



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

June 26, 2009

Volume Decline Boosts Product Price, Trims Cash

Summary and Recommendation

Among small cap and income buy recommendations, we project rising volume for **Canadian Oil Sands Trust (COSWF)**, a stable trend for **Dorchester Minerals (DMLP)** and natural decline for **Encore Acquisition (EAC)**, **Hugoton Royalty Trust (HGT)** and **Cimarex Energy (XEC)** (see charts pages 2 and 3, [Canadian Income Trusts](#), [Small Cap Independent Producers](#), [Top Line Cash Payers](#), and [Bottom Line Cash Payers](#)).

Inevitable natural volume decline works to tighten supply and boost the price of oil and natural gas. Because price changes are usually more important than volume changes, cash distributions turn from a declining trend for the past year to a rising trend for the next year (see additional charts pages 4 and 8, [Quarterly Distributions](#)). The wide variation from quarter to quarter in past distributions implies that differences in the near future are difficult to pin point. Longer term, there are clearer distinctions in reserve life, an indicator of volume trend, which we take into account in our estimates of present value. Meanwhile, low McDep Ratios for most of the stocks encourage continuing investment interest. Among buys, COSWF, DMLP and EAC are trading above their 200-day averages, XEC stock price is close to the 200-day mark and HGT remains below the 200-day though recovering rapidly from its lowest price. Oil/natural gas emphasis and volume trend may be the most important distinguishing factors in recent stock market performance.

Top Line Payers and Bottom Line Payers Differentiated

We have long struggled with how much of a valuation difference there should be between stocks that derive cash flow from top line, or revenue royalties as we have called them, and those that derive cash flow from bottom line, or profits royalties. Now we introduce a separate classification that has all the top line payers in the same group. The top line cash payers have a higher median McDep Ratio than the other groups (see Tables 1 and 2, pages 5 and 6). While reserves as reported correspond to a relatively long life index at a median 10 years, the index is less than the median 11 years for all 14 stocks (see Table 3, page 7). Yet, reserves are stated more conservatively for top line trusts in part because the trusts are not responsible for operations and may not have full information about underlying properties. Getting paid first, off-the-top, with its obvious lower risk seems to have an enduring special appeal.

