

Rating: Buy
S&P 500: 1214

Royal Dutch Shell plc **Downstream Beneficiary**

<i>Symbol</i>	RDS-A	<i>Ebitda Next Twelve Months ending 6/30/06 (US\$mm)</i>	57,500
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	6
<i>Price (US\$/sh)</i>	65.58	<i>Natural Gas and Oil Production/Ebitda (%)</i>	59
<i>Pricing Date (intraday)</i>	10/3/05	<i>Adjusted Reserves/Production NTM</i>	7.2
<i>Shares (mm)</i>	3372	<i>EV/Ebitda</i>	4.4
<i>Market Capitalization (US\$mm)</i>	221,100	<i>PV/Ebitda</i>	5.4
<i>Debt (US\$mm)</i>	29,700	<i>Undeveloped Reserves (%)</i>	44
<i>Enterprise Value (EV) (US\$mm)</i>	250,800	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	25.80
<i>Present Value (PV) (US\$mm)</i>	313,000	<i>Present Value Proven Reserves(US\$/boe)</i>	15.20
<i>Net Present Value (US\$/share)</i>	84	<i>Present Value Proven Reserves(US\$/mcf)</i>	2.53
<i>Debt/Present Value</i>	0.09	<i>Earnings Next Twelve Months (US\$/sh)</i>	8.22
<i>McDep Ratio - EV/PV</i>	0.80	<i>Price/Earnings Next Twelve Months</i>	8
<i>Dividend Yield (%/year)</i>	3.3	<i>Indicated Annual Dividend (US\$/sh)</i>	2.19

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

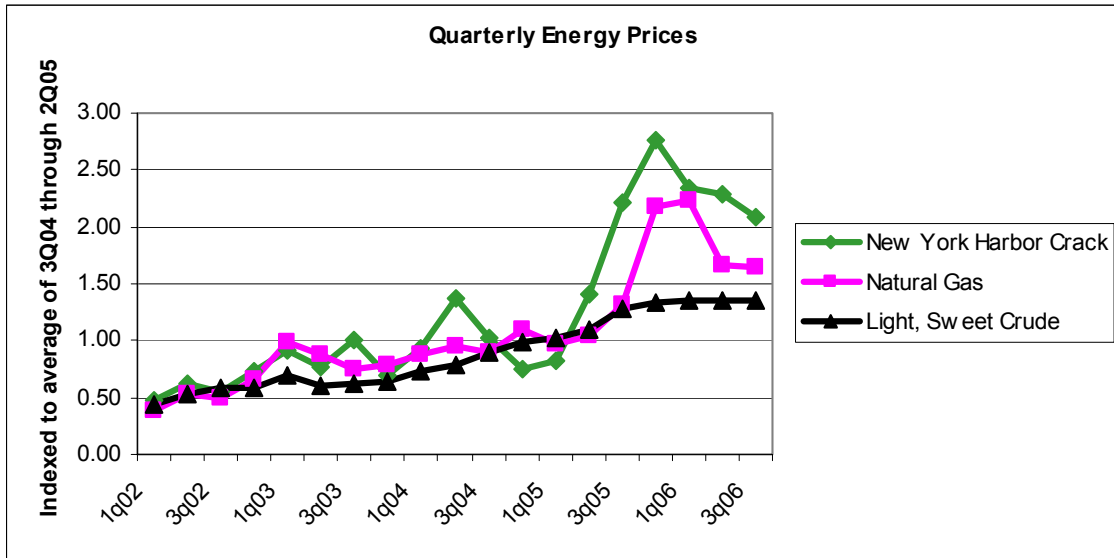
Buy-recommended **Royal Dutch Shell plc (RDS-A)** has the most concentration on the businesses downstream of natural gas and oil production among the five mega cap energy peers. Oil refining, the largest part of downstream, faces the greatest increase in expected year-ahead profit as signaled by the futures market. The potential benefit is obscured in the near term by lost production and the costs of adjusting. The stock has 32% appreciation potential to estimated net present value of \$84 a share. Risk is low with globally diversified, integrated operations and miniscule debt. Dividend increases seem likely along with stock repurchase.

