

Meter Reader

A Weekly Analysis of Energy Stocks Using the McDep Ratio

December 17, 2001

Calpine Collapses from Sell to Neutral

Summary and Recommendation

A formerly high McDep Ratio stock, Calpine (CPN), is now near a median McDep Ratio stock within its group. Therefore, we revise our rating on Calpine from Sell to Neutral. There may still be stock price vulnerability as the *New York Times* has called attention to the company's accounting and Moody's has downgraded the company's debt to junk status. Noting the Calpine experience and how dramatically stock prices have declined for other once high McDep Ratio stocks, we searched for issues that may have similar vulnerability. As a result, we added three new interconnected stocks to our Large Cap Power category. Rated Strong Sell, those stocks are **Kinder Morgan, Inc. (KMI)**, **Kinder Morgan Energy Partners, L.P. (KMP)** and **Kinder Morgan Management, LLC (KMR)**. A detailed analysis has been sent to clients and will be posted on www.mcdep.com in about a week. Meanwhile, seeing western markets lead energy prices up the past week, we plot prices for electricity, natural gas and refining margins. For ideas to build a diversified energy portfolio see our valuation ranking of 64 stocks (Tables L-1, L-2, S-1 and S-2).

Unwind Recommended Pair Trade of Calpine and Exelon

Calpine stock hit its all-time high of \$58 in March. Our coverage started with CPN's closing price of \$54 on May 4, 2001. The initial McDep Ratio on CPN was a high 1.78. It was not until August 6 that we completed a Sell analysis. Though our thesis was a long-term one that the company was short natural gas for its generators, we also questioned the company's reported growth in profits.

Our revised rating on Calpine also applies to half of the pair trade in which we recommended the sale of Calpine and purchase of **Exelon (EXC)** (see *Meter Reader*, November 5, 2001). Gratefully, both sides worked. Our Buy recommendation continues for EXC, the lowest McDep Ratio stock in the Large Cap Power group.

Not all recommendations work out as well as CPN did. The historical record of our research is on www.mcdep.com (for past commentary on CPN, click on Stock Ideas and then click on CPN)

Western Energy Markets Turn Up

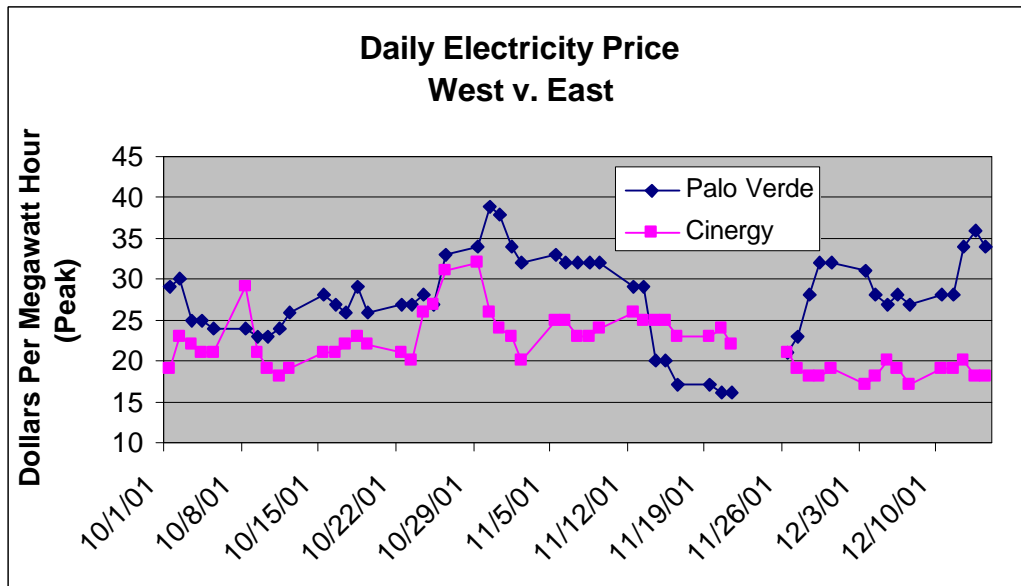
While the eastern part of our country has been warm, the western part has apparently been cooling down as it usually does with the approaching winter. Daily electricity prices reflect a stronger market in the West than in the East (see Chart).

