



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

July 15, 2011

## In Oil and Gas We Trust

### Summary and Recommendation

The prospects for small cap oil and gas stocks to deliver attractive investment returns with inflation protection and deflation resistance look appealing to us amid heightened concerns about the ability of governments in the U.S. and Europe to make interest and principal payments to savers and lenders. Normally, we look for oil and gas investments purchased at a McDep Ratio of 1.0 to earn 7% a year before taking account of inflation. Should recession or deflation arise, no-debt or low debt stocks would likely be able to ride out temporarily adverse conditions until growth takes hold again. Instead, the resolution of the current debate may be continued U.S. government spending at a high rate to stimulate economic activity and energy demand at least until the 2012 election. The U.S. central bank has helped facilitate the spending by purchasing government debt with freshly created money. The resulting decline in the value of the dollar stimulates exports which further boosts economic activity. A devalued dollar eventually helps make it possible for government to repay debt with cheapened money to the disadvantage of savers and lenders. Small cap growth stocks would deliver their return through volume gains while income stocks distribute about 7% a year in cash. Since it is the quantity of real goods like oil and gas that defines the value of a dollar, the return would go up as the dollar inflates. Meanwhile, weekly trends are positive with the price for the next six years for both oil and natural gas above the 40-week average, at \$101 a barrel vs. \$97 and \$5.47 a million btu vs. \$5.41 respectively. Finally, median McDep Ratio is 0.83 for small cap independent producers, 0.95 for top line cash payers and 1.01 for bottom line cash payers (see [Table ISC-1](#) to [Table ISC-4](#) on pages 2-4).

