

Meter Reader

A Weekly Analysis of Energy Stocks Using the McDep Ratio

April 8, 2002

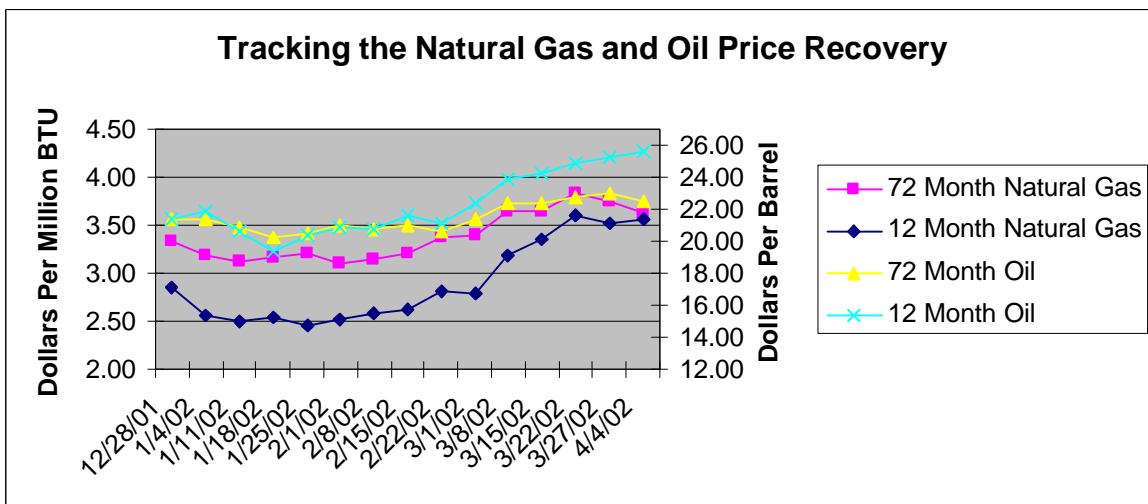
Shun Highest Debt

Summary and Recommendation

Energy companies that use debt most aggressively eventually perform poorly in our experience. Extreme debt is enough of a reason all by itself to shun Strong Sell recommended **Kinder Morgan (KMI, KMP, KMR)**. Strong Sell recommended **El Paso Energy Partners (EPN)** has high, though not extreme, debt. For the companies that employ prudent levels of debt we recommend that investors neutralize debt and concentrate on value. Alternatively, investors keenly attuned to near term performance might skew energy investments to high debt or low debt stocks depending on expectations. We have favorable comments this week after meeting with management of recommended **Burlington Resources (BR)**, ratio of debt of 0.33. Investing in a stock with a normal ratio of debt of 0.33 would represent business value of 1.5 times equity ($1/(1-0.33)$). To obtain similar business exposure in a stock with no debt, such as recommended **San Juan Basin Royalty Trust (SJT)**, one could invest 1.5 times as much as in the typical stock. Because it has no debt, recommended **CNOOC Limited (CEO)** might justify a larger commitment that then might be scaled back a bit because the stock of the Chinese producer may have additional political risk. For ratios of debt and further perspective on sell and buy ideas for energy representation in a diversified portfolio, see our valuation ranking of 73 stocks (Tables L-1, L-2, M-1, M-2, S-1 and S-2).

Six-Year Futures Pause

Six-year oil price receded 2% to \$22.49 from \$23.05. Six-year natural gas price receded 3% to \$3.63 from \$3.76 in the period ended April 4 (see Chart). By continuing to advance, one-year oil increased its backwardation. One-year natural gas has practically eliminated its contango pattern.



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Kinder Morgan and El Paso Partners In Debt Pyramids

During the 1920s when the stock market boomed in similar fashion as in the 1990s, pyramid ownership forms apparently became popular in the energy infrastructure industry. A company at the top of the pyramid owned a portion of the shares in companies at the second level. A company at the second level in turn owned a portion of the shares of companies in the third level. The company at the top exerted control over all the companies lower in the pyramid.

Magnified control also meant magnified leverage through borrowing at each level of the pyramid. When business slowed, the pyramids collapsed under the burden of excessive debt. Investors lost great sums.

The bust brought recrimination and a host of new regulations including the Public Utility Holding Company Act. Pyramids were severely curtailed in the energy infrastructure industry.

