Rating: Buy
S&P 500: 1113

Royal Dutch Petroleum
Cloud of Opportunity

Symbol	RD	*Ebitda Next Twelve Months ending 3/31/05 (US$mm)*	25,200
Rating	Buy	*North American Natural Gas/Ebitda (%)*	5
Price (US$/sh)	52.68	*Natural Gas and Oil Production/Ebitda (%)*	61
Pricing Date (intraday)	7/9/04	*Adjusted Reserves/Production NTM*	8.0
Shares (mm)	2033	*EV/Ebitda*	5.3
Market Capitalization (US$mm)	107,100	*PV/Ebitda*	5.9
Debt (US$mm)	25,900	*Undeveloped Reserves (%)*	44
Enterprise Value (EV) (US$mm)	133,000	*Natural Gas and Oil Ebitda (US$/boe)*	18.40
Present Value (PV) (US$mm)	147,900	*Present Value Proven Reserves(US$/boe)*	10.63
Net Present Value (US$/share)	60	*Present Value Proven Reserves(US$/mcfe)*	1.77
Debt/Present Value	0.18	*Earnings Next Twelve Months (US$/sh)*	5.54
McDep Ratio - EV/PV	0.90	*Price/Earnings Next Twelve Months*	10
Dividend Yield (%/year)	4.1	*Indicated Annual Dividend (US$/sh)*	2.18

Note: Estimated cash flow and earnings tied to one-year futures prices for oil, natural gas and refinery crack.
Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.

Summary and Recommendation

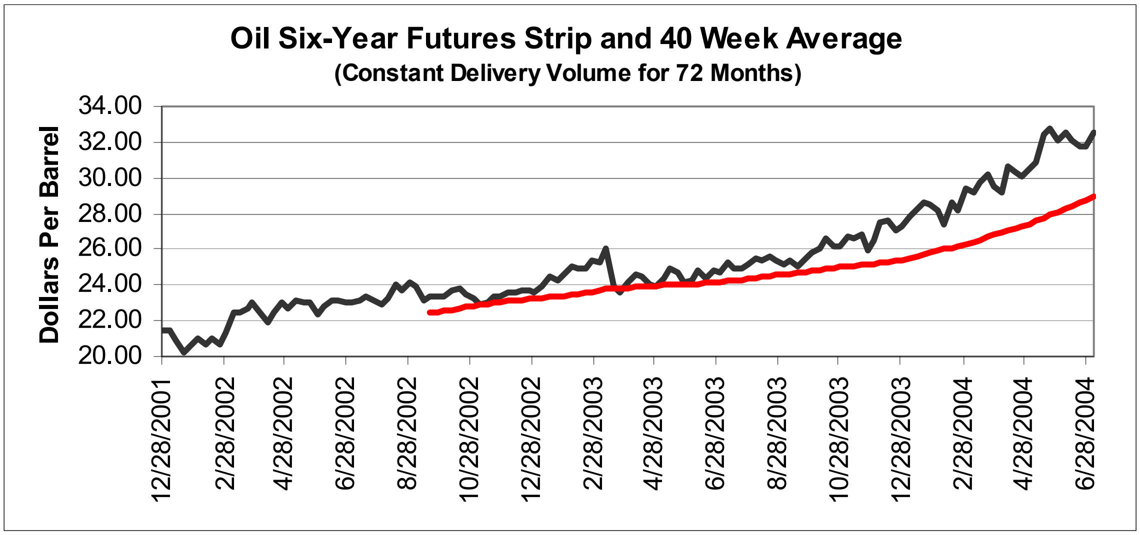
We continue to recommend current purchase of **Royal Dutch Petroleum (RD)**, 60% owner of the Royal Dutch/Shell Group, for attractive mega cap participation in rising oil profits, natural gas profits and oil products profits. Unfavorable publicity in the first half of 2004, some deserved, some exaggerated, may have held back the stock from better reflecting the improving prospects for leading oil and gas companies. Sparked by an apparent new willingness of management to listen to owners, an eventual simplification of the Group's Anglo-Dutch structure would help further should it unfold over the next year. We see 14% appreciation potential to net present value of US$60 a share and a long term unlevered return of about 5% per year above inflation thereafter. A low ratio of debt to present value implies low financial risk.

Trends Positive in Basic Business of Oil Production

Six-year futures describe the commodity price trends most relevant to estimating resource value. The longer time horizon better matches the period during which more of current resources will actually be produced. The longer term measure also smoothes the frantic near-month fluctuations and has the potential to keep climbing even if near-month quotes drop back temporarily.

