



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

May 28, 2010

## Shell Shale Gas Deal Boosts Independent Producers

### Summary and Recommendation

Continuing to attract investor interest during tumultuous weeks, buy recommended small cap independent oil and gas producers **Cimarex Energy (XEC)** and **Birchcliff Energy (BIREF)** trend upward in stock price compared to the 200-day average. Oil producers **Whiting Petroleum (WLL)** and **Berry Petroleum (BRY)** also have positive stock price momentum by the same measure. Added to our coverage this year, **Range Resources (RRC)**, **PetroHawk (HK)** and **Ultra Petroleum (UPL)** trend downward in stock price compared to the 200-day average thereby improving their attractiveness by the McDep Ratio (see Tables 1-3 on pages 5-7). All seven stocks have exciting upside in a scenario of global growth fueled by clean, secure energy. Today's announcement that contrarian buy-recommended **Royal Dutch Shell (RDS)** agreed to pay \$4.7 billion for a private shale gas producer validates that appeal. As Canadian small cap BIREF achieved the first phase of its rapid expansion in 2010 we added it to our buy recommendations on May 13. RRC could justify its current McDep Ratio premium before long as it develops its large, valuable acreage position in the shale gas boom in Pennsylvania, ignited when RRC drilled the industry's first big Marcellus well in 2004. HK's explosive growth is already evident in its steeply rising production from the Haynesville shale gas trend in Louisiana (see chart on page 2, [Volume](#)). Each of the stocks has the prospect to double or more in the next few years while also being more sensitive to political, economic, financial and industrial risk.

### Low Cash Flow Multiple for Cimarex

Breaking down Net Present Value (NPV) by separate reserve life and cash flow multiple for natural gas and for oil, we see for Cimarex that our standard estimate of \$75 a share is lower than the approximation for peer stocks (see tables on page 2-4, [Functional Cash Flow and Present Value](#)). The example illustrates how small cap companies can create rapid changes in value with changes in production volume and reserves. Higher reserves tend to increase life index and higher production tends to increase cash flow.

### Roll Forward NTM to June 30, 2011

Choosing the next twelve months as the most relevant period for estimating an annual rate of cash flow, or income, we need to adjust the date periodically as we did this week. Adding in the second quarter of 2011 and taking out the second quarter of 2010 happens to reduce cash flow modestly on the basis of futures prices for oil and gas as of Monday, May 24. Futures prices settled higher on Thursday, May 27, but we usually make our weekly calculations on Monday settlements.

