



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

December 18, 2009

Top Line Cash Payers

Raise CRT NPV 21%; Lower SBR NPV 18%

Summary and Recommendation

Top Line Cash Payers are a doubly conservative way to seek high income in an oil and gas uptrend. The five stocks in our group have low to slim levels of debt, and the top line arrangement means none or reduced exposure to operating and capital costs. The oil price uptrend has been proceeding most of the year. The natural gas outlook is getting new life from a fresh burst of strong winter demand and a rousing endorsement of long-term prospects from ExxonMobil's proposed acquisition of XTO Energy. Refining our analysis of Top Line Cash payers, we raise our estimate of Net Present Value (NPV) for **Cross Timbers Royalty Trust (CRT)** to \$34 a unit from \$28, prompted by higher than expected natural gas volume since April 2009. At the same time we lower our estimate of NPV for **Sabine Royalty Trust (SBR)** to \$45 a unit from \$55, prompted by lower than expected oil and gas volume in recent months. Those changes reverse a decrease in NPV for CRT and an increase for SBR that we made in the springtime (see charts Debt-Adjusted Volume per Unit and Net Present Value per Unit). Our current buy recommendation among the five stocks is **Dorchester Minerals (DMLP)**. Any of the four unrated stocks ranging in McDep Ratio from 0.75 to 1.03 could be suitable in an income and small cap segment of an energy portfolio (see Table 1).

While we expect lower McDep Ratio stocks to outperform higher McDep Ratio stocks, differences in structure may be more dominant at times. CRT and DMLP are more concentrated on natural gas while **Freehold Royalty Trust (FRHLF)**, SBR and **Permian Basin Royalty Trust (PBT)** are more concentrated on oil (see Table 1 again).

Only DMLP and FRHLF have debt, but the levels are modest (see Table 2). Selecting stocks by the McDep Ratio neutralizes the direct effect of financial leverage.

While the structure of revenue royalty defines a top line cash payer, the degree of top line participation ranges from 32% for PBT to 100% for SBR (see Table 3). "Royalty" traditionally refers to an arrangement that pays a fixed percent of revenue from oil and gas production to the royalty owner. We call that top line cash to differentiate from arrangements that may be a percentage of profits. Full concentration on top line cash helps make SBR a less volatile stock than PBT, for example

Revised estimates of present value result in a more logical alignment of reserve life with unlevered cash flow multiple for SBR and CRT (see *Adjusted Reserves/Production* and *PV/Ebitda* in Table 3). Recent misalignment of those multiples helped signal the need to reconsider estimated NPV.