The plot of weekly results since the beginning of 2002 trace a trend of six-year oil price rising some 20% a year (see chart). We measure momentum with the 40-week moving average. The charts look good as long as the current six-year quote remains above the trailing average.

Economics support the price trends. Oil demand is strong with world economic growth paced by developing countries, especially China. Supply is tight as the Middle East is showing maturity with the workhorse giant fields on the verge of peaking.



Monetary factors favor oil investment as interest rates below inflation drive investors to real assets for protection against currency debasement. Oil price is likely to rise more than the official U.S. government determined inflation measure.

Environmental factors favor higher oil and gas price. Coal is still a quarter of world primary energy supply. As long as large quantities of coal are burned, oil and gas must be undervalued because of the potential to displace environmentally disadvantageous coal.

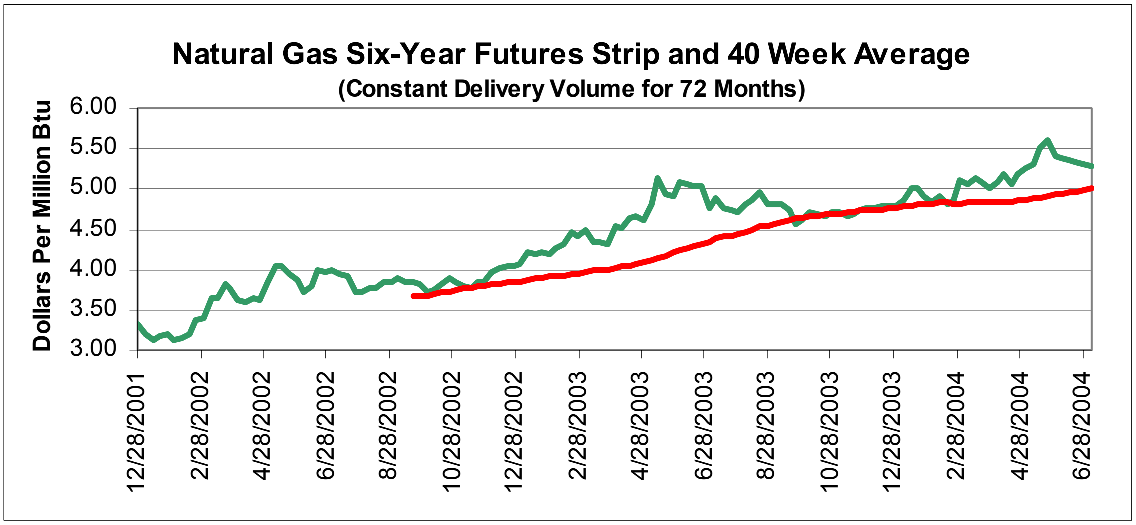
Political factors favor higher oil price as conditions in leading producing countries evolve in different directions. Now Saudi Arabia appears vulnerable to a change in control.

Nor can the U.S. military enforce an artificially low oil price for long. During the Arab oil embargo in 1973 some consumers advocated sending the troops. Thirty years later we have sent the troops only to see security deteriorate further, it seems.

At some point oil price could be too strong and economic activity would be adversely affected. In that sense it is a relief to see the recent pullback from a strong short-term price advance. Six times in the past thirty years the annual gain in monthly price exceeded 70% briefly. September futures near $40 a barrel for Light, Sweet Crude Oil would have to exceed $48 a barrel to trigger a 70% warning.

