

Rating: Buy
 S&P 500: 1530

Norsk Hydro (NHY)

Buy Old NHY, Hold New NHY, Buy Statoil (STO)

Summary and Recommendation

Buy-rated **Norsk Hydro (NHY)** reporting first quarter 2007 results on May 31 also becomes Hold-rated new Norsk Hydro and Buy-rated **Statoil (STO)**. By October 1, each share of Norsk Hydro is expected to spawn 0.8622 share of Statoil. Accordingly, we split our analysis of one stock into two parts. We calculate the stock price for the continuing NHY as the price quoted today minus 0.8622 times the price quoted for STO. Offering Net Present Value (NPV) of \$35 a share, STO has strong appeal with other oil and gas buy recommendations. New NHY appears to have a promising outlook as a pure play in aluminum, but our experience in analyzing that industry is limited.

<i>Symbol</i>	STO	<i>Ebitda Next Twelve Months ending 6/30/08 (US\$m)</i>	19,760
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	0
<i>Price (\$/sh)</i>	25.97	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	5/30/07	<i>Adjusted Reserves/Production NTM</i>	7.7
<i>Shares (mm)</i>	3200	<i>EV/Ebitda</i>	4.9
<i>Market Capitalization (\$mm)</i>	83,100	<i>PV/Ebitda</i>	6.3
<i>Debt (\$mm)</i>	13,100	<i>Undeveloped Reserves (%)</i>	35
<i>Enterprise Value (EV) (\$mm)</i>	96,200	<i>Natural Gas and Oil Ebitda (\$/boe)</i>	19.90
<i>Present Value (PV) (\$mm)</i>	125,100	<i>Present Value Proven Reserves(\$/boe)</i>	21.30
<i>Net Present Value (\$/share)</i>	35	<i>Present Value Proven Reserves(\$/mcf)</i>	3.60
<i>Debt/Present Value</i>	0.10	<i>Earnings Next Twelve Months (US\$/sh)</i>	2.40
<i>McDep Ratio - EV/PV</i>	0.77	<i>Price/Earnings Next Twelve Months</i>	11
<i>Dividend Yield (%/year)</i>	5.8	<i>Indicated Annual Dividend (US\$/sh)</i>	1.50

Note: Estimated cash flow and earnings tied to one-year futures prices for oil.

Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.

Estimated present value presumes a long-term price for oil of US\$66 a barrel and natural gas, \$11 a million btu.

The Norwegian government owns 71% of the shares in Statoil

<i>Symbol</i>	NHY	<i>Ebitda Next Twelve Months ending 6/30/08 (US\$m)</i>	2,310
<i>Rating</i>	Hold	<i>North American Natural Gas/Ebitda (%)</i>	
<i>Price (\$/sh) (excludes .8622 STO)</i>	11.57	<i>Natural Gas and Oil Production/Ebitda (%)</i>	
<i>Pricing Date</i>	5/30/07	<i>Adjusted Reserves/Production NTM</i>	
<i>Shares (mm)</i>	1241	<i>EV/Ebitda</i>	7.1
<i>Market Capitalization (\$mm)</i>	14,400	<i>PV/Ebitda</i>	6.8
<i>Debt (\$mm)</i>	2,000	<i>Undeveloped Reserves (%)</i>	
<i>Enterprise Value (EV) (\$mm)</i>	16,300	<i>Natural Gas and Oil Ebitda (\$/boe)</i>	
<i>Present Value (PV) (\$mm)</i>	15,600	<i>Present Value Proven Reserves(\$/boe)</i>	
<i>Net Present Value (\$/share)</i>	11	<i>Present Value Proven Reserves(\$/mcf)</i>	
<i>Debt/Present Value</i>	0.13	<i>Earnings Next Twelve Months (US\$/sh)</i>	0.97
<i>McDep Ratio - EV/PV</i>	1.05	<i>Price/Earnings Next Twelve Months</i>	12
<i>Dividend Yield (%/year)</i>	1.4	<i>Indicated Annual Dividend (US\$/sh)</i>	0.16

Note: Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.

The Norwegian government owns 44% of the shares in Norsk Hydro.

For historical analysis of NHY since 2004 see www.mcdep.com/2nhy.htm

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Two More Quarters of Transition

On the quarterly conference call on May 30, Statoil Chief Financial Officer Eldar Saetre explained that after shareholders of both companies vote on July 5 another 60 day waiting period is required meaning that the transaction would likely close by October 1. In the earnings press release on May 31, NHY Chief Executive Eivind Reiten confirms, “‘New’ Hydro will start trading as an aluminium and power share from 1 October”. Notwithstanding that likelihood, we have for convenience in making consistent valuation projections for the next twelve months (NTM) included all of Norsk Hydro’s oil and gas production with that of Statoil beginning July 1 (see tables Operating and Financial Estimates). Similarly we project only non-oil and gas results for Norsk Hydro for the same period.

