



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

August 26, 2011

Invest in Natural Gas

Summary and Recommendation

After taking a back seat to oil for price excitement the past few years, natural gas stocks are leading oil stocks in recent performance by some measures. The four strongest stocks in our income and small cap group measured by current price above the 200-day average are **Range Resources** (RRC- Buy), **Peyto Exploration** (PEYUF – 0.92 McDep Ratio), **Birchcliff Energy** (BIREF – Buy) and **Cross Timbers Royalty Trust** (CRT – 0.99 McDep Ratio). The same stocks plus **Mesa Royalty Trust** (MTR- 0.87 McDep Ratio) are among the strongest by the shorter term 50-day average (see Table ISC-4 on page 5). Rapidly expanding natural gas supply which has acted to keep downward pressure on natural gas price is attracting new demand that is beneficial economically and environmentally. Small cap natural gas stocks are leaders in developing new clean fuel supply. Natural gas royalty trusts pay high income from the longest-life older properties. Practically all the income and small cap stocks we analyze continuously have become more promising for new investment at lower McDep Ratios than in the spring (see Tables ISC-1 to ISC-3 on pages 2-4).

Maine Converting to Natural Gas

We like the story about the people of Maine taking advantage of the new natural gas economics (see *Gas Daily*, August 25, 2011). Traditionally, by the time natural gas from the Gulf Coast travelled to Maine, transportation costs ate up all the economic advantage compared to oil that markets closer to supply enjoyed. Now natural gas travels through Maine by pipeline from Nova Scotia to Massachusetts. At the same time new discoveries in the Marcellus shale are displacing Gulf Coast supplies in the Northeast and providing price competition to Nova Scotia natural gas. All of those changes have been occurring amid the backdrop of advancing price for oil on which Maine depends heavily. The economics have become compelling for the General Dynamics shipyard in Bath, Maine, to convert to heating with natural gas while its boilers can use either oil or natural gas. A pulp mill in northern Maine will convert to natural gas, apparently with the help of a loan guarantee from the state motivated by the desire to keep the state competitive in attracting jobs. Industrial users can become anchors that help bring natural gas to more commercial and residential users. Maine's energy consumption may not move the needle on a global level, but the example is just one of many of users acting on convincing economics.

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								
Symbol/Rating		(US\$/sh)	EV/	Enterprise	PV(%)		EV/	Dist.	Dist.		
B = Buy	25-Aug	Market	Value	Nat	Oil	Ebitda	NTM	Yield	McDep		
CB (see below)	2011	Cap	(\$mm)	Gas		NTM	(\$/un)	(%)	Ratio		
Small Cap Independent Producers											
Peyto Exploration and Development	PEYUF		21.69	1.17	3,390	76	24	11.0	0.74	3.4	0.92
Range Resources	RRC	B	58.31	1.21	11,250	69	31	14.5	0.16	0.3	0.86
Birchcliff Energy Ltd.	BIREF	B	12.43	1.24	2,010	56	44	12.5	-	-	0.81
Berry Petroleum Company	BRY		44.19	1.62	3,910	23	77	7.6	0.30	0.7	0.74
Denbury Resources Inc.	DNR		14.22	1.41	8,100	5	95	6.7	-	-	0.59
Whiting Petroleum Corporation	WLL	CB	43.59	1.31	6,790	11	89	5.2	-	-	0.55
Cimarex Energy Company	XEC	CB	61.86	1.14	6,060	45	55	5.0	0.40	0.6	0.55
<i>Total or Median</i>					41,500			7.6			0.74
Top Line Cash Payers											
Cross Timbers Royalty Trust	CRT		44.50	1.00	270	87	13		2.81	6.3	0.99
Permian Basin RT	PBT		21.63	1.00	1,010	42	58		1.42	6.6	0.98
Sabine Royalty Trust	SBR		60.05	1.00	880	51	49		4.22	7.0	0.86
Freehold Royalties Ltd.	FRHLF		18.33	1.06	1,160	17	83		1.70	9.3	0.84
Dorchester Minerals, L.P.	DMLP	CB	24.50	1.00	750	61	39		1.69	6.9	0.82
<i>Total or Median</i>					4,100					6.9	0.86
Bottom Line Cash Payers											
Linn Energy, LLC	LINE		36.41	1.48	9,510	31	69	15.5	2.76	7.6	1.05
Vanguard Natural Resources, LLC	VNR		26.85	1.47	2,020	23	77	11.0	2.30	8.6	1.00
Hugoton Royalty Trust	HGT	B	21.91	1.00	880	88	13	13.7	1.37	6.3	1.00
San Juan Basin Royalty Trust	SJT		23.89	1.00	1,110	100	-	13.7	1.44	6.0	0.96
Legacy Reserves L.P.	LGCY		26.52	1.49	1,720	21	79	9.3	2.16	8.1	0.92
Mesa Royalty Trust	MTR		45.97	1.00	86	75	25	13.5	2.71	5.9	0.87
Enerplus Corporation	ERF	CB	27.20	1.23	6,000	30	70	8.1	2.18	8.0	0.77
<i>Total or Median</i>					21,300			13.5		7.6	0.96
Composite											
<i>Enterprise Value Weighting</i>					66,900	38	62				0.75
<i>Equal Weighting</i>						48	52				0.85
<i>Equal Weighted Buys</i>						45	55				0.77

