

Rating: Buy
S&P 500: 1113

BP p.l.c. **Back Door to Russia**

<i>Symbol</i>	BP	<i>Ebitda Next Twelve Months ending 3/31/05 (US\$mm)</i>	43,200
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	10
<i>Price (US\$/sh)</i>	53.78	<i>Natural Gas and Oil Production/Ebitda (%)</i>	75
<i>Pricing Date</i>	5/25/04	<i>Adjusted Reserves/Production NTM</i>	9.6
<i>Shares (mm)</i>	3681	<i>EV/Ebitda</i>	5.3
<i>Market Capitalization (US\$mm)</i>	198,000	<i>PV/Ebitda</i>	5.9
<i>Debt (US\$mm)</i>	32,800	<i>Undeveloped Reserves (%)</i>	47
<i>Enterprise Value (EV) (US\$mm)</i>	230,700	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	22.30
<i>Present Value (PV) (US\$mm)</i>	253,600	<i>Present Value Proven Reserves(US\$/boe)</i>	10.48
<i>Net Present Value (US\$/share)</i>	60	<i>Present Value Proven Reserves(US\$/mcf)</i>	1.75
<i>Debt/Present Value</i>	0.13	<i>Earnings Next Twelve Months (US\$/sh)</i>	5.43
<i>McDep Ratio - EV/PV</i>	0.91	<i>Price/Earnings Next Twelve Months</i>	10
<i>Dividend Yield (%/year)</i>	3.0	<i>Indicated Annual Dividend (US\$/sh)</i>	1.62

Note: Estimated cash flow and earnings tied to one-year futures prices for oil, natural gas and refinery crack.

Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.

Summary and Recommendation

We initiate a "Buy" rating on the common shares of **BP (BP)** as a competitive mega cap energy investment with possible enhancement through investment growth in Russia. Distinctive among its peers, BP has 50% equity stake in a large Russian company that accounts for more than 20% of the company's oil and gas production. The extra growth potential in the Russian properties may give BP an edge while some disappointment would not affect the stock unduly. Another distinction is BP's 10% of cash flow from North American natural gas, the highest of mega caps and due to its acquisition of Amoco late in the last century. We see 14% appreciation potential to net present value of US\$60 a share and a long term return of about 5% per year above inflation thereafter. Financial risk is low with debt less than one year's cash flow.

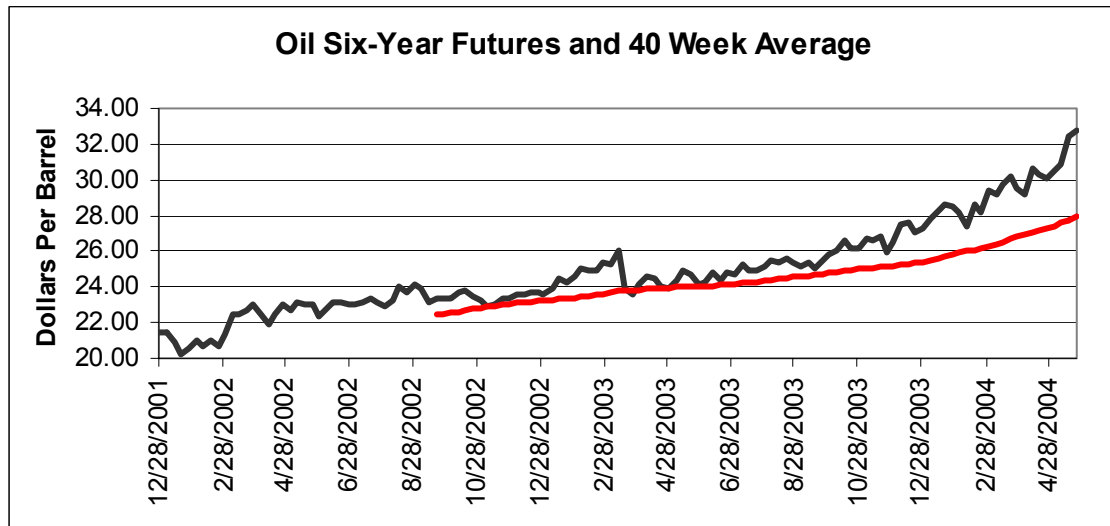
Oil Looks Up by the Charts, Fundamentals, Inflation and Security

Six-year futures describe the commodity price trends most relevant to estimating resource value. The longer time horizon better matches the period during which more of current resources will actually be produced. The longer term measure also smoothes the frantic near-month fluctuations and has the potential to keep climbing even if near-month quotes drop back temporarily.

The plots of weekly results since the beginning of 2002 trace a trend of six-year oil price rising 16% a year (see chart). We measure momentum with the 40-week moving average. The charts look good as long as the current six-year quote remains above the trailing average.

Fundamental factors support the price trends. Oil demand is strong with world economic growth paced by developing countries, especially China. Supply is tight as the Middle East is showing maturity with the workhorse giant fields on the verge of peaking.

