

Rating: Buy  
S&P 500: 1210

## **Anadarko Petroleum Corporation** **Raise Net Present Value to \$113 a Share**

<i>Symbol</i>	APC	<i>Ebitda Next Twelve Months ending 3/31/06 (US\$mm)</i>	4,690
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	51
<i>Price (US\$/sh)</i>	70.00	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	2/16/05	<i>Adjusted Reserves/Production NTM</i>	11.9
<i>Shares (mm)</i>	246	<i>EV/Ebitda</i>	4.6
<i>Market Capitalization (US\$mm)</i>	17,200	<i>PV/Ebitda</i>	6.9
<i>Debt (US\$mm)</i>	4,400	<i>Undeveloped Reserves (%)</i>	36
<i>Enterprise Value (EV) (US\$mm)</i>	21,600	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	28.64
<i>Present Value (PV) (US\$mm)</i>	32,200	<i>Present Value Proven Reserves(US\$/boe)</i>	13.60
<i>Net Present Value (US\$/share)</i>	113	<i>Present Value Proven Reserves(US\$/mcf)</i>	2.27
<i>Debt/Present Value</i>	0.14	<i>Earnings Next Twelve Months (US\$/sh)</i>	7.54
<i>McDep Ratio - EV/PV</i>	0.67	<i>Price/Earnings Next Twelve Months</i>	9
<i>Dividend Yield (%/year)</i>	1.0	<i>Indicated Annual Dividend (US\$/sh)</i>	0.72

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**

**Anadarko Petroleum Corporation (APC)** stock may be especially timely after a resource upgrading was completed last year. The stock has the lowest McDep Ratio among U.S.-based stocks in our coverage. We raised our estimate of net present value for the independent producer to \$113 a share from \$94 on January 26, 2005 when we revised our estimate of long-term oil price to \$40 a barrel constant real from \$35. The new NPV matches the level previously calculated in a sensitivity illustration (see *Stock Idea, Anadarko Petroleum*, September 7, 2004). We see potential appreciation of 61% to our new estimate of net present value.

### **Resource Upgrading Lengthens Reserve Life**

Last year the company sold short-life properties that accounted for about 11% of reserves and as much as 22% of production. The sale contributes to an increase in adjusted reserve life to a current 11.9 years from 10.9 that we estimated three months ago. Estimated cash flow is less because projected annual volume is lower. The changes are offsetting and we keep the same estimate of present value we previously carried except that on an industry basis we are now estimating a higher long-term oil price. Compared to stock price of peer companies, Anadarko's stock price seems to reflect the lower near-term cash flow, but not the higher multiple justified by longer life of cash flow.

North American natural gas resources have more value relative to cash flow than global oil resources (see table Functional Cash Flow and Present Value). The cleaner fuel has more long-term potential than oil and is also lagging in price on a short term basis considering day to day inventories. Anadarko's stock price appears to be lagging that of both oil producers and natural gas producers.

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Tight gas, as management calls it, accounts for a majority of North American natural gas production. Tight gas would provide perhaps half of the growth management expects for the next several years. In particular rapid development of the Vernon field in Louisiana has made it a large contributor to value enhancement.

**Anadarko Petroleum Corporation**  
**Functional Cash Flow and Present Value**

	<i>NTM Ebitda</i> <i>(US\$mm)</i>	<i>Adjusted</i> <i>R/P</i>	<i>PV/</i> <i>Ebitda</i>	<i>Present</i> <i>Value</i> <i>(US\$mm)</i>	
North American Natural Gas	2,390	11.9	7.5	18,000	56%
Oil	2,300	11.8	6.2	14,200	44%
	4,690	11.9	6.9	32,200	100%
Debt (US\$mm)				4,400	
Net Present Value (US\$mm)				27,800	
Shares (mm)				246	
Net Present Value (US\$/sh)				113	

**Hedging Position Improves**

New volume estimates take account of management's guidance (see table Next Twelve Months Operating and Financial Estimates). Natural gas and oil pricing is from the futures market with adjustment for the likely differentials for location and quality.

Better price parameters for hedges help cash flow in 2005 over 2004. Our projected Ebitda is before the impact of hedging.

**Correlation Supports Present Value Estimate**

Projected cash flow becomes the base against which we apply a multiple to test the continuing validity of our estimate of present value. We make the comparison separately for North American natural gas and for global oil. That multiple is low considering the current correlation of present value with reserve life for natural gas and for oil.

