



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

December 10, 2010

Reverse McDep Identifies Higher Oil Value

Summary and Recommendation

Barring a surprise, we should be increasing the estimated present value we use for oil in our McDep calculations. Oil-oriented stocks whose McDep Ratios would be lower on higher oil value include **Penn West Energy (PWE)**, **Berry Petroleum (BRY)**, **Freehold Royalty (FRHLF)** and **Encore Energy Partners (ENP)** (see Tables 1-4 on pages 2-5). The long-term oil price has likely risen to \$90 a barrel from the \$75 that we have been using for the past two years, judging by McDep Ratios near 1.2 for oil-oriented income and small cap stocks. Just as reverse engineering involves taking apart a final product to learn how it is made, we can reverse our McDep Ratio analysis to see what the market is saying about long-term oil price. If stocks are at a McDep Ratio of 1.2 and a McDep Ratio of 1.0 is normal, then the market is looking at value 20% higher than what we use in our estimates. As a result, we appear to have reentered a rising market. In that case, our past experience suggests that small cap stocks tend to track rising oil value and point the way for large cap stocks to follow. While a repeat of a four-fold expansion in oil value in 2010-2012 as we measured in 1978-1980 seems extreme, we believe investors should be positioned for some further gains.

Higher value for oil makes our long-term price of \$8 a million Btu for natural gas seem less unduly optimistic than compared to markets a few months ago. At the same time natural gas is turning more into a volume growth business with new technology making conservative estimates of proven developed reserves more understated relative to potential. Our seven buy recommendations, concentrated from 58% to 100% on natural gas, help balance the natural gas exposure of the overall McDep Energy Portfolio including both small cap and large cap. With higher values for oil and the same values for natural gas, McDep Ratios for oil-oriented stocks should be more comparable to those for natural gas oriented stocks.

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Table 1										
McDep Income and Small Cap Energy Portfolio										
Debt, Business Segments and Income Yield										
					Present Value by Segment (%)					
	Symbol/Rating	Price (US\$/sh)	EV/ Market	Enterprise Value (\$mm)	NAmer. Natural Gas	Oil Prod'n	Dist. NTM (\$/un)	Dist. Yield (%)	McDep Ratio	
	B = Buy CB (see below)	9-Dec 2010	Cap							
Canadian Income (US\$)										
Pengrowth Energy Trust	PGH	13.04	1.35	5,300	34	66	0.84	6.4	1.13	
Peyto Energy Trust	PEYUF	17.79	1.20	2,610	76	24	0.72	4.0	0.99	
Enerplus Resources Fund	ERF	29.56	1.20	6,300	41	59	2.15	7.3	0.99	
Penn West Energy Trust	PWE	21.94	1.35	13,000	22	78	1.08	4.9	0.96	
<i>Total or Median</i>				27,200				5.7	0.99	
Small Cap Independent Producers										
Denbury Resources Inc.	DNR	19.43	1.44	11,200	16	84	-	-	1.19	
Whiting Petroleum Corporation	WLL	112.16	1.18	7,800	15	85	-	-	1.15	
Berry Petroleum Company	BRY	41.05	1.47	3,280	32	68	0.30	0.7	1.11	
Cimarex Energy Company	XEC	B	86.28	1.09	8,030	58	42	0.32	0.4	
Ultra Petroleum	UPL	48.60	1.20	8,960	93	7	-	-	0.98	
Petrohawk Energy Corporation	HK	B	18.96	1.59	9,130	96	4	-	-	
Range Resources	RRC	B	42.44	1.31	8,760	74	26	0.16	0.4	
Birchcliff Energy Ltd. (US\$)	BIREF	B	9.59	1.28	1,560	69	31	-	-	
<i>Total or Median</i>				58,700					1.02	
Top Line Cash Payers										
Permian Basin RT	PBT	22.22	1.00	1,040	38	62	1.53	6.9	1.23	
Cross Timbers Royalty Trust	CRT	41.00	1.00	250	75	25	2.70	6.6	1.21	
Sabine Royalty Trust	SBR	57.92	1.00	840	45	55	4.08	7.0	1.16	
Freehold Royalty Trust (US\$)	FRHLF	19.09	1.07	1,200	25	75	1.67	8.8	1.11	
Dorchester Minerals, L.P.	DMLP	B	26.54	1.02	830	66	34	1.75	6.6	
<i>Total or Median</i>				4,200				6.9	1.16	
Bottom Line Cash Payers										
Linn Energy, LLC	LINE	36.30	1.42	7,550	45	55	2.64	7.3	1.42	
Vanguard Natural Resources, LLC	VNR	27.20	1.42	1,150	38	62	2.20	8.1	1.23	
Legacy Reserves L.P.	LGCY	26.58	1.36	1,450	17	83	2.08	7.8	1.22	
Encore Energy Partners, L.P. (52%)	ENP	20.77	1.26	620	25	75	2.00	9.6	1.17	
Mesa Royalty Trust	MTR	50.00	1.00	93	75	25	3.63	7.3	1.04	
San Juan Basin Royalty Trust	SJT	B	24.51	1.00	1,140	100	-	1.48	6.0	
Hugoton Royalty Trust	HGT	B	20.26	1.00	810	90	10	1.37	6.8	
<i>Total or Median</i>				12,800				7.3	1.17	
Composite										
<i>Enterprise Value Weighting</i>				102,900	49	51			1.06	
<i>Equal Weighting</i>					53	47			1.08	
<i>Equal Weighted Buys</i>					77	23			0.95	

