

Kovykta Kontroversy

Summary and Recommendation

Compromise is the reasonable expectation for imminent resolution of the dispute between the Russian government and buy-recommended **BP plc (BP)** over the rights to a natural gas field in Eastern Siberia. With reserves of seventy trillion cubic feet worth over a half a *trillion* dollars in revenue at today's futures prices, there is enough resource value to benefit all parties. BP has little to lose since all the company's Russian natural gas reserves account for 1% of estimated net present value (NPV) of \$87 a share. President Putin appears to have two objectives, first to prevent BP's selling the gas to China for a cheap price as is apparently the case with BP's Tangguh Indonesian LNG project, and second to reclaim some of the public resource value that moved into the hands of a few oligarchs under murky circumstances during the chaotic years of the Yeltsin era. Publicity over the current controversy may have contributed to less investor confidence not only in BP, but also in our buy-recommendations of **Gazprom (OGZPY)** and **Lukoil (LUKOY)**. We believe investments in Russian oil and gas are potentially among the most rewarding along with the risk of possibly disturbing political developments.

Retrieving the Crown Jewels

BP had Putin's approval, we understand, when it acquired 50% of TNK-BP, the company through which BP participates in Russia. Through that venture, BP has the rights to a third of Kovykta. Owners of the other half of TNK-BP, including prominent oligarchs, also account for a third. Other owners, unknown to us, hold the remaining third of the rights to the half-trillion dollar resource. Possible compromise includes selling a portion, perhaps half, of the whole field to the government, or to Gazprom, 50% owned by the government. In addition, Russian owners may be encouraged to sell direct interests in Kovykta to the government and/or sell shares of TNK-BP to the government or to a government company.

Precedent in Hugoton and Groningen

By size of the natural gas resource, Kovykta matches Hugoton and Groningen, the two earliest clean fuel giants of the U.S. and Europe. With price controls, the U.S. government virtually confiscated the economic value of Hugoton. The mistake was eventually rectified when controls were finally lifted in about 1990. Russia can learn from our errors.

In contrast, since about 1960 the Dutch government allowed Royal Dutch/Shell and Exxon to make profits from Groningen that strengthened the companies immeasurably

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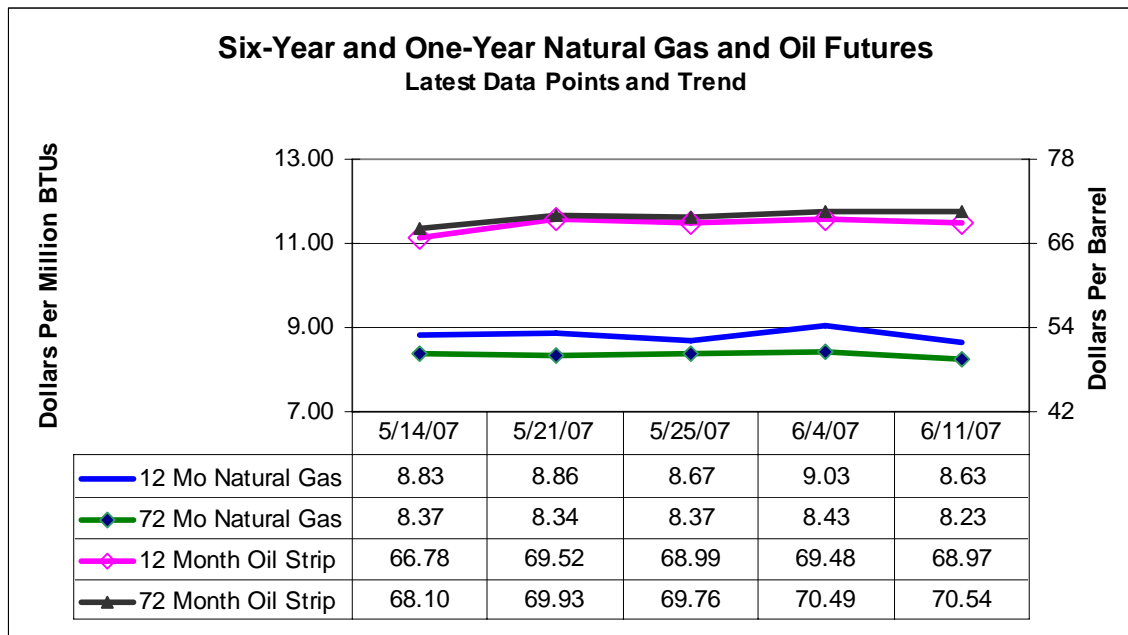
for more than the next four decades. Those two companies went on to make large natural gas discoveries in the southern North Sea and became leaders in the exploration of a whole new offshore petroleum province that benefited all of Europe.

