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FINANCE

Friday, April 9, 1999

Another jewel in crown of BP Amoco takeover king

PROFILE: Hot on the heels of merging BP and Amoco, Sir John Browne has shocked the markets with his $26.8 billion Arco takeover

OIL SECTOR: There was more than a hint of triumphalism last week as Sir John Browne, chief executive of BP Amoco, Britain's biggest company, took to the stage of London's Mermaid Theatre to give yet another performance as the takeover king of the international oil industry.

The script was somewhat different from the one Sir John delivered on a sweltering day last August when he startled the world's oil industry and jolted the markets with his takeover of Amoco of the US - which was then the biggest industrial merger in history.

Last year he spoke of the need to move the former British Petroleum into the oil "super league", alongside arch-rivals Royal Dutch/Shell and Exxon. He said last week's $26.8 billion (euro 24.8 billion) takeover of Los Angeles-based Atlantic Richfield (Arco) was more an exercise in filling the gaps in BP Amoco's global asset base.

But the boldness of the acquisition surprised many in the industry. It came only only three months after the formal integration of BP and Amoco and at a time when the recovery in oil prices from recent 12-year lows is still tentative.

Sir John likes to ascribe BP Amoco's success to teamwork and good management systems. That may be so. But teamwork alone cannot explain how, in the space of less

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teamwork alone cannot explain how, in the space of less than eight months, the former BP has transformed itself from a production company in Britain and the US into a global energy group, with a large and balanced international portfolio of oil and natural gas assets.

This astounding transformation, industry insiders agree, was possible largely because of the undisputed respect and authority Sir John commands in a highly competitive business.

"It's an incredible example of the management premium in BP Amoco's share price being used as an acquisition currency," says one admiring merchant banker.

How did Sir John earn such a sterling reputation in just 3 1/2 years at the helm of BP, and then BP Amoco?

Sir John has benefited to some degree by retaining, and refining, a few simple principles laid down by Lord Simon, his predecessor, now a minister in the department of trade and industry. The first is to set clear and realistic financial and performance targets.

The biggest crime a senior manager can commit in BP Amoco is to fail to give Sir John ample warning that an agreed target will not be met. Critics say he is autocratic and rules by fear. Supporters insist his business acumen and managerial skills more than offset his autocratic bent.

As for ruling by fear, they say it is an exaggeration, although one colleague concedes that Sir John does "engender a certain amount of trepidation".

Sir John has also followed Lord Simon's practice of maintaining a continuous charm offensive with the markets. There are rarely any nasty surprises from his company.

Instead investors are expertly drip-fed a series of pleasant surprises, while bad news - such as write-downs on questionable investments - are usually tucked away amid a welter of positive developments.

Sir John has also brought his own qualities to the job. It was his decision to break ranks with many other international oil companies and publicly acknowledge that the threat of global warming was real and that action needed to be taken, even if the scientific evidence was inconclusive.

Positioning BP Amoco as the most "progressive" company in a mature, conservative industry was a deliberate act, industry analysts say, intended to set it apart in the minds of consumers and governments.

Sir John may not personally embrace the full

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environmentalist agenda, but the strategy has helped cement his status as the undisputed leader of the western oil industry, and given him a public pulpit from which to further enhance BP Amoco's reputation.

His sheer capacity for work - and apparent enjoyment of it - are well known. An engineer by background, he admits to being "data driven". Colleagues say he can assimilate enormous amounts of detailed information, but in a way that, so far at least, does not seem to be at the expense of strategic thinking.

One colleague believes his business skills are of an order not seen in the international oil industry since the early decades of the century. Although he has been with BP his whole career, his instincts appear more entrepreneurial than bureaucratic. The way in which he has orchestrated the two takeovers illustrates the point.

At the beginning of last year, BP's strategy of wholesale cost cutting and volume growth was in danger of running out of steam. The oil price collapse occurred just as Sir John's frustration at the slowing pace of organic growth was rising.

Although low oil prices would come to ravage BP's earnings, Sir John knew that their impact on less fit companies than BP would expose deep-seated structural and managerial shortcomings. He also knew that the proven BP cost-cutting system would deliver billions of dollars of additional savings if it could only be applied across a bigger asset base.

But boldness was needed to break the industry's structural logjam, as there had not been a big takeover among the "seven sisters" of the international integrated oil industry since the 1980s.

Although people joke that Sir John is simply working his way through the alphabet of American oil companies, Amoco was a logical starting point. It had good assets, but its management system had atrophied in recent years, with internal processes taking precedence over business operations. And there was no obvious successor to Mr Larry Fuller, its longserving chairman and chief executive who was nearing retirement.

Sir John's gamble paid off. The Amoco takeover caused BP's share price to soar even as oil prices tumbled. And it is the market's confidence in Sir John's management, reflected in the share price, which allowed BP Amoco to make its all-share bid for Arco.

Executive succession problems at Arco were one of the factors that caused its management to seek a deal with BP Amoco. The fact that such problems played such central roles in the two takeovers has prompted Sir John - who is

not due to retire for more than nine years - to begin thinking about preparing the ground for his own departure.

"A key role of a chief executive officer is to prepare the succession," he said last week, as he relaxed with a cigar at the Mermaid Theatre. "It's never too early to start." But the oil industry is betting that there will be a few more performances of the takeover king before he bequeaths his crown. **(Financial Times Service)**

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Channel Islands

Thomas R. Marshall, Jr.
1569 Birchwood St.
Anchorage, Alaska 99508

April 18, 1999

Ms. Ramona Barnes
Alaska State House of Representatives
Chairwoman, World Trade and State and Federal Relations Committee
State Capitol (MS3100)
Juneau, Alaska 99801-1182

Dear Mr. Whitaker:

There's a darn good reason that North Slope Oil companies have resisted selling their natural gas.

Keeping the reservoir gas cap in place is the best way of achieving the greatest ultimate recovery of reservoir oil. Re-injecting gas produced with oil production is the best way to keep the gas cap in place. If the gas cap is reduced in size by gas cap production, the oil ring will rise to displace it. Once any part of the gas reservoir is "wetted" with reservoir oil, about 38% of that oil will become unproducable, held in the reservoir by molecular forces stronger than the reservoir energy available to move it to the well bore.

It is against the law to waste oil or gas. AS 31.05.170 defines waste to include "the inefficient , excessive or improper use of, or unnecessary dissipation of, reservoir energy".

Conservation order 83-A Rule 8 prohibits the venting or flaring of gas in the Prudhoe Bay field. The Prudhoe Bay Unit agreement also prohibits the flaring of gas. The State stopped the flaring of gas in Cook Inlet starting in 1968 with conservation order #32 and subsequent orders. The flaring of gas has the same detrimental reservoir effect as premature sale of the gas. In my opinion, the highest and best use for Prudhoe gas now is maintaining reservoir pressure to ultimately produce as much reservoir oil as possible at or below the Maximum Efficient Rate set by the Oil and Gas Conservation Commission. Considerable gas (approximately 400,000 cu. ft. per day) is now properly used for oil field fuel needs and in my opinion every effort should be made to allow private industry the opportunity to provide natural gas to Alaskans to heat homes and provide feedstock for Alaska industries. Assurance that low cost gas would be available over the long term will greatly stimulate Alaskan industries including greenhouses and clean petrochemical manufacturers. A geographic example would be the amazing steady growth of the Pacific Northwest from low cost hydro power. It makes much more sense to provide Alaskans with low cost energy than to ship it to the Orient. Alaska gas which after it has

been piped 800 miles, liquefied, shipped across an ocean in cryogenic tankers and then regasified becomes high cost gas. To make it competitive Alaska gas owners will have to accept bargain basement prices which means less State royalty and tax income.

Those advocating State ownership of a pipeline may not understand the risks involved. I have seen more than one pipeline being "back curled" out of the ground and cut for scrap. Market and supply conditions can change. There is at least a chance that some of Eastern Siberia's 1,100 trillion cubic feet of natural gas reserves could reach Pacific ports and compete with any LNG system depending on export to Asia.

Gas is an increasingly valuable commodity. The YMCA on Lake Otis Drive in Anchorage makes all of its electricity and heat some of its water with natural gas fuel cells without mainline electric power or noisy generators. Smaller fuel cells were shown at the Anchorage Home Show this Spring suitable for remote use. The exhibit was sponsored by a local electric utility company anxious to get in on the ground floor of a competing alternative. North Slope gas in quantities great enough to operate an initial modular GTL plant on the slope without damaging the reservoir may now be available. GTL liquids would help extend the economic life of the existing oil pipeline. Hopefully the liquids will be miscible with crude oil so that batching tankage is not required at either end of the trans Alaska oil pipeline but if not the batching method might provide finished products of greater economic value. This technology could be used in developing Pt. Thompson which is basically a non-rate sensitive gas reservoir and will probably involve construction of small product lines to the trans Alaska oil pipe line.

For some reason folks like to call GTL "unproven technology. This is quite a surprise to me having spent an entire day in Sasolburg, South Africa in 1978 on an operational inspection of the large scale GTL plant. This plant and several larger ones are now in production.

If a smaller, less expensive version of the proposed trans Alaska gas pipeline is built to Valdez or Cook Inlet it could serve many residential and industry customers along the way. A smaller scale LNG plant could service coastal communities not on a distribution net via a small LNG tanker. The last call on LNG would be to supply US or foreign markets.

The key disadvantage of overseas shipment of LNG is the huge volume of gas needed from the start to amortize the great cost of this very large capacity system. A slam-bang boom to flood the LNG market with the gas equivalent of 2 - 3 billion cu. ft. per day certainly isn't better for the average Alaskan than sustained economic growth.

Another word of caution. As Interstate Oil Compact Commission Representative under five Alaska governors I repeatedly heard the Louisiana Representatives rue the day that their state contracted away their low cost gas field gas to the post war "Big Inch" pipeline terminating in New Jersey. Gas was cheaper in Bayonne, New Jersey than in New Orleans raising prices for domestic users and putting their petro chemical industry at a competitive disadvantage. Then as now the hue and cry was that there will be enough for everybody forever so everything will be OK. This same Louisiana gas story from a

different source was discussed by the Common Wealth North Gas Pipeline Committee and reported in the Anchorage Times April 8, 1980.

My hope is that the current State government will take a balanced look at the North Slope natural gas reserves as an opportunity to benefit its present and future citizens by making it possible for the free enterprise system to supply many generations of **Alaskans** with low cost energy while giving us all the satisfaction that we are utilizing our oil and gas fields in an efficient manner.

Please don't conclude that I think I have the answers but I believe there are many ways to utilize North Slope gas and all ways should receive open minded consideration by your committees including matters of taxation and allocation.

I am a retired concerned citizen not in the consulting business and have no financial interest in oil companies doing business on the slope.

Please make this letter part of the committee hearing on the Arco - BP/Amoco merger to be held April 20 and 23, 1999.

Respectfully,

Thomas R. Marshall, Jr.

cc: Jim Whitaker, Alaska House of Representatives

cc: Wilson Condon, Commissioner, Dept of Revenue

Natchiq, Inc.
Keith D. Burke
Vice President Business Development
Comments before House Committee
World Trade and State/Federal Relations
BP Amoco-ARCO merger
April 20, 1999

Natchiq, Inc. is the third largest employer with 2300 employees just in Alaska and one of the largest oil field support contractors with $90 million of capital investment here in the state. Nationally we have been ranked in the top 30% of the largest oil & gas service companies in the U.S. for several years. Natchiq has a very good working relationship with Arco and BP Amoco.

