

Rating: Buy
S&P 500: 1294

BP plc

What Windfall Profits?

<i>Symbol</i>	BP	<i>Ebitda Next Twelve Months ending 12/31/06 (US\$m)</i>	48,700
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	6
<i>Price (US\$/sh)</i>	67.90	<i>Natural Gas and Oil Production/Ebitda (%)</i>	64
<i>Pricing Date</i>	1/11/06	<i>Adjusted Reserves/Production NTM</i>	9.5
<i>Shares (mm)</i>	3501	<i>EV/Ebitda</i>	5.6
<i>Market Capitalization (US\$m)</i>	237,700	<i>PV/Ebitda</i>	6.2
<i>Debt (US\$m)</i>	32,800	<i>Undeveloped Reserves (%)</i>	45
<i>Enterprise Value (EV) (US\$m)</i>	270,500	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	21.20
<i>Present Value (PV) (US\$m)</i>	302,300	<i>Present Value Proven Reserves(US\$/boe)</i>	10.70
<i>Net Present Value (US\$/share)</i>	77	<i>Present Value Proven Reserves(US\$/mcf)</i>	1.78
<i>Debt/Present Value</i>	0.11	<i>Earnings Next Twelve Months (US\$/sh)</i>	7.29
<i>McDep Ratio - EV/PV</i>	0.89	<i>Price/Earnings Next Twelve Months</i>	9
<i>Dividend Yield (%/year)</i>	3.2	<i>Indicated Annual Dividend (US\$/sh)</i>	2.14

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

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

Summary and Recommendation

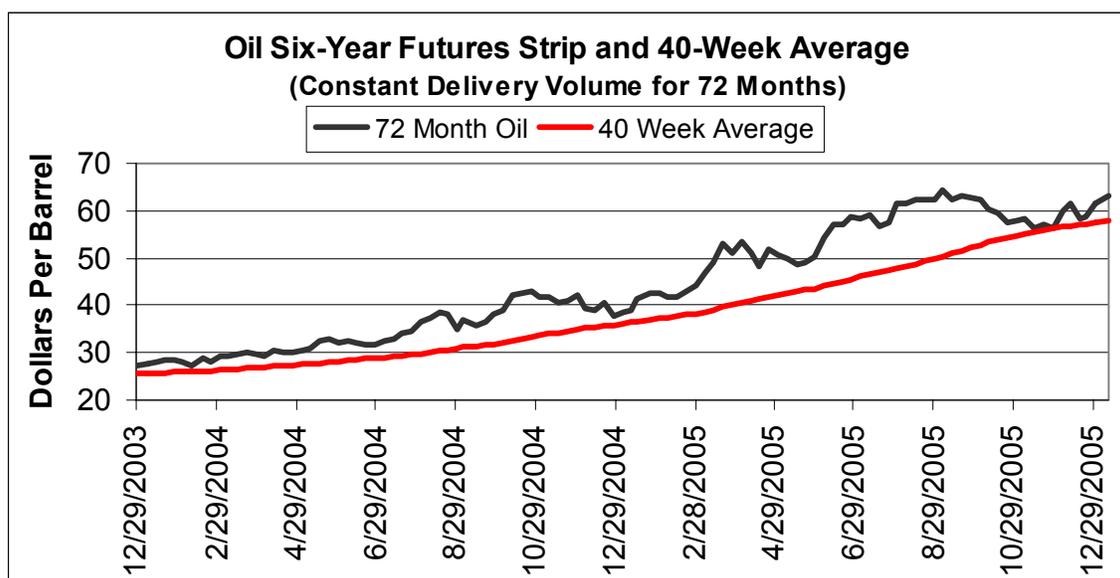
Buy-recommended **BP plc (BP)** offers 13% appreciation potential to estimated net present value of \$77 a share. Strengthening industry conditions have not translated to rising profits for BP for the past few quarters as readily as some of the extreme political opinion in BP's home country might suggest. Management's trading update released on January 11 is replete with examples of challenges related to hurricanes, operating safety, unexpected commodity price movements relative to contract, charges for damaged facilities and higher taxes. Nonetheless we are confident that BP will continue to generate valuable cash flow from natural gas and oil production and refined products. Accounting for a quarter of the company's global oil equivalent production, operations in Russia may contribute the most upside surprise in the years ahead.

