects so much that it expects to reduce its oil and gas production by 42% over the next decade, from 2.6 million barrels per day now to 1.5 million barrels per day in 2030. This historical strategic shift from its core business has greatly raised the uncertainty of future performance of BP and has thus led the stock to a 25-year low. A shift from the core business is always a red flag for any stock, particularly for BP, which has always been infamous for its aversion of renewable energy projects. Due to high uncertainty, we now expect BP to grow its earnings-per-share at a 4.0% (instead of 9.0%) average annual rate over the next five years off its mid-cycle level (4-year average) of $2.00.

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[1] Forward dividend yield.

[2] 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	***7.5***	***12.0***
Avg. Yld.	1.9%	3.9%	4.7%	5.1%	5.0%	6.4%	7.3%	6.6%	5.7%	6.1%	***8.4%***	***5.0%***

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 a price-to-earnings ratio of 7.5. If it reaches our assumed fair valuation level over the next five years, it will enjoy a 9.9% annualized gain in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

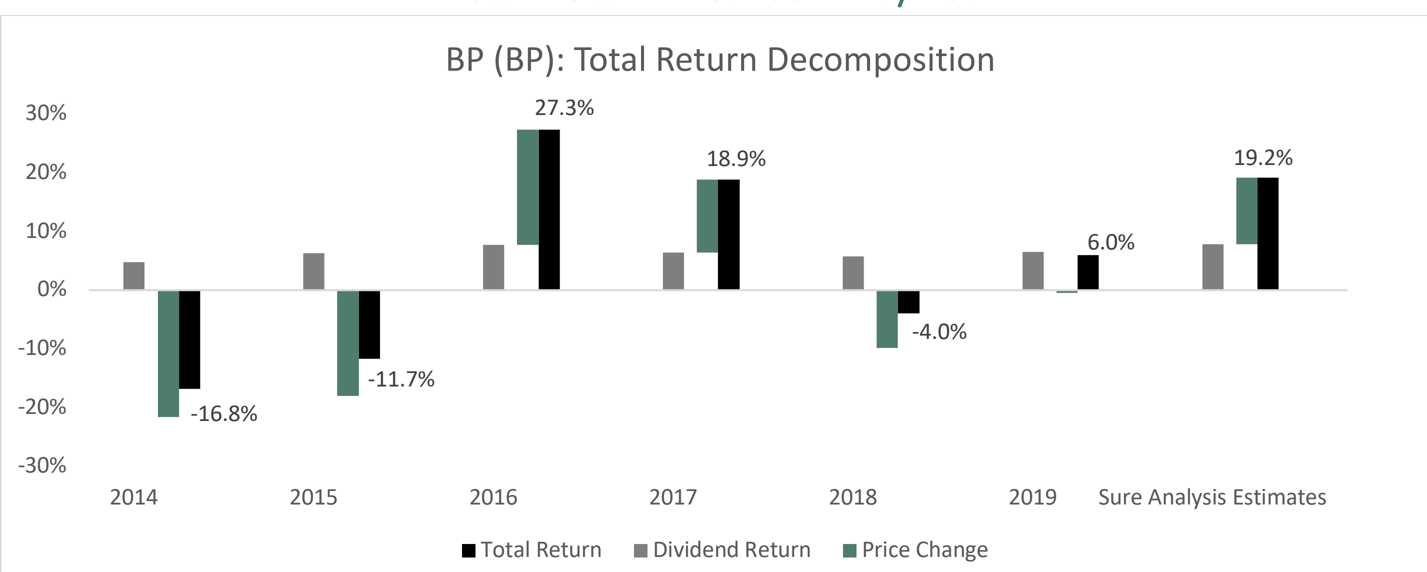
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	20.8%	35.6%	51.4%	47.2%	---	---	233%	65.5%	83.4%	***63.0%***	***60.0%***

After several years of a superior dividend yield, BP recently cut its dividend. Nevertheless, the management of BP 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, 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, but the recent cut was warranted due to the debt load of the company. We view the current 8.4% dividend as safe in the absence of a prolonged pandemic.

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. Given also the recent shift of BP from oil and gas to renewable energy, the stock has plunged to a 25-year low. We expect the energy market to begin to recover from next year and view BP as attractive. We expect BP to offer a 19.2% average annual return over the next five years and thus maintain our buy rating, but investors should note that great 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.