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Monetary factors also favor oil investment as interest rates below inflation drive investors to real assets for protection against currency debasement. Compared to Treasury Inflation Protected Securities that we also favor, oil price is likely to rise more than the official government determined inflation measure.

There appears to be little of the cost of maintaining global security reflected in the price of oil. The U.S. military presence in the Middle East may be controversial today. Yet when the U.S. supported government in Iran fell at the end of the 1970s, the world experienced its highest energy prices ever.

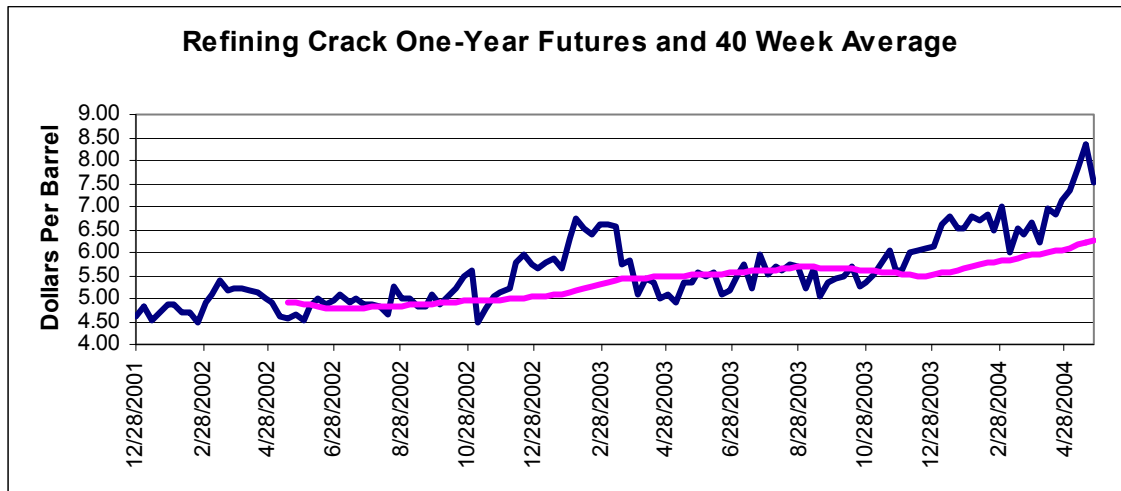
At some point oil price could be too strong and economic activity would be adversely affected. Six times in the past thirty years the annual gain in monthly price exceeded 70% briefly. June futures near \$40 a barrel for Light, Sweet Crude Oil would have to exceed \$52 a barrel to trigger a 70% warning.

Downstream Trends Also Strong

Industry people like to refer to the oil producing business as upstream and the oil refining/marketing business as downstream. Strong upstream business prospects captured in the rising trend of six-year futures are complemented by improving downstream prospects captured in the trend of one-year refining crack futures (see chart).

Compared to the two previous years, there has been no sign yet of a temporary peak in the trend. Perhaps there will be some falloff this year as in the past, but it would occur from a higher level.

The crack spread we measure is the price of two-thirds barrel of gasoline plus one-third barrel of heating oil minus a barrel of crude oil. While there are innumerable varieties of crude oil and products quoted around the world there is only one source of transparent, public quotes of futures prices for the next year, the New York Mercantile Exchange. As a result we use the Nymex quotes as an indicator of future downstream profitability globally, recognizing that markets are linked meaningfully, if not perfectly. Finally, the crack spread should be seasonally neutral because it always includes twelve months.



Volume, Price and Costs Translate to Attractive Cash Flow

Our process of estimating company-specific present value begins with an estimate of next twelve months cash flow. Current projections lead to a healthy level of unlevered cash flow, also known as Ebitda, short for earnings before interest, tax, depreciation and amortization (see table). We choose the next twelve months ending March 31, 2005 as the relevant time period.

For the next twelve months we project constant natural gas and oil volume at the first quarter 2004 level. That is sufficient for our valuation calculation. Management provides rich detail in conference calls, presentations and copious regulatory disclosures to put more color on a projection of growth for the rest of the decade.

We take the futures market at face value in projecting price for the next twelve months. Henry Hub quotes guide our projection of natural gas revenue. Light Sweet Crude quotes guide our projections of oil revenue. The refinery crack futures guide our projections of downstream cash flow. Because futures are constantly changing, our projection is adjusted accordingly. As a result, the specific amounts we project today may not be the amounts realized when the company next reports.

Assess Present Value Multiple Depending on Reserve Life

The important variables in the valuation of future production are captured in base year cash flow and a multiple of that cash flow that depends on reserve life. Indeed investors do differentiate on that basis as reflected in a high correlation of unlevered cash flow multiple with adjusted reserve life. We convert the market relationship to a formula that produces an anticipatory value with somewhat more sensitivity to reserve life.

