

Meter Reader

A Weekly Analysis of Energy Stocks Using the McDep Ratio

March 30, 2004

The Oil Factor

Summary and Recommendation

Authors Stephen Leeb and Donna Leeb in a new book, The Oil Factor, advocate a model investment portfolio 58% in energy and gold, 37% in stocks and 5% in bonds and cash. Because interest rates are below inflation, investment selection in the 2000s should be different than it was in the 1980s and 1990s when real interest rates were positive. Should the year-to-year change in monthly crude oil price exceed 80%, the authors advocate changing to a deflation portfolio with 50% in bonds and cash. Aimed at a wide investment audience, the readable account may overstate to make a point. Our buy recommendations, **ChevronTexaco (CVX)**, **PetroChina (PTR)** and **Encana (ECA)** are part of the model portfolio, coincidentally.

Inflation, Oil Price and a Leading Indicator of Deflation

A thoughtful client sent us The Oil Factor. First printed in February 2004, the book seems to have been written mostly in 2003. It is an easy read, and as our client must have anticipated, we agreed with much of it, particularly in regard to the outlook for inflation and oil price. A deflation indicator appears innovative.

There is probably no more fundamental sign of future inflation than current interest rates below current inflation. If the Federal Reserve raises rates above the rate of inflation the game may change. Yet higher interest rates have their own negative consequences. The authors point out that actual inflation is already higher than that measured by official statisticians.

If higher inflation is nearly here, then there are few assets as important and likely to keep or enhance their real value than oil. Moreover the supply/demand case is also strong. The book cites supply experts Hubbert, Deffeyes and Campbell among others to make the point that cheap oil is at a peak in annual volume. The book repeats emphasis on oft-cited demand growth from China and developing countries.

Warning that deflation could interrupt the scenario, the authors create a leading indicator of deflation. The recommended measure is year-to-year gain in monthly oil price. The indicator exceeded some 80% in January 1974, February 1980, July 1987, September 1990, and November 1999, all times near when it was temporarily advantageous to take a deflationary stance favoring bonds over stocks.

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When year-to-year oil price gains recede to below 20%, a stock portfolio would be more suitable again. Those times were December 1974, December 1981, December 1987, January 1991 and December 2000. Also, because interest rates are below inflation now as they were thirty years ago, the stock portfolio should have an overriding energy theme.

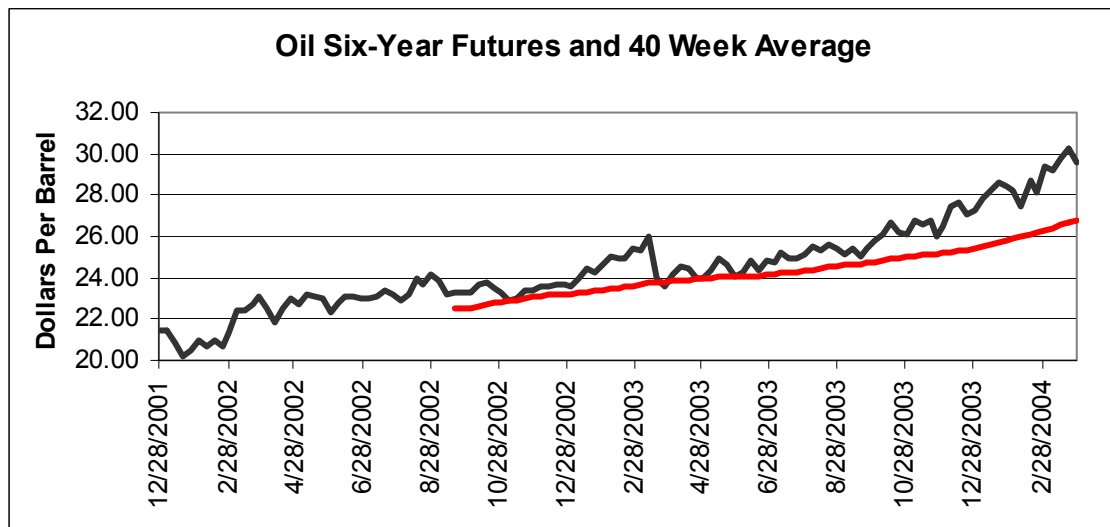
Is Oil Too Popular?

