

Meter Reader

A Weekly Analysis of Energy Stocks Using the McDep Ratio

October 23, 2003

New High for Expected Inflation

Summary and Recommendation

Rising inflation expectation adds appeal to McDep energy recommendations. Ten-year inflation expectation measured by the difference between the benchmark yield on the U.S. Ten-Year Treasury Note (TN) and the U.S. Ten-Year Treasury Inflation-Indexed Note (TIIN) is in a well-defined uptrend. Accelerating inflation means accelerating energy prices and energy asset prices. In order of sensitivity to energy resource values we would rank our recommendations first, royalty trusts; second, non-U.S. producers; third, independent producers; fourth, producer/refiners; and fifth, energy mega caps. Sell-recommended stocks are unlikely to fare as well for multiple reasons including lack of inflation protection. Buy and sell recommendations are ranked by valuation in our regular tables (see Tables 1-1, 2-1, and 3-1).

Surprise Inflation Means Surprise Energy Prices

In the old days, investors had to hope that nominal yields on bonds were high enough to deliver a real return after inflation. That worked poorly from about 1940 to about 1980 and worked well from about 1980 to about 2000. The pendulum may be swinging again to an extended period when nominal yields may not be high enough to deliver a real return after inflation.

Fortunately, since the mid 1990s investors in U.S. government bonds have had an increasingly liquid alternative where the real return is guaranteed by the government. We are referring to Treasury Inflation Protected Securities (TIPS) of which the ten-year TIIN is most prominent.

Our purpose is not to give investment advice on bonds, but to look to bonds for signs of expected inflation. The difference between the guaranteed real yield on the Treasury Inflation Indexed Note and the guaranteed nominal yield on the regular Treasury Note is expected inflation. Expected inflation is setting new highs for the two years since we have been paying attention on a daily basis (see Chart).

Expected inflation is also the difference between real energy prices and nominal energy prices. One might say that the normal factors of supply and demand influence real energy prices. Yet, higher inflation usually is accompanied by higher economic growth that in turn stimulates energy demand. Meanwhile energy supply has not been growing much particularly in North American natural gas and world oil. Unlike manufacturing plants that may have 20% and 30% spare capacity, world oil supply has maybe 2 or 3

