

MarketLine Case Study

BP PLC Case Study

After the Deepwater Horizon Oil Spill

Reference Code: ML00001-046

Publication Date: February 2012

WWW.MARKETLINE.COM

MARKETLINE. THIS PROFILE IS A LICENSED PRODUCT AND IS NOT TO BE PHOTOCOPIED

MarketLine

OVERVIEW

Catalyst

This case study focuses on British Petroleum (BP) in the aftermath of the Deepwater Horizon Oil Spill in 2010.

Summary

- The Deepwater Horizon Oil Spill had a massive impact on investors, as BP's market value fell sharply.
- BP's asset sales are focused on minority held assets and exhausting fields.
- BP is targeting focused investment and a managed portfolio.

TABLE OF CONTENTS

Overview	2
Catalyst.....	2
Summary	2
Table of Contents	3
Deepwater Horizon Oil Spill	5
The Deepwater Horizon Oil Spill occurred in April 2010	5
The Immediate Impact of the Oil Spill for BP.....	6
The Deepwater Horizon Oil Spill had a massive impact on investors as BP's market value fell sharply	6
BP's market value fell by over 50% in 2010	6
BP's dividend suspension hit investors and the wider economy	7
BP is selling its global assets to compensate victims of the oil spill	8
BP's Restructuring.....	9
BP's asset sales target minority held assets and exhausting fields	9
BP has implemented changes to focus on safety	9
There could also be major financial benefits for BP in restructuring its operations	9
Post-oil spill challenges continue to weigh down earnings.....	11
Conclusion	13
BP is targeting focused investment and a managed portfolio	13
BP plans to focus on upstream projects.....	13
BP wants a growing cash flow	13
BP will attempt to appease shareholders through increasing returns.....	13
Appendix	14
Definitions.....	14
Further Reading.....	14
Ask the analyst	15
About MarketLine	15
Disclaimer.....	15

TABLE OF FIGURES

Figure 1: Diagram showing BP's efforts to clean up the Deepwater Horizon Oil Spill	5
Figure 2: BP's share price fell dramatically in 2010	6
Figure 3: BP dividends paid, 2008–10	7
Figure 4: Table of key statistics showing BP's response to the Deepwater Horizon Oil Spill	8
Figure 5: Graph showing the market capitalization of BP, Royal Dutch Shell and Exxon Mobil as a percentage of assets	10
Figure 6: Average gas and oil marker price fluctuations	11
Figure 7: BP's replacement cost profit.....	12

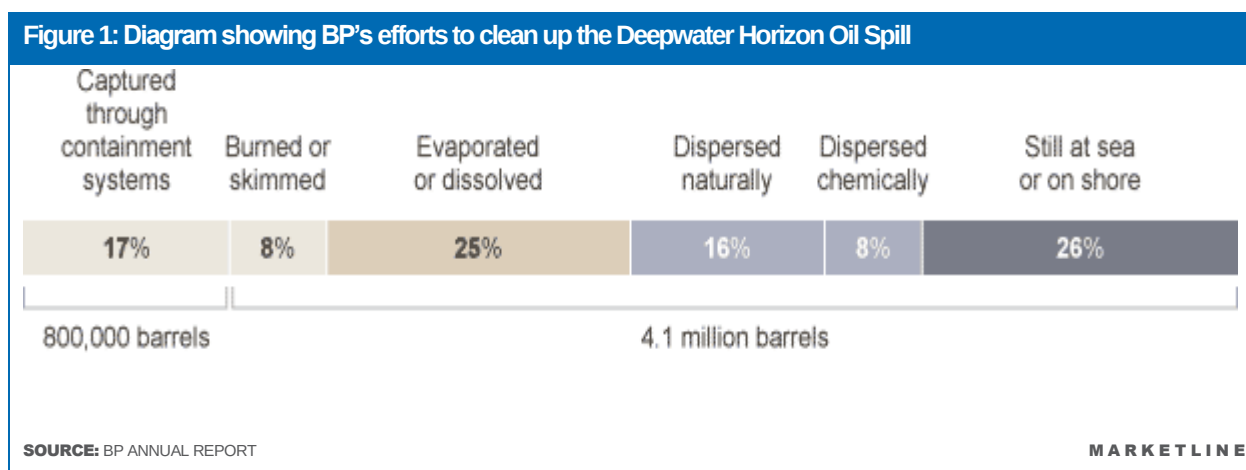
DEEPWATER HORIZON OIL SPILL

The Deepwater Horizon Oil Spill occurred in April 2010

The Deepwater Horizon Oil spill took place in the Gulf of Mexico in 2010. The spill emanated from a seafloor oil gusher caused by an explosion of the Deepwater Horizon semi-submersible Mobile Offshore Drilling Unit, which was owned and operated by US company Transocean. Transocean was drilling for BP in the Macondo Prospect oil field about 40 miles (60km) southeast of the Louisiana coast.

