lower debt buyback costs compared with 2003 offset by the inclusion of a full year's equity accounted interest for the TNK-BP joint venture. The charge in 2003 reflects lower interest rates and lower debt compared with 2002.

Other finance expense includes net pension finance costs, the interest accretion on provisions and interest accretion on the deferred consideration for the acquisition of investment in TNK-BP. Other finance expense in 2004 was $357 million compared with $547 million in 2003 and $73 million in 2002. The decrease in 2004 compared with 2003 primarily reflects a reduction in net pension finance costs partly offset by a revaluation of environmental and other provisions at a lower discount rate and the inclusion of a full year's charge for interest accretion on the deferred consideration for the investment in TNK-BP. The increase in 2003 compared with 2002 reflects an increase in net pension finance costs.

**Taxation**

The charge for corporate taxes in 2004 was $8,282 million, compared with $6,111 million in 2003 and $4,317 million in 2002. The effective rate was 34% in 2004, 36% in 2003 and 39% in 2002. The lower rate in 2004 compared with 2003 reflects the significantly higher inventory holding gain in 2004 as well as the low tax charge on the exceptional gains reported in 2004. The lower rate in 2003 compared with 2002 reflects tax restructuring benefits in 2003, as well as the rateably lower impact of goodwill amortization and depreciation on uplifted asset values (for which no tax deduction is available) on higher income in 2003. The tax rate in 2002 additionally reflected the inclusion of a $355 million charge to increase the North Sea deferred tax provision for the supplementary UK tax, and these combined effects more than offset the impact of higher inventory holding gains in 2002 compared with 2003.

**Business Operating Results**

Total operating profit, which is before interest expense, other finance expense, taxation, minority interests and exceptional items, was $24,427 million in 2004, $17,123 million in 2003 and $11,161 million in 2002.

***Exploration and Production***

| | | Years ended December 31, | | |
|---|---|---|---|---|
| | | **2004** | **2003** | **2002** |
| Turnover | ($ million) | 34,914 | 30,753 | 25,083 |
| Profit before interest and tax | ($ million) | 18,530 | 14,669 | 8,280 |
| Exceptional (gains) losses | ($ million) | (152) | (913) | 726 |
| Total operating profit | ($ million) | 18,378 | 13,756 | 9,006 |
| Results included: | | | | |
| Exploration expense | ($ million) | 637 | 542 | 644 |
| Key statistics: | | | | |
| Average BP crude oil realizations (a) | ($ per barrel) | 36.45 | 28.23 | 24.06 |
| Average BP NGL realizations (a) | ($ per barrel) | 26.75 | 19.26 | 12.85 |
| Average BP liquids realizations (a) (b) | ($ per barrel) | 35.39 | 27.25 | 22.69 |
| Average West Texas Intermediate oil price | ($ per barrel) | 41.49 | 31.06 | 26.14 |
| Average Brent oil price | ($ per barrel) | 38.27 | 28.83 | 25.03 |
| Average BP US natural gas realizations (a) | ($ per thousand cubic feet) | 5.11 | 4.47 | 2.63 |
| Average Henry Hub gas price (c) | ($/mmbtu) | 6.13 | 5.37 | 3.22 |
| Total liquids production for subsidiaries (b) (d) | (mb/d) | 1,480 | 1,615 | 1,766 |
| Total liquids production for equity-accounted entities (b) (d) | (mb/d) | 1,051 | 506 | 252 |
| Natural gas production for subsidiaries (d) | (mmcf/d) | 7,624 | 8,092 | 8,324 |
| Natural gas production for equity-accounted entities (d) | (mmcf/d) | 879 | 521 | 383 |
| Total production for subsidiaries (d) (e) | (mboe/d) | 2,795 | 3,011 | 3,201 |
| Total production for equity-accounted entities (d) (e) | (mboe/d) | 1,202 | 595 | 318 |

(a) The Exploration and Production business does not undertake any hedging activity. Consequently, realizations reflect the market price achieved.

(b) Crude oil and NGL.

(c) Henry Hub First of Month Index.

(d) Net of royalties.

(e) Expressed in thousands of barrels of oil equivalent per day (mboe/d). Natural gas is converted to oil equivalent at 5.8 billion cubic feet: 1 million barrels.

Turnover for 2004 was $35 billion compared with $31 billion in 2003 and $25 billion in 2002. The increase in 2004 reflected higher liquids and gas realizations of around $7 billion with an offset of around $3 billion due to lower production volumes (for subsidiaries) as a result of divestment activity in 2003. The increase in 2003 reflected the impact of higher liquids and natural gas realizations of approximately $7 billion with an offset of around $1 billion as a result of a decrease in production volumes in the USA and UK following divestments.