Natchiq, Inc. is supportive of this merger given that BP Amoco is committed to:

Local hire and Alaska buy
Recognition of local expertise and abilities
Continued aggressive exploration and field development
Reinvestment in Alaska of saving realized from this merger

It is generally our feeling that this merger will reduce the over all operating cost of the North Slope and place Alaska in a more competitive position for the future.

States step into new antitrust role in BP-Arco merger

By ROBERT KOWALSKI ADN 4-19-99
Daily News Juneau Bureau

JUNEAU — When Attorney General Bruce Botelho meets with Federal Trade Commission officials here this week to discuss BP Amoco's purchase of Atlantic Richfield Co., he'll be joined by antitrust officials from three other Pacific Coast states.

Botelho has invited his counterparts in California, Oregon and Washington state to present their concerns about the $26 billion deal to the federal regulators who must sign off on it.

Meantime, a national organization of attorneys general is assembling a task force to study the huge oil company acquisition in the light of state laws designed to keep corporate mergers and takeovers from squelching competition.

National experts in antitrust law say the deal that would join Alaska's two largest petroleum producers into the world's second largest oil company will likely undergo a kind of scrutiny rarely seen two decades ago: an independent review by states.

AkPIRG's Stephen Conn

Attorney Charlie Cole

Revenue chief Wilson Condon

Associate professor P.J. Hill

"Historically, states played almost no role in antitrust," said Albert Foer, president of the American Antitrust Institute in Washington, D.C. "There've been efforts by the states increasingly to be involved."

And for the BP-Arco purchase, "It sounds like Anchorage, Alaska, is going to be one of the testing grounds," he said.

The question for many Alaskans, three weeks after BP and Arco announced the takeover agreement, is whether, and on what grounds, the administration of Gov. Tony Knowles and the Legislature might challenge it.

Further, the question seems to be not whether the state will block the deal, but if it can exact concessions from the oil companies, such as divestiture of North Slope oil holdings, interests in the trans-Alaska pipeline, or agreements on tax and royalty payments to Alaska.

"It's a cataclysmic development — probably the most far-reaching political, economic

Please see Back Page, MERGER

MERGER: Attorneys general can raise antitrust hurdles for BP

Continued from Page A-1

and social event since oil was struck at Prudhoe Bay," former Attorney General Charlie Cole said.

"It's bigger than the pipeline. I think it's a bigger event than the Exxon Valdez spill, because in some ways it casts the die for Alaska's future for the next 30 years," he said.

BP has remained low-key since the purchase was formally announced on April 1.

Knowles said he has met and spoken with top officials of both BP and Arco. And executives of the firm have met with legislators here as well.

BP has promised to invest $5 billion in North Slope development in coming years and has said it would build a pilot natural gas processing plant in Alaska. The companies also have said the acquisition would result in 400 layoffs in Alaska.

Though the Federal Trade Commission must approve the deal, BP and Arco will also have to clear any antitrust hurdles thrown up by various states with an interest in the purchase.

Implications of the acquisition are very different for Alaska than its neighboring states to the south.

In California, regulators worry about how oil company mergers affect what are called "downstream" effects on the petroleum industry, or what millions of motorists pay for gasoline at the pump.

If it acquires Arco, BP will produce in Alaska half the oil sent to refineries in California, by one estimate.

"Obviously, that will be part of what the state will be jointly evaluating with the other states," Botelho said.

Such downstream impacts are a classic antitrust issue because they hit consumers directly.

"Usually, the focus is what it does to consumers," said P.J. Hill, a University of Alaska associate professor of economics.

But in Alaska officials are concerned about what industry insiders call "upstream" impacts of the BP-Arco purchase — competition in the exploration, production and transportation of crude oil.

"This is an interesting merger, because it's kind of on the other side of the market," Hill said.

There are few perceived direct impacts on consumers in Alaska because BP and Arco don't operate refineries or gas stations in the state, but the aspects of competition that do apply have huge potential ramifications for the state.

And antitrust laws can come into play on upstream issues, said Kevin O'Connor, a Wisconsin assistant attorney general who has led an antitrust task force with the National Association of Attorneys General.

"The upstream issues are fair game," O'Connor said. "That's a big deal. You don't just look at gas stations."

Knowles said a team of top officials he directed to review the buyout will focus on operation of the pipeline, oil tankers, new and existing oil and gas leases, the value of North Slope crude and development of oil and gas reserves in the state.

The Legislature's Republican majority also has agreed to hire legal counsel to study the acquisition

Knowles last week said the price of Alaska oil will be an important consideration in the state's review of the purchase.

Historically, as a major North Slope oil producer, BP has had an incentive to keep Alaska crude oil prices high, Knowles said. But if the purchase is completed, BP will own Arco's West Coast refineries and will, essentially, sell oil to itself, he said.

"Since the start-up of the pipeline, British Petroleum has had an incentive to keep the publicly reported oil prices as high as possible, and that's good news for Alaska," he said.

"One result of this merger may be the reversal of that role, because BP Amoco will now find itself essentially a buyer of its own crude," Knowles said. "This incentive to keep oil prices high may disappear."

The implications for Alaska are important. Every $1 in the price of a barrel of oil equates to about $70 million in revenue to the state at current production levels.

Last year, oil revenue paid for about three-quarters of the state's general fund budget.

If the buyout is completed, the resulting firm will own 72 percent of the trans-Alaska pipeline and more than half of all the feeder pipelines from major fields on the North Slope, according to the state.

BP and Arco now ship almost 800,000 barrels, or 68 percent, of the 1.16 million barrels of oil that flows through the pipeline each day.

Revenue Commissioner Wilson Condon, one of the members of the governor's team reviewing the purchase, said the state will have to address the revenue issue in another sense: what it charges the oil companies in royalties and taxes.

Alaska has different payment structures with Arco and BP, but those will have to be reconciled if the firms are combined.

The combined firms also would own leases to 870,000 acres of surface land, which exceeds the state's 500,000-acre limit. They might be forced to divest the difference.

Constraints the acquisition might face under the state's antitrust law are less clear.

Traditionally, experts say, the federal government has enforced antitrust laws.

But states began taking an active role in corporate mergers and acquisitions during the 1980s because the Reagan administration curtailed federal antitrust regulation, said O'Connor, an antitrust expert with the attorneys general association.

"About all they were doing was criminal enforcement," O'Connor said.

In the 1980s, New York state challenged the RJR-Nabisco merger. And California challenged a merger involving the American Stores grocery chain, O'Connor said.

More recently, 20 states joined in the Justice Department's antitrust challenge to Microsoft, Foer said.

"That's an example of the strong role that the states have been playing," he said.

State attorneys general also began banding together to review corporate buyouts and mergers. They formed an antitrust task force within the national association.

"It sort of grew out of the Reagan inactivity," O'Connor said. "We became much more like a national law firm than just a collection of states. ... There's no large merger that comes through anymore that isn't given at least a preliminary review."

Botelho said a task force is being formed within the attorneys general organization to study the BP-Arco purchase.

Some interests say Alaska should challenge the BP-Arco deal on antitrust grounds.

"It's not enough for the governor to form a little closet commission," said Stephen Conn, executive director of the Alaska Public Interest Research Group. "There's got to be a frontal assault on this by the state and the federal government."

But Cole said challenging companies the size of BP and Arco is a formidable task.

Alaska's legal work on the Exxon Valdez oil spill settlement cost the state $25 million a year, said Cole, who was attorney general during the administration of former Gov. Wally Hickel. Fighting an antitrust case against the BP-Arco buyout, he predicted, could cost more.

"Prosecuting those antitrust cases, the costs are staggering," Cole said. "This isn't any Carr's-Safeway deal in Anchorage. When you talk about the economic political forces that are engaged in this merger, they're huge."

Oil economist Matt Berman, of the University of Alaska Anchorage's Institute for Social and Economic Research, doubted Alaska would fight the acquisition.

"I don't think the state will end up challenging it because the state has too much at stake in having good relations" with the oil companies, he said.

"I think there's more concern about the jobs that would be lost here, and I don't think there's anything that can be done about that."

❑ Reporter Robert Kowalski can be reached at rkowalski@adn.com.

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Inv. Code: Unchanged
Estimates: Unchanged

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BP Amoco

Initial Perspectives on the ARCO Deal

- BP Amoco to acquire ARCO in an all-stock deal
- The deal has strong strategic logic
- Accounting treatment will result in large goodwill charges, diluting reported EPS
- However, the deal looks strongly cash-flow enhancing
- BP Amoco remains one of our top picks in Europe. We reiterate our 1L *(Buy, Low Risk)* code

Reuters: BPAL – Bloomberg: BPA LN

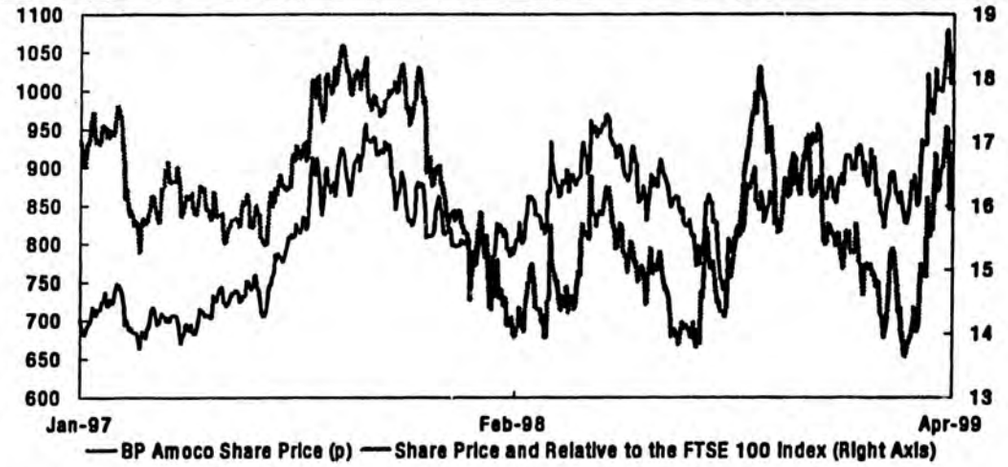
Figure 1. BP Amoco — Statistical Abstract

Year to Dec	Net Income ($ m)	EPS ($)	EPADR ($)	CFPS (cents)	DPS (cents)	P/E	P/CF	Net Yield %
1998A	4468	28.2	2.70	57.8	23.9	35.9	17.5	2.4
1999E	6604	41.9	4.15	78.7	24.7	24.1	12.8	2.4
2000E	9016	57.9	5.73	105.0	26.0	17.5	9.6	2.6

Sources: Company reports and Salomon Smith Barney estimates.

