



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

March 25, 2011

On Course to \$200 a Barrel by November 2012

Summary and Recommendation

Buy recommendations remain in place for now despite some favorites trading above a McDep Ratio of 1.0 because we see oil and natural gas price trending to higher levels than incorporated in McDep Ratios currently. Nonetheless, investors whose portfolio representation in oil and gas income and small cap stocks exceeds targeted overweight levels might reasonably sell enough shares to rebalance to target positions. Since oil is still a long way from \$200 a barrel, we are not considering any reduction in the target percentage. We encourage investors not well represented in buy recommendations to build participation. Among peer stocks offering comparable attraction we raised estimated Net Present Value (NPV) for **Cross Timbers Royalty Trust (CRT)** to \$45 a unit from \$37 on the basis of expected distributions and higher reported reserves. An increase in NPV raises the denominator and lowers the McDep Ratio (see Tables 1-4).

Government Actions Befriend High Oil and Gas Price

Numerous examples support the rising energy price trend. Just in the last few days the U.K. government increased its punitive tax on oil producers to 32% from 20%. The U.K. “supplementary charge” is on top of normal income tax, thereby making it punitive. The change in rules chills investment in new oil production and is sure to reduce U.K. supply from what it would be otherwise. In a tight global market, the incremental effect is to drive global price higher.

In the U.S., new oil production from Canada and North Dakota is bottled up by the refusal of the U.S. government to permit new pipeline capacity to take oil out of the region to supply the rest of the U.S. As a result, the widely quoted price for crude oil traded in the U.S. futures market, currently \$105 a barrel, is some \$10-15 a barrel below the effective global price.

Similarly the virtual shutdown of deep water Gulf of Mexico drilling limits the future supply of oil from that prolific source. Government leaders exaggerate the impact of an accidental oil spill to justify a drilling prohibition that benefits oil companies with existing production. The effect once again is to encourage buyers to bid higher for long-term oil supply.

Government Actions on Oil Befriend Defense Industry

The demand for military equipment and spending arising from conflict in Libya has roots in the oil price controls of the 1970s. In one of our more memorable research pieces from the past, “Billions for Tribute”, August 1973, we credited Federal price controls with reducing domestic oil and gas production and arming Colonel Qaddafi by paying him several times what U.S. producers received for the equivalent amount of energy. Logically, the politician in charge of price controls, or the Economic Stabilization Program as it was called, went on to become



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

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Secretary of Defense twice. Sales of arms to Libya, financed by high oil price, in turn supported more Defense Department buying of arms for the U.S.

Government Monetary and Fiscal Policy Increases Supply of Dollars

To sustain high market oil price caused by government policies, government gives away dollars for consumers to apply to oil and other needs. Monetary policy managed by the Federal Reserve expands dollars in circulation by lending at rates below inflation or buying assets with money created by computer code. Fiscal policy in the form of Federal spending in excess of revenue uses borrowed funds to finance consumption of oil and other goods and services by persons who would not otherwise have the means to do so. As a result, with government actions reducing oil supply and government actions promoting oil demand by increasing the supply of dollars, the price of oil naturally rises.

No Change in Course Evident

The concept of a potential near-doubling to \$200 oil by November 2012 is inspired by history from thirty-two years ago. To get there, the price might rise by \$4-5 dollars a month allowing time to adjust expectations along the way. A three-fold rate of gain in 1979-1980 was snapped with the election of a new president in November 1980 and two years of recession in 1981 and 1982. By picking a lower target than what was achieved then in terms of percentage gain, we are suggesting that government policy may be able to avoid a strong recession.

By our strategy, we are likely to continue suggesting rebalancing should the trend continue as it appears now. If the course changes, global growth will likely continue to demand energy on a more moderate, but positive price trend. A recession would be a negative outcome, temporarily, but it has a low probability of occurring soon, as we see it.

Government Actions Also Cause Recessions

A reversal of the fiscal and monetary policies that promote high oil price can also cause a recession and a softening of oil price. Eighteen months of increasing interest rates, ultimately to double digit levels, eventually wore on inflation and oil price to end the trend of 1979-1980. An abrupt increase in taxes could have the same effect. Neither of those changes is in sight for now.

Natural Gas Price May Be Turning Up Slowly

Finally, the Japanese earthquake and tsunami reminds us that we can always be surprised. The failure of nuclear plants to withstand the natural calamity thereby releasing radiation diminishes the outlook for that energy source and enhances the outlook for natural gas as the most readily available economic alternative.