The explosion took place on 20th April 2010 and resulted in the Deepwater Horizon oilrig sinking two days later. An average of over 50,000 barrels of oil flowed out of the well each day until it was finally contained on 15th July 2010, by which time 4.9 million barrels of oil had leaked out of the well. About 800,000 barrels, or 17%, were recaptured by BP's containment efforts.

Over half of the remaining 4.1 million barrels of oil were either burned or skimmed, or had already evaporated or dispersed by the beginning of August 2010. A further 1.3 million barrels of oil was still onshore as tar balls, buried under sand and sediment or floating on the ocean surface as a light sheen.



The Deepwater Horizon Oil Spill was a watershed moment for BP and the oil and gas industry. It was the largest oil spill in history, exceeding the Ixtoc I oil leak in 1980 when an estimated 10,000–30,000 barrels of oil spilled per day for almost ten months until it was capped in March 1980. The total amount spilled was estimated to be 140 million gallons, or about 3.3 million barrels, of crude oil.

The initial explosion of the Deepwater Horizon Oil Spill killed eleven workers and injured seventeen others. The human and environmental costs of the disaster have been colossal, killing thousands of birds and other wildlife, polluting thousands of miles of coastline, and decimating local fishing and tourism industries.

The cost to BP has also been noticeable, both initially and with regard to the medium and long term direction the company will take.

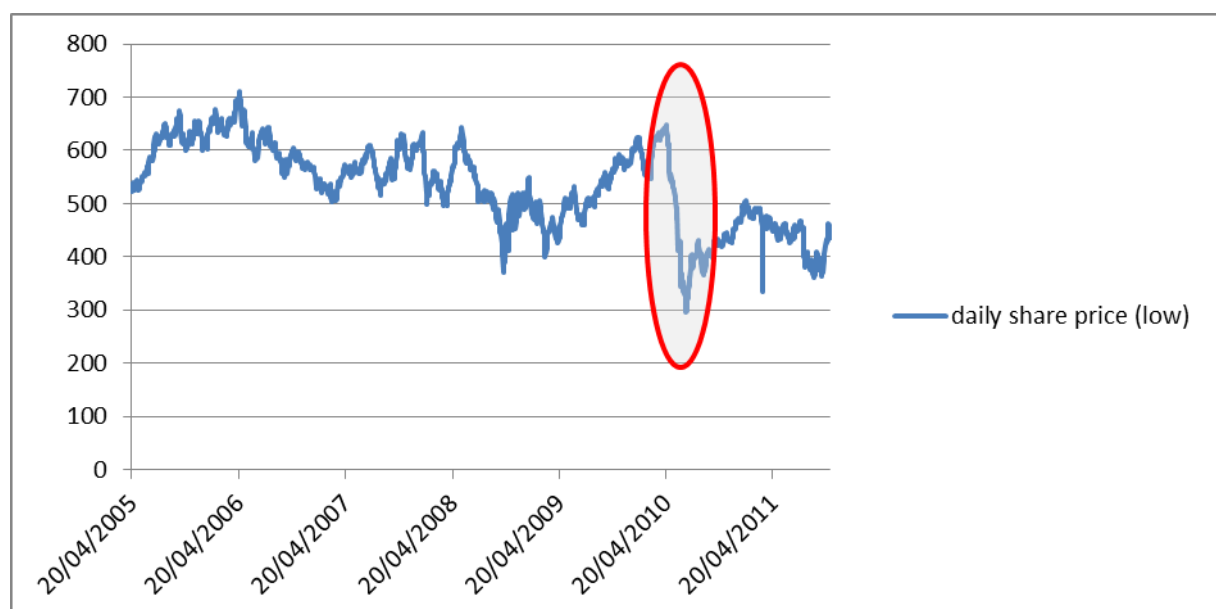
THE IMMEDIATE IMPACT OF THE OIL SPILL FOR BP

The Deepwater Horizon Oil Spill had a massive impact on investors as BP's market value fell sharply

BP's market value fell by over 50% in 2010

The most noticeable impact on BP was the decline in the company's market value. BP shares had historically been a safe and sure investment for many pension funds and stock market investors, and its status as a leading FTSE 100 company due to high market capitalization was a prominent pulling point.