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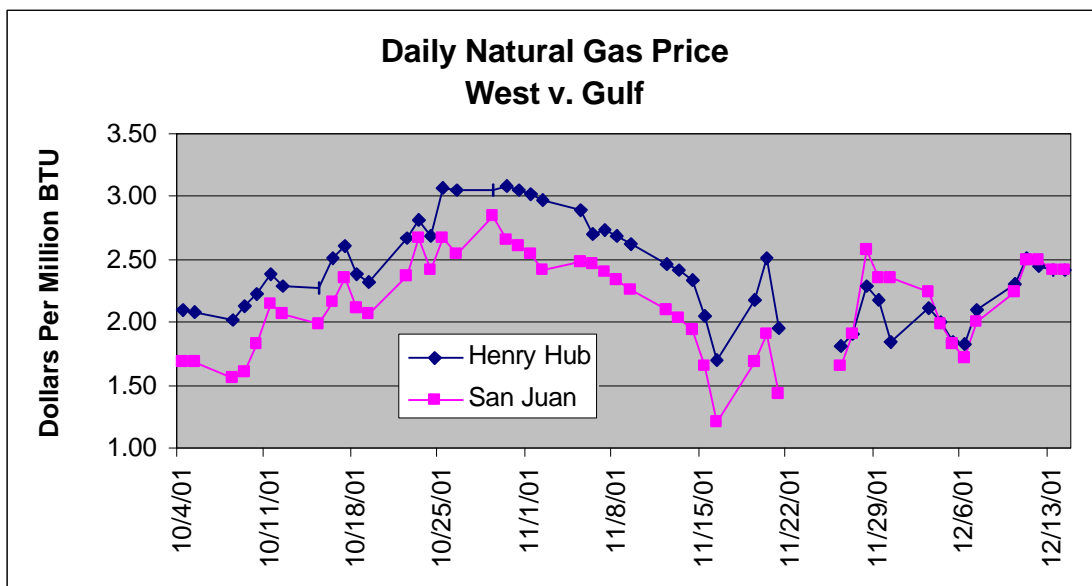
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The upturn in western electricity, as represented by Palo Verde prices, has been evident since the Thanksgiving break. Eastern electricity, represented by Cinergy prices, has drifted to minimal levels where only low cost coal and nuclear plants generate meaningful cash.

Higher western power prices also imply higher western natural gas prices. Also since the Thanksgiving break, western natural gas as represented by San Juan has closed the gap with the main industry pricing point at the Henry Hub in Louisiana (see Chart).



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Meter Reader

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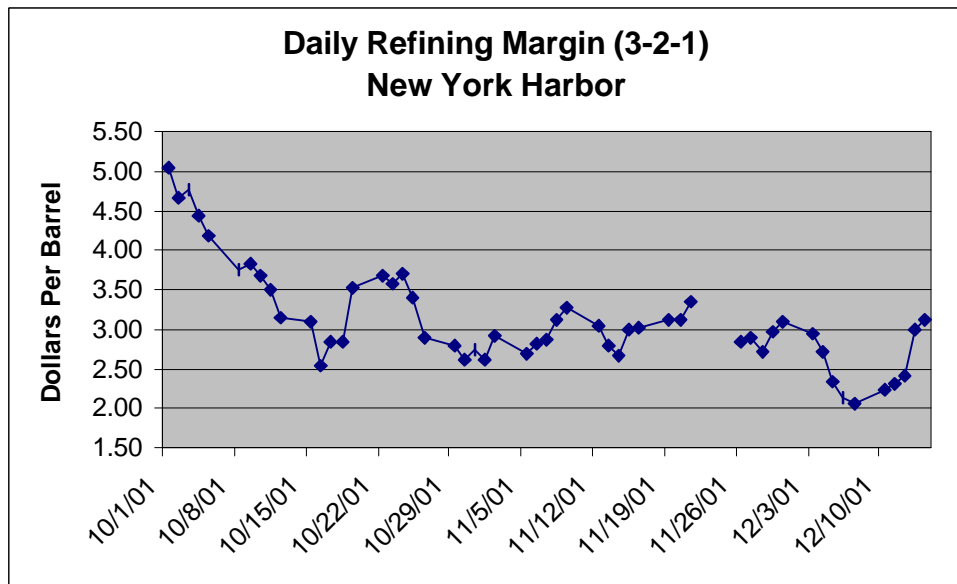
Divide the electricity price by 10 to get a rough natural gas equivalent for old, less efficient natural powered generators. That implies that the Palo Verde price at \$34 a megawatt-hour is exerting an upward pull on the San Juan price at about \$2.40 a million BTU's. Such a comparison in the East implies that less natural gas is needed for generating electricity because the Cinergy price at \$18 a mwh is under the equivalent of Henry Hub at about \$2.40 a mmbtu.

