

Rating: Buy
 S&P 500: 1260

ConocoPhillips Offers to Buy Burlington Resources

<i>Symbol</i>	COP	BR	COP+BR
<i>Rating</i>	Buy	Buy	
<i>Price (US\$/sh)</i>	61.25	82.50	61.25
<i>Pricing Date</i>	12/12/05	12/12/05	
<i>Shares (mm)</i>	1418	381	-106 1693
<i>Market Capitalization (US\$m)</i>	86,900	31,400	103,700
<i>Debt (US\$m)</i>	25,000	3,200	17,700 45,900
<i>Enterprise Value (EV) (US\$m)</i>	111,900	34,600	149,600
<i>Present Value (PV) (US\$m)</i>	166,800	36,000	202,800
<i>Net Present Value (US\$/share)</i>	100	86	93
<i>Debt/Present Value</i>	0.15	0.09	0.23
<i>McDep Ratio - EV/PV</i>	0.67	0.96	0.74
<i>Dividend Yield (%/year)</i>	2.0	0.5	2.0
<i>Ebitda Next Twelve Months ending 12/31/06 (US\$m)</i>	30,300	7,900	38,200
<i>North American Natural Gas/Ebitda (%)</i>	13	69	25
<i>Natural Gas and Oil Production/Ebitda (%)</i>	66	100	73
<i>Adjusted Reserves/Production NTM</i>	11.2	10.0	
<i>EV/Ebitda</i>	3.7	4.4	3.9
<i>PV/Ebitda</i>	5.5	4.6	5.3
<i>Undeveloped Reserves (%)</i>	29	26	
<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	30.70	45.00	
<i>Present Value Proven Reserves(US\$/boe)</i>	12.91	18.00	
<i>Present Value Proven Reserves(US\$/mcf)</i>	2.15	3.00	
<i>Earnings Next Twelve Months (US\$/sh)</i>	11.49	9.71	
<i>Price/Earnings Next Twelve Months</i>	5	8	
<i>Indicated Annual Dividend (US\$/sh)</i>	1.24	0.40	1.24

Summary and Recommendation

An offer from buy-recommended **ConocoPhillips (COP)** to acquire buy-recommended **Burlington Resources (BR)** attests to confidence in the future of North American natural gas. BR's 70% concentration of cash flow on natural gas in the U.S. and Canada would boost COP's 14% concentration to some 25%. The proposed terms of \$46.50 a share in cash and .7214 share of COP stock for each share of BR imply a McDep Ratio of 1.05 for the purchase. The continuing combination would have a low McDep Ratio of 0.74. Consummation of the deal may "elevate" ConocoPhillips to mega cap status in our rankings.

Please see disclosures on the final page.

Continue Buy Recommendation

The indicated price of the deal is about \$90.70 a BR share. In our framework, COP would be paying a McDep Ratio of 1.05. That would be a 5% premium to the going rate as we calculate it for oil and gas properties that would earn an unlevered return of 7% per year before inflation assuming a long-term oil price of \$50 a barrel and natural gas price of \$10 a million btu.

BR shareholders can take the cash from the transaction and recycle it into another low McDep Ratio buy recommendation. The COP stock that BR shareholders receive would also have a low McDep Ratio. Because of the likely arbitrage spread, buyers of BR can effectively obtain COP at a discount.

COP shareholders suffer some present value dilution unavoidably as already reflected in an immediate decline in stock price. Some of that dilution can be offset by operating efficiency.

The Best Companies Elevate

Remember the globe trotting cat in the popular Conoco ads several years ago? While we miss the cat, the latest ads have a theme that stresses the word “elevate”. Coincidentally, the company may be elevated to mega cap size in our classification when market cap exceeds \$100 billion. On latest closing stock price and assuming the deal was completed on the proposed terms, COP would have a market cap of about \$104 billion.

Mega caps have lower McDep Ratios today than has usually been the case. The perceived advantages of size that seemed evident several years ago have disappeared. Meanwhile the mega caps provide a readily available means for giant pools of long-term capital to earn a higher return. For individual investors, the mega caps offer low risk to offset hesitation about the timing of new commitments.