BP plc
Next Twelve Months Operating and Financial Estimates

	<i>Q1</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Next Twelve Months</i>
	<i>3/31/04</i>	<i>6/30/04</i>	<i>9/30/04</i>	<i>12/31/04</i>	<i>2004E</i>	<i>3/31/05</i>	<i>3/31/05</i>
Volume							
Natural Gas (mmcf)							
U.S. (or North America)	2,869	2,869	2,869	2,869	2,877	2,869	2,869
Overseas (or Int'l)	5,731	5,731	5,731	5,731	5,747	5,731	5,731
Total	8,600	8,600	8,600	8,600	8,624	8,600	8,600
Oil (mbd)	2,533	2,533	2,533	2,533	2,533	2,533	2,533
Total gas & oil (mmb)	361	361	365	365	1,452	357	1,448
Price							
Natural gas (\$/mcf)							
Henry Hub (\$/mmbtu)	5.64	6.22	6.78	6.93	6.39	7.11	6.76
U.S. (or North America)	4.72	5.20	5.67	5.80	5.35	5.95	5.65
Overseas (or Int'l)	3.32	3.73	3.89	3.72	3.67	3.56	3.72
Total	3.79	4.22	4.48	4.41	4.23	4.35	4.37
Oil (\$/bbl)							
WTI Cushing	35.23	39.51	41.20	39.42	38.84	37.67	39.45
Worldwide	30.48	34.19	35.65	34.11	33.61	32.60	34.14
Total gas & oil (\$/bbl)	27.68	30.99	32.48	31.35	30.63	30.26	31.28
NY Harbor 3-2-1 (\$/bbl)	6.98	12.29	9.34	5.82	8.61	5.82	8.32
Revenue (\$mm)							
Natural Gas							
U.S. (or North America)	1,232	1,358	1,496	1,531	5,618	1,536	5,922
Overseas (or Int'l)	1,734	1,945	2,050	1,962	7,690	1,834	7,790
Total	2,966	3,303	3,546	3,492	13,308	3,370	13,712
Oil	7,026	7,881	8,307	7,949	31,163	7,431	31,568
Other	59,488	59,488	59,488	59,488	237,953	59,488	237,953
Total	69,480	70,672	71,342	70,930	282,424	70,289	283,233
Expense							
Production	2,992	3,230	3,364	3,282	12,868	3,154	13,030
Other	56,979	56,024	56,441	57,014	226,457	57,545	227,023
Ebitda (\$mm)							
Exploration and Production	7,000	7,954	8,489	8,160	31,603	7,648	32,250
Other	2,509	3,464	3,048	2,474	11,496	1,944	10,930
Total Ebitda	9,509	11,418	11,537	10,634	43,098	9,591	43,180
Exploration	136	136	136	136	544	136	544
Deprec., Deplet., & Amort.	2,814	2,814	2,814	2,814	11,256	2,814	11,256
Ebit							
	6,559	8,468	8,587	7,684	31,298	6,641	31,380
Interest	152	152	152	152	608	152	608
Ebt							
	6,407	8,316	8,435	7,532	30,690	6,489	30,772
Income Tax	2,242	2,911	2,952	2,636	10,742	2,271	10,770
Net Income (\$mm)							
Exploration and Production	4,568						
Other	1,114						
Unallocated	(1,517)						
Total	4,165	5,405	5,483	4,896	19,949	4,218	20,002
Shares (millions)							
	3,681	3,681	3,681	3,681	3,681	3,681	3,681
Per share (\$)	1.13	1.47	1.49	1.33	5.42	1.15	5.43
Ebitda Margin (E&P)	70%	71%	72%	71%	71%	71%	71%
Tax Rate	35%	35%	35%	35%	35%	35%	35%

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The adjusted reserve life index is the sum of developed and half undeveloped reserves divided by next twelve months production. When we last did an industry-wide upward revaluation on March 23, we estimated cash flow multiple equal to 2.5 plus 0.5 times reserve life. That approximates present value assuming constant commodity price near the one-year quotes at that time, about \$35 a barrel for crude oil. Higher commodity prices since then imply higher cash flow and lower multiple by about 10%. Estimated present value provides a measure of appreciation potential should the market move toward that level as we expect.

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Research Methodology/Ratings Description: McDep Associates is an independent research originator focused on oil and gas stocks exclusively. The firm applies the thirty years of experience of its analyst to estimate a present value of the oil and gas resources and other businesses of covered companies. That value is compared with a company's stock market capitalization and debt. Stocks with low market cap and debt relative to present value tend to outperform stocks with high market cap and debt relative to present value. Buy recommendations are expected to deliver a total return better than 7% per year above inflation. Hold recommendations assume the attributes of the underlying business are more than fully reflected in the current price of the stock. Sell recommendations are expected to deliver a negative total return less than 7% per year including the effects of inflation.

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