



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

September 28, 2009

## Pure Natural Gas Income in Mesa Royalty Trust

**Mesa Royalty Trust (MTR)** offers pure natural gas income with no debt and no hedging, but limited trading liquidity. The practical alternatives for most investors are buy-recommended **San Juan Basin Royalty Trust (SJT)** and buy-recommended **Hugoton Royalty Trust (HGT)**. Persisting lower regional natural gas price discounts contribute to higher estimated distribution yield for the next twelve months for each trust of 8.4% for MTR, 6.9% for SJT and 5.9% for HGT (see Table 1). Offsetting the higher distribution expectation for MTR, we reduce estimated Net Present Value (NPV) to \$48 a unit from \$56 following the September 19 disclosure of reserves and operating results for the year 2008. Despite that change, MTR has the lowest McDep Ratio among natural gas producers (see Table 2). Trading in the stock is limited because the trust is less than a tenth the size of SJT and HGT. MTR now has the shortest reserve life index when previously it had the longest (see Table 3 and more explanation in the paragraph below). To analyze MTR we also look closely at our outlook for SJT and HGT because the three share concentration on natural gas in traditional long-life large fields. Underlying volume normally declines gently though there are opportunities to hold it stable with more reinvestment not considered here (see chart, top of page 5). Distributions declared monthly through the third quarter 2009 follow a similar pattern (see chart, bottom of page 5). Up-to-date distributions help in projecting cash flow while we await operating results for 2009 quarters (see table [Next Twelve Months Operating and Financial Performance](#), page 6).

### Conservatively Reported Reserves Need Adjustment for Equity Valuation

Last week's disclosure apparently completes MTR's two-year transition to reserves estimated by a conservative independent engineer, DeGolyer and MacNaughton. SJT went through a similar reduction in reserves when it changed independent engineer to Cawley Gillespie from Miller and Lents. HGT's reserves are estimated by Miller and Lents. Choice of engineer may be the most important differentiating factor in the ratio of Adjusted Reserves/NTM Production (see Table 3). The short reserve life indices of 8.0 years for MTR and 9.1 for SJT are unrealistically low, in our opinion, compared to 13.4 years for HGT. The lower numbers are useful for tax payers, lenders and buyers of property from unwilling or uninformed sellers. The lower numbers can mislead investors if the context is not considered carefully.

