

BP sets sights on Exxon's crown as industry leader

di Ed Crooks

It is a striking fact that BP's oil and gas production is now greater than that of ExxonMobil, but its market capitalisation is more than 40 per cent smaller.

That valuation gap will not disappear quickly. Exxon is a more diverse business, it is the world's largest oil refiner and it has a substantial chemicals business, unlike BP.

Yet the scale of disparity shows how BP still lags behind the acknowledged industry leader in terms of financial performance.

In the past year BP's market capitalisation has been catching up. Its shares have risen 15 per cent, while Exxon's have fallen 13 per cent. But although Tony Hayward, chief executive, talked yesterday about 2009 as having been a "very good" year for BP, he emphasised there was "a lot more to do", to squeeze costs while making the investments needed to deliver future growth.

The business environment, he pointed out, remains "challenging and volatile" with a slow recovery in the US and Europe.

While the oil price has rebounded from its low point below \$33 per barrel a year ago to about \$75 yesterday, the price of gas, which accounts for more than a third of BP's production, is still weak, having risen only 12 per cent in the US over the past 12 months.

The gas price has been hit by a combination of cyclical factors - new export projects coming on stream as demand slumps because of the recession - and a structural shift: the fall in the cost of production that has made it possible to exploit vast reserves of previously uneconomic gas in the US.

The cyclical factors will keep gas prices weak for the next three or four years, BP believes, but even after that there is likely to be a cap on any recovery because of the huge potential for increased US production.

The refining business, meanwhile, is suffering a similar combination of cyclical downturn and structural decline in some markets.

Those challenging conditions meant that in spite of \$4bn of cost savings and 7,500 job cuts, BP did not quite manage to cover its \$20bn investment programme and its \$10.9bn dividend payments from its cash flows.

Mr Hayward reiterated his objective to increase the dividend in line with long-term earnings growth, but the payment was unchanged for the sixth successive quarter at 14 cents a share.

Meanwhile, although production growth was impressive at more than 4 per cent, BP admitted that this was helped by an unusually benign hurricane season in the Gulf of Mexico. With more normal conditions it would expect a slight fall in output this year. It expects to return to growth in 2011, but is still expecting a long-term increase of just 1-2 per cent a year.

So it is easy to see why Mr Hayward is determined not too be seen to be resting on his laurels.

He plans to give more details in a strategy presentation next month about his plans to make further cost savings, but yesterday he made a strong statement of his ambitions.

"BP is performing okay now, we are back in the pack and doing fine," he said.

"But there is still a gap between us and the best in the industry and I would observe that the industry itself is not the most efficient I have ever observed. So we think there is a long way to run in terms of overall efficiency that we can drive into BP."

There were no more plans for "further major internal restructuring", he added, saying there had been "a lot to change in a few years".

Instead, he suggested, the focus would be on the supply chain. That would not necessarily mean "putting the squeeze on suppliers", he said, but was about procuring goods and services more efficiently. "There is quite a lot more to go there," he added.

The other focus of the strategy presentation will be on how to deliver on the promise of production growth.

Andy Inglis, BP's head of exploration and production, pointed to a successful year in winning access to resources. BP has replaced 129 per cent of its production to its reserves, booked under the definitions used by the US Securities and Exchange Commission, and 250 per cent under a looser definition of available resources.

The company had a trumpeted success last year in the Gulf of Mexico, drilling the world's deepest commercial exploration well to find an oilfield that is likely to be brought into production towards the end of the decade.

It has also signed deals to open up new opportunities in Iraq, Indonesia, Jordan and Egypt.

BP is being cautious about how all this will translate into production, but Mr Inglis says he is more confident about achieving the 1-2 per cent growth objective.

Jason Kenney of ING argues that BP has greater exposure to high-margin oil and gas production than to lower margin refining. And within its production mix it has more "good high-margin barrels" produced in areas such as the Gulf of Mexico. Helped by the planned efficiency gains, that could mean that between 2009 and 2014, BP's return on capital employed could surpass that of Exxon, for years the industry paragon. As he puts it, "BP could steal Exxon's crown."

Weak refining

di Ed Crooks

The weakest point in BP's results was its refining and marketing business, writes Ed Crooks .

Conditions in the industry have been tough, with excess capacity chasing inadequate demand for oil products, and refining margins worldwide have fallen to their lowest level for almost 15 years.

The underlying operating profit in BP's refining and marketing business was just \$15m (£9.4m) in the fourth quarter of last year, down from about \$600m in the equivalent period of 2008.

That compared with fourth-quarter refining losses of \$345m for Chevron and \$189m for ExxonMobil.

The market has been hit by the recession and a long-term shift away from oil-based road fuels in developed countries.

Tony Hayward, BP chief executive, says rising standards of fuel economy and the growth of biofuels and electric vehicles will mean demand for petrol in the US and western Europe will probably never rise higher than in 2007-08.

BP's response is not to get out of the industry, but to trust its relatively large and sophisticated refineries to survive while rivals fail.

But Mr Hayward said margins were "likely to remain depressed for the foreseeable future".

The poor performance of refineries augurs badly for Royal Dutch Shell, which reports full-year results tomorrow.