

Meter Reader

A Weekly Analysis of Energy Stocks Using the McDep Ratio

August 6, 2001

Power Glut or Opportunity?

Summary and Recommendation

There may be a temporary surplus developing for electric generation capacity to be fueled by natural gas, but we see opportunity in higher values for natural gas and unregulated low cost generation from old coal and nuclear plants. As investors sort through the implications of the dynamically changing energy industry we believe that our recommendations will be rewarding. Our Strong Buys are **Burlington Resources Inc. (BR)** and **USX-Marathon Group (MRO)**. Our Buys are **American Electric Power (AEP)**, **PetroChina (PTR)**, **Exelon Corporation (EXC)** and **Energy Partners, Ltd. (EPL)** (see Tables L-1, L-2, S-1, S-2). Further attempting to differentiate power glut from opportunity, we add a Sell rating for **Calpine Corporation (CPN)**, the company most exposed to any potential squeeze in the difference between the price of electricity and the price of natural gas.

Electricity Prices Converge and a Comedy Unfolds in California

Palo Verde electricity price, a proxy for the West, can now fit on the same chart with Cinergy electricity, a proxy for the East, along with natural gas and heating oil (see chart). Just two months ago the futures price for Palo Verde electricity was \$34 per million British Thermal Units for August and \$21 for September (see *Meter Reader, Forward with Energy*, June 4, 2001). Today, Palo Verde for September is just \$6. Cinergy for September remains near \$3. The futures market correctly anticipated the eventual convergence of Palo Verde and Cinergy, but it happened sooner.

While numbers tell an exciting story to analysts, the human story reads like "The Gang Who Couldn't Shoot Straight". After taking over electricity buying for the State of California, the governor and his aides signed advanced contracts to cover the state's needs at a price of \$100 or more. In a quick turn of events the governor's team apparently bought too much electricity and has resold the surplus for \$20 or less. As if to rebuild public confidence, the governor imposed strict rules after the fact on ownership of power company stocks by his electricity buyers. After learning that electricity buyers for the state had widespread holdings of Calpine and some **Enron**, we further learn that the governor's chief spokesperson bought Calpine stock during the height of the state's castigation of the power industry.

Heating Oil Price Points the Way to Profit

Here is the long-term interpretation of the futures prices we plot. The futures market prices heating oil at \$4 in 2007. We think it will be more like \$6 in 2005, but that is opinion not market fact.

