Analysts:

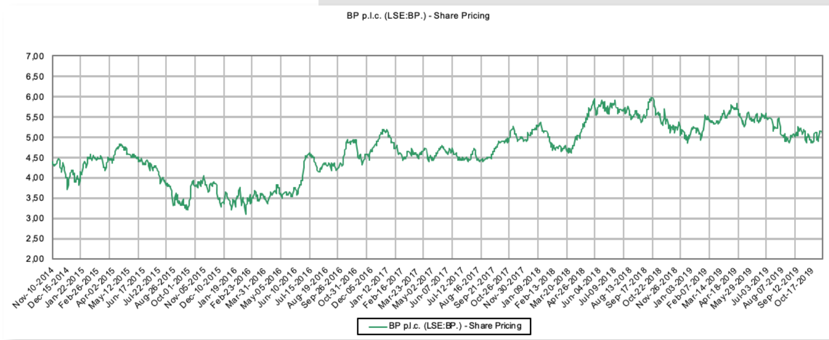
Aditya Rudrapatna
Dimos Badogiannakis

I. Investment Thesis

Sector:	Energy and Utilities
Industry:	Oil, Renewables
Sector Heads:	Daryna Kolobova Benjamin Young
Suggestion:	**BUY**
Target Price:	**GBP 7.70**
Ticker	BP:LSE
Price	4.39
Currency	GBP
Market Cap	100.316B
Average volume	37.45M
Dividend Yield	6.31%
Beta	1.06

BP Plc is a multinational oil & gas company headquartered in London, UK. We believe it should have a BUY rating for the following reasons.

1. **Unique business model:** BP should be a buy stock, because of its unique business model. As a result of it being in every stage of the oil and gas pipeline (upstream, downstream, supply & trading, etc.), it is effectively immune to adverse macroeconomic conditions. For instance, if there is a fall in the price of oil, then BP's upstream business - which entails exploration and production – will witness a decline in profits. However, crude oil is one of the principal raw materials for the downstream business, which entails refining crude oil into an array of fuels, petrochemicals, lubricants, and other problems. As per classical economics, a fall in the cost of a factor of production results in an increase in profits. And further, the company's supply and trading organisation regularly buys and sells crude oil as needed to further offset any damages. Coupled with their innovative look on the horizon, this unique business structure is capable of withstanding short and long-term.
2. **Strong fundamentals:** Despite headwinds such as the Gulf of Mexico oil spill repayments and lower-than-record oil prices, BP has continued to deliver great results. In 2018, BP more than doubled full-year earnings YoY with $12.7 billion in underlying replacement cost profit and average return on capital was also more than double, with 11.2% compared with 5.7% the previous year. BP has also consistently returned dividend yields of around 6.5%, and is often viewed as a safe investment guaranteed to deliver good results. Investor sentiment is also high, with analysts expecting the share price to reach upwards of 630p within the next 12 months.
3. **Strong growth prospects and high technology:** Despite having a market capitalisation of around $100 billion, there is significant room for the company to grow. First, BP made its biggest deal in 20 years – worth $10.5B - by acquiring mining group BHP's US shale assets to boost growth and increase Upstream pre-tax cash flow by $1B to $14-15B by 2021. In addition, BP has a venture capital arm that invests in companies developing high technology. This includes C-Capture, a firm working on cutting emissions and capturing carbon, and Fulcrum, a firm that creates biogas by gasification of household waste. BP Ventures focuses on companies in the areas of advanced mobility, power and storage, carbon management, bio and low carbon products, and digital transformation, across their upstream, downstream, and alternative energy businesses.



4. **A move towards a low carbon future:** BP's chairman, outgoing CEO, and incoming CEO all support the move to a low-carbon future, with the chairman and outgoing CEO going as far as publishing a commitment in the Financial Times. Platitudes aside, BP has a growing renewables business, concentrating on biofuels, bio power, wind energy, and solar energy. BP also acquired electric vehicle charging company Chargemaster, the UK's largest vehicle charging network operator during 2018.

