

Meter Reader

A Weekly Analysis of Energy Stocks Using the McDep Ratio

November 23, 2004

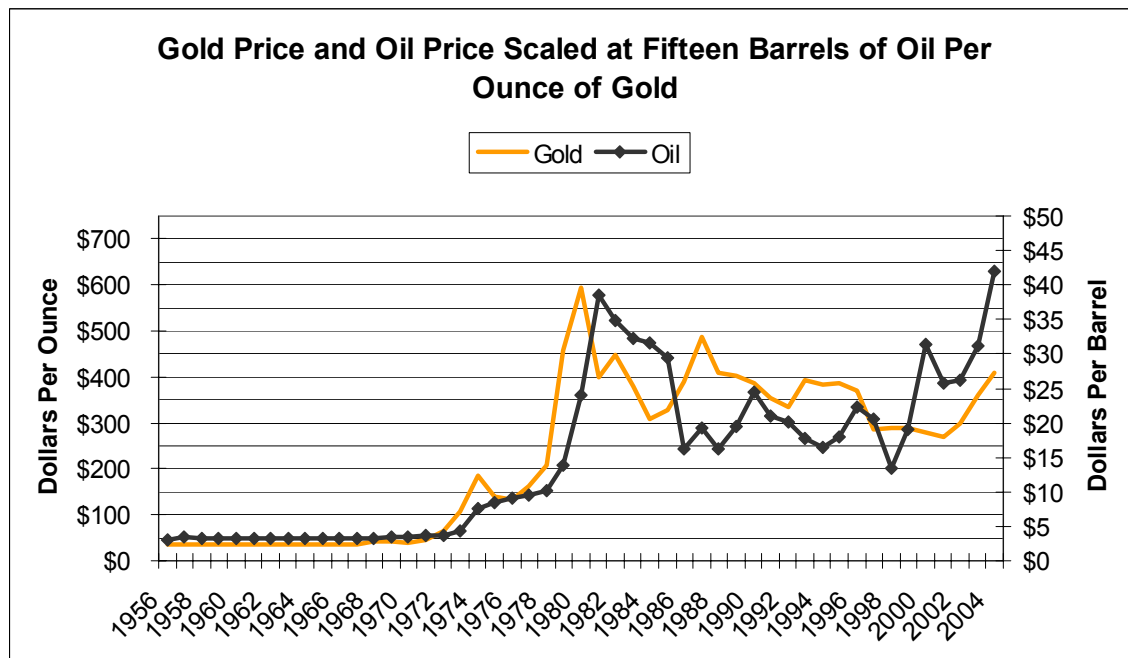
Gold Rush!

Summary and Recommendation

The accessibility of gold to investors widened greatly last week in the form of a new security, symbol GLD, launched on the New York Stock Exchange. We liken the significance of the financial invention to the introduction of the money market fund, the oil and gas royalty trust, oil futures and Treasury Inflation Protected Securities. There are valuation implications for oil and gas. A rising price of gold appears to confirm most of the increase in the price of oil reflected in recommended stocks. Oil futures point to further gains for oil and gas stocks and perhaps for gold also. Well-positioned buy recommendations include **Anadarko (APC)**, **XTO Energy (XTO)** and **Cimarex (XEC)**.

Gold Price to Oil Price – 15:1

It looks like gold price has approximated 15 times the price of light, sweet crude oil for the past 50 years (see chart Gold Price and Oil Price Scaled at Fifteen Barrels of Oil Per Ounce of Gold). We see gold primarily as a hedge against the declining value of the dollar and other currencies, a feature we also attribute to oil and gas. Yet there is no hard and fast relationship that says gold price and oil price should conform to a fixed ratio. In both cases there are other factors at play that may not be directly related.



