

## Meter Reader

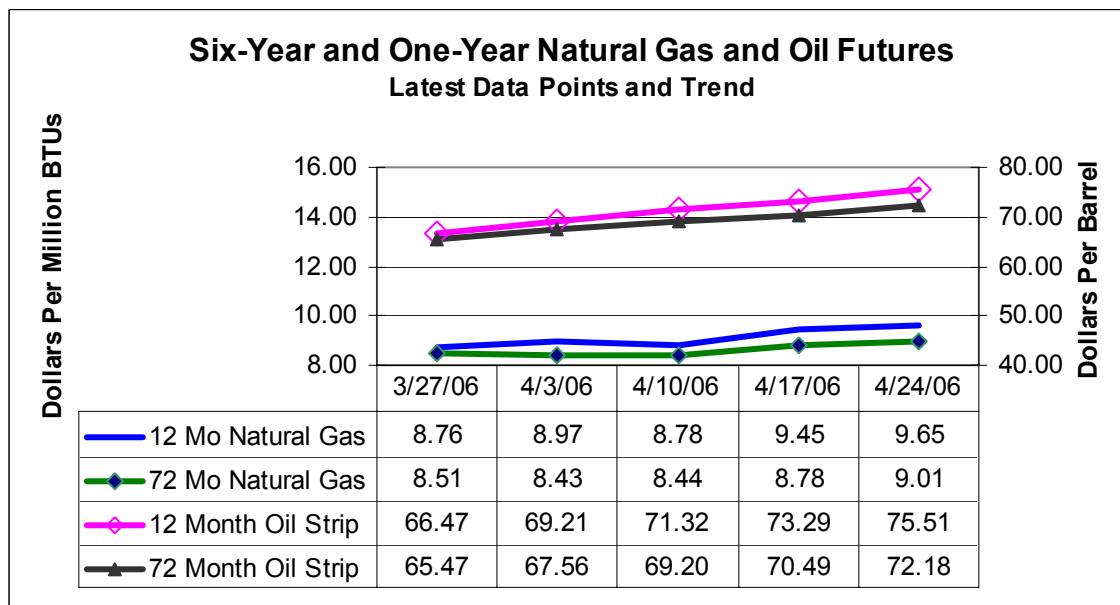
*A Weekly Analysis of Energy Stocks Using the McDep Ratio*

April 25, 2006

# Portfolio Points

## Summary and Recommendation

Buy-recommended **Gazprom (OGZPY)** has the highest weighting of a single stock in our illustrative portfolio. Among stocks of large cap operating companies, lower McDep Ratio buy recommendations have a double weighting and higher McDep Ratio buys have a half weighting. Small cap buys have half the weight of large caps and income buys have double weightings. The combined weightings are domiciled 48% outside the U.S. and are concentrated 31% on North American natural gas, 14% Rest of World natural gas, 45% oil and 11% downstream. The skewed weighting of buys has an average McDep Ratio of 0.88 that is 0.07 lower than that for an equal weighting of buys. A McDep Ratio of 0.88 implies a long-term oil price of about \$44 a barrel while six-year futures march to a new high of \$72.



## Portfolio Weightings Take Account of McDep Ratio

At the beginning of April we modified the regular valuation table titled Home Country and Business Segments to a new format titled Portfolio Composite of Buy Recommendations (see page 5). The new format weights individual buy recommendations taking account of McDep Ratio, company size and distribution policy.

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Stock selection for the illustrated portfolio is determined by the inputs in the column headed "Parts of EV". Weightings refer to Enterprise Value and ultimately translate to "Portfolio Equity Weight" in the previous column. Investors starting with an existing portfolio would enter portfolio equity weight and translate that to parts of enterprise value taking account of debt. In that case we suggest that instead of parts, enterprise value be expressed as a percent of the portfolio.

To determine parts of EV we divided stocks into three categories by McDep Ratio. Stocks in the lower third, or most undervalued category, were given a double weight, or 2.0 parts. Buys in the middle were given a normal weight, or 1.0 part. Buys in the upper third were given a half weight, or 0.5 parts. Many times, though not always, in tests over two decades of past performance lower third McDep Ratio stocks outperformed higher third McDep Ratio stocks. In 2005 the difference in price gain was 66% compared to 27%. Since the stocks are ranked by McDep Ratio in descending order, the highest weighted stocks should be at the bottom of each group. Ranking with the lowest McDep Ratio on the bottom connotes "buy low".

