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The Analysis of Financial Stability and Profitability of British Petroleum (BP) for the period 2014–2019

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Abstract

Any commercial organization tends to make a profit in the course of its activity. As a result, these enterprises may be risky since they take different risks in pursuit of generating a profit and achieving other goals. Taking various risks might make a company less financially stable. In other words, the level of financial stability of a company is likely to be decreased. The importance of the given topic is that analyzing the financial stability and profitability of an entity enables us to determine how financially stable and profitable a company is. Moreover, this analysis allows finding out how particular indicators change from year to year and to prevent a decrease in financial stability and profitability indicators. This paper may be considered as an attempt to analyze the financial stability and profitability of one company from the oil and gas industry, specifically, British Petroleum (BP) for the period from 2014 to 2019. Besides, some recommendations may be developed in terms of increasing the company's performance indicators if necessary.

Keywords: financial analysis; financial stability; profitability; company; financial coefficients
JEL Classification: L71

Nowadays, all companies need to operate and run their business in uncertainties. As far as the financial stability of an entity is concerned, it is essential for a company and its creditors. It is a vital aspect of any enterprise since it has a considerable impact on the ability of an entity to pay off its debt. The higher the level of financial stability, the higher the probability that a particular company will meet its obligations, for example, a bank loan. If an enterprise is not able to pay back its bank loan, it may lead to negative consequences. Firstly, such a company might go bankrupt. Secondly, a bank which provided a loan for a company may not receive the principal amount and interest on a loan. As a result, such a bank may incur losses in this case. That is why financial stability plays a great role for a company and a creditor as well. As for the profitability of a company, this aspect is primarily important because it exists and conducts its activities with a view to generating profit. Furthermore, the profitability of an entity is crucially important for its potential investors and creditors [Eskindarov, 2018, p. 245]. Investors are interested in the profitability of a company as they need to be sure that they will get a return on their investments, for instance, when putting money into shares of a company or implementing any mutual project with a particular company. The profitability of a particular company also may mean a lot for creditors [Corazza, 2016, p. 18]. This aspect might be considered as a sign of the ability of a company to pay off a bank loan. Taking into account these facts, there arises the need to regularly monitor, check and control financial indicators characterizing a particular company from the point of view of its financial stability and profitability. Economic agents have an opportunity to make more reasonable decisions concerning whether it is expedient to collaborate with a particular entity or not, depending on the results of this analysis. In other words, such an analysis is of great importance since a company

and all of its stakeholders, especially creditors, are interested in it.

We will analyze the financial stability and profitability of the company called BP. It will be possible to make detailed and objective conclusions regarding its financial stability and profitability based on this analysis.

The analysis of financial stability and profitability of a company has its own goal for the sake of which it is implemented. This analysis may be regarded as a systemized set of analytical procedures with the help of which we can obtain some conclusions in respect of the aspects aforementioned. Subsequently, specific recommendations are supposed to be developed with the aim of increasing levels of financial stability and profitability of the enterprise under study.

Taking into consideration the fact that the given research paper is devoted to the analysis of financial stability and profitability of the company, namely, BP, we will calculate the main indicators characterizing the company's aspects in question.

We will start from the coefficients reflecting short-term solvency of BP for the period from 2014 to 2019. As we know, the short-term solvency of a company is characterized by liquidity ratios. We commence with this aspect as there is no point in analyzing long-term solvency of a company if it is not solvent in the short run.

As can be seen, the values of all liquidity ratios were acceptable during this period. The current ratio was higher than 1 that means that the company's current assets exceeded its current liabilities. In other words, the company was able to meet its short-term liabilities with current assets. The value of this ratio changed in the range of from 1.05 to 1.37. It should be noted that we observe a negative trend of changes in the current ratio. This might happen because BP's current assets decreased a little bit from 2014 to 2019, while current liabilities increased over the period. However, the value of this ratio started to grow after 2018. Speaking about the quick ratio, the values of this coefficient were about 0.8–1.1 within the given period. This ratio shows that the entity had enough current assets, not including inventories to cover its short-term obligations. The tendency was also the same as in the case of the current ratio. The third liquidity ratio shows that about 0.3–0.5 of all current liabilities could be covered with the most liquid assets, namely, cash and cash equivalents. This indicator also had a negative trend. It is possible to state that the enterprise was solvent in the short term from 2014 to 2019.

