



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

February 10, 2012

## **Bakken and Canadian Crude Oil Backup Expect Future Reversal of Surprise Price Impact**

### **Summary and Recommendation**

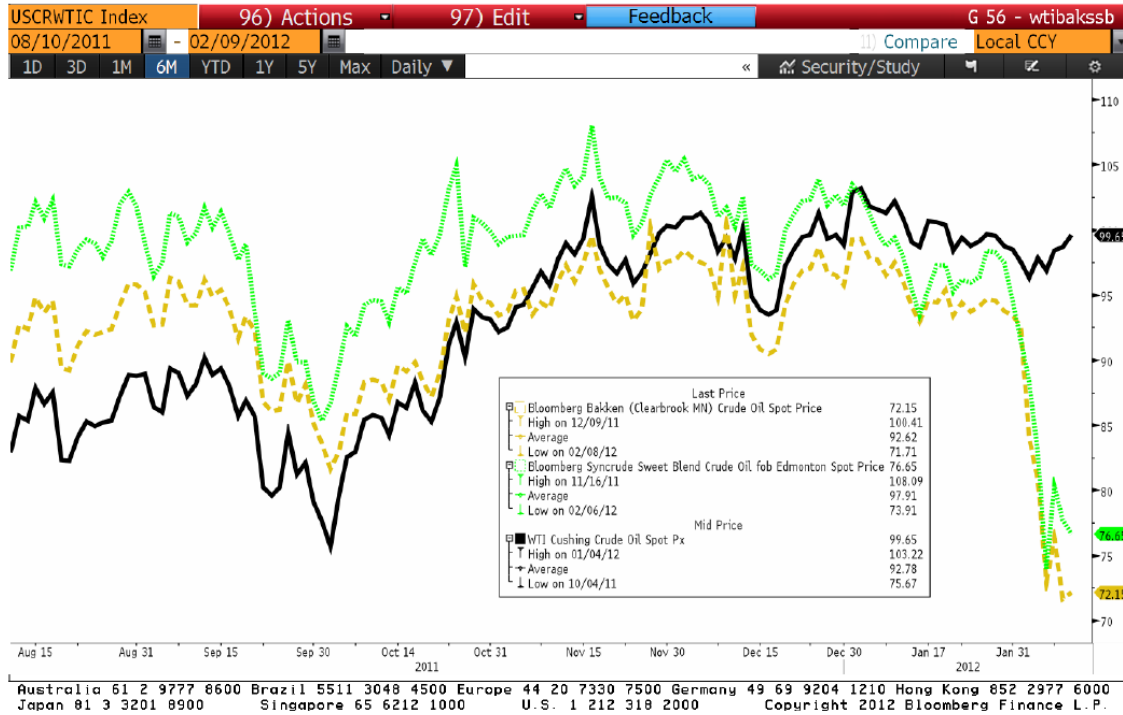
Oil producers in North Dakota and Western Canada may be foregoing near-term profit as the spot price for Bakken Crude Oil at the Clearbrook, Minnesota pipeline hub has fallen \$24 a barrel from \$96 at the end of January to \$72 on February 9 (see chart derived from *Bloomberg* on page 2). The shortage of transportation capacity has worked its way back to Edmonton, Alberta where the price of Syncrude Sweet Blend, high quality light oil like Bakken, has fallen \$22 a barrel from \$99 at the end of January to \$77. Income and Small Cap Buy recommendations that could be adversely affected are **Whiting Petroleum (WLL)**, which gets half of its production from North Dakota and **Enerplus (ERF)**, which looks to the Bakken for a third of cash flow and Canadian oil for another third. Covered separately in *Meter Reader*, large cap Buy recommendation **Canadian Oil Sands (COSWF)** could be adversely affected as it produces Syncrude Sweet Blend exclusively. Other large cap Canadian Buys **Imperial Oil (IMO)**, **Suncor (SU)** and **Cenovus (CVE)** may be less affected because their refining operations neutralize changes in crude oil price independent of product price. Large cap Buy **EOG Resources (EOG)**, deriving a quarter of cash flow from the Bakken, may be less affected by the pipeline price because it depends more on rail transportation. Most remaining oil producer Buys may benefit positively to the extent the restriction of Bakken and Canadian supply raises global oil price.

