

## ***Meter Reader***

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

November 16, 2004

# **Targets**

## **Summary and Recommendation**

Low McDep Ratio buy recommendations of producers with long reserve life may be vulnerable as targets in an environment more conducive to deals. Corporate strategists may interpret the multi-year strength of oil price as confirmation of a favorable long-term outlook and the recent pull back as an indicator of favorable timing to do a deal. Futures curves support that rationale with oil price for December 2010 up from seven weeks ago while the widely quoted oil price for December 2004 is down. We discuss the target appeal of **Canadian Oil Sands Trust (COSWF)** and **Burlington Resources (BR)**.

## **Canadian Oil Sands Trust a “Bolt-On” Gem**

Considering all the industry interest in expanding production from the oil sands of Alberta, avaricious eyes must be turned on the large existing producers. Existing operations have the uncertainty behind them of future construction costs and the risks of overruns and delays. Existing plants would reap a lot of cash flow benefit before the new plants can be completed.

In the case of Canadian Oil Sands Trust, 35% owner of the Syncrude oil sands facility, there could be a special advantage to an acquirer who already owns an interest in the joint venture. All of the management attention that **Imperial Oil (IMO)**, the largest operating company owner at 25%, invests in the facility would be more rewarding if it owned 60%. That would be what corporate strategists like to call a “bolt-on” acquisition, a property that can be added without any increase in ongoing owner effort.

Other owners of Syncrude include **ConocoPhillips (COP)**, **Petro-Canada (PCZ)** and **Nexen (NXY)**. Each of those companies and Imperial (70% owned by **ExxonMobil (XOM)**) have oil sands expansion projects. COP, PCZ and NXY have already been active in deals this year. COP is investing in **Lukoil (LUKOY)**. PCZ bought a U.S. natural gas producer, Prima Energy, and an interest in the Buzzard oil field in the North Sea. NXY is buying **Encana’s (ECA)** share of the Buzzard field. Imperial is likely to be investing in an Arctic pipeline.

Corporate acquirers look at the same future as do investors. Part of a more numerous group, some investors inevitably are ahead of corporate acquirers. As a result the attractive ideas we try to identify for investors are also typically attractive to operating companies. Yet we are not hoping for COSWF to be acquired as we would just as soon realize the long-term benefits as holders of the trust.

Historical independent energy investment analysis by Kurt Wulff doing business as McDep Associates is posted at [www.mcdep.com](http://www.mcdep.com). Analyses are prepared from sources and data believed to be reliable, but no representation is made as to their accuracy or completeness. Mr. Wulff is not paid by covered companies. Neither he nor his spouse trade a subject stock within a week before or after a change in rating. 1

## ***Meter Reader***

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

November 16, 2004

### **Burlington Resources a Long-Time Long-Life Target**

We once thought BR was an attractive target for Atlantic Richfield. California-based Arco was long on oil while BR, as one of the two dominant producers in the San Juan Basin, was one of the main natural gas suppliers to the Golden State. Alas, nothing happened and Arco was acquired by **BP (BP)**. BP also acquired Amoco, the other dominant producer in the San Juan Basin.

In hindsight, the 1990s was a cyclical period for natural gas and BR. Now we may be in a transition where the stock price of BR does not yet reflect the natural gas market of the 2000s. The company still has long-life reserves in the San Juan Basin and has added promising exposure in Canada's Deep Basin.

It is debatable as to how much the mega cap companies would be interested in onshore natural gas production. Near mega cap, ConocoPhillips, is a San Juan Basin producer with Canadian exposure and with long-term interest in Arctic gas. BR could be a good fit for COP to advance the acquirer's march to mega cap status.

### **Burlington Resources a Royalty Trust Candidate**

We often fielded the question of BR acquiring **San Juan Basin Royalty Trust (SJT)**, an obvious "bolt-on" possibility since BR operates and has a 25% interest in all the properties in which SJT has a 75% interest. BR did tender for the shares of **Permian Basin Royalty Trust (PBT)** and fell short of its expectations. Only 41% of the units were tendered to give BR the ownership of PBT that it retains today.

