

## Dutch Treat

### Summary and Recommendation

The market treated investors to an opportunity to buy **Royal Dutch/Shell (RD)** at a 15% lower price for the week ended September 21 and rewarded those investors who took the treat with a 14% higher price for the week ended September 28. We keep intact our new Buy recommendation released at the beginning of last week, although we now just expect the stock to perform in line with other Mega cap energy stocks from here. The second new Buy recommendation released a week ago, **San Juan Basin Royalty Trust (SJT)**, has not advanced in stock price since then, thereby continuing to offer the full potential we envisioned. Among our other recommendations for the energy portion of a diversified portfolio, Buy designations remain in place despite favorable relative performance for **American Electric Power (AEP)**, **PanCanadian Energy (PCX)** and **PetroChina (PTR)**. Buy recommendations having recent negative price performance that is unjustified in our view are **Exelon (EXC)** and **Energy Partners (EPL)**. Our Strong Buys remain **Marathon Oil (MRO)** and **Burlington Resources (BR)**. We keep our rating of Sell on **Calpine (CPN)** despite a steep decline in stock price. Look at the valuation tables for the relative positioning of recommended stocks and for possible alternatives (see Table L-1, L-2, S-1 and S-2).

### Mega Cap Discounted Sharply for a Week

Normally we eschew watching stock prices too closely. After all, our penchant is analysis, not trading. When we happened to catch a \$40 per share price on Royal Dutch, a stock that normally trades closer to \$60, we were stimulated to drop everything and get to work on a Buy recommendation. As it turns out, \$40 was gone by the end of the day leaving a closing price of \$44. A week later, the closing price is \$50.

Thus it paid to watch prices carefully. Yet we do not remember ever seeing a discount in Royal Dutch stock being closed so quickly. We remember a similar situation a few years ago in the same stock that unfolded over weeks and months. The experience also reminds us of the time BP dropped sharply more than a decade ago. While it was rewarding to commit to that company when it was temporarily out-of-favor, recovery was much slower than last week.

Nor could we be sure that RD stock would go up or that other Mega Caps would not go down instead. We were confident that the value of RD compared to **ExxonMobil (XOM)** could not have changed as much as it did in a short period of time. As it turned out, XOM held and RD went back up.

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## Meter Reader

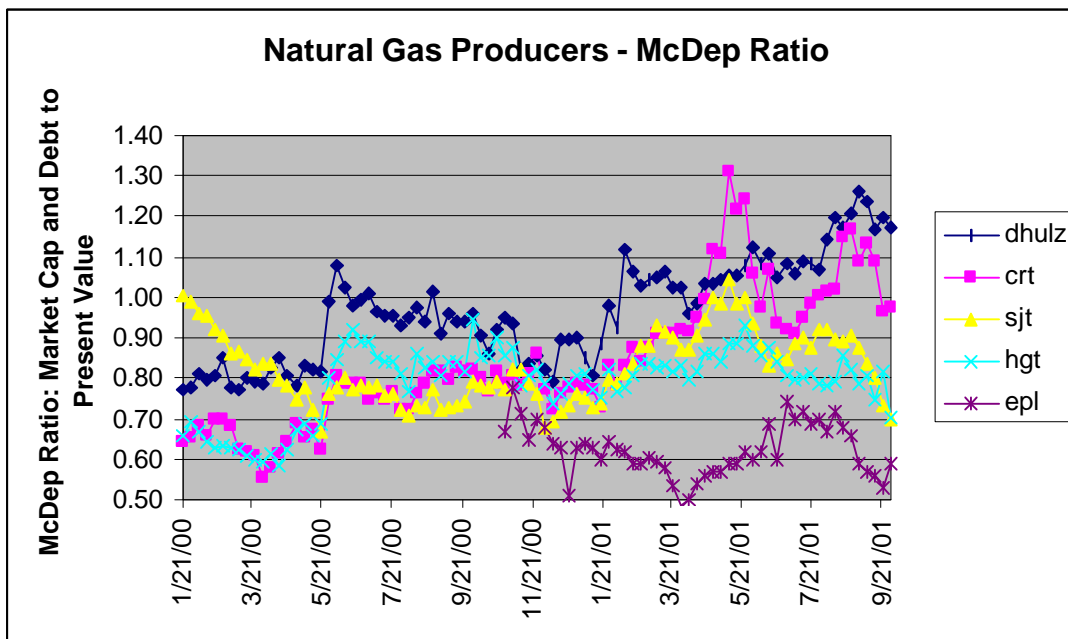
### A Weekly Analysis of Energy Stocks Using the McDep Ratio