Surprising price changes are a real-time indicator that regional supply and demand has gotten out of balance compared to global conditions. On the supply side, North Dakota oil production has been expanding rapidly, now exceeding a half million barrels daily and propelling the state to the country's fourth largest producer. On the demand side, there may be some refineries that are shut down for maintenance during the low seasonal period for motor fuel. Beyond the seasonal effect, gasoline demand at 8 million barrels daily is down by a surprising 6% in recent weeks compared to a year ago (see chart [U.S. Gasoline Demand](#) from *Platts* on page 2).

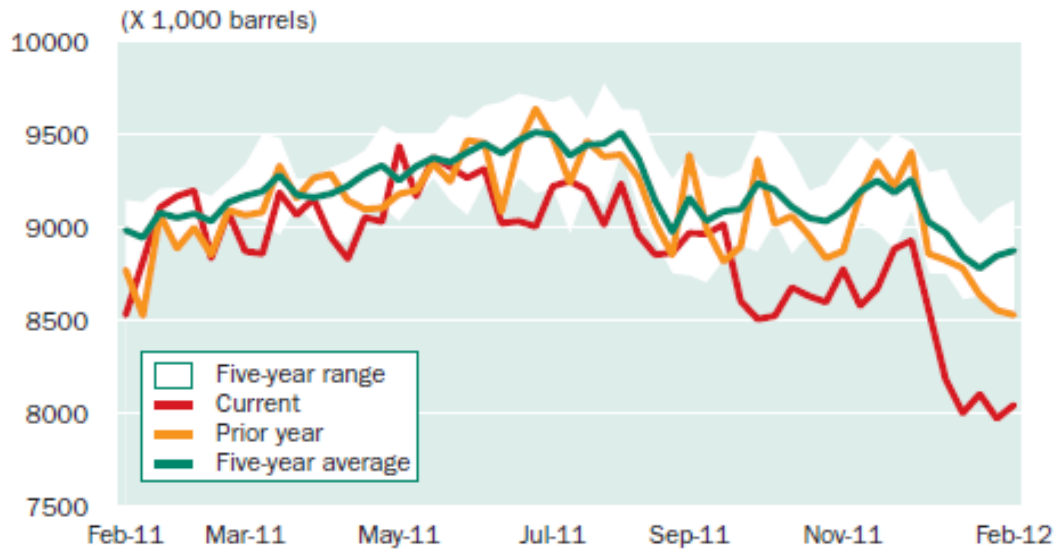
Transportation problems get worked out in weeks or months, but may impact first quarter results. Meanwhile, the Bakken backup makes it all the more necessary that Canada diversify its oil export options to realize full value for its resource and not depend so much on the Mid-Continent U.S. market. Moreover, U.S. oil demand may be stagnant, but global demand continues to grow as consumers in developing countries catch up to energy consumption in the developed world.

Finally, low McDep Ratios of 0.66 for WLL and 0.73 for ERF point to long-term opportunity. The two are among our four small cap independent producer Buys and three income Buys at McDep Ratios ranging from 0.65 to 0.92 (see Tables ISC-1 to ISC-3). Four of seven Buys are out of favor as flagged by stock price below 200-day average (see Table ISC-4).

