

Meter Reader

A Weekly Analysis of Energy Stocks Using the McDep Ratio

January 25, 2005

Raise Present Value to \$40 Oil Constant Real

Summary and Recommendation

We raise estimates of present value for ranking stocks by McDep Ratio to the level that reflects a constant real oil price of \$40 a barrel for Light, Sweet Crude Oil. Since March 2004, our standard estimates had been tied to \$35 a barrel. Suggesting more appreciation potential in the stocks of oil and gas producers, the new present value estimates are mostly consistent with recent illustrative calculations (see *Meter Reader*, [Sensitivity](#), October 12, 2004). Meanwhile for the diversified energy portfolio started last week, the next three stocks we would buy today are **ChevronTexaco (CVX)**, **Canadian Oil Sands Trust (COSWF)** and **PetroChina (PTR)**.

Select Stocks by Rating, McDep Ratio, and Industry Group

The principles of the McDep Energy Portfolio could be implemented in a personal portfolio and the ideas could be relevant to any energy investor. Last week we picked the three lowest McDep Ratio stocks in each of three groups as a concrete suggestion for an investor starting a new energy portfolio. Those stocks, **Lukoil (LUKOY)**, **Anadarko (APC)** and **Encore Acquisition (EAC)**, are still the lowest McDep Ratio stocks in each of three different groups. This week we move on to three more stocks looking first in the groups that were not represented last week.

ChevronTexaco appears to offer the best value among Mega Caps. Present value could be higher than we estimate on the basis of the company's current cash flow outlook and the adjusted reserve life we measure from the company's disclosure. Yet, we want to see some more confirmation of the seemingly better numbers with the continuing disclosures of the next several months.

Canadian Oil Sands Trust, our favorite income stock, appears to gain the most in present value as we move our standard from \$35 to \$40. The stock is concentrated entirely on production of high quality oil in North America. Since January 1, crude oil sales reflect the full benefit of world prices without hedging and the case is building for an increase in distribution in 2005.

Having picked one stock from each of five groups we repeat the process and look for the next lowest McDep Ratio B1 or B2 recommendation. PetroChina stands out with especially low valuation implying potentially greater appreciation. Our original premise to get in on the ground floor of the conversion of China to natural gas is playing out with

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the historic beginning of flow from a West to East pipeline. It is not obvious how profitable sales will be immediately, but the rewards should eventually flow to PetroChina and its investors.

\$40 Oil Constant Real Points to Attractive Return on Investment

Buy a stock at a median McDep Ratio of 0.8 and look for one-fourth unlevered appreciation in a year or two to reach a McDep Ratio of 1.0. For the levered appreciation potential simply compare Net Present Value per share to Stock Price (see table [Rank by McDep Ratio](#)). We show the unlevered ratio because the levered ratio can make high debt stocks look too good.

Even a McDep Ratio of 1.0 could be attractive as it implies an unlevered real return of 7% per year. That is 10% per year adjusted for inflation and a higher return on stock price depending on the amount of debt.

New estimates involve separate assessments by function (see table [Present Value by Line of Business](#)). The value of oil and gas resources correlates with initial annual cash flow and reserve life while the value of downstream business correlates primarily with initial annual cash flow.

Long-Term Oil Price Rising

The average price for the next six years in the futures market is \$42 a barrel (see chart [Latest Five Weekly Data Points and Trend](#)). We take that as partial confirmation of \$40 constant real. Yet, in our opinion, longer-term futures are low. Oil futures seem to have a built-in bias that the price will always be lower in time. Thus, even though futures investors, or speculators as infamously called, have been ahead of stock market investors in anticipating higher oil price, there still is a reluctance to recognize the persistence of the change underway. Nonetheless there appears to be a strong trend of gradually rising long-term expectations (see chart [Six-Year Commodity Price Meter](#)). As a result our assumption of \$40 constant real seems slightly ahead of the futures, but that may not be the case for long.

Continuous Analysis

Besides the weekly *Meter Reader* we update most of our single stock analyses at least once a quarter (see [Index of Recent Research](#)). In addition we have a weekly analysis of *U.S. Natural Gas Royalty Trusts* also with related single trust analyses.

