



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

February 20, 2009

Geographic Distortion in Natural Gas Price

Summary and Recommendation

Regional distortions magnify new low prices for near-month natural gas futures coinciding with new low prices for natural gas producers including buy recommendations **Cimarex Energy (XEC)** and **Hugoton Royalty Trust (HGT)** as well as hold-rated **San Juan Basin Royalty Trust (SJT)**. Real-time wellhead price in the fourth quarter of last year dropped from a normal ratio near 0.9 to as low as 0.56 times the Nymex (New York Mercantile Exchange) Henry Hub benchmark (see chart, page 5, [Natural Gas Price/Benchmark](#)). Normally the typical regional differential might be \$0.50 a thousand cubic feet or million Btu. The steep discounts reported for the latest quarter ranged from more than \$2 for XEC to \$3 for HGT. Though the spreads have not narrowed much so far in 2009, the forward markets and common sense indicate a narrowing with tightening of supply/demand conditions. The largest producers protect themselves with marketing, transportation or hedging insurance. The smaller producers may see some predatory activity working to their disadvantage temporarily, but not likely to a large degree for long, we hope. Meanwhile low McDep Ratios point to appreciation potential in the better days we believe lie ahead. We also introduce a modified format in our valuation tables this week.

Deflation Resistance, Inflation Protection and Return on Investment

Revamped valuation tables present the most important characteristics in selection of income and small cap stocks (see Tables 1 to 3). For another measure of financial strength to resist going out of business in tough times, we add the ratio of Enterprise Value to Market Cap (see Table 1). It supplements Debt/Present Value (see Table 2). In each case, lower is stronger. While both oil and gas offer inflation protection, the smaller stocks tend to offer more natural gas exposure. Excluding buy-recommended **Canadian Oil Sands Trust (COSWF)**, which we count as part of the Canadian group in our separate Large Cap Weekly, the two buy recommendations are concentrated mostly on natural gas (see Table 1). Our primary measure of potential return on investment, the McDep Ratio, is complemented in an adjacent column with distribution yield, a necessary requirement for income investors (see Table 1). The small number of buy recommendations reflects the need to be patient in today's stock market as well as a limit to our capacity to provide the more intensive coverage of rated stocks. For, example all six of the U.S. Royalty Trusts as well as **Dorchester Minerals (DMLP)** are high quality, long-term commitments that can fulfill the triplet objectives of deflation resistance, inflation protection and return on investment, in our opinion.

Rank by EV/Ebitda should normally match rank by PV/Ebitda with exceptions for some stocks with long histories and/or revenue royalty characteristics (see Table 3). Finally, Distribution/Equity Ebitda above 1.10 indicates in a few cases that the current rate may need to be reduced if current depressed commodity prices prevail too long (Table 3).

Kurt H. Wulff, CFA



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

February 20, 2009

Table 1										
McDep Income and Small Cap Energy Portfolio										
Debt, Business Segments and Income Yield										
						Present Value				
						by Segment (%)				
	Symbol/Rating	Price	EV/	Enterprise	NAmer.		Dist.	Dist.		
	B = Buy	19-Feb	Market	Value	Natural	Oil	NTM	Yield	McDep	
	H = Hold	2009	Cap	(\$mm)	Gas	Prod'n	(\$/un)	(%)	Ratio	
Canadian Income Trusts (US\$)										
Pengrowth Energy Trust	PGH	7.47	1.97	3,700	34	66	1.62	21.7	0.63	
Penn West Energy Trust	PWE	H	9.96	1.85	7,600	30	70	2.19	22.0	0.55
Enerplus Resources Fund	ERF		17.57	1.26	3,700	56	44	1.77	10.1	0.46
Canadian Oil Sands Trust	COSWF	B	16.65	1.14	9,100		100	0.49	2.9	0.43
<i>Total or Median</i>					24,100					
Small Cap Independent Producers										
Encore Acquisition Company	EAC	H	22.51	2.13	2,510	25	75	-	-	0.69
Berry Petroleum Company	BRY	H	6.99	5.31	1,700	42	58	0.30	4.3	0.53
Cimarex Energy Company	XEC	B	21.63	1.48	2,660	66	34	0.24	1.1	0.49
Birchcliff Energy Ltd. (US\$)	BIR.TO		3.12	1.50	560	75	25	-	-	0.41
<i>Total or Median</i>					7,430					
U.S. Royalty Trusts										
Sabine Royalty Trust	SBR		37.20	1.00	540	54	46	3.08	8.3	0.79
Cross Timbers Royalty Trust	CRT		22.65	1.00	140	76	24	2.30	10.2	0.54
San Juan Basin Royalty Trust	SJT	H	16.73	1.00	780	100	-	1.25	7.5	0.49
Permian Basin RT	PBT		9.17	1.00	430	33	67	0.97	10.6	0.48
Hugoton Royalty Trust	HGT	B	11.11	1.00	440	91	9	1.01	9.1	0.40
Mesa Royalty Trust	MTR		26.00	1.00	50	75	25	3.55	13.7	0.38
<i>Total or Median</i>					2,380					
U.S. Master Limited Partnerships (MLPs)										
Linn Energy, LLC	LINE		14.87	2.03	3,440	48	52	2.52	16.9	1.03
Encore Energy Partners, L.P. (3)	ENP		13.76	1.27	180	34	66	2.00	14.5	0.84
Dorchester Minerals, L.P.	DMLP		15.78	1.00	450	68	32	1.49	9.4	0.66
<i>Total or Median</i>					4,070					
Composite (excl COSWF)										
<i>Enterprise Value Weighting</i>					34,280	38	62			0.68
<i>Equal Weighting</i>						57	43			0.59
<i>Equal Weighted Buys</i>						70	30			0.44
* Percentages in Symbol column refer to current market Enterprise Value weightings; Rating column, equal weightings.										
* Percentages in Price column refer to equal weighted buys.										



