

## ***Meter Reader***

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

August 13, 2001

# **Lesson from 1974**

## **Summary and Recommendation**

By analogy with 27 years ago a widely anticipated natural gas price decline for the next few months may not materialize and stock prices for natural gas producers may be higher at year-end than today. Then as now the economy was struggling after an energy price increase. Then as now government officials were ranting against energy producers with the Secretary of the Treasury calling for a \$2 -3 per barrel reduction in the \$10 price of crude oil. Oil producers adjusted volume, the price held, the economy started to recover and energy investors were rewarded. 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)**. We add **PanCanadian Petroleum Ltd. (PCP.TO)** to the Buy list although taxable investors might wait to buy shares that will not have 10% of value immediately returned in the form of a cash dividend. Our Sell is **Calpine Corporation (CPN)** (see Tables L-1, L-2, S-1, S-2).

## **The Oil Price Scare of 1974**

Recall that crude oil price more than tripled in late 1973. By 1974, the economy was in recession. In the summer of 1974, then Secretary of the Treasury, the late William E. Simon, a former bond trader, publicly estimated a \$2 - 3 per barrel price reduction. Domestic oil stocks that had traded up to \$1.50 per barrel in the ground in early 1974 were back down to \$1.10 per barrel in the ground in the summer of 1974.

Secretary Simon's call coincided with the markdown in oil stocks that had already occurred. When the oil price did not weaken as forecast, oil stock prices recovered to begin a long march upward for the next six years.

## **Natural Gas in 2001 Parallels Oil in 1974**

We see a parallel in natural gas today. Price more than tripled in late 2000 and early 2001 (see chart). Now in mid 2001 the economy is in a form of recession. Some traders are looking for natural gas price to decline perhaps 25% from here in the next several months. Natural gas stock, Burlington Resources, traded as high as \$1.40 per mcf in the ground in early 2001 and is now back down to \$1.10 in the summer of 2001.

The real question then was "What is the fundamental value of oil?" Our conviction then was that U.S. oil at \$3 per barrel above ground was greatly undervalued and U.S. natural gas more so at a tiny fraction of the oil equivalent.

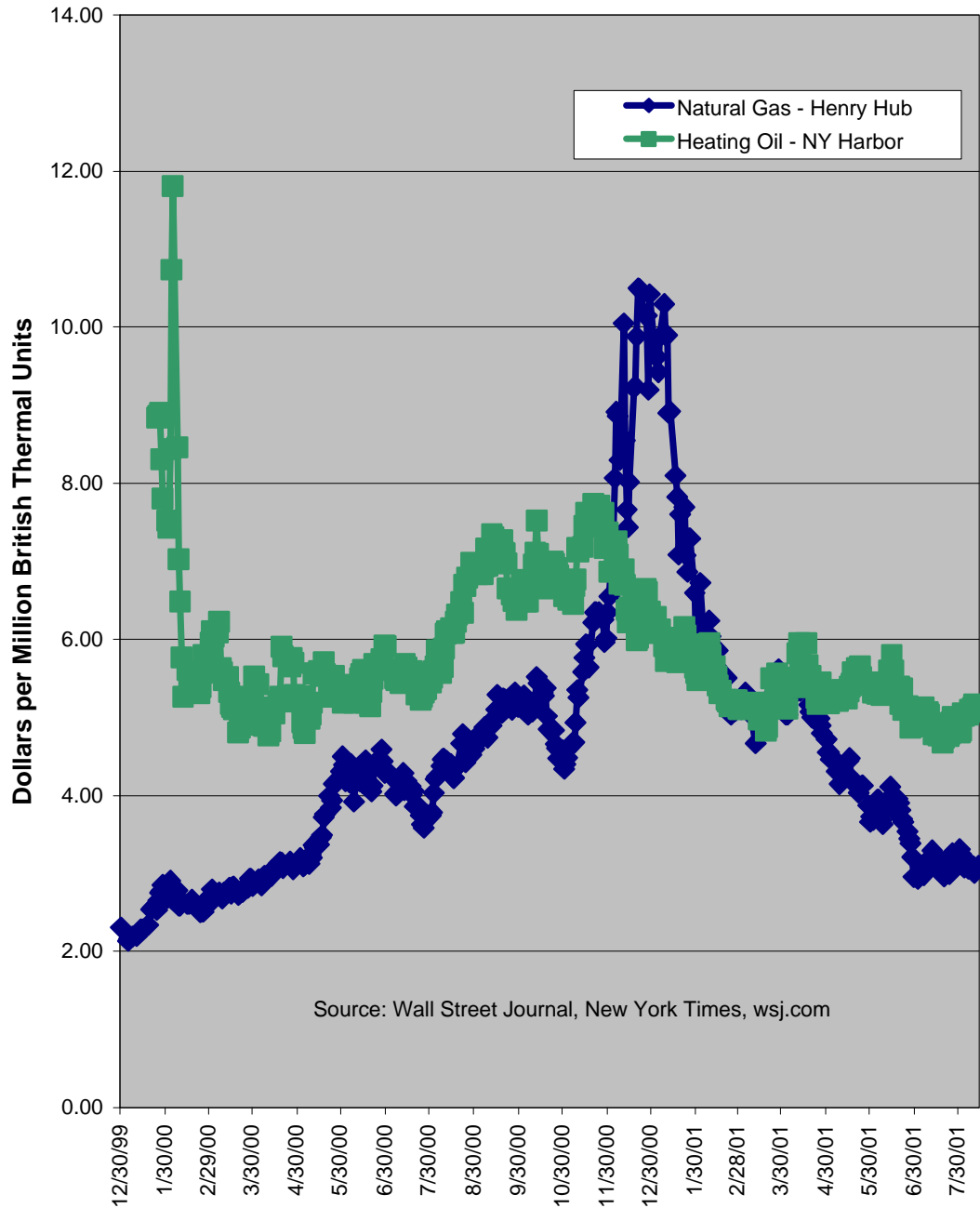
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### Natural Gas and Heating Oil