Kurt H. Wulff, CFA

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Present Value by Line of Business

(US\$millions)

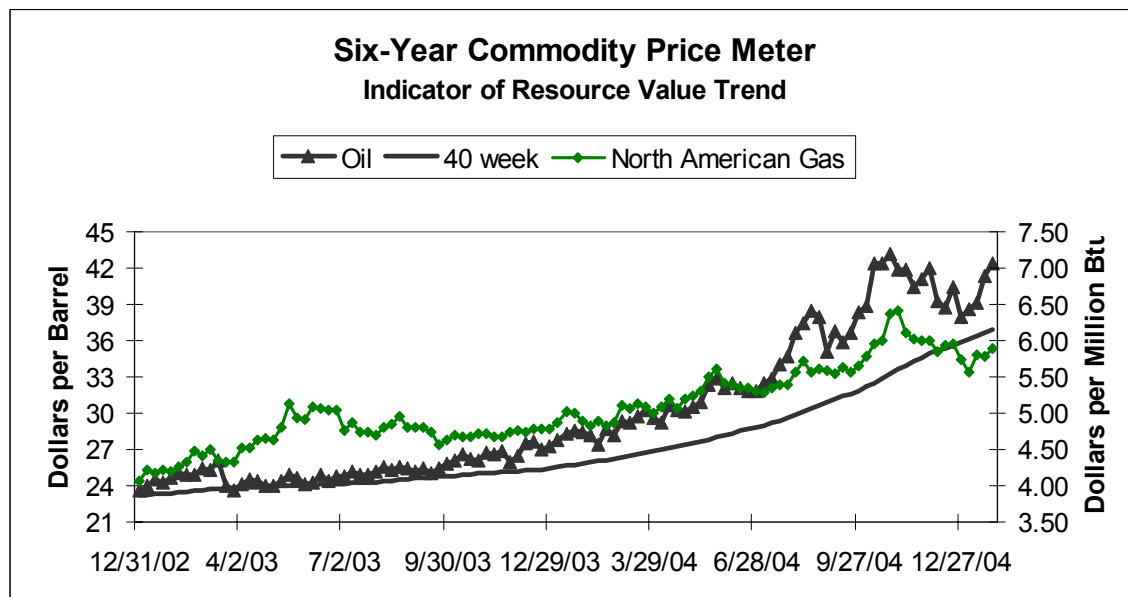
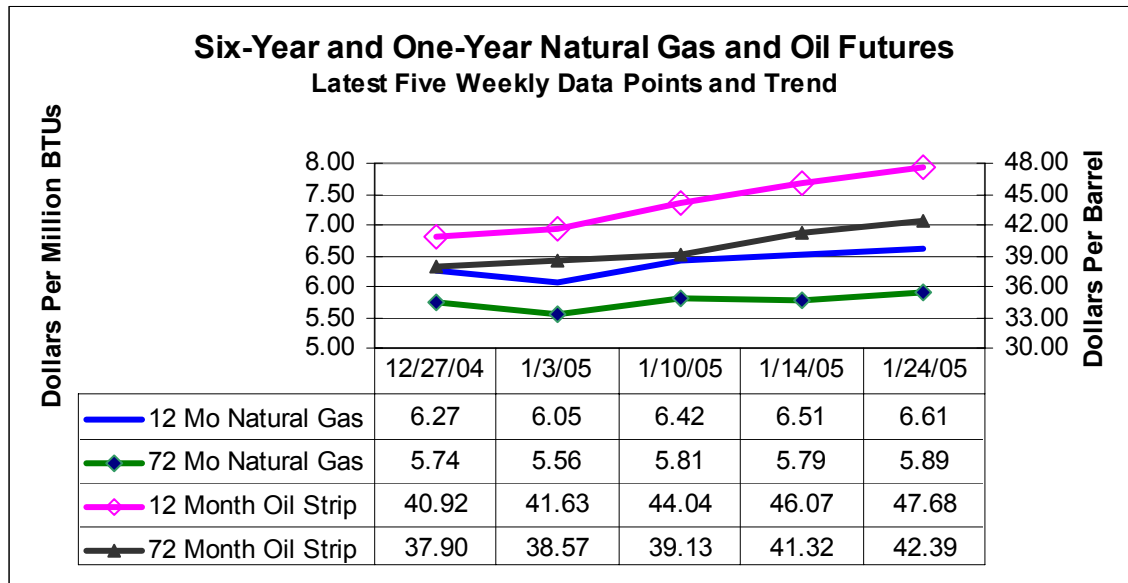
	<i>North American Natural Gas</i>	<i>Over- seas Natural Gas</i>	<i>Oil Prod.</i>	<i>Down- stream</i>	<i>Total</i>
Exxon Mobil Corporation	38,000	54,000	173,000	110,000	375,000
BP plc	30,000	30,000	134,000	70,000	264,000
Royal Dutch/Shell	9,000	47,000	101,000	107,000	264,000
PetroChina	-	13,000	139,800	21,000	173,800
Total S.A.	-	43,000	84,800	48,000	175,800
ChevronTexaco Corporation	14,000	11,000	105,800	50,000	180,800
ConocoPhillips	16,000	8,000	49,100	42,000	115,100
Lukoil Oil Company	-	-	44,900	-	44,900
Encana Corporation	29,000	-	15,200	-	44,200
Occidental Petroleum Corp.	5,700	600	30,200	4,800	41,300
Devon Energy Corporation	26,000	-	13,400	-	39,400
Anadarko Petroleum Corp.	19,500	-	15,100	-	34,600
Norsk Hydro ASA	-	6,000	12,900	11,600	30,500
Burlington Resources	20,000	1,300	8,800	-	30,100
CNOOC	-	3,300	24,300	-	27,600
Suncor Energy	1,300	-	24,300	1,900	27,500
Imperial Oil	3,200	-	16,300	5,700	25,200
Petro-Canada	5,000	1,000	12,900	3,900	22,800
Unocal Corporation	6,000	6,000	10,500	-	22,500
Marathon Oil Corporation	3,700	1,500	8,100	7,400	20,700
XTO Energy Inc.	12,000	-	2,900	-	14,900
Canadian Oil Sands Trust	-	-	10,100	-	10,100
Encore Acquisition Company	650	-	1,640	-	2,290
Cimarex Energy Company	1,400	-	400	-	1,800
San Juan Basin Royalty Trust	1,400	-	-	-	1,400
Berry Petroleum Company	-	-	1,180	-	1,180
Energy Partners Ltd.	550	-	530	-	1,080

