

Rating: Buy  
 S&P 500: 1290

## **Royal Dutch Shell plc** **Likely Acquirer**

<i>Symbol</i>	RDS-A	<i>Ebitda Next Twelve Months ending 12/31/06 (US\$m)</i>	57,000
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	4
<i>Price (US\$/sh)</i>	64.83	<i>Natural Gas and Oil Production/Ebitda (%)</i>	59
<i>Pricing Date (intraday)</i>	1/10/06	<i>Adjusted Reserves/Production NTM</i>	7.5
<i>Shares (mm)</i>	3352	<i>EV/Ebitda</i>	4.4
<i>Market Capitalization (US\$m)</i>	217,300	<i>PV/Ebitda</i>	5.5
<i>Debt (US\$m)</i>	31,600	<i>Undeveloped Reserves (%)</i>	44
<i>Enterprise Value (EV) (US\$m)</i>	248,900	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	26.70
<i>Present Value (PV) (US\$m)</i>	313,200	<i>Present Value Proven Reserves(US\$/boe)</i>	15.20
<i>Net Present Value (US\$/share)</i>	84	<i>Present Value Proven Reserves(US\$/mcf)</i>	2.53
<i>Debt/Present Value</i>	0.10	<i>Earnings Next Twelve Months (US\$/sh)</i>	8.37
<i>McDep Ratio - EV/PV</i>	0.79	<i>Price/Earnings Next Twelve Months</i>	8
<i>Dividend Yield (%/year)</i>	3.4	<i>Indicated Annual Dividend (US\$/sh)</i>	2.22

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**

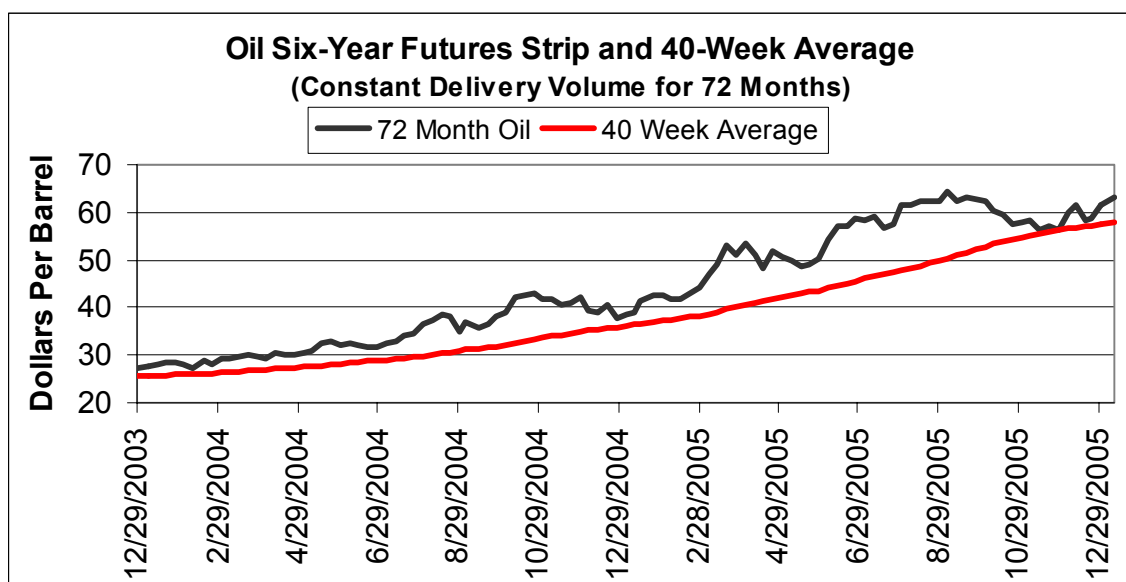
Newly streamlined under a single company structure, buy-recommended **Royal Dutch Shell plc (RDS-A)** may be ready to take some bold steps to add “more upstream” to “profitable downstream” to use Chief Executive Jeroen van der Veer’s words. Because North American natural gas representation looks light for a global liquefied natural gas leader, we hypothesize that buy-recommended **Encana (ECA)** or buy-recommended **Anadarko (APC)** could be acquisition targets. Modest immediate dilution could be offset by consolidation of operations and any further strength in the industry trend as has been the case this decade. Meanwhile a disproportionate emphasis on downstream in an improving environment contributes valuable cash flow. By itself, fundamentally, RDSA stock offers 30% appreciation potential to estimated net present value of \$84 a share.

