

Recommitting to Oil and Gas Stocks

Summary and Recommendation

After three months of reflection, reduced publication intensity, and a mini-sabbatical or two, we recommit to our published research and personal investment in oil and gas stocks. We like the stocks for the simple old fashioned rationale---the upside potential outweighs the downside risk. An unquantifiable part of the upside potential is the stark deterioration in the stability of the oil producing countries of the Middle East. At the same time, the case for appreciation has been made easier by the sharp decline in oil and gas prices and stock prices while the stock market has barely flinched from all-time highs. The quantifiable part of the upside is the \$90 a barrel we use to calculate McDep Ratios at a median 0.7. The downside is a further oil price decline, which can't be ruled out, but seems unlikely to be sustainable. Tracking the upside and downside, we expect to continue the new monthly schedule for *Meter Reader*. In addition we continue to communicate *Stock Ideas* and *Industry Ideas* when timely. Mainly to have more time to focus on remaining companies we reduce our coverage to 24 stocks from 27 with the deletion of **Lukoil (LUKOY)**, **Hugoton Royalty Trust (HGT)** and **Enduro Royalty Trust (NDRO)** as further explained below.

Fortify the Portfolio

Oil and gas stocks in a diversified investment portfolio provide a measure of comfort as the political situation seem to worsen in the Middle East. Successors to the religious fanatics who seized power in the 1979 Iranian Revolution are spreading revolution to Iraq, Syria, Lebanon, Gaza and Yemen on the way to encircling Saudi Arabia, the Emirates, Kuwait, Jordan and Israel. The 1979 power grab triggered the two best years for oil stocks in our experience. Today we pray for peace at the same time we fortify the portfolio for positive or negative consequences of political turmoil. Among our strongest stocks in ongoing coverage are **Cimarex (XEC)**, **EOG Resources (EOG)** and **ExxonMobil (XOM)**.

Median McDep Ratio of 0.7 on \$90 Oil

A McDep Ratio of 0.7 is definitely attractive for new investment, but is \$90 a barrel a sound estimate of long-term price and how soon might we get there? We think \$90 is a reasonable point at which supply and demand would balance out in a moderately growing world economy. It could be evident is as soon as two years. Shale oil supplies will likely stop growing in a few more months. Additions to supply from large conventional

projects will likely be mostly complete in two years and there few new projects underway. At the same time demand will likely improve with global economic growth stimulated by money printing and extraordinarily low interest rates.

Alternatively, we have considered recalculating McDep Ratios on \$60 oil, for example. Had the U.S. dollar not peaked temporarily at 100 on the DXY index we might have reduced our estimates. Instead it appears that our U.S. monetary authorities will try to contain the rate of change in the value of the currency.

Since so many factors beyond industry control can affect oil price, let's take another approach and look at unlevered cash flow multiples, EV/Ebitda and PV/Ebitda. We estimate Ebitda for the next twelve months using oil price as quoted in the futures market, independent of whatever we think it should be. There are still some big questions about projected volume and cost cutting, which are both moving targets in a changing price environment. That will be the most important information tracked in quarterly results next to be reported in late April and early May.

A median market multiple, EV/Ebitda, of 11 today would be consistent with a long-term unlevered return near 7% a year after reinvesting perhaps 25% of Ebitda to keep Ebitda flat. Not surprisingly, stock prices have adjusted to a long-term oil price near today's level.

At the other extreme, a median present value multiple, PV/Ebitda, of 18 today is too high to earn a normal return at today's oil price. The high multiple points to risk that Present Value would have to be reduced if prices did not reach the \$90 target. But that is a risk for stock price upside, not stock price downside. Stocks with low PV/Ebitda and low McDep Ratio include **Total (TOT)**, **Marathon (MRO)**, **Whiting (WLL)**, and **Birchcliff (BIREF)**.

Rearrange Coverage

Beginning the second calendar quarter of 2015, we rearrange our coverage of 24 stocks, down from 27 (see [Tables 1-4](#) on pages 4-7). A third to a half of the energy portion in a diversified portfolio might be concentrated on the four stocks in the Global Integrated Group. We have discontinued our coverage of Lukoil in that group. While the case for extreme undervaluation appears to persist, information flow has declined with the deterioration of political relations.

