

Meter Reader

A Weekly Analysis of Energy Stocks Using the McDep Ratio

May 10, 2005

Nice Return for Low Risk

Summary and Recommendation

Five mega cap energy producers are priced to deliver an equity return of 11% per year assuming light, sweet crude oil at about \$37 a barrel. The expected unlevered return of 7% per year is boosted to a levered 8% real with modest debt. Add the recent year over year inflation of 3% and the total equity return would be 11% per year. Meanwhile actual long-term oil price is likely to be higher considering that current futures prices average about \$50. The median return for the next ten years may well beat the median of 15% per year for the past ten years. By the McDep Ratio, buy recommendations **ExxonMobil (XOM)**, **BP plc (BP)**, **Royal Dutch/Shell (RD/SC)** and **Total S.A. (TOT)** are closely ranked while buy-recommended and newly renamed **Chevron (CVX)** appears to offer more appreciation potential.

Mega Caps Outperform on Ten, Five and One-Year Basis

Total return calculations from Bloomberg illustrate a favorable historical pattern (see table Equity Total Return thru 4/30/05). Such comparisons are inevitably influenced strongly by recent gains. Similarly because the companies are leaders in the economy it is no surprise that the long-term performance has been favorable.

Mega Cap Energy Producers
Equity Total Return thru 4/30/05
(percent per year)

In other ways the comparison may be understated. It looks like the return for Total excludes the *avoir fiscal* payment to shareholders from the French government that added some 2-3 percentage points to total return. That adjustment would make Total the best performer for the ten

	<i>10 year</i>	<i>5 year</i>	<i>1 year</i>
ExxonMobil (XOM)	16	11	37
Total S.A. (TOT)	16	11	26
BP plc (BP)	15	7	19
Shell Transport (SC)	13	6	33
Chevron (CVX)	12	8	17
Royal Dutch (RD)	10	4	26
S&P 500	10	-3	6

and five year period. Apparently the bonus is being phased out and we do not include it in our estimate of future dividends.

Four of the five companies have made major acquisitions. Investors in the acquired companies, which typically got a premium for their stock, may have earned a higher total return than the amount shown for the surviving company.

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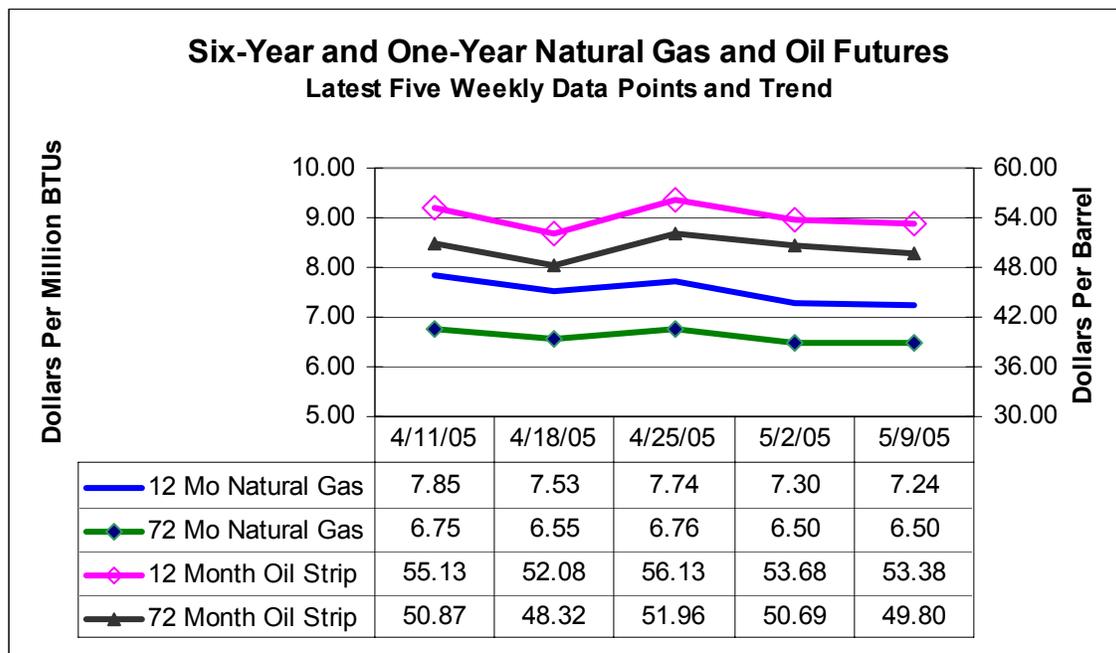
The main caution about future performance is that the gain for the past year has already been strong at a median 26%. Yet long-term oil price increased 73% from \$30 a barrel to \$52 a barrel over the same period. As a result the inherent caution of investors seems to have restrained stock prices for mega caps by such an amount that the risk of sustained stock price decline seems low.