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

	Symbol/ Rating		Price (\$/sh) 24-Jan 2005	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio
Mega Cap								
Exxon Mobil Corporation	XOM	B3	51.13	6,508	333,000	54.00	0.06	0.95
Shell Transport and Trading Co. plc	SC	B3	51.76	1,587	82,000	56.10	0.16	0.94
BP plc	BP	B3	58.31	3,614	211,000	64.00	0.12	0.92
Total S.A.	TOT	B3	106.60	1,228	131,000	120.00	0.16	0.91
Royal Dutch Petroleum	RD	B1	57.35	2,021	116,000	66.00	0.16	0.89
ChevronTexaco Corporation	CVX	B1	52.62	2,126	112,000	76.00	0.11	0.73
<i>Total or Median</i>					985,000		0.14	0.91
Producer/Refiners - Large Cap and Mid Cap								
Kinder Morgan, Inc.	KMI	S2	74.86	125	9,360	20.00	0.74	1.72
Marathon Oil Corporation	MRO	B3	38.57	347	13,380	42.00	0.29	0.94
Imperial Oil Limited (30%)	IMO	B3	59.08	107	6,310	64.00	0.09	0.93
Norsk Hydro ASA	NHY	B1	78.35	254	19,910	101.00	0.16	0.81
Petro-Canada	PCZ	B3	51.59	269	13,900	70.00	0.17	0.78
ConocoPhillips	COP	B1	88.47	702	62,100	128.00	0.22	0.76
Suncor Energy	SU	B3	33.47	460	15,400	54.00	0.10	0.66
PetroChina Company Ltd (10%)	PTR	B2	54.50	176	9,580	94.00	0.05	0.60
Lukoil Oil Company	LUKOY	B2	116.50	209	24,000	208.00	0.03	0.57
<i>Total or Median</i>					174,000		0.16	0.78
Independent Natural Gas and Oil - Large Cap and Mid Cap								
XTO Energy Inc.	XTO	B1	34.66	279	9,670	45.00	0.16	0.81
Encana Corporation	ECA	B1	57.79	472	27,300	77.00	0.18	0.80
Unocal Corporation	UCL	B3	47.24	274	13,000	65.00	0.21	0.79
CNOOC Limited (19%)	CEO	B2	52.47	78	4,100	67.00	-	0.78
Occidental Petroleum Corp.	OXY	B3	57.80	403	23,300	87.00	0.15	0.71
Devon Energy Corporation	DVN	B3	39.70	500	19,900	63.00	0.20	0.71
Burlington Resources	BR	B1	43.42	395	17,200	67.00	0.12	0.69
Anadarko Petroleum Corp.	APC	B1	64.05	253	16,200	113.00	0.17	0.64
<i>Total or Median</i>					131,000		0.17	0.75
Independent Natural Gas and Oil - Small Cap								
Berry Petroleum Company	BRY	B2	48.25	22	1,080	50.00	0.05	0.97
Cimarex Energy Company	XEC	B2	39.87	43	1,710	42.00	0.00	0.95
Energy Partners Ltd.	EPL	B3	20.50	39	800	24.00	0.14	0.88
Encore Acquisition Company	EAC	B2	34.92	33	1,140	57.00	0.19	0.69
<i>Total or Median</i>					4,700		0.09	0.91
Income								
Kinder Morgan Energy Partners, L.P.	KMP	S3	47.01	150	7,050	15.00	0.52	2.03
Kinder Morgan Management, LLC	KMR	S3	42.61	56	2,400	15.00	0.52	1.89
Pengrowth Energy Trust	PGH		20.97	136	2,850	16.00	0.24	1.24
Enerplus Resources Fund	ERF		37.05	104	3,850	32.00	0.17	1.13
San Juan Basin Royalty Trust	SJT	H	30.25	47	1,410	30.00	-	1.01
Canadian Oil Sands Trust (US\$)	COSWF	B1	58.00	91	5,280	94.00	0.15	0.67
