



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

August 31, 2012

## **Royalty Trust McDep Opportunities Volume Trends Better than Reported Reserves**

### **Summary and Recommendation**

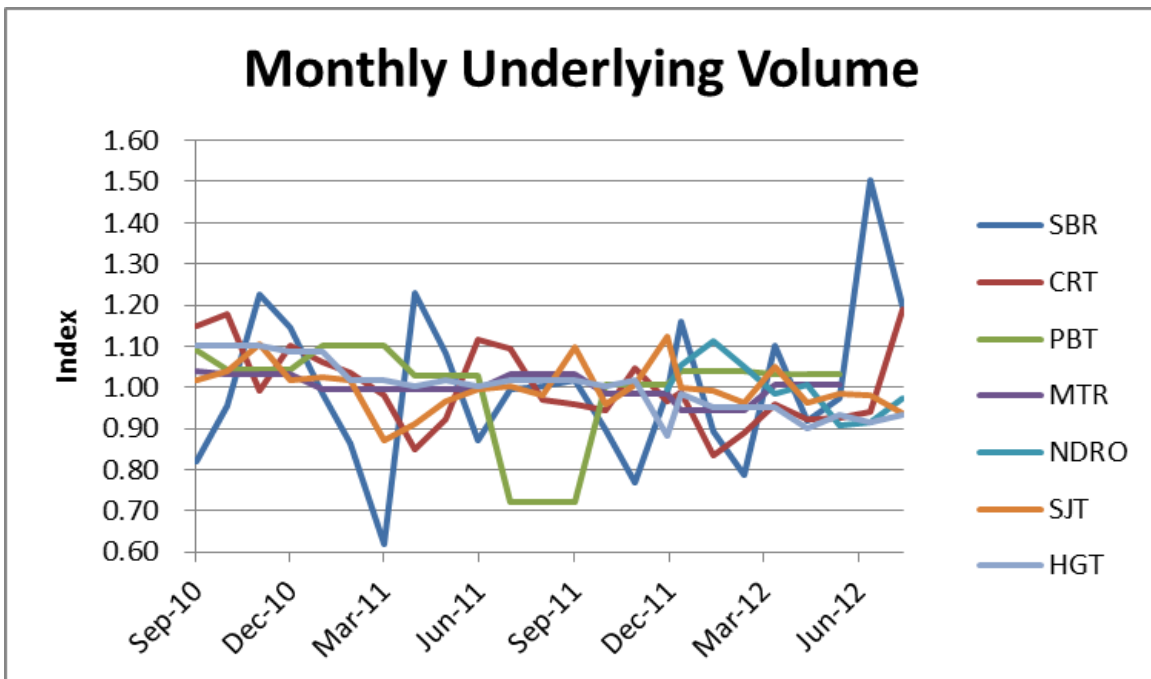
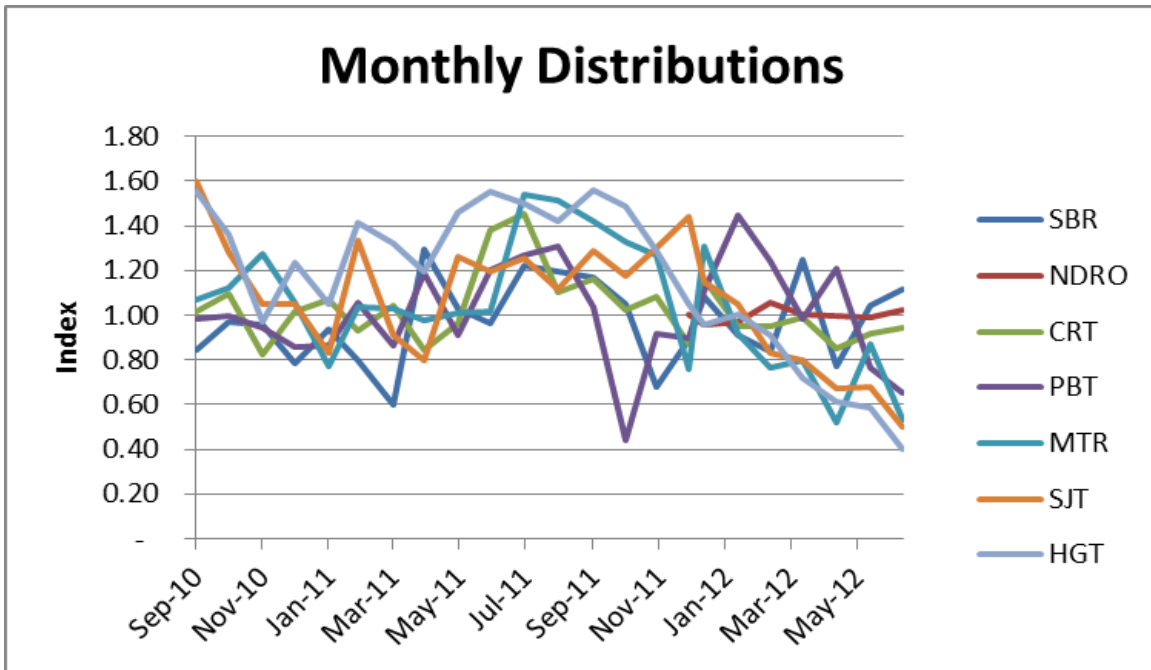
McDep Ratios put all seven royalty trusts in our coverage in buy range with **Mesa Royalty Trust (MTR)**, **San Juan Basin Royalty Trust (SJT)** and **Hugoton Royalty Trust (HGT)** especially low at 0.66, 0.65 and 0.44 respectively. **Permian Basin Royalty Trust (PBT)**, **Sabine Royalty Trust (SBR)**, **Cross Timbers Royalty Trust (CRT)** and **Enduro Royalty Trust (NDRO)** offer their high quality characteristic at lower than normal McDep Ratios of 0.76, 0.80, 0.83, and 0.87. Stock prices have declined along with monthly distributions for PBT, MTR, SJT and HGT (see chart [Monthly Distributions](#) on page 2). Despite lower oil and natural gas price, recent distributions for SBR, NDRO and CRT are rising or stable. Yet, volumes are just declining gently as normal or rising (see chart [Monthly Underlying Volume](#) on page 2). Those favorable trends generally contradict the more rapid decline implied by conservatively reported reserves. Moreover, much of the fracking revolution is taking place where oil and gas has already been found as in the areas where the properties of the trusts are located. Rising capital outlays to exploit those opportunities are adding to future production at SJT and PBT among others while reducing current distributions. That accounting contradiction has provided countless opportunities for investors to buy when traders sell. Meanwhile, estimated distribution yields range up to 9.4% for the next twelve months (see Table [ISC-1](#) on page 3). Another unique feature of the royalty trusts is zero debt (see Table [ISC-2](#) on page 4). Cash flow multiples (EV/Ebitda) appear amply justified by long life for Bottom Line Cash Payers and by the advantage of not paying for costs for all or much of the production of Top Line Cash Payers (see [Table ISC-3](#) on page 6). Finally, royalty trusts are among the most out-of-favor stocks measured by Enterprise Value to 200-day average (see [Table ISC-4](#)). Oil and gas price risk appears no greater and may be less than for operating companies.