Income and Small Cap Weekly

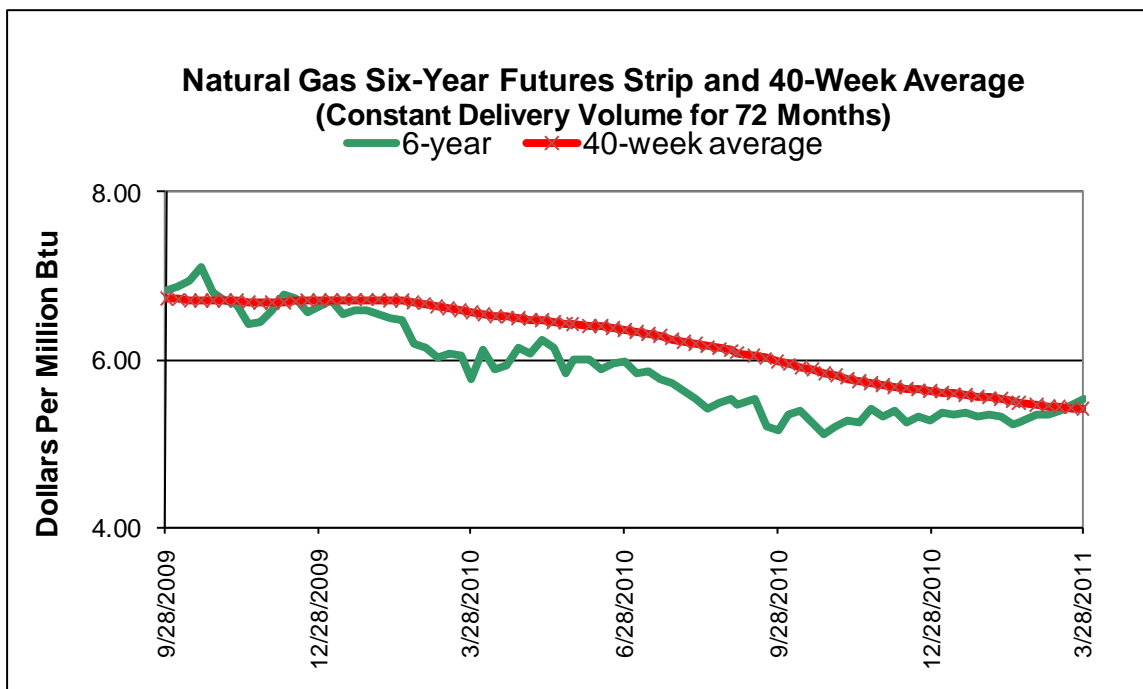
Analysis of Oil & Gas Stocks

March 25, 2011

Latest quote for natural gas for delivery over six years at \$5.54 a million btu remains above its 40-week average for the second week since the nuclear disaster (see chart below [Natural Gas Six-Year Futures Strip](#)). From a fundamental point of view the long term outlook for natural gas has strengthened irrefutably.

Natural gas in Europe and Asia has responded strongly in the short term. As North American producers develop export capability over the next three years and more, the global natural gas markets will become linked again and could then trade closer to the heating equivalent of oil.

