Rating: Buy
S&P 500: 1136

Anadarko Petroleum Corporation
Managing for Value

Symbol	APC	*Ebitda Next Twelve Months ending 3/31/05 (US$mm)*	4,600
Rating	Buy	*North American Natural Gas/Ebitda (%)*	55
Price (US$/sh)	57.48	*Natural Gas and Oil Production/Ebitda (%)*	100
Pricing Date	6/10/04	*Adjusted Reserves/Production NTM*	11.0
Shares (mm)	254	*EV/Ebitda*	4.5
Market Capitalization (US$mm)	14,600	*PV/Ebitda*	6.6
Debt (US$mm)	6,300	*Undeveloped Reserves (%)*	31
Enterprise Value (EV) (US$mm)	20,900	*Natural Gas and Oil Ebitda (US$/boe)*	23.84
Present Value (PV) (US$mm)	30,200	*Present Value Proven Reserves(US$/boe)*	12.02
Net Present Value (US$/share)	94	*Present Value Proven Reserves(US$/mcfe)*	2.00
Debt/Present Value	0.21	*Earnings Next Twelve Months (US$/sh)*	7.23
McDep Ratio - EV/PV	0.69	*Price/Earnings Next Twelve Months*	8
Dividend Yield (%/year)	1.0	*Indicated Annual Dividend (US$/sh)*	0.56

Note: Estimated cash flow and earnings tied to one-year futures prices for oil and natural gas.
Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.

Summary and Recommendation

We continue to recommend current purchase of the common shares of Anadarko Petroleum Corporation as management seeks to realize the higher value that prospective acquirers missed last year. Plans have been announced to sell about 10% of assets and probably to repurchase stock with some of the proceeds. Most of the resources remain positioned to benefit from the improving environment for oil and gas production. Concentration on North American natural gas at 55% is appealing. We see potential appreciation of about 64% to net present value of US$94 a share subject to the risk of low to moderate debt.

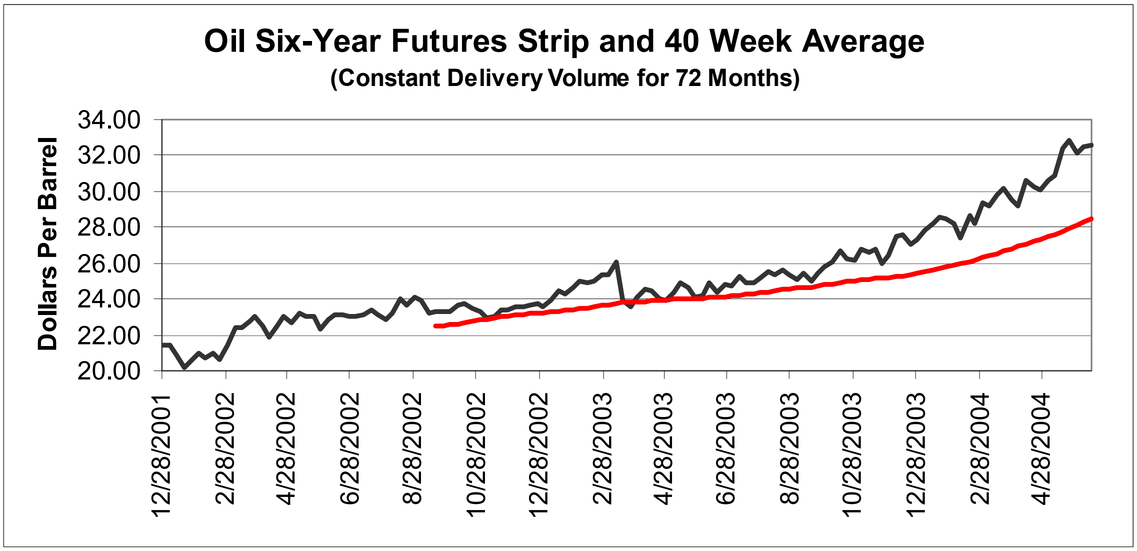
Oil Looks Up by the Charts, Fundamentals, Inflation and Security

Six-year futures describe the commodity price trends most relevant to estimating resource value. The longer time horizon better matches the period during which more of current resources will actually be produced. The longer term measure also smoothes the frantic near-month fluctuations and has the potential to keep climbing even if near-month quotes drop back temporarily.

The plots of weekly results since the beginning of 2002 trace a trend of six-year oil price rising 16% a year (see chart). We measure momentum with the 40-week moving average.
The chart looks good as long as the current six-year quote remains above the trailing average.