In the wake of an earlier dispute over another giant Russian natural gas field, Jeroen van der Veer, chief executive of buy-recommended **Royal Dutch Shell (RDS)** credits Russian President Putin for his help in arriving at a compromise according to the *Financial Times*. Settling the Sakhalin Saga, Shell and its partners sold a half interest in the Far East natural gas project to Gazprom. Mr. van der Veer told Dutch television that Shell continues to look for new business in Russia according to global oil and gas publication *Upstream*.

Read the Meter of Commodity Price, McDep Ratio and Unlevered Cash Flow

Latest futures prices for oil and gas for delivery over the next six years continue above 40-week averages of about \$66 a barrel and \$7.80 a million btu (see chart Natural Gas and Oil Futures). McDep Ratios promise positive appreciation for buy recommendations (see table Rank by McDep Ratio). Cash flow multiples are low by almost any standard except for sell recommendations (see table Rank by EV/Ebitda). Suggested unlevered portfolio weightings take account of McDep Ratio, geography, line of business, and peer group among other factors (see table McDep Energy Portfolio).

Kurt H. Wulff, CFA



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Oil and Gas Producers - Rank by McDep Ratio

	Symbol/ Rating		Price (US\$/sh) 11-Jun 2007	Shares (mm)	Market Cap (US\$m)	Net Present Value (US\$/sh)	Debt/ Present Value	McDep Ratio
Mega Cap								
Exxon Mobil Corporation	XOM	B	83.06	5,714	475,000	92.00	0.05	0.91
Total S.A.	TOT	B	74.27	2,281	169,000	89.00	0.13	0.86
Royal Dutch Shell plc	RDS-A	B	76.12	3,153	240,000	94.00	0.13	0.84
BP plc	BP	B	67.19	3,231	217,000	87.00	0.16	0.81
Chevron Corporation	CVX	B	81.36	2,206	180,000	105.00	0.09	0.79
ConocoPhillips	COP	B	77.87	1,669	130,000	112.00	0.18	0.75
Gazprom (50%)	OGZPY	B	38.00	2,849	108,300	62.00	0.06	0.64
<i>Total or Median</i>					<i>1,519,000</i>		<i>0.13</i>	<i>0.81</i>
Producer/Refiners - Large Cap								
Imperial Oil Limited (30%)	IMO	B	46.66	287	13,410	42.00	0.07	1.10
Norsk Hydro ASA	NHY	H	12.13	1,241	15,050	11.00	0.13	1.09
Marathon Oil Corporation	MRO	H	124.92	347	43,350	124.00	0.13	1.01
Petro-Canada	PCZ	B	50.83	502	25,520	55.00	0.18	0.94
Suncor Energy	SU	B	88.16	461	40,650	105.00	0.07	0.85
PetroChina Company Ltd (10%)	PTR	B	134.90	181	24,420	166.00	0.05	0.82
Statoil ASA (29%)	STO	B	27.76	928	25,760	35.00	0.11	0.82
Lukoil Oil Company	LUKOY	B	76.40	830	63,000	121.00	0.02	0.64
<i>Total or Median</i>					<i>251,000</i>		<i>0.09</i>	<i>0.89</i>
Independent Natural Gas and Oil - Large Cap								
CNOOC Limited (34%)	CEO	B	105.65	140	14,770	108.00	-	0.98
Encana Corporation	ECA	B	62.90	780	49,100	72.00	0.14	0.89
XTO Energy Inc.	XTO	B	60.70	372	22,580	70.00	0.13	0.89
Anadarko Petroleum Corp.	APC	B	50.24	465	23,400	74.00	0.38	0.80
Occidental Petroleum Corp.	OXY	B	57.00	847	48,300	77.00	0.07	0.76
EOG Resources	EOG	B	75.66	247	18,700	102.00	0.05	0.75
Devon Energy Corporation	DVN	B	78.72	450	35,400	129.00	0.15	0.67
<i>Total or Median</i>					<i>212,000</i>		<i>0.13</i>	<i>0.80</i>
Independent Natural Gas and Oil - Small Cap								
Berry Petroleum Company	BRY	B	37.98	45	1,690	44.00	0.24	0.89
Encore Acquisition Company	EAC	B	28.97	53	1,540	54.00	0.34	0.70
Energy Partners Ltd.	EPL	B	17.68	31	550	38.00	0.35	0.65
Cimarex Energy Company	XEC	B	40.19	84	3,390	76.00	0.09	0.57
<i>Total or Median</i>					<i>7,200</i>		<i>0.29</i>	<i>0.67</i>
Income								
Kinder Morgan Energy Partners, L.P.	KMP	S	53.63	172	9,210	15.00	0.54	2.18
Kinder Morgan Management, LLC	KMR	S	50.76	62	3,130	15.00	0.54	2.09
Pengrowth Energy Trust	PGH		18.90	244	4,610	17.00	0.29	1.08
Penn West Energy Trust	PWE	B	34.94	240	8,380	36.00	0.17	0.98
Enerplus Resources Fund	ERF		48.49	123	5,980	52.00	0.13	0.94
San Juan Basin Royalty Trust	SJT	B	32.90	47	1,530	40.00	-	0.82
Hugoton Royalty Trust	HGT	B	27.08	40	1,080	34.00	-	0.79
Canadian Oil Sands Trust	COSWF	B	28.41	479	13,610	39.00	0.08	0.75
<i>Total or Median</i>					<i>47,500</i>		<i>0.15</i>	<i>0.96</i>

