

Rating: Buy  
S&P 500: 1272

## ConocoPhillips Longest Life Mega Cap

<i>Symbol</i>	COP	<i>Ebitda Next Twelve Months ending 3/31/07 (US\$mm)</i>	34,500
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	12
<i>Price (US\$/sh)</i>	59.14	<i>Natural Gas and Oil Production/Ebitda (%)</i>	70
<i>Pricing Date</i>	3/9/06	<i>Adjusted Reserves/Production NTM</i>	12.1
<i>Shares (mm)</i>	1693	<i>EV/Ebitda</i>	4.2
<i>Market Capitalization (US\$mm)</i>	100,100	<i>PV/Ebitda</i>	6.0
<i>Debt (US\$mm)</i>	46,000	<i>Undeveloped Reserves (%)</i>	28
<i>Enterprise Value (EV) (US\$mm)</i>	146,000	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	29.20
<i>Present Value (PV) (US\$mm)</i>	206,700	<i>Present Value Proven Reserves(US\$/boe)</i>	12.45
<i>Net Present Value (US\$/share)</i>	95	<i>Present Value Proven Reserves(US\$/mcf)</i>	2.08
<i>Debt/Present Value</i>	0.22	<i>Earnings Next Twelve Months (US\$/sh)</i>	9.65
<i>McDep Ratio - EV/PV</i>	0.71	<i>Price/Earnings Next Twelve Months</i>	6
<i>Dividend Yield (%/year)</i>	2.4	<i>Indicated Annual Dividend (US\$/sh)</i>	1.44

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 **ConocoPhillips (COP)** lengthens its adjusted reserve life to 12.1 years from 10.9 after we interpret latest annual disclosures. More reserves add support to our estimate of net present value that remains at \$95 a share. That value is about half in oil production and a quarter each in natural gas and downstream. The stock also has upside considering our vision of a price for light, sweet crude oil of \$150 a barrel in 2010. Six-year oil futures currently trade at \$65 a barrel. Our estimate of present value presumes \$50 oil. Stock price at a McDep Ratio of 0.71 implies the stock may be priced for crude oil as low as \$35 a barrel. A momentous event occurs at month end when the acquisition of **Burlington Resources (BR)** is expected to be final.

### Reserves Point to Future Production

In past presentations management outlined more than 3% per year volume growth in addition to the volumes added with the Lukoil equity investment and BR acquisition. Contributions from Russia boosted last year's reserves and we added the BR quantities to the amounts reported (see table Production and Reserves, 2005).

Not all barrels are the same. Large Alaskan oil reserves are valuable, but Alaskan natural gas awaits a pipeline before value can be realized. Most reserves are concentrated in safer areas politically. In contrast we do not credit much value to the eight percent of company reserves in Venezuela considering the state of politics there.

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**ConocoPhillips**  
**Production and Reserves, 2005**

	<u>12/31/2005 Proven Reserves</u>					<u>Weighted</u> <u>Life Index</u> <u>(years)</u>	<u>2006</u> <u>Adjusted</u> <u>R/P</u> <u>(years)</u>
	<u>2005 Production</u> <u>(daily)</u>	<u>Developed</u> <u>(annual)</u> <u>(bcf or mmb)</u>	<u>Undeveloped</u> <u>(bcf or mmb)</u>	<u>Weighted</u> <u>(bcf or mmb)</u>			
North American Natural Gas							
Alaska	169	62	3,316	156	3,394	55.0	
Lower 48	2,181	796	7,718	1,671	8,554	10.7	
Canada	1,227	448	2,874	635	3,192	7.1	
Total	3,577	1,306	13,908	2,462	15,139	11.6	11.6
Rest of World Natural Gas							
European North Sea	1,023	373	2,312	750	2,687	7.2	
Asia Pacific	350	128	2,279	1,421	2,990	23.4	
Middle East and Africa	84	31	730	331	896	29.2	
Russia and other	67	24	581	1,813	1,488	60.8	
Venezuela	7	3	155	133	222	86.7	
Burlington Resources Int'l	151	55	398	296	546	9.9	
Total	1,682	614	6,456	4,743	8,828	14.4	14.5
Oil							
Alaska	315	115	1,505	146	1,578	13.7	
Lower 48	175	64	657	138	726	11.3	
Canada	60	22	123	19	133	6.0	
European North Sea	271	99	440	418	649	6.6	
Asia Pacific	118	43	266	79	306	7.1	
Middle East and Africa	58	21	328	3	330	15.7	
Russia	249	91	1,013	556	1,291	14.2	
Venezuela	107	39	472	617	781	20.0	
Syncrude	21	8	153		153	20.0	
Burlington Resources	38	14	42	30	57	4.1	
Total Oil Equivalent	1,413	516	4,999	2,006	6,002	11.6	11.9
Total Oil Equivalent	2,289	836	8,393	3,207	9,997	12.0	12.1

Our regular distinction between North American Natural Gas and Rest of World reflects the different pricing conditions in the two geographic areas. In the U.S and Canada natural gas is priced primarily on a monthly index basis that is almost completely short-term market sensitive. In the rest of the world natural gas is priced primarily on indices that respond more slowly to changing market conditions. The likelihood that rest of the world natural gas will catch up to oil price is one the great energy investment opportunities.