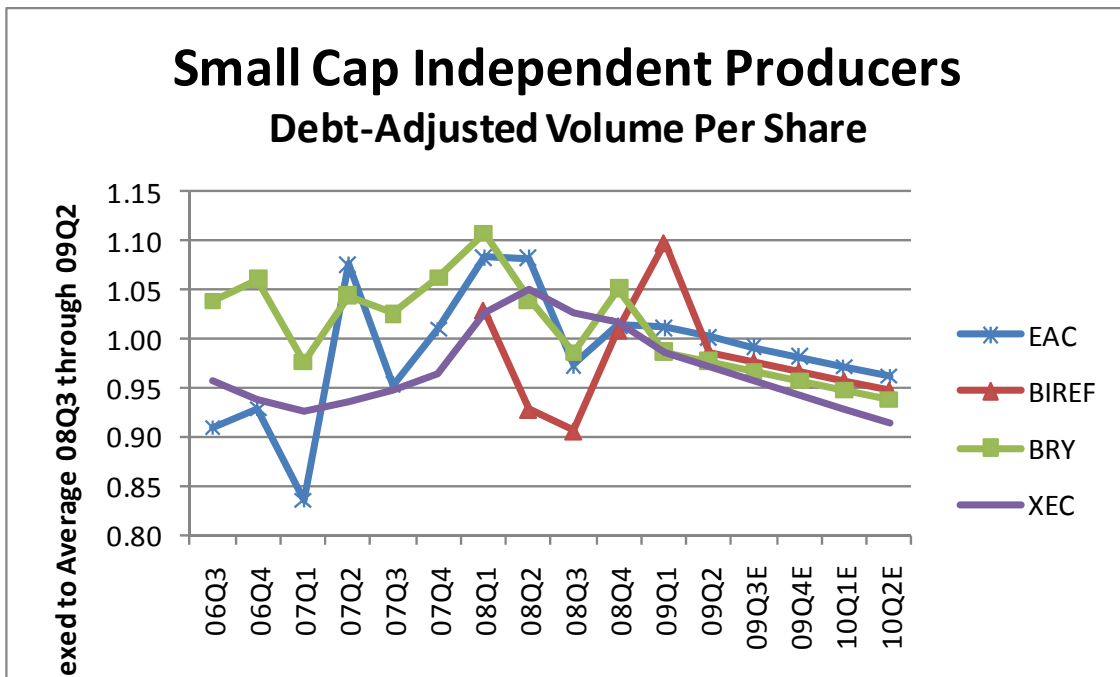
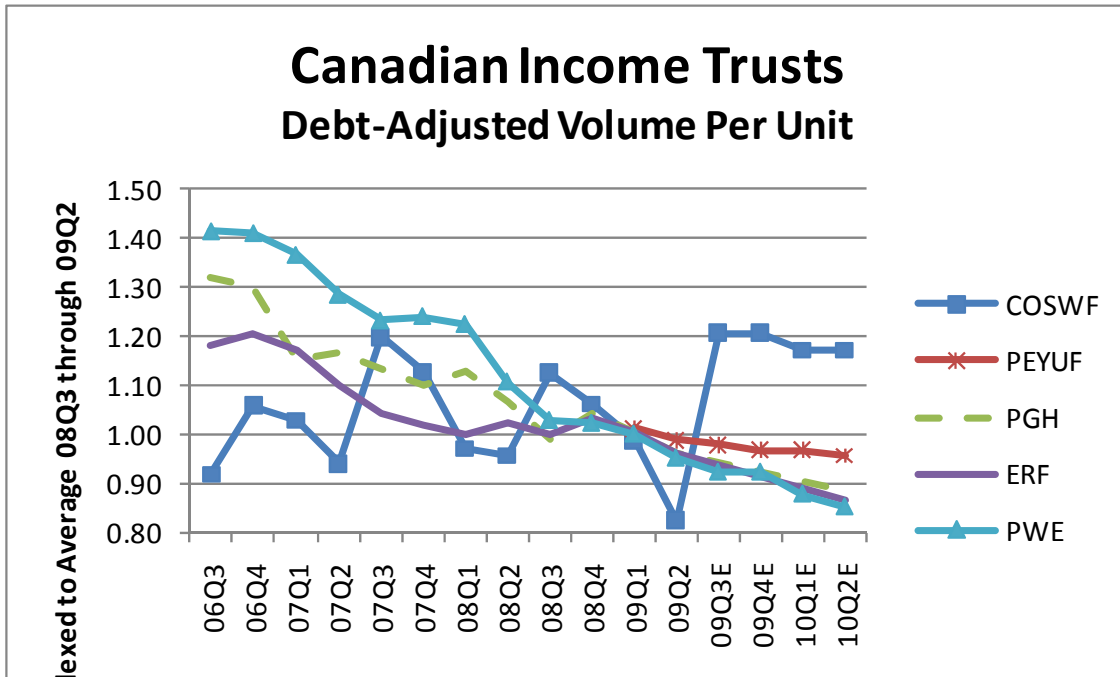
Kurt H. Wulff, CFA