Kurt H. Wulff, CFA



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July 15, 2011

| Table ISC-1                                       |       |                    |               |                               |            |     |                      |                         |                       |                |      |
|---|-------|--------------------|---------------|-------------------------------|------------|-----|----------------------|-------------------------|-----------------------|----------------|------|
| McDep Income and Small Cap Energy Portfolio       |       |                    |               |                               |            |     |                      |                         |                       |                |      |
| Debt, Segments, Cash Flow, Income and McDep Ratio |       |                    |               |                               |            |     |                      |                         |                       |                |      |
| Symbol/Rating                                     |       | Price<br>(US\$/sh) | EV/<br>Market | Enterprise<br>Value<br>(\$mm) | PV(%)      |     | EV/<br>Ebitda<br>NTM | Dist.<br>NTM<br>(\$/un) | Dist.<br>Yield<br>(%) | McDep<br>Ratio |      |
|   |       |                    |               |                               | Nat<br>Gas | Oil |                      |                         |                       |                |      |
| CB (see below)                                    |       | 14-Jul<br>2011     | Cap           |                               |            |     |                      |                         |                       |                |      |
| <b>Small Cap Independent Producers</b>            |       |                    |               |                               |            |     |                      |                         |                       |                |      |
| Peyto Exploration and Development                 | PEYUF |                    | 23.08         | 1.22                          | 3,730      | 71  | 29                   | 11.6                    | 0.74                  | 3.2            | 0.97 |
| Range Resources                                   | RRC   | B                  | 55.10         | 1.20                          | 10,470     | 76  | 24                   | 14.3                    | 0.16                  | 0.3            | 0.93 |
| Berry Petroleum Company                           | BRY   |                    | 52.50         | 1.50                          | 4,260      | 26  | 74                   | 9.1                     | 0.30                  | 0.6            | 0.91 |
| Birchcliff Energy Ltd.                            | BIREF | B                  | 13.63         | 1.23                          | 2,170      | 56  | 44                   | 12.4                    | -                     | -              | 0.87 |
| Denbury Resources Inc.                            | DNR   |                    | 18.59         | 1.32                          | 9,710      | 6   | 94                   | 7.6                     | -                     | -              | 0.79 |
| Petrohawk Energy Corporation                      | HK    | B                  | 23.49         | 1.55                          | 11,130     | 76  | 24                   | 6.5                     | -                     | -              | 0.78 |
| Cimarex Energy Company                            | XEC   | CB                 | 83.54         | 1.10                          | 7,910      | 44  | 56                   | 5.8                     | 0.40                  | 0.5            | 0.72 |
| Whiting Petroleum Corporation                     | WLL   | CB                 | 55.50         | 1.24                          | 8,140      | 11  | 89                   | 5.8                     | -                     | -              | 0.67 |
| <i>Total or Median</i>                            |       |                    |               |                               | 57,500     |     |                      | 8.3                     |                       |                | 0.83 |
| <b>Top Line Cash Payers</b>                       |       |                    |               |                               |            |     |                      |                         |                       |                |      |
| Permian Basin RT                                  | PBT   |                    | 22.59         | 1.00                          | 1,050      | 42  | 58                   |                         | 1.69                  | 7.5            | 1.03 |
| Cross Timbers Royalty Trust                       | CRT   |                    | 44.06         | 1.00                          | 260        | 87  | 13                   |                         | 2.72                  | 6.2            | 0.98 |
