



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

May 20, 2011

Sabine Royalty Trust (SBR)

Raise NPV to \$70 from \$59 on Rising Volume

<i>Symbol</i>	SBR	<i>Ebitda Next Twelve Months ending 3/31/12 (US\$mm)</i>	70
<i>Rating</i>		<i>North American Natural Gas/Ebitda (%)</i>	47
<i>Price (US\$/sh)</i>	66.28	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	5/19/11	<i>Adjusted Reserves/Production NTM</i>	7.0
<i>Shares (mm)</i>	14.58	<i>EV/Ebitda</i>	13.7
<i>Market Capitalization (US\$mm)</i>	966	<i>PV/Ebitda</i>	14.5
<i>Debt (US\$mm)</i>	0	<i>Undeveloped Reserves (%)</i>	7
<i>Enterprise Value (EV) (US\$mm)</i>	966	<i>Natural Gas and Oil Ebitda (US\$/mcf)</i>	6.59
<i>Present Value (PV) (US\$mm)</i>	1,021	<i>Present Value Proven Reserves(US\$/boe)</i>	79.50
<i>Net Present Value (US\$/unit)</i>	70	<i>Oil and Gas Ebitda Margin (%)</i>	97
<i>Debt/Present Value</i>	0.00	<i>Earnings Next Twelve Months (US\$/un)</i>	4.83
<i>McDep Ratio - EV/PV</i>	0.95	<i>Price/Earnings Next Twelve Months</i>	14
<i>Distribution Yield (%/year)</i>	7.3	<i>Distribution Next Twelve Months (US\$/sh)</i>	4.83
Note: Estimated cash flow and earnings tied to one-year futures prices for natural gas.			
Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.			
Estimated present value presumes a long-term price for oil of US\$100 a barrel and natural gas, \$8 a million btu.			

Summary and Recommendation

Rising natural gas volume presumed to be from the Haynesville Shale in Louisiana prompts us to raise Net Present Value (NPV) for **Sabine Royalty Trust (SBR)** despite a low level of reported reserves in the trust's official disclosures (see chart Natural Gas Volume on page 3). Deriving all of its cash flow as a percentage of revenue on production by others, the trust has little information from operators on the specific characteristics of the reserves behind the production or on plans for future drilling. As a result, we rely on the historical record, anecdotal evidence from some of the few persons who know the trust best and our own experience to estimate value. Looking ahead, we may also see a rising volume trend develop in oil production in the Permian Basin of West Texas where the trust has larger royalty holdings than in Louisiana. NPV is about half oil and half natural gas. Further attesting to the quality of properties selected by the founder of the trust, a total return of 45 times over the past 26.5 years exceeds that of any other stock in our coverage publicly trading for that time (see table Total Return on page 4).

Recent increases in oil price will likely boost upcoming distributions more than projected natural gas volume (see Next Twelve Months Operating and Financial Performance on page 4). All of the distribution is top line income where operating expense and capital cost is paid by others.

“Never Sell!”

Visiting recently with Jon Brumley, the founder of **Permian Basin Royalty Trust (PBT)**, **San Juan Basin Royalty Trust (SJT)** and later **Cross Timbers Royalty Trust (CRT)**, we were reminded of his personal mantra concerning his creations, “Never Sell!” He recalls that when the



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price of any of the three may have been stagnant, the high distributions continued to be paid. In another conversation years ago we made reference to a recommended weighting of oil and gas in a portfolio. Mr. Brumley's response went something like "H---, all my money is in oil and gas."

Getting back to SBR, Ashley Priddy, the founder of SBR, and Mr. Brumley were close contemporaries who apparently discussed deals from time to time. As we hear it, Mr. B. was skeptical that the stock market would ever give full recognition to the value of SBR. We presume that is because without the normal disclosures of reserves made by operating companies investors would not know the true quality of the underlying properties. As we know now, the holders of SBR who never sold enjoyed a high long-term return.

Trustee More Active for SBR

After consolidation in the banking and trust business, Trustee Ron Hooper and his group have responsibility for SBR, PBT, CRT and **Hugoton Royalty Trust (HGT)** among those in our coverage. His responsibilities for SBR include collecting royalties from some 5400 tracts of land primarily in Texas, Oklahoma and Louisiana. For the other trusts, the working interest owner, ConocoPhillips or ExxonMobil, collects the revenues and pays the expenses leaving the trustee to distribute the funds to individual unit holders. As part of the expanded responsibility, Mr. Hooper told us that the trustee investigates alerts it may receive about any improper treatment of the royalty interest by a lease holder. On another matter in 2006, Mr. Hooper dealt with an unsolicited acquisition offer by providing a recap of historical reserves illustrating the unusual strengths of SBR's properties in a letter to unit holders. Also in our recent visit, we learned new pieces of royalty trust history that he retold enthusiastically.