Kurt H. Wulff, CFA



## US Gasoline Demand



Data Source: US Energy Information Administration



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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		9-Feb	Market	Value	Nat	Oil	Ebitda	NTM	Yield	McDep	
CB (see below)		2012	Cap	(\$mm)	Gas		NTM	(\$/un)	(%)	Ratio	
<b>Small Cap Independent Producers</b>											
Range Resources	RRC	B	63.35	1.22	12,270	66	34	16.3	0.16	0.3	0.92
PDC Energy	PETD		34.12	1.46	1,180	55	45	7.1	-	-	0.89
Birchcliff Energy Ltd.	BIREF	B	13.41	1.24	2,180	56	44	13.3	-	-	0.87
Peyto Exploration and Development	PEYUF		18.88	1.22	3,060	75	25	10.3	0.72	3.8	0.82
Berry Petroleum Company	BRY		50.50	1.52	4,200	17	83	6.6	0.32	0.6	0.80
Denbury Resources Inc.	DNR		19.25	1.32	10,250	4	96	6.5	-	-	0.74
Whiting Petroleum Corporation	WLL	B	53.09	1.25	7,930	9	91	4.9	-	-	0.66
Cimarex Energy Company	XEC	CB	67.99	1.13	6,620	41	59	5.3	0.40	0.6	0.65
<i>Total or Median</i>					47,700			6.8			0.81
<b>Top Line Cash Payers</b>											
Permian Basin RT	PBT		20.41	1.00	950	37	63		1.49	7.3	1.02
Cross Timbers Royalty Trust	CRT		44.37	1.00	270	70	30		2.55	5.8	1.01
Freehold Royalties Ltd.	FRHLF		21.00	1.06	1,300	14	86		1.69	8.1	1.00
Sabine Royalty Trust	SBR		62.22	1.00	910	55	45		3.98	6.4	0.96
Dorchester Minerals, L.P.	DMLP	CB	22.83	1.00	700	57	43		1.74	7.6	0.85
<i>Total or Median</i>					4,100					7.3	1.00
<b>Bottom Line Cash Payers</b>											
Linn Energy, LLC	LINE		35.92	1.47	9,290	29	71	13.4	2.76	7.7	1.13
Vanguard Natural Resources, LLC	VNR		26.87	1.56	2,040	26	74	10.1	2.31	8.6	1.05
Legacy Reserves L.P.	LGCY		29.15	1.40	1,780	19	81	8.7	2.18	7.5	0.98
Enduro Royalty Trust (40%)	NDRO		20.13	1.00	270	45	55	7.2	1.68	8.4	0.96
Mesa Royalty Trust	MTR		42.70	1.00	80	75	25	12.0	3.15	7.4	0.89
Hugoton Royalty Trust	HGT		15.01	1.00	600	87	13	14.6	0.89	5.9	0.88
San Juan Basin Royalty Trust	SJT	CB	18.50	1.00	860	100	-	12.8	1.11	6.0	0.88
Enerplus Corporation	ERF	CB	23.60	1.21	5,600	26	74	6.7	2.17	9.2	0.73
<i>Total or Median</i>					20,500			11.0		7.6	0.93
<b>Composite</b>											
<i>Enterprise Value Weighting</i>					72,300	35	65				0.82
<i>Equal Weighting</i>						46	54				0.89
<i>Equal Weighted Buys</i>						42	58				0.79

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 \$6 a million btu for natural gas.

Dist. = Income distribution. NTM = Next Twelve Months Ended December 31, 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

