



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

February 18, 2011

Raise Peyto NPV to \$24 from \$20

Summary and Recommendation

<i>Symbol</i>	PEYUF	<i>Ebitda Next Twelve Months ending 12/31/11 (US\$mm)</i>	206
<i>Rating</i>		<i>North American Natural Gas/Ebitda (%)</i>	69
<i>Price (US\$/un)</i>	19.10	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	2/17/11	<i>Adjusted Reserves/Production NTM</i>	21.5
<i>Units (mm)</i>	122	<i>EV/Ebitda</i>	13.5
<i>Market Capitalization (US\$mm)</i>	2,330	<i>PV/Ebitda</i>	16.4
<i>Debt (US\$mm)</i>	450	<i>Probable Reserves (%)</i>	31
<i>Enterprise Value (EV) (US\$mm)</i>	2,780	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	21.74
<i>Present Value (PV) (US\$mm)</i>	3,380	<i>Present Value Proven and Probable Reserves(US\$/boe)</i>	13.03
<i>Net Present Value (US\$/unit)</i>	24	<i>Oil and Gas Ebitda Margin (%)</i>	80
<i>Debt/Present Value</i>	0.13	<i>Earnings Next Twelve Months (US\$/un)</i>	0.89
<i>McDep Ratio - EV/PV</i>	0.82	<i>Price/Earnings Next Twelve Months</i>	21
<i>Distribution Yield (%/year)</i>	3.8	<i>Indicated Annual Distribution (US\$/un)</i>	0.73
Note: Estimated cash flow and earnings tied to one-year futures prices for oil and natural gas.			
Reported results may vary widely from estimates. Estimated present value per unit revised only infrequently.			
Estimated present value presumes a long-term price for oil of US\$100 a barrel and natural gas, \$8 a million btu.			
For historical analysis of Peyto Energy Trust see www.mcdep.com/5pey.htm			

Shares of Canadian Deep Basin natural gas producer **Peyto Exploration and Development Corp. (PEYUF)** offer unlevered appreciation potential of 21% to our new estimate of Net Present Value (NPV) of US\$24. On the basis of continued success with horizontal multistage fracturing, we raise NPV from US\$20 a unit. Natural gas and oil reserves for 2010, reported on February 16, were up 30% on a proven and probable basis from 2009. While final operating and financial results are not yet available publicly, we estimate that production gained 28%. The technological success on a classically valuable resource base contributes to our comfort with a high multiple of present value to cash flow normally implied by the extra long reserve life Peyto reports (see tables [Functional Cash Flow and Present Value](#) and [Natural Gas and Oil Reserves](#) on page 2). The ability of Peyto and other successful producers to increase volume has helped the supply of natural gas hold price down. Yet, demand is strong, too, with inventory of natural gas in storage dropping rapidly to the low end of the range with a month of winter left (see chart from the U.S. EIA on page 6). At a McDep Ratio of 0.82, PEYUF ranks as more undervalued among Small Cap Independent Producers (see [Tables 1-2](#) on pages 3-4). An unlevered cash flow multiple (EV/Ebitda) of 13.5 for Peyto partly recognizes the backlog of reserves to be developed (see [Table 3](#) on page 5). Some 47% of NPV is represented by non-producing, undeveloped and probable reserves that require new investment to produce cash flow. The other 53% of NPV in producing reserves provides cash flow to unlock the identified potential. While there are risks in energy investment, Peyto has demonstrated a strong historical record of identifying opportunities and developing them successfully.

Kurt H. Wulff, CFA



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February 18, 2011

Peyto Exploration and Development Corp.					
Functional Cash Flow and Present Value					
	<i>NTM Ebitda</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Present</i>	
	<i>(US\$mm)</i>	<i>R/P</i>	<i>Ebitda</i>	<i>Value</i>	
				<i>(US\$mm)</i>	
North American Natural Gas	141	21.4	18.4	2,600	77%
Oil	65	21.7	11.8	770	23%
	206	21.5	16.4	3,370	100%
Debt (US\$mm)					450
Net Present Value (US\$mm)					2,920
Shares (mm)					122
Net Present Value - Standard Estimate (US\$/sh)					24

