



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

December 17, 2010

## Canadian Income Trusts R.I.P.

### Summary and Recommendation

A four-year adjustment period to tax change in Canada is now history. Six former trusts are repositioned to benefit from the broader stock market for corporations and a promising oil and gas outlook. Buy-recommended **Canadian Oil Sands Limited (COSWF)** is lowest in McDep Ratio followed in increasing order by **Enerplus Corporation (ERF)**, **Penn West Petroleum Ltd. (PWE)**, **Peyto Exploration and Development Corporation (PEYUF)**, **Pengrowth Energy Corporation (PGH)** and **Freehold Royalties Ltd. (FRHLF)**.

We change the names of six former trusts and place each into a peer group of North American stocks with similar characteristics (see [Tables 1-4](#)). The smallest of the six, **Freehold Royalties Ltd. (FRHLF)**, stays in the same Top Line Cash Payer group. It fits on the basis of high income, estimated at 8.5% for 2011, derived from percentage of revenue royalties on production by others. Next smallest **Peyto Exploration and Development Corporation (PEYUF)** moves to the Small Cap Independent Producer Group. Its dividend yield of 3.9%, half the previous distribution yield, still stands out and its low cost Deep Basin production is growing rapidly. **Pengrowth Energy Corporation (PGH)** and **Enerplus Corporation (ERF)** move to the Bottom Line Cash Payer Group where their dividend yields of 6.5% and 7.5% are competitive with the group median 7.4% distribution yield. Both are actively exploiting horizontal multistage fracturing to maintain production despite declining volume from reported proven and probable reserves. **Penn West Petroleum Ltd. (PWE)**, Canada's largest conventional light oil producer, moves to the Large Cap Canada Group in *Meter Reader*, a separate weekly analysis. Dividend yield of 4.8% is the highest of new peers while lowest adjusted reserve life does not yet include volumes expected to be unlocked with horizontal multi-frac. Our only stock listed in both large cap and income groups, buy-recommended **Canadian Oil Sands Limited (COSWF)**, now appears only in the Large Cap Canada Group in *Meter Reader*. A steep stock price decline this month accompanying a reduction in dividend yield to 3.2% has opened a McDep Ratio gap that we believe will be narrowed in 2011.

