

## ***Meter Reader***

*A Weekly Analysis of Energy Stocks Using the McDep Ratio*

November 1, 2005

# **Quarterly Results and the Correlation**

## **Summary and Recommendation**

During this cycle of quarterly earnings disclosures, we have referred to a correlation in our quick analyses for most rated stocks. Specifically, we correlate present value with projected cash flow and adjusted reserve life for each of four main businesses of some thirty companies in our coverage. The correlation helps us decide if the denominator of the McDep Ratio is realistic and in turn whether the company is on track. Among buy recommendations that reported recently, the correlation points to McDep Ratios potentially lower (stronger) than the low measures we already see for **Anadarko (APC)** and **ConocoPhillips (COP)**.

## **Degrees of Buy and Degrees of McDep Ratio**

McDep Ratios point to degrees of buy continuously while buy, sell and hold ratings change only occasionally. Though McDep Ratios hinted at a weakening case for buy in late September, we did not change any buys to hold or sell. Now after the October declines lower McDep Ratios make buy recommendations timelier as the uptrend in commodity price and stock price continues.

We refer to a correlation which points to degrees of McDep Ratio. In analyses immediately following disclosure of quarterly results for most rated stocks we emphasized not only the present value estimate that is part of the McDep Ratio, but also the comparison with a correlation of 30 stocks. The correlation helps us to analyze quarterly results rapidly, but it can be sensitive to interpretations that might be refined on more detailed consideration of latest information. Quarterly results mostly reported just last week provide company specific volume, price and cost information for estimating the present value that is the denominator of the McDep Ratio.

## **Commodity Price and Present Value Support Investment**

Crude oil quotes are well above the \$50 a barrel used in estimating present value, the denominator of the McDep Ratio (see table [Oil and Gas Commodity and Stock Price](#)). One-year natural gas is above our long-term estimate while six-year natural gas commodity price has extra appreciation potential. Refining margin is 20% above our long-term estimate.

The McDep Ratio compares present value calculated from commodity price with enterprise value as determined in the stock market. A stock with a McDep Ratio of 1.0 presumably offers a 7% per year unlevered real return on constant real prices for oil of \$50 a barrel, natural gas of \$10 a million btu and refining crack of \$10 a barrel. Four of the five groups have median McDep Ratios below 1.0.

Thus while current commodity prices suggest our estimates of present value could be higher, current stock prices are less than the values we calculate. As a result, thriving commodity prices and low McDep Ratios make a positive case for investing in buy-recommended stocks.

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#### **Oil and Gas Commodity and Stock Price**

**Monday, October 31, 2005**

	<i>Units</i>	<i>Futures Price</i>		<i>McDep Ratio</i>
		<i>Six-Year</i>	<i>One-Year</i>	<i>Denominator</i>
<b>Crude Oil</b>	\$/barrel	57.99	60.98	50
<b>Natural Gas</b>	\$/million btu	8.46	11.08	10
<b>Oil Refining</b>	\$/barrel		11.97	10

<i>Stocks</i>	<i>Median McDep Ratio</i>
<b>Mega Cap</b>	0.77
<b>Producer/Refiner</b>	0.83
<b>Independent - Large</b>	0.78
<b>Independent - Small</b>	0.74
<b>Income</b>	1.04

Source: McDep Associates, Bloomberg, New York Mercantile Exchange,  
Yahoo and company disclosures

#### **Select Stocks on Valuation and Strategic Considerations**

Stocks are ranked in descending order of McDep Ratio to suggest “buy low and sell high” (see table [Rank by McDep Ratio](#)). We recommend representation in each of the five groups from Mega Cap to Income with emphasis on low McDep Ratio stocks.

Next Twelve Months Cash Flow, Ebitda, changes continuously with futures prices for natural gas and oil (see table [Rank by EV/Ebitda](#)). We regularly check the correlation of present value with cash flow multiple by business and expected life of production.

