

## ***Meter Reader***

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

June 4, 2001

# **Forward With Energy**

## **Summary and Recommendation**

The forward curves of energy futures prices point to profits in electric generation, oil refining, natural gas and crude oil production that should benefit investors in **American Electric Power (AEP)**, **Marathon Group (MRO)**, **Burlington Resources (BR)** and **Energy Partners (EPL)** among other stocks. High electricity price in the west points to higher electricity price in the east. Refined product prices point to higher natural gas price, as refined oil is the main alternative fuel for the new generators designed to use natural gas. The whole unregulated energy price structure rests on crude oil that merely needs to remain near current levels to be higher than the futures price a few years out. Preparing for further recommendations we expand our energy research coverage by six stocks to forty. Spanning the energy industry, Mega Cap and Large Cap stocks are now in one set of valuation tables while Mid Cap and Small Cap are in another.

## **Free Market Puts High Value on Electric Generation**

The gradual unfolding of a free market in wholesale electricity is emitting important price signals previously masked by regulation. The futures market anticipates that Palo Verde electricity will move at a peak \$34 per million Btu (mmbtu) in August 2001 (see Chart, Electricity Futures Prices). Palo Verde refers to a generation/transmission hub in Arizona that we take as a rough indicator of the Southern California market. The futures market anticipates that Cinergy electricity will move at a peak of just \$8/mmbtu in July 2001. Cinergy refers to a pricing point in coal country where power prices are among the lowest. Like the futures market we see Palo Verde and Cinergy prices coming together, but instead of at \$5 as the chart shows for 2000, more likely at \$10 in 2005. Because new sources of power are likely to be more expensive, AEP's old plants receiving low regulated prices are likely to become more valuable as pricing becomes less regulated.

## **Refining Margins Higher Despite Seasonal Volatility**

Gasoline in New York harbor, the pricing point for traders, is still a cheap fuel at \$6/mmbtu (see Chart, Energy Futures Prices). The spread versus crude oil has been particularly attractive lately, but may have peaked the week before last on a seasonal basis. Yet the summer is not over and there can still be surprises. MRO stock seems long overdue for better recognition of its refining/marketing position. The stock should get extra interest as a result of a complete separation of oil from steel expected by yearend.

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### **Natural Gas a Cheap Fuel for Electricity**

About thirty years ago, electric demand was also driving natural gas demand to the point that not all natural gas needs could be met. Back then; there was no free market in natural gas or electricity. Instead regulators decreed that electric generation was an "inferior use" and natural gas should be rationed away from electricity. How wrong we were! The past winter has made it abundantly evident that electric generation is the highest and best use for natural gas as measured by the free market. To be fair, there has been a technological breakthrough in combined cycle plants that use natural gas more efficiently than the simple Carnot cycle process. The electric generators have a product so valuable they can pay whatever it takes to get marginal users to give up their gas for a superior use.

The most competitive alternate fuel in combined cycle plants is distillate oil, the same form used for home heating in some areas. Those plants with dual firing capability would presumably not pay more for natural gas than the equivalent price for refined oil as represented by the forward curves for gasoline and heating oil. That implies a price for gas next winter of \$5.50, not \$4.50 as gas is quoted in the futures market today. Any significant amount of substitution in turn would put upward pressure on oil prices.

### **Natural Gas Price Due to Recover**

Only a few months ago natural gas investors were basking in the warm glow of record price that averaged \$9/mmbtu for a while. Today natural gas is trading at the low ratios to crude oil it traded at last summer. As a result we see no further sustained decline in relative natural gas price. Natural gas producer stocks like BR look attractive at current prices. Some of our favorite royalty trusts have fallen back understandably from their highs coincident with lower natural gas spot price. There could be a lag in price recovery for the trusts to the extent that investors react to monthly distributions that are sharply lower than peak levels. Distributions in turn lag real price by a couple of months.

