



# Meter Reader

A Weekly Analysis of Large Cap Oil and Gas Stocks

September 29, 2009

## My Visit to Russia

### Summary and Recommendation

Highlighted by meetings with executives of buy-recommendations **Gazprom (OGZPY)** and **Lukoil (LUKOY)**, I had a memorable first visit to Russia last week (see pictures, pages 4-5). I also glimpsed first-hand the cultural legacy of the country while touring its current and former capital cities, Moscow and St. Petersburg. I travelled alone while trusting two excellent local guides, one in each city, both provided by an American travel agent with long experience in Russia. It was an adventure to explore new places safely and it was rewarding to meet warm and friendly people who work hard for a better life. Adventure may also describe investment in Russian stocks as demonstrated by last year's stock price volatility. My thesis for including Russian investments in a diversified portfolio is a motivated government will seek long-term growth in a global economy that enriches Russia and by necessity must also reward international investors. Success will be measured by higher stock prices. Stock prices will be higher only if investors see appropriate reward.

### Russian Pride

Like people everywhere, Russians take pride in their achievements. Despite communism's antipathy to the monarchy, the government directed support to restoring historic palaces. After communism, cathedrals were restored. The accumulation of wealth in the form of gold, precious stones, and fine craftsmanship in glorious structures is startling.

There are many smart and talented Russians, of course. One of my favorites is the 19<sup>th</sup> century chemist, Dmitri Mendeleev, the inventor of the Periodic Table of Elements. Another is a current national hero, Irina Rodnina, the all-time great pairs figure skater.

The Kremlin, a symbol of a controlling government, also showcases history. I once pictured the Kremlin as a building that looked like what turns out to be Lubyanka, the former KGB headquarters. Instead the Kremlin, or ancient fortress, surrounds cathedrals and museums along with an office building for President Medvedev. The Assumption Cathedral in which all the tsars were crowned is practically gold clad, it seems to have so much of the precious metal. The Armory Museum does have ancient armor that Russians used to repel the Mongols who dominated the country in its early history. Otherwise the Armory is better known for its collection of Faberge eggs. The tsar's coaches are also on display looking just as I envisioned in fairy tales.

Steeped in the knowledge that Communism was atheist, I was surprised to see churches and cathedrals seemingly everywhere. The government supports the Russian Orthodox religion again and likely controls it. Apparently there are also choices for those seeking solace away from the government religion.



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## **Government Control**

In the Putin years, the government has reasserted its control over the economy. As a result, Russians have respect for order. No graffiti in public places and no trash on the streets. The air above central Moscow was mostly clear during my visit and seemed clean.

Journalistic expression is controlled by government ownership of the media. Illustrating that, the tallest structure in Moscow appears to be a communications tower standing over the downtown skyline. As it looks like a needle, some of the locals apparently refer to it as the “ideological injection”.

## **Russia Rising with Resources to Export**

I am optimistic about Russia with the hope that well-publicized problems and challenges can be overcome. The daily facts are on the side of hope as evidenced by the price of the ruble, the Russian currency, above its 200-day average relative to the dollar and stock prices of Gazprom and Lukoil also above their 200-day average. Of course, that still doesn't guarantee tomorrow when trends could change without notice. Investors need to be vigilant.

Russia's appeal to me lies in its natural resources, particularly natural gas and oil. Other Arctic and near-Arctic countries and states, including Norway, Canada and Alaska have similar appeal. Investors have a history of making money in the latter, subject to setbacks from time to time. Changes in the rules of the game as occurred in Alaska and Alberta are discouraging. Norway has the highest tax rate, but at least it hasn't changed much in 30 years and companies can invest accordingly. Russia has only a short history as a market oriented country and there have been large disappointments for international investors along with better experience recently.

## **Opportunity in the International Capital Markets**

What's missing in the resource picture is financing for development. Historically, a strong government just took what it needed. Peter the Great, the founder of St. Petersburg in 1703, built the city from scratch with military labor, we understand. Catherine the Great, whose art collection formed the core of the Hermitage Museum, apparently financed her monarchy in part with the labor of serfs and the spoils of conquest. Coincidentally, Tsar Alexander II freed Russian serfs beginning in 1861, the same year President Abraham Lincoln began freeing U.S. slaves. Joseph Stalin apparently built the magnificent, museum quality, underground subway stations in the 1930s with the labor of political prisoners.

