Rating: Buy
S&P 500: 1121

XTO Energy Inc.
High Performance, High Compensation

Symbol	XTO	*Ebitda Next Twelve Months ending 6/30/05 (US$mm)*	1,700
Rating	Buy	*North American Natural Gas/Ebitda (%)*	76
Price (US$/sh)	28.36	*Natural Gas and Oil Production/Ebitda (%)*	100
Pricing Date	9/7/04	*Adjusted Reserves/Production NTM*	11.9
Shares (mm)	271	*EV/Ebitda*	6.3
Market Capitalization (US$mm)	7,700	*PV/Ebitda*	7.8
Debt (US$mm)	2,800	*Undeveloped Reserves (%)*	22
Enterprise Value (EV) (US$mm)	10,400	*Natural Gas and Oil Ebitda (US$/boe)*	24.05
Present Value (PV) (US$mm)	13,000	*Present Value Proven Reserves(US$/boe)*	14.04
Net Present Value (US$/share)	38	*Present Value Proven Reserves(US$/mcfe)*	2.34
Debt/Present Value	0.21	*Earnings Next Twelve Months (US$/sh)*	2.30
McDep Ratio - EV/PV	0.80	*Price/Earnings Next Twelve Months*	12
Dividend Yield (%/year)	0.1	*Indicated Annual Dividend (US$/sh)*	0.04

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

We continue to recommend current purchase of the common shares of **XTO Energy (XTO)** for breakout valuation potential supported by recent breakthrough acquisitions subject to an advanced compensation policy. A ten-bagger performer, stock price up ten times or more in ten years, XTO has less than half the unlevered cash flow multiple of the most highly valued stock in our coverage. An advantageous billion dollar acquisition from a major oil company seller included a quarter of the Yates oil field as an example of the quality of properties purchased. Though management was defensive about its rich compensation, the rewards are just a fraction of that for the most highly compensated general partner in our coverage. While we illustrate a calculation of present value of $38 a share, our type of analysis has understated the company's appeal in the past.

A Contrary Time for Natural Gas

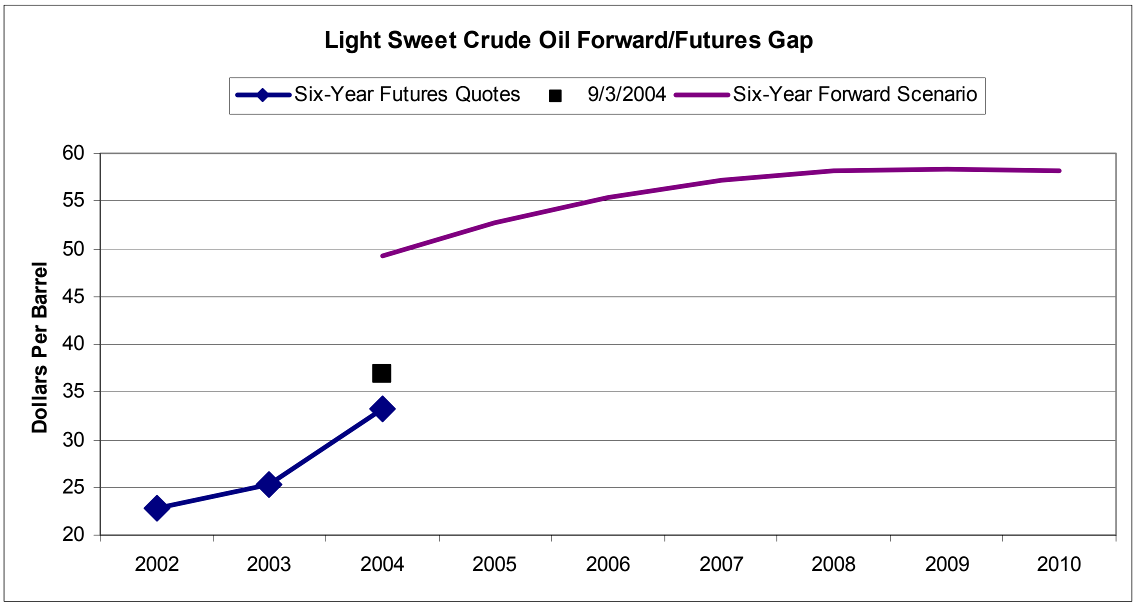
Concentrated 76% on North American natural gas, the value of the company depends on the outlook for the preferred fuel. The current spot price for natural gas just under $5 a million btus is at its low point for 2004. Indeed one-year futures for natural gas are trading at the 40-week average testing the recent positive momentum for most of the year. Yet six-year futures continue to trade well above the 40-week average. Moreover, we believe that six-year natural gas futures recently trading at 0.91 times six-year oil futures are likely to trade above six-year oil in the next few years.