### **McDep Ratio Relates Oil Price to Opportunity**

A McDep Ratio below 1.0 tells us that Royal Dutch Shell’s market cap and debt, or enterprise value, is less than the estimated present value of its energy resources assuming a long-term real price of \$50 a barrel for Light, Sweet Crude Oil. Alternatively we could say that Royal Dutch Shell’s stock is priced for \$40 oil, an approximation derived by multiplying \$50 times the McDep Ratio.

Meanwhile six-year oil futures are about \$63 a barrel. Momentum has been positive for more than three years as the current quote stays above the 40-week average (see chart [Oil Six-Year Futures and 40-Week Average](#)). Six-year oil has tripled in the four years we have been calculating it on a weekly basis. We do not need further gains in oil price to make money in buy recommendations. Yet our vision of \$150 oil in 2010 implies additional scope to exceed common expectations.

**Please see disclosures on the final page.**



Royal Dutch Shell's McDep Ratio ranks in the midst of peer companies (see table [Rank by McDep Ratio](#)). Aside from the fundamental appreciation potential we outlined above, a McDep Ratio of 1.0 is an indication of takeover value. The McDep Ratio of buy-recommended **Burlington Resources (BR)**, increased to 1.0 immediately after buy-recommended **ConocoPhillips (COP)** announced its takeover offer. Royal Dutch Shell is more likely to be the buyer in a takeover. Should that be the case, there could be a short-term negative impact depending on the transaction. As a result, we recommend that investors in RDSA also own likely targets such as buy-recommended **Encana (ECA)** and buy-recommended **Anadarko (APC)**.

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

	Symbol/ Rating	Price (\$/sh) 10-Jan 2006	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio
<b>Mega Cap</b>							
BP plc	BP B	68.18	3,501	239,000	77.00	0.11	0.90
Total S.A.	TOT B	132.15	1,176	155,000	160.00	0.12	0.85
Exxon Mobil Corporation	XOM B	59.86	6,303	377,000	74.00	0.04	0.82
Royal Dutch Shell plc	RDS-A B	64.83	3,352	217,000	84.00	0.10	0.79
Chevron Corporation	CVX B	59.24	2,256	134,000	85.00	0.13	0.74
ConocoPhillips	COP B	60.76	1,693	103,000	95.00	0.22	0.72
<i>Total or Median</i>				<i>1,225,000</i>		<i>0.12</i>	<i>0.81</i>

#### Low Cash Flow Multiple

Unlevered cash flow multiples in single digits attest to low valuation (see table [Rank by EV/Ebitda](#)). Multiples may be low because investors do not think cash flow will last long at current levels. That depends on commodity price and reserve life. Cash flow estimated for the next twelve months, Ebitda NTM, reflects latest futures prices. Reserve life is measured as adjusted reserves divided by next twelve months production.

Please see disclosures on the final page.

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

	<i>Symbol/ Rating</i>		<i>Price (\$/sh) 10-Jan 2006</i>	<i>Adjstd Resrvs/ Prod NTM</i>	<i>PV/ Ebitda NTM</i>	<i>EV/ Ebitda NTM</i>	<i>P/E NTM</i>	<i>Divd or Distrib NTM (%)</i>
<b>Mega Cap</b>								
BP plc	BP	B	68.18	9.4	6.1	5.5	9	3.1
Exxon Mobil Corporation	XOM	B	59.86	11.7	6.7	5.5	10	1.9
Total S.A.	TOT	B	132.15	9.2	6.1	5.1	9	2.8
Royal Dutch Shell plc	RDS-A	B	64.83	7.5	5.5	4.4	8	3.4
Chevron Corporation	CVX	B	59.24	9.6	5.7	4.2	7	3.0
ConocoPhillips	COP	B	60.76	11.0	5.4	3.9	6	2.0
	<i>Median</i>			<i>9.5</i>	<i>5.9</i>	<i>4.8</i>	<i>8</i>	<i>2.9</i>

A short reserve life for RDSA compared to peers may justify a lower multiple of present value to cash flow. We do take that into account, but do not make the full adjustment because management may have overreacted in the face of recent criticism.

**Concentration on Downstream**

Each oil and gas stock has its own unique mix of energy resources (see table Business Segments). Royal Dutch Shell's concentration on downstream is the highest of peers. With the company's reduction in oil and gas reserves, the traditional strength of downstream exposure has cushioned the negative impact.

