



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

July 6, 2012

## Lowballing LIBOR

### Summary and Recommendation

The unfolding LIBOR controversy implies to us that investors in oil and gas income and small cap stocks should keep an independent perspective and be prepared to act against what may seem to be the popular interpretation of events. Revelations that the global benchmark commercial short-term interest rate was manipulated downward may be a telling sign of government overreach as was the apparent downward manipulation of oil price in 1998. The parallel suggests that interest rates ten years from now may be far higher just as oil price advanced more than ten times by 2008 from an artificially low level in 1998. Though we claim no special expert knowledge of the global money system, we are betting 70% that interest rates will be higher either because of growth and/or inflation and 30% that weak economic conditions accompanying low interest rates will persist or worsen. Our buy recommendations ought to be rewarding in the 70% case and mostly survive the 30% case. The percentages coincide with our personal portfolio allocation targets of 70% in global equities over weighted in oil and gas and 30% in gold, cash and bonds. Meanwhile, stock price volatility that may be disconcerting looking back a few months, may offer opportunity looking ahead. Valuations by McDep Ratios are low on an oil price trending around \$100 a barrel and North American natural gas price moving toward \$6 a million Btu. Elevated political risk in Syria and Iran adds to the investment challenge.

### Governments Promote Artificial Conditions

The interest rate in question, the London Interbank Offered Rate (LIBOR), was intended to be more market-related and more global than the U.S. "Prime Rate" it replaced, as we understand. LIBOR was set by collecting indications from multiple commercial banks of the rate at which each bank could borrow funds overnight in the marketplace. Apparently, few of the banks were truthful, instead submitting a "lowball" rate below which they could actually borrow. Moreover government financial authorities who were already pursuing policies of artificially low rates likely welcomed and may have encouraged the commercial misrepresentation of market conditions. We like stocks of oil and gas producers whose economic contributions are real (see Tables ISC-1 through ISC-4 on pages 2-5).

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	5-Jul	Market	Value	Nat	Ebitda	NTM	Yield	McDep		
CB (see below)	2012	Cap	(\$mm)	Gas	Oil	NTM	(\$/un)	(%)	Ratio	
<b>Small Cap Independent Producers</b>										
Continental Resources	CLR	70.29	1.18	14,980	27	73	8.8	-	-	1.00
Halcon Resources	HK	9.46	1.07	1,710	20	80	8.7	-	-	0.95
Range Resources	RRC CB	61.63	1.27	12,550	71	29	14.4	0.16	0.3	0.90
Peyto Exploration and Developmen	PEYUF	19.81	1.18	3,240	77	23	10.3	0.71	3.6	0.85
PDC Energy	PEED	25.81	1.86	1,150	56	44	7.8	-	-	0.77
Berry Petroleum Company	BRY	40.23	1.71	3,760	13	87	6.1	0.32	0.8	0.70
Denbury Resources Inc.	DNR	15.08	1.46	8,620	6	94	5.9	-	-	0.63
Birchcliff Energy Ltd.	BIREF CB	5.98	1.50	1,350	62	38	9.5	-	-	0.60
Whiting Petroleum Corporation	WLL CB	43.17	1.36	7,010	8	92	4.8	-	-	0.57
Cimarex Energy Company	XEC CB	55.26	1.22	5,800	42	58	5.2	0.48	0.9	0.55
<i>Total or Median</i>				60,200			8.2			0.74
<b>Top Line Cash Payers</b>										
Permian Basin RT	PBT	18.30	1.00	850	37	63		1.28	7.0	0.92
Freehold Royalties Ltd.	FRHLF	18.24	1.04	1,230	16	84		1.66	9.1	0.87
Sabine Royalty Trust	SBR	54.17	1.00	790	55	45		3.37	6.2	0.83
Cross Timbers Royalty Trust	CRT	36.49	1.00	220	70	30		2.19	6.0	0.83
Dorchester Minerals, L.P.	DMLP CB	21.94	1.00	670	57	43		1.80	8.2	0.81
<i>Total or Median</i>				3,800					7.0	0.83
<b>Bottom Line Cash Payers</b>										
Linn Energy, LLC	LINE	38.89	1.63	12,220	40	60	12.7	2.90	7.5	1.16
Vanguard Natural Resources, LLC	VNR	27.09	1.48	2,110	27	74	11.0	2.37	8.7	1.05
Legacy Reserves L.P.	LGCY	25.49	1.40	1,700	23	77	8.5	2.22	8.7	0.89
Enduro Royalty Trust (40%)	NDRO	16.72	1.00	220	42	58	7.5	1.43	8.5	0.80
San Juan Basin Royalty Trust	SJT CB	15.77	1.00	740	100	-	11.9	1.01	6.4	0.75
Enerplus Corporation	ERF CB	13.26	1.65	4,300	26	74	5.8	1.33	10.0	0.74
Mesa RoyaltyTrust	MTR	29.75	1.00	55	75	25	9.8	2.55	8.6	0.74
Hugoton RoyaltyTrust	HGT	7.69	1.00	310	89	11	8.1	0.11	1.4	0.55
<i>Total or Median</i>				21,700			9.2		8.6	0.77
<b>Composite</b>										
<i>Enterprise Value Weighting</i>				85,600	36	64				0.80
<i>Equal Weighting</i>					45	55				0.80
<i>Equal Weighted Buys</i>					46	54				0.70