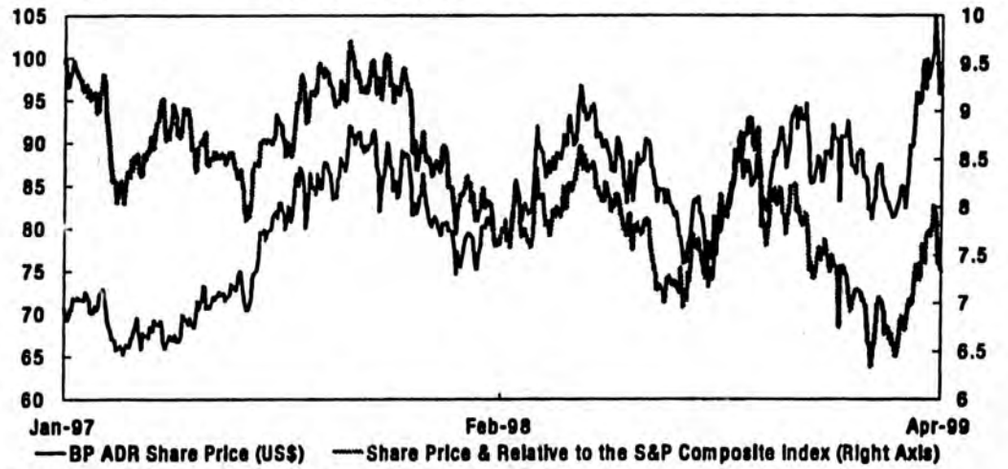
BP Amoco's agreed purchase of ARCO represents a bold strategic move, coming as quickly as it has after completion of the Amoco merger[1]. ARCO's assets provide a good strategic fit with those of BP Amoco, giving it access to West Coast downstream and substantial Asian gas reserves, as well as offering significant E&P synergies in Alaska and elsewhere. In view of the US$1 billion annual prospective cost savings, the premium being paid for ARCO appears reasonable. Purchase accounting will result in substantial goodwill charges which look set to dilute reported earnings and returns. However, the deal looks immediately accretive to cash flow. BP Amoco remains one of our top investment picks among the European Oils. We are reiterating our 1L (Buy, Low Risk) code on the stock.

Figure 2. BP Amoco — Share Price and Relative to the FTSE 100 Index, Jan 97-Apr 99



Source: Datastream.

Figure 3. BP Amoco — Share Price and Relative to the S&P Composite Index, Jan 97-Apr 99



Source: Datastream.

[1] *Salomon Smith Barney is an advisor to the Atlantic Richfield Company in its pending merger with BP Amoco.*

ARCO Deal a Bold Strategic Move

- BP Amoco agrees all-stock takeover of ARCO
- Deal has a strong strategic rationale
- Cost savings estimated at US$1 billion per annum pre-tax
- Goodwill charges likely to dilute EPS
- Deal looks strongly cash-flow accretive

Transaction description

BP Amoco has announced an agreed offer for Atlantic Richfield (ARCO). The terms of the deal are: 0.82 BP Amoco ADSs, or 4.92 ordinary shares, per ARCO share.

Price represents a 26% premium

26% premium

Closing prices for the two stocks on Friday 26 March, the last day of trading before word of the talks leaked, were US$100.44 for BP Amoco and US$65.25 for ARCO. On this basis, the implied price of the offer was US$82.36 per ARCO share. This represents a premium of 26%, or around US$5.6 billion.

Combined company valued at US$181bn

Based on the current market price of BP Amoco, the offer is worth US$78.9 per ARCO share, a premium of 7% above its last closing price. It values ARCO at US$26 billion, giving a combined market capitalisation for the two companies of around US$181 billion.

Figure 4. BP Amoco — Details of ARCO Transaction

BP Amoco Ords per ARCO share	4.92
BP Amoco ADSs per ARCO share	0.82
Pre-deal BP Amoco price	100.44
Pre-deal ARCO price	65.25
Implied purchase price	82.36
Implied premium, %	26%
Implied premium, $bn	5.58
Current BP Amoco ADS Price, $	96.25
Offer price based on current BPA price, $	78.93
ARCO current discount to offer price, $	5.30

Sources: Company reports and Salomon Smith Barney estimates.

Figure 5. BP Amoco and ARCO — Market Capitalisation, US$ Billions

	Share/ADR Price US$	Shares/ ADRs	Mkt Cap US$bn
BP Amoco ADSs	96	1614	155.3
ARCO shares	74	326	24.0
BP Amoco/ARCO	96	1881	181.1
New BP Amoco ADSs created	96	267	25.7
New BP Ords created		1603	25.7

Sources: Company reports and Salomon Smith Barney estimates.

The merger will create a company with a size more closely rivalling Royal Dutch (RD)/Shell but still well short of the proposed Exxon Mobil combination. BP Amoco/ARCO's market capitalisation of US$181 billion compares against Exxon/Mobil's US$250 billion. Its total hydrocarbon reserves of 18.7 billion boe match those of RD/Shell but are less than Exxon/Mobil's 20.7 billion boe. BP Amoco/ARCO's refining throughput will be around half of Exxon/Mobil's 6mmb/d.

Figure 6. BP Amoco — Comparison With Other 'Supermajors'

	BPA	Arco	BPA-Arco	RD Shell	XON-MOB
Market Capitalisation (US$bn)	155	24	181	180	249
Capital Employed (US$bn)	56.6	14.9	90.2	71.7	80.8
1997 Reserves (mmboe)	14,599	4,052	18,651	18,763	20,743
1998 Oil and Gas Production (mboed)	3,050	1,002	4,052	3,664	4,272
1998 Refining Throughput (mbd)	2,698	450	3,148	4,027	6,060
1998 Chemical Sales (US$m)	9,691	0	9,691	12,272	14,949

Sources: Company reports and Salomon Smith Barney estimates.

Timing and regulatory issues

BP Amoco expects the transaction to be completed by around late summer. This implies a longer time frame than that needed to complete its recent merger with Amoco. In part, this is because of the large volume of other transactions, including the proposed Exxon/Mobil merger, being considered at present by the FTC.

Outside of the US, regulatory issues appear minimal. Within the US, the downstream business should not present significant regulatory problems since there is no material overlap between ARCO's businesses, which are concentrated on the West Coast, and BP Amoco's interests, which are virtually all in the Mid West or on the East Coast.

Regulatory issues in Alaska

In Alaska, there are clearly regulatory issues now that the group is by far the dominant upstream player in the state. The combined entity will control 75% of Alaskan oil production and 75% of the trans-Alaskan pipeline. In particular, it expects to have to divest exploration rights to around 360,000 acres of land to come into compliance with the state limit of 500,000 acres for any single company. The dominance over crude production may cause the state concerns over potential reductions in future investment levels. However, BP Amoco is indicating that it aims to increase investment in the region, including a US$70 million gas-to-liquids pilot plant.

Integration of ARCO into BP Amoco

Integration of Amoco well under way

The speed with which BP has moved to fully integrate its operations with those of Amoco has been such that this process is now well on the way to being completed. Nevertheless, a separate team has been established to manage the integration of ARCO's businesses. The aim is to isolate this process so that it does not interfere with processes still remaining in the integration of BP and Amoco.

ARCO's businesses are to be absorbed into the existing BP Amoco structure of separate business units. The disruption to BP Amoco's businesses should be limited, since only around 10% of its 125 business units are directly affected. BP Amoco's current executive management team is not to be expanded as a result of this transaction.

Strong strategic rationale

Substantial overlaps in Alaskan upstream

Substantial common interests in Alaskan upstream

In the upstream, there appear to be several areas where overlaps could result in significant restructuring gains. The most obvious of these is Alaska, where BP Amoco and ARCO each operate half of the giant Prudhoe Bay Field and have several other common interests. Alaska contributed 53% of ARCO's 1998 crude production and 22% of that of BP Amoco. Between them, the two companies had total production from Alaska of 800mbd in 1998, equivalent to 21% of their combined worldwide output of oil and gas.

The elimination of the overhead expense of one operator suggests the potential for some cost savings. However, given the already sizeable cost-cutting initiatives the two companies have set up in the North Slope previously, the potential for significant incremental cost savings from Alaska may be constrained. Nevertheless US$200 million or 20% of the US$1 billion of total estimated synergy benefit from the deal is expected to come from Alaska. BP Amoco also expects that 15%-20% of the headcount reduction from the ARCO deal will occur in Alaska.

Faster realisation of value from Alaskan gas?

Major reserves of natural gas in Alaska

We also believe that the merger should enhance the prospects of a speedier commercialisation of North Slope natural gas which, in the face of declining oil production rates, could convince the state of Alaska of the benefits of the merger. In its analyst presentation, BP Amoco suggested higher hydrocarbon production as a potential benefit of the merger for Alaska and the company announced its plans to build a US$70 million gas-to-liquids pilot plant in the state. In the North Slope, the merger would add ARCO's 43% ownership interest in the 25 tcf Prudhoe Bay natural gas cap to BP Amoco's 14% interest and could enhance the prospects for a commercial development scheme.

Having two instead of three major owners of the gas cap could lessen the potential for disagreement between the parties over the means of commercialising the reserve. In past years there have been disputes between BP Amoco and ARCO regarding the timing and extent of natural gas development in the North Slope of Alaska. This stemmed from the differential ownership percentage of oil and gas between the two companies, with BP Amoco owning a larger proportion of oil and therefore favouring maximum oil production at the expense of natural gas production, while ARCO faced an opposite situation, owning a larger share of the gas.

Another source of contention has been the method of commercialising North Slope gas with ARCO having favoured LNG while Exxon and BP preferred a gas-to-liquids alternative. ARCO had previously suggested possible commercialisation by 2007 or thereabouts; the acquisition could accelerate this timetable.

Figure 7. Prudhoe Bay Field — Ownership Interests (Percentage)

	ARC	BPA	XON	ARC-BPA	Total Reserves	
Prudhoe Bay Oil	22%	51%	22%	73%	3,900	B bbls
Prudhoe Bay Gas Cap	43%	14%	43%	57%	25	tcf

Sources: Company reports and Salomon Smith Barney estimates.

An even stronger position in the US Gulf

Elsewhere in the upstream, there is likely to be significant further synergy between operations in the lower 48 states of the US, the Gulf of Mexico, the UK and Venezuela. BP Amoco/ARCO will have an imposing position in the Deepwater Gulf of Mexico with an even larger lease position than deepwater pioneer RD/Shell.

Asian natural gas reserves

Strong growth potential in natural gas

Another core rationale of the transaction is long-term growth in natural gas. The combination will further shift BP Amoco's reserve profile toward gas. In addition to North Slope gas the acquisition will add ARCO's giant Tangguh natural gas find in Indonesia and give BP Amoco a large portfolio of potential future Pacific basin natural gas developments.

Tangguh was discovered by ARCO and has gross reserves of 20 tcf, or 8 tcf (40%) net to ARCO. Little of the gas has yet been booked as reserves. Commercialisation of Tangguh through an LNG scheme has been delayed due to the east Asian economic downturn but it is deemed one of the more promising LNG projects currently being considered in the region. In addition, the deal brings with it ARCO's 25% stake in the Malaysia/Thailand JDA gas project.

Figure 8. BP Amoco — ARCO: Reserves, 1995-98

	1995	1996	1997	1998	1998
Reserves, mmboe					
Oil	11268	11715	12306	12159	62%
Gas	6532	6633	6999	7347	38%
Total	17800	18348	19305	19506	100%
USA	9273	9092	9327	8834	45%
Rest of World	8527	9256	9978	10672	55%
Total	17800	18348	19305	19506	100%

Sources: Company reports and Salomon Smith Barney estimates.

