

## Put Away Some Natural Gas

### Summary and Recommendation

We recommend that investors buy some shares of natural gas stocks and not worry about the next few months of possible continued low commodity price. Since the clean fuel cannot be stored cheaply in large quantities the price swings wildly with the demand for heating and air conditioning among other factors. We sense that natural gas price has now declined to the point where producers will shut in, i.e. reduce, production. Our North American natural gas recommendations from largest to smallest market cap are Strong Buy **Burlington Resources (BR)** and Buys **PanCanadian Energy (PCX\_w)**, **Louis Dreyfus Natural Gas (LD)**, and **Energy Partners, Ltd. (EPL)**. Our Sell recommendation, **Calpine Corporation (CPN)**, is a reverse play on natural gas. Though we have not rated it yet, we have a brief positive comment on **Unocal Corporation (UCL)**. For more recommendations, McDep Ratios, EV/Ebitda multiples and cash distribution estimates see Tables L-1, L-2, S-1, S-2.

### Opportunity in Volatility

Investors might as well get used to energy price fluctuations. Electricity is going to be most volatile as generation is deregulated. It is even more costly to store than natural gas and has an even higher end value.

Yet, for those who can stand the volatility, we think the long-term investment case remains powerful. Even in a slow economy we need energy. And we remember well that energy investments were rewarding in the 1970s when the stock market as a whole rested.

### Natural Gas Price Near a Supply Floor

More specifically we think natural gas price appeared to bump along a bottom a week ago when the daily price at the Henry Hub dropped to \$2.18 per million British thermal units (mmbtu) (see chart). While we can never be sure there won't be another lower price at some point we take comfort in the attitude of **Unocal** Chief Executive Charles Williamson. Asked if producers were likely to shut in production in the next few weeks, Mr. Williamson thought not. Instead, he said that Unocal has cut back on drilling from having some 17 rigs under contract in the Gulf of Mexico to about 6. He further seemed to indicate that if the price of natural gas dropped below \$2 Unocal probably would shut in production. Unocal puts its book costs in the Gulf Region at \$1.99 per mcf equivalent (about \$2.07 per mmbtu) including depletion.

