



# Meter Reader

A Weekly Analysis of Large Cap Oil and Gas Stocks  
November 30, 2010

## Free Money Enhances Energy Outlook for 2011

### Summary and Recommendation

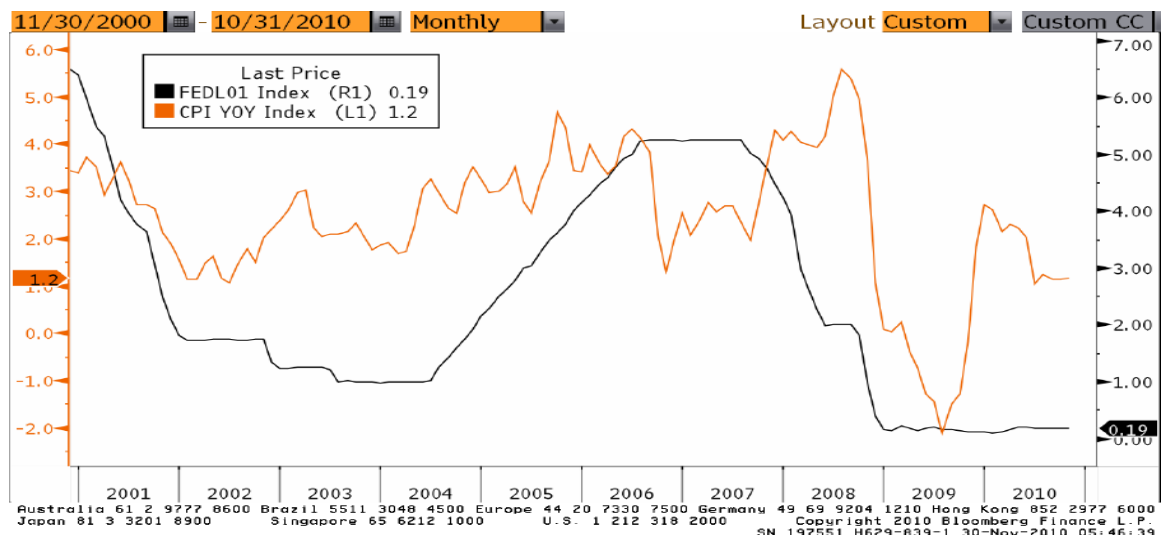
The outlook for energy stocks in 2011 appears promising considering U.S. Federal Reserve efforts to keep interest rates low to encourage inflation and promote economic growth. Fundamentally, rising oil demand is close to supply limits. The opposite appears to be the case for natural gas where abundant supply may attract a bigger share of global energy. Six-year futures are holding above \$5 a million btu ahead of a potential advance in 2011. A leading stock in 2010 such as **ConocoPhillips (COP)** in the U.S. Integrated group has further potential. Some lagging stocks in 2010 might be winners in 2011 such as **Total (TOT)** in the European and **Canadian Oil Sands Trust (COSWF)** in the Canadian group.

### Oil and Gas Stocks Respond to Free Money

In the past oil and gas stocks have responded positively to free money, which occurs when the rate of interest is below the rate of inflation. Most recently the stocks advanced strongly to a peak in 2008 following free money in 2002-2006. We expect a positive response in 2011 to the restoration of free money in 2010 (see chart below).

#### Interest Rate below Inflation

Consumer Price Index (%/year)(left scale), U.S Federal Funds (%/year) (right scale),



While weak economic growth prompts free money in the U.S., strong economic growth in China and emerging markets has contributed to higher inflation. We are optimistic China can counter those pressures with the lifting of price controls on oil and gas and allowing its currency to



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appreciate. Chinese energy demand would likely remain strong as lifting local price limits would be offset by a lower price for imports in Chinese currency terms.

## **Oil Demand Stronger than Supply**

People love the freedom of personal transportation everywhere in the world. Transportation is booming in less developed economies and oil has little competition as a fuel for mobility. Supply limits were reached in 2008 and little new capacity has been added. High taxes, price controls and environmental overreaction further tend to restrict supply growth. Nearly all new sources of oil supply are expensive. We judge the base case price outlook as moderate appreciation with the likelihood of sharper increases greater than the likelihood of decline.

