2Q 2010 Results Presentation, 27 July 2010

Fergus MacLeod, Head of Investor Relations

Hello and welcome to BP's second-quarter 2010 results conference call. I am Fergus MacLeod, and today's presentation will be by Tony Hayward, our Group Chief Executive, and Byron Grote, our Chief Financial Officer. We are also joined today by our Chairman, Carl-Henric Svanberg, for the first few minutes, and he will make some introductory remarks.

Before we start, I'd like to draw your attention to our cautionary statement.

During today's presentation, we will make reference to estimates, plans and expectations that are forward-looking statements. Actual outcomes could differ materially due to factors we note on this slide and in our regulatory filings. Please refer to our Annual Report and Accounts and second-quarter Stock Exchange Announcement for more details. Both of these documents are available on our website.

Thank you, and I will now hand over to Carl-Henric.

Carl-Henric Svanberg, Chairman

Thank you, Fergus, and thank you all for joining us. I am joined here now by Tony Hayward, Byron Grote and Bob Dudley and the others in the management team.

As you can see, we have issued two important announcements this morning:

- One is the first half-year results, including the impact of the Gulf of Mexico and the spill
- The other one is about the departure of Tony Hayward as our CEO and the appointment of Bob Dudley as the new group chief executive with effect from October 1.

After I have made my introductory remarks, Tony will say a few things about the management change and so will Bob, and then we will take a couple of questions before I hand back to Tony and Byron to go through the main points of the results announcement with questions focused on that. I will not sit through the whole presentation; I have other appointments, which means that if you have any questions on the dividend you should ask in that first section there.

But let me first say this: the tragic accident on 20 April and the subsequent events have shocked and saddened us all. They have had a profound effect on the families of the victims, on the communities of the region, on this company and on the industry in which we operate.

We deeply regret the impacts of this incident and we are committed to healing and restoring the communities of the Gulf Coast – to finish the immediate clean-up, to mitigate long-term environmental impacts, and to make whole those whose livelihoods have been damaged. As I speak the well is capped, and no oil has flowed into the Gulf for nearly two weeks and we all look forward to sealing the well permanently. But we also know that even when that happens we will still have much to do to make it right.

I would also like to say that we are determined to restore value to our shareholders. They have seen enormous loss of capital value and of the dividend. The Board is committed to creating value for shareholders and believes that we can deliver a stronger BP for them over time.

Looking ahead, I want to make four points today.

First, BP will change as a result of this accident. We are taking a hard look at ourselves, what we do, and how we do it. What we learn will have implications for our strategy, our ways of working and our governance.

Second, we are committed to meeting our obligations in the Gulf of Mexico – and this set of results underlines the company’s ability to do so, while providing a first estimate of our costs.

Clearly the financial impact is very substantial, and as a result we have recorded a significant headline loss. But our businesses around the world are performing well and our cash flow is strong.

We have taken a charge of $32.2 billion for costs that we expect to need to cover. This charge is based on the belief that we were not grossly negligent in this incident.

Third, the Board has been very focused for quite a while on the company’s financial position. Our liquidity position is strong. Last week we enhanced it further through the sale of assets for $7bn, and today we are announcing our intention to extend this divestment programme to a total of $25 billion - $30 billion. We expect to achieve attractive offers for assets that have a higher strategic value to others than to us.

This programme will reset our position and create a stronger performing portfolio while at the same time removing any worry about our financial strength.

Finally, let me then turn to the change of leadership. As we announced this morning, by mutual agreement with the Board and Tony Hayward, Tony will step down on October 1.

The Board is deeply saddened to lose Tony as our CEO. However, the decision is typical of the principled leadership that he has shown throughout his three years in the job and a lifetime of service to BP. On behalf of the entire company I want to thank him for all that he has achieved in that time in improving the company’s performance in so many critical ways.

But we have to recognise that the tragedy of the Macondo well explosion and subsequent oil spill has been a watershed for BP. In the future we will be a different company, and the challenge of rebuilding our reputation requires fresh leadership supported by robust governance and a very engaged board.