#### **Single Best Idea a Triple Weighting**

Gazprom has the potential to be the most valuable company in the global energy industry. Russia has more natural gas than Saudi Arabia has oil. Gazprom accounts for practically all of Russia's production and half or more of reserves. The company sold its premium product for just \$2 a million btu last year. Oil at \$70 a barrel implies natural gas at \$14 a million btu. Our vision is for oil to reach \$150 a barrel in 2010. While that implies \$30 natural gas, it would undoubtedly take longer for some natural gas to appreciate that much because of the lag in contracts. With a potential 7-15 fold gain in the price of its product the stock is a possible ten bagger, one that goes up ten times in ten years.

Of course such potential is not without risk. Nonetheless, we suggest that the combination of reward and risk justifies a triple weight.

#### **Higher Risk in Small Cap, Lower Risk in Income**

Small cap stocks can be exciting investments. Our best small cap natural gas stocks went up 17 times from about 1975 to 1980, a period similar to the present. Yet operating risks are also concentrated in smaller companies. Similarly stock prices can be more volatile. As a result we make the weighting of small cap stocks half that of large caps. Thus, instead of a double weight for a low McDep Ratio small cap stock we make it a normal weight.

We weight the three income stocks among our buys at double despite McDep Ratios that might suggest half. Income stocks by making high distributions shift the risk of reinvestment to unit holders. That can be a good thing though it depends on many factors. The properties in most of the royalty trusts in our coverage tend to be among the highest quality with longer life and hidden potential. We also cover more income stocks that in some cases and at some times could be as attractive as the active buy recommendations.

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### **Trade Thoughtfully**

When a stock performs especially well it can become a large portion of the portfolio. Should it then be sold partially to bring its weighting down? The answer is part of the art of investment management. Some investors may prefer to let their winners ride until the trend turns. Others may prefer to hedge against too much in one stock in case of unforeseen negative surprise.

We would be wary of selling an overweighted stock and replacing it with an alternative near the same McDep Ratio. In taxable accounts there should be at least a wide enough difference in McDep Ratio to cover taxes incurred on sale and repurchase.

We are also reaching a point now when present value might be revised upward. As a result, a McDep Ratio that looks a bit high may look more reasonable after the revision.

### **Opportunities are Global**

Having determined weights we can see how the selections add up to a portfolio composite. The weights are translated to a percentage of total portfolio enterprise value.

To get an idea of the concentration of the portfolio outside the U.S. we list the enterprise value of each non-U.S. company as a percent of portfolio enterprise value in the column headed "Non-U.S. Home". The total is 48%, 20% in Canada, 14% in Russia, and the remainder in China, U.K., France and Norway.

### **Natural Gas, Oil and Downstream are Complementary**

The next four columns tell us how the portfolio is concentrated by function. Natural gas is further separated by geography. Rarely are all the functions in favor at the same time.

### **Weightings Lower Portfolio McDep Ratio**

The McDep Ratio is one reason why one might want to pick stocks as opposed to buying an index or an exchange traded fund. By concentrating the portfolio disproportionately on lower McDep Ratio stocks, performance might be better than an index that weights stocks equally or by market cap without regard to valuation.

