

BP

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INVESTMENT RESEARCH

17 JUNE 2010

The meeting between BP and the US government will hopefully mark the beginning of the end of the cloud overhanging BP shares following the Gulf of Mexico accident in April. The set up of a \$20bn fund for victims' claims, the proposed sale of \$10bn of non-core assets and the planned cut in investment will not materially hurt the growth prospects, demonstrating the company's financial strength.

Clearly the loss of the dividend is a blow to income oriented investors. However, more worrying has been the threat of bankruptcy or the seizure of its assets to compensate the victims. We think the moves made at that meeting reduce those possibilities. **BUY.**

The key element in the agreement was the establishment of an Independent Claims Facility to cover all legitimate claims associated with the accident. \$20bn seems like a huge figure given that the cost to the middle of June was less than \$2bn. However, this figure is within our forecast revised forecast of \$40bn, including additional costs associated with our assumption of tighter drilling, safety and testing regulations. The payments are stretched out for three and a half years and a matching \$20bn of assets has been set aside as collateral to be reduced as and when payments are made from the fund. The fund has not been capped and cannot be used to any fines or penalties which may arise.

The cancellation of the dividend is disappointing and we think this is partly the blame of the credit markets, as is the proposed sale of \$10bn of non-core assets. The financial stability of the company was put at risk by the downgrading of BP's credit rating. Add to this the increased estimate of the daily spill to up to 60,000 barrels and BP could be facing multi-billion dollar lawsuits under various environmental acts. Consequently, the possibility of raising the gearing to 30%, the top of the normal range over a cycle, was unavailable or prohibitively expensive, hence the need for dividend cuts and asset sales.

The bigger question still to be solved is the plugging of the well and we shall not know the answer to that until the end of August when the relief wells hit their target. In the meantime a second containment system to increase the oil capture is now in place and a more permanent hurricane proof system designed to capture the majority of the oil will be in place in July.

Clearly the loss of the dividend is a blow to income oriented investors. We think that BP's response to the US government's demands are positive and reduce the possibility of the company seeking bankruptcy protection and the seizure of assets. These concerns have contributed to the collapse in the share price which we feel is overdone.

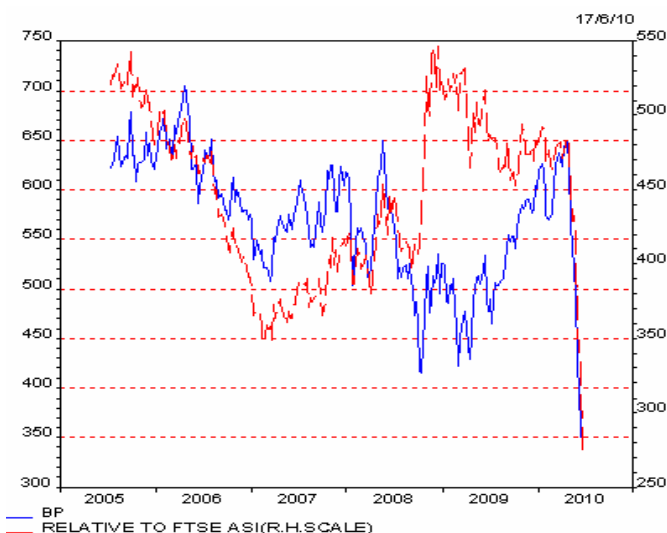
**History:** In 1998 British Petroleum merged with the US oil company Amoco to create the third largest oil company in the world. The company decided to go one step further with the purchase of Atlantic Richfield (ARCO) in March 2000. In 2005, BP derived 84% of its operating profits from its upstream activities including LNG. The remainder came from refining and marketing and chemicals. Its strengths are in the US and the North Sea; it is relatively weak in Asia and the Far East. BP is the third largest marketer of gasoline in the US and sells products in about 100 other countries. In late 2003 the company formed an oil and gas joint venture with TNK in Russia.

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Please see important notes on the next page

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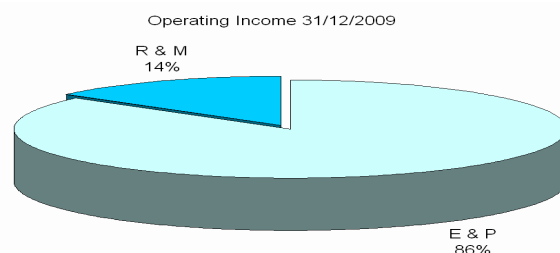
|                       |                              |
|-----------------------|------------------------------|
| <b>Recommendation</b> | <b>BUY</b>                   |
| COB as at             | 16/06/2010                   |
| Price                 | 337p                         |
| 52 Week High          | 655.40p                      |
| 52 Week Low           | 337.00p                      |
| Market Capitalisation | £63,318.00 m                 |
| Gearing               | 19 %                         |
| Sector Gearing        | 19 %                         |
| Sector                | Oil & Gas                    |
| Sector Recommendation | Overweight                   |
| Next News             | Interim Results: 27 Jul 2010 |



|                       | 1 mth | 3 mths | 12 mths |
|-----------------------|-------|--------|---------|
| BP. Absolute          | -36.4 | -45.9  | -33.0   |
| Relative to Sector    | -28.0 | -32.3  | -30.8   |
| Relative to All Share | -36.0 | -42.4  | -45.2   |

|               | 12/09A | 12/10E | 12/11E | 12/12E |
|---------------|--------|--------|--------|--------|
| Op. Income £m | 14465  | 20330  | 23375  | 25490  |
| PBT £m        | 13700  | 20000  | 22700  | 24816  |
| EPS p         | 49.7   | 71.0   | 78.9   | 86.3   |
| EPS % Chg     | -33    | 43     | 11     | 9      |
| P/E           | 6.8    | 4.7    | 4.3    | 3.9    |
| DPS p         | 35.7   | 0.0    | 18.8   | 37.5   |
| DPS % Chg     | 29     | -100   | 0      | 99     |
| Net Yield %   | 10.6   | 0.0    | 5.6    | 11.1   |
| Div Cover     | 1.4    | 0.0    | 4.2    | 2.3    |

A = Actual E = Estimate



## IMPORTANT NOTES

Main Source of information: Company Report and Accounts, Thomson Reuters.

|                |  |  |  |
|----------------|--|--|--|
| Date           |  |  |  |
| Recommendation |  |  |  |

If there is no data in the above box, the recommendation has not been changed in the past twelve months.

Text last changed: **10/06/2010**

The information contained in this report represents an impartial assessment of the value or prospects of the subject matter.

Recommendation Parameters:

BUY = We believe the stock will outperform other researched stocks within the sector.

HOLD = We believe the stock will perform in-line with other researched stocks within the sector.

SELL = We believe the stock will underperform other researched stocks within the sector.

OVERWEIGHT = We believe the sector will outperform the FTSE 350.

IN-LINE = We believe the sector will perform in-line with the FTSE 350.

UNDERWEIGHT = We believe the sector will underperform the FTSE 350.

Gearing expresses the extent to which a company is debt funded. The above measure of gearing is calculated by dividing the total net debt of a company by the shareholders equity of a company.

Prices, graphs etc. are as at the close of business on the day preceding the date of the note.

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