



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

June 15, 2012

## Energy Price Action and Income Hysteria

### Summary and Recommendation

A 53% decline in natural gas price in the past year along with a 15% decline in oil price undoubtedly contributed mightily to the median 20% negative total return for the 12 income and 8 small cap stocks in our coverage (see table [Stock Performance](#) on page 2). After noting stock price declines at six of seven Contrarian Buys, we reaffirm our confidence that investors should stay the course investing in North American income and small cap stocks for return and growth (see [Tables ISC-1](#) through [ISC-4](#) on pages 3-6). Well-managed capitalist enterprises creating value are likely to be the greatest contributors to the global growth needed to lift decaying economies from stifling debt.

Futures prices for natural gas point to a recovery, particularly from the conditions of an unusually warm winter. At the same time, natural gas demand is growing rapidly to take advantage of new supply as a result of the horizontal drilling and fracking breakthrough.

The outlook for oil price is also up from the current futures quote at the low end of an \$80 to \$120 a barrel range. The proposed sanctions against Iranian oil scheduled for July 1 may present some short-term surprises as a result of possible government attempts to control the price reaction by using strategic reserves. Oil use continues to grow globally, especially in rapidly developing countries. Oil demand in Europe may stagnate while spendthrift countries demonstrate reform before getting a financial bailout. In the U.S., President Obama's policies to restrict oil supply and to boost demand with handouts to consumers have been friendly to oil price. His increasingly likely successor, Mr. Romney, may usher in a transition period leading to more oil supply, but also more oil demand as a result of stronger economic growth.

Steep declines in stock price in 2012, mainly in the past several weeks, at **Hugoton Royalty Trust (HGT)** and Contrarian Buy **Enerplus (ERF)** appear to have been exaggerated by hysteria over reduced income. There have been no recent operating problems of any consequence in either case to our knowledge. From our underlying value point of view, investors often overreact to a change in income and traders may accentuate that overreaction. As a result, there appears to be a special investment opportunity in HGT and we continue our Contrarian Buy rating on ERF.

Kurt H. Wulff, CFA



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<b>Oil and Gas Income and Small Cap</b>				
<b>Stock Performance</b>				
		<i>Total Return</i>		<i>Oil</i>
		<i>(percent a year)</i>		<i>Percent</i>
		<i>1 Year</i>	<i>5 Year</i>	<i>of Value</i>
<b>Small Cap Independent Producers</b>				
Denbury Resources Inc.	DNR	-25	-5	94
Whiting Petroleum Corporation	WLL	-28	13	92
Berry Petroleum Company	BRY	-18	0	87
Cimarex Energy Company	XEC	-44	5	58
PDC Energy	PETD	-26	-15	44
Birchcliff Energy Ltd.	BIREF	-58	6	38
Range Resources	RRC	9	9	29
Peyto Exploration and Development Cor	PEYUF	-18	8	23
	<i>Median</i>	-26	6	51
<b>Top Line Cash Payers</b>				
Freehold Royalties Ltd.	FRHLF	-7	18	84
Permian Basin RT	PBT	-10	14	63
Sabine Royalty Trust	SBR	-21	11	45
Dorchester Minerals, L.P.	DMLP	-14	6	43
Cross Timbers Royalty Trust	CRT	-16	3	30
	<i>Median</i>	-14	11	45
<b>Bottom Line Cash Payers</b>				
Legacy Reserves L.P.	LGCY	-3	10	77
Enerplus Corporation	ERF	-54	-15	74
Vanguard Natural Resources, LLC	VNR	-2		74
Linn Energy, LLC	LINE	4	11	60
Mesa RoyaltyTrust	MTR	-35	-7	25
Hugoton RoyaltyTrust	HGT	-68	-19	11
San Juan Basin Royalty Trust	SJT	-43	-12	0
	<i>Median</i>	-35	-10	60
Crude Oil - Nymex		-15	4	
Natural Gas - Nymex		-53	-22	
Russell 2000 Small Cap Index		-2	-1	
Performance measured to intraday June 13, 2012 from Bloomberg				