Oil is priced similarly around the world. We take account of differences in taxation by normalizing cash flow.

**Adjusted Reserves/Production Increases to 12.1 from 10.9 Years**

Normally we summarize a company's reserve position in adjusted life index. The longer the life the higher our estimated present value, or the market's assessment of enterprise value, can be as a multiple of next twelve months cash flow (see table Functional Cash Flow and Present Value).

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**ConocoPhillips**  
**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	4,260	11.6	8.0	34,000	16%
Rest of World Natural Gas	2,430	14.5	8.2	20,000	10%
Oil	17,450	11.9	5.6	97,000	47%
Downstream	10,400		5.4	56,000	27%
	34,540	12.1	6.0	207,000	100%
Debt (US\$mm)				46,000	
Net Present Value (US\$mm)				161,000	
Shares (mm)				1,693	
Net Present Value - Standard Estimate (US\$/sh)				95	
Net Present Value - Approximation by Correlation (US\$/sh)				108	

ConocoPhillips' index increases by a year from that in our most recent published analysis in January. Some of the increase is our own doing as we restore arbitrary reductions we made previously when reported reserves exceeded 20 years in some geographic segments. The changes do not prompt a revision to present value, but contribute to a cushion between our official estimate and the approximation by correlation with 30 companies. For reasons explained above, Alaskan natural gas and Venezuelan oil have less value than the correlation would indicate.

Forward estimates complete the summary detail for valuing ConocoPhillips (see table [Next Twelve Months Operating and Financial Estimates](#)). Futures prices drive the estimates of production cash flow and earnings. There are no widely quoted futures that seem appropriate to drive estimates for downstream operations.

**Futures Favor Oil**

Not only does there appear to be a wide gap between the price of oil reflected in ConocoPhillips' stock price and the quote for six-year oil futures, but also the trend in oil price continues to look favorable. The current quote trades above the 40-week average as it has for several years (see chart [Six-Year Commodity Price Meter](#)).

The futures market does not think as highly of natural gas as we believe is justified. During the past several years six-year and one-year natural gas has traded between about oil divided by 5 and oil divided by 8. Natural gas and refined oil deliver the same heating value when the natural gas price is the oil price divided by 5. We believe that 5 is the long-term norm. Yet six-year natural gas is priced currently at oil divided by 8, the low end of the range. The current situation appears to offer temporary relief for consumers while an adjustment to higher long term price is underway.

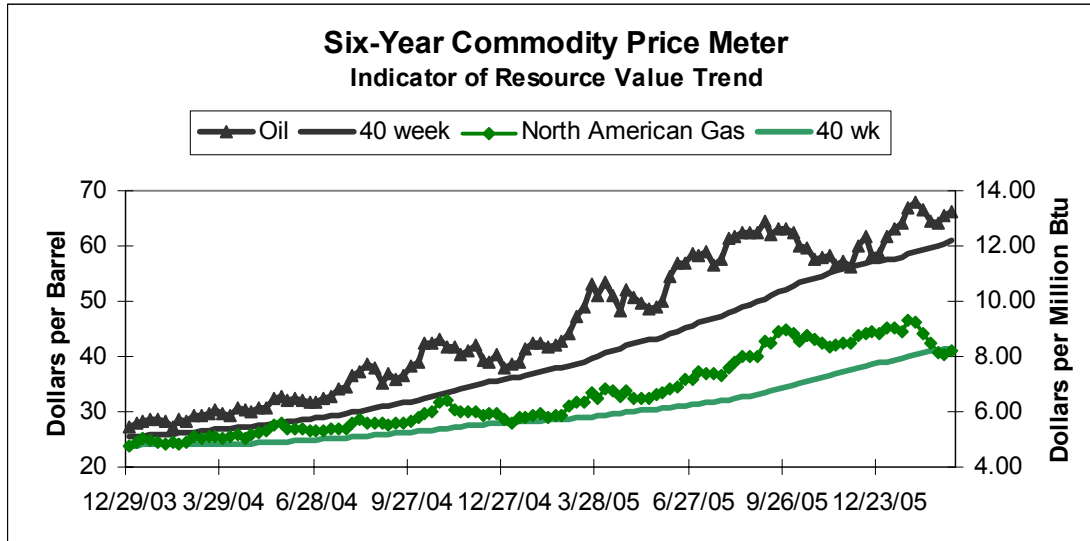
A skeptic might question the timing of the BR acquisition pointing to the decline in near month natural gas price to less than \$7 a million btu today from near \$15 in mid-December when the deal was announced. Yet six-year natural gas is between \$8 and \$9 today just as it was when COP priced BR.

