

Rating: Buy
S&P 500: 1182

XTO Energy Inc.

Twenty Per Cent per Year per Share

<i>Symbol</i>	XTO	<i>Ebitda Next Twelve Months ending 12/31/05 (US\$mm)</i>	2,090
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	78
<i>Price (US\$/sh)</i>	35.96	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	11/24/04	<i>Adjusted Reserves/Production NTM</i>	11.7
<i>Shares (mm)</i>	272	<i>EV/Ebitda</i>	5.8
<i>Market Capitalization (US\$mm)</i>	9,800	<i>PV/Ebitda</i>	6.1
<i>Debt (US\$mm)</i>	2,400	<i>Undeveloped Reserves (%)</i>	22
<i>Enterprise Value (EV) (US\$mm)</i>	12,200	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	29.64
<i>Present Value (PV) (US\$mm)</i>	12,700	<i>Present Value Proven Reserves(US\$/boe)</i>	13.72
<i>Net Present Value (US\$/share)</i>	38	<i>Present Value Proven Reserves(US\$/mcfe)</i>	2.29
<i>Debt/Present Value</i>	0.19	<i>Earnings Next Twelve Months (US\$/sh)</i>	3.23
<i>McDep Ratio - EV/PV</i>	0.96	<i>Price/Earnings Next Twelve Months</i>	11
<i>Dividend Yield (%/year)</i>	0.6	<i>Indicated Annual Dividend (US\$/sh)</i>	0.20

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 its concentration on North American natural gas and a remarkable growth record developing the premium fuel resource. Though the stock is approaching net present value of \$38 a share, that estimate assumes a constant real oil price of \$35 a barrel when the average futures price for the next six years is \$41 a barrel. Moreover among energy stocks, the company has a practically unmatched record of growth in reserves per share of more than 20% per year for the past ten years. XTO's stock price could double and the cash flow multiple, EV/Ebitda, at 10.5 times would still be low for the growth record.

Growth Offers Valuation Upside

Our estimate of present value appears to validate the growth that XTO has achieved to date, but it gives no credit for future performance beyond earning a normal return. We further validate the growth by stating it in real terms --- physical units of natural gas reserves per share. The results are similar in terms of annual production per share thereby ruling out changes in reserve life or reserve statement as an artificial explanation for growth. A modest ratio of debt today rules out debt as the major explanation for growth. Price increases turn a real growth rate into an even higher nominal growth rate.

What is 20% per year growth worth? A popular downstream energy income partnership is sometimes marketed at 6% distribution yield plus 8% per year growth for a prospective total return of 14% per year. On that basis XTO's 0.6% dividend yield plus 20% per year growth offers a prospective total return of 21% per year. The popular partnership is valued by investors at a cash flow multiple of some 15 times. Should XTO's prospective return be worth 20 times cash flow? In fact, XTO's EV/Ebitda multiple is less than 6!

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Concentrated on Longer-Life North American Natural Gas

Meanwhile, we go back to our less exciting, normal valuation analysis. The company's natural gas representation dominates resource value (see table Functional Cash Flow and Present Value). The overall adjusted reserve life of 11.7 years exceeds the median of 10.6 years for peer companies. Undeveloped reserves account for a modest 22% of the total. The estimates have been adjusted approximately for two large acquisitions completed since the year-end 2003 reserve report.

XTO Energy Inc.					
Functional Cash Flow and Present Value					
	<i>NTM Ebitda</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Present</i>	
	<u>(US\$mm)</u>	<u>R/P</u>	<u>Ebitda</u>	<u>Value</u>	
				<u>(US\$mm)</u>	
North American Natural Gas	1,640	11.6	6.0	9,900	78%
Oil	450	12.1	6.2	2,800	22%
	2,090	11.7	6.1	12,700	100%
Debt (US\$mm)				2,400	
Net Present Value (US\$mm)				10,300	
Shares (mm)				272	
Net Present Value (US\$/sh)				38	

XTO derives about 40% of current production from its Freestone Trend in East Texas. Practically all of the 400 million cubic feet of daily volume has been developed in the 2000s. Some 500 wells have been drilled and there may be 1000 more locations. Magic words denoting other areas where the company has been successful and has additional promise include San Juan, Raton, Arkoma and Permian.