Total production for 2004 was 2,795 mboe/d for subsidiaries and 1,202 mboe/d for equity-accounted entities, compared with 3,011 mboe/d and 595 mboe/d, respectively, in the prior period. For subsidiaries, the 7.2% decrease includes 95 mboe/d impact of divestments and for equity-accounted entities the increase of 101.8% includes an increase of 108 mboe/d from the TNK-BP share of Slavneft from January 2004.

Profit before interest and tax for 2004 includes net exceptional gains of $152 million which includes the reversal of a previously reported exceptional loss on disposal in respect of our interests in

Desarrollo Zuli Occidental (DZO) and Boqueron in Venezuela (as a result of the lapse of the sales agreement we retained our interests in the fields), losses on the divestment of our interest in the Kangean Production Sharing Contract and our participating interest in the Muriah Production Sharing Contract, a gain on the sale of our interest in Swordfish in the deepwater Gulf of Mexico, a gain on the sale of 5.3% of our reserves in the North West Shelf in Australia and net losses resulting from the sale of various other upstream assets. Profit before interest and tax for 2003 includes net exceptional gains of $913 million, which includes a gain on the sale of the UK North Sea Forties oil field together with a package of shallow-water assets in the Gulf of Mexico, a gain resulting from Repsol's exercise of its option to acquire a further 20% interest in BP Trinidad and Tobago LLC and net losses resulting from the sale of various other upstream assets. Profit before interest and tax for 2002 includes net exceptional losses of $726 million, which includes a gain resulting from the redemption of certain preferred partnership interests BP retained following the disposal in 2000 of the Altura Energy common interest in exchange for BP loan notes held by the partnership and net losses on the disposal of various other upstream interests.

Total operating profit for 2004 was $18,378 million including inventory holding gains of $10 million and is after an impairment charge of $267 million in respect of fields in the deepwater Gulf of Mexico and US Onshore, an impairment charge of $60 million in respect of the partner operated Temsah platform in Egypt following a blow-out, a charge of $35 million in respect of Alaskan tankers that are no longer required, an impairment charge of $108 million in respect of a gas processing plant in the USA and a field in the Gulf of Mexico Shelf and an impairment charge of $186 million related to our interests in DZO and Boqueron in Venezuela. We previously reported an exceptional loss on disposal of $217 million in respect of these assets; however, the sales agreement has lapsed and we will retain our interests in the fields. As a result of the lapse of the agreement, the exceptional loss was reversed and an impairment charge was recognized in the first quarter of 2004.

Total operating profit for 2003 was $13,756 million including inventory holding gains of $3 million. The result for 2003 includes an impairment charge of $296 million related to four assets in the Gulf of Mexico Shelf following technical reassessments and reevaluation of future investments options; an impairment charge of $133 million related to the Miller field in the UK following a decision not to proceed with waterflood and gas import options; an impairment charge of $108 million related to the Kepodang field in Indonesia; an impairment charge of $105 million related to the Yacheng field in China; and a $49 million write-down of the Viscount asset in the North Sea. Although all of these fields continue in operation, BP has disposed of its interest in the Kepodang field in 2004. Additionally, there were restructuring charges of $117 million in respect of ongoing restructuring activities in the UK and North America.

Total operating profit for 2002 was $9,006 million including inventory holding gains of $3 million. The result for 2002 includes a charge of $1,091 million related to the impairments of Shearwater in the North Sea, Rhourde El Baguel in Algeria, LL652 and Boqueron in Venezuela, Pagerungan in Indonesia and Badami in Alaska, following full technical reassessments and reevaluations of future investment opportunities. All these fields continued in operation. In addition, there were restructuring charges of $184 million relating to significant restructuring to reposition the business in North America and the North Sea, $94 million for the write-off of our Gas-to-Liquids demonstration plant in Alaska and $55 million of litigation costs. The restructuring costs comprised $145 million of severance, $19 million repatriation and other costs of $20 million, which were mostly settled in 2002.

The primary reasons for the increase in operating profit for 2004 compared with 2003 are higher liquids and gas realizations of around $5,150 million combined with an increase of $400 million due to higher volumes, partly offset by adverse foreign exchange impacts and inflationary pressures of around $350 million and higher costs of around $650 million. Operating profit for 2004 includes a charge of $191 million, reflecting an increase in the provision for unrealized profit in inventory compared with a charge of $61 million in 2003.