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	30-Aug	Market	Cap	Value	Nat	Oil	Ebitda	NTM	Yield	McDep	
CB (see below)	2012			(\$mm)	Gas		NTM	(\$/un)	(%)	Ratio	
<b>Small Cap Independent Producers</b>											
PDC Energy	PDCE		27.92	1.81	1,580	54	46	9.9	-	-	0.96
Range Resources	RRC	B	64.55	1.31	13,500	74	26	16.0	0.16	0.2	0.94
Continental Resources (32%)	CLR		72.41	1.20	5,020	25	75	7.9	-	-	0.92
Payto Exploration and Developmen	PEYUF		20.04	1.20	3,310	75	25	11.7	0.72	3.6	0.86
Halcón Resources	HK		7.60	1.34	2,940	12	88	8.9	-	-	0.81
Birchcliff Energy Ltd.	BIREF	CB	6.86	1.51	1,510	62	38	10.1	-	-	0.67
Berry Petroleum Company	BRY		36.39	1.81	3,610	13	87	5.2	-	-	0.66
Denbury Resources Inc.	DNR		15.07	1.53	9,030	6	94	5.5	-	-	0.64
Whiting Petroleum Corporation	WLL	CB	43.67	1.37	7,120	8	92	4.6	-	-	0.57
Cimarex Energy Company	XEC	CB	56.68	1.25	6,140	45	55	5.3	0.48	0.8	0.57
<i>Total or Median</i>					53,800			8.4			0.74
<b>Top Line Cash Payers</b>											
Freehold Royalties Ltd.	FRHLF		19.47	1.04	1,310	16	84		1.69	8.7	0.93
Cross Timbers Royalty Trust	CRT		36.36	1.00	220	70	30		2.41	6.6	0.83
Dorchester Minerals, L.P.	DMLP	CB	22.00	1.00	680	57	43		1.88	8.5	0.81
Sabine Royalty Trust	SBR		52.05	1.00	760	55	45		3.81	7.3	0.80
Permian Basin RT	PBT		15.17	1.00	710	37	63		1.28	8.4	0.76
<i>Total or Median</i>					3,700					8.4	0.81
<b>Bottom Line Cash Payers</b>											
Linn Energy, LLC	LINE		39.30	1.78	13,820	40	60	13.3	2.90	7.4	1.15
Vanguard Natural Resources, LLC	VNR		28.28	1.70	2,510	23	77	10.6	2.40	8.5	1.07
Legacy Reserves L.P.	LGCY		27.49	1.33	1,740	24	76	8.7	2.24	8.1	0.94
Enduro Royalty Trust (40%)	NDRO		18.27	1.00	240	39	61	7.8	1.71	9.4	0.87
Enerplus Corporation	ERF	CB	15.51	1.60	4,900	30	70	6.6	1.36	8.8	0.82
Mesa RoyaltyTrust	MTR		26.07	1.00	49	75	25	9.6	2.18	8.4	0.66
San Juan Basin Royalty Trust	SJT	CB	13.59	1.00	630	100	-	11.4	0.70	5.2	0.65
Hugoton RoyaltyTrust	HGT		6.15	1.00	250	88	13	6.4	0.15	2.4	0.44