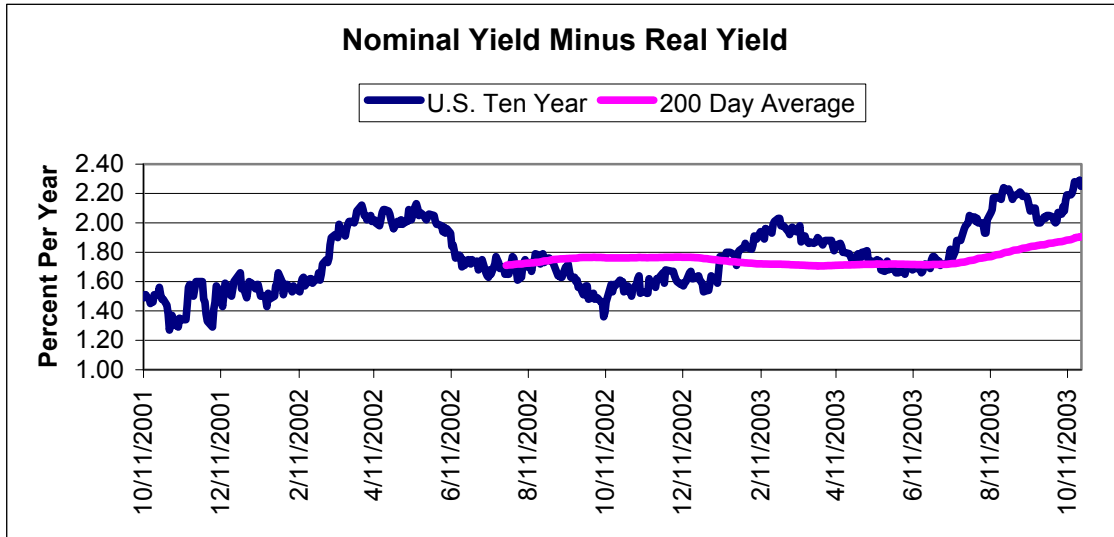
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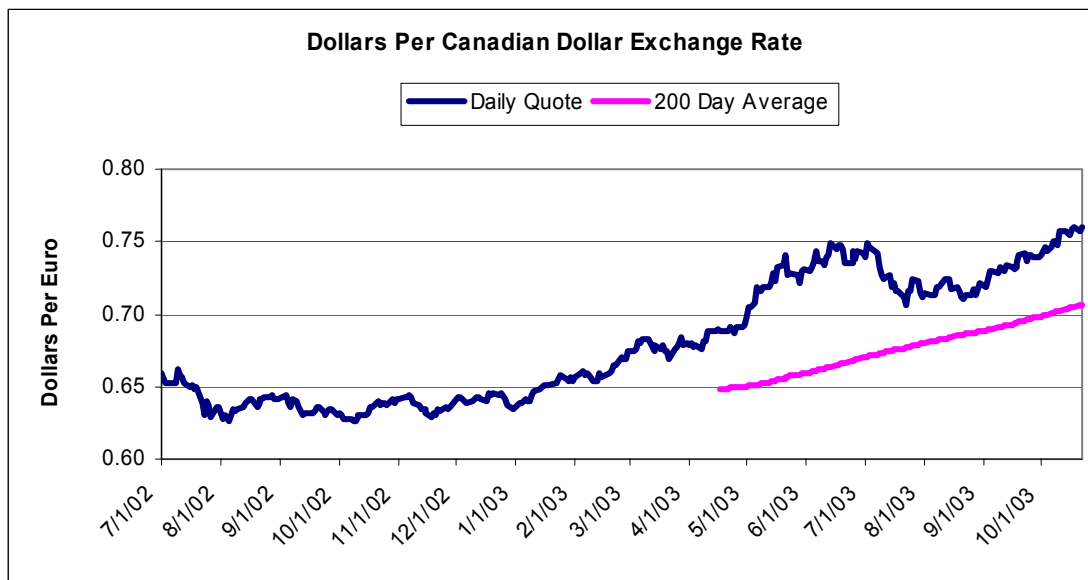
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4% spare capacity. As a result the real price of energy may be moving up because of demand increasing faster than producing capacity and inflation multiplies the real price gain to an even higher nominal price gain.



Canadian Dollar Setting New Highs

Because we are recommending some Canadian stocks we pay attention to the Canadian currency (see Chart). The recent strength of the Canadian dollar may be just the reverse of the weakness in the U.S. dollar. It might also reflect the fact that Canada is a large exporter of energy to the U.S.



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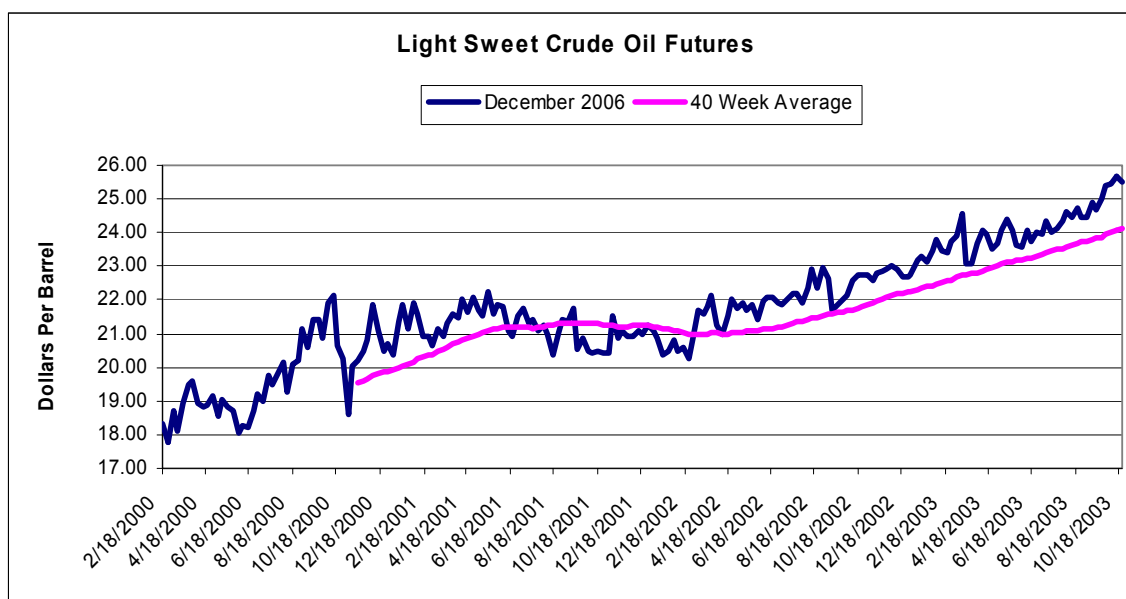
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A visitor to www.mcdep.com thinking the U.S. dollar could fall more against the Canadian dollar, asks whether it would make more sense to own the Canadian shares rather than the American shares of stocks that trade in both countries. Our experience is that for a specific stock, the price in Toronto and the price in New York track closely the exchange value of the Canadian dollar and the U.S. dollar relative to each other. There are good reasons, we believe, to own stock in a company like recommended **Encana (ECA)**, but any difference in buying the stock in Toronto or in New York normally would be slight, if any, after adjusting for exchange rate.