One implication is that Burlington Resources did not value SJT and PBT as highly as did the market. If the comparison is with BR stock today, we agree that BR stock is cheaper than SJT and PBT among royalty trusts. That leads to the logical question raised by a veteran oil analyst on BR's most recent quarterly call. Why not turn Burlington Resources into a royalty trust? About twenty years ago, Boone Pickens made that proposal to Gulf Oil. He was summarily dismissed. Gulf soon fell into the hands of what is now **ChevronTexaco CVX**). The Seven Sisters of international oil, **XOM**, **Royal Dutch/Shell (RD/SC)**, BP, Chevron, Mobil, Texaco and Gulf, became six.

Though Gulf never became a royalty trust, a large share of oil and gas production in Canada has been transferred to trusts. Nor would all of BR be turned into a trust. There would presumably be a continuing leaner company that would own perhaps 20% of the resources put into a trust and operate those and perhaps other properties.

Historical independent energy investment analysis by Kurt Wulff doing business as McDep Associates is posted at [www.mcdep.com](http://www.mcdep.com). Analyses are prepared from sources and data believed to be reliable, but no representation is made as to their accuracy or completeness. Mr. Wulff is not paid by covered companies. Neither he nor his spouse trade a subject stock within a week before or after a change in rating.

## Meter Reader

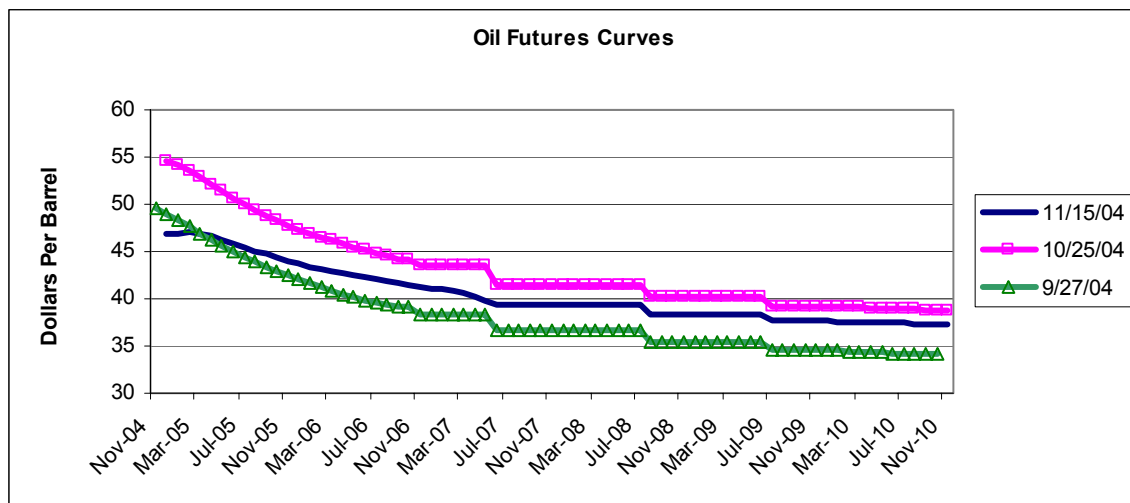
*A Weekly Analysis of Energy Stocks Using the McDep Ratio*

November 16, 2004

### Oil Futures Curve Positive for Deals and Investments

When short-term interest rates are higher than long-term interest rates the implication is that economic activity should slow from a high pace. Similarly when short-term oil prices are higher than long-term oil prices the signal is that consumption should slow from a high pace.

The oil futures curve in recent weeks has been quite steep (see chart [Oil Futures Curve](#)). Since then the front end has come down from a high of \$55 a barrel to \$47 a barrel while the back end at \$37 a barrel is up from seven weeks ago and down slightly from a month ago. The flatter curve for oil futures as for interest rates implies less need for restraining the pace of consumption. Consumers can breathe easier near-term.



