

Meter Reader

A Weekly Analysis of Energy Stocks Using the McDep Ratio

July 18, 2006

MidEast Hostilities

Summary and Recommendation

Ongoing hostilities in the Middle East, deplorable as they may be, fit the pattern of the 1970s when oil price multiplied ten fold in a decade. Current conditions feel as they did in 1978 when we worried that the loss of Iran would eliminate world spare oil capacity. It happened with the Iranian Revolution in 1979-1980. We sincerely hope that chronic conflict will be contained now because we are out of spare capacity even with Iran producing actively. Despite the security issues, most of the oil price gain in the 1970s proved to be justified by the long-term fundamental considerations of supply and demand. Thus, our vision of a crude oil price of \$150 a barrel in 2010 is intended to be reasonable in a market sense. We don't want or need enmity to make money in our recommendations. Separately, our reaction that a low McDep Ratio for buy-recommended **Encore Acquisition (EAC)** made it a takeover candidate despite highly-respected management attracted attention in the *New York Times* on July 16.

Nearly All Buy Recommendations Takeover Candidates

Any stock priced at a McDep Ratio less than 1.0 offers oil and gas resources for less than our estimate of economic value. Considering that the commodity price expectations embedded in our calculation may be low, we have kept buy ratings up to a McDep Ratio of 1.2. McDep Ratios of 0.8 and lower seem to suggest special attraction. A few companies with government ownership or extreme size might be ruled out as takeover candidates.

Encore Acquisition at 0.59 ranks lowest by McDep Ratio. As a small cap it has declined more from recent highs. Though concentration on oil rather than natural gas might have helped the stock in today's commodity market, Encore's oil price has been unusually low this year compared to the global benchmark.

At the same time Canadian income trusts, including **Enerplus (ERF)** in our coverage, have been expanding south of the border. ERF owns 70% of the Sleeping Giant oil field in Montana, in the same state as Encore's Cedar Creek Anticline. ERF apparently is studying High Pressure Air Injection (HPAI), a technique Encore uses to unlock reserves. On July 7, Prime West Energy Trust (PWI) announced it closed a \$300 million acquisition of oil properties in the broader three-state area. After transforming the Canadian industry by shifting ownership toward income production, Canadian income trusts are relatively new buyers of U.S. assets.

Because we have confidence in Encore management, we do not normally emphasize the company's takeover potential. It may be too early. As the president of Southland Royalty in the 1970s, Encore's Mr. Brumley guided his company to further strong stock market appreciation before distributing two income stocks. Several years later the residual company was absorbed by an unfriendly acquirer.