Strong pricing in the West is helpful for Strong Buy **Burlington Resources (BR)** and Buy recommended **PanCanadian Energy (PCX)**, **Forest Oil (FST)**, **San Juan Basin Royalty Trust (SJT)** and **Purcell Energy (PEL.TO)**.

Depressed Refining Margins Rebound on the Week

As one might expect with unusually low gasoline and heating oil prices, refiners are not making much money these days. Few companies are complaining yet because profits were good in recent seasons past. Since there is not a lot of excess refining capacity, particularly for cleaner products, more profitable days will return.

Our proxy for refining profits is the 3-2-1 margin (see Chart). That measure assumes purchase of three barrels of Light Sweet Crude and sale of two barrels of New York Harbor Unleaded Gasoline and one barrel of Heating Oil.



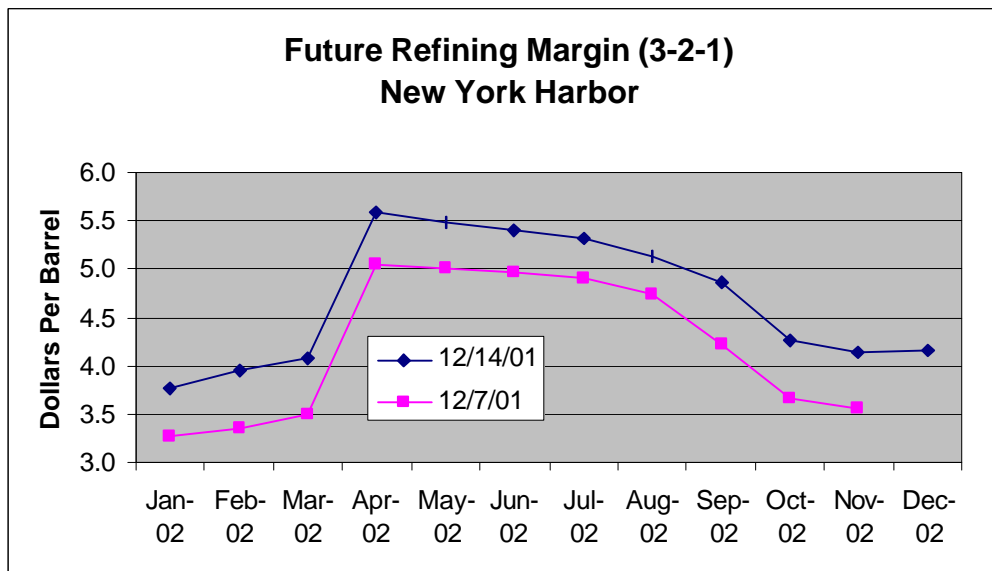
Thankfully for refiners, the low daily margins of a week ago have been temporary. Futures traded on the New York Mercantile Exchange imply more normal profits after the coming winter (see Chart).

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The whole futures curve moved up with daily margin in the past week. The shape of the futures curve implies the usual seasonal strength in the spring ahead of the summer gasoline season. The shape further implies that next winter, 2002-2003, will be more profitable than the current winter, 2001-2002.

Strong Buy **Marathon Oil (MRO)** is sensitive to refining margins. MRO's business is concentrated in the Midwest where recent profits have been greater than implied by New York Harbor prices. While perhaps one third of MRO's value is in refining/marketing, another third is in oil production and the final third in natural gas. The unique aspect of MRO is its imminent complete separation from Steel. The company then becomes a more attractive building block for a Mega Cap energy company or simply a more attractive stock without complicated corporate ownership.