### **Meter Reader's Roots in Natural Gas Royalty Trusts**

Meter Reader was started in early 2000 to share the results of a weekly recalculation of the present value of natural gas royalty trusts that took account of latest futures prices for natural gas and oil, interest rates, inflation rates, production volume and operating costs. In addition Meter Reader projects distributions for the next twelve months (NTM), a more relevant and consistent indicator of income generation than the historical results reported by general financial sources. We continue to reprint in detail a present value calculation and a distribution or cash flow projection for each of five small cap stocks (see Meter Reader Tables - Small Cap, a separate appendix to Meter Reader).

The same analytical framework is extended to each company in coverage although in considerably less detail. Present Value (PV) is represented in the first summary table

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covering all companies. Stocks are ranked by the McDep Ratio, which relates Market Cap and Debt, or Enterprise Value (EV), to Present Value (PV) (see Tables L-1 and S-1). The only justification we print for the present value calculation is the multiple of EV/PV in the far right hand column of the second summary table (see Tables L-2 and S-2). The assessments necessarily are somewhat arbitrary with a general reluctance to be as generous as the stock market in applying high multiples.

The most important information in the second summary table is NTM cash flow or Ebitda. We have a quarterly model for each company, which is printed in a Stock Idea when we go into detail on a single stock. Most of the quarterly models not yet printed are brief. The model for AEP has not been printed as AEP is in the process of reorganizing into regulated and unregulated businesses, which will cause historical results to be restated.

Having started in natural gas royalty trusts, Meter Reader now applies the same analytical framework to the whole energy field. We hope Meter Reader can continue to make money for you.

