Rating: Buy
S&P 500: 1097

Berry Petroleum Company
Leader's Legacy

Symbol	BRY	*Ebitda Next Twelve Months ending 3/31/05 ($mm)*	128
Rating	Buy	*North American Natural Gas/Ebitda (%)*	0
Price ($/sh)	26.42	*Natural Gas and Oil Production/Ebitda (%)*	100
Pricing Date	5/12/04	*Adjusted Reserves/Production NTM*	13.4
Shares (mm)	22	*EV/Ebitda*	5.1
Market Capitalization ($mm)	590	*PV/Ebitda*	8.0
Debt ($mm)	70	*Undeveloped Reserves (%)*	27
Enterprise Value (EV) ($mm)	660	*Natural Gas and Oil Ebitda ($/boe)*	18.10
Present Value (PV) ($mm)	1,030	*Present Value Proven Reserves($/boe)*	9.30
Net Present Value ($/share)	43	*Present Value Proven Reserves($/mcfe)*	1.60
Debt/Present Value	0.07	*Price/Earnings Next Twelve Months*	10
McDep Ratio - EV/PV	0.64	*Dividend Yield (%)*	1.7

Summary and Recommendation

We continue to recommend current purchase of the common shares of small cap Berry Petroleum for representation in growing volume and rising value of domestic oil production. Recently retired for personal and health reasons, the company's long-time leader, Mr. Jerry V. Hoffman, leaves a legacy of a company with rich assets heading in a profitable direction. Yet, the lack of a permanent chief executive and the presence of a strong oil market have to tempt descendants of Berry's founder, who control the board of directors, to think about selling the company. By our present value measure the stock has more than 60% appreciation potential to $43 a share, the point at which it would then offer a normal return of perhaps 5% a year above inflation. The main risk is commodity price.

Family Owners Face Options

While Berry's classic oil properties have value that has already transcended generations, it is also important that the properties be managed well. We have seen Mr. Hoffman perform effectively for more than a decade. He leaves a team of competent people in place after his surprise retirement, but not a new permanent chief executive officer. A director since 2002, Mr. Robert F. Heinemann, named chairman on April 2, 2004, took on the role of interim chief executive officer on April 26 when Mr. Hoffman retired.

A search for a new chief executive is apparently underway. The choice must be a person who can be trusted with a dominant portion of the net worth of family owners. Descendants of the founder apparently have three of the nine seats on the board of directors, account for at least 13% of the outstanding stock and have practically all of the stock represented by the directors. Alternatively, the directors might be receptive to an offer for the whole company.

To try to understand what might happen let us review some history. Clarence Berry, who founded the company in 1909, left his holdings to descendants who kept the company private. Then the owners of Berry saw Shell Oil pay an eye-popping $3.6 billion to the owners of a nearby field, Belridge, near the peak of the previous oil cycle in 1979-1980. The peak passed and it soon became too late for the Berry owners to reap a similar, smaller scale, gain.

The Berry heirs decided to consolidate their interests in Berry Petroleum Company in 1985. Berry Petroleum became publicly traded by acquiring another company that was already trading, Norris Oil Company, in 1987. The next step was to increase the liquidity of the public market with a secondary offering of shares. The first try was withdrawn because of market conditions and the second try was successful in 1989. While Berry stock was now more liquid and family members have been able to do some selling, industry conditions have remained subdued until recently.

