



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

July 22, 2011

Income and Small Cap 23% of McDep Buy Portfolio

Summary and Recommendation

We raise our suggested weighting of Income and Small Cap (ISC) stocks to 23% of a newly named McDep Energy Portfolio of Buy Recommendations on the basis of growth in shale gas and shale oil as well as sensitivity to rising oil and gas price. Previously, we had suggested that ISC and the five large cap sectors covered in *Meter Reader* be weighted about equally at roughly 17%. Mining giant BHP Billiton ratifies ISC growth appeal with its \$15 billion acquisition of shale pioneer **Petrohawk (HK)**, which we now remove as a buy recommendation as the stock trades close to the takeover offer price. At the same time intense political pressure to sustain uneconomic government spending with consequent currency depreciation enhances the appeal of stocks concentrated on high quality assets likely to keep their real value. We derive the 23% sector weighting by assessing an individual weighting by Enterprise Value of each of our 26 large cap and small cap buy recommendations. The average weighting of 4% applies to stocks with McDep Ratios from 0.70 to 0.79. We weight stocks with lower McDep Ratios at 5% except that we limit to 4% those in Brazil, China and Russia out of concern for political risk. We weight stocks with higher McDep Ratios at 3%. As a result, we add five ISC buys at 3% and two at 4% to get 23% for the ISC sector weighting (see table [Weightings by McDep Ratio and Sector](#) on page 2). Meanwhile, weekly trends are positive for oil price for the next six years at \$103 a barrel, above the 40-week average at \$97. Six-year natural gas at \$5.38 a million btu is below the 40-week average at \$5.41. Finally, peer stocks have potential comparable to buy-recommended stocks (see [Table ISC-1](#) to [Table ISC-4](#) on pages 4-6).

U.S. Approaches Self-Imposed Debt Limit

Among the risks, market disruptions of some kind seem likely should the U.S. government run out of money to pay all of its bills on August 2. The validity of the U.S. dollar as a medium of exchange may be challenged temporarily, but its dominance is likely to prevail for lack of ready alternatives. Yet the dollar as a store of value may decline further, perhaps noticeably overnight. In the less likely case of an immediate recession, the dollar could gain temporarily. We think that a reasonable approach to the uncertainty is a strong commitment to oil and gas stocks while preserving emergency access to a supply of dollars.

Business Risk Segmented

Aside from income features and capitalization the ISC stocks offer more portfolio exposure to natural gas, the clean fuel whose price is depressed. The McDep buy portfolio has about 31% of enterprise value concentrated on natural gas, 22% North America and 9% Rest of World (see table [Enterprise Value by Segment](#) on page 3). Half of the North American participation is in the ISC stocks.