Today, the international financial markets are well-suited to provide the capital to develop Russian energy resources, either through Russian companies or international companies. Companies with high stock prices can raise capital on the most efficient terms. Stock prices go up when companies make money. The most important factor influencing profitability in Russia is



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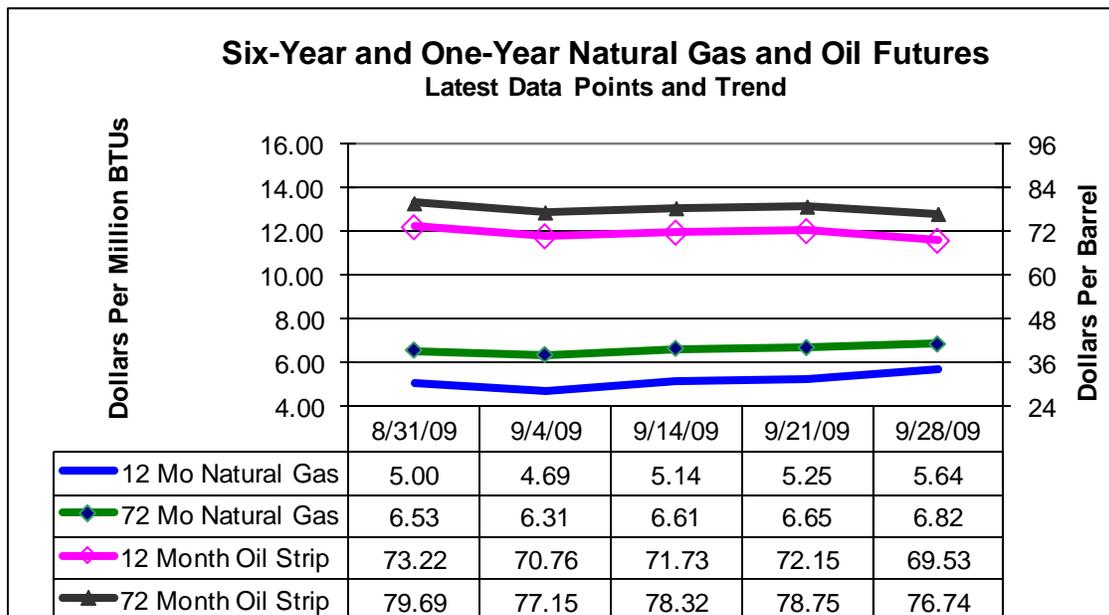
government policy. By relaxing excise taxes and price controls, the government can make the companies more profitable.

The same week I was in the two cities, Prime Minister Putin was entertaining international oil executives at a conference in the Arctic on the Yamal Peninsula, the location of the country's largest undeveloped natural gas resources. It is welcome news that international companies are being invited again to invest alongside Russian companies. As long as a country needs new investment, existing companies should do well. Though conditions can change and there is a long way to go, the trends appear better for now.

## Weekly Six-Year Natural Gas Price above 40-Week Average

Lastly, the industry backdrop looks positive with an upward price trend for both oil and natural gas. Latest settlement prices for the average of futures for the next six years at \$77 a barrel are above the 40-week average of \$72 (see chart below, Six-Year and One-Year Natural Gas and Oil Futures and chart on page 6, Six-Year Commodity Price Meter). The current quote of \$6.82 for six-year natural gas exceeds the 40-week average of \$6.73, perhaps the beginning of the long-awaited break to the upside.