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, 2011. Enterprise Value = Market Cap and Debt.



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			Price (\$/sh)	Revenue Royalty (%)	Dist/ Equity Ebitda	Adjstd Resrvs/ Prod NTM	PV/ Ebitda NTM	EV/ Ebitda NTM
	Symbol/ Rating		9-Dec 2010					
Canadian Income (US\$)								
Peyto Energy Trust	PEYUF		17.79		0.49	18.4	12.2	12.1
Pengrowth Energy Trust	PGH		13.04		0.57	9.6	7.5	8.5
Penn West Energy Trust	PWE		21.94		0.41	9.9	8.8	8.5
Enerplus Resources Fund	ERF		29.56		0.57	9.7	8.0	7.9
	<i>Median</i>					9.8	8.4	8.5
Small Cap Independent Producers								
Range Resources	RRC	B	42.44		-	11.8	14.8	14.2
Ultra Petroleum	UPL		48.60		-	12.6	12.2	11.9
Birchcliff Energy Ltd. (US\$)	BIREF	B	9.59		-	19.8	15.6	11.5
Petrohawk Energy Corporation	HK	B	18.96		-	7.0	10.7	10.4
Denbury Resources Inc.	DNR		19.43		-	12.9	7.5	8.9
Berry Petroleum Company	BRY		41.05		-	11.3	7.7	8.5
Whiting Petroleum Corporation	WLL		112.16		-	9.3	6.2	7.1
Cimarex Energy Company	XEC	B	86.28		-	6.2	6.5	7.0
	<i>Median</i>					11.5	9.2	9.6
Top Line Cash Payers								
Cross Timbers Royalty Trust	CRT		41.00	84	0.96	13.2	12.1	14.6
Permian Basin RT	PBT		22.22	32	0.98	13.2	11.5	14.3
Sabine Royalty Trust	SBR		57.92	100	1.00	7.8	12.2	14.2
Dorchester Minerals, L.P.	DMLP	B	26.54	77	0.87	6.7	13.4	13.2
Freehold Royalty Trust (US\$)	FRHLF		19.09	71	0.88	8.4	8.9	9.9
	<i>Median</i>					8.4	12.1	14.2
Bottom Line Cash Payers								
Linn Energy, LLC	LINE		36.30		1.62	18.3	12.9	18.3
San Juan Basin Royalty Trust	SJT	B	24.51		0.84	13.7	14.1	13.9
Hugoton Royalty Trust	HGT	B	20.26		0.86	12.6	13.2	12.7
Mesa Royalty Trust	MTR		50.00		0.91	8.7	12.0	12.5
Legacy Reserves L.P.	LGCY		26.58		0.92	12.0	8.9	10.9
Encore Energy Partners, L.P.	ENP		20.77		1.02	13.5	8.6	10.1
Vanguard Natural Resources, LLC	VNR		27.20		0.90	13.0	8.2	10.0
	<i>Median</i>					13.0	12.0	12.5

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, 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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December 10, 2010