We are fortunate to have a successor of the calibre of Bob Dudley. He has spent his working life in this industry both in the US and overseas and he has proved himself a great operator in the toughest circumstances.

I have no doubt that he will provide the strong leadership the company needs to move forward and rebuild trust with all our stakeholders. BP has strong assets and I have already discovered during my short time as a Chairman great people, great motivated people. Right across the company, they are determined to play a full part in restoring BP's position in the vanguard of this industry.

So let me hand over for a remark from Tony.

Tony Hayward, Group Chief Executive

Thank you, Carl-Henric. Let me add my welcome to those joining the call.

Today is a very sad day for me. As many of you know I have spent my entire professional career at BP. I love the company and everything it stands for. I have thought long and hard about what is the right course of action. It is clear that this tragedy will leave BP a changed company and that to move forward, particularly in the U.S., it should do so under new leadership. It is for that reason I have agreed with the Board to stand down as CEO. In the unstinting way in which BP has met its obligations, I believe the company has demonstrated what corporate social responsibility really means. That responsibility applies to individuals as well as companies.

I plan to work with Bob over the coming months to effect a smooth transition and support him in every way possible. I know that with Bob as my successor I leave the leadership of BP in safe and able hands.

My final thoughts are with the families and friends of those who died on 20th April. We can and will compensate those financially affected by the spill and in the long run we can restore the environmental impact on the Gulf coast - but nothing can bring back the 11 people who lost their lives. We must never forget them and it is important that everyone remembers them on days like today.

Bob Dudley, President & CEO Gulf Coast Restoration Organization

Thank you, Tony. I can only echo Tony's sentiments that our thoughts and deepest sympathies are with the families from that day in April – and those impacted by the spill in the Gulf of Mexico.

As I said earlier today, I have the greatest admiration for Tony and what he has done as the chief executive of BP and how he transformed the company over the last three years – and for his unwavering dedication to ensuring BP will meet its commitments to the people of the American Gulf Coast.

As we announce our results today, you will see that BP's commitments run deep and we will fulfil the promises we have made to the Gulf States and the Federal government. I believe strongly that meeting our commitments in the Gulf is critical to BP's long-term success.

I believe that BP has made an unprecedented corporate response to a tragedy – a response that is an indication of the values we hold as a company.

Certainly, taking up this role over the coming months will not reduce my commitment to the region.

I do not underestimate the nature and the complexity of the work ahead as we restore our financial and reputational circumstances. Equally, I know that BP has a portfolio of very strong businesses and great professional teams around the globe to ensure that we will be back on the road to recovery.

Now, let me turn it back to Carl-Henric.

Carl-Henric Svanberg, Chairman

That turns it over to Fergus.

Fergus MacLeod, Head of Investor Relations

We will now take some questions from the telephone lines.

Fergus MacLeod, Head of Investor Relations

Thank you very much indeed for your questions in this section. I am afraid, as I am sure you will realise, today is an extremely busy day and that Carl-Henric has other commitments he must fulfil so unfortunately he's got to leave us now.

Tony Hayward, Group Chief Executive

Thank you very much, Carl-Henric. Let's now move into the results presentation as we normally would.

We will start off with Byron covering our second-quarter results announced this morning, which as you will have seen demonstrate that our operations continue to run well and that we are a strong company. Byron will also explain the new disclosures we have made regarding the Gulf of Mexico oil spill costs.

I will then provide an update on our response to the spill, including the status of containment, well kill and clean-up operations, as well as the claims and investigation processes. I will also share our early views of some of the potential implications of the incident for how our industry operates in the future.

And I'll close by sharing some early insights into what will be different in BP going forward as a result of these tragic events, including changes to our portfolio and financial framework.

Let me now hand over to Byron.

Byron Grote, Chief Financial Officer

Thank you, Tony, and good day to those joining us on this call.

I will begin with an explanation of the impact of the Gulf of Mexico oil spill response on our financial results. The costs of the response are identified separately in order to present a more transparent view of the underlying performance of the Group.

Our 2Q headline replacement cost result was a loss of $17.0 billion, which includes a non-operating pre-tax charge of $32.2 billion in respect of the Gulf of Mexico oil spill. Our underlying performance remains strong and I will return to talk about this later in the presentation.