October 1, 2001

Was it the legendary Gus Levy of Goldman Sachs who said he would rather be lucky than smart? It was smart to buy RD as a long-term investment. It was lucky to see so much appreciation in such a large stock in one week.

### San Juan Basin Royalty Trust is a Smart Choice

You can still get in our second recommendation of last week. We have been bidding our time all year to pick the moment to recommend the stock again. The trigger was a McDep Ratio falling below 0.8 (see Chart).



Although we have been analyzing the properties that became SJT since 1975, only in the past two years have we been doing a weekly calculation that compares present value of future cash flow to stock price. Since the trust has no debt, that ratio is the same as the McDep Ratio. When the McDep Ratio was below 0.8 in the past two years, the stock subsequently outperformed.

We think it is smart to buy a high quality, unique asset like SJT now, but will we also be lucky? We acknowledge we could be early as there are some low payouts likely in the months ahead. The smart answer is that what is known is in the stock. Yet we recognize that sometimes the market is inefficient and stocks still go down when known information is publicized.

The next few months' distributions are the main topic of conversation on the Yahoo message board for SJT. One casual estimate is that the October distribution will be \$0.06

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

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and November, \$0.02. Another estimate that apparently takes into account daily San Juan Basin natural gas prices is that October will be \$0.10 and November, \$0.054.

Not wishing to overemphasize monthly numbers, we estimate a distribution of \$0.14 for the next three months. Our real distribution focus is on the next twelve months for which our projection is now \$0.84 per unit, down from \$0.90 last week. We think the important question is not what the distribution will be in the next few months, but what will futures prices at any time imply for distributions further out. Even then we will want to make our own judgment as to whether the markets make sense.

Our judgment is that SJT is attractive for new commitments now. Save some buying power in case short-term developments have a temporary negative impact.

### **Energy Stocks Oversold Off the Mark for a Day**

Our theme for last week's Meter Reader referred to the observation that energy stock prices were down more after September 11 than were energy commodity prices. Then on Monday oil for immediate delivery dropped by the largest amount in ten years. Yet by the end of the week, spot oil made up half its decline. Oil for delivery any time after June 2004 was actually up on the week.

Energy Stocks Oversold was a simple conclusion to make on a mechanical basis. Yet what we were doing was comparing two volatile markets, the stock market and the commodities market, neither of which always acts sensibly. As a result weekly comparisons will be volatile as well. More important, we should keep the broader trend in mind.

### **"Energy has Never Been More Valuable Than Now"**

A friend of many years who has always been supportive of our work felt compelled last week to call with his strong feelings about energy. This person has always been partial to energy and in the last two years has been vociferous on the risks in the stock market in general.

Our friend is greatly concerned about instability in the oil producing countries and further terrorist threats. He reminds us of the strong extremist element in Saudi Arabia, the largest oil producer in the Middle East. He further frets about the risks to nuclear power. In that context, our friend finds it hard to understand how investors can be dumping energy stocks, particularly publicly traded oil and gas producers and most particularly North American natural gas producers.

Our friend's call was well timed at least on a short-term basis. Most energy stocks along with crude oil rallied at the end of the week.

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No one can assure us that all will be well in the world. If we make intelligent investments in energy stocks we will also be gaining some insurance against a possible adverse combination of political and human circumstances. Yet we do not need suffering to justify our recommendations.

#### **New Standard of Present Value: 9.0 Times Ebitda**

With the continual changes in energy futures, we have revised our estimates of cash flow (earnings before interest, tax, depreciation and amortization) for the next twelve months. We have new estimates for most oil and gas producers, but keep the old estimates for power and service companies. New cash flow estimates trigger new estimates of the present value of all future cash flow.

