Rating: Buy
S&P 500: 1205

Shell Transport & Trading
Historic Streamlining

Symbol	SC	*Ebitda Next Twelve Months ending 12/31/05 (US$mm)*	17,500
Rating	Buy	*North American Natural Gas/Ebitda (%)*	4
Price (US$/sh)	50.44	*Natural Gas and Oil Production/Ebitda (%)*	61
Pricing Date (intraday)	12/21/04	*Adjusted Reserves/Production NTM*	8.1
Shares (mm)	1587	*EV/Ebitda*	5.5
Market Capitalization (US$mm)	80,000	*PV/Ebitda*	5.6
Debt (US$mm)	16,600	*Undeveloped Reserves (%)*	44
Enterprise Value (EV) (US$mm)	96,600	*Natural Gas and Oil Ebitda (US$/boe)*	19.70
Present Value (PV) (US$mm)	97,400	*Present Value Proven Reserves(US$/boe)*	10.60
Net Present Value (US$/share)	50.95	*Present Value Proven Reserves(US$/mcfe)*	1.77
Debt/Present Value	0.17	*Earnings Next Twelve Months (US$/sh)*	4.79
McDep Ratio - EV/PV	0.99	*Price/Earnings Next Twelve Months*	11
Dividend Yield (%/year)	4.0	*Indicated Annual Dividend (US$/sh)*	2.01

Note: Estimated cash flow and earnings tied to one-year futures prices for oil, natural gas and refinery crack.
Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.

Summary and Recommendation

We continue a "Buy" rating on the common shares of **Shell Transport (SC)** that will be combined with **Royal Dutch Petroleum (RD)** in about mid 2005 to become Royal Dutch Shell plc. The historic transformation concentrates ownership in a single company with one chief executive and one board of directors. Management appears to have turned controversy over reporting of reserves into the opportunity to create a streamlined mega cap competitor to earn rising oil profits, natural gas profits and oil products profits. Dividends to be paid quarterly rather than semi-annually are expected to beat inflation for a real return of at least 4.0% per year. Stock price has nearly reached estimated net present value of $51 a share that relates to our standard assumption of constant real oil price of $35 a barrel. The average futures price for continuous delivery over the next six years is about $41 a barrel.

Management Did the Right Thing

The historic development combines the 60% owner and the 40% owner of Royal Dutch/Shell Group as a single company. The transformation is a constructive and worthwhile outcome to the unfavorable publicity the group received earlier in 2004 on disclosure of reserves. A change of management at the top resulted in Mr. Jeroen van der Veer becoming the new chief executive. Mr. van der Veer communicated his ideas for Structure and Governance as "Effectiveness + accountability + transparency + simplicity". The concepts have been turned into bold action that no predecessor has been able to achieve for a hundred years.

Royal Dutch shares are to be converted to Royal Dutch Shell A shares and Shell Transport shares to Royal Dutch Shell B shares. The remaining distinction is that the dividend on the A shares will be sourced in the Netherlands for tax purposes and the equal pre-tax dividend on the B shares will be sourced in the U.K. The relatively stronger recent performance of SC as compared to RD may reflect differences in after-tax dividend yield for some shareholders.

Downstream Leads

Estimated 41% concentration on downstream appears to be the highest among mega cap peers (see table Functional Cash Flow and Present Value). That is not too surprising as it fits traditional perceptions about Shell. The functional area includes both the oil products business and the growing gas and power segment.

As reported reserves have been trimmed so has adjusted reserve life. That also shows up as lower multiple of present value to cash flow. As a result estimated value of oil reserves now appears to be less than downstream. In the current correlation of present value with reserve life for 30 stocks, the company's cash flow multiple for oil and gas appears in line.

Overseas natural gas has growth potential in liquefied natural gas (LNG). The company is a leader in the field along with **ExxonMobil (XOM)** and **Total SA (TOT)**. In addition to the producing profits, an undetermined amount of the cash flow from liquefaction and transportation of LNG is reported in the downstream function.