Trends More Positive for Natural Gas

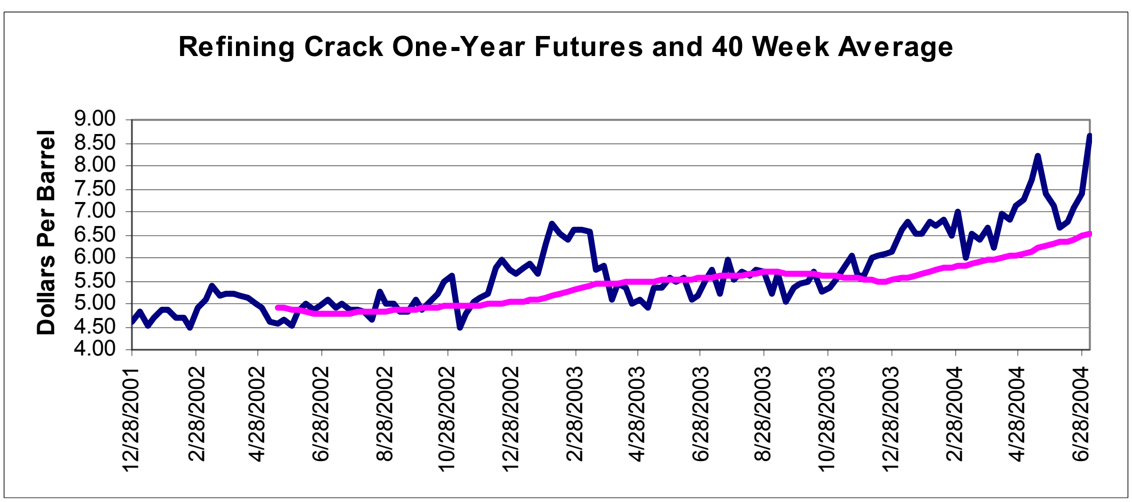
Natural gas price is on an even stronger upward trend than is oil (see chart). The ratio of natural gas to oil on a heating equivalent basis now near parity has been rising steadily over the decades and is likely to continue to do so for the cleaner fuel.



Trends Also Strong Downstream

Industry people like to refer to the oil producing business as upstream and the oil refining/marketing business as downstream. Strong upstream business prospects captured in the rising trend of six-year futures are complemented by improving downstream prospects captured in the trend of one-year refining crack futures (see chart).

The crack spread we measure is the price of two/thirds barrel of gasoline plus one/third barrel of heating oil minus a barrel of crude oil. While there are innumerable varieties of crude oil and products quoted around the world there is only one source of transparent, public quotes of futures prices for the next year, the New York Mercantile Exchange. As a result we use the Nymex quotes as an indicator of future downstream profitability globally, recognizing that markets are linked meaningfully, if not perfectly. Finally, the crack spread should be seasonally neutral because it always includes twelve months.



Volumes Steady, Cash Flow Rising

Our process of estimating company-specific present value begins with an estimate of next twelve months cash flow (see table). We concentrate on unlevered cash flow, also known as Ebitda, short for earnings before interest, tax, depreciation and amortization.

For the next twelve months we project constant oil volume at the first quarter 2004 level. That is sufficient for our valuation calculation. A short adjusted life index of 6.3 years for proven oil reserves suggests that it would be no surprise if volumes declined from current levels. Natural gas production is seasonal outside the U.S., particularly in Europe.

We take the futures market at face value in projecting price for the next twelve months. Light Sweet Crude quotes guide our projections of oil revenue and for overseas natural gas. Projections of revenue from U.S. natural gas depend on futures quotes for the Henry Hub in Louisiana.

The refinery crack futures guide our projections of downstream cash flow. The crack spread may be for New York Harbor, but it is the world benchmark for the year ahead. Because futures are constantly changing, our projection is adjusted accordingly. As a result, the specific amounts we project today may not be the amounts realized when the company next reports.

We estimate cash flow per equivalent barrel for Royal Dutch/Shell that is slightly lower than for its peers implying possible understatement, but not materially different. What is materially different is the Group's greater concentration on downstream at 39% of cash flow compared to a median 27% for four peers. The surprising strength in refined products in the past few weeks is a relative plus for the Group.

Present Value Multiple Related to Reserve Life

The important variables in the valuation of future production are captured in base year cash flow and a multiple of that cash flow that depends on reserve life. Indeed investors do differentiate on that basis as reflected in a high correlation of unlevered cash flow multiple with adjusted reserve life for North American producers. We convert the market relationship to a formula that produces an anticipatory value with somewhat more sensitivity to reserve life.

The adjusted reserve life index is the sum of developed and half undeveloped reserves divided by next twelve months production. When we last did an industry-wide upward revaluation on March 23, we estimated cash flow multiple equal to 2.5 plus 0.5 times reserve life. That approximates present value assuming constant commodity price near the one-year quotes at that time, about $35 a barrel for crude oil. Higher commodity prices since then imply higher cash flow and lower multiple.

Shell's adjusted reserve life of 8.0 years is lower than the median for some 70 companies of 9.3. By the relationship of March 23 that would support a multiple of estimated cash flow of 6.5. Changing markets since then bring the current multiple of present value to cash flow for Shell to 5.9 times. Regardless, the unlevered market multiple of cash flow, EV/Ebitda, of only 5.3 times suggests attractive total return potential in one of the world's leading oil companies.