Present value for five natural gas producers amounts to a median near 12 times Ebitda according to rigorous weekly calculation. The multiple appears high because natural gas is now depressed and the median of the five producers has a long-life.

Present value for all other stocks is estimated as a multiple of cash flow. The standard, or default multiple, is that for the Mega Cap energy companies, currently about 9.0 years. We extend that multiple to all the Mega and Large Cap stocks (see far right hand column, Table L-2). For Mid, Small and Micro Cap stocks we adjust that multiple where warranted for factors like recent discoveries, reserve life, government control and accounting considerations (see Table S-2).

The importance of present value is that it is the denominator of the McDep Ratio and the Debt/PV ratio, our prime measures of valuation and financial risk. We choose Buy recommendations from stocks with low McDep Ratios and we adjust our recommended size of investment using Debt/PV.

#### **Some Stock Market Values: 7.0 and 5.0 Times Ebitda**

We see undervaluation in Large Cap Natural Gas and Oil and Mid Cap Natural Gas and Oil where the groups are trading at under 7.0 times Ebitda and just over 5.0 times respectively. At a median McDep Ratio of 0.96, Mega Caps are trading at slightly less than 9.0 times Ebitda. At a median McDep Ratio of 1.02, Large Cap Power stocks are trading at slightly more than 9.0 times Ebitda.

Kurt H. Wulff, CFA

## Meter Reader

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

October 1, 2001

**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) 28-Sep 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	39.40	6,963	274,000	38.60	0.04	1.02
Royal Dutch/Shell	RD 2	50.25	3,544	178,000	50.80	0.06	0.99
BP PLC	BP	49.17	3,744	184,000	51.50	0.15	0.96
Chevron (incl. Texaco)	CHV	84.75	1,063	90,100	92.00	0.16	0.93
TOTAL Fina Elf S.A.	TOT	67.55	1,406	95,000	86.80	0.14	0.81
	<i>Total or Median</i>			<i>821,000</i>		<i>0.14</i>	<i>0.96</i>
<b>Power</b>							
Enron Corp.	ENE	27.23	891	24,300	10.20	0.76	1.40
Dynegy Inc.	DYN	34.65	338	11,700	20.60	0.56	1.30
Duke Energy Corporation	DUK	37.85	779	29,500	26.40	0.55	1.19
Calpine Corporation	CPN 4	22.81	318	7,300	18.90	0.54	1.10
Williams Companies	WMB	27.30	485	13,200	23.30	0.62	1.06
Mirant Corporation	MIR	21.90	353	7,700	18.60	0.65	1.06
American Electric Power Co. Inc.	AEP 2	43.23	322	13,900	46.40	0.61	0.97
Southern Company	SO	23.98	683	16,400	27.40	0.42	0.93
El Paso Corporation	EPG	41.55	532	22,100	48.60	0.47	0.92
Dominion Resources	D	59.35	247	14,600	79.40	0.45	0.86
AES Corporation	AES	12.82	538	6,900	24.80	0.63	0.82
Exelon Corporation	EXC 2	44.60	324	14,500	87.40	0.39	0.70
	<i>Total or Median</i>			<i>182,000</i>		<i>0.56</i>	<i>1.02</i>
<b>Natural Gas and Oil</b>							
Occidental Petroleum	OXY	24.34	372	9,100	32.20	0.46	0.87
Burlington Resources, Inc	BR 1	34.21	211	7,200	48.50	0.19	0.76
Phillips (incl. Tosco)	P	53.94	383	20,600	82.70	0.28	0.75
Anadarko Petroleum Corp.	APC	48.08	268	12,900	73.70	0.21	0.72
ENI S.p.A.	E	61.10	789	48,200	99.20	0.15	0.67
Conoco Inc.	COC.B	25.34	636	16,100	54.80	0.26	0.60
	<i>Total or Median</i>			<i>114,000</i>		<i>0.24</i>	<i>0.74</i>
<b>Service</b>							
Baker Hughes Inc.	BHI	28.95	338	9,800	24.50	0.13	1.16
Schlumberger Ltd.	SLB	45.70	581	26,600	44.00	0.12	1.04
Halliburton Company	HAL	22.55	430	9,700	27.20	0.13	0.85