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-2								
McDep Income and Small Cap Energy Portfolio								
Net Present Value and McDep Ratio								
			Price			Net		
			(\$/sh)		Market	Present	Debt/	
	Symbol/		25-Aug	Shares	Cap	Value	Present	McDep
	Rating		2011	(mm)	(\$mm)	(\$/un)	Value	Ratio
Small Cap Independent Producers								
Peyto Exploration and Development Cor	PEYUF		21.69	133.1	2,890	24.00	0.14	0.92
Range Resources	RRC	B	58.31	159.0	9,270	70.00	0.15	0.86
Birchcliff Energy Ltd.	BIREF	B	12.43	131.0	1,630	16.00	0.15	0.81
Berry Petroleum Company	BRY		44.19	54.7	2,420	70.00	0.28	0.74
Denbury Resources Inc.	DNR		14.22	404.0	5,740	28.00	0.17	0.59
Whiting Petroleum Corporation	WLL	CB	43.59	119.0	5,190	90.00	0.13	0.55
Cimarex Energy Company	XEC	CB	61.86	86.1	5,330	120.00	0.07	0.55
<i>Total or Median</i>					32,470		0.15	0.74
Top Line Cash Payers								
Cross Timbers Royalty Trust	CRT		44.50	6.0	270	45.00	-	0.99
Permian Basin RT	PBT		21.63	46.6	1,010	22.00	-	0.98
Sabine Royalty Trust	SBR		60.05	14.6	880	70.00	-	0.86
Freehold Royalties Ltd.	FRHLF		18.33	59.4	1,090	22.00	0.05	0.84
Dorchester Minerals, L.P.	DMLP	CB	24.50	30.7	750	30.00	-	0.82
<i>Total or Median</i>					4,000			0.86
Bottom Line Cash Payers								
Linn Energy, LLC	LINE		36.41	176.0	6,410	34.00	0.34	1.05
Vanguard Natural Resources, LLC	VNR		26.85	51.1	1,370	27.00	0.32	1.00
Hugoton Royalty Trust	HGT	B	21.91	40.0	880	22.00	-	1.00
San Juan Basin Royalty Trust	SJT		23.89	46.6	1,110	25.00	-	0.96
Legacy Reserves L.P.	LGCY		26.52	43.6	1,160	30.00	0.30	0.92
Mesa Royalty Trust	MTR		45.97	1.9	86	53.00	-	0.87
Enerplus Corporation	ERF	CB	27.20	179.6	4,890	37.00	0.14	0.77
<i>Total or Median</i>					15,910			0.96
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.								