Figure 2: BP's share price fell dramatically in 2010



SOURCE: MARKETLINE

MARKETLINE

As the graph shows, BP's share price (daily high) had consistently been between 500 and 700 pence in the five years leading up to 10th April 2010. In the immediate aftermath of the oil spill the share price plummeted to a low of 296 pence on 25th June 2010, shedding over 50% of the company's value (approximately \$100 billion) in just two and a half months. The share price has rarely frequented over 450 pence since August 2010. Overall recovery of the company's value since the oil spill has been slow.

BP's dividend suspension hit investors and the wider economy

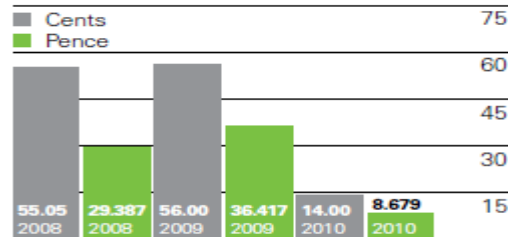
In an unprecedented move BP suspended dividend payments to shareholders for the first three quarters of 2010, as a result of increasing political and public pressure in the US. This was a major blow to investors as BP's dividends had yielded solid returns of 6–8% during the preceding five dividend periods from 4th quarter 2008 until 4th quarter 2009. The return to dividend payments during 4th quarter 2010 saw a greater than 50% decline in dividend value, at 4.3372 pence per share. The declining yield and value of dividend payments have made BP shares less attractive to potential investors and have caused many others to take a financial hit.

Figure 3: BP dividends paid, 2008–10

Dividends paid per ordinary share

This measure shows the total dividend per share paid to ordinary shareholders in the year.

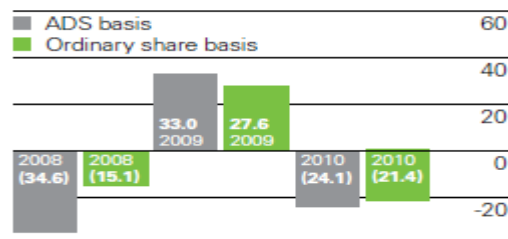
In June 2010 the BP board reviewed its dividend policy in light of the Gulf of Mexico incident, and the agreement to establish a \$20-billion trust fund, and decided to cancel ordinary share dividends in respect of the first three quarters of 2010.



Total shareholder return (%)

Total shareholder return represents the change in value of a shareholding over a calendar year, assuming that dividends are re-invested to purchase additional shares at the closing price applicable on the ex-dividend date.

Total shareholder returns in 2010 were significantly impacted by the cancellation of dividend payments and the fall in share price brought about by the events in the Gulf of Mexico.



SOURCE: BP ANNUAL REPORT 2010

MARKETLINE

Amongst the biggest financial casualties have been British pension funds and savings plans, as shareholder dividends paid out by BP in 2009 accounted for as much as £1 in every £7 paid by the FTSE 100 firms into Britain's pension funds and saving plans.

Moreover, the British and US governments are likely to take a hit in terms of tax revenues; BP is expected to pay lower levels of tax as a result of declining profits, due to the allowance in offsetting clean-up costs against company revenue.

BP's cash flow problems are expected to continue into the short to medium term, as it continues to meet its obligations for the oil spill. This will likely continue to impact investors, with low rates expected on dividend payments for some time to come.

BP is selling its global assets to compensate victims of the oil spill

In response to the spill BP set up a \$20 billion trust fund called the Gulf Coast Claims Facility (GCCF), in order to deal with the financial fallout. The sum is intended to compensate the victims of the spill. A direct consequence of making this facility available was the suspension of dividend payments as discussed above.