Peyto Exploration and Development Corp.					
Natural Gas and Oil Reserves					
	<i>Natural Gas</i>	<i>Oil</i>	<i>Total</i>		
	<i>(bcf)</i>	<i>(mmb)</i>	<i>(bcf)</i>	<i>(mmb)</i>	
<i>Reserves (bcf or mmb)</i>					
Proven and Probable (P1+P2)	1353	34	1557	260	100
Proven (P1)	929	25	1079	180	69
Probable (P2)	424	9	478	80	31
<i>Production, Next Twelve Months</i>	49	1.3	57	9	
<i>Reserve Life Index (years)</i>					
R/P (P1+P2)	27.5	26.6	27.3	27.3	
R/P (P1)	18.9	19.6	18.9	18.9	
R/P (P2)	8.6	7.0	8.4	8.4	
R/P (P1+.3P2)	21.4	21.7	21.5	21.5	



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

February 18, 2011

Table ISC-1											
McDep Income and Small Cap Energy Portfolio											
Debt, Segments, Cash Flow, Income and McDep Ratio											
		Price									
Symbol/Rating	(US\$/sh)	EV/	Enterprise	PV(%)	EV/	Dist.	Dist.				
B = Buy	17-Feb	Market	Value	Nat	Ebitda	NTM	Yield	McDep			
CB (see below)	2011	Cap	(\$mm)	Gas	Oil	NTM	(\$/un)	(%)	Ratio		
Small Cap Independent Producers											
Denbury Resources Inc.	DNR	23.06	1.37	12,660	12	88	9.7	-	-	1.03	
Berry Petroleum Company	BRY	47.57	1.40	3,640	26	74	9.2	0.30	0.6	1.01	
Range Resources	RRC	B	48.69	1.27	9,740	77	23	16.3	0.16	0.3	0.98
Cimarex Energy Company	XEC	B	114.00	1.07	10,430	45	55	8.4	0.32	0.3	0.95
Ultra Petroleum	UPL	47.46	1.20	8,790	90	10	12.5	-	-	0.93	
Petrohawk Energy Corporation	HK	B	20.58	1.55	9,620	92	8	11.7	-	-	0.90
Whiting Petroleum Corporation	WLL	124.56	1.16	8,530	11	89	7.5	-	-	0.85	
Peyto Exploration and Development	PEYUF	19.10	1.19	2,780	77	23	13.5	0.73	3.8	0.82	
Birchcliff Energy Ltd.	BIREF	B	11.75	1.23	1,840	62	38	11.9	-	-	0.77
<i>Total or Median</i>					68,000			11.7		-	0.93
Top Line Cash Payers											
Cross Timbers Royalty Trust	CRT	47.72	1.00	290	69	31		2.69	5.6	1.29	
Sabine Royalty Trust	SBR	62.93	1.00	920	38	62		4.02	6.4	1.07	
Freehold Royalties Ltd.	FRHLF	21.87	1.07	1,360	20	80		1.69	7.7	0.99	
Permian Basin RT	PBT	21.22	1.00	990	31	69		1.55	7.3	0.96	
Dorchester Minerals, L.P.	DMLP	B	27.50	1.02	860	60	40	1.80	6.6	0.92	
<i>Total or Median</i>					4,400				6.6	0.99	
Bottom Line Cash Payers											
Linn Energy, LLC	LINE	38.66	1.39	7,900	38	62	18.9	2.64	6.8	1.25	
Vanguard Natural Resources, LLC	VNR	31.25	1.37	1,270	31	69	10.8	2.24	7.2	1.11	
Legacy Reserves L.P.	LGCY	30.10	1.32	1,590	13	87	11.5	2.08	6.9	1.06	
Encore Energy Partners, L.P.	ENP	23.07	1.23	1,290	19	81	10.7	2.00	8.7	1.00	
San Juan Basin Royalty Trust	SJT	CB	24.68	1.00	1,150	100	-	14.1	1.43	5.8	0.99
Hugoton Royalty Trust	HGT	B	21.58	1.00	860	86	14	13.8	1.34	6.2	0.98
Pengrowth Energy Corporation	PGH	12.56	1.37	5,100	29	71	8.2	0.84	6.7	0.92	
Mesa Royalty Trust	MTR	46.07	1.00	86	75	25	11.8	3.55	7.7	0.87	
Enerplus Corporation	ERF	31.08	1.19	6,600	34	66	8.2	2.16	6.9	0.86	
<i>Total or Median</i>					25,800			11.5		6.9	0.99
Composite											
<i>Enterprise Value Weighting</i>					98,300	48	52				0.96
<i>Equal Weighting</i>						49	51				0.98
<i>Equal Weighted Buys</i>						71	29				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 (PV) presumes long-term prices of \$100 a barrel for oil and \$8 a million btu for natural gas.
 Dist. = Income distribution. NTM = Next Twelve Months Ended December 31, 2011. Enterprise Value = Market Cap and Debt.



