



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

January 4, 2013

Oil Price Perks Up Six-Year Strip Touches 40-Week Average

Summary and Recommendation

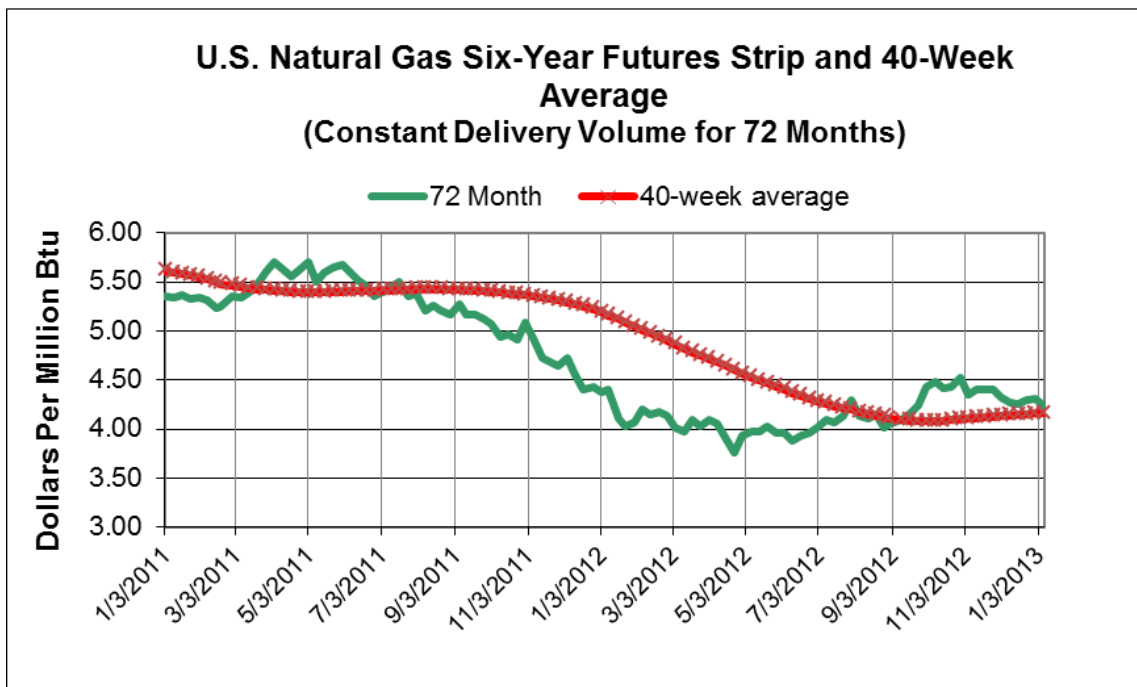
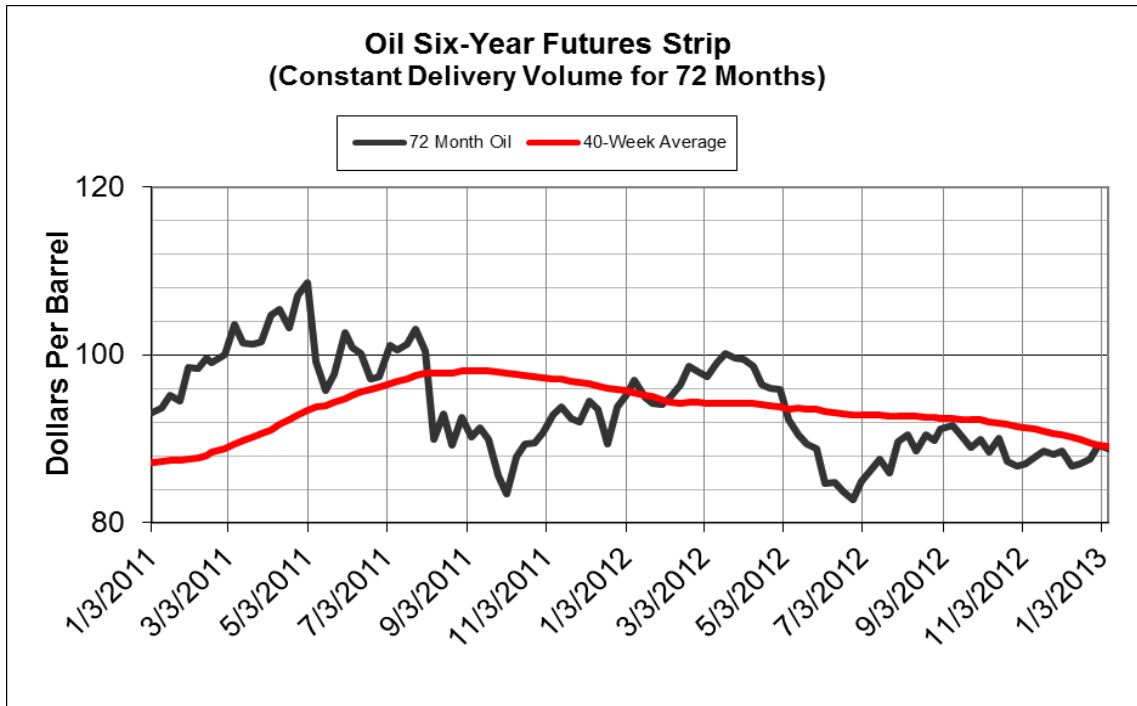
Our main long-term oil price indicator, the six-year futures strip for Light Sweet Crude, touched its 40-week average for the first time since it crossed below in April 2012 (see chart [Oil](#) on page 2). While the 40-week average still points down, crude oil price has been seasonally strong in the early months of recent years. In any case, the drop in stock price for most Income and Small Cap oil and gas stocks since April 2012 exceeded the drop in oil price. In contrast, natural gas price bottomed in April 2012 and is now in a confirmed uptrend (see chart [Natural Gas](#) on page 2). Natural gas pricing is at a critical weather juncture as we are now in the coldest weeks of the northern winter. So far, so good on the weather front, despite some unseasonal warmth ahead forecast by some meteorologists. Yet, some natural gas stocks also dropped to surprisingly low levels. Those low prices suggest further downside may be limited. Moreover, McDep Ratios are low and most of the producers are in sound financial condition (see Tables [ISC-1](#) through [ISC-3](#) on pages 3 to 5). Comfortable with the downside risk, we are ready to benefit from any upside surprise. In the first days of 2013, median year-to-date returns by group are 3% for Small Cap Independent Producers, 4% for Leveraged Cash Payers and 5% for RTF Cash Payers (see Table [ISC-4](#) on page 6).