One can get a sense of the correlation by scanning estimates of North American natural gas present value by stock (see table North American Natural Gas Cash Flow and Present Value). The stocks are ranked by adjusted reserve life (see second numerical column from the left). Anadarko's cash flow multiple (see third numerical column from the left) is lower than for companies with similar reserve life. The correlation is continually changing as we get new information. If we waited until we got fully consistent information for each company the comparison would lose timeliness.

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**Anadarko Petroleum Corporation**  
**Next Twelve Months Operating and Financial Estimates**

	<i>Q3</i>	<i>Q4</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Next Twelve Months</i>
	<i>9/30/04</i>	<i>12/31/04</i>	<i>2004</i>	<i>3/31/05</i>	<i>6/30/05</i>	<i>9/30/05</i>	<i>12/31/05</i>	<i>2005E</i>	<i>3/31/06</i>	<i>3/31/06</i>
<b>Volume</b>										
Natural Gas (mmcf)	1,813	1,641	<b>1,741</b>	1,440	1,490	1,490	1,490	<b>1,478</b>	1,490	<b>1,490</b>
Oil (mbd)	232	223	<b>230</b>	200	200	200	200	<b>200</b>	200	<b>200</b>
Total gas & oil (bcf)	295	274	<b>1,142</b>	238	245	247	247	<b>977</b>	242	<b>982</b>
<b>Price</b>										
Natural gas (\$/mcf)										
Henry Hub (\$/mmbtu)	5.75	7.10	<b>6.15</b>	6.20	6.23	6.38	6.76	<b>6.39</b>	7.21	<b>6.65</b>
Company (\$/mcf)	4.93	6.10	<b>5.30</b>	5.33	5.36	5.48	5.81	<b>5.50</b>	6.20	<b>5.71</b>
Oil (\$/bbl)										
WTI Cushing	43.89	48.30	<b>41.44</b>	46.93	48.10	47.42	46.57	<b>47.25</b>	45.47	<b>46.89</b>
Worldwide	33.38	42.15	<b>34.01</b>	40.96	41.98	41.38	40.64	<b>41.24</b>	39.68	<b>40.93</b>
Total gas & oil (\$/mcf)	5.20	6.52	<b>5.31</b>	6.01	6.09	6.11	6.24	<b>6.20</b>	6.38	<b>6.29</b>
<b>Revenue (\$mm)</b>										
Natural Gas	822	921	<b>3,375</b>	690	726	751	797	<b>2,965</b>	831	<b>3,106</b>
Oil	712	865	<b>2,863</b>	737	764	761	748	<b>3,011</b>	714	<b>2,988</b>
Other	27	(184)	<b>(171)</b>	20	20	20	20	<b>80</b>	20	<b>80</b>
Total	1,562	1,602	<b>6,067</b>	1,448	1,511	1,533	1,565	<b>6,055</b>	1,566	<b>6,173</b>
<b>Expense</b>										
Fixed	158	191	<b>766</b>	191	191	191	191	<b>766</b>	191	<b>766</b>
Variable	158	191	<b>766</b>	153	157	159	163	<b>632</b>	163	<b>641</b>
<b>Ebitda (\$mm)</b>	1,246	1,219	<b>4,535</b>	1,083	1,142	1,162	1,191	<b>4,578</b>	1,191	<b>4,686</b>
Deprec., Deplet., & Amort.	387	355	<b>1,447</b>	355	355	355	355	<b>1,420</b>	355	<b>1,420</b>
Hedging and other	-	-	<b>9</b>	12	17	15	13	<b>56</b>		<b>44</b>
<b>Ebit</b>	859	864	<b>3,079</b>	716	770	792	823	<b>3,102</b>	836	<b>3,222</b>
Interest	131	92	<b>352</b>	92	92	92	92	<b>368</b>	92	<b>368</b>
<b>Ebt</b>	728	772	<b>2,727</b>	624	678	700	731	<b>2,734</b>	744	<b>2,854</b>
Income Tax	255	270	<b>954</b>	219	237	245	256	<b>957</b>	261	<b>999</b>
<b>Net Income (\$mm)</b>	473	502	<b>1,773</b>	406	441	455	475	<b>1,777</b>	484	<b>1,855</b>
<b>Shares (millions)</b>	253	246	<b>251</b>	246	246	246	246	<b>246</b>	246	<b>246</b>
Per share (\$)	1.87	2.04	<b>7.05</b>	1.65	1.79	1.85	1.93	<b>7.22</b>	1.97	<b>7.54</b>
Ebitda Margin	80%	76%	<b>75%</b>	75%	76%	76%	76%	<b>76%</b>	76%	<b>76%</b>
Tax Rate	35%	35%	<b>35%</b>	35%	35%	35%	35%	<b>35%</b>	35%	<b>35%</b>

**Buy Oil and Gas Producers at Mid Decade**

APC stock appears most undervalued among peers (see table [Rank by McDep Ratio](#)). Moreover we confirm our estimate that appears to create a gap with the next lowest McDep Ratio stock.