Rebalancing on the Road to \$200 Oil

Meanwhile, the shares of SBR that do trade are small in number and we need more than SBR to fill an investment portfolio. We advocate targeting an overweighting in our covered stocks and rebalancing to the weighting when the performance deviates from the rest of the portfolio. The designated overweighting offers reward should the global economy continue on the road to \$200 by November 2012. At the same time, rebalancing toward the weighting when there is favorable relative performance as in the first quarter allows the extraction of some profits along the way. It further rebuilds the capacity to add shares when oil and gas stocks give back relative performance as has been the case so far in the second quarter.

Positive real interest rates, less government spending and global peace would not be good for the \$200 oil case. Nor would a recession be good for \$200 oil. Political pressure to avoid a recession will likely keep interest rates artificially low and government spending high. Hopefully, \$200 is overstated and we'll have global growth with a sustainable oil price near the current level and rising gradually.



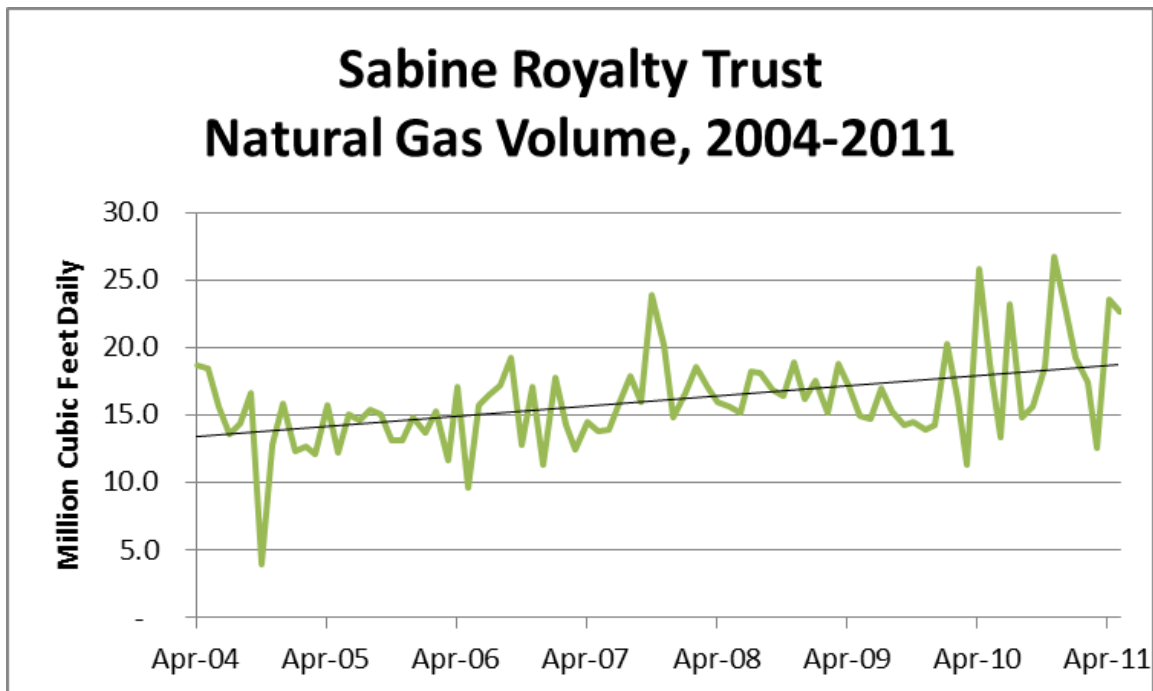
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As for natural gas, price in North America is a genuine bargain for consumers and a bright spot in the economic and environmental outlook. Economic incentives to use more natural gas are high without government action. We expect producer profits to grow gradually. Nearly all producers are represented in both fuels. Just as relative profitability can often surprise, the net benefit or penalty of one can be muted by the other. Jon Brumley made that point when he formed two royalty trusts in 1980 with SJT concentrated on natural gas and PBT concentrated on oil.