If risk is low, attractive return likely and high return possible, the combination of risk and reward seems quite favorable for most investors. Finally, for taxable investors the median mega cap dividend yield of 3.3% taxed at about 15% beats the ten-year Treasury Inflation Protected Security at 1.7% taxed at about 35%

Quantitative Updates

Six-year commodity price for oil and natural gas are both above the 40-week average of \$42.53 a barrel and \$6.02 a million btu (see chart [Six-Year and One-Year Natural Gas and Oil Futures](#)). McDep Ratios at a median 0.90 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 times, median P/E at 9.6 and median dividend yield at 2.3% per year (see table [Rank by EV/Ebitda](#)). Single-stock analyses are available on more than 31 stocks (see [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) 9-May 2005	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio
Mega Cap								
BP plc	BP	B	61.90	3,574	221,000	64.00	0.13	0.97
Shell Transport and Trading Co. plc	SC	B	54.00	1,587	86,000	56.00	0.14	0.97
Exxon Mobil Corporation	XOM	B	58.01	6,421	373,000	60.00	0.06	0.97
Total S.A.	TOT	B	114.78	1,192	137,000	126.00	0.16	0.92
Royal Dutch Petroleum	RD	B	59.48	2,018	120,000	66.00	0.14	0.91
Chevron Corporation	CVX	B	53.45	2,100	112,000	76.00	0.10	0.73
<i>Total or Median</i>					<i>1,049,000</i>		<i>0.13</i>	<i>0.95</i>
Producer/Refiners - Large Cap and Mid Cap								
Kinder Morgan, Inc.	KMI	S2	77.04	125	9,630	20.00	0.74	1.75
Marathon Oil Corporation	MRO	B	49.28	349	17,180	42.00	0.30	1.12
Imperial Oil Limited (30%)	IMO	B	70.30	105	7,370	64.00	0.11	1.09
ConocoPhillips	COP	B	106.76	706	75,400	128.00	0.23	0.87
Petro-Canada	PCZ	B	58.26	263	15,350	70.00	0.19	0.86
Norsk Hydro ASA	NHY	B	81.55	252	20,570	101.00	0.16	0.84
Suncor Energy	SU	B	39.80	460	18,310	54.00	0.10	0.76
PetroChina Company Ltd (10%)	PTR	B	62.19	176	10,930	94.00	0.05	0.68
Lukoil Oil Company	LUKOY	B	34.30	834	29,000	52.00	0.03	0.67
<i>Total or Median</i>					<i>204,000</i>		<i>0.16</i>	<i>0.86</i>
Independent Natural Gas and Oil - Large Cap and Mid Cap								
XTO Energy Inc.	XTO	B	31.22	349	10,910	33.80	0.17	0.94
Encana Corporation	ECA	B	69.08	471	32,500	77.00	0.19	0.92
Unocal Corporation	UCL	B	56.45	271	15,300	65.00	0.21	0.90
Occidental Petroleum Corp.	OXY	B	70.70	406	28,700	87.00	0.14	0.84
CNOOC Limited (19%)	CEO	B	55.95	78	4,370	67.00	-	0.83
Burlington Resources	BR	B	50.55	389	19,700	67.00	0.12	0.78
Devon Energy Corporation	DVN	B	45.28	500	22,600	63.00	0.16	0.76
Anadarko Petroleum Corp.	APC	B	74.44	246	18,300	113.00	0.14	0.71
<i>Total or Median</i>					<i>152,000</i>		<i>0.15</i>	<i>0.84</i>
Independent Natural Gas and Oil - Small Cap								
Berry Petroleum Company	BRY	B	48.67	22	1,090	50.00	0.12	0.97
Energy Partners Ltd.	EPL	B	24.47	39	960	30.00	0.20	0.85
Cimarex Energy Company	XEC	B	36.90	81	2,970	50.00	0.15	0.78
Encore Acquisition Company	EAC	B	37.65	33	1,230	57.00	0.19	0.72
<i>Total or Median</i>					<i>6,300</i>		<i>0.17</i>	<i>0.81</i>
Income								
Kinder Morgan Energy Partners, L.P.	KMP	S3	47.39	150	7,110	15.00	0.52	2.04
Kinder Morgan Management, LLC	KMR	S3	44.03	56	2,480	15.00	0.52	1.93