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

February 18, 2011

Table ISC-2								
McDep Income and Small Cap Energy Portfolio								
Net Present Value and McDep Ratio								
			<i>Price</i>			<i>Net</i>		
			<i>(\$/sh)</i>		<i>Market</i>	<i>Present</i>	<i>Debt/</i>	
	<i>Symbol/</i>		<i>17-Feb</i>	<i>Shares</i>	<i>Cap</i>	<i>Value</i>	<i>Present</i>	
	<i>Rating</i>		<i>2011</i>	<i>(mm)</i>	<i>(\$mm)</i>	<i>(\$/un)</i>	<i>Value</i>	
							<i>McDep</i>	
							<i>Ratio</i>	
Small Cap Independent Producers								
Denbury Resources Inc.	DNR		23.06	401.0	9,250	22.00	0.28	1.03
Berry Petroleum Company	BRY		47.57	54.4	2,590	47.00	0.29	1.01
Range Resources	RRC	B	48.69	157.1	7,650	50.00	0.21	0.98
Cimarex Energy Company	XEC	B	114.00	85.8	9,780	120.00	0.06	0.95
Ultra Petroleum	UPL		47.46	154.0	7,310	52.00	0.16	0.93
Petrohawk Energy Corporation	HK	B	20.58	302.0	6,220	24.00	0.32	0.90
Whiting Petroleum Corporation	WLL		124.56	59.0	7,350	150.00	0.12	0.85
Peyto Exploration and Development Corp	PEYUF		19.10	121.8	2,330	24.00	0.13	0.82
Birchcliff Energy Ltd.	BIREF	B	11.75	127.3	1,500	16.00	0.14	0.77
<i>Total or Median</i>					<i>53,980</i>		<i>0.16</i>	<i>0.93</i>
Top Line Cash Payers								
Cross Timbers Royalty Trust	CRT		47.72	6.0	290	37.00	-	1.29
Sabine Royalty Trust	SBR		62.93	14.6	920	59.00	-	1.07
Freehold Royalties Ltd.	FRHLF		21.87	58.4	1,280	22.00	0.06	0.99
Permian Basin RT	PBT		21.22	46.6	990	22.00	-	0.96
Dorchester Minerals, L.P.	DMLP	B	27.50	30.7	840	30.00	0.02	0.92
<i>Total or Median</i>					<i>4,320</i>			<i>0.99</i>
Bottom Line Cash Payers								
Linn Energy, LLC	LINE		38.66	146.5	5,660	28.00	0.35	1.25
Vanguard Natural Resources, LLC	VNR		31.25	29.8	930	27.00	0.30	1.11
Legacy Reserves L.P.	LGCY		30.10	40.1	1,210	28.00	0.25	1.06
Encore Energy Partners, L.P.	ENP		23.07	45.3	1,050	23.00	0.19	1.00
San Juan Basin Royalty Trust	SJT	CB	24.68	46.6	1,150	25.00	-	0.99
Hugoton Royalty Trust	HGT	B	21.58	40.0	860	22.00	-	0.98
Pengrowth Energy Corporation	PGH		12.56	299.0	3,760	14.00	0.25	0.92
Mesa Royalty Trust	MTR		46.07	1.9	86	53.00	-	0.87
Enerplus Corporation	ERF		31.08	177.5	5,520	37.00	0.14	0.86
<i>Total or Median</i>					<i>20,230</i>			<i>0.99</i>
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 \$100 a barrel for oil and \$8 a million btu for natural gas.								