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) 24-Apr 2006	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio
<b>Mega Cap</b>								
BP plc	BP	B	75.86	3,465	263,000	77.00	0.15	0.99
Total S.A.	TOT	B	140.90	1,173	165,000	160.00	0.12	0.90
Royal Dutch Shell plc	RDS-A	B	69.74	3,293	230,000	80.00	0.11	0.89
Exxon Mobil Corporation	XOM	B	64.40	6,211	400,000	74.00	0.04	0.88
ConocoPhillips	COP	B	69.84	1,693	118,000	95.00	0.22	0.79
Chevron Corporation	CVX	B	60.99	2,236	136,000	85.00	0.11	0.75
<i>Total or Median</i>					<i>1,312,000</i>		<i>0.12</i>	<i>0.88</i>
<b>Producer/Refiners - Large Cap and Mid Cap</b>								
Kinder Morgan, Inc.	KMI	S2	89.53	135	12,090	33.00	0.75	1.42
Imperial Oil Limited (30%)	IMO	B	111.44	101	11,230	90.00	0.10	1.22
Norsk Hydro ASA	NHY	B	155.60	251	38,980	130.00	0.16	1.17
Petro-Canada	PCZ	B	50.05	523	26,180	42.00	0.19	1.16
Suncor Energy	SU	B	86.69	461	39,970	75.00	0.10	1.14
Marathon Oil Corporation	MRO	B	83.87	367	30,820	75.00	0.20	1.09
PetroChina Company Ltd (10%)	PTR	B	113.64	178	20,210	120.00	0.05	0.95
Lukoil Oil Company	LUKOY	B	93.20	830	77,000	110.00	0.01	0.85
Gazprom (50%)	OGZPF	B	42.00	2,833	119,000	56.00	0.02	0.76
<i>Total or Median</i>					<i>375,000</i>		<i>0.10</i>	<i>1.14</i>
<b>Independent Natural Gas and Oil - Large Cap and Mid Cap</b>								
CNOOC Limited (29%)	CEO	B	85.90	119	10,240	84.00	-	1.02
Encana Corporation	ECA	B	50.27	873	43,900	51.00	0.18	0.99
Occidental Petroleum Corp.	OXY	B	105.55	432	45,600	120.00	0.12	0.89
XTO Energy Inc.	XTO	B	44.77	370	16,560	52.00	0.16	0.88
EOG Resources	EOG	B	75.32	245	18,500	90.00	0.04	0.84
Anadarko Petroleum Corp.	APC	B	111.27	234	26,000	160.00	0.10	0.73
Devon Energy Corporation	DVN	B	62.53	451	28,200	94.00	0.12	0.70
<i>Total or Median</i>					<i>189,000</i>		<i>0.12</i>	<i>0.88</i>
<b>Independent Natural Gas and Oil - Small Cap</b>								
Berry Petroleum Company	BRY	B	76.75	23	1,730	65.00	0.11	1.16
Energy Partners Ltd.	EPL	B	27.26	41	1,110	29.00	0.21	0.95
Cimarex Energy Company	XEC	B	45.62	85	3,880	64.00	0.08	0.74
Encore Acquisition Company	EAC	B	31.28	50	1,550	50.00	0.24	0.72
<i>Total or Median</i>					<i>8,300</i>		<i>0.16</i>	<i>0.84</i>
<b>Income</b>								
Kinder Morgan Energy Partners, L.P.	KMP	S3	47.67	165	7,880	15.00	0.56	1.97
Kinder Morgan Management, LLC	KMR	S3	43.65	58	2,530	15.00	0.56	1.85
Pengrowth Energy Trust	PGH		24.70	160	3,950	18.00	0.16	1.31
Enerplus Resources Fund	ERF		52.89	114	6,040	42.00	0.15	1.22
Penn West Energy Trust (US\$)	PWTFF	B	39.03	230	8,960	33.00	0.15	1.16
Canadian Oil Sands Trust (US\$)	COSWF	B	154.01	93	14,380	136.00	0.12	1.12
San Juan Basin Royalty Trust	SJT	B	41.12	47	1,920	40.00	-	1.03
<i>Total or Median</i>					<i>45,700</i>		<i>0.15</i>	<i>1.22</i>

B = Buy, S2 = Short half unlevered position, S3 = Short quarter unlevered position, H = Hold