Kurt H. Wulff, CFA



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<b>Table 1</b>										
<b>McDep Income and Small Cap Energy Portfolio</b>										
<b>Debt, Business Segments and Income Yield</b>										
						<i>Present Value by Segment (%)</i>				
	<i>Symbol/Rating</i>	<i>Price (US\$/sh)</i>	<i>EV/Market</i>	<i>Enterprise Value (\$mm)</i>	<i>N.Amer. Natural Gas</i>	<i>Oil Prod'n</i>	<i>Dist. NTM (\$/un)</i>	<i>Dist. Yield (%)</i>	<i>McDep Ratio</i>	
	B = Buy H = Hold	25-Sep 2009	Market Cap							
<b>Canadian Income Trusts (US\$)</b>										
Penn West Energy Trust	PWE	H	15.29	1.66	10,400	27	73	1.67	10.9	0.87
Peyto Energy Trust	PEYUF		9.63	1.42	1,450	67	33	1.34	13.9	0.80
Pengrowth Energy Trust	PGH		9.81	1.72	4,400	34	66	1.11	11.3	0.80
Enerplus Resources Fund	ERF		22.10	1.24	4,600	43	57	2.00	9.1	0.66
Canadian Oil Sands Trust	COSWF	B	26.30	1.11	14,200		100	2.13	8.1	0.65
<i>Total or Median</i>					<i>35,100</i>					<i>0.80</i>
<b>Small Cap Independent Producers</b>										
Cimarex Energy Company	XEC	B	41.01	1.25	4,200	62	38	0.24	0.6	0.91
Encore Acquisition Company	EAC	B	36.31	1.89	3,620	23	77	-	-	0.90
Berry Petroleum Company	BRY	H	25.21	2.01	2,270	31	69	0.30	1.2	0.84
Birchcliff Energy Ltd. (US\$)	BIREF		6.78	1.23	1,030	62	38	-	-	0.79
<i>Total or Median</i>					<i>11,120</i>					<i>0.87</i>
<b>Top Line Cash Payers</b>										
Cross Timbers Royalty Trust	CRT		30.41	1.00	180	64	36	1.87	6.1	1.08
Freehold Royalty Trust (US\$)	FRHLF		14.47	1.21	870	25	75	1.11	7.7	0.87
Dorchester Minerals, L.P.	DMLP	B	22.88	1.00	680	63	38	1.39	6.1	0.85
Sabine Royalty Trust	SBR		40.22	1.00	590	38	63	2.90	7.2	0.73
Permian Basin RT	PBT		12.74	1.00	590	27	73	0.89	7.0	0.71
<i>Total or Median</i>					<i>2,910</i>					<i>0.85</i>
<b>Bottom Line Cash Payers</b>										
Linn Energy, LLC	LINE		23.13	1.54	4,060	38	62	2.52	10.9	1.30
Encore Energy Partners, L.P. (52%)	ENP		15.88	1.35	500	24	76	2.15	13.5	0.95
San Juan Basin Royalty Trust	SJT	B	17.75	1.00	830	100	-	1.23	6.9	0.84
Hugoton Royalty Trust	HGT	B	17.57	1.00	700	89	11	1.03	5.9	0.76
Mesa Royalty Trust	MTR		31.63	1.00	59	75	25	2.66	8.4	0.66
<i>Total or Median</i>					<i>6,150</i>					<i>0.84</i>
<b>Composite (excl COSWF)</b>										
<i>Enterprise Value Weighting</i>					<i>41,000</i>	<i>40</i>	<i>60</i>			<i>0.85</i>
<i>Equal Weighting</i>						<i>50</i>	<i>50</i>			<i>0.85</i>
<i>Equal Weighted Buys</i>						<i>53</i>	<i>47</i>			<i>0.85</i>
* 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-Sep 2009	Shares (mm)	(\$mm)	(\$/un)		
<b>Canadian Income Trusts (US\$)</b>								
	PWE	H	15.29	410.0	6,270	19.00	0.35	0.87
	PEYUF		9.63	105.9	1,020	13.00	0.24	0.80
	PGH		9.81	260.0	2,550	14.00	0.34	0.80
	ERF		22.10	166.3	3,680	36.00	0.13	0.66
	COSWF	B	26.30	484.0	12,730	42.00	0.07	0.65
	<i>Total or Median</i>				26,300		0.24	0.80
<b>Small Cap Independent Producers</b>								
	XEC	B	41.01	82.0	3,360	46.00	0.18	0.91
	EAC	B	36.31	53.0	1,920	44.00	0.42	0.90
	BRY	H	25.21	44.8	1,130	35.00	0.42	0.84
	BIREF		6.78	124.0	840	9.00	0.15	0.79
	<i>Total or Median</i>				7,250		0.30	0.87
<b>Top Line Cash Payers</b>								
	CRT		30.41	6.0	180	28.00	-	1.08
	FRHLF		14.47	49.5	720	17.00	0.15	0.87
	DMLP	B	22.88	29.8	680	27.00	-	0.85
	SBR		40.22	14.6	590	55.00	-	0.73
	PBT		12.74	46.6	590	18.00	-	0.71
	<i>Total or Median</i>				2,760			0.85
<b>Bottom Line Cash Payers</b>								
	LINE		23.13	114.0	2,640	15.00	0.45	1.30
	ENP		15.88	23.4	370	17.00	0.25	0.95
	SJT	B	17.75	46.6	830	21.00	-	0.84
	HGT	B	17.57	40.0	700	23.00	-	0.76
	MTR		31.63	1.9	59	48.00	-	0.66
	<i>Total or Median</i>				4,600			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 \$8 a million btu for natural gas.								



