

Rating: Buy
S&P 500: 1188

Burlington Resources, Inc. **Royalty Trust Candidate**

<i>Symbol</i>	BR	<i>Ebitda Next Twelve Months ending 12/31/05 (US\$m)</i>	4,300
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	61
<i>Price (\$/sh)</i>	41.10	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	1/6/05	<i>Adjusted Reserves/Production NTM</i>	9.9
<i>Shares (mm)</i>	395	<i>EV/Ebitda</i>	4.6
<i>Market Capitalization (\$mm)</i>	16,200	<i>PV/Ebitda</i>	6.2
<i>Debt (\$mm)</i>	3,600	<i>Undeveloped Reserves (%)</i>	26
<i>Enterprise Value (EV) (\$mm)</i>	19,800	<i>Natural Gas and Oil Ebitda (\$/mcf)</i>	4.10
<i>Present Value (PV) (\$mm)</i>	26,500	<i>Present Value Proven Reserves(\$/boe)</i>	13.50
<i>Net Present Value (\$/share)</i>	58	<i>Present Value Proven Reserves(\$/mcf)</i>	2.30
<i>Debt/Present Value</i>	0.14	<i>Earnings Next Twelve Months (US\$/sh)</i>	4.13
<i>McDep Ratio - EV/PV</i>	0.75	<i>Price/Earnings Next Twelve Months</i>	10
<i>Dividend Yield (%/year)</i>	0.8	<i>Indicated Annual Dividend (US\$/sh)</i>	0.34

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 **Burlington Resources (BR)** for its concentration on North American natural gas and its low valuation that presents interesting possibilities. Not only is the stock an attractive target for acquisition, it is an attractive candidate to help itself with the transfer of choice assets to an income paying royalty trust. Meanwhile the January Thaw in commodity prices offers another chance to acquire investment representation in clean fuel resources at a low stock price. At a McDep Ratio of 0.75 the stock is priced as though the future price of oil would be just \$26 a barrel constant real. At our standard assumption of \$35 for Light, Sweet Crude Oil the stock has 41% appreciation potential to estimated net present value of \$58 a share.

Distinctive Concentration on North American Natural Gas

BR has few peers with the combination of stock market size and concentration on a premium energy resource. North American Natural Gas accounts for 63% of estimated present value as we estimate currently (see table Functional Cash Flow and Present Value).

The present value to cash flow multiple, PV/Ebitda, appears in line with the current correlation for thirty companies. The proportion of proven reserves reported as undeveloped is slightly less than the median.

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Burlington Resources
Functional Cash Flow and Present Value

	<i>NTM Ebitda</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Present</i>	
	<i>(US\$mm)</i>	<i>R/P</i>	<i>Ebitda</i>	<i>Value</i>	
				<i>(US\$mm)</i>	
North American Natural Gas	2,640	10.1	6.2	16,600	63%
Overseas Natural Gas	220	8.2	5.6	1,200	5%
Oil	1,440	9.9	6.0	8,700	33%
	4,300	9.9	6.2	26,500	100%
Debt (US\$mm)				3,600	
Net Present Value (US\$mm)				22,900	
Shares (mm)				395	
Net Present Value (US\$/sh)				58	

Projected Cash Flow and Profits Sensitive to Futures Price

We forecast a natural gas price for 2005 of \$6.21 for the industry benchmark. That is the average of the index price for January and futures prices for the remaining eleven months as quoted on the New York Mercantile Exchange. We are grateful for all the analysts and traders in the commodity markets who readily absorb and act on every detailed piece of information that may affect near-term natural gas price. Commodity price is the volatile input to our projection of unlevered cash flow (Ebitda) for 2005 (see table Next Twelve Months Operating and Financial Results).

Low Cash Flow Multiple Spells Opportunity

Comparing market cap and debt, also known as Enterprise Value, to unlevered cash flow, also known as Ebitda, results in a multiple of 4.6 times. Thus, ignoring taxes, a buyer of all of BR's debt and shares at the current price would get the purchase price back in just 4.6 years and still have assets that continue to generate cash flow at a high rate. The obvious implication is that investors do not believe that BR's cash flow will remain at the current level for long.

Our present value work detailed in previous analyses concludes that if the price of oil were to be constant at \$35 a barrel before adjustment for future inflation, BR's natural gas and oil resources would be worth our estimated present value of \$58 a share. The analysis assumes a 7% real rate of return and that natural gas price will rise relative to oil price over time.

BR's stock price is about \$41, not \$58. To get our present value down to current stock price we would have to lower our oil price assumption to about \$26 a barrel. The current one-year oil price is \$44 and the current six-year oil price is about \$40. Logically, one might conclude that as long as oil price stays above the price embedded in BR's stock price, there is a case for immediate stock price appreciation.

