



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

September 10, 2010

Patience is Free

Summary and Recommendation

Because the nominal risk-free rate of return is zero, it costs investors nothing if gains in natural gas and oil investments are delayed. The real rate of return on U.S. government short-term securities is negative considering that monetary inflation continues every day. That was the case for twenty years beginning in the mid 1930s when a Democrat was the U.S. president at a time of high economic uncertainty (see downward slope of “Bills” from about 1934 to 1954 in chart on page 2). Like today, bonds earned a modest real return for about ten years and then the return was negative for forty years. From the depth of the most uncertain times, equities were winners for thirty years. In other words, an investor in equities who had the patience and fortitude to remain invested lost nothing by not being in cash or bonds instead. Considering our stance that natural gas futures may have bottomed, we believe we have nothing to lose from an investment point of view if the gains take longer. Four income-paying buy recommendations, **Canadian Oil Sands Trust (COSWF)**, **Dorchester Minerals (DMLP)**, **Hugoton Royalty Trust (HGT)** and **San Juan Basin Royalty Trust (SJT)** make attractive cash distributions while we wait. Two small cap buy recommendations, **Birchcliff Energy (BIR)** and **Cimarex Energy (XEC)** reinvest cash flow efficiently (see Tables 1-3 on pages 3-5).

New Measure of Near-Term Price Trend

Though patient, we also pay attention to near-term trends. Frequently referring to the comparison of price to 200-day average, we add our own wrinkle to the popular measure – Enterprise Value to 200-day average (see Table 4). Enterprise Value, or Market Cap and Debt, removes financial leverage when ranking stocks by degree of deviation from moving average. As a result we can turn the momentum measure into a ranking comparable to what we do with McDep Ratio to help spot price anomalies.

For example, COSWF ranks lowest in the Canadian Income Trust group by both the McDep Ratio and the EV/200day measure. We think that means the stock is attractive from a contrarian point of view on both value and stock price trend.

In the same group, we see that **Enerplus (ERF)** has recently moved up in the EV/200day ranking. We find that encouraging because the stock had our lowest McDep Ratio ranking not long ago.



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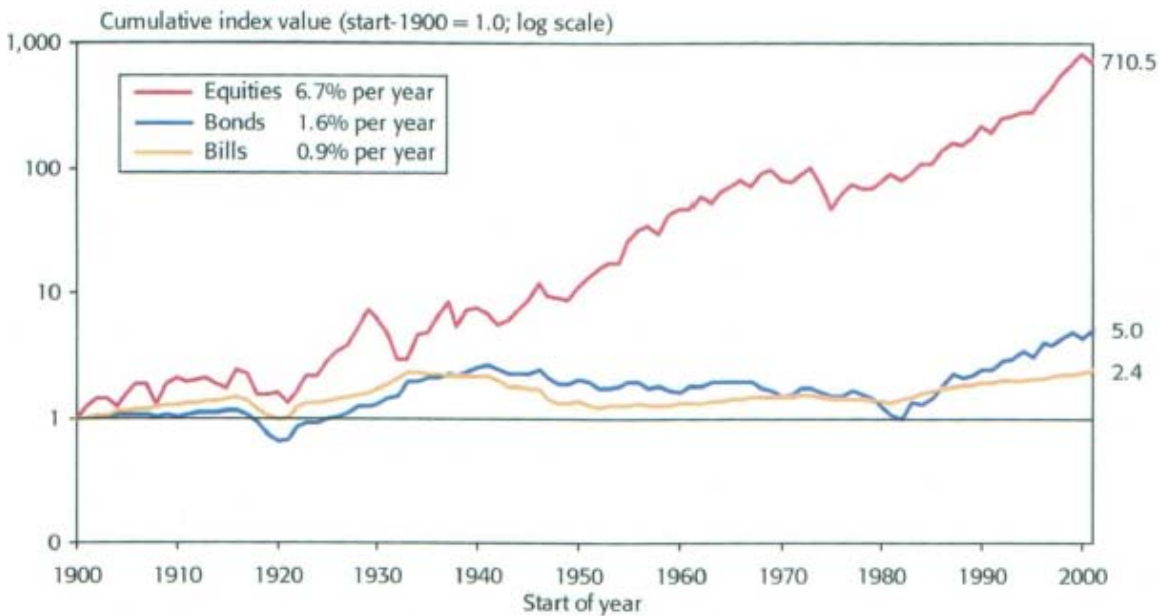
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Among small cap independent producers, the formerly popular natural gas growth stocks **Ultra Petroleum (UPL)**, **Petrohawk (HK)**, and **Range Resources (RRC)** increasingly trade at low EV/200day ratios. In the process, their McDep Ratios become more supportive of new commitments.

