



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

February 11, 2011

## China Buys Natural Gas in Canada

### Summary and Recommendation

Buy-recommended large cap **PetroChina (PTR)** announced a \$5.4 billion purchase of natural gas resources from large cap buy-recommended **Encana (ECA)** in a pending transaction that fits our McDep strategy for long-term investment in natural gas and oil. It is entirely logical that the world's largest energy consuming country, China, would invest in the world's cheapest source of clean energy, North American natural gas. The price to be paid appears to cover, with room to spare, the McDep present value for ECA when allocated to the assets in the deal, primarily ECA's Montney shale gas/tight gas play along the border of Alberta and British Columbia. Investors can match the strategy in the income and small cap stocks we cover with emphasis on current buy recommendations. Specifically, **Birchcliff Energy (BIREF)** is a pure play in the same Montney trend and is available at a discount in the stock market at a McDep Ratio of 0.77 (see [Tables 1-2](#) on pages 2-3). BIREF and all our stocks are priced lower by unlevered cash flow multiple, EV/Ebitda, than the apparent 24 that PTR would pay ECA (see [Table 3](#) on page 4). Though natural gas price has been under pressure, confidence and values are rising with stock prices in an uptrend (see [Table 4](#) on page 5). Finally, on a short-term basis, natural gas in storage is depleting more rapidly than usual, which may suggest better pricing ahead (see chart on page 8).

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	10-Feb	Market	Value	Nat	Ebitda	NTM	Yield	McDep			
CB (see below)	2011	Cap	(\$mm)	Gas	Oil	NTM	(\$/un)	(%)	Ratio		
<b>Small Cap Independent Producers</b>											
Cimarex Energy Company	XEC	B	105.66	1.07	9,700	50	50	8.3	0.32	0.3	1.05
Range Resources	RRC	B	48.88	1.27	9,770	77	23	16.1	0.16	0.3	0.98
Denbury Resources Inc.	DNR		21.32	1.40	11,960	12	88	9.1	-	-	0.98
Berry Petroleum Company	BRY		45.06	1.43	3,500	26	74	8.8	0.30	0.7	0.97
Peyto Exploration and Development	PEYUF		18.77	1.20	2,740	69	31	13.0	0.73	3.9	0.95
Ultra Petroleum	UPL		47.45	1.20	8,790	90	10	12.2	-	-	0.93
Petrohawk Energy Corporation	HK	B	20.33	1.55	9,540	92	8	11.3	-	-	0.90
Whiting Petroleum Corporation	WLL		122.95	1.16	8,430	11	89	7.3	-	-	0.84
Birchcliff Energy Ltd.	BIREF	B	11.79	1.23	1,840	62	38	13.5	-	-	0.77
<i>Total or Median</i>					66,300			11.3		-	0.95
<b>Top Line Cash Payers</b>											
Cross Timbers Royalty Trust	CRT		45.81	1.00	280	69	31		2.73	6.0	1.24
Sabine Royalty Trust	SBR		63.29	1.00	920	38	62		4.08	6.4	1.07
Freehold Royalties Ltd.	FRHLF		21.31	1.07	1,330	20	80		1.70	8.0	0.97
Permian Basin RT	PBT		20.43	1.00	950	31	69		1.57	7.7	0.93
Dorchester Minerals, L.P.	DMLP	B	27.41	1.02	860	60	40		1.79	6.5	0.92
<i>Total or Median</i>					4,300					6.5	0.97
<b>Bottom Line Cash Payers</b>											
Linn Energy, LLC	LINE		38.11	1.40	7,810	38	62	18.5	2.64	6.9	1.23
Vanguard Natural Resources, LLC	VNR		31.15	1.37	1,270	31	69	10.7	2.24	7.2	1.11
Legacy Reserves L.P.	LGCY		29.15	1.33	1,550	13	87	11.2	2.08	7.1	1.03
Hugoton Royalty Trust	HGT	B	21.57	1.00	860	86	14	13.8	1.34	6.2	0.98
Encore Energy Partners, L.P.	ENP		22.38	1.24	1,260	19	81	10.3	2.00	8.9	0.98
San Juan Basin Royalty Trust	SJT	CB	23.98	1.00	1,120	100	-	13.7	1.43	6.0	0.96
Pengrowth Energy Corporation	PGH		12.34	1.37	5,100	29	71	8.1	0.84	6.8	0.91
Mesa Royalty Trust	MTR		47.24	1.00	88	75	25	11.9	3.61	7.6	0.89
Enerplus Corporation	ERF		31.12	1.19	6,600	34	66	8.2	2.16	6.9	0.86
<i>Total or Median</i>					25,700			11.2		6.9	0.98
<b>Composite</b>											
<i>Enterprise Value Weighting</i>					96,300	48	52				0.96
<i>Equal Weighting</i>						49	51				0.98
<i>Equal Weighted Buys</i>						73	27				0.94