## **Natural Gas Supply Gift**

The biggest surprise in the global energy picture is the booming production of natural gas with the success of horizontal drilling with multi-stage fracturing, especially in shale formations. Despite a low price at one-third the heating equivalent of oil, natural gas volume reached a record 75 billion cubic feet daily (bcfd) in September 2010, reported on November 29. Natural gas has about a 25% share of total U.S. primary energy production of about 300 bcfd equivalent. Considering that oil is limited by supply, coal is environmentally less desirable and that alternative fuels need increasingly unaffordable government subsidies, natural gas looks like a long-term winner for investors and the economy. The average of futures prices for the next six-years for natural gas may have found a floor above \$5 a million btu (see charts [Six-Year Commodity Price Meter](#) on page 3 and [Six-Year and One-Year Natural Gas and Oil Futures](#) on page 9).

## **Income and Small Cap Show the Way**

After recovering in 2009, stock returns have been mostly less than 10% in 2010 for large cap oil and gas recommendations. Income and Small Caps have been more exciting as we cover in a separate weekly publication. In a free money environment, income and small cap can show the way to appreciation for large cap. Large caps have the financial strength to take advantage of free money to buy small caps or to do partial purchases through joint ventures. At the same time appreciation in purer play small caps highlights resource values also present in large caps. In short, higher McDep Ratios for small caps may point the way to higher McDep Ratios for large caps.

## **Invest at Home and Abroad**

European stocks may be better performers in 2011 from their current position as the group with the lowest median McDep Ratio after lagging in 2010. Much of the deviation in performance appears to reflect currency fluctuations which appear to be surprisingly volatile and



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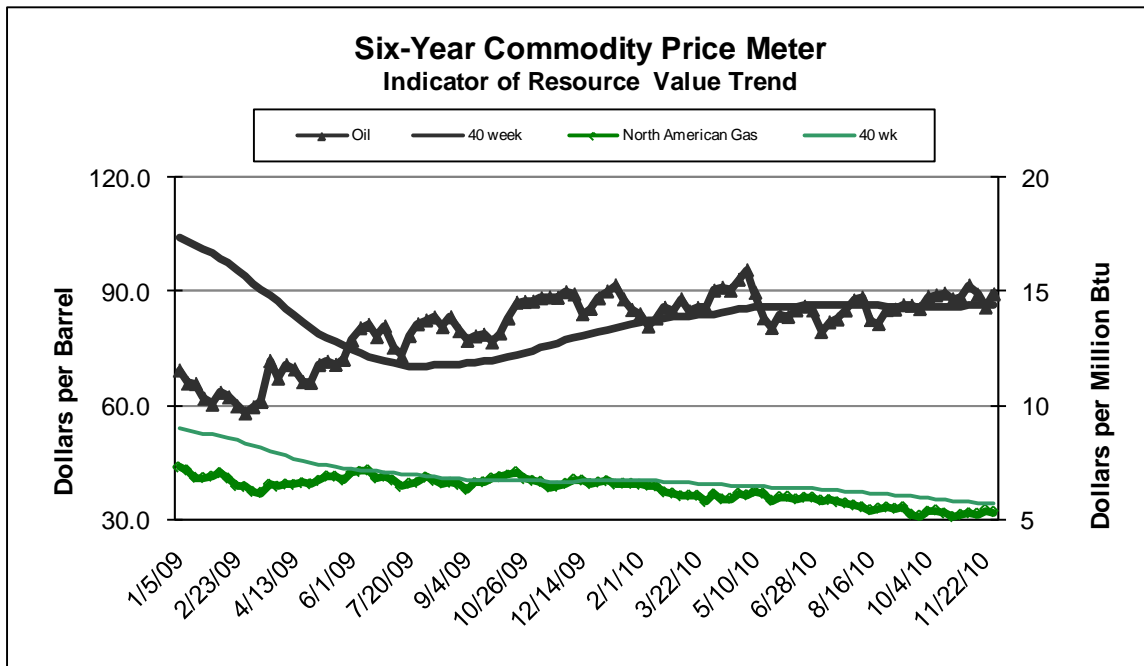
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unpredictable. Oil and gas companies depend fundamentally on global trends that should be relatively independent of currency trends.

