

Meter Reader

A Weekly Analysis of Energy Stocks Using the McDep Ratio

December 13, 2005

ConocoPhillips/Burlington Resources

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. The takeover implications are positive for most buy-recommended stocks including close peers **Anadarko Petroleum (APC)**, **Devon Energy (DVN)**, and **Encana (ECA)**.

<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\$mm)</i>	86,900	31,400		103,700
<i>Debt (US\$mm)</i>	25,000	3,200	17,700	45,900
<i>Enterprise Value (EV) (US\$mm)</i>	111,900	34,600		149,600
<i>Present Value (PV) (US\$mm)</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\$mm)</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\$/mcfe)</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

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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
	<u>Stocks</u>			<u>Median</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

Select Stocks on Valuation and Strategic Considerations

Stocks are ranked in descending order of McDep Ratio to suggest “buy low and sell high” (see table Rank by McDep Ratio). We recommend representation in each of the five groups from Mega Cap to Income with emphasis on low McDep Ratio stocks.

Next Twelve Months Cash Flow, Ebitda, changes continuously with futures prices for natural gas and oil (see table Rank by EV/Ebitda). We regularly check the correlation of present value with cash flow multiple by business and expected life of production.

Investors can diversify political risk by owning stocks of companies headquartered in other countries (see table Home Country and Business Segments). Russian stocks offer potential resource value beyond that reflected in the McDep Ratio. Finally, we recommend balance among business segments. Investors should be sure to be represented in the stocks of companies with strong natural gas concentration.

Timely analyses are available on all recommended stocks (see table Index of Recent Research).

Kurt H. Wulff, CFA

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

	Symbol/ Rating		Price (\$/sh) 12-Dec 2005	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio
Mega Cap								
BP plc	BP	B	67.33	3,501	236,000	77.00	0.11	0.89
Total S.A.	TOT	B	128.45	1,176	151,000	160.00	0.12	0.83
Exxon Mobil Corporation	XOM	B	58.86	6,303	371,000	74.00	0.04	0.80
Royal Dutch Shell plc	RDS-A	B	63.50	3,352	213,000	84.00	0.10	0.78
Chevron Corporation	CVX	B	59.58	2,256	134,000	85.00	0.13	0.74
<i>Total or Median</i>					<i>1,105,000</i>		<i>0.11</i>	<i>0.80</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>
Independent Natural Gas and Oil - Large Cap and Mid Cap								
Encana Corporation	ECA	B	51.24	876	44,900	51.00	0.20	1.00
Burlington Resources	BR	B	82.50	381	31,400	86.00	0.09	0.96
XTO Energy Inc.	XTO	B	45.59	370	16,870	48.00	0.20	0.96
CNOOC Limited (29%)	CEO	B	71.95	119	8,580	84.00	0.00	0.86
Devon Energy Corporation	DVN	B	66.39	454	30,100	86.00	0.15	0.81
Anadarko Petroleum Corp.	APC	B	98.77	238	23,500	140.00	0.12	0.74
Occidental Petroleum Corp.	OXY	B	82.64	404	33,400	120.00	0.11	0.72
<i>Total or Median</i>					<i>189,000</i>		<i>0.12</i>	<i>0.86</i>
Independent Natural Gas and Oil - Small Cap								
Berry Petroleum Company	BRY	B	62.71	23	1,410	65.00	0.11	0.97
Encore Acquisition Company	EAC	B	34.41	50	1,710	50.00	0.21	0.76
Energy Partners Ltd.	EPL	B	24.92	41	1,020	38.00	0.19	0.72
Cimarex Energy Company	XEC	B	41.31	85	3,510	64.00	0.11	0.68
<i>Total or Median</i>					<i>7,700</i>		<i>0.15</i>	<i>0.74</i>
Income								
Kinder Morgan Energy Partners, L.P.	KMP	S3	49.93	160	7,990	15.00	0.55	2.04
Kinder Morgan Management, LLC	KMR	S3	48.56	57	2,750	15.00	0.55	2.00
Pengrowth Energy Trust	PGH		23.92	159	3,800	20.00	0.16	1.16
Penn West Energy Trust	PWTFF	B	33.22	179	5,940	28.00	0.15	1.16
Enerplus Resources Fund	ERF		49.30	110	5,420	42.00	0.14	1.15
San Juan Basin Royalty Trust	SJT		45.35	47	2,110	40.00	-	1.13
Canadian Oil Sands Trust (US\$)	COSWF	B	121.58	93	11,320	136.00	0.12	0.91
<i>Total or Median</i>					<i>39,300</i>		<i>0.15</i>	<i>1.16</i>

B = Buy, S2 = Short half unlevered position, S3 = Short quarter unlevered position

McDep Ratio = Market cap and Debt to present value of oil and gas and other businesses

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Meter Reader

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December 13, 2005

Oil and Gas Producers

Rank by EV/Ebitda: Enterprise Value to Earnings Before Interest, Tax, Deprec.