Kurt H. Wulff, CFA





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Long-Life Oil and Gas Stocks		
Total Return, 9/28/84-3/31/11		
	<i>Multiple of Initial \$1</i>	<i>Percent/ Year</i>
Sabine Royalty Trust (SBR)	45.4	15.6
ExxonMobil (XOM/XON)	36.5	14.6
Dorchester Minerals (DMLP/DHULZ)	36.4	14.5
Permian Basin RT (PBT)	28.0	13.5
San Juan Basin RT (SJT)	24.0	12.9
S&P 500	14.1	10.8
Mesa Royalty Trust (MTR)	10.3	9.6

Sabine Royalty Trust									
Next Twelve Months Operating and Financial Performance									
	<i>Q2</i>	<i>Year</i>	<i>Q1</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Next Twelve Months</i>
	<i>6/30/10</i>	<i>2010</i>	<i>3/31/11</i>	<i>6/30/11</i>	<i>9/30/11</i>	<i>12/31/11</i>	<i>2011E</i>	<i>3/31/12</i>	<i>3/31/12</i>
Volume									
Natural Gas (mmcf)	18.2	18.9	20.5	21.1	21.7	22.4	20.8	23.1	22.1
Oil (mbd)	1.06	1.17	1.20	1.20	1.20	1.20	1.16	1.20	1.20
Total (bcfe)	2.20	9.46	2.22	2.55	2.63	2.72	10.13	2.78	10.69
Total (mmcf)	24.5	25.9	27.7	28.3	28.9	29.6	27.8	30.3	29.3
Price (Henry Hub natural gas lagged three months; WTI Cushing oil, two months)									
Henry Hub (\$/mmbtu)	5.32	4.49	3.80	4.11	4.31	4.41	4.16	4.67	4.38
Differential (%)	10	(1)	(6)	(6)	(6)	(6)	(7)	(6)	(6)
Company (\$/mcf)	4.79	4.55	4.04	4.37	4.58	4.69	4.44	4.96	4.66
WTI Cushing (\$/bbl)	80.71	77.68	87.66	100.91	98.24	98.30	96.28	102.38	99.96
Differential	4.16	4.02	4.06	4.67	4.55	4.55	4.22	4.74	4.63
Company (\$/bbl)	76.56	73.66	83.60	96.24	93.69	93.75	92.05	97.64	95.33
Total (\$/bcfe)	6.83	6.64	6.62	7.33	7.32	7.35	7.18	7.65	7.42
Revenue (\$mm)									
Natural Gas	7.8	31.4	6.6	8.3	9.1	9.7	33.7	10.5	37.6
Oil	7.2	31.4	8.1	10.4	10.2	10.3	39.0	10.8	41.7
Other	(1.0)	(6.7)	(1.1)	(1.1)	(1.4)	(3.1)	(6.7)	(1.3)	(6.9)
Total	14.0	56.1	13.7	17.6	17.9	16.9	66.0	20.0	72.4
Expense									
General and administrative	0.6	2.1	0.5	0.5	0.5	0.5	2.0	0.5	2.0
Ebitda	13.4	54.0	13.2	17.1	17.4	16.4	64.0	19.5	70.4
Ebit	13.4	54.0	13.2	17.1	17.4	16.4	64.0	19.5	70.4
Ebt	13.4	54.0	13.2	17.1	17.4	16.4	64.0	19.5	70.4
Distributable Income (\$mm)	13.4	54.0	13.2	17.1	17.4	16.4	64.0	19.5	70.4
Units (millions)	14.6	14.6	14.6	14.6	14.6	14.6	14.6	14.6	14.6
Per Unit (\$)	0.92	3.70	0.90	1.17	1.19	1.13	4.39	1.34	4.83