For professional energy investors, the Leeb book may be a measure of the popularity of energy investing. While too many books dealing with the subject could be a sign that all the buyers are already in oil and gas stocks that does not seem to be the case now.

At a recent meeting of the National Association of Petroleum Investment Analysts we sensed caution, not widespread optimism. There was no shortage of opinions about a \$38 oil price being unsustainable. While that view turned out correctly for the subsequent days, there was also recognition that some of the improvement in industry conditions was likely to last. Some were more bullish than they would let on perhaps for superstition that to be too confident would invite disappointment.

In our view, we are beyond the turn in the outlook for oil price and a few years into a new rising cycle that has at least several years remaining before a peak. A favorite chart points to a continuing steady upturn (see below). Six-year oil futures could drop from the current quote under \$30 a barrel to the 40 week moving average under \$27 and the trend, by definition, would still be up. Alternatively, six-year futures are still low compared to one-year futures at \$33 and the 2004 daily spot high above \$38. To us the question is not so much about oil price but what are stocks worth (see Tables 1-1 thru 2-2)?

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) 29-Mar 2004	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio
Mega Cap							
Exxon Mobil Corporation	XOM	41.09	6,612	272,000	43.00	0.09	0.96
BP plc	BP	49.45	3,684	182,000	60.00	0.13	0.85
Total S.A.	TOT	90.51	1,251	113,200	113.00	0.16	0.83
Royal Dutch/Shell	RD B	47.14	3,389	160,000	60.00	0.18	0.82
ChevronTexaco Corporation	CVX B	85.38	1,064	90,800	125.00	0.14	0.73
<i>Total or Median</i>				818,000		0.14	0.83
Producer/Refiners - Large Cap and Mid Cap							
Kinder Morgan, Inc.	KMI s	62.11	124	7,700	14.00	0.80	1.67
Valero Energy Corporation	VLO	58.59	120	7,020	55.00	0.42	1.04
Murphy Oil Corporation	MUR	61.81	93	5,740	62.00	0.20	1.00
Imperial Oil Limited (30%)	IMO	43.87	110	4,820	44.00	0.12	1.00
Marathon Oil Corporation	MRO	31.46	350	11,010	41.00	0.31	0.84
ConocoPhillips	COP B	67.43	680	45,900	110.00	0.28	0.72
ENI S.p.A.	E	98.70	755	74,500	150.00	0.12	0.70
Petro-Canada	PCZ	43.74	265	11,590	68.00	0.10	0.68
Norsk Hydro ASA	NHY B	70.30	257	18,050	120.00	0.13	0.64
Suncor Energy	SU	27.33	475	12,980	48.00	0.08	0.60
Lukoil Oil Company	LUKOY b	120.25	211	25,000	208.00	0.05	0.60
PetroChina Company Ltd (10%)	PTR b	48.90	176	8,600	88.00	0.07	0.59
Petroleo Brasileiro S. A.	PBR	31.03	1,096	34,000	65.00	0.20	0.58
<i>Total or Median</i>				267,000		0.13	0.70
Independent Natural Gas and Oil							
CNOOC Limited (19%)	CEO b	40.60	78	3,170	55.00	-	0.74
Canadian Natural Resources Limited	CNQ	54.67	137	7,490	88.00	0.29	0.73
Encana Corporation	ECA B	42.07	472	19,800	63.00	0.18	0.73
Apache Corporation	APA	42.09	324	13,600	64.00	0.15	0.71
Unocal Corporation	UCL	36.54	274	10,000	60.00	0.22	0.70
XTO Energy Inc.	XTO B	24.25	225	5,470	38.00	0.15	0.69
Pioneer Natural Resources Company	PXD	33.09	119	3,940	57.00	0.22	0.67
Occidental Petroleum Corp.	OXY	44.39	396	17,600	75.00	0.19	0.67
Pogo Producing Company	PPP	43.99	64	2,820	70.00	0.07	0.66
Anadarko Petroleum Corp.	APC B	50.65	252	12,800	94.00	0.21	0.64
Burlington Resources	BR B	61.42	198	12,200	115.00	0.15	0.61
Devon Energy	DVN	55.86	242	13,500	120.00	0.24	0.60
<i>Total or Median</i>				122,000		0.18	0.68
Service							
Baker Hughes Inc.	BHI	34.98	336	11,800	30.00	0.07	1.16
Halliburton Company	HAL	29.19	435	12,700	28.00	0.28	1.03
Schlumberger Ltd.	SLB	61.36	585	35,900	60.00	0.17	1.02
<i>Total or Median</i>				60,000		0.17	1.03

