



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

October 7, 2011

Birchcliff Seeks Offers to Acquire the Company

Summary and Recommendation

Rapidly growing Canadian natural gas producer, contrarian buy **Birchcliff Energy (BIREF)** announced on October 3 that it was seeking offers to acquire the company. If the land-rich horizontal driller were to be acquired at a McDep Ratio of 1.10 as was the case with Petrohawk in mid-summer, the takeover price would be US\$18 a share compared to current stock price of US\$11.40. Like the successful strategy Petrohawk pursued, Birchcliff has deliberately sought to create a company with abundant drilling potential that might be developed more rapidly by a large acquirer. The timing for a deal may be good for buyers considering that stock prices appear depressed at the same time natural gas demand is in a seasonal lull ahead of winter. Yet, should no satisfactory transaction be concluded, BIREF is well-positioned to continue its rapid growth of low-cost production in Alberta's portion of the Montney natural gas resource play. Apparently having received unsolicited interest from prospective buyers or companies interested in joint ventures, Birchcliff's board decided to hire investment bankers and open a data room while making the process publicly known. At the same time, the company released a midyear estimate that shows six-month gains of 14% in proven and probable reserves, 21% in present value and 100% in drilling locations (see table Mid-Year Reserves and Resources on page 2). The new estimates from third party reserves evaluator AJM Deloitte and the company illustrate the upside potential beyond our estimates, which we limit by multiple of next twelve months cash flow (see tables Functional Cash Flow and Present Value on page 2 and Next Twelve Months Operating and Financial Estimates on page 3).

Despite a recovery in recent days from what may have been the seasonal low in a depressed stock market, McDep Ratios remain low for Birchcliff and related stocks in our coverage (see Table ISC-1 to ISC-4 on pages 4-7). We urge rebuilding equity weightings that automatically have been lowered by market price action in recent months relative to cash and fixed income.

Kurt H. Wulff, CFA



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Birchcliff Energy Ltd.					
Mid-Year Reserves and Resources					
			<i>30-Jun-11</i>	<i>31-Dec-10</i>	<i>Change</i>
Oil and Natural Gas Reserves					
Million barrels equivalent (mmboe)					
	Proven and Probable		229.3	201.1	14%
	Proven		121.7	114.0	7%
	Probable		107.6	87.2	23%
Present Value Discounted at 10% a Year					
	Million Canadian Dollars		3,117	2,568	21%
Montney/Doig Reserves and Resources					
Million barrels equivalent (mmboe)					
	Proven and Probable		186.8	158.6	
	Contingent Resources Best Estimate		433.0	420.2	
	Prospective Resources Best Estimate		2,742.0	2,421.5	
Billion cubic feet equivalent (bcfe)					
	Proven and Probable		1,120.9	951.6	18%
	Contingent Resources Best Estimate		2,597.8	2,521.2	3%
	Prospective Resources Best Estimate		16,452.2	14,529.2	13%
Net Sections of Land					
	Proven and Probable (2P)		105	76.1	37%
	Remainder		389	187.6	108%
	Total		494	263.7	87%
	2P Reserves/Section (bcf)		10.7	12.5	
Net Horizontal Drilling Locations					
	Proven and Probable (2P)		255.4	219	17%
	Remainder		1,644.6	731	125%
	Total		1,900.0	950	100%
	2P Reserves/Location (bcf)		4.4	4.3	
	2P Locations/Section		2.4	2.9	

Birchcliff Energy Ltd.					
Functional Cash Flow and Present Value					
	<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	83	21.5	16.5	1,370	55%
Oil	74	15.9	14.9	1,100	45%
	157	20.3	15.7	2,470	100%
Debt					370
Net Present Value (US\$mm)					2,100
Shares					131
Net Present Value - Standard Estimate (US\$/sh)					16
NPV Approximation by Cash Flow Multiple Depending on Reserve Life (US\$/sh)					13



