



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

11/11/11

## Oil and Gas Investing under Uncertainty

### Summary and Recommendation

Under political and economic uncertainty in a world with developed countries awash in government debt, oil and gas stocks can be major contributors to the triple objectives of growth, inflation protection and deflation resistance in diversified long-term investment portfolios, we believe. To best explain what we mean, we'll use our own real-life personal choices. Every circumstance is different and what seems suitable for us will be different for others. Our current portfolio objectives are to be invested 30% in protection and 70% in growth.

Protection allows us peace of mind in case everything falls apart either because inflation gets out of control or economic activity collapses into deflation. We get our protection from short-life bonds, cash and gold. The bonds are mostly inflation linked. Because we think we have the downside covered we can have confidence to act on the upside. Since protection has outperformed growth in 2011, we are rebalancing by shifting some assets from protection to growth. With portfolio turnover at 1-2% a month we make incremental, rather than dramatic changes. Yet with liquid securities we could always move faster, if necessary.

Recently the 70% growth portion was actually 68% including 12% in global equities, 8% in ExxonMobil and 48% in other McDep buy recommendations and related McDep stocks. There is more rebalancing to do. We depend more on energy stocks because we think we know the companies and we believe industry prospects are favorable.

Many oil and gas stocks offer absolute volume growth. The shift in global growth to less mature, more rapidly growing economies is good for oil and gas. In the earlier stages of economic growth, countries build infrastructure and newly prosperous households acquire autos, appliances and gain protection from heat and cold climate. Most oil and gas stocks offer growth in the sense of total return that makes an investment portfolio grow. Moreover, the industry offers abundant examples of growth through innovation including value-adding discoveries and leading edge application of new technology.

Small cap stocks are interesting because growth can have more dramatic impact. Also, investors can learn more about a company and the industry by paying attention to the management of small cap companies who in turn want investors to pay more attention to them. Income stocks are interesting at a time when traditional sources of fixed income have vanished with low interest rates accompanying free money. There may be a double-barreled effect as the same free money tends to drive up oil and gas price making oil and gas income doubly attractive. About 20% of our oil and gas stocks or 12% of the total portfolio is invested in the stocks covered in this *Income and Small Cap Weekly*. In our latest rankings, we confirm our present value estimates after analyzing latest quarterly results (see Tables ISC-1 to ISC-4).

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			PV(%)					
Symbol/Rating		(US\$/sh)	EV/	Enterprise			EV/	Dist.	Dist.		
B = Buy	10-Nov	Market	Value	Nat	Oil	Ebitda	NTM	Yield	McDep		
CB (see below)	2011	Cap	(\$mm)	Gas		NTM	(\$/un)	(%)	Ratio		
<b>Small Cap Independent Producers</b>											
Range Resources	RRC	B	71.19	1.19	13,520	66	34	17.0	0.16	0.2	1.01
PDC Energy	PETD		32.00	1.72	1,300	62	38	8.3	-	-	1.00
Peyto Exploration and Developmen	PEYUF		22.70	1.18	3,560	75	25	11.0	0.71	3.1	0.95
Birchcliff Energy Ltd.	BIREF	B	13.85	1.22	2,220	56	44	13.0	-	-	0.89
Berry Petroleum Company	BRY		41.92	1.63	3,730	21	79	6.3	0.32	0.8	0.71
Denbury Resources Inc.	DNR		16.87	1.37	9,290	4	96	6.3	-	-	0.67
Whiting Petroleum Corporation	WLL	CB	47.30	1.29	7,240	11	89	4.5	-	-	0.59
Cimarex Energy Company	XEC	CB	64.82	1.14	6,350	46	54	5.2	0.40	0.6	0.57
<i>Total or Median</i>					47,200			7.3			0.80
<b>Top Line Cash Payers</b>											
Cross Timbers Royalty Trust	CRT		47.40	1.00	280	87	13		2.94	6.2	1.05
Sabine Royalty Trust	SBR		66.13	1.00	960	51	49		4.22	6.4	0.94
Permian Basin RT	PBT		20.00	1.00	930	42	58		1.39	6.9	0.91
Freehold Royalties Ltd.	FRHLF		17.81	1.06	1,120	18	82		1.65	9.3	0.82
Dorchester Minerals, L.P.	DMLP	CB	24.40	1.00	750	61	39		1.95	8.0	0.81
<i>Total or Median</i>					4,000					6.9	0.91
<b>Bottom Line Cash Payers</b>											
Linn Energy, LLC	LINE		36.89	1.46	9,460	31	69	13.6	2.76	7.5	1.06
Hugoton Royalty Trust	HGT		22.21	1.00	890	88	13	16.8	1.18	5.3	1.01
Vanguard Natural Resources, LLC	VNR		26.47	1.56	2,020	27	73	10.0	2.31	8.7	0.99
San Juan Basin Royalty Trust	SJT	B	24.59	1.00	1,150	100	-	15.4	1.23	5.0	0.98
Legacy Reserves L.P.	LGCY		27.58	1.42	1,710	22	78	8.4	2.18	7.9	0.94
Enduro Royalty Trust (40%)	NDRO		19.05	1.00	250	47	53	8.2	1.62	8.5	0.86
Mesa Royalty Trust	MTR		43.33	1.00	81	75	25	11.1	3.38	7.8	0.82
Enerplus Corporation	ERF	CB	27.03	1.27	6,200	29	71	8.2	2.12	7.8	0.77
<i>Total or Median</i>					21,800			10.6		7.8	0.96
<b>Composite</b>											
<i>Enterprise Value Weighting</i>					73,000	38	62				0.80
<i>Equal Weighting</i>						48	52				0.87
<i>Equal Weighted Buys</i>						45	55				0.81

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 September 30, 2012. Enterprise Value = Market Cap and Debt.