Kurt H. Wulff, CFA



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

July 22, 2011

McDep Energy Portfolio of Buy Recommendations									
Weightings by McDep Ratio and Sector									
			<i>Price</i>						
	<i>Symbol/Rating</i>		<i>(US\$/sh)</i>		<i>Market</i>		<i>Enterprise</i>		<i>McDep</i>
			<i>22-Jul</i>	<i>Shares</i>	<i>Value</i>	<i>Debt</i>	<i>Value</i>	<i>Weight</i>	<i>Ratio</i>
			<i>2011</i>		<i>(\$)</i>	<i>(US\$/sh)</i>	<i>(\$)</i>		
U.S. Integrated									
Exxon Mobil Corporation	XOM	B	85.22	49	4,100	13.42	4,800	4%	0.79
Chevron Corporation	CVX	B	108.97	39	4,300	13.60	4,800	4%	0.73
ConocoPhillips	COP	B	75.26	46	3,400	29.75	4,800	4%	0.71
<i>Total</i>					<i>11,800</i>		<i>14,400</i>	<i>12%</i>	<i>0.74</i>
Europe									
Royal Dutch Shell plc	RDS-A	B	74.13	38	2,800	21.12	3,600	3%	0.81
Statoil ASA (33%)	STO	B	25.10	164	4,100	11.58	6,000	5%	0.66
Total S.A.	TOT	B	56.81	82	4,700	16.19	6,000	5%	0.57
<i>Total</i>					<i>11,600</i>		<i>15,600</i>	<i>13%</i>	<i>0.65</i>
Growth Countries									
PetroChina Company Ltd (14%)	PTR	B	149.31	26	3,900	36.33	4,800	4%	0.75
Petrobras	PBR	CB	33.30	114	3,800	8.96	4,800	4%	0.60
Gazprom (50%)	OGZPY	B	14.51	267	3,900	3.47	4,800	4%	0.57
Lukoil Oil Company	LUKOY	B	67.51	65	4,400	6.64	4,800	4%	0.47
<i>Total</i>					<i>16,000</i>		<i>19,200</i>	<i>16%</i>	<i>0.58</i>
U.S. Independent									
Occidental Petroleum Corp.	OXY	B	107.88	31	3,300	9.72	3,600	3%	0.89
EOG Resources, Inc.	EOG	B	106.57	28	3,000	20.32	3,600	3%	0.84
Devon Energy Corporation	DVN	B	84.35	51	4,300	9.30	4,800	4%	0.77
Marathon Oil Corporation	MRO	B	32.01	154	4,900	6.87	6,000	5%	0.64
<i>Total</i>					<i>15,500</i>		<i>18,000</i>	<i>15%</i>	<i>0.75</i>
Canada									
Cenovus Energy Inc.	CVE	B	40.21	71	2,900	10.52	3,600	3%	0.85
Imperial Oil Limited (30%)	IMO	B	46.68	91	4,200	6.27	4,800	4%	0.78
EnCana Corporation	ECA	CB	30.49	132	4,000	14.91	6,000	5%	0.69
Suncor Energy	SU	B	41.30	119	4,900	9.05	6,000	5%	0.69
Canadian Oil Sands Limited	COSWF	B	30.00	179	5,400	3.53	6,000	5%	0.60
<i>Total</i>					<i>21,400</i>		<i>26,400</i>	<i>22%</i>	<i>0.70</i>
Small Cap									
Range Resources	RRC	B	64.43	48	3,100	11.14	3,600	3%	1.06
Birchcliff Energy Ltd.	BIREF	B	14.45	205	3,000	3.09	3,600	3%	0.92
Cimarex Energy Company	XEC	CB	92.76	47	4,400	8.33	4,800	4%	0.79
Whiting Petroleum Corporation	WLL	B	62.26	63	3,900	13.48	4,800	4%	0.73
Income									
Hugoton RoyaltyTrust	HGT	B	23.68	152	3,600	-	3,600	3%	1.08
Dorchester Minerals, L.P.	DMLP	B	27.42	131	3,600	-	3,600	3%	0.91
Enerplus Corporation	ERF	B	31.83	89	2,800	8.79	3,600	3%	0.89
<i>Total Income and Small Cap</i>					<i>24,400</i>		<i>27,600</i>	<i>23%</i>	<i>0.88</i>
Composite					<i>100,000</i>		<i>120,000</i>	<i>100%</i>	<i>0.71</i>
Note: B = Buy, CB = Contrarian Buy									



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Analysis of Oil & Gas Stocks