Royal Dutch/Shell
Functional Cash Flow and Present Value

	NTM Ebitda (US$mm)	*Adjusted R/P*	*PV/ Ebitda*	*Present Value (US$mm)*	
North American Natural Gas	1,850	5.3	4.3	8,000	3%
Overseas Natural Gas	6,370	11.1	6.2	39,500	16%
Oil	18,610	6.6	5.1	95,000	39%
Downstream	16,840		6.0	101,000	41%
	43,670	8.1	5.6	243,500	100%

Cash Continues to Flow Strongly

Commodity price drives cash flow in our near-term model (see table Next Twelve Months Operating and Financial Estimates). We project constant volume for production operations with seasonal variation for overseas gas. Projected refining/marketing margins reflect futures prices for gasoline and heating oil compared to crude oil.

After a gain in the last quarter of 2004, cash flow would be sustained at a high level in 2005. Because we use futures for our NTM price projection, there is gradual erosion from the initial level. That has been the pattern of futures and of analyst's estimates for the past several years while the reality has been the opposite. Thus, it is likely misleading to conclude that a slight downward projection means that stock price might follow.

Royal Dutch/Shell
Next Twelve Months Operating and Financial Estimates

	Q1 3/31/04	*Q2 6/30/04*	*Q3 9/30/04*	*Q4E 12/31/04*	***Year 2004E***	*Q1E 3/31/05*	*Q2E 6/30/05*	*Q3E 9/30/05*	*Q4E 12/31/05*	***Next Twelve Months 12/31/05***
Volume										
Natural Gas (mmcfd)										
U.S. (or North America)	1,405	1,327	1,294	1,294	**1,333**	1,294	1,294	1,294	1,294	**1,294**
Overseas (or Int'l)	8,767	6,446	6,412	8,977	**7,672**	9,206	6,751	6,137	8,592	**7,666**
Total	10,172	7,773	7,706	10,271	**9,005**	10,500	8,045	7,431	9,886	**8,960**
Oil (mmb)	213	204	206	206	**829**	201	204	206	206	**817**
Oil (mbd)	2,342	2,238	2,238	2,238	**2,270**	2,238	2,238	2,238	2,238	**2,238**
Total gas & oil (mmb)	367	322	324	363	**1,376**	359	326	320	357	**1,362**
Price										
Natural gas ($/mcf)										
Henry Hub ($/mmbtu)	5.64	6.10	5.75	7.10	**6.15**	6.99	6.53	6.61	6.90	**6.76**
U.S. (or North America)	5.81	6.08	6.18	7.03	**6.26**	6.92	6.47	6.54	6.83	**6.69**
Overseas (or Int'l)	3.01	2.99	2.96	4.21	**3.35**	3.98	3.93	3.86	3.78	**3.89**
Total	3.40	3.52	3.50	4.57	**3.78**	4.34	4.34	4.33	4.18	**4.29**
Oil ($/bbl)										
WTI Cushing	35.23	38.34	43.89	48.35	**41.45**	45.73	45.10	44.36	43.42	**44.65**
Worldwide	30.33	33.80	38.23	42.11	**36.07**	39.83	39.28	38.64	37.82	**38.88**
Total gas & oil ($/bbl)	26.15	29.15	31.95	35.73	**30.75**	33.79	34.31	34.13	32.42	**33.63**
NY Harbor 3-2-1 ($/bbl)	6.98	12.78	7.83	5.44	**8.26**	6.82	8.28	7.29	6.48	**7.22**
Revenue ($mm)										
Natural Gas										
U.S. (or North America)	743	734	736	836	**3,049**	806	761	779	814	**3,159**
Overseas (or Int'l)	2,401	1,756	1,746	3,478	**9,380**	3,300	2,413	2,182	2,990	**10,884**
Total	3,144	2,490	2,481	4,314	**12,430**	4,105	3,175	2,960	3,803	**14,043**
Oil	6,464	6,884	7,871	8,670	**29,889**	8,022	8,000	7,955	7,787	**31,764**