Figure 9. BP Amoco and ARCO — Oil and Gas Production, 1998

	Quantity			Proportion		
	BP Amoco	ARCO	Combined	BP Amoco	ARCO	Combined
Liquids, mbd						
Europe	623	34	657	30%	5%	24%
USA	833	528	1361	41%	80%	50%
Other	593	96	689	29%	15%	25%
Total	2049	658	2707	100%	100%	100%
Natural Gas, mmcfd						
Europe	1458	369	1827	25%	18%	23%
USA	2321	1175	3496	40%	56%	44%
Other	2029	560	2589	35%	27%	33%
Total	5808	2104	7912	100%	100%	100%
Oil and Gas, mboed						
Europe	874	98	972	29%	10%	24%
USA	1233	730	1963	40%	72%	48%
Other	943	193	1136	31%	19%	28%
Total	3050	1021	4071	100%	100%	100%

Sources: Company reports and Salomon Smith Barney estimates.

Strong West Coast downstream presence

ARCO a major player in US West Coast R&M

The other key strategic rationale would be the strong position in US West Coast refining and marketing which ARCO would bring to BP Amoco. Although BP Amoco is currently the US's second largest downstream player (until the Exxon/Mobil deal is completed), it has no presence on the West Coast.
A combination with ARCO would lift BP Amoco's total US refining capacity from around 1.5mmbd to just over 1.9mmbd, lifting the US to almost 60% of its worldwide refining capacity. Because of the lack of geographical overlap, it is possible that anti-trust concerns may not be that great. The combined entity would have a 13% share of the US gasoline market, ranking it third after Shell/Texaco and Exxon/Mobil, assuming completion of the latter merger.

Figure 10. BP Amoco and ARCO — Refining and Marketing Data, 1998

	Quantity			Proportion		
	BP Amoco	ARCO	Combined	BP Amoco	ARCO	Combined
Refining capacity, mbd						
Europe	899	0	899	32%	0%	27%
USA	1464	476	1940	52%	100%	59%
Other	438	0	438	16%	0%	13%
Total	**2801**	**476**	**3277**	**100%**	**100%**	**100%**
Crude Runs	2698	450	3148			
Utilisation	97%	95%	96%			
Marketing Sales (ex trading sales), mbd						
Europe	1030	0	1030	33%	0%	28%
USA	1503	565	2068	48%	100%	56%
Other	603	0	603	19%	0%	16%
Total	**3136**	**565**	**3701**	**100%**	**100%**	**100%**
Retail Outlets						
Europe	8200	0	8200	30%	0%	28%
USA	15700	1760	17460	58%	100%	60%
Other	3300	0	3300	12%	0%	11%
Total	**27200**	**1760**	**28960**	**100%**	**100%**	**100%**

Sources: Company reports and Salomon Smith Barney estimates.

Increased US exposure

The merger with Amoco significantly increased BP's overall exposure to the US, where it was already the largest producer of crude oil and is now also its largest gas producer. BP Amoco currently has 40% of its worldwide production in the US, and this figure would rise to almost 50% on completion of the ARCO deal.
In refining and marketing, the deal would boost the US from 52% of the group's worldwide refining capacity to around 59%.

Rationalisation benefits and costs: US$1 billion in annual pre-tax savings

US$1 billion annual savings

BP Amoco's management have estimated savings from the deal at around US$1 billion before tax. Around US$5-600 million of these synergy benefits are expected to be generated in 2000, and the full amount by the end of 2001. Costs of the acquisition are expected to amount to around US$1 billion in 2000, of which some US$400 million will comprise UK stamp duty reserve tax.

We estimate that such a level of savings, if generated, would have a dcf value after tax and acquisition charges of around US$5 billion, compared to the implied premium for ARCO of US$5.6 billion. Although the value of the initial cost savings appears lower than the premium being paid, the annual upside from synergy benefits between the two companies could ultimately exceed US$1 billion significantly.

The majority of the savings in E&P

More than 70% of the cost savings are expected to come from upstream operations, where a closer focus on exploration spending is expected to yield around US$350 million in annual savings. Elsewhere, US$110 million of cost reduction is expected in the downstream businesses, while elimination of a second head office will contribute to corporate cost savings estimated at US$180 million. In total, the deal is expected to result in around 2,000 job losses.

Figure 11. BP Amoco — Annual Pre-Tax Synergy Benefits from the ARCO Transaction (US$ Millions)

E&P: Alaska	200	Organisational Efficiencies	300
E&P: Rest of World	510	Reduced Exploration Spend	350
Refining and Marketing	110	Business Processes/IT	180
Corporate	180	Operational Rationalisation	170
Total	1000		1000

Sources: Company reports and Salomon Smith Barney estimates.

Per-share effects: earnings dilution from transaction goodwill, but cash flow enhanced

ARCO on much lower P/CFs than BP Amoco

At current share prices, BP Amoco and ARCO trade on similar 2000 P/E multiples of around 20-22 times, based on our SSB official crude price estimates. However, ARCO's prospective price/cash flow multiple of 7 times is considerably lower than BP Amoco's 10.5 times.

US$1.25bn pa of goodwill charges

Because the transaction is treated as a purchase under UK GAAP, it will result in a write-up of ARCO's assets of the order of US$19 billion. In addition, goodwill is expected to be amortised at a rate of around US$1.25 billion per annum. BP Amoco intends to report its net income after goodwill charges, but also to restate the figures excluding the asset write ups and goodwill charges, for comparison with the peer group companies.

Figure 12. BP Amoco — Goodwill on ARCO Purchase

ARCO book value per share, $	21.5
Current implied offer price, $	78.9
Current premium over book value per share, $	57.4
Offer price/book value	3.7
Implied Asset Write-Up, $m	18722
Annual goodwill charge over 15 yrs, $m	1248

Sources: Company Reports and Salomon Smith Barney estimates.

EPS diluted after goodwill

Based on the US$1 billion of projected cost savings but before goodwill charges, we estimate that the deal would be accretive to BP Amoco's EPS by around 2% in 2000, rising to around 5% in 2001. However, after goodwill charges we estimate EPS dilution of approximately 12% in 2000, falling to some 7% in 2001.

CFPS enhanced from year 1

As a result of the substantial difference in cash flow valuations between the two companies, we believe the transaction will immediately enhance cash flow per share from 2000. Our estimates indicate a healthy level of CFPS accretion of around 7% in 2000 and 2001.

Figure 13. BP Amoco — ARCO: Provisional Pro Forma Estimates, 1998-2001E

	1998	1999E	2000E	2001E
BP Amoco				
Earnings, $bn	4502.6	5400.0	7512.0	9343.0
Cash Flow, $bn	9231.0	10893	14550	17451
ADSs Outstanding	1,614	1,614	1,581	1,544
EPS Pre-Merger	$2.79	$3.35	$4.75	$6.05
CFPS Pre-Merger	$5.72	$6.75	$9.20	$11.30
ADS Price, $	**$98.25**			
P/E	34.5	28.8	20.3	15.9
P/CF	16.8	14.3	10.5	8.5
ARCO				
Earnings, $m	551	686	1102	1416
Cash Flow, $m	2949	2845	3397	3779
Shares Outstanding	326	326	326	326
EPS Pre-Merger	$1.69	$2.10	$3.35	$4.30
CFPS Pre-Merger	$9.05	$8.70	$10.30	$11.45
Share Price, $	**$73.63**			
P/E	43.6	35.1	22.0	17.1
P/CF	8.1	8.4	7.1	6.3
BP-Amoco/ARCO: 100% Credit for Cost Savings				
BPA ADSs per ARCO share	0.82	0.82	0.82	0.82
New BPA ADSs	267	267	267	267
Total BPA ADSs	1881	1881	1849	1812
Rationalisation Benefits Pre-Tax, $m			500	1000
Rationalisation Benefits Taxed @ 30%			350	700
Goodwill Amortisation charge Post tax			(1250)	(1250)
Pro forma Results, $m				
Net Income, $m Pre Goodwill Charge			8964	11459
Net Income, $m Post Goodwill Charge			7714	10209
Cash Flow, $m			18372	21859
Per Share Amounts, $				
EPS Pre Goodwill Charge			$4.85	$6.33
EPS Post Goodwill Charge			$4.17	$5.63
CFPS			$9.94	$12.07
Accretion (Dilution), %				
EPS Pre Goodwill Charge			2%	5%
EPS Post Goodwill Charge			(12%)	(7%)
CFPS			7%	7%
Prospective Multiples				
P/E			19.9	15.2
Adj P/E			23.1	17.1
P/CF			9.7	8.0

Sources: Company reports and Salomon Smith Barney estimates.

Still cash flow accretive if half the savings are competed away

The analysis above assumes that the company retains 100% of the cost savings. However, we have also estimated pro forma earnings and cash flows under another scenario whereby 50% of the cost reduction is competed away in the market. Under this scenario, the earnings dilution after goodwill charges rises to 14% in 2000 and 10% in 2001. However, we still see cash flow accretion of the order of 6% in 2000 and 2001.

Figure 14. BP Amoco/ARCO —Assuming 50% of Cost Savings Competed Away

	2000	2001
Pro forma Results, $m		
Net Income, $m Pre Goodwill Charge	8789	11109
Net Income, $m Post Goodwill Charge	7539	9859
Cash Flow, $m	18197	21509
Per Share Amounts, $		
EPS Pre Goodwill Charge	$4.75	$6.13
EPS Post Goodwill Charge	$4.08	$5.44
CFPS	$9.84	$11.87
Accretion (Dilution), %		
EPS	0%	1%
EPS Post Goodwill Charge	(14%)	(10%)
CFPS	6%	6%
Prospective Multiples		
P/E	20.2	15.7
P/CF	9.8	8.1

Sources: Company Reports and Salomon Smith Barney estimates.

Report ROACE back down to around sector average

BP Amoco's return on average capital employed (ROACE) will also be adversely affected by the asset write-up and goodwill charges. We estimate a 2001 ROACE of 19.3% for BP Amoco alone, but a ROACE of just over 13% after allowing for accounting effects of the deal. This is broadly in line with the sector average.

Valuation attractive despite lower returns

ROACEs have historically had relatively good correlations with companies' ratios of firm value/capital employed. BP Amoco looked good value on this basis prior to the deal, and it remains so. The reduction in reported ROACE is more then compensated by a sharply lower ratio of FV/CE. While the company's firm value should rise by around 19%, we estimate a 59% increase in its capital employed. This reduces its ratio of FV/CE from 3.0 to only 2.2 times.

Underlying returns still well above average

Our calculations of underlying returns on average invested capital (ROAIC) exclude goodwill effects. On this measure, we still see BP Amoco's return amongst the highest of the integrated oils at around 15% for 2001.

Technical factors: UK institutions' underweight position could get worse

UK institutions already underweight BP Amoco

The UK remains significantly underweight BP Amoco, a situation which has been the case since the Amoco merger. At the time of the merger, the new BP Amoco ADSs diluted UK institutions' holdings from a fairly neutral level of around 60% to below 40%. Since then, UK buying has raised this percentage once more, but only to a level of around 50%. We believe that increasing confidence over prospects for crude prices and the sector will force UK institutions to continue to weight up in the stock in the coming months. This technical buying is likely to continue to support the shares.

ARCO could exaggerate this situation

The deal announced with ARCO will probably exacerbate the technical situation which already exists in UK institutions. As was the case with the Amoco merger, the substantial majority of new BPA shares will again go to US investors. We estimate that this could well see UK institutions having their proportional holding diluted once more to around 44%. In order only to redress the imbalance caused by the ARCO deal and bring weightings back to the pre-deal level of around 50%, this implies net UK institutional buying of around US$12 billion of stock.