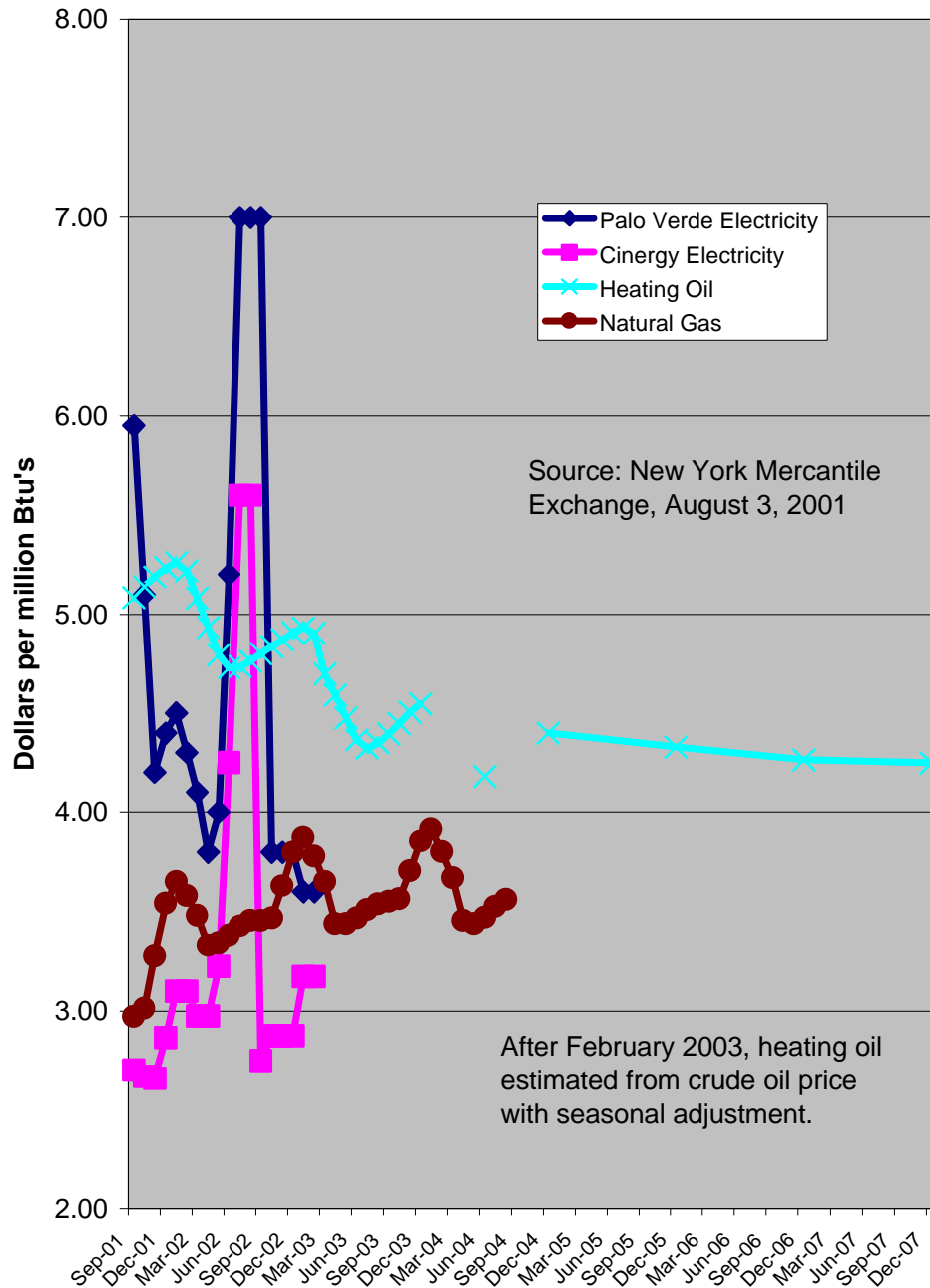
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Energy Futures Prices



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The natural gas price is likely to approach the heating oil price. The futures curve already slopes upward in that direction. So much new capacity will be installed to use natural gas that the clean fuel will be in short supply. For a price, low value users of gas will give up their supply to electric generators who can readily pay more. Only heating oil puts a cap on gas price for the next few years. There won't be much LNG or any Arctic gas available in 2005. Owners of gas-fired generation can usually use heating oil as a substitute, but it may take some planning.

The electricity price is likely to approach the natural gas price. Already some 60% of the cost of electricity from natural gas is cost of fuel. The dependence increases as gas price increases. Palo Verde electricity declines to the natural gas price by the end of next year. Cinergy electricity is moving up to the natural gas price and should reach that level in a few years.

Just as higher price for natural gas drives away low value users, a higher price for electricity will also lead to lower demand growth. That is how the new generation capacity may see a margin squeeze. We could readily have a situation where the price of natural gas is higher than expected and the profit for generating electricity from natural gas is lower than expected.

If the Future is So Bright, Why is Natural Gas Price So Low Now?

Trends take time. There appears to be no immediate urgency. More natural gas has been put in storage for the winter than was the case last year at this time.

We take comfort in the fact that oil price is holding rather than declining as the futures market suggests. We expect oil to remain relatively strong and to strengthen in future years. We do not expect natural gas to decline further relative to oil and we expect it to strengthen at least as much as the futures market expects in the winter. Yet we cannot control prices and surprises are always possible.

Energy Partners Proves the Difficulty of Expanding Oil and Gas Production

Investors reacted sharply to EPL's report of second quarter results that fell short of expectations. Natural gas volumes failed to show the sharp growth management promised only three months ago. The shortfall is attributed to delays in getting rigs to drill the additional wells required.

We are surprised, but only moderately so as we appreciate how difficult it is to grow production. Our projections have been cut back quite sharply (see Tables EPL-1 and EPL-2 in *Meter Reader Tables*, a separate weekly publication). Yet, the decline in stock price has more than compensated for reduced expectations and a low McDep Ratio continues to point to appreciation potential.

