



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

July 31, 2009

## Deducing the Trend at Mesa Royalty Trust

### Summary and Recommendation

With natural gas, the commodity, deeply depressed, we believe it is a time for investors to accumulate and be patient in stocks like **Mesa Royalty Trust (MTR)**, the Income and Small Cap with the lowest McDep Ratio, 0.43. The trustee made news on July 28, 2009 with the filing at the Securities and Exchange Commission (SEC) the quarterly reports for the periods ended March 31, 2008 and June 30, 2008. As a result, we now know volume, price and costs for operations for those periods, but not since then. Existing investors continue to receive regular quarterly income from distributions declared monthly. The monthly disclosures also attribute royalty income separately to the Hugoton properties and the San Juan Basin properties. Coincidentally, we have recent disclosures from two other royalty trusts with the relevant names, **Hugoton (HGT)** and **San Juan Basin (SJT)**. By analogy with HGT and SJT we estimate volume, price and costs that will enable MTR to pay a distribution of \$1.76 in the next twelve months (see table Next Twelve Months Operating and Financial Performance). That places the distribution yield at 7.4%, near that for HGT and SJT (see Table 1). Despite a similar yield, we estimate Net Present Value (NPV) that leads to a lower McDep Ratio than for HGT and SJT (see Table 2). A higher reserve life supports greater value relative to the distribution (see Table 3).

The delay in financial disclosures stems from a shift to an independent engineer, DeGolyer and MacNaughton (D&M), for making annual estimates of reserves for the San Juan Basin properties. An estimate as of December 31, 2007 has been released with the filing of the annual report to the SEC for 2007 earlier this year. We await the 2008 version as well as the quarterly disclosures for the remainder of 2008 and the first two quarters of 2009.

MTR can't be for every investor considering the small size of the trust at less than \$50 million in market value. Trading in the shares is light and price swings can be exaggerated.

Finally, the McDep Ratio does not tell us when the value we estimate will be recognized. There are widespread fears of further price weakness for natural gas between now and November 1 when seasonal demand is light and there is no obvious place to put the clean fuel that is currently being produced. Either a new source of demand has to open up, displacing coal in power plants, for example, or supply has to be curtailed. Astute traders might make a buck on calling the short-term price. Our conviction lies with long-term investors who see unusual opportunity to make new investments.

Kurt H. Wulff, CFA



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Mesa Royalty Trust									
Next Twelve Months Operating and Financial Performance									
									<i>Next</i>
	<i>Q2</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Twelve</i>
	6/30/08	3/31/09	6/30/09	9/30/09	12/31/09	2009E	3/31/10	6/30/10	Months
									6/30/10
<b>Volume (90% of working interest)</b>									
Natural Gas (bcf)	0.35	0.34	0.32	0.32	0.31	1.29	0.30	0.28	1.22
Natural Gas (mmcf)	3.9	3.7	3.6	3.5	3.4	3.5	3.3	3.2	3.3
Days	90	92	89	92	92	365	92	89	365
Oil (mmb)	0.02	0.02	0.02	0.02	0.02	0.09	0.02	0.02	0.08
Oil (mbd)	0.27	0.25	0.24	0.24	0.23	0.24	0.23	0.22	0.23
Total (bcfe)	0.50	0.48	0.45	0.45	0.44	1.82	0.43	0.40	1.72
Total (mmcf)	5.5	5.2	5.1	4.9	4.8	5.0	4.7	4.5	4.7
<b>Price (Henry Hub and WTI Cushing lagged two months)</b>									
Henry Hub (\$/mmbtu)	8.83	6.50	4.06	3.61	3.79	4.49	5.24	5.61	4.56
Differential (\$/mmbtu)	1.55	1.95	1.22	1.08	1.14	1.32	1.54	1.65	1.38
Trust (\$/mcf)	7.29	4.55	2.84	2.52	2.66	3.17	3.70	3.96	3.18
WTI Cushing (\$/bbl)	104.49	46.82	45.65	64.39	68.94	56.45	72.38	74.48	70.05
Differential	46.51	20.13	19.63	27.68	29.64	24.40	31.29	32.20	30.27
Trust (\$/bbl)	57.98	26.69	26.02	36.70	39.30	32.04	41.09	42.28	39.78
Total (\$/mcf)	7.97	4.52	3.28	3.57	3.78	3.80	4.63	4.87	4.19
<b>Revenue (\$mm)</b>									
Natural Gas	2.58	1.55	0.91	0.81	0.83	4.10	1.12	1.12	3.87
Oil	1.40	0.62	0.57	0.80	0.83	2.82	0.87	0.84	3.34
Total	3.98	2.17	1.48	1.61	1.66	6.91	1.99	1.96	7.21
<b>Expense</b>									
	0.35	0.79	0.48	0.64	0.66	2.57	0.79	0.78	2.89
<b>Ebitda</b>									
	3.63	1.38	1.00	0.97	0.99	4.34	1.19	1.18	4.33
Development (90%)	0.16	0.25	0.25	0.25	0.25	1.00	0.25	0.25	1.00
<b>Royalty Income</b>									
Hugoton	1.47	0.48	0.39						-
San Juan	2.00	0.65	0.35						-
Total Royalty Income	3.48	1.13	0.75	0.72	0.74	3.34	0.94	0.93	3.33
Administrative	0.02	0.05	0.04	0.01	0.01	0.12	0.01	0.01	0.05
<b>Distributable Income (\$mm)</b>									
	3.45	1.09	0.70	0.70	0.73	3.22	0.93	0.91	3.28
Per Unit (\$)	1.85	0.58	0.38	0.38	0.39	1.73	0.50	0.49	1.76
<b>Units (millions)</b>									
	1.86	1.86	1.86	1.86	1.86	1.86	1.86	1.86	1.86
Ebitda Margin	91%	64%	67%	60%	60%	63%	60%	60%	60%
Development/Ebitda	4%	18%	25%	26%	25%	23%	21%	21%	23%
Expense/Revenue	9%	36%	33%	40%	40%	37%	40%	40%	40%



