



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

June 24, 2011

Income Enhancers HGT, SJT, MTR

Summary and Recommendation

Units of Bottom-Line Cash Payers **San Juan Basin Royalty Trust (SJT)**, **Mesa Royalty Trust (MTR)** and buy-recommended **Hugoton Royalty Trust (HGT)** continue to pay attractive income at estimated annual rates of 6.6%, 6.7%, and 6.8% while traditional savings accounts, Treasury Bills and Money Market Accounts pay practically nothing. Moreover, Federal Reserve Chairman Bernanke warned on June 22 that money market funds are vulnerable to debt default via European banks, which are the main creditors of weak borrowers like Greece. The three royalty trusts owe no debt, have among the lowest costs of energy producers and their natural gas output is in demand whether economic activity is weak or strong. Recent political action on June 23 to reduce energy price with the release of oil from the strategic reserve is unlikely to have a lasting impact. Near-term oil price dropped in reaction while the longer-term average for the next six years remains in an uptrend at \$97 a barrel compared to the 40-week average of \$96. Six-year natural gas price that had recently climbed above its 40-week average dropped below once more. Natural gas is already depressed and there is little downside remaining, we believe. HGT stock is trending up while SJT and MTR are contrarian opportunities to complement or substitute for officially recommended HGT. Distribution and volume trends are closely similar as we discuss further.

Steady Volume from Long-Life Wells

While high volume shale gas wells capture investors' attention, natural gas flows steadily from the wells of long-life royalty trusts. In engineering terminology, the producing time pattern of shale gas is hyperbolic in contrast to the mature trust properties which have an exponential time pattern. A shale gas well may decline in producing rate by 50% in its first year and at progressively slower rates thereafter. That means a lot of drilling is required to keep the rate up in a shale gas field until enough wells are in the later, slower stage of decline. In contrast, with only a modest amount of drilling, if any, the royalty trust properties decline only slowly. Over the past seven and a half years, the rate of volume decline has been about 3% a year for SJT and 5% a year for HGT (see chart [Monthly Volume](#) on page 2).

Projecting volumes on a quarterly basis for the next twelve months ending June 30, 2012, we have HGT declining slightly more than SJT and MTR (see chart [Quarterly Volume](#) on page 2). Gradually increasing natural gas price according to latest futures quotes drives rising distributions (see chart [Quarterly Distributions](#) on page 2). Distributions for MTR in 2011 are temporarily lower than would otherwise be the case because the trustee is withholding some cash to build a reserve. A jump in distribution for MTR in 2012 and a lower McDep Ratio point to extra opportunity subject to limited liquidity because of the small number of units outstanding (see Tables ISC-1 through ISC-4 on pages 3-6).

