



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

September 6, 2013

Shale, McDep and the Portfolio

Summary and Recommendation

We like Income and Small Cap oil and gas stocks for shale growth and McDep value. The most rapidly growing companies include **Range Resources (RRC)**, the discoverer of the Marcellus shale in Pennsylvania and **Continental Resources (CLR)**, the first to unlock the Bakken shale of North Dakota with multi-stage horizontal fracking. The largest oil gains ahead may be in the Permian Basin in West Texas where **Cimarex (XEC)** is a leading fracker. The widely misunderstood and overlooked RTF (Royalty Trust Fund) Cash Payers offer stealth fracking growth and debt-free, tax-advantaged income at a current median rate of 8% for the next twelve months. Permian Basin sleepers, for example, include **Cross Timbers RT (CRT)**, eponymous **Permian Basin RT (PBT)** and **Sabine RT (SBR)**.

Rewarding Oil Price and Cheap Natural Gas

In our oil and gas outlook, long-term investment at current McDep Ratios near a median of 0.8 is attractive (see [Tables ISC-1](#) through [ISC-4](#) on pages 2-5). Oil price is near a reasonable balance that encourages efficient use and covers political and economic costs of new supply, in our view. Cash flow estimates for the year ahead use recent futures prices of about \$100 a barrel for the next twelve months. Estimates of present value presume a longer-term price near the average futures price for the next six years still holding under \$90 a barrel. The economic antidote to relatively expensive oil is undervalued natural gas. We use futures prices averaging under \$4 a million Btu (the heating equivalent of \$24 a barrel) for the next 12 months. We presume that the long-term price will be modestly higher at \$6 a million Btu compared to the current futures quote for the next six years near \$4.25.

Energy Enhances the Portfolio

We also like the outlook for non-energy stocks as the whole economy is benefitting from the innovation and entrepreneurship of the oil and gas independent producers who have contributed to reversing the long-term decline in U.S. oil and gas production. We advocate a steady cash position to take advantage of any unpredictably strong advance or decline in stocks in the near-term. Investors can also be systematic with regard to buy recommendations. If a stock has done well and it is a larger position, taking some profits can be consistent even though the stock is still rated buy.

Kurt H. Wulff, CFA



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Analysis of Oil & Gas Stocks

September 6, 2013

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	5-Sep	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	57.31	1.45	2,570	32	68	12.4	-	-	1.18	
Range Resources	RRC B	76.47	1.28	15,800	74	26	13.8	0.16	0.2	0.88	
Halcón Resources	HK	4.89	2.44	5,270	8	92	6.1	-	-	0.85	
Continental Resources (32%)	CLR B	97.24	1.25	7,200	16	84	6.9	-	-	0.84	
Denbury Resources Inc.	DNR	17.71	1.52	9,980	5	95	5.8	-	-	0.84	
Peyto Exploration and Development Cor	PEYUF	27.34	1.19	4,840	80	20	9.7	0.80	2.9	0.83	
Berry Petroleum Company	BRY	41.42	1.80	4,120	14	86	6.2	0.32	0.8	0.82	
Cimarex Energy Company	XEC B	85.92	1.19	8,830	43	57	5.7	0.56	0.7	0.81	
Whiting Petroleum Corporation	WLL B	51.28	1.37	8,370	8	92	4.0	-	-	0.75	
Birchcliff Energy Ltd.	BIREF CB	6.76	1.43	1,600	68	32	8.3	-	-	0.65	
<i>Total or Median</i>				1.40	68,600	24	76	6.6			0.83
Leveraged Cash Payers											
Vanguard Natural Resources, LLC	VNR	27.28	1.50	3,060	41	59	9.8	2.46	9.0	1.06	
Legacy Reserves L.P.	LGCY	27.00	1.65	2,550	24	76	9.3	2.32	8.6	1.05	
Enerplus Corporation	ERF	17.42	1.47	5,000	34	66	6.2	1.02	5.9	0.98	
Linn Energy, LLC	LINE	24.43	2.11	12,040	47	53	9.4	2.90	11.9	0.97	
<i>Total or Median</i>				1.57	22,700	38	62	9.4			8.8
RTF Cash Payers											
Freehold Royalties Ltd.	FRHLF	22.30	TL	1,560	16	84	11.0	1.59	7.1	1.06	
Dorchester Minerals, L.P.	DMLP B	24.03	TL	740	54	46	10.5	1.88	7.8	0.92	
Enduro Royalty Trust (40%)	NDRO	15.35	BL	200	48	52	9.0	1.54	10.0	0.90	
Sabine Royalty Trust	SBR	52.13	TL	760	52	48	11.8	4.41	8.4	0.81	
San Juan Basin Royalty Trust	SJT B	16.36	BL	760	100	-	11.7	0.86	5.2	0.78	
Mesa RoyaltyTrust	MTR	22.97	BL	43	75	25	9.3	2.02	8.8	0.77	
Permian Basin RT	PBT	13.46	TL	630	19	81	7.9	1.06	7.8	0.75	
Cross Timbers Royalty Trust	CRT	28.59	TL	170	83	17	9.6	2.74	9.6	0.68	
Hugoton RoyaltyTrust	HGT	7.90	BL	320	90	10	7.7	0.91	11.6	0.66	
<i>Total or Median</i>				5,200	54	46	9.6				8.4
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 \$90 a barrel for oil and \$6 a million btu for natural gas.											
Dist. = Income distribution. NTM = Next Twelve Months Ended June 30, 2014. Enterprise Value = Market Cap and Debt.											
TL = Top Line income sources, BL = Bottom Line income sources											