<i>Total or Median</i>					24,100			9.2		8.3	0.84
<b>Composite</b>											
<i>Enterprise Value Weighting</i>					81,600	37	63				0.80
<i>Equal Weighting</i>						45	55				0.80
<i>Equal Weighted Buys</i>						48	52				0.72

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-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		30-Aug 2012	(mm)				
<b>Small Cap Independent Producers</b>								
PDC Energy	PDCE		27.92	31.0	870	30.00	0.43	0.96
Range Resources	RRC	B	64.55	160.0	10,330	70.00	0.22	0.94
Continental Resources (32%)	CLR		72.41	57.6	4,170	80.00	0.16	0.92
Peyto Exploration and Development Cor	PEYUF		20.04	138.5	2,770	24.00	0.14	0.86
Halcón Resources	HK		7.60	290.0	2,200	10.00	0.20	0.81
Birchcliff Energy Ltd.	BIREF	CB	6.86	145.0	1,000	12.00	0.23	0.67
Berry Petroleum Company	BRY		36.39	54.7	1,990	70.00	0.30	0.66
Denbury Resources Inc.	DNR		15.07	391.0	5,890	28.00	0.22	0.64
Whiting Petroleum Corporation	WLL	CB	43.67	119.0	5,200	88.00	0.16	0.57
Cimarex Energy Company	XEC	CB	56.68	86.4	4,900	110.00	0.12	0.57
<i>Total or Median</i>					39,320		0.21	0.74
<b>Top Line Cash Payers</b>								
Freehold Royalties Ltd.	FRHLF		19.47	64.7	1,260	21.00	0.03	0.93
Cross Timbers Royalty Trust	CRT		36.36	6.0	220	44.00	-	0.83
Dorchester Minerals, L.P.	DMLP	CB	22.00	30.7	680	27.00	-	0.81
Sabine Royalty Trust	SBR		52.05	14.6	760	65.00	-	0.80
Permian Basin RT	PBT		15.17	46.6	710	20.00	-	0.76
<i>Total or Median</i>					3,630			0.81
<b>Bottom Line Cash Payers</b>								
Linn Energy, LLC	LINE		39.30	198.0	7,780	30.00	0.50	1.15
Vanguard Natural Resources, LLC	VNR		28.28	52.2	1,480	25.00	0.44	1.07
Legacy Reserves L.P.	LGCY		27.49	47.5	1,310	30.00	0.23	0.94
Enduro Royalty Trust (40%)	NDRO		18.27	13.2	240	21.00	-	0.87
Enerplus Corporation	ERF	CB	15.51	196.0	3,040	21.00	0.31	0.82
Mesa RoyaltyTrust	MTR		26.07	1.9	49	40.00	-	0.66
San Juan Basin Royalty Trust	SJT	CB	13.59	46.6	630	21.00	-	0.65
Hugoton RoyaltyTrust	HGT		6.15	40.0	250	14.00	-	0.44
<i>Total or Median</i>					14,780			0.84
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 \$6 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 Royalty (%)	Dist/ Equity Ebitda	Adjstd Resrvs/ Prod NTM	PV/ Ebitda NTM	EV/ Ebitda NTM