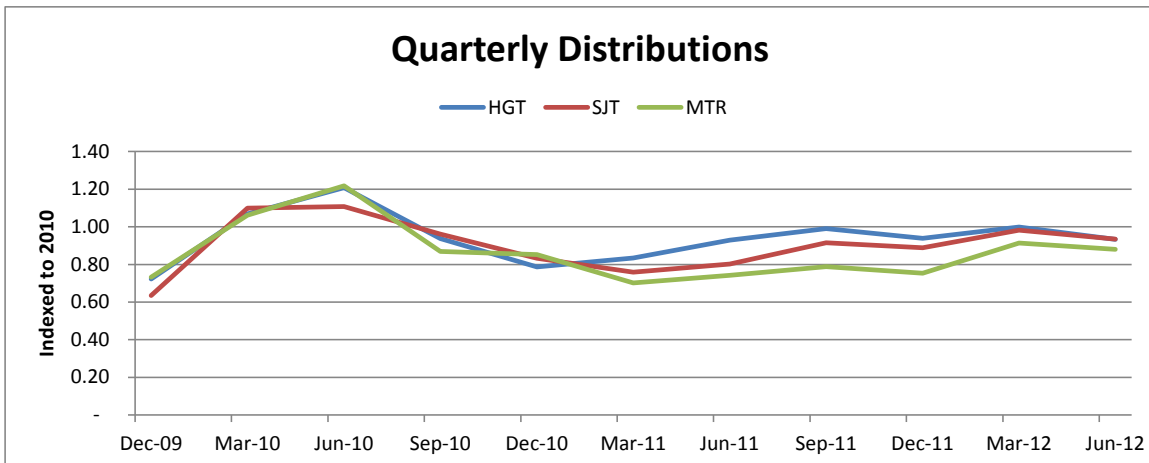
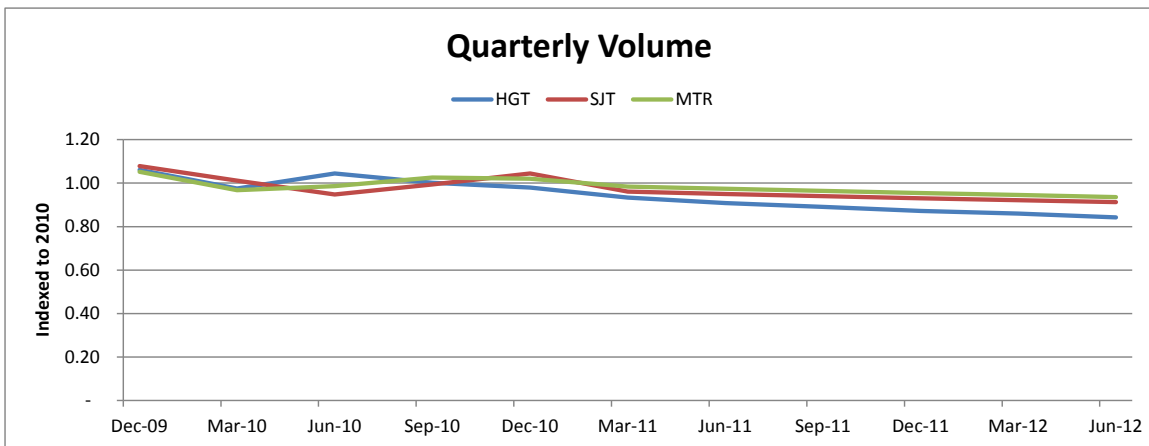
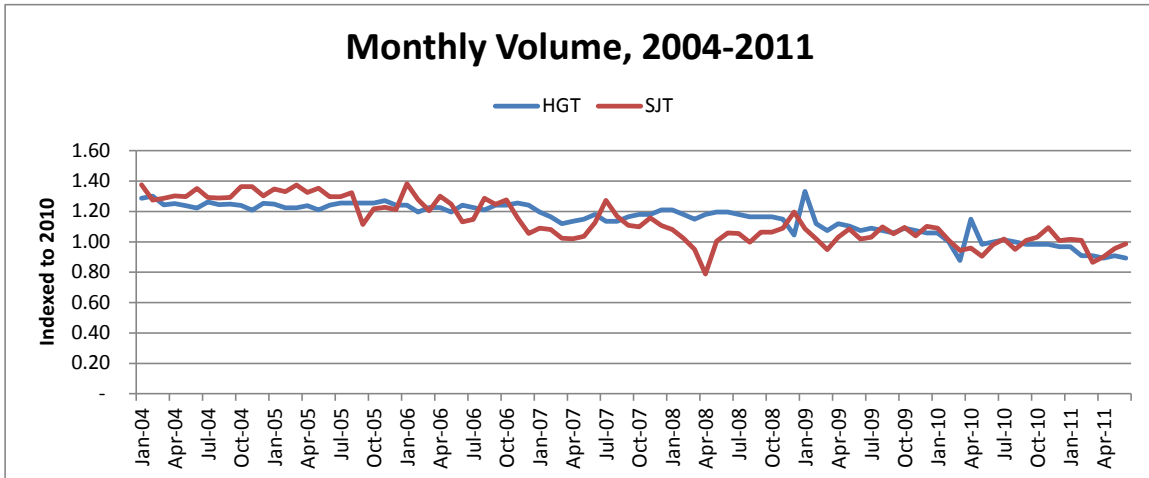
Kurt H. Wulff, CFA