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The real question today is "What is the fundamental value of natural gas?" Our conviction is that natural gas at \$3 per mcf is strongly undervalued because it is selling for 60% of the heating oil equivalent.

Like Secretary Simon's call in 1974, current calls for lower natural gas price the next few months coincide with declines in stock prices that have already taken place. We are confident that energy stocks are at price levels that are attractive for purchase relative to the gains we anticipate in the next several years.

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) 10-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>
<b>Mega Cap</b>							
Exxon Mobil Corporation	XOM	41.35	7,020	290,000	37.10	0.09	1.10
Chevron (incl. Texaco)	CHV	91.75	1,064	97,600	84.00	0.17	1.08
BP PLC	BP	50.92	3,720	189,000	48.90	0.17	1.04
TOTAL Fina Elf S.A.	TOT	70.75	1,400	99,000	72.00	0.16	0.99
Royal Dutch/Shell	RD	55.10	3,580	197,000	60.80	0.09	0.91
	<i>Total or Median</i>			<i>873,000</i>		<i>0.16</i>	<i>1.04</i>
<b>Power</b>							
Calpine Corporation	CPN 4	32.09	318	10,200	9.90	0.69	1.70
Enron Corp.	ENE	42.81	891	38,100	15.00	0.69	1.58
Dynegy Inc.	DYN	44.59	338	15,100	20.60	0.56	1.52
Mirant Corporation	MIR	31.10	353	11,000	12.70	0.73	1.39
Duke Energy Corporation	DUK	37.97	779	29,600	19.90	0.62	1.35
AES Corporation	AES	35.57	538	19,100	17.40	0.71	1.30
Williams Companies	WMB	32.37	485	15,700	16.60	0.69	1.29
El Paso Corporation	EPG	46.37	521	24,200	30.00	0.57	1.23
American Electric Power Co. Inc.	AEP 2	45.24	324	14,700	25.90	0.73	1.20
Southern Company	SO	23.15	683	15,800	16.90	0.54	1.17
Exelon Corporation	EXC 2	55.33	324	17,900	55.30	0.51	1.00
	<i>Total or Median</i>			<i>211,000</i>		<i>0.69</i>	<i>1.30</i>
<b>Natural Gas and Oil</b>							
Occidental Petroleum	OXY	27.44	370	10,200	35.60	0.46	0.88
Anadarko Petroleum Corp.	APC	55.20	263	14,500	66.30	0.24	0.87
Phillips (incl. Tosco)	P	57.94	383	22,200	75.90	0.31	0.84
Burlington Resources, Inc	BR 1	40.50	215	8,700	54.90	0.17	0.78
ENI S.p.A.	E	63.05	800	50,500	91.90	0.10	0.72
Conoco Inc.	COC.B	29.83	623	18,600	48.00	0.21	0.70
	<i>Total or Median</i>			<i>125,000</i>		<i>0.22</i>	<i>0.81</i>
<b>Service</b>							
Baker Hughes Inc.	BHI	33.39	338	11,300	24.50	0.13	1.32
Schlumberger Ltd.	SLB	49.54	581	28,800	37.70	0.14	1.27
Halliburton Company	HAL	31.50	430	13,500	27.20	0.13	1.13