Emphasis on the Large Independent Group is unchanged at 5 stocks. There are also 5



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stocks in the Small Independent Group as we transfer Birchcliff to the Canada Group which also now numbers 5.

The RTF (Royalty Trust Fund) Group is now the Income Group with 5 stocks. We have discontinued our coverage of Hugoton and Enduro. We remain concerned about the rate of production decline in Hugoton despite our belief that stock price adequately reflects the trend. NDRO's small market cap makes it difficult for us to allocate enough time to explain it. We reemphasize that our discontinuation of both HGT and NDRO is motivated mostly by research capacity considerations rather than by valuation which seems quite depressed.

Kurt H. Wulff, CFA

Table 1
McDep Energy Stocks
Enterprise Value, Segments, Yield and McDep Ratio

		Price (US\$/sh) 31-Mar 2015	EV/ Market Cap	Enterprise Value (\$mm)	Present Value by Segment (%)				Dist. Yield NTM (%)	McDep Ratio	
					North Amer.	Rest of World	Oil Prod'n	Down- stream			
											Natural Gas
Global Integrated											
Exxon Mobil Corporation	XOM	85.00	1.23	443,000	7	16	61	17	3.2	0.86	
Chevron Corporation	CVX	104.98	1.27	251,000	3	10	72	15	4.1	0.75	
Total S.A.	TOT	49.66	1.53	174,000			23	59	18	5.3	0.71
Royal Dutch Shell plc	RDS-A	59.65	1.46	273,000	4	22	56	18	6.3	0.71	
<i>Total or Median</i>			<i>1.36</i>	<i>1,141,000</i>			<i>60</i>	<i>17</i>	<i>4.7</i>	<i>0.73</i>	
Large Independent											
EOG Resources, Inc.	EOG	91.69	1.11	56,000	14	4	83		0.7	0.85	
Occidental Petroleum Corp.	OXY	73.00	1.12	63,400	6	1	81	12	3.9	0.75	
Devon Energy Corporation	DVN	60.31	1.68	41,500	28		64	8	1.6	0.72	
ConocoPhillips	COP	62.26	1.46	113,000	13	14	73		4.7	0.71	
Marathon Oil Corporation	MRO	26.11	1.48	26,100	8	2	89		3.2	0.62	
<i>Total or Median</i>			<i>1.46</i>	<i>300,000</i>	<i>13</i>		<i>81</i>		<i>3.2</i>	<i>0.72</i>	
Small Independent											
Cimarex Energy Company	XEC	115.09	1.16	11,700	41		59		0.6	0.84	
Range Resources	RRC	52.04	1.45	12,600	68		32		0.3	0.61	
Continental Resources (32%)	CLR	43.67	1.41	7,300	21		79		-	0.60	
California Resources	CRC	7.61	3.37	9,800	13		88		0.5	0.53	
Whiting Petroleum Corporation	WLL	30.90	2.16	11,400	7		93		-	0.53	
<i>Total or Median</i>			<i>1.45</i>	<i>53,000</i>	<i>21</i>		<i>79</i>		<i>0.3</i>	<i>0.60</i>	
Income											
Dorchester Minerals, L.P.	DMLP	22.74	1.00	700	37		63		4.9	0.71	
Sabine Royalty Trust	SBR	39.34	1.00	570	44		56		5.9	0.58	
San Juan Basin Royalty Trust	SJT	11.97	1.00	560	100		-		4.7	0.57	
Permian Basin RT	PBT	8.09	1.00	380	23		77		3.9	0.51	
Cross Timbers Royalty Trust	CRT	19.17	1.00	120	58		42		5.7	0.46	
<i>Total or Median</i>			<i>1.00</i>	<i>2,300</i>	<i>44</i>		<i>56</i>		<i>4.9</i>	<i>0.57</i>	
Canada											
Imperial Oil Limited (30%)	IMO	39.88	1.26	12,800	2		79	19	1.0	0.81	
EnCana Corporation	ECA	11.15	2.47	20,200	53		47		2.5	0.59	
Canadian Oil Sands Limited	COSWF	7.80	1.72	6,500			100		2.0	0.52	
Cenovus Energy Inc.	CVE	16.88	1.46	18,700	8		84	8	5.0	0.50	
Birchcliff Energy Ltd.	BIREF	5.38	1.62	1,300	75		25		-	0.45	
<i>Total or Median</i>			<i>1.62</i>	<i>60,000</i>			<i>79</i>		<i>2.0</i>	<i>0.52</i>	