While the curve has become flatter it has not returned to past low levels. The implication is that consumers should be on alert that long-term the price may be higher than in past indications.

Futures traders counting on further gains in the near term price may have been disappointed lately. For oil investors the one-year futures are indicative of next twelve months cash flow while six-year futures are indicative of present value of future cash flow (see chart [Six-Year and One-Year Natural Gas and Oil Futures](#)). NTM cash flow expectations have receded a bit, but stock price depends more on long-term prospects.

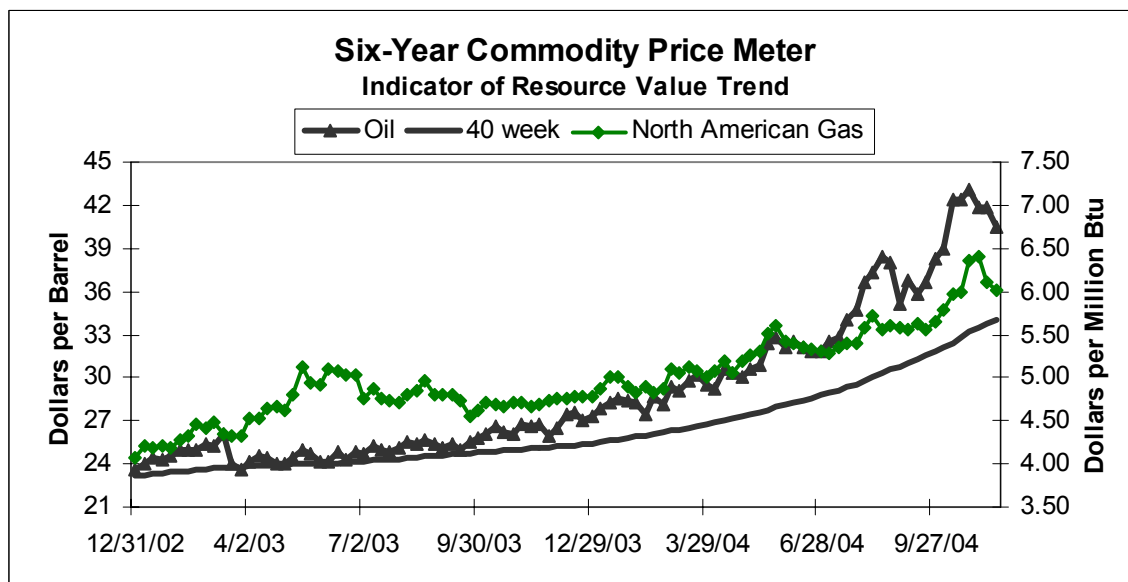
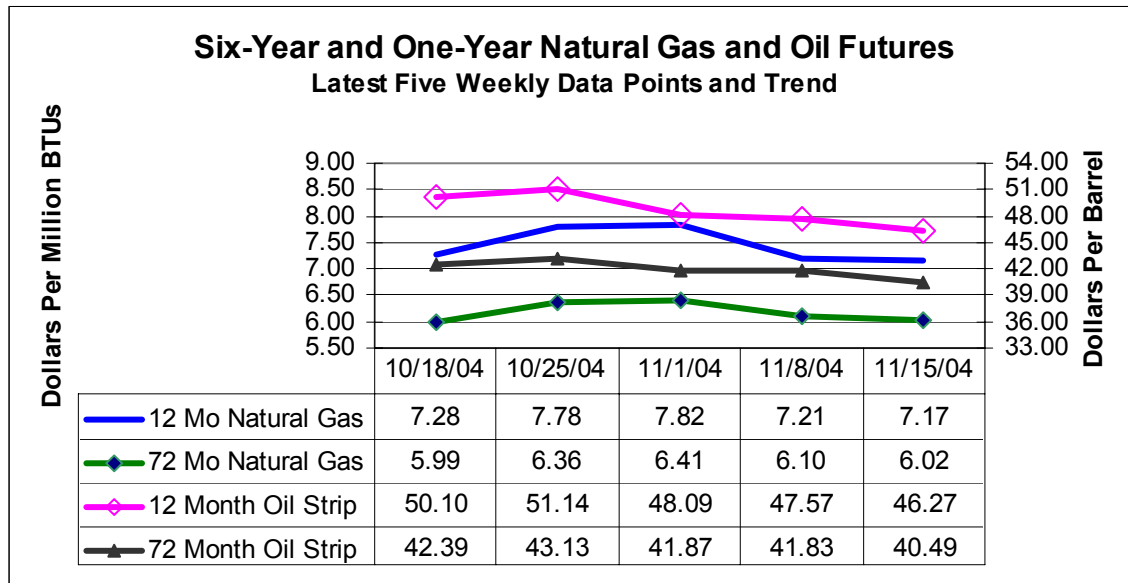
Six-year futures have receded too, but by a smaller amount, to an average \$40 a barrel for continuous delivery. Moreover the trend continues to be up as defined by the current quote being above the 40-week average (see chart [Six-Year Commodity Price Meter](#)). The current six-year futures quote is higher than the constant real price of less than \$35 a barrel that seems reflected in current stock prices. As a result buy recommendations continue to be valid as does the logic we outlined for deals.

