

## ***Meter Reader***

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

October 11, 2005

# **Oil, Natural Gas and the U.S. Economy**

## **Summary and Recommendation**

Buy-recommended stocks offer attractive prospects with our standard values of crude oil, natural gas and oil refining at 5.6% of current gross national product. That seems low compared to how important energy is to economic growth. It is also low enough to diminish concerns for the impact of energy price on economic activity that may be overstated. Meanwhile steep stock price declines in the past week create an October opportunity in buy recommendations including oil producers **Suncor (SU)**, **Encore (EAC)** and **Canadian Oil Sands Trust (COSWF)**; and natural gas producers **Burlington Resources (BR)**, **Devon Energy (DVN)** and **Cimarex (XEC)**.

## **Oil and Gas Share of Economy Modest**

The raw energy of crude oil and natural gas and the cost of refining oil products is less than 6% of the economy using the long-term prices embedded in our current estimates of present value of oil and gas businesses (see table Oil, Natural Gas and the U.S. Economy).

### **Oil, Natural Gas and the U.S. Economy**

	<i>Annual Volume</i>	<i>Long-Term Price</i>	<i>Annual Value (\$billion)</i>	<i>Share of \$12 Trillion Economy</i>
<b>Crude Oil</b>	21 million barrels daily	\$50 a barrel	380	3.2%
<b>Natural Gas</b>	21 trillion cubic feet	\$10 a million btu	210	1.8%
<b>Oil Refining</b>	21 million barrels daily	\$10 a barrel	<u>80</u>	<u>0.7%</u>
<i>Total</i>			670	5.6%

Source: Energy Information Administration, McDep Associates

More than half of oil is imported while most natural gas is produced domestically. Increasing amounts of product are imported.

There are further costs of marketing and transportation of natural gas and oil products that we have not included. Those functions might be regarded as part of the services that make up most of economic activity and are sensitive to a wide range of cost considerations.

Current trends point to prices higher than our long-term assumptions. Though no one can know how much higher, no early limit is yet apparent.

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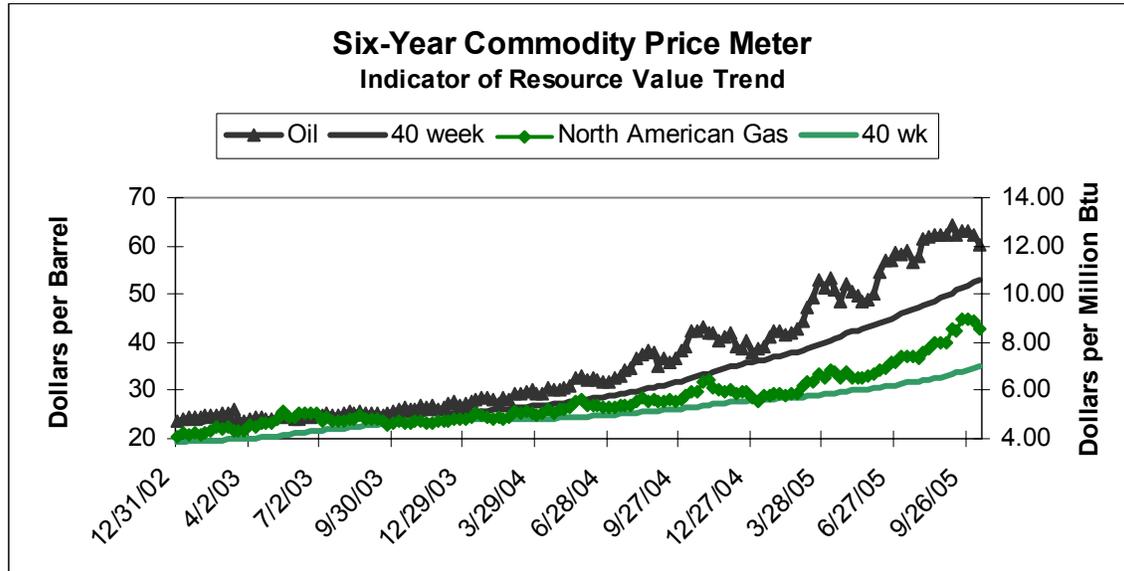
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#### Long-Term Crude Oil Futures Exceed \$50 a Barrel

A recent dip in six-year oil price looks little different from that which has occurred regularly in the marching trend (see chart [Six-Year Commodity Price Meter](#)). Eventually we expect the natural gas price trend to cross above the oil price trend. Should the winter ahead be a cold one, the lines may cross sooner rather than later.