<i>Total or Median</i>					22,800		0.20	1.18

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

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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Oil and Gas Producers

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

	Symbol/ Rating		Price (\$/sh) 24-Jan 2005	Adjstd Resrvs/ Prod NTM	PV/ Ebitda NTM	EV/ Ebitda NTM	P/E NTM	Divd or Distrib NTM (%)
Mega Cap								
Exxon Mobil Corporation	XOM	B3	51.13	11.1	6.8	6.5	12	2.1
BP plc	BP	B3	58.31	9.9	7.0	6.5	12	2.9
Total S.A.	TOT	B3	106.60	9.6	6.6	6.0	11	3.0
Shell Transport and Trading Co. plc	SC	B3	51.76	8.1	5.7	5.3	10	3.8
Royal Dutch Petroleum	RD	B1	57.35	8.1	5.7	5.1	9	4.0
ChevronTexaco Corporation	CVX	B1	52.62	11.4	6.4	4.6	8	3.0
	<i>Median</i>			9.7	6.5	5.7	10	3.0
Producer/Refiners - Large Cap and Mid Cap								
Kinder Morgan, Inc.	KMI	S2	74.86		7.5	12.9	17	3.7
Suncor Energy	SU	B3	33.47	18.4	10.0	6.6	14	0.6
Imperial Oil Limited (30%)	IMO	B3	59.08	11.3	6.8	6.3	11	1.2
Marathon Oil Corporation	MRO	B3	38.57	7.8	5.8	5.4	10	2.9
Norsk Hydro ASA	NHY	B1	78.35	8.9	5.7	4.6	11	2.2
ConocoPhillips	COP	B1	88.47	11.9	6.1	4.6	7	1.9
Petro-Canada	PCZ	B3	51.59	7.7	5.7	4.5	8	1.0
PetroChina Company Ltd (10%)	PTR	B2	54.50	13.3	6.6	4.0	8	4.3
Lukoil Oil Company	LUKOY	B2	116.50	12.2	4.5	2.6	4	2.9
	<i>Median</i>			11.6	6.1	4.6	10	2.2
Independent Natural Gas and Oil - Large Cap and Mid Cap								
XTO Energy Inc.	XTO	B1	34.66	11.7	7.5	6.0	12	0.6
Occidental Petroleum Corp.	OXY	B3	57.80	11.2	6.5	4.7	8	1.9
Unocal Corporation	UCL	B3	47.24	8.9	5.9	4.7	10	1.7
Burlington Resources	BR	B1	43.42	9.9	6.5	4.5	9	0.8
CNOOC Limited (19%)	CEO	B2	52.47	9.6	5.6	4.4	8	3.4
Encana Corporation	ECA	B1	57.79	6.8	5.4	4.3	10	0.7
Anadarko Petroleum Corp.	APC	B1	64.05	10.9	6.5	4.2	9	0.9
Devon Energy Corporation	DVN	B3	39.70	6.6	5.4	3.8	8	1.0
	<i>Median</i>			9.7	6.2	4.4	9	0.9
Independent Natural Gas and Oil - Small Cap								
Berry Petroleum Company	BRY	B2	48.25	12.5	6.4	6.2	14	1.0
Encore Acquisition Company	EAC	B2	34.92	11.9	8.0	5.5	11	-
Cimarex Energy Company	XEC	B2	39.87	5.2	4.4	4.1	11	-
Energy Partners Ltd.	EPL	B3	20.50	4.9	4.1	3.6	12	-
	<i>Median</i>			8.6	5.4	4.8	12	-
Income								
Kinder Morgan Energy Partners, L.P.	KMP	S3	47.01		7.7	15.5	21	6.2
Kinder Morgan Management, LLC	KMR	S3	42.61		7.7	14.5	19	6.9
San Juan Basin Royalty Trust	SJT	H	30.25	12.5	9.4	9.5	11	9.4
Canadian Oil Sands Trust (USS)	COSWF	B1	58.00	20.0	11.5	7.8	9	2.8
Enerplus Resources Fund	ERF		37.05	8.3	6.7	7.6	18	9.3
Pengrowth Energy Trust	PGH		20.97	7.9	6.0	7.4	14	10.9
	<i>Median</i>			10.4	7.7	8.6	16	8.1