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Table ISC-1											
McDep Income and Small Cap Energy Portfolio											
Debt, Segments, Cash Flow, Income and McDep Ratio											
Symbol/Rating	Price (US\$/sh)	EV/ Market	Enterprise Value (\$mm)	PV(%)		EV/ Ebitda NTM	Dist. NTM (\$/un)	Dist. Yield (%)	McDep Ratio		
				Nat Gas	Oil					B = Buy	CB (see below)
Small Cap Independent Producers											
Peyto Exploration and Development	PEYUF	21.82	1.23	3,570	71	29	11.3	0.74	3.4	0.93	
Range Resources	RRC B	52.76	1.21	10,100	76	24	14.1	0.16	0.3	0.90	
Berry Petroleum Company	BRY	49.45	1.53	4,090	26	74	9.1	0.30	0.6	0.88	
Birchcliff Energy Ltd.	BIREF B	12.93	1.23	2,070	55	45	12.2	-	-	0.84	
Denbury Resources Inc.	DNR	19.13	1.31	9,920	6	94	8.1	-	-	0.81	
Petrohawk Energy Corporation	HK B	23.89	1.54	11,260	76	24	6.7	-	-	0.79	
Cimarex Energy Company	XEC CB	85.79	1.10	8,110	44	56	6.2	0.40	0.5	0.73	
Whiting Petroleum Corporation	WLL CB	54.78	1.25	8,050	11	89	6.0	-	-	0.66	
<i>Total or Median</i>				57,200			8.6			0.82	
Top Line Cash Payers											
Cross Timbers Royalty Trust	CRT	43.63	1.00	260	87	13		2.65	6.1	0.97	
Permian Basin RT	PBT	21.20	1.00	990	42	58		1.63	7.7	0.96	
Freehold Royalties Ltd.	FRHLF	20.57	1.07	1,280	18	82		1.72	8.3	0.94	
Sabine Royalty Trust	SBR	61.82	1.00	900	51	49		4.78	7.7	0.88	
Dorchester Minerals, L.P.	DMLP CB	26.38	1.00	810	61	39		1.75	6.6	0.88	
<i>Total or Median</i>				4,200					7.7	0.94	
Bottom Line Cash Payers											
Linn Energy, LLC	LINE	37.66	1.42	8,730	35	65	13.5	2.64	7.0	1.07	
Hugoton Royalty Trust	HGT B	22.17	1.00	890	88	13	12.9	1.50	6.8	1.01	
Vanguard Natural Resources, LLC	VNR	27.16	1.72	1,600	26	74	12.9	2.28	8.4	1.00	
Legacy Reserves L.P.	LGCY	27.56	1.45	1,740	19	81	10.7	2.12	7.7	0.99	
San Juan Basin Royalty Trust	SJT	23.82	1.00	1,110	100	-	12.7	1.56	6.6	0.95	
Encore Energy Partners, L.P.	ENP	20.65	1.32	1,240	17	83	10.4	1.96	9.5	0.92	
Enerplus Corporation	ERF B	30.40	1.28	7,000	33	67	8.6	2.21	7.3	0.86	
Mesa Royalty Trust	MTR	43.55	1.00	81	75	25	12.2	2.92	6.7	0.82	
<i>Total or Median</i>				22,400			12.5		7.1	0.97	
Composite											
<i>Enterprise Value Weighting</i>				83,800	43	57					0.84
<i>Equal Weighting</i>					48	52					0.89
<i>Equal Weighted Buys</i>					53	47					0.83

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 June 30, 2012. Enterprise Value = Market Cap and Debt.