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Birchcliff Energy Ltd.									
Next Twelve Months Operating and Financial Estimates									
(Canadian Dollars)									
									<i>Next</i>
	<i>Q3</i>	<i>Q2</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Twelve</i>
	<i>9/30/10</i>	<i>6/30/11</i>	<i>9/30/11</i>	<i>12/31/11</i>	<i>2011E</i>	<i>3/31/12</i>	<i>6/30/12</i>	<i>9/30/12</i>	<i>Months</i>
									<i>9/30/12</i>
Volume (before royalty)									
Natural Gas (mmcf)	58	79	90	90	85	95	100	105	98
Oil (mbd)	3.5	4.2	4.5	4.5	4.4	4.5	4.5	4.5	4.5
Total (mboed)	13.1	17.3	19.5	19.5	18.5	20.3	21.2	22.0	20.8
Price									
Henry Hub (US\$/mmbtu)	4.38	4.32	4.19	3.77	4.10	4.09	4.10	4.19	4.04
Currency (US\$/C\$)	0.96	1.03	1.02	0.96	1.01	0.96	0.96	0.96	0.96
Henry Hub (C\$/mmbtu)	4.55	4.18	4.11	3.91	4.06	4.25	4.25	4.36	4.19
Differential (C\$/mmbtu)	0.76	0.03	0.03	0.02	0.03	0.03	0.03	0.03	0.02
Company (C\$/mcf)	3.79	4.15	4.08	3.89	4.03	4.22	4.23	4.33	4.17
WTI Cushing (US\$/bbl)	76.08	102.55	89.76	77.64	91.01	77.91	78.81	79.83	78.55
WTI Cushing (C\$/bbl)	79.05	99.21	87.94	80.65	90.24	80.93	81.87	82.92	81.59
Differential (C\$/bbl)	3.75	0.66	0.58	0.53	2.30	0.54	0.54	0.55	0.54
Company (C\$/bbl)	75.30	98.56	87.36	80.11	87.94	80.40	81.32	82.37	81.05
Total (\$/bbl)	36.60	42.78	39.00	36.44	39.26	37.52	37.26	37.50	37.19
Revenue (\$mm)									
Natural Gas	20	30	34	32	125	36	38	42	149
Oil	24	38	36	33	141	33	33	34	133
Royalties	(4)	(9)	(9)	(9)	(32)	(8)	(9)	(9)	(35)
Total	41	59	61	57	233	61	63	67	247
Expense	13	20	21	19	79	21	22	23	85
Ebitda (\$mm)	27	39	40	37	154	40	41	44	163
Deprec., Deplet., & Amort.	19	16	16	16	64	16	16	16	64
Other non-cash	3	3	3	3	11	3	3	3	12
Interest	4	5	5	5	22	5	5	5	22
Ebt	1	15	16	13	57	16	17	20	66
Income tax	1	4	6	5	18	6	6	7	23
Net Income (\$mm)	-	10	10	9	38	10	11	13	43
Per share (\$)	-	0.08	0.08	0.07	0.29	0.08	0.09	0.10	0.33
Shares (millions)	127	131	131	131	131	131	131	131	131
Ebitda margin (after royalty)	68%	66%	66%	66%	66%	66%	66%	66%	66%
Tax rate	100%	29%	35%	35%	32%	35%	35%	35%	35%



