

## ***Meter Reader***

*A Weekly Analysis of Energy Stocks Using the McDep Ratio*

July 23, 2001

# Let's Contango

## **Summary and Recommendation**

An upward sloping futures price curve, known as contango, implies growing profits for natural gas producers. Commodities usually trace a downward sloping futures price curve, known as backwardation. Our natural gas recommendation is Strong Buy **Burlington Resources Inc. (BR)**, whose stock price is holding on the downside in part due to share repurchase. In decreasing sensitivity to North American natural gas our remaining recommendations for a diversified energy portfolio include **Energy Partners Limited (EPL)**, Strong Buy **USX-Marathon Group (MRO)**, **American Electric Power (AEP)**, and **PetroChina (PTR)**. An unfavorable change in the technical pattern of stock price may discourage some potential new investors in recommended **Exelon Corporation (EXC)**.

## **Contango Aligns Commodity Buyers with Equity Buyers**

The main reason we are interested in natural gas is that we believe the clean fuel is more valuable to the economy than current price suggests. In other words we see a high futures price. We got a glimpse of the future this past January when natural gas price hit new highs. While it is now a fact that the peaks did not last, we expect to be back there again in the next few years.

Commodity traders as a group usually expect future prices to be lower. That was true a year ago when the futures price of \$4 at year-end 2000 was expected to decline to \$3.50 at year-end 2002 (see first and third peak in lower wavy line on chart). In other words, a year ago, the prices that traders expected for each month three years into the future followed a downward sloping trend (backwardation) with seasonal variation.

It turns out, of course, that no one has barely a clue as to what future prices will actually be. The actual year-end 2000 price hit \$10, not \$4. Six months ago, from such a high level, a downward sloping curve for futures prices could hardly be disputed (see top wavy line on chart).

Now the actual price of natural gas near \$3 is less than anticipated a year ago when the futures price for July 2001 was about \$3.50. It is far less than the futures price for July 2001 of about \$5.70 anticipated only six months ago. After that history, closing futures prices on July 21, 2001 follow an upward sloping trend (contango) to about \$3.60 in July 2004 (see middle wavy line on chart). As a result and contrary to normal, commodity traders now expect futures prices for natural gas to be higher than today.

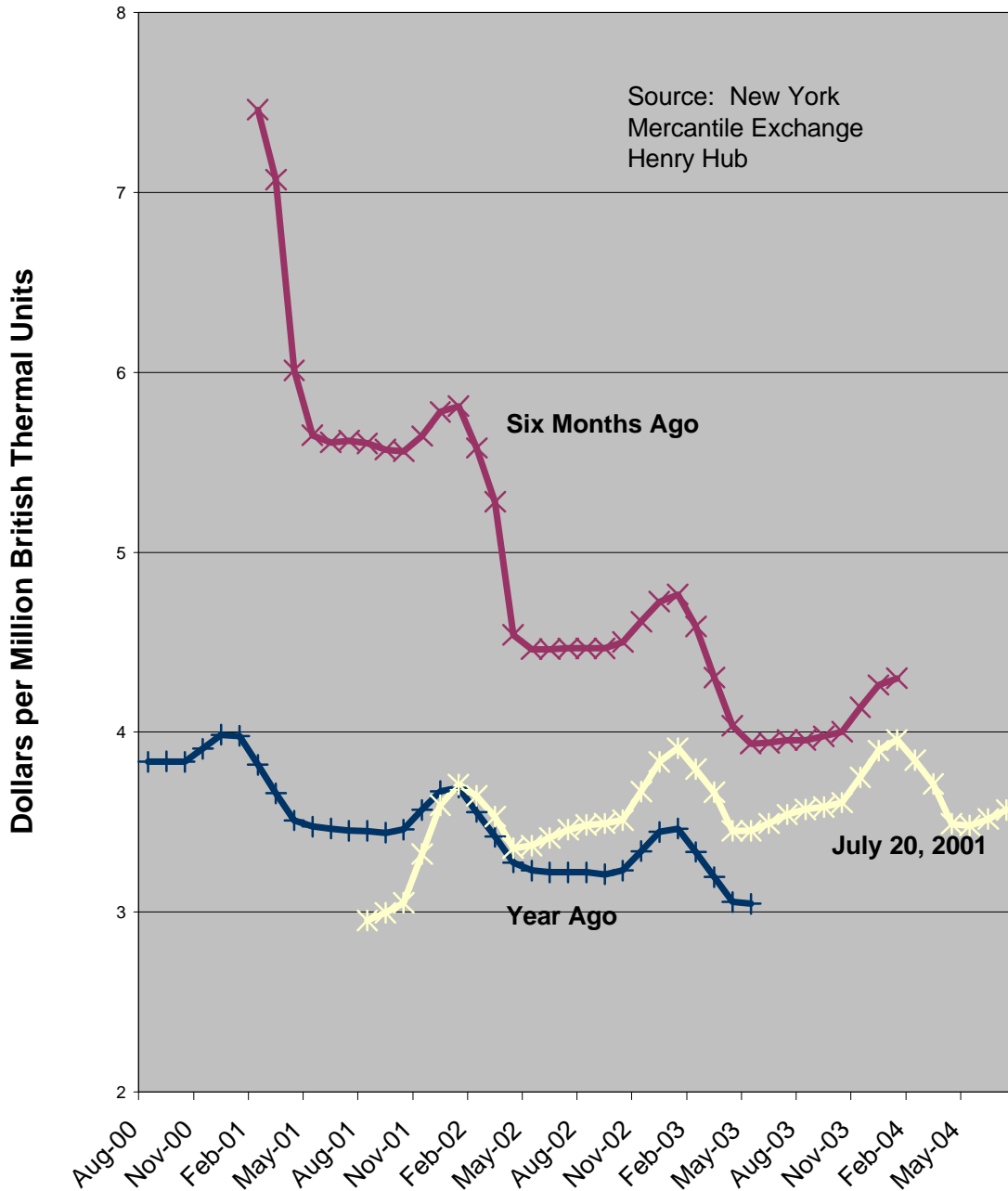
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**Natural Gas Futures Prices**



