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RPT-Fitch Affirms BP at 'A'; Outlook Stable

Mon, Jul 7 2014

(Repeat for additional subscribers)

July 7 (Reuters) - (The following statement was released by the rating agency)

Fitch Ratings has affirmed BP plc's (BP) Long-term Issuer Default Rating (IDR) at 'A'. The Outlook is Stable. A full list of rating actions is at the end of this commentary.

BP is a leading global integrated oil and gas producer, and we view its operational profile as commensurate with the 'AA' category. Presently, BP's rating direction depends largely on the outcome of legal proceedings related to the 2010 Macondo oil spill. At end-1Q14, BP had provisioned USD42.7bn in total for claims and other related payments, of which it had paid out USD34.9bn. We estimate that total payments below USD70bn, including amounts already paid out and the balance paid over a period of several years, are likely to keep BP in the 'A' rating category, while payments exceeding this amount may push the company's ratings into the 'BBB' category.

KEY RATING DRIVERS

- An Oil and Gas Super-Major

We view BP's operational profile as commensurate with the 'AA' category, as it remains a leading integrated oil and gas producer. Its 2013 production of 1.9 million barrels of oil equivalent (mmbob/d) (without equity affiliates) was trailing that of Royal Dutch Shell (AA/Stable, 2.4mmbob/d), but ahead of Total SA's (AA/Negative, 1.5mmbob/d) and ConocoPhillips' (A/Stable, 1.4mmbob/d). BP has strong positions in gas, including LNG - it accounted for 54% of its 2013 upstream production volumes. Its diversified proved reserves of 10bn barrels of oil equivalent (boe) (without equity affiliates) imply a healthy proved reserve life of 14 years, ahead of many of its peers.

- Multi-Billion Dollar Litigation

The Macondo-related provisions for claims and other payments that BP is facing fall broadly into three categories - the USD20bn Oil Spill Trust already almost fully utilised, the yet unknown penalty under the Clean Water Act and the USD35bn claim from the five US states for losses and property damage plus miscellaneous smaller claims. In our view, BP is likely to keep its 'A' category rating if its total payments do not exceed USD70bn, including USD35bn paid to date.

USD20bn Oil Spill Trust Fund

Following the Macondo accident, BP set up a USD20bn Trust to cover different claims and other payments associated with the oil spill, excluding fines and penalties. The Trust covers settlements under the Economic and Property Damages Settlement Agreement (EPD Settlement Agreement) with the Plaintiff Steering Committee (PSC). At end-1Q14, BP recognized USD9.2bn of such claims, but this amount does not include claims not yet received, processed and paid. BP continues to contest the payment of business economic loss claims it believes are unfounded and it also contested the rules under which the losses are calculated. The court came up with new rules a move BP welcomed, that are now pending the final approval.

As at end-1Q14, cumulative charges to be paid from the Trust amounted to USD19.3bn. Thus, BP has USD700m of headroom for new claims, before it faces additional cash outflows.

Clean Water Act Penalty

BP also faces a large penalty under the Clean Water Act, which we calculate may reach USD18bn in the worst case, should the company be found grossly negligent. The penalty, if any, is to be determined by the court mainly based on two factors - the volume of oil spilled into the water and the penalty factor. At end-1Q14, BP had a USD3.5bn provision for the penalty, and we believe that in a worst case scenario its total charge will increase by USD14.5bn. The case is brought before the federal multi-district litigation proceedings in New Orleans (MDL 2179), and the penalty phase is expected to begin in January 2015. The outcome of the proceedings is still highly uncertain: BP may potentially be found not guilty at all and hence have no fine, or be found guilty but have a modest fine through the application of mitigating factors. However, BP is likely to keep its 'A' rating even if it is found grossly negligent and has the maximum possible USD18bn fine, provided that it faces no other massive cash outflows under the current or possible future litigations.

States' Lawsuit Uncertainty Remains

In January 2013, the states of Alabama, Mississippi and Florida presented their claims to BP for alleged losses and property damage as a result of the oil spill; the states of Louisiana and Texas presented their claims later. The total amount claimed by the five states is nearly USD35bn, which BP has not provisioned for, as it believes the claims are unsubstantiated. We do not anticipate the final damages awarded to be as much as USD35bn, but acknowledge that large legal uncertainties remain and note that legal proceedings may drag for years.

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- Disposals Bring Cash, But Hurt Production

In 2013, BP completed its USD38bn divestment programme aimed at funding the oil spill payments and enhancing its liquidity. It also announced that it would divest a further USD10bn by end-2015. While we positively view the company's ability to raise cash through disposals, we note that such disposals coupled with a tight capex budget and suspended drilling in the Gulf of Mexico have resulted in falling production. In 2013, BP's hydrocarbon output, excluding equity affiliates, mainly Russia's OJSC OC Rosneft (Rosneft), was 1.9mmboe/d, 29% lower than in 2009. BP's proved reserves at end-2013 were down 20% compared to end-2009 numbers. We expect that BP's production will stabilize over the medium term and that it will deliver solid operating cash flows by focusing on higher-margin upstream projects, in line with its strategy.

- Rosneft's Dividends Included

We generally focus on oil and gas production from consolidated subsidiaries because cash flows generated by equity affiliates may not be readily available to service debt at the parent company's level. In our forecasts, we assume that BP will continue receiving sizable dividends from Rosneft, in which it holds 19.75%. Rosneft approved 2013 dividends at RUB136bn (USD3.9bn), meaning BP is entitled to around USD750m in 2014.

While BP confirmed its long-term commitment to Rosneft, we note that its stake in Rosneft, currently valued at around USD15bn, may become an additional source of liquidity in case it faces much higher Macondo-related charges than currently anticipated. However, we do not incorporate this into our analysis of BP's available sources of cash.

LIQUIDITY AND DEBT STRUCTURE

At end-1Q14, BP had USD22.4bn in cash and equivalents and USD2bn in uncollected asset sales proceeds. At end-2013, it also reported committed credit lines of USD7.4bn. This amount comfortably covered the company's short-term debt of USD8.7bn at end-1Q14 and payments it may face under the Clean Water Act, which we estimate at no more than USD18bn, if BP is found grossly negligent. BP's liquidity may be challenged if it faces massive charges under the states' claims. However, we believe the trial will entail years of litigation. Furthermore, should plaintiffs be awarded significant compensation from BP, the payments are likely to be spread over several years, similar to the model adopted with funding the USD20bn Trust. Therefore, we view BP's liquidity as adequate.

RATING SENSITIVITIES

'A+' rating: With total payments of under USD45bn, including USD35bn paid up to date and the balance paid over a period of several years, we forecast BP's funds from operations (FFO) adjusted net leverage of between 2x and 2.5x, which could lead to an upgrade. This may happen if BP is not found grossly negligent, and if the payments under the states' lawsuit and other litigation are minimal. 'A-' rating: Should total payments end up between USD60bn and USD70bn, we forecast FFO adjusted net leverage of between 2.5x and 3x, which could result in a downgrade to 'A-'.

'BBB' category: Total payments exceeding USD70bn may increase FFO adjusted net leverage to above 3x and could result in a downgrade to the 'BBB' rating category.

The rating actions are as follows:

BP plc

Long-term IDR: affirmed at 'A'; Outlook Stable

Senior unsecured debt: affirmed at 'A'

BP Capital Markets

Senior unsecured debt: affirmed at 'A'

BP Capital Markets America Inc

Senior unsecured debt: affirmed at 'A'

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