

Rating: Buy
S&P 500: 1191

ConocoPhillips

Raise Net Present Value to \$140 a Share

| | | | |
|---------------------------------------|---------|--|--------|
| <i>Symbol</i> | COP | <i>Ebitda Next Twelve Months ending 3/31/06 (US\$mm)</i> | 21,800 |
| <i>Rating</i> | Buy | <i>North American Natural Gas/Ebitda (%)</i> | 9 |
| <i>Price (US\$/sh)</i> | 101.36 | <i>Natural Gas and Oil Production/Ebitda (%)</i> | 62 |
| <i>Pricing Date</i> | 5/19/05 | <i>Adjusted Reserves/Production NTM</i> | 11.5 |
| <i>Shares (mm)</i> | 710 | <i>EV/Ebitda</i> | 4.5 |
| <i>Market Capitalization (US\$mm)</i> | 72,000 | <i>PV/Ebitda</i> | 5.7 |
| <i>Debt (US\$mm)</i> | 25,900 | <i>Undeveloped Reserves (%)</i> | 29 |
| <i>Enterprise Value (EV) (US\$mm)</i> | 97,900 | <i>Natural Gas and Oil Ebitda (US\$/boe)</i> | 21.30 |
| <i>Present Value (PV) (US\$mm)</i> | 125,300 | <i>Present Value Proven Reserves(US\$/boe)</i> | 9.08 |
| <i>Net Present Value (US\$/share)</i> | 140 | <i>Present Value Proven Reserves(US\$/mcf)</i> | 1.51 |
| <i>Debt/Present Value</i> | 0.21 | <i>Earnings Next Twelve Months (US\$/sh)</i> | 14.21 |
| <i>McDep Ratio - EV/PV</i> | 0.78 | <i>Price/Earnings Next Twelve Months</i> | 7 |
| <i>Dividend Yield (%/year)</i> | 2.4 | <i>Indicated Annual Dividend (US\$/sh)</i> | 2.48 |

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 purchase of the common shares of **ConocoPhillips (COP)** for near mega cap size participation in the rising profit opportunities in oil and gas production and refined products. We raise our estimate of net present value for the producer/refiner to \$140 a share on the basis of continuing favorable performance, particularly in refining. Estimated net present value had been \$128 since January 26, 2005 up from \$110 per share before that. We see potential appreciation of 38% to our new estimate of net present value. We are concerned about political risk in Venezuela which accounts for about 10% of the company's oil production. All figures are for the stock before it begins trading on a 2 for 1 split price on June 2.

Downstream Increases to 39% of Present Value

By our current calculation, the downstream business accounts for 39% of the present value of COP (see table Functional Cash Flow and Present Value). The previous estimate was 37%. Management's target portfolio balance is 30-35% in R&M. Downstream includes chemicals and "midstream" reported on an equity basis, but is mostly R&M, oil refining and marketing. We count the downstream portion of the company's 11% interest in Lukoil as oil production. The present value cash flow multiple, PV/Ebitda, of 5.8 times for downstream compares to a median 6.2 for 14 stocks with downstream operations.

COP's downstream business is sixth largest among companies in our coverage (see table Present Value by Line of Business). Only Royal Dutch/Shell is more concentrated on downstream among larger companies.

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ConocoPhillips
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 | 1,960 | 13.4 | 8.2 | 16,000 | 13% |
| Overseas Natural Gas | 1,380 | 13.0 | 6.5 | 9,000 | 7% |
| Oil | 10,100 | 10.7 | 5.1 | 51,300 | 41% |
| Downstream | 8,400 | | 5.8 | 49,000 | 39% |
| | 21,840 | 11.5 | 5.7 | 125,300 | 100% |
| Debt (US\$mm) | | | | | 25,900 |
| Net Present Value (US\$mm) | | | | | 99,400 |
| Shares (mm) | | | | | 710 |
| Net Present Value (US\$/sh) | | | | | 140 |