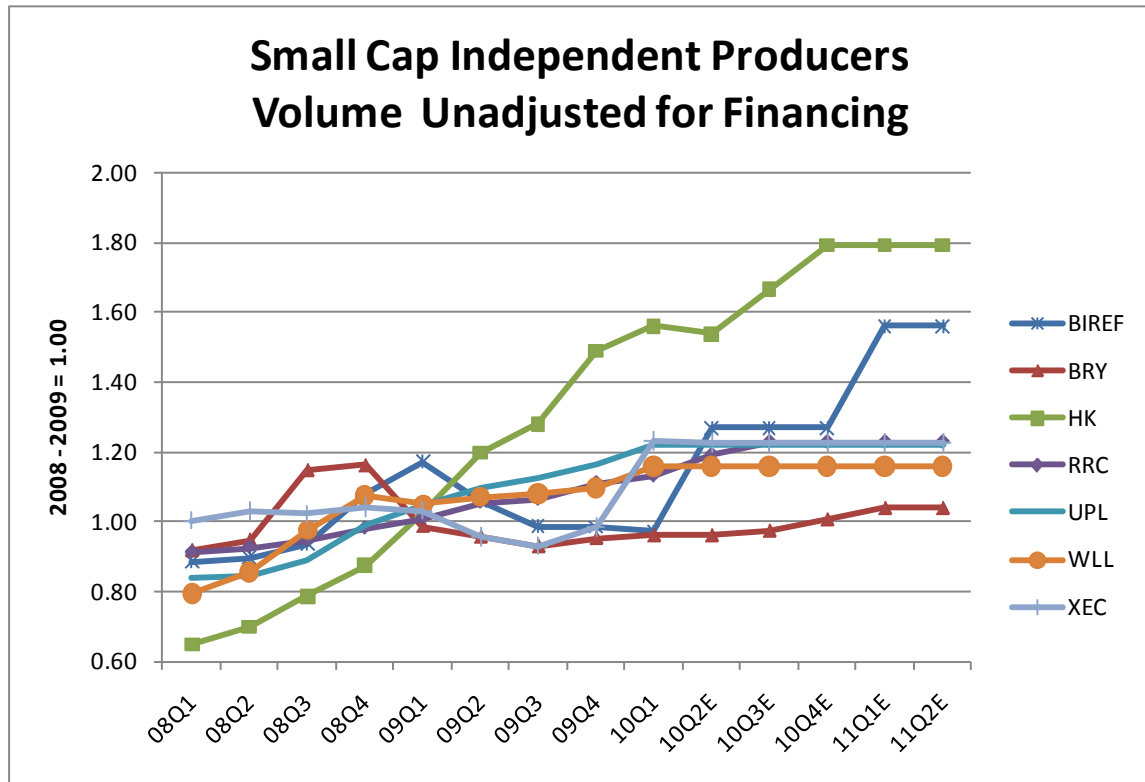
Kurt H. Wulff, CFA



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Cimrex Energy Company					
Functional Cash Flow and Present Value					
	<i>NTM Ebitda</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Present</i>	
	<i>(US\$mm)</i>	<i>R/P</i>	<i>Ebitda</i>	<i>Value</i>	
				<i>(US\$mm)</i>	
North American Natural Gas	570	7.2	8.1	4,600	66%
Oil	585	4.8	4.1	2,420	34%
	1,155	6.4	6.1	7,020	100%
Debt (US\$mm)					620
Net Present Value (US\$mm)					6,400
Shares (mm)					85
Net Present Value - Standard Estimate (US\$/sh)					75
NPV Approximation by Cash Flow Multiple Depending on Reserve Life (US\$/sh)					89



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<b>Birchcliff Energy Ltd.</b>					
<b>Functional Cash Flow and Present Value</b>					
	<i>NTM</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Present</i>	
	<i>Ebitda</i>	<i>R/P</i>	<i>Ebitda</i>	<i>Value</i>	
North American Natural Gas	65	24.3	20.3	1,320	65%
Oil	66	17.7	10.6	700	35%
	131	22.4	15.4	2,020	100%
Debt					240
Net Present Value (US\$m)					1,780
Shares					127
Net Present Value - Standard Estimate (US\$/sh)					14
NPV Approximation by Cash Flow Multiple Depending on Reserve Life (US\$/sh)					15

<b>Whiting Petroleum Corporation</b>					
<b>Functional Cash Flow and Present Value</b>					
	<i>NTM Ebitda</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Present</i>	
	<i>(US\$m)</i>	<i>R/P</i>	<i>Ebitda</i>	<i>Value</i>	
				<i>(US\$m)</i>	
North American Natural Gas	87	9.2	10.4	900	13%
Oil	755	10.6	7.8	5,850	87%
	841	10.3	8.0	6,750	100%
Debt (US\$m)					1,130
Net Present Value (US\$m)					5,620
Shares (mm)					59
Net Present Value - Standard Estimate (US\$/sh)					95
NPV Approximation by Cash Flow Multiple Depending on Reserve Life (US\$/sh)					96

<b>Berry Petroleum Company</b>					
<b>Functional Cash Flow and Present Value</b>					
	<i>NTM Ebitda</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Present</i>	
	<i>(US\$m)</i>	<i>R/P</i>	<i>Ebitda</i>	<i>Value</i>	
				<i>(US\$m)</i>	
North American Natural Gas	50	22.8	18.0	900	31%
Oil	292	10.3	6.7	1,960	69%
	342	13.1	8.4	2,860	100%
Debt (US\$m)					1,070
Net Present Value (US\$m)					1,790
Shares (mm)					51
Net Present Value - Standard Estimate (US\$/sh)					35
NPV Approximation by Cash Flow Multiple Depending on Reserve Life (US\$/sh)					42



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<b>Range Resources Corporation</b>					
<b>Functional Cash Flow and Present Value</b>					
	<i>NTM Ebitda</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Present</i>	
	<i>(US\$mm)</i>	<i>R/P</i>	<i>Ebitda</i>	<i>Value</i>	
				<i>(US\$mm)</i>	
North American Natural Gas	447	13.4	13.4	6,000	81%
Oil	188	12.1	7.6	1,430	19%
	635	13.2	11.7	7,430	100%
Debt (US\$mm)					1,830
Net Present Value (US\$mm)					5,600
Shares (mm)					160
Net Present Value - Standard Estimate (US\$/sh)					35
NPV Approximation by Cash Flow Multiple Depending on Reserve Life (US\$/sh)					34