B = Buy, S = Sell, H = Hold

Present Value = Shares times Net Present Value divided by (1-Debt/Present Value).

Debt = Present Value times Debt/Present Value

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

	Symbol/ Rating		Price (US\$/sh) 11-Jun 2007	Adjustd Resrvs/ Prod NTM	PV/ Ebitda NTM	EV/ Ebitda NTM	P/E NTM	Divd or Distrib NTM (%)
Mega Cap								
Exxon Mobil Corporation	XOM	B	83.06	11.5	7.1	6.4	11	1.7
Gazprom (50%)	OGZPY	B	38.00	24.0	9.4	6.0	9	0.2
Total S.A.	TOT	B	74.27	9.4	6.7	5.8	10	1.6
BP plc	BP	B	67.19	9.6	7.0	5.7	9	3.7
Chevron Corporation	CVX	B	81.36	10.0	6.5	5.2	9	2.9
Royal Dutch Shell plc	RDS-A	B	76.12	7.9	6.1	5.1	9	3.8
ConocoPhillips	COP	B	77.87	11.2	6.6	5.0	8	2.1
		<i>Median</i>		<i>10.0</i>	<i>6.7</i>	<i>5.7</i>	<i>9</i>	<i>2.1</i>
Producer/Refiners - Large Cap								
Imperial Oil Limited (30%)	IMO	B	46.66	13.3	8.4	9.2	16	0.6
Suncor Energy	SU	B	88.16	23.6	10.0	8.5	15	0.3
Norsk Hydro ASA	NHY	H	12.13	-	6.7	7.3	12	1.4
PetroChina Company Ltd (10%)	PTR	B	134.90	15.1	8.3	6.8	14	3.5
Marathon Oil Corporation	MRO	H	124.92	7.8	6.0	6.0	11	1.5
Petro-Canada	PCZ	B	50.83	6.9	5.5	5.2	10	1.0
Statoil ASA (29%)	STO	B	27.76	7.7	6.3	5.1	12	5.5
Lukoil Oil Company	LUKOY	B	76.40	18.3	7.8	5.0	9	1.7
		<i>Median</i>		<i>10.6</i>	<i>7.3</i>	<i>6.4</i>	<i>12</i>	<i>1.5</i>
Independent Natural Gas and Oil - Large Cap								
XTO Energy Inc.	XTO	B	60.70	12.2	8.3	7.3	14	0.8
Anadarko Petroleum Corp.	APC	B	50.24	11.2	8.2	6.6	12	1.4
Encana Corporation	ECA	B	62.90	9.5	7.1	6.3	13	1.3
CNOOC Limited (34%)	CEO	B	105.65	10.6	6.4	6.2	11	3.2
EOG Resources	EOG	B	75.66	9.6	7.3	5.5	12	0.5
Occidental Petroleum Corp.	OXY	B	57.00	11.9	7.2	5.5	11	1.5
Devon Energy Corporation	DVN	B	78.72	9.4	7.7	5.2	9	0.7
		<i>Median</i>		<i>10.6</i>	<i>7.3</i>	<i>6.2</i>	<i>12</i>	<i>1.3</i>
Independent Natural Gas and Oil - Small Cap								
Berry Petroleum Company	BRY	B	37.98	10.3	8.8	7.9	13	0.8
Encore Acquisition Company	EAC	B	28.97	14.8	9.0	6.3	16	-
Cimarex Energy Company	XEC	B	40.19	8.1	6.5	3.7	8	0.4
Energy Partners Ltd.	EPL	B	17.68	5.4	5.0	3.3	-	-
		<i>Median</i>		<i>9.2</i>	<i>7.7</i>	<i>5.0</i>	<i>13</i>	<i>0.2</i>
Income								
Kinder Morgan Energy Partners, L.P.	KMP	S	53.63		7.9	17.2	52	6.2
Kinder Morgan Management, LLC	KMR	S	50.76		7.9	16.5	49	6.5
Canadian Oil Sands Trust	COSWF	B	28.41	21.1	11.8	8.8	12	7.0
San Juan Basin Royalty Trust	SJT	B	32.90	10.2	10.5	8.6	11	9.5
Pengrowth Energy Trust	PGH		18.90	7.5	7.2	7.8	25	15.0
Hugoton Royalty Trust	HGT	B	27.08	14.0	9.3	7.4	10	9.7
Penn West Energy Trust	PWE	B	34.94	7.6	7.3	7.1	14	11.0
Enerplus Resources Fund	ERF		48.49	9.0	7.5	7.0	13	9.8
		<i>Median</i>		<i>9.6</i>	<i>7.9</i>	<i>8.2</i>	<i>14</i>	<i>9.6</i>