| Freehold Royalties Ltd.                           | FRHLF |                    | 20.80         | 1.07                          | 1,300      | 18  | 82                   |                         | 1.75                  | 8.4            | 0.95 |
| Sabine Royalty Trust                              | SBR   |                    | 64.02         | 1.00                          | 930        | 51  | 49                   |                         | 4.88                  | 7.6            | 0.91 |
| Dorchester Minerals, L.P.                         | DMLP  | CB                 | 27.01         | 1.00                          | 830        | 61  | 39                   |                         | 1.80                  | 6.7            | 0.90 |
| <i>Total or Median</i>                            |       |                    |               |                               | 4,400      |     |                      |                         |                       | 7.5            | 0.95 |
| <b>Bottom Line Cash Payers</b>                    |       |                    |               |                               |            |     |                      |                         |                       |                |      |
| Linn Energy, LLC                                  | LINE  |                    | 38.82         | 1.41                          | 8,910      | 35  | 65                   | 13.4                    | 2.64                  | 6.8            | 1.10 |
| Vanguard Natural Resources, LLC                   | VNR   |                    | 29.47         | 1.67                          | 1,680      | 26  | 74                   | 13.1                    | 2.28                  | 7.7            | 1.05 |
| Hugoton Royalty Trust                             | HGT   | B                  | 22.73         | 1.00                          | 910        | 88  | 13                   | 13.0                    | 1.52                  | 6.7            | 1.03 |
| Legacy Reserves L.P.                              | LGCY  |                    | 28.92         | 1.43                          | 1,800      | 19  | 81                   | 10.6                    | 2.12                  | 7.3            | 1.02 |
| San Juan Basin Royalty Trust                      | SJT   |                    | 25.02         | 1.00                          | 1,170      | 100 | -                    | 13.3                    | 1.58                  | 6.3            | 1.00 |
| Encore Energy Partners, L.P.                      | ENP   |                    | 21.70         | 1.30                          | 1,290      | 17  | 83                   | 10.4                    | 1.96                  | 9.0            | 0.96 |
| Mesa Royalty Trust                                | MTR   |                    | 46.00         | 1.00                          | 86         | 75  | 25                   | 12.7                    | 2.99                  | 6.5            | 0.87 |
| Enerplus Corporation                              | ERF   | B                  | 30.71         | 1.28                          | 7,100      | 33  | 67                   | 8.4                     | 2.25                  | 7.3            | 0.86 |
| <i>Total or Median</i>                            |       |                    |               |                               | 22,900     |     |                      | 12.9                    |                       | 7.1            | 1.01 |
| <b>Composite</b>                                  |       |                    |               |                               |            |     |                      |                         |                       |                |      |
| <i>Enterprise Value Weighting</i>                 |       |                    |               |                               | 84,800     | 43  | 57                   |                         |                       |                | 0.85 |
| <i>Equal Weighting</i>                            |       |                    |               |                               |            | 48  | 52                   |                         |                       |                | 0.92 |
| <i>Equal Weighted Buys</i>                        |       |                    |               |                               |            | 53  | 47                   |                         |                       |                | 0.85 |

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 (PV) presumes long-term prices of \$100 a barrel for oil and \$8 a million btu for natural gas.  
 Dist. = Income distribution. NTM = Next Twelve Months Ended June 30, 2012. Enterprise Value = Market Cap and Debt.



