



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

July 1, 2011

Shale Strategy

Summary and Recommendation

Technological innovation in producing oil and gas from shale formations is part of the economic achievement worth celebrating on the birthdays of Canada and the U.S. on July 1 and July 4. Income and Small Cap buy recommendations offering rising oil production include **Whiting (WLL)** and **Enerplus (ERF)** in the Bakken formation and **Petrohawk (HK)** in the Eagle Ford. Buys offering rising natural gas production include **Birchcliff (BIREF)** in the Alberta Montney, **Range Resources (RRC)** in the Marcellus and **Dorchester Minerals (DMLP)** in the Fayetteville. At favorable global conditions, oil producers are proving the economic principle that higher price stimulates new supply which is good for general economic well-being. Technological innovation in natural gas has produced enough new supply to keep natural gas price at an extraordinary bargain compared to oil. We believe investors should build positions in buy recommendations or complementary stocks while being guided by the McDep Ratio and the balance of natural gas and oil (see [Table ISC-1](#) and [Table ISC-2](#)). Ranking by EV/Ebitda parallels ranking by McDep Ratio illustrating how much or how little valuation depends on future cash flow (see [Table ISC-3](#)). Because shale oil and shale gas exploitation is still in the early stages, future volume potential appears vast. Oil drilling is supported by a rising price trend with the recent settlement of six-year futures at \$100 a barrel compared to the 40-week average of \$96.

Kurt H. Wulff, CFA



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Table ISC-1											
McDep Income and Small Cap Energy Portfolio											
Debt, Segments, Cash Flow, Income and McDep Ratio											
			Price		Enterprise	PV(%)		EV/	Dist.	Dist.	
Symbol/Rating		(US\$/sh)	EV/	Value	Nat	Oil	Ebitda	NTM	Yield	McDep	
CB (see below)		2011	Market	(\$mm)	Gas		NTM	(\$/un)	(%)	Ratio	
			Cap								
Small Cap Independent Producers											
Peyto Exploration and Development	PEYUF		22.34	1.23	3,630	71	29	11.5	0.74	3.3	0.94
Range Resources	RRC	B	55.42	1.20	10,520	76	24	14.7	0.16	0.3	0.94
Berry Petroleum Company	BRY		53.14	1.50	4,290	26	74	9.6	0.30	0.6	0.92
Birchcliff Energy Ltd.	BIREF	B	13.51	1.22	2,150	55	45	12.7	-	-	0.87
Denbury Resources Inc.	DNR		19.99	1.29	10,270	6	94	8.4	-	-	0.84
Petrohawk Energy Corporation	HK	B	24.67	1.53	11,490	76	24	6.9	-	-	0.80
Cimarex Energy Company	XEC	CB	89.95	1.09	8,460	44	56	6.4	0.40	0.4	0.77
Whiting Petroleum Corporation	WLL	CB	56.90	1.24	8,300	11	89	6.2	-	-	0.68
<i>Total or Median</i>					59,100			9.0			0.85
Top Line Cash Payers											
Cross Timbers Royalty Trust	CRT		44.72	1.00	270	87	13		2.64	5.9	0.99
Permian Basin RT	PBT		21.64	1.00	1,010	42	58		1.63	7.5	0.98
Freehold Royalties Ltd.	FRHLF		20.37	1.07	1,270	18	82		1.70	8.4	0.93
Sabine Royalty Trust	SBR		63.70	1.00	930	51	49		4.77	7.5	0.91
Dorchester Minerals, L.P.	DMLP	CB	26.91	1.00	830	61	39		1.74	6.5	0.90
<i>Total or Median</i>					4,300					7.5	0.93
Bottom Line Cash Payers											
Linn Energy, LLC	LINE		39.07	1.41	8,950	35	65	13.9	2.64	6.8	1.10
Legacy Reserves L.P.	LGCY		29.69	1.42	1,830	19	81	11.3	2.12	7.1	1.04
Hugoton Royalty Trust	HGT	B	22.74	1.00	910	88	13	13.2	1.50	6.6	1.03
Vanguard Natural Resources, LLC	VNR		28.12	1.70	1,630	26	74	13.2	2.28	8.1	1.02
San Juan Basin Royalty Trust	SJT		24.15	1.00	1,130	100	-	12.9	1.57	6.5	0.97
Encore Energy Partners, L.P.	ENP		21.34	1.31	1,270	17	83	10.7	1.96	9.2	0.94
Enerplus Corporation	ERF	B	31.57	1.27	7,200	33	67	8.9	2.19	6.9	0.88
Mesa Royalty Trust	MTR		45.00	1.00	84	75	25	12.7	2.92	6.5	0.85
<i>Total or Median</i>					23,000			12.8		6.8	1.00
Composite											
<i>Enterprise Value Weighting</i>					86,400	43	57				0.87
<i>Equal Weighting</i>						48	52				0.92
<i>Equal Weighted Buys</i>						52	48				0.86

CB=Contrarian Buy, Stock Price apparently in downtrend compared to 200-day average.
 McDep Ratio = Market cap and Debt to present value of oil and gas and other businesses.
 Present Value (PV) presumes long-term prices of \$100 a barrel for oil and \$8 a million btu for natural gas.
 Dist. = Income distribution. NTM = Next Twelve Months Ended June 30, 2012. Enterprise Value = Market Cap and Debt.