Investors can diversify political risk by owning stocks of companies headquartered in other countries (see table [Home Country and Business Segments](#)). Russian stocks offer potential resource value beyond that reflected in the McDep Ratio.

Finally, we recommend balance among business segments. Investors should be sure to be represented in the stocks of companies with strong natural gas concentration. Nor should that be at the expense of reasonable downstream exposure in other stocks.

Timely analyses are available on all recommended stocks (see table [Index of Recent Research](#)).

Kurt H. Wulff, CFA

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

	Symbol/ Rating		Price (\$/sh) 31-Oct 2005	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio
<b>Mega Cap</b>								
BP plc	BP	B	66.40	3,501	233,000	77.00	0.11	0.88
Total S.A.	TOT	B	126.02	1,182	149,000	160.00	0.12	0.81
Exxon Mobil Corporation	XOM	B	56.14	6,303	354,000	74.00	0.04	0.77
Royal Dutch Shell plc	RDS-A	B	62.04	3,352	208,000	84.00	0.10	0.77
Chevron Corporation	CVX	B	57.07	2,256	129,000	85.00	0.13	0.71
<i>Total or Median</i>					<i>1,073,000</i>		<i>0.11</i>	<i>0.77</i>
<b>Producer/Refiners - Large Cap and Mid Cap</b>								
Kinder Morgan, Inc.	KMI	S2	90.77	123	11,160	20.00	0.76	1.86
Imperial Oil Limited (30%)	IMO	B	87.83	102	8,970	84.00	0.10	1.04
Marathon Oil Corporation	MRO	B	60.16	368	22,150	65.00	0.27	0.95
Petro-Canada	PCZ	B	34.75	525	18,260	42.00	0.19	0.86
Lukoil Oil Company	LUKOY	B	55.00	830	46,000	65.00	0.03	0.85
Suncor Energy	SU	B	53.63	461	24,730	68.00	0.11	0.81
Norsk Hydro ASA	NHY	B	99.32	251	24,920	130.00	0.12	0.79
ConocoPhillips	COP	B	65.38	1,418	92,700	100.00	0.15	0.71
Gazprom (50%)	OGZPF	B	59.10	1,022	60,400	90.00	0.03	0.67
PetroChina Company Ltd (10%)	PTR	B	76.73	176	13,490	120.00	0.01	0.64
<i>Total or Median</i>					<i>323,000</i>		<i>0.11</i>	<i>0.83</i>
<b>Independent Natural Gas and Oil - Large Cap and Mid Cap</b>								
XTO Energy Inc.	XTO	B	43.46	370	16,080	48.00	0.20	0.92
Encana Corporation	ECA	B	45.91	876	40,200	51.00	0.20	0.92
Burlington Resources	BR	B	72.20	381	27,500	86.00	0.09	0.85
CNOOC Limited (29%)	CEO	B	65.70	119	7,840	84.00	0.01	0.78
Devon Energy Corporation	DVN	B	60.38	471	28,400	86.00	0.15	0.75
Occidental Petroleum Corp.	OXY	B	78.88	404	31,900	120.00	0.11	0.70
Anadarko Petroleum Corp.	APC	B	90.71	238	21,600	140.00	0.12	0.69
<i>Total or Median</i>					<i>174,000</i>		<i>0.12</i>	<i>0.78</i>
<b>Independent Natural Gas and Oil - Small Cap</b>								
Berry Petroleum Company	BRY	B	59.69	23	1,340	65.00	0.10	0.92
Encore Acquisition Company	EAC	B	34.30	50	1,700	50.00	0.21	0.75
Energy Partners Ltd.	EPL	B	25.37	41	1,030	38.00	0.17	0.73
Cimarex Energy Company	XEC	B	39.25	85	3,340	64.00	0.12	0.66
<i>Total or Median</i>					<i>7,400</i>		<i>0.15</i>	<i>0.74</i>
<b>Income</b>								
Kinder Morgan Energy Partners, L.P.	KMP	S3	52.08	159	8,290	15.00	0.55	2.11
Kinder Morgan Management, LLC	KMR	S3	48.23	57	2,730	15.00	0.55	1.99
Pengrowth Energy Trust	PGH		21.75	157	3,410	20.00	0.17	1.07
San Juan Basin Royalty Trust	SJT		41.60	47	1,940	40.00	-	1.04
Enerplus Resources Fund	ERF		42.00	105	4,410	42.00	0.13	1.00
Penn West Energy Trust	PWTFF	B	26.57	174	4,620	28.00	0.16	0.96
Canadian Oil Sands Trust (US\$)	COSWF	B	93.97	93	8,720	136.00	0.11	0.73
<i>Total or Median</i>					<i>34,100</i>		<i>0.16</i>	<i>1.04</i>