McDep Ratio Relates Oil Price to Opportunity

A McDep Ratio below 1.0 tells us that BP's market cap and debt, or enterprise value, is less than the estimated present value of its energy resources assuming a long-term real price of \$50 a barrel for Light, Sweet Crude Oil. Alternatively we could say that BP's stock is priced for \$45 oil, an approximation derived by multiplying \$50 times the McDep Ratio.

Meanwhile six-year oil futures are about \$63 a barrel. Momentum has been positive for more than three years as the current quote stays above the 40-week average (see chart [Oil Six-Year Futures and 40-Week Average](#)). Six-year oil has tripled in the four years we have been calculating it on a weekly basis. We do not need further gains in oil price to make money in buy recommendations. Yet our vision of \$150 oil in 2010 implies additional scope to exceed common expectations.

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BP's McDep Ratio ranks at the high end of peer companies (see table [Rank by McDep Ratio](#)). Aside from the fundamental appreciation potential we outlined above, a McDep Ratio of 1.0 is an indication of takeover value. The McDep Ratio of buy-recommended **Burlington Resources (BR)**, increased to 1.0 immediately after buy-recommended **ConocoPhillips (COP)** announced its takeover offer. Having expanded aggressively buying up American and Russian companies, BP may need to concentrate on what it already owns.

Rank by McDep Ratio: Market Cap and Debt to Present Value

	<i>Symbol/</i>	<i>Price</i>	<i>Market</i>	<i>Net</i>	<i>Debt/</i>	<i>McDep</i>		
	<i>Rating</i>	<i>(\$/sh)</i>	<i>Cap</i>	<i>Present</i>	<i>Present</i>	<i>Ratio</i>		
		<i>11-Jan</i>	<i>Shares</i>	<i>Value</i>	<i>Value</i>			
		<i>2006</i>	<i>(mm)</i>	<i>(\$mm)</i>	<i>(\$/sh)</i>			
Mega Cap								
BP plc	BP	B	67.90	3,501	238,000	77.00	0.11	0.89
Total S.A.	TOT	B	133.31	1,176	157,000	160.00	0.12	0.85
Exxon Mobil Corporation	XOM	B	60.27	6,303	380,000	74.00	0.04	0.82
Royal Dutch Shell plc	RDS-A	B	65.11	3,352	218,000	84.00	0.10	0.80
Chevron Corporation	CVX	B	59.84	2,256	135,000	85.00	0.13	0.74
ConocoPhillips	COP	B	60.77	1,693	103,000	95.00	0.22	0.72
			<i>Total or Median</i>		<i>1,231,000</i>		<i>0.12</i>	<i>0.81</i>

Low Cash Flow Multiple

Unlevered cash flow multiples in single digits attest to low valuation (see table [Rank by EV/Ebitda](#)). Multiples may be low because investors do not think cash flow will last long at current levels. That depends on commodity price and reserve life. Cash flow estimated for the next twelve months, Ebitda NTM, reflects latest futures prices. Reserve life is measured as adjusted reserves divided by next twelve months production. A median reserve life for BP compared to peers may justify a multiple of present value to cash flow that is also close to the median.

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Rank by EV/Ebitda: Enterprise Value to Earnings Before Interest, Tax, Deprec.