Historical independent energy investment analysis by Kurt Wulff doing business as McDep Associates is posted at [www.mcdep.com](http://www.mcdep.com). Analyses are prepared from sources and data believed to be reliable, but no representation is made as to their accuracy or completeness. Mr. Wulff is not paid by covered companies. Neither he nor his spouse trade a subject stock within a week before or after a change in rating.

## Meter Reader

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

November 16, 2004



For recommendations and valuation measures, see tables [Rank by McDep Ratio](#) and [Rank by EV/Ebitda](#). For recent single-stock research, see [Index of Stock Ideas](#).

Kurt H. Wulff, CFA

Historical independent energy investment analysis by Kurt Wulff doing business as McDep Associates is posted at [www.mcdep.com](http://www.mcdep.com). Analyses are prepared from sources and data believed to be reliable, but no representation is made as to their accuracy or completeness. Mr. Wulff is not paid by covered companies. Neither he nor his spouse trade a subject stock within a week before or after a change in rating.

## Meter Reader

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

November 16, 2004

#### Rated Oil and Gas Producers Rank by McDep Ratio: Market Cap and Debt to Present Value

	Symbol/ Rating		Price (\$/sh) 15-Nov 2004	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio
<b>Mega Cap</b>								
Exxon Mobil Corporation	XOM	B3	49.58	6,508	323,000	50.00	0.07	0.99
BP plc	BP	B3	59.30	3,614	214,000	60.00	0.13	0.99
Shell Transport and Trading Co. plc	SC	B3	48.84	1,587	78,000	51.00	0.17	0.97
Total S.A.	TOT	B3	107.37	1,228	132,000	113.00	0.17	0.96
Royal Dutch Petroleum	RD	B1	55.63	2,021	112,000	60.00	0.17	0.94
ChevronTexaco Corporation	CVX	B1	52.97	2,126	113,000	62.50	0.13	0.87
<i>Total or Median</i>					972,000		0.15	0.96
<b>Producer/Refiners - Large Cap and Mid Cap</b>								
Kinder Morgan, Inc.	KMI	S2	66.41	125	8,280	20.00	0.74	1.60
Imperial Oil Limited (30%)	IMO	B3	58.11	107	6,210	58.00	0.10	1.00
Marathon Oil Corporation	MRO	B3	36.83	347	12,780	40.00	0.31	0.94
Suncor Energy	SU	B3	32.48	460	14,940	38.00	0.13	0.87
Norsk Hydro ASA	NHY	B1	74.75	254	19,000	90.00	0.17	0.86