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We think that contango is a more realistic trend for natural gas price than backwardation except from an extreme level as we reached last winter. One of the reasons we feel natural gas is worth more is that there are no long-term sellers of any substance. Anadarko's Allison captured some of the conviction we feel when he appeared on television on or about July 13, 2001.

### **No Such Thing as a Credible Long Term Natural Gas Contract with a Fixed Price**

Robert Allison of Anadarko offered unusual insight on pricing attitudes in an interview on CNBC. Asked whether his company has hedged future production at high prices, Mr. Allison responded along the following lines, "In my forty years in the industry, whenever I had a long-term contract and the price was below current market I had to deliver. Whenever the price was above current market, the buyer reneged." After the interviewer seemed a bit startled, Mr. Allison calmly added that there was very little volume in longer dated futures. He was implying that Anadarko could not actually get a contract at large volume from a credible buyer at reasonable prices. We would add that neither a political entity like the State of California nor a highly leveraged dealer in financial derivatives is a credible buyer in large size.

The reality is that no soundly capitalized large producer of natural gas has committed to sell any sizeable volumes at a contract price. Those producers are resigned to selling short term expecting that the highs and lows will average out. Current lows are averaging against the recent highs. We believe that there will be highs again and the average will be better than the current lows.

### **Burlington Resources Has Better Downside Protection Than Two Years Ago**

"A no-brainer under 40" characterizes our conviction on the value in BR stock. While we note that when the industry was under pressure two years ago, the stock dropped further, we don't see that happening this time. Then BR was still under restrictions as a result of choosing pooling of interests accounting treatment for its acquisition of POCO Petroleum. While we talked of breaking the pooling restrictions and buying back stock anyway, it didn't happen. Now management appears to be more sensitive to the frustration it has caused investors with unproductive spending and seems to realize the irrefutable logic of stock repurchase. Meanwhile the balance sheet is strong and there are no artificial restrictions to taking sensible action. As a result we do not expect to see the stock fall very much under 40 or to stay here long.

Last week, for the first time in a while, the mood among investors at a meeting with Burlington Resources seemed more positive. It was just a conference call as opposed to a face-to-face session. The call was handled by the new Chief Financial Officer, Steve Shapiro, who has a positive record with investors as a result of his association with

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Vastar, the successful Gulf of Mexico exploration and production arm of Atlantic Richfield.

Instead of having to make excuses, Mr. Shapiro was able to report that BR produced more than expected at a higher price than expected and at cost lower than expected. We are further encouraged that the company, in fact, is repurchasing its stock aggressively.

Senior Vice President Randy Limbacher, experienced in the San Juan Basin, told of successful results from pilot projects of infill drilling in the Dakota Formation. The 50-year-old field continues to offer more treasure not fully reflected in proven reserves. New formations continue to be developed and old formations continue to be drilled in more concentrated patterns.

### **Exelon Stock Breaks 200 Day Average on Downside**

If natural gas is going to set a higher price for electricity in the future, old nuclear plants that sell their product in a deregulated market are going to be more valuable. Our choice to participate in that theme is the largest operator of nuclear plants, Exelon.