B = Buy, S2 = Short half unlevered position, S3 = Short quarter unlevered position

McDep Ratio = Market cap and Debt to present value of oil and gas and other businesses

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#### Oil and Gas Producers

#### Rank by EV/Ebitda: Enterprise Value to Earnings Before Interest, Tax, Deprec.

	Symbol/ Rating		Price (\$/sh) 31-Oct 2005	Adjstd Resrvs/ Prod NTM	PV/ Ebitda NTM	EV/ Ebitda NTM	P/E NTM	Divd or Distrib NTM (%)
<b>Mega Cap</b>								
BP plc	BP	B	66.40	9.4	6.2	5.5	9	3.2
Exxon Mobil Corporation	XOM	B	56.14	11.7	6.8	5.2	9	2.1
Total S.A.	TOT	B	126.02	9.2	6.1	5.0	8	2.6
Royal Dutch Shell plc	RDS-A	B	62.04	7.5	5.6	4.3	8	3.6
Chevron Corporation	CVX	B	57.07	9.6	5.9	4.2	7	3.2
		<i>Median</i>		9.4	6.1	5.0	8	3.2
<b>Producer/Refiners - Large Cap and Mid Cap</b>								
Kinder Morgan, Inc.	KMI	S2	90.77		7.5	14.0	19	3.3
Gazprom (50%)	OGZPF	B	59.10	22.0	12.9	8.6	17	0.6
Suncor Energy	SU	B	53.63	17.9	9.3	7.5	16	0.4
Imperial Oil Limited (30%)	IMO	B	87.83	11.5	6.7	7.0	12	0.9
Marathon Oil Corporation	MRO	B	60.16	7.4	5.0	4.7	7	2.2
Petro-Canada	PCZ	B	34.75	5.7	5.0	4.3	7	0.8
Norsk Hydro ASA	NHY	B	99.32	8.1	5.2	4.1	8	3.1
Lukoil Oil Company	LUKOY	B	55.00	19.8	4.7	4.0	7	1.8
ConocoPhillips	COP	B	65.38	11.2	5.6	3.9	6	1.9
PetroChina Company Ltd (10%)	PTR	B	76.73	13.9	6.0	3.9	8	4.9
		<i>Median</i>		11.5	5.8	4.5	8	1.8
<b>Independent Natural Gas and Oil - Large Cap and Mid Cap</b>								
XTO Energy Inc.	XTO	B	43.46	10.8	5.6	5.2	9	0.5
Encana Corporation	ECA	B	45.91	7.1	4.8	4.4	8	0.7
Occidental Petroleum Corp.	OXY	B	78.88	11.0	6.2	4.3	7	1.8
CNOOC Limited (29%)	CEO	B	65.70	9.4	5.3	4.1	7	3.5
Anadarko Petroleum Corp.	APC	B	90.71	12.5	5.9	4.1	7	0.8
Burlington Resources	BR	B	72.20	10.0	4.6	3.9	8	0.6
Devon Energy Corporation	DVN	B	60.38	7.3	3.9	2.9	5	0.5
		<i>Median</i>		10.0	5.3	4.1	7	0.7
<b>Independent Natural Gas and Oil - Small Cap</b>								
Berry Petroleum Company	BRY	B	59.69	11.0	5.5	5.1	13	1.0
Encore Acquisition Company	EAC	B	34.30	14.3	6.0	4.5	9	-
Cimarex Energy Company	XEC	B	39.25	7.7	4.0	2.7	5	-
Energy Partners Ltd.	EPL	B	25.37	5.1	3.1	2.3	5	-
		<i>Median</i>		9.3	4.8	3.6	7	-
<b>Income</b>								
Kinder Morgan Energy Partners, L.P.	KMP	S3	52.08		7.9	16.6	24	6.1
Kinder Morgan Management, LLC	KMR	S3	48.23		7.9	15.7	22	6.6
San Juan Basin Royalty Trust	SJT		41.60	12.2	8.0	8.4	9	11.1
Canadian Oil Sands Trust (US\$)	COSWF	B	93.97	20.0	10.7	7.8	9	3.6
Pengrowth Energy Trust	PGH		21.75	7.6	5.3	5.7	8	10.8
Enerplus Resources Fund	ERF		42.00	9.8	5.3	5.3	7	10.2
Penn West Energy Trust	PWTFF	B	26.57	8.0	4.2	4.0	6	11.9
		<i>Median</i>		9.8	7.9	7.8	9	10.2