<b>Petrohawk Energy Corporation</b>					
<b>Functional Cash Flow and Present Value</b>					
	<i>NTM Ebitda</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Present</i>	
	<i>(US\$mm)</i>	<i>R/P</i>	<i>Ebitda</i>	<i>Value</i>	
				<i>(US\$mm)</i>	
North American Natural Gas	782	7.2	9.4	7,330	97%
Oil	52	5.1	5.0	260	3%
	834	7.1	9.1	7,590	100%
Debt (US\$mm)					2,740
Net Present Value (US\$mm)					4,850
Shares (mm)					303
Net Present Value - Standard Estimate (US\$/sh)					16
NPV Approximation by Cash Flow Multiple Depending on Reserve Life (US\$/sh)					17

<b>Ultra Petroleum Corporation</b>					
<b>Functional Cash Flow and Present Value</b>					
	<i>NTM Ebitda</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Present</i>	
	<i>(US\$mm)</i>	<i>R/P</i>	<i>Ebitda</i>	<i>Value</i>	
				<i>(US\$mm)</i>	
North American Natural Gas	622	14.0	13.4	8,300	94%
Oil	59	16.1	9.4	560	6%
	681	14.1	13.0	8,860	100%
Debt (US\$mm)					1,160
Net Present Value (US\$mm)					7,700
Shares (mm)					154
Net Present Value - Standard Estimate (US\$/sh)					50
NPV Approximation by Cash Flow Multiple Depending on Reserve Life (US\$/sh)					54



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	Symbol/Rating	Price (US\$/sh)	EV/ Market	Enterprise Value (\$mm)	Present Value by Segment (%)					McDep Ratio
					N.Amer. Natural Gas	Oil Prod'n	Dist. NTM (\$/un)	Dist. Yield (%)		
	B = Buy CB (see below)	27-May 2010	Cap							
<b>Canadian Income Trusts (US\$)</b>										
Peyto Energy Trust	PEYUF	13.25	1.26	2,020	76	24	1.36	10.3	0.91	
Pengrowth Energy Trust	PGH	9.50	1.46	4,000	39	61	0.79	8.4	0.90	
Penn West Energy Trust	PWE	19.25	1.40	11,500	23	77	1.70	8.8	0.88	
Enerplus Resources Fund	ERF	21.78	1.22	4,800	42	58	2.04	9.4	0.77	
Canadian Oil Sands Trust	COSWF CB	26.60	1.10	14,200		100	1.89	7.1	0.72	
<i>Total or Median</i>				36,500					0.88	
<b>Small Cap Independent Producers</b>										
Range Resources	RRC	44.95	1.25	9,020	81	19	0.08	0.2	1.21	
Petro-Hawk	HK	19.09	1.47	8,530	97	3	-	-	1.12	
Cimarex Energy Company	XEC B	72.45	1.10	6,810	66	34	0.32	0.4	0.97	
Berry Petroleum Company	BRY	31.24	1.67	2,660	31	69	0.30	1.0	0.93	
Whiting Petroleum Corporation	WLL	83.48	1.23	6,070	13	87	-	-	0.90	
Ultra Petroleum	UPL	45.17	1.17	8,120	94	6	-	-	0.92	
Birchcliff Energy Ltd. (US\$)	BIREF B	8.92	1.22	1,370	65	35	-	-	0.68	
<i>Total or Median</i>				41,200					0.95	
<b>Top Line Cash Payers</b>										
Sabine Royalty Trust	SBR	49.21	1.00	720	39	61	3.21	6.5	1.09	
Cross Timbers Royalty Trust	CRT	33.68	1.00	200	78	22	2.36	7.0	0.99	
Permian Basin RT	PBT	17.78	1.00	830	27	73	1.10	6.2	0.99	
Dorchester Minerals, L.P.	DMLP B	26.04	1.02	790	67	33	1.69	6.5	0.97	
Freehold Royalty Trust (US\$)	FRHLF	15.57	1.09	990	29	71	1.59	10.2	0.92	
<i>Total or Median</i>				3,500					0.99	
<b>Bottom Line Cash Payers</b>										
Linn Energy, LLC	LINE	24.78	1.48	5,280	45	55	2.52	10.2	1.11	
Legacy Reserves L.P.	LGCY	22.10	1.40	1,210	16	84	2.08	9.4	1.07	
San Juan Basin Royalty Trust	SJT B	23.47	1.00	1,090	100	-	1.32	5.6	1.02	
Mesa Royalty Trust	MTR	46.50	1.00	87	75	25	3.12	6.7	0.97	
Encore Energy Partners, L.P. (52%)	ENP	15.48	1.38	500	23	77	2.00	12.9	0.93	
Hugoton Royalty Trust	HGT B	18.89	1.00	760	90	10	1.49	7.9	0.90	
<i>Total or Median</i>				8,900					1.00	
<b>Composite (excl COSWF)</b>										
<i>Enterprise Value Weighting</i>				77,400	57	43			0.96	
<i>Equal Weighting</i>					55	45			0.96	
<i>Equal Weighted Buys</i>					65	35			0.91	