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended June 30, 2008; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

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**McDep Energy Portfolio
Composite of Buy Recommendations**

Symbol	Price (US\$/sh)	Portfolio Weight		Non- U.S. HQ	North Amer. Natural Gas (%)	Rest of World Natural Gas (%)	Oil Prod'n (%)	Down- stream (%)	McDep Ratio	
		11-Jun 2007	Equity (%)							EV (%)
Mega Cap										
Exxon Mobil Corporation	XOM	83.06	1.6	1.4		0.1	0.2	0.8	0.4	0.91
Total S.A.	TOT	74.27	2.8	2.9	2.9		0.7	1.5	0.6	0.86
Royal Dutch Shell plc	RDS-A	76.12	2.8	2.9	2.9	0.1	0.4	1.4	1.0	0.84
BP plc	BP	67.19	2.7	2.9	2.9	0.2	0.3	1.7	0.7	0.81
Chevron Corporation	CVX	81.36	6.0	5.7		0.3	0.4	3.6	1.5	0.79
ConocoPhillips	COP	77.87	5.1	5.7		0.9	0.4	3.0	1.4	0.75
Gazprom	OGZPY	38.00	9.1	8.6	8.6		6.6	2.0		0.64
Producer/Refiners - Large Cap										
Imperial Oil Limited	IMO	46.66	1.6	1.4	1.4	0.1		1.1	0.2	1.10
Petro-Canada	PCZ	50.83	1.4	1.4	1.4	0.2	0.0	1.0	0.2	0.94
Suncor Energy	SU	88.16	1.5	1.4	1.4	0.1		1.3	0.1	0.85
PetroChina Company Ltd.	PTR	134.90	3.1	2.9	2.9		0.2	2.5	0.2	0.82
Statoil ASA	STO	27.76	1.5	1.4	1.4		0.5	0.9	-	0.82
Lukoil Oil Company	LUKOY	76.40	6.5	5.7	5.7			4.1	1.6	0.64
Independent Natural Gas and Oil - Large Cap										
CNOOC Limited	CEO	105.65	3.4	2.9	2.9		0.3	2.6		0.98
Encana Corporation	ECA	62.90	4.2	4.3	4.3	3.2		0.9	0.1	0.89
XTO Energy Inc.	XTO	60.70	4.3	4.3		3.3		1.0		0.89
Anadarko Petroleum Corp.	APC	50.24	1.7	2.9		1.5		1.3	0.1	0.80
Occidental Petroleum Corp	OXY	57.00	3.0	2.9		0.4	0.0	2.2	0.3	0.76
EOG Resources	EOG	75.66	6.3	5.7		4.3	0.4	1.0		0.75
Devon Energy Corporation	DVN	78.72	5.2	5.7		3.2		2.5		0.67
Independent Natural Gas and Oil - Small Cap										
Berry Petroleum Company	BRY	37.98	1.2	1.4		0.4		1.0		0.89
Encore Acquisition Comp	EAC	28.97	1.7	2.9		0.5		2.4		0.70
Energy Partners Ltd.	EPL	17.68	1.5	2.9		1.4		1.5		0.65
Cimarex Energy Company	XEC	40.19	2.8	2.9		2.0		0.9		0.57
Income										
Penn West Energy Trust	PWE	34.94	2.8	2.9	2.9	0.9		1.9		0.98
San Juan Basin Royalty Tr	SJT	32.90	6.7	5.7		5.7				0.82
Hugoton Royalty Trust	HGT	27.08	3.4	2.9		2.9				0.79
Canadian Oil Sands Trust	COSWF	28.41	6.0	5.7	5.7	(0.6)		6.3		0.75
Portfolio Composite			100	100	47	31	10	50	8	0.76
Canada					17					
Russia					14					
Europe					10					
China					6					

