

Bumps on the Road

Summary and Recommendation

Our national political leaders' accommodations to California politicians on electricity price controls raise the risk of economic recession that will dampen energy price appreciation. Yet the energy market will not be denied. The upward pressures are still there to be exerted anew later. Each of our recommended stocks has a special strength to carry it through possible adversity to eventual gains. Our Strong Buys are **USX-Marathon Group (MRO)** and **Energy Partners Limited (EPL)**. Our Buys are **American Electric Power (AEP)**, **Burlington Resources (BR)** and **PetroChina (PTR)** (For latest numbers, see Valuation Tables L-1, L-2, S-1, and S-2 attached. For justification of each recommendation, see Stock Ideas on www.mcdep.com).

Federal Energy Regulatory Commission Adopts Price Controls for Western Electricity

Having already written more than necessary on the controversy we have little to add except to acknowledge what the FERC has concluded. Our previous comments about the political failure in the West can be found in past editions of Meter Reader on www.mcdep.com. Price controls raise the risk of recession by lowering business and investor confidence. Lower confidence implies less spending and less investment and less economic growth. Compensatory action like a blackout, along with irrational and wasteful consumption impairs economic efficiency. A decline in civility and morality also seems to follow. To be optimistic, we would hope that implementation of the new regulations would be as benign as possible.

Six-Month Outlook for Natural Gas, Oil and Electricity

"What is the outlook for gas, oil and energy for the next six months? Will we go back to the previous highs in your opinion?"

The six-month energy outlook is between what the future market says and what we experienced last year by our reckoning. For a reading on the numbers, look at page 13 of the latest Meter Reader Tables on www.mcdep.com. The quarterly prices for Henry Hub natural gas and WTI oil are the actual historical numbers and what the futures market says for the quarters ahead.

For natural gas, last year's fourth quarter was \$6.52 and this year the market says \$4.12. The \$4.12 price is below the trend we see, but a cool summer, a warm fall or a recession

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could make the near term even lower and vice versa. While energy is less sensitive to a slowdown than most businesses, there is still a rub off in lower usage if industrial and commercial activity slows and if consumers feel it necessary to conserve more.

For oil, last year's fourth quarter was \$32.00 and this year the market says \$26.58. We can't call it any closer.

Five-Year Outlook for Natural Gas, Oil and Electricity

Where we differ with oil futures is further out. The futures price for 2006 is only \$21. That has got to be low. As a result the market has built into it some pretty modest long term oil pricing.

Let's say \$30 for oil five years out. That means \$6 for gas and \$60/MWh for electricity. Flat oil means natural gas up 50% at the wellhead and electricity double or more at the generation level.

My hypothetical 2005 environment is \$50 oil, \$10 natural gas and \$100/MWh power. That is optimistic, but not out of the question if we get a little inflation.

Buy Low McDep Ratio Energy Stocks

So the strategy we advocate is low McDep Ratio energy stocks for nice returns over several years. Along the way we will be positioned to benefit from positive surprises.

On the downside we may be facing a recession. While we hope that won't be the case, we want to be sure we can withstand it. If so, the post recession energy performance ought to be more like the years following 1974 rather than 1982 or 1990.

Controls Only Delay Price Gains

This time electricity generation after California in 2001 could act like natural gas and oil did after the Arab Oil Embargo in 1973. Recall that the international oil price after quadrupling in 1973, settled back a bit and then tripled again by 1980. Price controls were only gradually lifted on domestic oil over that seven-year period. Price controls were more rigidly applied to natural gas leading to a bifurcated market where the "free price" was almost 100 times the lowest regulated price. Price controls were not finally lifted completely on natural gas until more than fifteen years later.

