



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

August 27, 2010

## Rockies Ideas

### Summary and Recommendation

Buy recommended **Cimarex Energy (XEC)** accelerates oil drilling while expanding at a lesser rate in natural gas in a sign of the times reflected by some 70 companies at the Enercom conference in Denver, August 23-26, 2010. Among small cap independents in our coverage, XEC, and **Whiting Petroleum (WLL)** are in stock price up trends compared to the 200-day average while the remaining six stocks in the group are trending lower in price by the same measure along with oil and natural gas. Executives of oil drillers **Berry Petroleum (BRY)** and **Denbury Resources (DNR)** feel more confident about their spending while managers of natural gas producers **Ultra Petroleum (UPL)**, **Range Resources (RRC)** and **Petrohawk Energy (HK)** are more concerned that current industry drilling activity is too high. Income payers **Penn West Energy Trust (PWE)** and **Enerplus Resources (ERF)** are seeing an improved volume trend with the shift to more reinvestment in advance of converting from trusts to corporations in the next few months. PWE announced a value-creating joint venture with Mitsubishi to develop natural gas that ultimately may be shipped in liquefied form to Japan. On the cautious side, negotiations are going slowly apparently as general partner DNR of **Encore Energy Partners (ENP)** seeks a deal to apply carbon dioxide enhanced recovery to the Elk Basin oil field in Wyoming. We hope the independent committee evaluating such a proposal will apply the standards of **Dorchester Minerals (DMLP)** and the royalty trusts we cover in respecting the rights of ENP's limited partners.

### Ideas to Watch

Creative executives of companies not in our current coverage shared new ideas, too. We were surprised to see that oil and gas production earnings had reached 85% and 52% respectively at long-time dividend paying natural gas utilities **Energen (EGN)** and **National Fuel Gas (NFG)**. NFG finds itself in a unique position in the Marcellus Shale Trend in Pennsylvania with 700,000 net acres of which more than half grant NFG both the royalty and the working interest. In another seemingly heretical development, NFG has the unique opportunity to reverse its pipeline from Canada to provide an outlet for Pennsylvania natural gas in Ontario.

Like PWE, **Progress Energy Resources (PRQ.TO)** has an intriguing natural gas resource for export to Japan in a northwest extension of the Montney play in British Columbia. Along the theme of new natural gas exports to Asian markets, **Interoil (IOC)** has attracted stock price recognition for its proposed liquefied natural (LNG) project in



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

August 27, 2010

Papua New Guinea. Investor's early anticipations may be validated if IOC can reach agreement with its Japanese partner on a joint venture that would set a value on IOC's large resource.

While the focus of natural gas excitement extends to future years, oil is the here and now for operating companies. **Venoco (VQ)**, headed by a former Unocal executive, seeks newly economic accumulations of oil onshore California in the same Monterey formation that is prolific offshore. VQ is a concentrated play on large cap buy-recommended **Occidental Petroleum (OXY)**'s new oil exploration interest onshore California. Long-time California oil producer BRY could be a Monterey player if circumstances fall into place.

Finally, two new companies surprised us when we learned that both were Rockies companies renamed and renewed with new generation leadership. **SM Energy (SM)** is the successor to St. Mary Land and Exploration, a successful conservatively-financed independent producer now finding opportunity in the Eagle Ford shale among other places. **PDC Energy (PETD)**, successor to Petroleum Development a long time operator of drilling partnerships for individual investors, offers a concentrated play on the Niobrara oil shale trend.

All the ideas to watch along with the stocks in our coverage demonstrate how market capitalism fosters creative responses to price signals. Future demand and supply of oil and gas are just a matter of investment and time. Today's futures market for the next six years says oil will balance out at \$83 a barrel and natural gas at \$5.50 a million btu. Yet, the futures market is only a consensus leaving investors to judge how that consensus will change. Currently, the short-term trend in the consensus is down, a signal that patience and financial strength may be tested before the trend turns up again as we believe it will.