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Table 1										
McDep Income and Small Cap Energy Portfolio										
Debt, Business Segments and Income Yield										
						Present Value by Segment (%)				
	Symbol/Rating	Price (US\$/sh)	EV/ Market	Enterprise Value (\$mm)	NAmer. Natural Gas	Oil Prod'n	Dist. NTM (\$/un)	Dist. Yield (%)	McDep Ratio	
	B = Buy H = Hold	31-Jul 2009	Cap							
<b>Canadian Income Trusts (US\$)</b>										
Pengrowth Energy Trust	PGH	8.23	1.89	4,000	34	66	1.11	13.5	0.73	
Peyto Energy Trust	PEYUF	8.31	1.49	1,310	67	33	1.33	16.0	0.72	
Penn West Energy Trust	PWE H	13.07	1.77	9,500	27	73	1.67	12.7	0.70	
Enerplus Resources Fund	ERF	21.80	1.25	4,500	43	57	2.00	9.2	0.66	
Canadian Oil Sands Trust	COSWF B	25.19	1.12	13,600		100	1.80	7.2	0.63	
<i>Total or Median</i>				32,900						0.70
<b>Small Cap Independent Producers</b>										
Encore Acquisition Company	EAC B	35.60	1.87	3,530	24	76	-	-	0.89	
Cimarex Energy Company	XEC B	35.78	1.30	3,790	62	38	0.24	0.7	0.82	
Berry Petroleum Company	BRY H	23.72	1.91	2,030	33	67	0.30	1.3	0.80	
Birchcliff Energy Ltd. (US\$)	BIREF	5.80	1.35	960	70	30	-	-	0.71	
<i>Total or Median</i>				10,310						0.81
<b>Top Line Cash Payers</b>										
Cross Timbers Royalty Trust	CRT	24.36	1.00	150	64	36	1.61	6.6	0.87	
Freehold Royalty Trust (US\$)	FRHLF	13.86	1.22	840	25	38	1.11	8.0	0.84	
Dorchester Minerals, L.P.	DMLP B	22.76	1.00	680	63	38	1.48	6.5	0.84	
Sabine Royalty Trust	SBR	39.00	1.00	570	38	63	2.87	7.4	0.71	
Permian Basin RT	PBT	10.30	1.00	480	27	73	0.89	8.7	0.57	
<i>Total or Median</i>				2,720						0.84
<b>Bottom Line Cash Payers</b>										
Linn Energy, LLC	LINE	22.39	1.55	3,960	48	52	2.52	11.3	1.49	
Encore Energy Partners, L.P. (52%)	ENP	15.87	1.31	490	24	76	2.15	13.5	0.95	
San Juan Basin Royalty Trust	SJT H	13.34	1.00	620	100	-	0.93	7.0	0.64	
Hugoton Royalty Trust	HGT B	13.08	1.00	520	89	11	0.96	7.3	0.57	
Mesa Royalty Trust	MTR	23.88	1.00	45	75	25	1.76	7.4	0.43	
<i>Total or Median</i>				5,640						0.64
<b>Composite (excl COSWF)</b>										
<i>Enterprise Value Weighting</i>				38,000	41	59				0.78
<i>Equal Weighting</i>					51	49				0.77
<i>Equal Weighted Buys</i>					48	52				0.78
* 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)	Shares	Market Cap (\$mm)	Net Present Value (\$/un)	Debt/ Present Value	McDep Ratio
	Symbol/ Rating		31-Jul 2009	(mm)				
<b>Canadian Income Trusts (US\$)</b>								
Pengrowth Energy Trust	PGH		8.23	257.0	2,120	14.00	0.34	0.73
Peyto Energy Trust	PEYUF		8.31	105.9	880	13.00	0.24	0.72
Penn West Energy Trust	PWE	H	13.07	410.0	5,360	23.00	0.31	0.70
Enerplus Resources Fund	ERF		21.80	165.7	3,610	36.00	0.13	0.66
Canadian Oil Sands Trust	COSWF	B	25.19	484.0	12,190	42.00	0.07	0.63
<i>Total or Median</i>					24,200		0.24	0.70