Next, we will consider long-term solvency of the enterprise under investigation for the analogical period. In addition to it, we have compared some of the coefficients of BP with its competitors, specifically, Shell, Lukoil and Rosneft.

We have collected the main coefficients reflecting the long-term solvency of a company. As we can see from this table, most of the indicators did not fluctuate in a considerable way that might imply that the company in question strived to develop its strategy of financial management thoroughly to stick to this while managing its financial resources. We have computed the debt/equity ratio in two ways. The first variant is that debt is based only financial borrowings, whereas the second version of the calculation of this ratio includes all liabilities of the company. As for the debt/equity ratio including only financial borrowings, the value of this coefficient was lower than 1 during the whole period under consideration that means that the sum of short-term and long-term debt of the entity was less than its equity. The share of debt in the total equity was equal to about 0.47–0.67 from 2014 to 2019. The ratio of debt to equity can be expressed as follows: 32% to 68% in 2014, 35% to 65% in 2015, 38% to 62% in 2016, 39% to 61% in 2017, 39% to 61% in 2018 and 40% to 60% in 2019, respectively. It is possible to observe increases in the debt/equity ratio within the given period. The rising debt/equity ratio does not necessarily mean that this will have an unfavourable influence on a company. In such a case, a lot may depend on whether ROE is increased due to using additional borrowed capital or not. We need to emphasize that borrowing additional money may be a very effective measure for increasing ROE of an entity [Garcia, 2013, p. 57]. As for our case, ROE grew from 2015 to 2019. It is possible to assume that using additional borrowings contributed to an increase in ROE to some extent. Furthermore, the ratio of debt and equity was in an acceptable range from 2014 to 2019 as an acceptable ratio of debt to equity for many companies should equal about 40% to 60%, respectively. Debt approximately rose from 32% to 40% while equity went down from 68% to 60%.

Having calculated and analyzed the D/E ratio for BP, it might be very effective and informa-

Table 1
Liquidity ratios of BP, 2014–2019

Liquidity ratios	Period					
	2014	2015	2016	2017	2018	2019
Current ratio	1.37	1.29	1.16	1.16	1.05	1.12
Quick ratio	1.08	1.03	0.86	0.86	0.78	0.83
Cash ratio	0.47	0.48	0.4	0.4	0.33	0.31

Source: Lozinskaia, 2017, p. 842.

Table 2
Long-term solvency indicators of BP, 2014–2019

Coefficients	Period					
	2014	2015	2016	2017	2018	2019
Debt/Equity Ratio (including only financial borrowings)	0.47	0.54	0.6	0.63	0.65	0.67
Debt/Equity Ratio (including all liabilities)	1.52	1.66	1.72	1.75	1.78	1.93
Debt/EBITDA Ratio	2.59	7.93	5.02	2.89	2.17	2.3
EBITDA/Debt Ratio	0.39	0.13	0.2	0.35	0.46	0.44
Interest Coverage Ratio (ICR)	17.76	4.98	6.93	10.56	11.99	8.45
Net debt/EBITDA Ratio	1.13	3.99	3	1.72	1.43	1.53

Source: Dmytryshyn, 2014, p. 57.

tive to compare this ratio for BP with its competitors. It may give us an understanding of how much debt and equity other similar companies had from 2014 to 2019. We can state that BP and Rosneft stand out among these companies by the D/E ratio because these two companies had a higher share of debt in the total capital than others. Subsequently, their D/E ratios were quite high. BP and Rosneft actively used both sources of funding, unlike their competitors. It might mean that these two companies were riskier, especially for their shareholders.

On the other hand, they used an opportunity to get additional profit from using borrowed capital. BP's D/E ratios changed from 0.47 to 0.67 while Rosneft had 0.89 and even higher than 1, which meant that debt equalled its equity or was higher than its equity. As for other companies, we can say that they had their D/E ratios equal to about 0.2, so it was not big, and perhaps companies lost some possibility to earn additional money, but their financial stability was not risky. We have resorted to Damodaran database, which gives D/E ratio equal to 14.25% for the oil and gas industry. In most cases, the companies under study had higher values.

Speaking about the second variant of calculating the debt/equity ratio, we can see that this figure also increased during the period. It could mainly arise from a significant increase in total liabilities, especially short-term and long-term debt. The value of this coefficient changed from 1.5 to 1.9 over the period. The share of all liabilities in the total capital rose from around 0.6 in 2014 to 0.66 in 2019 while that of equity fell from about 0.4 in 2014 to 0.34 in 2019.