Present Value by Line of Business
 (US\$millions)

| | <i>North</i> | <i>Over-</i> | | | |
|-------------------------|-----------------|----------------|-------------------|---------------|--------------|
| | <i>American</i> | <i>seas</i> | | | |
| | <i>Natural</i> | <i>Natural</i> | <i>Oil</i> | <i>Down-</i> | <i>Total</i> |
| | <i>Gas</i> | <i>Gas</i> | <i>Production</i> | <i>stream</i> | |
| Exxon Mobil Corporation | 40,000 | 76,000 | 151,000 | 142,000 | 409,000 |
| Royal Dutch/Shell | 9,000 | 44,000 | 86,000 | 118,000 | 257,000 |
| BP plc | 27,000 | 32,000 | 119,000 | 84,000 | 262,000 |
| Total S.A. | - | 42,000 | 69,000 | 66,000 | 177,000 |
| Chevron Corporation | 11,000 | 14,000 | 92,000 | 60,000 | 177,000 |
| ConocoPhillips | 16,000 | 9,000 | 51,300 | 49,000 | 125,300 |
| PetroChina Company Ltd | - | 13,000 | 127,000 | 34,000 | 174,000 |

A Wild Man Running Venezuela

The company's heavy oil projects in Venezuela, Petrozuata and Hamaca, have been subject recently to a unilateral change in contract terms to a higher royalty rate. Supposedly profitability was higher than contemplated, therefore undeserved. We have problems with that because if the profitability was lower than contemplated the producing company would be expected to absorb the shortfall. Apparently ConocoPhillips and other producers are conceding reluctantly for now.

Fresh from one unilateral change, Venezuela's leader, Mr. Hugo Chavez, soon implemented another in the form of a steep income tax increase. The tax increase supposedly does not apply to Petrozuata and Hamaca. We shall see.

The populist leader is also challenging the price that buyers pay for Venezuelan oil. Pretty soon with a higher royalty rate, a higher tax rate and a government-imposed artificial price there will

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be nothing left for international companies. That was the pattern followed in the Middle East in the 1970s.

ConocoPhillips and its larger competitors are sufficiently diversified that the loss of Venezuela would not hurt much. Rough numbers, Venezuela may be 10% of COP's oil production and perhaps 20% of oil reserves. Oil production is 41% of the value of the company.

On the contrary, the loss of Venezuela would add further strength to international oil price that could more than make up the negative impact. Of course, too much strength in international oil price is not a desirable outcome either.

The middle ground is that the companies hang on and Venezuela continues to contribute to world oil supply. State-run production is declining and the national oil company is in disarray. Mr. Chavez may become a Castro or a Qaddafi ruling over a deteriorating country for a long time.

Commodity Prices Point to Cash Flow Gains

Higher prices in future quarters for natural gas, oil and New York Harbor 3-2-1 refining crack spread indicate further gains in cash flow that is already at a high level relative to stock price (see table [Next Twelve Months Operating and Financial Estimates](#)). Oil production volume includes COP's share of Russian leader, Lukoil. Now owning about 11%, COP continues to buy Lukoil shares on its way to 20%. Overseas natural gas price, after lagging oil and North American natural gas, is higher than projected previously.

We project downstream cash flow, Ebitda – Other, at the continuation of the first quarter level. It seems that could readily be exceeded considering that refining margins widened sharply in the current quarter. We have excluded a one-time gain from the sale of a mid stream asset from first quarter cash flow though the gain is included in reported earnings.

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. The current benchmark oil average futures price for the next six years is about US\$48 a barrel. That level defines an uptrend as it is higher than the 40-week average of the 72-month quote of about \$43. 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](#)).