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Table ISC-1											
McDep Income and Small Cap Energy Portfolio											
Debt, Segments, Cash Flow, Income and McDep Ratio											
			Price								
Symbol/Rating		(US\$/sh)	EV/	Enterprise	PV(%)		EV/	Dist.	Dist.		
B = Buy	14-Jun	Market	Value	Nat	Oil	Ebitda	NTM	Yield	McDep		
CB (see below)	2012	Cap	(\$mm)	Gas		NTM	(\$/un)	(%)	Ratio		
<b>Small Cap Independent Producers</b>											
Range Resources	RRC	CB	57.23	1.29	11,850	71	29	14.6	0.16	0.3	0.85
Peyto Exploration and Developmen	PEYUF		17.04	1.21	2,850	77	23	10.0	0.70	4.1	0.75
PDC Energy	PETD		22.51	1.99	1,070	56	44	7.5	-	-	0.72
Berry Petroleum Company	BRY		37.12	1.77	3,590	13	87	5.9	0.32	0.9	0.67
Denbury Resources Inc.	DNR		14.57	1.49	8,470	6	94	5.8	-	-	0.62
Birchcliff Energy Ltd.	BIREF	CB	5.88	1.50	1,340	62	38	9.9	-	-	0.59
Whiting Petroleum Corporation	WLL	CB	40.18	1.39	6,650	8	92	4.6	-	-	0.54
Cimarex Energy Company	XEC	CB	48.03	1.25	5,180	42	58	4.8	0.48	1.0	0.49
<i>Total or Median</i>					41,000			6.7			0.64
<b>Top Line Cash Payers</b>											
Permian Basin RT	PBT		17.12	1.00	800	37	63		1.30	7.6	0.86
Freehold Royalties Ltd.	FRHLF		17.06	1.04	1,150	16	84		1.64	9.6	0.82
Cross Timbers Royalty Trust	CRT		33.35	1.00	200	70	30		2.11	6.3	0.76
Sabine Royalty Trust	SBR		48.38	1.00	710	55	45		3.25	6.7	0.74
Dorchester Minerals, L.P.	DMLP	CB	20.01	1.00	610	57	43		1.68	8.4	0.74
<i>Total or Median</i>					3,500					7.6	0.76
<b>Bottom Line Cash Payers</b>											
Linn Energy, LLC	LINE		35.94	1.68	11,650	40	60	12.6	2.90	8.1	1.11
Vanguard Natural Resources, LLC	VNR		25.05	1.52	2,000	27	74	10.7	2.37	9.5	1.00
Legacy Reserves L.P.	LGCY		25.40	1.40	1,700	23	77	8.7	2.22	8.7	0.89
Enduro Royalty Trust (40%)	NDRO		15.88	1.00	210	42	58	7.1	1.42	8.9	0.76
Enerplus Corporation	ERF	CB	12.66	1.67	4,100	26	74	5.7	1.32	10.4	0.72
Mesa RoyaltyTrust	MTR		26.14	1.00	49	75	25	9.1	2.42	9.3	0.66
San Juan Basin Royalty Trust	SJT	CB	12.87	1.00	600	100	-	10.8	0.85	6.6	0.61
Hugoton RoyaltyTrust	HGT		6.55	1.00	260	89	11	8.0	0.08	1.3	0.47
<i>Total or Median</i>					20,600			8.9		8.8	0.74
<b>Composite</b>											
<i>Enterprise Value Weighting</i>					65,000	38	62				0.72
<i>Equal Weighting</i>						47	53				0.73
<i>Equal Weighted Buys</i>						45	55				0.63

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 \$6 a million btu for natural gas.  
 Dist. = Income distribution. NTM = Next Twelve Months Ended June 30, 2013. 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