For UK institutions to have moved to a roughly neutral 60% weighting would have required further net purchases of the order of US$15 billion even before allowing for the ARCO deal. Adding in this latest effect, a return to 60% weightings implies a massive US$30 billion of net purchases.

Figure 15. BP Amoco — Ownership Distribution of BP Amoco (Approx %)

	BP %	BP Amoco 31/12/98 %	BP Amoco Current %	BP Amoco + ARCO %	BP Amoco Current $bn	BP Amoco + ARCO $bn
UK Institutional	62	38	50	43	78	78
UK Individual	7	4	4	3	6	6
US	16	48	37	45	57	82
RDO	6	4	4	3	6	6
Continental Europe	4	3	3	3	4	5
Other	6	3	3	3	5	5
	100	100	100	100	155	181

Sources: Company reports and Salomon Smith Barney estimates.

Figure 16. BP Amoco — Potential UK Net Buying of Stock

Neutral UK Institutional Weighting, % (approx)	60				
Pre-ARCO deal					
UK institutional ownership (%)	60	55	50		
Implied UK buying of ADRs (m)	160	80	0		
Implied UK buying ($bn)	15.4	7.7	0.0		
Including ARCO					
UK institutional ownership (%)	60	55	50	45	43
Implied UK buying of ADRs (m)	314	220	126	32	0
Implied UK buying ($bn)	30.2	21.2	12.1	3.1	0.0

Sources: Company reports and Salomon Smith Barney estimates.

The improving fundamentals of the crude market are aggravating this problem. At the start of 1999, many UK institutions adopted an underweight position by default simply by not increasing weightings post the Amoco merger. This decision was strongly influenced by the weak industry environment at the time. Despite the recent sector rally, we still see considerable upside over the coming months, and believe that the risks to being underweight the sector have increased substantially. Increasing confidence in the sector's prospects could not only lead to stronger buying pressure from underweight institutions but also increase the reluctance of existing shareholders to sell.

An even larger component of UK indexes

BP Amoco is currently the UK's largest stock, a factor which leaves underweight institutions particularly exposed. The stock currently comprises 6.4% of the FTSE All Share Index and 7.9% of the FTSE 100. If the ARCO deal is completed under the terms indicated, these proportions would rise to 7.4% and 9.0% respectively. The proportion would have been even larger but for the dilutive effects of the recent Astra/Zeneca deal.

Another prospective deal, Vodafone/Airtouch, could dilute these index weightings somewhat further, but even allowing for this deal, we see the enlarged BP Amoco comprising around 7.2% of the All Share and 8.8% of the FTSE 100.

Figure 17. BP Amoco — Index Weightings (%)

	S&P 500	FTSE All Share	FTSE 100	FTSE All Share*	FTSE 100*	DJ STOXX Pan-Euro
ARCO	0.2	0.0	0.0	0.0	0.0	0.0
BP Amoco	0.0	6.4	7.9	6.2	7.6	2.8
BP Amoco post deal	0.0	7.4	9.0	7.2	8.8	3.3

* Diluted for effects of Vodafone/Airtouch.
Sources: Company reports and Salomon Smith Barney estimates.

Conclusions

The market may be slightly sceptical over BP Amoco's ability to successfully consummate such a deal so quickly after the Amoco merger. However, BP's (and now BP Amoco's) management have an excellent track record so far, which gives a good degree of confidence in the likelihood of success.

Dilution effect of some concern

The dilution effect on reported EPS may be of some concern to investors, but we believe that from a valuation standpoint, the healthy accretion of per-share cash flow is more significant.

We continue to believe the sector has considerable further upside. BP Amoco remains one of our favourite stocks. Although the stock has performed very well, further strength in crude prices and technical UK buying should continue to push it further.

If crude prices do strengthen significantly, the deal with ARCO could prove to be well timed. ARCO's shares have recovered strongly in recent weeks, and jumped more than 10% on the announcement of talks. However, this has only brought them back to the relative level seen in early December. On balance, they have still underperformed the US market by more than 30% since the start of 1998. There appears to be a good strategic fit between the two companies' operations, and the terms of the deal appear reasonable.

We are reiterating our 1L (*Buy, Low Risk)* investment code on BP Amoco.

Notes

Notes

Notes

ADDITIONAL INFORMATION AVAILABLE UPON REQUEST

Guide to investment ratings: *RANK* is a guide to the expected total return over the next 12-18 months. The total return required for a given rank depends on the degree of risk (see below) in a stock. The higher the risk, the higher the required return. For example, a 1 (BUY) rating indicates a total return ranging from 15% or greater for a low risk stock to 30% or greater for speculative stocks. Estimated returns for other risk categories are scaled accordingly. *RISK* takes into account predictability of earnings and dividends, financial leverage, and stock price volatility. *L (Low Risk):* predictable earnings and dividends, suitable for conservative investor. *M (Medium Risk):* moderately predictable earnings and dividends, suitable for average equity investor. *H (High Risk):* earnings and dividends are less predictable, suitable for aggressive investor. *S (Speculative):* very low predictability of fundamentals and a high degree of volatility, suitable only for investors/traders with diversified portfolios that can withstand material losses. *V (Venture):* indicates a stock with venture capital characteristics that is suitable for sophisticated investors with a high tolerance for risk and broadly diversified investment portfolios. A thorough explanation of the ratings system is available upon request.

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BP Amoco/ARCO

Earnings Dilutive/Cash Flow Accretive

- BP Amoco announced plans to acquire ARCO in an all-stock transaction. Under terms of the merger, 0.82 BPA ADS will be exchanged for each ARCO share. Hence, ARCO is $6.00 below the terms of the merger. BPA/ARCO will be similar in size to Royal Dutch/Shell and smaller than Exxon Mobil.

- On the positive side:
  1) BPA/ARCO will be more oil sensitive; to the extent oil prices increase this could be a plus; 2) The deal will be cash flow accretive in 2000 and 2001 (5%-6%); 3) Stand-alone ARCO would have been free cash flow negative in 2000. BPA/ARCO will not be; 4) The combination should accelerate the potential development of Alaskan North Slope and Tangguh (Indonesia) gas.

- On the negative side:
  1) BPA/ARCO will likely be earnings dilutive by 10.5% ($0.63 per share per year) owing to purchase accounting; 2) ROCE will decline from above peer to average ROCE.

- The deal should be positive for ARCO while earnings dilutive for BP Amoco.

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Executive Summary

Following the announcement of the intended merger between BP Amoco and ARCO, we are reiterating our Outperform rating on ARCO and our Buy rating on BP Amoco. For BP Amoco, the resulting increased upstream exposure should place the company in a more favorable position. However, the financial impact of the dilution on earnings could counter some of the positive associated with higher upstream exposure. However, in the long term, BPA shares should be governed by longer-term fundamentals including oil prices.

BP Amoco will acquire ARCO in an all-stock transaction.
BP Amoco has signed a definitive agreement to acquire Atlantic Richfield Corp. (ARCO) in a stock-swap transaction. BP Amoco will exchange 0.82 ADS for each ARCO share. The transaction values ARCO at a 26% premium to its pre-acquisition rumor price (Friday, March 26).

Synergies could total $1 billion per year.
BPA has announced total synergies from the merger of $1 billion per year. There is virtually no overlap in the refining and marketing (R&M) businesses of the two companies, but there is scope for savings in the upstream operations, particularly in the Alaskan North Slope, where ARCO operates one half and BP operates the other half of the Prudhoe Bay oil field. Additional savings could come from thei lower 48 and U.K. upstream operations and from corporate and administrative expenses.

The deal should be dilutive to earnings but Accretive to cash flow.
We estimate the acquisition to be dilutive on an earnings basis, but should be accretive on a cash flow basis by 2000. In addition, purchase accounting will have the effect of further diminishing BPA's previously stellar return on capital employed by both reducing earnings and increasing its capital employed.

Salomon Smith Barney is an advisor to ARCO in its pending merger with BP Amoco.

Key Points

Acquisition Description

BP Amoco has signed a definitive agreement to acquire ARCO in a stock-for-stock transaction. BP Amoco will exchange 0.82 ADS for each ARCO share. The transaction values ARCO at a 26% premium to its pre-acquisition rumor price (Friday, March 26). Based on the April 1 closing prices, the acquisition values ARCO at $79 per share, which is still an 8% discount to ARCO's implied acquisition price. The merger is targeted to close toward the end of the year.

The merger will create a company with a size closely rivaling **Royal Dutch/Shell** but well short of the proposed **Exxon Mobil** combination. BP Amoco-ARCO's market capitalization would be $185 billion, whereas the proposed Exxon Mobil would be $250 billion. Its total hydrocarbon reserves of 18.7 billion BOE matches RD/Shell but is less than Exxon Mobil's 20.7 billion BOE. BP Amoco-ARCO's refining throughput will be less than half of Exxon Mobil's 6 MMB/D.

Figure 1. BPA, RD Shell, Exxon Mobil Comparison of Size

	BPA	Arco	BPA-Arco	RD Shell	XON-MOB
Market Capitalization (Billions of $)	$160.7	$25.0	$185.7	$187.7	$246.4
Capital Employed (Billions of $)	$56.6	$14.9	$71.5	$71.7	$80.8
1997 Reserves (MMBOE)	14,599	4,052	18,651	18,763	20,743
1998 Oil and Gas Production (MBOED)	3,050	1,002	4,052	3,664	4,272
1998 Refining Throughput (MB/D)	2,698	450	3,148	4,027	6,060
1998 Chemical Sales	$9,691	$0	$9,691	$12,272	$14,949

Source: Salomon Smith Barney

Merger Synergies/Cost Savings

BPA has announced total synergies from the merger of $1 billion per year. There is virtually no overlap in the R&M businesses of the two companies, which although lessening any potential anti-trust impediments, will limit the scope of cost savings from the merger. All of ARCO downstream assets are located on the West Coast, while BP Amoco's U.S. assets are concentrated east of the Rocky mountains (see table below). Given the lack of overlap we expected limited R&M savings from a merger between BPA and ARCO. BP Amoco has announced that it expects to save $110 million (10% of total savings) from downstream operations.

Figure 2. Refining & Marketing by PADD Districtt

U.S. DOMESTIC DOWNSTREAM
Refining and Marketing by PADD's and Class of Trade

	PADD1 (East Coast)	PADD2 (Mid West)	PADD3 (Gulf Coast)	PADD4 (Rocky Mts.)	PADD5 w/o CA (West Coast)	California (West Coast)	U.S. Volume MB/D
ARCO (ARC)							
Refining	0	0	0	0	201	238	439
Marketing	0	0	0	0	107	150	257
BP Amoco (BPA)							
Refining	57	623	688	52	0	0	1420
Marketing	270	462	201	25	0	0	957
BPA-Arco							
Refining	57	623	688	52	201	238	1859
Marketing	270	462	201	25	107	150	1214
XON-MOB							
Refining	0	219	1302	47	0	262	1830
Marketing	616	97	153	16	19	185	1087

Source: Salomon Smith Barney Estimates

There is scope for savings in the upstream, particularly in the Alaskan North Slope, where ARCO operates one half and BP operates the other half of the Prudhoe Bay oil field. The elimination of the overhead expense of one operator suggest the potential for some cost savings. However given the sizable cost cutting initiatives that the two companies have already set up in the North Slope, the potential for significant incremental cost savings from Alaska may be constrained. Nevertheless $200 million or 20% of the $1 billion of announced synergies is expected to come from Alaska. Upstream overlap in the lower 48, the Gulf of Mexico, and (to a lesser extent) the North Sea, as well as corporate overhead cost savings will provide other major sources of the cost savings. The transaction will result in 2000 job losses. The cost of merger implementation will total $1 billion.