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Dorchester Hugoton Announces an Intended Deal

The founding general partner of DHULZ has apparently found a younger person he can trust to use the partnership's assets as part of a base in a larger entity that will attempt to develop a growing income stream free of UBTI (unrelated business taxable income). We need to study the proposed transaction before we draw a firm conclusion. Nonetheless we can say that DHULZ already enjoys favorable market recognition with a McDep Ratio of 1.14. A conservative investor looking for high income might choose to cash in, pay the tax and invest the proceeds in something like **Hugoton Royalty Trust** at a McDep Ratio of 0.78. Yet, an optimistic investor might look at the favorable recognition enjoyed by the only other master limited partnership in our coverage, **Teppco Partners**, at a McDep Ratio of 1.47 and hope that DHULZ might do particularly well in the proposed new entity.

Kurt H. Wulff, CFA

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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) 3-Aug 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>
Mega Cap							
Exxon Mobil Corporation	XOM	41.26	7,020	290,000	37.10	0.09	1.10
BP PLC	BP	49.11	3,720	183,000	48.90	0.17	1.00
TOTAL Fina Elf S.A.	TOT	70.55	1,400	99,000	72.00	0.16	0.98
Royal Dutch/Shell	RD	55.49	3,580	199,000	60.80	0.09	0.92
Chevron (incl. Texaco)	CHV	90.68	1,060	96,100	103.40	0.15	0.90
	<i>Total or Median</i>			<i>867,000</i>		<i>0.15</i>	<i>0.98</i>
Power							
Calpine Corporation	CPN 4	36.67	318	11,700	9.90	0.69	1.85
Enron Corp.	ENE	45.36	891	40,400	15.00	0.69	1.63
Dynegy Inc.	DYN	46.99	338	15,900	20.60	0.56	1.57
Mirant Corporation	MIR	33.85	353	11,900	12.70	0.73	1.45
Duke Energy Corporation	DUK	39.90	779	31,100	19.90	0.62	1.38
AES Corporation	AES	38.97	538	21,000	17.40	0.71	1.36
El Paso Corporation	EPG	51.25	521	26,700	30.00	0.57	1.30
Williams Companies	WMB	33.51	485	16,300	16.60	0.69	1.31
American Electric Power Co. Inc.	AEP 2	46.30	324	15,000	25.90	0.73	1.21
Southern Company	SO	24.20	683	16,500	16.90	0.54	1.20
Exelon Corporation	EXC 2	58.71	324	19,000	55.30	0.51	1.03
	<i>Total or Median</i>			<i>226,000</i>		<i>0.69</i>	<i>1.36</i>
Natural Gas and Oil							
Anadarko Petroleum Corp.	APC	56.01	263	14,700	66.30	0.24	0.88
Occidental Petroleum	OXY	27.30	370	10,100	35.60	0.46	0.87
Phillips (incl. Tosco)	P	56.66	383	21,700	75.90	0.31	0.82
Burlington Resources, Inc	BR 1	41.64	215	9,000	54.90	0.17	0.80
Conoco Inc.	COC.B	29.95	623	18,700	48.00	0.21	0.70
ENI S.p.A.	E	61.00	800	48,800	91.90	0.10	0.70
	<i>Total or Median</i>			<i>123,000</i>		<i>0.22</i>	<i>0.81</i>
Service							
Schlumberger Ltd.	SLB	52.02	581	30,200	37.70	0.14	1.33
Halliburton Company	HAL	35.16	430	15,100	27.20	0.13	1.25