#### One-Year Natural Gas Price Approaching Oil

Our long-term natural gas price assumption of \$10 a million btu looks high compared to recent futures quotes. Practically closing a gap with oil, one-year natural gas futures seem to be reinforcing our point about undervaluation. Settling back a bit from the recent peak, one-year futures may have a run higher depending on winter weather (see chart [One-Year Commodity Price Meter](#)).

#### Oil Refining Getting Cleaner, Too

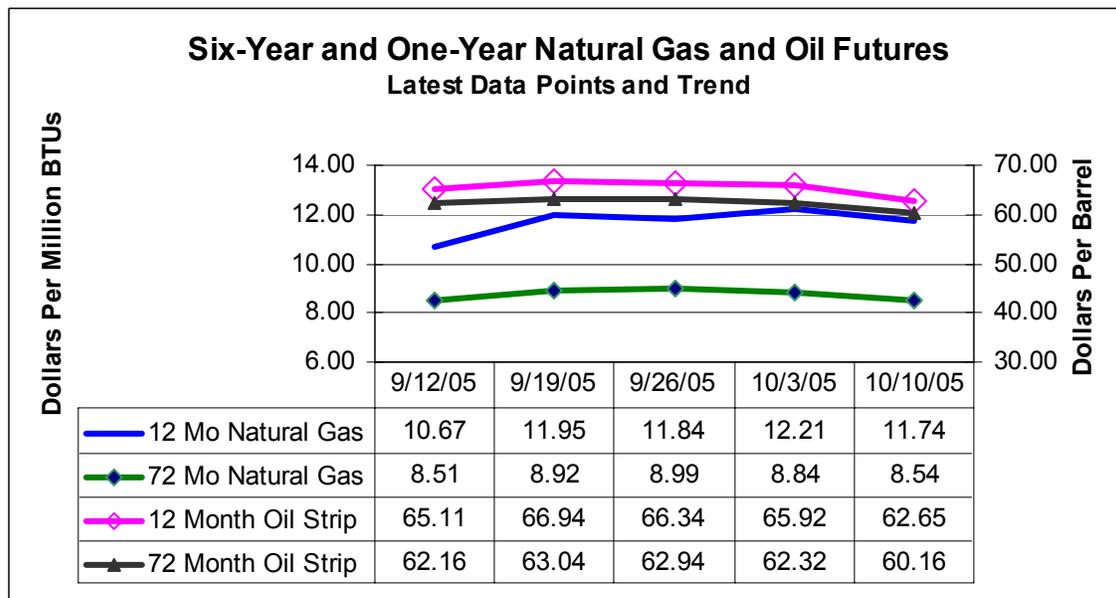
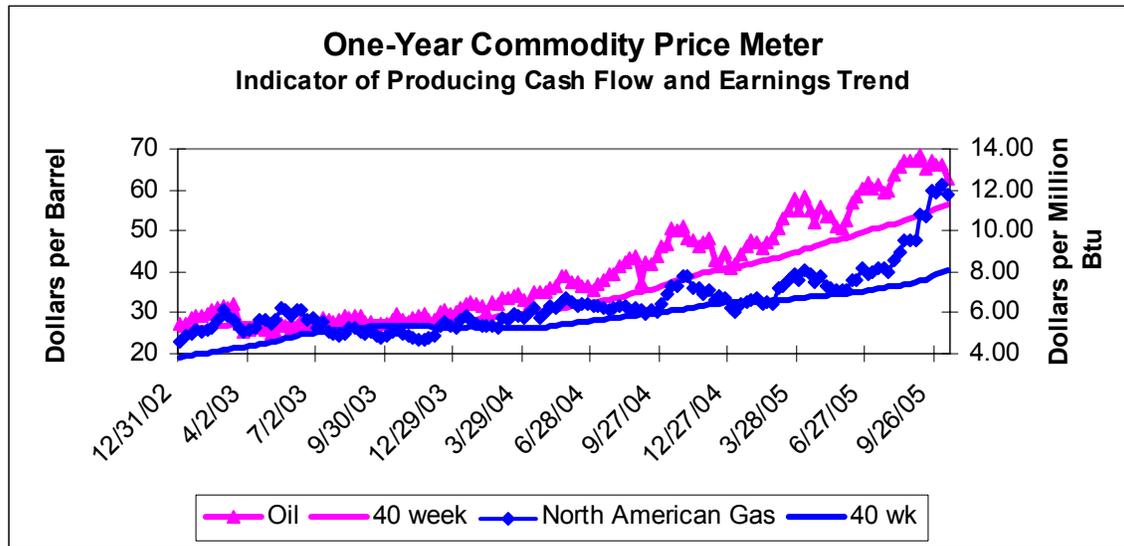
Compared to the prominent protests of high energy prices, it may also seem surprising that the refiner's margin is as low as it is. Our long-term assumption of \$10 a barrel appears modest. There is a lot more that can be justified with a little wider margin. Refiners are expecting to produce ultra-low sulfur diesel fuel next summer that will be considerably cleaner than home heating oil though still not as clean as natural gas. Ultra-low sulfur diesel would sell for a premium price. Yet in the current situation of tight capacity, environmental restrictions have been eased and it remains to be seen how soon they will be tightened again. Meanwhile the trend in the crack spread, a measure of refining cash flow, continues the definitive move above the 40-week average initiated earlier in 2005 (see chart [One-Year Refining Crack Meter](#)).