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II. Executive Summary

Recent Performance

In 2018, BP more than doubled full-year earnings year-over-year with $12.7 billion in underlying replacement cost profit. Average return on capital was also more than double, with 11.2% compared with 5.7% the previous year. Plant reliability in the upstream business also reached record levels, and the downstream business saw record levels of throughput. BP also set clear targets for operational greenhouse gas emissions and has been tracking progress. BP also engages in a share buyback program, meaning they believe in the value of their stock, and the P/E ratio is in line with other oil supermajors, implying that it's a well-valued business. BP has also consistently returned dividend yields of around 6.5% and is often viewed as a safe investment guaranteed to deliver good results. Investor sentiment is also high, with analysts expecting the share price to reach upwards of £6.30 within the next 12 months. An overview of insider trades points to the company's CFO and Chairman buying a total of 600,536 shares over the last 10 months, with none sold.

Future Prospects

BP indicates strong growth through high technology. BP has a venture capital arm that invests in blue-sky, high growth startups with the aims of creating more energy and reduce carbon emissions. BP Ventures has invested more than $500M in 40 companies and is continuing to increase its activity. BP Ventures focuses on companies in the areas of advanced mobility, power and storage, carbon management, bio and low carbon products, and digital transformation, across their upstream, downstream, and alternative energy businesses. BP's management has vocally voiced support for the move to a low-carbon future. Platitudes aside, BP has a growing renewables business, concentrating on biofuels, biopower, wind energy, and solar energy. BP also acquired electric vehicle charging company Chargemaster, the UK's largest vehicle charging network operator during 2018. What follows is a breakdown of BP's renewables business.

As for solar energy, BP bought a 43% stake in Europe's largest solar developer, Lightsource, with plans to invest a further $200M over a 3 year period BP has also agreed to bring a further 25MW of solar power to the western US and has doubled the number of active countries since Dec 2017. In the Wind power sector BP has nine sites across the US that generate over 1000MW. They introduced a new partnership with Tesla to store more power more efficiently, a move to secure long-term wind portfolio while also recently restructuring wind business to optimize for growth. As for Biofuels, BP Produced 765M liters of ethanol from sugar across 2018 and has increased the size of biofuels business by 50% in 2019 alone by purchasing a 50% stake in a biofuels market leader. BP has implemented a waste-management system, using biomass to power its sites and selling extra back to the grid Lastly, BP has a 50% joint venture with DuPont to make petrochemicals out of biofuels.

Company Culture

A new CEO will take over BP on February 2020, the current head of the upstream business, Bernard Looney. Looney is viewed very well in the company; he's viewed particularly as youthful, dynamic, energetic, and modern, and someone who can guide BP into a carbon-free future. He's also been at the company for 28 years and a trusted insider, and the rest of the executive team – which has remained relatively constant – will remain the same. Investor sentiment is also very optimistic with the new incoming CEO and the company's future, and the idea that BP will become Big Energy rather than just Big Oil is prevalent. Thus, the company appears to have a stable and secure future. BP also has longstanding relationships with arts and culture houses, such as the British Museum, and tends to enjoy a more positive perception in the press.

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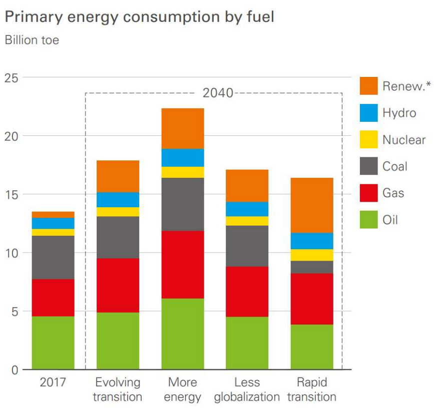
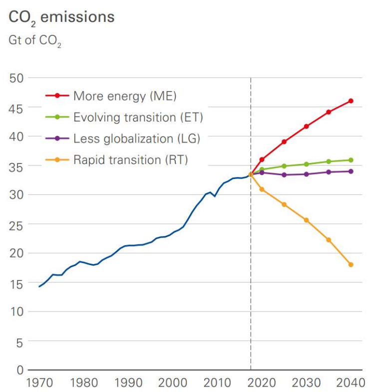
III. Company Overview

BP Plc is a multinational oil & gas company headquartered in London, UK. It is one of the world's seven oil and gas "supermajors", the world's sixth-largest oil and gas company, the sixth-largest energy company by market capitalization, and the company with the world's seventh-largest revenue. The company has a presence in over 50 countries worldwide.