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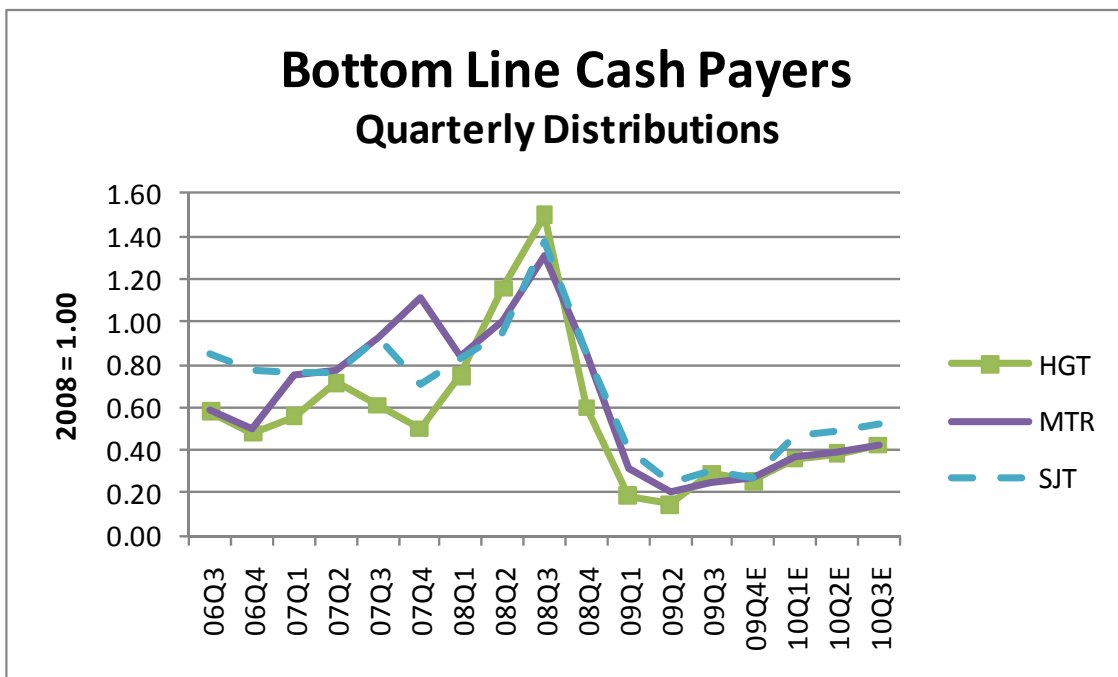
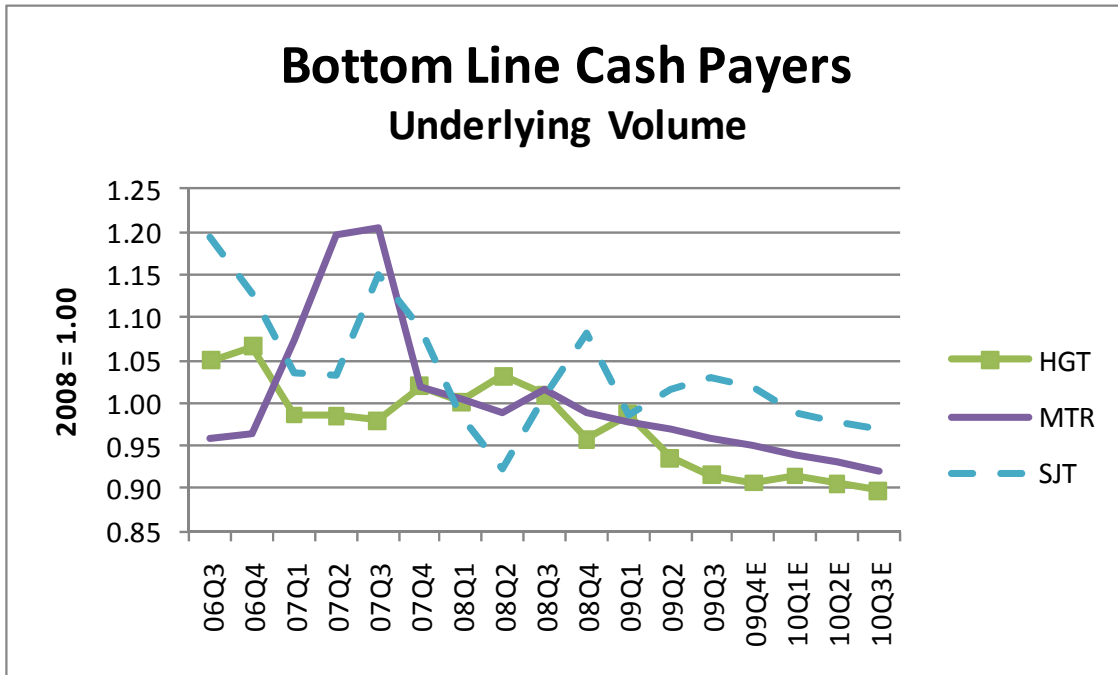
Table 3									
Oil and Gas Income and Small Cap Stocks									
Value Multiples - Rank by EV/Ebitda									
			Price (\$/sh)	Revenue	Dist/ Equity	Adjstd Resrvs/ Prod	PV/ Ebitda	EV/ Ebitda	
	Symbol/ Rating		25-Sep 2009	Royalty (%)	Ebitda	NTM	NTM	NTM	
<b>Canadian Income Trusts (US\$)</b>									
	Canadian Oil Sands Trust	COSWF	B	26.30		0.70	21.8	13.9	9.0
	Peyto Energy Trust	PEYUF		9.63		1.15	17.2	11.2	9.0
	Penn West Energy Trust	PWE	H	15.29		0.85	8.2	9.7	8.5
	Enerplus Resources Fund	ERF		22.10		0.64	9.4	11.4	7.6
	Pengrowth Energy Trust	PGH		9.81		0.75	7.9	9.4	7.6
	<i>Median</i>						9.4	11.2	8.5
<b>Small Cap Independent Producers</b>									
	Birchcliff Energy Ltd. (US\$)	BIREF		6.78		-	10.1	14.2	11.2
	Encore Acquisition Company	EAC	B	36.31		-	11.5	9.4	8.4
	Berry Petroleum Company	BRY	H	25.21		-	12.1	9.1	7.6