Refining Crack Comes to Life

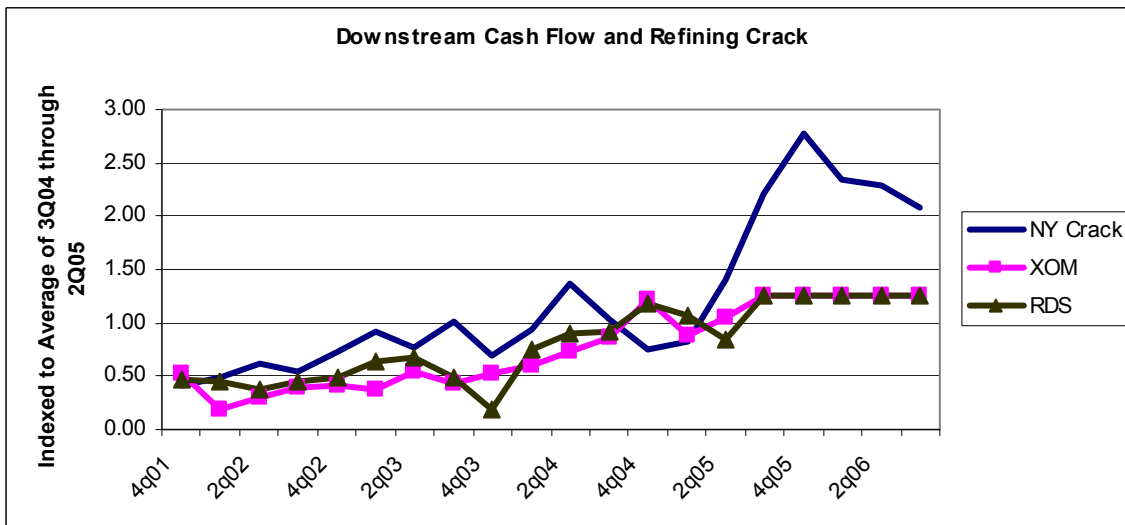
In its own volatile manner, the refining crack has increased along with crude oil and natural gas price in recent years (see chart [Quarterly Energy Prices](#)). The future prices are from the New York Mercantile Exchange and historical prices are the average of daily spot prices from Bloomberg and the Wall Street Journal. The crack refers to the gross margin measured as the difference in price between crude oil and the average of two parts of gasoline and one part of heating oil.

The crack came to life when the 2005 hurricanes, Katrina and Rita, caused the loss of up to a third of U.S. refining capacity temporarily. The expected crack spread for the next four quarters through September 30, 2006 is two to two and a half times the norm for the four quarters through June 30, 2005.

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Downstream cash flow tracks refining gross margin though the relationship is subject to many business and geographic complications (see chart [Downstream Cash Flow and Refining Crack](#)). Cutting through the complexity we have made the simple assumption that future downstream cash flow would be at 125% of the rate for the year ended June 30, 2005. Among the unknowns are the costs of lost capacity and the timing of realizing product prices in the end market at the gasoline pump. Presumably if the futures prices were to materialize, cash flow and profits ought to be considerably higher than we project.



The New York harbor crack for the past period ending June 30, 2005 was about \$8 a barrel. Our long-term assumption of \$10 a barrel constant real is also 125% of the recent past period. Commodity market expectation for the next twelve months ended September 30, 2006 is \$17.93 a barrel (see last row of numbers in section under Price in table [NTM Operating and Financial Estimates](#)).