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Burlington Resources Inc.
Next Twelve Months Operating and Financial Results

	<i>Q1</i>	<i>Q2</i>	<i>Q3</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Next Twelve Months</i>
	<i>3/31/04</i>	<i>6/30/04</i>	<i>9/30/04</i>	<i>12/31/04</i>	<i>2004E</i>	<i>3/31/05</i>	<i>6/30/05</i>	<i>9/30/05</i>	<i>12/31/05</i>	<i>12/31/05</i>
Volume										
Natural Gas (mmcf)										
U.S.	880	905	935	935	916	935	935	935	935	935
Canada	846	834	796	800	821	800	800	800	800	800
Overseas	227	160	175	220	196	227	160	190	220	199
Total	1,953	1,899	1,906	1,955	1,934	1,962	1,895	1,925	1,955	1,934
Days	91	91	92	92	366	90	91	92	92	365
Oil (mb)	14	13	14	14	55	14	14	14	14	55
Oil (mbd)	149	143	152	152	149	152	152	152	152	152
Total gas & oil (bcf)	259	251	259	264	1,033	258	255	261	264	1,038
Price										
Natural gas (\$/mcf)										
Henry Hub (\$/mmbtu)	5.64	6.10	5.75	7.10	6.15	6.12	6.07	6.13	6.51	6.21
U.S.	5.49	5.56	5.24	6.46	5.70	5.57	5.53	5.59	5.93	5.65
Canada	5.53	5.76	5.68	6.46	5.85	5.57	5.53	5.59	5.93	5.65
Overseas	3.69	3.12	3.40	4.39	3.71	4.12	4.09	4.02	3.94	4.04
Total	5.30	5.44	5.27	6.23	5.56	5.40	5.41	5.43	5.70	5.49
Oil (\$/bbl)										
WTI Cushing	35.23	38.34	43.89	48.30	41.44	45.29	45.02	44.20	43.37	44.47
Worldwide	26.39	30.62	34.89	38.39	32.65	36.00	35.79	35.13	34.48	35.35
Total gas & oil (\$/mcf)	5.05	5.31	5.45	6.28	5.53	5.59	5.59	5.57	5.72	5.62
Revenue (\$mm)										
Natural Gas										
U.S.	440	458	453	556	1,907	469	471	481	510	1,930
Canada	426	437	416	476	1,755	401	403	411	436	1,651
Overseas	76	45	55	89	265	84	60	70	80	294
Total	942	940	924	1,121	3,927	954	933	962	1,026	3,874
Oil	359	399	487	535	1,780	491	494	490	481	1,956
Other	8	(6)	0		2					-
Total	1,308	1,333	1,411	1,656	5,708	1,445	1,427	1,452	1,507	5,830
Expense										
Production taxes	59	62	67	79	267	69	68	69	72	277
Cash costs	296	328	315	339	1,278	318	316	319	324	1,278
Ebitda (\$mm)	953	943	1,029	1,238	4,164	1,058	1,042	1,064	1,111	4,275
Exploration	60	62	55	80	257	80	80	80	80	320
Deprec., Deplet., & Amort.	277	270	284	290	1,121	290	290	290	290	1,160
Ebit	616	611	690	868	2,786	688	672	694	741	2,795
Interest	71	69	71	71	282	71	71	71	71	284
Ebt	545	542	619	797	2,504	617	601	623	670	2,511
Income Tax	193	161	232	279	865	216	210	218	234	879
Net Income (\$mm)	352	381	387	518	1,639	401	391	405	435	1,632
Shares (millions)	396	397	395	395	396	395	395	395	395	395
Per Share (\$)	0.89	0.96	0.98	1.31	4.14	1.02	0.99	1.03	1.10	4.13
Ebitda Margin	73%	71%	73%	75%	73%	73%	73%	73%	74%	73%
Tax Rate	35%	30%	37%	35%	35%	35%	35%	35%	35%	35%
Cash costs (\$/mcf)	1.14	1.31	1.22	1.29	1.24	1.23	1.24	1.22	1.23	1.23
D.D.&A. (\$/mcf)	1.07	1.08	1.10	1.10	1.09	1.12	1.14	1.11	1.10	1.12

Investors might ask why the price of the stock is so far below its present value. Good question. There is a publicly traded security, one of our long-time favorites, **San Juan Basin Royalty Trust (SJT)** that is nearly equivalent to a 12% representation in BR's San Juan Basin properties. The San Juan Basin is one of BR's two great assets. The other is the Deep Basin in Canada which has San Juan Basin type potential. Ironically, the long term return in SJT exceeds that in BR and the current stock price of SJT approximates its present value on \$35 oil. The question then becomes why does BR stock not trade as well as SJT when SJT is basically a showcase for BR's choicest asset?

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Why Do Operating Companies Trade for Less than Royalty Trusts?

The most distinctive feature of royalty trusts is that they pay a nice income. The seven stocks in our regular coverage offered a next twelve months distribution yield of 8.4% at the end of the year. Typically SJT has paid about 10% annually in distributions while BR has paid less than 1%. BR's leaders might argue that it was better for management to reinvest the money that would otherwise have been spent on dividends in order to build long-term value that would be reflected in higher share price.