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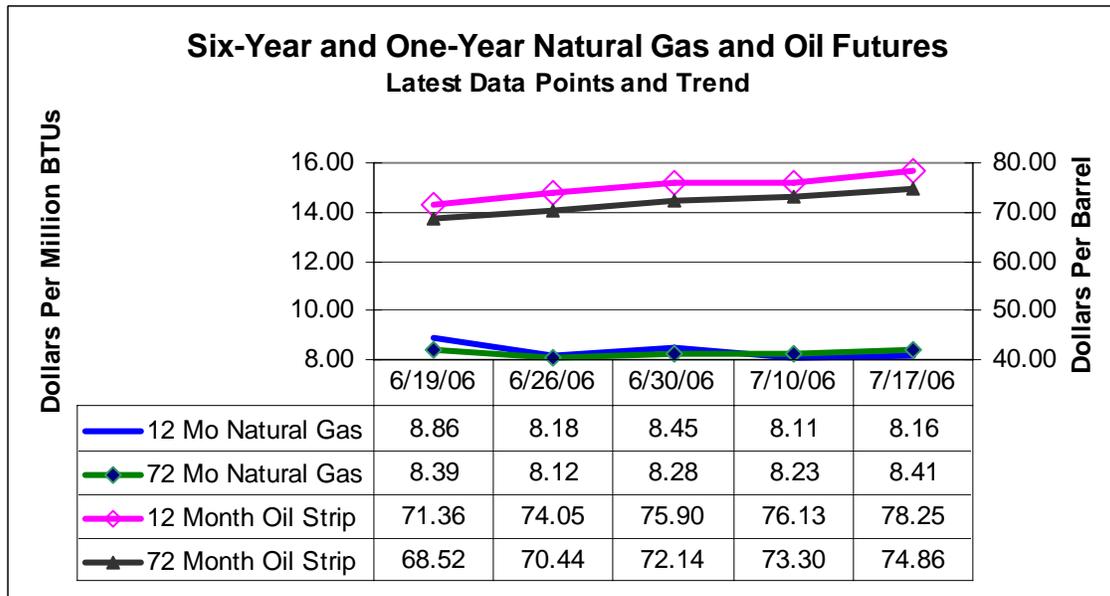
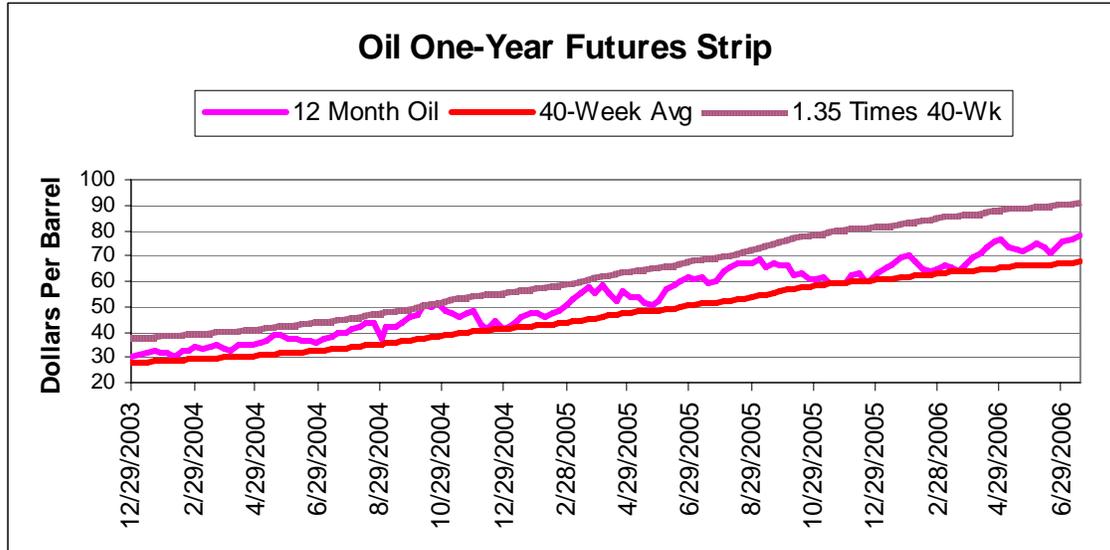
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Oil Price Advancing in Orderly Fashion

At \$78 a barrel, one-year oil is trading within a band that defines the orderly upward trend of the past few years (see chart [Oil One-Year Futures Strip](#)). As long as the price remains above \$68, the trend is up as defined by the 40-week average. As long as the price remains below \$91, the trend may be sustainable by recent standards.