Canadian large caps look good to us for 2011 after a quiet 2010 stock market performance. The attractiveness of Canada for resource investment by giant companies in our coverage from the U.S., Europe, and China reinforces investment in the stocks of publicly-traded Canadian companies.

McDep Ratios suggest appreciation in most of the remaining stocks in the U.S. Integrated, Emerging Market, and U.S. Independent groups (see [Table 1-4](#)).

Kurt H. Wulff, CFA







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Table 2								
McDep Large Cap Energy Portfolio								
Net Present Value and McDep Ratio								
			Price			Net		
			(US\$/sh)		Market	Present	Debt/	
	Symbol/Rating		29-Nov	Shares	Cap	Value	Present	McDep
	B = Buy, CB (see below)		2010	(mm)	(US\$mm)	(US\$/sh)	Value	Ratio
<b>U.S. Integrated</b>								
Exxon Mobil Corporation	XOM	B	69.45	5,089	353,000	89.00	0.13	0.81
Chevron Corporation	CVX	B	81.69	2,007	164,000	116.00	0.10	0.73
ConocoPhillips	COP	B	60.68	1,400	85,000	95.00	0.23	0.72
Marathon Oil Corporation	MRO	B	33.69	712	23,990	53.00	0.23	0.72
<i>Total or Median</i>					626,000		0.18	0.73
<b>Europe</b>								
BG Group plc	BRGXF		18.38	3,402	62,500	22.00	0.13	0.86
Royal Dutch Shell plc	RDS-A	B	61.40	3,069	188,000	79.00	0.22	0.83
BP plc	BP		40.59	3,156	128,000	72.00	0.29	0.69
Statoil ASA (33%)	STO	CB	20.17	1,050	21,200	35.00	0.24	0.68
Total S.A.	TOT	CB	49.29	2,245	111,000	90.00	0.16	0.62
<i>Total or Median</i>					511,000		0.22	0.69
<b>Australia/Brazil/China/Russia</b>								
CNOOC Limited (34%)	CEO		221.89	152	33,800	170.00	0.05	1.29
Woodside Petroleum Ltd.	WOPEY	B	40.19	782	31,400	44.00	0.13	0.92
PetroChina Company Ltd (14%)	PTR	B	124.15	256	31,800	170.00	0.13	0.77
Petrobras	PBR		32.59	6,428	209,500	51.00	0.13	0.69
Lukoil Oil Company	LUKOY	CB	54.00	848	45,800	135.00	0.05	0.43
Gazprom (50%)	OGZPY	B	22.25	2,865	63,700	64.00	0.08	0.40
<i>Total or Median</i>					416,000		0.11	0.73
<b>U.S. Independent</b>								
Anadarko Petroleum Corp.	APC		64.04	496	31,800	60.00	0.41	1.04
Southwestern Energy Company	SWN		36.49	349	12,700	35.00	0.09	1.04
Occidental Petroleum Corp.	OXY	B	88.98	814	72,400	95.00	0.06	0.94
Chesapeake Energy Corp.	CHK		22.05	744	16,400	31.00	0.38	0.82
EOG Resources	EOG	CB	89.22	250	22,300	120.00	0.14	0.78
Devon Energy Corporation	DVN	B	70.46	436	30,700	98.00	0.09	0.74
<i>Total or Median</i>					186,300		0.12	0.88
<b>Canada</b>								
Cenovus Energy Inc.	CVE	B	29.20	752	22,000	37.00	0.19	0.83
Canadian Natural Resources	CNQ	B	39.11	1,089	42,600	50.00	0.16	0.82
Imperial Oil Limited (30%)	IMO	CB	36.72	257	9,400	48.00	0.08	0.78
Suncor Energy	SU	B	34.07	1,572	53,600	48.00	0.17	0.76
Canadian Oil Sands Trust	COSWF	B	27.25	484	13,200	38.00	0.08	0.74
EnCana Corporation	ECA	CB	28.03	736	20,600	50.00	0.19	0.64
<i>Total or Median</i>					161,000		0.17	0.77
CB=Contrarian Buy, Stock Price may in downtrend compared to 200-day average.								
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.								