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended September 30, 2006; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

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#### Oil and Gas Producers Home Country and Business Segments

	Symbol/ Rating		Non- U.S. Domicile	North Amer. Natural Gas (%)	Rest of World Natural Gas (%)	Oil Prod'n (%)	Down- stream (%)	Total Present Value (US\$m)
<b>Mega Cap</b>								
Exxon Mobil Corporation	XOM	B		10	19	38	33	487,000
BP plc	BP	B	UK	10	12	42	36	302,000
Royal Dutch Shell plc	RDS-A	B	UK	4	19	33	45	313,000
Chevron Corporation	CVX	B		9	9	52	29	221,000
Total S.A.	TOT	B	France	-	27	38	35	215,000
	<i>Total or Median</i>			9	19	38	35	1,538,000
<b>Producer/Refiners - Large Cap and Mid Cap</b>								
PetroChina Company Ltd.	PTR	B	China	-	9	71	20	213,000
Gazprom	OGZPF	B	Russia		100			190,000
ConocoPhillips	COP	B		13	7	45	35	166,800
Lukoil Oil Company	LUKOY	B	Russia	-	-	62	38	55,700
Norsk Hydro ASA	NHY	B	Norway	-	27	38	35	36,900
Suncor Energy	SU	B	Canada	5	-	89	7	35,200
Marathon Oil Corporation	MRO	B		14	8	33	46	32,900
Imperial Oil Limited	IMO	B	Canada	13	-	62	25	31,800
Petro-Canada	PCZ	B	Canada	23	4	53	20	27,100
	<i>Median</i>			9	7	58	30	789,000
<b>Independent Natural Gas and Oil - Large Cap and Mid Cap</b>								
Occidental Petroleum Corp.	OXY	B		15	1	73	11	54,700
Encana Corporation	ECA	B	Canada	83	-	17	-	55,600
Devon Energy Corporation	DVN	B		62	-	38	-	47,500
Anadarko Petroleum Corp.	APC	B		60	-	40	-	37,700
Burlington Resources	BR	B		69	5	26	-	36,000
CNOOC Limited	CEO	B	China	-	12	88	-	34,800
XTO Energy Inc.	XTO	B		83	-	17	-	22,100
	<i>Median</i>			62	-	38	-	288,000
<b>Independent Natural Gas and Oil - Small Cap</b>								
Cimarex Energy Company	XEC	B		70	-	30	-	6,140
Encore Acquisition Company	EAC	B		25	-	75	-	3,150
Berry Petroleum Company	BRY	B		16	-	84	-	1,920
Energy Partners Ltd.	EPL	B		56	-	44	-	1,860
	<i>Median</i>			41	-	59	-	13,070
<b>Income</b>								
Canadian Oil Sands Trust (US\$)	COSWF	B	Canada	-	-	100	-	14,300
Penn West Energy Trust	PWTFF	B	Canada	43	-	57	-	5,800
Enerplus Resources Fund	ERF		Canada	61	-	39	-	5,080
Pengrowth Energy Trust	PGH		Canada	43	-	57	-	3,720
San Juan Basin Royalty Trust	SJT			100	-	-	-	1,860
	<i>Median</i>			43	-	57	-	30,800