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) 17-Jul 2006	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio
Mega Cap								
BP plc	BP	B	69.58	3,420	238,000	80.00	0.15	0.89
Exxon Mobil Corporation	XOM	B	64.00	6,126	392,000	78.00	0.04	0.83
Total S.A.	TOT	B	62.95	2,336	147,000	80.00	0.13	0.81
Royal Dutch Shell plc	RDS-A	B	66.44	3,268	217,000	84.00	0.10	0.81
Chevron Corporation	CVX	B	64.87	2,224	144,000	88.00	0.11	0.77
ConocoPhillips	COP	B	65.15	1,693	110,000	96.00	0.22	0.75
Gazprom (50%)	OGZPY	B	38.40	2,845	109,200	56.00	0.06	0.70
<i>Total or Median</i>					<i>1,357,000</i>		<i>0.11</i>	<i>0.81</i>
Producer/Refiners - Large Cap and Mid Cap								
Kinder Morgan, Inc.	KMI	S2	99.78	135	13,470	33.00	0.75	1.50
Imperial Oil Limited (30%)	IMO	B	36.80	299	11,010	37.00	0.08	1.00
Marathon Oil Corporation	MRO	B	84.95	367	31,180	86.00	0.18	0.99
Petro-Canada	PCZ	B	45.58	520	23,700	49.00	0.17	0.94
Norsk Hydro ASA	NHY	B	26.60	1,251	33,260	31.00	0.14	0.88
Suncor Energy	SU	B	78.13	461	36,030	95.00	0.07	0.84
PetroChina Company Ltd (10%)	PTR	B	106.90	178	19,010	140.00	0.05	0.77
Lukoil Oil Company	LUKOY	B	82.00	830	68,000	110.00	0.01	0.75
<i>Total or Median</i>					<i>236,000</i>		<i>0.11</i>	<i>0.91</i>
Independent Natural Gas and Oil - Large Cap and Mid Cap								
Encana Corporation	ECA	B	49.42	865	42,700	55.00	0.13	0.91
XTO Energy Inc.	XTO	B	42.58	370	15,750	52.00	0.15	0.85
CNOOC Limited (29%)	CEO	B	79.45	119	9,480	98.00	-	0.81
Anadarko Petroleum Corp.	APC	B	43.84	464	20,300	77.00	0.46	0.77
Occidental Petroleum Corp.	OXY	B	98.98	431	42,700	138.00	0.11	0.75
EOG Resources	EOG	B	67.45	246	16,600	92.00	0.03	0.74
Devon Energy Corporation	DVN	B	59.74	449	26,800	102.00	0.11	0.63
<i>Total or Median</i>					<i>174,000</i>		<i>0.11</i>	<i>0.77</i>
Independent Natural Gas and Oil - Small Cap								
Berry Petroleum Company	BRY	B	31.24	45	1,410	39.00	0.17	0.84
Energy Partners Ltd.	EPL	B	17.89	75	1,340	31.00	0.44	0.76
Cimarex Energy Company	XEC	B	39.81	85	3,380	68.00	0.08	0.62
Encore Acquisition Company	EAC	B	27.13	54	1,460	54.00	0.18	0.59
<i>Total or Median</i>					<i>7,600</i>		<i>0.18</i>	<i>0.69</i>
Income								
Kinder Morgan Energy Partners, L.P.	KMP	S3	45.81	166	7,610	15.00	0.56	1.91
Kinder Morgan Management, LLC	KMR	S3	42.90	58	2,490	15.00	0.56	1.83
Pengrowth Energy Trust	PGH		24.87	161	4,000	20.00	0.15	1.21
Enerplus Resources Fund	ERF		54.75	123	6,740	47.00	0.10	1.15
Penn West Energy Trust (US\$)	PWE	B	37.85	244	9,250	39.00	0.12	0.97
San Juan Basin Royalty Trust	SJT	B	38.26	47	1,780	40.00	-	0.95
Canadian Oil Sands Trust (US\$)	COSWF	B	28.81	464	13,370	35.00	0.09	0.84
<i>Total or Median</i>					<i>45,200</i>		<i>0.12</i>	<i>1.15</i>

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

Present Value = Shares times Net Present Value divided by (1-Debt/Present Value).

