Rating: Buy
S&P 500: 1201

CNOOC Ltd.
Unocal Bid?

Symbol	CEO	*Ebitda Next Twelve Months ending 6/31/06 (US$mm)*	5,500
Rating	Buy	*North American Natural Gas/Ebitda (%)*	0
Price (US$/sh)	54.05	*Natural Gas and Oil Production/Ebitda (%)*	100
Pricing Date	6/8/05	*Adjusted Reserves/Production NTM*	9.6
Shares (mm)	411	*EV/Ebitda*	4.1
Market Capitalization (US$mm)	22,200	*PV/Ebitda*	5.1
Debt (US$mm)	300	*Undeveloped Reserves (%)*	46
Enterprise Value (EV) (US$mm)	22,600	*Natural Gas and Oil Ebitda (US$/boe)*	34.28
Present Value (PV) (US$mm)	27,900	*Present Value Proven Reserves(US$/boe)*	14.06
Net Present Value (US$/share)	67	*Present Value Proven Reserves(US$/mcfe)*	2.34
Debt/Present Value	0.01	*Earnings Next Twelve Months (US$/sh)*	7.32
McDep Ratio - EV/PV	0.81	*Price/Earnings Next Twelve Months*	7
Dividend Yield (%/year)	3.8	*Indicated Annual Dividend (US$/sh)*	2.04

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 our buy-rating on the shares of **CNOOC Ltd. (CEO)**, China's independent producer, for growth in natural gas and oil production that supports a rapidly increasing dividend. It seems unlikely that CEO would make an offer for **Unocal (UCL)** at this stage, but the company does not rule it out. The combination would continue to offer attractive investment value, particularly if CEO stock were to decline further if an announcement of acquisition intention was made. Otherwise, the stock has appreciation potential of 24% to net present value of $67 a share subject to political risk and normal uncertainty.

Unocal Would Be Strategic Fit, but Stock Could Get Hit

Just when we thought the **Chevron (CVX)** acquisition of Unocal looked like a done deal, we see that CEO management is still considering making an offer. A "Clarification Announcement" by CEO states "Shareholders and potential investors are advised to exercise caution when dealing in the shares of the Company." We agree that Unocal is a tempting strategic opportunity for its oil and gas producing assets in Asia.

On a McDep Ratio basis the transaction would be dilutive because Unocal is trading at a higher McDep Ratio than CEO even before considering any premium to current price and the cost of a breakup fee to Chevron. The combined company would have Present Value of $50 billion. The combined Enterprise Value would be perhaps $45 billion including a premium for Unocal stock. The resulting McDep Ratio of 0.90 would still be attractive and within the range of buy-recommended peers.

Ordinarily we would expect CEO stock to decline on the announcement of an offer. From the low point the stock could gradually outperform as investors focus on the value of the combined entity. Yet there are few secrets kept from the market. CEO stock already reflects investor nervousness having traded near the same price for some eight months.

Present Value Low Relative to Cash Flow

Estimated originally on a discounted cash flow basis assuming $40 oil, present value looks low relative to next twelve months cash flow (see table Functional Cash Flow and Present Value). Cash flow multiple for the company compares closely to our current correlation with adjusted reserve life index for twenty-seven producers. Natural Gas is above the correlation multiple for Rest of World natural gas by 0.8. Oil is 0.3 above the correlation multiple.

CNOOC Limited
Functional Cash Flow and Present Value

	NTM Ebitda (US$mm)	*Adjusted R/P*	*PV/ Ebitda*	*Present Value (US$mm)*	
Natural Gas	300	20.0	11.0	3,300	12%
Oil	5,200	7.8	4.7	24,600	88%
	5,500	9.6	5.1	27,900	100%
Debt (US$mm)					300
Net Present Value (US$mm)					27,600
Shares (mm)					411
Net Present Value (US$/sh)					67

Cash Flow Rising with Commodity Price

A dynamic measure, projected revenue is updated frequently with latest futures quotes (see table Next Twelve Months Operations). Natural gas volumes are growing rapidly while price remains low. Ultimately we expect natural gas price to reflect world levels as oil price does.

Revenues drive cash flow and earnings that are reported on a half-year basis (see table Next Twelve Months Financial Results). Projected unlevered cash flow (Ebitda) of some RMB45 billion translates to some $5.5 billion. Cash flow (Ebitda) at 81% of revenue is high for a producer and signifies efficient operations. Projected gains in earnings would be translated directly into gains in dividends.

China Has Need for Long-Term Oil and Gas Supply

China appears to be consuming more incremental energy every year than any other country on the globe. Consumption of oil exceeds domestic production. Demand for natural gas exceeds growing domestic production. In fact, rising demand from China is making global natural gas and oil resources more valuable. It is only logical that China should try to capture more of the economic value that it is creating.