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

September 6, 2013

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		5-Sep 2013	(mm)				
Small Cap Independent Producers								
PDC Energy	PDCE		57.31	31.0	1,780	45.00	0.36	1.18
Range Resources	RRC	B	76.47	161.0	12,310	90.00	0.19	0.88
Halcón Resources	HK		4.89	441.0	2,160	7.00	0.50	0.85
Continental Resources (32%)	CLR	B	97.24	59.2	5,760	120.00	0.17	0.84
Denbury Resources Inc.	DNR		17.71	372.0	6,590	23.00	0.28	0.84
Peyto Exploration and Development Corp.	PEYUF		27.34	149.0	4,070	34.00	0.13	0.83
Berry Petroleum Company	BRY		41.42	55.3	2,290	58.00	0.36	0.82
Cimarex Energy Company	XEC	B	85.92	86.5	7,430	110.00	0.13	0.81
Whiting Petroleum Corporation	WLL	B	51.28	119.0	6,100	75.00	0.20	0.75
Birchcliff Energy Ltd.	BIREF	CB	6.76	166.0	1,120	12.00	0.20	0.65
	<i>Total or Median</i>				49,610		0.20	0.83
Leveraged Cash Payers								
Vanguard Natural Resources, LLC	VNR		27.28	75.0	2,050	25.00	0.35	1.06
Legacy Reserves L.P.	LGCY		27.00	57.3	1,550	25.00	0.41	1.05
Enerplus Corporation	ERF		17.42	196.0	3,410	18.00	0.31	0.98
Linn Energy, LLC	LINE		24.43	234.0	5,720	26.00	0.51	0.97
	<i>Total or Median</i>				12,730		0.38	1.01
RTF Cash Payers								
Freehold Royalties Ltd.	FRHLF		22.30	66.8	1,490	21.00	0.05	1.06
Dorchester Minerals, L.P.	DMLP	B	24.03	30.7	740	26.00	-	0.92
Enduro Royalty Trust (40%)	NDRO		15.35	13.2	200	17.00	-	0.90
Sabine Royalty Trust	SBR		52.13	14.6	760	64.00	-	0.81
San Juan Basin Royalty Trust	SJT	B	16.36	46.6	760	21.00	-	0.78
Mesa Royalty Trust	MTR		22.97	1.9	43	30.00	-	0.77
Permian Basin RT	PBT		13.46	46.6	630	18.00	-	0.75
Cross Timbers Royalty Trust	CRT		28.59	6.0	170	42.00	-	0.68
Hugoton Royalty Trust	HGT		7.90	40.0	320	12.00	-	0.66
	<i>Total or Median</i>				5,110			0.78
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 \$90 a barrel for oil and \$6 a million btu for natural gas.								
Recent NPV Changes: CLR to \$120 from \$110, VNR to \$25 from \$22, XEC to \$110 from \$100								