As far as the debt/EBITDA ratio is concerned, this indicator shows that it took about 2–8 years to pay off a debt of the company with the help of EBITDA. We observe a positive trend as the number of years decreased from 2015 to 2018.

The EBITDA/debt ratio is the opposite indicator to the debt/EBITDA ratio. It can be interpreted vice versa, that is, the higher the ratio, the better. In general, this indicator shows to what extent a company can cover its debt with EBITDA.

Having analyzed the EBITDA/Debt ratio of BP, it will be useful to compare this with its competitors for six years. It is possible to state that Lukoil had the biggest EBITDA/Debt ratio, since this company did not have much debt, unlike its rivals. Lukoil had ratios equal to more than 1 and even 2. Other companies had lower ratios as they had more debt. Their ratios were lower than 1. As a result, it was difficult for these companies to cover lots of debt with EBITDA.

Analyzing an interest coverage ratio, it is quite evident that EBITDA of the company exceeded its interest expenses. It implies that the enterprise generated enough profit to cover its interest expenses. This coefficient was subject to fluctuations during the period. The figure rose stably from 2015 to 2018.

It was having analyzed the EBITDA/Int. expense ratio, it is possible to say that this ratio is also related to coverage ratios like the EBITDA/Debt ratio. It should be noted that this ratio was much higher than the EBITDA/Debt ratio since the debt was higher than just interests. The lowest ratio belonged to Rosneft, and it was about 4. In most cases, this ratio was very high, namely, from 10 to 70. It meant that most companies were able to pay off their interests very well.

The net debt/EBITDA ratio shows that it took about 1–4 years to repay the debt of the company. In most periods, it took even fewer than two years to do it. This figure was not high; that means that the entity generated a sufficient amount of EBITDA in order to cover its debt. The value of this ratio did not change significantly during the period. We can conclude that BP might be considered as a solvent in the long term for the reasons mentioned above.

It is also crucially important to analyze some additional coefficients connected with covering expenses of the company, namely, capital expenditure and dividends.

As can be seen, we have presented some additional main expenses that companies usually incur in the course of their activities. The CAPEX coverage ratio shows that the company had enough cash from its operating activity to cover the capital expenditure in all periods except for 2016. This figure fluctuated in the range of from 1.1 to 1.7 within the period in question. This ratio increased after 2016 in a stable way which may imply that cash flows from an operating activity were increased from 2016 to 2019. As for the dividend coverage ratio, we can see that the entity had enough cash from its operating activity to cover expenses linked with paying out dividends. The value of this indicator changed from 2.3 to 5.6 during the period. Another financial coefficient is connected with the ability of the company to cover capital expenditure and expenses related to paying out dividends with cash flows from its operating activity. We can notice that the enterprise was able to meet its obligations concerning capital expenditure and paying out dividends fully in 2014 and 2019. As for other periods, the entity did not have enough cash flows from its operating activity to cover both of these expenses in a full amount. It should be stressed that the value of this ratio started to grow stably from 2016 to 2019. Moreover, the given indicator reached the same value as it was at the very beginning of the period under consideration, that is, 2014. It might be caused due to an increase in net cash flows from BP's operating activity.

The next aspect of the business of BP is related to its profitability for the same period.

Having computed the main profitability indicators of BP for the period from 2014 to 2019, we can see that the company was profitable in most periods in question. There were some losses in 2016 as expenses of the enterprise exceeded its revenues to some extent. All of these indicators rose from 2015 to 2018. The ratio characterizing return on sales of the company shows that BP generated profit by implementing its business in all periods except for 2015. The maximum return on sales was observed in 2018, and the figure accounted for 3.21%. As for the return on equity, we have calculated this ratio in two ways. The first variant is a standard computation, that is, net profit is divided by equity. The second version of calculating ROE is based on the DuPont approach [Patlasov, 2014, p. 496]. As it is known, we get the same result in both cases. It is necessary to emphasize that one crucial advantage of the DuPont approach is that it gives us an excellent opportunity to determine what elements of the five-factor model have the most considerable influence on return on equity. In our case, components of the model, specifically, the EBIT/Revenue ratio and the Total assets/Equity ratio had the most considerable impact on ROE as these ratios increased more than others during the period under investi-

Table 3
Additional ratios related to covering expenses of BP, 2014–2019

Coefficients	Period					
	2014	2015	2016	2017	2018	2019
CAPEX Coverage Ratio	1.45	1.03	0.64	1.14	1.37	1.67
Dividend Coverage Ratio	5.6	2.87	2.32	3.08	3.41	3.71
CAPEX + Dividends Coverage Ratio	1.15	0.76	0.5	0.83	0.98	1.15

Source: Coser, 2019, p. 151.