Kurt H. Wulff, CFA





Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

March 25, 2011

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	24-Mar	Market	Value	Nat	Ebitda	NTM	Yield	McDep			
CB (see below)	2011	Cap	(\$mm)	Gas	Oil	NTM	(\$/un)	(%)	Ratio		
Small Cap Independent Producers											
Range Resources	RRC	B	55.00	1.27	11,020	70	30	15.6	0.16	0.3	1.08
Denbury Resources Inc.	DNR		24.02	1.35	13,070	12	88	8.9	-	-	1.07
Petrohawk Energy Corporation	HK	B	22.68	1.50	10,250	87	13	10.7	-	-	0.96
Whiting Petroleum Corporation	WLL		68.99	1.14	9,390	11	89	7.3	-	-	0.93
Cimarex Energy Company	XEC	B	110.05	1.07	10,090	45	55	7.3	0.30	0.3	0.92
Berry Petroleum Company	BRY		47.77	1.52	3,820	24	76	8.3	0.30	0.6	0.91
Peyto Exploration and Development	PEYUF		21.32	1.15	3,090	76	24	13.1	0.73	3.4	0.90
Ultra Petroleum	UPL		47.68	1.20	8,820	92	8	11.5	-	-	0.82
Birchcliff Energy Ltd.	BIREF	B	12.42	1.23	1,920	62	38	10.8	-	-	0.81
<i>Total or Median</i>					71,500			10.7		-	0.92
Top Line Cash Payers											
Sabine Royalty Trust	SBR		62.99	1.00	920	38	62		4.56	7.2	1.07
Cross Timbers Royalty Trust	CRT		48.03	1.00	290	75	25		2.97	6.2	1.07
Freehold Royalties Ltd.	FRHLF		22.88	1.06	1,420	20	80		1.71	7.5	1.04
Permian Basin RT	PBT		21.63	1.00	1,010	31	69		1.76	8.1	0.98
Dorchester Minerals, L.P.	DMLP	B	28.73	1.00	880	61	39		1.80	6.3	0.96
<i>Total or Median</i>					4,500					7.2	1.04
Bottom Line Cash Payers											
Linn Energy, LLC	LINE		39.16	1.42	8,260	36	64	15.6	2.64	6.7	1.25
Vanguard Natural Resources, LLC	VNR		32.22	1.59	1,660	28	72	12.9	2.24	7.0	1.11
Legacy Reserves L.P.	LGCY		31.14	1.31	1,630	13	87	10.7	2.10	6.7	1.08
San Juan Basin Royalty Trust	SJT	B	27.00	1.00	1,260	100	-	16.0	1.42	5.3	1.08
Hugoton Royalty Trust	HGT	B	23.46	1.00	940	89	11	15.4	1.29	5.5	1.07
Encore Energy Partners, L.P.	ENP		23.15	1.24	1,290	18	82	9.7	1.80	7.8	1.01
Pengrowth Energy Corporation	PGH		13.97	1.33	5,600	29	71	8.1	0.85	6.1	1.00
Mesa Royalty Trust	MTR		48.98	1.00	91	75	25	11.7	3.48	7.1	0.92
Enerplus Corporation	ERF		31.62	1.22	6,800	35	65	7.8	2.19	6.9	0.88
<i>Total or Median</i>					27,500			11.7		6.7	1.07
Composite											
<i>Enterprise Value Weighting</i>					103,500	46	54				0.98
<i>Equal Weighting</i>						49	51				1.00
<i>Equal Weighted Buys</i>						69	31				0.98

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 March 31, 2012. Enterprise Value = Market Cap and Debt.



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

March 25, 2011

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		24-Mar 2011	(mm)				
Small Cap Independent Producers								
Range Resources	RRC	B	55.00	157.0	8,640	50.00	0.23	1.08
Denbury Resources Inc.	DNR		24.02	402.0	9,660	22.00	0.28	1.07
Petrohawk Energy Corporation	HK	B	22.68	302.0	6,850	24.00	0.32	0.96
Whiting Petroleum Corporation	WLL		68.99	119.0	8,210	75.00	0.12	0.93
Cimarex Energy Company	XEC	B	110.05	85.8	9,440	120.00	0.06	0.92
Berry Petroleum Company	BRY		47.77	52.8	2,520	55.00	0.31	0.91
Peyto Exploration and Development Corp	PEYUF		21.32	125.7	2,680	24.00	0.12	0.90
Ultra Petroleum	UPL		47.68	154.0	7,340	60.00	0.14	0.82
Birchcliff Energy Ltd.	BIREF	B	12.42	126.0	1,560	16.00	0.15	0.81
<i>Total or Median</i>					56,900		0.15	0.92
Top Line Cash Payers								
Sabine Royalty Trust	SBR		62.99	14.6	920	59.00	-	1.07
Cross Timbers Royalty Trust	CRT		48.03	6.0	290	45.00	-	1.07
Freehold Royalties Ltd.	FRHLF		22.88	58.4	1,340	22.00	0.06	1.04
Permian Basin RT	PBT		21.63	46.6	1,010	22.00	-	0.98
Dorchester Minerals, L.P.	DMLP	B	28.73	30.7	880	30.00	-	0.96
<i>Total or Median</i>					4,440			1.04
Bottom Line Cash Payers								
Linn Energy, LLC	LINE		39.16	148.3	5,810	28.00	0.37	1.25
Vanguard Natural Resources, LLC	VNR		32.22	32.4	1,040	27.00	0.41	1.11
Legacy Reserves L.P.	LGCY		31.14	40.1	1,250	28.00	0.25	1.08
San Juan Basin Royalty Trust	SJT	B	27.00	46.6	1,260	25.00	-	1.08
Hugoton Royalty Trust	HGT	B	23.46	40.0	940	22.00	-	1.07
Encore Energy Partners, L.P.	ENP		23.15	45.0	1,040	23.00	0.19	1.01
Pengrowth Energy Corporation	PGH		13.97	299.0	4,180	14.00	0.25	1.00
Mesa Royalty Trust	MTR		48.98	1.9	91	53.00	-	0.92
Enerplus Corporation	ERF		31.62	178.0	5,630	37.00	0.16	0.88
<i>Total or Median</i>					21,240			1.07
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.								