Estimated present value presumes a long-term price for oil of US\$90 a barrel and natural gas, \$6 a million btu.
McDep Ratio = Market cap and Debt to present value of oil and gas and other businesses

		<i>Price</i> <i>(US\$/sh)</i>	<i>Shares</i> <i>(mm)</i>	<i>Market</i> <i>Cap</i> <i>(US\$mm)</i>	<i>Net</i> <i>Present</i> <i>Value</i> <i>(US\$/sh)</i>	<i>Debt/</i> <i>Present</i> <i>Value</i>	<i>McDep</i> <i>Ratio</i>
		<i>31-Mar</i> <i>2015</i>					
Global Integrated							
Exxon Mobil Corporation	XOM	85.00	4,235	360,000	102.00	0.16	0.86
Chevron Corporation	CVX	104.98	1,884	198,000	150.00	0.16	0.75
Total S.A.	TOT	49.66	2,287	114,000	80.00	0.25	0.71
Royal Dutch Shell plc	RDS-A	59.65	3,151	188,000	95.00	0.22	0.71
	<i>Total or Median</i>			<i>860,000</i>		<i>0.19</i>	<i>0.73</i>
Large Independent							
EOG Resources, Inc.	EOG	91.69	549	50,300	110.00	0.09	0.85
Occidental Petroleum Corp.	OXY	73.00	773	56,400	100.00	0.08	0.75
Devon Energy Corporation	DVN	60.31	409	24,700	100.00	0.29	0.72
ConocoPhillips	COP	62.26	1,240	77,000	100.00	0.22	0.71
Marathon Oil Corporation	MRO	26.11	677	17,680	50.00	0.20	0.62
	<i>Total or Median</i>			<i>226,100</i>		<i>0.20</i>	<i>0.72</i>
Small Independent							
Cimarex Energy Company	XEC	115.09	88	10,100	140.00	0.12	0.84
Range Resources	RRC	52.04	166	8,600	100.00	0.19	0.61
Continental Resources (32%)	CLR	43.67	119	5,200	85.00	0.17	0.60
California Resources	CRC	7.61	382	2,900	30.00	0.38	0.53
Whiting Petroleum Corporation	WLL	30.90	170	5,300	90.00	0.29	0.53
	<i>Total or Median</i>			<i>32,000</i>		<i>0.19</i>	<i>0.60</i>
Income							
Dorchester Minerals, L.P.	DMLP	22.74	31	700	32.00	-	0.71
Sabine Royalty Trust	SBR	39.34	15	570	68.00	-	0.58
San Juan Basin Royalty Trust	SJT	11.97	47	560	21.00	-	0.57
Permian Basin RT	PBT	8.09	47	380	16.00	-	0.51
Cross Timbers Royalty Trust	CRT	19.17	6	120	42.00	-	0.46
	<i>Total or Median</i>			<i>2,300</i>		<i>-</i>	<i>0.57</i>
Canada							
Imperial Oil Limited (30%)	IMO	39.88	255	10,200	52.00	0.16	0.81
EnCana Corporation	ECA	11.15	736	8,200	30.00	0.35	0.59
Canadian Oil Sands Limited	COSWF	7.80	485	3,800	20.00	0.22	0.52
Cenovus Energy Inc.	CVE	16.88	757	12,800	42.00	0.16	0.50
Birchcliff Energy Ltd.	BIREF	5.38	155	800	16.00	0.17	0.45
	<i>Total or Median</i>			<i>36,000</i>		<i>0.17</i>	<i>0.52</i>
Estimated present value presumes a long-term price for oil of US\$90 a barrel and natural gas, \$6 a million btu.							
McDep Ratio = Market cap and Debt to present value of oil and gas and other businesses							