BP is very active in nearly every market in the world. It has a major focus on developing nations (such as India and Brazil), and through its acquisition of Amoco in the United States, and its 20% stake in Russian oil company Rosneft, BP is relatively immune to geopolitics. Despite being headquartered in the UK, BP's global interests mean that Brexit will have little to no impact on the company. And despite mostly trading on the London Stock Exchange, the oil industry runs in US dollars, which is doing quite well. And despite headwinds such as the Gulf of Mexico oil spill repayments (and the negative press associated) and lower-than-record oil prices, BP has continued to deliver great results. Given that these are some of the most adverse challenges any company in the industry could face, BP's strong leadership and good performance implies that it will deliver good short-term results and is also a good investment for the long term.

Areas of business include upstream operations (exploration and production), downstream operations (refining, distribution, and marketing), petrochemicals, power generation, and energy trading. BP also has a renewable energy business, focusing on biofuels, wind power, and solar technology. Notably, in 2018, downstream amounted to 82% of total revenue, upstream to 17%, while other businesses and operations including renewables amounted to 1%. As described by the 2019 third quarter review BP constantly seeks to enter various other niche markets, besides solely renewable energy production. Such examples include, a joint venture with DiDi to develop an electric vehicle charging network in China and to the installation of 400 ultra-fast chargers at BP Chargemaster's UK retail sites. A $30 million venturing investment in Calysta, which will use BP's natural gas to produce protein feed for aquaculture and agriculture. Also, providing measurement services of methane emissions on all future major operated oil and gas processing projects, to ensure that no regulations are overlooked.





BP has a few main competitors, primarily, Chevron, a Public company operating in the oil & gas and exploration & production industry, founded in 1879 in San Ramon, California. Relative to BP, Chevron almost generates half the total revenue and has 25,900 fewer employees. Second comes ExxonMobil, a company involved in Oil & Gas refining and marketing industry. It was founded 90 after BP (1999) in Texas, US. Compared to BP, ExxonMobil generates $20B less Revenue and has 3.500 less employees. In third place is Royal Dutch Shell, also operates in the Oil & Gas refining and marketing industry. Shell is a Dutch company founded in 1907. It accrues $92.8B more revenue than BP while also having an excess of 18000 employees.

The oil and gas industry, despite being a fundamental sector of modern economy, will soon start to saturate due to sustainability issues. However, BP has the resources and the scale of a company to also be a world leader in the emerging market of renewable energy which looks to dominate the energy industry in years to come.

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IV. Industry Overview

Porter's 5 Forces Analysis:

The first "force" that is employed to **review competition in an industry is the competition itself.** BP has a number of competitors in the oil & gas industry. These include publicly held companies, such as Chevron, ExxonMobil, Royal Dutch Shell, Total, etc.., and privately held companies, such as Sinopec, Saudi ARAMCO, and Gazprom. Nonetheless, BP has the seventh-largest revenue of any company in the world, just behind Saudi ARAMCO. Notably, with the industry moving towards a future of renewable energy resources, it is plausible that some of BP's current competitors might not survive in the long-term. However, given BP's numerous - and growing - investments in renewable energy, it is well-placed to survive the energy transition and remain a dominant player in the industry.

The second "force" refers to the **potential of new entrants to the industry**. The oil & gas industry, is one of the markets with the highest barriers to entry. The majority of companies that dominate the sector were founded in the early 1900s (BP 1909, Shell 1907, Chevron 1879) and have been doing business since then. As such, it is unlikely that a new company can challenge BPs performance in the industry. This is primarily because the oil industry is highly capital-intensive. Running an oil rig for a day often costs well over a million US dollars, and this makes it very difficult for smaller companies to afford the levels of capital expenditure and liabilities common in the oil industry. It is comparatively easier for new entrants in the renewable energy sector, but this too is quite capital intensive and is thus challenging to do at scale. Given BP's venture capital arm and M&A tactics, it is quite likely that if a small/new company enters the industry with an innovative and promising technology, BP would have the intention and capability of acquiring that company. BP also invests highly in Research and Development practices, which enables them to use innovation as a further defensive measure against any possible new entrants.