The pyramid is back in energy infrastructure. KMI sits atop a pyramid with KMP and KMR and other KMI investments at the second level and about a billion dollars of KMP investments in pipelines at the third level. Our ratio of debt for KMI of 0.78 includes KMP debt from the second level of the pyramid, but none of the debt from the third level or from other second level KMI investments. Only **AES**, among Mid Cap and larger companies in our coverage, has a ratio of debt higher than KMI.

Pyramids are not inherently bad and debt is a vital tool to promote economic growth. Using a pyramid structure to disguise too much debt can be deceptive. Too much debt is a condition investors can readily avoid if they recognize it.

Burlington Resources Outlook Improves

The same model that in mid February projected Ebitda of \$1.3 billion for the year ended March 31, 2003, now projects \$2.0 billion. During that time natural gas price increased to almost \$3.50 per mcf from \$2.63 (see *Stock Idea*, Burlington Resources, February 12, 2002). In other words the company makes a lot of money when natural gas pricing is favorable.

In management's recent update to analysts, Senior Vice President Production Randy Limbacher declared that BR could keep production flat by spending about \$1 billion per year. Obviously that level of spending could not be justified at mid February prices, but looks like good business at current prices.

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Nor can other companies easily beat BR's economics on a large scale. As a result there is a strong cost argument that natural gas prices ought to stay near the current level if we are to develop new volumes.

BR appears rich in investment opportunities at a \$3.50 natural gas price. Mr. Limbacher comments that BR's San Juan Basin reserves are likely to remain at 4 trillion cubic feet and production at 750 mmcf/d for years to come. The San Juan Basin remains BR's most important asset accounting for 35% of North American gas production and delivering the highest cash flow per mcf.

More of the future natural gas opportunities are in Canada that now accounts for 46% of BR's North American production. We highlighted the Deep Basin in our February Stock Idea. The Canadian acquisitions give BR exploitation type opportunities that it does well.

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) 4-Apr 2002</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		43.15	6,924	299,000	36.00	0.09	1.18
BP plc	BP		52.02	3,738	195,000	47.00	0.16	1.09
Royal Dutch/Shell	RD	3	53.39	3,520	188,000	55.00	0.04	0.97
TotalFinaElf S.A.	TOT		75.75	1,352	102,000	85.00	0.15	0.91
ChevronTexaco Corporation	CVX	2	87.79	1,062	93,300	110.00	0.16	0.83
					<i>Total or Median</i>		<i>0.15</i>	<i>0.97</i>
					877,000			
Energy Infrastructure								
American Electric Power Co. Inc.	AEP	3	47.15	322	15,200	42.10	0.64	1.04
Duke Energy Corporation	DUK		38.55	781	30,100	36.30	0.44	1.04
Williams Companies	WMB		22.95	521	12,000	22.70	0.58	1.01
El Paso Corporation	EPG		45.19	532	24,000	44.80	0.49	1.00
Southern Company	SO		26.97	683	18,400	27.40	0.42	0.99
Dominion Resources	D		66.19	247	16,300	79.40	0.45	0.91
Exelon Corporation	EXC	2	52.20	323	16,900	84.00	0.40	0.77
					<i>Total or Median</i>		<i>0.44</i>	<i>1.00</i>
					118,000			
Natural Gas and Oil								
Occidental Petroleum Corp.	OXY		28.88	372	10,700	30.00	0.48	0.98
Anadarko Petroleum Corp.	APC		54.49	266	14,500	56.00	0.26	0.98
Unocal Corporation	UCL		37.84	257	9,700	39.00	0.34	0.98
ENI S.p.A.	E		72.50	789	57,200	75.00	0.19	0.97
Devon Energy	DVN		46.91	165	7,700	55.00	0.48	0.92
Encana Corporation	PCX	2	29.58	490	14,500	35.00	0.19	0.87
Burlington Resources	BR	1	39.00	201	7,800	48.00	0.33	0.87
ConocoPhillips	P	2	61.85	680	42,100	80.00	0.32	0.85
OAo Lukoil	LUKOY		57.50	299	17,200	70.00	0.08	0.84
Marathon Oil Corporation	MRO	1	28.23	310	8,700	42.00	0.32	0.78
					<i>Total or Median</i>		<i>0.32</i>	<i>0.87</i>
					179,000			
Service								
Baker Hughes Inc.	BHI		35.61	338	12,000	24.50	0.13	1.39
Schlumberger Ltd.	SLB		56.04	581	32,600	44.00	0.12	1.24
Halliburton Company	HAL		16.71	429	7,200	24.90	0.12	0.71