	Symbol/ Rating		30-Aug 2012					
<b>Small Cap Independent Producers</b>								
Range Resources	RRC	B	64.55		-	15.1	17.1	16.0
Peyto Exploration and Development Corp	PEYUF		20.04		0.41	10.4	13.7	11.7
Birchcliff Energy Ltd.	BIREF	CB	6.86		-	22.0	15.1	10.1
PDC Energy	PDCE		27.92		-	8.9	10.2	9.9
Halcón Resources	HK		7.60		-	7.2	11.0	8.9
Continental Resources (32%)	CLR		72.41		-	10.7	8.6	7.9
Cimarex Energy Company	XEC	CB	56.68		-	7.9	9.2	5.3
Berry Petroleum Company	BRY		36.39		-	11.8	7.9	5.2
Denbury Resources Inc.	DNR		15.07		-	13.2	8.5	5.5
Whiting Petroleum Corporation	WLL	CB	43.67		-	9.5	8.1	4.6
	<i>Median</i>					10.5	9.7	8.4
<b>Top Line Cash Payers</b>								
Sabine Royalty Trust	SBR		52.05	100	1.00	7.1	17.1	13.7
Cross Timbers Royalty Trust	CRT		36.36	78	0.96	17.8	17.6	14.5
Dorchester Minerals, L.P.	DMLP	CB	22.00	77	0.98	6.4	14.1	11.5
Permian Basin RT	PBT		15.17	47	0.82	9.7	12.9	9.8
Freehold Royalties Ltd.	FRHLF		19.47	71	0.84	5.4	10.4	9.7
	<i>Median</i>					7.1	14.1	11.5
<b>Bottom Line Cash Payers</b>								
Linn Energy, LLC	LINE		39.30		1.12	15.1	11.6	13.3
Mesa RoyaltyTrust	MTR		26.07		0.80	7.5	14.7	9.6
San Juan Basin Royalty Trust	SJT	CB	13.59		0.59	8.8	17.7	11.4
Vanguard Natural Resources, LLC	VNR		28.28		0.95	14.0	9.9	10.6
Legacy Reserves L.P.	LGCY		27.49		0.70	11.4	9.3	8.7
Enduro Royalty Trust (40%)	NDRO		18.27		0.73	7.2	9.0	7.8
Enerplus Corporation	ERF	CB	15.51		0.52	6.3	8.0	6.6
Hugoton RoyaltyTrust	HGT		6.15		0.15	13.4	14.6	6.4
	<i>Median</i>					10.1	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		30-Aug 2012	52Wk High	52Wk Low	50 Day Avg.	200 Day Avg.	McDep Ratio	
<b>Small Cap Independent Producers</b>									
	Range Resources	RRC	B	64.55	0.87	1.17	1.02	1.03	0.94
	Peyto Exploration and Development C	PEYUF		20.04	0.80	1.29	0.99	1.02	0.86
	Continental Resources (32%)	CLR		72.41	0.78	1.52	1.04	0.96	0.92
	PDC Energy	PDCE		27.92	0.81	1.34	1.05	0.95	0.96
	Whiting Petroleum Corporation	WLL	CB	43.67	0.75	1.33	1.03	0.93	0.57
	Denbury Resources Inc.	DNR		15.07	0.79	1.27	1.00	0.93	0.64
	Cimarex Energy Company	XEC	CB	56.68	0.70	1.17	1.01	0.91	0.57