The third "force" used to **analyze competition in an industry is supplier power.** BP has a massive supply chain with over 60,000 suppliers, meaning that switching costs between rival suppliers are low. Hence, if one of the suppliers decided to increase prices, BP would be easily able to switch suppliers, keeping its input costs stable or even lower. As such, BP does not have to worry about input costs and focus on enhancing its profits.

The fourth "force" refers to **the power of customers.** BP has several different types of customers, from other oil companies (through its supply & trading division), to airlines (through its fuels division; a subsidiary of its oil refining business), everyday consumers (through its retail gas stations and direct-to-consumer car lubricant sales via its subsidiary Castrol), and more. The price elasticity of demand for each of BP's customer segments would be different. For instance, its supply & trading division - which sells crude oil to other oil companies - will be heavily influenced by global oil markets, with BP having little control over its price. However, on the other hand, BP could charge higher prices for its consumer car lubricant products (under its Castrol brand), as they have a lower price elasticity of demand. Given BP's heavily diversified portfolio, the company has a mix of revenue streams, where it can influence the prices of some to increase profitability, but has less influence over others. Evidently, it has so many clients that it can sacrifice losing some when following profit maximizing strategies.

Lastly, evaluating the fifth "force", **the threat of substitute products,** BP, is emerging to be a strong market player in the renewable/alternative energy sector, the principal substitute of oil & gas. Although alternative energy has yet to seriously compete with oil in order to meet the world's energy demands, it's an increasingly important part of the global energy mix. While there is plenty of work to do on BP's part to remain competitive as the world's energy transition takes place, BP's investments are setting it up well for a future when fossil fuels will be replaced by renewables. BP's renewables business is thoroughly examined in the Future Prospects paragraph of the Executive Summary section. However, while renewable energy may supplant the need for oil & gas for energy demands, there are currently no substitutes to petrochemicals, such as plastic. Although research is being conducted on alternative production methods for plastic and other petrochemicals, there is no technology that can rival petrochemicals at the quality and scale that are produced from oil today. Thus, BP doesn't face any threats on the parts of its business not directly related to energy and fuel.

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V. Ratio Analysis

Fig. 1 (a), (b), and (c), which refer to the three tables below respectively.

		Size	Profitability	Growth	
Ticker	Company	Market Cap (mn GBP)	Operating Margin (%)	Sales growth (3yr CAGR)	EPS growth (3yr CAGR)
BP	BP Plc	100,316	6.80%	5.70%	12%
XOM	ExxonMobil Corporation	235,610	4.70%	3.80%	-9.10%
CVX	Chevron Corporation	179,598	9.30%	4.50%	13.10%
RDSA	Royal Dutch Shell plc	194,154	7.60%	6%	16.10%
Aggregation method: Harmonic Mean		-	7.10%	5%	8%

		Valuation						
Ticker	Company	Current P/E	Forward P/E	PEG	EV/EBITDA	EV/EBIT	P/B	P/S
BP	BP Plc	14.58 x	27.48 x	1.23 x	3.69 x	7.96 x	0.21 x	0.01 x
XOM	ExxonMobil Corporation	20.62 x	26.46 x	1.79 x	11.46 x	35.11 x	1.58 x	1.14 x
CVX	Chevron Corporation	17.36 x	22.27 x	2.65 x	8.13 x	23.36 x	1.47 x	1.58 x
RDSA	Royal Dutch Shell Plc	12.16 x	11.60x	0.35 x	14.23 x	13.73 x	1.32 x	0.69 x
Aggregation method: Harmonic Mean		15.93 x	17.76 x	1.51 x	1.51 x	20.82 x	1.45 x	1.01 x

		Returns			Debt	
Ticker	Company	Dividend yield (%)	FCFy (%)	ROE (%)	Net debt/EBITDA	Debt/ Equity
BP	BP Plc	6.31%	35.20%	7.60%	3.4	66.00%
XOM	ExxonMobil Corporation	4.80%	0.00%	2.60%	3.6	26.80%
CVX	Chevron Corporation	3.90%	2.30%	4.70%	2.1	23.50%
RDSA	Royal Dutch Shell Plc	6.30%	12.30%	7.70%	4.4	46.20%
Aggregation method: Harmonic Mean		5.33%	12.40%	5.60%	3.4	40.60%

