

BP Financial Performance and Ratio Analysis

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Financial-ratio analysis converts accounting statements into relationships that help evaluate liquidity, profitability, leverage, efficiency, and market performance. The original essay applied ratio analysis to BP p.l.c., historically known as British Petroleum, using figures from a particular reporting period. That historical focus should be preserved because ratios must be interpreted within the same accounting year, currency, and set of published statements. BP is an integrated energy company whose financial results are strongly influenced by oil and gas prices, refining margins, production, asset sales, impairment, environmental obligations, taxation, and major events such as the Deepwater Horizon liabilities. A ratio is therefore not a complete judgment about management or solvency. It is a diagnostic measure that becomes meaningful when compared across time, against competitors, and with the notes to the financial statements. (Fraser & Ormiston, 2016; White et al., 2003)

Purpose of Ratio Analysis

Investors, lenders, managers, suppliers, regulators, and employees use ratios for different purposes. A lender may focus on cash flow, liquidity, interest coverage, and debt maturity. A shareholder may examine return on equity, earnings, dividends, and valuation. Management may track working capital, asset utilization, project returns, and capital discipline. Because BP operates in a capital-intensive and cyclical industry, short-term earnings can move sharply even when physical assets and long-term strategy change little. Ratio analysis should therefore combine income-statement measures with cash-flow and balance-sheet evidence. A single good ratio cannot compensate for weak cash generation or hidden obligations. (Penman, 2013)

Data and Comparability

The analyst should use BP's audited annual report and ensure that the numerator and denominator come from compatible periods. Average balance-sheet values are preferable for some return and turnover ratios because income is earned throughout the year, whereas the balance sheet reports one date. Continuing operations should be distinguished from discontinued operations and one-off items. BP reports under International Financial Reporting Standards, while some United States competitors report under U.S. GAAP, creating differences in presentation and measurement. Exchange rates also affect comparisons. Every calculation should identify the year, unit, and formula. (BP p.l.c., 2017, 2018)

Current Ratio

The current ratio is current assets divided by current liabilities. It indicates the amount of short-term assets available for each unit of short-term obligation. A value above one suggests that reported current assets exceed current liabilities, but it does not prove that cash will be available when payments are due. Inventories may be difficult to sell quickly at expected prices, receivables may be delayed, and current liabilities include items with different timing. An integrated oil company may operate with a lower ratio than a small retailer because it has continuing cash inflows, credit access, and valuable inventories. The historical BP result should be compared with its previous years and cash-flow profile rather than a universal benchmark.

Quick Ratio

The quick ratio, or acid-test ratio, excludes inventory and sometimes other less liquid current assets from the numerator. A common formula is cash and cash equivalents plus short-term investments and receivables, divided by current liabilities. The measure is relevant to BP because crude oil, refined products, and other inventories can fluctuate in value and may not convert into cash immediately during disrupted markets. A low quick ratio does not necessarily imply immediate failure, but it indicates stronger dependence on inventory sales, operating cash flow, or financing. The analyst should review committed credit facilities and short-term debt maturities alongside the calculation.

Cash Ratio

The cash ratio compares cash and near-cash investments with current liabilities. It is the most conservative conventional liquidity ratio but can understate practical liquidity because healthy companies do not normally hold enough idle cash to pay every current liability immediately. Excess cash may also indicate underinvestment. For BP, access to capital markets and operating cash generation are important, but those sources can weaken during commodity-price stress. The cash ratio is therefore useful as one layer in a liquidity assessment rather than a target to maximize.

Working Capital

Net working capital equals current assets minus current liabilities. Positive working capital provides a buffer, while negative working capital may indicate pressure or an efficient business model depending on operations. Changes may result from oil-price movements, tax timing, trade balances, inventories, derivative positions, or reclassification of debt. Analysts should identify what caused the movement. A large increase in receivables can raise working capital while weakening actual cash collection. The cash-flow statement helps distinguish accounting expansion from usable liquidity.

Operating Cash Flow Ratio

The operating cash flow ratio divides cash generated from operations by current liabilities. It addresses a weakness of current and quick ratios by using actual period cash generation. For BP, operating cash flow is highly sensitive to commodity prices, working-capital movements, and settlement payments. One year may be unusually strong or weak, so a multi-year average can be more informative. Cash generated after interest, tax, and operating needs supports dividends, capital expenditure, debt reduction, and acquisitions. Persistent divergence between profit and operating cash flow requires investigation.

Gross and Operating Margins

Gross margin compares gross profit with revenue, while operating margin compares operating profit with revenue. BP's integrated structure complicates simple margin comparison because upstream, refining, marketing, trading, and other activities have different economics. Rising crude prices may benefit production while increasing feedstock costs for refining. Revenue can increase substantially because prices rise without a proportional improvement in physical performance. Segment reporting and replacement-cost measures used by energy analysts can clarify operations, but they should not be confused with statutory profit. Margin trends should be related to market conditions and strategy.