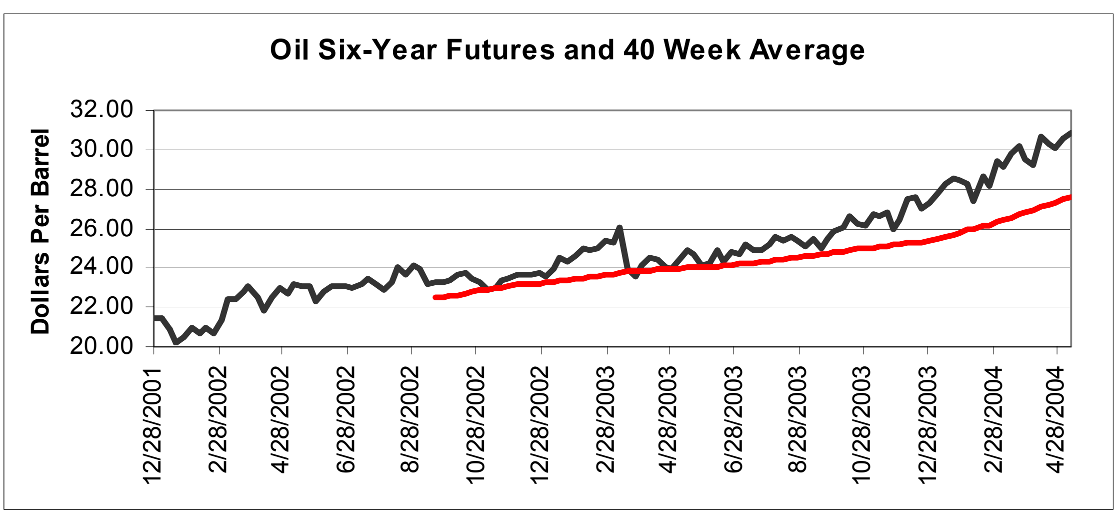
Considering that the industry outlook now is the most favorable it has been since Belridge was sold, we suspect that the owners of Berry have to be thinking about the sale of the company. The sellers might prefer cash if they think the market is at its peak. Alternatively the sellers might prefer stock to avoid a taxable transaction and to retain some of the upside if they think their asset might gain further in value.

Meanwhile the record date for owning shares to be voted at the annual meeting has been rescheduled to a time after the leadership change. A revised proxy statement has been filed to reflect Mr. Hoffman's retirement. The remainder of our analysis discusses the fundamental outlook and valuation.

Six-Year Futures Point to Growing Oil and Gas Value

The whole value of Berry is sensitive to crude oil price. We look to the futures market for expectations of the trend in price of the global crude oil benchmark. Thirty years ago when we last had a decade-long major move in oil there was no meaningful futures market. Today futures contracts for oil to be delivered over the next six years are quoted every trading day. We track the average for the next 72 months.

The plot of weekly results shows a strong uptrend with the 40-week moving average rising at the rate of 12% a year (see Chart). At that rate the price in 2010 would be three times the price in 2000. The comparable rate of gain from 1970 to 1980 was about ten times.



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.

Interest rates below inflation encourage investment in assets like oil that can increase in price more than inflation. At some point oil price could be too strong. Six times in the past thirty years the annual gain in monthly price exceeded 70% briefly. June futures near $40 a barrel for Light, Sweet Crude Oil would have to exceed $52 a barrel to trigger a 70% warning.

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 some $128 million 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. The rationale is that if one is buying a stock today, previously reported cash flow is relevant only for the information it may give about future cash flow.

For the next twelve months we project constant oil volume at the first quarter 2004 level. That is sufficient for our valuation calculation. Management projects average volume for 2004 about 5% higher than that of the first quarter.

We take the futures market at face value in projecting price for the next twelve months. 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.

Like most producers, Berry is losing money this year on oil price hedges. We project cash flow before the deduction for hedging while our projected net income is after hedging. Since most producers do not hedge for more than a year, the long term consequences of temporary opportunity loss is not great as long as it is not chronically repeated.

Long 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.

Reported reserves at year end 2003 imply an adjusted life index of 13.4 years. The index is the sum of developed and half undeveloped reserves divided by next twelve months production. That could justify a multiple of 9.2 in the framework we applied on March 23 when we estimated present value assuming constant commodity price near the one-year quotes at that time, about $35 a barrel for crude oil. Our present value remains unchanged while higher commodity prices since then imply higher cash flow and a lower multiple of 8.0 times. We are saying that we think the multiple of cash flow should be 8.0 times while the actual multiple implied by current stock price is only 5.1 times.