Other	48,491	53,176	60,639	60,639	**222,945**	60,639	60,639	60,639	60,639	**242,557**
Total	58,099	62,549	70,992	73,624	**265,264**	72,766	71,814	71,554	72,230	**288,364**
Expense										
Production	3,427	3,326	4,525	5,052	**16,329**	4,880	4,690	4,638	4,773	**18,980**
Other	44,965	48,967	56,368	57,020	**207,320**	56,562	56,125	56,395	56,630	**225,713**
Ebitda ($mm)										
Exploration and Production	6,182	6,048	5,828	7,933	**25,990**	7,247	6,485	6,277	6,818	**26,827**
Other	3,526	4,209	4,271	3,619	**15,624**	4,077	4,514	4,244	4,009	**16,844**
Total Ebitda	9,707	10,257	10,098	11,552	**41,614**	11,324	10,999	10,522	10,826	**43,671**
Exploration	125	880	304	600	**1,909**	600	600	600	600	**2,400**
Deprec., Deplet., & Amort.	2,617	3,130	2,605	2,605	**10,957**	2,605	2,605	2,605	2,605	**10,420**
Other non cash	137	159	97	100	**493**	100	100	100	100	**400**
Ebit	6,828	6,088	7,092	8,247	**28,255**	8,019	7,694	7,217	7,521	**30,451**
Interest	312	307	304	304	**1,227**	304	304	304	304	**1,216**
Ebt	6,516	5,781	6,788	7,943	**27,028**	7,715	7,390	6,913	7,217	**29,235**
Income Tax	2,281	2,023	2,376	2,780	**9,460**	2,700	2,586	2,419	2,526	**10,232**
Net Income ($mm)										
Exploration and Production	2,746	1,935	2,405							
Other	1,778	2,255	2,367							
Unallocated	(289)	(433)	(359)							
Total	4,235	3,757	4,413	5,163	**17,568**	5,015	4,803	4,493	4,691	**19,003**
Shares (millions) - RD	2,033	2,031	2,021	2,021	**2,026**	2,021	2,021	2,021	2,021	**2,021**
Per share ($) - RD	1.25	1.11	1.31	1.53	**5.20**	1.49	1.43	1.33	1.39	**5.64**
Shares (millions) - SC	1,587	1,584	1,578	1,578	**1,579**	1,578	1,578	1,578	1,578	**1,578**
Per share ($) - SC	1.07	0.95	1.12	1.31	**4.45**	1.27	1.22	1.14	1.19	**4.82**
Ebitda Margin (E&P)	64%	65%	56%	61%	**61%**	60%	58%	58%	59%	**59%**
Tax Rate	35%	35%	35%	35%	**35%**	35%	35%	35%	35%	**35%**

Reserves Restatement Turned into Opportunity

There are further implications beyond the simplified RD/SC structure. It may be that new management is wiping the slate clean for a fresh start. Reserves may now be stated more conservatively than for competitors. We know that Securities and Exchange Commission standards understate likely ultimate production especially when rigidly applied. The typical oil field would probably not be developed if the capital program had to be justified by SEC reserves. As a result from a more conservative base, RD/SC may be able to report performance that looks better than would otherwise be the case.

At the other extreme, the Shell experience calls attention to other potential overstatements. The Middle Eastern producing countries come to mind. Russia is another case. Widely quoted reserves for Russian companies conform typically to the Society of Petroleum Engineers standard. We saw that **ConocoPhillips (COP)** cut **Lukoil (LUKOY)**'s reserves by more than a half to approximate the SEC standard.