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

February 20, 2009

Table 2								
Oil and Gas Income and Small Cap Stocks								
Net Present Value and McDep Ratio								
			Price (\$/sh)		Market Cap (\$mm)	Net Present Value (\$/un)	Debt/ Present Value	McDep Ratio
	Symbol/ Rating		19-Feb 2009	Shares (mm)				
Canadian Income Trusts (US\$)								
Pengrowth Energy Trust	PGH		7.47	249.0	1,860	16.00	0.31	0.63
Penn West Energy Trust	PWE	H	9.96	410.0	4,080	25.00	0.25	0.55
Enerplus Resources Fund	ERF		17.57	164.9	2,900	44.00	0.09	0.46
Canadian Oil Sands Trust	COSWF	B	16.65	482.0	8,030	42.00	0.05	0.43
<i>Total or Median</i>					16,900		0.17	0.50
Small Cap Independent Producers								
Encore Acquisition Company	EAC	H	22.51	52.6	1,180	44.00	0.37	0.69
Berry Petroleum Company	BRY	H	6.99	45.5	320	40.00	0.43	0.53
Cimarex Energy Company	XEC	B	21.63	83.2	1,800	55.00	0.16	0.49
Birchcliff Energy Ltd. (US\$)	BIR.TO		3.12	117.0	370	10.00	0.14	0.41
<i>Total or Median</i>					3,670		0.26	0.51
U.S. Royalty Trusts								
Sabine Royalty Trust	SBR		37.20	14.6	540	47.00	-	0.79
Cross Timbers Royalty Trust	CRT		22.65	6.0	140	42.00	-	0.54
San Juan Basin Royalty Trust	SJT	H	16.73	46.6	780	34.00	-	0.49
Permian Basin RT	PBT		9.17	46.6	430	19.00	-	0.48
Hugoton Royalty Trust	HGT	B	11.11	40.0	440	28.00	-	0.40
Mesa Royalty Trust	MTR		26.00	1.9	50	67.00	-	0.38
<i>Total or Median</i>					2,380			0.49
U.S. Master Limited Partnerships (MLPs)								
Linn Energy, LLC	LINE		14.87	114.0	1,700	14.00	0.52	1.03
Encore Energy Partners, L.P. (32%)	ENP		13.76	10.6	150	17.00	0.18	0.84
Dorchester Minerals, L.P.	DMLP		15.78	28.2	450	24.00	-	0.66
<i>Total or Median</i>					2,300		0.18	0.84
B = Buy, H = Hold								
McDep Ratio = Market cap and Debt to present value of oil and gas and other businesses								
Present Value presumes long-term prices of \$75 a barrel for oil and \$10 a million btu for natural gas.								