When recommending Exelon recently we noted, "If we are surprised and the stock drops in price to break the rising trend, investors would fear that momentum was broken and the rising trend was turning to a declining trend." Regrettably a drop in price last week to about \$61 pierces the 200-day moving average of about \$63. Nonetheless we retain our buy rating, as we believe that our fundamental thesis for gains over the next few years remains intact.

Stock price for our other power recommendation, AEP, remains well within the range of an uptrend on the chart. Strong Buys, BR and MRO, do not exhibit an uptrend currently, but the situation could change quickly. Recommended PTR is on the 200-day average and EPL has not yet traded 200 days.

### **Track Value in Tables**

For current ranking of stocks by value see Tables L-1, L-2, S-1, and S-2. For latest present value calculations and cash flow forecasts for five Small Cap stocks see Meter Reader Tables, a companion analysis.

Three royalty trusts just declared monthly distributions that prompt no noticeable modification of projections. Considering latest commodity futures prices we look for distributions for the next twelve months that range from 9.6 to 10.3% of current price.

Kurt H. Wulff, CFA

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### A Weekly Analysis of Energy Stocks Using the McDep Ratio

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**Table L-1**  
**Mega Cap and Large Cap Energy Companies**  
**Rank by McDep Ratio: Market Cap and Debt to Present Value**

	<i>Symbol/ Rating</i>	<i>Price (\$/sh) 20-Jul 2001</i>	<i>Shares (mm)</i>	<i>Market Cap (\$mm)</i>	<i>Net Present Value (\$/sh)</i>	<i>Debt/ Present Value</i>	<i>McDep Ratio</i>
<b>Mega Cap</b>							
Exxon Mobil Corporation	XOM	43.36	7,020	304,000	37.10	0.09	1.15
BP PLC	BP	48.45	3,720	180,000	48.90	0.17	0.99
TOTAL Fina Elf S.A.	TOT	68.65	1,400	96,000	72.00	0.16	0.96
Royal Dutch/Shell	RD	56.48	3,580	202,000	60.80	0.09	0.94
Chevron (incl. Texaco)	CHV	88.95	1,060	94,300	103.40	0.15	0.88
	<i>Total or Median</i>			<i>876,000</i>		<i>0.15</i>	<i>0.96</i>
<b>Power</b>							
Enron Corp.	ENE	48.16	891	42,900	15.00	0.69	1.69
Dynegy Inc.	DYN	45.61	338	15,400	20.60	0.56	1.54
Calpine Corporation	CPN	39.66	317	12,600	19.90	0.52	1.48
Mirant Corporation	MIR	33.30	353	11,800	12.70	0.73	1.44
Duke Energy Corporation	DUK	40.26	779	31,400	19.90	0.62	1.39
El Paso Corporation	EPG	52.43	521	27,300	30.00	0.57	1.32
AES Corporation	AES	35.72	538	19,200	17.40	0.71	1.31
Williams Companies	WMB	32.86	485	15,900	16.60	0.69	1.30
American Electric Power Co. Inc.	AEP 2	46.30	324	15,000	25.90	0.73	1.21
Southern Company	SO	23.05	683	15,700	16.90	0.54	1.17
Exelon Corporation	EXC 2	60.55	324	19,600	55.30	0.51	1.05
	<i>Total or Median</i>			<i>227,000</i>		<i>0.62</i>	<i>1.32</i>
<b>Natural Gas and Oil</b>							
Occidental Petroleum	OXY	26.19	370	9,700	35.60	0.46	0.86
Anadarko Petroleum Corp.	APC	51.51	263	13,500	66.30	0.24	0.83
Phillips (incl. Tosco)	P	54.91	383	21,000	75.90	0.31	0.81
Burlington Resources, Inc	BR 1	39.47	215	8,500	54.90	0.17	0.77
ENI S.p.A.	E	59.00	800	47,200	91.90	0.10	0.68
Conoco Inc.	COC.B	28.48	623	17,700	48.00	0.21	0.68
	<i>Total or Median</i>			<i>118,000</i>		<i>0.22</i>	<i>0.79</i>
<b>Service</b>							
Schlumberger Ltd.	SLB	53.45	581	31,100	37.70	0.14	1.36
Halliburton Company	HAL	33.74	430	14,500	27.20	0.13	1.21

Buy/Sell rating after symbol: 1 - Strong Buy, 2 - Buy

McDep Ratio = Market cap and Debt to present value of oil and gas and other businesses

