



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

September 3, 2010

Natural Gas Futures May Be Bottoming

Summary and Recommendation

Amid widespread low expectations for natural gas price we see signs of a bottoming that may set the stage for a multi-year advance. For more than four consecutive weeks, seasonal inventory build has been slower than normal (see chart [Working Gas in Underground Storage](#) on page 2). The positive wiggle in the inventory line follows a flat trend for one-year futures price roughly near \$5 a million btu since the spring of 2009 (see chart [Natural Gas One-Year Futures Strip](#) on page 2). Mr. Eric Miller, long-time colleague in decades past and respected investment strategist, impressed on us that a long basing period after a decline may indicate there is little more selling to be done and that new buying may drive price up. Price patterns aside, the fundamental case for natural gas as the most economic clean fuel has rarely been stronger (see [Price Pressure for Natural Gas, ISCW, March 19, 2010, <http://www.mcdep.com/rweek100319.pdf>](#)). Also we are at peak political uncertainty in the second year of the presidential cycle ahead of mid-term elections. That uncertainty is usually followed by better stock prices in the next two years. Positioning for the future, investors can choose attractive natural gas ideas among income and small cap stocks by weighing concentration of present value in the natural gas segment, income yield and McDep Ratio, among the most important considerations (see [Tables 1-3](#) on pages 3-5). With notable exceptions, income and small cap stocks offer more natural gas concentration than large cap stocks. Five buy recommendations concentrated on the clean fuel include income payers **Dorchester Minerals (DMLP)**, **Hugoton Royalty Trust (HGT)** and **San Juan Basin Royalty Trust (SJT)** along with independent producers **Birchcliff Energy (BIR)** and **Cimarex Energy (XEC)**.

Quarterly Roll Boosts Estimates Modestly

Once a quarter, usually after the distribution declaration for the second month of the quarter, we roll forward our Next Twelve Months (NTM) period by three months. Today's estimates of distribution yield are for the year ending September 30, 2011 compared to yesterday's estimates for the year ended June 30, 2011. Since futures prices that we use for our estimates have rising slope with time, the quarter added at the future end of the period usually has a higher price for oil and natural gas than the quarter dropped and at the present end of the period. Simply resulting from the roll, our estimates are a few percent higher for cash flow for practically all companies and for distributions in selective cases as in the U.S. royalty trusts, for example.