Moderate Oil Price Scenario

The future price of natural gas depends in large part on the future price of crude oil. Publicly traded in the commodity markets, futures contracts for delivery over the next six years continue in a steep uptrend. Whether the trend will slow for awhile we cannot know. Our scenario is that a move that began in the low $20 and is now in the mid $30 could reach $50 (see chart Light Sweet Crude Oil Forward/Futures Gap).

To construct the scenario we assumed oil would peak in 2010 at $50 in constant dollars. That is more moderate than the peak in early 1981 at more than $80 in constant dollars. Then we applied 3% per year inflation and calculated six-year averages to build a forward curve.

Economics support the price trends. Oil demand is strong with world economic growth paced by developing countries, especially China. Supply growth is limited as spare capacity has virtually disappeared. The largest producing fields in the Middle East are now mature. It will take time, large amounts of capital and a secure political climate to boost producing rates.



Monetary factors favor oil investment as interest rates below inflation drive investors to real assets for protection against the dollar losing value. If similar past periods are any guide, the authorities may not raise interest rates above inflation for the rest of the decade.

Environmental factors favor higher oil and gas price. Coal is still a quarter of world primary energy supply. Cleaner oil and gas are undervalued as long as we tolerate environmentally disadvantageous coal.

Political factors favor higher oil price in consuming countries and producing countries. Consuming governments often resort to artificial forces to hold down oil price that can appear to work temporarily.

In producing countries we have seen time and again that oil production goes down when international oil companies are not welcome. After Iran, Iraq and Venezuela, now Saudi Arabia appears vulnerable to political change that may bring about production decline.

Too much of a gain in oil price might cause problems of economic adjustment though we think much of the concern expressed is exaggerated. Nonetheless we have a threshold of 60% gain in monthly price compared to a year earlier when we start to become concerned about weak demand for oil. October futures currently near $43 a barrel would have to remain above $52 for the 60% threshold to be breached.

One-Year Futures Point to Higher Cash Flow and Profits

As our next twelve months (NTM) cash flow model moves ahead to the period ending June 30, 2005 expectations also advance mainly because of advancing one-year futures. We relate natural gas and oil price to the quotes for commodities traded on the New York Mercantile Exchange (see table Next Twelve Months Operating and Financial Performance).

Investors who want calendar year estimates can find 2004 in the table. For 2005 we suggest using the next twelve months as a rough estimate. Estimates can change frequently along with oil markets.

Present Value at Real Price and Real Return

NTM estimates determine to a large extent the first year of projected cash flow that we discount to present value (see table Present Value of Oil and Gas Reserves). The calculation is set up on the basis of a barrel of proven reserves, 0.69 developed and 0.31 undeveloped.

While there are many assumptions that could be discussed, discount rate and oil price are especially important. Price escalation and discount rate interact. In this case we make the simplification of dealing in constant dollars. That assumes price escalation, cost escalation and discount rate are all net of inflation.

For discount rate we use a 7% real return per year on an unlevered basis. That means a buyer who pays present value would earn 7% per year above inflation if all the projections were to materialize as stated.

First year oil price is from the futures market. We hold it constant at an arbitrary level thereafter. The assumed price listed in the upper right hand corner is the commonly quoted benchmark Light, Sweet Crude. A price of $35 a barrel leads to present value of future cash flow from a barrel of reserves equal to $14.10 (see box in right hand column).

