

Meter Reader

A Weekly Analysis of Energy Stocks Using the McDep Ratio

May 3, 2005

In It to Win It

Summary and Recommendation

Our weekly update highlights buy recommendations of **PetroChina (PTR)**, **CNOOC Ltd. (CEO)** and **Burlington Resources (BR)** where we are “in it to win it”, in the words of a Chicago investor. A widely anticipated upward revaluation of the Chinese currency ought to have a positive impact on the dollar stock price of PTR and CEO though the explanation could be complicated. Separately, the ten bagger performance of **San Juan Basin Royalty Trust (SJT)** ought to inspire continued improved performance of **Burlington Resources (BR)**, concentrated on similar if not identical properties. Our “in it to win it” conviction is that oil and gas are undervalued as commodities and buy-recommended oil and gas shares are undervalued by the McDep Ratio.

China Currency Question

An investor asks, “If China revalues its currency relative to the dollar, what does that mean for PetroChina? There can be many contradicting factors, but generally speaking an upward revaluation of China’s currency should be positive for the dollar price of PetroChina stock. The historical presumption is that local markets have the most influence in stock pricing. If local investors continue to price the stock at the same local price, the dollar equivalent should be higher if the local currency increases in value.

The impact of currency change on profits is likely to be beneficial in dollar terms depending on how selling price and operating costs change. Most of PetroChina’s revenue appears to be priced in local currency. The government seems to limit oil product price and the price for natural gas seems artificially low. Just by remaining the same in Chinese currency, revenue would go up in dollar terms. Partly offsetting that, local cost, such as for labor, would also go up in dollar terms.

CNOOC Ltd appears to receive a world price for crude oil that it sells to others while the price it receives for natural gas may increase in dollar terms with upward revaluation of the Chinese currency.

PetroChina has a particularly low McDep Ratio that implies stock price could be higher considering the international value of the business. A currency change may be the catalyst that contributes to a higher McDep Ratio.

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Ten Bagger Inspiration

One stock that returns ten times in ten years, or 26% per year for that period, would give a meaningful boost to almost any portfolio. The challenge is not only to identify the ten-bagger in advance, but also to trade successfully. Of course, there is no assurance of future performance after past gains. With those qualifications in mind we recently highlighted a stock that achieved that rare status (see *Stock Idea, San Juan Basin Royalty Trust (SJT)*, [Ten-Bagger](#), April 28, 2005).

Presenting a table of comparative performance of several stocks, we expressed reservations about the data. Prompted by the investor who is “In It to Win It”, we retrieved performance for the same period from Bloomberg. The results of total equity return are somewhat different, but the ranking is still the same (see table [Ten-Year Equity Returns, 1995-2004](#)). If we had adjusted for debt, the return for XTO would be close to that for SJT while the returns for Devon and Anadarko would be closer to that for BR.

Ten-Year Equity Returns, 1995-2004 Percent Per Year

	Bloomberg	Calculated from Yahoo
XTO Energy	36	44
San Juan Basin Royalty Trust	28	29
ExxonMobil	16	20
Devon Energy	16	17
Anadarko Petroleum	14	14
Burlington Resources	11	13

Another investor who apparently owned **Burlington Resources (BR)** was concerned that BR did not rank higher in past performance. Though one can never be sure about the future, BR’s period of weak performance was in the first half of the ten-year record. In the last five years the company has done better. We sense an improving appreciation by BR management of the factors that have made SJT a better stock than BR even though BR is the working interest owner and operator of most of the properties of SJT.

Commodity Price Momentum Positive

Six-year commodity price for oil and natural gas are both above the 40-week average of \$42.16 a barrel and \$6.00 a million btu (see chart [Six-Year and One-Year Natural Gas and Oil Futures](#)). Nor is the pace of price gain too rapid as one-year oil trades under \$63.67 a barrel, the warning limit at 1.35 times the 40-week moving average (see chart [Oil One-Year Futures Strip](#)).