Kurt H. Wulff, CFA

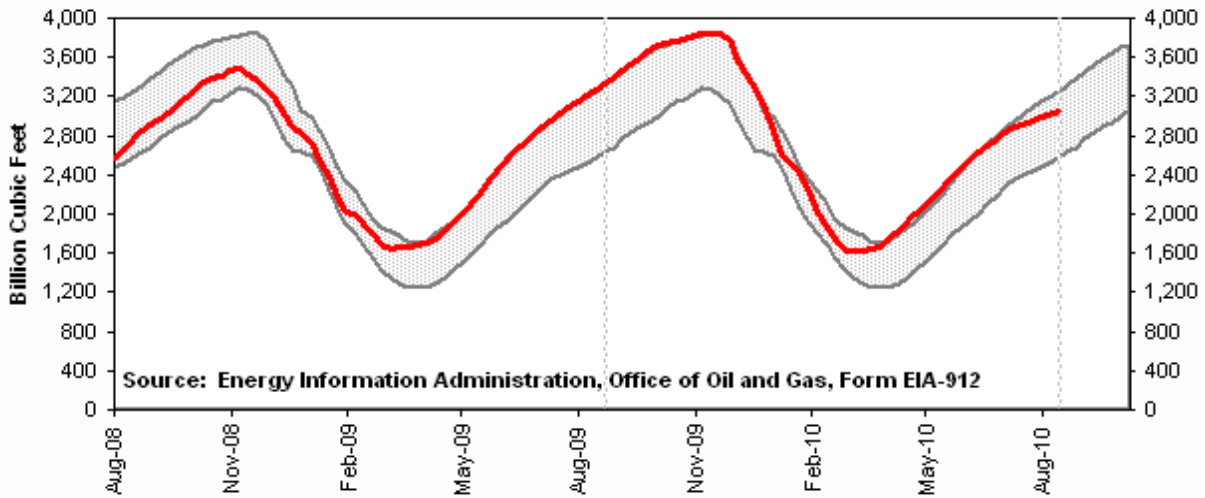


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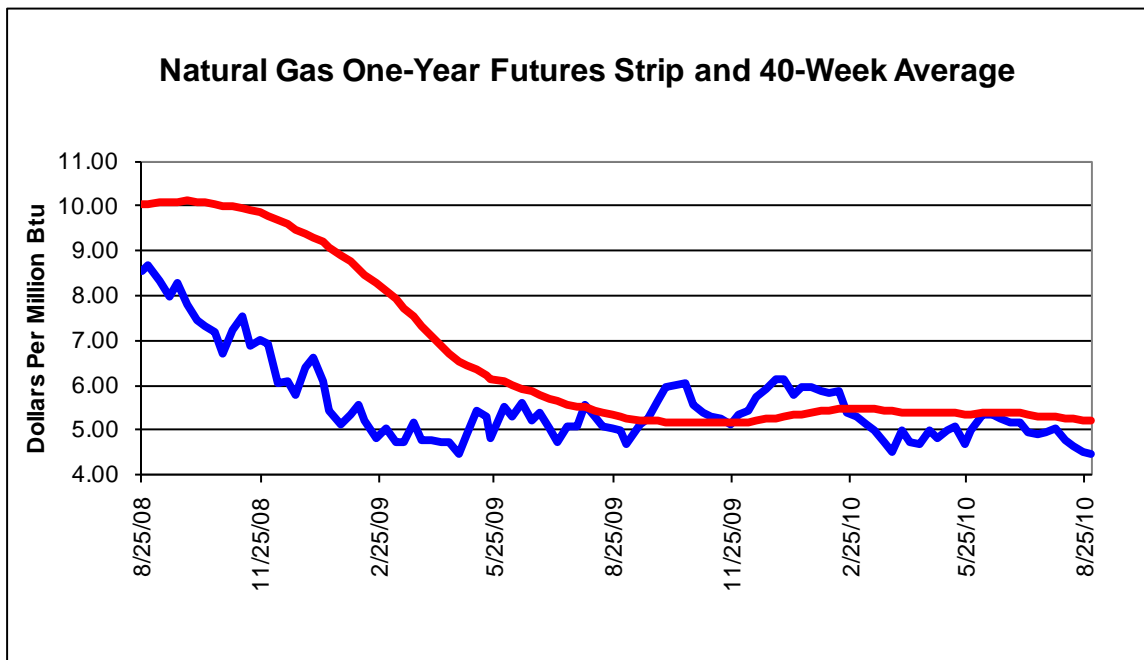
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Working Gas in Underground Storage Compared with 5-Year Range