**Home Country and Business Segments**

	<i>Symbol/ Rating</i>			<i>North Amer. Natural Gas (%)</i>	<i>Rest of World Natural Gas (%)</i>	<i>Oil Prod'n (%)</i>	<i>Down- stream (%)</i>	<i>Total Present Value (US\$mm)</i>
<b>Mega Cap</b>								
Exxon Mobil Corporation	XOM	B		10	19	38	33	487,000
Royal Dutch Shell plc	RDS-A	B	UK	4	19	33	45	313,000
BP plc	BP	B	UK	10	12	42	36	302,000
Chevron Corporation	CVX	B		9	9	52	29	221,000
Total S.A.	TOT	B	France	-	28	37	35	214,000
ConocoPhillips	COP	B		23	7	43	28	207,000
	<i>Total or Median</i>			<i>9</i>	<i>15</i>	<i>40</i>	<i>34</i>	<i>1,744,000</i>

Unlike the previous rising phase in the oil price cycle thirty years ago, the outlook for refined products is also rising. Some of the favorable differences between then and now include better global economic growth and increasing appreciation of cleaner, more refined oil products.

With its emphasis on liquefied natural gas, Shell's concentration on Rest of World natural gas is high among peers. Yet its representation in North American natural gas is low. For that reason the potential acquisition of ECA or APC could make sense strategically.

**Please see disclosures on the final page.**

### Static Present Value Justified by Dynamic Cash Flow

Present value analysis presumes that fundamental value is measured by the projection of cash flows years into the future and bringing them to the present applying a real discount rate, currently 7% a year. We generally hold present value estimates static until there is justification to make new commodity price assumptions.

Next Twelve Months (NTM) cash flow represents the volumes and costs that form the base for future projections. Reserve life index tells how long cash flow will last. NTM cash flow and reserve life are the two main variables in our correlation by function for about 30 companies. Net present value indicated by the current combined correlation is about \$4 a share lower than our ongoing standard estimate for the company (see table Functional Cash Flow and Present Value).

	<b>Royal Dutch Shell plc</b>				
	<b>Functional Cash Flow and Present Value</b>				
	<i>NTM Ebitda</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Present</i>	
	<i>(US\$mm)</i>	<i>R/P</i>	<i>Ebitda</i>	<i>Value</i>	
				<i>(US\$mm)</i>	
North American Natural Gas	2,530	5.0	4.3	11,000	4%
Rest of World Natural Gas	6,700	11.0	9.0	60,000	19%
Oil	24,690	5.7	4.1	102,000	33%
Downstream	23,100		6.1	140,000	45%
	57,020	7.5	5.5	313,000	100%
Debt (US\$mm)					31,000
Net Present Value (US\$mm)					282,000
Shares (mm)					3,352
Net Present Value (US\$/sh)					84
Over (-)/ Under (+) Correlation (US\$/sh)					(4)

### Futures Prices Propel Estimated Cash Flow by Quarter

Cash flow for the next year is projected from a base through the latest reported quarter (see table Next Twelve Months Operating and Financial Estimates). Company disclosures provide the clues for future volumes and costs as well as geographic and quality differences in price. Futures prices from the New York Mercantile Exchange determine industry benchmarks for the next year in our model.