Expect Royalty Trust Declarations About December 20

Royalty trust distributions are generally declared ten days before the last business day of the month. Investors can get an idea of expected monthly distribution from our estimates of quarterly amounts (see *Meter Reader Tables*, a separate weekly analysis). Last week we initiated estimates of monthly distribution for the largest of the three natural gas royalty trusts we cover, SJT.

Though we have an estimate of a low \$0.01 per unit for the next monthly declaration by the trustee of SJT, anything from \$0.00 to \$0.10 is possible. The additional disclosures about price, volume and costs will help tell the story. Note that our projection for the January declaration is back up to \$0.07.

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Fluctuating distributions give some investors pause as to the timing of an investment in SJT. We well remember months in the past decades when SJT sold below \$10. Bolstering concern on the negative side, warm weather and a weak economy are not good for natural gas prices. Yet, futures prices are far higher than in past periods of spot price weakness. Moreover, production volume for the properties in the trust is higher than at any time in fifty years. Finally, investors are more awash in liquidity than at any time in our lifetime. Even a low monthly payout is competitive with money market funds. Whatever SJT pays out, it is worth more in the extraordinarily low interest rate environment of today compared to decades past.

Those who prefer a predictable income payment might invest in the popular new master limited partnerships. For that predictability, investors take on much more financial risk and give away half the upside to the general partner.

Our no debt, low McDep Ratio, natural gas royalty trusts are among the best income investments we know. For a little bit of analysis there is a potentially bountiful payoff.

Kurt H. Wulff, CFA

Meter Reader

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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

	Symbol/ Rating		Price (\$/sh) 14-Dec 2001	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio
Mega Cap								
Exxon Mobil Corporation	XOM		36.86	6,924	255,000	36.00	0.09	1.02
BP plc	BP		44.12	3,738	165,000	47.00	0.16	0.95
Royal Dutch/Shell	RD	3	47.43	3,520	167,000	55.00	0.04	0.87
TotalFinaElf S.A.	TOT		65.04	1,382	90,000	80.00	0.15	0.84
ChevronTexaco Corporation	CVX		84.00	1,062	89,200	110.00	0.14	0.80
		<i>Total or Median</i>			766,000		0.14	0.87
Power								
Kinder Morgan Management, LLC	KMR	5	35.85	30	1,100	12.80	0.43	2.03
Kinder Morgan Energy Partners, L.P.	KMP	5	35.81	135	4,800	12.80	0.43	2.03
Kinder Morgan, Inc.	KMI	5	49.85	121	6,000	9.10	0.88	1.52
AES Corporation	AES		14.55	543	7,900	8.80	0.83	1.11
Dynegy Inc.	DYN		24.94	338	8,400	20.30	0.58	1.10
Calpine Corporation	CPN	3	13.20	377	5,000	12.50	0.66	1.02
Duke Energy Corporation	DUK		35.00	773	27,100	35.80	0.43	0.99
American Electric Power Co. Inc.	AEP	2	41.50	322	13,400	45.50	0.61	0.97
El Paso Corporation	EPG		40.23	532	21,400	44.80	0.49	0.95
Mirant Corporation	MIR		15.70	353	5,500	18.60	0.65	0.94
Southern Company	SO		23.27	683	15,900	27.40	0.42	0.91
Williams Companies	WMB		24.31	515	12,500	32.30	0.47	0.87
Dominion Resources	D		57.00	247	14,100	79.40	0.45	0.85
Exelon Corporation	EXC	2	46.03	323	14,900	78.60	0.42	0.76
		<i>Total or Median</i>			152,000		0.53	0.96
Natural Gas and Oil								
Occidental Petroleum Corp.	OXY		24.75	372	9,200	28.50	0.50	0.93
Unocal Corporation	UCL		33.26	257	8,500	38.90	0.35	0.90
ConocoPhillips	P		56.61	680	38,500	71.20	0.34	0.86
Anadarko Petroleum Corp.	APC		52.05	250	13,000	64.10	0.24	0.86
ENI S.p.A.	E		58.45	789	46,100	71.40	0.19	0.85
Devon Energy (incl MND,AXN)	DVN		33.92	165	5,600	54.60	0.48	0.80
Burlington Resources (incl HTR)	BR	1	35.50	205	7,300	53.00	0.30	0.77
Marathon Oil Corporation	MRO	1	27.85	310	8,600	42.00	0.27	0.75
OAo Lukoil	LUKOY		45.00	299	13,500	69.10	0.09	0.68
		<i>Total or Median</i>			141,000		0.28	0.83
Service								
Baker Hughes Inc.	BHI		34.72	338	11,700	24.50	0.13	1.36
Schlumberger Ltd.	SLB		52.00	581	30,200	44.00	0.12	1.16
Halliburton Company	HAL		12.99	429	5,600	24.90	0.12	0.58