Debt = Present Value times Debt/Present Value

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

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Oil and Gas Producers

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

	Symbol/ Rating		Price (\$/sh) 17-Jul 2006	Adjstd Resrvs/ Prod NTM	PV/ Ebitda NTM	EV/ Ebitda NTM	P/E NTM	Divd or Distrib NTM (%)
Mega Cap								
Gazprom (50%)	OGZPY	B	38.40	20.0	9.0	6.3	11	0.6
BP plc	BP	B	69.58	9.3	6.1	5.4	9	3.2
Exxon Mobil Corporation	XOM	B	64.00	11.4	6.2	5.1	9	2.0
Total S.A.	TOT	B	62.95	9.4	5.6	4.6	8	3.2
Royal Dutch Shell plc	RDS-A	B	66.44	7.3	5.3	4.3	7	3.8
ConocoPhillips	COP	B	65.15	12.1	5.6	4.2	6	2.2
Chevron Corporation	CVX	B	64.87	11.0	5.3	4.0	7	3.2
		<i>Median</i>		<i>11.0</i>	<i>5.6</i>	<i>4.6</i>	<i>8</i>	<i>3.2</i>
Producer/Refiners - Large Cap and Mid Cap								
Kinder Morgan, Inc.	KMI	S2	99.78		8.6	13.0	20	3.5
Imperial Oil Limited (30%)	IMO	B	36.80	9.4	7.6	7.5	13	2.3
Suncor Energy	SU	B	78.13	18.2	8.0	6.6	12	0.3
Petro-Canada	PCZ	B	45.58	6.9	5.5	5.2	9	0.8
Lukoil Oil Company	LUKOY	B	82.00	18.9	6.2	4.7	7	1.5
PetroChina Company Ltd (10%)	PTR	B	106.90	14.8	6.0	4.7	8	4.0
Norsk Hydro ASA	NHY	B	26.60	7.8	5.3	4.6	10	2.6
Marathon Oil Corporation	MRO	B	84.95	8.3	4.6	4.5	7	1.6
		<i>Median</i>		<i>9.4</i>	<i>6.1</i>	<i>4.9</i>	<i>10</i>	<i>1.9</i>
Independent Natural Gas and Oil - Large Cap and Mid Cap								
XTO Energy Inc.	XTO	B	42.58	12.1	7.6	6.4	11	0.5
Encana Corporation	ECA	B	49.42	8.6	6.4	5.8	13	0.8
Anadarko Petroleum Corp.	APC	B	43.84	11.2	7.1	5.4	7	1.6
EOG Resources	EOG	B	67.45	9.6	6.9	5.1	12	0.4
Occidental Petroleum Corp.	OXY	B	98.98	10.4	5.7	4.3	7	1.5
Devon Energy Corporation	DVN	B	59.74	8.6	6.3	4.0	7	0.8
CNOOC Limited (29%)	CEO	B	79.45	10.0	4.3	3.5	6	3.2
		<i>Median</i>		<i>10.0</i>	<i>6.4</i>	<i>5.1</i>	<i>7</i>	<i>0.8</i>
Independent Natural Gas and Oil - Small Cap								
Berry Petroleum Company	BRY	B	31.24	10.5	6.5	5.4	18	1.0
Encore Acquisition Company	EAC	B	27.13	14.4	7.4	4.4	9	-
Energy Partners Ltd.	EPL	B	17.89	6.2	5.1	3.9	18	-
Cimarex Energy Company	XEC	B	39.81	7.2	6.0	3.7	8	0.4
		<i>Median</i>		<i>8.9</i>	<i>6.3</i>	<i>4.1</i>	<i>14</i>	<i>0.2</i>
Income								
Kinder Morgan Energy Partners, L.P.	KMP	S3	45.81		8.3	15.8	27	7.1
Kinder Morgan Management, LLC	KMR	S3	42.90		8.3	15.1	26	7.6
San Juan Basin Royalty Trust	SJT	B	38.26	13.8	12.1	11.6	14	7.3
Canadian Oil Sands Trust (US\$)	COSWF	B	28.81	25.1	10.2	8.5	11	6.4
Enerplus Resources Fund	ERF		54.75	9.4	7.1	8.1	15	8.1
Pengrowth Energy Trust	PGH		24.87	7.5	6.4	7.7	13	10.6
Penn West Energy Trust (US\$)	PWE	B	37.85	7.9	7.0	6.8	9	9.5
		<i>Median</i>		<i>9.4</i>	<i>8.3</i>	<i>8.5</i>	<i>14</i>	<i>7.6</i>

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended June 30, 2007; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

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Oil and Gas Producers Portfolio Composite of Buy Recommendations

Symbol	Portfolio Weight		Non-U.S. Home (%)	North Amer. Natural Gas (%)	Rest of World Natural Gas (%)	Oil Prod'n (%)	Down-stream (%)	McDep Ratio	
	Equity (%)	EV (%)							
Mega Cap									
BP plc	BP	2.8	2.9	2.9	0.2	0.3	1.4	0.9	0.89
Exxon Mobil Corporation	XOM	3.2	2.9		0.2	0.6	1.2	0.8	0.83
Total S.A.	TOT	2.9	2.9	2.9		0.8	1.2	0.9	0.81
Royal Dutch Shell plc	RDS-A	3.0	2.9	2.9	0.1	0.5	1.1	1.1	0.81
Chevron Corporation	CVX	5.8	5.8		0.4	0.6	3.3	1.5	0.77
ConocoPhillips	COP	4.8	5.8		0.9	0.6	2.7	1.6	0.75
Gazprom	OGZPY	9.3	8.7	8.7		8.7			0.70
Producer/Refiners - Large Cap and Mid Cap									
Imperial Oil Limited	IMO	1.6	1.4	1.4	0.1		1.0	0.3	1.00
Marathon Oil Corporation	MRO	1.4	1.4		0.2	0.1	0.5	0.6	0.99
Petro-Canada	PCZ	1.4	1.4	1.4	0.3	0.1	0.9	0.2	0.94
Norsk Hydro ASA	NHY	1.4	1.4	1.4		0.4	0.6	0.5	0.88
Suncor Energy	SU	1.5	1.4	1.4	0.0		1.3	0.1	0.84
PetroChina Company Ltd.	PTR	3.2	2.9	2.9		0.2	2.4	0.2	0.77
Lukoil Oil Company	LUKOY	6.7	5.8	5.8			4.3	1.5	0.75
Independent Natural Gas and Oil - Large Cap and Mid Cap									
Encana Corporation	ECA	2.9	2.9	2.9	2.3		0.6		0.91
XTO Energy Inc.	XTO	2.8	2.9		2.4		0.5		0.85
CNOOC Limited	CEO	3.4	2.9	2.9		0.3	2.6		0.81
Anadarko Petroleum Corp.	APC	1.4	2.9		1.7		1.2		0.77
Occidental Petroleum Corp.	OXY	2.9	2.9		0.4	0.0	2.2	0.3	0.75
EOG Resources	EOG	6.4	5.8		4.5	0.4	0.8		0.74
Devon Energy Corporation	DVN	5.5	5.8		3.5		2.3		0.63
Independent Natural Gas and Oil - Small Cap									
Berry Petroleum Company	BRY	1.3	1.4		0.2		1.2		0.84
Energy Partners Ltd.	EPL	0.7	1.4		0.3		1.2		0.76
Cimarex Energy Company	XEC	2.9	2.9		2.0		0.9		0.62
Encore Acquisition Company	EAC	2.3	2.9		0.7		2.2		0.59
Income									
Penn West Energy Trust (US\$)	PWE	5.9	5.8	5.8	1.8		4.0		0.97
San Juan Basin Royalty Trust	SJT	6.8	5.8		5.8				0.95
Canadian Oil Sands Trust (US\$)	COSWF	6.0	5.8	5.8			5.8		0.84
Portfolio Composite		100	100	49	28	14	48	11	0.78