	Symbol/ Rating		Price (\$/sh) 12-Dec 2005	Adjstd Resrvs/ Prod NTM	PV/ Ebitda NTM	EV/ Ebitda NTM	P/E NTM	Divd or Distrib NTM (%)
Mega Cap								
BP plc	BP	B	67.33	9.4	6.1	5.4	9	3.2
Exxon Mobil Corporation	XOM	B	58.86	11.7	6.7	5.4	9	2.0
Total S.A.	TOT	B	128.45	9.2	6.2	5.1	9	2.8
Royal Dutch Shell plc	RDS-A	B	63.50	7.5	5.5	4.3	8	3.5
Chevron Corporation	CVX	B	59.58	9.6	5.6	4.2	7	3.0
	<i>Median</i>			9.4	6.1	5.1	9	3.0
Producer/Refiners - Large Cap and Mid Cap								
Kinder Morgan, Inc.	KMI	S2	92.73		8.5	12.9	19	3.2
Suncor Energy	SU	B	64.25	17.6	8.9	8.5	18	0.3
Imperial Oil Limited (30%)	IMO	B	101.93	11.5	6.7	8.0	13	0.8
Gazprom (50%)	OGZPF	B	75.90	20.0	11.0	7.1	12	0.5
Marathon Oil Corporation	MRO	B	61.87	7.4	5.0	4.8	7	2.1
Petro-Canada	PCZ	B	40.39	5.7	4.9	4.8	8	0.7
Norsk Hydro ASA	NHY	B	109.47	8.0	5.1	4.4	9	2.7
Lukoil Oil Company	LUKOY	B	60.65	19.8	4.6	4.3	7	1.6
PetroChina Company Ltd (10%)	PTR	B	82.47	13.8	6.1	4.2	9	4.6
ConocoPhillips	COP	B	61.25	11.2	5.5	3.7	5	2.0
	<i>Median</i>			11.5	5.8	4.8	9	1.8
Independent Natural Gas and Oil - Large Cap and Mid Cap								
XTO Energy Inc.	XTO	B	45.59	10.8	5.6	5.4	9	0.4
Encana Corporation	ECA	B	51.24	7.1	4.8	4.8	9	0.6
CNOOC Limited (29%)	CEO	B	71.95	9.2	5.2	4.5	8	3.2
Burlington Resources	BR	B	82.50	10.0	4.6	4.4	8	0.5
Occidental Petroleum Corp.	OXY	B	82.64	11.0	6.0	4.4	7	1.7
Anadarko Petroleum Corp.	APC	B	98.77	12.5	5.8	4.3	8	0.7
Devon Energy Corporation	DVN	B	66.39	7.8	4.3	3.5	6	0.5
	<i>Median</i>			10.0	5.2	4.4	8	0.6
Independent Natural Gas and Oil - Small Cap								
Berry Petroleum Company	BRY	B	62.71	10.1	5.3	5.2	10	1.0
Encore Acquisition Company	EAC	B	34.41	14.3	6.0	4.5	9	-
Cimarex Energy Company	XEC	B	41.31	7.4	4.0	2.8	5	-
Energy Partners Ltd.	EPL	B	24.92	5.7	3.7	2.7	7	-
	<i>Median</i>			8.8	4.7	3.6	8	-
Income								
Kinder Morgan Energy Partners, L.P.	KMP	S3	49.93		7.9	16.2	23	6.3
Kinder Morgan Management, LLC	KMR	S3	48.56		7.9	15.9	22	6.5
Canadian Oil Sands Trust (USS)	COSWF	B	121.58	20.0	11.4	10.4	12	2.9
San Juan Basin Royalty Trust	SJT		45.35	12.1	7.0	7.9	8	11.8
Pengrowth Energy Trust	PGH		23.92	7.6	4.9	5.7	8	10.9
Enerplus Resources Fund	ERF		49.30	8.6	5.0	5.7	8	8.9
Penn West Energy Trust	PWTFF	B	33.22	8.0	4.3	5.0	7	9.7
	<i>Median</i>			8.6	7.0	7.9	8	8.9

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended December 31, 2006; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

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Oil and Gas Producers Home Country and Business Segments