Table 4
Profitability indicators of BP, 2014–2019

Coefficients	Period					
	2014	2015	2016	2017	2018	2019
Return on sales (ROS), %	1.13	-2.87	0.09	1.44	3.21	1.5
ROE (a standard computation), %	3.55	-6.5	0.18	3.45	9.43	4.16
ROE (based on DuPont approach), %	3.55	-6.5	0.18	3.45	9.43	4.16
ROA, %	1.41	-2.44	0.07	1.25	3.39	1.42
Operating profit margin, %	1.81	-3.55	-0.23	3.94	6.49	4.2

Source: Ivanickova, 2016, p. 389.

Table 5
Indicators of paying off the enterprise value of BP, 2014–2019

Coefficient	Period					
	2014	2015	2016	2017	2018	2019
EV/EBITDA	6.89	18.39	13.64	8.19	5.67	6.13
EV/NCFO	4.29	6.45	14.81	9.47	7.52	7.02
FCF/EV	0.07	0.004	-0.04	0.01	0.04	0.06

Source: Vrbka, 2019, p. 326.

gation. The maximum return on equity was equal to 9.43% in 2018. Speaking about return on assets, the tendency of changes in this ratio was the same as for the previous coefficients mentioned above. This indicator reached its maximum value in 2018. As far as the operating profit margin is concerned, we can state that this ratio increased after 2016 and changed in the range of between 3.94% and 6.49% from 2017 to 2019.

Also, we have presented some analytics connected with BP's enterprise value.

As we can see, the first coefficient is similar to the second one since both of these ratios reflect how many years it takes to pay off the enterprise value of a particular company. The EV/EBITDA ratio and the EV/NCFO ratio show the number of years to pay off the enterprise value of a company with EBITDA and NCFO, respectively. We can notice that these indicators oscillated to some extent because EBITDA and NCFO were not as stable as the enterprise value. Such a situation is not extraordinary as EBITDA, and NCFO of an entity may change substantially every year. We can observe a positive tendency of changes in the EV/EBITDA ratio and the EV/NCFO ratio as they started to decrease after 2016. It could mainly arise from increases in EBITDA and NCFO from 2016 to 2019. As for the FCF/EV ratio, this shows that the business of the company brought about 4–7 cents of FCF on each dollar invested in its

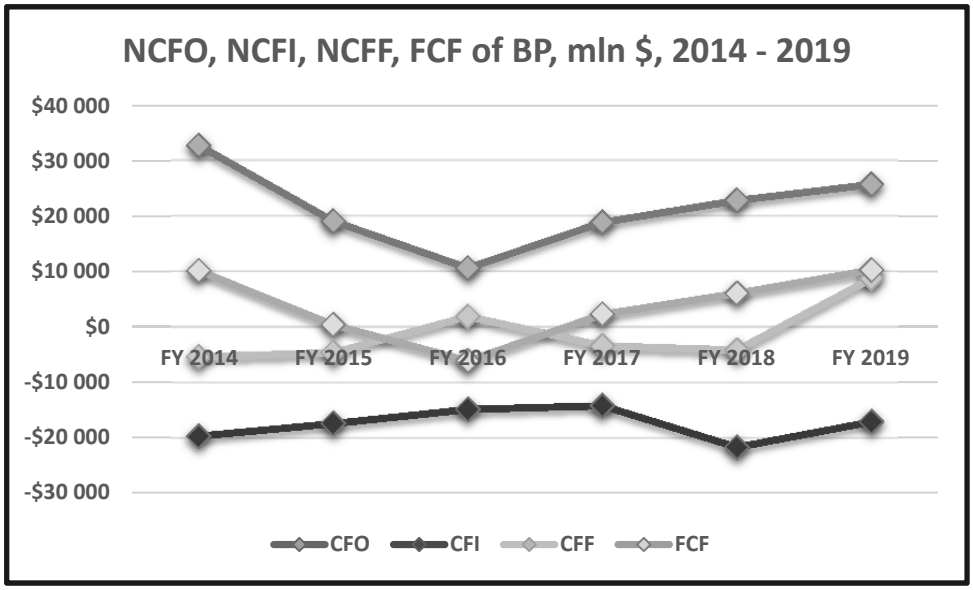

Figure 1. NCFO, NCFI, NCFF, FCF of BP, mln $, 2014–2019

Source: BP's website, 2020, p. 397.

