



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

March 13, 2009

Oversold, Undervalued Stocks

Summary and Recommendation

Six U.S. Royalty Trusts are the most oversold stocks in our coverage of 42 income, small cap and large cap oil and gas producer stocks. Among the next stocks under the most selling pressure are the three conventional Canadian Income Stocks and our natural gas buy recommendation among Small Cap Independent Producers. We define oversold as the stocks with the lowest ratio of enterprise value to 50-day moving average. Nine of the ten oversold stocks have McDep Ratios of 0.52 or less, implying undervaluation by our analysis. As we watch the stocks in our coverage over the days, weeks and months, the same stocks do not stay oversold for long as extreme action seems to rotate from one stock group to another. For awhile near-month natural gas had a lower ratio of price to 50-day average, but no longer as momentum in the commodity has improved. Moreover, several of the most oversold stocks have a majority of value concentrated on oil rather than natural gas. The six most oversold stocks, with ratios of price to 50-day average and McDep Ratio in parentheses, are **Cross Timbers Royalty Trust (CRT, 0.64, 0.41)**, buy-recommended **Hugoton Royalty Trust (HGT, 0.70, 0.32)**, hold-rated **San Juan Basin Royalty Trust (SJT, 0.70, 0.43)**, **Mesa Royalty Trust (MTR, 0.73, 0.35)**, **Sabine Royalty Trust (SBR, 0.78, 0.64)** and **Permian Basin Royalty Trust (PBT, 0.79, 0.50)**. We have further comments on uncharacteristic reserve increases for SBR, CRT, PBT and **Dorchester Minerals (DMLP)**.

Proven Reserves Surprises

Normally, investors would not expect much growth from income stocks because most of the gain in economic value is periodically paid out to unit, or share, holders. That expectation would likely be stronger for royalty trusts that are chartered with specific properties and restricted from active management to take on debt or acquire new properties. As a result, when new estimates of proven reserves of remaining oil and gas to be produced are released each year, investors expect the total to decline by the amount produced in the past year. At the same time the amount of oil left to be produced is sensitive to price as production is projected to end some years in the future when the cost of the last barrel equals the revenue to be received. For an estimate of future price to be used in calculating remaining production, the Securities and Exchange Commission requires producers to use the price quoted on the last day of the year. Thus, with oil and gas price down at the end of 2008, estimates of reserves would normally be revised downward. The impact on present value of the volume change is diminished by the fact that the omitted amounts would apply to oil and gas to be produced only in the final years of field life.

Given that long explanation of what to expect, we are surprised to see that year-end reserve estimates were higher than the previous year for three royalty trusts and one partnership. The four entities have in common whole or part concentration on what we call revenue royalties rather than the more common net profits royalties. **SBR**, with 100% revenue royalties, reported higher reserves and higher volume for 2008. Revenue royalties give SBR a free carry on investment made by others who apparently found it worthwhile to do more drilling on SBR's proven lands or



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on land not previously proven. **CRT** registered an increase in reserves on oil properties in which it holds revenue royalties. **PBT** registered increases on both oil and gas properties subject to revenue royalties. The partnership, **DMLP**, which operates with the restrictions and tax benefits of a royalty trust, scored gains on revenue royalty properties under development by its limited partner. When those gains are added to gains on properties already reported in the partnership, overall reserves increased as well.

Reported reserves on revenue royalty properties include multiple layers of conservatism. Part of the reason is that revenue royalty owners seldom have access to property information beyond the disclosures of volume produced which must be reported. Engineers making estimates of reserves may rely primarily on extrapolated production by well or groups of wells with no information about new wells that might be drilled. Accordingly, the reported reserves of revenue royalty properties include no noticeable quantities in the proved undeveloped category (colloquially known as "PUD's") that typically account for a third of proven reserves of operating companies.

On one hand, reported reserves can cause investors to underestimate the true value of revenue royalties. On the other hand, there is a tax advantage to unit holders of conservative reporting. It translates to a higher rate of depletion that increases the rate at which cost of purchase can shelter current distribution from taxation.