July 22, 2011

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Enterprise Value by Segment					
	<i>North Amer.</i>	<i>Rest of World</i>			
	<i>Natural Gas</i>	<i>Natural Gas</i>	<i>Oil Prod'n</i>	<i>Down- stream</i>	<i>Total (\$)</i>
U.S. Integrated					
Exxon Mobil Corporation	431	892	2,708	769	4,800
Chevron Corporation	143	457	3,714	486	4,800
ConocoPhillips	666	505	2,848	781	4,800
<i>Total</i>					<i>14,400</i>
Europe					
Royal Dutch Shell plc	119	796	1,939	746	3,600
Statoil ASA (33%)	-	2,203	3,797	-	6,000
Total S.A.	-	1,112	4,049	839	6,000
<i>Total</i>					<i>15,600</i>
Growth Countries					
PetroChina Company Ltd (14%)	-	640	3,307	853	4,800
Petrobras	-	115	3,966	719	4,800
Gazprom (50%)	-	3,845	955	-	4,800
Lukoil Oil Company	-	-	3,229	1,571	4,800
<i>Total</i>					<i>19,200</i>
U.S. Independent					
Occidental Petroleum Corp.	300	33	3,066	200	3,600
EOG Resources, Inc.	1,628	163	1,810	-	3,600
Devon Energy Corporation	2,593	-	2,207	-	4,800
Marathon Oil Corporation	524	221	5,255	-	6,000
<i>Total</i>					<i>18,000</i>
Canada					
Cenovus Energy Inc.	691	-	2,588	321	3,600
Imperial Oil Limited (30%)	148	-	4,117	535	4,800
EnCana Corporation	5,421	-	579	-	6,000
Suncor Energy	187	-	5,034	779	6,000
Canadian Oil Sands Limited	-	-	6,000	-	6,000
<i>Total</i>					<i>26,400</i>
Small Cap					
Range Resources	2,722	-	878	-	3,600
Birchcliff Energy Ltd.	2,003	-	1,597	-	3,600
Cimarex Energy Company	2,134	-	2,666	-	4,800
Whiting Petroleum Corporation	511	-	4,289	-	4,800
Income					
Hugoton Royalty Trust	3,150	-	450	-	3,600
Dorchester Minerals, L.P.	2,191	-	1,409	-	3,600
Enerplus Corporation	1,188	-	2,412	-	3,600
<i>Total Income and Small Cap</i>					<i>27,600</i>
Composite	26,752	10,983	74,865	8,600	121,200
	22%	9%	62%	7%	100%

Please see disclosures on the final page.

Page 3



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

July 22, 2011

Table ISC-1											
McDep Income and Small Cap Energy Portfolio											
Debt, Segments, Cash Flow, Income and McDep Ratio											
		Price									
Symbol/Rating		(US\$/sh)	EV/	Enterprise	PV(%)		EV/	Dist.	Dist.		
B = Buy	22-Jul	Market	Value	Nat	Oil	Ebitda	NTM	Yield	McDep		
CB (see below)	2011	Cap	(\$mm)	Gas		NTM	(\$/un)	(%)	Ratio		
Small Cap Independent Producers											
Petrohawk Energy Corporation	HK	38.24	1.34	15,630	76	24	8.9	-	-	1.09	
Range Resources	RRC B	64.43	1.17	11,940	76	24	15.9	0.16	0.2	1.06	
Peyto Exploration and Development	PEYUF	24.19	1.21	3,880	71	29	11.8	0.74	3.0	1.01	
Berry Petroleum Company	BRY	60.00	1.44	4,660	26	74	9.9	0.30	0.5	1.00	
Birchcliff Energy Ltd.	BIREF B	14.45	1.21	2,280	56	44	12.8	-	-	0.92	
Denbury Resources Inc.	DNR	20.73	1.28	10,560	6	94	8.2	-	-	0.86	
Cimarex Energy Company	XEC CB	92.76	1.09	8,710	44	56	6.3	0.40	0.4	0.79	
Whiting Petroleum Corporation	WLL B	62.26	1.22	8,940	11	89	6.3	-	-	0.73	
<i>Total or Median</i>				66,600			9.4			0.96	
Top Line Cash Payers											
Permian Basin RT	PBT	23.22	1.00	1,080	42	58		1.72	7.4	1.06	
Cross Timbers Royalty Trust	CRT	47.41	1.00	280	87	13		2.78	5.9	1.05	
Freehold Royalties Ltd.	FRHLF	22.41	1.06	1,390	18	82		1.76	7.9	1.02	
Sabine Royalty Trust	SBR	66.86	1.00	980	51	49		4.96	7.4	0.96	
Dorchester Minerals, L.P.	DMLP B	27.42	1.00	840	61	39		1.85	6.8	0.91	
<i>Total or Median</i>				4,600					7.4	1.02	
Bottom Line Cash Payers											
Linn Energy, LLC	LINE	40.90	1.39	9,250	35	65	13.7	2.64	6.5	1.14	
Vanguard Natural Resources, LLC	VNR	30.61	1.64	1,720	26	74	13.2	2.28	7.4	1.08	
Hugoton Royalty Trust	HGT B	23.68	1.00	950	88	13	13.1	1.59	6.7	1.08	
Legacy Reserves L.P.	LGCY	30.49	1.41	1,870	19	81	10.9	2.12	7.0	1.06	
San Juan Basin Royalty Trust	SJT	24.93	1.00	1,160	100	-	12.7	1.65	6.6	1.00	
Encore Energy Partners, L.P.	ENP	22.53	1.29	1,320	17	83	10.6	1.96	8.7	0.98	
Mesa Royalty Trust	MTR	48.50	1.00	90	75	25	13.1	3.06	6.3	0.91	
Enerplus Corporation	ERF B	31.83	1.28	7,300	33	67	8.6	2.27	7.1	0.89	
<i>Total or Median</i>				23,700			12.9		6.8	1.03	
Composite											
<i>Enterprise Value Weighting</i>				94,800	44	56					0.95
<i>Equal Weighting</i>					48	52					0.98
<i>Equal Weighted Buys</i>					54	46					0.93

