



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

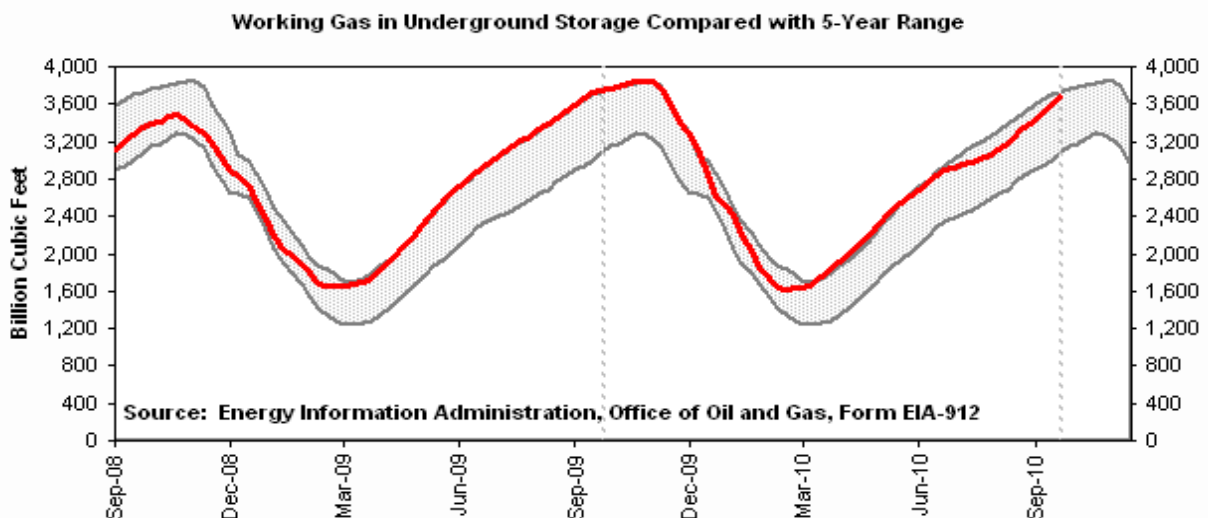
October 22, 2010

Natural Gas Explorers Reduce Drilling

Summary and Recommendation

Drilling cutbacks are spreading in reaction to an uneconomically low natural gas price. Inevitably, that is how the free market mechanism is supposed to work to realign supply growth with demand growth. Large caps Occidental Petroleum (OXY) and Encana (ECA) in the first of third quarter earnings releases on October 19-20 cut natural gas production forecasts for the rest of 2010 and drilling budgets for 2011. North American producers have seen the price-firming of August return to the price-softness of October, reflecting an acceleration of the pace of storage buildup (see chart [Working Gas in Underground Storage](#) below). We expect supporting comments from a top three producer ConocoPhillips (COP) on October 27. Last week we discussed a shift away from natural gas drilling toward oil drilling by small cap, buy-recommended **Cimarex (XEC)**. Profitable oil production also helps small cap, buy-recommended **Birchcliff (BIREF)** sustain low natural gas price. A doubling of Birchcliff's Pouce Coupe gas plant is on time and on budget to reduce operating costs and keep its natural gas competitive. Continued low pricing would likely cause Birchcliff to stretch out the next doubling of plant capacity. The three small cap independent producers in our coverage most concentrated on natural gas, **Petrohawk (HK)**, **Range Resources (RRC)** and **Ultra Petroleum (UPL)** remain in stock price downtrends by the 200-day average. Recent turning up by the 60-day average may be sustained considering the seasonal trends that are often favorable for the stock market and for natural gas going into the winter months. Median measures for Small Cap Independent Producers are a McDep Ratio of 0.96, unlevered cash flow multiple (EV/Ebitda) of 8.9 and enterprise value to 200-day average of 0.99 (see [Tables 1-4](#) on pages 2-5).

