Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

February 6, 2009

Penn West Strengthens Its Balance Sheet

Summary and Recommendation

Hold-rated **Penn West Energy Trust (PWE)** completed a surprise offering of new units on February 3 following an announcement on January 30. Management's action appears prudent under the circumstances and adds assurance that the trust will survive tough times to be in a position to prosper when economic growth resumes. An increase in equity matching a corresponding reduction in debt has a neutral effect on McDep Ratio. Yet, the resulting immediate reduction in stock price after the announcement reduces already low McDep Ratio and makes the deal more attractive to new buyers. Meanwhile, as industry conditions have evolved, **Enerplus Resources Fund (ERF)** is looking stronger than PWE in our analytical framework with a lower McDep Ratio, only nominal debt, similarly low unlevered cash flow multiple (EV/Ebitda) and a lower, but more sustainable, distribution yield (see Tables 1, 2, 3).

Debt Capacity Influenced by Hedging and Resource Value

PWE's ratio of debt to present value of 0.26, down from 0.27 last week normally would not be a great concern considering our traditional borderline debt limit of 0.50. Moreover four stocks in our coverage of 17 income and small cap issues have higher debt than PWE.

Trusts and companies with higher debt also tend to hedge oil and gas prices with financial counterparties. In the case of **Linn Energy (LINE)**, we understand that the market value of such derivative contracts at the end of 2008 may have the effect of reducing the partnership's debt to PV ratio by our calculation from 0.52 to perhaps 0.30. Not fond of derivatives, we like to see management cash out of hedges while values are high and use the proceeds to reduce risk by paying down debt. We are pleased to see that Penn West management has done some of that and may do more.

While hedges may mitigate debt concerns, fears of lower present value may accentuate them. Though we use $75 a barrel in our calculation of PV, a median McDep Ratio of 0.6 for small cap and income stocks implies that investors may be acting as though the long-term price were $45 instead. In that case, a debt to PV ratio of 0.30 would become 0.50. PWE has increased its cushion against that possibility. We hope the timing of PWE's stock offering signals the bottom of stock price for years to come.

Kurt H. Wulff, CFA

Table 1

Oil and Gas Income and Small Cap Stocks

Net Present Value and McDep Ratio

	Symbol/	Rating	*Price ($/sh) 5-Feb 2009*	*Shares (mm)*	*Market Cap ($mm)*	*Net Present Value ($/un)*	*Debt/ Present Value*	*McDep Ratio*
Canadian Income Trusts (US$)								
Pengrowth Energy Trust	PGH		8.24	249.0	2,050	16.00	0.32	0.67
Penn West Energy Trust	PWE	H	11.05	410.0	4,530	25.00	0.26	0.59
Enerplus Resources Fund	ERF		20.89	164.9	3,440	44.00	0.10	0.52
Canadian Oil Sands Trust	COSWF	B	16.63	482.0	8,020	42.00	0.05	0.43
Total or Median					*18,000*		*0.18*	*0.56*
Small Cap Independent Producers								
Encore Acquisition Company	EAC	H	28.73	53.5	1,540	48.00	0.36	0.74
Berry Petroleum Company	BRY	H	7.52	45.5	340	40.00	0.43	0.54
Birchcliff Energy Ltd. (US$)	BIR.TO		3.96	117.0	460	10.00	0.14	0.48
Cimarex Energy Company	XEC	B	27.18	84.5	2,300	70.00	0.09	0.44
Total or Median					*4,640*		*0.25*	*0.51*
U.S. Royalty Trusts								
Sabine Royalty Trust	SBR		42.29	14.6	620	47.00	-	0.90
Cross Timbers Royalty Trust	CRT		34.22	6.0	210	42.00	-	0.81
Permian Basin RT	PBT		12.59	46.6	590	19.00	-	0.66
San Juan Basin Royalty Trust	SJT	H	19.22	46.6	900	34.00	-	0.57
Mesa RoyaltyTrust	MTR		34.03	1.9	60	67.00	-	0.50
Hugoton RoyaltyTrust	HGT	B	12.96	40.0	520	28.00	-	0.46
Total or Median					*2,900*			*0.61*
U.S. Master Limited Partnerships (MLPs)								
Linn Energy, LLC	LINE		16.08	114.0	1,830	14.00	0.52	1.07
Encore Energy Partners, L.P. (32%)	ENP		13.52	10.6	140	19.00	0.23	0.78
Dorchester Minerals, L.P.	DMLP		19.28	28.2	540	24.00	-	0.80
Total or Median					*2,510*		*0.23*	*0.80*
B = Buy, H = Hold								
McDep Ratio = **M**arket **c**ap and **De**bt to **p**resent value of oil and gas and other businesses								
Present Value presumes long-term prices of $75 a barrel for oil and $10 a million btu for natural gas.								