BP's overall image is significantly bolstered when considered in conjunction with some of its closest competitors. ExxonMobil Corporation, Chevron Corporation, and Royal Dutch Shell Plc. Are three other oil supermajors, and are of a similar size to BP, in terms of market capitalization, revenue, employee number, and more. Therefore, a clearer picture of BP's health is presented.

First, consider the price-to-earnings ratio. At 14.58, it's well in line with the rest of the industry, which implies that it's well valued. The forward P/E, on the other hand, increases with a similar level to to other oil majors, implying a potentially impeding increase in share price. If the stock is bought at the current price - which is lower than that forecasted in the valuation by the forward P/E - this results in an opportunity for the fund to achieve a higher realised return on investment.

Secondly, BP's growth is strong when compared to the competition. BP's 3-year CAGR of 5.7% is higher than both Chevron and ExxonMobil, and tied with Royal Dutch Shell. This demonstrates that the company continued to innovate and grow despite its large size, and various macroeconomic headwinds. Furthermore, recent acquisitions such as Chargemaster and BHP's shale assets, along with continued investment in renewable energy point towards sustained and continued growth in the short to medium term. The story is even more spectacular when looking at EPS growth, with a 3-year CAGR of 12%. Although this is in line with Chevron and Royal Dutch Shell, it is in stark contrast to ExxonMobil - which has long been the industry's so-called reigning king - which declined by 9%.

Lastly, BP's debt-to-equity ratio, while higher than others, is not much of a cause for concern. First, a D/E ratio of this level is common among large-cap companies, because the interest payments on debt are tax-deductible and thus debt is a cheaper source of capital than equity. Second, its debt is significantly impacted by its repayments due to the Gulf of Mexico oil spill in 2010. However, the company is approaching the end of its payment schedule, and is therefore likely going to see an improvement in its debt levels in the short-to-medium term. Furthermore, some of this debt was created by purchasing BHP's assets, as well as other acquisitions. In fact, BP chose to pay for the BHP assets in cash as opposed to funding part of it in stock, instead planning to raise the amount in asset sales through to the end of FY2020. These, however, have a silver lining as they create new growth avenues for the company and will set it up well for the energy transition.

Fig. 2: BP's recent income statement, balance sheet, and cash flow

	FY17	FY18	FY19	FY20E
Income statement				
Revenue	185,028.8	230,648.7	218,561.4	
Operating expenses (Opex)			(203,598)	
operating income (EBIT)			14,963.0	
Operating margin (%)			*6.8%*	
Depreciation and amortisation			17,333.0	
EBITDA			32,296	
Net interest income (expense)			(2,023.0)	
Net interest % of revenue			*-0.9%*	
Pretax income			12,940	
Pretax income % of EBIT			*86.5%*	
Tax			(5,350.0)	
Tax % of EBIT			*35.8%*	
Net income			7,590	
Net income margin (%)			*3.5%*	
Net income available to common	3,388.0		4772.0	4,696
number of ordinary shares (mn)	20,348		20,417	20,417
eps ($)	0.17		0.23	0.23
Balance sheet				
Cash, cash equivalent & st investments			19,806.0	
All other current assets			56,101	
Current assets			75,907.0	
Property, plant and equipment			131,664.0	
Intangible assets			15,084.0	
All other non-current assets			63,608	
Non-current asset			210,356.0	
Total assets			286,263	
Short-term debt			59,155.0	
All Other current liabilities			5,813	
Current liabilities			64,968.0	
Long-term debt			58,311.0	
Other long-term liabilities			62,969	
Total non-current liabilities			121,280.0	
Total liabilities			186,248	
Shareholder's equity			100,015	
Total liabilities and equity			286,263	
Cash flow statement data				
Cash flows from operations			24,996.0	
Capital expenditure			(17,444.0)	
Free cash flow			7,552	