Net Profit Margin

Net profit margin equals profit attributable to ordinary shareholders or total net income divided by revenue, depending on the purpose. It shows how much accounting profit remains from sales after expenses, finance costs, tax, and other items. A low or negative margin in one year may reflect impairment, legal settlements, restructuring, or price collapse rather than ordinary operating weakness. Conversely, a high margin may include asset-sale gains. The analyst should calculate both reported and adjusted measures transparently, never removing unfavorable items merely to create a better result. Adjustments should be reconciled with audited figures.

Return on Assets

Return on assets (ROA) divides net income by average total assets. It evaluates how effectively a company generates earnings from its asset base. BP owns expensive, long-lived exploration, production, refining, infrastructure, retail, and energy assets, so ROA is generally lower than in asset-light industries. Impairments reduce the asset base and may mechanically raise future ROA even if operations do not improve. Asset age, reserves, lease accounting, and acquisition history affect comparison among companies. ROA is most useful against BP's own long-term trend and similar integrated energy firms.

Return on Equity

Return on equity (ROE) divides profit attributable to shareholders by average shareholders' equity. It measures earnings relative to the book capital invested by owners. Leverage can increase ROE when asset returns exceed borrowing costs, but it can also magnify losses. Share repurchases reduce equity and may raise ROE mechanically. Large impairments or provisions can also change the denominator. Therefore, a high ROE is not automatically evidence of superior operations. A DuPont analysis can separate profit margin, asset turnover, and financial leverage to show which component drives the result.

DuPont Analysis

The basic DuPont identity expresses ROE as net profit margin multiplied by asset turnover and the equity multiplier. Margin captures profitability from sales, asset turnover captures revenue generated per unit of assets, and the equity multiplier captures leverage. For BP, the framework helps explain whether a change in shareholder return came from stronger margins, more productive use of assets, or increased debt. An improvement driven solely by leverage is riskier than one supported by operating efficiency and margin. The analysis should use compatible averages and definitions.

Asset Turnover

Asset turnover divides revenue by average total assets. It indicates how intensively the asset base generates sales, not profit. Commodity-price increases can raise BP's revenue and asset turnover even if production volume is unchanged. Different business mixes also matter: retail and trading can generate high revenue relative to assets, while upstream projects require large capital before production. The ratio should be interpreted with margin because a company can pursue high volume at low profitability. The combination of margin and turnover contributes to ROA.

Inventory Turnover

Inventory turnover is cost of sales divided by average inventory, with days inventory calculated from its reciprocal. It shows how quickly inventory moves through the business. BP's inventories include crude oil, petroleum products, chemicals, and other materials whose value is affected by market prices and operational needs. Very high turnover may indicate efficiency or insufficient stocks that increase disruption risk. Low turnover may indicate weak demand, strategic storage, maintenance, or falling prices. Comparisons require consistent inventory valuation and business mix.

Receivables Turnover

Receivables turnover compares revenue or credit sales with average trade receivables. A decline can indicate slower collection, changing customer mix, higher prices, or credit weakness. Days sales outstanding provides a more intuitive estimate of collection time. BP trades with governments, industrial customers, distributors, and retail counterparties, so credit risk varies. The notes on expected credit losses and concentration are important. Strong revenue accompanied by rapidly increasing receivables may not improve liquidity.

Debt-to-Equity Ratio

Debt-to-equity compares interest-bearing debt with shareholders' equity. Some analysts use total liabilities instead of debt, producing a different result; the formula must be stated. BP's financing decisions reflect capital expenditure, acquisitions, divestments, dividends, share repurchases, and liabilities from past events. A higher ratio can reduce financial flexibility and expose shareholders to commodity downturns. However, modest debt can lower the cost of capital and support long-lived projects. Book equity can change through currency translation and impairment, so leverage should also be examined using cash flow and market value.

Debt Ratio and Net Debt

The debt ratio divides debt or total liabilities by assets, depending on definition. Energy companies also report net debt, usually borrowings less cash and cash equivalents, and a gearing measure. BP's own definition should be read in the annual report because non-GAAP or alternative performance measures may differ from textbook formulas. Net debt recognizes available cash but assumes that cash can be used for repayment. Restricted balances and operating needs may limit that assumption. Trend and maturity structure are more informative than one percentage.

Interest Coverage

Interest coverage commonly divides earnings before interest and tax by net finance expense. It indicates the margin available to meet interest obligations. Cash-based coverage can use operating cash flow or EBITDA with careful definition. A low ratio during a commodity downturn signals vulnerability, while a high ratio suggests a buffer. Capitalized interest, pension finance items, lease interest, and exceptional losses may complicate the calculation. Analysts should also examine fixed-charge obligations and refinancing needs rather than interest expense alone.

Free Cash Flow

Free cash flow is generally operating cash flow minus capital expenditure, though BP and analysts may define it differently. It is essential in a capital-intensive company because accounting profit can appear strong while projects consume cash. Free cash flow funds debt reduction, dividends, repurchases, and new investment. Cutting capital expenditure can improve short-term free cash flow but damage future production or safety if taken too far. Sustainable analysis distinguishes efficiency from underinvestment. Divestment proceeds should not be mistaken for recurring operating cash generation.