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Table ISC-2								
McDep Income and Small Cap Energy Portfolio								
Net Present Value and McDep Ratio								
			Price (\$/sh)	Shares	Market Cap (\$mm)	Net Present Value (\$/un)	Debt/ Present Value	McDep Ratio
	Symbol/ Rating		23-Jun 2011	(mm)				
Small Cap Independent Producers								
Peyto Exploration and Development Cor	PEYUF		21.82	132.7	2,900	24.00	0.17	0.93
Range Resources	RRC	B	52.76	158.0	8,340	60.00	0.16	0.90
Berry Petroleum Company	BRY		49.45	54.0	2,670	60.00	0.30	0.88
Birchcliff Energy Ltd.	BIREF	B	12.93	130.0	1,680	16.00	0.16	0.84
Denbury Resources Inc.	DNR		19.13	397.0	7,590	25.00	0.19	0.81
Petrohawk Energy Corporation	HK	B	23.89	305.0	7,290	34.00	0.28	0.79
Cimarex Energy Company	XEC	CB	85.79	86.1	7,390	120.00	0.06	0.73
Whiting Petroleum Corporation	WLL	CB	54.78	118.0	6,460	90.00	0.13	0.66
<i>Total or Median</i>					44,320		0.17	0.82
Top Line Cash Payers								
Cross Timbers Royalty Trust	CRT		43.63	6.0	260	45.00	-	0.97
Permian Basin RT	PBT		21.20	46.6	990	22.00	-	0.96
Freehold Royalties Ltd.	FRHLF		20.57	58.4	1,200	22.00	0.06	0.94
Sabine Royalty Trust	SBR		61.82	14.6	900	70.00	-	0.88
Dorchester Minerals, L.P.	DMLP	CB	26.38	30.7	810	30.00	-	0.88
<i>Total or Median</i>					4,160			0.94
Bottom Line Cash Payers								
Linn Energy, LLC	LINE		37.66	163.0	6,140	34.00	0.32	1.07
Hugoton RoyaltyTrust	HGT	B	22.17	40.0	890	22.00	-	1.01
Vanguard Natural Resources, LLC	VNR		27.16	34.2	930	27.00	0.42	1.00
Legacy Reserves L.P.	LGCY		27.56	43.5	1,200	28.00	0.31	0.99
San Juan Basin Royalty Trust	SJT		23.82	46.6	1,110	25.00	-	0.95
Encore Energy Partners, L.P.	ENP		20.65	45.5	940	23.00	0.22	0.92
Enerplus Corporation	ERF	B	30.40	179.5	5,460	37.00	0.19	0.86
Mesa RoyaltyTrust	MTR		43.55	1.9	81	53.00	-	0.82
<i>Total or Median</i>					16,750			0.97
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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Table ISC-3								
McDep Income and Small Cap Energy Portfolio								
Value Multiples - Rank by EV/Ebitda								
			Price (\$/sh)	Revenue	Dist/ Equity	Adjstd Resrvs/ Prod	PV/ Ebitda	EV/ Ebitda
	Symbol/ Rating		23-Jun 2011	Royalty (%)	Ebitda	NTM	NTM	NTM
Small Cap Independent Producers								
	RRC	B	52.76		-	16.1	15.7	14.1
	BIREF	B	12.93		-	19.7	14.6	12.2
	PEYUF		21.82		0.38	14.9	12.3	11.3
	BRY		49.45		-	12.0	10.4	9.1
	DNR		19.13		-	13.6	10.0	8.1
	HK	B	23.89		-	5.6	8.6	6.7
	XEC	CB	85.79		-	7.0	8.4	6.2
	WLL	CB	54.78		-	9.0	9.1	6.0
	<i>Median</i>					12.8	10.2	8.6
Top Line Cash Payers								
	CRT		43.63	80	0.96	15.1	16.4	15.9
	DMLP	CB	26.38	77	0.87	7.0	14.9	13.1
	SBR		61.82	100	1.00	6.8	14.7	12.9
	PBT		21.20	32	0.97	15.7	13.2	12.7
	FRHLF		20.57	71	0.85	6.3	10.9	10.3
	<i>Median</i>					7.0	14.7	12.9
Bottom Line Cash Payers								
	LINE		37.66		0.98	17.5	12.6	13.5
	VNR		27.16		1.09	13.2	12.9	12.9
	HGT	B	22.17		0.87	14.0	12.8	12.9
	SJT		23.82		0.84	9.2	13.4	12.7
	MTR		43.55		0.82	14.5	14.9	12.2
	LGCY		27.56		0.82	12.0	10.8	10.7
	ENP		20.65		0.96	13.1	11.3	10.4
	ERF	B	30.40		0.60	8.3	10.1	8.6
	<i>Median</i>					13.2	12.7	12.5
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, 2012; 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 ISC-4								
Oil and Gas Income and Small Cap Stocks								
Rank by Enterprise Value to 200 Day Average								
			Price (\$/sh)	Enterprise Value/				
	Symbol/ Rating		23-Jun 2011	52Wk High	52Wk Low	50 Day Avg.	200 Day Avg.	McDep Ratio
Small Cap Independent Producers								
	BIRCL	B	12.93	0.91	1.49	0.98	1.15	0.84
	PEYUF		21.82	0.98	1.52	1.04	1.14	0.93
	RRC	B	52.76	0.90	1.47	0.99	1.10	0.90
	HK	B	23.89	0.91	1.35	0.97	1.10	0.79
	BRY		49.45	0.95	1.50	1.01	1.09	0.88
	DNR		19.13	0.78	1.26	0.93	0.97	0.81
	XEC	CB	85.79	0.75	1.32	0.90	0.94	0.73
	WLL	CB	54.78	0.76	1.36	0.88	0.94	0.66
	<i>Median</i>			<i>0.91</i>	<i>1.41</i>	<i>0.97</i>	<i>1.09</i>	<i>0.82</i>
Top Line Cash Payers								
	CRT		43.63	0.90	1.32	1.03	1.04	0.97
	SBR		61.82	0.88	1.34	0.94	1.02	0.88
	FRHLF		20.57	0.85	1.38	0.93	1.00	0.94
	PBT		21.20	0.89	1.25	1.01	1.00	0.96
	DMLP	CB	26.38	0.88	1.11	0.96	0.97	0.88
	<i>Median</i>			<i>0.88</i>	<i>1.32</i>	<i>0.96</i>	<i>1.00</i>	<i>0.94</i>
Bottom Line Cash Payers								
	HGT	B	22.17	0.90	1.23	0.98	1.04	1.01
	LINE		37.66	0.94	1.29	0.99	1.02	1.07
	ERF	B	30.40	0.93	1.32	0.98	1.02	0.86
	LGCY		27.56	0.87	1.19	0.93	0.98	0.99
	SJT		23.82	0.85	1.14	0.99	0.97	0.95
	ENP		20.65	0.85	1.17	0.94	0.97	0.92
	VNR		27.16	0.88	1.21	0.95	0.97	1.00
	MTR		43.55	0.85	1.09	0.96	0.92	0.82
	<i>Median</i>			<i>0.87</i>	<i>1.20</i>	<i>0.97</i>	<i>0.97</i>	<i>0.97</i>