Royalty trusts avoid double taxation. There is no corporate taxation between the natural gas properties and the unitholders. Moreover new unitholders can shelter practically all of the distribution from income taxation at the investor level in the early years of ownership. Still, an investor might say that BR has not paid corporate tax at a high current rate and repurchasing stock was more tax-efficient paying bigger dividends.

Royalty trusts don't hedge commodity prices or borrow money. Again BR does hedge and borrows money on the theoretical notion that management can create more value than not doing so.

Royalty trusts do not pay high management compensation. Royalty trusts get management for free whether it is good or bad. Yet management compensation should be justified as management should create more value than the amount by which it is compensated.

Thus fine old companies like BR that can reinvest cash flow for growth, hedge commodity prices, borrow money and reward management should do a lot better than a royalty trust with rigid rules for paying out all of its cash flow and seemingly no future beyond the depletion of its properties. Wrong! Obviously the reality is that until recently BR has not lived up to expectations. So, if you cannot beat them, why not join them!

BR a Likely Royalty Trust Candidate

Supposedly BR should know more about the advantages of royalty trusts than any other company because it is the working interest owner for three trusts. BR has a 25% interest in all the properties in which SJT has a 75% interest. BR is also the working interest owner and owner of half the units of **Permian Basin Royalty Trust (PBT)**. Finally, BR is the working interest owner for LL&E Royalty Trust (LRT).

In practice, BR has been a difficult sponsor for SJT. There appears to be an element in the BR culture that treats SJT as something to take advantage of. The trust obtained a court judgment against BR about 15 years ago and recently BR has made another remedial payment to the trust as a result of complaints by the trust's consultants. We have never understood why BR does not treat the trust more positively and even promote it as a sound investment because by doing so it would indirectly be enhancing its own appeal to investors. Perhaps that is another twist of irony. By trying to take advantage of the trust, BR has damaged its own stock market image.

We remain hopeful that BR can overcome its past management record and we are encouraged by the progress since Mr. Randy Limbacher and Mr. Steve Shapiro have become top managers. Yet, we can't help but wonder if there is a better answer. One alternative that we believe could be implemented successfully is to turn the mature properties of BR into one or more royalty trusts.

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BR would still operate the properties and pursue its long-term projects. At the same time a large chunk, or chunks, of the high quality asset base would realize the highest value as income generators for investors seeking reliable distributions. We realize that there are tax complications around the formation of the trust, but taxes should not be an excuse.

Management Ought to be Proactive

The timing of forming a royalty trust could be now or later. Most of the royalty trusts in our coverage were formed around the past peak in oil price in 1979-1982. In the current cycle we think the peak is at least several years away. Forming a royalty trust when oil may be about to peak could be good sense because the discipline of paying distributions would inhibit any tendency for a producer to make reinvestment decisions that may not be well-timed.

Meanwhile, BR should have a better answer for investors who ask about royalty trusts. Management could also greatly improve its dealings and sharing of information with the trusts it now sponsors. Perhaps there are acquisitions to be made of properties to be turned into trusts. Perhaps there is an acquisition to be made of BR for its valuable properties that could be turned into trusts. We are optimistic that one way or another BR should be a rewarding stock for investors.

Undervalued among Large Cap Independent Producers

BR stock appears to have high potential in a high-potential group (see table of stocks ranked by McDep Ratio).

	<i>Symbol/</i>	<i>Rating</i>	<i>Price</i> <i>(\$/sh)</i>	<i>Shares</i>	<i>Market</i>	<i>Net</i>	<i>Debt/</i>	<i>McDep</i>
			<i>6-Jan</i>	<i>(mm)</i>	<i>Cap</i>	<i>Present</i>	<i>Present</i>	<i>Ratio</i>
			<i>2005</i>		<i>(\$mm)</i>	<i>Value</i>	<i>Value</i>	
Independent Natural Gas and Oil - Large Cap and Mid Cap								
Encana Corporation	ECA	B1	53.65	472	25,300	63.00	0.21	0.88
XTO Energy Inc.	XTO	B1	32.45	273	8,850	38.00	0.19	0.88
CNOOC Limited (19%)	CEO	B2	51.85	78	4,050	59.00	-	0.88
Unocal Corporation	UCL	B3	44.34	274	12,200	54.00	0.24	0.87
Occidental Petroleum Corp.	OXY	B3	56.67	403	22,900	75.00	0.17	0.80
Devon Energy Corporation	DVN	B3	37.11	500	18,600	55.00	0.22	0.75
Burlington Resources	BR	B1	41.10	395	16,200	58.00	0.14	0.75
Anadarko Petroleum Corp.	APC	B1	61.50	253	15,600	94.00	0.20	0.73
<i>Total or Median</i>					<i>124,000</i>		<i>0.20</i>	<i>0.83</i>

B1 = Buy full unlevered position, B2 = Buy half unlevered position, B3 = Alternative 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

Buy Oil and Gas Producers at Mid Decade

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 \$40 a barrel. That is higher than our estimate that current stock price of BR reflects a constant real oil price of perhaps \$26 a barrel.

Kurt H. Wulff, CFA

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