At the same time, we will be inclined to keep our buy recommendation on XEC as long as EV/200day is above 1.0. When the McDep Ratio is higher we encourage rebalancing, or trading around a core position, as a natural process in investment management.

Kurt H. Wulff, CFA

Figure 4-2: Cumulative returns on US asset classes in real terms, 1900–2000



Source: *Triumph of the Optimists*, Dimson, Marsh and Staunton, 2002



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Table 1									
McDep Income and Small Cap Energy Portfolio									
Debt, Business Segments and Income Yield									
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	9-Sep 2010	Market Cap							
CB (see below)									
Canadian Income Trusts (US\$)									
Pengrowth Energy Trust	PGH	10.15	1.43	4,200	36	64	0.79	7.8	0.94
Penn West Energy Trust	PWE	18.72	1.39	11,500	22	78	1.05	5.6	0.86
Enerplus Resources Fund	ERF	23.68	1.23	5,200	41	59	2.04	8.6	0.82
Peyto Energy Trust	PEYUF	13.61	1.24	2,020	79	21	1.36	10.0	0.80
Canadian Oil Sands Trust	COSWF CB	24.14	1.12	13,100		100	1.92	8.0	0.66
<i>Total or Median</i>				36,000					0.82
Small Cap Independent Producers									
Denbury Resources Inc.	DNR	15.41	1.55	9,590	16	84	-	-	1.02
Petrohawk Energy Corporation	HK	15.85	1.68	7,780	96	4	-	-	0.97
Whiting Petroleum Corporation	WLL	91.52	1.20	6,110	14	86	-	-	0.92
Berry Petroleum Company	BRY	29.28	1.64	2,610	31	69	0.30	1.0	0.89
Range Resources	RRC	36.47	1.36	7,400	82	18	0.04	0.1	0.89
Cimarex Energy Company	XEC B	67.13	1.10	6,350	59	41	0.32	0.5	0.85
Ultra Petroleum	UPL	39.62	1.22	7,420	94	6	-	-	0.82
Birchcliff Energy Ltd. (US\$)	BIREF CB	8.69	1.23	1,360	68	32	-	-	0.67
<i>Total or Median</i>				48,600					0.89
Top Line Cash Payers									
Sabine Royalty Trust	SBR	53.64	1.00	780	50	50	3.35	6.2	1.19
Permian Basin RT	PBT	18.69	1.00	870	38	62	1.39	7.4	1.04
Cross Timbers Royalty Trust	CRT	35.09	1.00	210	75	25	2.21	6.3	1.03
Freehold Royalty Trust (US\$)	FRHLF	16.10	1.09	1,020	25	75	1.59	9.9	0.95
Dorchester Minerals, L.P.	DMLP B	24.07	1.02	750	66	34	1.70	7.1	0.89
<i>Total or Median</i>				3,600					1.03
Bottom Line Cash Payers									
Linn Energy, LLC	LINE	30.42	1.45	6,460	47	53	2.52	8.3	1.27
Legacy Reserves L.P.	LGCY	23.80	1.37	1,310	17	83	2.08	8.7	1.13
Encore Energy Partners, L.P. (52%)	ENP	18.75	1.29	560	25	75	2.00	10.7	1.08
Mesa Royalty Trust	MTR	43.70	1.00	81	75	25	3.56	8.1	0.91
San Juan Basin Royalty Trust	SJT B	22.57	1.00	1,050	100	-	1.22	5.4	0.90
Hugoton Royalty Trust	HGT B	18.58	1.00	740	90	10	1.36	7.3	0.88
<i>Total or Median</i>				10,200					0.99
Composite (excl COSWF)									
<i>Enterprise Value Weighting</i>				85,400	50	50			0.92
<i>Equal Weighting</i>					54	46			0.95
<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 September 30, 2011. Enterprise Value = Market Cap and Debt.