Natural Gas One-Year Futures Strip and 40-Week Average





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Table 1									
McDep Income and Small Cap Energy Portfolio									
Debt, Business Segments and Income Yield									
Symbol/Rating	Price (US\$/sh)	EV/Market	Enterprise Value (\$mm)	Present Value by Segment (%)			Dist. Yield (%)	Dist. NTM (\$/un)	McDep Ratio
				NAmer. Natural Gas	Oil Prod'n				
B = Buy	2-Sep 2010	Market Cap							
CB (see below)									
Canadian Income Trusts (US\$)									
Pengrowth Energy Trust	PGH	9.92	1.44	4,100	36	64	0.79	8.0	0.93
Penn West Energy Trust	PWE	18.60	1.39	11,300	22	78	1.32	7.1	0.85
Enerplus Resources Fund	ERF	23.53	1.23	5,200	41	59	2.04	8.7	0.82
Peyto Energy Trust	PEYUF	14.04	1.23	2,070	79	21	1.36	9.7	0.82
Canadian Oil Sands Trust	COSWF CB	24.51	1.11	13,200		100	1.89	7.7	0.67
<i>Total or Median</i>				35,900					0.82
Small Cap Independent Producers									
Denbury Resources Inc.	DNR	15.48	1.55	9,620	16	84	-	-	1.02
Petrohawk Energy Corporation	HK	15.78	1.68	7,780	96	4	-	-	0.97
Whiting Petroleum Corporation	WLL	90.56	1.20	6,110	14	86	-	-	0.92
Bery Petroleum Company	BRY	29.38	1.64	2,610	31	69	0.30	1.0	0.89
Range Resources	RRC	35.20	1.36	7,400	82	18	0.04	0.1	0.89
Cimarex Energy Company	XEC B	67.98	1.10	6,420	59	41	0.32	0.5	0.86
Ultra Petroleum	UPL	41.00	1.22	7,420	94	6	-	-	0.82
Birchcliff Energy Ltd. (US\$)	BIREF CB	8.56	1.24	1,350	68	32	-	-	0.66
<i>Total or Median</i>				48,700					0.89
Top Line Cash Payers									
Sabine Royalty Trust	SBR	51.79	1.00	760	50	50	3.35	6.5	1.15
Cross Timbers Royalty Trust	CRT	35.20	1.00	210	75	25	2.21	6.3	1.03
Permian Basin RT	PBT	18.61	1.00	870	38	62	1.39	7.5	1.03
Freehold Royalty Trust (US\$)	FRHLF	15.82	1.09	1,010	25	75	1.59	10.0	0.94
Dorchester Minerals, L.P.	DMLP B	24.24	1.02	760	66	34	1.70	7.0	0.90
<i>Total or Median</i>				3,600					1.03
Bottom Line Cash Payers									
Linn Energy, LLC	LINE	29.24	1.47	6,290	47	53	2.52	8.6	1.24
Legacy Reserves L.P.	LGCY	23.15	1.38	1,280	17	83	2.08	9.0	1.11
Encore Energy Partners, L.P. (52%)	ENP	18.18	1.29	550	25	75	2.00	11.0	1.05
Mesa Royalty Trust	MTR	43.40	1.00	81	75	25	3.56	8.2	0.91
Hugoton Royalty Trust	HGT B	18.34	1.00	730	90	10	1.36	7.4	0.87
San Juan Basin Royalty Trust	SJT B	21.51	1.00	1,000	100	-	1.22	5.7	0.86
<i>Total or Median</i>				9,900					0.98
Composite (excl COSWF)									
<i>Enterprise Value Weighting</i>				84,900	50	50			0.91
<i>Equal Weighting</i>					54	46			0.94
<i>Equal Weighted Buys</i>					62	38			0.83

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 September 30, 2011. Enterprise Value = Market Cap and Debt.



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			<i>Price</i>			<i>Net</i>		
			<i>(\$/sh)</i>		<i>Market</i>	<i>Present</i>	<i>Debt/</i>	
	<i>Symbol/</i>		<i>2-Sep</i>	<i>Shares</i>	<i>Cap</i>	<i>Value</i>	<i>Present</i>	<i>McDep</i>
	<i>Rating</i>		<i>2010</i>	<i>(mm)</i>	<i>(\$mm)</i>	<i>(\$/un)</i>	<i>Value</i>	<i>Ratio</i>
Canadian Income Trusts (US\$)								
Pengrowth Energy Trust	PGH		9.92	290.0	2,880	11.00	0.28	0.93
Penn West Energy Trust	PWE		18.60	439.6	8,180	23.00	0.24	0.85
Enerplus Resources Fund	ERF		23.53	177.5	4,180	30.00	0.16	0.82
Peyto Energy Trust	PEYUF		14.04	119.4	1,680	18.00	0.15	0.82
Canadian Oil Sands Trust	COSWF	CB	24.51	484.0	11,860	38.00	0.07	0.67
<i>Total or Median</i>					28,800		0.16	0.82
Small Cap Independent Producers								
Denbury Resources Inc.	DNR		15.48	401.0	6,210	15.00	0.36	1.02
Petrohawk Energy Corporation	HK		15.78	303.0	4,640	16.00	0.39	0.97
Whiting Petroleum Corporation	WLL		90.56	59.2	5,070	95.00	0.16	0.92
Berry Petroleum Company	BRY		29.38	54.3	1,590	35.00	0.35	0.89
Range Resources	RRC		35.20	158.5	5,430	40.00	0.24	0.89
Cimarex Energy Company	XEC	B	67.98	85.6	5,820	80.00	0.08	0.86
Ultra Petroleum	UPL		41.00	154.0	6,080	50.00	0.15	0.82
Birchcliff Energy Ltd. (US\$)	BIREF	CB	8.56	127.0	1,090	14.00	0.13	0.66
<i>Total or Median</i>					35,930		0.20	0.89
Top Line Cash Payers								
Sabine Royalty Trust	SBR		51.79	14.6	760	45.00	-	1.15
Cross Timbers Royalty Trust	CRT		35.20	6.0	210	34.00	-	1.03
Permian Basin RT	PBT		18.61	46.6	870	18.00	-	1.03
Freehold Royalty Trust (US\$)	FRHLF		15.82	58.3	920	17.00	0.08	0.94
Dorchester Minerals, L.P.	DMLP	B	24.24	30.7	740	27.00	0.02	0.90
<i>Total or Median</i>					3,500			1.03
Bottom Line Cash Payers								
Linn Energy, LLC	LINE		29.24	146.5	4,280	21.00	0.39	1.24
Legacy Reserves L.P.	LGCY		23.15	40.1	930	20.00	0.31	1.11
Encore Energy Partners, L.P. (52%)	ENP		18.18	23.4	430	17.00	0.24	1.05
Mesa RoyaltyTrust	MTR		43.40	1.9	81	48.00	-	0.91
Hugoton RoyaltyTrust	HGT	B	18.34	40.0	730	21.00	-	0.87
San Juan Basin Royalty Trust	SJT	B	21.51	46.6	1,000	25.00	-	0.86
<i>Total or Median</i>					7,450			0.98
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.								