Kurt H. Wulff, CFA





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	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)	21-Oct 2010	Cap						
Canadian Income Trusts (US\$)									
Pengrowth Energy Trust	PGH	11.50	1.40	4,700	35	65	0.84	7.3	1.03
Penn West Energy Trust	PWE	22.53	1.34	13,200	22	78	1.08	4.8	0.98
Enerplus Resources Fund	ERF	26.85	1.22	5,800	41	59	2.15	8.0	0.91
Pepto Energy Trust	PEYUF	15.00	1.23	2,200	78	22	1.43	9.6	0.86
Canadian Oil Sands Trust	COSWF CB	25.54	1.11	13,800		100	1.68	6.6	0.70
<i>Total or Median</i>				39,700					0.91
Small Cap Independent Producers									
Denbury Resources Inc.	DNR	17.08	1.50	10,260	16	84	-	-	1.09
Whiting Petroleum Corporation	WLL	101.48	1.17	7,240	14	86	-	-	1.09
Petrohawk Energy Corporation	HK	17.28	1.59	8,500	96	4	-	-	1.06
Berry Petroleum Company	BRY	33.97	1.55	2,860	31	69	0.30	0.9	0.98
Range Resources	RRC	36.99	1.33	7,890	82	18	0.04	0.1	0.95
Cimarex Energy Company	XEC B	72.56	1.10	6,810	59	41	0.32	0.4	0.91
Ultra Petroleum	UPL	41.02	1.21	7,850	94	6	-	-	0.87
Birchcliff Energy Ltd. (US\$)	BIREF CB	8.05	1.27	1,290	68	32	-	-	0.63
<i>Total or Median</i>				52,700					0.96
Top Line Cash Payers									
Sabine Royalty Trust	SBR	53.71	1.00	780	50	50	3.64	6.8	1.19
Permian Basin RT	PBT	20.84	1.00	970	38	62	1.35	6.5	1.16
Cross Timbers Royalty Trust	CRT	37.20	1.00	220	75	25	2.31	6.2	1.09
Freehold Royalty Trust (US\$)	FRHLF	18.27	1.08	1,150	25	75	1.58	8.7	1.07
Dorchester Minerals, L.P.	DMLP B	26.89	1.02	840	66	34	1.62	6.0	1.00
<i>Total or Median</i>				4,000					1.09
Bottom Line Cash Payers									
Linn Energy, LLC	LINE	32.57	1.42	6,780	47	53	2.52	7.7	1.33
Legacy Reserves L.P.	LGCY	26.18	1.34	1,410	17	83	2.08	7.9	1.21
Encore Energy Partners, L.P. (52%)	ENP	19.88	1.27	590	25	75	2.00	10.1	1.13
Mesa Royalty Trust	MTR	47.95	1.00	89	75	25	3.56	7.4	0.99
San Juan Basin Royalty Trust	SJT B	24.83	1.00	1,160	100	-	1.17	4.7	0.99
Hugoton Royalty Trust	HGT B	20.02	1.00	800	90	10	1.22	6.1	0.95
<i>Total or Median</i>				10,800					1.06
Composite (excl COSWF)									
<i>Enterprise Value Weighting</i>				93,400	50	50			1.00
<i>Equal Weighting</i>					54	46			1.02
<i>Equal Weighted Buys</i>					68	32			0.90