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**ConocoPhillips**  
**Next Twelve Months Operating and Financial Estimates**

	<i>Q4</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Next Twelve Months</i>
	<i>12/31/05</i>	<i>2005</i>	<i>3/31/06</i>	<i>6/30/06</i>	<i>9/30/06</i>	<i>12/31/06</i>	<i>2006E</i>	<i>3/31/07</i>	<i>3/31/07</i>
<b>Volume</b>									
Natural Gas (mmcf)									
U.S. (or North America)	1,866	<b>1,806</b>	3,589	3,589	3,589	3,589	<b>3,589</b>	3,589	<b>3,589</b>
Overseas (or Int'l)	1,605	<b>1,464</b>	1,713	1,713	1,473	1,789	<b>1,672</b>	1,713	<b>1,672</b>
Total	3,471	<b>3,270</b>	5,302	5,302	5,062	5,378	<b>5,261</b>	5,302	<b>5,261</b>
Oil (mbd)	1,305	<b>1,263</b>	1,386	1,386	1,386	1,386	<b>1,386</b>	1,386	<b>1,386</b>
Total gas & oil (mbd)	1,884	<b>1,808</b>	2,270	2,270	2,230	2,282	<b>2,263</b>	2,270	<b>2,263</b>
<b>Price</b>									
Natural gas (\$/mcf)									
Henry Hub (\$/mmbtu)	13.00	<b>8.65</b>	8.97	6.80	7.33	8.69	<b>7.95</b>	10.35	<b>8.29</b>
U.S. (or North America)	9.33	<b>7.13</b>	5.95	4.51	4.86	5.76	<b>5.27</b>	5.50	<b>5.16</b>
Overseas (or Int'l)	6.33	<b>5.26</b>	6.33	6.33	6.33	6.33	<b>6.33</b>	6.33	<b>6.33</b>
Total	7.94	<b>6.29</b>	6.07	5.09	5.28	5.95	<b>5.60</b>	5.76	<b>5.53</b>
Oil (\$/bbl)									
WTI Cushing	60.02	<b>56.31</b>	62.47	62.10	64.59	65.63	<b>63.70</b>	66.14	<b>64.62</b>
Worldwide	52.02	<b>48.80</b>	53.15	52.84	54.95	55.84	<b>54.20</b>	55.27	<b>55.33</b>
Total gas & oil (\$/mcf)	8.45	<b>7.58</b>	7.77	7.36	7.69	7.99	<b>7.70</b>	7.87	<b>7.73</b>
NY Harbor 3-2-1 (\$/bbl)	9.06	<b>10.63</b>	4.93	8.56	9.01	8.18	<b>7.67</b>	8.93	<b>8.67</b>
<b>Revenue (\$mm)</b>									
Natural Gas									
U.S. (or North America)	1,602	<b>4,700</b>	1,922	1,472	1,604	1,902	<b>6,899</b>	1,776	<b>6,753</b>
Overseas (or Int'l)	934	<b>2,808</b>	975	986	857	1,041	<b>3,859</b>	975	<b>3,859</b>
Total	2,535	<b>7,508</b>	2,897	2,458	2,461	2,943	<b>10,758</b>	2,751	<b>10,612</b>
Oil	6,246	<b>22,498</b>	6,630	6,664	7,007	7,120	<b>27,421</b>	6,895	<b>27,685</b>
Other	43,392	<b>153,357</b>	43,392	43,392	43,392	43,392	<b>173,567</b>	43,392	<b>173,567</b>
Total	52,173	<b>183,364</b>	52,919	52,514	52,859	53,455	<b>211,746</b>	53,037	<b>211,865</b>
<b>Expense</b>									
Fixed	883	<b>3,986</b>	1,050	1,050	1,050	1,050	<b>4,200</b>	1,050	<b>4,200</b>
Variable	2,648	<b>9,095</b>	2,477	2,372	2,462	2,616	<b>9,927</b>	2,508	<b>9,957</b>
Other	41,292	<b>144,257</b>	40,792	40,792	40,792	40,792	<b>163,167</b>	40,792	<b>163,167</b>
<b>Ebitda (\$mm)</b>									
Exploration and Production	5,251	<b>16,925</b>	6,000	5,700	5,956	6,397	<b>24,053</b>	6,087	<b>24,140</b>
Other	2,100	<b>9,100</b>	2,600	2,600	2,600	2,600	<b>10,400</b>	2,600	<b>10,400</b>
Total Ebitda	7,351	<b>26,025</b>	8,600	8,300	8,556	8,997	<b>34,453</b>	8,687	<b>34,540</b>
Exploration	229	<b>661</b>	240	240	240	240	<b>960</b>	240	<b>960</b>
Deprec., Deplet., & Amort.	1,178	<b>4,253</b>	1,539	1,539	1,539	1,539	<b>6,156</b>	1,539	<b>6,156</b>
Other non cash	11	<b>(380)</b>	150	150	150	150	<b>600</b>	150	<b>600</b>
<b>Ebit</b>	5,933	<b>21,491</b>	6,671	6,371	6,627	7,068	<b>26,737</b>	6,758	<b>26,824</b>
Interest	110	<b>497</b>	422	422	422	422	<b>1,688</b>	422	<b>1,688</b>
<b>Ebt</b>	5,823	<b>20,994</b>	6,249	5,949	6,205	6,646	<b>25,049</b>	6,336	<b>25,136</b>
Income Tax	2,038	<b>7,348</b>	2,187	2,082	2,172	2,326	<b>8,767</b>	2,218	<b>8,798</b>
<b>Net Income (\$mm)</b>									
Exploration and Production	2,619	<b>9,091</b>					-		
Other	1,313	<b>5,327</b>					-		
Unallocated	(147)	<b>(772)</b>					-		
Total	3,785	<b>13,646</b>	4,062	3,867	4,033	4,320	<b>16,282</b>	4,119	<b>16,339</b>
<b>Shares (millions)</b>	1,407	<b>1,416</b>	1,693	1,693	1,693	1,693	<b>1,693</b>	1,693	<b>1,693</b>
Per share (\$)	2.69	<b>9.64</b>	2.40	2.28	2.38	2.55	<b>9.62</b>	2.43	<b>9.65</b>
Ebitda Margin (E&P)	60%	<b>56%</b>	63%	62%	63%	64%	<b>63%</b>	63%	<b>63%</b>
Tax Rate	35%	<b>35%</b>	35%	35%	35%	35%	<b>35%</b>	35%	<b>35%</b>