Kurt H. Wulff, CFA



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

August 27, 2010

	Symbol/Rating	Price (US\$/sh)	EV/ Market	Enterprise Value (\$mm)	Present Value by Segment (%)			Dist. NTM (\$/un)	Dist. Yield (%)	McDep Ratio
					N.Amer. Natural Gas	Oil Prod'n				
	B = Buy CB (see below)	26-Aug 2010	Cap							
<b>Canadian Income Trusts (US\$)</b>										
Pengrowth Energy Trust	PGH	9.51	1.46	4,000	36	64	0.80	8.4	0.90	
Penn West Energy Trust	PWE	19.08	1.38	11,600	22	78	1.71	9.0	0.87	
Enerplus Resources Fund	ERF	22.27	1.25	4,900	41	59	2.04	9.2	0.78	
Peyto Energy Trust	PEYUF	13.10	1.25	1,950	79	21	1.36	10.4	0.77	
Canadian Oil Sands Trust	COSWF CB	23.98	1.12	13,000		100	1.90	7.9	0.66	
<i>Total or Median</i>				35,500					0.78	
<b>Small Cap Independent Producers</b>										
Denbury Resources Inc.	DNR	14.62	1.58	9,270	16	84	-	-	0.98	
Petrohawk Energy Corporation	HK	14.62	1.71	7,570	96	4	-	-	0.95	
Whiting Petroleum Corporation	WLL	84.29	1.20	6,190	14	86	-	-	0.93	
Range Resources	RRC	32.93	1.38	7,190	82	18	0.08	0.2	0.87	
Berry Petroleum Company	BRY	27.52	1.68	2,510	31	69	0.30	1.1	0.86	
Cimarex Energy Company	XEC B	64.93	1.11	6,160	59	41	0.32	0.5	0.83	
Ultra Petroleum	UPL	38.51	1.23	7,280	94	6	-	-	0.80	
Birchcliff Energy Ltd. (US\$)	BIREF CB	8.51	1.24	1,340	68	32	-	-	0.66	
<i>Total or Median</i>				47,500					0.86	
<b>Top Line Cash Payers</b>										
Sabine Royalty Trust	SBR	50.51	1.00	740	50	50	3.20	6.3	1.12	
Permian Basin RT	PBT	18.64	1.00	870	38	62	1.39	7.5	1.04	
Cross Timbers Royalty Trust	CRT	35.13	1.00	210	75	25	2.13	6.1	1.03	
Freehold Royalty Trust (US\$)	FRHLF	15.38	1.09	980	25	75	1.60	10.4	0.91	
Dorchester Minerals, L.P.	DMLP B	24.50	1.02	770	66	34	1.65	6.7	0.91	
<i>Total or Median</i>				3,600					1.03	
<b>Bottom Line Cash Payers</b>										
Linn Energy, LLC	LINE	27.95	1.49	6,100	47	53	2.52	9.0	1.20	
Legacy Reserves L.P.	LGCY	22.97	1.39	1,280	17	83	2.08	9.1	1.10	
Encore Energy Partners, L.P. (52%)	ENP	18.15	1.29	550	25	75	2.00	11.0	1.05	
Mesa Royalty Trust	MTR	43.50	1.00	81	75	25	3.51	8.1	0.91	
San Juan Basin Royalty Trust	SJT B	22.33	1.00	1,040	100	-	1.29	5.8	0.89	
Hugoton Royalty Trust	HGT B	18.64	1.00	750	90	10	1.44	7.7	0.89	
<i>Total or Median</i>				9,800					0.98	
<b>Composite (excl COSWF)</b>										
<i>Enterprise Value Weighting</i>				83,300	50	50			0.90	
<i>Equal Weighting</i>					54	46			0.92	
<i>Equal Weighted Buys</i>					62	38			0.84	

CB=Contrarian Buy, Stock Price apparently in downtrend compared to 200-day average.

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.

Dist. = Income distribution. NTM = Next Twelve Months Ended March 31, 2011. Enterprise Value = Market Cap and Debt.

# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

August 27, 2010

**Table 2  
McDep Income and Small Cap Energy Portfolio  
Net Present Value and McDep Ratio**

		Price (\$/sh)	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/un)	Debt/ Present Value	McDep Ratio
Symbol/ Rating	26-Aug 2010						
<b>Canadian Income Trusts (US\$)</b>							
Pengrowth Energy Trust	PGH	9.51	290.0	2,760	11.00	0.28	0.90
Penn West Energy Trust	PWE	19.08	439.6	8,390	23.00	0.24	0.87
Enerplus Resources Fund	ERF	22.27	177.5	3,950	30.00	0.16	0.78
Peyto Energy Trust	PEYUF	13.10	119.4	1,560	18.00	0.15	0.77
Canadian Oil Sands Trust	COSWF CB	23.98	484.0	11,610	38.00	0.07	0.66
<i>Total or Median</i>				28,300		0.16	0.78
<b>Small Cap Independent Producers</b>							
Denbury Resources Inc.	DNR	14.62	401.0	5,860	15.00	0.36	0.98
Petrohawk Energy Corporation	HK	14.62	303.0	4,680	16.00	0.39	0.98
Whiting Petroleum Corporation	WLL	84.29	59.2	5,150	95.00	0.16	0.93
Range Resources	RRC	32.93	158.5	5,390	40.00	0.24	0.89
Berry Petroleum Company	BRY	27.52	54.3	1,490	35.00	0.35	0.86
Cimarex Energy Company	XEC B	64.93	85.6	5,560	80.00	0.08	0.83
Ultra Petroleum	UPL	38.51	154.0	6,060	50.00	0.15	0.82
Birchcliff Energy Ltd. (US\$)	BIREF CB	8.51	127.0	1,080	14.00	0.13	0.66
<i>Total or Median</i>				35,270		0.20	0.87
<b>Top Line Cash Payers</b>							
Sabine Royalty Trust	SBR	50.51	14.6	740	45.00	-	1.12
Permian Basin RT	PBT	18.64	46.6	870	18.00	-	1.04
Cross Timbers Royalty Trust	CRT	35.13	6.0	210	34.00	-	1.03
Freehold Royalty Trust (US\$)	FRHLF	15.38	58.2	900	17.00	0.08	0.91
Dorchester Minerals, L.P.	DMLP B	24.50	30.7	750	27.00	0.02	0.91
<i>Total or Median</i>				3,470			1.03
<b>Bottom Line Cash Payers</b>							
Linn Energy, LLC	LINE	27.95	146.5	4,100	21.00	0.39	1.20
Legacy Reserves L.P.	LGCY	22.97	40.1	920	20.00	0.31	1.10
Encore Energy Partners, L.P. (52%)	ENP	18.15	23.4	430	17.00	0.24	1.05
Mesa Royalty Trust	MTR	43.50	1.9	81	48.00	-	0.91
San Juan Basin Royalty Trust	SJT B	22.33	46.6	1,040	25.00	-	0.89
Hugoton Royalty Trust	HGT B	18.64	40.0	750	21.00	-	0.89
<i>Total or Median</i>				7,320			0.98
B=Buy; CB=Contrarian Buy, Stock Price apparently in downtrend compared to 200-day average. 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.							