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Royal Dutch/Shell
Next Twelve Months Operating and Financial Estimates

	<i>Q4</i>	<i>Year</i>	<i>Q1</i>	<i>Q2</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Next</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>2005E</i>	<i>3/31/06</i>	<i>6/30/06</i>	<i>9/30/06</i>	<i>Twelve</i>	
											<i>Months</i>	
											<i>9/30/06</i>	
Volume												
Natural Gas (mmcf)												
U.S. (or North America)	1,302	1,335	1,385	1,357	1,357	1,357	1,364	1,357	1,357	1,357	1,357	
Overseas (or Int'l)	8,408	7,528	8,490	6,518	5,925	8,296	7,303	8,764	6,427	5,842	7,327	
Total	9,710	8,864	9,875	7,875	7,282	9,653	8,667	10,121	7,784	7,199	8,684	
Oil (mbd)	2,163	2,261	2,144	2,168	2,168	2,168	2,162	2,168	2,168	2,168	2,168	
Total gas & oil (mmb)	348	1,365	341	317	311	347	1,316	347	315	310	1,320	
Price												
Natural gas (\$/mcf)												
Henry Hub (\$/mmbtu)	7.10	6.15	6.27	6.76	8.56	14.14	8.93	14.44	10.74	10.62	12.48	
U.S. (or North America)	7.27	6.33	6.83	7.31	8.48	13.99	9.16	14.30	10.63	10.51	12.35	
Overseas (or Int'l)	3.32	3.08	3.92	3.78	3.97	4.17	3.97	4.38	4.60	4.83	4.46	
Total	3.85	3.57	4.33	4.39	4.81	5.55	4.79	5.71	5.65	5.90	5.69	
Oil (\$/bbl)												
WTI Cushing	48.31	41.44	49.65	53.05	62.49	65.41	57.65	65.94	66.22	66.00	65.89	
Worldwide	40.17	35.56	43.84	48.05	56.59	59.24	52.01	59.72	59.97	59.77	59.68	
Total gas & oil (\$/bbl)	32.86	29.98	36.08	39.86	46.64	48.19	42.68	48.58	50.21	51.08	49.45	
NY Harbor 3-2-1 (\$/bbl)	5.72	7.74	6.17	10.59	16.70	20.95	13.60	17.68	17.30	15.80	17.93	
Revenue (\$mm)												
Natural Gas												
U.S. (or North America)	871	3,084	851	903	1,058	1,747	4,560	1,746	1,313	1,312	6,118	
Overseas (or Int'l)	2,568	8,471	2,997	2,243	2,165	3,182	10,587	3,453	2,689	2,594	11,919	
Total	3,439	11,555	3,848	3,146	3,223	4,929	15,147	5,199	4,002	3,906	18,037	
Oil	7,994	29,357	8,459	9,480	11,288	11,816	41,043	11,653	11,832	11,922	47,223	
Other	64,991	227,152	59,848	70,018	70,018	70,018	269,903	70,018	70,018	70,018	280,073	
Total	76,424	268,064	72,156	82,644	84,530	86,764	326,093	86,870	85,852	85,847	345,333	
Expense (\$mm)												
Production	4,466	15,888	5,292	5,959	6,902	8,019	26,173	8,073	7,563	7,561	31,216	
Other	59,488	209,644	54,834	66,067	64,162	64,162	249,227	64,162	64,162	64,162	256,650	
Ebitda (\$mm)												
Exploration and Production	6,967	25,024	7,016	6,666	7,609	8,726	30,017	8,779	8,270	8,268	34,044	
Other	5,503	17,508	5,014	3,951	5,856	5,856	20,677	5,856	5,856	5,856	23,424	
Total Ebitda	12,470	42,532	12,030	10,617	13,465	14,582	50,694	14,635	14,126	14,124	57,467	
Exploration	519	1,828	261	248	500	500	1,509	500	500	500	2,000	
Deprec., Deplet., & Amort.	3,545	11,897	3,155	3,136	3,136	3,136	12,563	3,136	3,136	3,136	12,544	
Other non cash	161	554	-	-	-	-	-	-	-	-	-	
Ebit	8,245	28,253	8,614	7,233	9,829	10,946	36,622	10,999	10,490	10,488	42,923	
Interest	336	1,259	78	74	74	74	300	74	74	74	296	
Ebt	7,909	26,994	8,536	7,159	9,755	10,872	36,322	10,925	10,416	10,414	42,627	
Income Tax	2,768	9,448	2,987	2,506	3,414	3,805	12,713	3,824	3,646	3,645	14,920	
Net Income (\$mm)												
Exploration and Production	2,578	9,664	2,955	2,745								
Other	3,036	9,436	2,797	2,290								
Unallocated	(473)	(1,554)	(204)	(382)								
Total	5,141	17,546	5,548	4,653	6,341	7,067	23,609	7,102	6,770	6,769	27,708	
Shares (millions)	3,360	3,374	3,363	3,372	3,372	3,372	3,370	3,372	3,372	3,372	3,372	
Per share (\$)	1.53	5.20	1.65	1.38	1.88	2.10	7.01	2.11	2.01	2.01	8.22	
Ebitda Margin (E&P)	61%	61%	57%	53%	52%	52%	53%	52%	52%	52%	52%	
Tax Rate	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%	