Dividend Measures

Dividend payout compares dividends with earnings, while dividend cover is earnings divided by dividends. Cash dividend coverage can compare free cash flow with distributions. A payout above earnings may be maintained temporarily through cash balances or debt but cannot continue indefinitely without stronger results. BP's dividend has strategic importance to investors, yet management must balance it against debt, transition investment, remediation, and project needs. Historical changes should be interpreted in the context of oil prices and extraordinary liabilities. Yield alone does not measure safety because a falling share price can create a high yield.

Earnings per Share

Basic earnings per share divides profit attributable to ordinary shareholders by the weighted average number of shares. Diluted EPS includes potential shares from compensation or other instruments. Repurchases can increase EPS even without higher total profit, while new issuance can dilute it. Extraordinary gains and losses can make one-year EPS misleading. The annual report provides the authoritative calculation and reconciliation. Analysts should compare EPS with cash flow per share and consider whether changes are operational or financial.

Price-Earnings and Market Ratios

The price-earnings ratio divides share price by earnings per share and represents how much the market pays for reported earnings. It becomes meaningless when earnings are negative and can appear artificially low at the peak of a commodity cycle. Price-to-book, enterprise value to EBITDA, dividend yield, and cash-flow measures offer additional perspectives. Market ratios incorporate expectations about oil prices, transition risk, regulation, reserves, management, and interest rates. A low valuation can indicate opportunity or anticipated decline; ratio analysis cannot decide without qualitative research.

Deepwater Horizon and Provisions

BP's historical statements after the 2010 Deepwater Horizon disaster included substantial charges, provisions, settlements, and payments. These items affected profit, liabilities, cash flow, leverage, and comparability for years. An analyst should not simply exclude them as "nonrecurring," because the obligations were economically real even if they did not arise from ordinary annual operations. At the same time, separating ongoing operations from settlement timing can clarify performance. The event also demonstrates that safety and environmental risk eventually become financial risk. Traditional ratios should be supplemented by assessment of governance and contingent liabilities.

Commodity-Price Cyclicalities

BP's upstream earnings respond strongly to crude oil and natural-gas prices, while refining and marketing can react differently. Ratios calculated during a price collapse may look weak even when the company maintains competitive assets, and ratios at peak prices may overstate sustainable return. Analysts can use multi-year averages, stress scenarios, and break-even estimates. Hedging and trading complicate direct sensitivity. Management's capital discipline across the cycle matters more than one favorable year. Debt taken on near a peak can become burdensome when prices reverse.

Energy Transition and Stranded-Asset Risk

Long-term ratio interpretation must consider climate policy, technology, demand change, carbon pricing, and the possibility that some reserves or infrastructure will not generate expected cash. Investment in lower-carbon energy may initially reduce returns or require new capabilities, while delayed transition may expose the company to regulatory and market risk. Accounting estimates for asset life, decommissioning, and impairment depend on assumptions. Ratio analysis based solely on historical cost can miss these strategic risks. The notes, scenarios, and capital-allocation policy are essential context.

Comparison With Competitors

BP can be compared with integrated peers, but differences in geography, accounting, refining exposure, chemicals, trading, renewables, debt, and fiscal regimes limit direct ranking. Ratios should use the same formula and period. A peer median can identify outliers, while explaining the outlier is more important than declaring it good or bad. A lower current ratio may reflect efficient working capital; a higher ROE may reflect leverage. Benchmarking should lead to questions rather than automatic conclusions.

Limitations of Ratio Analysis

Ratios use historical accounting data affected by estimates, classification, inflation, and policy. They can be manipulated through transaction timing, asset sales, working-capital management, and definitions of adjusted earnings. Ratios do not measure safety culture, reserve quality, political risk, employee capability, technological change, or social license directly. They also compress large organizations into a few numbers. The analyst should combine them with segment information, cash-flow forecasts, management discussion, auditor reports, sustainability risks, and industry conditions.

Overall Interpretation

The original BP calculations should be read as a historical snapshot rather than a permanent judgment. Liquidity ratios reveal short-term buffers; profitability ratios show the earnings generated during the chosen period; efficiency ratios show how assets and working capital were used; leverage ratios show financing risk; and market ratios reflect investor expectations. The most reliable conclusion comes from patterns. Improving operating cash flow, controlled leverage, adequate coverage, disciplined capital expenditure, and returns above the cost of capital would support financial strength. Strong earnings combined with rising debt, weak cash conversion, or large unrecognized risk would require caution.

Conclusion

Financial ratios provide a structured way to analyze BP, but their meaning depends on formula, period, accounting basis, and industry context. Current, quick, cash, and operating-cash-flow ratios assess different aspects of liquidity. Margins, ROA, ROE, and DuPont analysis evaluate profitability and its sources. Turnover ratios examine asset and working-capital use, while debt, gearing, and interest coverage measure financial risk. Free cash flow and dividend coverage connect accounting results with capital allocation. BP's commodity exposure, Deepwater Horizon obligations, large asset base, and energy-transition risks make qualitative analysis indispensable. Ratios should not be used to declare the company healthy or unhealthy from one year. They should identify changes that require explanation and support a wider judgment about sustainable cash generation, risk, and strategy.

References

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