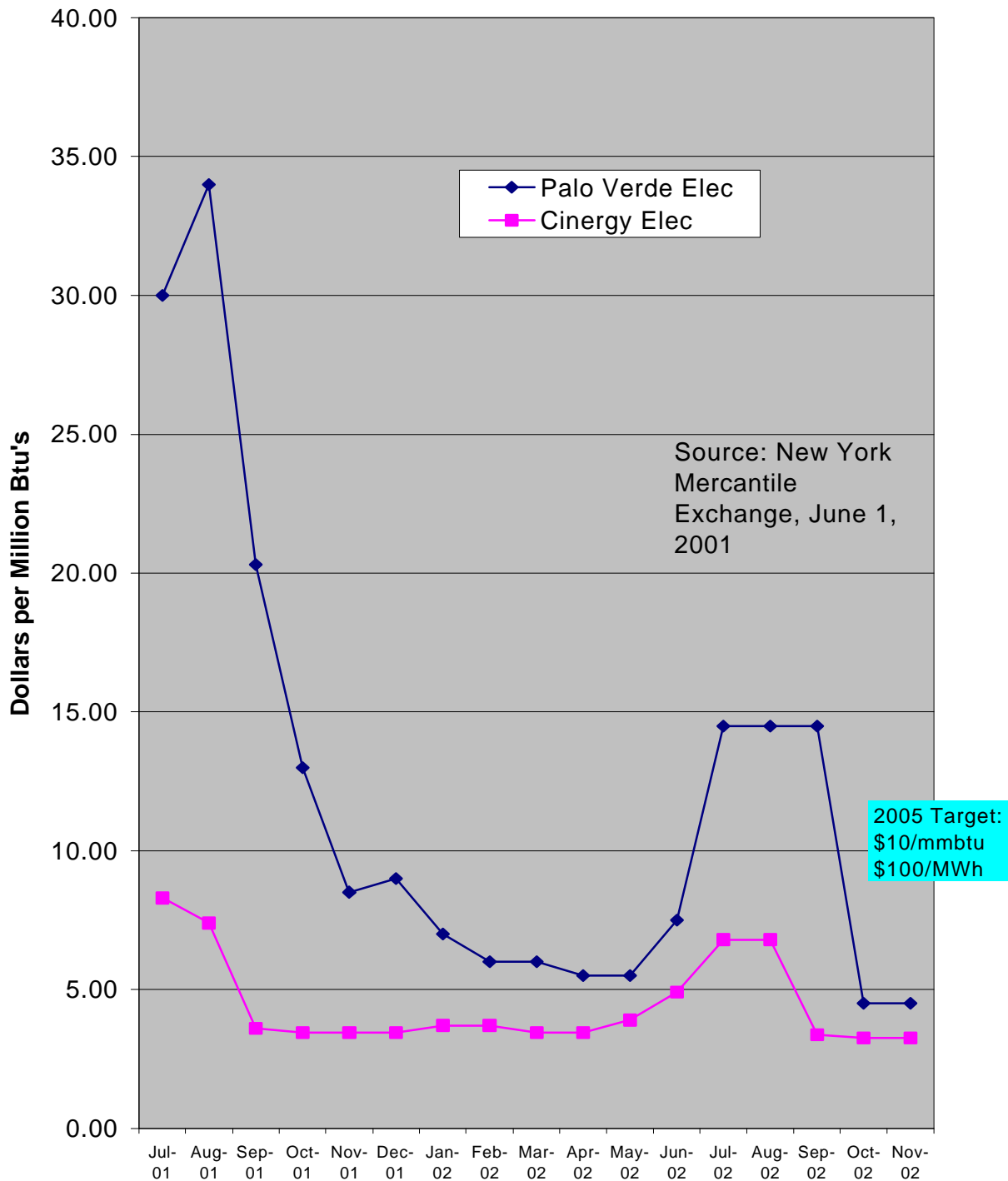
Kurt H. Wulff, CFA

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### Electricity Futures Prices



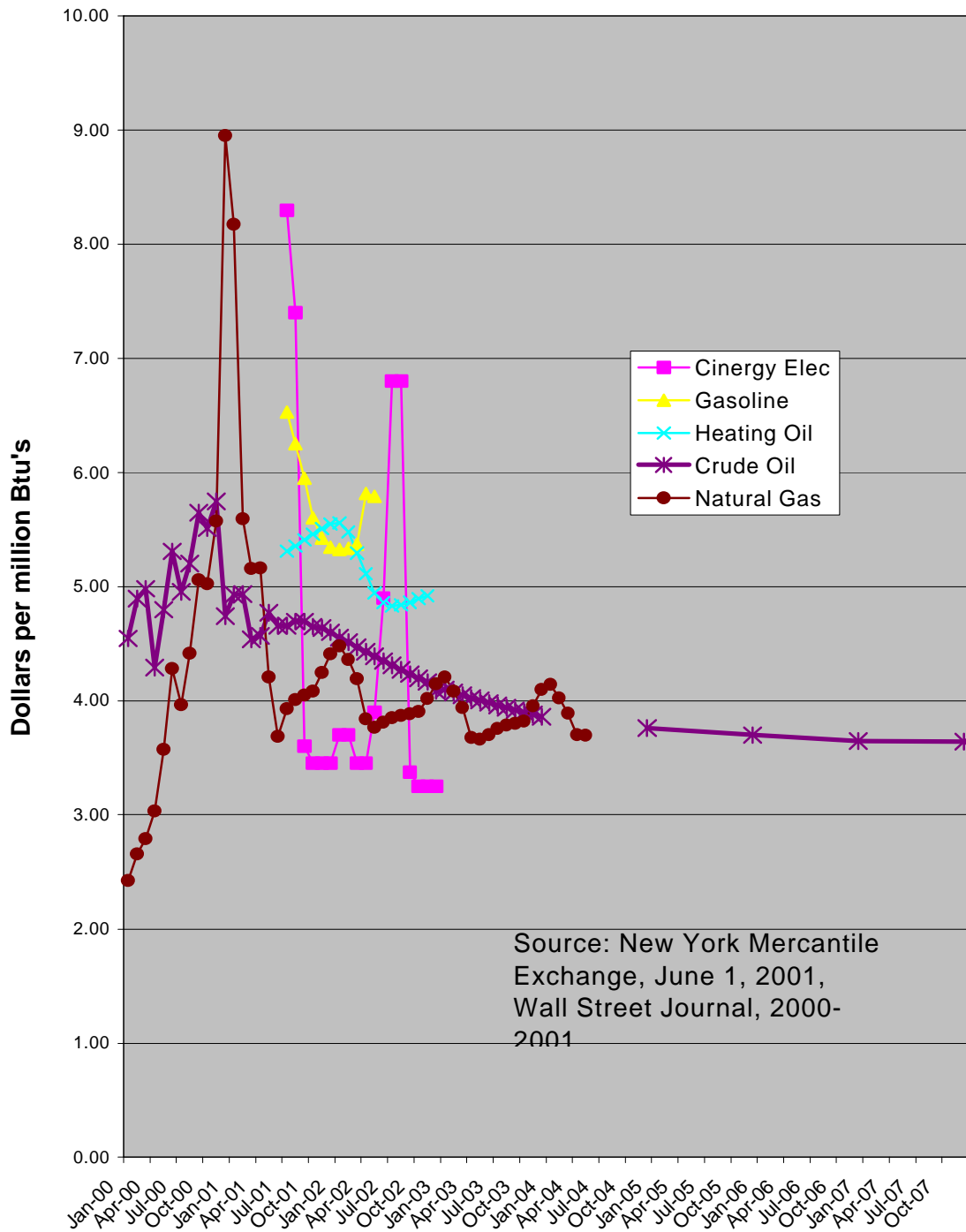
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### Energy Futures Prices