Figure 3. Potential Savings from Synergies (In MM's)

Alaska	$200
Non-Alaska	$510
Upstream	$710*
Downstream	$110
Corporate	$180
Total	$1,000

*1/2 of the upstream savings will come from lower exploratory expenses.
Source: Salomon Smith Barney & Company Data

BP Amoco/ARCO will have a commanding position in the Alaskan upstream sector and this could pose the greatest potential regulatory issue for the merger. The combined entity will control 75% of the oil production in Alaska and 75% of the Trans-Alaskan Pipeline. BPA-ARC could divest 360,000 acres of exploration rights to come into compliance with the state's limit of 500,000 acres for one company. On the other hand, we believe that the merger would enhance the prospects of a speedier commercialization of North Slope natural gas, which in the face of declining oil production rates, could convince the state of Alaska of the benefits of merger. Indeed, in its analyst presentation, BP Amoco suggested higher hydrocarbon production as a potential benefit of the merger for Alaska, and the company announced its plans to build a $70 million gas-to-liquids pilot plant in the

state. In the North Slope, the merger would add ARCO's 43% ownership interest in the 25 TCF Prudhoe Bay natural gas cap to BP Amoco's 15% interest (all ownership percentages are before royalty interest) and could enhance the prospects for a commercial development scheme. Having two instead of three major owners of the gas cap could lessen the potential for disagreement between the parties over the means of commercializing the reserve. In past years there have been disputes between BP Amoco and ARCO regarding the timing and extent of natural gas development in the North Slope of Alaska. This stemmed from the differential ownership percentage of oil and gas between the two companies, with BPA owning a larger proportion of oil and therefore favoring maximum oil production at the expense of natural gas production, while ARCO had a larger ownership share of the gas relative to oil (see table). Another source of contention has been the method of commercializing North Slope gas with ARCO favoring liquefied natural gas (LNG) scheme, while Exxon and BP preferred a gas-to-liquids alternative. ARCO had previously suggested possible commercialization by 2007 or thereabouts; the acquisition could accelerate this timetable.

Figure 4. Total Reserves of Prudhoe Bay

	ARC	BPA	XON	ARC-BPA	Total Reserves	
Prudhoe Bay Oil	22%	51%	22%	73%	3,900	B bbls
Prudhoe Bay Gas Cap	43%	14%	43%	57%	25	TCF

Source: Salomon Smith Barney

The combination will further shift BP Amoco's reserve profile toward natural gas. In addition to North Slope gas the acquisition will add ARCO's giant Tangguh natural gas find in Indonesia giving BPA a large portfolio of potential future Pacific basin natural gas developments. Tangguh was discovered by ARCO and has gross reserves of 20 TCF with 8 TCF (40%) net to ARCO. Little of the gas has been booked. Commercialization of Tangguh through a LNG scheme has been delayed owing to the East Asian economic downturn, but it is thought of as one of the more promising LNG projects currently being considered in the region.

The acquisition would also give BP Amoco exposure the West Coast downstream market. With a tight supply demand balance, logistic isolation from the broader oversupplied global refining sector and dominated by a small number of competitors, the West Coast and California in particularly, is the most attractive downstream market in the U.S. ARCO has consistently generated one of the highest domestic downstream returns of its peers and the addition of this to BP Amoco asset base was identify as one of the key strategic rationale for the merger. BP previously exited the West Coast R&M business through its sale of the Ferndale, Wash. refinery and associated retail assets to Tosco in 1993.

BPA-ARCO will have a imposing position in the Deepwater Gulf of Mexico with an even larger lease position than deepwater pioneer RD/Shell. The combined BPA-ARCO will have the largest proportion of its assets in the United States. Fifty percent of the company's combined worldwide production and close to 60% of its worldwide refining throughput will be in the United States.

Accretion/Dilution

The acquisition will be accounted for using the purchase method of acquisition accounting under U.K. GAAP. As a result, an estimated $18.7 billion of acquisition premium (or asset write-up) will be added to BP Amoco's equity book value, and the company will incur $1.25 billion of annual amortization charges (derived by amortizing $18.7 billion acquisition premium over 15 years).

Announced cost reductions are typically competed away by the market or eroded by inflationary factors. Assuming 50% of the $1 billion synergies is in place in 2000, all the synergies are in place in 2001, and half of the announced synergies are competed away and eroded by inflation, we estimate the acquisition will be dilutive by $0.63/share or 10.5% of BP Amoco's 2001 earnings per share and will be dilutive by $0.73/share on 2000 EPS. The acquisition will be accretive to cash flow per share for 2000 and 2001. In addition, purchase accounting will have the effect of further diminishing BPA's previously stellar return on capital employed by both reducing earnings and increasing its capital employed. We estimate that BPA's 2001 pro forma return on capital employed will be reduced from an above-peer average of 19.3% to 13.1% (versus an international majors average = 13.9%).

We have also estimated pro forma earnings and cash flows under an alternate scenario that assumes all the announced synergies are realized by 2001 and are not subject to any market erosion. The acquisition remains EPS dilutive under this scenario.

Figure 5. EPS CFPS Accretion/Dilution

	1999	2000	2001
Base Case - Assumes 50% of Synergies Competed Away by Market			
WTI Oil Price	$14.75	$17.00	$18.50
EPS ACCRETION/DILUTION			
Arco Earnings (pre merger)	$686	$1,102	$1,416
BPA Earnings (pre merger)	$5,400	$7,512	$9,343
- Implementation Expense (after tax)		-$70	-$70
+ Synergies (after tax) (a)		$175	$350
- Acquisition Premium Amortization (after tax)		-$1,250	-$1,250
Pro-forma BPA -ARC Earnings		$7,469	$9,789
ARC EPS (pre-merger)	$2.10	$3.35	$4.30
BPA EPS (pre-merger)	$3.35	$4.75	$6.05
Pro Forma BPA-ARC EPS		$4.02	$5.42
EPS Accretion / Dilution		-$0.73	-$0.63
Acc/Dil as a % of EPS		-15.3%	-10.5%
BPA-ARC P/E		23.8	17.7
Avg P/E Int'l Majors		20.9	17.3
CFPS ACCRETION/DILUTION			
Pro-forma BPA -ARC Earnings		$7,469	$9,789
+ Non-cash Expenses & Expl Exp		$10,657	$11,648
= Pro forma BPA-ARC Cash Flow		$18,125	$21,437
ARC CFPS (pre-merger)	$8.70	$10.30	$11.45
BPA CFPS (pre-merger)	$6.75	$9.20	$11.30
Pro Forma BPA-ARC CFPS		$9.77	$11.86
CFPS Accretion / Dilution		$0.57	$0.56
Acc/Dil as a % of CFPS		6.1%	5.0%
BPA-ARC P/CF		9.8	8.1
Avg P/CF Int'l Majors		10.0	8.9
Alternate Case - Assumes Full Credit For Announced Synergies			
EPS ACCRETION/DILUTION			
Pro-forma BPA -ARC Earnings		$7,644	$10,139
Pro Forma BPA-ARC EPS		$4.12	$5.61
EPS Accretion / Dilution		-$0.63	-$0.44
Acc/Dil as a % of EPS		-13.3%	-7.3%
BPA-ARC P/E		23.3	17.1
Avg P/E Int'l Majors		20.9	17.3
CFPS ACCRETION/DILUTION			
= Pro forma BPA-ARC Cash Flow		$18,300	$21,787
Pro Forma BPA-ARC CFPS		$9.86	$12.06
CFPS Accretion / Dilution		$0.66	$0.76
Acc/Dil as a % of CFPS		6.7%	6.3%
BPA-ARC P/CF		9.7	7.9
Avg P/CF Int'l Majors		10.0	8.9
Fully Diluted Shares Outstanding	1,882	1,856	1,807

(a) assumes 50% of synergies in place in 2000 and 100% in 2001; also assumes 1/2 of the announced synergies is competed away

Source: Salomon Smith Barney

Figure 6. BPA-ARC Capital Employed

BPA-ARC Key Statistics

	BPA	Arco	BPA-ARC	Peer Average
Capital Employed	$56,613	$14,913	$90,276	
Debt	$13,755	$7,074	$20,829	
Equity (a)	$41,786	$7,580	$68,116	
Others	$1,072	$259	$1,331	
Cash	$875	$917	$1,792	
Net Debt/Capitalization	23.1%	44.0%	21.5%	
1997 ROCE	13.3%	13.6%		*13.7%*
1998 ROCE	8.9%	6.4%		*8.8%*
1999 ROCE	10.2%	7.2%	6.4%	*9.7%*
2000 ROCE	14.7%	9.6%	9.7%	*12.1%*
2001 ROCE	19.3%	11.2%	13.1%	*13.6%*
Mkt Cap (3/26)	$160,709	$21,000	$181,709	

(a) equity value of BPA-Arco includes acquisition premium of $18.75B

Source: Salomon Smith Barney

We also note that the actual level of accretion/dilution will change depending on ARCO (and, indirectly, BPA's) eventual share price at the time the acquisition is consummated with a higher share price leading to a larger goodwill expenses and greater earnings dilution.

Figure 7. Accretion/Dilution Analysis—BPA-ARC

BPA-Arco Accretion / Dilution Analysis

	BPA	ARC	Synergies	BPA-ARC Earnings Before Goodwill Amortization
2001 Earnings	$9,342	$1,418	$350	$11,110
2001 Shares Outs.	1,539	327		
EPS	$6.05	$4.30		

$1 B X 1/2 X (1-30%)

BPA Share Price 3/26	$100.44	*pre acquisition price*
ARC Share Price 3/26	$65.38	*pre acquisition price*
Exchange Ratio	0.82	
BPA ARC Shares Outs	1,807	