Please see disclosures on the final page.

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			Price (\$/sh)	Revenue Royalty (%)	Dist/ Equity Ebitda	Adjstd Resrvs/ Prod NTM	PV/ Ebitda NTM	EV/ Ebitda NTM
	Symbol/ Rating		2-Sep 2010					
Canadian Income Trusts (US\$)								
Peyto Energy Trust	PEYUF		14.04		1.01	21.5	13.4	10.9
Penn West Energy Trust	PWE		18.60		0.57	9.9	10.0	8.5
Canadian Oil Sands Trust	COSWF	CB	24.51		0.59	26.7	11.8	7.9
Enerplus Resources Fund	ERF		23.53		0.60	9.7	8.8	7.2
Pengrowth Energy Trust	PGH		9.92		0.53	9.3	7.3	6.8
	<i>Median</i>					9.9	10.0	7.9
Small Cap Independent Producers								
Range Resources	RRC		35.20		-	12.1	13.8	12.2
Ultra Petroleum	UPL		41.00		-	13.2	13.0	10.7
Birchcliff Energy Ltd. (US\$)	BIREF	CB	8.56		-	21.4	14.4	9.5
Petrohawk Energy Corporation	HK		15.78		-	7.1	9.5	9.2
Denbury Resources Inc.	DNR		15.48		-	12.8	8.5	8.7
Berry Petroleum Company	BRY		29.38		-	11.9	8.6	7.7
Whiting Petroleum Corporation	WLL		90.56		-	9.6	6.9	6.3
Cimarex Energy Company	XEC	B	67.98		-	6.3	6.9	6.0
	<i>Median</i>					12.0	9.0	9.0
Top Line Cash Payers								
Sabine Royalty Trust	SBR		51.79	100	1.00	8.7	13.4	15.4
Cross Timbers Royalty Trust	CRT		35.20	84	0.96	13.7	14.7	15.2
Dorchester Minerals, L.P.	DMLP	B	24.24	77	0.89	6.8	14.1	12.7
Permian Basin RT	PBT		18.61	42	0.95	13.1	12.3	12.7
Freehold Royalty Trust (US\$)	FRHLF		15.82	71	0.91	8.2	9.8	9.1
	<i>Median</i>					8.7	13.4	12.7
Bottom Line Cash Payers								
Linn Energy, LLC	LINE		29.24		1.67	18.4	13.9	17.2
San Juan Basin Royalty Trust	SJT	B	21.51		0.76	14.0	15.5	13.4
Hugoton Royalty Trust	HGT	B	18.34		0.88	12.7	13.6	11.9
Mesa Royalty Trust	MTR		43.40		0.92	9.0	12.4	11.2
Legacy Reserves L.P.	LGCY		23.15		1.03	12.2	9.9	11.0
Encore Energy Partners, L.P.	ENP		18.18		1.10	13.2	9.3	9.8
	<i>Median</i>					12.9	13.0	11.6

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 September 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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