Raise Industry Present Value Estimates Ten Percent

On May 29 we raised our long-term price assumptions for estimating present value to \$66 a barrel for oil from \$60, to \$11 a million btu for natural gas from \$10 and to \$11 a barrel for the refining margin from \$10. As a result estimated NPV for Statoil increased to \$35 a share from \$32. NPV for new Norsk Hydro increased to \$11 a share from \$8 though it will be an aluminum company, not an oil and gas company.

The Statoil estimate fits our correlation with reserve life and cash flow for some thirty producers (see table Functional Cash Flow and Present Value). From its dominant position offshore Norway, the company has expanded to offshore Africa and the U.S. Gulf of Mexico among other areas.

Results exceeding expectations reported on May 31 point to a modest NTM unlevered cash flow multiple (EV/Ebitda) of about 7 times for new Hydro. The valuation looks lower than that for industry competitors Alcoa and Alcan, but we have not done a complete independent analysis of those stocks. Moreover, the connection between reported results as part of old Hydro and the actual results that new Hydro will eventually report is complicated and subject to different interpretation.

Changing Ratings and Weights

We keep a Buy rating on old NHY, the existing stock priced at \$35.03 at the close on May 30, as a reflection of the combination of Buy for the two-thirds of current stock price that relates to Buy-rated Statoil and Hold for the one third of current stock price that relates to Hold-rated new NHY. Also on May 29 when we increased long-term oil price in present value, we lowered the unlevered weighting of old NHY in the illustrative McDep Energy Portfolio to half from full. The main reason was favorable price performance. Looking ahead, we replace old NHY with STO at a half weighting in the illustrative portfolio. Investors who had a full weighting in old NHY and reduce that by a fourth would have a half weighting in STO and a residual of new NHY for equity exposure outside oil and gas.

Kurt H. Wulff, CFA

Statoil
Next Twelve Months Operating and Financial Estimates

	<i>Year</i>	<i>Q1</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Next Twelve Months</i>
	<i>2006</i>	<i>3/31/07</i>	<i>6/30/07</i>	<i>9/30/07</i>	<i>12/31/07</i>	<i>2007E</i>	<i>3/31/08</i>	<i>6/30/08</i>	<i>6/30/08</i>
Volume									
Natural gas (bcf)	1,022	279	239	322	368	1,208	378	331	1,399
Natural Gas (mmcf)	2,791	3,102	2,598	3,500	4,000	3,301	4,200	3,600	3,823
Days	366	90	92	92	92	366	90	92	366
Oil (mmb)	245	61	63	99	99	323	97	99	395
Oil (mbd)	670	682	682	1,080	1,080	882	1,080	1,080	1,080
Total gas & oil (mbd)	1,135	1,199	1,115	1,663	1,747	1,432	1,780	1,680	1,717
Price									
Natural gas (NOK/mcf)	54	49	50	52	57	52	57	50	54
Natural gas (NOK/Sm3)	1.91	1.74	1.77	1.82	2.01	1.85	2.01	1.77	1.91
Oil									
WTI Cushing US\$/bbl)	66.05	58.08	64.27	66.42	68.78	64.39	70.01	70.76	68.99
Kroner/\$	6.41	6.23	6.07	6.07	6.07	6.11	6.07	6.07	6.07
WTI Cushing (NOK/bbl)	423	362	390	403	417	393	425	429	419
Wellhead (NOK/bbl)	413	359	387	400	414	394	422	426	415
Total gas & oil (NOK/bb)	377	332	354	368	387	363	390	381	382
Revenue (NOKmm)									
Natural Gas	55,377	13,761	11,985	16,602	20,954	63,302	21,524	16,607	75,686
Oil	101,202	22,035	24,288	39,745	41,159	127,228	40,985	42,342	164,231
Other	327,299	78,464	78,464	78,464	78,464	313,854	78,464	78,464	313,854
Total	428,501	100,499	114,736	134,810	140,577	490,623	140,972	137,413	553,771
Expense									
Ebitda (NOKmm)	87,859	17,426	18,136	28,173	31,057	94,792	31,254	29,475	119,959
Exploration	5,664	1,177	1,177	3,000	3,000	8,354	3,000	3,000	12,000
Deprec., Deplet., & Amort.	21,767	5,438	5,438	8,500	8,500	27,876	8,500	8,500	34,000
Ebit	60,428	10,811	11,521	16,673	19,557	58,562	19,754	17,975	73,959
Interest	1,250	568	568	568	568	2,272	568	568	2,272
Foreign Exchange	(3,286)	(1,571)							
Ebt	62,464	11,814	10,953	16,105	18,989	57,861	19,186	17,407	71,687
Income Tax	21,858	4,135	3,834	5,637	6,646	20,252	6,715	6,092	25,090
Net Income (NOKmm)	40,605	7,679	7,120	10,468	12,343	37,610	12,471	11,314	46,596
Shares (millions)									
Per share (NOK)	18.79	3.58	3.32	3.27	3.86	14.03	3.90	3.54	14.56
Ebitda Margin (E&P)	56%	49%	50%	50%	50%	50%	50%	50%	50%
Tax Rate	35%	35%	35%	35%	35%	35%	35%	35%	35%