Pengrowth Energy Trust	PGH		20.48	136	2,780	16.00	0.24	1.21
San Juan Basin Royalty Trust	SJT		37.85	47	1,760	32.00	-	1.18
Enerplus Resources Fund	ERF		36.17	104	3,760	32.00	0.16	1.11
Canadian Oil Sands Trust (US\$)	COSWF	B	67.35	92	6,210	94.00	0.16	0.76
<i>Total or Median</i>					<i>24,100</i>		<i>0.20</i>	<i>1.20</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) 9-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	58.01	11.2	6.6	6.4	11	1.9	
BP plc	BP	B	61.90	9.4	5.7	5.5	10	3.3	
Total S.A.	TOT	B	114.78	9.0	5.6	5.2	9	3.0	
Shell Transport and Trading Co. plc	SC	B	54.00	7.3	5.1	5.0	9	3.7	
Royal Dutch Petroleum	RD	B	59.48	7.3	5.1	4.7	9	4.0	
Chevron Corporation	CVX	B	53.45	9.7	6.1	4.5	8	3.4	
	<i>Median</i>				9.2	5.6	5.1	9	3.3
Producer/Refiners - Large Cap and Mid Cap									
Kinder Morgan, Inc.	KMI	S2	77.04		7.5	13.1	17	3.6	
Suncor Energy	SU	B	39.80	18.2	11.0	8.4	21	0.5	
Imperial Oil Limited (30%)	IMO	B	70.30	9.9	7.1	7.8	14	1.0	
Marathon Oil Corporation	MRO	B	49.28	7.5	4.3	4.8	8	2.3	
ConocoPhillips	COP	B	106.76	11.6	5.3	4.6	7	2.3	
Petro-Canada	PCZ	B	58.26	6.7	5.3	4.5	8	0.8	
Norsk Hydro ASA	NHY	B	81.55	8.5	5.1	4.2	10	3.9	
PetroChina Company Ltd (10%)	PTR	B	62.19	13.5	5.9	4.0	7	5.1	
Lukoil Oil Company	LUKOY	B	34.30	12.2	4.2	2.8	5	2.9	
	<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	31.22	11.6	6.2	5.8	12	0.6	
Encana Corporation	ECA	B	69.08	7.2	5.7	5.2	11	0.9	
Occidental Petroleum Corp.	OXY	B	70.70	11.6	5.7	4.8	8	1.8	
Burlington Resources	BR	B	50.55	9.9	5.8	4.6	10	0.7	
Unocal Corporation	UCL	B	56.45	8.5	5.1	4.5	10	1.4	
Anadarko Petroleum Corp.	APC	B	74.44	11.9	6.1	4.3	8	1.0	
Devon Energy Corporation	DVN	B	45.28	7.9	5.2	4.0	9	0.7	
CNOOC Limited (19%)	CEO	B	55.95	8.7	4.5	3.7	7	3.6	
	<i>Median</i>				9.3	5.7	4.6	9	0.9
Independent Natural Gas and Oil - Small Cap									
Berry Petroleum Company	BRYP	B	48.67	11.2	5.7	5.5	14	1.0	
Encore Acquisition Company	EAC	B	37.65	15.6	7.4	5.3	12	-	
Cimarex Energy Company	XEC	B	36.90	7.6	4.9	3.8	9	-	
Energy Partners Ltd.	EPL	B	24.47	5.0	3.7	3.1	8	-	
	<i>Median</i>				9.4	5.3	4.6	10	-
Income									
Kinder Morgan Energy Partners, L.P.	KMP	S3	47.39		7.6	15.5	20	6.2	
Kinder Morgan Management, LLC	KMR	S3	44.03		7.6	14.7	19	6.6	
San Juan Basin Royalty Trust	SJT		37.85	12.1	9.2	10.9	12	8.2	
Enerplus Resources Fund	ERF		36.17	8.3	5.9	6.6	13	9.4	
Canadian Oil Sands Trust (US\$)	COSWF	B	67.35	20.0	8.3	6.3	7	2.4	
Pengrowth Energy Trust	PGH		20.48	7.9	5.2	6.3	10	10.9	
	<i>Median</i>				10.2	7.6	8.7	12	7.4

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>
9-May	TOT	Total S.A.	Raise Net Present Value to \$120 a Share
6-May	IMO	Imperial Oil Limited	Oil Sands Strategy
5-May	BRY	Berry Petroleum Company	Oil in the Kitty Litter
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
10-Feb	* UCL	Unocal Corporation	Raise Net Present Value to \$65 a Share

Meter Reader - A Weekly Analysis

10-May		Nice Return for Low Risk
3-May	*	In It to Win It
25-Apr	*	Refining Deal
18-Apr	*	Trend Intact
11-Apr	*	Positive Signs

* Archived on www.mcdep.com

Also see

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

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