Fundamental factors support the price trends. Oil demand is strong with world economic growth paced by developing countries, especially China. Supply is tight as the Middle East is showing maturity with the workhorse giant fields on the verge of peaking.

Monetary factors also favor oil investment as interest rates below inflation drive investors to real assets for protection against currency debasement. Compared to Treasury Inflation Protected Securities that we also favor, oil price is likely to rise more than the official government determined inflation measure.



There appears to be little of the cost of maintaining global security reflected in the price of oil. Escalating violence in Saudi Arabia reminds us that the Iranian Revolution in 1979 was accompanied by a tripling in oil price after it had quadrupled earlier in the decade.

At some point oil price could be too strong and economic activity would be adversely affected. Six times in the past thirty years the annual gain in monthly price exceeded 70% briefly. July futures near $40 a barrel for Light, Sweet Crude Oil would have to exceed $52 a barrel to trigger a 70% warning.

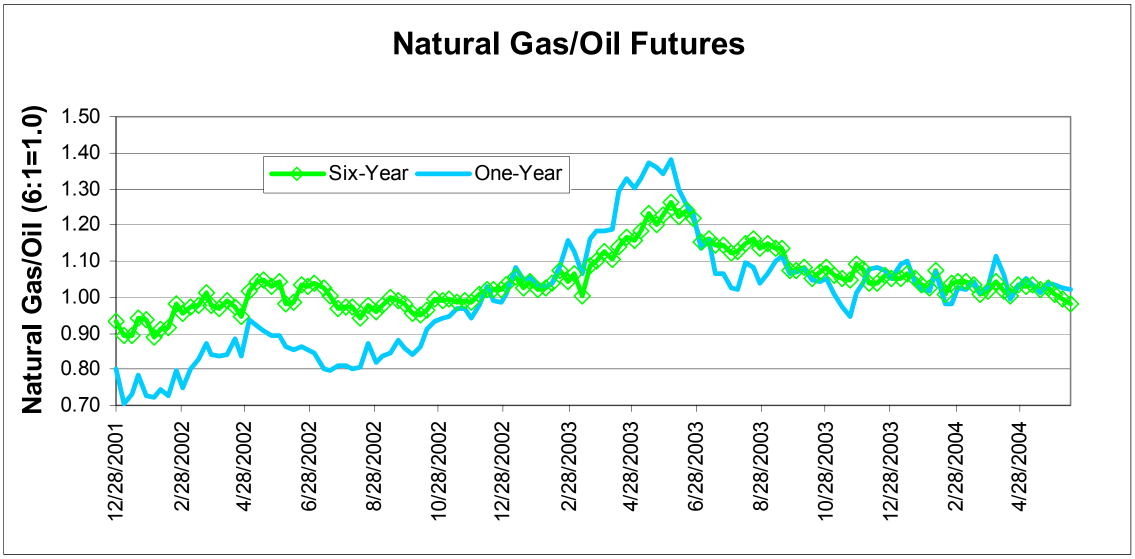
Natural Gas Outlook Stronger than Oil

Natural gas prices are advancing faster than oil. The ratio of natural gas to oil on a heating content basis advanced from 0.2 times oil in 1970 to 1.0 times oil today. That trend points to a ratio of perhaps 1.3 in 2010. We find that easy to believe in part because the ratio exceeded that for one-year futures for most of the spring of 2003 (see chart). As the cleanest fuel, natural gas should continue to advance in price relative to oil as the world increasingly desires a cleaner environment.

Volume, Price and Costs Translate to Attractive Cash Flow

Our process of estimating company-specific present value begins with an estimate of next twelve months cash flow. Current projections lead to a healthy level of unlevered cash flow, also known as Ebitda, short for earnings before interest, tax, depreciation and amortization (see table). We choose the next twelve months ending March 31, 2005 as the relevant time period.

For the next twelve months we project natural gas and oil volume near the first quarter 2004 level. That is sufficient for our valuation calculation. Management provides rich detail in conference calls, presentations and copious regulatory disclosures to put more color on a projection of growth for the rest of the decade. At a recent analyst meeting, the company discussed plans to sell properties that could result in lower volumes.



We take the futures market at face value in projecting price for the next twelve months. Henry Hub quotes guide our projection of natural gas revenue. Light Sweet Crude quotes guide our projections of oil revenue. Because futures are constantly changing, our projection is adjusted accordingly. As a result, the specific amounts we project today may not be the amounts realized when the company next reports.

The company actively hedges oil and gas price. The company still should derive most of the long-term benefit from the higher price we expect. We use unhedged prices for our cash flow projection that becomes a comparative benchmark for valuation. We make an allowance for hedging losses in estimating earnings.