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Table 1										
McDep Income and Small Cap Energy Portfolio										
Debt, Business Segments and Income Yield										
						Present Value				
		Price	EV/	Enterprise	by Segment (%)					
Symbol/Rating	(US\$/sh)	EV/	Market	Value	N.Amer.	Oil	Dist.	Dist.	McDep	
B = Buy	16-Dec	Market	Cap	(\$mm)	Natural	Prod'n	NTM	Yield	Ratio	
CB (see below)	2010	Cap	Cap	(\$mm)	Gas	Prod'n	(\$/un)	(%)	Ratio	
<b>Small Cap Independent Producers</b>										
Denbury Resources Inc.	DNR	18.79	1.45	10,940	16	84	-	-	1.16	
Whiting Petroleum Corporation	WLL	113.39	1.18	7,870	15	85	-	-	1.16	
Berry Petroleum Company	BRY	42.67	1.45	3,370	32	68	0.30	0.7	1.14	
Cimarex Energy Company	XEC	B	88.40	1.08	8,210	58	42	0.32	0.4	1.10
Peyto Exploration and Development	PEYUF	18.35	1.20	2,680	76	24	0.71	3.9	1.02	
Range Resources	RRC	B	42.26	1.31	8,730	74	26	0.16	0.4	0.95
Petrohawk Energy Corporation	HK	B	18.41	1.61	8,960	96	4	-	-	0.95
Ultra Petroleum	UPL	46.84	1.21	8,690	93	7	-	-	0.95	
Birchcliff Energy Ltd.	BIREF	B	9.57	1.27	1,550	69	31	-	-	0.73
<i>Total or Median</i>					61,000				-	1.02
<b>Top Line Cash Payers</b>										
Permian Basin RT	PBT	22.31	1.00	1,040	38	62	1.53	6.9	1.24	
Cross Timbers Royalty Trust	CRT	40.75	1.00	250	75	25	2.69	6.6	1.20	
Sabine Royalty Trust	SBR	57.85	1.00	840	45	55	4.07	7.0	1.16	
Freehold Royalties Ltd.	FRHLF	19.63	1.07	1,230	25	75	1.66	8.5	1.14	
Dorchester Minerals, L.P.	DMLP	B	25.88	1.02	810	66	34	1.75	6.8	0.96
<i>Total or Median</i>					4,200				6.9	1.16
<b>Bottom Line Cash Payers</b>										
Linn Energy, LLC	LINE	36.11	1.42	7,520	45	55	2.64	7.3	1.42	
Vanguard Natural Resources, LLC	VNR	26.99	1.43	1,150	38	62	2.20	8.2	1.22	
Legacy Reserves L.P.	LGCY	26.34	1.36	1,440	17	83	2.08	7.9	1.21	
Encore Energy Partners, L.P.	ENP	21.19	1.26	1,210	25	75	2.00	9.4	1.19	
Pengrowth Energy Corporation	PGH	12.84	1.36	5,200	34	66	0.83	6.5	1.12	
Mesa Royalty Trust	MTR	49.10	1.00	92	75	25	3.62	7.4	1.03	
Hugoton Royalty Trust	HGT	B	20.15	1.00	810	90	10	1.36	6.7	0.96
Enerplus Corporation	ERF	28.36	1.20	6,100	41	59	2.14	7.5	0.95	
San Juan Basin Royalty Trust	SJT	B	23.82	1.00	1,110	100	-	1.47	6.2	0.95
<i>Total or Median</i>					24,600				7.4	1.12
<b>Composite</b>										
<i>Enterprise Value Weighting</i>					89,800	53	47			1.06
<i>Equal Weighting</i>						54	46			1.08
<i>Equal Weighted Buys</i>						77	23			0.94
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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			<i>Price</i> <i>(\$/sh)</i>	<i>Revenue</i>	<i>Dist/</i>	<i>Adjstd</i>		
	<i>Symbol/</i>		<i>16-Dec</i>	<i>Royalty</i>	<i>Equity</i>	<i>Resrvs/</i>	<i>PV/</i>	<i>EV/</i>
	<i>Rating</i>		<i>2010</i>	<i>(%)</i>	<i>Ebitda</i>	<i>Prod</i>	<i>Ebitda</i>	<i>Ebitda</i>
						<i>NTM</i>	<i>NTM</i>	<i>NTM</i>
<b>Small Cap Independent Producers</b>								
Range Resources	RRC	B	42.26		-	11.8	14.9	14.2
Peyto Exploration and Development Corp	PEYUF		18.35		0.49	18.4	12.3	12.5
Ultra Petroleum	UPL		46.84		-	12.6	12.2	11.6
Birchcliff Energy Ltd.	BIREF	B	9.57		-	19.8	15.6	11.5
Petrohawk Energy Corporation	HK	B	18.41		-	7.0	10.8	10.2
Berry Petroleum Company	BRY		42.67		-	11.3	7.7	8.7
Denbury Resources Inc.	DNR		18.79		-	12.9	7.4	8.6
Cimarex Energy Company	XEC	B	88.40		-	6.2	6.5	7.2
Whiting Petroleum Corporation	WLL		113.39		-	9.3	6.1	7.1
	<i>Median</i>					<i>11.8</i>	<i>10.8</i>	<i>10.2</i>
<b>Top Line Cash Payers</b>								
Cross Timbers Royalty Trust	CRT		40.75	84	0.96	13.2	12.2	14.6
Permian Basin RT	PBT		22.31	32	0.98	13.2	11.6	14.3
Sabine Royalty Trust	SBR		57.85	100	1.00	7.8	12.3	14.2
Dorchester Minerals, L.P.	DMLP	B	25.88	77	0.87	6.7	13.4	12.9
Freehold Royalties Ltd.	FRHLF		19.63	71	0.87	8.4	8.9	10.2
	<i>Median</i>					<i>8.4</i>	<i>12.2</i>	<i>14.2</i>
<b>Bottom Line Cash Payers</b>								
Linn Energy, LLC	LINE		36.11		1.62	18.3	12.9	18.2
San Juan Basin Royalty Trust	SJT	B	23.82		0.84	13.7	14.2	13.6
Hugoton Royalty Trust	HGT	B	20.15		0.86	12.6	13.3	12.7
Mesa Royalty Trust	MTR		49.10		0.91	8.7	12.1	12.4
Legacy Reserves L.P.	LGCY		26.34		0.92	12.0	8.9	10.8
Encore Energy Partners, L.P.	ENP		21.19		1.01	13.5	8.6	10.2
Vanguard Natural Resources, LLC	VNR		26.99		0.90	13.0	8.1	10.0
Pengrowth Energy Corporation	PGH		12.84		0.57	9.6	7.5	8.4
Enerplus Corporation	ERF		28.36		0.57	9.7	8.0	7.6
	<i>Median</i>					<i>12.6</i>	<i>8.9</i>	<i>10.8</i>
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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Table 4									
Oil and Gas Income and Small Cap Stocks									
Rank by Enterprise Value to 200 Day Average									
			Price (\$/sh)		Enterprise Value/				
	Symbol/ Rating		16-Dec 2010	52Wk High	52Wk Low	50 Day Avg.	200 Day Avg.	McDep Ratio	
<b>Small Cap Independent Producers</b>									
	Cimarex Energy Company	XEC	B	88.40	1.00	1.71	1.10	1.22	1.10
	Berry Petroleum Company	BRY		42.67	0.99	1.42	1.10	1.22	1.14
	Peyto Exploration and Development C	PEYUF		18.35	0.97	1.50	1.10	1.21	1.02
	Whiting Petroleum Corporation	WLL		113.39	0.98	1.61	1.06	1.21	1.16
	Denbury Resources Inc.	DNR		18.79	0.96	1.24	1.02	1.08	1.16
	Birchcliff Energy Ltd.	BIREF	B	9.57	0.92	1.19	1.04	1.04	0.73
	Ultra Petroleum	UPL		46.84	0.89	1.21	1.03	1.04	0.95
	Petrohawk Energy Corporation	HK	B	18.41	0.77	1.18	1.02	1.00	0.95
	Range Resources	RRC	B	42.26	0.82	1.22	1.04	1.00	0.95
	<i>Median</i>				0.96	1.24	1.04	1.08	1.02
<b>Top Line Cash Payers</b>									
	Permian Basin RT	PBT		22.31	0.94	1.67	1.02	1.15	1.24
	Freehold Royalties Ltd.	FRHLF		19.63	0.98	1.37	1.03	1.15	1.14
	Cross Timbers Royalty Trust	CRT		40.75	0.97	1.45	1.04	1.13	1.20
	Sabine Royalty Trust	SBR		57.85	0.97	1.44	1.03	1.12	1.16
	Dorchester Minerals, L.P.	DMLP	B	25.88	0.88	1.28	0.95	1.01	0.96
	<i>Median</i>				0.97	1.44	1.03	1.13	1.16
<b>Bottom Line Cash Payers</b>									
	Linn Energy, LLC	LINE		36.11	0.97	1.84	1.02	1.15	1.42
	Enerplus Corporation	ERF		28.36	0.94	1.75	1.01	1.13	0.95
	Pengrowth Energy Corporation	PGH		12.84	0.98	1.99	1.03	1.13	1.12
	Encore Energy Partners, L.P.	ENP		21.19	0.98	1.78	1.04	1.08	1.19
	Mesa RoyaltyTrust	MTR		49.10	0.91	1.38	1.01	1.07	1.03
	Vanguard Natural Resources, LLC	VNR		26.99	0.98	1.35	1.02	1.07	1.22
	Legacy Reserves L.P.	LGCY		26.34	0.97	1.35	1.00	1.07	1.21
	Hugoton RoyaltyTrust	HGT	B	20.15	0.91	1.34	0.99	1.04	0.96
	San Juan Basin Royalty Trust	SJT	B	23.82	0.83	1.39	0.96	0.99	0.95
	<i>Median</i>				0.97	1.39	1.01	1.07	1.12