Table 3							
McDep Energy Stocks							
Value Multiples and Dividend							
Ranked by EV/Ebitda							
		<i>Price</i>	<i>Adjustd</i>				
		<i>(US\$/sh)</i>	<i>Resrvs/</i>	<i>PV/</i>	<i>EV/</i>		<i>Dividend</i>
		<i>31-Mar</i>	<i>Prod</i>	<i>Ebitda</i>	<i>Ebitda</i>	<i>P/E</i>	<i>NTM</i>
		<i>2015</i>	<i>NTM</i>	<i>NTM</i>	<i>NTM</i>	<i>NTM</i>	<i>(\$/sh)</i>
Global Integrated							
Exxon Mobil Corporation	XOM	85.00	14.2	10.8	9.3	20	2.76
Chevron Corporation	CVX	104.98	9.1	12.0	9.0	32	4.28
Total S.A.	TOT	49.66	10.3	10.3	7.3	21	2.62
Royal Dutch Shell plc	RDS-A	59.65	10.2	9.3	6.6	19	3.76
	<i>Median</i>		<i>10.3</i>	<i>10.5</i>	<i>8.1</i>	<i>20</i>	
Large Independent							
EOG Resources, Inc.	EOG	91.69	9.3	16.5	14.0	32	0.67
Devon Energy Corporation	DVN	60.31	10.3	15.3	11.0	84	0.96
ConocoPhillips	COP	62.26	11.4	14.3	10.1		2.92
Occidental Petroleum Corp.	OXY	73.00	9.7	13.4	10.1	41	2.88
Marathon Oil Corporation	MRO	26.11	12.3	15.3	9.4		0.84
	<i>Median</i>		<i>10.3</i>	<i>15.3</i>	<i>10.1</i>	<i>41</i>	
Small Independent							
Range Resources	RRC	52.04	14.8	34.9	21.4		0.16
Cimarex Energy Company	XEC	115.09	8.2	18.3	15.4		0.64
Continental Resources (32%)	CLR	43.67	11.4	18.8	11.2	160	-
California Resources	CRC	7.61	11.4	19.5	10.4		0.04
Whiting Petroleum Corporation	WLL	30.90	10.2	15.8	8.4		-
	<i>Median</i>		<i>11.4</i>	<i>18.8</i>	<i>11.2</i>	<i>160</i>	
Income							
Dorchester Minerals, L.P.	DMLP	22.74	7.9	24.3	17.3	34	1.12
Sabine Royalty Trust	SBR	39.34	9.4	29.1	16.9	17	2.33
San Juan Basin Royalty Trust	SJT	11.97	8.0	27.7	15.8	21	0.56
Permian Basin RT	PBT	8.09	9.9	25.5	12.9	25	0.32
Cross Timbers Royalty Trust	CRT	19.17	12.1	26.3	12.0	17	1.10
	<i>Median</i>		<i>9.4</i>	<i>26.3</i>	<i>15.8</i>	<i>21</i>	
Canada							
Imperial Oil Limited (30%)	IMO	39.88	28.3	17.9	14.4	21	0.41
EnCana Corporation	ECA	11.15	6.7	21.8	12.9	108	0.28
Canadian Oil Sands Limited	COSWF	7.80	19.4	19.0	9.9		0.16
Cenovus Energy Inc.	CVE	16.88	15.1	19.7	9.8		0.84
Birchcliff Energy Ltd.	BIREF	5.38	13.0	17.7	8.0	218	-
	<i>Median</i>		<i>15.1</i>	<i>19.0</i>	<i>9.9</i>	<i>108</i>	
	<i>Grand Median</i>		<i>10</i>	<i>18</i>	<i>11</i>		
EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended March 31, 2016; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses							