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### Stocks Priced for \$41 Oil

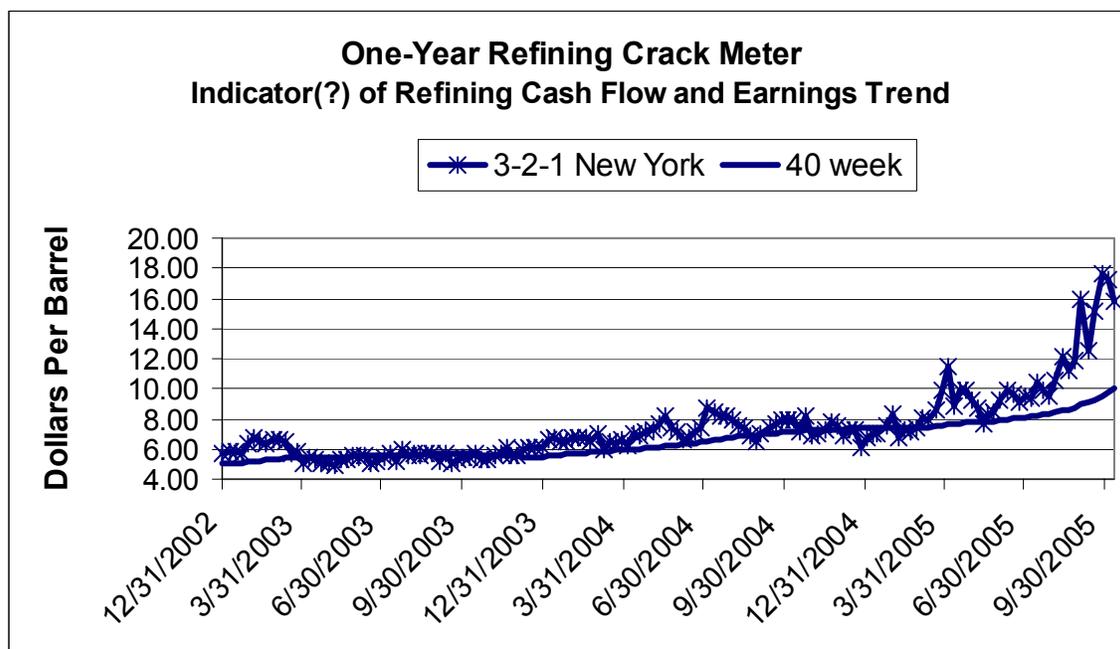
Current stock prices for natural gas and oil producers approximate a median McDep Ratio of 0.83 (see table [Rank by McDep Ratio](#)). A McDep Ratio of 1.0 presumes a 7% per year real return on constant real prices for oil of \$50 a barrel, natural gas of \$10 a million btu and refining crack of \$10 a barrel. Roughly, we could say that stocks are priced for \$41 oil, or \$8 natural gas, or \$8 refining margins.

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Stocks are ranked in descending order of McDep Ratio to suggest “buy low and sell high”. 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 weekly 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.

Stocks of companies headquartered in other countries diversify political risk (see table [Home Country and Business Segments](#)). The Russian stocks offer more potential gain in resource value.

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](#)).

### October Opportunity

Fourteen Meter Reader stocks declined more than 10% in stock price during the past week. Among the buy-recommendations with lower McDep Ratios and steep price decline are long-life oil producers **Suncor (SU)**, **Encore (EAC)** and **Canadian Oil Sands Trust (COSWF)**; and natural gas producers **Burlington Resources (BR)**, **Devon Energy (DVN)** and **Cimarex (XEC)**.