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

July 15, 2011

| Table ISC-2  |                   |    |                  |        |                         |                                    |                           |                |
|--|-------------------|----|------------------|--------|-------------------------|------------------------------------|---------------------------|----------------|
| McDep Income and Small Cap Energy Portfolio  |                   |    |                  |        |                         |                                    |                           |                |
| Net Present Value and McDep Ratio  |                   |    |                  |        |                         |                                    |                           |                |
|  |                   |    | Price<br>(\$/sh) | Shares | Market<br>Cap<br>(\$mm) | Net<br>Present<br>Value<br>(\$/un) | Debt/<br>Present<br>Value | McDep<br>Ratio |
|  | Symbol/<br>Rating |    | 14-Jul<br>2011   | (mm)   |                         |                                    |                           |                |
| <b>Small Cap Independent Producers</b>   |                   |    |                  |        |                         |                                    |                           |                |
| Peyto Exploration and Development Cor  | PEYUF             |    | 23.08            | 132.7  | 3,060                   | 24.00                              | 0.17                      | 0.97           |
| Range Resources  | RRC               | B  | 55.10            | 158.0  | 8,710                   | 60.00                              | 0.16                      | 0.93           |
| Berry Petroleum Company  | BRY               |    | 52.50            | 54.0   | 2,840                   | 60.00                              | 0.30                      | 0.91           |
| Birchcliff Energy Ltd.   | BIREF             | B  | 13.63            | 130.0  | 1,770                   | 16.00                              | 0.16                      | 0.87           |
| Denbury Resources Inc.   | DNR               |    | 18.59            | 397.0  | 7,380                   | 25.00                              | 0.19                      | 0.79           |
| Petrohawk Energy Corporation   | HK                | B  | 23.49            | 305.0  | 7,160                   | 34.00                              | 0.28                      | 0.78           |
| Cimarex Energy Company   | XEC               | CB | 83.54            | 86.1   | 7,190                   | 120.00                             | 0.06                      | 0.72           |
| Whiting Petroleum Corporation  | WLL               | CB | 55.50            | 118.0  | 6,550                   | 90.00                              | 0.13                      | 0.67           |
| <i>Total or Median</i>   |                   |    |                  |        | 44,660                  |                                    | 0.17                      | 0.83           |
| <b>Top Line Cash Payers</b>  |                   |    |                  |        |                         |                                    |                           |                |
| Permian Basin RT   | PBT               |    | 22.59            | 46.6   | 1,050                   | 22.00                              | -                         | 1.03           |
| Cross Timbers Royalty Trust  | CRT               |    | 44.06            | 6.0    | 260                     | 45.00                              | -                         | 0.98           |
| Freehold Royalties Ltd.  | FRHLF             |    | 20.80            | 58.4   | 1,220                   | 22.00                              | 0.06                      | 0.95           |
| Sabine Royalty Trust   | SBR               |    | 64.02            | 14.6   | 930                     | 70.00                              | -                         | 0.91           |
| Dorchester Minerals, L.P.  | DMLP              | CB | 27.01            | 30.7   | 830                     | 30.00                              | -                         | 0.90           |
| <i>Total or Median</i>   |                   |    |                  |        | 4,290                   |                                    |                           | 0.95           |
| <b>Bottom Line Cash Payers</b>   |                   |    |                  |        |                         |                                    |                           |                |
| Linn Energy, LLC   | LINE              |    | 38.82            | 163.0  | 6,330                   | 34.00                              | 0.32                      | 1.10           |
| Vanguard Natural Resources, LLC  | VNR               |    | 29.47            | 34.2   | 1,010                   | 27.00                              | 0.42                      | 1.05           |
| Hugoton RoyaltyTrust   | HGT               | B  | 22.73            | 40.0   | 910                     | 22.00                              | -                         | 1.03           |
| Legacy Reserves L.P.   | LGCY              |    | 28.92            | 43.5   | 1,260                   | 28.00                              | 0.31                      | 1.02           |
| San Juan Basin Royalty Trust   | SJT               |    | 25.02            | 46.6   | 1,170                   | 25.00                              | -                         | 1.00           |
| Encore Energy Partners, L.P.   | ENP               |    | 21.70            | 45.5   | 990                     | 23.00                              | 0.22                      | 0.96           |
| Mesa RoyaltyTrust  | MTR               |    | 46.00            | 1.9    | 86                      | 53.00                              | -                         | 0.87           |
| Enerplus Corporation   | ERF               | B  | 30.71            | 179.5  | 5,510                   | 37.00                              | 0.19                      | 0.86           |
| <i>Total or Median</i>   |                   |    |                  |        | 17,270                  |                                    |                           | 1.01           |
| 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 \$100 a barrel for oil and \$8 a million btu for natural gas. |                   |    |                  |        |                         |                                    |                           |                |