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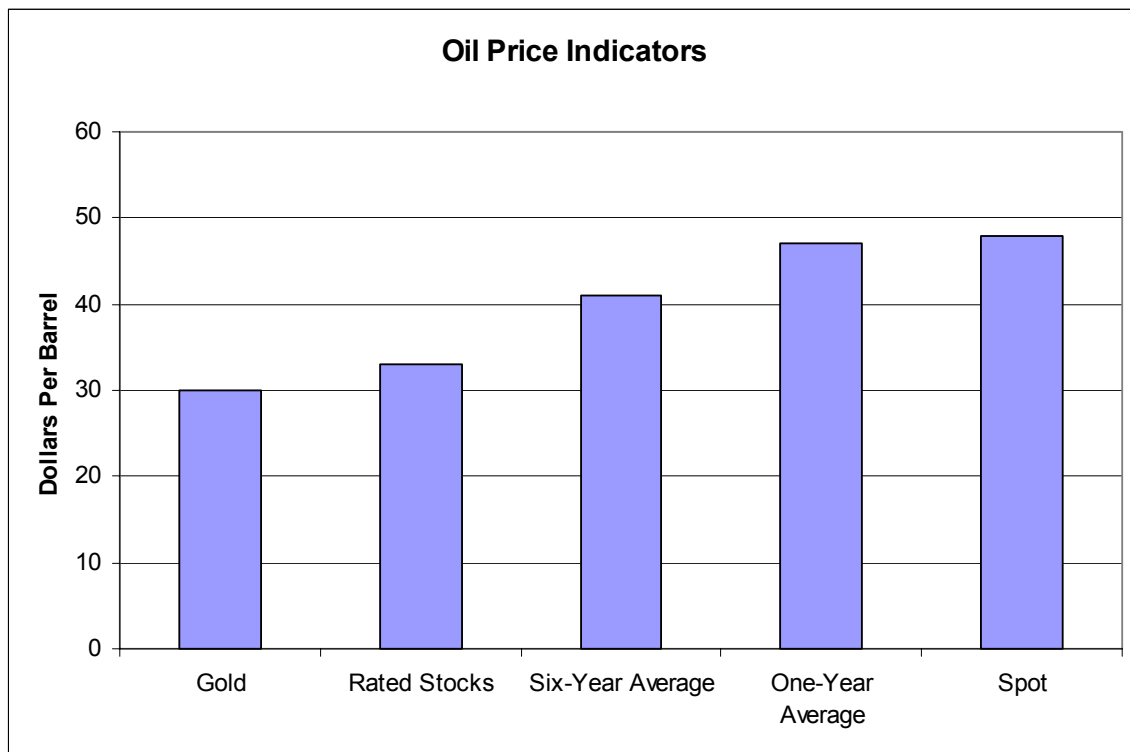
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Like oil, gold seems to trace about a 28-year economic cycle measured from the bottom of the steep stock market decline in 1974 to the bottom of the steep stock market decline in 2002. Last time gold was leading oil in the advancing phase. This time it looks like oil is leading gold up.

Gold Price Confirms \$30 Oil, So Far

The current spot price of gold near \$450 an ounce appears to confirm an oil price of \$30 a barrel assuming a 15:1 relationship (see chart [Oil Price Indicators](#)). That is close to what may be reflected in current stock prices for recommended issues. We say that present value of oil reserves relates to a constant real oil price of \$35 a barrel. The median McDep Ratio is less than 0.90, thereby implying that the price of oil in the stock market may be about \$33 a barrel. On that basis the price of gold seems to confirm most of the advance in energy price that stock market investors seem to believe. We do not need gold to confirm the oil price advance, but it does seem to reduce further any likelihood that oil would return to past low levels.



The futures market, another great financial innovation, points higher for oil as we like to repeat. Whether the same conclusion applies to gold, we will let investors decide as we do not feel qualified to opine authoritatively on the outlook for that commodity.

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Financial Invention Expected to be Popular

The general goals of investment as we see them are growth with inflation protection and deflation resistance. Our oil and gas recommendations fit all three to different degrees.

Treasury Inflation Protection Securities (TIPS) offer less growth, presumably 1:1 inflation protection and strong deflation resistance with the return of principal regardless of deflation. TIPS have been popular and especially rewarding for the early adopters. The problem that has developed with TIPS is that the government measure of inflation, the Consumer Price Index, appears understated because of subjective substitution and quality adjustments.

Gold offers a more free-market inflation adjustment less dependent on the whims of bureaucrats. The problem with gold has been the awkwardness of investing in it. The new security, an exchange traded fund, is highly convenient. Moreover the tax implications of owning the security appear to be less restrictive than owning gold coins. We suppose that almost anyone who owns a stock can now own gold with practically the same convenience. Investors traded \$1.5 billion of GLD in its first three days.

Strangely, gold also seems to offer deflation resistance. Apparently the rationale is that during weak economic times investors fear currency collapse. To counter those concerns, the U.S. government outlawed private ownership of gold bullion and the issuance of inflation-indexed securities for much of the last century as we recall.