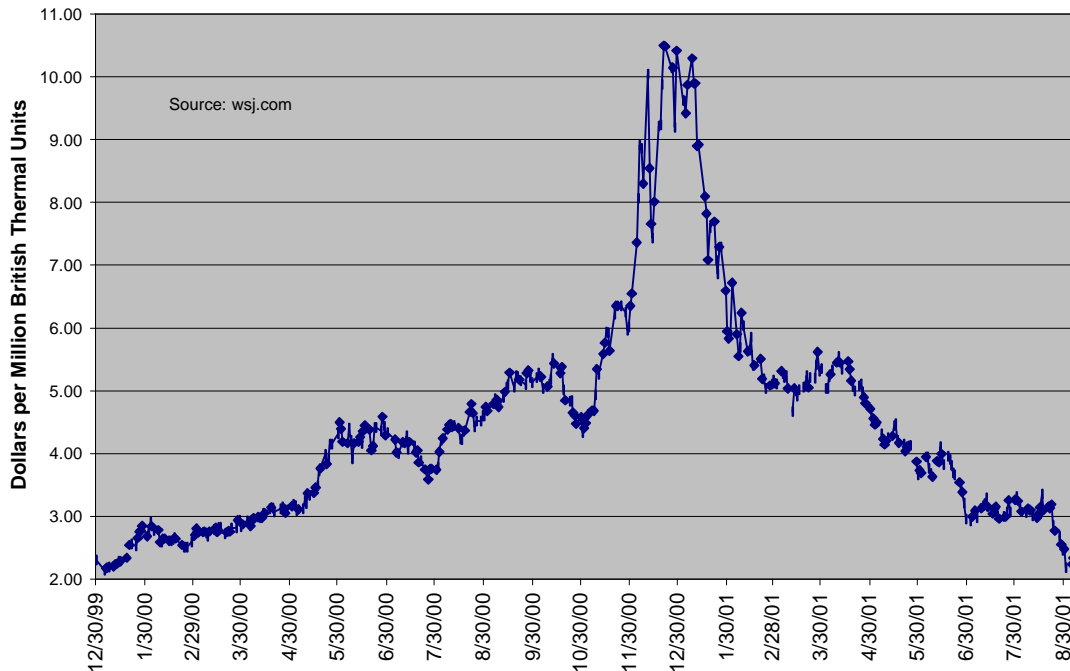
## Meter Reader

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

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Historical book costs understate the reality of new investment. A floor price suggested by historical costs is therefore a low number.

#### Daily Natural Gas Price at Henry Hub



Parenthetically we also like Unocal stock even if we do not yet have a rating on it. The McDep Ratio implies attractive value. The new CEO is impressive. Asian exposure at half the company's potential is quite promising. We visited Unocal's facilities in Indonesia earlier this year and in Thailand a few years ago. Recent discovery news has been good with two large, deep-water oil finds, one in Indonesia and the other in the Gulf of Mexico.

#### Smart Money Strikes Again

Only three weeks ago we thought it a favorable omen for natural gas investors that **Devon Energy** was acquiring Mitchell Energy (see *Meter Reader*, Smart Money Buying Natural Gas, August 20, 2001). Now last week's big news for the stocks we cover was Devon's offer for Anderson Exploration. Devon CEO Larry Nichols was high on Canada when we visited with him in early August. Now we know what he had in mind.

We are high on Canada, too. What the Devon deal did for our recommendations was to call attention to PanCanadian Energy.

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#### **PanCanadian Energy Trading in the U.S.**

Some high quality Canadian companies are now trading in the U.S. as well as in Canada. We hope to get more of them in our coverage. Anderson began trading on the NYSE only in May 2001 under the symbol AXN. Some investors may be thinking that if AXN attracted a takeover bid within four months of listing in NY, how long would it be before the same happens to PCX? Our goal is for PCX to appreciate, but we are not counting on a takeover.

When we were analyzing PanCanadian Petroleum we debated whether to recommend the stock when we did or to wait until trading started in the U.S. That is now a moot point, as U.S. investors can buy the stock on the New York Stock Exchange and not be concerned about taxation of a special dividend. Yet for those investors with efficient trading connections in Toronto, there are three stocks to consider.

Existing shares, PCP.TO, closed at C\$47.80 on Friday. Shareholders of record as of September 13 will receive a special dividend of C\$4.60 per share on September 14.

Shares to be issued about October 1 upon the reorganization of Canadian Pacific, owner of 85% of PanCanadian, closed at C\$42.83 on Friday. The "when issued" shares are in the name of PanCanadian Energy and trade in Canada under the symbol PCE.TO. If the special dividend were the only substantive difference, one would expect the PCE shares to trade C\$0.37 higher to match C\$47.80 minus C\$4.60.

PCX\_w on the NYSE closed at US\$27.30 on Friday. At the same time the Canadian dollar traded down to US\$0.6387 at the close on Friday. Since far greater volume traded in Canada, one would expect PCX to be PCE times the exchange rate, or US\$27.36. In fact, the spread is only US\$0.06.

The exercise described is only illustrative as the pricing relationships are constantly changing. In a few days, the special dividend will no longer be a consideration and PCP.TO should trade very close to PCE.TO. Meanwhile, most U.S. investors ought to be able to buy PCX very close to its Canadian equivalent, but traders and large investors will want to keep an eye on Toronto for any inefficiency.

#### **Energy Partners May Be Especially Timely For New Investment**

Volatility that struck EPL on the upside in June has struck the stock on the downside in September. We do not have any explanation for the recent weakness. It only takes a little selling pressure from an unknown source to affect the price of a stock we now classify as a Micro Cap considering that only about 30% of the shares are widely held.