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**Table L-2**  
**Mega Cap and Large Cap Energy Companies**  
**Rank by EV/Ebitda: Enterprise Value to Earnings Before Interest, Tax, Deprec.**

	<i>Symbol</i>	<i>Price (\$/sh)</i> <i>20-Jul 2001</i>	<i>EV/Sales</i> <i>2001E</i>	<i>EV/Ebitda</i> <i>NTM</i>	<i>P/E</i> <i>NTM</i>	<i>Dividend or Distribution</i> <i>NTM (%)</i>	<i>PV/Ebitda</i> <i>NTM</i>
<b>Mega Cap</b>							
	XOM	43.36	1.5	8.1	16	2.0	7.0
	BP	48.45	1.2	7.0	11	2.9	7.0
	TOT	68.65	1.0	6.7	16	1.6	7.0
	RD	56.48	1.4	6.5	14	2.5	7.0
	CHV	88.95	1.0	5.3	10	2.9	6.0
	<i>Median</i>		<i>1.2</i>	<i>6.7</i>	<i>14</i>	<i>2.5</i>	<i>7.0</i>
<b>Power</b>							
	ENE	48.16	0.3	16.9	24	1.0	10.0
	DYN	45.61	0.4	13.8	22	0.7	9.0
	CPN	39.66	2.7	13.3	19	-	9.0
	MIR	33.30	0.7	11.5	15	-	8.0
	DUK	40.26	0.9	11.1	16	2.7	8.0
	AES	35.72	3.7	10.5	17	-	8.0
	WMB	32.86	3.3	10.4	14	1.8	8.0
	EPG	52.43	0.7	9.2	16	1.6	7.0
	AEP	2 46.30	0.7	8.5	13	5.2	7.0
	SO	23.05	2.7	8.2	14	5.8	7.0
	EXC	2 60.55	2.5	7.3	13	2.8	7.0
	<i>Median</i>		<i>0.9</i>	<i>10.5</i>	<i>16</i>	<i>1.6</i>	<i>8.0</i>
<b>Natural Gas and Oil</b>							
	BR	1 39.47	4.3	6.9	30	1.4	9.0
	P	54.91	0.8	5.7	9	2.6	7.0
	OXY	26.19	1.2	5.1	7	3.8	6.0
	APC	51.51	2.2	5.0	9	0.4	6.0
	COC.B	28.48	0.6	4.1	8	2.7	6.0
	E	59.00	1.1	3.4	6	2.7	5.0
	<i>Median</i>		<i>1.1</i>	<i>5.1</i>	<i>8</i>	<i>2.6</i>	<i>6.0</i>
<b>Service</b>							
	HAL	33.74	1.2	9.7	23	1.5	8.0
	SLB	53.45	2.7	9.5	26	1.4	7.0

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended March 31, 2002; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

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**Mid Cap and Small Cap Energy Companies**  
**Rank by McDep Ratio: Market Cap and Debt to Present Value**

	<i>Symbol/ Rating</i>	<i>Price (\$/sh) 20-Jul 2001</i>	<i>Shares (mm)</i>	<i>Market Cap (\$mm)</i>	<i>Net Present Value (\$/sh)</i>	<i>Debt/ Present Value</i>	<i>McDep Ratio</i>
<b>Power</b>							
CMS Energy Corporation	CMS	25.89	128	3,300	19.80	0.80	1.06
Sempra Energy	SRE	26.29	203	5,300	23.10	0.65	1.05
Consol Energy Inc.	CNX	19.25	79	1,500	19.70	0.65	0.99
Constellation Energy Group	CEG	32.40	152	4,900	37.10	0.45	0.93
<i>Total or Median</i>				<i>15,000</i>		<i>0.65</i>	<i>1.02</i>
<b>Natural Gas and Oil</b>							
Triton Energy Limited	OIL	44.68	59	2,600	24.50	0.24	1.63
TEPPCO Partners, L.P.	TPP	30.50	38	1,160	13.20	0.65	1.46
Ocean Energy, Inc.	OEI	18.85	177	3,300	21.90	0.27	0.90
PanCanadian Pete (15%)(US\$)	PCP.TO	27.09	38	1,040	37.00	0.08	0.75
Unocal Corporation	UCL	34.10	256	8,700	51.90	0.27	0.75
Norsk Hydro ASA (49%)	NHY	41.96	128	5,400	61.60	0.16	0.73
Petro-Canada	PCZ	24.41	272	6,700	35.20	0.09	0.72
Valero Energy Corp.(with UDS)	VLO	34.97	112	3,900	70.70	0.42	0.71
Marathon Oil Corporation	MRO 1	28.21	309	8,700	48.00	0.24	0.69
Devon Energy Corporation	DVN	50.11	135	6,800	80.10	0.16	0.69
PetroChina Company Ltd (10%)	PTR 2	19.44	176	3,400	32.50	0.15	0.66
<i>Total or Median</i>				<i>51,700</i>		<i>0.24</i>	<i>0.73</i>
<b>Small Cap</b>							
Dorchester Hugoton, Ltd.*	DHULZ	13.52	10.7	145	12.50	-	1.08
Cross Timbers Royalty Tr*	CRT	16.75	6.0	101	17.00	-	0.99
Encore Acquisition Corporation	EAC	14.15	30.0	430	16.40	0.15	0.88
San Juan Basin Royalty Tr*	SJT	13.29	46.6	620	15.20	-	0.87
Hugoton RoyaltyTrust*	HGT	12.79	40.0	510	15.80	-	0.81
Penn Virginia Corporation	PVA	34.50	8.8	300	44.20	0.00	0.78
Energy Partners Ltd.*	EPL 2	12.42	27.0	340	18.40	0.04	0.69
<i>Total or Median</i>				<i>2,450</i>		<i>-</i>	<i>0.87</i>
<b>Micro Cap</b>							
Purcell Energy, Ltd. (US\$)	PEL.TO	2.20	26.0	57	3.70	0.07	0.63