The Gulf of Mexico oil spill charge includes $2.9 billion of costs to the end of June for spill response, containment, relief well drilling, grants to the states whose shorelines are affected, claims paid and federal costs, including US Coast Guard costs.

The $29.3 billion provided for future costs includes:

- First, further offshore and onshore oil spill response and clean-up costs
- Second, the commitment to establish an escrow account of $20 billion over the next three and a half years. This will be available to satisfy legitimate claims payable under the Gulf Coast Claims Facility, final judgments in litigation and litigation settlements, state and local response costs, and natural resource damages and related costs.
- Third, estimates of fines under the Clean Water Act.
- Fourth, estimated legal costs expected to be incurred in relation to litigation.
- And finally, other announced commitments, including BP's commitment to a 10-year environmental research programme and the remainder of the funding of the Louisiana barrier islands project.

What is not included in the spill provision is any other fines and penalties and any claims on the escrow account that might exceed $20 billion. These costs are currently not estimable and are treated as contingent liabilities.

While BP believes that the partners' share of the costs incurred are recoverable, no amounts have been recognised in the financial statements. Instead it is noted as a contingent asset.

Tax relief has been assumed in line with the requirements of the US tax code.

Now looking at the quarter's trading environment.

The table shows the percentage year-on-year changes in our average upstream realisations and the refining indicator margin.

Compared with the previous quarter, our liquids realisation was up 1%, at $73 per barrel, and 39% higher than a year ago.

Our gas realisation fell to $3.76 per thousand cubic feet, down 12% on the prior quarter but over 30% higher than a year ago.

Taking both oil and gas together, our total average hydrocarbon realisation was down 4% compared to the first quarter of 2010 but around 34% higher than a year ago.

The refining indicator margin strengthened by over $2 per barrel from the weak level seen in the first quarter, to $5.49 per barrel, and was 10% higher than a year ago.

Turning to the underlying financials.

Adjusting for non-operating items and fair value accounting effects, our second-quarter underlying replacement cost profit was $5.0 billion, an increase of 70% on the 2Q'09 result.

Excluding the impact of the Gulf of Mexico oil spill, the underlying effective tax rate in the second quarter was slightly less than 35%, and for the first half averaged 34%, in line with previous guidance.

Second-quarter operating cash flow was $6.8 billion. However, excluding Gulf of Mexico oil spill-related payments, underlying operating cash flow was $8.9 billion, up 31% compared with last year and up 15% on the prior quarter.

Moving now to E&P, I remind you that the Gulf of Mexico oil spill costs are reported separately and thus not included in the E&P segment result. For the second quarter, exploration and production, after adjusting for non-operating items and fair value accounting effects, reported a pre-tax underlying replacement cost profit of $6.3 billion, up $1.9 billion compared with last year.

Relative to a year ago, the result was impacted by lower production volumes but benefited from the improved price environment and lower depreciation. In addition, a loss in gas marketing and trading in 2Q resulted in a contribution reduction versus both the prior year and the first quarter of over $500 million.

Production at 3.85 million barrels of oil equivalent per day was 4% lower than a year ago and was 2% lower after adjusting for entitlement effects on our production-sharing agreements. As expected, second-quarter production was impacted by seasonal turnaround activities. Production volumes were also impacted as a consequence of the Gulf of Mexico oil spill.

Turnaround activities will continue in the third quarter and once again, are planned for some of our highest-margin areas, including the Gulf of Mexico and the North Sea. These activities will impact margins and costs as well as volumes.

After the end of the quarter, we announced the sale of $7 billion of assets to Apache and our intention to divest further upstream assets. Production and income in 2010 will be impacted by these transactions. Tony will talk more about the divestment plans later.

BP's share of TNK-BP net income was $490 million for the quarter and we received a dividend of $505 million.

In Refining and Marketing, after adjusting for non-operating items and fair value accounting effects, we reported a pre-tax underlying replacement cost profit of $1.7 billion for the second quarter.