enterprise value during the period. This ratio also changed in a positive direction because the value of this coefficient grew after 2016. It means that the company generated more and more FCF from 2016 to 2019.

It is also expedient to consider how cash flows from operating, investing and financing activities of BP changed from 2014 to 2019.

Analyzing this graph, reflecting changes in all types of cash flows of the company for the period in question, we can state that net cash flows from an operating activity were positive within the whole period. This fact means that the company had an opportunity to use a particular amount of cash from an operating activity to cover a specific amount of its investments, especially capital expenditure from 2014 to 2019. Moreover, some amount of cash might be directed to its financing activity for meeting its obligations connected with paying out dividends during the period. The value of net cash flows from an operating activity changed in the range of from 10691 mln $ to 32753 mln $ during the period. We can observe a significant decrease in net cash flows from an operating activity in 2016. It might chiefly arise out of decreasing revenue and net profit of BP in 2015 and 2016. Despite the negative trend observed up to 2016, the enterprise managed to overcome the problematic situation and net cash flows from an operating activity started to go up from 2016 to 2019.

As for an investing activity, net cash flows from this activity were negative in all periods under study. This situation may be considered usual since BP spent a lot of money on its capital expenditure within the overall period. The value of net cash flows from an investing activity fluctuated between –21571 mln $ to –14077 mln $ over the given period.

When we speak about a financing activity, we can see that net cash flows from a financing activity were negative in most periods except for 2016 and 2019. An increase in capital expenditure in 2016 might result in borrowing more money, that is, obtaining additional short-term and long-term debt to finance an investing activity of the company. The value of net cash flows from a financing activity changed from –5266 mln $ to 8817 mln $ during the period under investigation.

As far as free cash flow is concerned, this indicator was positive in most periods except for 2016. The main reason why free cash flow declined and became negative in 2016, was a decrease in net cash flows from operating activity. Free cash flow changed in the same direction as net cash flows from an operating activity within the whole period. It is quite logical as free cash flow directly depends on the operating activity of a company. This indicator oscillated in the range of from –6010 mln $ to 10352 mln $ during the overall period. Positive free cash flow in most periods implies that there was a particular amount of money available for creditors and shareholders of BP in those periods.

All in all, having conducted the analysis of financial stability and profitability of BP for the

period from 2014 to 2019, we can conclude that BP operated quite successfully for the period in question. It was able to compete with other companies from this industry. The company was solvent in the short term and long term. The entity generated profit with positive NCFO almost in all periods under study. It actively used equity as well as debt for supporting its activity. FCF was positive in many periods, which means that the company performed the business in a favourable way for its shareholders and creditors.

Nevertheless, there were some problems and drawbacks with this company. Although the entity did not have too much financial debt, it should control the share of its debt in the whole capital structure. Besides, it may need to change its capital structure by decreasing the share of total liabilities and increasing the share of its equity. Moreover, BP should increase its EBITDA regularly. Some problems were connected with generating not enough profit and NCFO. These indicators should be increased as well.

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Анализ финансового состояния и рентабельности British Petroleum (BP) за период 2014–2019 годов

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Аннотация. В статье анализируется влияние различных рисков на стабильность компании в финансовом отношении. Важность данной темы заключается в том, что проведение анализа финансовой устойчивости и рентабельности предприятия позволяет определить, насколько финансово стабильной и прибыльной является компания. Этот анализ дает также возможность выяснить, как конкретные показатели меняются из года в год, и предотвратить их снижение. Анализ проведен на примере оценки финансовой устойчивости и рентабельности одной из компаний нефтегазовой отрасли British Petroleum (BP) за период 2014–2019 гг.
Ключевые слова: финансовый анализ; финансовая устойчивость; рентабельность; компания; финансовые коэффициенты