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			<i>Price</i>			<i>Net</i>		
			<i>(\$/sh)</i>		<i>Market</i>	<i>Present</i>	<i>Debt/</i>	
	<i>Symbol/</i>		<i>9-Sep</i>	<i>Shares</i>	<i>Cap</i>	<i>Value</i>	<i>Present</i>	<i>McDep</i>
	<i>Rating</i>		<i>2010</i>	<i>(mm)</i>	<i>(\$mm)</i>	<i>(\$/un)</i>	<i>Value</i>	<i>Ratio</i>
Canadian Income Trusts (US\$)								
Pengrowth Energy Trust	PGH		10.15	290.0	2,940	11.00	0.28	0.94
Penn West Energy Trust	PWE		18.72	439.6	8,230	23.00	0.24	0.86
Enerplus Resources Fund	ERF		23.68	177.5	4,200	30.00	0.16	0.82
Peyto Energy Trust	PEYUF		13.61	119.4	1,630	18.00	0.15	0.80
Canadian Oil Sands Trust	COSWF	CB	24.14	484.0	11,680	38.00	0.07	0.66
<i>Total or Median</i>					28,700		0.16	0.82
Small Cap Independent Producers								
Denbury Resources Inc.	DNR		15.41	401.0	6,180	15.00	0.36	1.02
Petrohawk Energy Corporation	HK		15.85	303.0	4,640	16.00	0.39	0.97
Whiting Petroleum Corporation	WLL		91.52	59.2	5,070	95.00	0.16	0.92
Berry Petroleum Company	BRY		29.28	54.3	1,590	35.00	0.35	0.89
Range Resources	RRC		36.47	158.5	5,430	40.00	0.24	0.89
Cimarex Energy Company	XEC	B	67.13	85.6	5,750	80.00	0.08	0.85
Ultra Petroleum	UPL		39.62	154.0	6,080	50.00	0.15	0.82
Birchcliff Energy Ltd. (US\$)	BIREF	CB	8.69	127.0	1,100	14.00	0.13	0.67
<i>Total or Median</i>					35,840		0.20	0.89
Top Line Cash Payers								
Sabine Royalty Trust	SBR		53.64	14.6	780	45.00	-	1.19
Permian Basin RT	PBT		18.69	46.6	870	18.00	-	1.04
Cross Timbers Royalty Trust	CRT		35.09	6.0	210	34.00	-	1.03
Freehold Royalty Trust (US\$)	FRHLF		16.10	58.3	940	17.00	0.08	0.95
Dorchester Minerals, L.P.	DMLP	B	24.07	30.7	740	27.00	0.02	0.89
<i>Total or Median</i>					3,540			1.03
Bottom Line Cash Payers								
Linn Energy, LLC	LINE		30.42	146.5	4,460	21.00	0.39	1.27
Legacy Reserves L.P.	LGCY		23.80	40.1	950	20.00	0.31	1.13
Encore Energy Partners, L.P. (52%)	ENP		18.75	23.4	440	17.00	0.24	1.08
Mesa RoyaltyTrust	MTR		43.70	1.9	81	48.00	-	0.91
San Juan Basin Royalty Trust	SJT	B	22.57	46.6	1,050	25.00	-	0.90
Hugoton RoyaltyTrust	HGT	B	18.58	40.0	740	21.00	-	0.88
<i>Total or Median</i>					7,720			0.99

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.