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Table ISC-1

McDep Income and Small Cap Energy Portfolio											
Debt, Segments, Cash Flow, Income and McDep Ratio											
Symbol/Rating		Price (US\$/sh)	EV/ Market	Enterprise Value (\$mm)	PV(%)		EV/ Ebitda NTM	Dist. NTM (\$/un)	Dist. Yield (%)	McDep Ratio	
					Nat Gas	Oil					
B = Buy	6-Oct	2011	Cap								
CB (see below)											
Small Cap Independent Producers											
Range Resources	RRC	B	60.71	1.21	11,630	69	31	15.8	0.16	0.3	0.89
Peyto Exploration and Developmen	PEYUF		19.55	1.19	3,100	76	24	9.8	0.74	3.8	0.84
Birchcliff Energy Ltd.	BIREF	CB	11.40	1.25	1,860	55	45	11.8	-	-	0.75
Berry Petroleum Company	BRY		37.49	1.73	3,540	23	77	7.6	0.30	0.8	0.67
Denbury Resources Inc.	DNR		11.92	1.49	7,180	5	95	6.5	-	-	0.53
Cimarex Energy Company	XEC	CB	57.00	1.15	5,640	46	54	4.9	0.40	0.7	0.51
Whiting Petroleum Corporation	WLL	CB	37.01	1.36	6,000	11	89	4.5	-	-	0.49
<i>Total or Median</i>					39,000			7.6			0.67
Top Line Cash Payers											
Cross Timbers Royalty Trust	CRT		43.84	1.00	260	87	13		2.74	6.3	0.97
Sabine Royalty Trust	SBR		64.00	1.00	930	51	49		3.95	6.2	0.91
Permian Basin RT	PBT		19.61	1.00	910	42	58		1.35	6.9	0.89
Dorchester Minerals, L.P.	DMLP	CB	24.32	1.00	750	61	39		1.53	6.3	0.81
Freehold Royalties Ltd.	FRHLF		15.87	1.07	1,000	18	82		1.60	10.1	0.73
<i>Total or Median</i>					3,900					6.3	0.89
Bottom Line Cash Payers											
Linn Energy, LLC	LINE		35.29	1.50	9,310	31	69	16.5	2.76	7.8	1.02
Vanguard Natural Resources, LLC	VNR		25.33	1.50	1,940	23	77	11.4	2.30	9.1	0.96
Hugoton RoyaltyTrust	HGT		21.01	1.00	840	88	13	15.0	1.26	6.0	0.95
Legacy Reserves L.P.	LGCY		26.48	1.49	1,720	21	79	10.2	2.16	8.2	0.92
San Juan Basin Royalty Trust	SJT	CB	22.94	1.00	1,070	100	-	13.6	1.33	5.8	0.92
Mesa RoyaltyTrust	MTR		42.66	1.00	80	75	25	12.5	2.87	6.7	0.81
Enerplus Corporation	ERF	CB	24.51	1.24	5,400	30	70	7.8	2.06	8.4	0.71
<i>Total or Median</i>					20,400			12.5		7.8	0.92
Composite											
<i>Enterprise Value Weighting</i>					63,200	39	61				0.71
<i>Equal Weighting</i>						48	52				0.80
<i>Equal Weighted Buys</i>						47	53				0.73

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 September 30, 2012. Enterprise Value = Market Cap and Debt.