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) 28-Sep 2001</i>	<i>EV/ Sales 2001E</i>	<i>EV/ Ebitda NTM</i>	<i>P/E NTM</i>	<i>Dividend or Distribution NTM (%)</i>	<i>PV/ Ebitda NTM</i>	
<b>Mega Cap</b>								
	XOM	39.40	1.3	9.2	19	2.3	9.0	
	Royal Dutch/Shell	RD 2	50.25	1.1	8.9	20	2.8	9.0
	BP PLC	BP	49.17	1.1	8.7	19	2.7	9.0
	Chevron (incl. Texaco)	CHV	84.75	1.1	8.4	19	3.1	9.0
	TOTAL Fina Elf S.A.	TOT	67.55	1.3	7.3	14	2.7	9.0
	<i>Median</i>		<i>1.1</i>	<i>8.7</i>	<i>19</i>	<i>2.7</i>	<i>9.0</i>	
<b>Power</b>								
	Enron Corp.	ENE	27.23	0.3	12.6	14	1.8	9.0
	Dynegy Inc.	DYN	34.65	0.3	11.7	17	0.9	9.0
	Duke Energy Corporation	DUK	37.85	0.9	10.7	15	2.9	9.0
	Calpine Corporation	CPN 4	22.81	2.0	9.9	12	-	9.0
	Williams Companies	WMB	27.30	3.1	9.6	12	2.2	9.0
	Mirant Corporation	MIR	21.90	0.6	9.5	10	-	9.0
	American Electric Power Co. Inc.	AEP 2	43.23	0.6	8.8	12	5.6	9.0
	Southern Company	SO	23.98	2.8	8.4	15	5.6	9.0
	El Paso Corporation	EPG	41.55	0.8	8.3	12	2.0	9.0
	Dominion Resources	D	59.35	3.4	7.7	14	4.3	9.0
	AES Corporation	AES	12.82	2.6	7.4	6	-	9.0
	Exelon Corporation	EXC 2	44.60	2.2	6.3	10	3.8	9.0
	<i>Median</i>		<i>1.4</i>	<i>9.2</i>	<i>12</i>	<i>2.1</i>	<i>9.0</i>	
<b>Natural Gas and Oil</b>								
	Occidental Petroleum	OXY	24.34	1.4	7.8	13	4.1	9.0
	Burlington Resources, Inc	BR 1	34.21	4.0	6.8	43	1.6	9.0
	Phillips (incl. Tosco)	P	53.94	0.7	6.7	13	2.7	9.0
	Anadarko Petroleum Corp.	APC	48.08	2.4	6.5	16	0.4	9.0
	ENI S.p.A.	E	61.10	1.5	6.1	12	3.0	9.0
	Conoco Inc.	COC.B	25.34	0.8	5.4	11	3.0	9.0
	<i>Median</i>			<i>1.5</i>	<i>6.6</i>	<i>13</i>	<i>2.8</i>	<i>9.0</i>
<b>Service</b>								
	Baker Hughes Inc.	BHI	28.95	1.9	9.3	20	1.6	9.0
	Schlumberger Ltd.	SLB	45.70	2.4	8.3	23	1.6	9.0
	Halliburton Company	HAL	22.55	0.8	6.8	15	2.2	9.0

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

October 1, 2001

**Table S-1**  
**Mid Cap and Small Cap Energy Companies**  
**Rank by McDep Ratio: Market Cap and Debt to Present Value**