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| Table ISC-3   |                   |    |                  |                |                 |                           |               |               |
|---|-------------------|----|------------------|----------------|-----------------|---------------------------|---------------|---------------|
| McDep Income and Small Cap Energy Portfolio   |                   |    |                  |                |                 |                           |               |               |
| Value Multiples - Rank by EV/Ebitda   |                   |    |                  |                |                 |                           |               |               |
|   |                   |    | Price<br>(\$/sh) | Revenue        | Dist/<br>Equity | Adjstd<br>Resrvs/<br>Prod | PV/<br>Ebitda | EV/<br>Ebitda |
|   | Symbol/<br>Rating |    | 14-Jul<br>2011   | Royalty<br>(%) | Ebitda          | NTM                       | NTM           | NTM           |
| <b>Small Cap Independent Producers</b>  |                   |    |                  |                |                 |                           |               |               |
| Range Resources   | RRC               | B  | 55.10            |                | -               | 16.1                      | 15.3          | 14.3          |
| Birchcliff Energy Ltd.  | BIREF             | B  | 13.63            |                | -               | 19.7                      | 14.2          | 12.4          |
| Peyto Exploration and Development Corp  | PEYUF             |    | 23.08            |                | 0.37            | 14.9                      | 12.0          | 11.6          |
| Berry Petroleum Company   | BRY               |    | 52.50            |                | -               | 12.0                      | 10.0          | 9.1           |
| Denbury Resources Inc.  | DNR               |    | 18.59            |                | -               | 13.6                      | 9.6           | 7.6           |
| Petrohawk Energy Corporation  | HK                | B  | 23.49            |                | -               | 5.6                       | 8.4           | 6.5           |
| Cimarex Energy Company  | XEC               | CB | 83.54            |                | -               | 7.0                       | 8.1           | 5.8           |
| Whiting Petroleum Corporation   | WLL               | CB | 55.50            |                | -               | 9.0                       | 8.7           | 5.8           |
|   | <i>Median</i>     |    |                  |                |                 | 12.8                      | 9.8           | 8.3           |
| <b>Top Line Cash Payers</b>   |                   |    |                  |                |                 |                           |               |               |
| Cross Timbers Royalty Trust   | CRT               |    | 44.06            | 80             | 0.96            | 15.1                      | 15.9          | 15.6          |
| Sabine Royalty Trust  | SBR               |    | 64.02            | 100            | 1.00            | 6.8                       | 14.4          | 13.1          |
| Permian Basin RT  | PBT               |    | 22.59            | 32             | 0.98            | 15.7                      | 12.7          | 13.1          |
| Dorchester Minerals, L.P.   | DMLP              | CB | 27.01            | 77             | 0.87            | 7.0                       | 14.5          | 13.0          |
| Freehold Royalties Ltd.   | FRHLF             |    | 20.80            | 71             | 0.84            | 6.3                       | 10.5          | 10.0          |
|   | <i>Median</i>     |    |                  |                |                 | 7.0                       | 14.4          | 13.1          |
| <b>Bottom Line Cash Payers</b>  |                   |    |                  |                |                 |                           |               |               |
| Linn Energy, LLC  | LINE              |    | 38.82            |                | 0.95            | 17.5                      | 12.2          | 13.4          |
| San Juan Basin Royalty Trust  | SJT               |    | 25.02            |                | 0.84            | 9.2                       | 13.3          | 13.3          |
| Vanguard Natural Resources, LLC   | VNR               |    | 29.47            |                | 1.05            | 13.2                      | 12.4          | 13.1          |
| Hugoton Royalty Trust   | HGT               | B  | 22.73            |                | 0.87            | 14.0                      | 12.6          | 13.0          |
| Mesa Royalty Trust  | MTR               |    | 46.00            |                | 0.82            | 14.5                      | 14.6          | 12.7          |
| Legacy Reserves L.P.  | LGCY              |    | 28.92            |                | 0.79            | 12.0                      | 10.4          | 10.6          |
| Encore Energy Partners, L.P.  | ENP               |    | 21.70            |                | 0.93            | 13.1                      | 10.9          | 10.4          |
| Enerplus Corporation  | ERF               | B  | 30.71            |                | 0.59            | 8.3                       | 9.8           | 8.4           |
|   | <i>Median</i>     |    |                  |                |                 | 13.2                      | 12.3          | 12.9          |
| 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, 2012; 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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July 15, 2011