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) 10-Oct 2005	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio
<b>Mega Cap</b>								
BP plc	BP	B	66.35	3,545	235,000	82.00	0.10	0.83
Total S.A.	TOT	B	128.55	1,182	152,000	160.00	0.12	0.83
Exxon Mobil Corporation	XOM	B	58.50	6,370	373,000	74.00	0.04	0.80
Royal Dutch Shell plc	RDS-A	B	62.38	3,372	210,000	84.00	0.09	0.77
Chevron Corporation	CVX	B	60.33	2,256	136,000	90.00	0.12	0.71
<i>Total or Median</i>					<i>1,106,000</i>		<i>0.10</i>	<i>0.80</i>
<b>Producer/Refiners - Large Cap and Mid Cap</b>								
Kinder Morgan, Inc.	KMI	S2	89.05	123	10,960	20.00	0.76	1.84
Imperial Oil Limited (30%)	IMO	B	99.20	104	10,270	84.00	0.09	1.16
Marathon Oil Corporation	MRO	B	62.04	367	22,770	65.00	0.27	0.97
Petro-Canada	PCZ	B	37.96	526	19,970	42.00	0.19	0.92
Lukoil Oil Company	LUKOY	B	55.00	830	46,000	65.00	0.03	0.85
Norsk Hydro ASA	NHY	B	102.00	251	25,600	130.00	0.12	0.81
Suncor Energy	SU	B	51.08	461	23,550	68.00	0.10	0.78
ConocoPhillips	COP	B	63.20	1,419	89,700	100.00	0.15	0.69
Gazprom (50%)	OGZPF	B	59.60	1,022	60,900	90.00	0.03	0.67
PetroChina Company Ltd (10%)	PTR	B	78.80	176	13,850	120.00	0.01	0.66
<i>Total or Median</i>					<i>324,000</i>		<i>0.11</i>	<i>0.83</i>
<b>Independent Natural Gas and Oil - Large Cap and Mid Cap</b>								
Encana Corporation	ECA	B	48.81	892	43,500	51.00	0.16	0.96
XTO Energy Inc.	XTO	B	41.00	367	15,050	48.00	0.17	0.88
Burlington Resources	BR	B	70.37	385	27,100	86.00	0.09	0.83
CNOOC Limited (29%)	CEO	B	65.10	119	7,760	84.00	0.01	0.78
Devon Energy Corporation	DVN	B	61.82	471	29,100	86.00	0.15	0.76
Occidental Petroleum Corp.	OXY	B	76.97	406	31,300	120.00	0.11	0.68
Anadarko Petroleum Corp.	APC	B	89.11	238	21,200	140.00	0.11	0.68
<i>Total or Median</i>					<i>499,000</i>		<i>0.11</i>	<i>0.80</i>
<b>Independent Natural Gas and Oil - Small Cap</b>								
Berry Petroleum Company	BRY	B	60.08	23	1,350	65.00	0.10	0.93
Energy Partners Ltd.	EPL	B	26.78	41	1,090	38.00	0.17	0.76
Encore Acquisition Company	EAC	B	32.95	49	1,630	50.00	0.17	0.72
Cimarex Energy Company	XEC	B	40.56	85	3,450	64.00	0.12	0.68
<i>Total or Median</i>					<i>7,500</i>		<i>0.15</i>	<i>0.74</i>
<b>Income</b>								
Kinder Morgan Energy Partners, L.P.	KMP	S3	51.70	157	8,120	15.00	0.55	2.10
Kinder Morgan Management, LLC	KMR	S3	49.31	56	2,740	15.00	0.55	2.02
Pengrowth Energy Trust	PGH		22.75	157	3,560	20.00	0.16	1.11
San Juan Basin Royalty Trust	SJT		42.44	47	1,980	40.00	-	1.06