Kurt H. Wulff, CFA

**Royal Dutch/Shell**  
**Next Twelve Months Operating and Financial Estimates**

	<i>Q4</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>12/31/04</i>	<i>9/30/05</i>	<i>12/31/05</i>	<i>2005E</i>	<i>3/31/06</i>	<i>6/30/06</i>	<i>9/30/06</i>	<i>12/31/06</i>	<i>12/31/06</i>
<b>Volume</b>									
Natural Gas (mmcf)									
U.S.	1,302	948	1,300	<b>1,246</b>	1,300	1,300	1,300	1,300	<b>1,300</b>
Overseas (or Int'l)	8,408	5,603	7,844	<b>7,108</b>	8,529	6,255	5,686	7,961	<b>7,102</b>
Total	9,710	6,551	9,144	<b>8,354</b>	9,829	7,555	6,986	9,261	<b>8,402</b>
Oil (mbd)	2,163	2,077	2,077	<b>2,116</b>	2,077	2,077	2,077	2,077	<b>2,077</b>
Total gas & oil (mmb)	348	292	331	<b>1,281</b>	334	304	298	333	<b>1,269</b>
<b>Price</b>									
Natural gas (\$/mcf)									
Henry Hub (\$/mmbtu)	7.10	8.56	13.00	<b>8.65</b>	10.07	9.32	9.47	10.19	<b>9.76</b>
U.S.	7.27	8.35	12.87	<b>8.84</b>	9.97	9.23	9.37	10.08	<b>9.66</b>
Overseas (or Int'l)	3.32	3.95	4.15	<b>3.96</b>	4.36	4.58	4.81	5.05	<b>4.69</b>
Total	3.85	4.59	5.39	<b>4.69</b>	5.10	5.38	5.66	5.75	<b>5.46</b>
Oil (\$/bbl)									
WTI Cushing	48.31	62.52	59.99	<b>56.30</b>	62.72	65.23	65.85	66.14	<b>64.99</b>
Worldwide	40.17	56.83	54.53	<b>50.77</b>	57.01	59.29	59.85	60.12	<b>59.08</b>
Total gas & oil (\$/bbl)	32.86	46.74	45.14	<b>41.79</b>	45.37	49.09	50.54	49.21	<b>48.48</b>
NY Harbor 3-2-1 (\$/bbl)	5.72	16.70	9.05	<b>10.63</b>	10.50	13.19	13.51	9.42	<b>11.66</b>
<b>Revenue (\$mm)</b>									
Natural Gas									
U.S.	871	728	1,540	<b>4,022</b>	1,166	1,091	1,121	1,206	<b>4,585</b>
Overseas (or Int'l)	2,568	2,038	2,996	<b>10,274</b>	3,346	2,605	2,514	3,696	<b>12,162</b>
Total	3,439	2,766	4,536	<b>14,296</b>	4,512	3,697	3,635	4,902	<b>16,746</b>
Oil	7,994	10,859	10,420	<b>39,218</b>	10,658	11,207	11,437	11,489	<b>44,790</b>
Other	64,991	62,809	62,809	<b>255,485</b>	62,809	62,809	62,809	62,809	<b>251,237</b>
Total	76,424	76,435	77,765	<b>309,000</b>	77,979	77,713	77,882	79,200	<b>312,774</b>
<b>Expense (\$mm)</b>									
Production	4,466	6,026	6,691	<b>23,968</b>	6,798	6,665	6,749	7,408	<b>27,620</b>
Other	59,488	58,026	57,034	<b>235,962</b>	57,034	57,034	57,034	57,034	<b>228,136</b>
<b>Ebitda (\$mm)</b>									
Exploration and Production	6,967	7,600	8,265	<b>29,547</b>	8,372	8,239	8,323	8,982	<b>33,917</b>
Other	5,503	4,783	5,775	<b>19,524</b>	5,775	5,775	5,775	5,775	<b>23,102</b>
Total Ebitda	12,470	12,383	14,040	<b>49,071</b>	14,148	14,014	14,099	14,758	<b>57,019</b>
Exploration	519	275	275	<b>1,059</b>	275	275	275	275	<b>1,100</b>
Deprec., Deplet., & Amort.	3,545	2,903	2,903	<b>12,097</b>	2,903	2,903	2,903	2,903	<b>11,612</b>
Other non cash	161			-					-
<b>Ebit</b>	8,245	9,205	10,862	<b>35,915</b>	10,970	10,836	10,921	11,580	<b>44,307</b>
Interest	336	284	284	<b>720</b>	284	284	284	284	<b>1,136</b>
<b>Ebt</b>	7,909	8,921	10,578	<b>35,195</b>	10,686	10,552	10,637	11,296	<b>43,171</b>
Income Tax	2,768	3,123	3,702	<b>12,318</b>	3,740	3,693	3,723	3,954	<b>15,110</b>
<b>Net Income (\$mm)</b>									
Exploration and Production	2,578	3,212							
Other	3,036	2,723							
Unallocated	(473)	(136)							
Total	5,141	5,799	6,876	<b>22,876</b>	6,946	6,859	6,914	7,342	<b>28,061</b>
<b>Shares (millions)</b>	3,360	3,352	3,352	<b>3,359</b>	3,352	3,352	3,352	3,352	<b>3,352</b>
Per share (\$)	1.53	1.73	2.05	<b>6.81</b>	2.07	2.05	2.06	2.19	<b>8.37</b>
Ebitda Margin (E&P)	61%	56%	55%	<b>55%</b>	55%	55%	55%	55%	<b>55%</b>
Tax Rate	35%	35%	35%	<b>35%</b>	35%	35%	35%	35%	<b>35%</b>

Please see disclosures on the final page.

**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.

McDep does no investment banking business. McDep is not paid by covered companies including revenue from advertising, trading, consulting, subscriptions or research service. McDep shall not own more than 1% of outstanding stock in a covered company. No one at McDep is on the Board of Directors at a covered company nor is anyone at a covered company on the Board of Directors of McDep.

McDep or its employees may take positions in stocks the firm covers for research purposes. No trades in a subject stock shall be made within a week before or after a change in recommendation.

**Certification:** I, Kurt H. Wulff, certify that the views expressed in this research analysis accurately reflect my personal views about the subject securities and issuers. No part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this research analysis.

**Research Methodology/Ratings Description:** McDep Associates is an independent research originator focused on oil and gas stocks exclusively. The firm applies the thirty 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.