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

August 27, 2010

			Price (\$/sh)	Revenue Royalty (%)	Dist/ Equity Ebitda	Adjst Resrvs/ Prod NTM	PV/ Ebitda NTM	EV/ Ebitda NTM
	Symbol/ Rating		26-Aug 2010					
<b>Canadian Income Trusts (US\$)</b>								
Peyto Energy Trust	PEYUF		13.10		1.04	21.5	13.7	10.5
Canadian Oil Sands Trust	COSWF	CB	23.98		0.70	28.0	13.9	9.1
Penn West Energy Trust	PWE		19.08		0.77	9.9	10.3	9.0
Enerplus Resources Fund	ERF		22.27		0.62	9.7	9.1	7.1
Pengrowth Energy Trust	PGH		9.51		0.54	9.3	7.5	6.8
	<i>Median</i>					9.9	10.3	9.0
<b>Small Cap Independent Producers</b>								
Range Resources	RRC		32.93		-	12.4	14.6	12.6
Ultra Petroleum	UPL		38.51		-	13.2	13.3	10.7
Birchcliff Energy Ltd. (US\$)	BIREF	CB	8.51		-	23.0	15.9	10.4
Petrohawk Energy Corporation	HK		14.62		-	7.2	9.9	9.3
Denbury Resources Inc.	DNR		14.62		-	12.8	8.8	8.6
Berry Petroleum Company	BRY		27.52		-	11.9	8.8	7.6
Whiting Petroleum Corporation	WLL		84.29		-	9.6	7.1	6.6
Cimarex Energy Company	XEC	B	64.93		-	6.3	7.2	5.9
	<i>Median</i>					12.1	9.3	9.0
<b>Top Line Cash Payers</b>								
Sabine Royalty Trust	SBR		50.51	100	1.00	8.7	14.0	15.8
Cross Timbers Royalty Trust	CRT		35.13	84	0.96	13.6	15.3	15.8
Dorchester Minerals, L.P.	DMLP	B	24.50	77	0.89	6.8	14.6	13.2
Permian Basin RT	PBT		18.64	42	0.97	13.0	12.5	13.0
Freehold Royalty Trust (US\$)	FRHLF		15.38	71	0.95	8.2	10.1	9.2
	<i>Median</i>					8.7	14.0	13.2
<b>Bottom Line Cash Payers</b>								
Linn Energy, LLC	LINE		27.95		1.72	18.4	14.3	17.2
San Juan Basin Royalty Trust	SJT	B	22.33		0.78	13.6	15.1	13.5
Legacy Reserves L.P.	LGCY		22.97		1.06	12.2	10.2	11.3
Mesa RoyaltyTrust	MTR		43.50		0.92	8.9	12.6	11.4
Hugoton RoyaltyTrust	HGT	B	18.64		0.89	12.5	13.0	11.6
Encore Energy Partners, L.P.	ENP		18.15		1.12	13.1	9.5	10.0
	<i>Median</i>					12.8	12.8	11.5

B=Buy; CB=Contrarian Buy, Stock Price apparently in downtrend compared to 200-day average.  
 EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended June 30, 2011; 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).

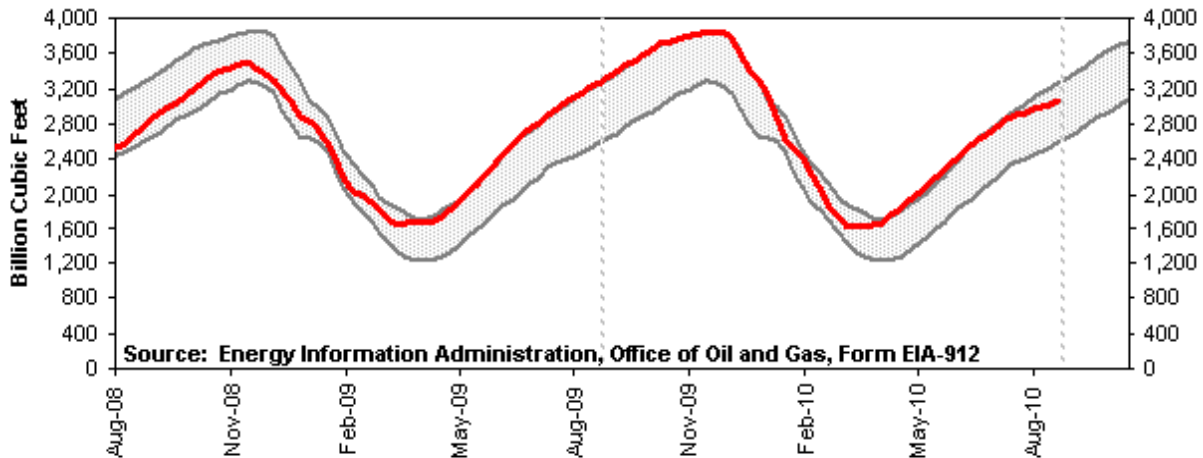


# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

August 27, 2010

**Working Gas in Underground Storage Compared with 5-Year Range**



**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 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.