ConocoPhillips	COP	B1	86.50	702	60,700	110.00	0.25	0.84
Petro-Canada	PCZ	B3	53.85	269	14,510	68.00	0.18	0.83
PetroChina Company Ltd (10%)	PTR	B2	54.73	176	9,620	82.00	0.06	0.69
Lukoil Oil Company	LUKOY	B2	130.75	209	27,000	208.00	0.06	0.65
<i>Total or Median</i>					173,000		0.17	0.86
<b>Independent Natural Gas and Oil - Large Cap and Mid Cap</b>								
CNOOC Limited (19%)	CEO	B2	53.68	78	4,190	59.00	-	0.91
XTO Energy Inc.	XTO	B1	32.98	272	8,960	38.00	0.19	0.89
Encana Corporation	ECA	B1	51.81	472	24,400	63.00	0.21	0.86
Unocal Corporation	UCL	B3	43.18	274	11,800	54.00	0.24	0.85
Occidental Petroleum Corp.	OXY	B3	56.55	403	22,800	75.00	0.17	0.80
Anadarko Petroleum Corp.	APC	B1	66.52	253	16,800	94.00	0.20	0.77
Devon Energy Corporation	DVN	B3	74.95	250	18,700	110.00	0.22	0.75
Burlington Resources	BR	B1	40.89	395	16,200	58.00	0.14	0.75
<i>Total or Median</i>					124,000		0.20	0.82
<b>Independent Natural Gas and Oil - Small Cap</b>								
Cimarex Energy Company	XEC	B2	37.67	43	1,620	38.00	0.00	0.99
Berry Petroleum Company	BRY	B2	40.80	22	910	43.00	0.06	0.95
Energy Partners Ltd.	EPL	B3	17.63	39	690	22.00	0.15	0.83
Encore Acquisition Company	EAC	B2	31.53	33	1,030	47.00	0.20	0.73
<i>Total or Median</i>					4,300		0.10	0.89
<b>Income</b>								
Kinder Morgan Energy Partners, L.P.	KMP	S3	45.55	145	6,600	15.00	0.52	1.98
Kinder Morgan Management, LLC	KMR	S3	41.10	55	2,260	15.00	0.52	1.84
San Juan Basin Royalty Trust	SJT	H	28.70	47	1,340	27.00	-	1.06
Canadian Oil Sands Trust (US\$)	COSWF	B1	47.73	93	4,430	72.00	0.18	0.72
<i>Total or Median</i>					14,600		0.35	1.45

B1 = Buy full unlevered position, B2 = Buy half unlevered position, B3 = Alternative buy

S2 = Short half unlevered position, S3 = Short quarter unlevered position

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

Historical independent energy investment analysis by Kurt Wulff doing business as McDep Associates is posted at [www.mcdep.com](http://www.mcdep.com). Analyses are prepared from sources and data believed to be reliable, but no representation is made as to their accuracy or completeness. Mr. Wulff is not paid by covered companies. Neither he nor his spouse trade a subject stock within a week before or after a change in rating.