Buy/Sell rating after symbol: 1 - Strong Buy, 2 - Buy, 4 - Sell

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) 3-Aug 2001</i>	<i>EV/ Sales 2001E</i>	<i>EV/ Ebitda NTM</i>	<i>Dividend or Distribution P/E NTM</i>	<i>NTM (%)</i>	<i>PV/ Ebitda NTM</i>
Mega Cap							
	E Exxon Mobil Corporation	XOM	41.26	1.4	7.7	15	2.1 7.0
	BP PLC	BP	49.11	1.2	7.0	11	2.9 7.0
	TOTAL Fina Elf S.A.	TOT	70.55	1.1	6.9	16	1.6 7.0
	Royal Dutch/Shell	RD	55.49	1.4	6.4	14	2.5 7.0
	Chevron (incl. Texaco)	CHV	90.68	1.0	5.4	10	2.9 6.0
	<i>Median</i>			<i>1.2</i>	<i>6.9</i>	<i>14</i>	<i>2.5 7.0</i>
Power							
	Enron Corp.	ENE	45.36	0.3	16.3	23	1.1 10.0
	Dynegy Inc.	DYN	46.99	0.4	14.1	22	0.6 9.0
	Calpine Corporation	CPN 4	36.67	2.6	13.0	20	- 7.0
	Mirant Corporation	MIR	33.85	0.7	11.6	16	- 8.0
	Duke Energy Corporation	DUK	39.90	0.9	11.1	15	2.8 8.0
	AES Corporation	AES	38.97	3.9	10.9	18	- 8.0
	Williams Companies	WMB	33.51	3.4	10.5	15	1.8 8.0
	El Paso Corporation	EPG	51.25	0.7	9.1	16	1.7 7.0
	American Electric Power Co. Inc.	AEP 2	46.30	0.7	8.5	13	5.2 7.0
	Southern Company	SO	24.20	2.8	8.4	15	5.5 7.0
	Exelon Corporation	EXC 2	58.71	2.5	7.2	13	2.9 7.0
	<i>Median</i>			<i>0.9</i>	<i>10.9</i>	<i>16</i>	<i>1.7 8.0</i>
Natural Gas and Oil							
	Burlington Resources, Inc	BR 1	41.64	4.5	7.2	32	1.3 9.0
	Phillips (incl. Tosco)	P	56.66	0.8	5.8	9	2.5 7.0
	Occidental Petroleum	OXY	27.30	1.3	5.2	8	3.7 6.0
	Anadarko Petroleum Corp.	APC	56.01	2.3	5.3	9	0.4 6.0
	Conoco Inc.	COC.B	29.95	0.6	4.2	8	2.5 6.0
	ENI S.p.A.	E	61.00	1.1	3.5	6	2.6 5.0
	<i>Median</i>			<i>1.2</i>	<i>5.3</i>	<i>9</i>	<i>2.5 6.0</i>
Service							
	Halliburton Company	HAL	35.16	1.2	10.0	24	1.4 8.0
	Schlumberger Ltd.	SLB	52.02	2.7	9.3	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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Power							
Consol Energy Inc.	CNX	23.80	79	1,900	19.70	0.65	1.07
CMS Energy Corporation	CMS	25.19	128	3,200	19.80	0.80	1.05
Sempra Energy	SRE	26.35	203	5,400	23.10	0.65	1.05
Constellation Energy Group	CEG	30.60	152	4,700	37.10	0.45	0.90
	<i>Total or Median</i>			<i>15,200</i>		<i>0.65</i>	<i>1.05</i>
Natural Gas and Oil							
Triton Energy Limited	OIL	44.87	59	2,700	24.50	0.24	1.64
TEPPCO Partners, L.P.	TPP	31.00	38	1,180	13.20	0.65	1.47
Valero Energy Corp.(with UDS)	VLO	35.60	110	3,900	30.80	0.63	1.06
Ocean Energy, Inc.	OEI	19.68	177	3,500	21.90	0.27	0.93
PanCanadian Pete (15%)(US\$)	PCP.TO	28.12	38	1,080	37.00	0.08	0.78
Marathon Oil Corporation	MRO 1	29.60	310	9,200	42.60	0.26	0.78
Unocal Corporation	UCL	35.59	256	9,100	51.90	0.27	0.77
Petro-Canada	PCZ	25.61	272	7,000	35.20	0.09	0.75
Norsk Hydro ASA (49%)	NHY	42.04	128	5,400	61.60	0.16	0.73
Devon Energy Corporation	DVN	51.90	135	7,000	80.10	0.16	0.71
PetroChina Company Ltd (10%)	PTR 2	20.69	176	3,600	32.50	0.15	0.69
	<i>Total or Median</i>			<i>53,700</i>		<i>0.24</i>	<i>0.78</i>
Small Cap							
Dorchester Hugoton, Ltd.*	DHULZ	13.92	10.7	150	12.20	-	1.14
Cross Timbers Royalty Tr*	CRT	17.03	6.0	102	16.80	-	1.01
San Juan Basin Royalty Tr*	SJT	13.71	46.6	640	14.90	-	0.92
Encore Acquisition Corporation	EAC	14.85	30.0	450	16.40	0.15	0.92
Penn Virginia Corporation	PVA	36.11	8.8	320	44.20	0.00	0.82
Hugoton RoyaltyTrust*	HGT	12.05	40.0	480	15.40	-	0.78
Energy Partners Ltd.*	EPL 2	10.95	27.0	300	16.10	0.08	0.70
	<i>Total or Median</i>			<i>2,440</i>		<i>-</i>	<i>0.92</i>
Micro Cap							
Purcell Energy, Ltd. (US\$)	PEL.TO	2.43	26.0	63	3.70	0.07	0.69