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Table ISC-2								
McDep Income and Small Cap Energy Portfolio								
Net Present Value and McDep Ratio								
			Price (\$/sh)	Shares	Market Cap (\$mm)	Net Present Value (\$/un)	Debt/ Present Value	McDep Ratio
	Symbol/ Rating		6-Oct 2011	(mm)				
Small Cap Independent Producers								
Range Resources	RRC	B	60.71	159.0	9,650	70.00	0.15	0.89
Peyto Exploration and Development Cor	PEYUF		19.55	133.1	2,600	24.00	0.14	0.84
Birchcliff Energy Ltd.	BIREF	CB	11.40	131.0	1,490	16.00	0.15	0.75
Berry Petroleum Company	BRY		37.49	54.7	2,050	70.00	0.28	0.67
Denbury Resources Inc.	DNR		11.92	404.0	4,820	28.00	0.17	0.53
Cimarex Energy Company	XEC	CB	57.00	86.1	4,910	120.00	0.07	0.51
Whiting Petroleum Corporation	WLL	CB	37.01	119.0	4,400	90.00	0.13	0.49
<i>Total or Median</i>					29,920		0.15	0.67
Top Line Cash Payers								
Cross Timbers Royalty Trust	CRT		43.84	6.0	260	45.00	-	0.97
Sabine Royalty Trust	SBR		64.00	14.6	930	70.00	-	0.91
Permian Basin RT	PBT		19.61	46.6	910	22.00	-	0.89
Dorchester Minerals, L.P.	DMLP	CB	24.32	30.7	750	30.00	-	0.81
Freehold Royalties Ltd.	FRHLF		15.87	59.1	940	22.00	0.05	0.73
<i>Total or Median</i>					3,790			0.89
Bottom Line Cash Payers								
Linn Energy, LLC	LINE		35.29	176.0	6,210	34.00	0.34	1.02
Vanguard Natural Resources, LLC	VNR		25.33	51.1	1,290	27.00	0.32	0.96
Hugoton RoyaltyTrust	HGT		21.01	40.0	840	22.00	-	0.95
Legacy Reserves L.P.	LGCY		26.48	43.6	1,160	30.00	0.30	0.92
San Juan Basin Royalty Trust	SJT	CB	22.94	46.6	1,070	25.00	-	0.92
Mesa RoyaltyTrust	MTR		42.66	1.9	80	53.00	-	0.81
Enerplus Corporation	ERF	CB	24.51	179.6	4,400	37.00	0.14	0.71
<i>Total or Median</i>					15,050			0.92
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 (\$/sh)	Revenue	Dist/ Equity	Adjstd Resrvs/ Prod	PV/ Ebitda	EV/ Ebitda
	Symbol/ Rating		6-Oct 2011	Royalty (%)	Ebitda	NTM	NTM	NTM
Small Cap Independent Producers								
	RRC	B	60.71		-	14.4	17.8	15.8
	BIREF	CB	11.40		-	20.3	15.7	11.8
	PEYUF		19.55		0.36	13.6	11.7	9.8
	BRY		37.49		-	11.9	11.4	7.6
	DNR		11.92		-	13.4	12.4	6.5
	XEC	CB	57.00		-	6.8	9.7	4.9
	WLL	CB	37.01		-	8.7	9.2	4.5
	<i>Median</i>					13.4	11.7	7.6
Top Line Cash Payers								
	SBR		64.00	100	1.00	7.4	17.7	16.2
	CRT		43.84	80	0.96	13.9	15.8	15.4
	PBT		19.61	32	0.98	16.5	16.0	14.2
	DMLP	CB	24.32	77	0.83	6.6	16.3	13.2
	FRHLF		15.87	71	0.99	6.6	13.6	10.0
	<i>Median</i>					7.4	16.0	14.2
Bottom Line Cash Payers								
	LINE		35.29		1.31	17.1	16.1	16.5
	HGT		21.01		0.90	13.9	15.7	15.0
	SJT	CB	22.94		0.79	8.6	14.8	13.6
	MTR		42.66		0.84	14.5	15.4	12.5
	VNR		25.33		1.02	8.8	11.9	11.4
	LGCY		26.48		0.80	10.2	11.1	10.2
	ERF	CB	24.51		0.62	8.3	11.1	7.8
	<i>Median</i>					10.2	14.8	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 September 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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Table ISC-4									
Oil and Gas Income and Small Cap Stocks									
Rank by Enterprise Value to 200 Day Average									
			Price (\$/sh)	Enterprise Value/					
	Symbol/ Rating		6-Oct 2011	52Wk High	52Wk Low	50 Day Avg.	200 Day Avg.	McDep Ratio	
Small Cap Independent Producers									
	Range Resources	RRC	B	60.71	0.82	1.54	0.99	1.09	0.89
	Peyto Exploration and Development C	PEYUF		19.55	0.80	1.26	0.92	0.95	0.84
	Birchcliff Energy Ltd.	BIREF	CB	11.40	0.79	1.35	0.91	0.93	0.75
	Berry Petroleum Company	BRY		37.49	0.73	1.12	0.88	0.86	0.67
	Whiting Petroleum Corporation	WLL	CB	37.01	0.56	1.19	0.86	0.70	0.49
	Denbury Resources Inc.	DNR		11.92	0.56	1.11	0.86	0.70	0.53
	Cimarex Energy Company	XEC	CB	57.00	0.52	1.10	0.87	0.66	0.51
	<i>Median</i>			<i>0.73</i>	<i>1.19</i>	<i>0.88</i>	<i>0.86</i>	<i>0.86</i>	<i>0.67</i>
Top Line Cash Payers									
	Sabine Royalty Trust	SBR		64.00	0.91	1.35	1.04	1.02	0.91
	Cross Timbers Royalty Trust	CRT		43.84	0.90	1.24	0.99	0.99	0.97
	Permian Basin RT	PBT		19.61	0.83	1.09	0.91	0.91	0.89
	Dorchester Minerals, L.P.	DMLP	CB	24.32	0.81	1.17	1.00	0.91	0.81
	Freehold Royalties Ltd.	FRHLF		15.87	0.67	1.15	0.88	0.77	0.73
	<i>Median</i>			<i>0.83</i>	<i>1.17</i>	<i>0.99</i>	<i>0.91</i>	<i>0.91</i>	<i>0.89</i>
Bottom Line Cash Payers									
	Linn Energy, LLC	LINE		35.29	0.90	1.09	0.97	0.95	1.02
	Hugoton RoyaltyTrust	HGT		21.01	0.85	1.09	0.95	0.95	0.95
	San Juan Basin Royalty Trust	SJT	CB	22.94	0.82	1.12	0.98	0.94	0.92
	Legacy Reserves L.P.	LGCY		26.48	0.85	1.13	0.99	0.93	0.92
	Mesa RoyaltyTrust	MTR		42.66	0.84	1.10	0.96	0.93	0.81
	Vanguard Natural Resources, LLC	VNR		25.33	0.82	1.10	0.95	0.90	0.96
	Enerplus Corporation	ERF	CB	24.51	0.78	1.10	0.91	0.84	0.71
	<i>Median</i>			<i>0.84</i>	<i>1.10</i>	<i>0.96</i>	<i>0.93</i>	<i>0.93</i>	<i>0.92</i>