Commodity Price Points to Further Gains

Natural gas and oil futures prices drive further gains in cash flow in our model (see table Next Twelve Months Operating and Financial Estimates). We hold volume constant in our projection after the current quarter that includes full contribution from latest acquisitions.

The complications of the cash flow model include incentive compensation and hedging. The cash flow we calculate for valuation purposes excludes hedging and unusual compensation. The hedging exposure appears well-defined. For management compensation our provision for overhead includes perhaps \$10-15 million per quarter of some form of unspecified deduction.

Projected cash flow becomes the base against which we apply a multiple to test the continuing validity of our estimate of present value. That multiple is low at 6.1 times. The level seems readily justifiable considering the adjusted reserve life index of 11.7 times. In the current correlation of present value with reserve life for 28 stocks, the company's multiple could be considered in line at 0.2 times under the level implied by the correlation.

Perhaps our estimated present value should be reduced by a few dollars a share to reflect future incentive compensation at some 7% of incremental value created. While the amount is quite

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rewarding to the recipients and is generous by exploration company standards it is not large enough to cause valuation concern. To the contrary, we might instead contemplate how continued performance along the lines of past results might magnify the values we identify.

XTO Energy Inc.										
Next Twelve Months Operating and Financial Estimates										
	<i>Q1</i>	<i>Q2</i>	<i>Q3</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Next Twelve Months</i>
	<i>3/31/04</i>	<i>6/30/04</i>	<i>9/30/04</i>	<i>12/31/04</i>	<i>2004E</i>	<i>3/31/05</i>	<i>6/30/05</i>	<i>9/30/05</i>	<i>12/31/05</i>	<i>12/31/05</i>
Volume										
Natural Gas (mmcf)	771	803	847	920	836	920	920	920	920	920
Oil (mbd)	20	25	33	39	29	39	39	39	39	39
Total gas & oil (bcf)	81	87	96	106	370	105	105	106	106	422
Price										
Natural gas (\$/mcf)										
Henry Hub (\$/mmbtu)	5.64	6.10	5.75	6.75	6.06	7.56	6.62	6.64	6.94	6.94
Company (\$/mcf)	5.12	5.52	5.44	6.07	5.65	7.15	5.96	5.98	6.25	6.33
Oil (\$/bbl)										
WTI Cushing	35.23	38.34	43.89	49.90	41.84	48.68	47.68	46.26	45.01	46.91
Worldwide	29.65	32.70	38.58	43.45	37.43	42.39	41.96	40.71	39.61	41.16
Total gas & oil (\$/mcf)	5.10	5.51	5.63	6.55	5.75	7.13	6.17	6.14	6.32	6.44
Revenue (\$mm)										
Natural Gas	359	403	424	540	1,726	598	499	506	529	2,132
Oil	55	75	117	156	403	150	149	146	142	588
Total	414	478	541	696	2,129	749	648	652	671	2,720
Expense										
Production	86	93	111	127	417	132	123	123	125	502
Overhead	14	17	33	33	96	33	33	33	33	131
Ebitda (\$mm)	314	368	398	536	1,616	584	492	496	513	2,086
Exploration	1	2	3	3	8	3	3	3	3	12
Deprec., Deplet., & Amort.	82	93	107	120	402	119	119	120	120	477
Hedging and other	66	100	36	90	291	49	27	27	32	135
Ebit	165	174	252	324	914	414	344	347	358	1,462
Interest	20	22	23	28	93	28	28	28	28	112
Ebt	145	152	229	296	821	386	316	319	330	1,350
Income Tax	51	53	88	103	295	135	110	112	115	473
Net Income (\$mm)	94	99	141	192	526	251	205	207	214	878
Shares (millions)	236	247	261	261	253	261	261	285	285	272
Per share (\$)	0.40	0.40	0.54	0.74	2.08	0.96	0.79	0.73	0.75	3.23
Ebitda Margin - O&G	76%	77%	73%	77%	76%	78%	76%	76%	77%	77%
Tax Rate	35%	35%	38%	35%	36%	35%	35%	35%	35%	35%

