Rating: Buy
S&P 500: 1136

CNOOC Limited
Offshore China Independent Oil Producer

Symbol	CEO	*Ebitda Next Twelve Months ending 3/31/05 (US$mm)*	3,000
Rating	Buy	*North American Natural Gas/Ebitda (%)*	0
Price (US$/sh)	43.36	*Natural Gas and Oil Production/Ebitda (%)*	100
Pricing Date	6/10/04	*Adjusted Reserves/Production NTM*	10.4
Shares (mm)	411	*EV/Ebitda*	5.9
Market Capitalization (US$mm)	17,800	*PV/Ebitda*	7.5
Debt (US$mm)	0	*Undeveloped Reserves (%)*	51
Enterprise Value (EV) (US$mm)	17,800	*Natural Gas and Oil Ebitda (US$/boe)*	22.60
Present Value (PV) (US$mm)	22,600	*Present Value Proven Reserves(US$/boe)*	12.04
Net Present Value (US$/share)	55	*Present Value Proven Reserves(US$/mcfe)*	2.01
Debt/Present Value	0.00	*Earnings Next Twelve Months (US$/sh)*	3.66
McDep Ratio - EV/PV	0.79	*Price/Earnings Next Twelve Months*	12
Dividend Yield (%/year)	3.7	*Indicated Annual Dividend (US$/sh)*	1.59

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.
The Peoples Republic of China holds 81% of the outstanding shares.

Summary and Recommendation

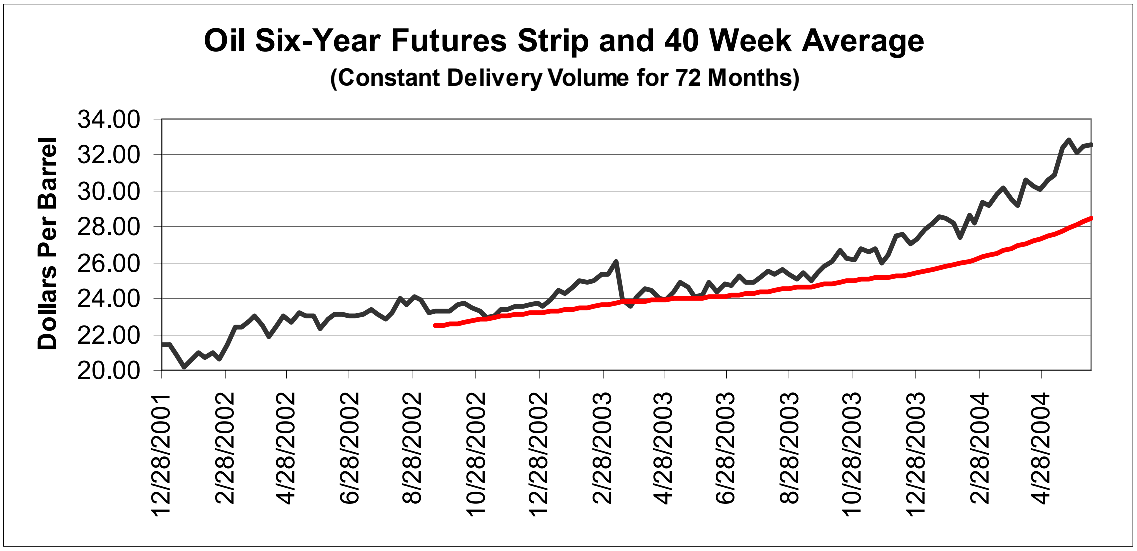
We continue to recommend current purchase of the American Depositary Shares of **CNOOC Limited (CEO)** the "independent producer" of China-domiciled oil and gas companies. An investment in the stock is (1) a preferred land owner's participation in practically all the oil and gas producing and prospective acreage offshore China, (2) concentration on growing high margin natural gas and oil production offshore China and (3) representation in producing profits of projects to deliver liquefied natural gas to China. Business risk is partly shifted to other companies and financial risk is low as there is no net debt on the company's balance sheet. We see 27% appreciation potential to net present value of US$55 a share and a long term return of about 5% per year above inflation thereafter. To allow for political risk, investors may want to limit ownership to half a normal portfolio position.

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 charts look 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. The U.S. military presence in the Middle East may be controversial today. Yet when the U.S. supported government in Iran fell at the end of the 1970s, the world experienced its highest energy prices ever.

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.

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. We choose the next twelve months ending June 30, 2005 as the relevant time period.

For the next twelve months we project constant natural gas and oil volume at the first quarter 2004 level. That is sufficient for our valuation calculation.

We take the futures market at face value in projecting price for the next twelve months. Henry Hub quotes may be irrelevant for natural gas in China, but point to the eventual premium value for the cleanest fossil fuel. Light Sweet Crude quotes guide our projections of oil revenue. CEO reports volume and prices quarterly (see table).