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### Index of Recent Research

#### Stock Ideas

<u>Date</u>	<u>Symbol</u>	<u>Stock</u>	<u>Theme</u>
31-Oct	CVX	Chevron Corporation	Lower Net Present Value to \$85 a Share
31-Oct	APC	Anadarko Petroleum Corporation	Long Life for Free
31-Oct	BR	Burlington Resources, Inc.	Natural Gas Beneficiary
28-Oct	XOM	Exxon Mobil Corporation	Momentum Challenge
28-Oct	RDSA	Royal Dutch Shell plc	Downstream Gains
28-Oct	SU	Suncor Energy Inc.	Up and Running Again
28-Oct	MRO	Marathon Oil Corporation	Downstream Gains
28-Oct	PCZ	Petro-Canada	Oil Sands Producer
27-Oct	COP	ConocoPhillips	Emerging Mega Cap
27-Oct	ECA	EnCana Corporation	Natural Gas Leader
27-Oct	EAC	Encore Acquisition Company	Long Life Oil Value
26-Oct	BP	BP p.l.c.	Lower Net Present Value to \$77 a Share
26-Oct	NHY	Norsk Hydro ASA	Record Results
26-Oct	COSWF	Canadian Oil Sands Trust	Distribution Doubled and Unit Split Proposed
21-Oct	IMO	Imperial Oil Limited	The Unpromoters
21-Oct	XTO	XTO Energy Inc.	Ready for Winter
20-Oct	KMx	Kinder Morgan	Wheel and Deal
14-Oct	OXY	Occidental Petroleum Corporation	Buy Despite Momentum Signal
13-Oct	APC BR DVN OXY XTO		Edge of Panic
7-Oct	ECA IMO PCZ SU		Exaggerated Stock Price Change
26-Sep	* LUKOY	Lukoil Oil Company	Adapting to New Russia
15-Sep	* OGZPF	Gazprom	The Ultimate Natural Gas Stock
7-Sep	* EPL	Energy Partners, Ltd.	Katrina Survivor
30-Aug	* CEO	CNOOC Ltd	Independent Producer with Income
28-Aug	* PTR	PetroChina Company Limited	Income Stock
21-Aug	* PTR	PetroChina Company Limited	Understated Natural Gas Resources
18-Aug	* SJT	San Juan Basin Royalty Trust	Sharp Stock Price Drop
15-Aug	* XEC	Cimarex Energy Company	\$Billion Cash Flow for Small Cap NG Producer
11-Aug	* PWTFE	Penn West Energy Trust	Undiscovered by U.S. Investors
8-Aug	* TOT	Total S.A.	Oil Sands Oui!
3-Aug	* DVN	Devon Energy Corporation	Raise Net Present Value to \$86 a Share
2-Aug	*	26 Stocks - Single Issue Statistics	Raise Net Present Value to \$xx a Share

#### Meter Reader - A Weekly Analysis

24-Oct		Back Up the Truck
17-Oct	*	Winter Rally
11-Oct	*	Oil, Natural Gas and the U.S. Economy
6-Oct	*	Flash: Industry Outlook Stable

#### Natural Gas and Oil Royalty Trusts - A Weekly Analysis

28-Oct		Winter Payoff
21-Oct	*	Third Week in October
14-Oct	*	Fraud on the Street
7-Oct	*	October Jitters

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