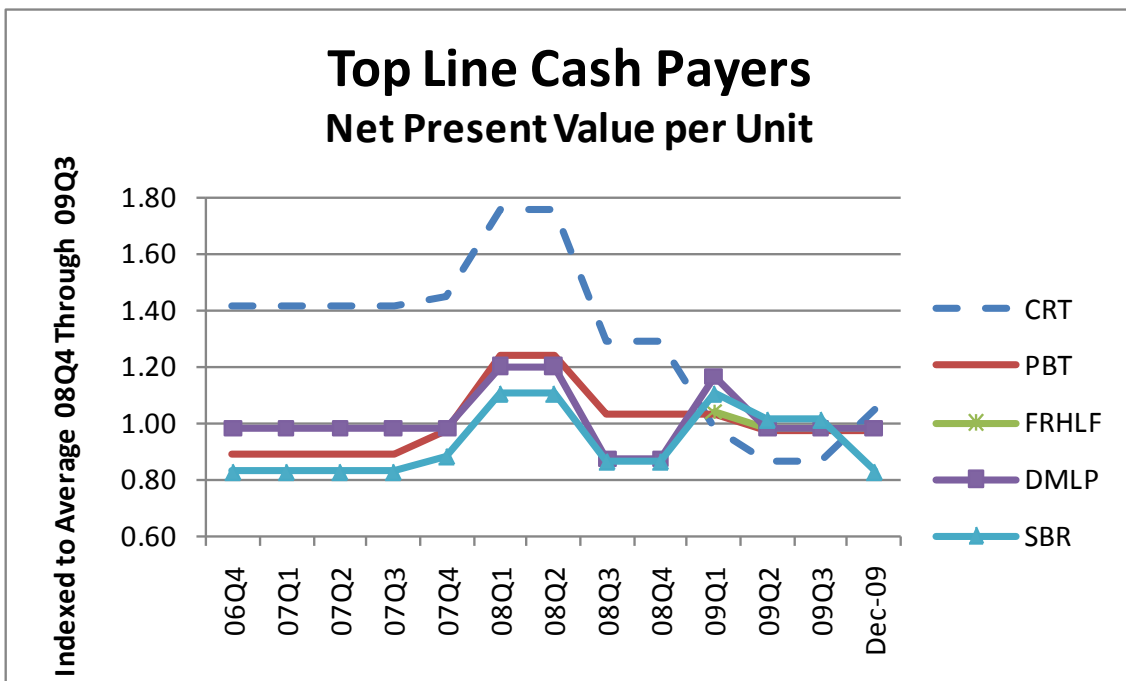
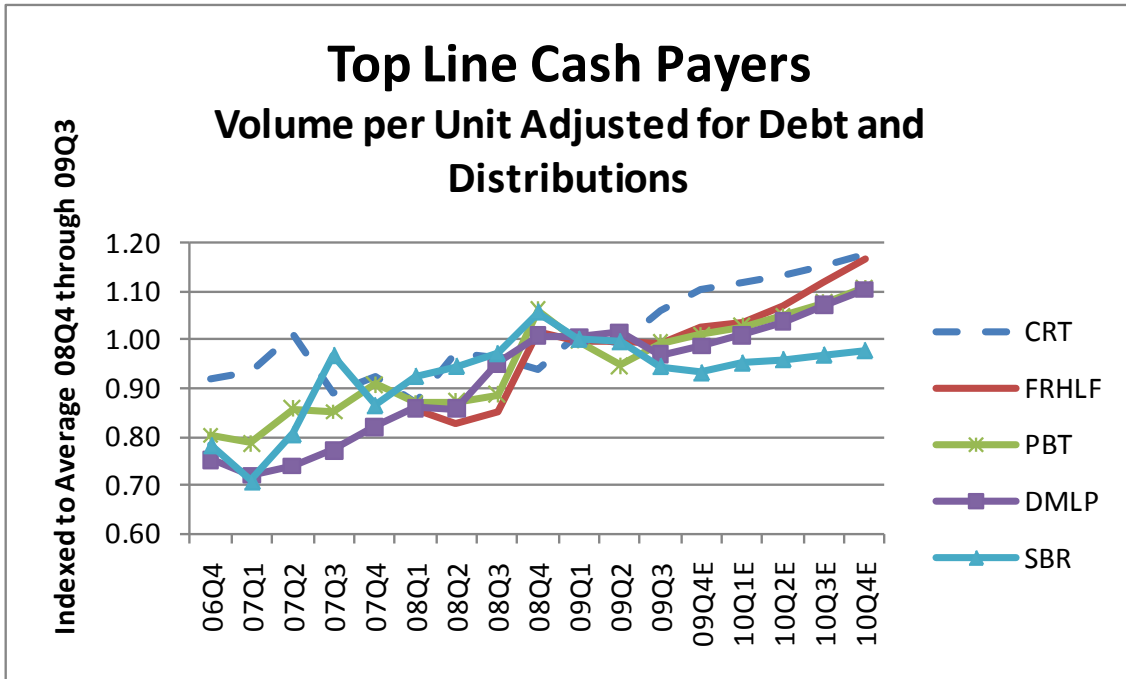
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Table 1										
McDep Income and Small Cap Energy Portfolio										
Debt, Business Segments and Income Yield										
						Present Value by Segment (%)				
	Symbol/Rating	Price (US\$/sh)	EV/ Market	Enterprise Value (\$mm)	NAmer. Natural Gas	Oil Prod'n	Dist. NTM (\$/un)	Dist. Yield (%)	McDep Ratio	
	B = Buy H = Hold	17-Dec 2009	Cap							
Canadian Income Trusts (US\$)										
Peyto Energy Trust	PEYUF	12.48	1.27	1,820	72	28	1.36	10.9	0.97	
Penn West Energy Trust	PWE	17.39	1.56	11,400	22	78	1.70	9.8	0.94	
Pengrowth Energy Trust	PGH	9.55	1.54	4,300	35	65	0.79	8.3	0.86	
Enerplus Resources Fund	ERF	22.25	1.23	4,600	42	58	2.04	9.2	0.78	
Canadian Oil Sands Trust	COSWF B	27.52	1.11	14,700		100	1.75	6.3	0.68	
<i>Total or Median</i>				36,800						0.86
Small Cap Independent Producers										
Cimarex Energy Company	XEC B	51.24	1.19	5,000	67	33	0.24	0.5	1.02	
Encore Acquisition Company	EAC	47.22	1.66	4,100	22	78	-	-	0.97	
Berry Petroleum Company	BRY	29.12	1.85	2,420	31	69	0.30	1.0	0.90	
Birchcliff Energy Ltd. (US\$)	BIREF	7.80	1.20	1,230	64	36	-	-	0.88	