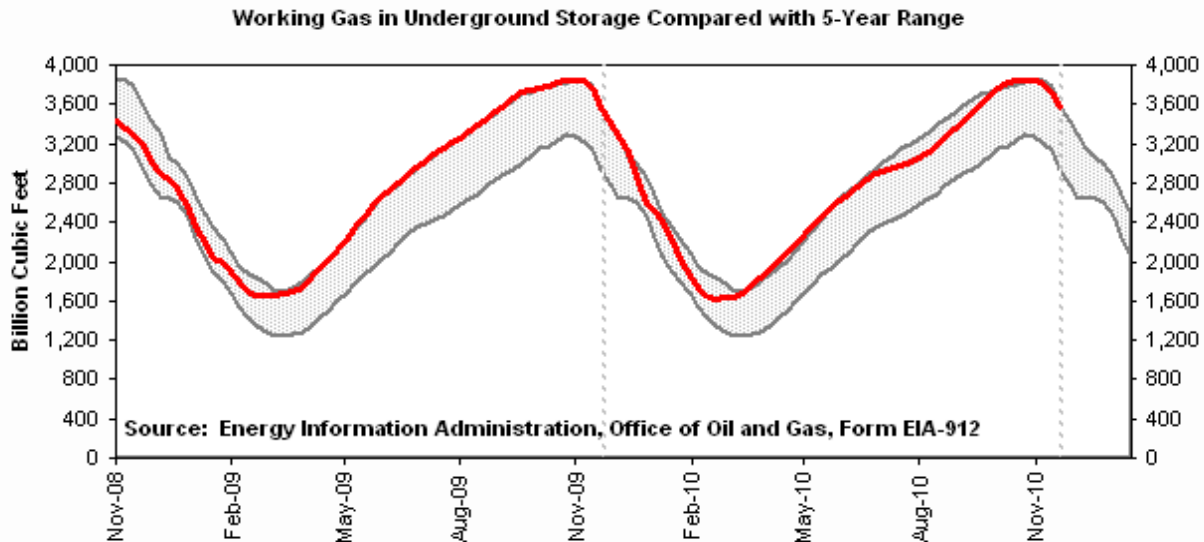
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