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>Market</i>	<i>Net</i>		
			<i>(\$/sh)</i>		<i>Cap</i>	<i>Present</i>	<i>Debt/</i>	
	<i>Symbol/</i>		<i>21-Oct</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		11.50	290.0	3,340	11.00	0.29	1.03
Penn West Energy Trust	PWE		22.53	439.6	9,900	23.00	0.25	0.98
Enerplus Resources Fund	ERF		26.85	177.5	4,770	30.00	0.16	0.91
Peyto Energy Trust	PEYUF		15.00	119.4	1,790	18.00	0.16	0.86
Canadian Oil Sands Trust	COSWF	CB	25.54	484.0	12,360	38.00	0.07	0.70
<i>Total or Median</i>					32,200		0.16	0.91
Small Cap Independent Producers								
Denbury Resources Inc.	DNR		17.08	401.0	6,850	15.00	0.36	1.09
Whiting Petroleum Corporation	WLL		101.48	59.2	6,210	95.00	0.16	1.09
Petrohawk Energy Corporation	HK		17.28	303.0	5,350	16.00	0.39	1.06
Berry Petroleum Company	BRY		33.97	54.3	1,840	35.00	0.35	0.98
Range Resources	RRC		36.99	158.5	5,910	40.00	0.24	0.95
Cimarex Energy Company	XEC	B	72.56	85.6	6,210	80.00	0.08	0.91
Ultra Petroleum	UPL		41.02	154.0	6,500	50.00	0.15	0.87
Birchcliff Energy Ltd. (US\$)	BIREF	CB	8.05	127.0	1,020	14.00	0.13	0.63
<i>Total or Median</i>					39,890		0.20	0.96
Top Line Cash Payers								
Sabine Royalty Trust	SBR		53.71	14.6	780	45.00	-	1.19
Permian Basin RT	PBT		20.84	46.6	970	18.00	-	1.16
Cross Timbers Royalty Trust	CRT		37.20	6.0	220	34.00	-	1.09
Freehold Royalty Trust (US\$)	FRHLF		18.27	58.3	1,060	17.00	0.08	1.07
Dorchester Minerals, L.P.	DMLP	B	26.89	30.7	830	27.00	0.02	1.00
<i>Total or Median</i>					3,860			1.09
Bottom Line Cash Payers								
Linn Energy, LLC	LINE		32.57	146.5	4,770	21.00	0.39	1.33
Legacy Reserves L.P.	LGCY		26.18	40.1	1,050	20.00	0.31	1.21
Encore Energy Partners, L.P. (52%)	ENP		19.88	23.4	470	17.00	0.24	1.13
Mesa RoyaltyTrust	MTR		47.95	1.9	89	48.00	-	0.99
San Juan Basin Royalty Trust	SJT	B	24.83	46.6	1,160	25.00	-	0.99
Hugoton RoyaltyTrust	HGT	B	20.02	40.0	800	21.00	-	0.95
<i>Total or Median</i>					8,340			1.06
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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			Price (\$/sh)	Revenue	Dist/ Equity	Adjstd Resrvs/ Prod	PV/ Ebitda	EV/ Ebitda
	Symbol/ Rating	21-Oct 2010	Royalty (%)	Ebitda	NTM	NTM	NTM	NTM
Canadian Income Trusts (US\$)								
Peyto Energy Trust	PEYUF		15.00		1.12	21.5	14.0	12.0
Penn West Energy Trust	PWE		22.53		0.45	9.9	9.7	9.5
Canadian Oil Sands Trust	COSWF	CB	25.54		0.54	29.5	12.2	8.5
Enerplus Resources Fund	ERF		26.85		0.62	9.7	8.6	7.9
Pengrowth Energy Trust	PGH		11.50		0.52	9.3	6.9	7.1
	<i>Median</i>					9.9	9.7	8.5
Small Cap Independent Producers								
Range Resources	RRC		36.99		-	12.1	14.2	13.5
Ultra Petroleum	UPL		41.02		-	13.2	14.0	12.2
Petrohawk Energy Corporation	HK		17.28		-	7.1	10.2	10.9
Birchcliff Energy Ltd. (US\$)	BIREF	CB	8.05		-	21.4	14.5	9.2
Denbury Resources Inc.	DNR		17.08		-	12.8	8.0	8.7
Berry Petroleum Company	BRY		33.97		-	11.9	8.1	8.0
Whiting Petroleum Corporation	WLL		101.48		-	9.6	6.5	7.0
Cimarex Energy Company	XEC	B	72.56		-	6.3	6.9	6.3
	<i>Median</i>					12.0	9.2	8.9
Top Line Cash Payers								
Cross Timbers Royalty Trust	CRT		37.20	84	0.96	13.7	14.1	15.4
Permian Basin RT	PBT		20.84	42	0.98	13.1	13.1	15.1
Dorchester Minerals, L.P.	DMLP	B	26.89	77	0.89	6.8	14.8	14.8
Sabine Royalty Trust	SBR		53.71	100	1.00	8.9	12.4	14.7
Freehold Royalty Trust (US\$)	FRHLF		18.27	71	0.87	8.2	9.3	9.9
	<i>Median</i>					8.9	13.1	14.8
Bottom Line Cash Payers								
Linn Energy, LLC	LINE		32.57		1.63	18.4	13.5	18.1
San Juan Basin Royalty Trust	SJT	B	24.83		0.82	14.1	17.5	17.3
Hugoton RoyaltyTrust	HGT	B	20.02		0.87	12.8	15.0	14.3
Mesa RoyaltyTrust	MTR		47.95		0.94	9.0	12.6	12.6
Legacy Reserves L.P.	LGCY		26.18		0.97	12.2	9.4	11.4
Encore Energy Partners, L.P.	ENP		19.88		1.04	13.2	8.8	10.0
	<i>Median</i>					13.0	13.1	13.5