Kurt H. Wulff, CFA

Royal Dutch/Shell
Next Twelve Months Operating and Financial Estimates

	Year 2003	*Q1 3/31/04*	*Q2E 6/30/04*	*Q3E 9/30/04*	*Q4E 12/31/04*	*Year 2004E*	*Next Twelve Months 6/30/05*
Volume							
Natural Gas (mmcfd)							
U.S. (or North America)	**1,527**	1,405	1,405	1,405	1,405	**1,409**	**1,405**
Overseas (or Int'l)	**7,418**	8,767	6,429	5,845	8,183	**7,324**	**7,310**
Total	**8,945**	10,172	7,834	7,250	9,588	**8,733**	**8,715**
Oil (mmb)	**872**	213	213	215	215	**857**	**855**
Oil (mbd)	**2,388**	2,342	2,342	2,342	2,342	**2,348**	**2,342**
Total gas & oil (mmb)	**1,416**	367	332	327	362	**1,388**	**1,385**
Price							
Natural gas ($/mcf)							
Henry Hub ($/mmbtu)	**5.49**	5.64	6.10	6.09	6.46	**6.07**	**6.30**
U.S. (or North America)	**5.62**	5.81	5.49	5.48	5.81	**5.65**	**5.67**
Overseas (or Int'l)	**2.74**	3.01	3.30	3.31	3.27	**3.21**	**3.22**
Total	**3.23**	3.40	3.69	3.73	3.64	**3.60**	**3.61**
Oil ($/bbl)							
WTI Cushing	**31.13**	35.23	38.34	38.42	37.97	**37.49**	**37.35**
Worldwide	**27.38**	30.33	33.01	33.08	32.69	**32.28**	**32.16**
Total gas & oil ($/bbl)	**24.30**	26.15	29.13	29.43	28.30	**28.19**	**28.15**
NY Harbor 3-2-1 ($/bbl)	**6.42**	6.98	11.01	11.14	8.55	**9.42**	**8.96**
Revenue ($mm)							
Natural Gas							
U.S. (or North America)	**3,130**	743	702	709	751	**2,904**	**2,907**
Overseas (or Int'l)	**7,416**	2,401	1,931	1,778	2,461	**8,572**	**8,578**
Total	**10,546**	3,144	2,633	2,487	3,212	**11,477**	**11,486**
Oil	**23,863**	6,464	7,035	7,127	7,045	**27,670**	**27,495**
Other	**167,523**	48,491	48,491	48,491	48,491	**193,963**	**193,963**
Total	**201,932**	58,099	58,159	58,104	58,748	**233,110**	**232,944**
Expense							
Production	**11,384**	3,427	3,439	3,428	3,556	**13,850**	**13,816**
Other	**158,235**	44,965	43,947	43,921	44,451	**177,284**	**177,505**
Ebitda ($mm)							
Exploration and Production	**23,025**	6,182	6,230	6,186	6,700	**25,297**	**25,165**
Other	**9,288**	3,526	4,543	4,570	4,040	**16,679**	**16,458**
Total Ebitda	**32,313**	9,707	10,773	10,756	10,740	**41,976**	**41,622**
Exploration	**1,285**	125	125	200	200	**650**	**800**
Deprec., Deplet., & Amort.	**11,128**	2,617	2,617	2,617	2,617	**10,468**	**10,468**
Other non cash	**584**	137	137	137	137	**548**	**548**
Ebit	**19,316**	6,828	7,894	7,802	7,786	**30,310**	**29,806**
Interest	**1,381**	312	312	312	312	**1,248**	**1,248**
Ebt	**17,935**	6,516	7,582	7,490	7,474	**29,062**	**28,558**
Income Tax	**6,277**	2,281	2,654	2,622	2,616	**10,172**	**9,995**
Net Income ($mm)							
Exploration and Production	**9,068**	2,746					
Other	**3,907**	1,778					
Unallocated	**(1,317)**	(289)					
Total	**11,658**	4,235	4,928	4,869	4,858	**18,891**	**18,563**

Research Methodology/Ratings Description: McDep Associates is an independent research originator focused on oil and gas stocks exclusively. The firm applies the thirty years of experience of its analyst to estimate a present value of the oil and gas resources and other businesses of covered companies. That value is compared with a company's stock market capitalization and debt. Stocks with low market cap and debt relative to present value tend to outperform stocks with high market cap and debt relative to present value. Buy recommendations are expected to deliver a total return better than 7% per year above inflation. Hold recommendations assume the attributes of the underlying business are more than fully reflected in the current price of the stock. Sell recommendations are expected to deliver a negative total return less than 7% per year including the effects of inflation.

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