Industry Idea

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		Price (\$/sh)	Price (\$/sh)	Price Change (%)	Cash Distrib. (%)	Equity Total Return (%)	Unlevered Total Return (%)		McDep Ratio	
	Symbol	31-Mar 2015	29-Dec 2014				Debt (\$/sh)			
Global Integrated										
	TOT	49.66	52.74	(6)	1	(5)	26	(3)	0.71	
	Chevron Corporation	CVX	104.98	113.32	(7)	1	(6)	28	(5)	0.75
	Exxon Mobil Corporation	XOM	85.00	93.07	(9)	1	(8)	20	(7)	0.86
	Royal Dutch Shell plc	RDS-A	59.65	68.31	(13)	1	(11)	27	(8)	0.71
	<i>Median</i>			(8)		(7)		(6)	0.73	
Large Independent										
	Devon Energy Corporation	DVN	60.31	61.15	(1)	0	(1)	41	(1)	0.72
	EOG Resources, Inc.	EOG	91.69	94.33	(3)	0	(3)	10	(2)	0.85
	Marathon Oil Corporation	MRO	26.11	28.58	(9)	1	(8)	12	(6)	0.62
	ConocoPhillips	COP	62.26	70.11	(11)	1	(10)	29	(7)	0.71
	Occidental Petroleum Corp.	OXY	73.00	81.71	(11)	1	(10)	9	(9)	0.75
	<i>Median</i>			(9)		(8)		(6)	0.72	
Small Independent										
	Continental Resources (32%)	CLR	43.67	38.26	14	-	14	18	10	0.60
	California Resources (from 17-Nov)	CRC	7.61	5.77	32	0	32	18	8	0.53
	Cimarex Energy Company	XEC	115.09	110.27	4	0	5	19	4	0.84
	Whiting Petroleum Corporation	WLL	30.90	34.09	(9)	-	(9)	36	(5)	0.53
	Range Resources	RRC	52.04	56.00	(7)	0	(7)	24	(5)	0.61
	<i>Median</i>			4		5		4	0.60	
Income										
	Sabine Royalty Trust	SBR	39.34	36.68	7	3	10	-	10	0.58
	Cross Timbers Royalty Trust	CRT	19.17	18.07	6	2	8	-	8	0.46
	Dorchester Minerals, L.P.	DMLP	22.74	25.16	(10)	2	(8)	-	(8)	0.71
	Permian Basin RT	PBT	8.09	9.12	(11)	1	(10)	-	(10)	0.51
	San Juan Basin Royalty Trust	SJT	11.97	13.97	(14)	1	(13)	-	(13)	0.57
	<i>Median</i>			(10)		(8)		(8)	0.57	
Canada										
	Imperial Oil Limited (30%)	IMO	39.88	43.49	(8)	0	(8)	10	(7)	0.81
	EnCana Corporation	ECA	11.15	13.94	(20)	1	(20)	16	(9)	0.59
	Canadian Oil Sands Limited	COSWF	7.80	9.20	(15)	0	(15)	6	(9)	0.52
	Cenovus Energy Inc.	CVE	16.88	20.95	(19)	1	(18)	8	(13)	0.50
	Birchcliff Energy Ltd.	BIREF	5.38	6.75	(20)	-	(20)	3	(14)	0.45
	<i>Median</i>			(19)		(18)		(9)	0.52	
	<i>Grand Median</i>			(7)		(7)		(5)	0.71	
	Natural Gas (\$/mmbtu)		2.64	3.19	(17)					
	Oil -West Texas Intermediate (\$/bbl)		47.44	53.69	(12)					