				Purchase Accounting				
BPA Share Price	ARC Implied Acquisition Share Price	Premium to Pre-Acquisition Price	ARC's Implied Acquisition Mkt Cap	ARC's Acquisition Value - BV of Equity	Acquisition Premium Amortized over 15 Years	BPA ARC Earnings	BPA ARC EPS	Accretion / (Dilution)
$90.00	$73.80	13%	$23,706	$16,126	$1,075	$9,965	$5.51	-$0.54
$91.00	$74.62	14%	$23,969	$16,389	$1,093	$9,947	$5.50	-$0.55
$92.00	$75.44	15%	$24,233	$16,653	$1,110	$9,930	$5.49	-$0.56
$93.00	$76.26	17%	$24,496	$16,916	$1,128	$9,912	$5.49	-$0.56
$94.00	$77.08	18%	$24,760	$17,180	$1,145	$9,895	$5.48	-$0.57
$95.00	$77.90	19%	$25,023	$17,443	$1,163	$9,877	$5.47	-$0.58
$96.00	$78.72	20%	$25,286	$17,706	$1,180	$9,860	$5.46	-$0.59
$97.00	$79.54	22%	$25,550	$17,970	$1,198	$9,842	$5.45	-$0.60
$98.00	$80.36	23%	$25,813	$18,233	$1,216	$9,824	$5.44	-$0.61
$99.00	$81.18	24%	$26,077	$18,497	$1,233	$9,807	$5.43	-$0.62
$100.00	***$82.00***	***25%***	***$26,340***	***$18,760***	***$1,251***	***$9,789***	***$5.42***	***-$0.63***
$101.00	$82.82	27%	$26,603	$19,023	$1,268	$9,772	$5.41	-$0.64
$102.00	$83.64	28%	$26,867	$19,287	$1,286	$9,754	$5.40	-$0.65
$103.00	$84.46	29%	$27,130	$19,550	$1,303	$9,737	$5.39	-$0.66
$104.00	$85.28	30%	$27,394	$19,814	$1,321	$9,719	$5.38	-$0.67
$105.00	$86.10	32%	$27,657	$20,077	$1,338	$9,702	$5.37	-$0.68
$106.00	$86.92	33%	$27,920	$20,340	$1,356	$9,684	$5.36	-$0.69
$107.00	$87.74	34%	$28,184	$20,604	$1,374	$9,666	$5.35	-$0.70
$108.00	$88.56	35%	$28,447	$20,867	$1,391	$9,649	$5.34	-$0.71
$109.00	$89.38	37%	$28,711	$21,131	$1,409	$9,631	$5.33	-$0.72
$110.00	$90.20	38%	$28,974	$21,394	$1,426	$9,614	$5.32	-$0.73
$111.00	$91.02	39%	$29,237	$21,657	$1,444	$9,596	$5.31	-$0.74
$112.00	$91.84	40%	$29,501	$21,921	$1,461	$9,579	$5.30	-$0.75

Source: Salomon Smith Barney

Given ARCO's leverage to the E&P sector, the acquisition will increase BP Amoco's upstream exposure. Its upstream interest will rise from an already high 60% of capital employed to 64%.

Figure 8. Percentage Capital—BPA-ARC

	BPA	Arco	Combined	Peer Averag
% Cap Empl R&M	24%	21%	23%	35%
% Cap Empl E&P	60%	79%	64%	52%
% Cap Empl Chemicals	16%	0%	12%	14%

Source: Salomon Smith Barney

Increasing its leverage to the upstream and oil prices, BPA's ratio of refining throughput to oil production will decrease from a below average 132% to 117% and its refining to hydrocarbon production ratio will drop from 89% to 79% (see table). Indeed by this measure, with the exception of YPF, BPA will become the most oil prone among the integrateds in our universe. We believe BPA's higher leverage to oil prices is a long-term positive given our expectations of higher oil prices and the generally higher returns generated from upstream investments.

Figure 9. Natural Gas & Oil Production Analysis

	Nat Gas / Total Production	*US Nat Gas / Total Production*	*Refining / Oil and Gas Production*	*Refining / Oil Production*
Amerada Hess	*32%*	*16%*	*129%*	*190%*
ARCO	*35%*	*20%*	*45%*	*69%*
BP Amoco	*32%*	*13%*	*89%*	*132%*
BP Amoco/Arco	*33%*	*15%*	*78%*	*117%*
Chevron	*26%*	*19%*	*89%*	*121%*
Conoco	*40%*	*25%*	*141%*	*237%*
Exxon	*40%*	*13%*	*150%*	*251%*
Exxon Mobil	*41%*	*12%*	*142%*	*242%*
Marathon	*52%*	*30%*	*135%*	*283%*
Mobil	*43%*	*11%*	*129%*	*228%*
Murphy	*39%*	*29%*	*179%*	*296%*
Occidental	*27%*	*24%*	*0%*	*0%*
Phillips	*51%*	*34%*	*79%*	*160%*
RD Shell	*36%*	*11%*	*110%*	*171%*
Texaco	*29%*	*22%*	*118%*	*165%*
YPF S.A.	*32%*	*3%*	*40%*	*54%*
Average	*37%*	*19%*	*102%*	*168%*

Source: Salomon Smith Barney

For ARCO, the merger has come at a time when the company cash flow position is vulnerable. Particular concerns have been raised of its ability to sustain its high dividend yield (4.5%). We estimate that without the benefits of approximately $900 million in asset sales, ARCO would have had a cash shortfall of $1 billion during 1999 (7% of capital employed) after paying dividend of about $900 million. The company's debt-to-capitalization ratio was at an already high 44% compared to its peers 36%. Even at $17/bbl oil prices in 2000, we estimate the company would be $800 million free cash flow negative after meeting its dividend and capex requirements. In addition without financial flexibility for higher capex the company's goal of "no decline after 1999" in production level from its core Alaskan upstream interest has been placed increasingly in question. Its acquisition by BPA provides a needed injection of financial flexibility that would have been required to sustain and grow oil and gas production. ARCO shares closed on April 1 at $72.44, or an 8% discount to its implied acquisition price ($78.50 per share). In the near term ARCO's shares will likely traded at a 5%-10% discount to its implied acquisition value. We saw a similar trading pattern with Amoco and Mobil after their mergers with BP and Exxon respectively (see attached graph). BP Amoco's dividend policy will be maintained after the merger (2.7% dividend yield vs. ARCO's 4.5%).

Technical Considerations

The U.K. market remains significantly underweight in BP Amoco, a situation which has been the case since the Amoco merger. At the time of the merger, the new BP Amoco ADS diluted U.K. institutions' holdings from a fairly neutral level of around 60% to below 40%. Since then, U.K. buying has raised this percentage once more, but only to a level of around 50%. Technical buying is likely to continue to support the shares, especially as the recovery in oil prices prompt more U.K. institutional investors to increase their weighting in oil companies.

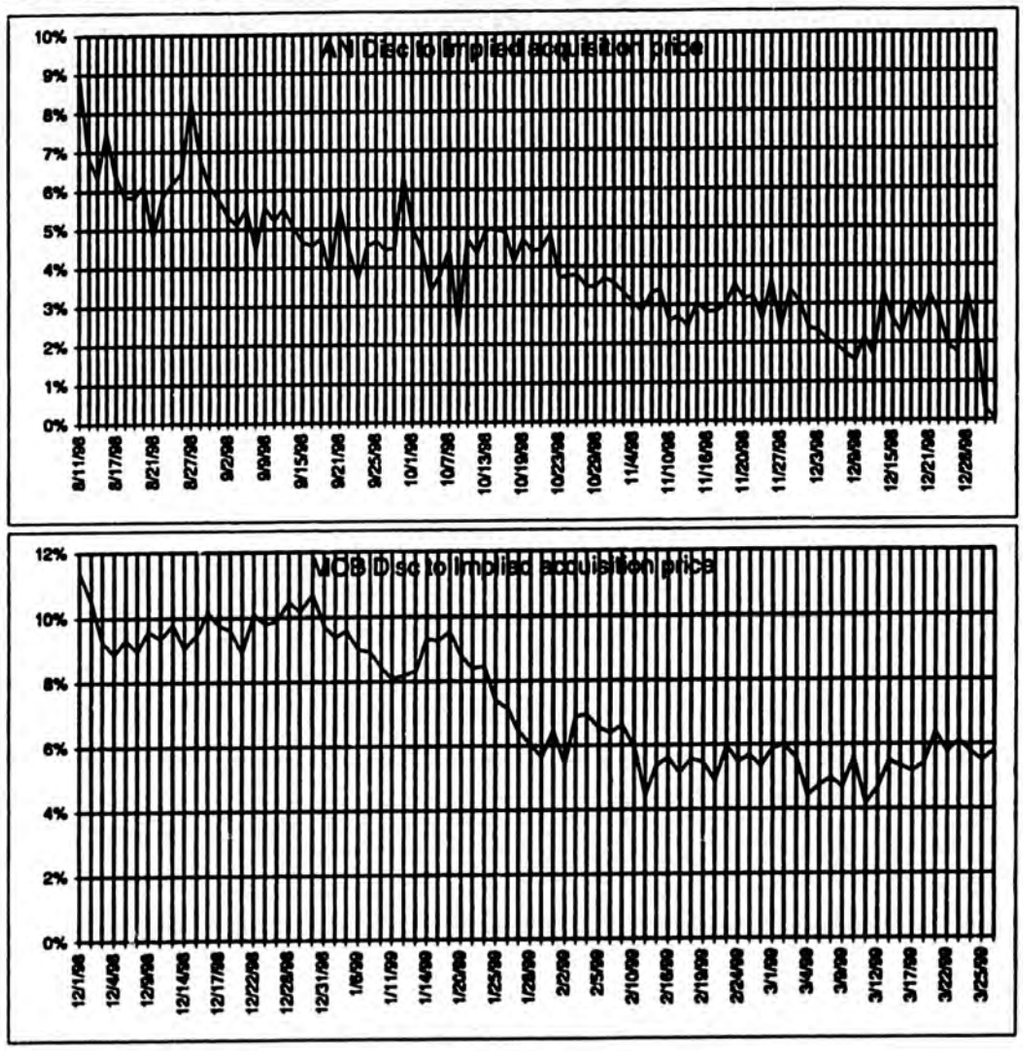
The deal announced with ARCO will probably exacerbate the technical situation that already exists in U.K. institutions. The substantial majority of new BPA shares will again go to U.S. investors. We estimate that this could well see U.K. institutions having their proportional holding diluted once more to around 44%. In order only to redress the imbalance caused by the ARCO deal and bring weightings back to the pre-deal level of around 50%, this implies net U.K. institutional buying of around $12 billion of stock. Adding in this latest effect, a return to 60% weighting implies a massive $31 billion in net purchases. Technical buying could put upward pressure on BPA share price.

Conclusion

ARCO closed at an 8% discount to its implied acquisition price on April 1, after the deal was announced. Based on the trading pattern of Amoco and Mobil after their respective mergers with BP and Exxon, we believe this trading gap is likely to narrow, providing potential share price upside. For BPA, the increase upstream exposure that will result from the acquisition will place the company in a more favorable position. The upstream sector has generated the highest returns of the majors businesses of the integrateds. The financial impact of dilution on earnings

could counter some of the positive associated with higher upstream exposure. In addition the reduction in BPA's previous stellar ROCE could be another concern among investors. In the long term, BPA shares will be governed by longer-term fundamentals including oil prices and despite its recent runup, we expect oil prices will continue to improve as the OPEC production cuts begins to have their effect on markets fundamentals.

