



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

October 15, 2010

Looking for Latent Riches in Land

Summary and Recommendation

Buy recommendations **Cimarex Energy (XEC)** and **Birchcliff Energy (BIR)** have the lowest Enterprise Value per acre of undeveloped land among Small Cap Independent Producers in our coverage (see table [Exploration Lands](#) on page 2). Billion dollar deals by global companies attest to the appeal of that North American resource potential for which we attribute little specific worth in the McDep Ratio. Most recently, Norway's Statoil (STO) and China's CNOOC Ltd. (CEO) invested in the Texas Eagle Ford Shale at upwards of \$10,000 an acre (see *Meter Reader*, October 12, 2010). Territory in the same trend likely cost less than a tenth as much two years ago before **Petrohawk (HK)** drilled the first Eagle Ford well, according to the Texas Railroad Commission. To exaggerate a bit in order to illustrate the significance of the prize, Cimarex's undeveloped property at \$10,000 an acre would be worth \$40 billion dollars, some six times enterprise value. Conversely, much of the acreage may turn out to be no more than the farmland, ranchland or moose pasture it is today. Meanwhile, exploratory lands are part of the qualitative upside to quantitative estimates pegging Small Cap Independent Producers at a median McDep Ratio of 0.97. Cimarex and oil-oriented **Whiting Petroleum (WLL)**, **Berry Petroleum (BRY)** and **Denbury Resources (DNR)** are leading the stock price trend with current quotes above the 200-day average (see [Tables 1-4](#) on pages 3-6).

Cimarex Creates Value in the Midcontinent, Permian and Gulf Coast

Cimarex has a surprising amount of unexplored land at some four million acres. The company has had particularly good results in demonstrating how it can create value by drilling prospective land. The Cana Shale play in western Oklahoma may be the largest contributor to reserve growth currently. The Cana wells are big and reproducible, characteristics global acquirers like to see. Also in the Midcontinent region, the Granite Wash formation may assume greater significance as it responds to horizontal drilling with multiple stages of fracturing. High-volume Gulf Coast wells are exceptionally profitable while the life of each well may be short. The Midcontinent and Gulf Coast wells produce natural gas primarily with generous portions of associated oil that is often the largest contributor to revenue at today's high ratio of oil price to natural gas price.

The company known as predominantly a Midcontinent natural gas producer five years ago, has nimbly adapted to changing commodity price to becoming predominantly an oil producer by revenue. Contributing to that timely shift, Cimarex's activity in the oil-rich Permian Basin is approaching half of its total corporate effort. Underneath some of its million and a half acres in west Texas and New Mexico, Cimarex has been early in the revival of the Bone Springs formation, including portions known as the Avalon Shale to connote previously unexploited resources.



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Birchcliff Creates Value in the Alberta Montney

Building a large, concentrated, yet manageable land position in the Montney formation of Northwest Alberta is an explicit aim of Birchcliff Energy. Management emphasizes that it has rights to some 130 sections (83,000 acres) with a high likelihood of adding to reserves. Proven and probable reserves have been attributed to 77 net sections of land. Our valuation is tied to proven and probable reserves with little importance for the additional 130 sections.

The Montney formation regularly attracts new deals, mostly for acreage, going back to Royal Dutch Shell (RDS)'s acquisition of Duvernay in July 2008 for \$6 billion (see *Meter Reader*, July 15, 2008). Depressed pricing for natural gas, the main product of the Montney formation, may appeal to the timing instincts of buyers looking for an attractive price today for likely higher future value.