	Symbol/ Rating		Price (\$/sh) 11-Jan 2006	Adjstd Resrvs/ Prod NTM	PV/ Ebitda NTM	EV/ Ebitda NTM	P/E NTM	Divd or Distrib NTM (%)
Mega Cap								
BP plc	BP	B	67.90	9.5	6.2	5.6	9	3.2
Exxon Mobil Corporation	XOM	B	60.27	11.7	6.7	5.5	10	1.9
Total S.A.	TOT	B	133.31	9.2	6.1	5.2	9	2.7
Royal Dutch Shell plc	RDS-A	B	65.11	7.5	5.5	4.4	8	3.4
Chevron Corporation	CVX	B	59.84	9.6	5.7	4.2	7	3.0
ConocoPhillips	COP	B	60.77	11.0	5.4	3.9	6	2.0
	<i>Median</i>			9.6	5.9	4.8	8	2.9

Least Unusual Pattern of Concentration by Segment

Each oil and gas stock has its own unique mix of energy resources (see table Business Segments). BP appears least unusual among peers as its concentration on each segment is close to the median.

Home Country and Business Segments

	Symbol/ Rating		Non- U.S. Domicile	North Amer. Natural Gas (%)	Rest of World Natural Gas (%)	Oil Prod'n (%)	Down- stream (%)	Total Present Value (US\$mm)
Mega Cap								
Exxon Mobil Corporation	XOM	B		10	19	38	33	487,000
Royal Dutch Shell plc	RDS-A	B	UK	4	19	33	45	313,000
BP plc	BP	B	UK	10	12	42	36	302,000
Chevron Corporation	CVX	B		9	9	52	29	221,000
Total S.A.	TOT	B	France	-	28	37	35	214,000
ConocoPhillips	COP	B		23	7	43	28	207,000
	<i>Total or Median</i>			9	15	40	34	1,744,000

Static Present Value Justified by Dynamic Cash Flow

Present value analysis presumes that fundamental value is measured by the projection of cash flows years into the future and bringing them to the present applying a real discount rate, currently 7% a year. We generally hold present value estimates static until there is justification to make new commodity price assumptions.

Next Twelve Months (NTM) cash flow represents the volumes and costs that form the base for future projections. Reserve life index tells how long cash flow will last. NTM cash flow and reserve life are the two main variables in our correlation by function for about 30 companies. Net present value indicated by the current combined correlation is about \$4 a share lower than our ongoing standard estimate for the company (see table Functional Cash Flow and Present Value).

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Functional Cash Flow and Present Value

	<i>NTM Ebitda</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Present</i>	
	<i>(US\$mm)</i>	<i>R/P</i>	<i>Ebitda</i>	<i>Value</i>	
				<i>(US\$mm)</i>	
North American Natural Gas	3,010	13.9	9.6	29,000	10%
Rest of World Natural Gas	4,290	10.6	8.2	35,000	12%
Oil	23,670	8.4	5.4	128,000	42%
Downstream	17,740		6.2	110,000	36%
	48,710	9.5	6.2	302,000	100%
Debt (US\$mm)				32,800	
Net Present Value (US\$mm)				269,600	
Shares (mm)				3,501	
Net Present Value (US\$/sh)				77	
Over (-)/ Under (+) Correlation (US\$/sh)					(4)

Futures Prices Propel Estimated Cash Flow by Quarter

Cash flow for the next year is projected from a base through the latest reported quarter (see table Next Twelve Months Operating and Financial Estimates). Company disclosures provide the clues for future volumes and costs as well as geographic and quality differences in price. Futures prices from the New York Mercantile Exchange determine industry benchmarks for the next year in our model.

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Next Twelve Months Operating and Financial Estimates