Table 2									
Oil and Gas Income and Small Cap Stocks									
Value Multiples - Rank by EV/Ebitda									
			Price	*Adjstd*					
			($/sh)	*Resrvs/*	*PV/*	*EV/*			*Ebitda*
	Symbol/		*5-Feb*	*Prod*	*Ebitda*	*Ebitda*	*P/E*		*Margin*
		Rating	*2009*	*NTM*	*NTM*	*NTM*	*NTM*		*(%)*
Canadian Income Trusts (US$)									
Canadian Oil Sands Trust	COSWF	B	16.63	23.3	28.0	12.0			41
Pengrowth Energy Trust	PGH		8.24	9.5	12.4	8.3			70
Penn West Energy Trust	PWE	H	11.05	8.3	11.1	6.5			75
Enerplus Resources Fund	ERF		20.89	10.6	12.4	6.5			74
Median				*10.0*	*12.4*	*7.4*			*72*
Small Cap Independent Producers									
Encore Acquisition Company	EAC		28.73	13.4	13.6	10.1			53
Birchcliff Energy Ltd. (US$)	BIR.TO		3.96	6.9	20.9	10.0			73
Berry Petroleum Company	BRY		7.52	9.6	12.0	6.5	8.7		60
Cimarex Energy Company	XEC		27.18	7.4	11.6	5.1			56
Median				*8.5*	*12.8*	*8.2*			*58*
U.S. Royalty Trusts									
Cross Timbers Royalty Trust	CRT		34.22	14.5	17.1	13.9	14.7		74
Sabine Royalty Trust	SBR		42.29	9.2	15.1	13.6	13.5		96
San Juan Basin Royalty Trust	SJT	H	19.22	10.6	20.5	11.6	14.7		68
Permian Basin RT	PBT		12.59	8.8	16.3	10.8	12.6		75
Mesa RoyaltyTrust	MTR		34.03	21.1	15.3	7.7	8.9		82
Hugoton RoyaltyTrust	HGT	B	12.96	13.1	15.6	7.2	10.4		63
Median				*11.9*	*15.9*	*11.2*	*13.1*		*74*
U.S. Master Limited Partnerships (MLPs)									
Dorchester Minerals, L.P.	DMLP		19.28	8.5	16.2	13.0	24.2		86
Linn Energy, LLC	LINE		16.08	13.6	11.3	12.1			70
Encore Energy Partners, L.P.	ENP		13.52	12.7	13.3	10.3			70
Median				*12.7*	*13.3*	*12.1*	*24.2*		*70*
EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation									
and amortization; NTM = Next Twelve Months Ended December 31, 2009; P/E = Stock Price to									
Earnings; PV = Present Value of oil and gas and other businesses									

Table 3								
Oil and Gas Income and Small Cap Stocks								
Next Twelve Months Distribution Yield								
			Natural					
		Revenue	*Gas*		*Dist/*			*Dist.*
	Symbol	*Royalty*	*%*	*Dist/*	*Equity*	*NTM Distribution*		*Yield*
		(%)	*NPV*	*Ebitda*	*Ebitda*	*($mm)*	*($/un)*	*(%)*
Canadian Income Trusts (US$)								
Canadian Oil Sands Trust	COSWF	-	-	0.30	0.32	233	0.48	2.9
Enerplus Resources Fund	ERF	-	56	0.46	0.51	298	1.81	8.7
Pengrowth Energy Trust	PGH	-	34	0.88	1.28	412	1.66	20.1
Penn West Energy Trust	PWE	-	29	0.74	1.00	918	2.24	20.3
Total or Median			*32*	*0.60*	*0.75*	*1,900*		*14.4*
Small Cap Independent Producers								
Birchcliff Energy Ltd. (US$)	BIR.TO	-	75	-	-	-	-	-
Encore Acquisition Company	EAC	-	18	-	-	-	-	-
Cimarex Energy Company	XEC	-	65	0.04	0.04	20	0.24	0.9
Berry Petroleum Company	BRY	-	42	0.05	0.09	14	0.30	4.0
Total or Median			*53*					
U.S. Royalty Trusts								
San Juan Basin Royalty Trust	SJT	-	100	0.79	0.79	61	1.31	6.8
Cross Timbers Royalty Trust	CRT	84	76	0.95	0.95	14	2.33	6.8
Sabine Royalty Trust	SBR	100	54	1.00	1.00	46	3.12	7.4
Permian Basin RT	PBT	32	33	0.85	0.85	46	1.00	7.9
Hugoton RoyaltyTrust	HGT	-	91	0.69	0.69	50	1.25	9.6
Mesa RoyaltyTrust	MTR	-	75	0.87	0.87	7	3.83	11.2
Total or Median			*76*	*0.86*	*0.86*	*220*		*7.6*
U.S. Master Limited Partnerships (MLPs)								
Dorchester Minerals, L.P.	DMLP	64	68	1.02	1.02	43	1.51	7.8
Encore Energy Partners, L.P.	ENP		30	1.08	1.40	21	2.00	14.8
Linn Energy, LLC	LINE		48	0.97	2.04	287	2.52	15.7
Total or Median			*48*	*1.02*	*1.40*	*350*		*14.8*
NTM = Next Twelve Months Ended December 31, 2009								
Ebitda = Earnings before interest, tax, depreciation and amortization								

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