



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

March 5, 2010

## **Raise Distribution for DMLP, HGT, SJT; NPV for SJT**

### **Summary and Recommendation**

We raise our estimated 2010 distribution yield for buy-recommended **Dorchester Minerals (DMLP)**, **Hugoton Royalty Trust (HGT)** and **San Juan Basin Royalty Trust (SJT)** to 8.9%, 8.2% and 8.1% respectively, because the natural gas price trend has been better for the North American average than for the widely quoted New York Mercantile Exchange near month futures. New capacity has made the continental pipeline transmission grid more efficient. We also raise estimated Net Present Value (NPV) for SJT to \$23 a share from \$21 because year-end 2009 reserves estimated by the independent engineer, disclosed on March 1, point to a longer life index of more than 15 years compared to 9 years previously. While we never believed the low number, it had a restraining influence on our estimate of NPV and perhaps stock price.

### **Price Differentials Trend Up**

Regional price differentials are recovering from surprisingly wide discounts compared to the Henry Hub reference point in Louisiana. Each producer is typically active in more than one region and makes different adjustments to price. We can see the overall trend in the history and projections in two of our income groups (see charts on page 2, [Natural Gas Price Differential](#)). Natural gas transmission has some “common carrier” characteristics with “equal access” under government regulation. In a fully developed transportation system with ample capacity the differences in price from region to region ought to be minimal, similar to commissions on securities transactions when trading is active. Major contributors to the current leveling include the completion of west to east pipeline capacity and new shale gas supply close to the Henry Hub.

### **Raise NPV for SJT on Reserve Life**

Independent estimates of reserves for royalty trusts, like local government assessments on real estate, have conflicting implications. When estimates are low, tax payments are lower, but the suggested market value is also low. In the case of royalty trusts, investors claim depletion to reduce income taxes. A low ratio of reserves to production, as was the case for SJT a year ago, allows for more depletion and lower income tax payments. That could be an advantage to long-term owners. Yet when a low reserve life for a natural gas property, or a low assessed value for a house influences realized price, the owner who sells at that time may be disadvantaged. Technically, we calculate reserve life for SJT by scaling up the engineer’s estimate of royalty reserves by the ratio of working interest production to royalty interest production and dividing by 2010 working interest production. On the revised estimate, NPV for SJT looks more reasonable in the relationship of cash flow multiple and reserve life (see Table 3).