Obviously there is still a lot of oil in the Middle East and Russia. That has always been the case. What is different now is that there is no known spare capacity of light oil. The pace of investment needed to expand capacity is likely to lag market requirements just as capital spending is inherently cyclical. The question is more how rapidly will consumers have access to growing volumes. For the next several years it looks like a seller's market. The producers must spend large sums. Inevitably there are delays and some producers may not see the situation as urgently.

Competitive Value among Mega Caps

Like its mega cap peers, RD/SC is well positioned to supply more light, clean products. The overseas natural gas business is growing faster than oil. Shell's oil refineries are well-equipped to transform more readily available heavy, sour oil into light, sweet products. The valuation distinctions among mega caps are slight (see table Rank by McDep Ratio).

	Symbol/	*Rating*	*Price ($/sh) 21-Dec 2004*	*Shares (mm)*	*Market Cap ($mm)*	*Net Present Value ($/sh)*	*Debt/ Present Value*	*McDep Ratio*
Mega Cap								
Exxon Mobil Corporation	XOM	B3	51.69	6,508	336,000	50.00	0.07	1.03
Shell Transport and Trading Co. plc	SC	B3	50.44	1,587	80,000	51.00	0.17	0.99
BP plc	BP	B3	59.03	3,614	213,000	60.00	0.13	0.99
Total S.A.	TOT	B3	107.11	1,228	132,000	113.00	0.17	0.96
Royal Dutch Petroleum	RD	B1	56.21	2,021	114,000	60.00	0.17	0.95
ChevronTexaco Corporation	CVX	B1	52.78	2,126	112,000	62.50	0.13	0.86

B1 = Buy full unlevered position, B2 = Buy half unlevered position, B3 = Alternative buy
McDep Ratio = **M**arket **c**ap and **De**bt to **p**resent value of oil and gas and other businesses

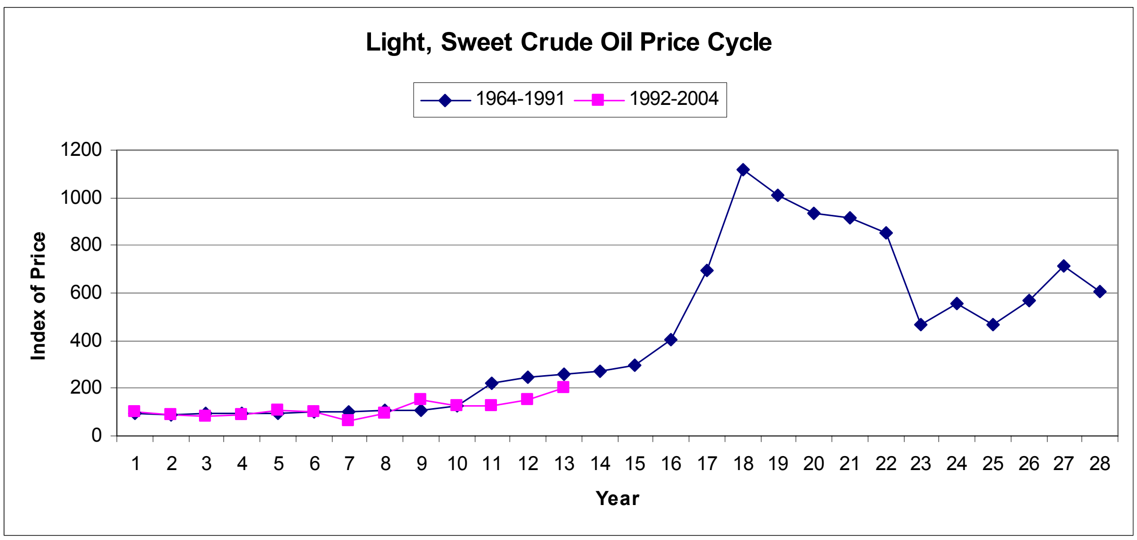
Source: www.mcdep.com

Buy Oil and Gas Producers at Mid Decade

Three to five-fold gain potential for oil and gas price over the next 5 to 13 years justifies investment in recommended oil and gas producers including RD/SC, in our opinion. Supporting improving prospects, the average futures prices of oil and gas for continuous delivery over the next six years are in a multi-year uptrend defined by the current quotes above the 40-week average. The current benchmark oil average futures price for the next six years is about $41 a barrel. That is higher than our estimate that current stock price of RD/SC reflects a constant real oil price approaching $35 a barrel.