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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Mid Cap and Small Cap Energy Companies
Rank by EV/Ebitda: Enterprise Value to Earnings Before Interest, Tax, Deprec.

	<i>Symbol</i>	<i>Price (\$/sh)</i> <i>3-Aug 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>
Power							
Consol Energy Inc.	CNX	23.80	2.0	7.5	8	4.7	7.0
CMS Energy Corporation	CMS	25.19	0.9	7.4	9	5.8	7.0
Sempra Energy	SRE	26.35	1.2	7.4	10	3.8	7.0
Constellation Energy Group	CEG	30.60	1.8	6.3	10	1.6	7.0
	<i>Median</i>		<i>1.5</i>	<i>7.4</i>	<i>9</i>	<i>4.3</i>	<i>7.0</i>
Natural Gas and Oil							
TEPPCO Partners, L.P.	TPP	31.00	0.7	11.8	16	6.8	8.0
Triton Energy Limited	OIL	44.87	6.3	9.8	24	-	6.0
Valero Energy Corp.(with UDS)	VLO	35.60	0.3	6.3	5	0.9	6.0
Ocean Energy, Inc.	OEI	19.68	3.5	5.6	12	0.8	6.0
Unocal Corporation	UCL	35.59	1.7	4.6	13	2.2	6.0
PanCanadian Pete (15%)(US\$)	PCP.TO	28.12	1.2	4.3	7	0.9	5.5
Petro-Canada	PCZ	25.61	1.0	4.1	9	1.1	5.5
Marathon Oil Corporation	MRO 1	29.60	0.4	3.9	7	3.1	5.0
Norsk Hydro ASA (49%)	NHY	42.04	0.8	3.7	8	2.5	5.0
Devon Energy Corporation	DVN	51.90	2.7	3.5	7	0.4	5.0
PetroChina Company Ltd (10%)	PTR 2	20.69	1.5	2.8	5	8.3	4.0
	<i>Median</i>		<i>1.2</i>	<i>4.3</i>	<i>8</i>	<i>1.1</i>	<i>5.5</i>
Small Cap							
Dorchester Hugoton, Ltd.*	DHULZ	13.92	7.9	10.6	12	7.8	9.2
Cross Timbers Royalty Tr*	CRT	17.03	6.1	9.9	10	9.6	9.7
San Juan Basin Royalty Tr*	SJT	13.71	6.7	8.6	12	8.6	9.3
Hugoton RoyaltyTrust*	HGT	12.05	5.0	7.3	10	10.0	9.3
Encore Acquisition Corporation	EAC	14.85	3.7	5.5	13	-	6.0
Penn Virginia Corporation	PVA	36.11	3.5	4.9	11	2.5	6.0
Energy Partners Ltd.*	EPL 2	10.95	2.2	4.0	31	-	5.7
	<i>Median</i>		<i>5.0</i>	<i>7.3</i>	<i>12</i>	<i>7.8</i>	<i>9.2</i>
Micro Cap							
Purcell Energy, Ltd. (US\$)	PEL.TO	2.43	3.2	4.1	14	-	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

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