As one might expect, EPL is employing fewer drilling rigs with the decline in natural gas price. Two of the remaining rigs are drilling exploratory prospects rather than

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development wells as the company has been emphasizing until now. Favorable results that could be known by month end might have a magnified impact on stock price from the currently depressed level. The X 8-A prospect in the Bay Marchand area has reserve potential of 40 million barrels (60% EPL working interest), enough to add several dollars per share of value if successful.

While we call EPL a gas stock from time to time, the company would generate 72% of its next twelve months revenue from oil by our projections. The dominant oil representation makes the recent stock price decline more puzzling, as oil price remains strong.

Kurt H. Wulff, CFA

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**Table L-1**  
**Mega Cap and Large Cap Energy Companies**  
**Rank by McDep Ratio: Market Cap and Debt to Present Value**

	<i>Symbol/ Rating</i>	<i>Price (\$/sh) 7-Sep 2001</i>	<i>Shares (mm)</i>	<i>Market Cap (\$mm)</i>	<i>Net Present Value (\$/sh)</i>	<i>Debt/ Present Value</i>	<i>McDep Ratio</i>
<b>Mega Cap</b>							
Exxon Mobil Corporation	XOM	40.90	6,963	285,000	39.10	0.04	1.04
TOTAL Finna Elf S.A.	TOT	72.40	1,400	101,000	72.00	0.16	1.00
Royal Dutch/Shell	RD	54.55	3,544	193,000	56.70	0.06	0.96
BP PLC	BP	50.27	3,744	188,000	52.90	0.14	0.96
Chevron (incl. Texaco)	CHV	92.40	1,063	98,300	98.00	0.15	0.95
	<i>Total or Median</i>			<i>865,000</i>		<i>0.14</i>	<i>0.96</i>
<b>Power</b>							
Enron Corp.	ENE	31.57	891	28,100	5.40	0.86	1.68
Dynegy Inc.	DYN	40.15	338	13,600	15.40	0.63	1.60
Calpine Corporation	CPN 4	29.96	318	9,500	14.40	0.60	1.43
Duke Energy Corporation	DUK	40.20	779	31,300	19.90	0.62	1.39
Mirant Corporation	MIR	25.99	353	9,200	12.70	0.73	1.28
Williams Companies	WMB	31.47	485	15,300	16.60	0.69	1.28
AES Corporation	AES	29.58	538	15,900	17.40	0.71	1.20
El Paso Corporation	EPG	50.00	532	26,600	38.40	0.53	1.14
American Electric Power Co. Inc.	AEP 2	47.11	322	15,200	33.20	0.68	1.13
Southern Company	SO	23.86	683	16,300	22.20	0.47	1.04
Exelon Corporation	EXC 2	55.17	324	17,900	71.30	0.44	0.87
	<i>Total or Median</i>			<i>199,000</i>		<i>0.63</i>	<i>1.28</i>
<b>Natural Gas and Oil</b>							
Occidental Petroleum	OXY	28.41	372	10,600	25.30	0.52	1.06
Anadarko Petroleum Corp.	APC	53.33	263	14,000	66.30	0.24	0.85
Phillips (incl. Tosco)	P	59.17	383	22,700	75.90	0.31	0.85
Burlington Resources, Inc	BR 1	37.89	215	8,100	48.50	0.19	0.82
Conoco Inc.	COC.B	30.97	636	19,700	43.70	0.31	0.80
ENI S.p.A.	E	65.60	800	52,500	91.90	0.10	0.74
	<i>Total or Median</i>			<i>128,000</i>		<i>0.27</i>	<i>0.83</i>
<b>Service</b>							
Baker Hughes Inc.	BHI	33.95	338	11,500	24.50	0.13	1.34
Schlumberger Ltd.	SLB	50.64	581	29,400	44.00	0.12	1.13
Halliburton Company	HAL	28.28	430	12,200	27.20	0.13	1.04

Buy/Sell rating after symbol: 1 - Strong Buy, 2 - Buy, 4 - Sell

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

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**Table L-2**  
**Mega Cap and Large Cap Energy Companies**  
**Rank by EV/Ebitda: Enterprise Value to Earnings Before Interest, Tax, Deprec.**