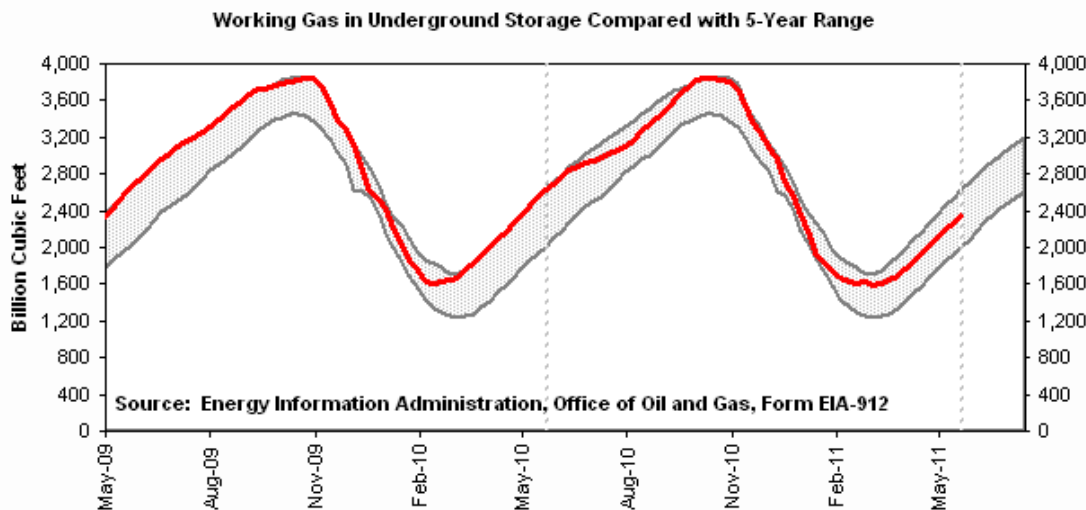
CB=Contrarian Buy, Stock Price apparently in downtrend compared to 200-day average.



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