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) 4-Apr 2002</i>	<i>EV/ Sales NTM</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	43.15	1.6	11.9	26	2.1	10.1	
BP plc	BP	52.02	1.3	9.8	17	2.5	9.0	
Royal Dutch/Shell	RD	3	53.39	1.2	8.5	19	2.6	8.7
TotalFinaElf S.A.	TOT		75.75	1.3	8.0	16	2.8	8.9
ChevronTexaco Corporation	CVX	2	87.79	1.3	7.2	17	3.2	8.7
	<i>Median</i>			<i>1.3</i>	<i>8.5</i>	<i>17</i>	<i>2.6</i>	<i>8.9</i>
Energy Infrastructure								
American Electric Power Co. Inc.	AEP	3	47.15	0.7	10.4	17	5.1	10.0
Williams Companies	WMB		22.95	2.4	10.1	15	3.5	10.0
Duke Energy Corporation	DUK		38.55	0.9	9.3	14	2.9	9.0
El Paso Corporation	EPG		45.19	0.9	9.0	14	1.9	9.0
Southern Company	SO		26.97	2.9	8.9	17	5.0	9.0
Dominion Resources	D		66.19	3.6	8.2	15	3.9	9.0
Exelon Corporation	EXC	2	52.20	2.3	7.0	11	3.2	9.0
	<i>Median</i>			<i>2.3</i>	<i>9.0</i>	<i>15</i>	<i>3.5</i>	<i>9.0</i>
Natural Gas and Oil								
Occidental Petroleum Corp.	OXY		28.88	1.5	7.9	14	3.5	8.1
Anadarko Petroleum Corp.	APC		54.49	3.1	7.9	17	0.6	8.1
Devon Energy	DVN		46.91	3.0	6.8	47	0.4	7.4
ENI S.p.A.	E		72.50	1.7	6.7	13	2.5	6.9
Encana Corporation	PCX	2	29.58	1.8	6.6	17	0.9	7.5
Unocal Corporation	UCL		37.84	2.5	6.5	21	2.1	6.7
Burlington Resources	BR	1	39.00	4.2	6.4		1.4	7.3
ConocoPhillips	P	2	61.85	0.9	6.1	13	2.3	7.2
Marathon Oil Corporation	MRO	1	28.23	0.5	4.1	7	3.3	5.3
OAO Lukoil	LUKOY		57.50	1.5	4.1	8	1.9	4.9
	<i>Median</i>			<i>1.8</i>	<i>6.6</i>	<i>14</i>	<i>2.0</i>	<i>7.2</i>
Service								
Baker Hughes Inc.	BHI		35.61	2.2	11.1	25	1.3	9.0
Schlumberger Ltd.	SLB		56.04	2.9	9.9	28	1.3	9.0
Halliburton Company	HAL		16.71	0.6	5.7	12	3.0	9.0

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended March 31, 2003; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

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

	<i>Symbol/ Rating</i>		<i>Price (\$/sh) 4-Apr 2002</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>
Energy Infrastructure								
Kinder Morgan Management, LLC	KMR	5	34.12	30	1,000	12.40	0.48	1.91
Kinder Morgan Energy Partners, L.P.	KMP	5	33.25	136	4,500	12.40	0.48	1.88
Kinder Morgan, Inc.	KMI	5	48.43	120	5,800	16.00	0.78	1.45
Enterprise Products Part.	EPD		45.00	87	3,900	31.70	0.23	1.33
Dynegy Inc.	DYN		28.20	339	9,600	20.60	0.57	1.16
AES Corporation	AES		9.06	543	4,900	8.80	0.83	1.01
Calpine Corporation	CPN	3	11.93	377	4,500	12.50	0.66	0.98
Mirant Corporation	MIR		13.40	353	4,700	18.60	0.65	0.90
Valero Energy Corporation	VLO		46.67	104	4,900	60.00	0.46	0.88
Consol Energy Inc.	CNX		26.52	79	2,100	35.90	0.51	0.87
CMS Energy Corporation	CMS		22.04	128	2,800	43.80	0.62	0.81
Sempra Energy	SRE		25.05	203	5,100	41.70	0.50	0.80
Constellation Energy Group	CEG		30.51	152	4,600	56.50	0.35	0.70
	<i>Total or Median</i>				53,800		0.54	1.00
Natural Gas and Oil								
Murphy Oil Corporation	MUR		93.00	46	4,200	82.00	0.18	1.11
Imperial Oil Limited (30%)	IMO		29.55	119	3,500	30.00	0.11	0.99
Ocean Energy, Inc.	OEI		19.12	178	3,400	20.00	0.30	0.97
Norsk Hydro ASA (49%)	NHY		49.75	126	6,300	54.00	0.18	0.94
Petro-Canada	PCZ		25.57	262	6,700	31.00	0.11	0.84
PetroChina Company Ltd (10%)	PTR	2	20.85	176	3,700	28.00	0.16	0.79
	<i>Total or Median</i>				27,800		0.17	0.95