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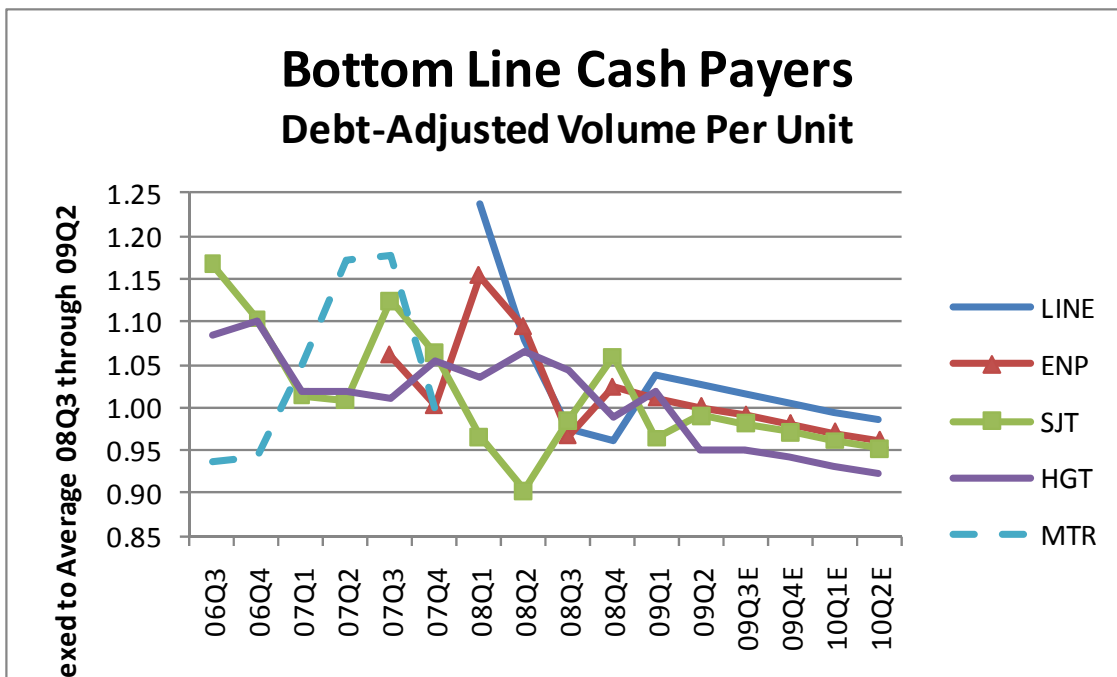
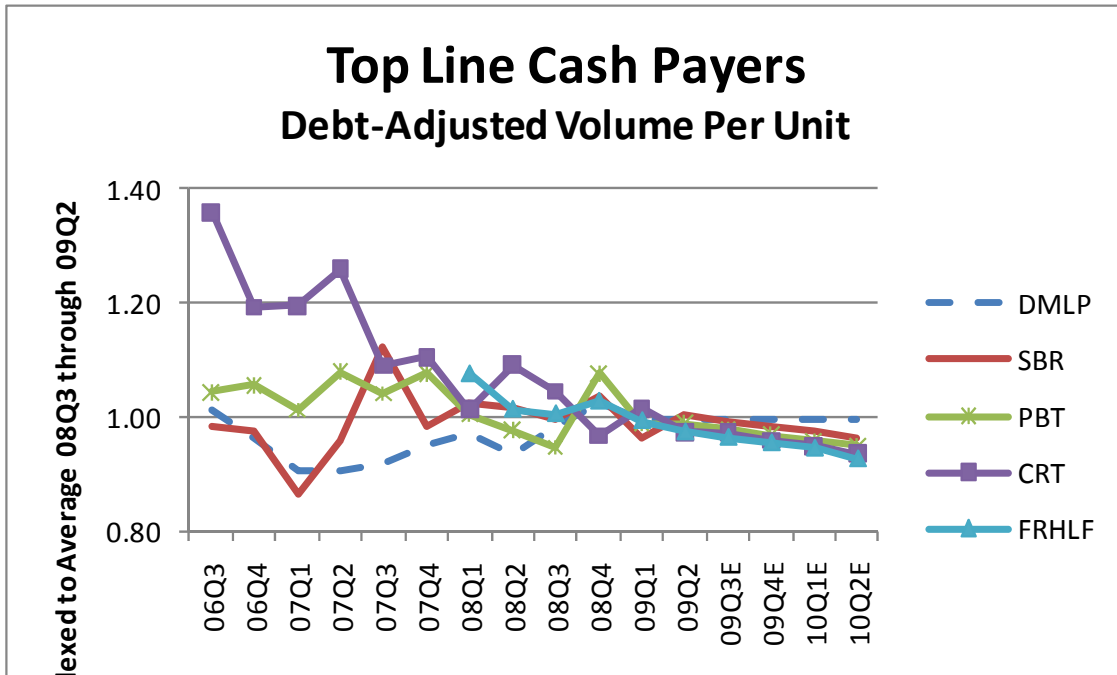