	<i>Q4</i>	<i>Q3</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Next Twelve Months</i>
	<i>12/31/04</i>	<i>9/30/05</i>	<i>12/31/05</i>	<i>2005E</i>	<i>3/31/06</i>	<i>6/30/06</i>	<i>9/30/06</i>	<i>12/31/06</i>	<i>12/31/06</i>
Volume									
Natural Gas (mmcf)									
U.S. (or North America)	2,651	2,456	2,456	2,585	2,456	2,456	2,456	2,456	2,456
Overseas (or Int'l)	6,063	5,385	5,934	5,869	5,934	5,934	5,934	5,934	5,934
Total	8,714	7,841	8,390	8,455	8,390	8,390	8,390	8,390	8,390
Oil (mmb)	239	227	240	945	235	238	240	240	953
Oil (mbd)	2,593	2,472	2,612	2,574	2,612	2,612	2,612	2,612	2,612
Total gas & oil (mbd)	4,045	3,779	4,010	3,975	4,010	4,010	4,010	4,010	4,010
Price									
Natural gas (\$/mcf)									
Henry Hub (\$/mmbtu)	7.10	8.56	13.00	8.65	10.07	9.32	9.47	10.19	9.76
U.S. (or North America)	5.72	6.77	10.28	6.99	7.96	7.37	7.49	8.05	7.72
Overseas (or Int'l)	3.65	3.83	4.02	3.84	4.22	4.43	4.65	4.89	4.55
Total	4.28	4.75	5.85	4.80	5.32	5.29	5.48	5.81	5.48
Oil (\$/bbl)									
WTI Cushing	48.31	62.52	59.99	56.30	62.72	65.23	65.85	66.14	64.99
Worldwide	39.88	54.80	52.58	48.70	54.98	57.18	57.72	57.98	56.97
Total gas & oil (\$/bbl)	34.78	45.70	46.49	41.70	46.93	48.31	49.06	49.92	48.57
NY Harbor 3-2-1 (\$/bbl)	5.72	16.70	9.05	10.63	10.50	13.19	13.51	9.42	11.66
BP Refining Indicator	5.60	12.35	7.60						
Revenue (\$mm)									
Natural Gas									
U.S. (or North America)	1,395	1,530	2,323	6,593	1,759	1,646	1,691	1,820	6,917
Overseas (or Int'l)	2,036	1,897	2,195	8,231	2,254	2,393	2,541	2,668	9,856
Total	3,431	3,427	4,518	14,823	4,013	4,040	4,232	4,487	16,773
Oil	9,514	12,463	12,636	46,007	12,924	13,590	13,869	13,932	54,316
Other	67,719	81,836	81,836	303,497	81,836	81,836	81,836	81,836	327,343
Total	80,664	97,725	98,989	364,328	98,773	99,466	99,937	100,255	398,431
Expense									
Production	6,045	9,089	9,721	31,999	9,614	9,960	10,195	10,354	40,123
Other	64,301	78,067	77,770	288,067	77,401	77,401	77,401	77,401	309,603
Ebitda (\$mm)									
Exploration and Production	6,900	6,800	7,432	28,832	7,324	7,670	7,906	8,065	30,965
Other	3,418	3,769	4,065	15,430	4,435	4,435	4,435	4,435	17,740
Total Ebitda	10,318	10,569	11,497	44,262	11,759	12,105	12,341	12,500	48,705
Exploration	151	177	177	653	177	177	177	177	708
Deprec., Deplet., & Amort.	4,383	2,041	2,041	8,745	2,041	2,041	2,041	2,041	8,164
Other non cash	-	1,420							
Ebit	5,784	6,931	9,279	32,613	9,541	9,887	10,123	10,282	39,833
Interest	189	144	144	588	144	144	144	144	576
Ebt	5,595	6,787	9,135	32,025	9,397	9,743	9,979	10,138	39,257
Income Tax	1,958	2,375	3,197	11,209	3,289	3,410	3,493	3,548	13,740
Net Income (\$mm)									
Exploration and Production	5,489	6,535							
Other	2,198	1,579							
Unallocated	(4,050)	(3,703)							
Total	3,637	4,411	5,938	20,816	6,108	6,333	6,486	6,590	25,517
Shares (millions)	3,601	3,501	3,501	3,531	3,501	3,501	3,501	3,501	3,501
Per share (\$)	1.01	1.26	1.70	5.90	1.74	1.81	1.85	1.88	7.29
Ebitda Margin (E&P)	53%	43%	43%	47%	43%	44%	44%	44%	44%
Tax Rate	35%	35%	35%	35%	35%	35%	35%	35%	35%

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