Regional Discounts Arising from Transportation Mismatch

The shale oil boom for the past two years has been creating wide disparities that ebb and flow. The global oil spot price represented by North Sea Brent is currently \$113 a barrel. The U.S. benchmark, a.k.a. West Texas Intermediate quoted in Cushing Oklahoma, is \$93. North Dakota Bakken comes in at \$89 after being discounted as much as \$16 compared to WTI Cushing earlier last year. The latest surprise is that West Texas Intermediate is \$82 in Midland, where it originates, compared to \$93 in Cushing Oklahoma, where it is stored while in transit. The Midland discount opened up only in the fourth quarter of 2012 and ought to be narrower by the second quarter of 2013, we suppose. At different times, unpredictable crude oil discounts can have disproportionate impact on stock price for producers affected. The oil price differences send a strong signal to providers of transportation who soon find solutions, often creative, to narrow the gaps.

Among the near-term developments, the Seaway oil pipeline is expected to start within a week tripling volume to 400,000 barrels daily from Cushing, Oklahoma to the Gulf Coast where the crude can compete globally. A U.S. segment of the still-to-be-fully-approved Keystone XL line will take 600,000 barrels daily from Cushing within a year followed by another expansion of Seaway in 2014 as reviewed in today's *Platts Oilgram*.

