



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

May 29, 2009

## Deal Conditions Ripe

### Summary and Recommendation

Conditions may be ripe for a U.S. income stock deal in which high McDep Ratio **Linn Energy (LINE)**, for example, offers shares for a low McDep Ratio royalty trust such as buy-recommended **Hugoton Royalty Trust (HGT)**, hold-rated **San Juan Basin Royalty Trust (SJT)** or one or more of its peers. The spread in McDep Ratios from 1.2 for the prospective acquirer to less than 0.7 for the possible targets appears unusually wide for stocks with similar characteristics. The prospective acquirer can offer a premium to the target and score an increase in Net Present Value (NPV) per share if the deal can be completed. A reasonable offer need not be considered unfriendly as target unitholders who choose not to sell can continue to participate in the ongoing trust with the same trustee. Today's publicly held units of **Mesa Royalty Trust (MTR)** and **Permian Basin Royalty Trust (PBT)** are those which were not tendered in past acquisition attempts. Coincidentally the president and some of the top professionals at Linn are alumni of Burlington Resources which made the tender offer for PBT and once operated the underlying properties for both PBT and SJT. Linn's motivation to do such a transaction would be to take advantage of its strength, a high stock price, to acquire cash flow that would better support its high debt and spread its high cost of talent over a bigger base. While the deal logic we outline may not lead to a transaction, it highlights the degree to which some high-quality income stocks are out of favor, a condition likely to change as investor confidence rebuilds.

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Table 1										
McDep Income and Small Cap Energy Portfolio										
Debt, Business Segments and Income Yield										
						Present Value by Segment (%)				
	Symbol/Rating	Price (US\$/sh)	EV/ Market	Enterprise Value (\$mm)	NAmer. Natural Gas	Oil Prod'n	Dist. NTM (\$/un)	Dist. Yield (%)	McDep Ratio	
	B = Buy H = Hold	28-May 2009	Cap							
<b>Canadian Income Trusts (US\$)</b>										
Freehold Royalty Trust	FRHLF	11.98	1.24	740	29	21	1.07	8.9	0.71	
Peyto Energy Trust	PEYUF	9.83	1.40	1,450	79	21	1.29	13.1	0.69	
Pengrowth Energy Trust	PGH	8.60	1.83	4,000	39	61	1.07	12.5	0.68	
Penn West Energy Trust	PWE	H	13.27	1.76	9,300	32	68	1.61	12.1	0.67
Canadian Oil Sands Trust	COSWF	B	24.93	1.10	13,200		100	0.54	2.1	0.62
Enerplus Resources Fund	ERF		23.09	1.22	4,700	45	55	1.93	8.4	0.58
<i>Total or Median</i>					33,400					
<b>Small Cap Independent Producers</b>										
Encore Acquisition Company	EAC	B	35.02	1.61	3,000	23	77	-	-	0.86
Berry Petroleum Company	BRY	H	18.99	2.14	1,820	38	62	0.30	1.6	0.66
Cimarex Energy Company	XEC	B	31.75	1.34	3,460	67	33	0.24	0.8	0.65
Birchcliff Energy Ltd. (US\$)	BIREF		5.52	1.39	860	70	30	-	-	0.63
<i>Total or Median</i>					9,140					
<b>U.S. Royalty Trusts</b>										
Cross Timbers Royalty Trust	CRT		24.50	1.00	150	69	31	1.58	6.4	0.77
Sabine Royalty Trust	SBR		39.40	1.00	570	43	57	2.48	6.3	0.66
San Juan Basin Royalty Trust	SJT	H	16.76	1.00	780	100	-	0.79	4.7	0.64
Permian Basin RT	PBT		10.79	1.00	500	33	67	0.85	7.8	0.57
Hugoton Royalty Trust	HGT	B	13.14	1.00	530	91	9	0.67	5.1	0.47
Mesa Royalty Trust	MTR		26.40	1.00	50	75	25	2.97	11.3	0.39
<i>Total or Median</i>					2,580					
<b>U.S. Master Limited Partnerships (MLPs)</b>										
Linn Energy, LLC	LINE		19.40	1.64	3,620	53	47	2.52	13.0	1.20
Encore Energy Partners, L.P. (3)	ENP		15.74	1.29	210	24	76	2.00	12.7	0.94
Dorchester Minerals, L.P.	DMLP		19.64	1.00	560	51	49	1.36	6.9	0.61
<i>Total or Median</i>					4,390					
<b>Composite (excl COSWF)</b>										
<i>Enterprise Value Weighting</i>					39,200	46	54			0.72
<i>Equal Weighting</i>						53	47			0.69
<i>Equal Weighted Buys</i>						50	50			0.66
* Percentages in Symbol column refer to current market Enterprise Value weightings; Rating column, equal weightings.										
* Percentages in Price column refer to equal weighted buys.										