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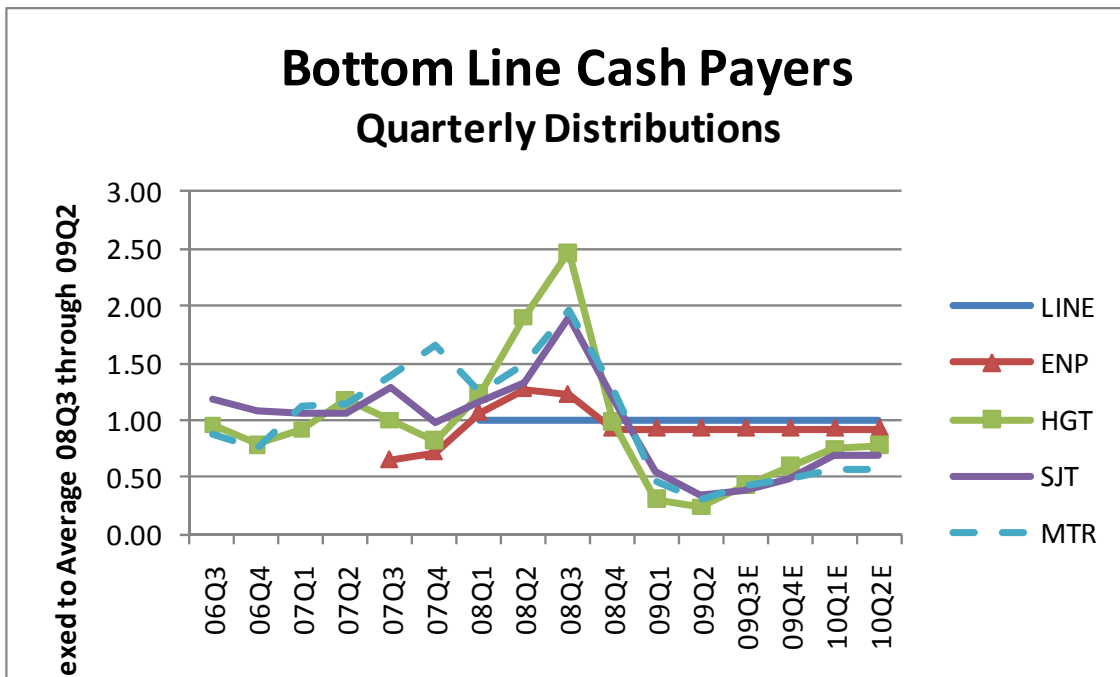
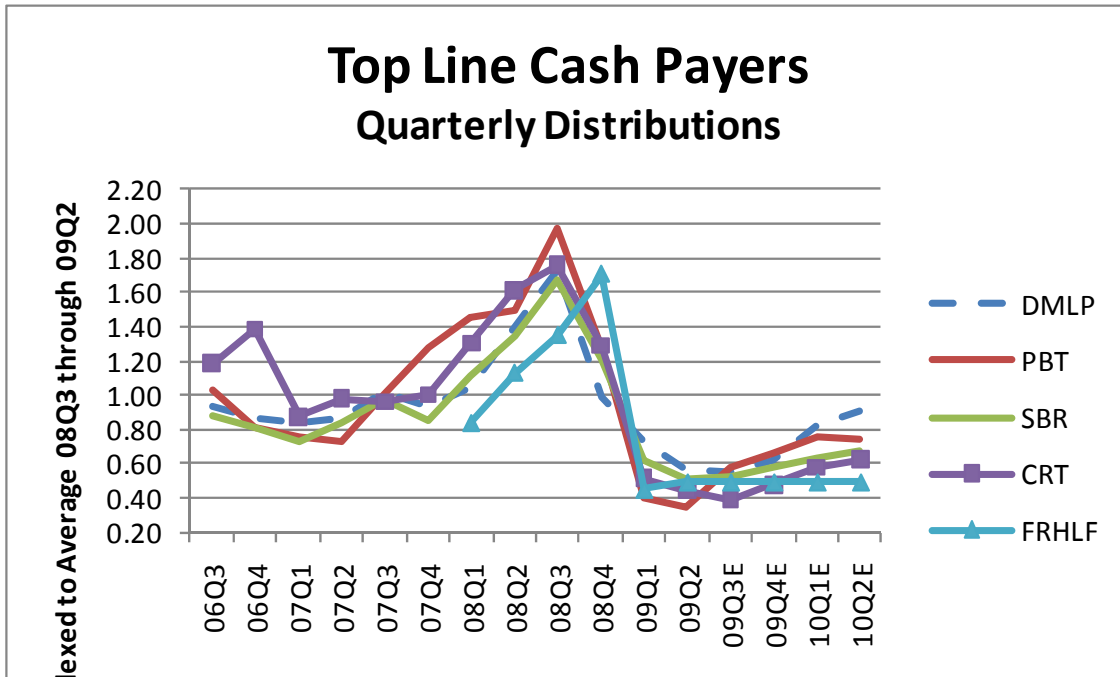




