

Rating: Buy  
S&P 500: 1273

## **XTO Energy** **Independent Natural Gas Producer**

<i>Symbol</i>	XTO	<i>Ebitda Next Twelve Months ending 12/31/06 (US\$m)</i>	3,430
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	76
<i>Price (US\$/sh)</i>	45.31	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	1/4/06	<i>Adjusted Reserves/Production NTM</i>	10.8
<i>Shares (mm)</i>	370	<i>EV/Ebitda</i>	6.1
<i>Market Capitalization (US\$m)</i>	16,800	<i>PV/Ebitda</i>	6.4
<i>Debt (US\$m)</i>	4,300	<i>Undeveloped Reserves (%)</i>	28
<i>Enterprise Value (EV) (US\$m)</i>	21,100	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	39.90
<i>Present Value (PV) (US\$m)</i>	22,100	<i>Present Value Proven Reserves(US\$/boe)</i>	20.48
<i>Net Present Value (US\$/share)</i>	48	<i>Present Value Proven Reserves(US\$/mcf)</i>	3.41
<i>Debt/Present Value</i>	0.20	<i>Earnings Next Twelve Months (US\$/sh)</i>	4.34
<i>McDep Ratio - EV/PV</i>	0.95	<i>Price/Earnings Next Twelve Months</i>	10
<i>Dividend Yield (%/year)</i>	0.4	<i>Indicated Annual Dividend (US\$/sh)</i>	0.20

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

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

### **Summary and Recommendation**

Buy-recommended **XTO Energy (XTO)** combines a rich natural gas resource base with a high-performance record to offer investment exposure to the rising commodity value of clean fuel. The absence of costly hedges that expired at year end should boost 2006 revenue beyond that implied by futures prices. The stock has again nearly reached net present value that has been appreciating with natural gas. XTO's takeover potential is less obvious than for peers, but could be real for a performance oriented acquirer.

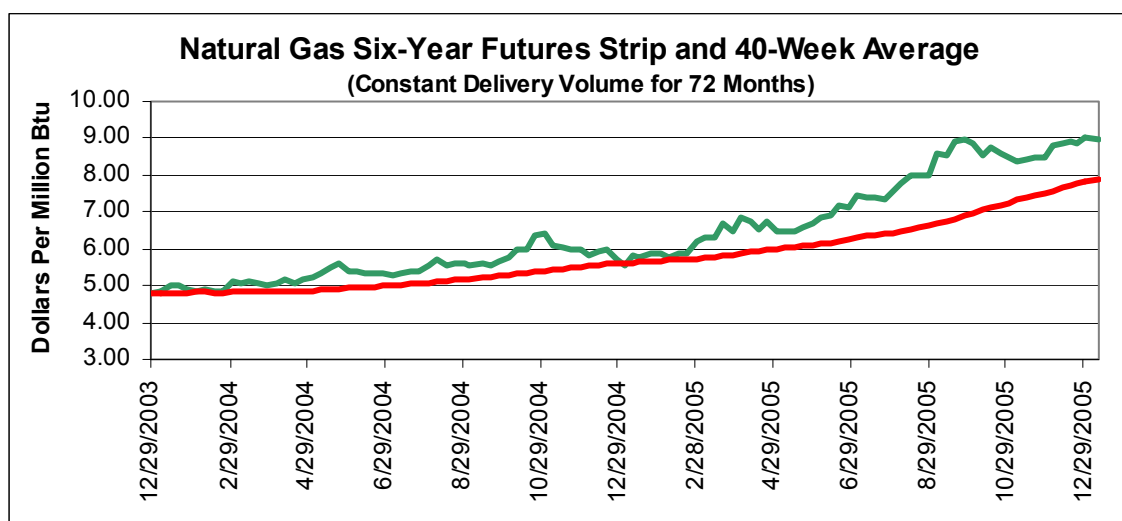
### **McDep Ratio Relates Natural Gas Price to Opportunity**

A McDep Ratio near 1.0 tells us that XTO's market cap and debt, or enterprise value, is near the estimated present value of its energy resources. The estimate assumes a long-term real price of \$10 a million btu for Louisiana Natural Gas.

Meanwhile six-year oil futures are about \$63 a barrel. The natural gas equivalent is more than \$12 a million btu (\$63 divided by 5 equals \$12.60). The current quote for six-year futures of natural gas has reached \$9. The gap between \$12 and \$9 appears to be contributing to positive momentum as the current quote stays above the 40-week average (see chart Natural Gas Six-Year Futures and 40-Week Average).

Six-year oil has tripled in the four years we have been calculating it on a weekly basis. Our vision of \$150 oil in 2010 implies additional scope to exceed common expectations. The natural gas equivalent would be \$30.