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11/11/11

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	10-Nov 2011		(mm)				
<b>Small Cap Independent Producers</b>								
Range Resources	RRC	B	71.19	159.0	11,320	70.00	0.17	1.01
PDC Energy	PETD		32.00	23.8	760	32.00	0.42	1.00
Peyto Exploration and Development Cor	PEYUF		22.70	133.1	3,020	24.00	0.14	0.95
Birchcliff Energy Ltd.	BIREF	B	13.85	131.0	1,810	16.00	0.16	0.89
Berry Petroleum Company	BRY		41.92	54.7	2,290	70.00	0.27	0.71
Denbury Resources Inc.	DNR		16.87	403.0	6,800	28.00	0.18	0.67
Whiting Petroleum Corporation	WLL	CB	47.30	119.0	5,630	90.00	0.13	0.59
Cimarex Energy Company	XEC	CB	64.82	86.2	5,590	120.00	0.07	0.57
<i>Total or Median</i>					37,220		0.16	0.80
<b>Top Line Cash Payers</b>								
Cross Timbers Royalty Trust	CRT		47.40	6.0	280	45.00	-	1.05
Sabine Royalty Trust	SBR		66.13	14.6	960	70.00	-	0.94
Permian Basin RT	PBT		20.00	46.6	930	22.00	-	0.91
Freehold Royalties Ltd.	FRHLF		17.81	59.3	1,060	22.00	0.05	0.82
Dorchester Minerals, L.P.	DMLP	CB	24.40	30.7	750	30.00	-	0.81
<i>Total or Median</i>					3,980			0.91
<b>Bottom Line Cash Payers</b>								
Linn Energy, LLC	LINE		36.89	176.0	6,490	34.00	0.33	1.06
Hugoton Royalty Trust	HGT		22.21	40.0	890	22.00	-	1.01
Vanguard Natural Resources, LLC	VNR		26.47	48.8	1,290	27.00	0.36	0.99
San Juan Basin Royalty Trust	SJT	B	24.59	46.6	1,150	25.00	-	0.98
Legacy Reserves L.P.	LGCY		27.58	43.6	1,200	30.00	0.28	0.94
Enduro Royalty Trust (40%)	NDRO		19.05	13.2	250	22.00	-	0.86
Mesa Royalty Trust	MTR		43.33	1.9	81	53.00	-	0.82
Enerplus Corporation	ERF	CB	27.03	180.6	4,880	37.00	0.16	0.77
<i>Total or Median</i>					16,230			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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11/11/11