Rising Inflation, Declining Dollar Support Rising Oil Price

Supported by expected inflation and the declining dollar among other factors the futures price for oil delivered in December 2006 remains near recently set highs (see Chart). Continuation of the 10% per year trend of the past three and a half years implies the actual price of oil in 2006 when the contract settles would be \$34 a barrel. That seemingly modest expectation is far higher than what current stock prices of energy producers appear to reflect.



Kurt H. Wulff, CFA

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

	Symbol/ Rating	Price (\$/sh) 22-Oct 2003	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio	
Mega Cap								
Exxon Mobil Corporation	XOM	37.35	6,687	250,000	35.00	0.10	1.06	
Total S.A.	TOT	78.18	1,276	99,700	85.00	0.19	0.93	
BP plc	BP	42.90	3,694	159,000	50.00	0.15	0.88	
Royal Dutch/Shell	RD	B	46.17	3,473	160,000	55.00	0.18	0.87
ChevronTexaco Corporation	CVX	B	73.49	1,064	78,200	95.00	0.22	0.82
<i>Total or Median</i>				<i>747,000</i>		<i>0.18</i>	<i>0.88</i>	
Producer/Refiners - Large Cap and Mid Cap								
Murphy Oil Corporation	MUR	59.89	92	5,530	41.00	0.26	1.34	
Imperial Oil Limited (30%)	IMO	40.08	113	4,550	36.00	0.12	1.10	
OAOLukoil	LUKOY	90.65	210	19,000	90.00	0.11	1.01	
Norsk Hydro ASA (49%)	NHY	54.97	126	6,950	60.00	0.27	0.94	
Petro-Canada	PCZ	40.68	265	10,780	45.00	0.19	0.92	
ENI S.p.A.	E	80.00	750	60,000	90.00	0.14	0.90	
Valero Energy Corporation	VLO	38.93	114	4,440	50.00	0.50	0.89	
ConocoPhillips	COP	B	56.79	681	38,700	70.00	0.38	0.88
Petroleo Brasileiro S. A.	PBR	24.00	1,096	26,300	30.00	0.25	0.85	
Suncor Energy	SU	20.53	474	9,730	25.00	0.14	0.85	
Marathon Oil Corporation	MRO	B	29.63	310	9,190	40.00	0.31	0.82
PetroChina Company Ltd (10%)	PTR	B	36.28	176	6,380	50.00	0.11	0.76
<i>Total or Median</i>				<i>196,000</i>		<i>0.19</i>	<i>0.89</i>	
Independent Natural Gas and Oil								
Pogo Producing Company	PPP	43.39	65	2,800	38.00	0.22	1.11	
Occidental Petroleum Corp.	OXY	36.11	383	13,800	35.00	0.38	1.02	
Apache Corporation	APA	70.64	159	11,200	70.00	0.20	1.01	
XTO Energy Inc.	XTO	B	23.51	186	4,380	24.00	0.25	0.98
Encana Corporation	ECA	B	36.71	472	17,300	40.00	0.20	0.93
CNOOC Limited (19%)	CEO	B	35.60	78	2,780	40.00	-	0.89
Burlington Resources	BR	B	48.99	202	9,900	60.00	0.27	0.87
Canadian Natural Resources Limited	CNQ	43.75	139	6,080	55.00	0.29	0.86	
Unocal Corporation	UCL	31.11	255	7,900	40.00	0.35	0.85	
Devon Energy	DVN	47.67	163	7,800	65.00	0.42	0.85	
Pioneer Natural Resources Company	PXD	25.70	119	3,060	35.00	0.33	0.82	
Anadarko Petroleum Corp.	APC	B	41.96	252	10,600	60.00	0.32	0.80
<i>Total or Median</i>				<i>98,000</i>		<i>0.28</i>	<i>0.88</i>	
Service								
Baker Hughes Inc.	BHI	29.18	339	9,900	25.00	0.09	1.15	
Schlumberger Ltd.	SLB	47.95	581	27,900	44.00	0.22	1.07	
Halliburton Company	HAL	23.95	434	10,400	22.00	0.25	1.07	