	Berry Petroleum Company	BRY		36.39	0.76	1.10	0.97	0.91	0.66
	Birchcliff Energy Ltd.	BIREF	CB	6.86	0.55	1.23	1.05	0.81	0.67
	Halcón Resources	HK		7.60	0.64		0.93		0.81
	<i>Median</i>				<i>0.77</i>	<i>1.27</i>	<i>1.01</i>	<i>0.93</i>	<i>0.74</i>
<b>Top Line Cash Payers</b>									
	Freehold Royalties Ltd.	FRHLF		19.47	0.92	1.40	1.05	1.03	0.93
	Dorchester Minerals, L.P.	DMLP	CB	22.00	0.83	1.11	1.00	0.96	0.81
	Sabine Royalty Trust	SBR		52.05	0.77	1.14	0.98	0.89	0.80
	Cross Timbers Royalty Trust	CRT		36.36	0.71	1.14	0.97	0.86	0.83
	Permian Basin RT	PBT		15.17	0.65	0.99	0.84	0.76	0.76
	<i>Median</i>				<i>0.77</i>	<i>1.14</i>	<i>0.98</i>	<i>0.89</i>	<i>0.81</i>
<b>Bottom Line Cash Payers</b>									
	Linn Energy, LLC	LINE		39.30	0.98	1.13	1.01	1.02	1.15
	Vanguard Natural Resources, LLC	VNR		28.28	0.97	1.15	1.01	1.02	1.07
	Legacy Reserves L.P.	LGCY		27.49	0.92	1.13	1.03	1.00	0.94
	Enerplus Corporation	ERF	CB	15.51	0.64	1.20	1.07	0.86	0.82
	San Juan Basin Royalty Trust	SJT	CB	13.59	0.54	1.13	0.89	0.75	0.65
	Mesa RoyaltyTrust	MTR		26.07	0.57	1.05	0.89	0.73	0.66
	Hugoton RoyaltyTrust	HGT		6.15	0.27	1.06	0.84	0.47	0.44
	<i>Median</i>				<i>0.64</i>	<i>1.13</i>	<i>1.01</i>	<i>0.86</i>	<i>0.82</i>

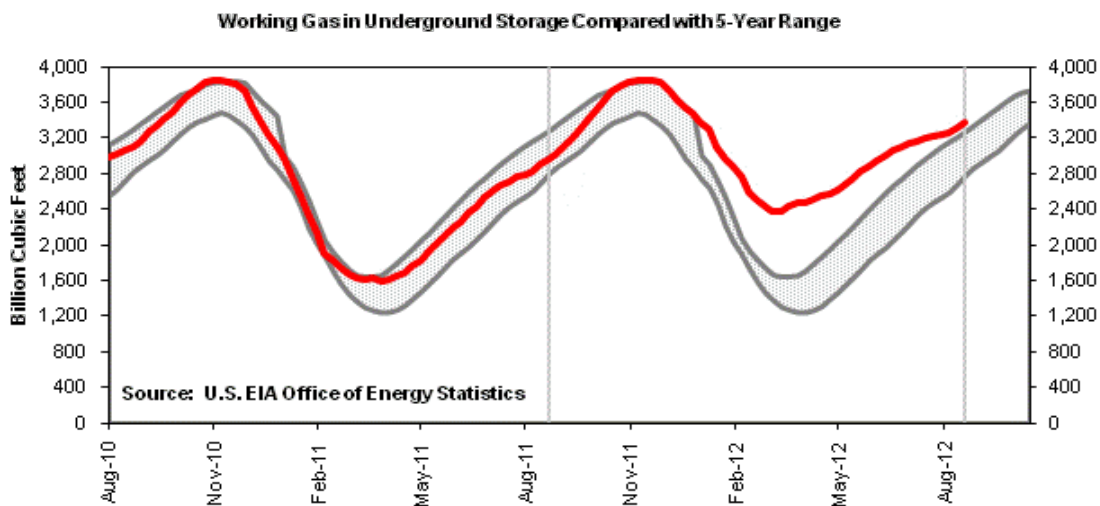
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**Research Methodology/Ratings Description:** McDep LLC is an independent research originator focused on oil and gas stocks exclusively. The firm applies the forty years of experience of its analyst to estimate a present value of the oil and gas resources and other businesses of covered companies. That value is compared with a company's stock market capitalization and debt. Stocks with low market cap and debt relative to present value tend to outperform stocks with high market cap and debt relative to present value. Buy recommendations are expected to deliver a total return better than 7% per year above inflation. Hold recommendations assume the attributes of the underlying business are reflected in the current price of the stock. Sell recommendations are expected to deliver a total return less than inflation.