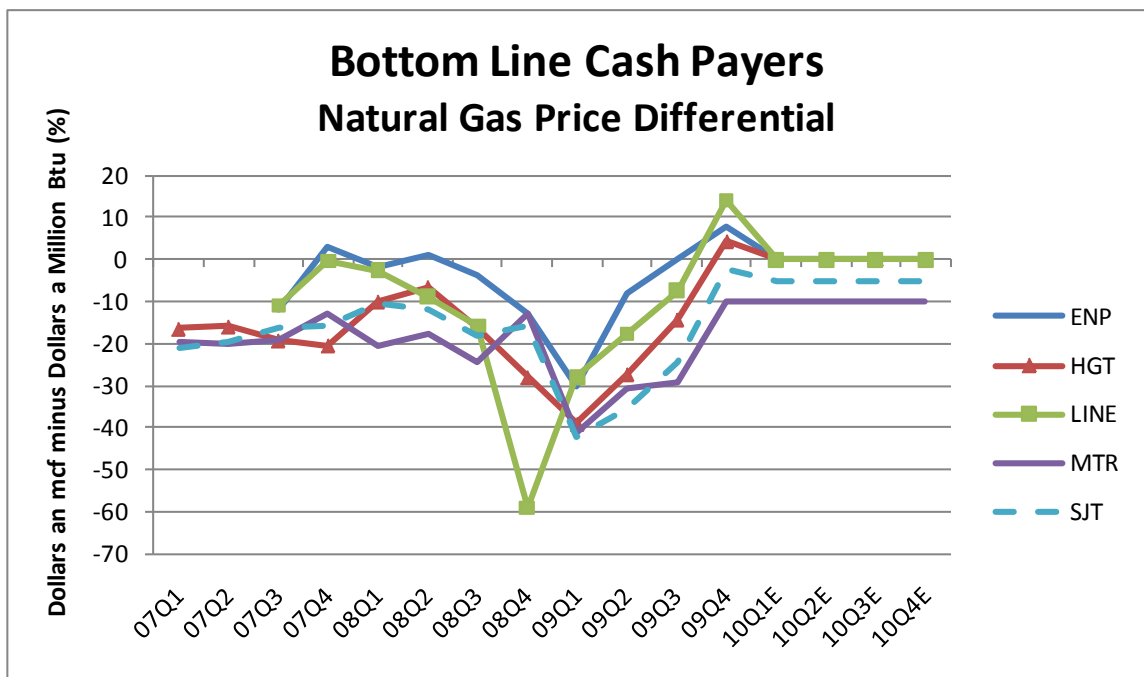
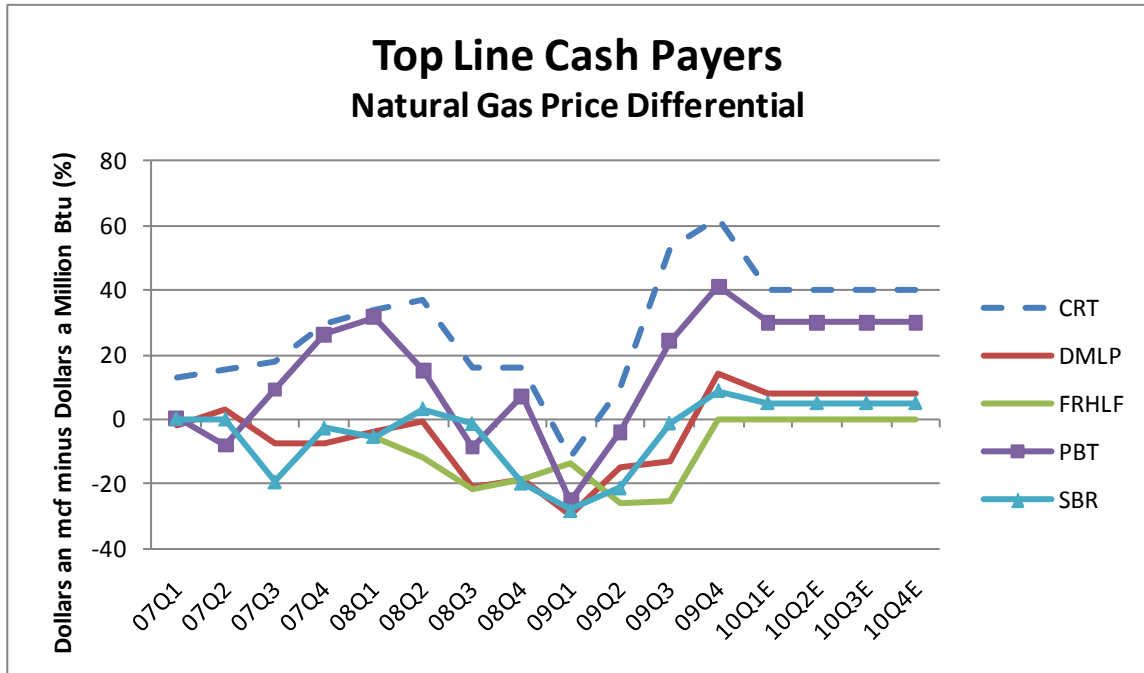
Kurt H. Wulff, CFA