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			<i>Price (\$/sh)</i>	<i>Revenue</i>	<i>Dist/ Equity</i>	<i>Adjstd Resrvs/ Prod</i>	<i>PV/ Ebitda</i>	<i>EV/ Ebitda</i>
	<i>Symbol/ Rating</i>		<i>9-Sep 2010</i>	<i>Royalty (%)</i>	<i>Ebitda</i>	<i>NTM</i>	<i>NTM</i>	<i>NTM</i>
Canadian Income Trusts (US\$)								
Peyto Energy Trust	PEYUF		13.61		1.01	21.5	13.4	10.6
Penn West Energy Trust	PWE		18.72		0.57	9.9	10.0	8.6
Canadian Oil Sands Trust	COSWF	CB	24.14		0.61	26.7	12.0	7.9
Enerplus Resources Fund	ERF		23.68		0.60	9.7	8.8	7.2
Pengrowth Energy Trust	PGH		10.15		0.53	9.3	7.3	6.9
	<i>Median</i>					<i>9.9</i>	<i>10.0</i>	<i>7.9</i>
Small Cap Independent Producers								
Range Resources	RRC		36.47		-	12.1	13.8	12.2
Ultra Petroleum	UPL		39.62		-	13.2	13.0	10.7
Birchcliff Energy Ltd. (US\$)	BIREF	CB	8.69		-	21.4	14.4	9.6
Petrohawk Energy Corporation	HK		15.85		-	7.1	9.5	9.2
Denbury Resources Inc.	DNR		15.41		-	12.8	8.5	8.7
Berry Petroleum Company	BRY		29.28		-	11.9	8.6	7.7
Whiting Petroleum Corporation	WLL		91.52		-	9.6	6.9	6.3
Cimarex Energy Company	XEC	B	67.13		-	6.3	6.9	5.9
	<i>Median</i>					<i>12.0</i>	<i>9.0</i>	<i>9.0</i>
Top Line Cash Payers								
Sabine Royalty Trust	SBR		53.64	100	1.00	8.7	13.4	16.0
Cross Timbers Royalty Trust	CRT		35.09	84	0.96	13.7	14.7	15.2
Permian Basin RT	PBT		18.69	42	0.95	13.1	12.3	12.7
Dorchester Minerals, L.P.	DMLP	B	24.07	77	0.89	6.8	14.1	12.6
Freehold Royalty Trust (US\$)	FRHLF		16.10	71	0.91	8.2	9.8	9.3
	<i>Median</i>					<i>8.7</i>	<i>13.4</i>	<i>12.7</i>
Bottom Line Cash Payers								
Linn Energy, LLC	LINE		30.42		1.67	18.4	13.9	17.6
San Juan Basin Royalty Trust	SJT	B	22.57		0.76	14.0	15.5	14.0
Hugoton Royalty Trust	HGT	B	18.58		0.88	12.7	13.6	12.1
Mesa Royalty Trust	MTR		43.70		0.92	9.0	12.4	11.2
Legacy Reserves L.P.	LGCY		23.80		1.03	12.2	9.9	11.2
Encore Energy Partners, L.P.	ENP		18.75		1.10	13.2	9.3	10.1
	<i>Median</i>					<i>12.9</i>	<i>13.0</i>	<i>11.7</i>

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 September 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).