Figure 4: Table of key statistics showing BP's response to the Deepwater Horizon Oil Spill

Key statistics	
	2010
Total pre-tax cost recognized in income statement (\$ million)	40,935
Total cash flow expended (pre-tax) (\$ million)	17,658
Total payments from \$20-billion trust fund (\$ million)	3,023
Total number of claimants to GCCF ^a	468,869
Number of people deployed (at peak) (approximately)	48,000
Number of active response vessels deployed during the response (approximately)	6,500
Barrels of oil collected or flared (approximately)	827,000
Barrels of oily liquid skimmed from surface of sea (approximately)	828,000
Barrels of oil removed through surface burns (UAC estimate)	265,450

^a Gulf Coast Claims Facility (GCCF).

SOURCE: BP ANNUAL REPORT 2010 **MARKETLINE**

The total financial cost to BP before tax was \$40.935 billion as of the end of December 2010. Included in this calculation is an initial deal whereby BP agreed to sell assets in Texas, Canada and Egypt to part-fund the clean-up cost of the oil spill. BP reached a \$7 billion (£4.6 billion) deal with US-based oil production firm Apache Corporation in the sale of these assets. Further assets in Pakistan, Venezuela, Colombia and Vietnam have also been sold to raise funds to contribute to the GCCF fund.

By November 2011 BP had sold \$19 billion worth of assets; however, the company suffered a setback when a major deal to sell its 60% stake in Pan American Energy to its partner in Argentina, Bidas Energy Holdings, fell through. The deal had been signed a year previously and was worth an estimated \$7 billion (£4.4 billion), one of the largest sales agreed by the firm following the disaster. The deal (which was also one of the largest in terms of value for asset sales) represents the mixed fortune that the company has had in trying to offload its assets, both to rivals and partners and certain state governments.

In November 2011 BP announced that it would be increasing its asset sales from the previously announced \$30 billion to \$45 billion. So far it has managed to sell \$19 billion in assets.

BP'S RESTRUCTURING

BP's asset sales target minority held assets and exhausting fields

The continuing sales of BP assets are mostly concerned with what have been termed mature fields, which translates into BP thinking that it has passed its peak in terms of potential resources. However, Apache, the major beneficiary of the early sales, has a well-earned reputation as a buyer of supposedly spent oil fields and boosting their production.

BP has also concentrated most of the sales in ventures in which it has a shared or minority stake. The company has adopted a strategy of investing in areas in which it has extensive knowledge, such as the North Sea. BP announced in July 2011 that it would invest £3 billion in redeveloping fields west of the Shetlands.

Even in the North Sea – which is a traditional stronghold in terms of exploration for BP – company assets are up for sale, mainly in the territory's southern region including Mercury, Ravenspurn North and South, and the Amethyst fields. The company is also selling infrastructure such as the Dimlington gas terminal in North Humberside and the Dimlington to Saltend pipeline.

However, the sales do not involve the company's core assets and do not represent a major restructuring of the company in any way. The \$19 billion in asset sales achieved so far of may seem to be an astronomical amount, but given that the company's total assets in 2010 were valued at \$272.262 billion this is most likely to be a manageable amount for BP.

One major downside to the sale of assets following the oil spill was BP's inability to garner the best price for its assets. The company's reputation has taken a battering and the urgent need to raise funds undoubtedly weakened the company's negotiating position in comparison to the pre-spill era.

In the short to medium term BP will accelerate the current divestment programme to \$45 billion, divesting a further \$15 billion in assets by the end of 2013 in addition to the current programme of \$30 billion. Previously announced plans to sell two US refineries and associated marketing activities are included in the extended programme.