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Table 3								
McDep Large Cap Energy Portfolio								
Value Multiples and Distribution Yield								
			Price (US\$/sh)	Adjustd Resrvs/ Prod	PV/ Ebitda	EV/ Ebitda	Divd or Distrib	
	Symbol/Rating		29-Nov 2010	NTM	NTM	NTM	NTM (%)	
B = Buy, CB (see below)								
<b>U.S. Integrated</b>								
	Exxon Mobil Corporation	XOM	B	69.45	13.3	7.6	11	2.5
	ConocoPhillips	COP	B	60.68	10.4	7.5	12	3.6
	Marathon Oil Corporation	MRO	B	33.69	9.2	6.9	11	3.0
	Chevron Corporation	CVX	B	81.69	9.2	6.1	9	3.5
	<i>Total or Median</i>				9.8	7.2	11	3.2
<b>Europe</b>								
	BG Group plc	BRGXF		18.38	14.9	8.8	14	1.1
	Royal Dutch Shell plc	RDS-A	B	61.40	8.6	6.4	10	5.5
	BP plc	BP		40.59	10.2	7.3	7	-
	Total S.A.	TOT	CB	49.29	9.5	6.9	7	6.1
	Statoil ASA (33%)	STO	CB	20.17	7.0	5.8	7	4.8
	<i>Total or Median</i>				9.5	6.9	7	4.8
<b>Australia/Brazil/China/Russia</b>								
	Woodside Petroleum Ltd.	WOPEY	B	40.19	17.1	11.4	20	2.5
	Petrobras	PBR		32.59	10.0	9.8	12	3.6
	CNOOC Limited (34%)	CEO		221.89	5.6	4.7	11	2.4
	PetroChina Company Ltd (14%)	PTR	B	124.15	13.6	6.9	10	3.5
	Gazprom (50%)	OGZPY	B	22.25	30.2	9.2	5	0.2
	Lukoil Oil Company	LUKOY	CB	54.00	15.8	7.4	5	3.1
	<i>Total or Median</i>				14.7	8.3	11	2.8
<b>U.S. Independent</b>								
	Southwestern Energy Company	SWN		36.49	5.7	9.6	22	-
	Chesapeake Energy Corp.	CHK		22.05	10.2	11.4	17	1.4
	Anadarko Petroleum Corp.	APC		64.04	8.5	7.6	7.9	0.6
	EOG Resources	EOG	CB	89.22	8.6	8.9	33	0.7
	Devon Energy Corporation	DVN	B	70.46	10.1	9.2	13	0.9
	Occidental Petroleum Corp.	OXY	B	88.98	10.4	6.8	14	1.7
	<i>Total or Median</i>				9.4	9.1	17	0.8
<b>Canada</b>								
	Cenovus Energy Inc.	CVE	B	29.20	18.2	11.1	23	2.7
	EnCana Corporation	ECA	CB	28.03	13.9	13.8	27	2.9
	Canadian Oil Sands Trust	COSWF	B	27.25	29.2	11.6	16	5.8
	Imperial Oil Limited (30%)	IMO	CB	36.72	21.0	10.4	15	1.2
	Canadian Natural Resources	CNQ	B	39.11	18.2	9.8	20	0.8
	Suncor Energy	SU	B	34.07	21.9	10.0	21	1.2
	<i>Total or Median</i>				19.6	10.7	21	1.9
CB=Contrarian Buy, Stock Price may be in downtrend compared to 200-day average.								
EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended December 31, 2011; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses								