Present Value per Barrel Leads to Present Value per Share

We illustrate the calculation of Net Present Value (NPV) in a sensitivity table where each column is headed by a different oil price (see table Net Present Value Calculation). Oil price corresponds to present value per barrel which then leads step by step to the final result. The price of $35 a barrel corresponds to our standardized present value of $38 a share. Turn the comparison around and a stock price of $29, near the current quote, corresponds to a constant real oil price of $29 a barrel.

Incentive Program Changed

In a press release issued on Labor Day, management announced that it was discontinuing the form of compensation that caused most of the $69 million overhead expense in the second quarter. A revised program continues to aim at paying management 6-7% of the appreciation in market cap. Some investors will support that rationale. Management also paid multi-million dollar acquisition bonuses that attracted negative attention last quarter.

We like XTO's business and we like the strategy of acquiring and exploiting high quality properties. We don't mind paying compensation that is earned. While we do not endorse all the elements of XTO's program it does not bother us as much as instances where the compensation appears unjustified.

Kurt H. Wulff, CFA

XTO Energy Inc.
Next Twelve Months Operating and Financial Estimates

	Q1 *3/31/04*	*Q2* *6/30/04*	*Q3E* *9/30/04*	*Q4E* *12/31/04*	***Year*** ***2004E***	*Q1E* *3/31/05*	*Q2E* *6/30/05*	***Next Twelve Months*** ***6/30/05***
Volume								
Natural Gas (mmcfd)	771	803	870	920	**841**	920	920	**907**
Oil (mbd)	20	25	34	39	**30**	39	39	**38**
Total gas & oil (bcf)	81	87	99	106	**373**	105	105	**415**
Price								
Natural gas ($/mcf)								
Henry Hub ($/mmbtu)	5.64	6.10	5.36	5.44	**5.64**	6.51	5.92	**5.81**
Company ($/mcf)	4.79	5.00	4.39	4.46	**4.65**	5.33	5.33	**4.88**
Oil ($/bbl)								
WTI Cushing	35.23	38.34	43.25	43.86	**40.17**	42.83	41.63	**42.89**
Worldwide	29.65	32.70	36.88	37.41	**34.95**	36.53	36.63	**36.86**
Total gas & oil ($/mcf)	4.81	5.07	4.73	4.82	**4.90**	5.49	5.49	**5.18**
Revenue ($mm)								
Natural Gas	336	365	352	378	**1,431**	447	446	**1,622**
Oil	55	75	115	134	**379**	130	130	**509**
Other	4	5	5	5	**19**	5	5	**19**
Total	395	445	472	517	**1,829**	581	581	**2,151**
Expense								
Production	86	93	96	100	**375**	107	107	**410**
Overhead	14	69	30	30	**143**	30	30	**120**
Other (incl hedging)	47	(33)	(15)	(17)	**(18)**	(2)	(8)	**(42)**
Ebitda ($mm)	248	316	361	403	**1,329**	447	453	**1,663**
Exploration	1	2	2	2	**6**	2	2	**6**
Deprec., Deplet., & Amort.	82	93	109	117	**400**	117	116	**458**
Other non cash		48	21	24	**93**	12	41	**99**
Ebit	165	174	229	261	**829**	317	294	**1,100**
Interest	20	22	35	35	**112**	35	35	**140**
Ebt	145	152	194	226	**717**	282	259	**960**
Income Tax	51	53	68	79	**251**	99	91	**336**
Net Income ($mm)	94	99	126	147	**466**	183	168	**624**
Shares (millions)	236	247	271	271	**258**	271	271	**271**
Per share ($)	0.40	0.40	0.47	0.54	**1.81**	0.68	0.62	**2.30**
Ebitda Margin - O&G	74%	63%	73%	75%	**71%**	76%	76%	**75%**
Tax Rate	35%	35%	35%	35%	**35%**	35%	35%	**35%**

XTO Energy Inc.
Present Value of Oil and Gas Reserves

Volume Decline (%/yr):	8
Volume Enhancement (%/yr):	5
Variable Cost (%):	18
Capex/Cash Flow (%):	10
Nymex Oil Price Post 2005 ($/bbl)	35
Price/Nymex Post 2005 (%):	88
Real Discount Rate (%/yr):	7.0