Kurt H. Wulff, CFA





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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	3-Jan	Market	Value	Nat	Ebitda	NTM	Yield	McDep			
CB (see below)	2013	Cap	(\$mm)	Gas	Oil	NTM	(\$/un)	(%)	Ratio		
Small Cap Independent Producers											
PDC Energy	PDCE		34.81	1.75	1,840	52	48	13.8	-	-	1.09
Range Resources	RRC	CB	63.40	1.34	13,570	75	25	16.7	0.16	0.3	0.93
Peyto Exploration and Developmen	PEYUF		22.36	1.23	3,930	76	24	10.3	0.72	3.2	0.86
Halcón Resources	HK		7.09	1.61	3,870	15	85	5.7	-	-	0.80
Continental Resources (32%)	CLR	B	76.03	1.22	5,410	24	76	7.1	-	-	0.79
Birchcliff Energy Ltd.	BIREF	B	7.22	1.48	1,600	63	37	9.3	-	-	0.69
Denbury Resources Inc.	DNR		16.50	1.50	9,670	4	96	6.0	-	-	0.68
Berry Petroleum Company	BRY		34.98	1.91	3,690	12	88	5.2	-	-	0.66
Cimarex Energy Company	XEC	CB	59.34	1.27	6,550	41	59	5.1	0.48	0.8	0.60
Whiting Petroleum Corporation	WLL	CB	45.33	1.39	7,520	9	91	4.7	-	-	0.60
<i>Total or Median</i>				1.44	57,700	33	67	6.6			0.74
Leveraged Cash Payers											
Linn Energy, LLC	LINE		36.45	1.68	14,280	43	57	12.4	2.90	8.0	1.12
Vanguard Natural Resources, LLC	VNR		27.31	1.63	2,370	33	67	11.6	2.40	8.8	1.05
Legacy Reserves L.P.	LGCY		24.70	1.50	1,750	25	75	9.0	2.26	9.1	0.87
Enerplus Corporation	ERF	CB	13.45	1.67	4,400	31	69	6.2	1.08	8.1	0.75
<i>Total or Median</i>				1.65	22,800	32	68	10.3		8.4	0.96
RTF Cash Payers											
Freehold Royalties Ltd.	FRHLF		21.88	TL	1,500	16	84	10.7	1.69	7.7	1.04
Enduro Royalty Trust (40%)	NDRO		16.97	BL	220	43	57	9.2	1.84	10.8	0.81
Dorchester Minerals, L.P.	DMLP	CB	20.86	TL	640	57	43	10.4	1.81	8.7	0.77
San Juan Basin Royalty Trust	SJT	CB	14.19	BL	660	100	-	9.5	1.13	8.0	0.68
Permian Basin RT	PBT		13.22	TL	620	33	67	8.6	1.08	8.2	0.66
Sabine Royalty Trust	SBR		42.10	TL	610	51	49	10.6	3.96	9.4	0.65
Cross Timbers Royalty Trust	CRT		28.28	TL	170	70	30	9.1	3.01	10.6	0.64
Hugoton RoyaltyTrust	HGT		7.62	BL	310	88	13	6.6	0.56	7.3	0.54
Mesa RoyaltyTrust	MTR		20.03	BL	37	75	25	7.9	2.01	10.0	0.50
<i>Total or Median</i>					4,800	57	43	9.2		8.7	0.66
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 December 31, 2013. Enterprise Value = Market Cap and Debt.											
TL = Top Line income sources, BL = Bottom Line income sources											