	Cimarex Energy Company	XEC	B	41.01		-	7.8	6.3	5.7
	<i>Median</i>						10.8	9.2	8.0
<b>Top Line Cash Payers</b>									
	Cross Timbers Royalty Trust	CRT		30.41	84	0.93	13.3	14.0	15.2
	Dorchester Minerals, L.P.	DMLP	B	22.88	64	0.87	8.2	16.9	14.3
	Sabine Royalty Trust	SBR		40.22	100	1.00	10.2	19.0	13.9
	Permian Basin RT	PBT		12.74	32	0.89	11.7	17.9	12.7
	Freehold Royalty Trust (US\$)	FRHLF		14.47	71	0.66	6.4	10.0	8.8
	<i>Median</i>						10.2	16.9	13.9
<b>Bottom Line Cash Payers</b>									
	Linn Energy, LLC	LINE		23.13		2.60	18.2	15.4	20.0
	Hugoton Royalty Trust	HGT	B	17.57		0.71	13.4	15.9	12.1
	San Juan Basin Royalty Trust	SJT	B	17.75		0.78	9.1	13.2	11.2
	Mesa Royalty Trust	MTR		31.63		0.88	8.0	15.9	10.5
	Encore Energy Partners, L.P.	ENP		15.88		1.37	13.9	10.8	10.3
	<i>Median</i>						13.4	15.4	11.2
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									
Top Line Cash Payers defined as those having Revenue Royalty (see fifth column from right).									