Buy/Sell rating after symbol: B - Buy full position, b - buy half position, s - short half position

McDep Ratio = Market cap and Debt to present value of oil and gas and other businesses

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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) 29-Mar 2004	EV/ Sales NTM	EV/ Ebitda NTM	P/E NTM	Divd or Distrib NTM (%)	PV/ Ebitda NTM	
Mega Cap								
Exxon Mobil Corporation	XOM	41.09	1.1	7.7	15	2.4	8.0	
Total S.A.	TOT	90.51	1.0	6.4	12	4.8	7.7	
BP plc	BP	49.45	0.9	6.2	13	3.3	7.3	
Royal Dutch/Shell	RD	B	47.14	1.0	5.6	12	4.6	6.8
ChevronTexaco Corporation	CVX	B	85.38	0.9	5.6	10	3.4	7.7
	<i>Median</i>		<i>1.0</i>	<i>6.2</i>	<i>12</i>	<i>3.4</i>	<i>7.7</i>	
Producer/Refiners - Large Cap and Mid Cap								
Kinder Morgan, Inc.	KMI	s	62.11	3.0	13.1	19	2.6	7.8
Imperial Oil Limited (30%)	IMO		43.87	1.3	7.9	16	1.5	7.9
Valero Energy Corporation	VLO		58.59	0.3	7.3	12	0.8	7.1
Suncor Energy	SU		27.33	2.8	7.0	13	0.6	11.6
Murphy Oil Corporation	MUR		61.81	1.4	7.0	15	1.3	7.0
ConocoPhillips	COP	B	67.43	0.7	5.8	9	2.6	8.0
ENI S.p.A.	E		98.70	1.5	5.2	10	4.6	7.4
Marathon Oil Corporation	MRO		31.46	0.4	5.1	10	3.2	6.0
PetroChina Company Ltd (10%)	PTR	b	48.90	2.5	4.6	9	4.4	7.8
Norsk Hydro ASA	NHY	B	70.30	0.8	4.6	13	2.3	7.1
Petro-Canada	PCZ		43.74	1.4	4.1	11	1.0	6.1
Lukoil Oil Company	LUKOY	b	120.25	1.0	3.8	6	2.1	6.4
Petroleo Brasileiro S. A.	PBR		31.03	1.6	3.7	4	3.3	6.4
	<i>Median</i>		<i>1.4</i>	<i>5.2</i>	<i>11</i>	<i>2.3</i>	<i>7.1</i>	
Independent Natural Gas and Oil								
CNOOC Limited (19%)	CEO	b	40.60	4.8	6.3	13	3.9	8.5
XTO Energy Inc.	XTO	B	24.25	4.3	5.9	11	0.2	8.6
Occidental Petroleum Corp.	OXY		44.39	2.4	5.3	9	2.5	7.9
Pioneer Natural Resources Company	PXD		33.09	3.8	5.3	19	-	7.9
Anadarko Petroleum Corp.	APC	B	50.65	3.5	5.1	9	1.1	8.0
Unocal Corporation	UCL		36.54	2.2	4.7	11	2.2	6.8
Burlington Resources	BR	B	61.42	3.4	4.7	10	1.0	7.8
Apache Corporation	APA		42.09	3.3	4.7	9	0.6	6.7
Canadian Natural Resources Limited	CNQ		54.67	3.1	4.5	9	0.8	6.1
Encana Corporation	ECA	B	42.07	2.1	4.5	12	1.0	6.2
Pogo Producing Company	PPP		43.99	2.5	3.5	8	0.5	5.3
Devon Energy	DVN		55.86	2.9	3.4	7	0.4	5.8
	<i>Median</i>			<i>3.2</i>	<i>4.7</i>	<i>10</i>	<i>0.9</i>	<i>7.3</i>
Service								
Baker Hughes Inc.	BHI		34.98	2.3	12.7	32	1.3	11.0
Halliburton Company	HAL		29.19	1.1	12.5	26	1.7	12.1
Schlumberger Ltd.	SLB		61.36	3.1	10.9	37	1.2	10.7
	<i>Median</i>			<i>2.3</i>	<i>12.5</i>	<i>32</i>	<i>1.3</i>	<i>11.0</i>