Buy/Sell rating after symbol: B - Buy, S - 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 1-2
Energy Producers
Rank by EV/Ebitda: Enterprise Value to Earnings Before Interest, Tax, Deprec.

	Symbol/ Rating	Price (\$/sh) 22-Oct 2003	EV/ Sales NTM	EV/ Ebitda NTM	P/E NTM	Dividend or Distribution NTM (%)	PV/ Ebitda NTM	
Mega Cap								
Exxon Mobil Corporation	XOM	37.35	1.2	7.8	15	2.7	7.3	
Total S.A.	TOT	78.18	1.1	6.8	13	4.5	7.3	
BP plc	BP	42.90	0.8	6.8	15	4.0	7.7	
ChevronTexaco Corporation	CVX	B	73.49	0.9	6.7	13	4.0	8.2
Royal Dutch/Shell	RD	B	46.17	1.1	6.4	13	4.3	7.4
	<i>Median</i>			<i>1.1</i>	<i>6.8</i>	<i>13</i>	<i>4.0</i>	<i>7.4</i>
Producer/Refiners - Large Cap and Mid Cap								
Murphy Oil Corporation	MUR	59.89	1.7	10.8	39	1.3	8.1	
Imperial Oil Limited (30%)	IMO	40.08	1.2	8.1	15	1.4	7.4	
Suncor Energy	SU	20.53	2.9	7.8	16	0.7	9.3	
OAo Lukoil	LUKOY	90.65	1.1	6.8	14	2.8	6.8	
ConocoPhillips	COP	B	56.79	0.7	6.0	9	3.0	6.8
Marathon Oil Corporation	MRO	B	29.63	0.4	5.6	13	3.4	6.8
Valero Energy Corporation	VLO	38.93	0.3	4.9	5	1.0	5.5	
Petro-Canada	PCZ	40.68	1.4	4.5	11	0.7	4.9	
ENI S.p.A.	E	80.00	1.7	4.2	9	5.4	4.7	
PetroChina Company Ltd (10%)	PTR	B	36.28	2.4	4.2	9	5.6	5.5
Petroleo Brasileiro S. A.	PBR	24.00	1.5	3.9	6	3.5	4.6	
Norsk Hydro ASA (49%)	NHY	54.97	0.9	3.7	10	2.7	4.0	
	<i>Median</i>			<i>1.3</i>	<i>5.2</i>	<i>11</i>	<i>2.8</i>	<i>6.2</i>
Independent Natural Gas and Oil								
Pioneer Natural Resources Company	PXD	25.70	5.2	7.1	23	-	8.6	
Occidental Petroleum Corp.	OXY	36.11	2.6	6.8	12	2.9	6.7	
Apache Corporation	APA	70.64	4.7	6.5	15	0.5	6.5	
CNOOC Limited (19%)	CEO	B	35.60	4.7	6.1	13	4.5	6.9
XTO Energy Inc.	XTO	B	23.51	4.3	5.8	11	0.2	5.9
Pogo Producing Company	PPP	43.39	3.7	5.8	17	0.3	5.2	
Burlington Resources	BR	B	48.99	3.9	5.7	13	1.2	6.6
Anadarko Petroleum Corp.	APC	B	41.96	3.6	5.5	10	1.0	6.8
Unocal Corporation	UCL	31.11	2.1	5.5	15	2.6	6.4	
Encana Corporation	ECA	B	36.71	2.4	5.0	13	0.8	5.3
Devon Energy	DVN	47.67	2.9	4.5	7	-	5.3	
Canadian Natural Resources Limited	CNQ	43.75	2.4	3.9	8	0.9	4.5	
	<i>Median</i>			<i>3.7</i>	<i>5.8</i>	<i>13</i>	<i>0.9</i>	<i>6.4</i>
Service								
Baker Hughes Inc.	BHI	29.18	2.1	12.4	35	1.6	10.8	
Halliburton Company	HAL	23.95	1.1	9.6	21	2.1	9.0	
Schlumberger Ltd.	SLB	47.95	2.6	9.6	35	1.6	8.9	