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Table ISC-1											
McDep Income and Small Cap Energy Portfolio											
Debt, Segments, Cash Flow, Income and McDep Ratio											
			Price		Enterprise	PV(%)		EV/	Dist.	Dist.	
Symbol/Rating		(US\$/sh)	EV/	Value	Nat	Oil	Ebitda	NTM	Yield	McDep	
CB (see below)		19-May	Market	(\$mm)	Gas		(\$/un)		(%)	Ratio	
		2011	Cap				NTM				
Small Cap Independent Producers											
Petrohawk Energy Corporation	HK	B	24.16	1.54	11,340	83	17	10.0	-	-	1.00
Range Resources	RRC	B	52.45	1.21	10,050	76	24	14.3	0.16	0.3	0.89
Payto Exploration and Developmen	PEYUF		20.79	1.15	3,170	76	24	11.6	0.74	3.6	0.88
Denbury Resources Inc.	DNR		21.10	1.28	10,710	6	94	8.2	-	-	0.87
Berry Petroleum Company	BRY		48.89	1.54	4,060	26	74	8.6	0.30	0.6	0.87
Birchcliff Energy Ltd.	BIREF	B	12.96	1.24	2,080	56	44	12.1	-	-	0.84
Ultra Petroleum	UPL		46.59	1.25	8,940	92	8	11.5	-	-	0.81
Cimarex Energy Company	XEC	B	91.13	1.09	8,570	44	56	6.4	0.30	0.3	0.78
Whiting Petroleum Corporation	WLL	B	63.74	1.21	9,110	11	89	6.9	-	-	0.75
<i>Total or Median</i>					68,000			10.0			0.87
Top Line Cash Payers											
Freehold Royalties Ltd.	FRHLF		22.05	1.07	1,370	18	82		1.73	7.9	1.00
Permian Basin RT	PBT		20.54	1.00	960	42	58		1.70	8.3	0.93
Sabine Royalty Trust	SBR		65.25	1.00	950	51	49		4.83	7.4	0.93
Dorchester Minerals, L.P.	DMLP	B	27.55	1.00	850	61	39		1.75	6.3	0.92
Cross Timbers Royalty Trust	CRT		40.18	1.00	240	87	13		2.97	7.4	0.89
<i>Total or Median</i>					4,400					7.4	0.93
Bottom Line Cash Payers											
Linn Energy, LLC	LINE		38.35	1.41	8,840	35	65	13.1	2.64	6.9	1.09
Legacy Reserves L.P.	LGCY		30.69	1.40	1,870	19	81	10.9	2.12	6.9	1.07
Vanguard Natural Resources, LLC	VNR		29.25	1.67	1,670	26	74	12.9	2.28	7.8	1.05
Hugoton RoyaltyTrust	HGT	B	22.06	1.00	880	88	13	13.7	1.39	6.3	1.00
Encore Energy Partners, L.P.	ENP		22.51	1.30	1,310	17	83	10.3	1.96	8.7	0.98
Pengrowth Energy Corporation	PGH		13.24	1.40	6,000	30	70	8.9	0.87	6.6	0.96
San Juan Basin Royalty Trust	SJT		23.19	1.00	1,080	100	-	13.7	1.43	6.2	0.93
Enerplus Corporation	ERF	B	31.80	1.27	7,300	33	67	8.8	2.23	7.0	0.89
Mesa RoyaltyTrust	MTR		45.50	1.00	85	75	25	12.6	2.90	6.4	0.86
<i>Total or Median</i>					29,000			12.6		6.9	0.98
Composite											
<i>Enterprise Value Weighting</i>					101,400	47	53				0.89
<i>Equal Weighting</i>						50	50				0.92
<i>Equal Weighted Buys</i>						53	47				0.88
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.											