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.



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

July 22, 2011

Table ISC-2								
McDep Income and Small Cap Energy Portfolio								
Net Present Value and McDep Ratio								
			Price (\$/sh)	Shares	Market Cap (\$mm)	Net Present Value (\$/un)	Debt/ Present Value	McDep Ratio
	Symbol/ Rating		22-Jul 2011	(mm)				
Small Cap Independent Producers								
Petrohawk Energy Corporation	HK		38.24	305.0	11,660	34.00	0.28	1.09
Range Resources	RRC	B	64.43	158.0	10,180	60.00	0.16	1.06
Peyto Exploration and Development Cor	PEYUF		24.19	132.7	3,210	24.00	0.17	1.01
Berry Petroleum Company	BRY		60.00	54.0	3,240	60.00	0.30	1.00
Birchcliff Energy Ltd.	BIREF	B	14.45	130.0	1,880	16.00	0.16	0.92
Denbury Resources Inc.	DNR		20.73	397.0	8,230	25.00	0.19	0.86
Cimarex Energy Company	XEC	CB	92.76	86.1	7,990	120.00	0.06	0.79
Whiting Petroleum Corporation	WLL	B	62.26	118.0	7,350	90.00	0.13	0.73
<i>Total or Median</i>					53,740		0.17	0.96
Top Line Cash Payers								
Permian Basin RT	PBT		23.22	46.6	1,080	22.00	-	1.06
Cross Timbers Royalty Trust	CRT		47.41	6.0	280	45.00	-	1.05
Freehold Royalties Ltd.	FRHLF		22.41	58.4	1,310	22.00	0.06	1.02
Sabine Royalty Trust	SBR		66.86	14.6	980	70.00	-	0.96
Dorchester Minerals, L.P.	DMLP	B	27.42	30.7	840	30.00	-	0.91
<i>Total or Median</i>					4,490			1.02
Bottom Line Cash Payers								
Linn Energy, LLC	LINE		40.90	163.0	6,670	34.00	0.32	1.14
Vanguard Natural Resources, LLC	VNR		30.61	34.2	1,050	27.00	0.42	1.08
Hugoton RoyaltyTrust	HGT	B	23.68	40.0	950	22.00	-	1.08
Legacy Reserves L.P.	LGCY		30.49	43.5	1,330	28.00	0.31	1.06
San Juan Basin Royalty Trust	SJT		24.93	46.6	1,160	25.00	-	1.00
Encore Energy Partners, L.P.	ENP		22.53	45.5	1,030	23.00	0.22	0.98
Mesa RoyaltyTrust	MTR		48.50	1.9	90	53.00	-	0.91
Enerplus Corporation	ERF	B	31.83	179.5	5,710	37.00	0.19	0.89
<i>Total or Median</i>					17,990			1.03
B=Buy; 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 presumes long-term prices of \$100 a barrel for oil and \$8 a million btu for natural gas.								