## Meter Reader

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

November 16, 2004

#### Rated Oil and Gas Producers

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

	Symbol/ Rating		Price (\$/sh) 15-Nov 2004	Adjstd Resrvs/ Prod NTM	PV/ Ebitda NTM	EV/ Ebitda NTM	P/E NTM	Divd or Distrib NTM (%)
<b>Mega Cap</b>								
BP plc	BP	B3	59.30	9.9	6.9	6.8	13	2.9
Exxon Mobil Corporation	XOM	B3	49.58	11.1	6.5	6.4	12	2.2
Total S.A.	TOT	B3	107.37	9.6	6.5	6.2	11	2.9
Shell Transport and Trading Co. plc	SC	B3	48.84	8.1	5.4	5.2	10	4.0
Royal Dutch Petroleum	RD	B1	55.63	8.1	5.4	5.1	9	4.1
ChevronTexaco Corporation	CVX	B1	52.97	11.4	5.5	4.8	8	3.0
	<i>Median</i>			9.7	6.0	5.7	10	3.0
<b>Producer/Refiners - Large Cap and Mid Cap</b>								
Kinder Morgan, Inc.	KMI	S2	66.41		8.3	13.3	17	3.4
Suncor Energy	SU	B3	32.48	18.4	7.8	6.8	15	0.6
Imperial Oil Limited (30%)	IMO	B3	58.11	11.3	6.3	6.3	11	1.3
Marathon Oil Corporation	MRO	B3	36.83	7.8	5.6	5.3	10	3.0
Petro-Canada	PCZ	B3	53.85	7.6	5.6	4.6	9	0.9
ConocoPhillips	COP	B1	86.50	11.9	5.5	4.6	7	2.0
Norsk Hydro ASA	NHY	B1	74.75	9.4	5.3	4.6	11	2.4
PetroChina Company Ltd (10%)	PTR	B2	54.73	13.5	6.5	4.4	9	4.3
Lukoil Oil Company	LUKOY	B2	130.75	12.2	5.7	3.7	6	2.6
	<i>Median</i>			11.6	5.7	4.6	10	2.4
<b>Independent Natural Gas and Oil - Large Cap and Mid Cap</b>								
XTO Energy Inc.	XTO	B1	32.98	11.7	5.7	5.1	10	0.1
CNOOC Limited (19%)	CEO	B2	53.68	9.6	5.1	4.6	9	3.3
Occidental Petroleum Corp.	OXY	B3	56.55	11.2	5.8	4.6	8	1.9
Unocal Corporation	UCL	B3	43.18	8.9	5.2	4.4	9	1.9
Anadarko Petroleum Corp.	APC	B1	66.52	10.9	5.5	4.2	9	0.8
Burlington Resources	BR	B1	40.89	9.9	5.6	4.1	8	0.8
Encana Corporation	ECA	B1	51.81	6.4	4.4	3.7	8	0.8
Devon Energy Corporation	DVN	B3	74.95	6.6	4.5	3.4	7	0.5
	<i>Median</i>			9.7	5.3	4.3	8	0.8
<b>Independent Natural Gas and Oil - Small Cap</b>								
Encore Acquisition Company	EAC	B2	31.53	11.9	7.7	5.7	10	-
Berry Petroleum Company	BRY	B2	40.80	12.5	5.8	5.5	12	1.2
Cimarex Energy Company	XEC	B2	37.67	5.2	3.7	3.7	9	-
Energy Partners Ltd.	EPL	B3	17.63	4.9	3.6	3.0	9	-
	<i>Median</i>			8.6	4.7	4.6	10	-
<b>Income</b>								
Kinder Morgan Energy Partners, L.P.	KMP	S3	45.55	12.0	7.9	15.7	21	6.4
Kinder Morgan Management, LLC	KMR	S3	41.10	12.0	7.9	14.6	19	7.1
Canadian Oil Sands Trust (US\$)	COSWF	B1	47.73	20.0	11.3	8.2	11	3.5
San Juan Basin Royalty Trust	SJT	H	28.70	12.5	7.6	8.1	9	11.1
	<i>Median</i>			12.2	7.9	11.4	15	6.8

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

Historical independent energy investment analysis by Kurt Wulff doing business as McDep Associates is posted at [www.mcdep.com](http://www.mcdep.com). Analyses are prepared from sources and data believed to be reliable, but no representation is made as to their accuracy or completeness. Mr. Wulff is not paid by covered companies. Neither he nor his spouse trade a subject stock within a week before or after a change in rating.