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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		28-May 2009	Shares (mm)				
<b>Canadian Income Trusts (US\$)</b>								
Freehold Royalty Trust	FRHLF		11.98	49.5	590	18.00	0.14	0.71
Peyto Energy Trust	PEYUF		9.83	105.9	1,040	16.00	0.20	0.69
Pengrowth Energy Trust	PGH		8.60	257.0	2,210	16.00	0.31	0.68
Penn West Energy Trust	PWE	H	13.27	398.4	5,290	25.00	0.29	0.67
Canadian Oil Sands Trust	COSWF	B	24.93	482.2	12,020	42.00	0.06	0.62
Enerplus Resources Fund	ERF		23.09	165.7	3,830	44.00	0.11	0.58
<i>Total or Median</i>					25,000		0.17	0.67
<b>Small Cap Independent Producers</b>								
Encore Acquisition Company	EAC	B	35.02	53.3	1,870	44.00	0.33	0.86
Berry Petroleum Company	BRY	H	18.99	44.6	850	40.00	0.35	0.66
Cimarex Energy Company	XEC	B	31.75	81.7	2,590	55.00	0.16	0.65
Birchcliff Energy Ltd. (US\$)	BIREF		5.52	112.0	620	10.00	0.18	0.63
<i>Total or Median</i>					5,930		0.25	0.65
<b>U.S. Royalty Trusts</b>								
Cross Timbers Royalty Trust	CRT		24.50	6.0	150	32.00	-	0.77
Sabine Royalty Trust	SBR		39.40	14.6	570	60.00	-	0.66
San Juan Basin Royalty Trust	SJT	H	16.76	46.6	780	26.00	-	0.64
Permian Basin RT	PBT		10.79	46.6	500	19.00	-	0.57
Hugoton Royalty Trust	HGT	B	13.14	40.0	530	28.00	-	0.47
Mesa Royalty Trust	MTR		26.40	1.9	50	67.00	-	0.39
<i>Total or Median</i>					2,580			0.61
<b>U.S. Master Limited Partnerships (MLPs)</b>								
Linn Energy, LLC	LINE		19.40	114.0	2,210	14.00	0.47	1.20
Encore Energy Partners, L.P. (32%)	ENP		15.74	10.6	170	17.00	0.21	0.94
Dorchester Minerals, L.P.	DMLP		19.64	28.2	560	32.00	-	0.61
<i>Total or Median</i>					2,940		0.21	0.94
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.								



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Table 3									
Oil and Gas Income and Small Cap Stocks									
Value Multiples - Rank by EV/Ebitda									
			Price (\$/sh)	Revenue	Dist/ Equity	Adjstd Resrvs/ Prod	PV/ Ebitda	EV/ Ebitda	
	Symbol/ Rating		28-May 2009	Royalty (%)	Ebitda	NTM	NTM	NTM	
<b>Canadian Income Trusts (US\$)</b>									
	Canadian Oil Sands Trust	COSWF	B	24.93		0.24	23.2	18.8	11.6
	Peyto Energy Trust	PEYUF		9.83		1.21	16.9	15.0	10.3
	Pengrowth Energy Trust	PGH		8.60		0.89	7.6	13.3	9.0
	Enerplus Resources Fund	ERF		23.09		0.65	9.1	14.9	8.6
	Freehold Royalty Trust	FRHLF		11.98	71	0.70	6.2	11.7	8.3
	Penn West Energy Trust	PWE	H	13.27		0.66	8.1	10.3	6.8
	<i>Median</i>						8.6	14.1	8.8
<b>Small Cap Independent Producers</b>									
	Birchcliff Energy Ltd. (US\$)	BIREF		5.52		-	10.0	28.3	17.9
	Encore Acquisition Company	EAC	B	35.02		-	11.5	11.1	9.6
	Berry Petroleum Company	BRY	H	18.99		-	11.3	11.6	7.6
	Cimarex Energy Company	XEC	B	31.75		-	7.1	9.2	5.9
	<i>Median</i>						10.7	11.3	8.6
<b>U.S. Royalty Trusts</b>									
	Sabine Royalty Trust	SBR		39.40	100	1.00	9.8	24.2	15.9
	San Juan Basin Royalty Trust	SJT	H	16.76		0.67	9.0	22.2	14.3
	Cross Timbers Royalty Trust	CRT		24.50	84	0.92	12.6	18.6	14.2
	Hugoton Royalty Trust	HGT	B	13.14		0.56	12.9	23.6	11.1
	Permian Basin RT	PBT		10.79	32	0.86	10.7	19.2	10.9
	Mesa Royalty Trust	MTR		26.40		0.87	13.5	19.7	7.7
	<i>Median</i>						11.6	20.9	12.6
<b>U.S. Master Limited Partnerships (MLPs)</b>									
	Linn Energy, LLC	LINE		19.40		4.90	18.1	27.2	32.8
	Dorchester Minerals, L.P.	DMLP		19.64	64	0.94	8.1	22.1	13.6
	Encore Energy Partners, L.P.	ENP		15.74		1.64	11.4	14.0	13.1
	<i>Median</i>						11.4	22.1	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									



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