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

July 22, 2011

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		22-Jul 2011	Royalty (%)	Ebitda	NTM	NTM	NTM
Small Cap Independent Producers								
Range Resources	RRC	B	64.43		-	16.1	15.0	15.9
Birchcliff Energy Ltd.	BIREF	B	14.45		-	19.7	14.0	12.8
Peyto Exploration and Development Corp	PEYUF		24.19		0.36	14.9	11.7	11.8
Berry Petroleum Company	BRY		60.00		-	12.0	9.9	9.9
Petrohawk Energy Corporation	HK		38.24		-	5.6	8.2	8.9
Denbury Resources Inc.	DNR		20.73		-	13.6	9.5	8.2
Whiting Petroleum Corporation	WLL	B	62.26		-	9.0	8.6	6.3
Cimarex Energy Company	XEC	CB	92.76		-	7.0	8.0	6.3
	<i>Median</i>					12.8	9.7	9.4
Top Line Cash Payers								
Cross Timbers Royalty Trust	CRT		47.41	80	0.97	15.1	15.6	16.5
Sabine Royalty Trust	SBR		66.86	100	1.00	6.8	14.1	13.5
Permian Basin RT	PBT		23.22	32	0.98	15.7	12.5	13.2
Dorchester Minerals, L.P.	DMLP	B	27.42	77	0.87	7.0	14.1	12.8
Freehold Royalties Ltd.	FRHLF		22.41	71	0.84	6.3	10.4	10.6
	<i>Median</i>					7.0	14.1	13.2
Bottom Line Cash Payers								
Linn Energy, LLC	LINE		40.90		0.93	17.5	12.0	13.7
Vanguard Natural Resources, LLC	VNR		30.61		1.04	13.2	12.3	13.2
Hugoton Royalty Trust	HGT	B	23.68		0.88	14.0	12.2	13.1
Mesa Royalty Trust	MTR		48.50		0.83	14.5	14.3	13.1
San Juan Basin Royalty Trust	SJT		24.93		0.84	9.2	12.8	12.7
Legacy Reserves L.P.	LGCY		30.49		0.78	12.0	10.3	10.9
Encore Energy Partners, L.P.	ENP		22.53		0.92	13.1	10.8	10.6
Enerplus Corporation	ERF	B	31.83		0.59	8.3	9.7	8.6
	<i>Median</i>					13.2	12.1	12.9
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).								