			<i>Price</i>			<i>Net</i>		
			<i>(\$/sh)</i>		<i>Market</i>	<i>Present</i>	<i>Debt/</i>	
	<i>Symbol/</i>		<i>14-Jun</i>	<i>Shares</i>	<i>Cap</i>	<i>Value</i>	<i>Present</i>	<i>McDep</i>
	<i>Rating</i>		<i>2012</i>	<i>(mm)</i>	<i>(\$mm)</i>	<i>(\$/un)</i>	<i>Value</i>	<i>Ratio</i>
<b>Small Cap Independent Producers</b>								
Range Resources	RRC	CB	57.23	160.0	9,160	70.00	0.19	0.85
Peyto Exploration and Development Cor	PEYUF		17.04	138.3	2,360	24.00	0.13	0.75
PDC Energy	PETD		22.51	23.9	540	40.00	0.36	0.72
Berry Petroleum Company	BRY		37.12	54.7	2,030	70.00	0.29	0.67
Denbury Resources Inc.	DNR		14.57	391.0	5,700	28.00	0.20	0.62
Birchcliff Energy Ltd.	BIREF	CB	5.88	151.1	890	12.00	0.20	0.59
Whiting Petroleum Corporation	WLL	CB	40.18	119.0	4,780	88.00	0.15	0.54
Cimarex Energy Company	XEC	CB	48.03	86.1	4,140	110.00	0.10	0.49
<i>Total or Median</i>					29,600		0.20	0.64
<b>Top Line Cash Payers</b>								
Permian Basin RT	PBT		17.12	46.6	800	20.00	-	0.86
Freehold Royalties Ltd.	FRHLF		17.06	64.7	1,100	21.00	0.03	0.82
Cross Timbers Royalty Trust	CRT		33.35	6.0	200	44.00	-	0.76
Sabine Royalty Trust	SBR		48.38	14.6	710	65.00	-	0.74
Dorchester Minerals, L.P.	DMLP	CB	20.01	30.7	610	27.00	-	0.74
<i>Total or Median</i>					3,420			0.76
<b>Bottom Line Cash Payers</b>								
Linn Energy, LLC	LINE		35.94	193.0	6,940	30.00	0.45	1.11
Vanguard Natural Resources, LLC	VNR		25.05	52.5	1,320	25.00	0.34	1.00
Legacy Reserves L.P.	LGCY		25.40	47.5	1,210	30.00	0.26	0.89
Enduro Royalty Trust (40%)	NDRO		15.88	13.2	210	21.00	-	0.76
Enerplus Corporation	ERF	CB	12.66	196.0	2,480	21.00	0.29	0.72
Mesa Royalty Trust	MTR		26.14	1.9	49	40.00	-	0.66
San Juan Basin Royalty Trust	SJT	CB	12.87	46.6	600	21.00	-	0.61
Hugoton Royalty Trust	HGT		6.55	40.0	260	14.00	-	0.47
<i>Total or Median</i>					13,070			0.74
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 \$6 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		14-Jun 2012	Royalty (%)	Ebitda	NTM	NTM	NTM
<b>Small Cap Independent Producers</b>								
Range Resources	RRC	CB	57.23		-	14.0	17.1	14.6
Peyto Exploration and Development Corp	PEYUF		17.04		0.39	10.0	13.4	10.0
Birchcliff Energy Ltd.	BIREF	CB	5.88		-	21.6	16.7	9.9
PDC Energy	PETD		22.51		-	8.1	10.4	7.5
Berry Petroleum Company	BRY		37.12		-	11.8	8.9	5.9
Denbury Resources Inc.	DNR		14.57		-	13.1	9.4	5.8
Cimarex Energy Company	XEC	CB	48.03		-	8.1	9.7	4.8
Whiting Petroleum Corporation	WLL	CB	40.18		-	9.5	8.6	4.6
	<i>Median</i>					<i>10.9</i>	<i>10.1</i>	<i>6.7</i>
<b>Top Line Cash Payers</b>								
Cross Timbers Royalty Trust	CRT		33.35	78	0.95	16.4	19.9	15.1
Sabine Royalty Trust	SBR		48.38	100	1.00	8.7	20.0	14.9
Permian Basin RT	PBT		17.12	32	0.91	9.7	14.0	12.0
Dorchester Minerals, L.P.	DMLP	CB	20.01	77	1.00	6.6	16.1	11.9
Freehold Royalties Ltd.	FRHLF		17.06	71	0.92	5.4	11.7	9.6
	<i>Median</i>					<i>8.7</i>	<i>16.1</i>	<i>12.0</i>
<b>Bottom Line Cash Payers</b>								
Linn Energy, LLC	LINE		35.94		1.10	14.3	11.3	12.6
San Juan Basin Royalty Trust	SJT	CB	12.87		0.71	8.6	17.6	10.8
Vanguard Natural Resources, LLC	VNR		25.05		1.02	13.6	10.7	10.7
Mesa RoyaltyTrust	MTR		26.14		0.84	8.0	13.8	9.1
Legacy Reserves L.P.	LGCY		25.40		0.73	11.3	9.9	8.7
Hugoton RoyaltyTrust	HGT		6.55		0.10	13.3	17.2	8.0
Enduro Royalty Trust (40%)	NDRO		15.88		0.63	5.3	9.3	7.1
Enerplus Corporation	ERF	CB	12.66		0.50	6.3	8.0	5.7
	<i>Median</i>					<i>9.9</i>	<i>11.0</i>	<i>8.9</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 June 30, 2013; 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		14-Jun 2012	52Wk High	52Wk Low	50 Day Avg.	200 Day Avg.	McDep Ratio	
<b>Small Cap Independent Producers</b>									
	Range Resources	RRC	CB	57.23	0.79	1.10	0.96	0.93	0.85
	Denbury Resources Inc.	DNR		14.57	0.76	1.25	0.91	0.91	0.62
	Berry Petroleum Company	BRY		37.12	0.73	1.11	0.94	0.91	0.67
	Peyto Exploration and Development C	PEYUF		17.04	0.70	1.14	1.02	0.89	0.75
	Whiting Petroleum Corporation	WLL	CB	40.18	0.70	1.25	0.87	0.87	0.54
	PDC Energy	PETD		22.51	0.72	1.20	0.87	0.85	0.72
	Cimarex Energy Company	XEC	CB	48.03	0.57	1.02	0.82	0.78	0.49
	Birchcliff Energy Ltd.	BIREF	CB	5.88	0.48	1.03	0.95	0.63	0.59
	<i>Median</i>				0.71	1.12	0.92	0.88	0.64
<b>Top Line Cash Payers</b>									
	Freehold Royalties Ltd.	FRHLF		17.06	0.75	1.24	0.94	0.92	0.82
	Dorchester Minerals, L.P.	DMLP	CB	20.01	0.71	1.01	0.86	0.85	0.74
	Permian Basin RT	PBT		17.12	0.73	1.04	0.86	0.83	0.86
	Sabine Royalty Trust	SBR		48.38	0.72	1.06	0.89	0.79	0.74
	Cross Timbers Royalty Trust	CRT		33.35	0.65	1.01	0.87	0.75	0.76
	<i>Median</i>				0.72	1.04	0.87	0.83	0.76
<b>Bottom Line Cash Payers</b>									
	Linn Energy, LLC	LINE		35.94	0.92	1.09	0.97	0.98	1.11
	Vanguard Natural Resources, LLC	VNR		25.05	0.85	1.09	0.96	0.95	1.00
	Legacy Reserves L.P.	LGCY		25.40	0.87	1.11	0.95	0.94	0.89
	Enerplus Corporation	ERF	CB	12.66	0.52	1.01	0.85	0.67	0.72
	Mesa RoyaltyTrust	MTR		26.14	0.53	1.05	0.82	0.66	0.66
	San Juan Basin Royalty Trust	SJT	CB	12.87	0.51	1.07	0.79	0.63	0.61
	Hugoton RoyaltyTrust	HGT		6.55	0.27	1.01	0.58	0.39	0.47
	<i>Median</i>				0.53	1.07	0.85	0.67	0.72