Figure 10. Amoco & Mobil—Discount to Implied Acquisition Price



Source: Company reports and Salomon Smith Barney

Figure 11. Major Oil Companies P/E Comps Base Case

Major Oil Companies - PE Comp - Base Case - WTI 1999:$14.75; 2000:$17; 2001:$18.50																				
						Adjusted EPS											P/E			
	Ticker	Rating	Shares Outs[1]	PRICE 04/01/99	Target Price	4Q97	1997	1Q98	2Q98	3Q98	4Q98	1998	SSB 1999E	Consensus 1999E	SSB 2000E	SSB 2001E	1997	1998E	1999E	2000E	2001E
WTI Oil Price (/bbl)						*$19.87*	*$20.65*	*$15.89*	*$14.76*	*$14.10*	*$13.50*	*$14.45*	*$14.75*	*$13.93*	*$17.00*	*$18.50*					
Amerada Hess	AHC	3M	89	$50.00	$55	($0.49)	$0.15	($0.76)	($0.24)	($0.07)	($1.11)	($2.19)	$1.10	($0.24)	$2.60	$3.70	333.3	(22.8)	45.5	19.2	13.5
Amoco	AN	3L	960	$63.40	NA	$0.54	$2.50	$0.36	$0.41	$0.31	$0.19	$1.27					25.4	49.9			
ARCO	ARC	2L	327	$72.44	$70	$1.23	$5.31	$0.62	$0.67	$0.19	$0.22	$1.69	$2.10	$1.76	$3.35	$4.30	13.6	42.9	34.5	21.6	16.8
BP	BP	1L	963	$95.81	NA	$1.11	$4.87	$1.00	$0.89	$0.76	$0.66	$3.31					19.7	28.9			
BP Amoco	BPA	1L	1,599	$95.81	$112	$0.87	$4.25	$0.81	$0.72	$0.72	$0.54	$2.79	$3.35	$3.14	$4.75	$6.05	22.5	34.3	28.6	20.2	15.8
Chevron (b)	CHV	2L	658	$86.81	$85	$1.22	$4.46	$0.73	$0.80	$0.63	$0.58	$2.73	$3.15	$2.87	$4.20	$5.25	19.5	31.8	27.6	20.7	16.5
Conoco	COC	2L	637	$24.44	$26	$0.32	$1.60	$0.46	$0.33	$0.29	$0.05	$1.13	$1.05	$0.98	$1.60	$1.95	15.3	21.6	23.3	15.3	12.5
Exxon	XON	1L	2,465	$70.13	$84	$0.88	$3.25	$0.76	$0.65	$0.58	$0.62	$2.61	$2.75	$2.59	$3.25	$3.70	21.6	26.9	25.5	21.6	19.0
Mobil	MOB	1L	808	$87.38	$105	$0.99	$4.21	$0.88	$0.81	$0.61	$0.62	$2.92	$3.45	$2.91	$4.00	$4.40	20.8	29.9	25.3	21.8	19.9
Murphy	MUR	2L	45	$42.50	$45	$0.64	$2.87	$0.35	$0.34	$0.20	$0.02	$0.91	$1.00	$0.54	$2.20	$3.35	14.8	46.7	42.5	19.3	12.7
Occidental	OXY	3H	350	$18.13	$21	$0.36	$1.80	$0.26	$0.12	$0.00	($0.11)	$0.25	$0.20	($0.25)	$1.10	$1.45	10.1	72.5	90.6	16.5	12.5
Phillips	P	2L	259	$47.25	$48	$0.77	$3.46	$0.65	$0.58	$0.26	$0.00	$1.50	$2.10	$1.39	$2.65	$3.35	13.7	31.5	22.5	17.8	14.1
Royal Dutch	RD	2L	2,144	$52.13	$57	$0.51	$2.41	$0.54	$0.43	$0.24	$0.23	$1.44	$1.65	$1.53	$2.20	$2.60	21.6	36.2	31.6	23.7	20.0
Texaco	TX	1L	526	$55.69	$70	$0.87	$3.52	$0.46	$0.61	$0.37	$0.15	$1.59	$2.20	$1.81	$3.30	$4.25	15.8	35.0	25.3	16.9	13.1
USX-Marathon	MRO	3L	292	$27.88	$29	$0.45	$2.20	$0.26	$0.55	$0.24	$0.04	$1.09	$1.60	$1.05	$2.15	$2.90	12.7	25.6	17.4	13.0	9.6
YPF	YPF	1M	353	$31.06	$34	$0.57	$2.48	$0.42	$0.44	$0.45	$0.33	$1.64	$1.65	$1.78	$2.20	$2.90	12.5	18.9	18.8	14.1	10.7
Total (ex AHC, XON-MOB, BP, AN)						$9.68	$41.82	$7.20	$7.05	$4.78	$3.29	$22.29	$26.25	$22.10	$36.95	$46.45					
Major Oil Companies' Mean P/E (exc AHC, OXY)																	*17.03*	*31.78*	*26.91*	*18.83*	*15.07*
Int'l Majors Mean PE (Big 6 [BPA,CHV, XON, MOB, RD, TX] + ARC)																	*19.35*	*33.86*	*28.34*	*20.92*	*17.31*
S&P Industrials (Rptad Basis)				1,560.2			42.13					42.30		45.70	48.93		*37.03*	*36.88*	*34.14*	*31.89*	
Int'l Majors P/E TO S&P Industrials P/E DISCOUNT [a]																	*47.8%*	*8.2%*	*17.0%*	*34.4%*	

[a] Defined as 1-(International Oils PE / S&P Industrials PE)

[b] Excludes the impact of foreign exchange charges.

[1] Represents fully diluted shares in MM.

Source: Company reports and Salomon Smith Barney

Figure 12. ARCO Model

EARNINGS ANALYSIS											
ARCO (ARC)	1991	1992	1993	1994	1995	1996	1997	1998	1999E	2000E	2001E
WTI Oil Price	*$21.49*	*$20.55*	*$18.42*	*$17.19*	*$18.39*	*$22.02*	*$20.65*	*$14.39*	*$14.75*	*$17.00*	*$18.50*
In millions of dollars except per share amounts											
REPORTED EARNINGS:											
Oil & Gas	$549	$962	$164	$527	$784	$1,329	$1,347	($616)			
Coal	$33	$83	$107	$70	$75	$60	$53				
Ref & Mktg	$266	$378	$333	$226	$200	$287	$320	$281			
Transportation	$212										
Chemical	$303	$219	$253	$376	$654	$373	$538	$183			
Other/Unallocated	($60)	$85	($94)	$235	$163	$60	($66)	($112)			
Int Exp	($594)	($534)	($494)	($515)	($500)	($446)	($421)	($225)			
Reported Net Income	$709	$801	$269	$919	$1,376	$1,663	$1,771	($489)			
Preferred Dividends	$2.0	$2.0	$2.0	$2.0	$2.0	$2.0	$2.0	$2.0			
Income Avail. to Common	$707	$799	$267	$917	$1,374	$1,661	$1,769	($491)			
NON-RECURRING ITEMS:											
Oil & Gas	($170)	$138	($409)	($57)	$29	$1	$0	($1,002)			
Coal	($50)	$0	$6	($3)	($10)	$0	($5)	$0			
Ref & Mktg	($10)	($39)	($84)	($79)	($22)	($10)	($38)	$1			
Transportation	($30)										
Chemical	($20)	($46)	($8)	($15)	$0	$0	$191				
Other/Unallocated	($15)	$87	($62)	$196	$51	$9	($54)	($148)			
Int Exp	$0	$0	$5	$0	$0	$0	($29)	$94			
SFAS 96	$0	$0	$0	$0	$0	$0	$0	$0			
SFAS 106/109	$0	($392)	$0	$0	$0	$0	$0	$0			
Non-recurring Items	($295)	($252)	($552)	$42	$48	$0	$65	($1,055)			
ADJUSTED EARNINGS:											
Oil & Gas	$719	$824	$573	$584	$755	$1,328	$1,347	$386	$688	$1,064	$1,387
Coal	$83	$83	$101	$73	$85	$60	$58				
Ref & Mktg	$276	$417	$417	$305	$222	$297	$358	$280	$330	$375	$406
Transportation (inc. in other segments 1992-)	$242										
Arco Chemical	$212	$256	$247	$280	$460	$320	$228	$171			
Lyondell Petrochemical Equity Earnings	$111	$10	$13	$111	$194	$53					
Total Chemical Earnings	$323	$265	$261	$391	$654	$373	$347	$171			
Other/Unallocated	($45)	($2)	($32)	$39	$112	$51	($12)	$36	($30)	($30)	($30)
Int Exp	($594)	($534)	($499)	($515)	($500)	($446)	($392)	($319)	($300)	($305)	($344)
Operating Net Income	$1,004	$1,053	$821	$877	$1,328	$1,663	$1,706	$554	$688	$1,104	$1,418
Preferred Dividends	$2	$2	$2	$2	$2	$2	$2	$2	$2	$2	$2
Income Avail. To Common	$1,002	$1,051	$819	$875	$1,326	$1,661	$1,704	$552	$686	$1,102	$1,416
Avg Shares-Basic (MM)	323.4	323.0	323.0	326.4	321.7	321.7	321.2	321.0	321.3	321.3	321.3
EPS - Reported	$2.19	$2.47	$0.83	$2.81	$4.27	$5.16	$5.51	($1.53)			
Non-recurring Items	($0.91)	($0.79)	($1.70)	$0.12	$0.14	$0.00	$0.20	($3.29)			
Adj. EPS - Operating	$3.10	$3.25	$2.54	$2.68	$4.12	$5.16	$5.31	$1.72	$2.14	$3.43	$4.41
Avg Shares-Diluted (MM)					326.5	326.5	327.4	327.0	327.0	327.0	327.0
EPS - Reported					$4.21	$5.09	$5.41	($1.50)			
Non-recurring Items					$0.15	$0.00	$0.20	($3.23)			
Adj. EPS - Operating					$4.07	$5.09	$5.21	$1.69	$2.10	$3.38	$4.34
Annual EPS Growth Rate						*25.3%*	*2.7%*	*-67.6%*	*24.2%*	*60.5%*	*28.5%*

Source: Company reports and Salomon Smith Barney

Figure 13. BPA Model

EARNINGS ANALYSIS						
BP Amoco (BPA)	**1996**	**1997**	**1998**	**1999E**	**2000E**	**2001E**
WTI Oil Price	*$22.02*	*$20.65*	*$14.39*	*$14.75*	*$17.00*	*$18.50*
Adjusted Earnings:						
E&P -- Worldwide	7,673	7,310	3,632	4,503	6,923	8,824
UK	2,293	2,271	1,598	1,333	1,920	2,459
Rest of Europe	507	599	372	283	386	474
USA	3,285	3,094	1,248	1,937	3,016	3,698
Rest of World	1,588	1,346	414	476	1,067	1,599
R&M -- Worldwide	1,708	2,292	2,564	3,477	3,959	4,355
UK	89	208	299	365	430	490
Rest of Europe	252	414	563	690	750	810
USA	607	921	1,168	440	495	540
Rest of World	760	749	534	1,982	2,284	2,515
Chemicals -- Worldwide	1,654	1,638	1,150	944	1,114	1,523
UK	393	447	207	275	360	440
Rest of Europe	233	306	310	524	559	823
USA	854	806	566	95	115	140
Rest of World	174	79	67	50	80	120
Other -- Worldwide	(491)	(524)	(324)	(288)	(259)	(244)
Adjusted Operating Income	**10,544**	**10,716**	**7,022**	**8,637**	**11,736**	**14,458**
Interest	(930)	(908)	(1,041)	(874)	(854)	(865)
Tax	(2,848)	(2,902)	(1,450)	(2,330)	(3,359)	(4,241)
Minorities	(19)	(151)	(63)	(10)	(10)	(10)
Adjusted Net Income	**6,747**	**6,755**	**4,468**	**5,423**	**7,513**	**9,343**
Average ADRs (MM)	1,575	1,590	1,599	1,614	1,588	1,539
Adj. EPADR (Post-exceptional)	**4.29**	**4.25**	**2.79**	**3.36**	**4.73**	**6.07**

Source: Salomon Smith Barney

Notes

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Companies mentioned in this report:

Atlantic Richfield (ARC–$74; 2L)
BP Amoco (BPA–$97; 1L)
Exxon (XON–$72; 1L)
Mobil# (MOB–$91; 1L)

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