Table 4									
Oil and Gas Income and Small Cap Stocks									
Rank by Enterprise Value to 200 Day Average									
			Price (\$/sh)	Enterprise Value/					
	Symbol/ Rating		9-Dec 2010	52Wk High	52Wk Low	50 Day Avg.	200 Day Avg.	McDep Ratio	
Canadian Income (US\$)									
	Peyto Energy Trust	PEYUF	17.79	0.99	1.46	1.08	1.19	0.99	
	Enerplus Resources Fund	ERF	29.56	0.97	1.81	1.06	1.18	0.99	
	Pengrowth Energy Trust	PGH	13.04	0.99	2.01	1.05	1.15	1.13	
	Penn West Energy Trust	PWE	21.94	0.94	1.25	0.99	1.05	0.96	
	<i>Median</i>			<i>0.98</i>	<i>1.63</i>	<i>1.06</i>	<i>1.16</i>	<i>0.99</i>	
Small Cap Independent Producers									
	Whiting Petroleum Corporation	WLL	112.16	0.97	1.60	1.06	1.20	1.15	
	Cimarex Energy Company	XEC	B	86.28	0.97	1.77	1.10	1.20	1.07
	Berry Petroleum Company	BRY		41.05	0.99	1.38	1.09	1.19	1.11
	Denbury Resources Inc.	DNR		19.43	0.98	1.31	1.06	1.11	1.19
	Ultra Petroleum	UPL		48.60	0.92	1.25	1.08	1.07	0.98
	Birchcliff Energy Ltd. (US\$)	BIREF	B	9.59	0.92	1.28	1.05	1.04	0.73
	Petrohawk Energy Corporation	HK	B	18.96	0.78	1.20	1.05	1.02	0.97
	Range Resources	RRC	B	42.44	0.82	1.22	1.05	1.00	0.96
	<i>Median</i>			<i>0.97</i>	<i>1.30</i>	<i>1.06</i>	<i>1.09</i>	<i>1.02</i>	
Top Line Cash Payers									
	Permian Basin RT	PBT		22.22	0.94	1.72	1.03	1.16	1.23
	Cross Timbers Royalty Trust	CRT		41.00	0.97	1.45	1.06	1.14	1.21
	Freehold Royalty Trust (US\$)	FRHLF		19.09	0.96	1.33	1.02	1.13	1.11
	Sabine Royalty Trust	SBR		57.92	0.97	1.46	1.04	1.12	1.16
	Dorchester Minerals, L.P.	DMLP	B	26.54	0.90	1.32	0.97	1.04	0.98
	<i>Median</i>			<i>0.96</i>	<i>1.45</i>	<i>1.03</i>	<i>1.13</i>	<i>1.16</i>	
Bottom Line Cash Payers									
	Linn Energy, LLC	LINE		36.30	0.98	1.85	1.03	1.16	1.42
	Mesa Royalty Trust	MTR		50.00	0.92	1.43	1.03	1.09	1.04
	Vanguard Natural Resources, LLC	VNR		27.20	0.99	1.36	1.03	1.08	1.23
	Legacy Reserves L.P.	LGCY		26.58	0.97	1.36	1.01	1.08	1.22
	Encore Energy Partners, L.P. (52%)	ENP		20.77	0.96	1.75	1.03	1.07	1.17
	Hugoton Royalty Trust	HGT	B	20.26	0.92	1.35	0.99	1.05	0.96
	San Juan Basin Royalty Trust	SJT	B	24.51	0.86	1.46	0.99	1.03	0.98
	<i>Median</i>			<i>0.96</i>	<i>1.43</i>	<i>1.03</i>	<i>1.08</i>	<i>1.17</i>	

CB=Contrarian Buy, Stock Price apparently in downtrend compared to 200-day average.

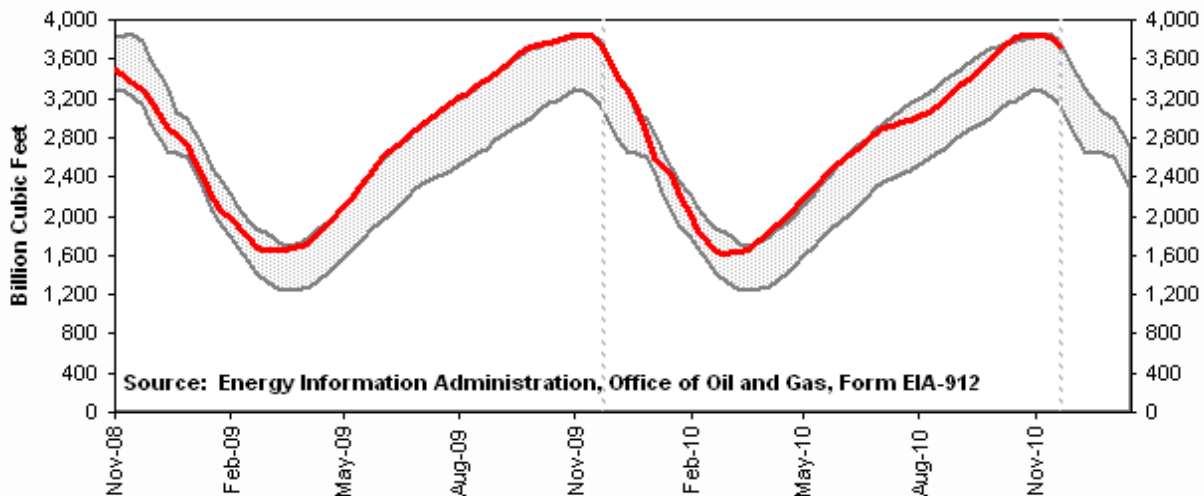


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Working Gas in Underground Storage Compared with 5-Year Range



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