



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

May 8, 2009

## Restore Buy on Encore Acquisition (EAC)

### Summary and Recommendation

The stock of buy-recommended **Encore Acquisition (EAC)** is trading above its 200-day average again for the first time in more than nine months. While stock price is the catalyst for us to restore our buy recommendation, a low McDep Ratio provides the fundamental rationale. By our analysis EAC stock offers unlevered appreciation potential of 17% to a McDep Ratio of 1.0 and levered appreciation potential of 27% to Net Present Value (NPV) of \$44 a share (see Independent Stock Idea, Encore Acquisition, April 22, 2009). Among other stocks in this weekly analysis, the U.S. Royalty Trusts and the Canadian Income Trusts offer some of the lowest McDep Ratios while the stocks remain out of favor with stock prices below the 200-day average. Income stocks sometimes have their own cycle. Contrarian investors may take advantage of the delay as ultimately income stocks respond to the same fundamental factors that are improving for the independent producers.

Kurt H. Wulff, CFA

<i>Symbol</i>	EAC	<i>Ebitda Next Twelve Months ending 3/31/10 (US\$m)</i>	298
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	19
<i>Price (\$/sh)</i>	33.11	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	5/7/09	<i>Adjusted Reserves/Production NTM</i>	11.5
<i>Shares (mm)</i>	53	<i>EV/Ebitda</i>	9.7
<i>Market Capitalization (\$mm)</i>	1,760	<i>PV/Ebitda</i>	11.7
<i>Debt (\$mm)</i>	1,130	<i>Undeveloped Reserves (%)</i>	20
<i>Enterprise Value (EV) (\$mm)</i>	2,900	<i>Natural Gas and Oil Ebitda (\$/boe)</i>	20.40
<i>Present Value (PV) (\$mm)</i>	3,480	<i>Present Value Proven Reserves(\$/boe)</i>	18.70
<i>Net Present Value (\$/share)</i>	44	<i>Oil and Gas Ebitda Margin (%)</i>	49
<i>Debt/Present Value</i>	0.33	<i>Earnings Next Twelve Months (US\$/sh)</i>	
<i>McDep Ratio - EV/PV</i>	0.83	<i>Price/Earnings Next Twelve Months</i>	
<i>Dividend Yield (%/year)</i>	0.0	<i>Indicated Annual Dividend (US\$/sh)</i>	0.00
Note: Estimated cash flow and earnings tied to one-year futures prices for oil and natural gas.			
Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.			
Estimated present value presumes a long-term price for oil of US\$75 a barrel and natural gas, \$10 a million btu.			
For historical research on Encore since 2003 see <a href="http://www.mcdep.com/4eac.htm">http://www.mcdep.com/4eac.htm</a>			



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

May 8, 2009

Table 1										
McDep Income and Small Cap Energy Portfolio										
Debt, Business Segments and Income Yield										
						Present Value				
		Price				by Segment (%)				
Symbol/Rating		(US\$/sh)	EV/	Enterprise	NAmer.		Dist.	Dist.		
	B = Buy	7-May	Market	Value	Natural	Oil	NTM	Yield	McDep	
	H = Hold	2009	Cap	(\$mm)	Gas	Prod'n	(\$/un)	(%)	Ratio	
<b>Canadian Income Trusts (US\$)</b>										
Pengrowth Energy Trust	PGH	7.92	1.85	3,700	40	60	1.03	13.0	0.64	
Penn West Energy Trust	PWE	H	12.60	1.76	8,900	33	67	1.54	12.2	0.64
Freehold Royalty Trust	FRHLF		10.43	1.27	650	29	21	1.03	9.9	0.64
Peyto Energy Trust	PEYUF		8.50	1.45	1,300	79	21	1.23	14.5	0.62
Canadian Oil Sands Trust	COSWF	B	23.81	1.10	12,600		100	0.51	2.1	0.59
Enerplus Resources Fund	ERF		21.88	1.23	4,400	46	54	1.85	8.5	0.55
<i>Total or Median</i>					31,600					
<b>Small Cap Independent Producers</b>										
Encore Acquisition Company	EAC	B	33.11	1.64	2,890	23	77	-	-	0.83
Birchcliff Energy Ltd. (US\$)	BIREF		5.74	1.33	930	72	28	-	-	0.64
Berry Petroleum Company	BRY	H	17.28	2.25	1,740	38	62	0.30	1.7	0.63
Cimarex Energy Company	XEC	B	28.59	1.37	3,210	67	33	0.24	0.8	0.60
<i>Total or Median</i>					8,770					
<b>U.S. Royalty Trusts</b>										
Cross Timbers Royalty Trust	CRT		24.01	1.00	140	69	31	1.50	6.2	0.75
Sabine Royalty Trust	SBR		40.00	1.00	580	43	57	2.43	6.1	0.67
San Juan Basin Royalty Trust	SJT	H	16.81	1.00	780	100	-	0.78	4.7	0.65
Permian Basin RT	PBT		9.72	1.00	450	33	67	0.80	8.2	0.51
Hugoton Royalty Trust	HGT	B	13.29	1.00	530	91	9	0.69	5.2	0.48
Mesa Royalty Trust	MTR		29.47	1.00	60	75	25	2.96	10.0	0.44
<i>Total or Median</i>					2,540					
<b>U.S. Master Limited Partnerships (MLPs)</b>										
Linn Energy, LLC	LINE		16.23	1.76	3,260	53	47	2.52	15.5	1.08
Encore Energy Partners, L.P. (3)	ENP		16.86	1.28	230	24	76	2.00	11.9	0.99
Dorchester Minerals, L.P.	DMLP		19.01	1.00	540	51	49	1.35	7.1	0.59
<i>Total or Median</i>					4,030					
<b>Composite (excl COSWF)</b>										
<i>Enterprise Value Weighting</i>					34,200	46	54			0.65
<i>Equal Weighting</i>						54	46			0.66
<i>Equal Weighted Buys</i>						50	50			0.64
* 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