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		10-Nov 2011	Royalty (%)	Ebitda	NTM	NTM	NTM
<b>Small Cap Independent Producers</b>								
Range Resources	RRC	B	71.19		-	14.4	16.8	17.0
Birchcliff Energy Ltd.	BIREF	B	13.85		-	20.1	14.7	13.0
Peyto Exploration and Development Corp	PEYUF		22.70		0.34	13.5	11.5	11.0
PDC Energy	PETD		32.00		-	8.2	8.3	8.3
Berry Petroleum Company	BRY		41.92		-	11.6	8.9	6.3
Denbury Resources Inc.	DNR		16.87		-	13.0	9.3	6.3
Cimarex Energy Company	XEC	CB	64.82		-	7.1	9.0	5.2
Whiting Petroleum Corporation	WLL	CB	47.30		-	8.7	7.7	4.5
	<i>Median</i>					12.3	9.2	7.3
<b>Top Line Cash Payers</b>								
Sabine Royalty Trust	SBR		66.13	100	1.00	7.4	16.6	15.7
Cross Timbers Royalty Trust	CRT		47.40	80	0.97	13.9	14.8	15.6
Permian Basin RT	PBT		20.00	32	0.98	17.3	15.6	14.1
Dorchester Minerals, L.P.	DMLP	CB	24.40	77	0.85	6.1	13.1	10.6
Freehold Royalties Ltd.	FRHLF		17.81	71	0.86	6.7	11.5	9.4
	<i>Median</i>					7.4	14.8	14.1
<b>Bottom Line Cash Payers</b>								
Hugoton Royalty Trust	HGT		22.21		0.89	14.0	16.6	16.8
San Juan Basin Royalty Trust	SJT	B	24.59		0.77	8.6	15.7	15.4
Linn Energy, LLC	LINE		36.89		1.04	16.2	12.8	13.6
Mesa Royalty Trust	MTR		43.33		0.87	13.8	13.6	11.1
Vanguard Natural Resources, LLC	VNR		26.47		0.87	8.7	10.1	10.0
Legacy Reserves L.P.	LGCY		27.58		0.65	9.9	8.9	8.4
Enerplus Corporation	ERF	CB	27.03		0.61	8.5	10.6	8.2
Enduro Royalty Trust (40%)	NDRO		19.05		0.70	7.4	9.5	8.2
	<i>Median</i>					9.3	11.7	10.6
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 September 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		10-Nov 2011	52Wk High	52Wk Low	50 Day Avg.	200 Day Avg.	McDep Ratio
<b>Small Cap Independent Producers</b>								
Range Resources	RRC	B	71.19	0.93	1.57	1.07	1.19	1.01
Peyto Exploration and Development C	PEYUF		22.70	0.91	1.31	1.08	1.06	0.95
Birchcliff Energy Ltd.	BIREF	B	13.85	0.91	1.40	1.04	1.06	0.89
PDC Energy	PETD		32.00	0.76	1.44	1.18	0.96	1.00
Berry Petroleum Company	BRY		41.92	0.78	1.20	1.00	0.92	0.71
Denbury Resources Inc.	DNR		16.87	0.72	1.41	1.13	0.91	0.67
Whiting Petroleum Corporation	WLL	CB	47.30	0.68	1.44	1.09	0.87	0.59
Cimarex Energy Company	XEC	CB	64.82	0.58	1.24	1.03	0.77	0.57
	<i>Median</i>			<i>0.77</i>	<i>1.40</i>	<i>1.07</i>	<i>0.94</i>	<i>0.80</i>
<b>Top Line Cash Payers</b>								
Cross Timbers Royalty Trust	CRT		47.40	0.98	1.26	1.03	1.06	1.05
Sabine Royalty Trust	SBR		66.13	0.94	1.39	1.03	1.04	0.94
Permian Basin RT	PBT		20.00	0.84	1.11	0.98	0.94	0.91
Dorchester Minerals, L.P.	DMLP	CB	24.40	0.81	1.17	1.01	0.92	0.81
Freehold Royalties Ltd.	FRHLF		17.81	0.74	1.28	1.03	0.88	0.82
	<i>Median</i>			<i>0.84</i>	<i>1.26</i>	<i>1.03</i>	<i>0.94</i>	<i>0.91</i>
<b>Bottom Line Cash Payers</b>								
San Juan Basin Royalty Trust	SJT	B	24.59	0.88	1.20	1.04	1.01	0.98
Hugoton RoyaltyTrust	HGT		22.21	0.90	1.15	1.01	1.00	1.01
Linn Energy, LLC	LINE		36.89	0.93	1.12	1.00	0.98	1.06
Legacy Reserves L.P.	LGCY		27.58	0.86	1.17	1.00	0.96	0.94
Mesa RoyaltyTrust	MTR		43.33	0.85	1.11	0.99	0.95	0.82
Vanguard Natural Resources, LLC	VNR		26.47	0.85	1.13	0.99	0.94	0.99
Enerplus Corporation	ERF	CB	27.03	0.85	1.19	1.01	0.92	0.77
	<i>Median</i>			<i>0.86</i>	<i>1.15</i>	<i>1.00</i>	<i>0.96</i>	<i>0.98</i>

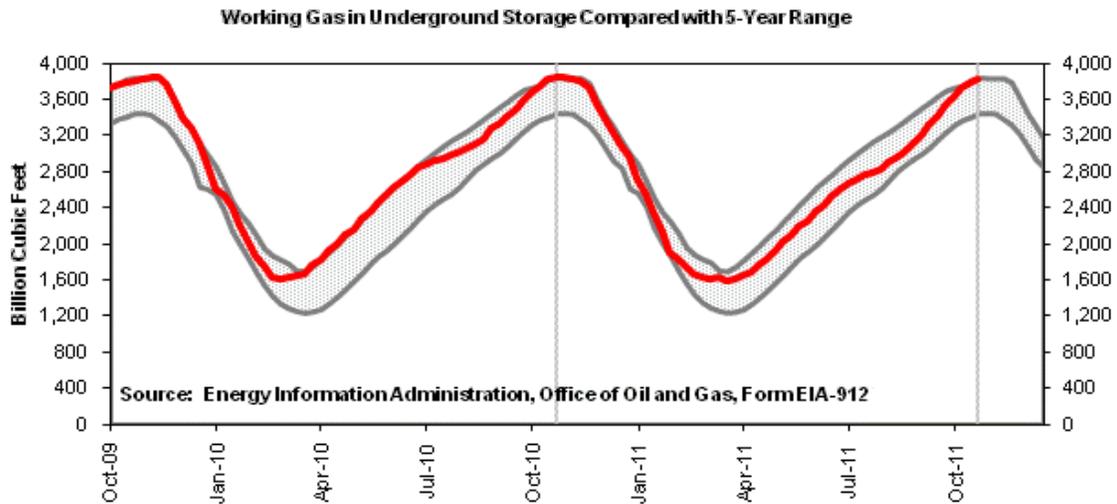
CB=Contrarian Buy, Stock Price apparently in downtrend compared to 200-day average.



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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 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. 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.