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Table ISC-2

McDep Income and Small Cap Energy Portfolio Net Present Value and McDep Ratio

			Price (\$/sh)		Market	Net	Debt/	
	Symbol/		3-Jan	Shares	Cap	Value	Present	McDep
	Rating		2013	(mm)	(\$mm)	(\$/un)	Value	Ratio
Small Cap Independent Producers								
PDC Energy	PDCE		34.81	30.2	1,050	30.00	0.46	1.09
Range Resources	RRC	CB	63.40	160.0	10,140	70.00	0.23	0.93
Peyto Exploration and Development Cor	PEYUF		22.36	143.2	3,200	27.00	0.16	0.86
Halcón Resources	HK		7.09	339.0	2,400	10.00	0.30	0.80
Continental Resources (32%)	CLR	B	76.03	58.6	4,450	100.00	0.14	0.79
Birchcliff Energy Ltd.	BIREF	B	7.22	149.0	1,080	12.00	0.22	0.69
Denbury Resources Inc.	DNR		16.50	391.0	6,450	28.00	0.23	0.68
Berry Petroleum Company	BRY		34.98	55.3	1,930	70.00	0.31	0.66
Cimarex Energy Company	XEC	CB	59.34	86.9	5,160	110.00	0.13	0.60
Whiting Petroleum Corporation	WLL	CB	45.33	119.0	5,390	88.00	0.17	0.60
<i>Total or Median</i>					41,250		0.23	0.74
Leveraged Cash Payers								
Linn Energy, LLC	LINE		36.45	233.0	8,490	30.00	0.45	1.12
Vanguard Natural Resources, LLC	VNR		27.31	53.1	1,450	25.00	0.41	1.05
Legacy Reserves L.P.	LGCY		24.70	47.5	1,170	30.00	0.29	0.87
Enerplus Corporation	ERF	CB	13.45	196.0	2,640	21.00	0.30	0.75
<i>Total or Median</i>					13,750		0.36	0.96
RTF Cash Payers								
Freehold Royalties Ltd.	FRHLF		21.88	65.7	1,440	21.00	0.05	1.04
Enduro Royalty Trust (40%)	NDRO		16.97	13.2	220	21.00	-	0.81
Dorchester Minerals, L.P.	DMLP	CB	20.86	30.7	640	27.00	-	0.77
San Juan Basin Royalty Trust	SJT	CB	14.19	46.6	660	21.00	-	0.68
Permian Basin RT	PBT		13.22	46.6	620	20.00	-	0.66
Sabine Royalty Trust	SBR		42.10	14.6	610	65.00	-	0.65
Cross Timbers Royalty Trust	CRT		28.28	6.0	170	44.00	-	0.64
Hugoton RoyaltyTrust	HGT		7.62	40.0	310	14.00	-	0.54
Mesa RoyaltyTrust	MTR		20.03	1.9	37	40.00	-	0.50
<i>Total or Median</i>					4,710			0.66
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		3-Jan 2013	Royalty (%)	Ebitda	NTM	NTM	NTM
Small Cap Independent Producers								
	RRC	CB	63.40		-	13.5	18.0	16.7
	PDCE		34.81		-	9.9	12.8	13.8
	PEYUF		22.36		0.32	9.2	12.0	10.3
	BIREF	B	7.22		-	19.4	13.4	9.3
	CLR	B	76.03		-	9.0	9.0	7.1
	DNR		16.50		-	13.0	8.8	6.0
	HK		7.09		-	5.5	7.1	5.7
	BRY		34.98		-	11.3	7.9	5.2
	XEC	CB	59.34		-	7.3	8.5	5.1
	WLL	CB	45.33		-	9.1	7.8	4.7
	<i>Median</i>					9.5	8.9	6.6
Leveraged Cash Payers								
	LINE		36.45		1.07	14.0	11.1	12.4
	VNR		27.31		1.06	13.2	11.0	11.6
	LGCY		24.70		0.78	11.0	10.3	9.0
	ERF	CB	13.45		0.43	6.3	8.3	6.2
	<i>Median</i>					12.1	10.6	10.3
RTF Cash Payers								
	FRHLF		21.88	80	0.83	5.1	10.3	10.7
	SBR		42.10	100	1.00	7.6	16.4	10.6
	DMLP	CB	20.86	77	0.90	6.8	13.4	10.4
	SJT	CB	14.19		0.76	9.1	14.1	9.5
	NDRO		16.97		1.00	6.4	11.4	9.2
	CRT		28.28	78	0.97	14.2	14.2	9.1
	PBT		13.22	52	0.71	9.9	13.1	8.6
	MTR		20.03		0.80	7.7	15.8	7.9
	HGT		7.62		0.48	12.9	12.2	6.6
	<i>Median</i>					7.7	13.4	9.2
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, 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									
McDep Income and Small Cap Energy Portfolio									
Total Return and Enterprise Value Momentum									
			Price (\$/sh)	Equity Total	Enterprise Value/				
	Symbol/ Rating		3-Jan 2013	Return YTD (%)	52Wk High	52Wk Low	50 Day Avg.	200 Day Avg.	McDep Ratio
Small Cap Independent Producers									
PDC Energy	PDCE		34.81	5	0.92	1.34	1.05	1.09	1.09
Peyto Exploration and Development C	PEYUF		22.36	(3)	0.87	1.39	0.93	1.06	0.86
Denbury Resources Inc.	DNR		16.50	2	0.84	1.16	1.04	1.02	0.68
Continental Resources (32%)	CLR	B	76.03	3	0.81	1.19	1.04	1.01	0.79
Birchcliff Energy Ltd.	BIREF	B	7.22	(4)	0.61	1.28	0.94	1.01	0.69
Range Resources	RRC	CB	63.40	1	0.89	1.15	0.97	1.00	0.93
Whiting Petroleum Corporation	WLL	CB	45.33	5	0.77	1.18	1.03	0.99	0.60
Cimarex Energy Company	XEC	CB	59.34	3	0.73	1.21	1.00	0.99	0.60
Berry Petroleum Company	BRY		34.98	4	0.75	1.08	1.02	0.95	0.66
Halcón Resources	HK		7.09	2	0.65		1.05	0.91	0.80
	<i>Median</i>			3	0.79	1.19	1.03	1.00	0.74
Leveraged Cash Payers									
Vanguard Natural Resources, LLC	VNR		27.31	5	0.94	1.11	0.99	0.99	1.05
Linn Energy, LLC	LINE		36.45	3	0.91	1.03	0.96	0.96	1.12
Legacy Reserves L.P.	LGCY		24.70	4	0.87	1.07	0.99	0.94	0.87
Enduro Royalty Trust (40%)	NDRO		16.97	1	0.77	1.13	0.97	0.92	0.81
Enerplus Corporation	ERF	CB	13.45	4	0.63	1.10	0.99	0.92	0.75
	<i>Median</i>			4	0.87	1.10	0.99	0.94	0.87
RTF Cash Payers									
Freehold Royalties Ltd.	FRHLF		21.88	1	0.96	1.29	1.02	1.11	1.04
San Juan Basin Royalty Trust	SJT	CB	14.19	6	0.61	1.18	1.06	0.94	0.68
Dorchester Minerals, L.P.	DMLP	CB	20.86	3	0.78	1.05	0.98	0.93	0.77
Hugoton Royalty Trust	HGT		7.62	4	0.40	1.34	1.04	0.88	0.54
Cross Timbers Royalty Trust	CRT		28.28	5	0.57	1.20	1.07	0.82	0.64
Sabine Royalty Trust	SBR		42.10	6	0.63	1.08	0.92	0.81	0.65
Permian Basin RT	PBT		13.22	8	0.57	1.10	0.99	0.77	0.66
Mesa Royalty Trust	MTR		20.03	4	0.46	1.06	0.88	0.70	0.50
	<i>Median</i>			5	0.59	1.14	1.01	0.85	0.65