Kurt H. Wulff, CFA

ConocoPhillips
Next Twelve Months Operating and Financial Estimates

| | <i>Q3</i> | <i>Q4</i> | <i>Year</i> | <i>Q1</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>2004E</i> | <i>3/31/05</i> | <i>3/31/06</i> |
| Volume | | | | | | | | | | |
| Natural Gas (mmcf) | | | | | | | | | | |
| U.S. (or North America) | 1,809 | 1,819 | 1,821 | 1,771 | 1,700 | 1,700 | 1,700 | 1,718 | 1,700 | 1,700 |
| Overseas (or Int'l) | 1,374 | 1,541 | 1,496 | 1,529 | 1,468 | 1,374 | 1,541 | 1,478 | 1,529 | 1,478 |
| Total | 3,183 | 3,360 | 3,317 | 3,300 | 3,168 | 3,074 | 3,241 | 3,195 | 3,229 | 3,178 |
| Oil (mbd) | 953 | 1,195 | 1,046 | 1,251 | 1,201 | 1,201 | 1,201 | 1,213 | 1,201 | 1,201 |
| Total gas & oil (bcf) | 819 | 969 | 3,511 | 973 | 944 | 946 | 961 | 3,823 | 939 | 3,790 |
| Price | | | | | | | | | | |
| Natural gas (\$/mcf) | | | | | | | | | | |
| Henry Hub (\$/mmbtu) | 5.75 | 7.10 | 6.15 | 6.27 | 6.83 | 6.48 | 7.07 | 6.66 | 7.83 | 7.05 |
| U.S. (or North America) | 5.06 | 5.92 | 5.25 | 5.45 | 5.94 | 5.63 | 6.15 | 5.79 | 6.81 | 6.13 |
| Overseas (or Int'l) | 3.72 | 4.20 | 3.89 | 4.89 | 4.90 | 4.90 | 5.01 | 4.93 | 5.02 | 4.96 |
| Total | 4.48 | 5.13 | 4.63 | 5.19 | 5.46 | 5.30 | 5.61 | 5.39 | 5.96 | 5.59 |
| Oil (\$/bbl) | | | | | | | | | | |
| WTI Cushing | 43.89 | 48.31 | 41.44 | 49.65 | 49.78 | 49.77 | 50.85 | 50.01 | 50.95 | 50.34 |
| Worldwide | 38.92 | 42.84 | 36.78 | 44.03 | 44.14 | 44.13 | 45.09 | 44.35 | 45.18 | 44.90 |
| Total gas & oil (\$/mcf) | 5.77 | 6.50 | 5.61 | 6.68 | 6.78 | 6.74 | 6.92 | 6.78 | 7.04 | 6.87 |
| NY Harbor 3-2-1 (\$/bbl) | 7.78 | 5.72 | 7.74 | 6.17 | 11.44 | 9.96 | 6.95 | 8.63 | 7.43 | 8.95 |
| Revenue (\$mm) | | | | | | | | | | |
| Natural Gas | | | | | | | | | | |
| U.S. (or North America) | 842 | 991 | 3,497 | 869 | 919 | 881 | 962 | 3,631 | 1,042 | 3,804 |
| Overseas (or Int'l) | 470 | 595 | 2,128 | 673 | 655 | 619 | 710 | 2,657 | 690 | 2,674 |
| Total | 1,312 | 1,586 | 5,625 | 1,541 | 1,574 | 1,500 | 1,672 | 6,288 | 1,732 | 6,478 |
| Oil | 3,412 | 4,710 | 14,082 | 4,957 | 4,824 | 4,876 | 4,982 | 19,640 | 4,883 | 19,566 |
| Other | 30,017 | 33,776 | 117,209 | 32,419 | 32,419 | 32,419 | 32,419 | 129,677 | 32,419 | 129,677 |
| Total | 34,741 | 40,072 | 136,916 | 38,918 | 38,818 | 38,796 | 39,074 | 155,605 | 39,035 | 155,722 |
| Expense (\$mm) | | | | | | | | | | |
| Fixed | 1,060 | 1,535 | 4,337 | 1,574 | 1,574 | 1,574 | 1,574 | 6,297 | 1,574 | 6,297 |
| Variable | 1,060 | 1,535 | 4,337 | 1,574 | 1,550 | 1,545 | 1,612 | 6,281 | 1,602 | 6,309 |
| Other | 28,267 | 31,726 | 110,459 | 30,319 | 30,319 | 30,319 | 30,319 | 121,277 | 30,319 | 121,277 |
| Ebitda (\$mm) | | | | | | | | | | |
| Exploration and Production | 2,604 | 3,226 | 11,032 | 3,350 | 3,274 | 3,258 | 3,468 | 13,350 | 3,439 | 13,439 |
| Other | 1,750 | 2,050 | 6,750 | 2,100 | 2,100 | 2,100 | 2,100 | 8,400 | 2,100 | 8,400 |
| Total Ebitda | 4,354 | 5,276 | 17,782 | 5,450 | 5,374 | 5,358 | 5,568 | 21,750 | 5,539 | 21,839 |
| Exploration | 205 | 192 | 703 | 171 | 250 | 250 | 250 | 921 | 250 | 1,000 |
| Deprec., Deplet., & Amort. | 938 | 1,030 | 3,798 | 1,041 | 1,041 | 1,041 | 1,041 | 4,164 | 1,041 | 4,164 |
| Other non cash | 12 | 101 | 164 | (400) | 150 | 150 | 150 | 50 | 150 | 600 |
| Ebit | 3,199 | 3,953 | 13,117 | 4,638 | 3,933 | 3,917 | 4,127 | 16,615 | 4,098 | 16,075 |
| Interest | 101 | 141 | 546 | 138 | 138 | 138 | 138 | 552 | 138 | 552 |
| Ebt | 3,098 | 3,812 | 12,571 | 4,500 | 3,795 | 3,779 | 3,989 | 16,063 | 3,960 | 15,523 |
| Income Tax | 1,084 | 1,334 | 4,400 | 1,575 | 1,328 | 1,323 | 1,396 | 5,622 | 1,386 | 5,433 |
| Net Income (\$mm) | | | | | | | | | | |
| Exploration and Production | 1,420 | 1,745 | 5,776 | 1,988 | | | | | | |
| Other | 762 | 912 | 3,045 | 1,210 | | | | | | |
| Unallocated | (168) | (179) | (650) | (273) | | | | | | |
| Total | 2,014 | 2,478 | 8,171 | 2,925 | 2,467 | 2,456 | 2,593 | 10,441 | 2,574 | 10,090 |
| Shares (millions) | 702 | 706 | 701 | 710 | 710 | 710 | 710 | 710 | 710 | 710 |
| Per share (\$) | 2.87 | 3.51 | 11.66 | 4.12 | 3.47 | 3.46 | 3.65 | 14.71 | 3.63 | 14.21 |
| Ebitda Margin (E&P) | 55% | 51% | 56% | 52% | 51% | 51% | 52% | 51% | 52% | 52% |
| Tax Rate | 35% | 35% | 35% | 35% | 35% | 35% | 35% | 35% | 35% | 35% |