Kurt H. Wulff, CFA

Exploration Lands						
				<i>Enterprise</i>		
	<i>Symbol</i>		<i>Undeveloped</i>	<i>Value</i>	<i>EV/Acre</i>	<i>McDep</i>
<i>Company</i>	<i>Rating</i>		<i>Acres</i>	<i>(\$mm)</i>	<i>(\$m/A)</i>	<i>Ratio</i>
Ultra Petroleum	UPL		212,000	7,800	37	0.86
Whiting Petroleum Corporation	WLL		372,000	7,200	19	1.08
Berry Petroleum Company	BRY		174,000	2,900	17	1.00
Denbury Resources Inc.	DNR		662,000	10,700	16	1.13
Petrohawk Energy Corporation	HK		672,000	8,400	13	1.05
Range Resources	RRC		1,284,000	7,800	6	0.94
Birchcliff Energy Ltd. (US\$)	BIREF	CB	350,000	1,400	4	0.67
Cimarex Energy Company	XEC	B	4,348,000	6,900	2	0.93
<i>Source: Company disclosures, McDep LLC</i>						



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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 CB (see below)	14-Oct 2010	Cap						
Canadian Income Trusts (US\$)									
Pengrowth Energy Trust	PGH	11.46	1.40	4,600	35	65	0.83	7.2	1.03
Penn West Energy Trust	PWE	22.43	1.34	13,200	22	78	1.07	4.8	0.98
Enerplus Resources Fund	ERF	26.94	1.21	5,800	41	59	2.13	7.9	0.91
Peyto Energy Trust	PEYUF	15.44	1.22	2,250	78	22	1.42	9.2	0.88
Canadian Oil Sands Trust	COSWF CB	25.94	1.11	14,000		100	1.68	6.5	0.71
<i>Total or Median</i>				39,900					0.91
Small Cap Independent Producers									
Denbury Resources Inc.	DNR	18.12	1.47	10,680	16	84	-	-	1.13
Whiting Petroleum Corporation	WLL	104.86	1.17	7,160	14	86	-	-	1.08
Petrohawk Energy Corporation	HK	17.67	1.60	8,370	96	4	-	-	1.05
Berry Petroleum Company	BRY	34.81	1.54	2,910	31	69	0.30	0.9	1.00
Range Resources	RRC	37.31	1.34	7,790	82	18	0.04	0.1	0.94
Cimarex Energy Company	XEC B	73.58	1.10	6,900	59	41	0.32	0.4	0.93
Ultra Petroleum	UPL	42.23	1.21	7,800	94	6	-	-	0.86
Birchcliff Energy Ltd. (US\$)	BIREF CB	8.64	1.25	1,370	68	32	-	-	0.67
<i>Total or Median</i>				53,000					0.97
Top Line Cash Payers									
Sabine Royalty Trust	SBR	53.95	1.00	790	50	50	3.67	6.8	1.20
Permian Basin RT	PBT	21.19	1.00	990	38	62	1.36	6.4	1.18
Cross Timbers Royalty Trust	CRT	37.43	1.00	230	75	25	2.33	6.2	1.10
Freehold Royalty Trust (US\$)	FRHLF	18.65	1.08	1,170	25	75	1.57	8.4	1.09
Dorchester Minerals, L.P.	DMLP B	28.64	1.02	900	66	34	1.65	5.8	1.06
<i>Total or Median</i>				4,100					1.10
Bottom Line Cash Payers									
Linn Energy, LLC	LINE	33.34	1.41	6,890	47	53	2.52	7.6	1.36
Legacy Reserves LP.	LGCY	25.99	1.34	1,400	17	83	2.08	8.0	1.21
Encore Energy Partners, L.P. (52%)	ENP	19.88	1.27	590	25	75	2.00	10.1	1.13
San Juan Basin Royalty Trust	SJT B	25.42	1.00	1,190	100	-	1.22	4.8	1.02
Mesa Royalty Trust	MTR	47.40	1.00	88	75	25	3.61	7.6	0.98
Hugoton Royalty Trust	HGT B	20.46	1.00	820	90	10	1.26	6.1	0.97
<i>Total or Median</i>				11,000					1.07
Composite (excl COSWF)									
<i>Enterprise Value Weighting</i>				93,900	49	51			1.01
<i>Equal Weighting</i>					54	46			1.03
<i>Equal Weighted Buys</i>					68	32			0.93