McDep Ratios at a median 0.89 imply that stocks are valued as though oil were \$36 a barrel or less (see table [Rank by McDep Ratio](#)). Considering the industry prospects, other valuation measures all seem low at a median unlevered cash flow multiple of 5.0

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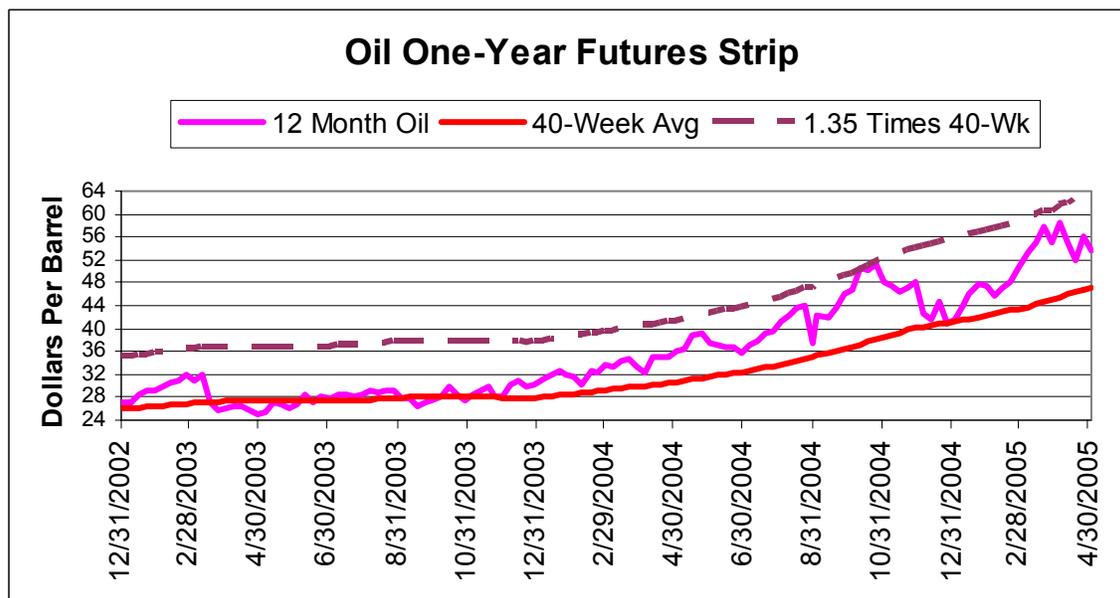
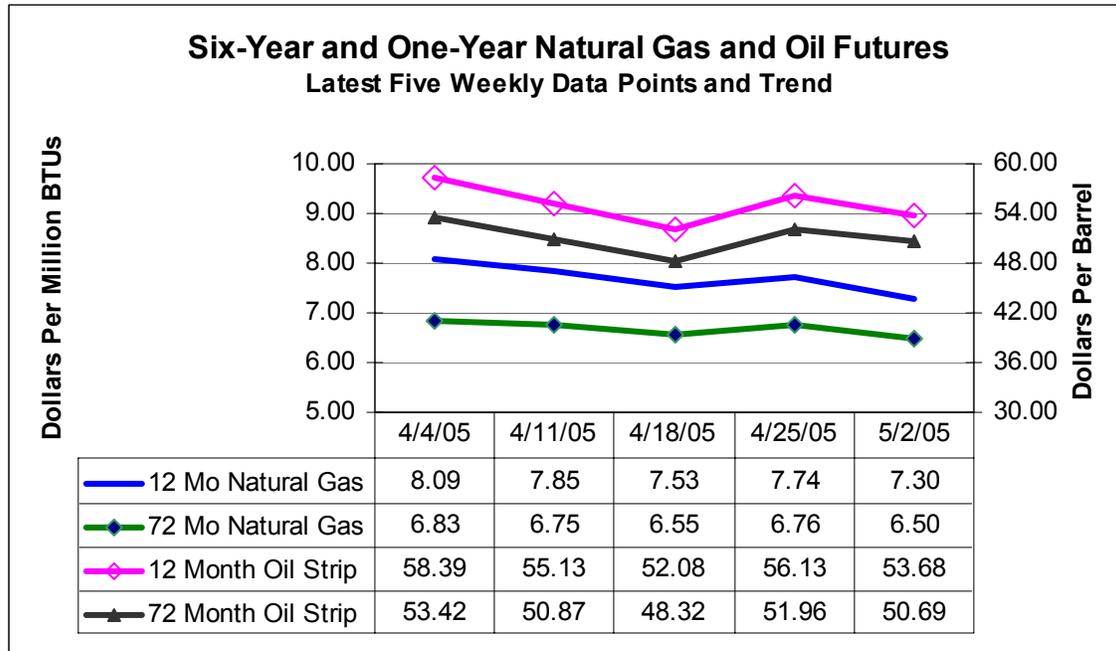
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times, median P/E at 9.6 and median dividend yield at 2.3% per year (see table Rank by EV/Ebitda).