The primary reasons for the increase in operating profit in 2003 compared with 2002 are higher natural gas realizations partly offset by higher costs and other factors. Higher natural gas realizations contributed $5,400 million to operating profit. This was offset by an increase of approximately $790 million in the charge for depreciation and an increase in other costs of around $340 million. Lower production volumes in the USA and the UK reduced profit by approximately $100 million and the net impact of acquisitions and divestments was a further reduction of about $100 million. Exploration expense was $102 million lower in 2003 compared with 2002. Operating profit for 2003 includes a charge of $61 million reflecting an increase in the provision for unrealized profit in inventory compared with a charge of $154 million in 2002.

Total hydrocarbon production for 2003 was 3,010 mboe/d for subsidiaries and 596 mboe/d for equity-accounted entities compared with 3,201 mboe/d and 252 mboe/d, respectively, in 2002. For subsidiaries this includes the 135 mboe/d impact of divestments and for equity-accounted entities reflects the inclusion of 205 mboe/d volumes incremental to Sidanco, from August 29, 2003.

***Refining and Marketing***

| | | Years ended December 31, | | |
|---|---|---|---|---|
| | | **2004** | **2003** | **2002** |
| Turnover (a) | ($ million) | 179,587 | 149,477 | 125,836 |
| Profit before interest and tax | ($ million) | 5,967 | 2,270 | 2,582 |
| Exceptional (gains) losses | ($ million) | 117 | 213 | (613) |
| Total operating profit | ($ million) | 6,084 | 2,483 | 1,969 |
| Global Indicator Refining Margin (b) | ($/bbl) | 6.08 | 3.88 | 2.11 |
| Refining availability (c) | (%) | 95.4 | 95.5 | 96.1 |
| Refinery throughputs | (mb/d) | 2,976 | 3,097 | 3,103 |
| Total marketing sales | (mb/d) | 4,002 | 3,969 | 4,180 |

(a) Excludes BP's share of joint venture turnover of $594 million in 2004, $453 million in 2003 and $415 million in 2002.

(b) The Global Indicator Refining Margin is the average of six regional industry indicator margins which we weight for BP's crude refining capacity in each region. Each regional indicator margin is based on a single representative crude with product yields characteristic of the typical level of upgrading complexity. The refining margins are industry specific rather than BP specific measures, which we believe are useful to investors in analysing trends in the industry and their impact on our results. The margins are calculated by BP based on published crude oil and product prices and take account of fuel utilization and catalyst costs. No account is taken of BP's other cash and non-cash costs of refining, such as wages and salaries and plant depreciation. The indicator margin may not be representative of the margins achieved by BP in any period because of BP's particular refining configurations and crude and product slate.

(c) Refining availability is the weighted average percentage of the period that refinery units are available for processing, after accounting for downtime such as turnarounds.

Turnover for 2004 was $180 billion compared with $149 billion for 2003 and $126 billion for 2002. The increase in turnover in 2004 compared with 2003 was principally due to higher prices contributing approximately $36 billion and foreign exchange movements contributing approximately $8 billion due to sales in local currencies being translated into the US dollar, partly offset by lower volumes (including trading and crude oil sales) of around $14 billion. The increase in turnover in 2003 compared with 2002 is due primarily to higher oil prices contributing approximately $14 billion and foreign exchange movements and higher volumes (including trading and supply sales) contributing a further $8 billion and $3 billion respectively.

Profit before interest and tax for 2004 includes net exceptional losses of $117 million which includes a gain on disposal of the Cushing to Chicago Pipeline in the US, and losses on the disposal of our interest in the Singapore Refining Company Private Limited and the closure of the lubricants operation of the Coryton Refinery in the UK. Profit before interest and tax for 2003 includes net exceptional losses of $213 million resulting from a number of disposals which primarily relate to retail assets. Profit before interest and tax for 2002 includes net exceptional gains of $613 million which include gains on the sale of our interest in Colonial Pipeline and a US downstream electronic payment system, along with a number of smaller items.

Total operating profit for 2004 was $6,084 million, including inventory holding gains of $1,245 million, and is after charging $206 million in relation to new, and revision to existing, environmental and other provisions. The Group undertakes an annual review of its environmental provisions in relation to current and former refinery, retail and other sites taking account of new legislation and emerging industry practice.

Total operating profit for 2003 was $2,483 million after inventory holding losses of $48 million and is after Veba integration costs of $287 million, a $369 million charge in relation to new, and revisions to existing, environmental and other provisions, and a credit of $10 million arising from the reversal of restructuring provisions.

Total operating profit for 2002 was $1,969 million including inventory holding gains of $1,049 million and is after a credit related to business interruption insurance proceeds of $184 million, as well as charges of $348 million related to Veba integration, $132 million restructuring costs, $62 million costs associated with an Olympic pipeline incident in 1999, a $35 million write-down of retail assets in Venezuela and $22 million settlement costs associated with a pre-acquisition Atlantic Richfield Company US MTBE supply contract.