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Table 4									
Oil and Gas Income and Small Cap Stocks									
Rank by Enterprise Value to 200 Day Average									
			Price (\$/sh)	Enterprise Value/					
	Symbol/ Rating		9-Sep 2010	52Wk High	52Wk Low	50 Day Avg.	200 Day Avg.	McDep Ratio	
Canadian Income Trusts (US\$)									
	Enerplus Resources Fund	ERF	23.68	0.96	1.51	1.03	1.03	0.82	
	Peyto Energy Trust	PEYUF	13.61	0.89	1.46	0.96	1.01	0.80	
	Pengrowth Energy Trust	PGH	10.15	0.89	1.70	1.04	1.00	0.94	
	Penn West Energy Trust	PWE	18.72	0.88	1.28	0.97	0.98	0.86	
	Canadian Oil Sands Trust	COSWF	CB	24.14	0.73	1.04	0.94	0.89	0.66
	<i>Median</i>			<i>0.89</i>	<i>1.46</i>	<i>0.97</i>	<i>1.00</i>	<i>0.82</i>	
Small Cap Independent Producers									
	Whiting Petroleum Corporation	WLL		91.52	0.93	1.51	1.00	1.07	0.92
	Cimarex Energy Company	XEC	B	67.13	0.84	1.66	0.96	1.06	0.85
	Berry Petroleum Company	BRY		29.28	0.91	1.14	1.02	1.00	0.89
	Denbury Resources Inc.	DNR		15.41	0.85	1.14	1.00	0.99	1.02
	Birchcliff Energy Ltd. (US\$)	BIREF	CB	8.69	0.85	1.24	0.94	0.99	0.67
	Ultra Petroleum	UPL		39.62	0.73	1.05	0.94	0.87	0.82
	Petrohawk Energy Corporation	HK		15.85	0.66	1.06	0.96	0.83	0.97
	Range Resources	RRC		36.47	0.64	1.04	0.93	0.80	0.89
	<i>Median</i>			<i>0.85</i>	<i>1.14</i>	<i>0.96</i>	<i>0.99</i>	<i>0.89</i>	
Top Line Cash Payers									
	Sabine Royalty Trust	SBR		53.64	0.98	1.40	1.04	1.13	1.19
	Permian Basin RT	PBT		18.69	0.93	1.59	0.99	1.08	1.04
	Freehold Royalty Trust (US\$)	FRHLF		16.10	0.90	1.21	1.02	1.03	0.95
	Cross Timbers Royalty Trust	CRT		35.09	0.89	1.40	1.00	1.02	1.03
	Dorchester Minerals, L.P.	DMLP	B	24.07	0.86	1.20	0.94	1.01	0.89
	<i>Median</i>			<i>0.90</i>	<i>1.40</i>	<i>1.00</i>	<i>1.03</i>	<i>1.03</i>	
Bottom Line Cash Payers									
	Linn Energy, LLC	LINE		30.42	0.97	1.68	1.03	1.09	1.27
	Legacy Reserves L.P.	LGCY		23.80	0.93	1.36	1.00	1.06	1.13
	Hugoton Royalty Trust	HGT	B	18.58	0.84	1.24	0.94	1.01	0.88
	Mesa Royalty Trust	MTR		43.70	0.80	1.47	0.96	1.01	0.91
	San Juan Basin Royalty Trust	SJT	B	22.57	0.79	1.44	0.93	1.01	0.90
	Encore Energy Partners, L.P. (52%)	ENP		18.75	0.89	1.62	1.00	0.99	1.08
	<i>Median</i>			<i>0.82</i>	<i>1.46</i>	<i>0.95</i>	<i>1.01</i>	<i>0.90</i>	

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

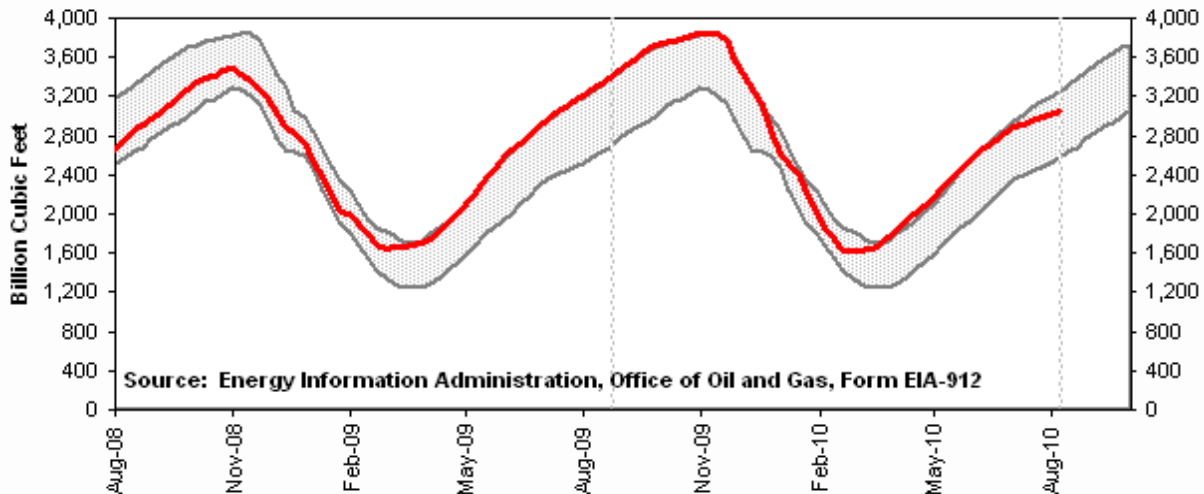


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Working Gas in Underground Storage Compared with 5-Year Range



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