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended September 30, 2004; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

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Table 2-1
Energy Pipeline and Power Companies
Rank by McDep Ratio: Market Cap and Debt to Present Value

	<i>Symbol/ Rating</i>	<i>Price (\$/sh) 22-Oct 2003</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>
Large Cap Power							
Duke Energy Corporation	DUK	18.51	832	15,400	16.00	0.69	1.05
Southern Company	SO	30.12	696	21,000	28.00	0.43	1.04
Exelon Corporation	EXC	63.79	325	20,700	65.00	0.51	0.99
American Electric Power Co. Inc.	AEP	29.62	348	10,300	35.00	0.60	0.94
Enel S.p.a. (32%)	EN	31.86	388	12,400	37.00	0.40	0.92
Dominion Resources	D	61.12	294	17,900	76.00	0.44	0.89
	<i>Total or Median</i>			<i>97,700</i>		<i>0.47</i>	<i>0.96</i>
Mid Cap Pipeline and Power							
Kinder Morgan Energy Partners, L.P.	KMP S	43.45	140	6,090	14.00	0.46	2.14
Kinder Morgan Management, LLC	KMR S	38.98	48	1,860	14.00	0.46	1.96
Kinder Morgan, Inc.	KMI S	53.73	124	6,680	14.00	0.80	1.56
Williams Companies	WMB	10.00	518	5,180	1.00	0.97	1.28
Constellation Energy Group	CEG	35.56	164	5,830	25.00	0.61	1.16
AES Corporation	AES	7.84	558	4,370	1.00	0.98	1.13
Calpine Corporation	CPN	4.56	381	1,740	1.00	0.98	1.08
Dynegy Inc.	DYN	3.57	418	1,490	1.00	0.97	1.08
CMS Energy Corporation	CMS	7.74	139	1,080	5.00	0.93	1.04
Sempra Energy	SRE	28.10	206	5,790	30.00	0.59	0.97
El Paso Corporation	EP	7.14	589	4,200	10.00	0.79	0.94
	<i>Total or Median</i>			<i>44,310</i>		<i>0.80</i>	<i>1.13</i>
Small Cap Pipeline							
Enterprise Products Part (44%)	EPD	21.42	96	2,050	8.50	0.49	1.78
Enbridge Energy Partners, L.P.	EEP S	50.40	39	1,970	19.00	0.57	1.72
Gulfterra Energy Partners	GTM S	40.15	55	2,210	15.70	0.56	1.68
Enbridge Energy Management, L.L.C	EEQ S	46.37	9	440	19.00	0.57	1.63
Plains All Amer. Pipeline, L.P.	PAA	30.37	50	1,520	15.00	0.44	1.57
TEPPCO Partners, L.P.	TPP	37.16	58	2,160	18.00	0.52	1.51
Northern Border Partners	NBP	42.07	47	1,960	20.00	0.62	1.42
Magellan Midstream Partners, L.P.	MMP	46.84	27	1,280	29.00	0.38	1.38
AmeriGas Partners, L.P.	APU	26.54	52	1,390	20.00	0.46	1.18
Western Gas Resources	WGR	41.50	37	1,540	40.00	0.27	1.03
	<i>Total or Median</i>			<i>16,520</i>		<i>0.50</i>	<i>1.54</i>