Kurt H. Wulff, CFA





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Gazprom Headquarters



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Lukoil Headquarters





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**Table 2**

## McDep Energy Portfolio Net Present Value and McDep Ratio

			Price			Net		
	Symbol/Rating		(US\$/sh)	Shares	Market	Present	Debt/	
	B = Buy	28-Sep			Cap	Value	Present	McDep
	H = Hold	2009		(mm)	(US\$mm)	(US\$/sh)	Value	Ratio
<b>U.S. Integrated</b>								
Exxon Mobil Corporation	XOM	B	69.59	4,871	339,000	89.00	0.10	0.80
Chevron Corporation	CVX	B	71.70	1,992	143,000	97.00	0.14	0.78
Marathon Oil Corporation	MRO	B	32.42	711	23,050	53.00	0.23	0.70
ConocoPhillips	COP	B	45.69	1,496	68,000	105.00	0.25	0.58
<i>Total or Median</i>					<i>573,000</i>		<i>0.19</i>	<i>0.74</i>
<b>Europe</b>								
BG Group plc	BRGXF	B	17.29	3,388	58,580	22.00	0.09	0.80
BP plc	BP	B	53.56	3,155	169,000	72.00	0.22	0.80
Royal Dutch Shell plc	RDS-A	B	58.22	3,065	178,000	79.00	0.19	0.79
StatoilHydro ASA (33%)	STO	B	22.58	1,051	23,730	35.00	0.22	0.72
Total S.A.	TOT	B	59.78	2,236	134,000	90.00	0.15	0.71
<i>Total or Median</i>					<i>563,000</i>		<i>0.19</i>	<i>0.79</i>
<b>Brazil/China/Russia</b>								
CNOOC Limited (34%)	CEO	B	135.99	152	20,690	135.00	0.01	1.01
Petrobras	PBR	B	45.38	4,387	199,080	58.00	0.13	0.81
PetroChina Company Ltd (14%)	PTR	B	115.80	256	29,670	150.00	0.06	0.79
Lukoil Oil Company	LUKOY	B	54.15	847	46,000	135.00	0.06	0.43
Gazprom (50%)	OGZPY	B	24.10	3,130	75,400	64.00	0.09	0.43
<i>Total or Median</i>					<i>371,000</i>		<i>0.06</i>	<i>0.79</i>
<b>U.S. Independent</b>								
Anadarko Petroleum Corp.	APC	B	63.67	495	31,500	59.00	0.33	1.05
XTO Energy Inc.	XTO	B	42.07	579	24,360	47.00	0.29	0.93
Occidental Petroleum Corp.	OXY	B	79.15	814	64,400	87.00	0.07	0.92
Chesapeake Energy Corp.	CHK		28.17	610	17,180	34.00	0.41	0.90
EOG Resources	EOG	B	80.13	250	20,000	92.00	0.10	0.88
Devon Energy Corporation	DVN	B	68.02	450	30,600	98.00	0.17	0.75
<i>Total or Median</i>					<i>188,000</i>		<i>0.23</i>	<i>0.91</i>
<b>Canada</b>								
Encana Corporation	ECA	B	56.59	751	42,500	62.00	0.21	0.93
Canadian Natural Resources	CNQ	B	67.47	542	36,600	80.00	0.22	0.88
Imperial Oil Limited (30%)	IMO	B	37.79	256	9,690	48.00	0.07	0.80
Suncor Energy	SU	B	34.47	1,572	54,170	52.00	0.17	0.72
Canadian Oil Sands Trust	COSWF	B	27.13	484	13,130	42.00	0.07	0.67
<i>Total or Median</i>					<i>156,000</i>		<i>0.17</i>	<i>0.80</i>

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

Estimated present value presumes a long-term price for oil of US\$75 a barrel and natural gas, \$8 a million btu.