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

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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) 10-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>
<b>Mega Cap</b>							
	XOM	41.35	1.5	7.7	15	2.1	7.0
	CHV	91.75	1.2	7.5	16	2.8	7.0
	BP	50.92	1.3	7.2	12	2.7	7.0
	TOT	70.75	1.1	6.9	16	1.6	7.0
	RD	55.10	1.4	6.4	14	2.5	7.0
	<i>Median</i>		<i>1.3</i>	<i>7.2</i>	<i>15</i>	<i>2.5</i>	<i>7.0</i>
<b>Power</b>							
	ENE	42.81	0.3	15.8	22	1.2	10.0
	DYN	44.59	0.4	13.6	21	0.7	9.0
	CPN 4	32.09	2.4	11.9	17	-	7.0
	MIR	31.10	0.7	11.1	14	-	8.0
	DUK	37.97	0.9	10.8	15	2.9	8.0
	AES	35.57	3.7	10.4	17	-	8.0
	WMB	32.37	3.3	10.3	14	1.9	8.0
	EPG	46.37	0.6	8.6	14	1.8	7.0
	AEP 2	45.24	0.7	8.4	13	5.3	7.0
	SO	23.15	2.7	8.2	14	5.8	7.0
	EXC 2	55.33	2.4	7.0	12	3.1	7.0
	<i>Median</i>		<i>0.9</i>	<i>10.4</i>	<i>14</i>	<i>1.8</i>	<i>8.0</i>
<b>Natural Gas and Oil</b>							
	BR 1	40.50	4.4	7.0	31	1.4	9.0
	P	57.94	0.8	5.9	10	2.5	7.0
	OXY	27.44	1.3	5.3	8	3.6	6.0
	APC	55.20	2.3	5.2	9	0.4	6.0
	COC.B	29.83	0.6	4.2	8	2.5	6.0
	E	63.05	1.1	3.6	6	2.5	5.0
	<i>Median</i>		<i>1.2</i>	<i>5.2</i>	<i>9</i>	<i>2.5</i>	<i>6.0</i>
<b>Service</b>							
	BHI	33.39	2.1	10.5	24	1.4	8.0
	HAL	31.50	1.1	9.1	21	1.6	8.0
	SLB	49.54	2.6	8.9	25	1.5	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) 10-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>	
<b>Power</b>								
Consol Energy Inc.	CNX	23.30	79	1,800	19.70	0.65	1.06	
Sempra Energy	SRE	26.62	203	5,400	23.10	0.65	1.05	
CMS Energy Corporation	CMS	24.59	128	3,200	19.80	0.80	1.05	
Constellation Energy Group	CEG	30.01	152	4,600	37.10	0.45	0.89	
<i>Total or Median</i>				<i>15,000</i>		<i>0.65</i>	<i>1.05</i>	
<b>Natural Gas and Oil</b>								
Triton Energy Limited	OIL	44.92	59	2,700	24.50	0.24	1.64	
TEPPCO Partners, L.P.	TPP	31.30	38	1,190	13.20	0.65	1.48	
Valero Energy Corp.(with UDS)	VLO	34.68	110	3,800	30.80	0.63	1.05	
Ocean Energy, Inc.	OEI	19.39	177	3,400	21.90	0.27	0.92	
Marathon Oil Corporation	MRO	1	30.00	310	9,300	42.60	0.26	0.78
Petro-Canada	PCZ	25.17	267	6,700	33.00	0.08	0.78	
Unocal Corporation	UCL	35.20	256	9,000	51.90	0.27	0.77	
PanCanadian Petroleum (US\$)	PCP.TO	2	27.86	262	7,300	37.50	0.06	0.76
Norsk Hydro ASA (49%)	NHY	42.30	128	5,400	61.60	0.16	0.74	
Devon Energy Corporation	DVN	49.79	135	6,700	80.10	0.16	0.68	
PetroChina Company Ltd (10%)	PTR	2	20.24	176	3,600	32.50	0.15	0.68
<i>Total or Median</i>				<i>59,100</i>		<i>0.24</i>	<i>0.78</i>	
<b>Small Cap</b>								
Quicksilver Resources Inc.	KWK	16.65	19.3	320	10.80	0.59	1.22	
Dorchester Hugoton, Ltd.*	DHULZ	14.50	10.7	156	12.10	-	1.20	
Swift Energy Company	SFY	29.04	25.7	750	27.70	0.24	1.04	
Cross Timbers Royalty Tr*	CRT	17.05	6.0	102	16.70	-	1.02	
Encore Acquisition Corporation	EAC	14.75	30.0	440	16.40	0.15	0.91	
San Juan Basin Royalty Tr*	SJT	13.29	46.6	620	14.80	-	0.90	
Penn Virginia Corporation	PVA	36.00	8.8	320	44.20	0.00	0.82	
Hugoton RoyaltyTrust*	HGT	12.11	40.0	480	15.30	-	0.79	
Energy Partners Ltd.*	EPL	2	10.94	27.0	300	15.70	0.08	0.72
<i>Total or Median</i>				<i>3,490</i>		<i>0.00</i>	<i>0.91</i>	
<b>Micro Cap</b>								
Purcell Energy, Ltd. (US\$)	PEL.TO	2.27	26.0	59	3.70	0.07	0.65	