Kurt H. Wulff, CFA

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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) 22-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>
Mega Cap							
Exxon Mobil Corporation	XOM	88.91	3,510	312,000	74.30	0.09	1.18
BP PLC	BP	52.43	3,720	195,000	48.90	0.17	1.06
TOTAL Fina Elf S.A.	TOT	72.79	1,400	102,000	72.00	0.16	1.01
Royal Dutch/Shell	RD	60.02	3,580	215,000	60.80	0.09	0.99
Chevron (incl. Texaco)	CHV	94.74	1,060	100,400	103.40	0.15	0.93
	<i>Total or Median</i>			<i>924,000</i>		<i>0.15</i>	<i>1.01</i>
Power							
Enron Corp.	ENE	44.88	814	36,500	16.90	0.68	1.53
Dynegy Inc.	DYN	44.08	338	14,900	20.60	0.56	1.50
AES Corporation	AES	41.06	538	22,100	15.80	0.73	1.44
Mirant Corporation	MIR	31.01	353	10,900	11.70	0.75	1.42
Calpine Corporation	CPN	37.70	313	11,800	21.40	0.48	1.40
Duke Energy Corporation	DUK	40.30	752	30,300	20.90	0.62	1.35
Williams Companies	WMB	34.07	485	16,500	16.60	0.69	1.32
El Paso Corporation	EPG	51.95	521	27,100	30.00	0.57	1.31
American Electric Power Co. Inc.	AEP 2	46.01	324	14,900	25.90	0.73	1.21
Southern Company	SO	23.15	683	15,800	16.90	0.54	1.17
Exelon Corporation	EXC	64.05	324	20,800	55.30	0.51	1.08
	<i>Total or Median</i>			<i>222,000</i>		<i>0.62</i>	<i>1.35</i>
Natural Gas and Oil							
Occidental Petroleum	OXY	28.36	370	10,500	35.60	0.46	0.89
Anadarko Petroleum Corp.	APC	56.70	263	14,900	66.30	0.24	0.89
Burlington Resources, Inc	BR 2	39.98	215	8,600	56.30	0.19	0.77
ENI S.p.A.	E	63.80	800	51,100	91.90	0.10	0.72
Conoco Inc.	COC.B	30.25	623	18,900	48.00	0.21	0.71
Phillips (incl. Tosco)	P	58.60	379	22,200	102.10	0.27	0.69
	<i>Total or Median</i>			<i>126,000</i>		<i>0.22</i>	<i>0.75</i>
Service							
Halliburton Company	HAL	39.26	430	16,900	27.20	0.13	1.39
Schlumberger Ltd.	SLB	54.10	581	31,400	37.70	0.14	1.37

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) 22-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>	
Mega Cap								
	E Exxon Mobil Corporation	XOM	88.91	1.6	8.3	16	2.0	7.0
	BP PLC	BP	52.43	1.3	7.4	12	2.7	7.0
	TOTAL Fina Elf S.A.	TOT	72.79	1.1	7.1	17	1.5	7.0
	Royal Dutch/Shell	RD	60.02	1.5	6.9	15	2.3	7.0
	Chevron (incl. Texaco)	CHV	94.74	1.1	5.6	11	2.7	6.0
	<i>Median</i>			<i>1.3</i>	<i>7.1</i>	<i>15</i>	<i>2.3</i>	<i>7.0</i>
Power								
	Enron Corp.	ENE	44.88	0.3	15.3	26	1.1	10.0
	Dynegy Inc.	DYN	44.08	0.4	13.5	21	0.7	9.0
	Calpine Corporation	CPN	37.70	3.6	12.6	19	-	9.0
	AES Corporation	AES	41.06	4.1	11.5	20	-	8.0
	Mirant Corporation	MIR	31.01	0.7	11.4	15	-	8.0
	Duke Energy Corporation	DUK	40.30	0.9	10.8	16	2.7	8.0
	Williams Companies	WMB	34.07	3.4	10.6	15	1.8	8.0
	El Paso Corporation	EPG	51.95	0.7	9.2	16	1.6	7.0
	American Electric Power Co. Inc.	AEP 2	46.01	0.7	8.4	13	5.2	7.0
	Southern Company	SO	23.15	2.7	8.2	14	5.8	7.0
	Exelon Corporation	EXC	64.05	2.6	7.6	14	2.6	7.0
	<i>Median</i>			<i>0.9</i>	<i>10.8</i>	<i>16</i>	<i>1.6</i>	<i>8.0</i>
Natural Gas and Oil								
	Burlington Resources, Inc	BR 2	39.98	3.0	5.4	8	1.4	7.0
	Occidental Petroleum	OXY	28.36	1.3	5.3	8	3.5	6.0
	Anadarko Petroleum Corp.	APC	56.70	2.4	5.3	9	0.4	6.0
	Conoco Inc.	COC.B	30.25	0.6	4.2	8	2.5	6.0
	Phillips (incl. Tosco)	P	58.60	0.7	4.1	7	2.3	6.0
	ENI S.p.A.	E	63.80	1.1	3.6	6	2.5	5.0
	<i>Median</i>			<i>1.2</i>	<i>4.8</i>	<i>8</i>	<i>2.4</i>	<i>6.0</i>
Service								
	Halliburton Company	HAL	39.26	1.4	11.1	27	1.3	8.0
	Schlumberger Ltd.	SLB	54.10	2.8	9.6	27	1.4	7.0

