

Royal Dutch/Shell

Reinstate Buy Recommendation on Steep Price Drop

<i>Symbol</i>	<i>Price</i>		<i>Market Cap</i>	<i>Net Present Value</i>			<i>EV/EBITDA</i>		<i>P/E</i>	<i>Div'd NTM (%)</i>	<i>PV/EBITDA NTM</i>
	<i>19-Jul 2002</i>	<i>Shares (mm)</i>		<i>Present Value (\$/sh)</i>	<i>Debt/ Present Value</i>	<i>McDep Ratio</i>	<i>Sales NTM</i>	<i>Ebitda NTM</i>			
RD	42.00	3,502	147,100	60.00	0.12	0.74	1.1	5.8	11	4.0	7.9

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

EV = Enterprise Value = Market Cap and Debt:

US\$mm 175,400

Ebitda = Earnings before interest, tax, depreciation and amortization:

US\$mm 30,300

NTM = Next Twelve Months Ended June 30, 2003; P/E = Stock Price to Earnings

PV = Present Value of energy businesses:

US\$mm 238,400

Present Value of Equity:

US\$mm 210,100

Summary and Recommendation

We recommend current purchase of the shares of Royal Dutch Petroleum, 60% owner of the Royal Dutch/Shell Group for undervalued, low risk participation in the global energy industry. A sharp decline in McDep Ratio to the low end of the range for peer companies flashes attractive relative value. The unusual opportunity in RD appears to have been caused in large part by the removal of the stock from the S&P 500 Index unleashing large-scale liquidation for artificial reasons. We believe that low McDep Ratio energy investment can enhance the risk adjusted return of diversified investment portfolios. Regardless of whether the stock declines further, we emphasize our conviction that low debt, Mega Cap RD is a sound long-term investment likely to prove rewarding after current market volatility passes.

Royal Dutch Stock Makes the Case for Equity Investment

Treasury Inflation Protected Securities (TIPS) are probably the most secure long-term investment. The problem is that the real yield is only 2.8% per year at the latest quote for ten-year maturity, down from 3.5% at the beginning of the year. Meanwhile RD paid a dividend of 1.66 euros per share in the past year. Translated at the current exchange rate, that is a yield of 4.0% per year, up from 3.0% at the beginning of the year. With the TIPS yield down 20% and the RD yield up 33% the relative change has been 67% in favor of RD.

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The total return on TIPS includes an inflation adjustment calculated by and guaranteed by the U.S. government. The RD dividend is expected to be increased at least enough to offset inflation, but it depends on the long-term profitability of energy. If existing and new energy investments earn more than 4% per year real, then additional value is being created that should ultimately benefit investors. RD also is now repurchasing stock regularly. That essentially supplements dividends as a tax efficient means to return real money to shareholders.

The valuation conclusion is that with the yield disadvantage reversed versus TIPS, RD is a fully competitive investment with the safest alternative. Thus investors who like the safety of TIPS can enhance their return with little incremental portfolio risk by adding RD shares.

McDep Ratio As Low As For Other Favorites

Coincidentally, RD has practically the same low McDep Ratio as the three peer companies we are recommending, **ChevronTexaco**, **ConocoPhillips**, and **Marathon**. The four stocks have equal unlevered appreciation potential as best we can measure it.

RD's financial leverage as measured by the ratio of Debt/Present Value is a third to a half of the moderate leverage for the latter two peers. Thus the price of RD stock should normally be more stable than that for most other energy companies. In normal times we would recommend neutralizing the impact of corporate leverage by owning disproportionately more of the low leverage stock. Investors who want protection in a possibly continuing down market might favor RD even more relative to peers with more leverage.

Fundamental Outlook Stable for the Past Few Months

We calculate a value of RD and other energy stocks by projecting next twelve months cash flow and assessing Present Value as a multiple of cash flow. Though we apply the now infamous Ebitda label to that cash flow, it is our own version normalized for taxes and any other unusual factors we can identify (see table). We take the most volatile elements in the projection from the futures market for oil, natural gas and refining margin. Contrary to the stock market, futures prices have been quite stable since an important readjustment in February and March. Thus the cash flow projection we present below is not much changed from what it would have been a few months ago. For earlier discussion on the company see <http://www.mcdep.com/rd10921.PDF>.