Mesa Royalty Trust to Cure Reporting Deficiency

Look for a new reserve report shortly from truly small market cap MTR. A year ago, ConocoPhillips, the operator of the trust's properties in the San Juan Basin apparently declined to furnish a reserve estimate, a reasonable stance, in our opinion, considering potential legal liability. Instead we expect to see an estimate for 2008 from an independent engineer like DeGolyer & MacNaughton, the trust's original engineer when MTR was formed in 1979. In the meantime, the New York Stock Exchange has issued repeated non-compliance notices for failure to provide such disclosure. The dire notices may have contributed, needlessly, we believe, to a lack of confidence accompanying the recent stock price collapse.

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Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

March 13, 2009

Table 1										
McDep Income and Small Cap Energy Portfolio										
Debt, Business Segments and Income Yield										
						Present Value				
		Price				by Segment (%)				
	Symbol/Rating	(US\$/sh)	EV/	Enterprise	NAmer.		Dist.	Dist.		
	B = Buy	13-Mar	Market	Value	Natural	Oil	NTM	Yield	McDep	
	H = Hold	2009	Cap	(\$mm)	Gas	Prod'n	(\$/un)	(%)	Ratio	
Canadian Income Trusts (US\$)										
Pengrowth Energy Trust	PGH	5.10	2.20	2,900	35	65	0.94	18.4	0.51	
Penn West Energy Trust	PWE	H 8.22	2.01	6,800	30	70	2.16	26.2	0.50	
Canadian Oil Sands Trust	COSWF	B 17.91	1.12	9,700		100	0.46	2.6	0.45	
Enerplus Resources Fund	ERF	15.24	1.30	3,300	56	44	1.69	11.1	0.41	
<i>Total or Median</i>				22,700						
Small Cap Independent Producers										
Encore Acquisition Company	EAC	H 20.50	2.05	2,210	26	74	-	-	0.64	
Berry Petroleum Company	BRY	H 7.28	4.73	1,560	41	59	0.30	4.1	0.51	
Birchcliff Energy Ltd. (US\$)	BIR.TO	4.03	1.39	650	75	25	-	-	0.48	
Cimarex Energy Company	XEC	B 17.87	1.58	2,350	66	34	0.24	1.3	0.43	
<i>Total or Median</i>				6,770						
U.S. Royalty Trusts										
Sabine Royalty Trust	SBR	29.95	1.00	440	54	46	2.60	8.7	0.64	
Permian Basin RT	PBT	9.51	1.00	440	33	67	0.86	9.1	0.50	
San Juan Basin Royalty Trust	SJT	H 14.53	1.00	680	100	-	1.23	8.5	0.43	
Cross Timbers Royalty Trust	CRT	17.17	1.00	100	76	24	2.15	12.5	0.41	
Mesa RoyaltyTrust	MTR	23.39	1.00	40	75	25	2.86	12.2	0.35	
Hugoton RoyaltyTrust	HGT	B 8.92	1.00	360	91	9	0.87	9.7	0.32	
<i>Total or Median</i>				2,060						
U.S. Master Limited Partnerships (MLPs)										
Linn Energy, LLC	LINE	14.37	2.07	3,380	48	52	2.52	17.5	1.01	
Encore Energy Partners, L.P. (3	ENP	15.02	1.25	200	34	66	2.00	13.3	0.91	
Dorchester Minerals, L.P.	DMLP	16.15	1.00	460	68	32	1.42	8.8	0.67	
<i>Total or Median</i>				4,040						
Composite (excl COSWF)										
<i>Enterprise Value Weighting</i>				25,900	45	55			0.52	
<i>Equal Weighting</i>					57	43			0.54	
<i>Equal Weighted Buys</i>					69	31			0.38	
* Percentages in Symbol column refer to current market Enterprise Value weightings; Rating column, equal weightings.										
* Percentages in Price column refer to equal weighted buys.										