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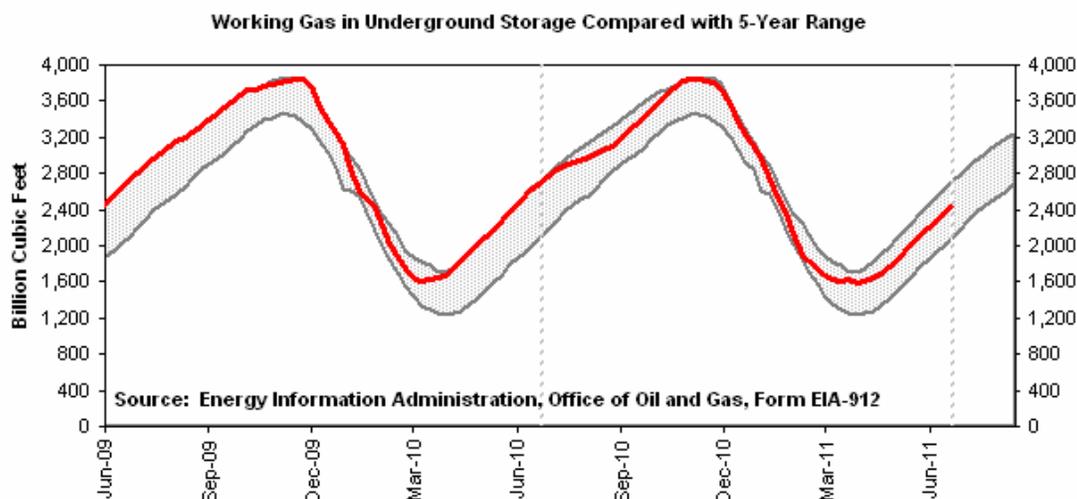
Table ISC-3								
McDep Income and Small Cap Energy Portfolio								
Value Multiples - Rank by EV/Ebitda								
			Price (\$/sh)	Revenue	Dist/ Equity	Adjstd Resrvs/ Prod	PV/ Ebitda	EV/ Ebitda
	Symbol/ Rating		30-Jun 2011	Royalty (%)	Ebitda	NTM	NTM	NTM
Small Cap Independent Producers								
Range Resources	RRC	B	55.42		-	16.1	15.7	14.7
Birchcliff Energy Ltd.	BIREF	B	13.51		-	19.7	14.6	12.7
Peyto Exploration and Development Corp	PEYUF		22.34		0.38	14.9	12.2	11.5
Berry Petroleum Company	BRY		53.14		-	12.0	10.4	9.6
Denbury Resources Inc.	DNR		19.99		-	13.6	10.0	8.4
Petrohawk Energy Corporation	HK	B	24.67		-	5.6	8.6	6.9
Cimarex Energy Company	XEC	CB	89.95		-	7.0	8.4	6.4
Whiting Petroleum Corporation	WLL	CB	56.90		-	9.0	9.1	6.2
	<i>Median</i>					12.8	10.2	9.0
Top Line Cash Payers								
Cross Timbers Royalty Trust	CRT		44.72	80	0.96	15.1	16.4	16.3
Dorchester Minerals, L.P.	DMLP	CB	26.91	77	0.87	7.0	14.9	13.4
Sabine Royalty Trust	SBR		63.70	100	1.00	6.8	14.7	13.4
Permian Basin RT	PBT		21.64	32	0.97	15.7	13.2	13.0
Freehold Royalties Ltd.	FRHLF		20.37	71	0.85	6.3	11.0	10.2
	<i>Median</i>					7.0	14.7	13.4
Bottom Line Cash Payers								
Linn Energy, LLC	LINE		39.07		0.98	17.5	12.6	13.9
Vanguard Natural Resources, LLC	VNR		28.12		1.09	13.2	12.9	13.2
Hugoton Royalty Trust	HGT	B	22.74		0.87	14.0	12.8	13.2
San Juan Basin Royalty Trust	SJT		24.15		0.84	9.2	13.4	12.9
Mesa Royalty Trust	MTR		45.00		0.82	14.5	14.9	12.7
Legacy Reserves L.P.	LGCY		29.69		0.82	12.0	10.8	11.3
Encore Energy Partners, L.P.	ENP		21.34		0.97	13.1	11.3	10.7
Enerplus Corporation	ERF	B	31.57		0.60	8.3	10.1	8.9
	<i>Median</i>					13.2	12.7	12.8
B=Buy; CB=Contrarian Buy, Stock Price apparently in downtrend compared to 200-day average.								
EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended June 30, 2012; P/E = Stock Price to								
Earnings; PV = Present Value of oil and gas and other businesses								
Top Line Cash Payers defined as those having Revenue Royalty (see fifth column from right).								



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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 thirty 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. Buy recommendations are expected to deliver a total return better than 7% per year above inflation. Hold recommendations assume the attributes of the underlying business are reflected in the current price of the stock. Sell recommendations are expected to deliver a total return less than inflation.