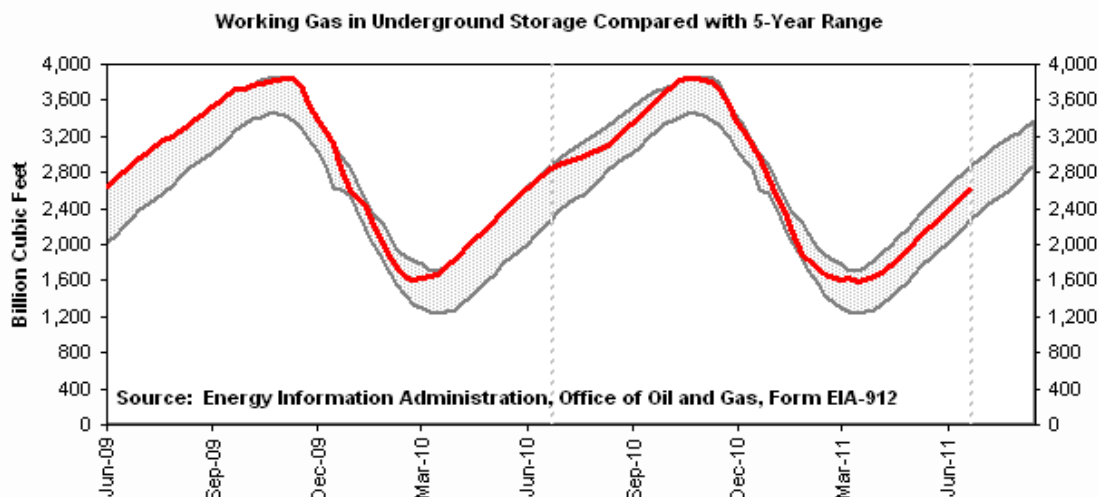
| Table ISC-4   |                   |    |                  |                   |             |                |                 |                |
|---|-------------------|----|------------------|-------------------|-------------|----------------|-----------------|----------------|
| Oil and Gas Income and Small Cap Stocks   |                   |    |                  |                   |             |                |                 |                |
| Rank by Enterprise Value to 200 Day Average   |                   |    |                  |                   |             |                |                 |                |
|   |                   |    | Price<br>(\$/sh) | Enterprise Value/ |             |                |                 |                |
|   | Symbol/<br>Rating |    | 14-Jul<br>2011   | 52Wk<br>High      | 52Wk<br>Low | 50 Day<br>Avg. | 200 Day<br>Avg. | McDep<br>Ratio |
| <b>Small Cap Independent Producers</b>  |                   |    |                  |                   |             |                |                 |                |
| Birchcliff Energy Ltd.  | BIREF             | B  | 13.63            | 0.95              | 1.55        | 1.01           | 1.17            | 0.87           |
| Peyto Exploration and Development C   | PEYUF             |    | 23.08            | 0.98              | 1.59        | 1.06           | 1.16            | 0.97           |
| Range Resources   | RRC               | B  | 55.10            | 0.94              | 1.53        | 1.02           | 1.12            | 0.93           |
| Berry Petroleum Company   | BRY               |    | 52.50            | 0.95              | 1.52        | 1.04           | 1.11            | 0.91           |
| Petrohawk Energy Corporation  | HK                | B  | 23.49            | 0.90              | 1.33        | 0.97           | 1.07            | 0.78           |
| Whiting Petroleum Corporation   | WLL               | CB | 55.50            | 0.77              | 1.32        | 0.94           | 0.94            | 0.67           |
| Denbury Resources Inc.  | DNR               |    | 18.59            | 0.77              | 1.22        | 0.94           | 0.94            | 0.79           |
| Cimarex Energy Company  | XEC               | CB | 83.54            | 0.73              | 1.29        | 0.93           | 0.90            | 0.72           |
|   | <i>Median</i>     |    |                  | <i>0.92</i>       | <i>1.43</i> | <i>0.99</i>    | <i>1.09</i>     | <i>0.83</i>    |
| <b>Top Line Cash Payers</b>   |                   |    |                  |                   |             |                |                 |                |
| Permian Basin RT  | PBT               |    | 22.59            | 0.95              | 1.25        | 1.08           | 1.05            | 1.03           |
| Sabine Royalty Trust  | SBR               |    | 64.02            | 0.91              | 1.30        | 0.99           | 1.05            | 0.91           |
| Cross Timbers Royalty Trust   | CRT               |    | 44.06            | 0.91              | 1.31        | 1.04           | 1.04            | 0.98           |
| Freehold Royalties Ltd.   | FRHLF             |    | 20.80            | 0.86              | 1.36        | 0.98           | 1.00            | 0.95           |
| Dorchester Minerals, L.P.   | DMLP              | CB | 27.01            | 0.90              | 1.14        | 1.00           | 0.99            | 0.90           |
|   | <i>Median</i>     |    |                  | <i>0.91</i>       | <i>1.30</i> | <i>1.00</i>    | <i>1.04</i>     | <i>0.95</i>    |
| <b>Bottom Line Cash Payers</b>  |                   |    |                  |                   |             |                |                 |                |
| Hugoton RoyaltyTrust  | HGT               | B  | 22.73            | 0.92              | 1.26        | 1.01           | 1.05            | 1.03           |
| Linn Energy, LLC  | LINE              |    | 38.82            | 0.97              | 1.27        | 1.01           | 1.03            | 1.10           |
| San Juan Basin Royalty Trust  | SJT               |    | 25.02            | 0.89              | 1.20        | 1.05           | 1.02            | 1.00           |
| Vanguard Natural Resources, LLC   | VNR               |    | 29.47            | 0.92              | 1.16        | 1.02           | 1.01            | 1.05           |
| Enerplus Corporation  | ERF               | B  | 30.71            | 0.94              | 1.30        | 0.99           | 1.01            | 0.86           |
| Legacy Reserves L.P.  | LGCY              |    | 28.92            | 0.90              | 1.18        | 0.98           | 1.00            | 1.02           |
| Encore Energy Partners, L.P.  | ENP               |    | 21.70            | 0.88              | 1.17        | 1.00           | 1.00            | 0.96           |
| Mesa RoyaltyTrust   | MTR               |    | 46.00            | 0.90              | 1.16        | 1.04           | 0.98            | 0.87           |
|   | <i>Median</i>     |    |                  | <i>0.91</i>       | <i>1.19</i> | <i>1.01</i>    | <i>1.01</i>     | <i>1.01</i>    |
| CB=Contrarian Buy, Stock Price apparently in downtrend compared to 200-day average. |                   |    |                  |                   |             |                |                 |                |



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**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.

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**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.