Enerplus Resources Fund	ERF		43.57	105	4,570	42.00	0.13	1.03
Penn West Energy Trust	PWTFF	B	28.23	174	4,900	28.00	0.16	1.01
Canadian Oil Sands Trust (US\$)	COSWF	B	100.34	93	9,320	136.00	0.12	0.77
<i>Total or Median</i>					<i>35,200</i>		<i>0.16</i>	<i>1.06</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) 10-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	66.35	9.4	6.6	5.5	9	3.2
Exxon Mobil Corporation	XOM	B	58.50	11.5	6.8	5.5	9	2.0
Total S.A.	TOT	B	128.55	9.2	6.1	5.1	8	2.5
Royal Dutch Shell plc	RDS-A	B	62.38	7.2	5.6	4.3	8	3.5
Chevron Corporation	CVX	B	60.33	9.3	5.9	4.2	7	3.0
	<i>Median</i>			9.3	6.1	5.1	8	3.0
<b>Producer/Refiners - Large Cap and Mid Cap</b>								
Kinder Morgan, Inc.	KMI	S2	89.05		8.1	15.0	21	3.4
Gazprom (50%)	OGZPF	B	59.60	22.0	12.9	8.7	17	0.6
Imperial Oil Limited (30%)	IMO	B	99.20	10.5	6.2	7.2	12	0.8
Suncor Energy	SU	B	51.08	18.1	9.1	7.0	14	0.4
Petro-Canada	PCZ	B	37.96	5.9	5.0	4.6	8	1.8
Norsk Hydro ASA	NHY	B	102.00	8.2	5.4	4.4	10	3.0
Marathon Oil Corporation	MRO	B	62.04	7.1	4.5	4.4	7	1.8
Lukoil Oil Company	LUKOY	B	55.00	19.8	4.7	4.0	6	1.8
ConocoPhillips	COP	B	63.20	11.2	5.8	4.0	6	2.0
PetroChina Company Ltd (10%)	PTR	B	78.80	13.9	6.0	3.9	8	4.8
	<i>Median</i>			11.2	5.9	4.5	9	1.8
<b>Independent Natural Gas and Oil - Large Cap and Mid Cap</b>								
XTO Energy Inc.	XTO	B	41.00	11.3	5.7	5.0	9	0.5
Encana Corporation	ECA	B	48.81	7.1	4.3	4.1	7	1.2
CNOOC Limited (29%)	CEO	B	65.10	9.4	5.2	4.0	7	3.6
Occidental Petroleum Corp.	OXY	B	76.97	11.3	5.9	4.0	7	1.6
Burlington Resources	BR	B	70.37	9.9	4.7	4.0	8	0.6
Anadarko Petroleum Corp.	APC	B	89.11	12.5	5.7	3.9	7	0.8
Devon Energy Corporation	DVN	B	61.82	7.3	4.0	3.0	6	0.5
	<i>Median</i>			10.6	5.4	4.0	7	1.0
<b>Independent Natural Gas and Oil - Small Cap</b>								
Berry Petroleum Company	BRY	B	60.08	11.0	5.5	5.1	13	1.0
Encore Acquisition Company	EAC	B	32.95	14.7	6.6	4.8	10	-
Cimarex Energy Company	XEC	B	40.56	7.7	4.1	2.8	6	-
Energy Partners Ltd.	EPL	B	26.78	5.1	3.2	2.4	5	-
	<i>Median</i>			9.3	4.8	3.8	8	-
<b>Income</b>								
Kinder Morgan Energy Partners, L.P.	KMP	S3	51.70		8.2	17.3	28	6.0
Kinder Morgan Management, LLC	KMR	S3	49.31		8.2	16.7	27	6.3
San Juan Basin Royalty Trust	SJT		42.44	12.0	7.9	8.4	9	11.1
Canadian Oil Sands Trust (USS)	COSWF	B	100.34	20.0	10.6	8.2	9	1.7
Pengrowth Energy Trust	PGH		22.75	7.6	5.3	5.9	8	10.3
Enerplus Resources Fund	ERF		43.57	9.8	5.3	5.5	8	8.3
Penn West Energy Trust	PWTFF	B	28.23	8.0	4.3	4.3	6	9.3
	<i>Median</i>			9.8	7.9	8.2	9	8.3