	Symbol/ Rating	Price (\$/sh) 28-Sep 2001	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio	
<b>Power</b>								
Consol Energy Inc.	CNX	21.43	79	1,700	35.90	0.51	0.80	
Sempra Energy	SRE	24.75	203	5,000	41.70	0.50	0.80	
CMS Energy Corporation	CMS	20.00	128	2,600	48.30	0.62	0.78	
Constellation Energy Group	CEG	24.20	152	3,700	56.50	0.35	0.63	
<i>Total or Median</i>				13,000		0.51	0.79	
<b>Natural Gas and Oil</b>								
Ocean Energy, Inc.	OEI	16.30	178	2,900	20.60	0.29	0.85	
Valero Energy Corp.(with UDS)	VLO	35.10	110	3,900	54.50	0.49	0.82	
Unocal Corporation	UCL	32.50	257	8,400	44.90	0.31	0.81	
PanCanadian Energy	PCX_w	2	24.00	262	6,290	32.10	0.14	0.78
Norsk Hydro ASA (49%)	NHY	36.40	127	4,600	51.90	0.19	0.76	
Petro-Canada	PCZ	24.55	267	6,600	34.40	0.08	0.74	
Devon Energy (incl MND,AXN)	DVN	34.40	165	5,700	65.50	0.39	0.71	
PetroChina Company Ltd (10%)	PTR	2	19.18	176	3,400	31.70	0.14	0.66
Marathon Oil Corporation	MRO	1	26.75	310	8,300	55.00	0.22	0.60
<i>Total or Median</i>				50,100		0.22	0.76	
<b>Small Cap</b>								
Quicksilver Resources Inc.	KWK	13.60	19.3	260	5.50	0.73	1.39	
Encore Acquisition Corp. (25%)	EAC	15.00	7.5	113	15.60	0.16	0.97	
Southwestern Energy Company	SWN	11.85	25.7	310	13.90	0.48	0.92	
Spinnaker Exploration Company	SKE	35.38	28.4	1,010	38.60	-	0.92	
Louis Dreyfus Natural Gas Corp.	LD	3	38.90	44.8	1,740	45.10	0.23	0.89
XTO Energy Inc.	XTO	13.95	123.0	1,720	17.70	0.29	0.85	
Penn Virginia Corporation	PVA	28.15	8.8	250	47.70	0.19	0.67	
Forest Oil Corporation	FST	24.80	50.2	1,250	42.90	0.21	0.67	
Newfield Exploration Company	NFX	29.20	49.3	1,440	49.50	0.17	0.66	
Swift Energy Company	SFY	20.62	25.7	530	37.40	0.19	0.64	
Stone Energy Company	SGY	32.20	26.5	850	54.60	0.09	0.63	
<i>Total or Median</i>				9,470		0.19	0.85	
<b>Trusts and Partnerships</b>								
TEPPCO Partners, L.P.	TPP	32.00	38	1,220	13.20	0.65	1.50	
Dorchester Hugoton, Ltd.	DHULZ	12.80	10.7	137	10.90	-	1.17	
Cross Timbers Royalty Trust	CRT	16.30	6.0	98	16.70	-	0.98	
San Juan Basin Royalty Trust	SJT	2	10.32	46.6	480	14.80	-	0.70
Hugoton RoyaltyTrust	HGT	9.95	40.0	400	14.20	-	0.70	
<i>Total or Median</i>				2,340		-	0.98	
<b>Micro Cap</b>								
Abraxas Petroleum Corporation	ABP	1.93	23.6	46	0.90	0.94	1.08	
Purcell Energy, Ltd. (US\$)	PEL.TO	1.82	26.6	49	3.10	0.10	0.63	
Energy Partners Ltd.(30%)	EPL	2	6.98	8.1	56	12.70	0.09	0.59

Buy/Sell rating after symbol: 1 - Strong Buy, 2 - Buy, 3 - Neutral

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October 1, 2001

Table S-2

#### Mid Cap and Small Cap Energy Companies

Rank by EV/Ebitda: Enterprise Value to Earnings Before Interest, Tax, Deprec.