The increase in operating profit for 2004 compared with 2003 is primarily due to stronger refining margins contributing approximately $3,100 million, offset by a decrease in marketing margins of approximately $400 million, the impact of weaker US dollar of approximately $250 million and charges of around $310 million related primarily to a review of carrying value of fixed and current marketing assets. The increase was further offset by higher purchased energy costs of around $100 million and portfolio impacts of around $100 million. Refining throughputs at 2,976 kb/d were 4% lower than in 2003 due principally to the disposal of BP's interests in SRC, the closure of refining operations at the ATAS Refinery in Mersin, south eastern Turkey and the disposal of the Bayernoil refinery in Germany in the second quarter of 2003. Refining availability for the year was 95.4% compared with 95.5% in 2003 and marketing volumes were relatively flat compared with 2003.

In addition to the factors above, operating profit for 2003 compared with 2002 reflects approximately $1,400 million from improved refining margins and approximately $600 million from marketing margins improvement. This was offset by adverse foreign exchange effects of around $100 million and additional portfolio impacts of around $150 million. Refining throughputs were relatively flat compared with 2002, with refining availability for the year at 95.5% in 2003 compared with 96.1% in 2002. Marketing volumes for 2003 were 4% lower than 2002, due to divestments.

The integration of Veba, which began in February 2002, was essentially completed during 2003. The 2003 charges of $287 million relating to the Veba acquisition comprised some $46 million of severance costs, $37 million of other integration costs such as consulting, studies and internal project teams, $48 million of system infrastructure and application costs and the balance of $156 million related to additional synergy projects. 2003 cash outflows related to these charges were approximately $260 million.

The 2002 charges of $348 million related to the Veba acquisition comprised $210 million of severance costs, $77 million of other integration costs such as consulting, studies and internal project teams, $24 million of system infrastructure and application costs, $22 million of office consolidation and relocation and $15 million of additional synergy projects. 2002 cash outflows related to these charges were approximately $140 million. The $132 million restructuring costs were associated with several restructuring and cost reduction initiatives during 2002 in different business units and support functions, primarily in the USA, Western Europe and in Africa. The largest single functional area affected was information technology. In Venezuela an impairment review was triggered by the current political crisis and poor business performance in 2002.

***Petrochemicals***

| | | Years ended December 31, | | |
|---|---|---|---|---|
| | | **2004** | **2003** | **2002** |
| Turnover | ($ million) | 21,209 | 16,075 | 13,064 |
| Profit before interest and tax | ($ million) | (551) | 623 | 191 |
| Exceptional (gains) losses | ($ million) | 563 | (38) | 256 |
| Total operating profit | ($ million) | 12 | 585 | 447 |
| Chemicals Indicator Margin (a) | ($/te) | 140 | 112 | 104 |
| Production volumes (b) | (kte) | 28,927 | 27,943 | 26,988 |

(a) The Chemicals Indicator Margin (CIM) is a weighted average of externally based industry product margins. It is based on market data collected by Nexant in their quarterly market analyses, which we weight based on BP's product portfolio. While it does not cover our entire portfolio, it includes a broad range of products. Among the products and businesses covered in the CIM are the olefins and derivatives, the aromatics and derivatives, LAOs, acetic acid, vinyl acetate monomers and nitriles. Not included are fabrics and fibres, PAOs, anhydrides, speciality intermediates and the remaining parts of the solvents and acetyls businesses. CIM is an environmental trend indicator. Changes in CIM are indicative of market environment trends rather than representative of the actual margins achieved by BP in any particular period.

(b) Includes BP share of joint ventures, associated undertakings and other interests in production.

Turnover has increased from $13 billion in 2002 to $16 billion in 2003 and to $21 billion in 2004. The increase in turnover for 2004 compared with 2003 was attributable principally to an increase of around $4 billion from higher prices, and an increase of around $1 billion from higher sales volumes, primarily to Asia. The increase in turnover for 2003 compared with 2002 primarily reflects higher sales prices.

Profit before interest and tax for 2004 includes net exceptional losses of $563 million associated largely with the closure of two plants at Hull, the sale of our Fabrics and Fibres business, the closure of the linear alpha-olefins production facility at Pasadena, Texas, the sale of our speciality intermediates businesses and the exit from the Baglan Bay site in the UK. Profit before interest and tax for 2003 includes net exceptional gains of $38 million resulting from a number of small transactions. Profit before interest and tax for 2002 includes net exceptional losses of $256 million, including a loss on the sale of our plastic fabrications business, a loss on the sale of Fosroc Construction, a loss associated with the closure of polypropylene capacity at Cedar Bayou, Texas and several other small transactions.