BP has implemented changes to focus on safety

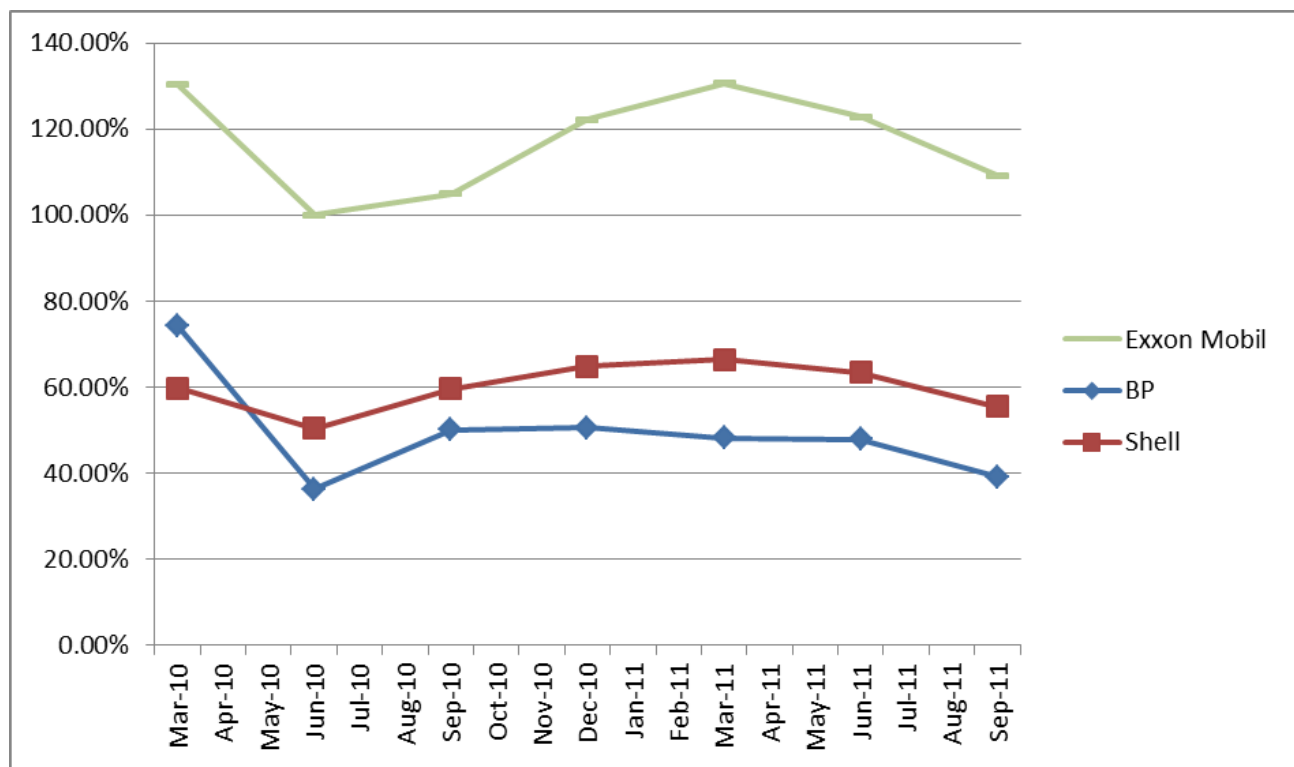
Among the major changes that BP has embarked upon is the implementation of a safety division with sweeping powers as part of a radical restructuring of its operations. The aim of this is to "rebuild trust in BP" following the oil spill disaster, indicating the extent to which the company has suffered in terms of its global image. The technical aspect of restructuring involves plans to reorganize upstream operations from a single business into three divisions: exploration, development and production.

There could also be major financial benefits for BP in restructuring its operations

The restructuring process is also down to BP's value in the market. At the end of 2010 BP's assets were valued at \$272.262 billion; however, during the last year its market capitalization has hovered between \$150 billion and \$180 billion. By all forecasts the company is heavily undervalued. This can be seen when comparing BP to two of its main

competitors, Shell and Exxon Mobil.

Figure 5: Graph showing the market capitalization of BP, Royal Dutch Shell and Exxon Mobil as a percentage of assets



SOURCE: MARKETLINE

MARKETLINE

As Figure 4 shows, since the Deepwater Horizon Oil Spill in 2010 BP's market capitalization relative to its assets has been below that of its rivals and way down on the comparative March 2010 value, which saw BP replace Royal Dutch Shell as Europe's largest oil company by market value for the first time in more than three years, following reviving output growth and faster cost-cutting.