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XTO's McDep Ratio ranks near peer companies (see table [Rank by McDep Ratio](#)). Aside from the fundamental meaning we outlined above, a McDep Ratio of 1.0 is an indication of takeover value. The McDep Ratio of peer company, buy-recommended **Burlington Resources (BR)**, increased to 1.0 immediately after buy-recommended **ConocoPhillips (COP)** announced its takeover offer. Since then we revised BR's present value upward to represent the present value in COP stock that would be exchanged for BR stock.

XTO looks less like a takeover candidate on a McDep Ratio basis on current estimates than lower ranked peers. On the other hand, XTO has a superior record and has often outperformed from a higher McDep Ratio ranking. A performance oriented acquirer might readily be attracted to XTO. For example, XTO has an excellent working relationship with buy-recommended **ExxonMobil (XOM)**. The mega cap continues to own valuable North American properties readily susceptible to the exploitation that XTO does so well.

**Rank by McDep Ratio: Market Cap and Debt to Present Value**

	Symbol/ Rating	Price (\$/sh) 4-Jan 2006	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio
<b>Independent Natural Gas and Oil - Large Cap and Mid Cap</b>							
XTO Energy Inc.	XTO B	45.31	370	16,760	48.00	0.20	0.95
Encana Corporation	ECA B	46.30	876	40,600	51.00	0.20	0.93
CNOOC Limited (29%)	CEO B	70.15	119	8,370	84.00	0.00	0.84
Devon Energy Corporation	DVN B	65.99	454	30,000	86.00	0.15	0.80
Burlington Resources	BR B	87.40	381	33,300	115.00	-	0.76
Occidental Petroleum Corp.	OXY B	84.95	432	36,700	120.00	0.12	0.74
Anadarko Petroleum Corp.	APC B	98.27	238	23,400	140.00	0.12	0.74
<i>Total or Median</i>				<i>189,000</i>		<i>0.12</i>	<i>0.80</i>

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### Low Cash Flow Multiple

Unlevered cash flow multiples in single digits attest to low valuation (see table [Rank by EV/Ebitda](#)). Multiples may be low because investors do not think cash flow will last long at current levels. That depends on commodity price and reserve life. Cash flow estimated for the next twelve months, Ebitda NTM, reflects latest futures prices. Reserve life is measured as adjusted reserves divided by next twelve months production. Apparently longer life for XTO's properties contributes to a McDep Ratio closer to peers than unlevered cash flow multiple.

#### Rank by EV/Ebitda: Enterprise Value to Earnings Before Interest, Tax, Deprec.

	Symbol/ Rating		Price (\$/sh) 4-Jan 2006	Adjstd Resrvs/ Prod NTM	PV/ Ebitda NTM	EV/ Ebitda NTM	P/E NTM	Divd or Distrib NTM (%)
<b>Independent Natural Gas and Oil - Large Cap and Mid Cap</b>								
XTO Energy Inc.	XTO	B	45.31	10.8	6.4	6.1	10	0.4
Encana Corporation	ECA	B	46.30	7.1	5.5	5.1	10	0.6
Anadarko Petroleum Corp.	APC	B	98.27	12.5	6.4	4.7	9	0.7
Occidental Petroleum Corp.	OXY	B	84.95	11.3	6.0	4.5	8	1.7
CNOOC Limited (29%)	CEO	B	70.15	9.2	5.2	4.3	8	3.3
Devon Energy Corporation	DVN	B	65.99	7.8	4.9	3.9	7	0.5
Burlington Resources	BR	B	87.40	-	-	-	-	-
	<i>Median</i>			9.2	5.5	4.5	8	0.6

### Concentration on Natural Gas

Each oil and gas stock has its own unique mix of energy resources (see table [Business Segments](#)). XTO is one of four close peers concentrated on natural gas while the other two are concentrated on oil. Prices of peer stocks may react in the short-term depending on relative changes in expectations for natural gas and oil. We recommend that investors have both natural gas and oil representation.

#### 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>Independent Natural Gas and Oil - Large Cap and Mid Cap</b>								
Encana Corporation	ECA	B	Canada	83	-	17	-	55,600
Occidental Petroleum Corp.	OXY	B		14	1	75	11	59,000
Devon Energy Corporation	DVN	B		64	-	36	-	46,000
Anadarko Petroleum Corp.	APC	B		60	-	40	-	37,700
Burlington Resources	BR	B						
CNOOC Limited	CEO	B	China	-	12	88	-	34,600
XTO Energy Inc.	XTO	B		83	-	17	-	22,100
	<i>Median</i>			62	-	38	-	255,000

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**Static Present Value Justified by Dynamic Cash Flow**

Present value analysis presumes that fundamental value is measured by the projection of cash flows years into the future and bringing them to the present applying a real discount rate, currently 7% a year. We generally hold present value estimates static until there is justification to make new commodity price assumptions.

Next Twelve Months (NTM) cash flow represents the volumes and costs that form the base for future projections. Reserve life index tells how long cash flow will last. NTM cash flow and reserve life are the two main variables in our correlation by function for about 30 companies. Net present value indicated by the current combined correlation is about \$2 a share higher than our ongoing standard estimate for the company (see table Functional Cash Flow and Present Value).