	<i>Symbol</i>	<i>Price (\$/sh)</i> <i>7-Sep 2001</i>	<i>EV/Sales</i> <i>2001E</i>	<i>EV/Ebitda</i> <i>NTM</i>	<i>P/E</i> <i>NTM</i>	<i>Dividend or Distribution</i> <i>NTM (%)</i>	<i>PV/Ebitda</i> <i>NTM</i>	
<b>Mega Cap</b>								
	E Exxon Mobil Corporation	XOM	40.90	1.3	8.4	16	2.2	8.0
	R Royal Dutch/Shell	RD	54.55	1.1	7.7	16	2.6	8.0
	B BP PLC	BP	50.27	1.1	7.7	16	2.6	8.0
	C Chevron (incl. Texaco)	CHV	92.40	1.2	7.6	16	2.8	8.0
	T TOTAL Finna Elf S.A.	TOT	72.40	1.1	7.0	17	2.5	7.0
	<i>Median</i>			<i>1.1</i>	<i>7.7</i>	<i>16</i>	<i>2.6</i>	<i>8.0</i>
<b>Power</b>								
	E Enron Corp.	ENE	31.57	0.3	13.5	16	1.6	8.0
	D Dynegy Inc.	DYN	40.15	0.3	12.8	19	0.7	8.0
	C Calpine Corporation	CPN 4	29.96	2.3	11.4	16	-	8.0
	D Duke Energy Corporation	DUK	40.20	0.9	11.1	16	2.7	8.0
	M Mirant Corporation	MIR	25.99	0.6	10.3	12	-	8.0
	W Williams Companies	WMB	31.47	3.3	10.2	14	1.9	8.0
	A AES Corporation	AES	29.58	3.4	9.6	14	-	8.0
	E El Paso Corporation	EPG	50.00	0.9	9.1	14	1.7	8.0
	A American Electric Power Co. Inc.	AEP 2	47.11	0.7	9.1	13	5.1	8.0
	S Southern Company	SO	23.86	2.7	8.3	15	5.6	8.0
	E Exelon Corporation	EXC 2	55.17	2.4	7.0	12	3.1	8.0
	<i>Median</i>			<i>0.9</i>	<i>10.2</i>	<i>14</i>	<i>1.7</i>	<i>8.0</i>
<b>Natural Gas and Oil</b>								
	B Burlington Resources, Inc	BR 1	37.89	4.4	7.4	37	1.5	9.0
	O Occidental Petroleum	OXY	28.41	1.5	6.4	9	3.5	7.0
	P Phillips (incl. Tosco)	P	59.17	0.8	5.9	10	2.4	7.0
	C Conoco Inc.	COC.B	30.97	0.8	5.6	10	2.5	7.0
	A Anadarko Petroleum Corp.	APC	53.33	2.3	5.1	9	0.4	6.0
	E ENI S.p.A.	E	65.60	1.2	3.7	7	2.4	5.0
	<i>Median</i>			<i>1.3</i>	<i>5.8</i>	<i>9</i>	<i>2.4</i>	<i>7.0</i>
<b>Service</b>								
	B Baker Hughes Inc.	BHI	33.95	2.2	10.7	24	1.4	8.0
	S Schlumberger Ltd.	SLB	50.64	2.6	9.1	25	1.5	8.0
	H Halliburton Company	HAL	28.28	1.0	8.3	19	1.8	8.0

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended March 31, 2002; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