## *Meter Reader*

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

November 16, 2004

#### **Index of Stock Ideas Recent Written Analyses**

<u>Date</u>	<u>Symbol</u>	<u>Stock</u>	<u>Theme</u>
15-Nov	EPL	Energy Partners, Ltd.	Lowest Cash Flow Multiple
15-Nov	OXY	Occidental Petroleum Corporation	Still Cheap
12-Nov	CRT	Cross Timbers Royalty Trust	Low Risk, Long Life
9-Nov	IMO	Imperial Oil Limited	Raise Present Value to US\$58 a Share
9-Nov	DVN	Devon Energy Corporation	Large Cap Natural Gas
8-Nov	BRY	Berry Petroleum Company	Smart Oil Contract
8-Nov	PCZ	Petro-Canada	Looking for Long Life
5-Nov	SJT	San Juan Basin Royalty Trust	High Winter Distributions Ahead
4-Nov	ECA	EnCana Corporation	Bold Moves
3-Nov	MRO	Marathon Oil Corporation	Lower Net Present Value to \$40 a Share
2-Nov	XOM	Exxon Mobil Corporation	Raise Present Value to \$50 a Share
26-Oct	KMP	Kinder Morgan Energy Partners, L.P.	Fallen Star
26-Oct	KMI	Kinder Morgan Inc.	Fallen Star
26-Oct	KMR	Kinder Morgan Management, LLC	Fallen Star
18-Oct	NHY	Norsk Hydro ASA	High Cash Flow
11-Oct	* BR	Burlington Resources, Inc.	Natural Gas Sensitivity
11-Oct	* COSWF	Canadian Oil Sands Trust	Raise Present Value to US\$72 a Unit
11-Oct	* SJT	San Juan Basin Royalty Trust	Raise Present Value to \$27 a Unit
6-Oct	* COSWF	Canadian Oil Sands Trust	Ten Percent Holder Surfaces
5-Oct	* LUKOY	Lukoil Oil Company	SEC Standard Reduces Reserves
30-Sep	* COP	ConocoPhillips	Lukoil Investment Confirmed
30-Sep	* LUKOY	Lukoil Oil Company	ConocoPhillips Partner Confirmed
28-Sep	* RD	Royal Dutch Petroleum	Low Risk, Attractive Reward
28-Sep	* SC	Shell Transport & Trading Company, p.l.c.	Low Risk, Attractive Reward
20-Sep	* BP	BP p.l.c.	Betting on Putin
20-Sep	* LUKOY	Lukoil Oil Company	ConocoPhillips Partner
8-Sep	* CEO	CNOOC Ltd ADS	Higher Dividend, Higher Present Value
8-Sep	* PTR	PetroChina Company Limited	Dividend Raised, Present Value Trimmed
8-Sep	* XTO	XTO Energy Inc.	High Performance, High Compensation
7-Sep	* APC	Anadarko Petroleum Corporation	Commodity Alternative
7-Sep	* XEC	Cimarex Energy Company	High Present Value per Barrel
3-Sep	* EAC	Encore Acquisition Company	Rising Recovery and Leadership
31-Aug	* COP	ConocoPhillips	Lukoil Investor?
26-Aug	* BP	BP p.l.c.	Russia Distinction
26-Aug	* TOT	Total S.A.	Shell Acquirer?
23-Aug	* UCL	Unocal Corporation	Asian Natural Gas and Oil
16-Aug	* SU	Suncor Energy Inc.	A Boone and Charlie Favorite
4-Aug	* CVX	ChevronTexaco Corporation	Stock Price Lagging Oil Price

\* Archived on [www.mcdep.com](http://www.mcdep.com)

Historical independent energy investment analysis by Kurt Wulff doing business as McDep Associates is posted at [www.mcdep.com](http://www.mcdep.com). Analyses are prepared from sources and data believed to be reliable, but no representation is made as to their accuracy or completeness. Mr. Wulff is not paid by covered companies. Neither he nor his spouse trade a subject stock within a week before or after a change in rating.