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) 24-Apr 2006	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	75.86	9.6	6.4	6.3	10	3.0
Exxon Mobil Corporation	XOM	B	64.40	11.7	6.2	5.4	9	2.0
Total S.A.	TOT	B	140.90	9.3	6.0	5.4	9	2.9
Royal Dutch Shell plc	RDS-A	B	69.74	7.3	5.3	4.7	9	3.3
ConocoPhillips	COP	B	69.84	12.1	5.6	4.4	7	2.1
Chevron Corporation	CVX	B	60.99	10.7	5.4	4.0	7	3.0
	<i>Median</i>			10.2	5.8	5.0	9	2.9
<b>Producer/Refiners - Large Cap and Mid Cap</b>								
Kinder Morgan, Inc.	KMI	S2	89.53		8.6	12.3	15	3.9
Suncor Energy	SU	B	86.69	17.7	7.5	8.5	17	0.2
Gazprom (50%)	OGZPF	B	42.00	20.0	9.5	7.2	12	0.4
Imperial Oil Limited (30%)	IMO	B	111.44	9.3	5.9	7.2	12	0.8
Petro-Canada	PCZ	B	50.05	6.0	5.2	6.0	11	0.7
PetroChina Company Ltd (10%)	PTR	B	113.64	11.6	6.0	5.7	11	3.7
Norsk Hydro ASA	NHY	B	155.60	7.8	4.6	5.3	16	2.2
Marathon Oil Corporation	MRO	B	83.87	7.8	4.6	5.1	9	1.6
Lukoil Oil Company	LUKOY	B	93.20	20.2	6.1	5.2	8	1.1
	<i>Median</i>			10.4	6.0	6.0	12	1.1
<b>Independent Natural Gas and Oil - Large Cap and Mid Cap</b>								
XTO Energy Inc.	XTO	B	44.77	12.1	7.1	6.3	11	0.4
EOG Resources	EOG	B	75.32	9.6	6.5	5.5	12	0.3
Encana Corporation	ECA	B	50.27	8.7	5.3	5.3	10	0.6
Occidental Petroleum Corp.	OXY	B	105.55	10.2	5.9	5.2	9	1.4
Anadarko Petroleum Corp.	APC	B	111.27	12.7	6.6	4.8	9	0.6
CNOOC Limited (29%)	CEO	B	85.90	10.1	4.2	4.3	7	3.0
Devon Energy Corporation	DVN	B	62.53	8.6	5.3	3.8	7	0.7
	<i>Median</i>			10.1	5.9	5.2	9	0.6
<b>Independent Natural Gas and Oil - Small Cap</b>								
Berry Petroleum Company	BRY	B	76.75	10.6	5.3	6.1	16	0.8
Encore Acquisition Company	EAC	B	31.28	14.8	7.2	5.2	11	-
Energy Partners Ltd.	EPL	B	27.26	5.7	4.0	3.8	22	-
Cimarex Energy Company	XEC	B	45.62	7.2	4.8	3.5	7	0.4
	<i>Median</i>			8.9	5.0	4.5	14	0.2
<b>Income</b>								
Kinder Morgan Energy Partners, L.P.	KMP	S3	47.67		8.3	16.3	28	6.8
Kinder Morgan Management, LLC	KMR	S3	43.65		8.3	15.3	26	7.4
San Juan Basin Royalty Trust	SJT	B	41.12	13.5	10.2	10.5	12	8.3
Canadian Oil Sands Trust (US\$)	COSWF	B	154.01	20.0	9.4	10.5	13	5.7
Enerplus Resources Fund	ERF		52.89	9.4	5.7	6.9	12	8.4
Penn West Energy Trust (US\$)	PWTFF	B	39.03	7.9	6.0	7.0	10	9.2
Pengrowth Energy Trust	PGH		24.70	7.2	5.2	6.8	10	10.7
	<i>Median</i>			9.4	8.3	10.5	12	8.3

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended March 31, 2007; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

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#### Oil and Gas Producers Portfolio Composite of Buy Recommendations

	Portfolio Equity Weight Symbol	Parts of EV (%)	Non- U.S. Home (%)	North Amer. Natural Gas (%)	Rest of World Natural Gas (%)	Oil Prod'n (%)	Down- stream (%)	McDep Ratio	
<b>Mega Cap</b>									
BP plc	BP	2.7	1.0	2.8	0.3	0.3	1.2	1.0	0.99
Total S.A.	TOT	2.7	1.0	2.8		0.8	1.1	1.0	0.90
Royal Dutch Shell plc	RDS-A	2.8	1.0	2.8	0.1	0.6	0.9	1.2	0.89
Exxon Mobil Corporation	XOM	3.0	1.0		0.2	0.8	1.0	0.8	0.88
ConocoPhillips	COP	4.6	2.0		0.9	0.5	2.6	1.5	0.79
Chevron Corporation	CVX	5.4	2.0		0.3	0.6	3.3	1.4	0.75
<b>Producer/Refiners - Large Cap and Mid Cap</b>									
Imperial Oil Limited	IMO	1.5	0.5	1.4	0.2		0.9	0.3	1.22
Norsk Hydro ASA	NHY	1.4	0.5	1.4		0.4	0.5	0.5	1.17
Petro-Canada	PCZ	1.3	0.5	1.4	0.3	0.1	0.8	0.3	1.16
Suncor Energy	SU	1.5	0.5	1.4	0.1		1.3	0.1	1.14
Marathon Oil Corporation	MRO	1.3	0.5		0.2	0.2	0.5	0.6	1.09
PetroChina Company Ltd.	PTR	3.0	1.0	2.8		0.3	2.3	0.3	0.95
Lukoil Oil Company	LUKOY	6.3	2.0	5.6			4.4	1.3	0.85
Gazprom	OGZPF	9.3	3.0	8.5		8.5			0.76
<b>Independent Natural Gas and Oil - Large Cap and Mid Cap</b>									
CNOOC Limited	CEO	3.2	1.0	2.8		0.4	2.5		1.02
Encana Corporation	ECA	2.6	1.0	2.8	2.3		0.5		0.99
Occidental Petroleum Corp.	OXY	2.8	1.0		0.4	0.0	2.1	0.3	0.89
XTO Energy Inc.	XTO	2.6	1.0		2.3		0.5		0.88
EOG Resources	EOG	6.0	2.0		4.5	0.4	0.7		0.84
Anadarko Petroleum Corp.	APC	5.5	2.0		3.4		2.3		0.73
Devon Energy Corporation	DVN	5.3	2.0		3.6		2.0		0.70
<b>Independent Natural Gas and Oil - Small Cap</b>									
Berry Petroleum Company	BRY	1.4	0.5		0.2		1.2		1.16
Energy Partners Ltd.	EPL	1.2	0.5		0.8		0.6		0.95
Cimarex Energy Company	XEC	2.8	1.0		2.1		0.8		0.74
Encore Acquisition Company	EAC	2.1	1.0		0.7		2.1		0.72
<b>Income</b>									
Penn West Energy Trust (US\$)	PWTFF	5.6	2.0	5.6	2.1		3.5		1.16
Canadian Oil Sands Trust (US\$)	COSWF	5.7	2.0	5.6			5.6		1.12
San Juan Basin Royalty Trust	SJT	6.4	2.0		5.6				1.03
<b>Portfolio Composite</b>		<b>100</b>	<b>35.5</b>	<b>48</b>	<b>31</b>	<b>14</b>	<b>45</b>	<b>11</b>	<b>0.88</b>