			<i>Price</i>			<i>Net</i>		
			<i>(\$/sh)</i>		<i>Market</i>	<i>Present</i>	<i>Debt/</i>	
	<i>Symbol/</i>		<i>9-Feb</i>	<i>Shares</i>	<i>Cap</i>	<i>Value</i>	<i>Present</i>	<i>McDep</i>
	<i>Rating</i>		<i>2012</i>	<i>(mm)</i>	<i>(\$mm)</i>	<i>(\$/un)</i>	<i>Value</i>	<i>Ratio</i>
<b>Small Cap Independent Producers</b>								
Range Resources	RRC	B	63.35	159.0	10,070	70.00	0.17	0.92
PDC Energy	PETD		34.12	23.8	810	40.00	0.28	0.89
Birchcliff Energy Ltd.	BIREF	B	13.41	131.0	1,760	16.00	0.17	0.87
Peyto Exploration and Development Cor	PEYUF		18.88	133.1	2,510	24.00	0.15	0.82
Berry Petroleum Company	BRY		50.50	54.7	2,760	70.00	0.27	0.80
Denbury Resources Inc.	DNR		19.25	403.0	7,760	28.00	0.18	0.74
Whiting Petroleum Corporation	WLL	B	53.09	119.0	6,320	88.00	0.13	0.66
Cimarex Energy Company	XEC	CB	67.99	86.2	5,860	110.00	0.07	0.65
<i>Total or Median</i>					<i>37,850</i>		<i>0.17</i>	<i>0.81</i>
<b>Top Line Cash Payers</b>								
Permian Basin RT	PBT		20.41	46.6	950	20.00	-	1.02
Cross Timbers Royalty Trust	CRT		44.37	6.0	270	44.00	-	1.01
Freehold Royalties Ltd.	FRHLF		21.00	58.8	1,240	21.00	0.05	1.00
Sabine Royalty Trust	SBR		62.22	14.6	910	65.00	-	0.96
Dorchester Minerals, L.P.	DMLP	CB	22.83	30.7	700	27.00	-	0.85
<i>Total or Median</i>					<i>4,070</i>			<i>1.00</i>
<b>Bottom Line Cash Payers</b>								
Linn Energy, LLC	LINE		35.92	176.0	6,320	30.00	0.36	1.13
Vanguard Natural Resources, LLC	VNR		26.87	48.8	1,310	25.00	0.37	1.05
Legacy Reserves L.P.	LGCY		29.15	43.6	1,270	30.00	0.28	0.98
Enduro Royalty Trust (40%)	NDRO		20.13	13.2	270	21.00	-	0.96
Mesa Royalty Trust	MTR		42.70	1.9	80	48.00	-	0.89
Hugoton Royalty Trust	HGT		15.01	40.0	600	17.00	-	0.88
San Juan Basin Royalty Trust	SJT	CB	18.50	46.6	860	21.00	-	0.88
Enerplus Corporation	ERF	CB	23.60	196.0	4,630	34.00	0.13	0.73
<i>Total or Median</i>					<i>15,340</i>			<i>0.93</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 \$6 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		9-Feb 2012	Royalty (%)	Ebitda	NTM	NTM	NTM
<b>Small Cap Independent Producers</b>								
Range Resources	RRC	B	63.35		-	15.2	17.8	16.3
Birchcliff Energy Ltd.	BIREF	B	13.41		-	19.3	15.4	13.3
Peyto Exploration and Development Corp	PEYUF		18.88		0.38	12.9	12.6	10.3
PDC Energy	PETD		34.12		-	8.2	8.0	7.1
Berry Petroleum Company	BRYP		50.50		-	11.4	8.3	6.6
Denbury Resources Inc.	DNR		19.25		-	13.5	8.7	6.5
Cimarex Energy Company	XEC	CB	67.99		-	6.9	8.2	5.3
Whiting Petroleum Corporation	WLL	B	53.09		-	10.2	7.5	4.9
	<i>Median</i>					12.1	8.5	6.8
<b>Top Line Cash Payers</b>								
Cross Timbers Royalty Trust	CRT		44.37	80	0.96	14.4	16.6	16.7
Sabine Royalty Trust	SBR		62.22	100	1.00	7.3	16.3	15.6
Permian Basin RT	PBT		20.41	32	0.98	17.2	13.2	13.4
Dorchester Minerals, L.P.	DMLP	CB	22.83	77	0.84	6.1	13.0	11.0
Freehold Royalties Ltd.	FRHLF		21.00	71	0.87	6.7	10.8	10.8
	<i>Median</i>					7.3	13.2	13.4
<b>Bottom Line Cash Payers</b>								
Hugoton Royalty Trust	HGT		15.01		0.87	14.0	16.5	14.6
Linn Energy, LLC	LINE		35.92		1.09	16.2	11.9	13.4
San Juan Basin Royalty Trust	SJT	CB	18.50		0.77	8.5	14.5	12.8
Mesa Royalty Trust	MTR		42.70		0.88	13.9	13.4	12.0
Vanguard Natural Resources, LLC	VNR		26.87		0.89	8.7	9.6	10.1
Legacy Reserves L.P.	LGCY		29.15		0.65	9.9	8.9	8.7
Enduro Royalty Trust (40%)	NDRO		20.13		0.60	5.7	7.5	7.2
Enerplus Corporation	ERF	CB	23.60		0.58	8.1	9.1	6.7
	<i>Median</i>					9.3	10.8	11.0
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, 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		9-Feb 2012	52Wk High	52Wk Low	50 Day Avg.	200 Day Avg.	McDep Ratio	
<b>Small Cap Independent Producers</b>									
	Denbury Resources Inc.	DNR	19.25	0.79	1.55	1.10	1.09	0.74	
	PDC Energy	PETD	34.12	0.76	1.61	1.01	1.08	0.89	
	Berry Petroleum Company	BRY	50.50	0.88	1.35	1.11	1.06	0.80	
	Range Resources	RRC	B	63.35	0.85	1.29	1.03	1.03	0.92
	Whiting Petroleum Corporation	WLL	B	53.09	0.75	1.57	1.07	1.03	0.66
	Birchcliff Energy Ltd.	BIREF	B	13.41	0.89	1.27	1.02	1.01	0.87
	Cimarex Energy Company	XEC	CB	67.99	0.61	1.29	1.08	0.94	0.65
	Peyto Exploration and Development C	PEYUF		18.88	0.77	1.06	0.87	0.89	0.82
	<i>Median</i>			<i>0.78</i>	<i>1.32</i>	<i>1.05</i>	<i>1.03</i>	<i>0.81</i>	
<b>Top Line Cash Payers</b>									
	Freehold Royalties Ltd.	FRHLF		21.00	0.87	1.50	1.07	1.07	1.00
	Cross Timbers Royalty Trust	CRT		44.37	0.87	1.17	0.94	0.98	1.01
	Permian Basin RT	PBT		20.41	0.87	1.13	1.01	0.98	1.02
	Sabine Royalty Trust	SBR		62.22	0.88	1.31	0.98	0.97	0.96
	Dorchester Minerals, L.P.	DMLP	CB	22.83	0.76	1.10	1.01	0.92	0.85
	<i>Median</i>			<i>0.87</i>	<i>1.17</i>	<i>1.01</i>	<i>0.98</i>	<i>1.00</i>	
<b>Bottom Line Cash Payers</b>									
	Legacy Reserves L.P.	LGCY		29.15	0.90	1.21	1.03	1.02	0.98
	Mesa RoyaltyTrust	MTR		42.70	0.86	1.18	1.04	0.98	0.89
	Vanguard Natural Resources, LLC	VNR		26.87	0.86	1.14	0.99	0.97	1.05
	Linn Energy, LLC	LINE		35.92	0.91	1.10	0.98	0.97	1.13
	Enerplus Corporation	ERF	CB	23.60	0.75	1.07	0.96	0.87	0.73
	San Juan Basin Royalty Trust	SJT	CB	18.50	0.66	1.04	0.85	0.79	0.88
	Hugoton RoyaltyTrust	HGT		15.01	0.61	1.09	0.84	0.71	0.88
	<i>Median</i>			<i>0.86</i>	<i>1.10</i>	<i>0.98</i>	<i>0.97</i>	<i>0.89</i>	