Investors' greatest concern may be the sustainability of the current level of oil price. Energy consumers and energy investors should, in our opinion, take recent oil price action as a sign of a long term change to higher price. Recent softening of oil price is welcome relief for the economy while we adjust to the price increases that have occurred and prepare for those that may occur in the future.

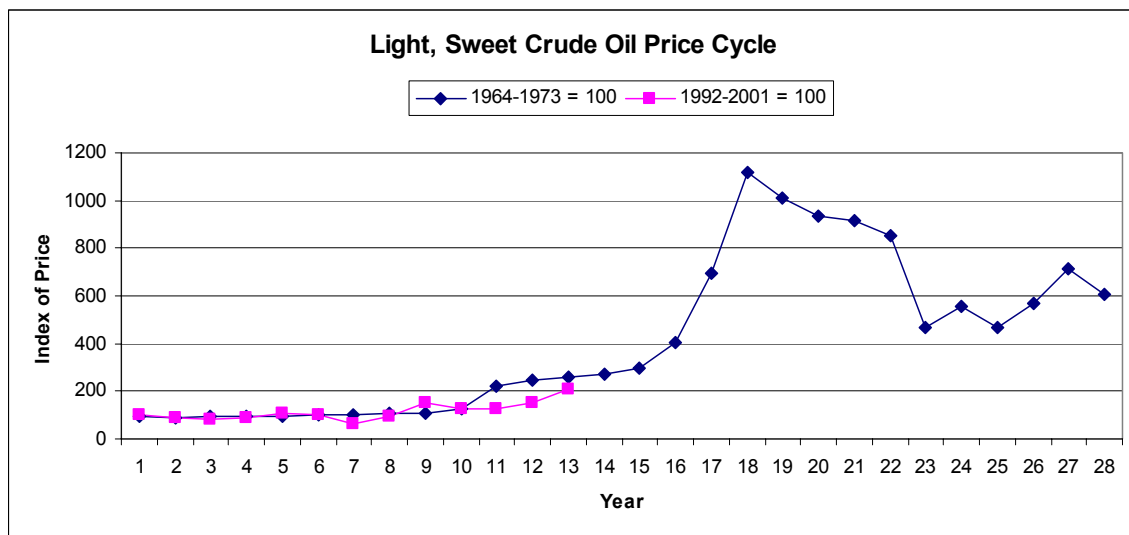
Oil Price Move Possibly Just Starting

To offset any inclination to underestimate further potential for oil and gas price, we compare the relatively stable price period from 1992 to 2001 to the period from 1964 to 1973. Each was a ten year period that immediately preceded a sharply lower stock market in 2002 and in 1974. After quiescence, oil price started moving up in each case. We may be in the early stages of a new historic move (see chart [Light, Sweet Crude Oil Price Cycle](#)).

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Frankly, few investors would give much weight to the likelihood of continued oil price strength. Contrast that with the growing chorus for a weaker dollar. It may just be that oil price is not high, but the real value of the dollar is low. That, too, is a parallel to historical experience.

Let us imagine how the cycle might unfold. By the way we chose to draw the chart Year 13 corresponds to 1976 and 2004. Once the move got going in the previous cycle, the annual average oil price did not decline until Year 19 (1982). The annual peak of 1100, or 11 times the first ten year average, was too high to be sustained. It might be less disruptive economically if the peak ahead of us were lower and the decline shallower. The end point in Year 28 at 600 implies a tripling over the next 15 years. If higher oil price unfolded gradually it would give everyone time to adjust.



Kurt H. Wulff, CFA

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