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Table 3-1
Independent Natural Gas and Oil Producers - Small Cap
Rank by McDep Ratio: Market Cap and Debt to Present Value

	Symbol/ Rating	Price (\$/sh) 22-Oct 2003	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio	
Short Life								
Dorchester Minerals, L.P.	DMLP	17.60	27.0	480	13.00	-	1.35	
Southwestern Energy Company	SWN	19.27	36.0	690	17.00	0.30	1.09	
Newfield Exploration Company	NFX	39.51	51.7	2,040	40.00	0.31	0.99	
Spinnaker Exploration Company	SKE	24.34	33.8	820	25.00	-	0.97	
Energy Partners Ltd.	EPL	B	11.43	37.3	427	12.00	0.26	0.97
Denbury Resources Inc.	DNR	12.83	55.0	710	15.00	0.29	0.90	
Chesapeake Energy Corporation	CHK	11.35	220	2,500	14.00	0.38	0.88	
Wesport Resources Corporation	WRC	23.94	68.0	1,630	30.00	0.29	0.86	
Stone Energy Company	SGY	35.54	26.5	940	46.00	0.27	0.83	
The Houston Exploraton Company	THX	35.28	31.0	1,090	45.00	0.16	0.82	
St. Mary Land and Exploration Company	SM	26.78	29.0	780	35.00	0.11	0.79	
Forest Oil Corporation	FST	23.79	48.2	1,150	35.00	0.33	0.78	
Cimarex Energy Company	XEC	B	20.34	42.0	850	27.00	0.00	0.75
<i>Total or Median</i>				<i>14,100</i>		<i>0.27</i>	<i>0.88</i>	
Long Life								
Ultra Petroleum Corp.	UPL	17.67	78.0	1,380	7.00	0.15	2.30	
Unit Corporation	UNT	19.65	43.6	860	18.00	0.04	1.09	
Penn Virginia Corporation	PVA	45.48	9.0	410	45.00	0.06	1.01	
Quicksilver Resources Inc.	KWK	25.27	20.4	520	25.00	0.35	1.01	
Encore Acquisition Corp. (40%)	EAC	B	21.85	11.2	245	24.00	0.18	0.93
Swift Energy Company	SFY	13.66	27.2	370	16.00	0.43	0.92	
Evergreen Resources, Inc.	EVG	27.22	44.0	1,200	30.00	0.10	0.92	
Magnum Hunter Resources, Inc.	MHR	8.70	69.0	600	11.00	0.45	0.88	
Vintage Petroleum, Inc.	VPI	11.44	63.0	720	20.00	0.40	0.74	
<i>Total or Median</i>				<i>6,300</i>		<i>0.18</i>	<i>0.93</i>	
Canadian Royalty Trusts								
Enerplus Resources Fund	ERF	28.21	83.7	2,360	20.00	0.16	1.34	
Provident Energy Trust	PVX	8.40	68.8	580	6.00	0.25	1.30	
Pengrowth Energy Trust	PGH	13.25	112.0	1,480	11.00	0.20	1.16	
Canadian Oil Sands Trust (US\$)	COSWF	B	30.17	86.3	2,600	45.00	0.19	0.73
<i>Total or Median</i>				<i>7,000</i>		<i>0.19</i>	<i>1.23</i>	
Natural Gas Royalty Trusts								
Hugoton Royalty Trust (46%)	HGT	19.78	18.4	360	15.10	-	1.31	
Sabine Royalty Trust	SBR	27.90	14.6	410	22.00	-	1.27	
Cross Timbers Royalty Trust	CRT	24.65	6.0	148	20.10	-	1.23	
Permian Basin RT (41%)	PBT	8.33	19.1	160	7.00	-	1.19	
San Juan Basin Royalty Trust	SJT	B	18.70	46.6	870	17.30	-	1.08
<i>Total or Median</i>				<i>1,900</i>		<i>-</i>	<i>1.23</i>	
Micro Cap								
Abraxas Petroleum Corporation	ABP	0.96	30.0	29	1.00	0.85	0.99	
Purcell Energy, Ltd. (US\$)	PEL.TO	2.11	27.9	59	2.80	0.32	0.83	