CNOOC Limited
Next Twelve Months Operations

	Q4 12/31/04	***Year 2004E***	*Q1 3/31/05*	*Q2E 6/30/05*	*Q3E 9/30/05*	*Q4E 12/31/05*	***Year 2005E***	*Q1E 3/31/06*	*Q2E 6/30/06*	***Next Twelve Months 6/30/06***
Volume										
Natural gas (bcf)	36	**133**	31	32	33	34	**131**	34	35	**136**
Natural Gas (mmcfd)	389	**364**	348	355	362	369	**359**	377	384	**373**
Days	92	**366**	90	91	92	92	**365**	90	91	**365**
Oil (mmb)	30	**117**	32	33	34	34	**132**	34	35	**138**
Oil (mbd)	326	**319**	352	359	366	374	**363**	381	389	**377**
Total gas & oil (bcf)	216	**834**	221	228	235	240	**925**	240	247	**962**
Total gas & oil (mbd))	391	**380**	410	418	427	435	**423**	444	453	**439**
Price		**139**					**154**			**160**
Natural gas ($/mcf)										
Henry Hub ($/mmbtu)	7.10	**6.15**	6.27	7.08	7.17	7.74	**7.06**	8.44	7.18	**7.63**
Company	2.43	**2.75**	2.69	2.69	2.69	2.69	**2.69**	2.69	2.69	**2.69**
Oil ($/bbl)										
WTI Cushing	48.31	**41.44**	49.65	52.24	55.54	57.13	**53.64**	57.25	56.88	**56.70**
Company	36.37	**35.41**	40.91	43.05	45.77	47.08	**44.27**	47.17	46.87	**46.73**
Total gas & oil ($/mcf)	5.46	**5.40**	6.23	6.54	6.93	7.12	**6.72**	7.13	7.09	**7.07**
Revenue ($mm)										
Natural Gas	87	**367**	84	87	90	91	**352**	91	94	**366**
Oil	1,091	**4,139**	1,296	1,406	1,542	1,618	**5,862**	1,618	1,658	**6,435**
Other										
Total	1,178	**4,506**	1,380	1,493	1,632	1,709	**6,214**	1,709	1,752	**6,801**

CNOOC Limited
Next Twelve Months Financial Estimates

	H2 12/31/04	***Year 2004***	*H1E 6/30/05*	*H2E 12/31/05*	***Year 2005E***	*H1E 6/30/06*	***Next Twelve Months 6/30/06***
Revenue (mmRMB)							
Natural Gas (from Q table)	1,556	**3,030**	1,414	1,495	**2,908**	1,530	**3,025**
Oil (from Q table)	19,368	**34,208**	22,335	26,115	**48,450**	27,068	**53,183**
Other	(66)	**(352)**	(66)	(66)	**(132)**	(66)	**(132)**
Total	20,858	**36,886**	23,683	27,544	**51,226**	28,533	**56,076**
Expense							
Fixed	2,297	**3,749**	2,297	2,297	**4,595**	2,297	**4,595**
Variable	2,297	**3,749**	2,607	3,031	**5,639**	3,140	**6,171**
Other		**-**			**-**		**-**
Ebitda	16,329	**29,740**	18,844	22,281	**41,125**	23,161	**45,442**
Exploration	765	**1,316**	765	765	**1,530**	765	**1,530**
Deprec., Deplet., & Amort.	2,807	**5,455**	2,807	2,807	**5,614**	2,807	**5,614**
Ebit	12,757	**22,969**	15,272	18,709	**33,981**	19,589	**38,298**
Interest	-	**-**	-	-	**-**	-	**-**
Ebt	12,757	**22,969**	15,272	18,709	**33,981**	19,589	**38,298**
Income Tax	3,710	**6,931**	5,345	6,548	**11,893**	6,856	**13,404**
Net Income	9,047	**16,038**	9,927	12,161	**22,087**	12,733	**24,894**
Shares (millions)	41,124	**41,124**	41,124	41,124	**41,124**	41,124	**41,124**
Per share (RMB)	0.22	**0.39**	0.24	0.30	**0.54**	0.31	**0.61**
Ebitda Margin	78%	**81%**	80%	81%	**80%**	81%	**81%**
Tax Rate	29%	**30%**	35%	35%	**35%**	35%	**35%**

CNOOC Ltd. is owned 81% by the state company China National Offshore Oil Corp (CNOOC). The publicly traded entity, CEO, has acquired interests in liquefied natural gas (LNG) export projects in Indonesia and Australia while the government company is building LNG import terminals in eastern China. On the oil side, CEO made a $120 million investment in a private company holding oil sands leases in Canada.

Buy Oil and Gas Producers at Mid Decade

Multi-fold gain potential for oil and gas price over the years ahead justifies investment in recommended oil and gas producers, in our opinion. A McDep Ratio of 1.0 implies that a stock would be priced at present value assuming a constant real oil price of US$40 (see table Rank by McDep Ratio).

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

	Symbol/	*Rating*	*Price ($/sh) 8-Jun 2005*	*Shares (mm)*	*Market Cap ($mm)*	*Net Present Value ($/sh)*	*Debt/ Present Value*	*McDep Ratio*
Independent Natural Gas and Oil - Large Cap and Mid Cap								
Encana Corporation	ECA	B	37.85	909	34,400	38.50	0.19	0.99
Unocal Corporation	UCL	B	58.50	273	16,000	65.00	0.19	0.92
XTO Energy Inc.	XTO	B	31.75	366	11,630	36.00	0.19	0.91
CNOOC Limited (19%)	CEO	B	54.05	78	4,220	67.00	0.01	0.81
Occidental Petroleum Corp.	OXY	B	74.52	406	30,300	94.00	0.13	0.82
Burlington Resources	BR	B	51.95	389	20,200	67.00	0.12	0.80
Devon Energy Corporation	DVN	B	47.71	496	23,700	63.00	0.16	0.80
Anadarko Petroleum Corp.	APC	B	76.43	239	18,300	113.00	0.14	0.72
Total or Median					*159,000*		*0.15*	*0.81*

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