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	<i>Symbol/ Rating</i>	<i>Price (\$/sh) 7-Sep 2001</i>	<i>Shares (mm)</i>	<i>Market Cap (\$mm)</i>	<i>Net Present Value (\$/sh)</i>	<i>Debt/ Present Value</i>	<i>McDep Ratio</i>	
<b>Power</b>								
Consol Energy Inc.	CNX	25.59	79	2,000	27.80	0.57	0.97	
Sempra Energy	SRE	27.30	203	5,500	32.40	0.57	0.93	
CMS Energy Corporation	CMS	23.51	128	3,000	34.00	0.70	0.91	
Constellation Energy Group	CEG	29.40	152	4,500	46.80	0.40	0.78	
<i>Total or Median</i>				<i>15,000</i>		<i>0.57</i>	<i>0.92</i>	
<b>Natural Gas and Oil</b>								
Valero Energy Corp.(with UDS)	VLO	42.77	110	4,700	54.50	0.49	0.89	
Ocean Energy, Inc.	OEI	19.90	177	3,500	24.40	0.25	0.86	
PanCanadian Energy	PCX_w	2	27.30	262	7,150	33.90	0.14	0.83
Unocal Corporation	UCL	35.90	257	9,200	47.80	0.30	0.83	
Marathon Oil Corporation	MRO	1	32.40	310	10,000	42.60	0.26	0.82
Petro-Canada	PCZ	25.83	267	6,900	33.00	0.08	0.80	
Norsk Hydro ASA (49%)	NHY	42.97	128	5,500	61.60	0.16	0.74	
Devon Energy Corp (incl MND)	DVN	42.76	165	7,100	66.20	0.26	0.74	
PetroChina Company Ltd (10%)	PTR	2	20.58	176	3,600	32.50	0.15	0.69
<i>Total or Median</i>				<i>57,700</i>		<i>0.25</i>	<i>0.82</i>	
<b>Small Cap</b>								
Quicksilver Resources Inc.	KWK	15.80	19.3	310	10.80	0.59	1.19	
Spinnaker Exploration Company	SKE	37.60	28.4	1,070	33.60	-	1.12	
XTO Energy Inc.	XTO	15.30	123.0	1,880	17.80	0.29	0.90	
Swift Energy Company	SFY	25.50	25.7	660	33.80	0.21	0.81	
Newfield Exploration Company	NFX	34.67	49.3	1,710	46.80	0.18	0.79	
Louis Dreyfus Natural Gas Corp.	LD	2	32.96	44.8	1,480	45.90	0.22	0.78
Stone Energy Company	SGY	38.49	26.5	1,020	51.90	0.09	0.77	
Encore Acquisition Corporation	EAC	12.55	30.0	380	17.40	0.14	0.76	
Penn Virginia Corporation	PVA	33.53	8.8	300	44.20	0.00	0.76	
Forest Oil Corporation	FST	27.15	50.2	1,360	42.10	0.21	0.72	
<i>Total or Median</i>				<i>10,170</i>		<i>0.19</i>	<i>0.78</i>	
<b>Trusts and Partnerships</b>								
TEPPCO Partners, L.P.	TPP	31.88	38	1,210	13.20	0.65	1.49	
Dorchester Hugoton, Ltd.	DHULZ	14.00	10.7	150	11.30	-	1.24	
Cross Timbers Royalty Trust	CRT	19.15	6.0	115	16.90	-	1.13	
San Juan Basin Royalty Trust	SJT	12.30	46.6	570	14.70	-	0.84	
Hugoton RoyaltyTrust	HGT	12.35	40.0	490	15.30	-	0.81	
<i>Total or Median</i>				<i>2,540</i>		<i>-</i>	<i>1.13</i>	
<b>Micro Cap</b>								
Abraxas Petroleum Corporation	ABP	2.21	23.6	52	1.70	0.89	1.04	
Purcell Energy, Ltd. (US\$)	PEL.TO	2.18	26.0	57	3.70	0.07	0.63	
Energy Partners Ltd.(30%)	EPL	2	8.79	8.1	70	16.40	0.07	0.57