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**Table L-1**  
**Mega Cap and Large Cap Energy Companies**  
**Rank by McDep Ratio: Market Cap and Debt to Present Value**

	<i>Symbol/ Rating</i>	<i>Price (\$/sh) 1-Jun 2001</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>
<b>Mega Cap</b>							
Exxon Mobil Corporation	XOM	88.95	3,520	313,000	72.10	0.16	1.20
BP PLC	BP	53.48	3,720	199,000	48.90	0.17	1.08
TOTAL Fina Elf S.A.	TOT	74.00	1,400	104,000	72.00	0.16	1.02
Royal Dutch/Shell	RD	60.89	3,580	218,000	60.80	0.09	1.00
Chevron (incl. Texaco)	CHV	96.38	1,060	102,200	103.40	0.15	0.94
	<i>Total or Median</i>			<i>936,000</i>		<i>0.16</i>	<i>1.02</i>
<b>Power</b>							
Enron Corp.	ENE	53.04	814	43,200	16.90	0.68	1.68
Calpine Corporation	CPN	48.89	313	15,300	21.40	0.48	1.67
Dynegy Inc.	DYN	47.98	338	16,200	20.60	0.56	1.59
Mirant Corporation	MIR	38.10	353	13,400	11.70	0.75	1.57
Duke Energy Corporation	DUK	44.19	752	33,200	20.90	0.62	1.42
Williams Companies	WMB	39.05	485	18,900	16.60	0.69	1.41
AES Corporation	AES	44.93	538	24,200	23.00	0.65	1.34
El Paso Corporation	EPG	59.85	521	31,200	40.00	0.50	1.25
American Electric Power Co. Inc.	AEP 2	49.00	324	15,900	25.90	0.73	1.24
Southern Company	SO	23.22	683	15,900	16.90	0.54	1.17
Exelon Corporation	EXC	67.29	324	21,800	55.30	0.51	1.11
	<i>Total or Median</i>			<i>249,000</i>		<i>0.62</i>	<i>1.41</i>
<b>Natural Gas and Oil</b>							
Occidental Petroleum	OXY	29.60	370	11,000	35.60	0.46	0.91
Burlington Resources, Inc	BR 2	48.25	215	10,400	56.30	0.19	0.89
Anadarko Petroleum Corp.	APC	62.19	249	15,500	90.90	0.17	0.74
ENI S.p.A.	E	65.08	800	52,100	91.90	0.10	0.74
Phillips (incl. Tosco)	P	64.48	379	24,400	102.10	0.27	0.73
Conoco Inc.	COC.B	31.19	623	19,400	48.00	0.21	0.72
	<i>Total or Median</i>			<i>133,000</i>		<i>0.20</i>	<i>0.74</i>
<b>Service</b>							
Halliburton Company	HAL	46.12	430	19,800	27.20	0.13	1.60
Schlumberger Ltd.	SLB	62.83	581	36,500	44.00	0.12	1.38