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 December 31, 2011. 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**

			<i>Price</i>			<i>Net</i>		
			<i>(\$/sh)</i>		<i>Market</i>	<i>Present</i>	<i>Debt/</i>	
	<i>Symbol/</i>		<i>10-Feb</i>	<i>Shares</i>	<i>Cap</i>	<i>Value</i>	<i>Present</i>	<i>McDep</i>
	<i>Rating</i>		<i>2011</i>	<i>(mm)</i>	<i>(\$mm)</i>	<i>(\$/un)</i>	<i>Value</i>	<i>Ratio</i>
<b>Small Cap Independent Producers</b>								
Cimarex Energy Company	XEC	B	105.66	85.8	9,070	100.00	0.07	1.05
Range Resources	RRC	B	48.88	157.1	7,680	50.00	0.21	0.98
Denbury Resources Inc.	DNR		21.32	401.0	8,550	22.00	0.28	0.98
Berry Petroleum Company	BRY		45.06	54.4	2,450	47.00	0.29	0.97
Peyto Exploration and Development Corp	PEYUF		18.77	121.8	2,290	20.00	0.16	0.95
Ultra Petroleum	UPL		47.45	154.0	7,310	52.00	0.16	0.93
Petrohawk Energy Corporation	HK	B	20.33	302.0	6,140	24.00	0.32	0.90
Whiting Petroleum Corporation	WLL		122.95	59.0	7,250	150.00	0.12	0.84
Birchcliff Energy Ltd.	BIREF	B	11.79	127.3	1,500	16.00	0.14	0.77
<i>Total or Median</i>					<i>52,240</i>		<i>0.16</i>	<i>0.95</i>
<b>Top Line Cash Payers</b>								
Cross Timbers Royalty Trust	CRT		45.81	6.0	280	37.00	-	1.24
Sabine Royalty Trust	SBR		63.29	14.6	920	59.00	-	1.07
Freehold Royalties Ltd.	FRHLF		21.31	58.4	1,250	22.00	0.06	0.97
Permian Basin RT	PBT		20.43	46.6	950	22.00	-	0.93
Dorchester Minerals, L.P.	DMLP	B	27.41	30.7	840	30.00	0.02	0.92
<i>Total or Median</i>					<i>4,240</i>			<i>0.97</i>
<b>Bottom Line Cash Payers</b>								
Linn Energy, LLC	LINE		38.11	146.5	5,580	28.00	0.35	1.23
Vanguard Natural Resources, LLC	VNR		31.15	29.8	930	27.00	0.30	1.11
Legacy Reserves L.P.	LGCY		29.15	40.1	1,170	28.00	0.25	1.03
Hugoton Royalty Trust	HGT	B	21.57	40.0	860	22.00	-	0.98
Encore Energy Partners, L.P.	ENP		22.38	45.3	1,010	23.00	0.19	0.98
San Juan Basin Royalty Trust	SJT	CB	23.98	46.6	1,120	25.00	-	0.96
Pengrowth Energy Corporation	PGH		12.34	299.0	3,690	14.00	0.25	0.91
Mesa Royalty Trust	MTR		47.24	1.9	88	53.00	-	0.89
Enerplus Corporation	ERF		31.12	177.5	5,520	37.00	0.14	0.86
<i>Total or Median</i>					<i>19,970</i>			<i>0.98</i>