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 March 31, 2011. Enterprise Value = Market Cap and Debt.





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**Table 3**

## McDep Income and Small Cap Energy Portfolio Value Multiples - Rank by EV/Ebitda

			<i>Price</i>	<i>Revenue</i>	<i>Dist/</i>	<i>Adjstd</i>	
	<i>Symbol/</i>		<i>(\$/sh)</i>	<i>Royalty</i>	<i>Equity</i>	<i>Resrvs/</i>	<i>PV/</i>
	<i>Rating</i>		<i>27-May</i>	<i>(%)</i>	<i>Ebitda</i>	<i>Prod</i>	<i>Ebitda</i>
			<i>2010</i>			<i>NTM</i>	<i>NTM</i>
						<i>NTM</i>	<i>NTM</i>
<b>Canadian Income Trusts (US\$)</b>							
Peyto Energy Trust	PEYUF		13.25		1.11	23.1	12.2
Canadian Oil Sands Trust	COSWF	CB	26.60		0.68	31.0	13.6
Penn West Energy Trust	PWE		19.25		0.72	9.9	9.7
Pengrowth Energy Trust	PGH		9.50		0.63	9.9	8.7
Enerplus Resources Fund	ERF		21.78		0.64	9.7	9.4
	<i>Median</i>					9.9	9.7
							8.5
<b>Small Cap Independent Producers</b>							
Range Resources	RRC		44.95		-	13.2	11.7
Ultra Petroleum	UPL		45.17		-	14.1	13.0
Birchcliff Energy Ltd. (US\$)	BIREF	B	8.92		-	22.4	15.5
Petro-Hawk	HK		19.09		-	7.1	9.1
Berry Petroleum Company	BRY		31.24		-	13.1	8.3
Whiting Petroleum Corporation	WLL		83.48		-	10.3	8.0
Cimarex Energy Company	XEC	B	72.45		-	6.4	6.1
	<i>Median</i>					13.1	9.1
							10.2
<b>Top Line Cash Payers</b>							
Sabine Royalty Trust	SBR		49.21	100	1.00	9.3	14.0
Permian Basin RT	PBT		17.78	32	0.88	13.3	14.4
Dorchester Minerals, L.P.	DMLP	B	26.04	64	0.91	7.5	14.6
Cross Timbers Royalty Trust	CRT		33.68	84	0.96	13.5	13.8
Freehold Royalty Trust (US\$)	FRHLF		15.57	71	0.89	8.6	9.5
	<i>Median</i>					9.3	14.0
							14.1
<b>Bottom Line Cash Payers</b>							
Linn Energy, LLC	LINE		24.78		1.64	20.0	13.6
San Juan Basin Royalty Trust	SJT	B	23.47		0.78	14.8	13.6
Mesa RoyaltyTrust	MTR		46.50		0.90	9.2	13.8
Hugoton RoyaltyTrust	HGT	B	18.89		0.89	12.3	12.6
Legacy Reserves L.P.	LGCY		22.10		1.00	12.0	9.6
Encore Energy Partners, L.P.	ENP		15.48		1.23	12.9	10.4
	<i>Median</i>					12.6	13.1
							12.4

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, 2011; 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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