Buy/Sell rating after symbol: 1 - Strong Buy, 2 - Buy

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**Table L-2**  
**Mega Cap and Large Cap Energy Companies**  
**Rank by EV/Ebitda: Enterprise Value to Earnings Before Interest, Tax, Deprec.**

	<i>Symbol</i>	<i>Price (\$/sh) 1-Jun 2001</i>	<i>EV/ Sales 2001E</i>	<i>EV/ Ebitda NTM</i>	<i>P/E NTM</i>	<i>Dividend or Distribution NTM (%)</i>	<i>PV/ Ebitda NTM</i>	
<b>Mega Cap</b>								
	E Exxon Mobil Corporation	XOM	88.95	1.5	8.4	18	2.0	7.0
	BP PLC	BP	53.48	1.3	7.5	12	2.6	7.0
	TOTAL Fina Elf S.A.	TOT	74.00	1.1	7.2	17	1.5	7.0
	Royal Dutch/Shell	RD	60.89	1.5	7.0	15	2.3	7.0
	Chevron (incl. Texaco)	CHV	96.38	1.1	5.7	11	2.7	6.0
	<i>Median</i>			<i>1.3</i>	<i>7.2</i>	<i>15</i>	<i>2.3</i>	<i>7.0</i>
<b>Power</b>								
	Enron Corp.	ENE	53.04	0.4	16.8	30	0.9	10.0
	Calpine Corporation	CPN	48.89	4.3	15.0	24	-	9.0
	Dynegy Inc.	DYN	47.98	0.4	14.3	23	0.6	9.0
	Mirant Corporation	MIR	38.10	0.8	12.6	18	-	8.0
	AES Corporation	AES	44.93	4.3	12.0	22	-	9.0
	Duke Energy Corporation	DUK	44.19	1.0	11.4	17	2.5	8.0
	Williams Companies	WMB	39.05	3.6	11.3	17	1.5	8.0
	El Paso Corporation	EPG	59.85	0.7	10.0	18	1.4	8.0
	American Electric Power Co. Inc.	AEP 2	49.00	0.7	8.7	14	4.9	7.0
	Southern Company	SO	23.22	2.7	8.2	14	5.8	7.0
	Exelon Corporation	EXC	67.29	2.7	7.7	15	2.5	7.0
	<i>Median</i>			<i>1.0</i>	<i>11.4</i>	<i>18</i>	<i>1.4</i>	<i>8.0</i>
<b>Natural Gas and Oil</b>								
	Burlington Resources, Inc	BR 2	48.25	3.5	6.2	9	1.1	7.0
	Occidental Petroleum	OXY	29.60	1.3	5.5	8	3.4	6.0
	Anadarko Petroleum Corp.	APC	62.19	2.1	4.4	9	0.3	6.0
	Phillips (incl. Tosco)	P	64.48	0.7	4.4	8	2.1	6.0
	Conoco Inc.	COC.B	31.19	0.7	4.3	9	2.4	6.0
	ENI S.p.A.	E	65.08	1.2	3.7	7	2.5	5.0
	<i>Median</i>			<i>1.2</i>	<i>4.4</i>	<i>8</i>	<i>2.3</i>	<i>6.0</i>
<b>Service</b>								
	Halliburton Company	HAL	46.12	1.6	12.8	31	1.1	8.0
	Schlumberger Ltd.	SLB	62.83	3.2	11.0	31	1.2	8.0

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended March 31, 2002; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