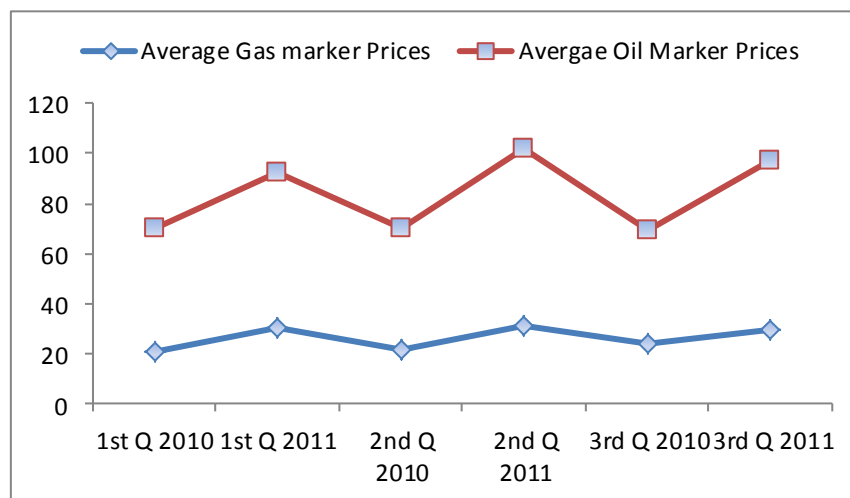
In order to redress its currently flagging market capitalization value BP is considering a possible split between its refinery arm and its exploration and production business. The potential financial benefits of this could be up to \$100 billion for BP investors. A similar restructuring strategy was attempted by Marathon Oil Corporation. Shares in the Houston-based oil company have risen by 23% since Marathon Oil announced the split on 13th January 2011, even as a new refining company with a market value of \$14.4 billion was created.

Post-oil spill challenges continue to weigh down earnings

The sale of assets has impacted BP in the short term, as 1st quarter 2011 results show. A lower than expected production output, partly resulting from the sale of certain oil fields, has offset the benefits of higher oil prices and refining margins.

As can be seen from Figure 5, BP's net profit did not increase in line with the rise in oil and gas marker prices during the first three quarters of 2010 and 2011 respectively. Comparing the first 3 quarters of 2010 to the first 3 quarters of 2011 we can see that average oil marker prices increased by 38.93% and average gas marker prices increased by 17.83%. Over the same period BP's net profit declined by 0.92%.

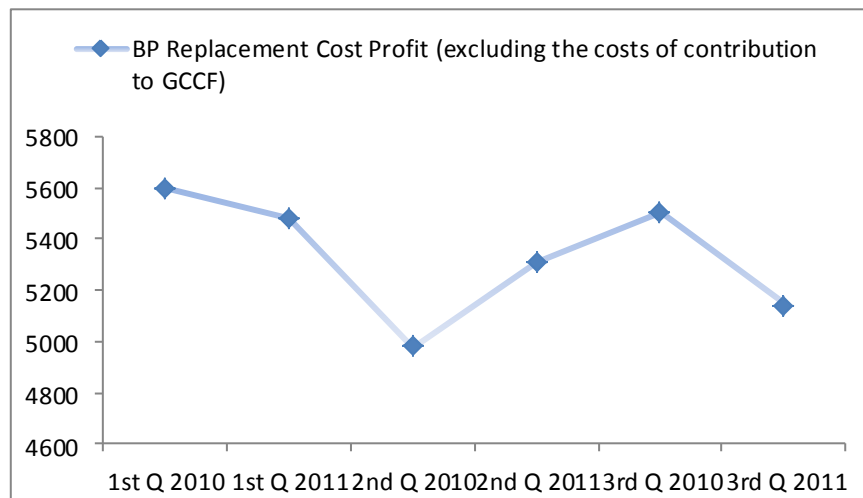
Figure 6: Average gas and oil marker price fluctuations



SOURCE: MARKETLINE

MARKETLINE

Figure 7: BP's replacement cost profit



SOURCE: MARKETLINE

MARKETLINE

The firm's first-quarter net profit of \$5,481 million was 2% below earnings of \$5,598 million in the previous year, as an 11% decline in production offset the benefits of a 30% gain in oil prices on the upstream side, in addition to downstream earnings gains.

As the 2nd and 3rd quarter 2011 results have shown, BP has in some way been protected by the high price of oil on the international market. However, any increase in profits as seen in the 2nd quarter 2011 was not relative to the increase in oil prices.

2nd quarter 2011 net profits were \$5.309 billion, compared to a \$16.9 billion loss in 2nd quarter 2010. The loss was mainly down to sales of assets to contribute to the GCCF. Excluding a \$20.7 billion charge for the oil spill and other non-operating costs, net profit would have been \$4.98 billion in 2nd quarter 2010.