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) 2-May 2005	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio
Mega Cap								
Shell Transport and Trading Co. plc	SC	B	54.45	1,587	86,000	55.90	0.16	0.98
Exxon Mobil Corporation	XOM	B	57.74	6,461	373,000	60.00	0.06	0.96
BP plc	BP	B	61.23	3,601	221,000	64.00	0.12	0.96
Total S.A.	TOT	B	111.73	1,218	136,000	120.00	0.16	0.94
Royal Dutch Petroleum	RD	B	58.89	2,016	119,000	66.00	0.16	0.91
ChevronTexaco Corporation	CVX	B	53.21	2,100	112,000	76.00	0.10	0.73
<i>Total or Median</i>					<i>1,047,000</i>		<i>0.14</i>	<i>0.95</i>
Producer/Refiners - Large Cap and Mid Cap								
Kinder Morgan, Inc.	KMI	S2	76.28	125	9,540	20.00	0.74	1.74
Marathon Oil Corporation	MRO	B	47.85	349	16,680	42.00	0.30	1.10
Imperial Oil Limited (30%)	IMO	B	70.00	105	7,340	64.00	0.10	1.08
ConocoPhillips	COP	B	106.70	706	75,300	128.00	0.23	0.87
Petro-Canada	PCZ	B	56.85	263	14,970	70.00	0.19	0.85
Norsk Hydro ASA	NHY	B	78.54	252	19,820	101.00	0.16	0.81
Suncor Energy	SU	B	38.42	460	17,670	54.00	0.09	0.74
PetroChina Company Ltd (10%)	PTR	B	60.85	176	10,700	94.00	0.05	0.67
Lukoil Oil Company	LUKOY	B	135.50	209	28,000	208.00	0.03	0.66
<i>Total or Median</i>					<i>200,000</i>		<i>0.16</i>	<i>0.85</i>
Independent Natural Gas and Oil - Large Cap and Mid Cap								
XTO Energy Inc.	XTO	B	30.79	349	10,760	33.80	0.17	0.93
Encana Corporation	ECA	B	67.01	471	31,500	77.00	0.19	0.89
Unocal Corporation	UCL	B	55.65	271	15,100	65.00	0.21	0.89
Occidental Petroleum Corp.	OXY	B	70.00	406	28,400	87.00	0.14	0.83
CNOOC Limited (19%)	CEO	B	54.35	78	4,250	67.00	-	0.81
Devon Energy Corporation	DVN	B	46.46	500	23,200	63.00	0.16	0.78
Burlington Resources	BR	B	49.97	389	19,400	67.00	0.12	0.77
Anadarko Petroleum Corp.	APC	B	74.22	246	18,300	113.00	0.14	0.71
<i>Total or Median</i>					<i>151,000</i>		<i>0.15</i>	<i>0.82</i>
Independent Natural Gas and Oil - Small Cap								
Berry Petroleum Company	BRY	B	47.55	22	1,070	50.00	0.12	0.96
Energy Partners Ltd.	EPL	B	23.25	39	920	30.00	0.20	0.82
Cimarex Energy Company	XEC	B	36.00	81	2,900	50.00	0.15	0.76
Encore Acquisition Company	EAC	B	37.78	33	1,230	57.00	0.19	0.73
<i>Total or Median</i>					<i>6,100</i>		<i>0.17</i>	<i>0.79</i>
Income								
Kinder Morgan Energy Partners, L.P.	KMP	S3	47.76	150	7,160	15.00	0.52	2.05
Kinder Morgan Management, LLC	KMR	S3	44.38	56	2,500	15.00	0.52	1.95
Pengrowth Energy Trust	PGH		20.20	136	2,750	16.00	0.24	1.20
San Juan Basin Royalty Trust	SJT		37.35	47	1,740	32.00	-	1.17