CNOOC Limited
Next Twelve Months Operations

	Year 2003	*Q1 3/31/04*	*Q2E 6/30/04*	*Q3E 9/30/04*	*Q4E 12/31/04*	*Year 2004E*	*Q1E 3/31/05*	*Q2E 6/30/05*	*Next Twelve Months 6/30/05*
Volume									
Natural gas (bcf)	**103**	33	33	33	33	**132**	33	33	**132**
Natural Gas (mmcfd)	**282**	363	363	363	363	**363**	363	363	**363**
Days	**365**	90	91	92	92	**365**	90	91	**365**
Oil (mmb)	**111**	28	28	28	28	**112**	28	28	**112**
Oil (mbd)	**304**	307	307	307	307	**307**	307	307	**307**
Total gas & oil (bcf)	**770**	198	201	203	203	**805**	198	201	**805**
Total gas & oil (mbd))	**351**	368	368	368	368	**368**	368	368	**368**
Price									
Natural gas ($/mcf)									
Henry Hub ($/mmbtu)	**5.49**	5.64	6.05	6.23	6.50	**6.11**	6.75	5.86	**6.34**
Company	**2.91**	2.30	2.30	2.30	2.30	**2.30**	2.30	2.30	**2.30**
Oil ($/bbl)									
WTI Cushing	**31.13**	35.23	38.55	38.55	37.91	**37.56**	36.77	35.84	**37.27**
Company	**27.96**	31.39	34.35	34.35	33.78	**33.39**	32.77	31.94	**33.22**
Total gas & oil ($/mcf)	**4.43**	4.70	4.83	5.16	5.08	**5.03**	4.94	4.83	**5.00**
Revenue ($mm)									
Natural Gas	**300**	75	76	77	77	**304**	75	76	**304**
Oil	**3,107**	857	960	970	954	**3,741**	905	892	**3,722**
Other									
Total	**3,407**	932	1,035	1,047	1,031	**4,045**	980	968	**4,026**

Cash flow is reported only semiannually (see table). 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.

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.

In calculating an adjusted reserve life for CNOOC Limited we arbitrarily limit proven natural gas reserves to 20 years. The resulting 10.4 years for natural gas and oil combined justifies most of our assessed present value to cash flow multiple (PV/Ebitda) of 7.5 times. We see additional value from the company's preferred risk position.

An Independent Producer with Special Advantages

Leading independent producers often describe their exploration and production prospects offshore China enthusiastically. If the prospects are attractive for the foreign company they must be really attractive for the local company that owns the basic land rights. The foreign company takes the exploration risk while CNOOC has the option to participate on the same basis if the project is successful.

Kurt H. Wulff, CFA

CNOOC Limited
Next Twelve Months Operating and Financial Estimates

	Year 2003	*H1E 6/30/04*	*H2E 12/31/04*	***Year 2004E***	*H1E 6/30/05*	***Next Twelve*** *Months 6/30/05*
Revenue (mmRMB)						
Natural Gas (from Q table)	**2,480**	1,247	1,260	**2,507**	1,247	**2,507**
Oil (from Q table)	**25,680**	15,014	15,393	**30,407**	14,857	**30,250**
Other	**(44)**	(129)	(129)	**(258)**	(129)	**(258)**
Total	**28,116**	16,131	16,525	**32,656**	15,975	**32,499**
Expense						
Fixed	**3,266**	1,767	1,767	**3,534**	1,767	**3,534**
Variable	**3,266**	2,069	2,119	**4,189**	2,049	**4,169**
Other	**-**			**-**		**-**
Ebitda	**21,628**	12,424	12,767	**25,192**	12,287	**25,055**
Exploration	**848**	456	456	**912**	456	**912**
Deprec., Deplet., & Amort.	**4,643**	2,499	2,499	**4,998**	2,499	**4,998**
Ebit	**16,137**	9,469	9,812	**19,282**	9,332	**19,145**
Interest	**-**	-	-	**-**	-	**-**
Ebt	**16,137**	9,469	9,812	**19,282**	9,332	**19,145**
Income Tax	**4,627**	3,314	3,434	**6,749**	3,266	**6,701**
Net Income	**11,510**	6,155	6,378	**12,533**	6,066	**12,444**
Shares (millions)	**8,221**	8,227	8,227	**8,227**	8,227	**8,227**
Per share (RMB)	**1.40**	0.75	0.78	**1.52**	0.74	**1.51**
Ebitda Margin	**77%**	77%	77%	**77%**	77%	**77%**
Tax Rate	**29%**	35%	35%	**35%**	35%	**35%**

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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