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

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

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<b>Power</b>								
	CNX	23.30	2.0	7.4	8	4.8	7.0	
	SRE	26.62	1.2	7.4	10	3.8	7.0	
	CMS	24.59	0.9	7.3	9	5.9	7.0	
	CEG	30.01	1.8	6.3	9	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>	
<b>Natural Gas and Oil</b>								
	TPP	31.30	0.7	11.8	16	6.7	8.0	
	OIL	44.92	6.3	9.8	24	-	6.0	
	VLO	34.68	0.3	6.3	5	0.9	6.0	
	OEI	19.39	3.5	5.5	12	0.8	6.0	
	PCZ	25.17	1.3	4.7	10	1.1	6.0	
	UCL	35.20	1.7	4.6	13	2.3	6.0	
	PCP.TO	2	27.86	1.1	4.2	7	1.0	5.5
	MRO	1	30.00	0.4	3.9	7	3.1	5.0
	NHY		42.30	0.8	3.7	8	2.5	5.0
	DVN		49.79	2.6	3.4	7	0.4	5.0
	PTR	2	20.24	1.4	2.7	5	8.4	4.0
	<i>Median</i>		<i>1.3</i>	<i>4.6</i>	<i>8</i>	<i>1.1</i>	<i>6.0</i>	
<b>Small Cap</b>								
	DHULZ		14.50	7.7	11.0	13	7.4	9.2
	KWK		16.65	4.9	11.0		-	9.0
	CRT		17.05	6.1	9.7	10	9.7	9.6
	SJT		13.29	6.4	8.2	11	9.1	9.1
	HGT		12.11	4.9	7.2	10	10.1	9.1
	SFY		29.04	4.7	6.2	15	-	6.0
	EAC		14.75	3.7	5.5	13	-	6.0
	PVA		36.00	3.5	4.9	11	2.5	6.0
	EPL	2	10.94	2.2	3.9	28	-	5.4
	<i>Median</i>			<i>4.9</i>	<i>7.2</i>	<i>12</i>	<i>2.5</i>	<i>9.0</i>
<b>Micro Cap</b>								
	PEL.TO		2.27	3.0	3.9	13	-	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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