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

| | <i>Symbol/</i> | | <i>Price</i> | | <i>Market</i> | <i>Net</i> | <i>Debt/</i> | |
|--|----------------|---------------|----------------|---------------|----------------|----------------|----------------|--------------|
| | <i>Rating</i> | <i>19-May</i> | <i>(\$/sh)</i> | <i>Shares</i> | <i>Cap</i> | <i>Present</i> | <i>Present</i> | <i>McDep</i> |
| | | <i>2005</i> | | <i>(mm)</i> | <i>(\$mm)</i> | <i>Value</i> | <i>Value</i> | <i>Ratio</i> |
| Producer/Refiners - Large Cap and Mid Cap | | | | | | | | |
| Kinder Morgan, Inc. | KMI | S2 | 76.02 | 125 | 9,500 | 20.00 | 0.74 | 1.74 |
| Marathon Oil Corporation | MRO | B | 46.71 | 349 | 16,280 | 42.00 | 0.30 | 1.08 |
| Imperial Oil Limited (30%) | IMO | B | 68.01 | 105 | 7,130 | 64.00 | 0.10 | 1.06 |
| Petro-Canada | PCZ | B | 55.00 | 263 | 14,490 | 70.00 | 0.19 | 0.83 |
| Norsk Hydro ASA | NHY | B | 79.00 | 252 | 19,930 | 101.00 | 0.16 | 0.82 |
| ConocoPhillips | COP | B | 101.36 | 710 | 72,000 | 140.00 | 0.21 | 0.78 |
| Suncor Energy | SU | B | 37.08 | 460 | 17,060 | 54.00 | 0.09 | 0.72 |
| PetroChina Company Ltd (10%) | PTR | B | 61.59 | 176 | 10,830 | 94.00 | 0.05 | 0.67 |
| Lukoil Oil Company | LUKOY | B | 33.40 | 834 | 28,000 | 52.00 | 0.03 | 0.65 |
| <i>Total or Median</i> | | | | | <i>195,000</i> | | <i>0.16</i> | <i>0.82</i> |

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