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Short Life								
Dorchester Minerals, L.P.	DMLP	17.60	11.5	13.2	48	7.5	9.8	
Southwestern Energy Company	SWN	19.27	3.2	6.6	14	-	6.0	
Chesapeake Energy Corporation	CHK	11.35	4.0	5.7	13	1.1	6.5	
Forest Oil Corporation	FST	23.79	3.5	5.7	18	-	7.2	
Energy Partners Ltd.	EPL	B	11.43	3.1	5.2	25	-	5.4
Wesport Resources Corporation	WRC	23.94	3.6	5.1	15	-	6.0	
St. Mary Land and Exploration Company	SM	26.78	2.9	4.5	13	0.4	5.7	
Denbury Resources Inc.	DNR	12.83	3.0	4.3	9	-	4.8	
Cimarex Energy Company	XEC	B	20.34	3.1	4.1	11	-	5.5
Newfield Exploration Company	NFX	39.51	2.9	3.8	8	-	3.8	
Stone Energy Company	SGY	35.54	2.8	3.7	8	-	4.5	
Spinnaker Exploration Company	SKE	24.34	3.2	3.6	13	-	3.7	
The Houston Exploraton Company	THX	35.28	2.9	3.5	9	-	4.3	
	<i>Median</i>		<i>3.1</i>	<i>4.5</i>	<i>13</i>	<i>-</i>	<i>5.5</i>	
Long Life								
Ultra Petroleum Corp.	UPL	17.67	15.1	24.5	48	-	10.6	
Evergreen Resources, Inc.	EVG	27.22	6.9	9.9	17	-	10.8	
Unit Corporation	UNT	19.65	3.6	8.2	21	-	7.6	
Quicksilver Resources Inc.	KWK	25.27	4.7	7.1	13	-	7.0	
Swift Energy Company	SFY	13.66	4.2	6.3	21	-	6.9	
Magnum Hunter Resources, Inc.	MHR	8.70	3.4	5.8	15	-	6.6	
Penn Virginia Corporation	PVA	45.48	3.1	5.6	15	2.0	5.6	
Encore Acquisition Corp. (40%)	EAC	B	21.85	3.8	5.6	12	-	6.0
Vintage Petroleum, Inc.	VPI	11.44	2.4	4.4	28	1.4	5.9	
	<i>Median</i>		<i>3.8</i>	<i>6.3</i>	<i>17</i>	<i>-</i>	<i>6.9</i>	
Canadian Royalty Trusts								
Enerplus Resources Fund	ERF	28.21	7.3	9.8	15	11.3	7.3	
Pengrowth Energy Trust	PGH	13.25	4.7	6.9	13	13.5	5.9	
Canadian Oil Sands Trust (US\$)	COSWF	B	30.17	3.6	6.5	7	4.8	8.9
Provident Energy Trust	PVX	8.40	4.2	6.1	13	15.4	4.7	
Natural Gas Royalty Trusts								
Cross Timbers Royalty Trust	CRT	24.65	7.9	11.2	12	8.7	9.2	
Sabine Royalty Trust	SBR	27.90	9.5	10.0	10	10.1	7.8	
Permian Basin RT (41%)	PBT	8.33	6.1	9.5	13	9.0	8.0	
Hugoton RoyaltyTrust (46%)	HGT	19.78	7.0	9.5	11	9.2	7.2	
San Juan Basin Royalty Trust	SJT	B	18.70	6.7	8.2	10	9.9	7.6
Micro Cap								
Abraxas Petroleum Corporation	ABP	0.96	6.7	12.6		-	12.6	
Purcell Energy, Ltd. (US\$)	PEL.TO	2.11	3.7	5.6	18	-	6.7	

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended September 30, 2004; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

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