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Symbol/Rating		Price (US\$/sh)	EV/ Market	Enterprise Value (\$mm)	Present Value by Segment (%)			Dist. NTM (\$/un)	Dist. Yield (%)	McDep Ratio
					NAmer. Natural Gas	Oil Prod'n				
B = Buy	H = Hold	25-Jun 2009	Cap							
Canadian Income Trusts (US\$)										
Penn West Energy Trust	PWE H	13.09	1.72	9,300	32	68	1.56	11.9	0.65	
Pengrowth Energy Trust	PGH	7.99	1.86	3,800	39	61	1.04	13.0	0.65	
Peyto Energy Trust	PEYUF	8.48	1.45	1,300	79	21	1.25	14.7	0.62	
Canadian Oil Sands Trust	COSWF B	23.67	1.11	12,700		100	1.99	8.4	0.59	
Enerplus Resources Fund	ERF	21.04	1.24	4,300	50	50	1.87	8.9	0.58	
<i>Total or Median</i>				31,400					0.62	
Small Cap Independent Producers										
Encore Acquisition Company	EAC B	30.41	1.86	3,010	21	79	-	-	0.81	
Berry Petroleum Company	BRY H	17.60	2.24	1,750	38	62	0.30	1.7	0.63	
Cimarex Energy Company	XEC B	28.90	1.37	3,230	67	33	0.24	0.8	0.60	
Birchcliff Energy Ltd. (US\$)	BIREF	5.28	1.37	870	72	28	-	-	0.60	
<i>Total or Median</i>				8,860					0.62	
Top Line Cash Payers										
Cross Timbers Royalty Trust	CRT	27.02	1.00	160	69	31	1.64	6.1	0.84	
Freehold Royalty Trust (US\$)	FRHLF	12.76	1.22	770	29	57	1.06	8.3	0.75	
Sabine Royalty Trust	SBR	44.00	1.00	640	43	57	2.77	6.3	0.73	
Dorchester Minerals, L.P.	DMLP B	20.91	1.00	590	69	31	1.60	7.6	0.65	
Permian Basin RT	PBT	11.20	1.00	520	33	67	0.90	8.1	0.59	
<i>Total or Median</i>				2,680					0.73	
Bottom Line Cash Payers										
Linn Energy, LLC	LINE	19.39	1.64	3,620	53	47	2.52	13.0	1.20	
Encore Energy Partners, L.P. (40%)	ENP	15.30	1.29	260	24	76	2.00	13.1	0.92	
San Juan Basin Royalty Trust	SJT H	14.60	1.00	680	100	-	1.18	8.1	0.56	
Hugoton Royalty Trust	HGT B	13.84	1.00	550	91	9	1.13	8.1	0.49	
Mesa Royalty Trust	MTR	27.15	1.00	50	75	25	2.56	9.4	0.41	
<i>Total or Median</i>				5,160					0.56	
Composite (excl COSWF)										
<i>Enterprise Value Weighting</i>				35,400	45	55			0.67	
<i>Equal Weighting</i>					55	45			0.68	
<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.										