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

September 6, 2013

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		5-Sep 2013	Royalty (%)	Ebitda	NTM	NTM	NTM
Small Cap Independent Producers								
Range Resources	RRC	B	76.47		-	13.6	15.7	13.8
PDC Energy	PDCE		57.31		-	16.2	10.5	12.4
Peyto Exploration and Development Corp	PEYUF		27.34		0.27	9.3	11.7	9.7
Birchcliff Energy Ltd.	BIREF	CB	6.76		-	18.6	12.9	8.3
Continental Resources (32%)	CLR	B	97.24		-	11.8	8.2	6.9
Berry Petroleum Company	BRY		41.42		-	12.2	7.6	6.2
Halcón Resources	HK		4.89		-	4.8	7.1	6.1
Denbury Resources Inc.	DNR		17.71		-	13.5	7.0	5.8
Cimarex Energy Company	XEC	B	85.92		-	7.6	7.0	5.7
Whiting Petroleum Corporation	WLL	B	51.28		-	8.7	5.3	4.0
	<i>Median</i>					12.0	7.9	6.6
Leveraged Cash Payers								
Vanguard Natural Resources, LLC	VNR		27.28		0.91	9.9	9.3	9.8
Linn Energy, LLC	LINE		24.43		1.08	13.6	9.7	9.4
Legacy Reserves L.P.	LGCY		27.00		0.83	11.1	8.9	9.3
Enerplus Corporation	ERF		17.42		0.36	6.7	6.4	6.2
	<i>Median</i>					10.5	9.1	9.4
RTF Cash Payers								
Sabine Royalty Trust	SBR		52.13	100	1.00	9.0	14.5	11.8
San Juan Basin Royalty Trust	SJT	B	16.36		0.61	10.2	15.0	11.7
Freehold Royalties Ltd.	FRHLF		22.30	86	0.79	4.8	10.4	11.0
Dorchester Minerals, L.P.	DMLP	B	24.03	75	0.82	7.3	11.3	10.5
Cross Timbers Royalty Trust	CRT		28.59	98	0.92	12.7	14.1	9.6
Mesa RoyaltyTrust	MTR		22.97		0.82	5.0	12.2	9.3
Enduro Royalty Trust (40%)	NDRO		15.35		0.90	5.8	9.9	9.0
Permian Basin RT	PBT		13.46	69	0.62	12.7	10.6	7.9
Hugoton RoyaltyTrust	HGT		7.90		0.88	13.0	11.6	7.7
	<i>Median</i>					9.0	11.6	9.6
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, 2014; 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).								



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

September 6, 2013

Table ISC-4

McDep Income and Small Cap Energy Portfolio Total Return and Enterprise Value Momentum