Buy/Sell rating after symbol: 1-Strong Buy, 2-Buy, 3-Neutral, 4-Sell, 5-Strong 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/ Rating</i>	<i>Price (\$/sh) 14-Dec 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>	
Mega Cap								
Exxon Mobil Corporation	XOM	36.86	1.4	11.3	26	2.5	11.1	
BP plc	BP	44.12	1.2	10.3	19	3.0	10.8	
Royal Dutch/Shell	RD	3	47.43	1.1	9.5	24	3.0	10.9
TotalFinaElf S.A.	TOT	65.04	1.2	9.2	19	2.8	10.9	
ChevronTexaco Corporation	CVX	84.00	1.2	8.7	20	3.3	11.0	
	<i>Median</i>		<i>1.2</i>	<i>9.5</i>	<i>20</i>	<i>3.0</i>	<i>10.9</i>	
Power								
Kinder Morgan Management, LLC	KMR	5	35.85	5.6	18.3	24	6.1	9.0
Kinder Morgan Energy Partners, L.P.	KMP	5	35.81	5.5	18.3	24	6.1	9.0
Kinder Morgan, Inc.	KMI	5	49.85	6.8	13.7	25	0.4	9.0
AES Corporation	AES		14.55	3.5	10.0	11	-	9.0
Dynegy Inc.	DYN		24.94	0.5	9.9	12	1.2	9.0
Calpine Corporation	CPN	3	13.20	1.9	9.2	8	-	9.0
Duke Energy Corporation	DUK		35.00	0.8	8.9	13	3.1	9.0
American Electric Power Co. Inc.	AEP	2	41.50	0.6	8.7	11	5.8	9.0
El Paso Corporation	EPG		40.23	0.8	8.5	12	2.1	9.0
Mirant Corporation	MIR		15.70	0.5	8.5	7	-	9.0
Southern Company	SO		23.27	2.7	8.2	14	5.8	9.0
Williams Companies	WMB		24.31	2.4	7.8	10	3.3	9.0
Dominion Resources	D		57.00	3.3	7.6	13	4.5	9.0
Exelon Corporation	EXC	2	46.03	2.1	6.8	10	3.7	9.0
	<i>Median</i>			<i>2.3</i>	<i>8.8</i>	<i>12</i>	<i>3.2</i>	<i>9.0</i>
Natural Gas and Oil								
Occidental Petroleum Corp.	OXY		24.75	1.5	9.3	22	4.0	10.0
Anadarko Petroleum Corp.	APC		52.05	2.8	8.1	24	0.6	9.5
Unocal Corporation	UCL		17.11	2.6	7.7	61	2.4	8.5
ConocoPhillips	P		56.61	0.8	7.3	19	2.5	8.5
ENI S.p.A.	E		58.45	1.5	6.8	15	3.1	8.0
Burlington Resources (incl HTR)	BR	1	35.50	4.1	6.3	28	1.5	8.1
Devon Energy (incl MND,AXN)	DVN		33.92	3.1	5.6	16	0.6	7.0
Marathon Oil Corporation	MRO	1	27.85	0.4	4.9	10	3.3	6.5
OAOLukoil	LUKOY		45.00	1.2	4.1	9	2.4	6.0
	<i>Median</i>			<i>1.5</i>	<i>6.8</i>	<i>19</i>	<i>2.4</i>	<i>8.1</i>
Service								
Baker Hughes Inc.	BHI		34.72	2.2	10.9	24	1.3	9.0
Schlumberger Ltd.	SLB		52.00	2.7	9.3	26	1.4	9.0
Halliburton Company	HAL		12.99	0.5	4.6	10	3.8	9.0