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

			<i>Price</i>	<i>Revenue</i>	<i>Dist/</i>	<i>Adjstd</i>	<i>PV/</i>	<i>EV/</i>
	<i>Symbol/</i>		<i>10-Feb</i>	<i>Royalty</i>	<i>Equity</i>	<i>Prod</i>	<i>Ebitda</i>	<i>Ebitda</i>
	<i>Rating</i>		<i>2011</i>	<i>(%)</i>	<i>Ebitda</i>	<i>NTM</i>	<i>NTM</i>	<i>NTM</i>
<b>Small Cap Independent Producers</b>								
Range Resources	RRC	B	48.88		-	16.8	16.4	16.1
Birchcliff Energy Ltd.	BIREF	B	11.79		-	17.6	17.4	13.5
Peyto Exploration and Development Corp	PEYUF		18.77		0.50	17.3	13.7	13.0
Ultra Petroleum	UPL		47.45		-	12.6	13.1	12.2
Petrohawk Energy Corporation	HK	B	20.33		-	8.8	12.6	11.3
Denbury Resources Inc.	DNR		21.32		-	12.9	9.3	9.1
Berry Petroleum Company	BRY		45.06		-	11.3	9.0	8.8
Cimarex Energy Company	XEC	B	105.66		-	6.2	7.9	8.3
Whiting Petroleum Corporation	WLL		122.95		-	9.3	8.7	7.3
	<i>Median</i>					<i>12.6</i>	<i>12.6</i>	<i>11.3</i>
<b>Top Line Cash Payers</b>								
Cross Timbers Royalty Trust	CRT		45.81	84	0.96	13.1	13.1	16.2
Sabine Royalty Trust	SBR		63.29	100	1.00	7.8	14.5	15.5
Dorchester Minerals, L.P.	DMLP	B	27.41	77	0.90	6.7	15.0	13.7
Permian Basin RT	PBT		20.43	32	0.94	13.2	13.2	12.2
Freehold Royalties Ltd.	FRHLF		21.31	71	0.85	8.1	11.0	10.6
	<i>Median</i>					<i>8.1</i>	<i>13.2</i>	<i>13.7</i>
<b>Bottom Line Cash Payers</b>								
Linn Energy, LLC	LINE		38.11		1.42	18.3	15.0	18.5
Hugoton Royalty Trust	HGT	B	21.57		0.86	12.6	14.0	13.8
San Juan Basin Royalty Trust	SJT	CB	23.98		0.82	13.6	14.3	13.7
Mesa Royalty Trust	MTR		47.24		0.91	8.7	13.4	11.9
Legacy Reserves L.P.	LGCY		29.15		0.81	12.0	10.9	11.2
Vanguard Natural Resources, LLC	VNR		31.15		0.80	13.0	9.7	10.7
Encore Energy Partners, L.P.	ENP		22.38		0.92	13.5	10.6	10.3
Enerplus Corporation	ERF		31.12		0.55	9.7	9.5	8.2
Pengrowth Energy Corporation	PGH		12.34		0.53	9.6	8.9	8.1
	<i>Median</i>					<i>12.6</i>	<i>10.9</i>	<i>11.2</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 December 31, 2011; 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