Enerplus Resources Fund	ERF		35.19	104	3,660	32.00	0.16	1.08
Canadian Oil Sands Trust (US\$)	COSWF	B	65.29	92	6,020	94.00	0.16	0.74
<i>Total or Median</i>					<i>23,800</i>		<i>0.20</i>	<i>1.18</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) 2-May 2005	Adjstd Resrvs/ Prod NTM	PV/ Ebitda NTM	EV/ Ebitda NTM	P/E NTM	Divd or Distrib NTM (%)
Mega Cap								
Exxon Mobil Corporation	XOM	B	57.74	11.1	6.7	6.5	11	1.9
BP plc	BP	B	61.23	9.4	5.9	5.7	11	3.3
Total S.A.	TOT	B	111.73	8.9	5.8	5.4	11	2.8
Shell Transport and Trading Co. plc	SC	B	54.45	7.6	5.1	5.0	10	3.6
Royal Dutch Petroleum	RD	B	58.89	7.6	5.1	4.7	9	3.9
ChevronTexaco Corporation	CVX	B	53.21	9.7	6.1	4.4	8	3.4
	<i>Median</i>			9.2	5.8	5.2	10	3.4
Producer/Refiners - Large Cap and Mid Cap								
Kinder Morgan, Inc.	KMI	S2	76.28		7.5	13.0	17	3.7
Suncor Energy	SU	B	38.42	18.2	10.8	8.0	19	0.5
Imperial Oil Limited (30%)	IMO	B	70.00	9.8	7.3	7.9	15	1.0
Marathon Oil Corporation	MRO	B	47.85	7.5	4.4	4.8	8	2.3
ConocoPhillips	COP	B	106.70	11.6	5.3	4.6	7	2.3
Petro-Canada	PCZ	B	56.85	6.7	5.2	4.4	8	0.8
Norsk Hydro ASA	NHY	B	78.54	8.5	5.0	4.1	9	4.0
PetroChina Company Ltd (10%)	PTR	B	60.85	13.5	5.8	3.9	7	5.2
Lukoil Oil Company	LUKOY	B	135.50	12.2	4.2	2.8	5	3.0
	<i>Median</i>			10.7	5.3	4.6	8	2.3
Independent Natural Gas and Oil - Large Cap and Mid Cap								
XTO Energy Inc.	XTO	B	30.79	11.6	6.2	5.7	12	0.6
Encana Corporation	ECA	B	67.01	7.2	5.6	5.0	11	0.9
Occidental Petroleum Corp.	OXY	B	70.00	11.6	5.7	4.7	8	1.8
Unocal Corporation	UCL	B	55.65	8.5	5.1	4.5	9	1.4
Burlington Resources	BR	B	49.97	9.9	5.8	4.5	10	0.7
Anadarko Petroleum Corp.	APC	B	74.22	11.9	6.0	4.2	8	1.0
Devon Energy Corporation	DVN	B	46.46	7.9	5.2	4.0	9	0.6
CNOOC Limited (19%)	CEO	B	54.35	8.7	4.4	3.6	6	3.8
	<i>Median</i>			9.3	5.7	4.5	9	0.9
Independent Natural Gas and Oil - Small Cap								
Berry Petroleum Company	BRYP	B	47.55	10.9	5.8	5.6	14	1.0
Encore Acquisition Company	EAC	B	37.78	15.6	7.0	5.1	11	-
Cimarex Energy Company	XEC	B	36.00	7.6	4.9	3.7	9	-
Energy Partners Ltd.	EPL	B	23.25	5.3	4.1	3.4	10	-
	<i>Median</i>			9.2	5.4	4.4	10	-
Income								
Kinder Morgan Energy Partners, L.P.	KMP	S3	47.76		7.6	15.6	20	6.1
Kinder Morgan Management, LLC	KMR	S3	44.38		7.6	14.8	19	6.6
San Juan Basin Royalty Trust	SJT		37.35	12.1	9.2	10.7	12	8.4
Enerplus Resources Fund	ERF		35.19	8.3	5.9	6.4	12	9.5
Pengrowth Energy Trust	PGH		20.20	7.9	5.1	6.2	10	10.9
Canadian Oil Sands Trust (US\$)	COSWF	B	65.29	20.0	8.2	6.1	6	2.4
	<i>Median</i>			10.2	7.6	8.6	12	7.5

