

ENERGY CENTRAL PROFESSIONAL

Lehman Raises Its '05-'06 Oil, Gas Price Forecasts

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With continued strength in commodities, Lehman Bros. raised its 2005 gas price forecast 12%, or 75 cents, to \$7 per million British thermal units and next year's price 8%, or 50 cents to \$6.50/MMBtu, the company said Tuesday.

The increased commodity price forecasts also spurred Lehman to raise 2005-2006 cash flow per share estimates for exploration and production companies by an average of 11% in both years and raising price targets by an average of 15%. With these increases, average potential upside is targeted at almost 30%, Lehman said.

Lehman also raised its 2005-2006 oil price forecasts by 11% and 12.5% from \$ 45/barrel to \$50/barrel and \$40/barrel to \$45/barrel respectively.

Lehman energy analyst Tom Driscoll said his firm continues to recommend E&P companies demonstrating the ability to grow assets faster than the balance sheet.

"Given the rapid increase in cost structures, we prefer those companies that favor earning high returns over delivering rapid production growth," Lehman's Driscoll said in his report.

Companies willing to restrain drilling capital in favor of share buybacks, debt pay-downs and dividend increases are likely to outperform those with aggressive drilling programs, he said.

According to Lehman's Driscoll, average large-cap exploration and production stock has appreciated roughly 25% in 2005 and has more than doubled since 2003. Risk that E&P shares could fall sharply has increased as a result of strong appreciation that E&P shares held over the past two years, he said.

"Heightening the risk is the fact that nearly all this appreciation is due to a re-evaluation of oil and gas assets, with only 15%-20% of the appreciation

coming from re-investment returns," Driscoll said in his report.

The Lehman report highlighted Occidental Petroleum (OXY) and Burlington Resources (BR).

Current oil and gas prices are much higher than price expectations reflected in E&P shares, the report said. Average E&P stock reflects a mid-cycle oil/gas price forecast of about \$39/bbl for oil and \$5.75-\$6/MMBtu for gas, close to \$ 15/bbl below current oil prices and roughly \$1.50/MMBtu below current gas prices.

If that gap continues to close as price expectations rise, E&P share prices should appreciate sharply, Driscoll said.

The Lehman report put oil to gas price ratio at 7.1 in 2005 and 6.9 in 2006 compared with an average 7.0 ratio from 2001-2004.

The New York Mercantile Exchange May gas futures contract was trading Tuesday at \$7.335/MMBtu, right at first-of-month April index and up from its Monday close. Benchmark Henry Hub was also running around \$7.34/MMBtu, according to traders early Tuesday.

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