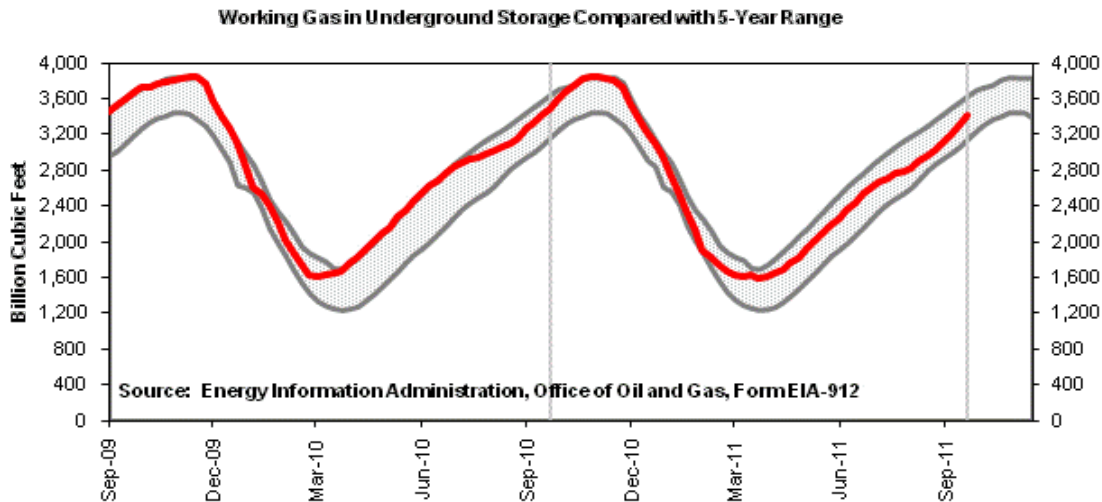
CB=Contrarian Buy, Stock Price apparently in downtrend compared to 200-day average.



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