Rating: Buy
S&P 500: 1129

BP p.l.c.
Betting on Putin

Symbol	BP	*Ebitda Next Twelve Months ending 9/30/05 (US$mm)*	37,300
Rating	Buy	*North American Natural Gas/Ebitda (%)*	8
Price (US$/sh)	56.43	*Natural Gas and Oil Production/Ebitda (%)*	73
Pricing Date	9/17/04	*Adjusted Reserves/Production NTM*	9.7
Shares (mm)	3651	*EV/Ebitda*	6.4
Market Capitalization (US$mm)	206,000	*PV/Ebitda*	6.8
Debt (US$mm)	32,800	*Undeveloped Reserves (%)*	46
Enterprise Value (EV) (US$mm)	238,800	*Natural Gas and Oil Ebitda (US$/boe)*	18.90
Present Value (PV) (US$mm)	251,800	*Present Value Proven Reserves(US$/boe)*	10.10
Net Present Value (US$/share)	60	*Present Value Proven Reserves(US$/mcfe)*	1.68
Debt/Present Value	0.13	*Earnings Next Twelve Months (US$/sh)*	4.52
McDep Ratio - EV/PV	0.95	*Price/Earnings Next Twelve Months*	12
Dividend Yield (%/year)	3.0	*Indicated Annual Dividend (US$/sh)*	1.70

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 continue 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. Supplementing our recent analysis of August 26, we comment on the recent centralizing of political power in Russia and restate our opinion on the widely reported difficulties of Russian producer, Yukos. President Putin's move to consolidate power in Moscow may be advantageous for oil producers who may get conflicting taxation and regulation regionally and nationally. Yukos appears to be a special case that does not seem to have spilled over to BP or the leading Russian oil company, Lukoil. We see interim appreciation potential in BP stock to net present value of $60 a share, our best estimate of the value of the oil and gas resources and other businesses of a company assuming reasonable future economic conditions.

Putin Centralizes Power

According to press reports, the Russian president recently announced that regional governors would no longer be elected. Instead they would be appointed by the central government. We got an early response from an industry leader that made sense to us. The change could be helpful to the oil producers who have been frustrated from time to time by trying to serve two masters, the local and the national authorities. Yet, for other matters, it is likely to be more difficult to run the country on a centralized basis.

President Putin appears to be an intelligent, serious person interested in advancing the economic status of his country in a secure environment. The country's most important natural resources and generators of foreign currency are oil and gas. On that basis we expect Mr. Putin to take actions that build confidence in international markets. That includes respecting capitalist principles as they apply to Russian producers and to the international oil companies who are likely to be part of the development of Russian resources.

Please see disclosures on the final page.

Yukos Apparently Bit the Hand that Fed It

In the development of a capitalist society after the fall of communism, ownership of oil resources became concentrated in the hands of a few "oligarchs". Investors seemed surprised by the jailing of Mr. Mikhail Khodorkovsky, the dominant owner of Yukos, an emerging corporate giant. The government may have moved against Mr. Khodorkovsky because he was too active supporting political opposition to the party in power. In view of the questions surrounding his sudden accumulation of wealth, Mr. K. may have overplayed his hand.

Mr. Vagit Alekperov, the president of Yukos competitor, Lukoil, is also one of the oligarchs. Mr. Alekperov may be more politically aware and apparently has not attempted to use his corporate or personal wealth to oppose the Russian political leader, Mr. Putin. Lukoil stock is also more widely held than that of Yukos. If Lukoil can continue to be a successful investment, it has favorable implications for BP's investment that offsets concerns about Yukos.

The rough analogy in the U.S. might be the era of the Standard Oil Trust. Mr. Rockefeller obviously went too far for some with his tactics in building his empire and brought down political wrath. Since the U.S. Supreme Court broke up Standard Oil in 1911, most of the pieces have gone on to be successful investments and some have even recombined.

Cash Flow and Profits from Russian Oil Depend on Access to International Markets

BP's Russian venture has been operating in its current form for just a few months. In contrast we have several years of financial reporting for Lukoil, a stock we are separately recommending. From that analysis we see that growing production volumes in Russia generate a cash flow margin of perhaps a third of normal. The most profitable production may be that which is accepted for transportation to international markets by the government controlled export pipelines. Rail transport is a high cost alternative for limited export volumes. Where BP or Lukoil refines its own crude oil it can get the equivalent of an international price in some of its gasoline sales while some refined products are sold at prices limited by government regulation. Crude oil sold domestically receives a depressed price.

Controlling access to markets is a means for the government to control the industry. In that context, it makes sense to us that production should be orderly. The government should have a longer term point of view that oil production should be stretched out to make the benefits last longer rather than to be developed as fast as possible.

Strategic Appeal and Political Risk

Investment in Russia requires a leap of faith and patience with the pace of evolution to a fully democratic and thriving capitalist society. Leading international oil companies see the opportunities and are proceeding at a controlled pace.

Investors in BP see some 20% of the mega cap's production coming from Russia. For that representation BP has invested about 5% of its Enterprise Value for its half interest in TNK-BP. Considering the limited size of BP's investment in Russia relative to other areas of the world, any political risk seems well contained.

Investors in ConocoPhillips may soon be participating in more Russian production as the large cap producer/refiner contemplates an investment in Lukoil with whom it already has joint operations. The Russian government intends to sell its remaining 9.6% interest in Lukoil at auction on September 29. The outcome of the sale would be a signal of how effectively the government is proceeding.

Net Present Value Analogous to Target Price

We get asked occasionally for a target price. Investors have a right to know how much a company may be worth in order to act intelligently on a buy/sell decision. That is the main emphasis of our analysis though we have not called our single point value, target price. We call it net present value to connote the discounted cash flow analysis that forms much of the basis for determining the result. The main thrust of a recent cycle of analyses has been to relate that result to the unknown of future oil price.

Though we often compare stock price to present value directly, we find it more rewarding to make the comparison on an unlevered basis. High-debt stocks can look too good to be true on a simple stock price to present value, or target price basis. As a result, an unlevered approach, the McDep Ratio, Market Cap and Debt to Present Value (Gross), drives us to give more emphasis to stocks with strong balance sheets.

Our recommendations with the most potential have McDep Ratios of 0.8 or less. BP has a McDep Ratio of 0.95. In today's market we could maintain our buy recommendation up to a McDep Ratio of 1.2. We like oil and gas and we know our analysis is not perfect. At 1.2, or possibly less, with no change in other oil and gas stocks we would have to reconsider whether any thing at BP has changed or whether we have overlooked something. If after that reconsideration the McDep Ratio does not change much, we would then most likely change our recommendation from Buy to Hold. Meanwhile the combination of low risk and attractive value continue to justify our positive position on BP and its peers.

Kurt H. Wulff, CFA

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