Total operating profit for 2004 was $12 million including inventory holding gains of $349 million and is after a charge of $1,110 million in respect of asset impairments, a charge of $39 million in respect of restructuring and a charge of $58 million in respect of revisions to environmental and other provisions.

Total operating profit for 2003 was $585 million including inventory holding gains of $55 million and is after a $36 million charge comprising a provision to cover future rental payments on surplus property, a charge of $20 million resulting from revisions to environmental and other provisions and a credit of $5 million resulting from a reduction in the provision for costs associated with the closure of polypropylene capacity in the USA.

Total operating profit for 2002 was $447 million including inventory holding gains of $26 million and is after a $140 million write-down of our Indonesian manufacturing assets held for sale following a review of immediate prospects and opportunities for future growth in a highly competitive market, costs of $81 million related to major site restructuring and Solvay and Erdölchemie integration and $29 million for restructuring our research and technology facilities.

In addition to the factors above, operating profit for 2004 compared with 2003 reflects higher margins of approximately $660 million and higher sales volumes of approximately $190 million, offset partially by higher fixed costs, adverse foreign exchange impacts and portfolio change of approximately $560 million.

In addition to the factors above, operating profit for 2003 reflects a decrease of around $180 million resulting from prolonged margin weakness, primarily in our European polymers business, a result from SARS-affected businesses in Asia that was approximately $60 million lower during the first half of the year and additional charges of $55 million related to additional depreciation from new plants, asset writedowns and provisions for bad debt, partly offset by an increase of $130 million due to higher sales volumes and lower fixed costs of around $60 million when compared to 2002.

BP's share of production for 2004 was 28,927 thousand tonnes, up 4% on 2003 due to higher asset utilization and increased Asian PTA capacity during the year, with additional High Density Polyethylene capacity in the fourth quarter from the acquisition of the BP Solvay ventures. Production for 2003 was 27,943 thousand tonnes, up 3.5% on 2002 due to improved asset utilization across the business as well as new production capacity and increased ownership in our Asian associated undertakings.

***Gas, Power and Renewables***

| | | Years ended December 31, | | |
|---|---|---|---|---|
| | | **2004** | **2003** | **2002** |
| Turnover | ($ million) | 83,320 | 65,639 | 37,580 |
| Profit before interest and tax | ($ million) | 982 | 576 | 2,020 |
| Exceptional (gains) losses | ($ million) | (56) | 6 | (1,551) |
| Total operating profit | ($ million) | 926 | 582 | 469 |
| Total natural gas sales volumes (a) | (mmcf/d) | 31,690 | 30,439 | 24,852 |

(a) Includes marketing, trading and supply sales.

Turnover was $83 billion in 2004 compared with $66 billion in 2003, reflecting increases of around $4 billion due to higher gas sales volumes and around $14 billion due to higher prices. The increases in 2003 from $38 billion in 2002 reflects approximately $20 billion additional turnover from higher natural gas prices and approximately $8 billion from higher gas sales volumes.

Profit before interest and tax for 2004 includes exceptional gains of $56 million from the disposal of BP's interests in NGL plants in Canada. Profit before interest and tax for 2003 includes net exceptional losses of $6 million resulting from several small transactions. Profit before interest and tax for 2002 includes net exceptional gains of $1,551 million that primarily relate to the disposal of our interest in Ruhrgas.

Total operating profit for 2004 was $926 million including inventory holding gains of $39 million.

Total operating profit for 2003 was $582 million including inventory holding gains of $6 million.

Total operating profit for 2002 was $469 million including inventory holding gains of $51 million, and is after a charge of $30 million related to the impairment of a cogeneration power plant under construction in the UK. The impairment is the result of a significant fall in power prices in the UK over the previous two years.

In addition to the factors above, the principal additional factors contributing to the increase in operating profit in 2004 compared with 2003 were a higher contribution from the natural gas liquids and solar businesses of approximately $350 million due to higher unit margins and higher volumes.

In addition to the factors above, the increase in operating profit for 2003 compared with 2002 reflects improvement in the marketing and trading business. Marketing and trading results increased by approximately $250 million with equal contributions from higher volumes and improved margins. Results for the LNG business also improved showing an increase of $90 million. This more than offset decreases of $70 million in the NGL business due to high natural gas prices relative to liquids prices in North America which led to lower sales volumes, the absence of any contribution from the Ruhrgas shareholding (sold in August 2002 and contributed $112 million in 2002) and a restructuring charge of $45 million in our Solar business.