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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Power							
	CMS	27.88	128	3,600	19.80	0.80	1.08
	CEG	41.15	152	6,300	37.10	0.45	1.06
	SRE	26.75	203	5,400	23.10	0.65	1.06
	<i>Total or Median</i>			<i>15,300</i>		<i>0.65</i>	<i>1.06</i>
Natural Gas and Oil							
	TPP	29.30	38	1,110	13.20	0.65	1.42
	OIL	28.00	59	1,700	24.50	0.24	1.11
	UCL	35.30	256	9,000	51.90	0.27	0.77
	PCP.TO	30.93	38	1,180	41.80	0.07	0.76
	MRO 1	30.19	309	9,300	44.80	0.23	0.75
	VLO	38.72	112	4,300	70.70	0.42	0.74
	PCZ	25.12	272	6,800	35.20	0.09	0.74
	NHY	43.40	128	5,600	65.90	0.15	0.71
	DVN	51.51	135	7,000	80.10	0.16	0.70
	PTR 2	20.96	176	3,700	32.50	0.15	0.70
	<i>Total or Median</i>			<i>49,690</i>		<i>0.20</i>	<i>0.74</i>
Small Cap							
	DHULZ	13.01	10.7	140	12.40	-	1.05
	CRT	15.92	6.0	96	17.00	-	0.94
	SJT	12.99	46.6	610	15.10	-	0.86
	HGT	13.39	40.0	540	15.90	-	0.84
	EAC	11.48	30.0	340	16.40	0.15	0.74
	EPL 1	12.09	27.0	330	20.80	0.03	0.60
	<i>Total or Median</i>			<i>2,060</i>		<i>-</i>	<i>0.85</i>
Micro Cap							
	PEL.TO	2.86	26.0	74	3.70	0.07	0.79

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

McDep Ratio = **M**arket cap and **D**ebt to **p**resent value of oil and gas and other businesses

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

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		Price (\$/sh)	EV/ Sales	EV/ Ebitda	Dividend or Distribution	PV/ Ebitda		
	Symbol	22-Jun 2001	2001E	NTM	P/E NTM	NTM (%)	NTM	
Power								
	CMS Energy Corporation	CMS	27.88	0.9	7.6	10	5.2	7.0
	Constellation Energy Group	CEG	41.15	2.1	7.4	13	1.2	7.0
	Sempra Energy	SRE	26.75	1.2	7.4	10	3.7	7.0
	<i>Median</i>			<i>1.2</i>	<i>7.4</i>	<i>10</i>	<i>3.7</i>	<i>7.0</i>
Natural Gas and Oil								
	TEPPCO Partners, L.P.	TPP	29.30	0.7	11.4	15	7.2	8.0
	Triton Energy Limited	OIL	28.00	4.3	6.7	15	-	6.0
	Unocal Corporation	UCL	35.30	1.7	4.6	13	2.3	6.0
	PanCanadian Pete (15%)(US\$)	PCP.TO	30.93	1.3	4.2	8	0.8	5.5
	Valero Energy Corp.(with UDS)	VLO	38.72	0.3	4.1	4	0.8	5.5
	Petro-Canada	PCZ	25.12	1.0	4.1	9	1.1	5.5
	USX-Marathon Group	MRO 1	30.19	0.4	3.8	6	3.0	5.0
	Devon Energy Corporation	DVN	51.51	2.7	3.5	7	0.4	5.0
	Norsk Hydro ASA (49%)	NHY	43.40	0.8	2.8	7	2.4	4.0
	PetroChina Company Ltd (10%)	PTR 2	20.96	1.5	2.8	5	8.2	4.0
	<i>Median</i>			<i>1.2</i>	<i>4.1</i>	<i>8</i>	<i>1.7</i>	<i>5.5</i>
Small Cap								
	Cross Timbers Royalty Tr*	CRT	15.92	5.3	8.4	9	11.4	8.9
	Dorchester Hugoton, Ltd.*	DHULZ	13.01	6.2	8.0	9	8.3	7.6
	San Juan Basin Royalty Tr*	SJT	12.99	5.4	6.8	9	10.9	7.9
	Hugoton RoyaltyTrust*	HGT	13.39	4.8	6.8	9	11.0	8.1
	Encore Acquisition Corporation	EAC	11.48	3.0	4.5	10	-	6.0
	Energy Partners Ltd.*	EPL 1	12.09	1.9	3.1	13	-	5.1
	<i>Median</i>			<i>5.1</i>	<i>6.8</i>	<i>9</i>	<i>9.6</i>	<i>7.7</i>
Micro Cap								
	Purcell Energy, Ltd. (US\$)	PEL.TO	2.86	3.7	4.8	16	-	6.0

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