Buy/Sell rating after symbol: 1 - Strong Buy, 2 - Buy

McDep Ratio = **M**arket cap and **D**ebt to **p**resent value of oil and gas and other businesses

\* For small cap stocks marked with asterisk, estimated present value recalculated weekly.

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<b>Power</b>							
CMS Energy Corporation	CMS	25.89	0.9	7.4	9	5.6	7.0
Sempra Energy	SRE	26.29	1.2	7.3	10	3.8	7.0
Consol Energy Inc.	CNX	19.25	1.9	6.9	6	5.8	7.0
Constellation Energy Group	CEG	32.40	1.9	6.5	10	1.5	7.0
	<i>Median</i>		<i>1.5</i>	<i>7.1</i>	<i>10</i>	<i>4.7</i>	<i>7.0</i>
<b>Natural Gas and Oil</b>							
TEPPCO Partners, L.P.	TPP	30.50	0.7	11.6	15	6.9	8.0
Triton Energy Limited	OIL	44.68	6.3	9.8	24	-	6.0
Ocean Energy, Inc.	OEI	18.85	3.4	5.4	12	0.8	6.0
Unocal Corporation	UCL	34.10	1.6	4.5	12	2.3	6.0
PanCanadian Pete (15%)(US\$)	PCP.TO	27.09	1.2	4.1	7	1.0	5.5
Petro-Canada	PCZ	24.41	1.0	4.0	9	1.1	5.5
Valero Energy Corp.(with UDS)	VLO	34.97	0.3	3.9	4	0.9	5.5
Norsk Hydro ASA (49%)	NHY	41.96	0.8	3.7	8	2.5	5.0
Marathon Oil Corporation	MRO 1	28.21	0.4	3.4	6	3.3	5.0
Devon Energy Corporation	DVN	50.11	2.6	3.4	7	0.4	5.0
PetroChina Company Ltd (10%)	PTR 2	19.44	1.4	2.6	4	8.8	4.0
	<i>Median</i>		<i>1.2</i>	<i>4.0</i>	<i>8</i>	<i>1.1</i>	<i>5.5</i>
<b>Small Cap</b>							
Cross Timbers Royalty Tr*	CRT	16.75	5.9	9.5	10	10.0	9.6
Dorchester Hugoton, Ltd.*	DHULZ	13.52	7.1	9.3	10	8.0	8.6
San Juan Basin Royalty Tr*	SJT	13.29	6.1	7.7	10	9.6	8.8
Hugoton RoyaltyTrust*	HGT	12.79	5.0	7.2	10	10.3	8.9
Encore Acquisition Corporation	EAC	14.15	3.6	5.3	12	-	6.0
Penn Virginia Corporation	PVA	34.50	3.4	4.7	10	2.6	6.0
Energy Partners Ltd.*	EPL 2	12.42	2.1	3.3	16	-	4.8
	<i>Median</i>		<i>5.0</i>	<i>7.2</i>	<i>10</i>	<i>8.0</i>	<i>8.6</i>
<b>Micro Cap</b>							
Purcell Energy, Ltd. (US\$)	PEL.TO	2.20	2.9	3.8	12	-	6.0

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended June 30, 2002; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

\* For small cap stocks marked with asterisk, estimated present value recalculated weekly.

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