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Index of Recent Research

Stock Ideas

<u>Date</u>	<u>Symbol</u>	<u>Stock</u>	<u>Theme</u>
10-Jul	OGZPY	Gazprom	Number One in Global Energy
30-Jun	LUKOY	Lukoil Oil Company	Russia Stronger than Ever
26-Jun	APC	Anadarko Petroleum Corporation	Hackett Job
23-Jun	* SJT	San Juan Basin Royalty Trust	Irrefutable Logic
30-May	* KMx	Kinder Morgan	Buyout Bailout
29-May	* COSWF	Canadian Oil Sands Trust	Minimal Startup Delay Assessed
26-May	* EPL	Energy Partners, Ltd.	Offers to Buy Stone Energy
16-May	* OXY	Occidental Petroleum Corporation	Ecuador Expropriates
10-May	* PWTFF	Penn West Energy Trust	Sleeping Seal
10-May	* BRY	Berry Petroleum	Debt for the Future
8-May	* XEC	Cimarex Energy Company	Seasonality Exaggerated
8-May	* EOG	EOG Resources Inc.	Seasonality Exaggerated
5-May	* SU	Suncor Energy Inc.	Retaking the Oil Sands Lead
5-May	* RDSA	Royal Dutch Shell plc	Tighter Markets and Cost Pressures
5-May	* TOT	Total S.A.	Spinoff and Split Ahead
3-May	* EAC	Encore Acquisition Company	Lower NPV to \$45 a Share
3-May	* DVN	Devon Energy Corporation	Barnett Bargain
3-May	* IMO	Imperial Oil Limited	Oil Sands and Arctic Natural Gas
1-May	* CVX	Chevron Corporation	India Opportunity, Venezuela Risk
28-Apr	* MRO	Marathon Oil Corporation	Oil Sands Link
28-Apr	* XOM	Exxon Mobil Corporation	Low Risk, High Return
28-Apr	* NHY	Norsk Hydro ASA	Earnings Blowout
27-Apr	* COP	ConocoPhillips	Strong Cash Flow and Value
27-Apr	* ECA	EnCana Corporation	Natural Gas at Present Value
26-Apr	* PCZ	Petro-Canada	Understated Oil Sands
26-Apr	* BP	BP p.l.c.	Understated Russian Resource
26-Apr	* CEO	CNOOC Ltd	Burst of Cash Flow
21-Apr	* XTO	XTO Energy Inc.	Distributing Royalty Trust Units
21-Mar	* PTR	PetroChina Company Limited	Growing Pains

Meter Reader - A Weekly Analysis

18-Jul		Mideast Hostilities
11-Jul	*	St. Petersburg Summit
3-Jul	*	The Cleanest, Most Economic Alternative Fuel
27-Jun	*	Deal Delirium

Natural Gas and Oil Royalty Trusts - A Weekly Analysis

14-Jul		Deluded in Dallas
7-Jul	*	Rising Replacement Cost
30-Jun	*	1970s Perspective in a Nutshell
23-Jun	*	PWE Rings the Bell

Industry Ideas

27-Jun	Presentation Slides	Oil and Gas Investment to 2010
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