Source: McDep LLC, Yahoo, CME Group, Bloomberg

Index of Recent Research			
Stock Ideas			
<u>Date</u>	<u>Symbol</u>	<u>Subject</u>	<u>Theme</u>
9-Mar	XOM	Exxon Mobil	Safe at Any Likely Oil Price
27-Feb	EOG	EOG Resources	Top Value Creator
30-Jan	COSWF	Canadian Oil Sands Ltd.	Syncrude Lowers Breakeven to \$US32 a Barrel
23-Dec	RRC	Range Resources	Record Appalachian Well (Meter Reader)
9-Dec	WLL	Whiting Petroleum	Kodiak Acquisition Completed (Meter Reader)
25-Nov	COP	ConocoPhillips	Strong 4% Dividend Independent Producer
13-Nov	BIREF	Birchcliff Energy	Raise NPV to US\$16 on Alberta Natural Gas
4-Nov	CRC	California Resources Corporation	Pure Play Largest California Producer (Meter Reader)
28-Oct	CVE	Cenovus Energy	Same Stock Price, Twice the Production (Meter Reader)
21-Oct	TOT	Total	Chief Executive Dies
21-Oct	XEC	Cimarex Energy	Strong Independent Producer (Meter Reader)
14-Oct	DVN	Devon Energy	Rebalance Candidate (Meter Reader)
7-Oct	ECA	Encana Corporation	Suttles' Stamp (Meter Reader)
23-Sep	CLR	Continental Resources	Raise NPV to \$85 on 29% Growth (Meter Reader)
16-Sep	RDSA	Royal Dutch Shell plc	Ben's Growth Strategy (Meter Reader)
2-Sep	LUKOY	Lukoil	Oil under Uncertainty (Meter Reader)
26-Aug	SJT	San Juan Basin Royalty Trust	Income and Shale (Meter Reader)
8-Aug	DMLP	Dorchester Minerals, L.P.	Robust Bakken and Permian Oil Growth
22-Jul	MRO	Marathon Oil	Frac Shale Oil, Sell Norway (Meter Reader)
10-Jun	OXY	Occidental Petroleum	Raise NPV to \$120, Spinoff Filed (Meter Reader)
27-May	CVX	Chevron	Oil Price Turns Up (Meter Reader)
23-Apr	HGT	Hugoton Royalty Trust	Positive Arbitration Ruling
18-Mar	PBT	Permian Basin Royalty Trust	Rising Oil Production, Understated Income (Meter Reader)
For historical research by stock, go to mcdep.com , click on Stock Ideas , click on stock by name.			
Meter Reader			
10-Mar		DMLP, SBR, CRT, SJT	RTF Income Tracks Oil Price
10-Feb		CRT, CRC, COP, CVX	Oil Price Cycle Advances
13-Jan		SBR, XEC, COSWF, DVN, XOM	Oil and Gas Stocks on Sale
30-Dec		Book Review	The Moral Case for Fossil Fuels by Alex Epstein
23-Dec	RRC	Range Resources	Record Appalachian Well
16-Dec			Oil and Gas Stocks for 2015 - For Contrarians and Rebalancers
9-Dec	WLL	Whiting Petroleum	Kodiak Acquisition Completed (Meter Reader)
2-Dec			Rebuild Oil and Gas Positions
25-Nov	COP	ConocoPhillips	Strong 4% Dividend Independent Producer
18-Nov	DMLP, SJT	RTF (Royalty Trust Fund)	DMLP, SJT and the RTF - High Income without Debt
11-Nov	COSWF	Canadian Oil Sands Ltd.	Record Monthly Production
4-Nov	CRC	California Resources Corporation	Pure Play Largest California Producer
28-Oct	CVE	Cenovus Energy	Same Stock Price, Twice the Production
21-Oct	XEC	Cimarex Energy	Strong Independent Producer
14-Oct	DVN	Devon Energy	Rebalance Candidate
7-Oct	ECA	Encana Corporation	Suttles' Stamp
30-Sep		RTF (Royalty Trust Fund)	Current Income and Future Fraccing
23-Sep	CLL	Continental Resources	Raise NPV to \$85 on 29% Growth
For earlier editions, go to mcdep.com , click on Meter Reader .			
Industry Ideas			
30-Dec		Book Review	The Moral Case for Fossil Fuels by Alex Epstein (Meter Reader)
18-Nov	DMLP, SJT	RTF (Royalty Trust Fund)	DMLP, SJT and the RTF - High Income without Debt (Meter Reader)
30-Sep		RTF (Royalty Trust Fund)	Current Income and Future Fraccing



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Research Methodology/Ratings Description: McDep LLC is an independent research originator focused on oil and gas stocks exclusively. The firm applies the more than forty 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.