	Symbol/	Rating	Price (\$/sh)		Enterprise Value/			McDep Ratio
			10-Feb 2011	52Wk High	52Wk Low	50 Day Avg.	200 Day Avg.	
<b>Small Cap Independent Producers</b>								
Cimarex Energy Company	XEC	B	105.66	0.99	1.88	1.13	1.33	1.05
Whiting Petroleum Corporation	WLL		122.95	0.96	1.67	1.04	1.21	0.84
Birchcliff Energy Ltd.	BIREF	B	11.79	0.96	1.40	1.12	1.20	0.77
Berry Petroleum Company	BRY		45.06	0.95	1.48	1.02	1.20	0.97
Peyto Exploration and Development Co	PEYUF		18.77	0.95	1.52	1.01	1.17	0.95
Denbury Resources Inc.	DNR		21.32	0.98	1.36	1.07	1.16	0.98
Range Resources	RRC	B	48.88	0.92	1.37	1.05	1.13	0.98
Petrohawk Energy Corporation	HK	B	20.33	0.90	1.26	1.04	1.08	0.90
Ultra Petroleum	UPL		47.45	0.90	1.22	1.00	1.05	0.93
	<i>Median</i>			0.95	1.40	1.04	1.17	0.95
<b>Top Line Cash Payers</b>								
Cross Timbers Royalty Trust	CRT		45.81	0.99	1.63	1.09	1.21	1.24
Freehold Royalties Ltd.	FRHLF		21.31	0.95	1.44	1.03	1.19	0.97
Sabine Royalty Trust	SBR		63.29	0.97	1.49	1.05	1.17	1.07
Dorchester Minerals, L.P.	DMLP	B	27.41	0.93	1.33	1.01	1.04	0.92
Permian Basin RT	PBT		20.43	0.86	1.42	0.92	1.02	0.93
	<i>Median</i>			0.95	1.44	1.03	1.17	0.97
<b>Bottom Line Cash Payers</b>								
Enerplus Corporation	ERF		31.12	0.94	1.88	1.00	1.17	0.86
Vanguard Natural Resources, LLC	VNR		31.15	0.98	1.50	1.05	1.16	1.11
Linn Energy, LLC	LINE		38.11	0.97	1.92	1.01	1.14	1.23
Encore Energy Partners, L.P.	ENP		22.38	0.95	1.86	1.02	1.12	0.98
Legacy Reserves L.P.	LGCY		29.15	0.96	1.41	1.03	1.12	1.03
Pengrowth Energy Corporation	PGH		12.34	0.93	1.93	0.97	1.08	0.91
Hugoton Royalty Trust	HGT	B	21.57	0.97	1.44	1.04	1.08	0.98
Mesa Royalty Trust	MTR		47.24	0.87	1.29	0.97	1.00	0.89
San Juan Basin Royalty Trust	SJT	CB	23.98	0.84	1.22	0.99	0.99	0.96
	<i>Median</i>			0.95	1.50	1.01	1.12	0.98

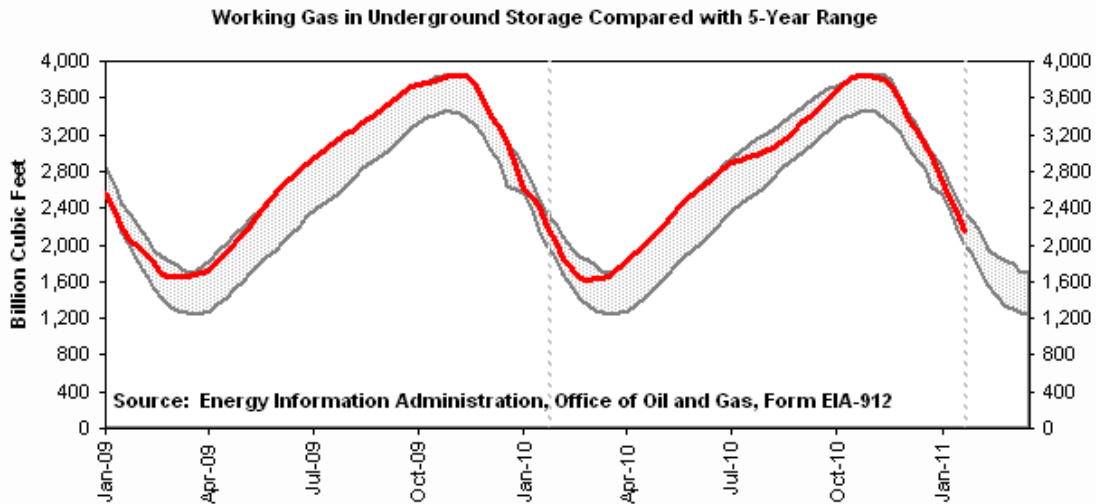
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