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 \$6 a million btu for natural gas.

Dist. = Income distribution. NTM = Next Twelve Months Ended June 30, 2013. Enterprise Value = Market Cap and Debt.





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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		5-Jul 2012	Royalty (%)	Ebitda	NTM	NTM	NTM
<b>Small Cap Independent Producers</b>								
Range Resources	RRC	CB	61.63		-	14.0	15.9	14.4
Peyto Exploration and Development Corp	PEYUF		19.81		0.36	10.0	12.1	10.3
Birchcliff Energy Ltd.	BIREF	CB	5.98		-	21.6	15.8	9.5
Continental Resources	CLR		70.29		-	9.6	8.7	8.8
Halcon Resources	HK		9.46		-	7.1	9.2	8.7
PDC Energy	PETD		25.81		-	8.1	10.0	7.8
Berry Petroleum Company	BRY		40.23		-	11.8	8.8	6.1
Denbury Resources Inc.	DNR		15.08		-	13.1	9.3	5.9
Cimarex Energy Company	XEC	CB	55.26		-	8.1	9.4	5.2
Whiting Petroleum Corporation	WLL	CB	43.17		-	9.5	8.5	4.8
	<i>Median</i>					9.8	9.3	8.2
<b>Top Line Cash Payers</b>								
Sabine Royalty Trust	SBR		54.17	100	1.00	8.7	19.3	16.1
Cross Timbers Royalty Trust	CRT		36.49	78	0.96	17.7	19.2	15.9
Permian Basin RT	PBT		18.30	32	0.88	9.7	13.8	12.6
Dorchester Minerals, L.P.	DMLP	CB	21.94	77	1.00	6.6	15.0	12.2
Freehold Royalties Ltd.	FRHLF		18.24	71	0.91	5.4	11.5	10.1
	<i>Median</i>					8.7	15.0	12.6
<b>Bottom Line Cash Payers</b>								
Linn Energy, LLC	LINE		38.89		1.06	14.3	10.9	12.7
San Juan Basin Royalty Trust	SJT	CB	15.77		0.76	8.6	15.9	11.9
Vanguard Natural Resources, LLC	VNR		27.09		0.99	13.6	10.4	11.0
Mesa Royalty Trust	MTR		29.75		0.85	8.0	13.3	9.8
Legacy Reserves L.P.	LGCY		25.49		0.71	11.3	9.6	8.5
Hugoton Royalty Trust	HGT		7.69		0.11	13.6	14.7	8.1
Enduro Royalty Trust (40%)	NDRO		16.72		0.64	5.5	9.4	7.5
Enerplus Corporation	ERF	CB	13.26		0.49	6.3	7.8	5.8
	<i>Median</i>					10.0	10.7	9.2
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 June 30, 2013; 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		5-Jul 2012	52Wk High	52Wk Low	50 Day Avg.	200 Day Avg.	McDep Ratio
<b>Small Cap Independent Producers</b>								
Peyto Exploration and Development C	PEYUF		19.81	0.80	1.29	1.11	1.01	0.85
Range Resources	RRC	CB	61.63	0.83	1.15	1.01	0.99	0.90
Continental Resources	CLR		70.29	0.76	1.50	0.96	0.97	1.00
Berry Petroleum Company	BRY		40.23	0.77	1.16	1.02	0.96	0.70
Denbury Resources Inc.	DNR		15.08	0.78	1.29	0.97	0.94	0.63
Whiting Petroleum Corporation	WLL	CB	43.17	0.74	1.32	0.97	0.92	0.57
PDC Energy	PETD		25.81	0.77	1.29	0.99	0.92	0.77
Cimarex Energy Company	XEC	CB	55.26	0.64	1.16	0.99	0.88	0.55
Birchcliff Energy Ltd.	BIREF	CB	5.98	0.49	1.13	0.99	0.66	0.60
Halcon Resources	HK		9.46	0.72		0.97		0.95
	<i>Median</i>			<i>0.76</i>	<i>1.29</i>	<i>0.99</i>	<i>0.94</i>	<i>0.74</i>
<b>Top Line Cash Payers</b>								
Freehold Royalties Ltd.	FRHLF		18.24	0.80	1.32	1.02	0.98	0.87
Dorchester Minerals, L.P.	DMLP	CB	21.94	0.78	1.10	0.99	0.94	0.81
Permian Basin RT	PBT		18.30	0.78	1.11	0.98	0.90	0.92
Sabine Royalty Trust	SBR		54.17	0.80	1.19	1.05	0.90	0.83
Cross Timbers Royalty Trust	CRT		36.49	0.72	1.15	0.98	0.84	0.83
	<i>Median</i>			<i>0.78</i>	<i>1.15</i>	<i>0.99</i>	<i>0.90</i>	<i>0.83</i>
<b>Bottom Line Cash Payers</b>								
Linn Energy, LLC	LINE		38.89	0.97	1.14	1.03	1.03	1.16
Vanguard Natural Resources, LLC	VNR		27.09	0.90	1.15	1.03	1.00	1.05
Legacy Reserves L.P.	LGCY		25.49	0.87	1.11	0.98	0.94	0.89
San Juan Basin Royalty Trust	SJT	CB	15.77	0.62	1.31	1.03	0.79	0.75
Mesa RoyaltyTrust	MTR		29.75	0.60	1.18	0.97	0.76	0.74
Enerplus Corporation	ERF	CB	13.26	0.53	1.10	0.95	0.72	0.74
Hugoton RoyaltyTrust	HGT		7.69	0.32	1.20	0.81	0.48	0.55
	<i>Median</i>			<i>0.62</i>	<i>1.15</i>	<i>0.98</i>	<i>0.79</i>	<i>0.75</i>