This is an increase of over $700 million compared to the same quarter of 2009, principally due to strong performance in the Fuels Value Chains and continued delivery in the international businesses.

In the Fuels Value Chains, throughputs were up 160 thousand barrels per day versus the second quarter of 2009, and Solomon refining availability remained high at almost 95%.

Our petrochemicals business captured the benefit of a recovering market, particularly in China, through high reliability and record sales volumes. Our Lubricants business also continued to perform strongly.

The US returned to profitability during the second quarter due to improved operational performance, margin capture, and further cost efficiencies, compared to the same quarter in 2009. Supply optimisation and trading improved significantly from the weak level seen in the previous quarter.

This is Refining & Marketing's strongest underlying result since the second quarter of 2006, when refining margins were more than double current levels. This significant performance improvement reflects the progress we have made on our strategy of safety, quality, efficiency and integration.

Looking ahead, we expect refining margins to decline somewhat in the third quarter in line with the usual seasonal trends.

In Other businesses and corporate, after adjusting for non-operating items, the pre-tax underlying replacement cost result was a charge of $140 million, an improvement of $400 million versus a year ago.

The underlying charge was significantly lower than the same period a year ago as improved business results, lower costs and foreign exchange effects all impacted the result favourably.

We do not expect the beneficial foreign exchange effects to continue in the second-half of the year, and we are maintaining the underlying charge guidance for the rest of the year at $400 million quarterly.

Turning now to cash flow, this slide compares our sources and uses of cash in the first half of 2009 and 2010.

As I mentioned earlier, our operating cash flow in the second quarter, excluding Gulf of Mexico oil spill payments, was $8.9 billion, up $2.1 billion on a year ago and reflects the benefits of higher oil prices and greater operating efficiencies.

The ongoing momentum in underlying operational and financial performance underpins the Group's strong financial position.

At the end of 2Q we held $7 billion in cash and we currently have $17 billion of committed, undrawn bank facilities.

During June, the group was downgraded from AA to single A by the main ratings agencies as a consequence of the uncertainty around future liabilities associated with the Gulf of Mexico oil spill.

In response to this, we have taken further steps to increase liquidity. As described in the webcast on the 16th June, we have reduced 2010 capital expenditure by approximately $2 billion and created additional financial flexibility through our actions with respect to 2010 dividend payments. In addition to this, today we announced an increase in planned disposals to between $25 and $30 billion over the next 18 months. As mentioned earlier, $7 billion of this was announced last week.

All of this gives us great confidence in our ability to meet our future financial obligations.

Despite payments with respect of the Gulf of Mexico oil spill, net debt was reduced by $2.0 billion during 2Q. At the end of the quarter, the debt level was $23.2 billion and gearing was 21%. This increase in gearing was due to the decrease in equity as a result of the Gulf of Mexico oil spill charge.

As a result of the actions outlined earlier, we are now expecting to bring our net debt level down to a range of $10 to 15 billion within the next 18 months.

This reflects a prudent approach to managing the balance sheet and the liquidity requirements of the firm, in order to ensure that the company has the flexibility to meet all of its future financial obligations.

Now back to Tony.

Tony Hayward, Group Chief Executive

Thanks, Byron.

Let me start by providing an update of our response to the spill. I'm sure many of you are following closely the briefings by Admiral Thad Allen, the National Incident Commander, and Kent Wells, BP's Vice President, so much of this will be familiar.

I am pleased to report that the cap remains closed and the integrity test continues. We are now on day 12 of the test and our monitoring activities have not revealed any indications of a lack of well integrity.

We are confident the well is now sealed. As the weather allows, we will move ahead with the static kill operations and finish the job with the relief well.

In addition, we now have 35 thousand barrels a day of containment capacity available should there be any developments that require us to re-open the cap, and we continue to build containment capacity.

On the first relief well, operations were suspended for tropical storm Bonnie. The rig has now returned to location and opening of the hole has begun ahead of running and cementing the final casing string. We will then begin the final, detailed, stages of drilling and ranging runs to ensure we accurately intersect the well. We expect this operation to conclude around the middle of August. The second relief well, which is a back-up in the event of problems with the first well, remains temporarily suspended to avoid interference with the first well.