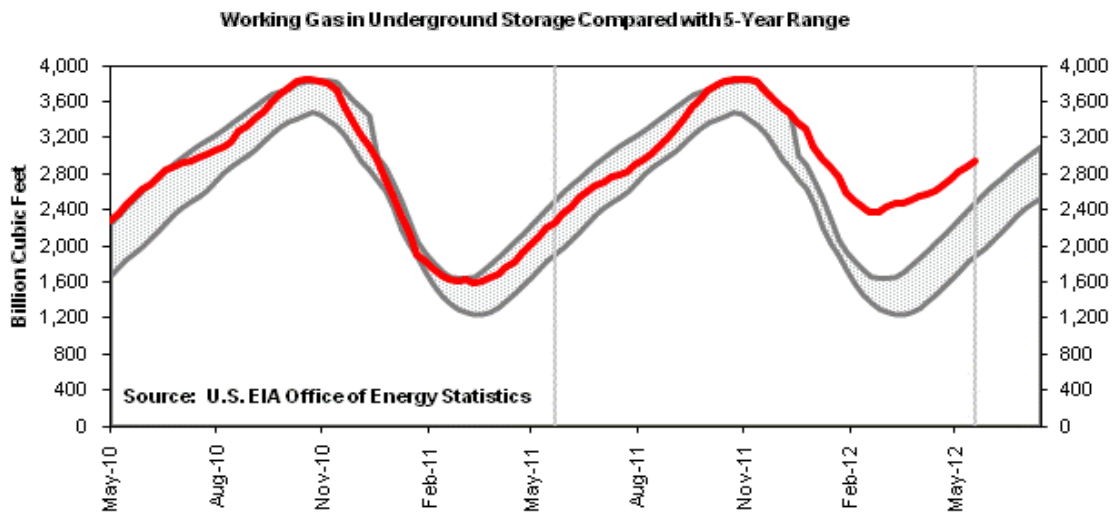
CB=Contrarian Buy, Stock Price apparently in downtrend compared to 200-day average.



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