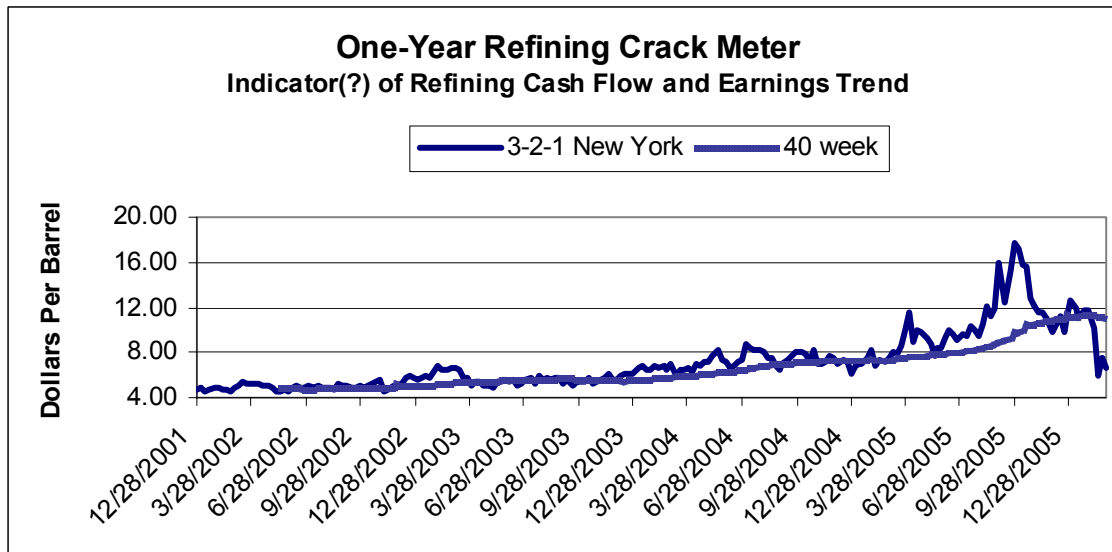
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**Futures Confused on Refining**

Futures investors have even more difficulty anticipating refining margin, or crack, the difference between the prices of heating oil and gasoline compared to crude oil. There are no publicly quoted six-year futures for refining crack and the one-year data is sketchy. Further, the crack widely quoted applies primarily to simpler refineries that run light, sweet crude while most refining investment is geared to the more intensive processing of heavy, sour crude.

In the absence of an obvious commodity market quote, we rely on our judgment as to the outlook for refining and downstream operations. The main consideration is that the trend to cleaner fuel that favors natural gas also favors more intensive refining. Not only must refined products be cleaner, they must also be derived increasingly from heavy oil. The world capacity to produce light oil apparently peaked in 2004 when Saudi Arabia reached its limits.



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