Assess Present Value Multiple Depending on Reserve Life

The important variables in the valuation of future production are captured in base year cash flow and a multiple of that cash flow that depends on reserve life. Indeed investors do differentiate on that basis as reflected in a high correlation of unlevered cash flow multiple with adjusted reserve life. We convert the market relationship to a formula that produces an anticipatory value with somewhat more sensitivity to reserve life.

The adjusted reserve life index is the sum of developed and half undeveloped reserves divided by next twelve months production. When we last did an industry-wide upward revaluation on March 23, we estimated cash flow multiple equal to 2.5 plus 0.5 times reserve life. That approximates present value assuming constant commodity price near the one-year quotes at that time, about $35 a barrel for crude oil. Higher commodity prices since then imply higher cash flow and lower multiple.

Anadarko Petroleum Corporation
Next Twelve Months Operating and Financial Estimates

	Q1 3/31/04	Q2E 6/30/04	Q3E 9/30/04	Q4E 12/31/04	**Year 2004E**	Q1E 3/31/05	**Next Twelve Months 3/31/05**
Volume							
Natural Gas (mmcfd)	1,723	1,723	1,723	1,723	**1,723**	1,723	**1,723**
Oil (mbd)	251	251	251	230	**246**	230	**241**
Total gas & oil (bcf)	294	294	297	285	**1,170**	279	**1,156**
Price							
Natural gas ($/mcf)							
Henry Hub ($/mmbtu)	5.64	6.22	6.78	6.93	**6.39**	7.11	**6.76**
Company ($/mcf)	5.03	5.32	5.60	5.68	**5.41**	5.76	**5.59**
Oil ($/bbl)							
WTI Cushing	35.23	39.51	41.20	39.42	**38.84**	37.67	**39.45**
Worldwide	30.31	32.45	33.29	32.40	**32.11**	31.53	**32.44**
Total gas & oil ($/mcf)	5.04	5.36	5.57	5.55	**5.36**	5.54	**5.51**
Revenue ($mm)							
Natural Gas	789	834	887	900	**3,409**	894	**3,515**
Oil	692	741	769	686	**2,888**	653	**2,848**
Other	(21)		-		**(21)**	-	**-**
Total	1,460	1,575	1,656	1,585	**6,276**	1,547	**6,363**
Expense							
Fixed	217	217	217	217	**869**	217	**869**
Variable	217	224	235	225	**901**	220	**903**
Ebitda ($mm)	1,026	1,134	1,204	1,143	**4,507**	1,110	**4,591**
Deprec., Deplet., & Amort.	348	348	348	348	**1,392**	348	**1,392**
Other non cash	9	30	30	30	**99**	30	**120**
Ebit	669	756	826	765	**3,016**	732	**3,079**
Interest	63	63	63	63	**252**	63	**252**
Ebt	606	693	763	702	**2,764**	669	**2,827**
Income Tax	212	243	267	246	**967**	234	**989**
Net Income ($mm)	394	451	496	456	**1,797**	435	**1,838**
Shares (millions)	254	254	254	254	**254**	254	**254**
Per share ($)	1.55	1.77	1.95	1.80	**7.07**	1.71	**7.23**
Ebitda Margin	70%	72%	73%	72%	**72%**	72%	**72%**
Tax Rate	35%	35%	35%	35%	**35%**	35%	**35%**

The Sharks Missed a Juicy Morsel

It seemed widely acknowledged that a large buyer was welcome to make a friendly acquisition of the whole company last year after executive turmoil. The fact that nothing happened speaks more about a prospective buyer's willingness to make a commitment than the desirability of Anadarko's assets. For example, last August cash flow for the next twelve months looked like it would be $3.3 billion. Now our projection is $4.6 billion. The acquisition might have been at our net present value of $60 a share when the stock price was about $42. Now the stock price has reached nearly $60 without the sale of the company.

Kurt H. Wulff, CFA

Research Methodology/Ratings Description: McDep Associates is an independent research originator focused on oil and gas stocks exclusively. The firm applies the thirty years of experience of its analyst to estimate a present value of the oil and gas resources and other businesses of covered companies. That value is compared with a company's stock market capitalization and debt. Stocks with low market cap and debt relative to present value tend to outperform stocks with high market cap and debt relative to present value. Buy recommendations are expected to deliver a total return better than 7% per year above inflation. Hold recommendations assume the attributes of the underlying business are more than fully reflected in the current price of the stock. Sell recommendations are expected to deliver a negative total return less than 7% per year including the effects of inflation.

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