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

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	Symbol/ Rating	Price (\$/sh) 14-Dec 2001	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio	
Power								
Consol Energy Inc.	CNX	22.54	79	1,800	35.90	0.51	0.82	
CMS Energy Corporation	CMS	22.73	128	2,900	48.30	0.62	0.80	
Sempra Energy	SRE	23.72	203	4,800	41.70	0.50	0.79	
Constellation Energy Group	CEG	25.20	152	3,800	56.50	0.35	0.64	
<i>Total or Median</i>				<i>13,300</i>		<i>0.51</i>	<i>0.79</i>	
Natural Gas and Oil								
Murphy Oil Corporation	MUR	77.75	46	3,600	82.00	0.18	0.96	
Ocean Energy, Inc.	OEI	17.99	178	3,200	20.00	0.30	0.93	
Imperial Oil Limited (30%)	IMO	27.35	119	3,300	30.00	0.11	0.92	
Norsk Hydro ASA (49%)	NHY	40.04	127	5,100	54.00	0.18	0.79	
Valero Energy Corp.(with UDS)	VLO	34.72	110	3,800	60.00	0.47	0.78	
PanCanadian Energy	PCX	2	24.25	256	6,210	33.00	0.14	0.77
Petro-Canada	PCZ		23.60	267	6,300	33.00	0.08	0.74
PetroChina Company Ltd (10%)	PTR	2	17.51	176	3,100	28.00	0.16	0.69
<i>Total or Median</i>				<i>34,600</i>		<i>0.17</i>	<i>0.78</i>	
Small Cap								
Quicksilver Resources Inc.	KWK	15.90	19.3	310	10.00	0.60	1.23	
Spinnaker Exploration Company	SKE	37.48	28.3	1,060	40.00	-	0.94	
Penn Virginia Corporation	PVA	30.45	9.0	270	35.00	0.10	0.88	
Stone Energy Company	SGY	35.83	26.4	950	42.00	0.11	0.87	
Newfield Exploration Company	NFX	32.27	49.3	1,590	39.00	0.21	0.86	
XTO Energy Inc.	XTO	14.84	124.0	1,840	19.00	0.28	0.84	
Southwestern Energy Company	SWN	10.50	25.6	270	15.00	0.47	0.84	
Encore Acquisition Corp. (25%)	EAC	12.61	7.5	95	16.00	0.22	0.84	
Magnum Hunter Resources, Inc.	MHR	8.00	36.8	290	11.00	0.35	0.82	
Swift Energy Company	SFY	17.29	24.8	430	25.00	0.29	0.78	
Forest Oil Corporation	FST	2	24.99	48.5	1,210	37.00	0.28	0.77
CNOOC Limited (19%)	CEO	2	18.37	78	1,430	30.00	-	0.61
<i>Total or Median</i>				<i>9,440</i>		<i>0.22</i>	<i>0.84</i>	
Trusts and Partnerships								
Penn Virginia Res. Part, L.P.(48%)	PVR	23.65	7.5	180	18.40	-	1.29	
Dorchester Hugoton, Ltd.	DHULZ	13.99	10.7	150	11.30	-	1.24	
TEPPCO Partners, L.P.	TPP	29.55	39	1,140	26.90	0.57	1.04	
Cross Timbers Royalty Trust	CRT	17.95	6.0	108	17.90	-	1.01	
San Juan Basin Royalty Trust	SJT	2	10.35	46.6	480	14.90	-	0.69
Hugoton RoyaltyTrust	HGT	10.18	40.0	410	14.90	-	0.68	
<i>Total or Median</i>				<i>2,470</i>		<i>-</i>	<i>1.02</i>	
Micro Cap								
Abraxas Petroleum Corporation	ABP	0.99	23.6	23	0.50	0.96	1.03	
Purcell Energy, Ltd. (US\$)	PEL.TO	2	2.15	27.4	59	3.50	0.09	0.65
Energy Partners Ltd.(30%)	EPL	2	5.69	8.1	46	10.00	0.16	0.64