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February 18, 2011

Table ISC-3

McDep Income and Small Cap Energy Portfolio

Value Multiples - Rank by EV/Ebitda

			<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>17-Feb 2011</i>	<i>Royalty (%)</i>	<i>Ebitda</i>	<i>NTM</i>	<i>NTM</i>	<i>NTM</i>
Small Cap Independent Producers								
Range Resources	RRC	B	48.69		-	16.8	16.7	16.3
Peyto Exploration and Development Corp	PEYUF		19.10		0.50	21.5	16.4	13.5
Ultra Petroleum	UPL		47.46		-	12.6	13.5	12.5
Birchcliff Energy Ltd.	BIREF	B	11.75		-	20.8	15.4	11.9
Petrohawk Energy Corporation	HK	B	20.58		-	8.8	12.9	11.7
Denbury Resources Inc.	DNR		23.06		-	12.9	9.3	9.7
Berry Petroleum Company	BRY		47.57		-	11.3	9.1	9.2
Cimarex Energy Company	XEC	B	114.00		-	7.4	8.8	8.4
Whiting Petroleum Corporation	WLL		124.56		-	9.3	8.8	7.5
	<i>Median</i>					<i>12.6</i>	<i>12.9</i>	<i>11.7</i>
Top Line Cash Payers								
Cross Timbers Royalty Trust	CRT		47.72	84	0.96	13.1	13.3	17.1
Sabine Royalty Trust	SBR		62.93	100	1.00	7.8	14.7	15.6
Dorchester Minerals, L.P.	DMLP	B	27.50	77	0.92	6.7	15.3	14.1
Permian Basin RT	PBT		21.22	32	0.94	13.2	13.3	12.8
Freehold Royalties Ltd.	FRHLF		21.87	71	0.85	8.1	11.0	11.0
	<i>Median</i>					<i>8.1</i>	<i>13.3</i>	<i>14.1</i>
Bottom Line Cash Payers								
Linn Energy, LLC	LINE		38.66		1.43	18.3	15.2	18.9
San Juan Basin Royalty Trust	SJT	CB	24.68		0.82	13.6	14.3	14.1
Hugoton Royalty Trust	HGT	B	21.58		0.86	12.6	14.0	13.8
Mesa Royalty Trust	MTR		46.07		0.91	8.7	13.5	11.8
Legacy Reserves L.P.	LGCY		30.10		0.81	12.0	10.9	11.5
Vanguard Natural Resources, LLC	VNR		31.25		0.81	13.0	9.8	10.8
Encore Energy Partners, L.P.	ENP		23.07		0.92	13.5	10.6	10.7
Pengrowth Energy Corporation	PGH		12.56		0.53	9.6	8.9	8.2
Enerplus Corporation	ERF		31.08		0.55	9.7	9.5	8.2
	<i>Median</i>					<i>12.6</i>	<i>10.9</i>	<i>11.5</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 December 31, 2011; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

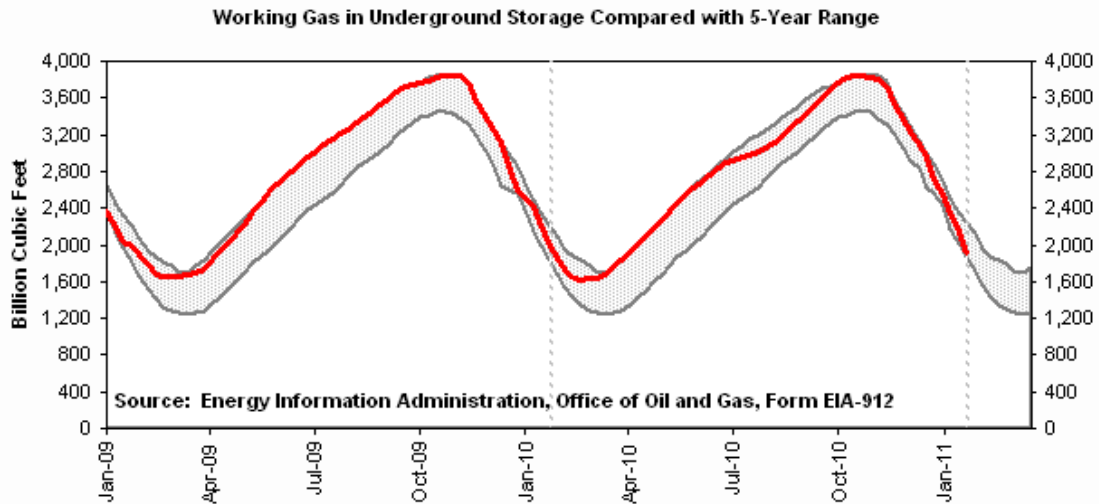
Top Line Cash Payers defined as those having Revenue Royalty (see fifth column from right).



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