Buy/Sell rating after symbol: 1 - Strong Buy, 2 - Buy

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	<i>Symbol/ Rating</i>	<i>Price (\$/sh) 7-Sep 2001</i>	<i>EV/ Sales 2001E</i>	<i>EV/ Ebitda NTM</i>	<i>Dividend or Distribution P/E NTM</i>	<i>PV/ NTM</i>	<i>PV/ Ebitda NTM</i>		
<b>Power</b>									
	Consol Energy Inc.	CNX	25.59	2.1	7.7	9	4.4	8.0	
	Sempra Energy	SRE	27.30	1.2	7.5	11	3.7	8.0	
	CMS Energy Corporation	CMS	23.51	0.9	7.3	8	6.2	8.0	
	Constellation Energy Group	CEG	29.40	1.8	6.2	9	1.6	8.0	
	<i>Median</i>			<i>1.5</i>	<i>7.4</i>	<i>9</i>	<i>4.0</i>	<i>8.0</i>	
<b>Natural Gas and Oil</b>									
	Valero Energy Corp.(with UDS)	VLO	42.77	0.3	6.2	6	0.7	7.0	
	Unocal Corporation	UCL	35.90	2.3	5.8	15	2.2	7.0	
	Ocean Energy, Inc.	OEI	19.90	3.6	5.6	12	0.8	6.5	
	Devon Energy Corp (incl MND)	DVN	42.76	2.6	4.8	11	0.5	6.5	
	Petro-Canada	PCZ	25.83	1.4	4.8	10	1.0	6.0	
	PanCanadian Energy	PCX_w	2	27.30	1.2	4.6	9	1.0	5.5
	Marathon Oil Corporation	MRO	1	32.40	0.4	4.1	8	2.8	5.0
	Norsk Hydro ASA (49%)	NHY		42.97	0.8	3.7	9	2.4	5.0
	PetroChina Company Ltd (10%)	PTR	2	20.58	1.5	2.8	5	8.3	4.0
	<i>Median</i>			<i>1.4</i>	<i>4.8</i>	<i>9</i>	<i>1.0</i>	<i>6.0</i>	
<b>Small Cap</b>									
	Quicksilver Resources Inc.	KWK		15.80	4.7	10.7	-	9.0	
	Spinnaker Exploration Company	SKE		37.60	6.7	7.8	30	-	7.0
	XTO Energy Inc.	XTO		15.30	4.7	7.2	17	0.3	8.0
	Louis Dreyfus Natural Gas Corp.	LD	2	32.96	4.8	7.0	19	-	9.0
	Encore Acquisition Corporation	EAC		12.55	3.8	6.1	14	-	8.0
	Swift Energy Company	SFY		25.50	4.2	5.6	13	-	7.0
	Forest Oil Corporation	FST		27.15	2.1	5.0	19	-	7.0
	Newfield Exploration Company	NFX		34.67	3.7	4.7	16	-	6.0
	Stone Energy Company	SGY		38.49	3.6	4.6	20	-	6.0
	Penn Virginia Corporation	PVA		33.53	3.3	4.6	10	2.7	6.0
	<i>Median</i>				<i>4.0</i>	<i>5.9</i>	<i>17</i>	<i>-</i>	<i>7.0</i>
<b>Trusts and Partnerships</b>									
	Dorchester Hugoton, Ltd.	DHULZ		14.00	8.5	12.6	16	21.2	10.2
	TEPPCO Partners, L.P.	TPP		31.88	0.7	11.9	16	6.6	8.0
	Cross Timbers Royalty Trust	CRT		19.15	6.9	11.6	13	7.8	10.2
	San Juan Basin Royalty Trust	SJT		12.30	6.6	8.5	12	8.0	10.1
	Hugoton RoyaltyTrust	HGT		12.35	5.5	8.2	11	8.7	10.2
	<i>Median</i>				<i>6.6</i>	<i>11.6</i>	<i>13</i>	<i>8.0</i>	<i>10.2</i>
<b>Micro Cap</b>									
	Abraxas Petroleum Corporation	ABP		2.21	4.8	7.3	-	7.0	
	Purcell Energy, Ltd. (US\$)	PEL.TO		2.18	2.9	3.8	12	-	6.0
	Energy Partners Ltd.(30%)	EPL	2	8.79	1.8	3.3	28	-	5.9

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended June 30, 2002; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

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