We can see portfolio benefits of combining oil and gas, TIPS and gold. If more investors also find gold more attractive, new demand may contribute to higher gold price that indirectly further strengthens the long-term oil price outlook.

Futures Sustain Trends

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](#)). 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 implications are favorable for all producer buy recommendations including APC, XTO, and XEC.

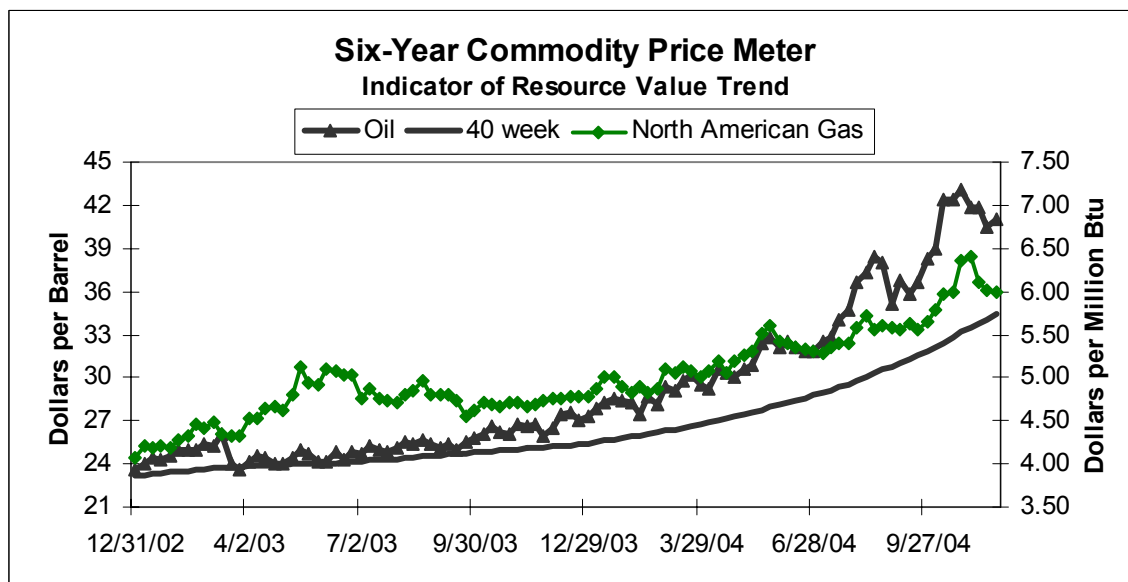
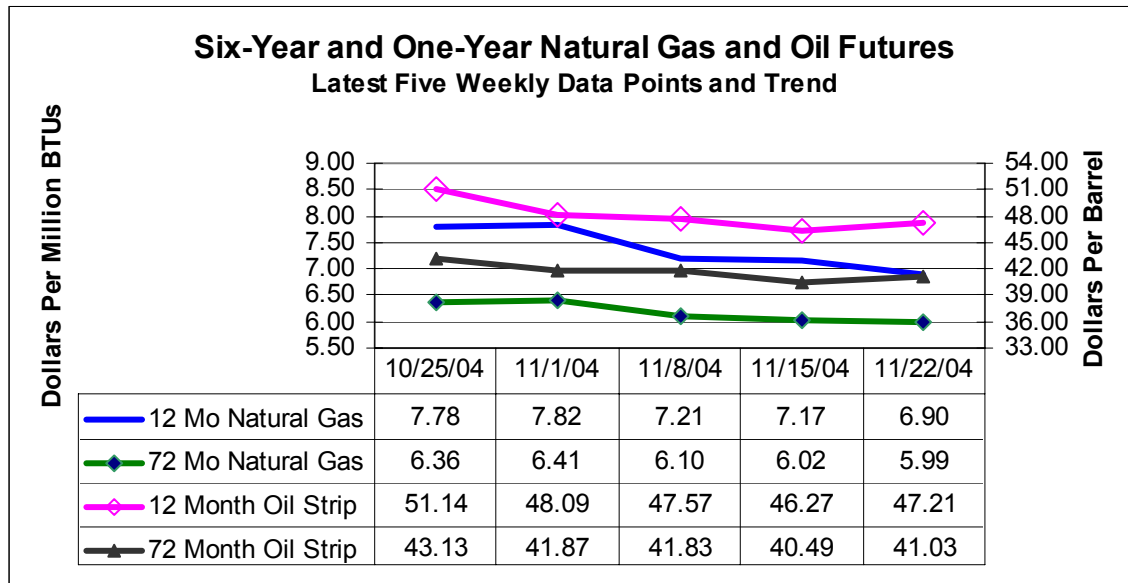
The refining margin chart is back! At its low point we were down to just five months of gasoline futures ending in March 2005. Now gasoline futures are quoted for December 2004 through November 2005, enough to give us a legitimate one-year refining crack future (see charts [One-Year Refining Crack Meter](#) and [Six Months Refining Crack Futures](#)). The implications are favorable for mega cap and producer/refiner buy recommendations.