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#### Index of Recent Research

##### Stock Ideas

<u>Date</u>	<u>Symbol</u>	<u>Stock</u>	<u>Theme</u>
21-Apr	XTO	XTO Energy Inc.	Distributing Royalty Trust Units
20-Apr	KMx	Kinder Morgan	False Debt Promotion Unmasked
18-Apr	OGZPF	Gazprom	Shares Trading Free at Last!
17-Apr	PWTFF	Penn West Energy Trust	To Buy Petrofund
17-Apr	LUKOY	Lukoil Oil Company	Raise Net Present Value to \$110 a Share
13-Apr	EPL	Energy Partners, Ltd.	Deep Water Success on First Well
6-Apr	KMx	Kinder Morgan	Debt Exposé
28-Mar	EPL	Energy Partners, Ltd.	Denali a Dry Hole
24-Mar	* CEO	CNOOC Ltd	Growth Marches On
23-Mar	* EOG	EOG Resources Inc.	New Natural Gas Buy Recommendation
21-Mar	* PTR	PetroChina Company Limited	Growing Pains
20-Mar	* SJT	San Juan Basin Royalty Trust	Upgrade to Buy
10-Mar	* COP	ConocoPhillips	Longest Life Mega Cap
9-Mar	* XOM	Exxon Mobil Corporation	Stronger than the Government
8-Mar	* CVX	Chevron Corporation	Momentum Break
23-Feb	* BRY	Berry Petroleum	Growth Record
21-Feb	* EAC	Encore Acquisition Company	Steady Progress
16-Feb	* XEC	Cimarex Energy Company	Eyed by Icahn
16-Feb	* TOT	Total S.A.	Challenges of Growth
16-Feb	* ECA	EnCana Corporation	Buying Opportunity
14-Feb	* NHY	Norsk Hydro ASA	Natural Gas Price Advance
8-Feb	* OXY	Occidental Petroleum Corporation	Longer Life Independent
8-Feb	* BP	BP p.l.c.	Temporary Setbacks
7-Feb	* APC	Anadarko Petroleum Corporation	Raise NPV to \$160 a Share
3-Feb	* RDSA	Royal Dutch Shell plc	Lower NPV to \$80 a Share
3-Feb	* IMO	Imperial Oil Limited	Raise NPV to \$90 a Share
2-Feb	* DVN	Devon Energy Corporation	Raise NPV to \$94 a Share
27-Jan	* SU	Suncor Energy Inc.	Raise Net Present Value to \$75 a Share
27-Jan	* PCZ	Petro-Canada	Favorable Relative Recognition
27-Jan	* MRO	Marathon Oil Corporation	Raise Net Present Value to \$75 a Share
26-Jan	* COSWF	Canadian Oil Sands Trust	Volume Affirmed

##### Meter Reader - A Weekly Analysis

25-Apr		Portfolio Points
18-Apr	*	Calgary Consolidation
11-Apr	*	Black Gold Rush
4-Apr	*	Qatari Quandary

##### Natural Gas and Oil Royalty Trusts - A Weekly Analysis

21-Apr		New Billion Dollar Float
14-Apr	*	Distribution Pictures
7-Apr	*	Volume for Income
31-Mar	*	Oil Sands and LNG

##### Industry Ideas

15-Feb	*	Presentation Slides	Russian Natural Gas, Canadian Tar Sands
26-Dec	*	Interview by Sandra Ward in Barron's	Bullish and Fully Fueled

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