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Table 4								
McDep Large Cap Energy Portfolio								
Rank by Enterprise Value to 200 Day Average								
			Price		Enterprise Value/			
	Symbol		29-Nov	52Wk	52Wk	50 Day	200 Day	McDep
	Ratin.		2010	High	Low	Avg.	Avg.	Ratio
<b>U.S. Integrated</b>								
Exxon Mobil Corporation	XOM	B	69.45	0.92	1.20	1.04	1.07	0.81
ConocoPhillips	COP	B	60.68	0.97	1.19	1.01	1.07	0.72
Chevron Corporation	CVX	B	81.69	0.95	1.19	0.99	1.05	0.73
Marathon Oil Corporation	MRO	B	33.69	0.95	1.14	0.99	1.03	0.72
	<i>Median</i>			<i>0.95</i>	<i>1.19</i>	<i>1.00</i>	<i>1.06</i>	<i>0.73</i>
<b>Europe</b>								
BG Group plc	BRGXF		91.90	0.88	1.26	0.97	1.06	0.86
Royal Dutch Shell plc	RDS-A	B	61.40	0.92	1.17	0.98	1.04	0.83
Statoil ASA (33%)	STO	CB	20.17	0.83	1.06	0.96	0.96	0.68
Total S.A.	TOT	CB	49.29	0.78	1.10	0.94	0.96	0.62
BP plc	BP		40.59	0.76	1.25	0.99	0.96	0.69
	<i>Median</i>			<i>0.86</i>	<i>1.18</i>	<i>0.97</i>	<i>1.00</i>	<i>0.71</i>
<b>Australia/Brazil/China/Russia</b>								
CNOOC Limited (34%)	CEO		221.89	0.95	1.56	1.05	1.23	1.29
PetroChina Company Ltd (14%)	PTR	B	124.15	0.92	1.20	1.00	1.06	0.77
Gazprom (50%)	OGZPY	B	22.25	0.86	1.18	1.02	1.02	0.40
Woodside Petroleum Ltd.	WOPEY	B	40.19	0.88	1.19	0.95	1.00	0.92
Lukoil Oil Company	LUKOY	CB	54.00	0.90	1.19	0.95	0.98	0.43
Petrobras	PBR		32.59	0.66	1.04	0.96	0.89	0.69
	<i>Median</i>			<i>0.89</i>	<i>1.19</i>	<i>0.98</i>	<i>1.01</i>	<i>0.73</i>
<b>U.S. Independent</b>								
Occidental Petroleum Corp.	OXY	B	88.98	0.98	1.22	1.08	1.09	0.94
Anadarko Petroleum Corp.	APC		64.04	0.91	1.38	1.04	1.06	1.04
Devon Energy Corporation	DVN	B	70.46	0.93	1.17	1.04	1.06	0.74
Chesapeake Energy Corp.	CHK		22.05	0.85	1.06	1.00	0.98	0.82
Southwestern Energy Company	SWN		40.53	0.71	1.17	1.04	0.96	1.04
EOG Resources	EOG	CB	89.22	0.81	1.05	0.96	0.92	0.78
	<i>Median</i>			<i>0.88</i>	<i>1.17</i>	<i>1.04</i>	<i>1.02</i>	<i>0.88</i>
<b>Canada</b>								
Canadian Natural Resources	CNQ	B	39.11	0.97	1.23	1.05	1.08	0.82
Cenovus Energy Inc.	CVE	B	29.20	0.96	1.20	1.01	1.05	0.83
Suncor Energy	SU	B	34.07	0.91	1.17	1.01	1.04	0.76
Canadian Oil Sands Trust	COSWF	B	27.25	0.84	1.16	1.04	1.01	0.74
Imperial Oil Limited (30%)	IMO	CB	36.72	0.86	1.04	0.97	0.95	0.78
EnCana Corporation	ECA	CB	28.03	0.84	1.05	0.98	0.93	0.64
	<i>Median</i>			<i>0.89</i>	<i>1.16</i>	<i>1.01</i>	<i>1.03</i>	<i>0.77</i>
CB=Contrarian Buy, Stock Price may be in downtrend compared to 200-day average.								