Three to Five in Five to Thirteen

Taking the experience of past trends in oil price we see the potential for further gains beyond what most investors contemplate. Keying on the twice-in-a-lifetime bear market bottoms in 1974 and 2002, we note a preceding ten-year period of relatively stable oil price. Thus, we plot a 28-year period of oil price indexed to the average for the first ten years (see chart Light, Sweet Crude Oil Price Cycle). The historical cycle runs from 1964 to 1991. We superimpose on that a new cycle starting in 1992 and continue it through the last data point, 2004, year 13. There are similarities between 2004 and 1976 as well as differences. Undoubtedly, the current cycle will play out differently. The main point that we think is valid is that there may be surprising upside in oil price after 2004 as there was after 1976.

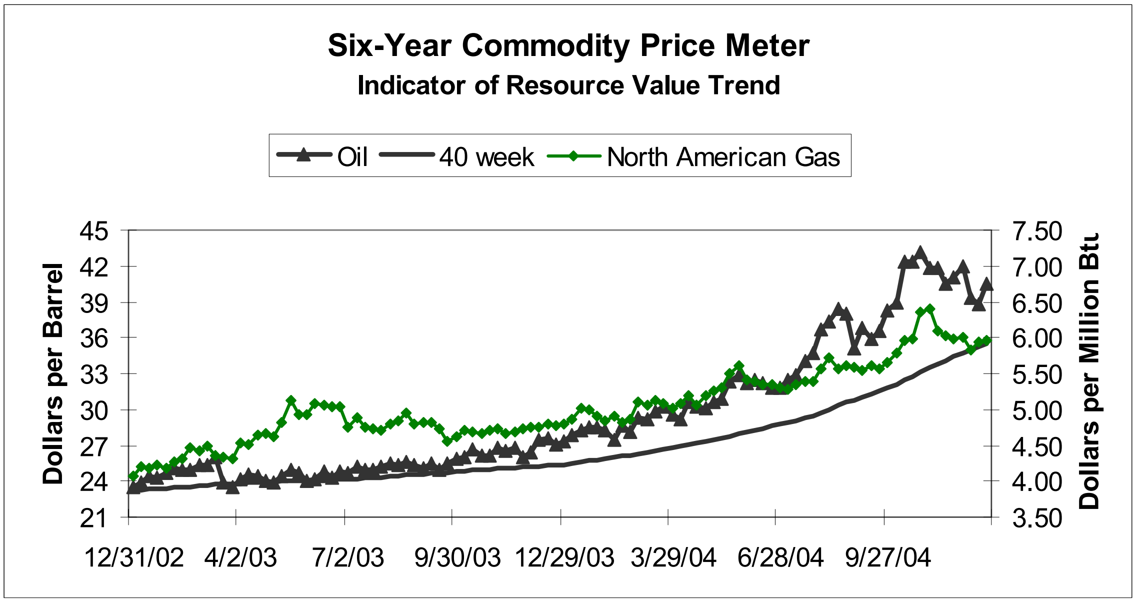


Source: www.eia.doe.gov, www.mcdep.com

Futures Trend Up

Futures traders are expressing increasing conviction that the oil price trend is up. Tracking the average futures price for continuous delivery over the next six-years we see that the current quote is above the 40-week average (see chart Six-Year Commodity Price Meter). A common presumption is that the trend is likely to continue until the current quote falls below the 40-week average. We believe the uptrend will continue, but cannot rule out occasional interruptions.

Kurt H. Wulff, CFA



Source: www.nymex.com, www.mcdep.com updated

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