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Norsk Hydro
Next Twelve Months Operating and Financial Estimates

	<i>Q1</i>	<i>Q4</i>	<i>Year</i>	<i>Q1</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Next Twelve Months</i>
	<i>3/31/06</i>	<i>12/31/06</i>	<i>2006</i>	<i>3/31/07</i>	<i>6/30/07</i>	<i>9/30/07</i>	<i>12/31/07</i>	<i>2007E</i>	<i>6/30/08</i>
Volume									
Natural gas (bcf)	112	109	407	104	93				
Natural Gas (mmcf)	1,248	1,182	1,111	1,152	1,014				
Days	90	92	366	90	92				
Oil (mmb)	36	37	142	38	38				
Oil (mbd)	402	398	387	418	418				
Total gas & oil (mbd)	610	595	572	610	587				
Price									
Natural gas (NOK/mcf)	61	56	55	54	51				
Natural gas (NOK/Sm3)	2.17	1.97	1.55	1.90	1.79				
Oil									
WTI Cushing US\$/bbl)	63.33	59.99	66.05	58.08	64.27				
Kroner/\$	6.67	6.39	6.40	6.22	6.07				
WTI Cushing (NOK/bbl)	422	383	423	361	390				
NHY (NOK/bbl)	404	369	403	348	376				
Total gas & oil (NOK/bb)	392	358	379	340	355				
Aluminum (US\$/tonne)	2,423	2,725	2,572	2,797					
Revenue (NOKmm)									
Natural Gas	6,905	6,069	22,222	5,581	4,730				
Oil	14,599	13,519	57,154	13,084	14,445				
Other	40,817	32,196	146,373	37,030	37,030	30,000	30,000	134,060	120,000
Total	55,416	45,715	203,527	50,114	56,205	30,000	30,000	166,319	120,000
Expense									
Production	13,812	11,011	47,875	10,876	11,285				
Other	34,275	27,396	124,284	31,267	32,023	26,500	26,500	116,291	106,000
Total	48,087	38,407	172,158	42,144	43,308	26,500	26,500	138,452	106,000
Ebitda (NOKmm)									
Exploration and Production	7,692	8,577	31,501	7,788	7,670				
Other	6,542	4,800	22,089	5,762	5,006	3,500	3,500	17,769	14,000
Total Ebitda	14,234	13,377	53,590	13,551	12,677	3,500	3,500	33,227	14,000
Exploration	1,407	2,093	4,986	786	786				
Deprec., Deplet., & Amort.	4,142	9,899	22,409	4,703	4,703	1,000	1,000	11,406	4,000
Ebit	8,685	1,385	26,195	8,062	7,188	2,500	2,500	20,249	10,000
Interest	172	208	654	140	140	40	40	360	160
Foreign Exchange	(529)	(714)	(1,057)	(566)				(566)	
Ebt	9,042	1,891	26,598	8,488	7,048	2,460	2,460	20,455	9,840
Income Tax	3,165	662	9,309	2,971	2,467	640	640	6,717	2,558
Net Income (NOKmm)									
Exploration and Production	14,126	5,647	46,252	11,166					
Other Operations	3,742	(1,073)	6,118	3,656					
Non operating deductions	(11,991)	(3,345)	(35,081)	(9,305)					
Total	5,877	1,229	17,289	5,517	4,581	1,820	1,820	13,739	7,282
Shares (millions)									
Per share (NOK)	4.70	1.00	13.90	4.50	3.74	1.47	1.47	11.17	5.87
Ebitda Margin (E&P)	36%	44%	40%	42%	40%				
Ebitda Margin						12%	12%		12%
Tax Rate	35%	35%	35%	35%	35%	26%	26%	33%	26%

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Statoil
Functional Cash Flow and Present Value

	<i>NTM Ebitda</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Present</i>	
	<u>(US\$mm)</u>	<u>R/P</u>	<u>Ebitda</u>	<u>Value</u>	<u>(US\$mm)</u>
Natural Gas	6,234	12.3	7.4	46,000	37%
Oil	13,528	5.0	5.8	79,100	63%
	19,763	7.7	6.3	125,100	100%
Debt (US\$mm)					13,100
Net Present Value (US\$mm)					112,000
Shares (mm)					3,200
Net Present Value - Standard Estimate (US\$/sh)					35
Net Present Value - Approximation by Correlation (US\$/sh)					36

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