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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		19-May 2011	(mm)				
Small Cap Independent Producers								
Petrohawk Energy Corporation	HK	B	24.16	305.0	7,370	24.00	0.35	1.00
Range Resources	RRC	B	52.45	158.0	8,290	60.00	0.16	0.89
Peyto Exploration and Development Cor	PEYUF		20.79	132.7	2,760	24.00	0.11	0.88
Denbury Resources Inc.	DNR		21.10	397.0	8,380	25.00	0.19	0.87
Berry Petroleum Company	BRY		48.89	54.0	2,640	60.00	0.30	0.87
Birchcliff Energy Ltd.	BIREF	B	12.96	130.0	1,680	16.00	0.16	0.84
Ultra Petroleum	UPL		46.59	154.0	7,170	60.00	0.16	0.81
Cimarex Energy Company	XEC	B	91.13	86.1	7,850	120.00	0.06	0.78
Whiting Petroleum Corporation	WLL	B	63.74	118.0	7,520	90.00	0.13	0.75
<i>Total or Median</i>					53,660		0.16	0.87
Top Line Cash Payers								
Freehold Royalties Ltd.	FRHLF		22.05	58.4	1,290	22.00	0.06	1.00
Permian Basin RT	PBT		20.54	46.6	960	22.00	-	0.93
Sabine Royalty Trust	SBR		65.25	14.6	950	70.00	-	0.93
Dorchester Minerals, L.P.	DMLP	B	27.55	30.7	850	30.00	-	0.92
Cross Timbers Royalty Trust	CRT		40.18	6.0	240	45.00	-	0.89
<i>Total or Median</i>					4,290			0.93
Bottom Line Cash Payers								
Linn Energy, LLC	LINE		38.35	163.0	6,250	34.00	0.32	1.09
Legacy Reserves L.P.	LGCY		30.69	43.5	1,340	28.00	0.31	1.07
Vanguard Natural Resources, LLC	VNR		29.25	34.2	1,000	27.00	0.42	1.05
Hugoton RoyaltyTrust	HGT	B	22.06	40.0	880	22.00	-	1.00
Encore Energy Partners, L.P.	ENP		22.51	45.0	1,010	23.00	0.22	0.98
Pengrowth Energy Corporation	PGH		13.24	326.0	4,320	14.00	0.27	0.96
San Juan Basin Royalty Trust	SJT		23.19	46.6	1,080	25.00	-	0.93
Enerplus Corporation	ERF	B	31.80	179.5	5,710	37.00	0.19	0.89
Mesa RoyaltyTrust	MTR		45.50	1.9	85	53.00	-	0.86
<i>Total or Median</i>					21,680			0.98
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								
			Price (\$/sh)	Revenue	Dist/ Equity	Adjstd Resrvs/ Prod	PV/ Ebitda	EV/ Ebitda
	Symbol/ Rating		19-May 2011	Royalty (%)	Ebitda	NTM	NTM	NTM
Small Cap Independent Producers								
Range Resources	RRC	B	52.45		-	17.4	16.0	14.3
Birchcliff Energy Ltd.	BIREF	B	12.96		-	20.1	14.5	12.1
Peyto Exploration and Development Corp	PEYUF		20.79		0.41	17.2	13.2	11.6
Ultra Petroleum	UPL		46.59		-	27.2	14.1	11.5
Petrohawk Energy Corporation	HK	B	24.16		-	7.6	10.0	10.0
Berry Petroleum Company	BRY		48.89		-	12.0	9.9	8.6
Denbury Resources Inc.	DNR		21.10		-	13.6	9.4	8.2
Whiting Petroleum Corporation	WLL	B	63.74		-	9.6	9.2	6.9
Cimarex Energy Company	XEC	B	91.13		-	7.4	8.3	6.4
	<i>Median</i>					<i>13.6</i>	<i>10.0</i>	<i>10.0</i>
Top Line Cash Payers								
Sabine Royalty Trust	SBR		65.25	100	1.00	7.0	14.5	13.5
Dorchester Minerals, L.P.	DMLP	B	27.55	77	0.85	7.1	14.6	13.4
Cross Timbers Royalty Trust	CRT		40.18	80	0.97	14.5	14.7	13.1
Permian Basin RT	PBT		20.54	32	0.94	15.6	12.2	11.4
Freehold Royalties Ltd.	FRHLF		22.05	71	0.83	6.4	10.5	10.5
	<i>Median</i>					<i>7.1</i>	<i>14.5</i>	<i>13.1</i>
Bottom Line Cash Payers								
San Juan Basin Royalty Trust	SJT		23.19		0.84	9.1	14.7	13.7
Hugoton Royalty Trust	HGT	B	22.06		0.86	13.6	13.6	13.7
Linn Energy, LLC	LINE		38.35		0.94	17.5	12.1	13.1
Vanguard Natural Resources, LLC	VNR		29.25		1.04	13.2	12.3	12.9
Mesa Royalty Trust	MTR		45.50		0.80	14.3	14.6	12.6
Legacy Reserves L.P.	LGCY		30.69		0.78	12.0	10.3	10.9
Encore Energy Partners, L.P.	ENP		22.51		0.90	13.0	10.5	10.3
Pengrowth Energy Corporation	PGH		13.24		0.58	9.2	9.3	8.9
Enerplus Corporation	ERF	B	31.80		0.60	8.4	9.9	8.8
	<i>Median</i>					<i>13.0</i>	<i>12.1</i>	<i>12.6</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).								