*Please see disclosures on the final page.*

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**Table 3**

## McDep Energy Portfolio Value Multiples and Distribution Yield

			<i>Price</i>	<i>Adjustd</i>				<i>Divd or</i>
	<i>Symbol/Rating</i>		<i>(US\$/sh)</i>	<i>Resrvs/</i>	<i>PV/</i>	<i>EV/</i>		<i>Distrib</i>
	B = Buy		<i>28-Sep</i>	<i>Prod</i>	<i>Ebitda</i>	<i>Ebitda</i>	<i>P/E</i>	<i>NTM</i>
	H = Hold		<i>2009</i>	<i>NTM</i>	<i>NTM</i>	<i>NTM</i>	<i>NTM</i>	<i>(%)</i>
<b>U.S. Integrated</b>								
Exxon Mobil Corporation	XOM	B	69.59	12.4	8.8	7.0	13	2.4
Chevron Corporation	CVX	B	71.70	9.8	7.9	6.2	15	3.8
ConocoPhillips	COP	B	45.69	10.6	8.9	5.1	9	4.1
Marathon Oil Corporation	MRO	B	32.42	8.3	7.1	5.0	11	3.0
	<i>Total or Median</i>			<i>10.2</i>	<i>8.4</i>	<i>5.6</i>	<i>12</i>	<i>3.4</i>
<b>Europe</b>								
BG Group plc	BRGXF	B	17.29	8.8	9.6	7.7	16	1.1
BP plc	BP	B	53.56	9.6	8.0	6.4	12	6.3
Total S.A.	TOT	B	59.78	9.7	8.6	6.1	12	5.6
Royal Dutch Shell plc	RDS-A	B	58.22	7.9	7.7	6.1	13	5.8
StatoilHydro ASA (33%)	STO	B	22.58	7.5	7.3	5.2	17	5.5
	<i>Total or Median</i>			<i>8.8</i>	<i>8.0</i>	<i>6.1</i>	<i>13</i>	<i>5.6</i>
<b>Brazil/China/Russia</b>								
Petrobras	PBR	B	45.38	9.2	10.9	8.9	17	3.0
PetroChina Company Ltd (14%)	PTR	B	115.80	14.0	8.8	6.9	19	3.5
CNOOC Limited (34%)	CEO	B	135.99	7.2	6.7	6.8	13	3.8
Lukoil Oil Company	LUKOY	B	54.15	16.3	9.5	4.1	8	2.3
Gazprom (50%)	OGZPY	B	24.10	24.6	8.5	3.7	5	0.2
	<i>Total or Median</i>			<i>14.0</i>	<i>8.8</i>	<i>6.8</i>	<i>13</i>	<i>3.0</i>
<b>U.S. Independent</b>								
Chesapeake Energy Corp.	CHK		28.17	11.3	10.4	9.4	14	1.1
Anadarko Petroleum Corp.	APC	B	63.67	9.2	8.5	9.0		0.6
XTO Energy Inc.	XTO	B	42.07	11.0	9.7	8.9	23	1.4
EOG Resources	EOG	B	80.13	10.1	9.3	8.2	24	0.7
Occidental Petroleum Corp.	OXY	B	79.15	11.0	8.1	7.4	16	1.7
Devon Energy Corporation	DVN	B	68.02	8.4	7.9	5.9	12	0.9
	<i>Total or Median</i>			<i>10.5</i>	<i>8.9</i>	<i>8.6</i>	<i>16</i>	<i>1.0</i>
<b>Canada</b>								
Imperial Oil Limited (30%)	IMO	B	37.79	18.4	14.7	11.8	24	1.0
Canadian Oil Sands Trust	COSWF	B	27.13	21.8	15.0	10.0	16	7.8
Encana Corporation	ECA	B	56.59	9.1	9.1	8.5	22	0.7
Canadian Natural Resources	CNQ	B	67.47	7.6	9.5	8.3	15	0.5
Suncor Energy	SU	B	34.47	12.5	10.8	7.8	92	0.5
	<i>Total or Median</i>			<i>12.5</i>	<i>10.8</i>	<i>8.5</i>	<i>22</i>	<i>0.7</i>
EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended September 30, 2010; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses								