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended March 31, 2005; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

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Table 2-1
Independent Natural Gas and Oil Producers - Small Cap
Rank by McDep Ratio: Market Cap and Debt to Present Value

	<i>Symbol/ Rating</i>	<i>Price (\$/sh) 29-Mar 2004</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>
Short Life							
Spinnaker Exploration Company	SKE	33.31	34.2	1,140	28.00	0.11	1.17
Western Gas Resources	WGR	49.35	37.0	1,830	50.00	0.17	0.99
Southwestern Energy Company	SWN	23.00	36.0	830	29.00	0.22	0.84
The Houston Exploraton Company	THX	41.20	31.0	1,280	55.00	0.20	0.80
Newfield Exploration Company	NFX	46.99	56.0	2,630	67.00	0.20	0.76
Stone Energy Company	SGY	48.05	26.6	1,280	72.00	0.20	0.73
Cimarex Energy Company	XEC	27.60	42.7	1,180	38.00	0.00	0.73
Denbury Resources Inc.	DNR	15.57	55.7	870	25.00	0.21	0.70
St. Mary Land and Exploration Company	SM	32.68	29.0	950	50.00	0.10	0.69
PetroKazakhstan Inc.	PKZ	27.87	81.0	2,260	42.00	0.03	0.67
Chesapeake Energy Corporation	CHK	12.68	220	2,790	24.00	0.29	0.66
Energy Partners Ltd.	EPL	12.99	37.4	486	22.00	0.14	0.65
Westport Resources Corporation	WRC	32.53	68.0	2,210	57.00	0.17	0.64
Forest Oil Corporation	FST	24.85	49.0	1,220	53.00	0.26	0.61
Range Resources Corporation	RRC	11.80	57.0	670	24.00	0.22	0.61
				<i>Total or Median</i>		<i>0.20</i>	<i>0.70</i>
				<i>21,600</i>			
Long Life							
Ultra Petroleum Corp.	UPL	29.17	78.0	2,280	25.00	0.05	1.16
Unit Corporation	UNT	26.50	44.1	1,170	25.00	0.01	1.06
Penn Virginia Corporation	PVA	59.20	9.1	540	72.00	0.14	0.85
Quicksilver Resources Inc.	KWK	37.13	25.2	940	50.00	0.19	0.79
Swift Energy Company	SFY	18.25	27.4	500	32.00	0.29	0.70
Magnum Hunter Resources, Inc.	MHR	9.97	68.0	680	20.00	0.32	0.66
Encore Acquisition Corp.	EAC	27.14	30.5	827	47.00	0.18	0.66
Whiting Petroleum Corporation	WLL	22.81	18.7	430	40.00	0.19	0.65
Evergreen Resources, Inc.	EVG	34.10	44.0	1,500	59.00	0.10	0.62
Berry Petroleum Company	BRY	25.34	22.1	560	43.00	0.07	0.62
Vintage Petroleum, Inc.	VPI	14.00	63.0	880	33.00	0.28	0.58
				<i>Total or Median</i>		<i>0.18</i>	<i>0.66</i>
				<i>10,300</i>			
Micro Cap							
Abraxas Petroleum Corporation	ABP	2.40	35.8	86	1.50	0.77	1.14
Purcell Energy, Ltd. (US\$)	PEL.TO	1.83	48.0	88	2.80	0.27	0.75

Buy/Sell rating after symbol: b - buy half unlevered position in diversified energy portfolio
 McDep Ratio = Market cap and Debt to present value of oil and gas and other businesses

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Table 2-2
Independent Natural Gas and Oil Producers - Small Cap
Rank by EV/Ebitda: Enterprise Value to Earnings Before Interest, Tax, Deprec.