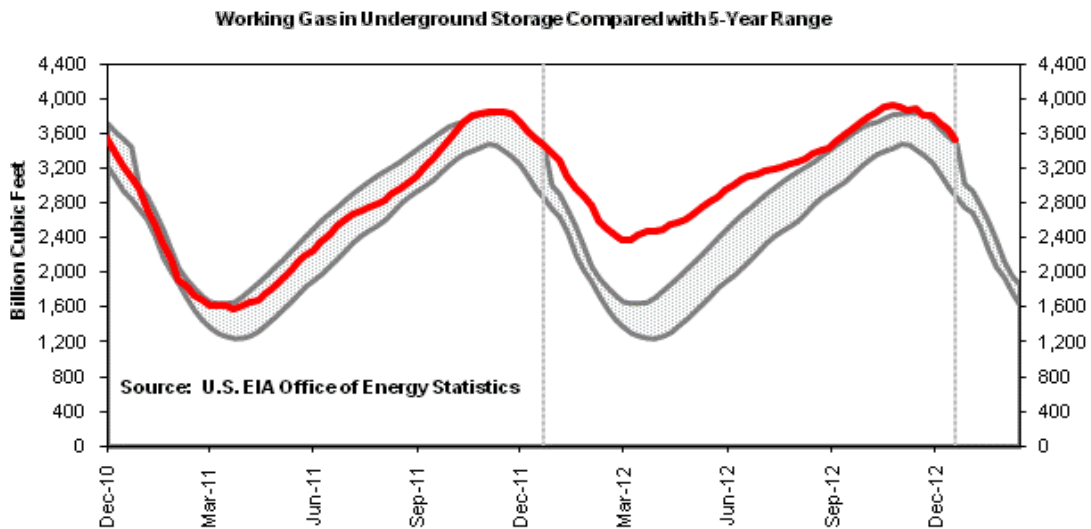
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