***Other Businesses and Corporate***

| | | Years ended December 31, | | |
|---|---|---|---|---|
| | | **2004** | **2003** | **2002** |
| Turnover | ($ million) | 546 | 515 | 510 |
| Profit (loss) before interest and tax | ($ million) | 314 | (184) | (744) |
| Exceptional (gains) losses | ($ million) | (1,287) | (99) | 14 |
| Total operating loss | ($ million) | (973) | (283) | (730) |

Other businesses and corporate comprises Finance, the Group's coal asset (divested October 2003), the Group's aluminium asset, its investments in PetroChina and Sinopec (both divested in early 2004), interest income and costs relating to corporate activities.

The profit before interest and tax for 2004 includes exceptional gains of $1,287 million primarily related to the sale of our investment in PetroChina and our investment in Sinopec. The loss before interest and tax for 2003 includes net exceptional gains of $99 million, which includes a gain on the sale of our interest in PT Kaltim Prima Coal, an Indonesian coal mining company, partly offset by net losses on several small transactions. The loss before interest and tax in 2002 includes net exceptional losses of $14 million resulting from several small transactions.

The net cost of Other businesses and corporate amounted to $973 million in 2004, $283 million in 2003 and $730 million in 2002. The operating loss for 2004 includes a charge of $225 million relating to new, and revisions to existing, environmental and other provisions, a charge of $102 million in respect of the separation of the Olefins and Derivatives business and a credit of $66 million primarily resulting from the reversal of vacant space provisions in the UK and the US. The operating loss for 2003 includes a charge of $193 million relating to new, and revisions to existing, environmental and other provisions, a credit of $648 million relating to a US medical plan and a charge of $74 million in respect of provisions for future rental payments on surplus leasehold properties. The operating loss for 2002 includes provisions of $140 million for future rentals on surplus leasehold property and a charge of $46 million for environmental liabilities in respect of a divested business.

**Environmental Expenditure**

| | Years ended December 31, | | |
|---|---|---|---|
| | **2004** | **2003** | **2002** |
| | | **($ million)** | |
| Operating expenditure | 526 | 498 | 485 |
| Clean-ups | 25 | 45 | 49 |
| Capital expenditure | 524 | 546 | 548 |
| New provisions for environmental remediation | 588 | 515 | 312 |
| New provisions for decommissioning | 294 | 1,159 | 308 |

Operating and capital expenditure on the prevention, control, abatement or elimination of air, water and solid waste pollution is often not incurred as a discrete identifiable transaction. Instead, it forms part of a larger transaction that includes, for example, normal maintenance expenditure. The figures for environmental operating and capital expenditure in the table are therefore estimates, based on the definitions and guidelines of the American Petroleum Institute.

Environmental operating and capital expenditures for 2004 were broadly in line with 2003. Similar levels of operating capital expenditures are expected in the foreseeable future. In addition to operating and capital expenditures, we also create provisions for future environmental remediation. Expenditure against such provisions is normally in subsequent periods and is not included in environmental operating expenditure reported for such periods. The charge for environmental remediation provisions in 2004 includes $484 million resulting from a reassessment of existing site obligations and $104 million in respect of provisions for new sites.

Provisions for environmental remediation are made when clean-up is probable and the amount reasonably determinable. Generally, their timing coincides with commitment to a formal plan of action or, if earlier, on divestment or on closure of inactive sites.

The extent and cost of future remediation programmes are inherently difficult to estimate. They depend on the scale of any possible contamination, the timing and extent of corrective actions and also the Group's share of liability. Although the cost of any future remediation could be significant and may be material to the result of operations in the period in which it is recognized, we do not expect that such costs will have a material effect on the Group's financial position or liquidity. We believe our provisions are sufficient for known requirements; and we do not believe that our costs will differ significantly from those of other companies (with similar assets) engaged in similar industries or that our competitive position will be adversely affected as a result.

In addition, we make provisions to meet the cost of eventual decommissioning of our oil- and gas-producing assets and related pipelines and other assets where the fair value of the asset retirement obligation can be reasonably estimated. On installation of oil or natural gas production facility a provision is established which represents the discounted value of the expected future cost of decommissioning the asset. Additionally, we undertake periodic reviews of existing provisions. These reviews take account of revised cost assumptions, changes in decommissioning requirements and any technological developments.

Provisions for environmental remediation and decommissioning are usually set up on a discounted basis, as required by Financial Reporting Standard No. 12, 'Provisions, Contingent Liabilities and Contingent Assets'. Further details of decommissioning and environmental provisions appear in

Item 18 — Financial Statements — Note 32 on page F-57. See also Item 4 — Information on the Company — Environmental Protection on page 67.