	Symbol/ Rating	Non- U.S. Domicile	North Amer. Natural Gas (%)	Rest of World Natural Gas (%)	Oil Prod'n (%)	Down- stream (%)	Total Present Value (US\$mm)
Mega Cap							
Exxon Mobil Corporation	XOM	B	10	19	38	33	487,000
BP plc	BP	B UK	10	12	42	36	302,000
Royal Dutch Shell plc	RDS-A	B UK	4	19	33	45	313,000
Chevron Corporation	CVX	B	9	9	52	29	221,000
Total S.A.	TOT	B France	-	28	37	35	214,000
	<i>Total or Median</i>		9	19	38	35	1,537,000
Producer/Refiners - Large Cap and Mid Cap							
PetroChina Company Ltd.	PTR	B China	-	9	71	20	213,000
Gazprom	OGZPF	B Russia		100			251,000
ConocoPhillips	COP	B	13	7	45	35	166,800
Lukoil Oil Company	LUKOY	B Russia	-	-	62	38	55,700
Norsk Hydro ASA	NHY	B Norway	-	27	38	35	36,800
Suncor Energy	SU	B Canada	5	-	89	7	35,200
Marathon Oil Corporation	MRO	B	14	8	33	46	32,900
Imperial Oil Limited	IMO	B Canada	13	-	62	25	31,900
Petro-Canada	PCZ	B Canada	23	4	53	20	27,200
	<i>Median</i>		9	7	58	30	851,000
Independent Natural Gas and Oil - Large Cap and Mid Cap							
Occidental Petroleum Corp.	OXY	B	15	1	73	11	54,700
Encana Corporation	ECA	B Canada	83	-	17	-	55,600
Devon Energy Corporation	DVN	B	64	-	36	-	46,000
Anadarko Petroleum Corp.	APC	B	60	-	40	-	37,700
Burlington Resources	BR	B	69	5	26	-	36,000
CNOOC Limited	CEO	B China	-	12	88	-	34,600
XTO Energy Inc.	XTO	B	83	-	17	-	22,100
	<i>Median</i>		64	-	36	-	287,000
Independent Natural Gas and Oil - Small Cap							
Cimarex Energy Company	XEC	B	71	-	29	-	6,080
Encore Acquisition Company	EAC	B	25	-	75	-	3,150
Berry Petroleum Company	BRY	B	15	-	85	-	1,950
Energy Partners Ltd.	EPL	B	54	-	46	-	1,930
	<i>Median</i>		40	-	60	-	13,110
Income							
Canadian Oil Sands Trust (US\$)	COSWF	B Canada	-	-	100	-	14,300
Penn West Energy Trust	PWTFF	B Canada	42	-	58	-	5,900
Enerplus Resources Fund	ERF	Canada	58	-	42	-	5,360
Pengrowth Energy Trust	PGH	Canada	42	-	58	-	3,800
San Juan Basin Royalty Trust	SJT		100	-	-	-	1,860
	<i>Median</i>		42	-	58	-	31,200

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Index of Recent Research

Stock Ideas

<u>Date</u>	<u>Symbol</u>	<u>Stock</u>	<u>Theme</u>
1-Dec	KMx	Kinder Morgan	Canada Deal Closed
28-Nov	OGZPF	Gazprom	Raise Net Present Value to \$120 a Share
14-Nov	PTR	PetroChina Company Limited	Diversify Political Risk
11-Nov	SJT	San Juan Basin Royalty Trust	Record Distributions Ahead
11-Nov	EPL	Energy Partners, Ltd.	Denali Partners
10-Nov	PWTF	Penn West Energy Trust	Quality Income Stock
7-Nov	TOT	Total S.A.	Global Clean Fuel Supplier
4-Nov	BRY	Berry Petroleum	Expanding on Multiple Fronts
4-Nov	XEC	Cimarex Energy Company	Doubling Done
3-Nov	DVN	Devon Energy Corporation	No Hedges in 2006
1-Nov	CEO	CNOOC Ltd	Low Price for Natural Gas
1-Nov	* OXY	Occidental Petroleum Corporation	Vintage Pending
31-Oct	* CVX	Chevron Corporation	Lower Net Present Value to \$85 a Share
31-Oct	* APC	Anadarko Petroleum Corporation	Long Life for Free
31-Oct	* BR	Burlington Resources, Inc.	Natural Gas Beneficiary
28-Oct	* XOM	Exxon Mobil Corporation	Momentum Challenge
28-Oct	* RDSA	Royal Dutch Shell plc	Downstream Gains
28-Oct	* SU	Suncor Energy Inc.	Up and Running Again
28-Oct	* MRO	Marathon Oil Corporation	Downstream Gains
28-Oct	* PCZ	Petro-Canada	Oil Sands Producer
27-Oct	* COP	ConocoPhillips	Emerging Mega Cap
27-Oct	* ECA	EnCana Corporation	Natural Gas Leader
27-Oct	* EAC	Encore Acquisition Company	Long Life Oil Value
26-Oct	* BP	BP p.l.c.	Lower Net Present Value to \$77 a Share
26-Oct	* NHY	Norsk Hydro ASA	Record Results
26-Oct	* COSWF	Canadian Oil Sands Trust	Distribution Doubled and Unit Split Proposed
21-Oct	* IMO	Imperial Oil Limited	The Unpromoters
21-Oct	* XTO	XTO Energy Inc.	Ready for Winter
14-Oct	* OXY	Occidental Petroleum Corporation	Buy Despite Momentum Signal
26-Sep	* LUKOY	Lukoil Oil Company	Adapting to New Russia

Meter Reader - A Weekly Analysis

13-Dec		ConocoPhillips/Burlington Resources
5-Dec	*	Energy Vision and Reality
29-Nov	*	Global Natural Gas Scramble
22-Nov	*	\$10 Refining Margin
15-Nov	*	\$10 Natural Gas

Natural Gas and Oil Royalty Trusts - A Weekly Analysis

9-Dec		Fiscal Follies
2-Dec	*	Calpine Farewell
25-Nov	*	Canadian Thanksgiving
18-Nov	*	D-Day

* Archived on www.mcdep.com

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