		<i>Price</i>	<i>EV/</i>	<i>EV/</i>	<i>Divd or</i>	<i>PV/</i>		
	<i>Symbol/</i>	<i>(\$/sh)</i>	<i>Sales</i>	<i>Ebitda</i>	<i>P/E</i>	<i>Ebitda</i>		
	<i>Rating</i>	<i>29-Mar</i>	<i>NTM</i>	<i>NTM</i>	<i>NTM</i>	<i>NTM</i>		
		<i>2004</i>	<i>NTM</i>	<i>NTM</i>	<i>NTM</i>	<i>NTM</i>		
					<i>Distrib</i>			
					<i>(%)</i>			
Short Life								
Western Gas Resources	WGR	49.35	0.8	9.2	19	-	9.3	
Southwestern Energy Company	SWN	23.00	3.3	5.8	11	-	6.9	
Spinnaker Exploration Company	SKE	33.31	4.8	5.5	15	-	4.7	
Denbury Resources Inc.	DNR	15.57	3.1	4.6	9	-	6.6	
Cimarex Energy Company	XEC	b	27.60	3.4	4.5	12	-	6.2
Stone Energy Company	SGY	48.05	3.2	4.4	9	-	6.0	
Chesapeake Energy Corporation	CHK	12.68	3.2	4.3	8	0.9	6.4	
Range Resources Corporation	RRC	11.80	3.3	4.2	8	0.3	6.9	
Westport Resources Corporation	WRC	32.53	3.2	4.1	10	-	6.4	
St. Mary Land and Exploration Company	SM	32.68	2.8	4.1	10	0.3	5.9	
Newfield Exploration Company	NFX	46.99	2.8	3.9	9	-	5.2	
Forest Oil Corporation	FST	24.85	2.7	3.6	6	-	5.9	
The Houston Exploraton Company	THX	41.20	2.8	3.6	8	-	4.5	
PetroKazakhstan Inc.	PKZ	27.87	1.8	3.4	5	-	5.0	
Energy Partners Ltd.	EPL	12.99	2.2	3.3	12	-	5.1	
	<i>Median</i>		<i>3.1</i>	<i>4.2</i>	<i>9</i>	<i>-</i>	<i>6.0</i>	
Long Life								
Ultra Petroleum Corp.	UPL	29.17	10.7	13.8	23	-	11.9	
Quicksilver Resources Inc.	KWK	37.13	6.3	9.6	18	-	12.1	
Unit Corporation	UNT	26.50	3.4	8.2	21	-	7.7	
Evergreen Resources, Inc.	EVG	34.10	5.3	7.5	12	-	12.0	
Penn Virginia Corporation	PVA	59.20	3.5	6.2	13	1.5	7.3	
Berry Petroleum Company	BRY	b	25.34	3.4	5.9	10	1.7	9.6
Encore Acquisition Corp.	EAC	b	27.14	4.1	5.7	9	-	8.6
Swift Energy Company	SFY	18.25	3.7	5.6	12	-	8.0	
Whiting Petroleum Corporation	WLL	22.81	3.2	5.0	10	-	7.6	
Magnum Hunter Resources, Inc.	MHR	9.97	3.2	4.9	9	-	7.4	
Vintage Petroleum, Inc.	VPI	14.00	2.3	3.9	8	1.3	6.7	
	<i>Median</i>		<i>3.5</i>	<i>5.9</i>	<i>12</i>	<i>-</i>	<i>8.0</i>	
Micro Cap								
Abraxas Petroleum Corporation	ABP	2.40	8.0	12.5		-	11.0	
Purcell Energy, Ltd. (US\$)	PEL.TO	1.83	3.3	4.4	8	-	5.9	

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended March 31, 2005; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

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