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

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Power								
Consol Energy Inc.	CNX	22.54	2.0	7.3	8	5.0	9.0	
CMS Energy Corporation	CMS	22.73	0.9	7.2	8	6.4	9.0	
Sempra Energy	SRE	23.72	1.1	7.1	9	4.2	9.0	
Constellation Energy Group	CEG	25.20	1.7	5.8	8	1.9	9.0	
	<i>Median</i>		<i>1.4</i>	<i>7.1</i>	<i>8</i>	<i>4.6</i>	<i>9.0</i>	
Natural Gas and Oil								
Imperial Oil Limited (30%)	IMO	27.35	1.1	10.2	26	2.0	11.1	
Murphy Oil Corporation	MUR	77.75	0.9	7.7	37	1.9	8.0	
Ocean Energy, Inc.	OEI	17.99	4.3	7.3	31	0.9	7.8	
PanCanadian Energy	PCX	2	24.25	1.2	6.5	16	1.1	8.4
Valero Energy Corp.(with UDS)	VLO	34.72	0.3	5.2	5	1.2	6.7	
Petro-Canada	PCZ	23.60	1.3	5.1	12	1.1	6.9	
Norsk Hydro ASA (49%)	NHY	40.04	0.8	4.8	15	2.6	6.0	
PetroChina Company Ltd (10%)	PTR	2	17.51	1.7	3.7	9	10.5	5.4
	<i>Median</i>		<i>1.1</i>	<i>5.8</i>	<i>15</i>	<i>1.5</i>	<i>7.4</i>	
Small Cap								
Quicksilver Resources Inc.	KWK	15.90	5.7	15.7		-	12.7	
Encore Acquisition Corp. (25%)	EAC	12.61	4.7	8.7	32	-	10.3	
XTO Energy Inc.	XTO	14.84	5.4	8.3	24	0.3	9.9	
Spinnaker Exploration Company	SKE	37.48	6.6	7.8	36	-	8.4	
Penn Virginia Corporation	PVA	30.45	4.2	7.8	36	3.0	8.8	
Swift Energy Company	SFY	17.29	5.0	7.4	32	-	9.4	
Forest Oil Corporation	FST	2	24.99	2.7	6.4	227	-	8.4
Magnum Hunter Resources, Inc.	MHR	8.00	3.7	6.4		-	7.8	
Southwestern Energy Company	SWN	10.50	2.7	6.1	21	-	7.3	
Stone Energy Company	SGY	35.83	3.9	5.2	26	-	6.0	
CNOOC Limited (19%)	CEO	2	18.37	3.6	4.8	10	1.3	7.9
Newfield Exploration Company	NFX	32.27	3.5	4.5	15	-	5.2	
	<i>Median</i>		<i>3.9</i>	<i>6.4</i>	<i>29</i>	<i>-</i>	<i>8.4</i>	
Trusts and Partnerships								
Dorchester Hugoton, Ltd.	DHULZ	13.99	9.5	14.5	19	20.6	11.7	
Penn Virginia Res. Part, L.P.(48%)	PVR	23.65	10.6	14.1	16	8.5	11.0	
Cross Timbers Royalty Trust	CRT	17.95	7.1	12.8	14	7.3	12.7	
TEPPCO Partners, L.P.	TPP	29.55	0.7	11.5	14	7.8	11.0	
San Juan Basin Royalty Trust	SJT	2	10.35	6.0	7.8	11	8.9	11.2
Hugoton RoyaltyTrust	HGT	10.18	4.8	7.5	11	9.0	11.0	
	<i>Median</i>		<i>6.5</i>	<i>12.1</i>	<i>14</i>	<i>8.7</i>	<i>11.1</i>	
Micro Cap								
Abraxas Petroleum Corporation	ABP	0.99	6.4	12.2		-	11.8	
Energy Partners Ltd.(30%)	EPL	2	5.69	2.0	4.5	-	7.1	
Purcell Energy, Ltd. (US\$)	PEL.TO	2	2.15	3.3	4.7	14	7.3	

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended December 31, 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.