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 (\$/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>14-Oct 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		15.44		1.08	21.5	13.7	12.1
Penn West Energy Trust	PWE		22.43		0.45	9.9	9.7	9.5
Canadian Oil Sands Trust	COSWF	CB	25.94		0.55	29.5	12.4	8.7
Enerplus Resources Fund	ERF		26.94		0.61	9.7	8.6	7.8
Pengrowth Energy Trust	PGH		11.46		0.52	9.3	6.9	7.1
	<i>Median</i>					9.9	9.7	8.7
Small Cap Independent Producers								
Range Resources	RRC		37.31		-	12.1	14.0	13.1
Ultra Petroleum	UPL		42.23		-	13.2	13.6	11.8
Petrohawk Energy Corporation	HK		17.67		-	7.1	10.0	10.4
Birchcliff Energy Ltd. (US\$)	BIREF	CB	8.64		-	21.4	14.3	9.6
Denbury Resources Inc.	DNR		18.12		-	12.8	8.1	9.1
Berry Petroleum Company	BRY		34.81		-	11.9	8.1	8.1
Whiting Petroleum Corporation	WLL		104.86		-	9.6	6.5	7.0
Cimarex Energy Company	XEC	B	73.58		-	6.3	6.8	6.3
	<i>Median</i>					12.0	9.0	9.4
Top Line Cash Payers								
Dorchester Minerals, L.P.	DMLP	B	28.64	77	0.89	6.8	14.5	15.4
Cross Timbers Royalty Trust	CRT		37.43	84	0.96	13.7	14.0	15.4
Permian Basin RT	PBT		21.19	42	0.98	13.1	13.0	15.3
Sabine Royalty Trust	SBR		53.95	100	1.00	8.9	12.3	14.7
Freehold Royalty Trust (US\$)	FRHLF		18.65	71	0.86	8.2	9.3	10.1
	<i>Median</i>					8.9	13.0	15.3
Bottom Line Cash Payers								
Linn Energy, LLC	LINE		33.34		1.62	18.4	13.5	18.3
San Juan Basin Royalty Trust	SJT	B	25.42		0.82	14.1	16.8	17.1
Hugoton Royalty Trust	HGT	B	20.46		0.87	12.8	14.6	14.2
Mesa Royalty Trust	MTR		47.40		0.94	9.0	12.5	12.3
Legacy Reserves L.P.	LGCY		25.99		0.97	12.2	9.4	11.3
Encore Energy Partners, L.P.	ENP		19.88		1.04	13.2	8.9	10.0
	<i>Median</i>					13.0	13.0	13.3
<p>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).</p>								

Please see disclosures on the final page.