3rd quarter 2011 results showed a similar pattern with a net profit of \$5,140 million, compared with \$1,847 million a year previously. However, when the costs of the oil spill are excluded BP's net profits for the 3rd quarter 2010 would have been \$5.5 billion, which demonstrates the effect of decreased production despite the rising prices of oil.

CONCLUSION

BP is targeting focused investment and a managed portfolio

BP plans to focus on upstream projects

It is clear from BP's sales, purchases, and areas of investment that the company is focused on consolidating its distinctive strength areas, where it has proven capabilities and experience. Among these are exploration, where BP intends to double its investment; operations in deep water ventures (as seen by its investment in the Shetland area of the North Sea); the management of giant fields; and building gas value chains.

BP will also aim to continue developing its competitively strong downstream businesses while maintaining its focus on upstream projects, with the company having been issued 67 new exploration licenses in 11 countries. The completion of major deals to enter new markets such as Brazil and India are also pending.

To a lesser extent BP will attempt to establish alliances with major resource holders and apply advanced technologies to its upstream activities, although it is moving away from operations in which it has minority or junior status shareholding.

BP wants a growing cash flow

In light of the cash flow problems resulting from the Deepwater Horizon Oil Spill, BP will attempt to boost its annual operating cash flow by 50% by 2014.

The strategy to achieve this involves bringing major upstream and downstream projects online. During 2011–14 BP is expected to bring 17 material new upstream projects into production. On the downstream side BP will move ahead with a major upgrade of the Whiting refinery in the US, to be completed in 2013.

BP's cash flow problem is also intended to be resolved by completing the necessary payments to the GCCF by the end of 2012.

BP will attempt to appease shareholders through increasing returns

The increasing cash flow will have two primary purposes, with half the projected additional cash flow to be used for increased investment in the company's project inventory.

The other half will be used to increase distributions to shareholders through dividends, which should make the company a more attractive proposition to potential investors and increase its ability to buy back shares.

APPENDIX

Definitions

Replacement cost profit – Net profit.

Market capitalization – Total value of shares multiplied by total number of outstanding shares

UAC - (Unified Area Command): Internal BP term referring to the area around New Orleans affected by the oil spill.

Further Reading

MarketLine (2011) *Industry Profile: Oil & Gas in the United Kingdom*, August 2011, 0183-2116-2010

MarketLine (2011) *Industry Profile: Oil & Gas in the United States*, August 2011, 0072-2116-2010

MarketLine (2011) *Industry Profile: Global Oil & Gas*, September 2010, 0199-2104-2010

BP Annual Report 2010

Royal Dutch Shell Annual Report 2010

Exxon Mobil Annual Report 2010

www.bp.com

Ask the analyst

We hope that the data and analysis in this brief will help you make informed and imaginative business decisions. If you have any questions or further requirements, MarketLine's research team may be able to help you. The MarketLine Research team can be contacted at ReachUs@MarketLine.com.

About MarketLine

At MarketLine, we deliver accurate, up-to-date insights on over 30,000 companies, 300 industries, and 215 countries, as well as the latest news and financial deal information from within your market and across the globe.

Established in 1997 when the Internet was in its infancy, we recognized the need for a convenient and reliable data service to help our clients understand local and global markets and the companies operating within them.

In today's information-rich world, sifting fact from fiction to pick out what's relevant and what's up to date has become the new 'holy grail' in business information provision.

Our 170 dedicated research professionals aggregate, analyze, and cross-check facts in line with our strict research methodology, ensuring a constant stream of new and accurate information is added to MarketLine every day.

Disclaimer

All Rights Reserved.

No part of this publication may be reproduced, stored in a retrieval system or transmitted in any form by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior permission of the publisher, MarketLine.

The facts of this report are believed to be correct at the time of publication but cannot be guaranteed. Please note that the findings, conclusions and recommendations that MarketLine delivers will be based on information gathered in good faith from both primary and secondary sources, whose accuracy we are not always in a position to guarantee. As such MarketLine can accept no liability whatever for actions taken based on any information that may subsequently prove to be incorrect.

MarketLine | John Carpenter House, John Carpenter Street |
London, United Kingdom, EC4Y 0AN
T: +44(0)203 377 3042
E: reachus@marketline.com

MarketLine