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Table 2								
Oil and Gas Income and Small Cap Stocks								
Net Present Value and McDep Ratio								
			Price (\$/sh)		Market Cap	Net Present Value	Debt/ Present Value	McDep Ratio
	Symbol/ Rating		25-Jun 2009	Shares (mm)	(\$mm)	(\$/un)		
Canadian Income Trusts (US\$)								
	PWE	H	13.09	410.0	5,370	25.00	0.27	0.65
	PGH		7.99	257.0	2,050	16.00	0.30	0.65
	PEYUF		8.48	105.9	900	16.00	0.19	0.62
	COSWF	B	23.67	482.2	11,420	42.00	0.06	0.59
	ERF		21.04	165.7	3,490	40.00	0.11	0.58
	<i>Total or Median</i>				23,200		0.19	0.62
Small Cap Independent Producers								
	EAC	B	30.41	53.3	1,620	44.00	0.37	0.81
	BRY	H	17.60	44.6	780	40.00	0.35	0.63
	XEC	B	28.90	81.7	2,360	55.00	0.16	0.60
	BIREF		5.28	122.0	640	10.00	0.16	0.60
	<i>Total or Median</i>				5,400		0.26	0.62
Top Line Cash Payers								
	CRT		27.02	6.0	160	32.00	-	0.84
	FRHLF		12.76	49.5	630	18.00	0.14	0.75
	SBR		44.00	14.6	640	60.00	-	0.73
	DMLP	B	20.91	28.2	590	32.00	-	0.65
	PBT		11.20	46.6	520	19.00	-	0.59
	<i>Total or Median</i>				2,540			0.73
Bottom Line Cash Payers								
	LINE		19.39	114.0	2,210	14.00	0.47	1.20
	ENP		15.30	13.2	200	17.00	0.21	0.92
	SJT	H	14.60	46.6	680	26.00	-	0.56
	HGT	B	13.84	40.0	550	28.00	-	0.49
	MTR		27.15	1.9	50	67.00	-	0.41
	<i>Total or Median</i>				3,690			0.56
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.								