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

March 25, 2011

Table ISC-3

McDep Income and Small Cap Energy Portfolio

Value Multiples - Rank by EV/Ebitda

			<i>Price</i>			<i>Adjstd</i>		
			<i>(\$/sh)</i>	<i>Revenue</i>	<i>Dist/</i>	<i>Resrvs/</i>	<i>PV/</i>	<i>EV/</i>
	<i>Symbol/</i>		<i>24-Mar</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>
Small Cap Independent Producers								
Range Resources	RRC	B	55.00		-	16.9	14.5	15.6
Peyto Exploration and Development Corp	PEYUF		21.32		0.44	19.7	14.6	13.1
Ultra Petroleum	UPL		47.68		-	27.1	14.0	11.5
Birchcliff Energy Ltd.	BIREF	B	12.42		-	20.2	13.3	10.8
Petrohawk Energy Corporation	HK	B	22.68		-	8.2	11.1	10.7
Denbury Resources Inc.	DNR		24.02		-	13.1	8.4	8.9
Berry Petroleum Company	BRY		47.77		-	11.9	9.2	8.3
Whiting Petroleum Corporation	WLL		68.99		-	10.7	7.9	7.3
Cimarex Energy Company	XEC	B	110.05		-	7.3	7.9	7.3
	<i>Median</i>					<i>13.1</i>	<i>11.1</i>	<i>10.7</i>
Top Line Cash Payers								
Cross Timbers Royalty Trust	CRT		48.03	80	0.97	13.7	14.7	15.7
Dorchester Minerals, L.P.	DMLP	B	28.73	77	0.87	7.6	14.5	13.9
Sabine Royalty Trust	SBR		62.99	100	1.00	7.7	12.9	13.8
Permian Basin RT	PBT		21.63	32	0.96	13.2	12.0	11.8
Freehold Royalties Ltd.	FRHLF		22.88	71	0.78	8.1	10.0	10.4
	<i>Median</i>					<i>8.1</i>	<i>12.9</i>	<i>13.8</i>
Bottom Line Cash Payers								
San Juan Basin Royalty Trust	SJT	B	27.00		0.84	9.1	14.8	16.0
Linn Energy, LLC	LINE		39.16		1.18	19.0	12.5	15.6
Hugoton Royalty Trust	HGT	B	23.46		0.85	13.3	14.5	15.4
Vanguard Natural Resources, LLC	VNR		32.22		0.96	13.1	11.6	12.9
Mesa Royalty Trust	MTR		48.98		0.83	8.8	12.7	11.7
Legacy Reserves L.P.	LGCY		31.14		0.74	11.9	9.9	10.7
Encore Energy Partners, L.P.	ENP		23.15		0.75	13.0	9.6	9.7
Pengrowth Energy Corporation	PGH		13.97		0.49	9.0	8.1	8.1
Enerplus Corporation	ERF		31.62		0.52	8.4	8.8	7.8
	<i>Median</i>					<i>11.9</i>	<i>11.6</i>	<i>11.7</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 March 31, 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).