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

February 20, 2009

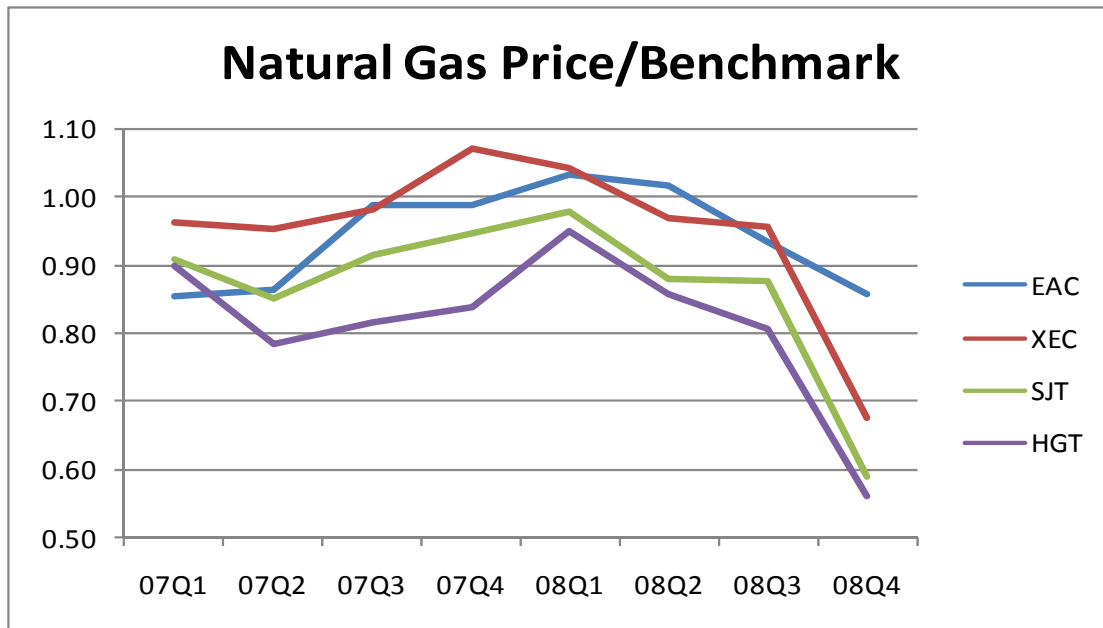
Table 3								
Oil and Gas Income and Small Cap Stocks								
Value Multiples - Rank by EV/Ebitda								
			Price (\$/sh)	Adjstd Resrvs/ Prod	PV/ Ebitda	EV/ Ebitda	Revenue Royalty (%)	Dist/ Equity Ebitda
	Symbol/ Rating		19-Feb 2009	NTM	NTM	NTM		
Canadian Income Trusts (US\$)								
Canadian Oil Sands Trust	COSWF	B	16.65	23.3	29.1	12.5		0.34
Pengrowth Energy Trust	PGH		7.47	9.5	12.5	7.9		1.27
Penn West Energy Trust	PWE	H	9.96	8.0	12.8	7.1		1.13
Enerplus Resources Fund	ERF		17.57	10.6	12.6	5.8		0.51
	<i>Median</i>			10.0	12.7	7.5		
Small Cap Independent Producers								
Encore Acquisition Company	EAC		22.51	11.4	12.7	8.8		-
Birchcliff Energy Ltd. (US\$)	BIR.TO		3.12	6.9	21.2	8.7		-
Berry Petroleum Company	BRY		6.99	9.6	12.2	6.5		-
Cimarex Energy Company	XEC		21.63	7.2	10.1	5.0		-
	<i>Median</i>			8.4	12.5	7.6		
U.S. Royalty Trusts								
Sabine Royalty Trust	SBR		37.20	9.2	15.3	12.1	100	1.00
San Juan Basin Royalty Trust	SJT	H	16.73	10.7	21.2	10.4		0.78
Cross Timbers Royalty Trust	CRT		22.65	14.5	17.3	9.4	84	0.95
Permian Basin RT	PBT		9.17	8.8	16.6	8.0	32	0.85
Hugoton Royalty Trust	HGT	B	11.11	13.1	19.2	7.6		0.69
Mesa Royalty Trust	MTR		26.00	22.4	16.5	6.3		0.87
	<i>Median</i>			11.9	17.0	8.7		
U.S. Master Limited Partnerships (MLPs)								
Encore Energy Partners, L.P.	ENP		13.76	10.9	16.1	13.6		1.90
Linn Energy, LLC	LINE		14.87	13.6	11.5	11.9		2.07
Dorchester Minerals, L.P.	DMLP		15.78	8.5	16.5	10.9	64	1.02
	<i>Median</i>			10.9	16.1	11.9		
EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended December 31, 2009; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses								



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

February 20, 2009



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.

McDep does no investment banking business. McDep is not paid by covered companies including revenue from advertising, trading, consulting, subscriptions or research service. McDep shall not own more than 1% of outstanding stock in a covered company. No one at McDep is on the Board of Directors at a covered company nor is anyone at a covered company on the Board of Directors of McDep.

McDep or its employees may take positions in stocks the firm covers for research purposes. No trades in a subject stock shall be made within a week before or after a change in recommendation.

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.