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

March 13, 2009

Table 2								
Oil and Gas Income and Small Cap Stocks								
Net Present Value and McDep Ratio								
			Price (\$/sh)		Market Cap (\$mm)	Net Present Value (\$/un)	Debt/ Present Value	McDep Ratio
	Symbol/ Rating		13-Mar 2009	Shares (mm)				
Canadian Income Trusts (US\$)								
Pengrowth Energy Trust	PGH		5.10	255.5	1,300	16.00	0.28	0.51
Penn West Energy Trust	PWE	H	8.22	410.0	3,370	25.00	0.25	0.50
Canadian Oil Sands Trust	COSWF	B	17.91	482.0	8,630	42.00	0.05	0.45
Enerplus Resources Fund	ERF		15.24	165.3	2,520	44.00	0.09	0.41
<i>Total or Median</i>					15,800		0.17	0.48
Small Cap Independent Producers								
Encore Acquisition Company	EAC	H	20.50	52.6	1,080	44.00	0.33	0.64
Berry Petroleum Company	BRY	H	7.28	45.2	330	40.00	0.40	0.51
Birchcliff Energy Ltd. (US\$)	BIR.TO		4.03	117.0	470	10.00	0.13	0.48
Cimarex Energy Company	XEC	B	17.87	83.2	1,490	55.00	0.16	0.43
<i>Total or Median</i>					3,370		0.24	0.50
U.S. Royalty Trusts								
Sabine Royalty Trust	SBR		29.95	14.6	440	47.00	-	0.64
Permian Basin RT	PBT		9.51	46.6	440	19.00	-	0.50
San Juan Basin Royalty Trust	SJT	H	14.53	46.6	680	34.00	-	0.43
Cross Timbers Royalty Trust	CRT		17.17	6.0	100	42.00	-	0.41
Mesa Royalty Trust	MTR		23.39	1.9	40	67.00	-	0.35
Hugoton Royalty Trust	HGT	B	8.92	40.0	360	28.00	-	0.32
<i>Total or Median</i>					2,060			0.42
U.S. Master Limited Partnerships (MLPs)								
Linn Energy, LLC	LINE		14.37	114.0	1,640	14.00	0.52	1.01
Encore Energy Partners, L.P. (32%)	ENP		15.02	10.6	160	17.00	0.18	0.91
Dorchester Minerals, L.P.	DMLP		16.15	28.2	460	24.00	-	0.67
<i>Total or Median</i>					2,260		0.18	0.91
B = Buy, H = Hold								
McDep Ratio = Market cap and Debt to present value of oil and gas and other businesses								
Present Value presumes long-term prices of \$75 a barrel for oil and \$10 a million btu for natural gas.								



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

March 13, 2009

Table 3								
Oil and Gas Income and Small Cap Stocks								
Value Multiples - Rank by EV/Ebitda								
			Price (\$/sh)	Adjstd Resrvs/ Prod	PV/ Ebitda	EV/ Ebitda	Revenue Royalty (%)	Dist/ Equity Ebitda
	Symbol/ Rating		13-Mar 2009	NTM	NTM	NTM		
Canadian Income Trusts (US\$)								
Canadian Oil Sands Trust	COSWF	B	17.91	23.3	23.2	10.6		0.26
Pengrowth Energy Trust	PGH		5.10	7.8	16.1	8.2		0.94
Penn West Energy Trust	PWE	H	8.22	8.2	12.0	6.0		1.04
Enerplus Resources Fund	ERF		15.24	8.9	12.8	5.2		0.49
	<i>Median</i>			8.5	14.4	7.1		
Small Cap Independent Producers								
Birchcliff Energy Ltd. (US\$)	BIR.TO		4.03	6.9	28.6	13.8		-
Berry Petroleum Company	BRY		7.28	11.2	17.5	9.0		-
Encore Acquisition Company	EAC		20.50	11.4	11.4	7.3		-
Cimarex Energy Company	XEC	B	17.87	7.3	9.9	4.3		-
	<i>Median</i>			9.3	14.4	8.1		
U.S. Royalty Trusts								
Sabine Royalty Trust	SBR		29.95	9.6	18.1	11.5	100	1.00
Permian Basin RT	PBT		9.51	10.4	18.9	9.5	32	0.86
San Juan Basin Royalty Trust	SJT	H	14.53	8.9	21.8	9.3		0.79
Cross Timbers Royalty Trust	CRT		17.17	12.2	18.4	7.5	84	0.94
Hugoton Royalty Trust	HGT	B	8.92	12.1	22.1	7.1		0.69
Mesa Royalty Trust	MTR		23.39	22.6	20.4	7.2		0.87
	<i>Median</i>			11.3	19.7	8.4		
U.S. Master Limited Partnerships (MLPs)								
Linn Energy, LLC	LINE		14.37	17.7	27.2	27.5		4.89
Encore Energy Partners, L.P.	ENP		15.02	10.9	15.0	13.6		1.77
Dorchester Minerals, L.P.	DMLP		16.15	8.2	15.9	10.7	64	0.94
	<i>Median</i>			10.9	15.9	13.6		
EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended March 31, 2010; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses								



Income and Small Cap Weekly

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