To date our containment systems have captured almost 830 thousand barrels of oil. On the surface, we have recovered around 825 thousand barrels of oil-water mixture, which is typically 80-90% water. We have also removed an estimated 265 thousand barrels of oil in 411 controlled burns. With no new oil leaking into the Gulf, it's encouraging that our aerial surveillance and our fleet of skimmers are finding it increasingly difficult to find oil in sufficient quantities to skim or burn.

Onshore, approximately 836 miles of shoreline in the Gulf Coast has been oiled. In response, the teams have cleaned over 7,000 miles of beach. This measure includes repeat cleaning of beaches which have been subsequently re-oiled, but it helps to highlight the scale of the response. These pictures give you some sense of what we mean by the terms light and heavy oiling, and the nature of tar balls.

The success with the cap is an important milestone. In the words of Churchill it is not the end, nor even the beginning of the end – but it is the end of the beginning. We are committed to restoring the Gulf Coast to the state it was in before the spill. Our progress to date is encouraging and we will not rest until we have completed the task.

We are also working very hard with our claims process to get money into the hands of people in the Gulf region. To date, we have issued over 80,000 checks and paid more than $243 million in claims. We are now working through the details of transitioning this claims process to the Gulf Coast Claims Facility to be run by Ken Feinberg.

And finally, as you are aware there are a number of investigations ongoing, including the independent investigation that BP is carrying out, which will issue an interim report before the end of August, as well as the Marine Board investigation and the Presidential Commission. From what has emerged so far it is clear that this accident was the result of multiple equipment failures and human error involving many companies.

The agreement with the US administration to set up a $20 billion escrow account which we reached on June 16th was an important step forward. The details are shown on this slide and I won't go through them line by line.

The key points are that the funding of the $20 billion is phased over the next three and a half years, and that the account covers most costs other than the federal government and our own direct response costs, and any possible fines and penalties.

There are many lessons to be learned for the industry from the Gulf of Mexico oil spill. We are committed to be at the forefront in sharing these lessons and building capability for the future.

For example, in the course of mounting the largest surface spill response in history we have made significant advances in skimming technology. We will share these with the industry.

In the subsea we have built an extensive tool kit to deal with subsea leaks. Much is reusable and can become part of the platform on which a shared subsea response capability is built, a process which is underway following the announcement by four other major oil companies last week. BP intends to make the capability we have already built available on a global basis.

It is also clear that our industry needs to re evaluate the safety systems for deepwater drilling operations. An example of this is the "fail safe" Blow Out Preventer, which this incident has clearly demonstrated is not fail safe. Standards need to be taken to a completely new level.

And finally it is likely that everyone in the industry will carefully re evaluate their business model, to determine how we can work better with our contractors in order to reduce the risks associated with deepwater drilling.

We entered the incident with a strong and valuable asset base, including more than 18 billion barrels of proven reserves and 63 billion barrels of resources at the end of 2009.

As Byron has mentioned, one element of our response will be to high grade our asset base by selling $25 to 30 billion of assets, principally in E&P, over the next 18 months. This will serve to fund our obligations relating to the incident and to strengthen our balance sheet. This is an increase from the $10 billion in asset sales which we talked about last month.

The first evidence of this response is the $7 billion asset sale to Apache announced last week, where we have entered into several agreements to sell upstream assets in the United States, Canada and Egypt. The deals comprise BP's Permian Basin assets in Texas and south-east New Mexico; our Western Canadian upstream gas assets; and the Western Desert business concessions and East Badr El-din exploration concession in Egypt.

This transaction demonstrates the significant value even in the non-core elements of BP's asset base. The market for resource assets is favourable at the present time so this is a good time to be high grading our portfolio.

This follows the already announced divestment of a number of R&M assets. These include the sale of our fuels and convenience retail business in France to the Delek Group, and the sale of crude oil storage and pipelines for around $300 million to Magellan Midstream Partners as part of our intent to divest a number of non-strategic pipelines and terminals in the US.