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McDep Associates
Independent Stock Ideas
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Royal Dutch/Shell
Next Twelve Months Operating and Financial Estimates

	<i>Q2</i>	<i>Q3</i>	<i>Q4</i>	<i>Year</i>	<i>Q1</i>	<i>Q2E</i>	<i>Year</i>	<i>Next</i>
	<i>6/30/01</i>	<i>9/30/01</i>	<i>12/31/01</i>	<i>2001</i>	<i>3/31/02</i>	<i>6/30/02</i>	<i>2002E</i>	<i>Twelve</i>
								<i>Months</i>
								<i>6/30/03</i>
Volume								
Natural Gas (mmcf)								
U.S. (or North America)	1,604	1,592	1,608	1,598	1,567	1,567	1,567	1,567
Overseas (or Int'l)	6,557	6,687	8,081	7,410	8,889	8,889	8,889	8,889
Total	8,161	8,279	9,689	9,009	10,456	10,456	10,456	10,456
Oil (mbd)	2,177	2,197	2,259	20,302	2,199	2,199	24,353	2,199
Price								
Natural gas (\$/mcf)								
Henry Hub (\$/mmbtu)	4.36	2.75	2.41	3.96	2.53	3.38	3.07	3.44
U.S. (or North America)	3.92	2.47	2.41	3.61	2.36	3.04	2.78	3.09
Overseas (or Int'l)	3.12	2.99	2.12	2.85	2.10	2.92	2.77	2.95
Total	3.28	2.89	2.17	2.98	2.14	2.94	2.77	2.97
Oil (\$/bbl)								
WTI Cushing	27.88	26.69	20.40	25.95	21.60	26.27	25.57	26.52
Worldwide	24.98	23.91	18.51	23.26	19.21	23.36	22.75	23.58
NY Harbor 3-2-1 (\$/bbl)	11.15	4.59	3.17	6.23	3.63	4.71	4.37	4.91
Revenue (\$mm)								
Natural Gas								
U.S. (or North America)	573	362	357	2,103	333	434	1,593	1,768
Overseas (or Int'l)	1,863	1,839	1,576	7,696	1,680	2,362	8,986	9,564
Total	2,436	2,201	1,933	9,799	2,013	2,795	10,578	11,332
Oil	4,949	4,833	3,847	18,850	3,802	4,674	18,260	18,928
Other	38,596	36,045	23,945	137,962	31,760	31,760	127,041	127,041
Total	45,981	43,079	29,725	166,612	37,575	39,230	155,880	157,301
Expense								
Production	2,898	3,074	2,446	11,412	2,087	2,418	9,463	9,748
Other	35,802	33,919	21,741	128,626	29,693	29,383	117,902	117,256
Ebitda (\$mm)								
Exploration and Production	4,487	3,960	3,333	17,238	3,728	5,052	19,375	20,512
Other	2,794	2,126	2,204	9,337	2,067	2,377	9,139	9,785
Total Ebitda	7,281	6,085	5,538	26,575	5,795	7,429	28,514	30,297
Exploration	171	205	344	882	175	175	700	700
Deprec., Deplet., & Amort.	1,468	1,568	1,671	6,117	1,750	1,750	7,000	7,000
Other non cash	72	110	150	387	86	86	344	344
Ebit	5,570	4,202	3,373	19,189	3,784	5,418	20,470	22,253
Interest	118	87	87	408	283	283	1,131	1,131
Ebt	5,452	4,116	3,286	18,780	3,502	5,135	19,340	21,122
Income Tax	1,908	1,440	1,150	6,573	1,226	1,797	6,769	7,393
Net Income (\$mm)								
Exploration and Production	2,185	1,778	1,237	8,047	1,570			
Other	1,552	1,056	268	4,242	649			
Unallocated	(193)	(159)	631	(82)	57			
Total	3,544	2,675	2,136	12,207	2,276	3,338	12,571	13,730
Shares (millions)	3,544	3,520	3,502	3,538	3,502	3,502	3,502	3,502
Per share (\$)	1.00	0.76	0.61	3.45	0.65	0.95	3.59	3.92
Ebitda Margin (E&P)	61%	56%	58%	60%	64%	68%	67%	68%
Tax Rate	35%	35%	35%	35%	35%	35%	35%	35%

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