Buy/Sell rating after symbol: 1 - Strong Buy, 2 - Buy, 3 - Neutral, 5 - Strong Sell

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Table M-2
Mid Cap Energy Companies
Rank by EV/Ebitda: Enterprise Value to Earnings Before Interest, Tax, Deprec.

			Price (\$/sh)	EV/ Sales	EV/ Ebitda	P/E	Dividend or Distribution	PV/ Ebitda
	Symbol/ Rating	4-Apr 2002	NTM	NTM	NTM	NTM	NTM (%)	NTM
Energy Infrastructure								
	KMR	5	34.12	4.6	17.2	22	6.4	9.0
	KMP	5	33.25	4.5	16.9	21	6.6	9.0
	KMI	5	48.43	4.2	13.0	20	0.4	9.0
	EPD		45.00	1.6	11.9	13	5.6	9.0
	DYN		28.20	0.5	10.4	14	1.1	9.0
	AES		9.06	3.2	9.1	7	-	9.0
	CPN	3	11.93	1.8	8.9	7	-	9.0
	MIR		13.40	0.5	8.1	6	-	9.0
	CNX		26.52	2.1	7.8	9	4.2	9.0
	CMS		22.04	0.8	7.3	11	6.6	9.0
	SRE		25.05	1.1	7.2	10	4.0	9.0
	CEG		30.51	1.8	6.3	10	1.6	9.0
	VLO		46.67	0.3	6.0	9	0.9	6.8
	<i>Median</i>			<i>1.8</i>	<i>8.9</i>	<i>10</i>	<i>1.6</i>	<i>9.0</i>
Natural Gas and Oil								
	IMO		29.55	1.2	10.9	28	1.8	11.1
	MUR		93.00	1.0	8.9	44	1.6	8.0
	OEI		19.12	4.5	7.6	33	0.8	7.8
	PCZ		25.57	1.6	6.2	16	1.0	7.4
	NHY		49.75	0.9	4.5	14	2.1	4.8
	PTR	2	20.85	1.7	3.4	7	8.8	4.3
	<i>Median</i>			<i>1.4</i>	<i>6.9</i>	<i>22</i>	<i>1.7</i>	<i>7.6</i>

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Energy Infrastructure								
El Paso Energy Partners	EPN	5	38.38	36.0	1,380	7.90	0.50	2.92
Enbridge Energy Partners,	EEP		44.76	31.0	1,390	16.60	0.58	1.72
Northern Border Partners	NBP		39.98	42.0	1,680	20.30	0.56	1.42
Plains All Amer. Pipeline	PAA		25.08	38.0	950	14.30	0.47	1.40
TEPPCO Partners, L.P.	TPP		31.96	39	1,240	15.60	0.69	1.32
Penn Virginia Res. Part, L.P.(48%)	PVR		22.50	7.7	170	16.50	0.13	1.32
Penn Virginia Corporation	PVA		39.20	9.0	350	35.00	0.10	1.11
AmeriGas Partners, L.P.	APU		21.71	44.0	960	19.50	0.54	1.05
	<i>Total or Median</i>				<i>8,100</i>		<i>0.52</i>	<i>1.36</i>
Natural Gas and Oil								
Dorchester Hugoton, Ltd.	DHULZ		13.75	10.7	148	11.60	(0.17)	1.22
Spinnaker Exploration Company	SKE		42.00	28.5	1,200	35.00	0.03	1.19
Quicksilver Resources Inc.	KWK		22.40	19.4	440	20.00	0.43	1.07
Newfield Exploration Company	NFX		35.86	48.6	1,740	33.00	0.25	1.06
Stone Energy Company	SGY		37.75	26.4	1,000	42.00	0.29	0.93
Swift Energy Company	SFY		19.42	24.8	480	22.00	0.32	0.92
Unit Corporation	UNT		18.40	36.2	670	21.00	0.03	0.88
Forest Oil Corporation	FST	2	29.01	46.7	1,360	35.00	0.29	0.88
Southwestern Energy Company	SWN		12.93	25.6	330	17.00	0.44	0.87
Pogo Producing Company	PPP		25.76	60.5	1,560	32.00	0.27	0.86
Magnum Hunter Resources, Inc.	MHR		7.84	71.5	560	11.00	0.43	0.84
CNOOC Limited (19%)	CEO	2	24.30	78	1,900	30.00	-	0.81
XTO Energy Inc.	XTO	2	19.72	124.0	2,450	26.00	0.21	0.81
Encore Acquisition Corp. (25%)	EAC		15.00	7.5	113	20.00	0.18	0.80
	<i>Total or Median</i>				<i>14,000</i>		<i>0.26</i>	<i>0.88</i>
Natural Gas Royalty Trusts								
Cross Timbers Royalty Trust	CRT		19.30	6.0	116	18.70	-	1.03
San Juan Basin Royalty Trust	SJT	2	11.94	46.6	560	15.10	-	0.79
Hugoton RoyaltyTrust (46%)	HGT		12.16	18.4	220	15.50	-	0.79
Micro Cap								
Torch Energy Royalty Trust	TRU		6.91	8.6	59	5.50	-	1.25
Abraxas Petroleum Corporation	ABP		1.38	26.8	37	0.50	0.96	1.07
Energy Partners Ltd.(30%)	EPL	2	8.30	8.1	67	10.00	0.34	0.89
Purcell Energy, Ltd. (US\$)	PEL.TO	2	1.86	27.4	51	3.50	0.09	0.57