Three to five-fold gain potential for oil and gas price over the next 5 to 13 years justifies investment in recommended oil and gas producers, in our opinion. Supporting improving prospects, the average futures price of oil for continuous delivery over the next six years is in a multi-year uptrend as defined by the current quotes above the 40-week average. The current benchmark oil average futures price for the next six years is about \$42 a barrel.

Kurt H. Wulff, CFA

**North American Natural Gas Cash Flow and Present Value**

	<i>Ebitda</i>	<i>Adjstd</i>	<i>PV/</i>	<i>Present</i>
	<i>NTM</i>	<i>Resrvs/</i>	<i>Ebitda</i>	<i>Value</i>
	<i>(\$mm)</i>	<i>Prod</i>	<i>NTM</i>	<i>(\$mm)</i>
		<i>NTM</i>		
Energy Partners Ltd.	170	4.7	3.7	630
Royal Dutch/Shell	1,890	4.9	4.3	9,000
Imperial Oil Limited (30%)	599	5.2	5.3	3,200
Cimarex Energy Company	310	5.2	4.5	1,400
Marathon Oil Corporation	660	5.9	5.6	3,700
Encana Corporation	5,380	6.5	5.4	29,000
Suncor Energy	210	7.3	6.2	1,300
ChevronTexaco Corporation	2,020	7.6	6.9	14,000
Devon Energy Corporation	3,830	7.7	6.1	23,500
Unocal Corporation	875	8.0	6.9	6,000
Petro-Canada	680	8.9	7.4	5,000
Occidental Petroleum Corp.	774	9.5	7.4	5,700
Burlington Resources	2,540	10.2	7.9	20,000
XTO Energy Inc.	1,530	11.7	7.8	12,000
Exxon Mobil Corporation	4,140	11.8	9.2	38,000
Anadarko Petroleum Corp.	2,390	11.9	7.5	18,000
ConocoPhillips	1,880	12.0	8.5	16,000
San Juan Basin Royalty Trust	145	12.5	9.6	1,400
Encore Acquisition Company	72	12.6	9.1	650
BP plc	2,700	13.6	11.1	30,000

**Oil and Gas Producers**

**Rank by McDep Ratio: Market Cap and Debt to Present Value**

	<i>Symbol/</i>	<i>Rating</i>	<i>Price</i>	<i>Shares</i>	<i>Market</i>	<i>Net</i>	<i>Debt/</i>	<i>McDep</i>
			<i>(\$/sh)</i>	<i>(mm)</i>	<i>Cap</i>	<i>Present</i>	<i>Present</i>	<i>Ratio</i>
			<i>16-Feb</i>		<i>(\$mm)</i>	<i>Value</i>	<i>Value</i>	
			<i>2005</i>			<i>(\$/sh)</i>		
<b>Independent Natural Gas and Oil - Large Cap and Mid Cap</b>								
XTO Energy Inc.	XTO	B	40.83	280	11,430	45.00	0.16	0.92
Encana Corporation	ECA	B	63.95	472	30,200	77.00	0.18	0.86
Unocal Corporation	UCL	B	51.42	271	13,900	65.00	0.21	0.83
CNOOC Limited (19%)	CEO	B	53.77	78	4,200	67.00	-	0.80
Occidental Petroleum Corp.	OXY	B	66.60	406	27,100	87.00	0.15	0.80
Burlington Resources	BR	B	48.04	391	18,800	67.00	0.12	0.75
Devon Energy Corporation	DVN	B	43.61	500	21,800	63.00	0.16	0.74
Anadarko Petroleum Corp.	APC	B	70.00	246	17,200	113.00	0.14	0.67
<i>Total or Median</i>					<i>145,000</i>		<i>0.15</i>	<i>0.80</i>

B = 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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