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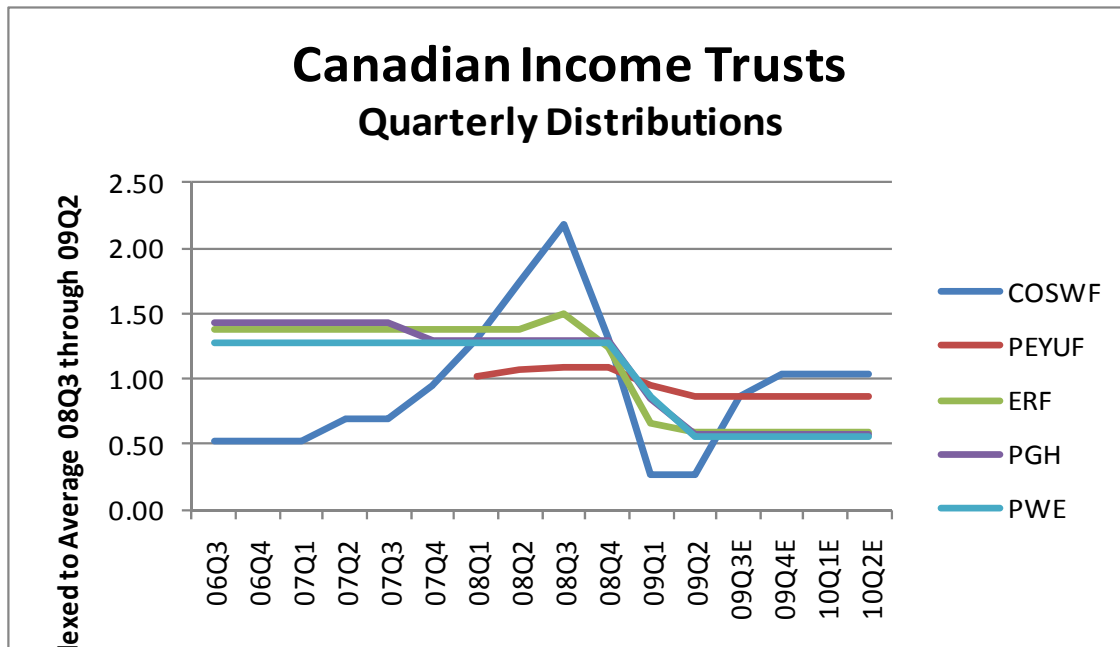
Table 3									
Oil and Gas Income and Small Cap Stocks									
Value Multiples - Rank by EV/Ebitda									
			Price (\$/sh)	Revenue	Dist/ Equity	Adjstd Resrvs/ Prod	PV/ Ebitda	EV/ Ebitda	
	Symbol/ Rating		25-Jun 2009	Royalty (%)	Ebitda	NTM	NTM	NTM	
Canadian Income Trusts (US\$)									
	Canadian Oil Sands Trust	COSWF	B	23.67		0.64	21.5	13.5	8.0
	Peyto Energy Trust	PEYUF		8.48		0.98	17.1	12.6	7.8
	Penn West Energy Trust	PWE	H	13.09		0.63	8.3	10.0	6.6
	Enerplus Resources Fund	ERF		21.04		0.53	9.3	11.2	6.5
	Pengrowth Energy Trust	PGH		7.99		0.65	8.1	10.0	6.5
	<i>Median</i>						9.3	11.2	6.6
Small Cap Independent Producers									
	Birchcliff Energy Ltd. (US\$)	BIREF		5.28		-	9.9	23.0	13.9
	Encore Acquisition Company	EAC	B	30.41		-	11.3	9.5	7.6
	Berry Petroleum Company	BRY	H	17.60		-	11.7	11.8	7.5
	Cimarex Energy Company	XEC	B	28.90		-	7.2	7.7	4.7
	<i>Median</i>						10.6	10.6	7.5
Top Line Cash Payers									
	Sabine Royalty Trust	SBR		44.00	100	1.00	10.0	21.6	15.9
	Cross Timbers Royalty Trust	CRT		27.02	84	0.92	13.0	17.9	15.1
	Dorchester Minerals, L.P.	DMLP	B	20.91	64	0.92	8.1	18.5	12.1
	Permian Basin RT	PBT		11.20	32	0.86	10.9	18.2	10.7
	Freehold Royalty Trust (US\$)	FRHLF		12.76	71	0.61	6.3	10.4	7.8
	<i>Median</i>						10.0	18.2	12.1
Bottom Line Cash Payers									
	Linn Energy, LLC	LINE		19.39		3.36	18.3	18.7	22.5
	Encore Energy Partners, L.P.	ENP		15.30		1.43	11.9	12.2	11.2
	San Juan Basin Royalty Trust	SJT	H	14.60		0.80	9.2	17.6	9.9
	Mesa Royalty Trust	MTR		27.15		0.91	14.4	23.9	9.8
	Hugoton Royalty Trust	HGT	B	13.84		0.75	13.3	18.6	9.2
	<i>Median</i>						13.3	18.6	9.9
EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended June 30, 2010; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses									



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