<i>Total or Median</i>				12,800						0.93
Top Line Cash Payers										
Cross Timbers Royalty Trust	CRT	35.23	1.00	210	71	29	2.50	7.1	1.03	
Sabine Royalty Trust	SBR	41.25	1.00	600	39	61	2.78	6.7	0.92	
Freehold Royalty Trust (US\$)	FRHLF	14.15	1.21	850	25	75	1.62	11.5	0.86	
Dorchester Minerals, L.P.	DMLP B	20.99	1.03	640	67	33	1.66	7.9	0.78	
Permian Basin RT	PBT	13.51	1.00	630	27	73	1.01	7.5	0.75	
<i>Total or Median</i>				2,900						0.86
Bottom Line Cash Payers										
Linn Energy, LLC	LINE	26.35	1.54	4,610	36	64	2.52	9.6	1.39	
Encore Energy Partners, L.P. (52%)	ENP	19.69	1.29	590	24	76	2.15	10.9	1.12	
San Juan Basin Royalty Trust	SJT B	17.52	1.00	820	100	-	1.55	8.9	0.83	
Mesa Royalty Trust	MTR	36.20	1.00	67	75	25	2.44	6.7	0.75	
Hugoton Royalty Trust	HGT B	16.58	1.00	660	89	11	1.24	7.5	0.72	
<i>Total or Median</i>				6,700						0.83
Composite (excl COSWF)										
<i>Enterprise Value Weighting</i>				44,500	40	60				0.94
<i>Equal Weighting</i>					51	49				0.92
<i>Equal Weighted Buys</i>					55	45				0.86
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 December 31, 2010. Enterprise Value = Market Cap and Debt.										