Oil Price Potential Positive

Our vision is an oil price in 2010 of \$150 a barrel. Crude oil price multiplied some ten times in the decade of the 1970s. Tripling in the first half of the 2000s, the price would be up nine times after another tripling in a half decade. Yet we recall with hindsight that oil price was too high for a few years after 1980. Instead we think that if oil price went up just 7.5 times in the 2000s, \$20 to \$150, the ending level could be better sustained.

Meanwhile the current relationships as we see them are reflected in latest prices for futures and stocks (see table [Oil and Gas Commodity and Stock Price](#)). All five of the futures prices are in an uptrend as measured by current price above the 40-week average.

Natural Gas Price Gap waiting to be Closed

COP appears to be making a multi-billion dollar bet on whether natural gas is cheap in BR stock. In recent months one-year natural gas has closed much of the gap with one-year oil. Crude oil price divided by 5 is our definition of energy parity until environmental restrictions add further value to clean-burning natural gas. A wide gap for six-year futures remains between oil at more than \$60 and natural gas at \$9 rather than \$12 (60 divided by 5).

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Oil and Gas Commodity and Stock Price
Monday, December 12, 2005

	<u>Units</u>	<u>Futures Price</u>		<u>McDep Ratio</u>
		<u>Six-Year</u>	<u>One-Year</u>	<u>Denominator</u>
Crude Oil	\$/barrel	61.72	63.52	50
Natural Gas	\$/million btu	8.85	12.06	10
Oil Refining	\$/barrel		11.29	10
				<i>Median</i>
	<u>Stocks</u>			<u>McDep Ratio</u>
	Mega Cap			0.80
	Producer/Refiner			0.94
	Independent - Large			0.86
	Independent - Small			0.74
	Income			1.16

Source: McDep Associates, Bloomberg, New York Mercantile Exchange,
 Yahoo and company disclosures

ConocoPhillips
Functional Cash Flow and Present Value

	<u>NTM Ebitda</u>	<u>Adjusted</u>	<u>PV/</u>	<u>Present</u>	
	<u>(US\$mm)</u>	<u>R/P</u>	<u>Ebitda</u>	<u>Value</u>	
				<u>(US\$mm)</u>	
North American Natural Gas	4,000	12.5	5.3	21,000	13%
Rest of World Natural Gas	1,480	13.0	8.1	12,000	7%
Oil	14,420	10.5	5.3	75,800	45%
Downstream	10,400		5.6	58,000	35%
	30,300	11.2	5.5	166,800	100%
Debt (US\$mm)				25,000	
Net Present Value (US\$mm)				141,800	
Shares (mm)				1,418	
Net Present Value (US\$/sh)				100	
Over (-)/ Under (+) Correlation (US\$/sh)				15	

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ConocoPhillips
Next Twelve Months Operating and Financial Estimates