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

July 22, 2011

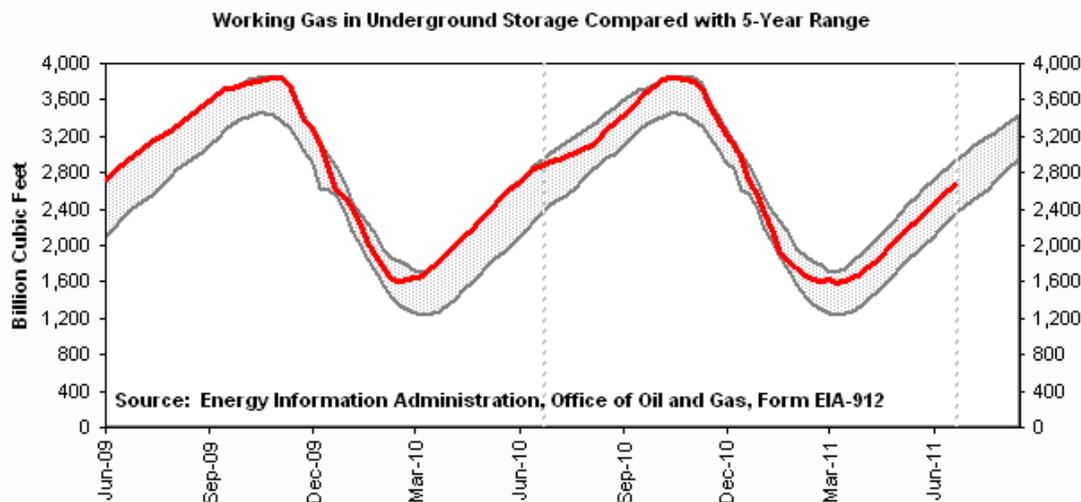
Table ISC-4								
Oil and Gas Income and Small Cap Stocks								
Rank by Enterprise Value to 200 Day Average								
			Price (\$/sh)		Enterprise Value/			
	Symbol/ Rating		22-Jul 2011	52Wk High	52Wk Low	50 Day Avg.	200 Day Avg.	McDep Ratio
Small Cap Independent Producers								
	Petrohawk Energy Corporation	HK	38.24	1.00	1.87	1.31	1.47	1.09
	Range Resources	RRC B	64.43	1.00	1.74	1.15	1.26	1.06
	Birchcliff Energy Ltd.	BIREF B	14.45	0.99	1.63	1.06	1.21	0.92
	Berry Petroleum Company	BRY	60.00	0.99	1.64	1.13	1.20	1.00
	Peyto Exploration and Development C	PEYUF	24.19	0.97	1.65	1.09	1.19	1.01
	Whiting Petroleum Corporation	WLL B	62.26	0.85	1.39	1.04	1.03	0.73
	Denbury Resources Inc.	DNR	20.73	0.83	1.32	1.03	1.01	0.86
	Cimarex Energy Company	XEC CB	92.76	0.80	1.42	1.04	0.99	0.79
	<i>Median</i>			<i>0.98</i>	<i>1.63</i>	<i>1.07</i>	<i>1.20</i>	<i>0.96</i>
Top Line Cash Payers								
	Cross Timbers Royalty Trust	CRT	47.41	0.98	1.41	1.10	1.11	1.05
	Sabine Royalty Trust	SBR	66.86	0.95	1.36	1.03	1.09	0.96
	Permian Basin RT	PBT	23.22	0.98	1.28	1.09	1.08	1.06
	Freehold Royalties Ltd.	FRHLF	22.41	0.93	1.46	1.05	1.06	1.02
	Dorchester Minerals, L.P.	DMLP B	27.42	0.91	1.16	1.02	1.00	0.91
	<i>Median</i>			<i>0.95</i>	<i>1.36</i>	<i>1.05</i>	<i>1.08</i>	<i>1.02</i>
Bottom Line Cash Payers								
	Hugoton RoyaltyTrust	HGT B	23.68	0.96	1.31	1.05	1.09	1.08
	Linn Energy, LLC	LINE	40.90	1.00	1.32	1.05	1.06	1.14
	Legacy Reserves L.P.	LGCY	30.49	0.93	1.23	1.02	1.03	1.06
	Enerplus Corporation	ERF B	31.83	0.96	1.33	1.02	1.03	0.89
	Vanguard Natural Resources, LLC	VNR	30.61	0.94	1.18	1.04	1.03	1.08
	Encore Energy Partners, L.P.	ENP	22.53	0.91	1.20	1.04	1.02	0.98
	Mesa RoyaltyTrust	MTR	48.50	0.94	1.22	1.09	1.02	0.91
	San Juan Basin Royalty Trust	SJT	24.93	0.89	1.19	1.04	1.01	1.00
	<i>Median</i>			<i>0.94</i>	<i>1.22</i>	<i>1.04</i>	<i>1.03</i>	<i>1.03</i>
CB=Contrarian Buy, Stock Price apparently in downtrend compared to 200-day average.								



Income and Small Cap Weekly

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July 22, 2011



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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.