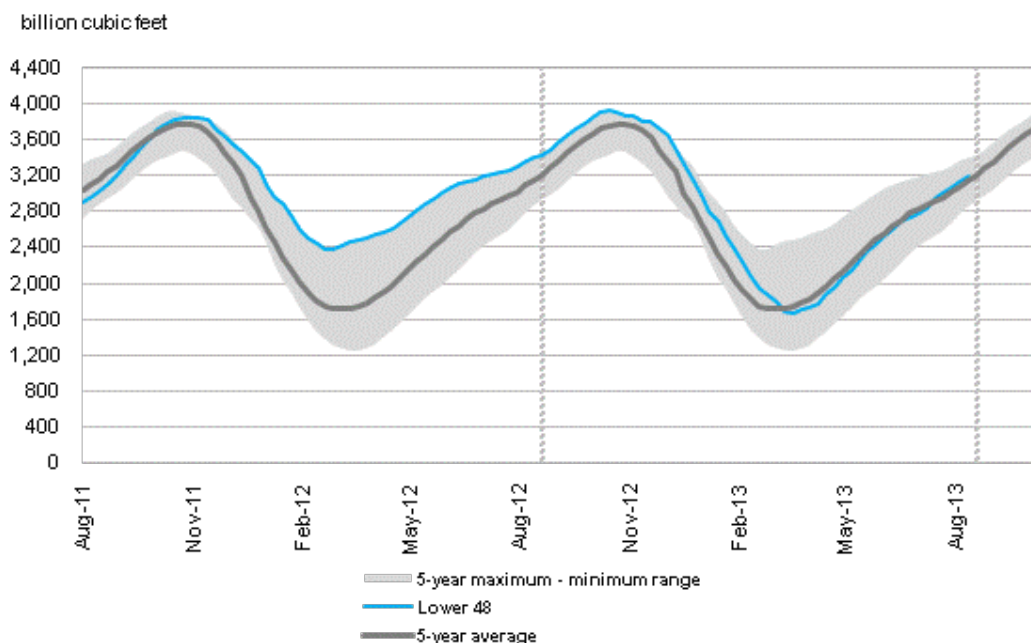
	Symbol/ Rating		Price	Equity	Enterprise Value/				McDep Ratio
			(\$/sh)	Total					
			5-Sep 2013	Return YTD (%)	52Wk High	52Wk Low	50 Day Avg.	200 Day Avg.	
Small Cap Independent Producers									
Cimarex Energy Company	XEC	B	85.92	50	0.99	1.42	1.11	1.19	0.81
PDC Energy	PDCE		57.31	72	0.98	1.62	1.03	1.16	1.18
Continental Resources (32%)	CLR	B	97.24	32	0.99	1.35	1.04	1.12	0.84
Whiting Petroleum Corporation	WLL	B	51.28	18	0.95	1.19	1.02	1.06	0.75
Range Resources	RRC	B	76.47	22	0.92	1.19	0.98	1.03	0.88
Peyto Exploration and Development C	PEYUF		27.34	21	0.88	1.27	0.97	1.02	0.83
Denbury Resources Inc.	DNR		17.71	9	0.93	1.15	1.01	1.01	0.84
Berry Petroleum Company	BRY		41.42	24	0.91	1.18	1.00	1.00	0.82
Birchcliff Energy Ltd.	BIREF	CB	6.76	(11)	0.82	1.03	0.92	0.91	0.65
Halcón Resources	HK		4.89	(29)	0.76	1.30	0.95	0.88	0.85
	<i>Median</i>			<i>21</i>	<i>0.93</i>	<i>1.23</i>	<i>1.01</i>	<i>1.03</i>	<i>0.83</i>
Leveraged Cash Payers									
Enerplus Corporation	ERF		17.42	42	1.00	1.30	1.05	1.13	0.98
Legacy Reserves L.P.	LGCY		27.00	21	0.94	1.12	1.00	1.02	1.05
Vanguard Natural Resources, LLC	VNR		27.28	11	0.93	1.08	1.00	0.99	1.06
Linn Energy, LLC	LINE		24.43	(26)	0.74	1.09	0.96	0.84	0.97
	<i>Median</i>			<i>16</i>	<i>0.94</i>	<i>1.10</i>	<i>1.00</i>	<i>1.00</i>	<i>1.01</i>
RTF Cash Payers									
Sabine Royalty Trust	SBR		52.13	38	0.95	1.34	1.01	1.07	0.81
San Juan Basin Royalty Trust	SJT	B	16.36	25	0.91	1.33	1.00	1.06	0.78
Dorchester Minerals, L.P.	DMLP	B	24.03	25	0.94	1.21	0.99	1.03	0.92
Permian Basin RT	PBT		13.46	14	0.83	1.13	1.00	1.02	0.75
Cross Timbers Royalty Trust	CRT		28.59	11	0.83	1.21	1.03	1.02	0.68
Mesa RoyaltyTrust	MTR		22.97	25	0.84	1.23	1.05	1.01	0.77
Freehold Royalties Ltd.	FRHLF		22.30	6	0.92	1.12	0.98	0.98	1.06
Enduro Royalty Trust (40%)	NDRO		15.35	(3)	0.79	1.05	1.00	0.95	0.90
Hugoton RoyaltyTrust	HGT		7.90	16	0.79	1.38	0.93	0.93	0.66
	<i>Median</i>			<i>16</i>	<i>0.84</i>	<i>1.21</i>	<i>1.00</i>	<i>1.02</i>	<i>0.78</i>
CB=Contrarian Buy, Stock Price apparently in downtrend compared to 200-day average.									
Source: Bloomberg, Yahoo, McDep LLC									



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Working gas in underground storage compared with the 5-year maximum and minimum



Source: U.S. Energy Information Administration

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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Research Methodology/Ratings Description: McDep LLC is an independent research originator focused on oil and gas stocks exclusively. The firm applies the forty 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.