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended March 31, 2006; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

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Index of Recent Research

Stock Ideas

<u>Date</u>	<u>Symbol</u>	<u>Stock</u>	<u>Theme</u>
19-Jan	KMP	Kinder Morgan Energy Partners, L.P.	Energy Houdini
19-Jan	KMI	Kinder Morgan Inc.	Energy Houdini
19-Jan	KMR	Kinder Morgan Management, LLC	Energy Houdini
13-Jan	NHY	Norsk Hydro ASA	Oil, Natural Gas and Aluminum
12-Jan	LUKOY	Lukoil Oil Company	Profits Advance
7-Jan	BR	Burlington Resources, Inc.	Royalty Trust Candidate
29-Dec	LUKOY	Lukoil Oil Company	After Yukos
29-Dec	CEO	CNOOC Ltd	Natural Gas Progress
27-Dec	* PTR	PetroChina Company Limited	West to East Pipeline Flowing
22-Dec	* RD	Royal Dutch Petroleum	Historic Streamlining
22-Dec	* SC	Shell Transport & Trading Company, p.l.c.	Historic Streamlining
20-Dec	* BP	BP p.l.c.	Cash Flows to Owners
9-Dec	* SU	Suncor Energy Inc.	Raise Net Present Value to US\$42 a Share
8-Dec	* CVX	ChevronTexaco Corporation	Mega Cap at a Discount
3-Dec	* COSWF	Canadian Oil Sands Trust	After Hubbert's Peak
3-Dec	* COP	ConocoPhillips	Connecting with Lukoil
29-Nov	* XEC	Cimarex Energy Company	Timely Talent
26-Nov	* XTO	XTO Energy Inc.	Twenty Per Cent per Year per Share
24-Nov	* APC	Anadarko Petroleum Corporation	Asset Upgrade
22-Nov	* EAC	Encore Acquisition Company	Opportunity in Hedging Impact
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
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

Meter Reader - A Weekly Analysis

18-Jan	*	Basics Revisited
11-Jan	*	When, Not If
4-Jan	*	January Thaw
28-Dec	*	Light Oil Volume Peak

* Archived on www.mcdep.com

Also see

U.S. Natural Gas Royalty Trusts - A Weekly Analysis, and Single Trust Analyses

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