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 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		21-Oct 2010	52Wk High	52Wk Low	50 Day Avg.	200 Day Avg.	McDep Ratio	
Canadian Income Trusts (US\$)									
	Enerplus Resources Fund	ERF	26.85	0.99	1.67	1.08	1.13	0.91	
	Penn West Energy Trust	PWE	22.53	0.99	1.28	1.10	1.10	0.98	
	Pengrowth Energy Trust	PGH	11.50	0.97	1.84	1.07	1.07	1.03	
	Peyto Energy Trust	PEYUF	15.00	0.95	1.31	1.04	1.07	0.86	
	Canadian Oil Sands Trust	COSWF	CB	25.54	0.80	1.09	1.01	0.95	0.70
	<i>Median</i>			<i>0.97</i>	<i>1.31</i>	<i>1.07</i>	<i>1.07</i>	<i>0.91</i>	
Small Cap Independent Producers									
	Whiting Petroleum Corporation	WLL		101.48	0.98	1.69	1.10	1.21	1.09
	Cimarex Energy Company	XEC	B	72.56	0.90	1.78	1.05	1.09	0.91
	Berry Petroleum Company	BRY		33.97	0.97	1.22	1.07	1.08	0.98
	Denbury Resources Inc.	DNR		17.08	0.91	1.22	1.04	1.04	1.09
	Ultra Petroleum	UPL		41.02	0.78	1.11	1.04	0.95	0.87
	Petrohawk Energy Corporation	HK		17.28	0.73	1.16	1.06	0.94	1.06
	Birchcliff Energy Ltd. (US\$)	BIREF	CB	8.05	0.80	1.17	0.94	0.91	0.63
	Range Resources	RRC		36.99	0.71	1.11	1.03	0.88	0.95
	<i>Median</i>			<i>0.90</i>	<i>1.19</i>	<i>1.04</i>	<i>1.00</i>	<i>0.96</i>	
Top Line Cash Payers									
	Permian Basin RT	PBT		20.84	0.97	1.65	1.07	1.15	1.16
	Freehold Royalty Trust (US\$)	FRHLF		18.27	0.94	1.36	1.09	1.12	1.07
	Sabine Royalty Trust	SBR		53.71	0.98	1.35	1.02	1.09	1.19
	Dorchester Minerals, L.P.	DMLP	B	26.89	0.92	1.33	1.04	1.09	1.00
	Cross Timbers Royalty Trust	CRT		37.20	0.94	1.32	1.04	1.07	1.09
	<i>Median</i>			<i>0.94</i>	<i>1.35</i>	<i>1.04</i>	<i>1.09</i>	<i>1.09</i>	
Bottom Line Cash Payers									
	Linn Energy, LLC	LINE		32.57	0.97	1.76	1.04	1.12	1.33
	Legacy Reserves L.P.	LGCY		26.18	0.98	1.46	1.06	1.10	1.21
	Mesa Royalty Trust	MTR		47.95	0.88	1.39	1.05	1.08	0.99
	San Juan Basin Royalty Trust	SJT	B	24.83	0.87	1.48	1.05	1.07	0.99
	Hugoton Royalty Trust	HGT	B	20.02	0.90	1.34	1.02	1.06	0.95
	Encore Energy Partners, L.P. (52%)	ENP		19.88	0.93	1.70	1.04	1.03	1.13
	<i>Median</i>			<i>0.92</i>	<i>1.47</i>	<i>1.05</i>	<i>1.07</i>	<i>1.06</i>	

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



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