Refining Strength Welcome after Reserves Writedown

Now accounting for 45% of present value, downstream appears to be Shell's most valuable segment by our classification (see table [Functional Cash Flow and Present Value](#)). The timing of rising refining profits helps the stock to appreciate despite the controversy of management change and writing down reserves during the past two years. The historic transformation to one company and one chief executive further enhances the company's prospects to prosper in a new era.

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Royal Dutch Shell plc
Functional Cash Flow and Present Value

	<i>NTM Ebitda</i> <i>(US\$mm)</i>	<i>Adjusted</i> <i>R/P</i>	<i>PV/</i> <i>Ebitda</i>	<i>Present</i> <i>Value</i> <i>(US\$mm)</i>	
North American Natural Gas	3,190	4.8	3.4	11,000	4%
Rest of World Natural Gas	6,220	10.7	9.6	60,000	19%
Oil	24,640	5.5	4.1	102,000	33%
Downstream	23,420		6.0	140,000	45%
	57,470	7.2	5.4	313,000	100%
Debt (US\$mm)					30,000
Net Present Value (US\$mm)					283,000
Shares (mm)					3,372
Net Present Value (US\$/sh)					84

Buy Mega Cap Natural Gas and Oil Producers

Current stock prices for mega cap natural gas and oil producers approximate a median McDep Ratio of 0.83 (see table Rank by McDep Ratio). That is surprisingly competitive with 0.85 for thirty stocks including producer/refiners, independents and income stocks. A McDep Ratio of 1.0 presumes a 7% per year real return on constant real prices for oil of \$50 a barrel, natural gas of \$10 a million btu and a refining margin of \$10 a barrel.

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

	<i>Symbol/</i> <i>Rating</i>	<i>Price</i> <i>(\$/sh)</i> <i>4-Oct</i> <i>2005</i>	<i>Shares</i> <i>(mm)</i>	<i>Market</i> <i>Cap</i> <i>(\$mm)</i>	<i>Net</i> <i>Present</i> <i>Value</i> <i>(\$/sh)</i>	<i>Debt/</i> <i>Present</i> <i>Value</i>	<i>McDep</i> <i>Ratio</i>
Mega Cap							
BP plc	BP B	68.80	3,545	244,000	82.00	0.10	0.86
Total S.A.	TOT B	131.52	1,182	156,000	160.00	0.12	0.84
Exxon Mobil Corporation	XOM B	60.55	6,370	386,000	74.00	0.04	0.83
Royal Dutch Shell plc	RDS-A B	63.85	3,372	215,000	84.00	0.09	0.78
Chevron Corporation	CVX B	62.84	2,256	142,000	90.00	0.12	0.73
	<i>Total or Median</i>			<i>1,143,000</i>		<i>0.10</i>	<i>0.83</i>

Kurt H. Wulff, CFA

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