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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		14-Oct 2010	52Wk High	52Wk Low	50 Day Avg.	200 Day Avg.	McDep Ratio	
Canadian Income Trusts (US\$)									
	Enerplus Resources Fund	ERF	26.94	0.99	1.67	1.10	1.13	0.91	
	Penn West Energy Trust	PWE	22.43	0.99	1.27	1.11	1.11	0.98	
	Peyto Energy Trust	PEYUF	15.44	0.97	1.34	1.07	1.09	0.88	
	Pengrowth Energy Trust	PGH	11.46	0.97	1.83	1.08	1.07	1.03	
	Canadian Oil Sands Trust	COSWF	CB	25.94	0.78	1.11	1.03	0.96	0.71
	<i>Median</i>			<i>0.97</i>	<i>1.34</i>	<i>1.08</i>	<i>1.09</i>	<i>0.91</i>	
Small Cap Independent Producers									
	Whiting Petroleum Corporation	WLL		104.86	0.97	1.67	1.10	1.20	1.08
	Cimarex Energy Company	XEC	B	73.58	0.91	1.81	1.06	1.11	0.93
	Berry Petroleum Company	BRY		34.81	1.00	1.25	1.10	1.11	1.00
	Denbury Resources Inc.	DNR		18.12	0.95	1.27	1.09	1.09	1.13
	Birchcliff Energy Ltd. (US\$)	BIREF	CB	8.64	0.85	1.24	0.98	0.97	0.67
	Ultra Petroleum	UPL		42.23	0.77	1.10	1.03	0.93	0.86
	Petrohawk Energy Corporation	HK		17.67	0.71	1.14	1.05	0.92	1.05
	Range Resources	RRC		37.31	0.68	1.10	1.01	0.86	0.94
	<i>Median</i>			<i>0.91</i>	<i>1.24</i>	<i>1.05</i>	<i>1.03</i>	<i>0.97</i>	
Top Line Cash Payers									
	Permian Basin RT	PBT		21.19	0.99	1.68	1.10	1.18	1.18
	Dorchester Minerals, L.P.	DMLP	B	28.64	1.00	1.42	1.12	1.17	1.06
	Freehold Royalty Trust (US\$)	FRHLF		18.65	0.96	1.39	1.13	1.15	1.09
	Sabine Royalty Trust	SBR		53.95	0.98	1.36	1.03	1.10	1.20
	Cross Timbers Royalty Trust	CRT		37.43	0.95	1.33	1.05	1.08	1.10
	<i>Median</i>			<i>0.98</i>	<i>1.39</i>	<i>1.10</i>	<i>1.15</i>	<i>1.10</i>	
Bottom Line Cash Payers									
	Linn Energy, LLC	LINE		33.34	0.99	1.79	1.07	1.14	1.36
	San Juan Basin Royalty Trust	SJT	B	25.42	0.89	1.52	1.07	1.10	1.02
	Legacy Reserves L.P.	LGCY		25.99	0.97	1.45	1.06	1.10	1.21
	Hugoton Royalty Trust	HGT	B	20.46	0.92	1.36	1.04	1.09	0.97
	Mesa Royalty Trust	MTR		47.40	0.87	1.37	1.04	1.08	0.98
	Encore Energy Partners, L.P. (52%)	ENP		19.88	0.93	1.70	1.04	1.03	1.13
	<i>Median</i>			<i>0.93</i>	<i>1.48</i>	<i>1.05</i>	<i>1.10</i>	<i>1.07</i>	

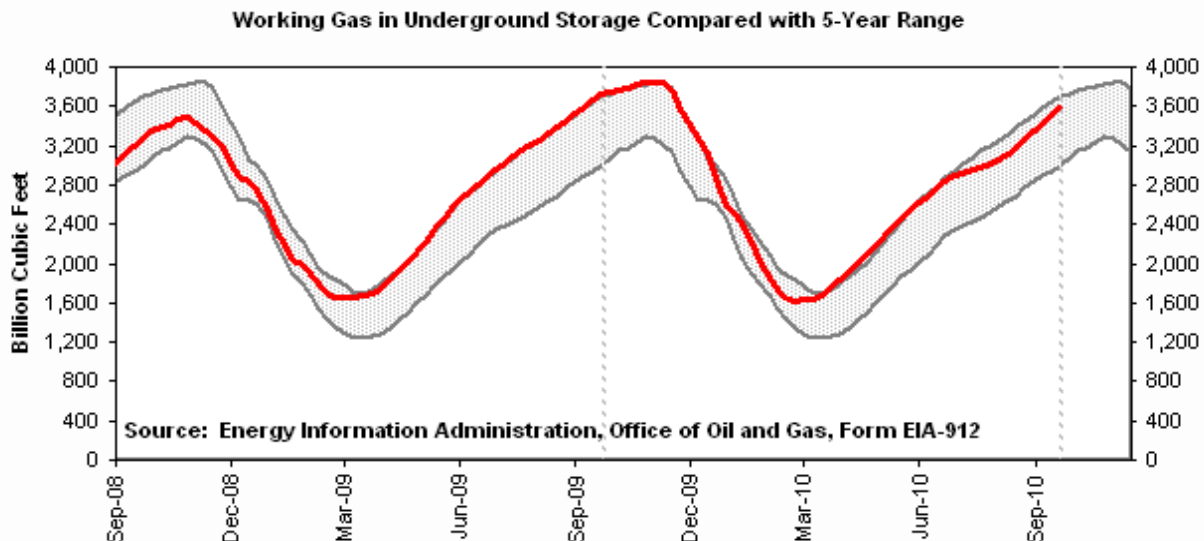
CB=Contrarian Buy, Stock Price apparently in downtrend compared to 200-day average.



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