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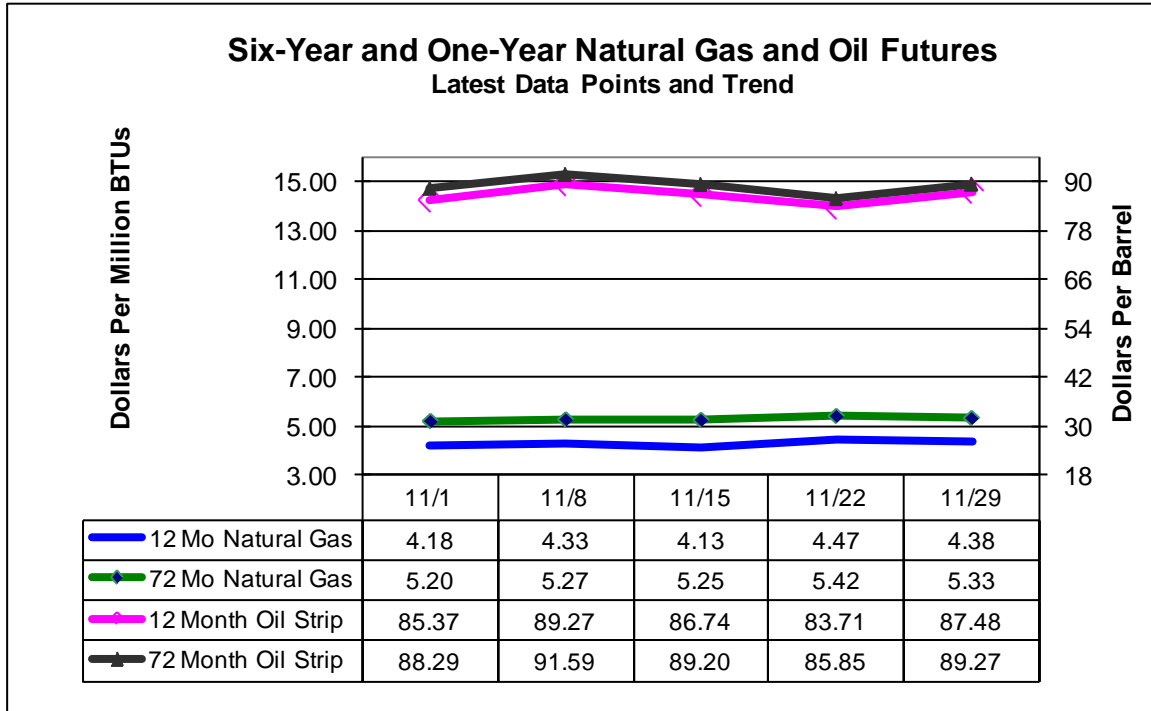
<b>Index of Recent Research</b>			
<b>Stock Ideas</b>			
<i>Date</i>	<i>Symbol</i>	<i>Subject</i>	<i>Theme</i>
26-Nov	SBR	Sabine Royalty Trust	Raise NPV on Proven Performance (Income and SC Weekly)
22-Nov	SJT	San Juan Basin Royalty Trust	Distribution Yield 5.8%, Not 4.6%
19-Nov	VNR	Vanguard Natural Resources	Vanguard to Manage High-Income Encore (Income and SCW)
19-Nov	ENP	Encore Energy Partners	Vanguard to Manage High-Income Encore (Income and SCW)
16-Nov	PBR	Petrobras	Digesting Record Stock Offering (Meter Reader)
11-Nov	BIREF	Birchcliff Energy Ltd.	Production Ahead of Forecast
9-Nov	OGZPY	Gazprom	Breakout from a Long Stock Price Base (Meter Reader)
9-Nov	SU	Suncor Energy	Breakout from a Long Stock Price Base (Meter Reader)
9-Nov	DVN	Devon Energy Corporation	Breakout from a Long Stock Price Base (Meter Reader)
4-Nov	EOG	EOG Resources	Buy on Stock Price Drop
2-Nov	XOM	ExxonMobil	Political Trends Turning (Meter Reader)
29-Oct	HGT	Hugoton Royalty Trust	Natural Gas Income at Low Price (Income and SC Weekly)
29-Oct	COSWF	Canadian Oil Sands Trust	Oil Value amid Political Turmoil
28-Oct	PTR	PetroChina	Raise NPV to \$170 from \$150 on Natural Gas and Downstream
8-Oct	DMLP	Dorchester Minerals	Golden Stocks ( Income and Small Cap Weekly)
28-Sep	CVX	Chevron Corporation	Reload Oil Stock Classics (Meter Reader)
28-Sep	MRO	Marathon Oil Company	Reload Oil Stock Classics (Meter Reader)
28-Sep	COP	ConocoPhillips	Reload Oil Stock Classics (Meter Reader)
7-Sep	LUKOY	Lukoil	Russian Growth in Oil (Meter Reader)
24-Aug	CEO	CNOOC Ltd	Raise NPV on Volume and Profit (Meter Reader)
17-Aug	ECA, CNQ	Encana, Canadian Natural	Raise NPV for ECA and CNQ on Probable Reserves (MR)
13-Aug	PEYUF	Peyto Energy Trust	Raise NPV to US\$18 from \$15 (Income and Small Cap Weekly)
5-Aug	XEC	Cimarex Energy Company	Raise NPV to \$80 from \$75
For historical research by stock, go to <a href="http://mcdep.com">mcdep.com</a> , click on <a href="#">Stock Ideas</a> , click on stock by name.			