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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		25-Aug 2011	Royalty (%)	Ebitda	NTM	NTM	NTM
Small Cap Independent Producers								
Range Resources	RRC	B	58.31		-	15.2	16.9	14.5
Birchcliff Energy Ltd.	BIREF	B	12.43		-	19.7	15.5	12.5
Peyto Exploration and Development Corp	PEYUF		21.69		0.37	14.3	12.0	11.0
Berry Petroleum Company	BRY		44.19		-	11.9	10.4	7.6
Denbury Resources Inc.	DNR		14.22		-	13.4	11.3	6.7
Whiting Petroleum Corporation	WLL	CB	43.59		-	8.9	9.4	5.2
Cimarex Energy Company	XEC	CB	61.86		-	7.4	9.0	5.0
	<i>Median</i>					<i>13.4</i>	<i>11.3</i>	<i>7.6</i>
Top Line Cash Payers								
Cross Timbers Royalty Trust	CRT		44.50	80	0.97	13.7	15.4	15.3
Permian Basin RT	PBT		21.63	32	0.97	16.6	15.0	14.8
Sabine Royalty Trust	SBR		60.05	100	1.00	7.3	16.6	14.3
Dorchester Minerals, L.P.	DMLP	CB	24.50	77	0.85	6.6	15.1	12.3
Freehold Royalties Ltd.	FRHLF		18.33	71	0.97	6.6	12.6	10.6
	<i>Median</i>					<i>7.3</i>	<i>15.1</i>	<i>14.3</i>
Bottom Line Cash Payers								
Linn Energy, LLC	LINE		36.41		1.21	17.2	14.9	15.5
Hugoton Royalty Trust	HGT	B	21.91		0.86	14.0	13.8	13.7
San Juan Basin Royalty Trust	SJT		23.89		0.83	9.2	14.3	13.7
Mesa Royalty Trust	MTR		45.97		0.79	14.4	15.5	13.5
Vanguard Natural Resources, LLC	VNR		26.85		0.94	9.0	11.1	11.0
Legacy Reserves L.P.	LGCY		26.52		0.73	10.2	10.2	9.3
Enerplus Corporation	ERF	CB	27.20		0.62	8.5	10.5	8.1
	<i>Median</i>					<i>10.2</i>	<i>13.8</i>	<i>13.5</i>
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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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		25-Aug 2011	52Wk High	52Wk Low	50 Day Avg.	200 Day Avg.	McDep Ratio
Small Cap Independent Producers								
Range Resources	RRC	B	58.31	0.89	1.58	1.01	1.11	0.86
Peyto Exploration and Development C	PEYUF		21.69	0.88	1.55	0.96	1.06	0.92
Birchcliff Energy Ltd.	BIREF	B	12.43	0.85	1.45	0.93	1.04	0.81
Berry Petroleum Company	BRY		44.19	0.81	1.33	0.90	0.96	0.74
Whiting Petroleum Corporation	WLL	CB	43.59	0.64	1.05	0.82	0.77	0.55
Denbury Resources Inc.	DNR		14.22	0.63	1.00	0.82	0.76	0.59
Cimarex Energy Company	XEC	CB	61.86	0.56	1.01	0.77	0.68	0.55
	<i>Median</i>			<i>0.81</i>	<i>1.33</i>	<i>0.90</i>	<i>0.96</i>	<i>0.74</i>
Top Line Cash Payers								
Cross Timbers Royalty Trust	CRT		44.50	0.92	1.29	1.01	1.03	0.99
Permian Basin RT	PBT		21.63	0.91	1.20	0.99	1.00	0.98
Sabine Royalty Trust	SBR		60.05	0.85	1.27	0.94	0.96	0.86
Dorchester Minerals, L.P.	DMLP	CB	24.50	0.81	1.18	0.93	0.90	0.82
Freehold Royalties Ltd.	FRHLF		18.33	0.76	1.21	0.90	0.87	0.84
	<i>Median</i>			<i>0.85</i>	<i>1.21</i>	<i>0.94</i>	<i>0.96</i>	<i>0.86</i>
Bottom Line Cash Payers								
Hugoton RoyaltyTrust	HGT	B	21.91	0.89	1.22	0.98	1.00	1.00
Mesa RoyaltyTrust	MTR		45.97	0.90	1.16	1.03	0.98	0.87
San Juan Basin Royalty Trust	SJT		23.89	0.85	1.17	0.99	0.97	0.96
Linn Energy, LLC	LINE		36.41	0.92	1.21	0.96	0.97	1.05
Vanguard Natural Resources, LLC	VNR		26.85	0.85	1.11	0.96	0.94	1.00
Legacy Reserves L.P.	LGCY		26.52	0.85	1.13	0.95	0.94	0.92
Enerplus Corporation	ERF	CB	27.20	0.85	1.20	0.91	0.90	0.77
	<i>Median</i>			<i>0.85</i>	<i>1.17</i>	<i>0.96</i>	<i>0.97</i>	<i>0.96</i>

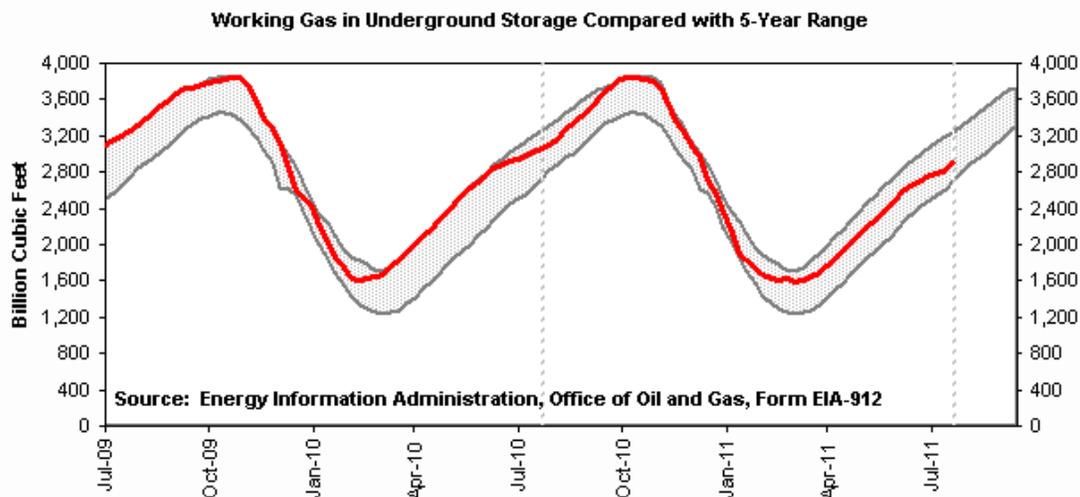
CB=Contrarian Buy, Stock Price apparently in downtrend compared to 200-day average.



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