The criteria used for this high grading are to sell assets that, in general, are below average in our portfolio in terms of quality and materiality. Many of these assets also have higher decline rates than the portfolio average. The result of this high grading will be a somewhat smaller, more focused and higher quality portfolio.

At the same time we have continued to add new opportunities.

In Azerbaijan, a key milestone in the gas negotiations for Shah Deniz Phase 2 was reached with the memoranda of understanding agreed between Azerbaijan and Turkey. These set key terms for the transit of gas from Azerbaijan to Turkey and ultimately to Europe, thus unlocking access to the European market for Shah Deniz gas. Also in Azerbaijan, SOCAR and BP signed a heads of agreement that defines the commercial terms for a Production Sharing Agreement for the Shafag and Asiman offshore exploration blocks.

In Egypt, we announced the signing of a new agreement with the Egyptian Ministry of Petroleum and the Egyptian General Petroleum Corporation to develop the significant hydrocarbon resources in the deepwater North Alexandria and West Mediterranean concessions of the Nile Delta. The estimated $9 billion investment in this project will develop an initial 5 trillion cubic feet of gas, production in phase 1 is projected to reach up to 1 billion cubic feet per day.

In China, we have reached agreement with Devon Energy to acquire an interest in Block 42/05 in the deepwater of the South China Sea. The transaction is currently progressing through the Chinese government approval process.

In Indonesia we were awarded a joint study on the West Sanga Sanga block to assess coalbed methane options.

Finally during the second quarter we completed two components of our transaction with Devon Energy – the acquisition of assets in the Gulf of Mexico and the sale of a 50% stake in our Kirby oil sands interests in Alberta, Canada. The other two components of the deal, Brazil and Azerbaijan, are on track to close during the second half of the year.

So what will BP look like as it emerges from this crisis?

As I have said, we will have a smaller, higher-quality, more focussed upstream business. We have an option of increasing our investment into exploration, which is a distinctive BP strength.

The outlook for the downstream is the same as described by Iain back in March, with an opportunity to improve per annum performance by a total of more than $2 billion over the next two to three years, as recovery and growth continue. None of that has changed.

We intend to maintain discipline on capital spending, as previously indicated, which is expected to be around $18 billion in both 2010 and 2011.

And finally, as Byron indicated, we are now expecting to bring our net debt level down to a range of between $10 and 15 billion within the next 18 months, in order to assure ourselves of the financial flexibility to meet any potential obligations.

Over the last three years that I have been Chief Executive, safety, people and performance have been my watchwords. We have made significant progress on this agenda.

Our Operating Management System, OMS, is now in use across more than 85% of our operating sites, and this will be complete by the end of this year.

We have been rebuilding our operating capability, a drive that reflected the lessons we learned from the incidents in 2005 and 2006 at Texas City and in Alaska – I have made that drive my top priority. Over the last three years, in addition to the extensive recruitment of engineers and technicians, over 2700 supervisors have been through our operations essentials programme and over 300 senior leaders have attended the operations academy we run in conjunction with MIT. The operations academy, and a similar programme for projects, are part of a series of major safety and operations training programmes that have been implemented across the company.

Performance has also shown considerable momentum versus our peers over this period, a direct outcome of safer, more reliable and more efficient operations.

There is always more to do, and in every crisis there is an opportunity.

As I said at the beginning of this webcast the impact of this tragedy will leave BP a changed company and it is right that it should face the challenges ahead under new leadership.

From the beginning of the crisis I have sought to do the right thing, do it the right way, and communicate openly and transparently.

In the unstinting way that we have met our obligations, I believe BP has shown what corporate social responsibility really means and as I said earlier I believe that responsibility applies to individuals as well as companies.

I will work with Bob Dudley over the coming months to effect a smooth transition and support him in every way possible. I know that with Bob as my successor I leave the leadership of BP in safe and able hands.

I would like to thank all of you for the support you have given me over the last three years. We have made great progress as a company during this time and I have no doubt that progress so tragically interrupted by recent events will soon resume and that BP will emerge as an even stronger company for the future.

Ladies and gentlemen, thank you very much. We would now be delighted to take your questions.