	Symbol/ Rating	Price (\$/sh) 28-Sep 2001	EV/ Sales 2001E	EV/ Ebitda NTM	P/E NTM	Dividend or Distribution NTM (%)	PV/ Ebitda NTM		
<b>Power</b>									
	Consol Energy Inc.	CNX	21.43	2.0	7.2	7	5.2	9.0	
	Sempra Energy	SRE	24.75	1.1	7.2	10	4.0	9.0	
	CMS Energy Corporation	CMS	20.00	0.8	7.0	7	7.3	9.0	
	Constellation Energy Group	CEG	24.20	1.6	5.7	8	2.0	9.0	
	<i>Median</i>			<i>1.4</i>	<i>7.1</i>	<i>7</i>	<i>4.6</i>	<i>9.0</i>	
<b>Natural Gas and Oil</b>									
	Unocal Corporation	UCL	32.50	2.4	6.5	25	2.5	8.0	
	Ocean Energy, Inc.	OEI	16.30	3.7	6.0	18	1.0	7.0	
	Valero Energy Corp.(with UDS)	VLO	35.10	0.3	5.7	5	0.9	7.0	
	PanCanadian Energy	PCX_w	2	24.00	1.1	5.5	11	1.1	7.0
	Petro-Canada	PCZ	24.55	1.3	5.2	12	1.0	7.0	
	Devon Energy (incl MND,AXN)	DVN	34.40	2.7	5.0	15	0.6	7.0	
	Marathon Oil Corporation	MRO	1	26.75	0.4	4.2	8	3.4	7.0
	Norsk Hydro ASA (49%)	NHY	36.40	0.7	3.8	9	2.9	5.0	
	PetroChina Company Ltd (10%)	PTR	2	19.18	1.6	3.3	7	9.7	5.0
	<i>Median</i>			<i>1.3</i>	<i>5.2</i>	<i>11</i>	<i>1.1</i>	<i>7.0</i>	
<b>Small Cap</b>									
	Quicksilver Resources Inc.	KWK	13.60	5.6	19.4		-	14.0	
	Louis Dreyfus Natural Gas Corp.	LD	3	38.90	6.0	8.9	32	-	10.0
	Encore Acquisition Corp. (25%)	EAC	15.00	5.0	8.8	27	-	9.0	
	Southwestern Energy Company	SWN	11.85	2.6	8.3	167	-	9.0	
	Spinnaker Exploration Company	SKE	35.38	6.9	8.2	38	-	9.0	
	XTO Energy Inc.	XTO	13.95	4.9	7.7	20	0.3	9.0	
	Penn Virginia Corporation	PVA	28.15	3.8	5.4	8	3.2	8.0	
	Forest Oil Corporation	FST	24.80	2.1	5.3	29	-	8.0	
	Swift Energy Company	SFY	20.62	3.8	5.1	12	-	8.0	
	Newfield Exploration Company	NFX	29.20	3.6	4.6	19	-	7.0	
	Stone Energy Company	SGY	32.20	3.4	4.4	24	-	7.0	
	<i>Median</i>			<i>3.8</i>	<i>7.7</i>	<i>25</i>	<i>-</i>	<i>9.0</i>	
<b>Trusts and Partnerships</b>									
	Dorchester Hugoton, Ltd.	DHULZ	12.80	8.7	13.4	18	21.9	11.5	
	TEPPCO Partners, L.P.	TPP	32.00	0.7	12.0	16	6.6	8.0	
	Cross Timbers Royalty Trust	CRT	16.30	6.6	11.6	12	8.0	11.9	
	San Juan Basin Royalty Trust	SJT	10.32	6.4	8.5	12	8.1	12.1	
	Hugoton RoyaltyTrust	HGT	9.95	5.1	8.1	12	8.1	11.6	
	<i>Median</i>			<i>6.4</i>	<i>11.6</i>	<i>12</i>	<i>8.1</i>	<i>11.6</i>	
<b>Micro Cap</b>									
	Abraxas Petroleum Corporation	ABP	1.93	6.5	11.8		-	11.0	
	Energy Partners Ltd.(30%)	EPL	2	6.98	1.8	3.9	-	6.7	
	Purcell Energy, Ltd. (US\$)	PEL.TO	1.82	2.7	3.8	10	-	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

Analyses are prepared from original sources and data believed to be reliable, but no representation is made as to their accuracy or completeness. Independent energy analysis by Kurt Wulff doing business as McDep Associates is accessible at <http://www.mcdep.com>. Owning shares in energy stocks, neither Mr. Wulff nor his spouse act contrary to a buy or sell rating. Mr. Wulff is not paid by covered companies.