Buy/Sell rating after symbol: 1 - Strong Buy, 2 - Buy, 3 - Neutral, 4 - Sell, 5 - Strong Sell
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Energy Infrastructure								
	EPN	5	38.38	20.4	26.3	53	6.5	9.0
	EEP		44.76	6.9	15.4	86	7.8	9.0
	NBP		39.98	8.0	12.8	18	8.0	9.0
	PAA		25.08	0.2	12.6	17	8.2	9.0
	TEPCO Partners, L.P.		31.96	0.7	11.9	15	7.2	9.0
	PVR		22.50	8.7	11.8	13	8.9	9.0
	APU		21.71	1.4	9.5	18	10.1	9.0
	PVA		39.20	4.4	7.6	25	2.3	6.9
	<i>Median</i>			<i>5.7</i>	<i>12.3</i>	<i>18</i>	<i>7.9</i>	<i>9.0</i>
Natural Gas and Oil								
	DHULZ		13.75	6.7	10.0	14	8.7	8.2
	KWK		22.40	4.8	8.8		-	8.2
	SFY		19.42	5.0	7.5	40	-	8.1
	FST	2	29.01	3.7	7.0		-	8.0
	MHR		7.84	3.3	6.7		-	8.0
	XTO	2	19.72	3.4	6.6	14	0.2	8.2
	PPP		25.76	3.7	6.2	36	0.5	7.3
	SKE		42.00	5.0	5.9	19	-	4.9
	EAC		15.00	3.9	5.9	13	-	7.4
	UNT		18.40	3.1	5.8	13	-	6.6
	SWN		12.93	2.3	5.6	13	-	6.4
	CEO	2	24.30	4.1	5.4	11	1.0	6.7
	NFX		35.86	3.6	5.0	20	-	4.7
	SGY		37.75	3.5	4.7	11	-	5.0
	<i>Median</i>			<i>3.7</i>	<i>6.1</i>	<i>14</i>	<i>-</i>	<i>7.3</i>
Natural Gas Royalty Trusts								
	CRT		19.30	7.3	10.4	11	8.9	10.1
	SJT	2	11.94	5.9	7.6	10	9.7	9.6
	HGT		12.16	4.9	7.2	10	10.1	9.1
Micro Cap								
	ABP		1.38	4.8	7.2		-	6.7
	TRU		6.91	4.8	5.7	7	15.1	4.6
	EPL	2	8.30	2.2	4.0		-	4.5
	PEL.TO	2	1.86	2.3	3.1	7	-	5.4

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended March 31, 2003; 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 investment analysis by Kurt Wulff doing business as McDep Associates is posted at www.mcdep.com. Mr. Wulff is not paid by covered companies. Owning shares in energy stocks, neither Mr. Wulff nor his spouse act contrary to a buy or sell rating.