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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		19-May 2011	52Wk High	52Wk Low	50 Day Avg.	200 Day Avg.	McDep Ratio
Small Cap Independent Producers								
	BIRCL	B	12.96	0.91	1.49	1.02	1.18	0.84
	PEYUF		20.79	0.97	1.60	1.01	1.15	0.88
	HK	B	24.16	0.92	1.36	1.00	1.14	1.00
	RRC	B	52.45	0.90	1.47	0.98	1.14	0.89
	BRY		48.89	0.94	1.49	1.00	1.12	0.87
	WLL	B	63.74	0.86	1.57	0.95	1.09	0.75
	DNR		21.10	0.85	1.36	0.94	1.07	0.87
	UPL		46.59	0.89	1.19	0.99	1.03	0.81
	XEC	B	91.13	0.79	1.42	0.86	1.01	0.78
	<i>Median</i>			<i>0.90</i>	<i>1.47</i>	<i>0.99</i>	<i>1.12</i>	<i>0.87</i>
Top Line Cash Payers								
	SBR		65.25	0.92	1.50	1.02	1.11	0.93
	FRHLF		22.05	0.91	1.47	0.96	1.10	1.00
	DMLP	B	27.55	0.92	1.16	0.98	1.02	0.92
	CRT		40.18	0.83	1.30	0.90	0.98	0.89
	PBT		20.54	0.86	1.33	0.96	0.98	0.93
	<i>Median</i>			<i>0.91</i>	<i>1.33</i>	<i>0.96</i>	<i>1.02</i>	<i>0.93</i>
Bottom Line Cash Payers								
	ERF	B	31.80	0.96	1.41	1.02	1.08	0.89
	LGCY		30.69	0.93	1.39	0.99	1.07	1.07
	PGH		13.24	0.93	1.34	0.98	1.05	0.96
	LINE		38.35	0.96	1.45	0.99	1.05	1.09
	HGT	B	22.06	0.89	1.28	0.96	1.05	1.00
	ENP		22.51	0.91	1.38	0.97	1.05	0.98
	VNR		29.25	0.92	1.31	0.96	1.02	1.05
	MTR		45.50	0.89	1.12	0.95	0.96	0.86
	SJT		23.19	0.81	1.12	0.91	0.95	0.93
	<i>Median</i>			<i>0.92</i>	<i>1.34</i>	<i>0.97</i>	<i>1.05</i>	<i>0.98</i>

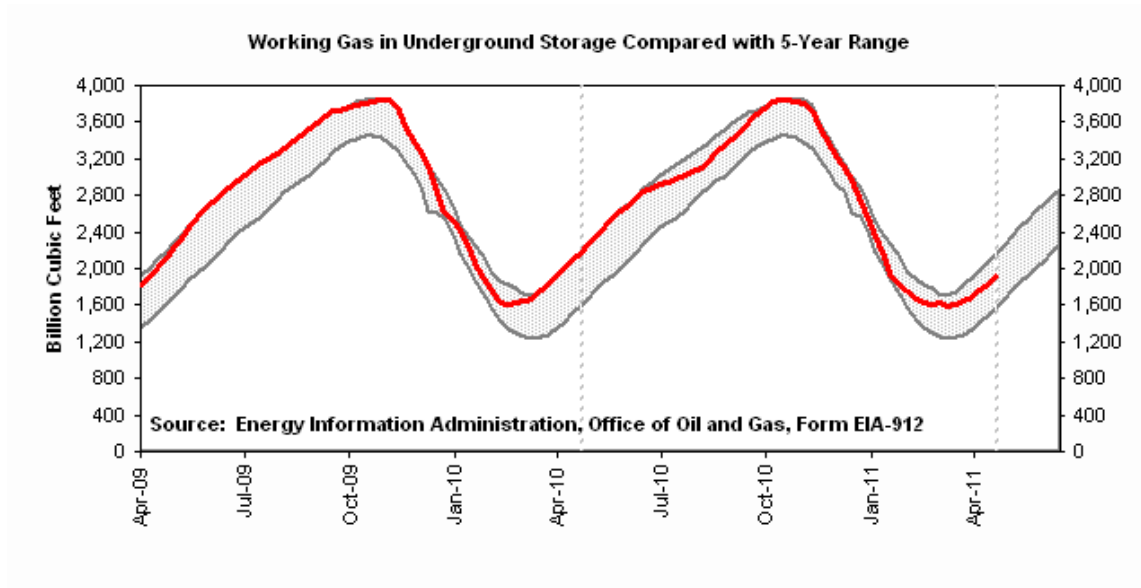
CB=Contrarian Buy, Stock Price apparently in downtrend compared to 200-day average.



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