**XTO Energy Inc.**  
**Functional Cash Flow and Present Value**

	<i>NTM Ebitda</i> <i>(US\$mm)</i>	<i>Adjusted</i> <i>R/P</i>	<i>PV/</i> <i>Ebitda</i>	<i>Present</i> <i>Value</i> <i>(US\$mm)</i>	
North American Natural Gas	2,610	11.2	7.0	18,300	83%
Oil	820	9.4	4.6	3,800	17%
	3,430	10.8	6.4	22,100	100%
Debt (US\$mm)				4,300	
Net Present Value (US\$mm)				17,800	
Shares (mm)				370	
Net Present Value (US\$/sh)				48	
Over (-)/ Under (+) Correlation (US\$/sh)				2	

**Futures Prices Propel Estimated Cash Flow by Quarter**

Positive volume trends support higher future expectations. (see table Next Twelve Months Operating and Financial Estimates). Company disclosures provide the clues for future volumes and costs as well as geographic and quality differences in price. Futures prices from the New York Mercantile Exchange determine industry benchmarks for the next year in our model. The line including hedging costs illustrates the opportunity after disadvantageous contracts ran out at the end of 2005.

Kurt H. Wulff, CFA

**XTO Energy Inc.**  
**Next Twelve Months Operating and Financial Estimates**

	<i>Q4</i>	<i>Q3</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Next Twelve Months</i>
	<i>12/31/04</i>	<i>9/30/05</i>	<i>12/31/05</i>	<i>2005E</i>	<i>3/31/06</i>	<i>6/30/06</i>	<i>9/30/06</i>	<i>12/31/06</i>	<i>12/31/06</i>
<b>Volume</b>									
Natural Gas (mmcf)	916	1,087	1,100	<b>1,032</b>	1,100	1,100	1,100	1,100	<b>1,100</b>
Oil (mbd)	42	52	52	<b>49</b>	52	52	52	52	<b>52</b>
Total gas & oil (bcf)	108	129	130	<b>486</b>	128	128	130	130	<b>516</b>
<b>Price</b>									
Natural gas (\$/mcf)									
Henry Hub (\$/mmbtu)	7.10	8.56	13.00	<b>8.65</b>	10.15	9.80	9.91	10.55	<b>10.10</b>
Company (\$/mcf)	5.91	7.04	11.05	<b>7.58</b>	8.62	8.33	8.43	8.97	<b>8.59</b>
Oil (\$/bbl)									
WTI Cushing	48.31	62.52	59.99	<b>56.30</b>	62.65	64.98	65.67	66.04	<b>64.83</b>
Company (\$/bbl)	42.96	49.10	52.79	<b>46.28</b>	55.13	57.18	57.79	58.12	<b>57.06</b>
Total gas & oil (\$/mcf)	6.18	7.29	10.56	<b>7.61</b>	8.75	8.60	8.69	9.13	<b>8.79</b>
<b>Revenue (\$mm)</b>									
Natural Gas	498	704	1,119	<b>2,862</b>	863	834	853	908	<b>3,458</b>
Oil	166	234	251	<b>834</b>	259	269	275	276	<b>1,080</b>
Other									
Total	665	938	1,370	<b>3,696</b>	1,123	1,103	1,128	1,184	<b>4,537</b>
<b>Expense</b>									
Production	134	192	304	<b>803</b>	240	235	241	256	<b>971</b>
Overhead	15	34	34	<b>152</b>	34	34	34	34	<b>134</b>
<b>Ebitda (\$mm)</b>	516	713	1,032	<b>2,742</b>	850	835	853	895	<b>3,433</b>
Exploration	5	13	13	<b>32</b>	13	13	13	13	<b>50</b>
Deprec., Deplet., & Amort.	128	182	182	<b>648</b>	182	182	182	182	<b>727</b>
Hedging and other	80	(10)	194	<b>230</b>	2	2	2	2	<b>8</b>
<b>Ebit</b>	302	528	644	<b>1,832</b>	653	639	657	698	<b>2,648</b>
Interest	28	44	44	<b>155</b>	44	44	44	44	<b>176</b>
<b>Ebt</b>	274	484	600	<b>1,677</b>	609	595	613	654	<b>2,472</b>
Income Tax	96	169	210	<b>587</b>	213	208	215	229	<b>865</b>
<b>Net Income (\$mm)</b>	178	315	390	<b>1,090</b>	396	387	398	425	<b>1,607</b>
<b>Shares (millions)</b>	349	370	370	<b>367</b>	370	370	370	370	<b>370</b>
Per share (\$)	0.51	0.85	1.05	<b>2.97</b>	1.07	1.05	1.08	1.15	<b>4.34</b>
Ebitda Margin - O&G	78%	76%	75%	<b>74%</b>	76%	76%	76%	76%	<b>76%</b>
Tax Rate	35%	35%	35%	<b>35%</b>	35%	35%	35%	35%	<b>35%</b>

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