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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October 11, 2005

#### 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\$mm)
<b>Mega Cap</b>								
Exxon Mobil Corporation	XOM	B		10	19	39	33	492,000
BP plc	BP	B	UK	10	12	44	34	324,000
Royal Dutch Shell plc	RDS-A	B	UK	4	19	33	45	313,000
Chevron Corporation	CVX	B		9	9	54	28	230,000
Total S.A.	TOT	B	France	-	27	38	35	215,000
			<i>Total or Median</i>	9	19	39	34	1,574,000
<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	166,900
Lukoil Oil Company	LUKOY	B	Russia	-	-	62	38	55,700
Norsk Hydro ASA	NHY	B	Norway	-	27	38	35	37,100
Suncor Energy	SU	B	Canada	5	-	89	7	34,900
Marathon Oil Corporation	MRO	B		14	8	33	46	32,900
Imperial Oil Limited	IMO	B	Canada	13	-	62	25	31,900
Petro-Canada	PCZ	B	Canada	23	4	53	20	27,200
			<i>Median</i>	9	7	58	30	790,000
<b>Independent Natural Gas and Oil - Large Cap and Mid Cap</b>								
Occidental Petroleum Corp.	OXY	B		15	1	73	11	54,900
Encana Corporation	ECA	B	Canada	84	-	16	-	54,500
Devon Energy Corporation	DVN	B		62	-	38	-	47,500
Anadarko Petroleum Corp.	APC	B		60	-	40	-	37,500
Burlington Resources	BR	B		69	5	26	-	36,300
CNOOC Limited	CEO	B	China	-	12	88	-	34,800
XTO Energy Inc.	XTO	B		82	-	18	-	21,300
			<i>Median</i>	62	-	38	-	287,000
<b>Independent Natural Gas and Oil - Small Cap</b>								
Cimarex Energy Company	XEC	B		70	-	30	-	6,140
Encore Acquisition Company	EAC	B		27	-	73	-	2,990
Berry Petroleum Company	BRY	B		16	-	84	-	1,920
Energy Partners Ltd.	EPL	B		56	-	44	-	1,860
			<i>Median</i>	42	-	58	-	12,910
<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	-	5,070
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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October 11, 2005

#### Index of Recent Research

##### Stock Ideas

<u>Date</u>	<u>Symbol</u>	<u>Stock</u>	<u>Theme</u>
7-Oct		Canadians ECA, IMO, PCZ, SU	Exaggerated Stock Price Change
5-Oct	RDSA	Royal Dutch Shell plc	Downstream Beneficiary
4-Oct	BR	Burlington Resources, Inc.	Natural Gas Beneficiary
27-Sep	ECA	EnCana Corporation	Canada's Largest Company
26-Sep	LUKOY	Lukoil Oil Company	Adapting to New Russia
22-Sep	MRO	Marathon Oil Corporation	Hurricane Watch
19-Sep	NHY	Norsk Hydro ASA	Acquiring U.S. Producer for \$2.45 Billion
16-Sep	XOM	Exxon Mobil Corporation	New Highs Ahead
15-Sep	* OGZPF	Gazprom	The Ultimate Natural Gas Stock
9-Sep	* APC	Anadarko Petroleum Corporation	Natural Gas Jumps
7-Sep	* EPL	Energy Partners, Ltd.	Katrina Survivor
6-Sep	* COP	ConocoPhillips	Refining and Natural Gas Event
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
17-Aug	* CVX	Chevron Corporation	Astute Acquisition
16-Aug	* EPL	Energy Partners, Ltd.	Denali 2006
15-Aug	* XEC	Cimarex Energy Company	\$Billion Cash Flow for Small Cap NG Producer
11-Aug	* PWTF	Penn West Energy Trust	Undiscovered by U.S. Investors
11-Aug	* SU	Suncor Energy Inc.	Oil Price and Operating Reliability
11-Aug	* KMx	Kinder Morgan	Canada May Block KM-Terasen Deal
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
28-Jul	* EAC	Encore Acquisition Company	HPAI Incline
27-Jul	* BP	BP p.l.c.	Steady-State Growth
26-Jul	* OXY	Occidental Petroleum Corporation	Back in Libya
22-Jul	* PCZ	Petro-Canada	Approaching Par
22-Jul	* IMO	Imperial Oil Limited	Syncrude Boost
22-Jul	* COSWF	Canadian Oil Sands Trust	Distribution Capability Blossoming
20-Jul	* XTO	XTO Energy Inc.	Simpson Sense
6-Jul	* COSWF	Canadian Oil Sands Trust	Free (Cash Flow) at Last
5-May	* BRY	Berry Petroleum Company	Oil in the Kitty Litter

##### Meter Reader - A Weekly Analysis

6-Oct	*	Flash: Industry Outlook Stable
4-Oct	*	Accentuate the Positive
27-Sep	*	You Ain't Seen Nothin Yet
20-Sep	*	Startling Gains for Natural Gas
13-Sep	*	Big Bucks for Big Oil
6-Sep	*	Refining and Natural Gas Event

\* Archived on [www.mcdep.com](http://www.mcdep.com)

Also see

**Natural Gas and Oil Royalty Trusts - A Weekly Analysis, and Single-Trust Analyses**

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