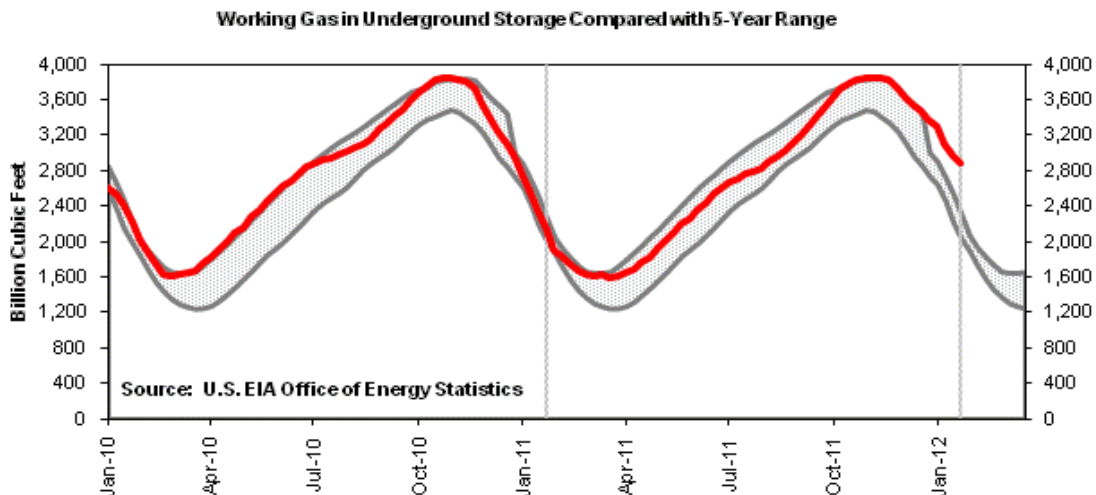
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