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

March 5, 2010





# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

March 5, 2010

	Symbol/Rating	Price (US\$/sh)	EV/ Market	Enterprise Value (\$mm)	Present Value by Segment (%)		Dist. NTM (\$/un)	Dist. Yield (%)	McDep Ratio
					NAmer. Natural Gas	Oil Prod'n			
	B = Buy CB (see below)	4-Mar 2010	Cap						
<b>Canadian Income Trusts (US\$)</b>									
Penn West Energy Trust	PWE	20.63	1.46	12,700	23	78	1.73	8.4	1.06
Peyto Energy Trust	PEYUF	13.32	1.26	1,930	71	29	1.38	10.4	1.02
Pengrowth Energy Trust	PGH	10.87	1.48	4,700	35	65	0.81	7.4	0.93
Enerplus Resources Fund	ERF	23.11	1.21	5,000	41	59	2.07	9.0	0.80
Canadian Oil Sands Trust	COSWF B	27.27	1.10	14,500		100	1.34	4.9	0.74
<i>Total or Median</i>				38,800					0.93
<b>Small Cap Independent Producers</b>									
Encore Acquisition Company	EAC	51.14	1.60	4,260	22	78	-	-	1.01
Whiting Petroleum Corporation	WLL	75.74	1.34	6,090	15	85	-	-	0.99
Cimarex Energy Company	XEC B	59.80	1.14	5,640	62	38	0.32	0.5	0.93
Berry Petroleum Company	BRY	28.36	1.90	2,440	31	69	0.30	1.1	0.89
Birchcliff Energy Ltd. (US\$)	BIREF	8.95	1.17	1,410	76	24	-	-	0.84
<i>Total or Median</i>				19,800					0.93
<b>Top Line Cash Payers</b>									
Sabine Royalty Trust	SBR	48.29	1.00	700	39	61	3.48	7.2	1.07
Cross Timbers Royalty Trust	CRT	33.20	1.00	200	78	22	2.63	7.9	0.98
Freehold Royalty Trust (US\$)	FRHLF	15.84	1.17	1,060	27	73	1.65	10.4	0.94
Permian Basin RT	PBT	16.87	1.00	790	27	73	1.26	7.5	0.94
Dorchester Minerals, L.P.	DMLP B	21.46	1.03	660	67	33	1.91	8.9	0.80
<i>Total or Median</i>				3,400					0.94
<b>Bottom Line Cash Payers</b>									
Linn Energy, LLC	LINE	27.26	1.43	4,950	41	59	2.52	9.2	1.36
Encore Energy Partners, L.P. (52%)	ENP	20.54	1.28	620	23	77	2.15	10.5	1.16
San Juan Basin Royalty Trust	SJT B	20.76	1.00	970	100	-	1.68	8.1	0.90
Mesa Royalty Trust	MTR	41.81	1.00	78	75	25	3.88	9.3	0.87
Hugoton Royalty Trust	HGT B	17.90	1.00	720	88	12	1.47	8.2	0.85
<i>Total or Median</i>				7,300					0.90
<b>Composite (excl COSWF)</b>									
<i>Enterprise Value Weighting</i>				54,900	37	63			0.98
<i>Equal Weighting</i>					50	50			0.97
<i>Equal Weighted Buys</i>					70	30			0.87
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 \$75 a barrel for oil and \$8 a million btu for natural gas.									
Dist. = Income distribution. NTM = Next Twelve Months Ended December 31, 2010. Enterprise Value = Market Cap and Debt.									



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

March 5, 2010

Table 2								
Oil and Gas Income and Small Cap Stocks								
Net Present Value and McDep Ratio								
			Price (\$/sh)		Market	Net		
	Symbol/		4-Mar	Shares	Cap	Value	Debt/	McDep
	Rating		2010	(mm)	(\$mm)	(\$/un)	Value	Ratio
<b>Canadian Income Trusts (US\$)</b>								
Penn West Energy Trust	PWE		20.63	420.7	8,680	19.00	0.33	1.06
Peyto Energy Trust	PEYUF		13.32	114.9	1,530	13.00	0.21	1.02
Pengrowth Energy Trust	PGH		10.87	290.0	3,150	12.00	0.30	0.93
Enerplus Resources Fund	ERF		23.11	177.0	4,090	30.00	0.14	0.80
Canadian Oil Sands Trust	COSWF	B	27.27	484.0	13,200	38.00	0.07	0.74
<i>Total or Median</i>					30,700		0.21	0.93
<b>Small Cap Independent Producers</b>								
Encore Acquisition Company	EAC		51.14	52.3	2,670	50.00	0.38	1.01
Whiting Petroleum Corporation	WLL		75.74	59.0	4,540	78.00	0.25	0.99
Cimarex Energy Company	XEC	B	59.80	82.6	4,940	65.00	0.12	0.93
Berry Petroleum Company	BRY		28.36	45.0	1,280	35.00	0.42	0.89
Birchcliff Energy Ltd. (US\$)	BIREF		8.95	134.0	1,200	11.00	0.12	0.84
<i>Total or Median</i>					14,630		0.25	0.93
<b>Top Line Cash Payers</b>								
Sabine Royalty Trust	SBR		48.29	14.6	700	45.00	-	1.07
Cross Timbers Royalty Trust	CRT		33.20	6.0	200	34.00	-	0.98
Freehold Royalty Trust (US\$)	FRHLF		15.84	57.2	910	17.00	0.14	0.94
Permian Basin RT	PBT		16.87	46.6	790	18.00	-	0.94
Dorchester Minerals, L.P.	DMLP	B	21.46	29.8	640	27.00	0.02	0.80
<i>Total or Median</i>					3,240			0.94
<b>Bottom Line Cash Payers</b>								
Linn Energy, LLC	LINE		27.26	127.0	3,460	17.00	0.41	1.36
Encore Energy Partners, L.P. (52%)	ENP		20.54	23.6	480	17.00	0.25	1.16
San Juan Basin Royalty Trust	SJT	B	20.76	46.6	970	23.00	-	0.90
Mesa Royalty Trust	MTR		41.81	1.9	78	48.00	-	0.87
Hugoton Royalty Trust	HGT	B	17.90	40.0	720	21.00	-	0.85
<i>Total or Median</i>					5,710			0.90
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 \$75 a barrel for oil and \$8 a million btu for natural gas.								