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended March 31, 2006; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

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Index of Recent Research

Stock Ideas

<u>Date</u>	<u>Symbol</u>	<u>Stock</u>	<u>Theme</u>
29-Apr	MRO	Marathon Oil Corporation	Between China and Canada
28-Apr	SJT	San Juan Basin Royalty Trust	Ten Bagger
27-Apr	PCZ	Petro-Canada	Oil Sands Strategy
26-Apr	COSWF	Canadian Oil Sands Trust	If You Could Own Only One
22-Apr	OXY	Occidental Petroleum Corporation	Return to Libya
22-Apr	ECA	EnCana Corporation	Natural Gas Leader
14-Apr	KMx	Kinder Morgan	Our Contrary View
8-Apr	NHY	Norsk Hydro ASA	New High for Oil and Aluminum
7-Apr	* LUKOY	Lukoil Oil Company	National Treasure
31-Mar	* BR	Burlington Resources, Inc.	San Juan Basin Value Expanding
29-Mar	* CEO	CNOOC Ltd	Nice Dividend
23-Mar	* CEO	CNOOC Ltd	Volume Gains Expected in 2005
21-Mar	* PTR	PetroChina Company Limited	Nice Dividend
18-Mar	* RD	Royal Dutch Petroleum	Transformation Approaching
18-Mar	* SC	Shell Transport & Trading Company, p.l.c.	Transformation Approaching
17-Mar	* BP	BP p.l.c.	More Cash Flow to Owners
7-Mar	* EPL	Energy Partners, Ltd.	Layer Cake
7-Mar	* DVN	Devon Energy Corporation	Target Diversification
7-Mar	* XEC	Cimarex Energy Company	Raise Net Present Value to \$50 a Share
7-Mar	* XOM	Exxon Mobil Corporation	Raise Net Present Value to \$60 a Share
2-Mar	* SU	Suncor Energy Inc.	Fire Tests Patience
28-Feb	* CVX	ChevronTexaco Corporation	Raise Net Present Value to \$76 a Share
25-Feb	* COP	ConocoPhillips	Raise Net Present Value to \$128 a Share
18-Feb	* EAC	Encore Acquisition Company	Raise Net Present Value to \$57 a Share
17-Feb	* APC	Anadarko Petroleum Corporation	Raise Net Present Value to \$113 a Share
17-Feb	* XTO	XTO Energy Inc.	Raise Net Present Value to \$45 a Share
14-Feb	* TOT	Total S.A.	Raise Net Present Value to \$120 a Share
10-Feb	* UCL	Unocal Corporation	Raise Net Present Value to \$65 a Share
9-Feb	* EPL	Energy Partners, Ltd.	South Timbalier Thrill
7-Feb	* BRY	Berry Petroleum Company	A Touch of Glamour
7-Feb	* DVN	Devon Energy Corporation	Raise Net Present Value to \$63 a Share
7-Feb	* IMO	Imperial Oil Limited	Raise Net Present Value to US\$64 a Share

Meter Reader - A Weekly Analysis

25-Apr	*	Refining Deal
18-Apr	*	Trend Intact
11-Apr	*	Positive Signs
5-Apr	*	Unocal Acquisition by ChevronTexaco
29-Mar	*	Value, Momentum and Growth
22-Mar	*	The Buy Stocks, Sell Commodity Futures Arbitrage

* Archived on www.mcdep.com

Also see

U.S. Natural Gas Royalty Trusts - A Weekly Analysis, and Single-Trust Analyses

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