**Insurance**

The Group generally restricts its purchase of insurance to situations where this is required for legal or contractual reasons. This is because external insurance is not considered an economic means of financing losses for the Group. Losses will therefore be borne as they arise rather than being spread over time through insurance premia with attendant transaction costs. The position will be reviewed periodically.

## LIQUIDITY AND CAPITAL RESOURCES

### Cash Flow

| | Years ended December 31, | | |
|---|---|---|---|
| | 2004 | 2003 | 2002 |
| | ($ million) | | |
| Net cash inflow from operating activities | 28,554 | 21,698 | 19,342 |
| Dividends from joint ventures | 1,908 | 131 | 198 |
| Dividends from associated undertakings | 291 | 417 | 368 |
| Net cash outflow from servicing of finance and returns on investment | (342) | (711) | (911) |
| Tax paid | (6,378) | (4,804) | (3,094) |
| Net cash outflow for capital expenditure and financial investment | (8,712) | (6,124) | (9,628) |
| Net cash outflow from acquisitions and disposals | (3,242) | (3,548) | (1,337) |
| Equity dividends paid | (6,041) | (5,654) | (5,264) |
| Net cash inflow (outflow) before financing | 6,038 | 1,405 | (326) |
| Financing | 6,777 | 1,129 | (163) |
| Management of liquid resources | 132 | (41) | (220) |
| Increase (decrease) in cash | (871) | 317 | 57 |
| | 6,038 | 1,405 | (326) |

Net cash inflow from operating activities increased to $28,554 million from $21,698 million in 2003, reflecting an increase in profit of $7,288 million, an increase in depreciation and amounts provided of $1,643 million and the absence of discretionary funding for the Group's pension plans of $2,533 million which was incurred in 2003. This was partially offset by an additional working capital requirement of $2,618 million and a higher share of profits of joint ventures and associated undertakings of $2,136 million. Net cash inflow from operating activities increased to $21,698 million in 2003 from $19,342 million in 2002, reflecting an increase in profit of $5,625 million partly offset by $2,533 million discretionary funding for the Group's pension plans, an additional working capital requirement of $1,091 million and higher share of profits of joint ventures and associated undertakings of $472 million.

Dividends from joint ventures and associated undertakings were $2,199 million in 2004 compared with $548 million in 2003 and $566 million in 2002. The increase in 2004 compared with 2003 is primarily due to the dividend from TNK-BP. The decrease in 2003 compared with 2002 was related to the Ruhrgas and Altura transactions in 2002 partly offset by the dividend from TNK-BP in 2003.

The net cash outflow from servicing of finance and returns from investments was $342 million in 2004, $711 million in 2003 and $911 million in 2002. The lower cash outflow in 2004 and 2003 is primarily due to lower interest payments. Additionally, interest received was higher in 2004.

Tax paid increased to $6,378 million in 2004 from $4,804 million in 2003 and $3,094 million in 2002, primarily reflecting the increase in profits in each period.

Net cash outflow for capital expenditure and financial investment amounted to $8,712 million in 2004 compared with $6,124 million in 2003 and $9,628 million in 2002. The increase in 2004 compared with 2003 reflects lower disposal proceeds of $1,930 million and an increase in payments for fixed assets of $667 million. The decrease in 2003 over 2002 reflects higher disposal proceeds of $3,783 million.

Net cash outflow from acquisitions and disposals produced net cash outflows of $3,242 million in 2004, $3,548 million in 2003 and $1,337 million in 2002. The lower outflow in 2004 compared with 2003 reflects higher disposal proceeds of $546 million and increased acquisition spending of $191 million.

The higher outflow in 2003 compared with 2002 reflects lower disposal proceeds of $4,133 million and lower acquisition spending of $1,762 million.

Overall net cash outflow for capital expenditure and acquisitions, net of disposals, was $11,954 million in 2004 compared with $9,672 million in 2003 and $10,965 million in 2002.

Equity dividends paid have increased to $6,041 million in 2004 compared with $5,654 million in 2003 and $5,264 million in 2002. The increase in both years reflects the impact of the higher dividend per share, partly offset by share repurchases.

Overall net cash inflow before financing was $6,038 million in 2004, $1,405 million in 2003 and was a net outflow of $326 million in 2002 as a result of the factors outlined above.

Net cash inflow from Financing was $6,777 million in 2004 compared with $1,129 million in 2003 and an outflow of $326 million in 2002. The increases in 2004 and 2003 are primarily due to the repurchase of ordinary share capital. See Item 18 — Financial Statements — Note 37 on page F-75.