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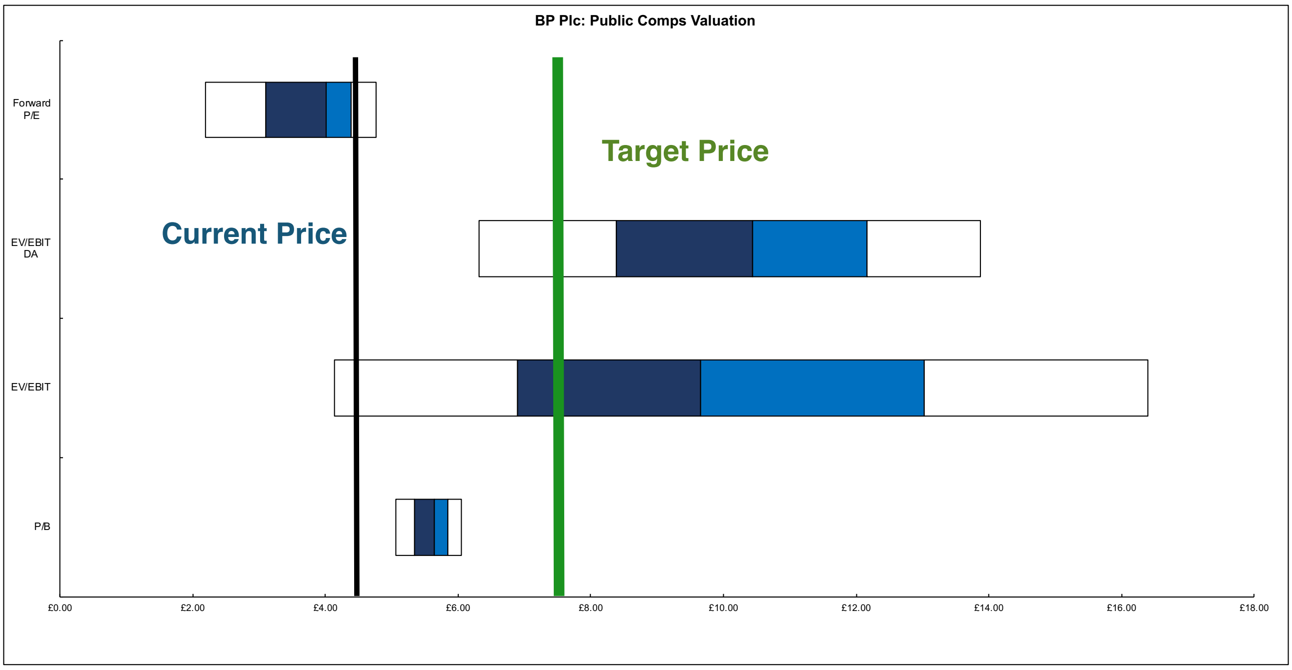
VI. Valuation

Fig. 3: Valuation Chart



Considering all the data and the charts presented above, as well as catalysts such as BP's renewables business and continued investment into various parts of the business (as a result of a higher CapEx, among other things), we believe BP is undervalued, and we expect the stock price to rise to £7.70 in the short-to-medium term.

As evidenced by the forward P/E ratio, it's roughly in line with the current stock price. This implies that the stock certainly isn't overpriced. Now, let's consider the EV/EBIT and EV/EBITDA values. At £4.93 per share, we see that BP's EV/EBIT and EV/EBITDA lower quartiles are above the share price, implying that the extrinsic value of the company is currently higher than the price of the company. Next, consider the company's P/B value. Even here, the lower quartile is higher than the company's share price. Since this takes into account the company's book value per share - which is the difference between its total assets and liabilities - this implies that BP is worth more than the value placed on them by the market. Thus, we believe the company is undervalued.

In 2018, BP's earnings were indicative of a time when oil was $100 a barrel rather than $50/barrel (the price in Dec 2018). Plant reliability in the upstream business reached record levels, and the downstream business saw record levels of throughput. BP also set clear targets for operational greenhouse gas emissions and has been tracking progress. BP also engages in a share buyback program, meaning they believe in the value of their stock. Oil production is also up, oil is at $60/barrel (the average price of Brent crude has consistently been above $60 over the last 15 years), and new projects in the pipeline point towards continued growth. It is also worth noting that the majority of BP shareholders are institutions, rather than individuals, which implies that the stock purchase has likely been carefully considered. In the last 2 years, earnings per share has also increased by over 35%, setting the company on a positive trajectory for an increase in EPS over the coming few years.