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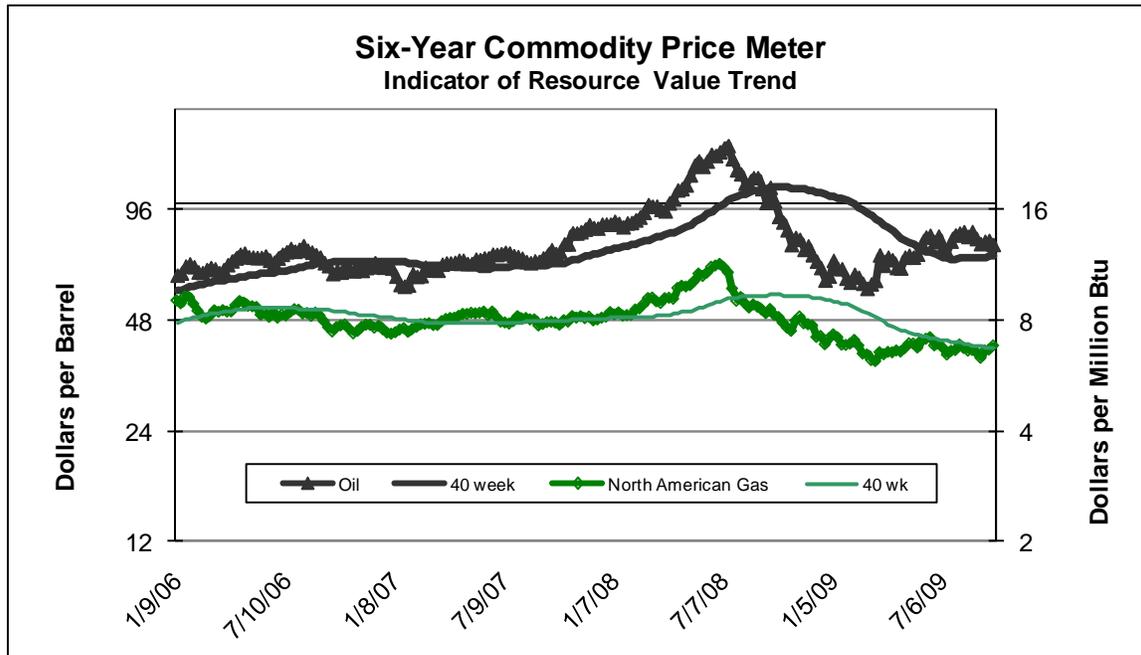
<b>Index of Recent Research</b>			
<b>Stock Ideas</b>			
<u>Date</u>	<u>Symbol</u>	<u>Subject</u>	<u>Theme</u>
17-Sep	COSWF	Canadian Oil Sands Trust	McDep Value (Income and Small Cap Weekly)
16-Sep	APC	Anadarko Petroleum Corporation	Rebalance on New Basin Discovery
15-Sep	ECA	EnCana Corporation	Creating Oil Sands Prize (Meter Reader)
4-Sep	SJT	San Juan Basin Royalty Trust	Upgrade to Buy (Income and Small Cap Weekly)
3-Sep	PBR	Petrobras	New Regulatory Model Points to Stock Issue
1-Sep	* XOM	Exxon Mobil Corporation	Stock May Be Timely (Meter Reader)
30-Aug	* LUKOY	Lukoil Oil Company	Contributing to Russia's Oil Future
30-Aug	* PTR	PetroChina Company Limited	Growing Giant in Clean Energy
26-Aug	* CEO	CNOOC Ltd	Full Current Valuation, Promising Prospects
26-Aug	* OGZPY	Gazprom	Natural Gas Giant Reemerging
14-Aug	* BIR.TO	Birchcliff Energy Ltd.	Spirited Small Cap Canadian Nat Gas Producer (ISCW)
12-Aug	* PWE	Penn West Energy Trust	Reduce NPV on Volume Trend
11-Aug	* DMLP	Dorchester Minerals, L.P.	Income Competitive with Growth
7-Aug	* XEC	Cimarex Energy Company	Can Shale Working Well
7-Aug	* EOG	EOG Resources Inc.	Low-Debt Natural Gas Growth
6-Aug	* CNQ	Canadian Natural Resources	First Cash from Horizon
5-Aug	* BRY	Berry Petroleum	Back on Track
5-Aug	* XTO	XTO Energy Inc.	Cutting Edge Natural Gas Producer
5-Aug	* DVN	Devon Energy Corporation	Stock Price Moves to Uptrend
4-Aug	* STO	StatoilHydro ASA	Natural Gas Growth with Dividends
3-Aug	* MRO	Marathon Oil Corporation	Favorable Trends for Future Profit
31-Jul	* CVX	Chevron Corporation	Strength in Tough Times
31-Jul	* TOT	Total S.A.	Real Return and Secure Income
30-Jul	* IMO	Imperial Oil Limited	Downstream Hiccup
30-Jul	* PCZ	Petro-Canada	Good Bye Petro-Canada, Hello Suncor
30-Jul	* RDSA	Royal Dutch Shell plc	Gaining Efficiency in Exploration and Production
29-Jul	* BRGXF	BG Group	Progressing in Pre-Salt Brazil
29-Jul	* EAC	Encore Acquisition Company	Tertiary Recovery Project Announced
29-Jul	* COP	ConocoPhillips	Positioned for Recovery
28-Jul	* BP	BP p.l.c.	Trending Up
23-Jul	* OXY	Occidental Petroleum Corporation	California Discovery May Be Worth \$2 a Share
22-Jul	* SU	Suncor Energy	Merger with Petro-Canada to be Effective August 1
10-Jul	* HGT	Hugoton Royalty Trust	Rounding the Bend (Income and Small Cap Weekly)
<b>Meter Reader</b>			
29-Sep		Weekly	
22-Sep		Weekly	Replaying Energy Regulation in Russia
15-Sep		EnCana Corporation (ECA)	Creating Oil Sands Prize
8-Sep	*	Weekly	Getting Oil Sands Right
<b>Income and Small Cap Weekly</b>			
25-Sep		Mesa Royalty Trust (MTR)	Pure Natural Income in Mesa Royalty Trust
18-Sep		Canadian Oil Sands Trust (COSWF)	McDep Value
11-Sep		Weekly	Natural Gas Low Set
4-Sep	*	San Juan Basin Royalty Trust (SJT)	Upgrade to Buy from Hold
<b>Industry Ideas</b>			
2-Apr	*	Presentation	Making Money in Oil and Gas Stocks
	*	Archived on <a href="http://www.mcdep.com">www.mcdep.com</a>	



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