May 8, 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		7-May 2009	Shares (mm)					
<b>Canadian Income Trusts (US\$)</b>									
Pengrowth Energy Trust	PGH		7.92	255.5	2,020	16.00	0.30	0.64	
Penn West Energy Trust	PWE	H	12.60	399.4	5,030	25.00	0.28	0.64	
Freehold Royalty Trust	FRHLF		10.43	49.5	520	18.00	0.13	0.64	
Peyto Energy Trust	PEYUF		8.50	105.9	900	16.00	0.19	0.62	
Canadian Oil Sands Trust	COSWF	B	23.81	482.2	11,480	42.00	0.05	0.59	
Enerplus Resources Fund	ERF		21.88	165.3	3,620	44.00	0.10	0.55	
<i>Total or Median</i>						23,600		0.16	0.63
<b>Small Cap Independent Producers</b>									
Encore Acquisition Company	EAC	B	33.11	53.3	1,760	44.00	0.33	0.83	
Birchcliff Energy Ltd. (US\$)	BIREF		5.74	122.0	700	10.00	0.16	0.64	
Berry Petroleum Company	BRY	H	17.28	44.6	770	40.00	0.35	0.63	
Cimarex Energy Company	XEC	B	28.59	81.7	2,340	55.00	0.16	0.60	
<i>Total or Median</i>						5,570		0.24	0.64
<b>U.S. Royalty Trusts</b>									
Cross Timbers Royalty Trust	CRT		24.01	6.0	140	32.00	-	0.75	
Sabine Royalty Trust	SBR		40.00	14.6	580	60.00	-	0.67	
San Juan Basin Royalty Trust	SJT	H	16.81	46.6	780	26.00	-	0.65	
Permian Basin RT	PBT		9.72	46.6	450	19.00	-	0.51	
Hugoton Royalty Trust	HGT	B	13.29	40.0	530	28.00	-	0.48	
Mesa Royalty Trust	MTR		29.47	1.9	60	67.00	-	0.44	
<i>Total or Median</i>						2,540			0.58
<b>U.S. Master Limited Partnerships (MLPs)</b>									
Linn Energy, LLC	LINE		16.23	114.0	1,850	14.00	0.47	1.08	
Encore Energy Partners, L.P. (32%)	ENP		16.86	10.6	180	17.00	0.21	0.99	
Dorchester Minerals, L.P.	DMLP		19.01	28.2	540	32.00	-	0.59	
<i>Total or Median</i>						2,570		0.21	0.99
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

May 8, 2009

Table 3								
Oil and Gas Income and Small Cap Stocks								
Value Multiples - Rank by EV/Ebitda								
			Price (\$/sh)	Revenue	Dist/ Equity	Adjstd Resrvs/ Prod	PV/ Ebitda	EV/ Ebitda
	Symbol/ Rating		7-May 2009	Royalty (%)	Ebitda	NTM	NTM	NTM
<b>Canadian Income Trusts (US\$)</b>								
Canadian Oil Sands Trust	COSWF	B	23.81		0.24	23.2	20.2	11.9
Peyto Energy Trust	PEYUF		8.50		1.31	16.7	17.0	10.6
Pengrowth Energy Trust	PGH		7.92		0.88	7.8	13.7	8.8
Freehold Royalty Trust	FRHLF		10.43	71	0.68	6.1	11.9	7.5
Penn West Energy Trust	PWE	H	12.60		0.70	8.1	11.3	7.2
Enerplus Resources Fund	ERF		21.88		0.53	8.9	12.6	6.9
	<i>Median</i>					8.5	13.1	8.2
<b>Small Cap Independent Producers</b>								
Birchcliff Energy Ltd. (US\$)	BIREF		5.74		-	9.5	20.7	13.3
Encore Acquisition Company	EAC	B	33.11		-	11.5	11.7	9.7
Berry Petroleum Company	BRY	H	17.28		-	11.3	12.6	8.0
Cimarex Energy Company	XEC	B	28.59		-	7.1	9.4	5.7
	<i>Median</i>					10.4	12.2	8.8
<b>U.S. Royalty Trusts</b>								
Sabine Royalty Trust	SBR		40.00	100	1.00	9.8	24.7	16.5
Cross Timbers Royalty Trust	CRT		24.01	84	0.92	12.5	19.6	14.7
San Juan Basin Royalty Trust	SJT	H	16.81		0.68	9.1	22.4	14.5
Hugoton Royalty Trust	HGT	B	13.29		0.57	12.7	22.9	10.9
Permian Basin RT	PBT		9.72	32	0.85	10.7	20.1	10.3
Mesa Royalty Trust	MTR		29.47		0.87	13.5	19.8	8.7
	<i>Median</i>					11.6	21.3	12.7
<b>U.S. Master Limited Partnerships (MLPs)</b>								
Linn Energy, LLC	LINE		16.23		5.35	18.1	29.7	32.3
Encore Energy Partners, L.P.	ENP		16.86		1.73	11.4	14.7	14.6
Dorchester Minerals, L.P.	DMLP		19.01	64	0.94	8.1	22.3	13.2
	<i>Median</i>					11.4	22.3	14.6
EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended March 31, 2010; 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

May 8, 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.