Furthermore, BP's free cash flow is over $7.5B. To put this into perspective, ExxonMobil, Chevron, and Royal Dutch Shell have free cash flow of $226M, $5.23B, and $30.52B respectively. This gives

BP enough cash to be able to use for future products and acquisitions without needing to accrue more debt. Perhaps more importantly, it gives BP the ability to increase dividends over time. An inhibiting factor is BP's CapEx, but this might prove to be a good move by the company. BP's depreciation and amortization is somewhat high at $17.3B, but is natural given how capital-intensive BP's business is, from offshore oil rigs, to oil refineries. Thus, $17B in CapEx will likely result in a reduction of depreciation and amortization in the short-to-medium term.

VII. Risks

As with any company, BP faces various risks, some of which are outlined below.

1. **Oil price volatility and geopolitics:** Geopolitics has forever been intertwined with oil prices, and will continue to be. With most of the world's oil production taking place in state-owned companies such as Gazprom (Russia), Sinopec Group (China), and ARAMCO (Saudi Arabia), the potential for geopolitics to influence the price of oil is high. It is likely that the ongoing US-China trade war will have an effect on oil prices, as will ARAMCO's impending IPO and OPEC's generally increasing influence. Furthermore on the geopolitical front, acts of terrorism, civil strife, and international sanctions all have an effect on BP's ability to do business.
2. **Exchange rates:** A further risk stems from exchange rate fluctuations. Crude oil is largely traded in the US dollar, whereas individual products are sold in various currencies. As the US dollar fluctuates, the price of crude oil as a factor of production (capital) will affect costs and revenues.
3. **Climate change and the energy transition:** Changes in laws, regulations, policies, obligations, social attitudes and customer preferences relating to the transition to a lower carbon economy could have a cost impact on BP's business, including increasing compliance and litigation costs, and could impact company strategy. Such changes could lead to constraints on production and supply and access to new reserves. Technological improvements or innovations that support the transition to a lower carbon economy, and customer preferences or regulatory incentives related to such changes that alter fuel or power choices, such as towards low emission energy sources, could impact demand for oil and gas. Depending on the nature and speed of any such changes and the company's response, this could adversely affect the demand for BP's products, investor sentiment, financial performance and competitiveness.
4. **Operational and environmental safety:** Technical integrity failure, natural disasters, extreme weather or a change in its frequency or severity, human error and other adverse events or conditions could lead to loss of containment of hydrocarbons or other hazardous materials or constrained availability of resources used in BP's operating activities, as well as fires, explosions or other personal and process safety incidents, including when drilling wells, operating facilities and those associated with transportation by road, sea or pipeline. There can be no certainty that BP's operating management system, or other policies and procedures will adequately identify all process safety, personal safety and environmental risks or that all operating activities will be conducted in conformance with these systems. Such events or conditions, including a marine incident, or inability to provide safe environments for the workforce and the public while at BP facilities, premises or during transportation, could lead to injuries, loss of life or environmental damage. As a result BP could face regulatory action and legal liability, including penalties and remediation obligations, increased costs and potentially denial of the company's licence to operate. BP's activities are sometimes conducted in hazardous, remote or environmentally sensitive locations, where the consequences of such events or conditions could be greater than in other locations.
5. **Uncertain contractor behavior:** BP conducts many of their activities through joint arrangements, associates, or with contractors and sub-contractors where BP may have limited influence and control over the performance of such operations. BP's partners and contractors are responsible for the adequacy of the resources and capabilities they bring to a project. If these are found to be lacking, there may be financial, operational or safety risks for BP. Should an incident occur in an operation that BP participates in, their partners and contractors may be unable or unwilling to fully compensate BP against costs BP may incur on their behalf or on behalf of the arrangement. Where BP does not have operational control of a venture, BP may still be pursued by regulators or claimants in the event of an incident.

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VIII. Disclosures

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