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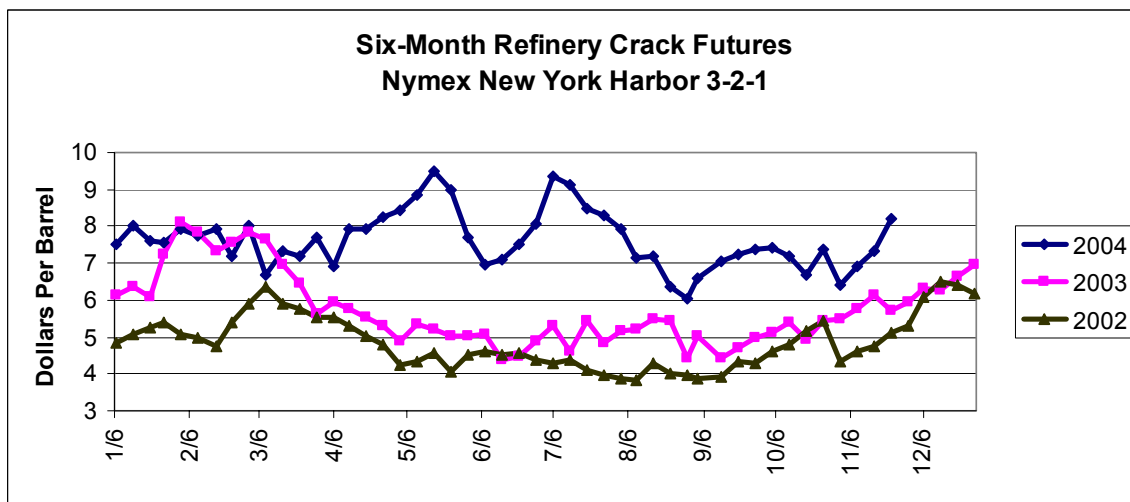
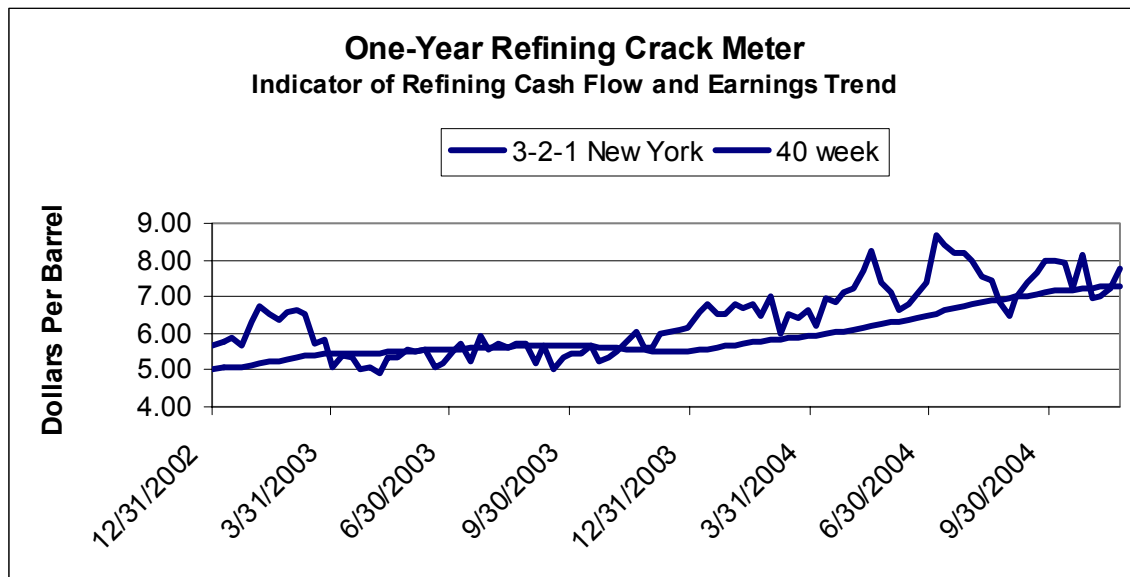


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For recommendations and valuation measures, see tables [Rank by McDep Ratio](#) and [Rank by EV/Ebitda](#). For recent single-stock research, see [Index of Stock Ideas](#).