	<i>Q4</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>12/31/04</i>	<i>9/30/05</i>	<i>12/31/05</i>	<i>2005E</i>	<i>3/31/06</i>	<i>6/30/06</i>	<i>9/30/06</i>	<i>12/31/06</i>	<i>12/31/06</i>
Volume									
Natural Gas (mmcf)									
U.S. (or North America)	1,819	1,820	1,820	1,794	1,820	1,820	1,820	1,820	1,820
Overseas (or Int'l)	1,541	1,289	1,541	1,448	1,529	1,529	1,289	1,541	1,472
Total	3,360	3,109	3,361	3,242	3,349	3,349	3,109	3,361	3,292
Oil (mbd)	1,195	1,227	1,227	1,233	1,227	1,227	1,227	1,227	1,227
Total gas & oil (bcf)	969	963	987	3,883	964	975	963	987	3,889
Price									
Natural gas (\$/mcf)									
Henry Hub (\$/mmbtu)	7.10	8.56	13.00	8.65	14.85	11.01	10.95	11.43	12.06
U.S. (or North America)	5.92	7.49	11.38	7.64	13.00	9.63	9.58	10.00	10.54
Overseas (or Int'l)	4.20	4.81	4.81	4.84	4.81	4.81	4.81	4.81	4.81
Total	5.13	6.38	8.37	6.39	9.26	7.43	7.60	7.62	7.98
Oil (\$/bbl)									
WTI Cushing	48.31	62.52	60.36	56.40	62.14	63.47	64.07	64.42	63.52
Worldwide	42.84	55.44	53.53	50.03	55.11	56.28	56.82	57.13	56.04
Total gas & oil (\$/mcf)	6.50	8.39	8.75	7.74	9.21	8.77	8.92	8.93	8.95
NY Harbor 3-2-1 (\$/bbl)	5.72	16.70	8.94	10.60	10.58	12.61	12.26	9.70	11.29
Revenue (\$mm)									
Natural Gas									
U.S. (or North America)	991	1,255	1,905	5,004	2,129	1,596	1,604	1,675	7,003
Overseas (or Int'l)	595	570	681	2,556	661	669	570	681	2,582
Total	1,586	1,825	2,587	7,560	2,791	2,264	2,174	2,356	9,585
Oil	4,710	6,259	6,042	22,516	6,085	6,284	6,414	6,449	25,233
Other	33,776	41,575	41,575	151,321	41,575	41,575	41,575	41,575	166,302
Total	40,072	49,659	50,205	181,396	50,451	50,124	50,164	50,380	201,120
Expense (\$mm)									
Fixed	1,535	882	882	4,111	882	882	882	882	3,526
Variable	1,535	2,645	2,823	9,365	2,904	2,797	2,810	2,880	11,391
Other	31,726	38,975	38,975	141,721	38,975	38,975	38,975	38,975	155,902
Ebitda (\$mm)									
Exploration and Production	3,226	4,558	4,925	16,599	5,091	4,871	4,897	5,043	19,901
Other	2,050	2,600	2,600	9,600	2,600	2,600	2,600	2,600	10,400
Total Ebitda	5,276	7,158	7,525	26,199	7,691	7,471	7,497	7,643	30,301
Exploration	192	140	140	572	140	140	140	140	560
Deprec., Deplet., & Amort.	1,030	1,049	1,049	4,124	1,049	1,049	1,049	1,049	4,196
Other non cash	101	-	-	(391)	-	-	-	-	-
Ebit	3,953	5,969	6,336	21,894	6,502	6,282	6,308	6,454	25,545
Interest	141	122	122	509	122	122	122	122	488
Ebt	3,812	5,847	6,214	21,385	6,380	6,160	6,186	6,332	25,057
Income Tax	1,334	2,046	2,175	7,485	2,233	2,156	2,165	2,216	8,770
Net Income (\$mm)									
Exploration and Production	1,745	2,555							
Other	912	1,491							
Unallocated	(179)	(246)							
Total	2,478	3,800	4,039	13,900	4,147	4,004	4,021	4,116	16,287
Shares (millions)	1,412	1,418	1,418	1,419	1,418	1,418	1,418	1,418	1,418
Per share (\$)	1.76	2.68	2.85	9.80	2.92	2.82	2.84	2.90	11.49
Ebitda Margin (E&P)	51%	56%	57%	55%	57%	57%	57%	57%	57%
Tax Rate	35%	35%	35%	35%	35%	35%	35%	35%	35%

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Oil and Gas Producers
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>12-Dec</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	92.73	135	12,560	33.00	0.71	1.52
Imperial Oil Limited (30%)	IMO	B	101.93	102	10,410	84.00	0.10	1.19
Petro-Canada	PCZ	B	40.39	525	21,220	42.00	0.19	0.97
Marathon Oil Corporation	MRO	B	61.87	368	22,760	65.00	0.27	0.97
Suncor Energy	SU	B	64.25	461	29,630	68.00	0.11	0.95
Lukoil Oil Company	LUKOY	B	60.65	830	50,000	65.00	0.03	0.94
Norsk Hydro ASA	NHY	B	109.47	251	27,470	130.00	0.11	0.86
PetroChina Company Ltd (10%)	PTR	B	82.47	176	14,500	120.00	0.01	0.69
ConocoPhillips	COP	B	61.25	1,418	86,900	100.00	0.15	0.67
Gazprom (50%)	OGZPF	B	75.90	1,013	76,900	120.00	0.03	0.64
	<i>Total or Median</i>				<i>352,000</i>		<i>0.11</i>	<i>0.94</i>

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