Note: Percentages in the Portfolio Weight - EV column correspond to unlevered positions ranging from triple at 8.6% to half at 1.4%.

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Index of Recent Research**Stock Ideas**

<u>Date</u>	<u>Symbol</u>	<u>Stock</u>	<u>Theme</u>
1-Jun	SJT	San Juan Basin Royalty Trust	Stable Present Value
1-Jun	HGT	Hugoton Royalty Trust	Stable Present Value
31-May	NHY	Norsk Hydro ASA	Hold New NHY, Buy Statoil
18-May	MRO	Marathon Oil Corporation	Downgrade to Hold from Buy on Price
9-May	XEC	Cimarex Energy Company	Lowest McDep Ratio
8-May	* OGZPY	Gazprom	Russian Value
8-May	PWE	Penn West Energy Trust	Committed to Income Distributions
7-May	* EAC	Encore Acquisition	Encore for Bell Creek
7-May	* PTR	PetroChina Company Limited	Raise NPV on Discovery
4-May	* TOT	Total S.A.	Integrated Model
4-May	* EPL	Energy Partners, Ltd.	Strategic Alternatives Disappointment
3-May	* RDSA	Royal Dutch Shell plc	Record Results
2-May	* BRY	Berry Petroleum	Piceance and Diatomite
2-May	* DVN	Devon Energy Corporation	Low McDep Ratio Natural Gas
2-May	* IMO	Imperial Oil Limited	Oil Sands Deal Unmasks Value
1-May	* EOG	EOG Resources Inc.	Productive Drilling Boosts Cash Flow
1-May	* MRO	Marathon Oil Corporation	Stock Split Declared
1-May	* APC	Anadarko Petroleum Corporation	Adjust NPV to \$70 a Share on Lower Debt
27-Apr	* CVX	Chevron Corporation	Solid Results
26-Apr	* CEO	CNOOC Ltd	Volume up 5%
26-Apr	* XOM	Exxon Mobil Corporation	Another Record Quarter
26-Apr	* COSWF	Canadian Oil Sands Trust	Distribution Raised 33%
25-Apr	* XTO	XTO Energy Inc.	Buy for Natural Gas
25-Apr	* ECA	EnCana Corporation	Buy for Natural Gas
25-Apr	* COP	ConocoPhillips	Strong Demand, Constrained Supply
25-Apr	* BP	BP p.l.c.	CEO Cycle
25-Apr	* LUKOY	Lukoil Oil Company	Tax Timing
24-Apr	* OXY	Occidental Petroleum Corporation	Well-Positioned in Oil
24-Apr	* PCZ	Petro-Canada	Volume Up 15%
18-Apr	* KMX	Kinder Morgan	Deal Delayed

Meter Reader - A Weekly Analysis

12-Jun		Kovykta Kontroversy
5-Jun		Enhance Performance with McDep Ratio
29-May	*	Raise Present Value for \$66 Long-Term Oil
22-May	*	Refining Rewards and Risks

Natural Gas and Oil Royalty Trusts - A Weekly Analysis

8-Jun		Real Value for Patient Investors
1-Jun		Stable Present Value
25-May	*	Futures Forecast Increasing Income
18-May	*	Encore's MLP Filed

* Archived on www.mcdep.com

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