<b>Small Cap Independent Producers</b>								
Encore Acquisition Company	EAC	B	35.60	53.0	1,890	44.00	0.41	0.89
Cimarex Energy Company	XEC	B	35.78	81.7	2,920	46.00	0.19	0.82
Berry Petroleum Company	BRY	H	23.72	44.6	1,060	35.00	0.38	0.80
Birchcliff Energy Ltd. (US\$)	BIREF		5.80	122.0	710	9.00	0.19	0.71
<i>Total or Median</i>					6,580		0.29	0.81
<b>Top Line Cash Payers</b>								
Cross Timbers Royalty Trust	CRT		24.36	6.0	150	28.00	-	0.87
Freehold Royalty Trust (US\$)	FRHLF		13.86	49.5	690	17.00	0.15	0.84
Dorchester Minerals, L.P.	DMLP	B	22.76	29.8	680	27.00	-	0.84
Sabine Royalty Trust	SBR		39.00	14.6	570	55.00	-	0.71
Permian Basin RT	PBT		10.30	46.6	480	18.00	-	0.57
<i>Total or Median</i>					2,570			0.84
<b>Bottom Line Cash Payers</b>								
Linn Energy, LLC	LINE		22.39	114.0	2,550	11.00	0.53	1.49
Encore Energy Partners, L.P. (52%)	ENP		15.87	23.4	370	17.00	0.23	0.95
San Juan Basin Royalty Trust	SJT	H	13.34	46.6	620	21.00	-	0.64
Hugoton Royalty Trust	HGT	B	13.08	40.0	520	23.00	-	0.57
Mesa Royalty Trust	MTR		23.88	1.9	50	56.00	-	0.43
<i>Total or Median</i>					4,110			0.64
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 \$8 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		31-Jul 2009	Royalty (%)	Ebitda	NTM	NTM	NTM	
<b>Canadian Income Trusts (US\$)</b>									
	Canadian Oil Sands Trust	COSWF	B	25.19		0.60	22.1	13.9	8.7
	Peyto Energy Trust	PEYUF		8.31		1.17	17.1	11.4	8.3
	Pengrowth Energy Trust	PGH		8.23		0.77	8.1	9.8	7.1
	Enerplus Resources Fund	ERF		21.80		0.60	9.3	10.8	7.1
	Penn West Energy Trust	PWE	H	13.07		0.72	8.3	10.0	7.0
	<i>Median</i>						9.3	10.8	7.1
<b>Small Cap Independent Producers</b>									
	Birchcliff Energy Ltd. (US\$)	BIREF		5.80		-	9.9	23.2	16.6
	Berry Petroleum Company	BRY	H	23.72		-	11.7	10.6	8.5
	Encore Acquisition Company	EAC	B	35.60		-	11.7	9.3	8.3
	Cimarex Energy Company	XEC	B	35.78		-	7.2	6.8	5.6
	<i>Median</i>						10.8	10.0	8.4
<b>Top Line Cash Payers</b>									
	Dorchester Minerals, L.P.	DMLP	B	22.76	64	0.93	8.1	17.0	14.3
	Cross Timbers Royalty Trust	CRT		24.36	84	0.91	13.0	15.9	13.8
	Sabine Royalty Trust	SBR		39.00	100	1.00	10.0	19.2	13.6
	Permian Basin RT	PBT		10.30	32	0.86	10.9	17.4	9.9
	Freehold Royalty Trust (US\$)	FRHLF		13.86	71	0.65	6.3	9.9	8.4
	<i>Median</i>						10.0	17.0	13.6
<b>Bottom Line Cash Payers</b>									
	Linn Energy, LLC	LINE		22.39		3.93	18.3	17.1	25.5
	Mesa RoyaltyTrust	MTR		23.88		0.76	16.8	24.1	10.4
	San Juan Basin Royalty Trust	SJT	H	13.34		0.70	9.2	15.8	10.0
	Encore Energy Partners, L.P.	ENP		15.87		1.33	13.8	10.6	10.0
	Hugoton RoyaltyTrust	HGT	B	13.08		0.69	13.1	16.7	9.5
	<i>Median</i>						13.8	16.7	10.0
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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**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.