Year	Basic (bbl)	Volume Enhanced (bbl)	Total (bbl)	Price ($/bbl)	Revenue ($)	Fixed Cost ($)	Var. Cost ($)	Cash Flow ($)	Cap Ex ($)	Free CF ($)	Disc Factor	Present Value ($)
Total 2005 through 2024; years ending on 6/30												
	0.780	0.221	1.000	33.93	33.94	3.18	6.11	24.65	1.14	23.51	0.60	14.10
2005	0.075	0.000	0.075	31.03	2.32	0.16	0.42	1.74	0.17	1.57	0.97	1.52
2006	0.069	0.004	0.073	30.80	2.24	0.16	0.40	1.68	0.17	1.51	0.90	1.36
2007	0.064	0.007	0.071	31.27	2.21	0.16	0.40	1.65	0.17	1.49	0.84	1.26
2008	0.059	0.010	0.069	31.74	2.18	0.16	0.39	1.63	0.16	1.47	0.79	1.16
2009	0.054	0.012	0.067	32.20	2.15	0.16	0.39	1.61	0.16	1.45	0.74	1.07
2010	0.050	0.015	0.065	32.67	2.12	0.16	0.38	1.58	0.16	1.42	0.69	0.98
2011	0.046	0.017	0.063	33.14	2.09	0.16	0.38	1.56	0.16	1.40	0.64	0.90
2012	0.043	0.019	0.061	33.61	2.06	0.16	0.37	1.53	0.00	1.53	0.60	0.92
2013	0.040	0.017	0.057	34.08	1.93	0.16	0.35	1.43	0.00	1.43	0.56	0.80
2014	0.037	0.016	0.052	34.55	1.81	0.16	0.33	1.33	0.00	1.33	0.53	0.70
2015	0.034	0.015	0.048	35.01	1.70	0.16	0.31	1.23	0.00	1.23	0.49	0.61
2016	0.031	0.013	0.045	35.48	1.59	0.16	0.29	1.14	0.00	1.14	0.46	0.53
2017	0.029	0.012	0.041	35.95	1.49	0.16	0.27	1.06	0.00	1.06	0.43	0.45
2018	0.027	0.012	0.038	36.42	1.39	0.16	0.25	0.98	0.00	0.98	0.40	0.39
2019	0.025	0.011	0.035	36.89	1.30	0.16	0.23	0.91	0.00	0.91	0.37	0.34
2020	0.023	0.010	0.033	37.35	1.22	0.16	0.22	0.84	0.00	0.84	0.35	0.29
2021	0.021	0.009	0.030	37.82	1.14	0.16	0.21	0.78	0.00	0.78	0.33	0.25
2022	0.019	0.008	0.028	38.29	1.07	0.16	0.19	0.71	0.00	0.71	0.31	0.22
2023	0.018	0.008	0.026	38.76	1.00	0.16	0.18	0.66	0.00	0.66	0.29	0.19
2024	0.017	0.007	0.024	39.23	0.93	0.16	0.17	0.60	0.00	0.60	0.27	0.16

XTO Energy Inc.
Net Present Value Calculation

Constant Oil Price ($/bbl):	29	35	40	50
Present Value per Barrel ($):	11.50	14.10	16.10	20.10
Oil and Gas reserves (million barrels equivalent):	926	926	926	926
Present Value of Oil and Gas Reserves ($mm):	10,600	13,050	14,900	18,600
Total	10,600	13,050	14,900	18,600
Debt ($mm):	2,800	2,800	2,800	2,800
Present Value of Equity ($mm):	7,800	10,250	12,100	15,800
Shares (mm):	271	271	271	271
Net Present Value ($/sh):	29	38	45	58

Disclaimer: This analysis was prepared by Kurt Wulff doing business as McDep Associates. The firm used sources and data believed to be reliable, but makes no representation as to their accuracy or completeness. This analysis is intended for informational purposes and is not a solicitation to buy or sell a security. Past performance is no guarantee of future results.

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