Berry Petroleum Company
Quarterly Results

	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							
Oil (mbd)	19.40	19.40	19.40	19.40	**19.40**	19.40	**19.40**
Total (mb)	1,765	1,765	1,784	1,784	**7,099**	1,746	**7,079**
Total (mbd)	19.4	19.4	19.4	19.4	**19.4**	19.4	**19.4**
Price							
WTI Cushing ($/bbl)	35.23	38.46	38.17	36.55	**37.10**	35.16	**37.08**
Differential	6.97	7.61	7.55	7.23	**8.02**	7.23	**7.33**
Company	28.26	30.85	30.62	29.32	**29.08**	28.21	**29.76**
Revenue ($mm)							
Oil	50	54	55	52	**211**	49	**211**
Other	(5)				**(5)**		
Total	45	54	55	52	**206**	49	**211**
Expense							
Lease operating	18	18	18	18	**71**	17	**71**
General and administrative	3	3	3	3	**12**	3	**12**
Total	21	21	21	21	**84**	20	**83**
Ebitda	24	34	34	31	**123**	29	**128**
Exploration	-	-	-	-		1	**1**
Deprec., Deplet., & Amort.	7	7	7	7	**29**	7	**28**
Other Non Cash	(0)	5	5	5	**14**		**15**
Ebit	17	22	22	19	**80**	21	**84**
Interest	1	1	1	1	**2**	1	**2**
Ebt	16	21	21	19	**78**	20	**82**
Income Tax	4	6	6	6	**23**	6	**25**
Net Income ($mm)	12	15	15	13	**55**	14	**57**
Per Share ($)	0.55	0.67	0.67	0.59	**2.48**	0.64	**2.57**
Shares (millions)	22	22	22	22	**22**	22	**22**
Lease operating ($/bbl)	10.20	10.00	10.00	10.00	**10.05**	10.00	**10.00**
General and admin ($/bbl)	1.87	1.70	1.70	1.70	**1.74**	1.70	**1.70**
Deprec., D,& A ($/bbl)	4.08	4.00	4.00	4.00	**4.02**	4.00	**4.00**
Ebitda Margin	53%	62%	62%	60%	**59%**	59%	**61%**
Tax rate	26%	30%	30%	30%	**29%**	30%	**30%**

At a time of increased scrutiny of internal estimates, Berry management points out that the same outside expert has estimated Berry's reserves since 1984. The independent engineer, DeGolyer and MacNaughton (D&M), has practically the premier reputation in the industry.

Berry's former chief executive officer, Jerry Hoffman, reminds investors that D&M assume that current production techniques will recover 65-70% of original oil in place, most of which has already been produced. Pointing to other producers who may expect to achieve 70-75% recovery, Mr. Hoffman says on that basis Berry's remaining recoverable reserves would be 25 million barrels, or some 23% higher.

Past Oil Price Volatility and Electricity Bankruptcies

As attractive as Berry's prospects may be there has been volatility in the past. Not only is Berry sensitive to the industry benchmark price of light, sweet crude oil, it is also sensitive to the differential between the benchmark and the California price of Berry's heavier grade. During the low oil price dips of 1993 and 1998, present value calculated on year end price vaporized. The company survived as it was helped by a conservative financial policy of almost no debt and a responsive management that kept costs under control as best as could be expected.

Most of Berry's oil production is near its headquarters in Bakersfield, California. While the San Joaquin Valley has some of the largest oil fields in the U.S., the quality of the oil is mostly heavy and the main method of production is to heat the oil underground by injecting steam. Energy to generate steam was originally supplied by the oil produced until the state passed environmental restrictions that essentially required the steam to be generated by burning natural gas. To offset some of the costs of steam, Berry generates electricity with natural gas and uses just the waste heat to generate steam used in oil recovery. As a result, Berry's profits are sensitive to the price of natural gas for fuel and the price of electricity as an offset.

In 2000-2001 Berry was hit by the double whammy of high natural gas price and bankrupt electricity purchasers. For awhile it looked like electricity price more than made up for high natural gas price until Berry got stuck holding a $25 million bag of unpaid receivables. Once again a conservative financial structure and adaptive management carried the company through the crisis. Natural gas price receded and Berry eventually collected much of what was owed to it for electricity.

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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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