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Mesa Royalty Trust									
Next Twelve Months Operating and Financial Performance									
									<i>Next</i>
	<i>Q4</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Twelve</i>
	<i>12/31/08</i>	<i>6/30/09</i>	<i>9/30/09</i>	<i>12/31/09</i>	<i>2009E</i>	<i>3/31/10</i>	<i>6/30/10</i>	<i>9/30/10</i>	<i>Months</i>
	<i>12/31/08</i>	<i>6/30/09</i>	<i>9/30/09</i>	<i>12/31/09</i>	<i>2009E</i>	<i>3/31/10</i>	<i>6/30/10</i>	<i>9/30/10</i>	<i>9/30/10</i>
<b>Volume (90% of working interest)</b>									
Natural Gas (bcf)	0.38	0.36	0.37	0.36	<b>1.46</b>	0.36	0.34	0.35	<b>1.42</b>
Natural Gas (mmcf)	4.2	4.0	4.0	3.9	<b>4.0</b>	3.9	3.9	3.8	<b>3.9</b>
Days	92	89	92	92	<b>365</b>	92	89	92	<b>365</b>
Oil (mmb)	0.02	0.02	0.02	0.02	<b>0.09</b>	0.02	0.02	0.02	<b>0.08</b>
Oil (mbd)	0.23	0.24	0.23	0.23	<b>0.23</b>	0.23	0.23	0.22	<b>0.23</b>
Total (bcfe)	0.51	0.48	0.49	0.49	<b>1.97</b>	0.48	0.46	0.48	<b>1.91</b>
Total (mmcf)	5.5	5.4	5.4	5.3	<b>5.4</b>	5.3	5.2	5.2	<b>5.2</b>
<b>Price (Henry Hub and WTI Cushing lagged two months)</b>									
Henry Hub (\$/mmbtu)	8.37	4.06	3.61	3.26	<b>4.36</b>	4.97	5.42	5.56	<b>4.80</b>
Differential (%)	13	20	20	20	<b>(468)</b>	20	20	20	<b>(550)</b>
Trust (\$/mcf)	6.56	3.25	2.89	2.61	<b>3.50</b>	3.99	4.35	4.46	<b>3.84</b>
WTI Cushing (\$/bbl)	99.06	45.65	64.29	69.97	<b>56.68</b>	70.43	71.94	73.42	<b>71.44</b>
Differential	39.95	19.94	28.08	30.56	<b>24.77</b>	30.78	31.44	32.09	<b>31.23</b>
Trust (\$/bbl)	59.12	25.71	36.21	39.40	<b>31.91</b>	39.65	40.50	41.34	<b>40.21</b>
Total (\$/mcf)	7.37	3.52	3.70	3.64	<b>3.97</b>	4.67	4.97	5.09	<b>4.59</b>
<b>Revenue (\$mm)</b>									
Natural Gas	2.52	1.16	1.06	0.95	<b>5.11</b>	1.43	1.49	1.57	<b>5.44</b>
Oil	1.23	0.54	0.78	0.84	<b>2.73</b>	0.83	0.81	0.85	<b>3.33</b>
Total	3.75	1.70	1.83	1.78	<b>7.83</b>	2.26	2.31	2.42	<b>8.77</b>
<b>Expense</b>									
	0.65	0.80	0.75	0.69	<b>3.47</b>	0.84	0.81	0.80	<b>3.14</b>
<b>Ebitda</b>									
	3.11	0.90	1.08	1.09	<b>4.36</b>	1.43	1.50	1.62	<b>5.63</b>
<b>Development (90%)</b>									
	0.16	0.16	0.16	0.16	<b>0.63</b>	0.16	0.16	0.16	<b>0.63</b>
<b>Royalty Income</b>									
Hugoton	1.48	0.39	0.35						-
San Juan	1.47	0.35	0.57						-
Total Royalty Income	2.95	0.75	0.92	0.93	<b>3.73</b>	1.27	1.34	1.46	<b>5.01</b>
Administrative	0.02	0.04	0.06	0.01	<b>0.16</b>	0.01	0.01	0.01	<b>0.05</b>
<b>Distributable Income (\$mm)</b>									
	2.93	0.70	0.86	0.92	<b>3.57</b>	1.26	1.33	1.45	<b>4.96</b>
Per Unit (\$)	1.57	0.38	0.46	0.49	<b>1.91</b>	0.67	0.71	0.78	<b>2.66</b>
<b>Units (millions)</b>									
	1.86	1.86	1.86	1.86	<b>1.86</b>	1.86	1.86	1.86	<b>1.86</b>
Ebitda Margin	83%	53%	59%	61%	<b>56%</b>	63%	65%	67%	<b>64%</b>
Development/Ebitda	5%	17%	15%	14%	14%	11%	10%	10%	11%
Expense/Revenue	17%	47%	41%	39%	44%	37%	35%	33%	36%



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