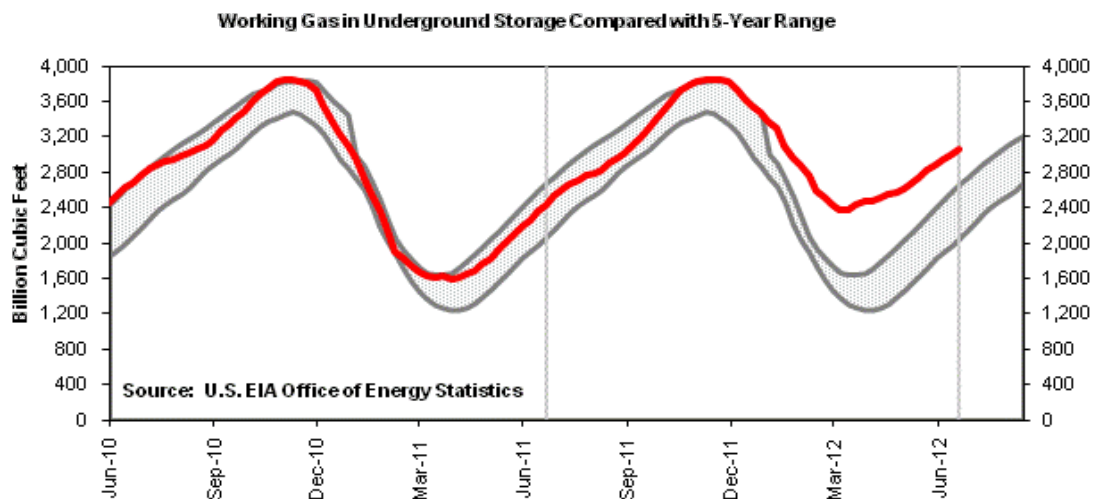
CB=Contrarian Buy, Stock Price apparently in downtrend compared to 200-day average.



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