<b>Meter Reader</b>			
23-Nov	DVN, ECA, RDS, LUKOY, MRO		A Little Life in Natural Gas Price and Oil Refining Margin
16-Nov	PBR	Petrobras	Digesting Record Stock Offering
9-Nov	DVN, SU, OGZPY		Breakout from a Long Stock Price Base
2-Nov	XOM	ExxonMobil	Political Trends Turning
26-Oct	TOT, STO, RDS		Euro Oil Income Buys
19-Oct		Weekly Valuation	Invest 30-40% in Natural Gas, Half in Oil
12-Oct	EOG	EOG Resources	Leads in Eagle Ford Shale
For earlier editions, go to <a href="http://mcdep.com">mcdep.com</a> , click on <a href="#">Meter Reader</a> .			
<b>Income and Small Cap Weekly</b>			
26-Nov	SBR	Sabine Royalty Trust	Raise NPV on Proven Performance
19-Nov	ENP, VNR	Encore Energy, Vanguard Natural	Vanguard (VNR) to Manage High-Income Encore (ENP)
12-Nov	DMLP	Dorchester Minerals, L.P.	Volume Trend Strengthening
5-Nov		Weekly Valuation	Frac Shortage Limits Energy Supply
29-Oct	SJT, HGT	San Juan RT, Hugoton RT	Natural Gas Income at Low Price
22-Oct		Weekly Valuation	Natural Gas Explorers Reduce Drilling
15-Oct	XEC, BIREF	Cimarex, Birchcliff	Looking for Latent Riches in Land
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**Research Methodology/Ratings Description:** McDep LLC is an independent research originator focused on oil and gas stocks exclusively. The firm applies the forty years of experience of its analyst to estimate a present value of the oil and gas resources and other businesses of covered companies. That value is compared with a company's stock market capitalization and debt. Stocks with low market cap and debt relative to present value tend to outperform stocks with high market cap and debt relative to present value. Buy recommendations are expected to deliver a total return better than 7% per year above inflation. Hold recommendations assume the attributes of the underlying business are reflected in the current price of the stock. Sell recommendations are expected to deliver a total return less than inflation.