Kurt H. Wulff, CFA

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

	Symbol/ Rating		Price (\$/sh) 22-Nov 2004	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio
Mega Cap								
Exxon Mobil Corporation	XOM	B3	50.91	6,508	331,000	50.00	0.07	1.02
BP plc	BP	B3	59.99	3,614	217,000	60.00	0.13	1.00
Shell Transport and Trading Co. plc	SC	B3	49.41	1,587	78,000	51.00	0.17	0.97
Total S.A.	TOT	B3	107.64	1,228	132,000	113.00	0.17	0.96
Royal Dutch Petroleum	RD	B1	56.13	2,021	113,000	60.00	0.17	0.95
ChevronTexaco Corporation	CVX	B1	54.80	2,126	117,000	62.50	0.13	0.89
					<i>Total or Median</i>			
					988,000		0.15	0.97
Producer/Refiners - Large Cap and Mid Cap								
Kinder Morgan, Inc.	KMI	S2	68.45	125	8,540	20.00	0.74	1.63
Imperial Oil Limited (30%)	IMO	B3	59.90	107	6,400	58.00	0.10	1.03
Marathon Oil Corporation	MRO	B3	39.05	347	13,550	40.00	0.31	0.98
Suncor Energy	SU	B3	33.77	460	15,530	38.00	0.13	0.90
Norsk Hydro ASA	NHY	B1	76.97	254	19,560	90.00	0.17	0.88
ConocoPhillips	COP	B1	88.87	702	62,400	110.00	0.25	0.86
Petro-Canada	PCZ	B3	55.50	269	14,950	68.00	0.18	0.85
PetroChina Company Ltd (10%)	PTR	B2	55.80	176	9,810	82.00	0.06	0.70
Lukoil Oil Company	LUKOY	B2	129.00	209	27,000	208.00	0.06	0.64
					<i>Total or Median</i>			
					178,000		0.17	0.88
Independent Natural Gas and Oil - Large Cap and Mid Cap								
CNOOC Limited (19%)	CEO	B2	57.85	78	4,520	59.00	-	0.98
XTO Energy Inc.	XTO	B1	34.43	272	9,370	38.00	0.19	0.92
Encana Corporation	ECA	B1	54.78	472	25,800	63.00	0.21	0.90
Unocal Corporation	UCL	B3	45.48	274	12,500	54.00	0.24	0.88
Occidental Petroleum Corp.	OXY	B3	59.45	403	24,000	75.00	0.17	0.83
Burlington Resources	BR	B1	44.10	395	17,400	58.00	0.14	0.79
Devon Energy Corporation	DVN	B3	39.50	500	19,800	55.00	0.22	0.78
Anadarko Petroleum Corp.	APC	B1	68.29	253	17,300	94.00	0.20	0.78
					<i>Total or Median</i>			
					131,000		0.20	0.85
Independent Natural Gas and Oil - Small Cap								
Cimarex Energy Company	XEC	B2	38.67	43	1,660	38.00	0.00	1.02
Berry Petroleum Company	BRY	B2	42.54	22	950	43.00	0.06	0.99
Energy Partners Ltd.	EPL	B3	18.45	39	720	22.00	0.15	0.86
Encore Acquisition Company	EAC	B2	34.19	33	1,120	47.00	0.22	0.79
					<i>Total or Median</i>			
					4,500		0.10	0.93
Income								
Kinder Morgan Energy Partners, L.P.	KMP	S3	45.75	145	6,630	15.00	0.52	1.99
Kinder Morgan Management, LLC	KMR	S3	41.25	55	2,270	15.00	0.52	1.84
San Juan Basin Royalty Trust	SJT	H	30.15	47	1,410	27.00	-	1.12
Canadian Oil Sands Trust (US\$)	COSWF	B1	51.99	93	4,830	72.00	0.18	0.77
					<i>Total or Median</i>			
					15,100		0.35	1.48