The Group has had significant levels of investment for many years. Investment, excluding acquisitions, was $14.4 billion in 2004, $14.0 billion in 2003 and $13.3 billion in 2002. Sources of funding are completely fungible, but the majority of the Group's funding requirements for new investment come from cash generated by existing operations. There has been little change in the Group's level of net debt, that is debt less cash and liquid resources; net debt was $20.3 billion at the end of 2002, $20.2 billion at the end of 2003 and was $21.6 billion at the end of 2004.

Over the period 2000 to 2004 our cash inflows and outflows were balanced, with sources and uses both totalling $152 billion. Since 2000, the year in which we completed the purchase of Atlantic Richfield Company, the price of Brent has averaged $29.00/bbl, somewhat higher than was expected as the period opened. The following table summarizes the five year sources and uses of cash:

| **Sources** | **$ billion** | **Uses** | **$ billion** |
|---|---|---|---|
| Operating cash flow | 112 | Capital expenditure | 66 |
| Dividends from joint ventures and associated undertakings | 5 | Acquisitions | 17 |
| | | Servicing of finance and and returns on investments | 4 |
| Divestments | 33 | Tax paid | 25 |
| Movement in net debt | 2 | Share buybacks | 14 |
| | | Dividends | 26 |
| | 152 | | 152 |

Significant acquisitions made for cash were more than offset by divestitures. Net investment over the same period has averaged $10 billion per year. Dividends, which grew on average by 8.2% per year in dollar terms, used $26 billion. $14 billion was used for share repurchases. Finally, cash was used to strengthen the financial condition of certain of our pension funds.

**Trend information**

Over the next three or four years we expect to see additional cash flows coming from three main sources:

- First, having contributed $2.5 billion in 2003 to address deficits in our funded pension plans, we now expect to return to a funding programme of $400-600 million per year. We have the capacity to adjust this funding should circumstances warrant.

- Secondly, organic capital expenditure, that is capital expenditure excluding acquisitions, is expected to level off as we pass the peak of the recent investment cycle.

- Lastly, and most importantly, that we expect operations to be our main source of additional cash. This includes the benefits from capital coming into service in our new Exploration and Production profit centres and greater margin contributions from our Customer Facing Businesses.

We expect capital expenditure, excluding acquisitions, to be around $14 billion in 2005; the exact level will depend on the level of the dollar and is subject to our ability to continue to offset normal underlying inflation of around 2% per annum. Refer to Item 4 for further information.

Further out, for the medium term, a level of around $14 billion is a reasonable expectation.

Total production for 2005 is estimated at an average of between 2.85 and 2.9 mmboe/d for subsidiaries and between 1.25 and 1.3 mmboe/d for equity accounted entities; these estimates are before any divestments and are based on our $20/bbl planning basis. The exact level will depend on oil prices, divestments and many other factors.

The anticipated decline in production volumes from subsidiaries in our existing profit centres is partly mitigated by the development of new projects and the investment in incremental reserves in and around existing fields. We expect that this overall decline in production from subsidiaries in our existing profit centres will be more than compensated for by strong increases in production from subsidiaries in our new profit centres over the next few years. Production in our equity-accounted joint venture, TNK-BP, is also expected to grow over the next few years.

The most important determinants of cash flows in relation to our oil and natural gas production are the prices of these commodities. In a stable price environment, cash flows from currently developed proved reserves are expected to decline in a manner consistent with anticipated production decline rates. Development activities associated with recent discoveries, as well as continued investment in these producing fields, are expected to more than offset this decline, resulting in increased operating cash flows over the next few years. Cash flows from equity-accounted entities are expected to be in the form of dividend payments.

***Dividends and Other Distributions to Shareholders and Gearing***

Our dividend policy is to progressively grow the dividend. In pursuing this policy and in setting the levels of dividends we are guided by several considerations, including:

- the prevailing circumstances of the Group. Last year we achieved all we set out to do. Performance is on track; investments are going in and producing revenue; strategy is on track;

- the future investment patterns and sustainability of the Group. We have a strong set of opportunities which we are pursuing, giving us a clear view of our future whether related to resources or customers and we are confident about that future;

- the future trading environment. It does seem that oil prices have a support level of $30/bbl for at least the medium term. This gives us some comfort in considering the timing of dividend changes. We currently use as our planning assumption $20/bbl as a measure for testing the downside in the balance between investment and total distributions to shareholders. However, in light of sustained high oil prices, the Group is in the course of reviewing this planning assumption.

Under UK GAAP our gearing band was 25-35%. Subsequent to the adoption of International Financial Reporting Standards (IFRS) from January 1, 2005, we reduced our gearing band from 25-35% to 20-30% in order to maintain the economic substance of our financial framework. This new band continues to give us an efficiently leveraged capital structure, and adequate protection against unforeseen events. This reduction brings the gearing band back to where it was, prior to the introduction of FRS19 in 2002.