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Table 2								
Oil and Gas Income and Small Cap Stocks								
Net Present Value and McDep Ratio								
			Price (\$/sh)		Market Cap (\$mm)	Net Present Value (\$/un)	Debt/ Present Value	McDep Ratio
	Symbol/ Rating	17-Dec 2009	Shares (mm)					
Canadian Income Trusts (US\$)								
	PEYUF		114.9		1,430	13.00	0.21	0.97
	PWE		420.0		7,300	19.00	0.34	0.94
	PGH		290.0		2,770	12.00	0.30	0.86
	ERF		169.0		3,760	30.00	0.14	0.78
	COSWF	B	27.52	484.0	13,320	42.00	0.06	0.68
	<i>Total or Median</i>				28,600		0.21	0.86
Small Cap Independent Producers								
	XEC	B	51.24	82.2	4,210	50.00	0.16	1.02
	EAC		47.22	52.3	2,470	50.00	0.38	0.97
	BRY		29.12	44.9	1,310	35.00	0.41	0.90
	BIREF		7.80	132.5	1,030	9.00	0.15	0.88
	<i>Total or Median</i>				9,020		0.27	0.93
Top Line Cash Payers								
	CRT		35.23	6.0	210	34.00	-	1.03
	SBR		41.25	14.6	600	45.00	-	0.92
	FRHLF		14.15	49.6	700	17.00	0.15	0.86
	DMLP	B	20.99	29.8	630	27.00	0.02	0.78
	PBT		13.51	46.6	630	18.00	-	0.75
	<i>Total or Median</i>				2,770			0.86
Bottom Line Cash Payers								
	LINE		26.35	114.0	3,000	15.00	0.48	1.39
	ENP		19.69	23.2	460	17.00	0.25	1.12
	SJT	B	17.52	46.6	820	21.00	-	0.83
	MTR		36.20	1.9	67	48.00	-	0.75
	HGT	B	16.58	40.0	660	23.00	-	0.72
	<i>Total or Median</i>				5,010			0.83
B = Buy, Hold ratings discontinued October 23, 2009								
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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Table 3								
Oil and Gas Income and Small Cap Stocks								
Value Multiples - Rank by EV/Ebitda								
			Price (\$/sh)	Revenue	Dist/ Equity	Adjstd Resrvs/ Prod	PV/ Ebitda	EV/ Ebitda
	Symbol/ Rating		17-Dec 2009	Royalty (%)	Ebitda	NTM	NTM	NTM
Canadian Income Trusts (US\$)								
	PEYUF		12.48		1.32	18.2	12.7	12.2
	COSWF	B	27.52		0.62	23.1	15.0	10.1
	PWE		17.39		0.82	8.3	9.2	8.7
	ERF		22.25		0.65	9.8	9.5	7.4
	PGH		9.55		0.55	8.3	8.4	7.2
	<i>Median</i>					9.8	9.5	8.7
Small Cap Independent Producers								
	BIREF		7.80		-	10.6	15.8	13.9
	EAC		47.22		-	11.7	8.4	8.1
	BRY		29.12		-	12.4	8.3	7.5
	XEC	B	51.24		-	7.6	5.3	5.5
	<i>Median</i>					11.2	8.3	7.8
Top Line Cash Payers								
	SBR		41.25	100	1.00	12.0	16.2	14.8
	CRT		35.23	84	0.95	12.3	12.9	13.3
	PBT		13.51	32	0.87	11.5	15.5	11.6
	DMLP	B	20.99	64	0.91	7.8	14.7	11.5
	FRHLF		14.15	71	0.95	6.8	9.9	8.5
	<i>Median</i>					11.5	14.7	11.6
Bottom Line Cash Payers								
	LINE		26.35		2.33	18.3	13.9	19.3
	MTR		36.20		0.88	9.2	17.3	13.0
	ENP		19.69		1.19	13.2	9.4	10.5
	HGT	B	16.58		0.71	13.4	13.2	9.5
	SJT	B	17.52		0.77	9.2	10.4	8.7
	<i>Median</i>					13.2	13.2	10.5
EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended December 31, 2010; 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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Research Methodology/Ratings Description: McDep LLC is an independent research originator focused on oil and gas stocks exclusively. The firm applies the thirty years of experience of its analyst to estimate a present value of the oil and gas resources and other businesses of covered companies. That value is compared with a company's stock market capitalization and debt. Stocks with low market cap and debt relative to present value tend to outperform stocks with high market cap and debt relative to present value. Buy recommendations are expected to deliver a total return better than 7% per year above inflation. Hold recommendations assume the attributes of the underlying business are reflected in the current price of the stock. Sell recommendations are expected to deliver a total return less than inflation.