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

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Rated Oil and Gas Producers

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

	Symbol/ Rating		Price (\$/sh) 22-Nov 2004	Adjstd Resrvs/ Prod NTM	PV/ Ebitda NTM	EV/ Ebitda NTM	P/E NTM	Divd or Distrib NTM (%)
Mega Cap								
BP plc	BP	B3	59.99	9.9	6.7	6.7	13	2.8
Exxon Mobil Corporation	XOM	B3	50.91	11.1	6.5	6.6	12	2.1
Total S.A.	TOT	B3	107.64	9.6	6.4	6.1	11	2.9
Shell Transport and Trading Co. plc	SC	B3	49.41	8.1	5.3	5.2	10	4.0
Royal Dutch Petroleum	RD	B1	56.13	8.1	5.3	5.1	9	4.1
ChevronTexaco Corporation	CVX	B1	54.80	11.4	5.5	4.9	8	2.9
	<i>Median</i>			9.7	5.9	5.7	10	2.9
Producer/Refiners - Large Cap and Mid Cap								
Kinder Morgan, Inc.	KMI	S2	68.45		8.3	13.5	17	3.3
Suncor Energy	SU	B3	33.77	18.4	7.7	7.0	15	0.6
Imperial Oil Limited (30%)	IMO	B3	59.90	11.3	6.3	6.5	12	1.2
Marathon Oil Corporation	MRO	B3	39.05	7.8	5.6	5.5	10	2.9
Petro-Canada	PCZ	B3	55.50	7.6	5.6	4.8	9	0.9
ConocoPhillips	COP	B1	88.87	11.9	5.5	4.7	7	1.9
Norsk Hydro ASA	NHY	B1	76.97	9.4	5.2	4.6	11	2.3
PetroChina Company Ltd (10%)	PTR	B2	55.80	13.5	6.3	4.4	9	4.2
Lukoil Oil Company	LUKOY	B2	129.00	12.2	5.5	3.5	6	2.6
	<i>Median</i>			11.6	5.6	4.8	10	2.3
Independent Natural Gas and Oil - Large Cap and Mid Cap								
XTO Energy Inc.	XTO	B1	34.43	11.7	5.9	5.4	11	0.6
CNOOC Limited (19%)	CEO	B2	57.85	9.6	5.0	4.9	9	3.1
Occidental Petroleum Corp.	OXY	B3	59.45	11.2	5.8	4.8	8	1.9
Unocal Corporation	UCL	B3	45.48	8.9	5.1	4.5	10	1.8
Burlington Resources	BR	B1	44.10	9.9	5.6	4.4	9	0.8
Anadarko Petroleum Corp.	APC	B1	68.29	10.9	5.6	4.4	9	0.8
Encana Corporation	ECA	B1	54.78	6.4	4.5	4.1	9	0.7
Devon Energy Corporation	DVN	B3	39.50	6.6	4.7	3.7	7	1.0
	<i>Median</i>			9.7	5.4	4.5	9	0.9
Independent Natural Gas and Oil - Small Cap								
Berry Petroleum Company	BRY	B2	42.54	12.5	5.6	5.6	12	1.1
Encore Acquisition Company	EAC	B2	34.19	11.9	6.9	5.4	11	-
Cimarex Energy Company	XEC	B2	38.67	5.2	3.7	3.8	9	-
Energy Partners Ltd.	EPL	B3	18.45	4.9	3.8	3.2	10	-
	<i>Median</i>			8.6	4.7	4.6	10	-
Income								
Kinder Morgan Energy Partners, L.P.	KMP	S3	45.75	12.0	7.9	15.8	21	6.4
Kinder Morgan Management, LLC	KMR	S3	41.25	12.0	7.9	14.6	19	7.1
San Juan Basin Royalty Trust	SJT	H	30.15	12.5	7.8	8.7	10	10.3
Canadian Oil Sands Trust (US\$)	COSWF	B1	51.99	20.0	10.9	8.4	11	3.2
	<i>Median</i>			12.2	7.9	11.7	15	6.7

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

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Index of Stock Ideas Recent Written Analyses

<u>Date</u>	<u>Symbol</u>	<u>Stock</u>	<u>Theme</u>
22-Nov	EAC	Encore Acquisition Company	Opportunity in Hedging Impact
22-Nov	MTR	Mesa Royalty Trust	Hugoton Predictability, San Juan Surprise
17-Nov	TOT	Total S.A.	African Oil, European Refining
17-Nov	UCL	Unocal Corporation	Incremental Production in 2005
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
31-Aug	* COP	ConocoPhillips	Lukoil Investor?
26-Aug	* BP	BP p.l.c.	Russia Distinction
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

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