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

March 25, 2011

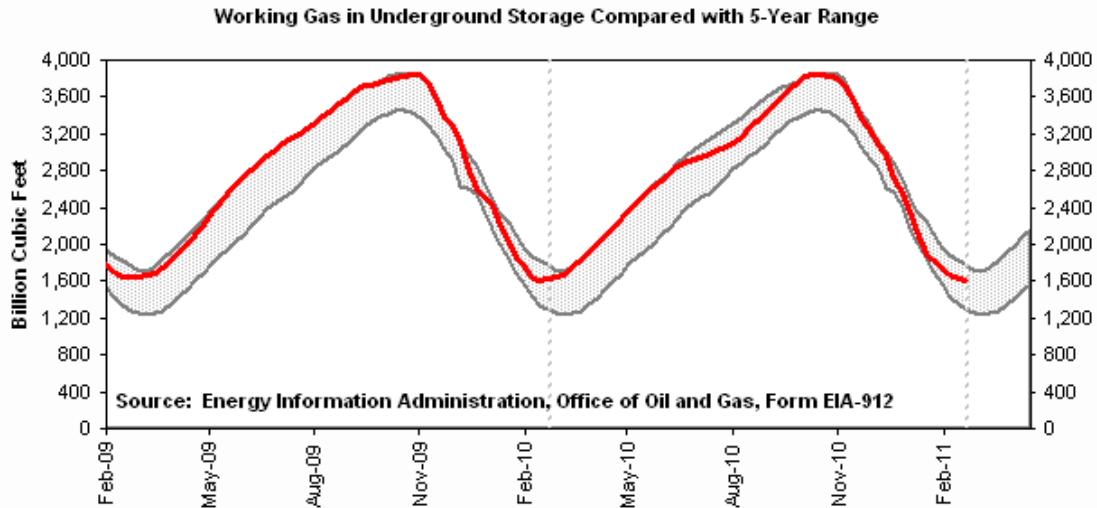
Table ISC-4									
Oil and Gas Income and Small Cap Stocks									
Rank by Enterprise Value to 200 Day Average									
			Price (\$/sh)	Enterprise Value/					
	Symbol/ Rating		24-Mar 2011	52Wk High	52Wk Low	50 Day Avg.	200 Day Avg.	McDep Ratio	
Small Cap Independent Producers									
	Cimarex Energy Company	XEC	B	110.05	0.94	1.84	1.03	1.29	0.92
	Whiting Petroleum Corporation	WLL		68.99	0.99	1.73	1.08	1.27	0.93
	Peyto Exploration and Development Co	PEYUF		21.32	1.00	1.72	1.09	1.24	0.90
	Denbury Resources Inc.	DNR		24.02	0.98	1.44	1.08	1.22	1.07
	Range Resources	RRC	B	55.00	0.99	1.48	1.09	1.22	1.08
	Birchcliff Energy Ltd.	BIREF	B	12.42	0.98	1.45	1.06	1.21	0.81
	Berry Petroleum Company	BRY		47.77	0.94	1.48	1.01	1.18	0.91
	Petrohawk Energy Corporation	HK	B	22.68	0.97	1.35	1.07	1.15	0.96
	Ultra Petroleum	UPL		47.68	0.90	1.23	1.03	1.06	0.82
	<i>Median</i>				0.98	1.48	1.07	1.22	0.92
Top Line Cash Payers									
	Cross Timbers Royalty Trust	CRT		48.03	0.99	1.55	1.06	1.22	1.07
	Freehold Royalties Ltd.	FRHLF		22.88	0.98	1.53	1.04	1.21	1.04
	Sabine Royalty Trust	SBR		62.99	0.97	1.48	1.01	1.13	1.07
	Dorchester Minerals, L.P.	DMLP	B	28.73	0.98	1.37	1.05	1.08	0.96
	Permian Basin RT	PBT		21.63	0.91	1.51	1.02	1.05	0.98
	<i>Median</i>				0.98	1.51	1.04	1.13	1.04
Bottom Line Cash Payers									
	Pengrowth Energy Corporation	PGH		13.97	1.00	2.10	1.06	1.15	1.00
	Hugoton Royalty Trust	HGT	B	23.46	0.99	1.47	1.09	1.14	1.07
	Legacy Reserves L.P.	LGCY		31.14	0.97	1.48	1.03	1.13	1.08
	Enerplus Corporation	ERF		31.62	0.96	1.87	1.00	1.13	0.88
	Vanguard Natural Resources, LLC	VNR		32.22	0.98	1.42	1.02	1.12	1.11
	Encore Energy Partners, L.P.	ENP		23.15	0.97	1.91	1.02	1.11	1.01
	Linn Energy, LLC	LINE		39.16	0.99	1.91	1.01	1.11	1.25
	San Juan Basin Royalty Trust	SJT	B	27.00	0.95	1.36	1.09	1.10	1.08
	Mesa Royalty Trust	MTR		48.98	0.90	1.20	1.02	1.04	0.92
	<i>Median</i>				0.97	1.48	1.02	1.12	1.07
CB=Contrarian Buy, Stock Price apparently in downtrend compared to 200-day average.									



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

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