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

March 5, 2010

Table 3								
Oil and Gas Income and Small Cap Stocks								
Value Multiples - Rank by EV/Ebitda								
			Price (\$/sh)	Revenue	Dist/ Equity	Adjstd Resrvs/ Prod	PV/ Ebitda	EV/ Ebitda
	Symbol/ Rating		4-Mar 2010	Royalty (%)	Ebitda	NTM	NTM	NTM
<b>Canadian Income Trusts (US\$)</b>								
	PEYUF		13.32		1.35	18.2	12.7	13.0
	COSWF	B	27.27		0.47	23.1	13.3	9.8
	PWE		20.63		0.73	9.6	8.0	8.5
	PGH		10.87		0.53	8.3	7.9	7.4
	ERF		23.11		0.59	9.6	8.5	6.8
	<i>Median</i>					9.6	8.5	8.5
<b>Small Cap Independent Producers</b>								
	BIREF		8.95		-	12.1	16.7	14.0
	EAC		51.14		-	12.1	7.9	8.0
	BRY		28.36		-	12.9	8.8	7.8
	WLL		75.74		-	10.9	7.4	7.3
	XEC	B	59.80		-	6.9	5.8	5.4
	<i>Median</i>					12.1	7.9	7.8
<b>Top Line Cash Payers</b>								
	SBR		48.29	100	1.00	9.3	12.9	13.9
	CRT		33.20	84	0.96	12.9	12.5	12.1
	PBT		16.87	32	0.90	21.0	12.8	12.0
	DMLP	B	21.46	64	0.94	7.9	13.4	10.7
	FRHLF		15.84	71	1.02	8.8	10.6	9.9
	<i>Median</i>					9.3	12.8	12.0
<b>Bottom Line Cash Payers</b>								
	LINE		27.26		1.93	19.1	13.0	17.7
	ENP		20.54		1.14	12.5	9.0	10.4
	SJT	B	20.76		0.81	15.9	11.1	10.1
	MTR		41.81		0.92	8.0	11.4	9.9
	HGT	B	17.90		0.76	11.8	10.9	9.3
	<i>Median</i>					12.5	11.1	10.1
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 December 31, 2010; 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 5, 2010

**Disclaimer:** This analysis was prepared by Kurt Wulff, Manager of McDep LLC. The firm used sources and data believed to be reliable, but makes no representation as to their accuracy or completeness. This analysis is intended for informational purposes and is not a solicitation to buy or sell a security. Past performance is no guarantee of future results.

McDep or its employees may take positions in stocks the firm covers for research purposes. No trades in a subject stock shall be made within a week before or after a change in recommendation.

**Certification:** I, Kurt H. Wulff, certify that the views expressed in this research analysis accurately reflect my personal views about the subject securities and issuers. No part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this research analysis.

**Research Methodology/Ratings Description:** McDep LLC is an independent research originator focused on oil and gas stocks exclusively. The firm applies the thirty 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.