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<b>Power</b>							
CMS Energy Corporation	CMS	29.76	128	3,800	19.80	0.80	1.10
<b>Natural Gas and Oil</b>							
Barrett Resources Corporation	BRR	71.10	34	2,400	53.80	0.21	1.26
PanCanadian Pete Ltd. (15%)	PCP.TO	48.99	38	1,900	49.10	0.07	1.00
PetroChina Company Ltd (10%)	PTR	22.59	176	4,000	28.40	0.24	0.84
Unocal Corporation	UCL	38.37	256	9,800	51.90	0.27	0.81
USX-Marathon Group	MRO 1	32.15	309	9,900	44.80	0.23	0.78
Devon Energy Corporation	DVN	58.84	135	7,900	80.10	0.16	0.78
Valero Energy Corp.	VLO	44.73	64	2,900	65.00	0.25	0.77
Petro-Canada	PCZ	26.87	272	7,300	38.70	0.08	0.72
Norsk Hydro ASA (49%)	NHY	41.70	128	5,400	65.90	0.15	0.69
<i>Total or Median</i>				<i>47,200</i>		<i>0.21</i>	<i>0.78</i>
<b>Small Cap</b>							
Dorchester Hugoton, Ltd.*	DHULZ	14.47	10.7	155	12.90	-	1.12
Cross Timbers Royalty Tr*	CRT	19.09	6.0	115	18.00	-	1.06
Encore Acquisition Corporation	EAC	15.80	30.0	470	16.70	0.12	0.95
San Juan Basin Royalty Tr*	SJT	16.01	46.6	750	17.10	-	0.94
Hugoton RoyaltyTrust*	HGT	15.81	40.0	630	17.90	-	0.88
Energy Partners Ltd.*	EPL 1	10.75	27.0	290	18.50	0.04	0.60
<i>Total or Median</i>				<i>2,410</i>		-	<i>0.94</i>

Buy/Sell rating after symbol: 1 - Strong Buy, 2 - Buy

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

\* For small cap stocks marked with asterisk, estimated present value recalculated weekly.

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<b>Power</b>							
CMS Energy Corporation	CMS	29.76	0.9	7.7	11	4.9	7.0
<b>Natural Gas and Oil</b>							
Barrett Resources Corporation	BRR	71.10	5.4	7.5	16	-	6.0
PanCanadian Pete Ltd. (15%)	PCP.TO	48.99	2.0	6.0	14	0.5	6.0
PetroChina Company Ltd (10%)	PTR	22.59	2.1	5.1	7	6.3	6.0
Unocal Corporation	UCL	38.37	1.8	4.9	14	2.1	6.0
Valero Energy Corp.	VLO	44.73	0.3	4.6	6	0.7	6.0
Petro-Canada	PCZ	26.87	1.1	4.3	10	1.0	6.0
USX-Marathon Group	MRO 1	32.15	0.4	3.9	6	2.9	5.0
Devon Energy Corporation	DVN	58.84	2.9	3.9	8	0.3	5.0
Norsk Hydro ASA (49%)	NHY	41.70	0.8	2.7	7	2.5	4.0
	<i>Median</i>		<i>1.8</i>	<i>4.6</i>	<i>8</i>	<i>1.0</i>	<i>6.0</i>
<b>Small Cap</b>							
Cross Timbers Royalty Tr*	CRT	19.09	5.6	8.7	9	11.1	8.1
Dorchester Hugoton, Ltd.*	DHULZ	14.47	6.3	8.0	9	8.5	7.2
San Juan Basin Royalty Tr*	SJT	16.01	6.1	7.5	10	10.2	8.0
Hugoton RoyaltyTrust*	HGT	15.81	5.1	7.1	9	10.7	8.0
Encore Acquisition Corporation	EAC	15.80	4.2	5.7		-	6.0
Energy Partners Ltd.*	EPL 1	10.75	1.8	2.8	11	-	4.6
	<i>Median</i>		<i>5.4</i>	<i>7.3</i>	<i>9</i>	<i>9.3</i>	<i>7.6</i>

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended March 31, 2002; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

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