

McDep Energy Income Producers

A Weekly Analysis of Royalty Trusts and Master Limited Partnerships

July 27, 2004

Rising Cream

Summary and Recommendation

As **San Juan Basin Royalty Trust (SJT)** has reached a McDep Ratio near 1.2, investors may wish to trim an overweighting that may have developed or slow the buildup to a normal position. Among the reasons that favor our continued buy recommendation are the natural gas outlook, an attractive 9.5% distribution for the next twelve months, absence of dilution from management compensation and better relative valuation than popular pipeline partnerships. Similar rising price in other U.S. Royalty Trusts, cream among income stocks, diminishes specific risk in SJT. Yet, much of the unexpected increase in SJT's latest monthly distribution declaration may not recur.

Natural Gas Forward/Futures Gap

Our forward oil price scenario (*Meter Reader*, July 13, 2004) also implies a gap between a natural gas forward scenario and six-year natural gas futures. Natural gas price depends on oil price in a fashion that reflects an increasing premium for environmental advantage. Our scenario for natural gas is our scenario for oil plus a 2% per year adjustment that raises the premium 20% in ten years.

Publicly traded in the commodity markets, futures contracts for delivery over the next six years continue in a steep uptrend. Whether the trend will slow for awhile we cannot know. Six-year futures for oil have moved from the low \$20s and are now in the low \$30s. At the same time, six-year futures for natural gas have moved from under \$4 to over \$5.

In our "moderate" scenario, oil would peak at \$50 in 2003 dollars in the year 2010. Converting oil to natural gas at an increasing premium, adjusting for inflation of 3% annually and cumulating six-year periods gives a six-year "forward" scenario. If the scenario were to materialize we would expect six-year futures to approach the six-year forward curve. As a result we see further upside for six-year futures and consequently present value estimates and ultimately stock prices (see chart).

Compensation Attracts Attention

XTO Energy (XTO), a producing company we continue to recommend, stirred investor's interest on July 20 with the disclosure that management compensation amounted to 28% of latest quarterly earnings. In a spirited defense on the quarterly call, the chairman suggested that other leading producers were paying similar amounts though

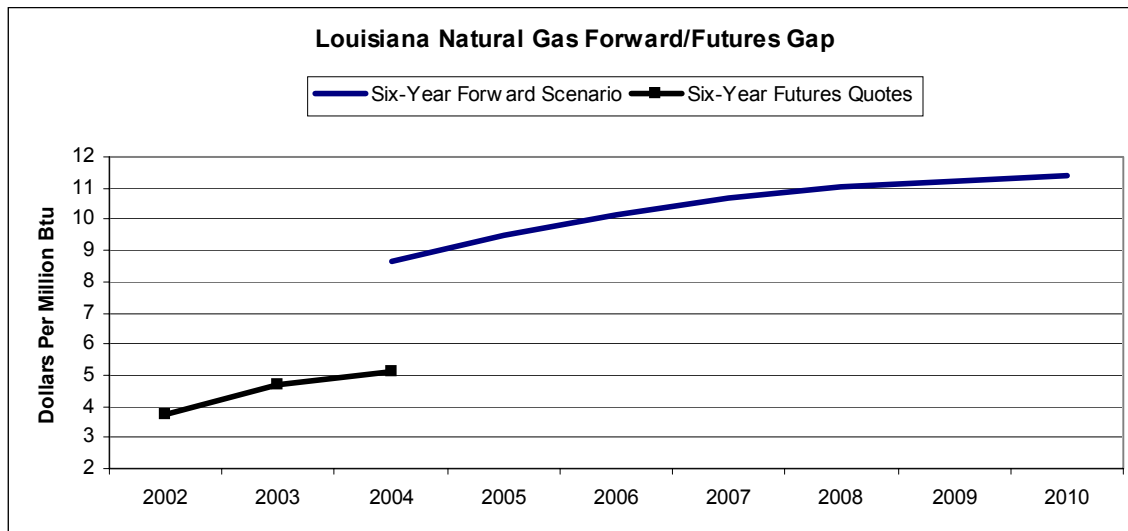
Historical independent energy investment analysis by Kurt Wulff doing business as McDep Associates is posted at www.mcdep.com. Analyses are prepared from sources and data believed to be reliable, but no representation is made as to their accuracy or completeness. Mr. Wulff is not paid by covered companies. Neither he nor his spouse trade a subject stock within a week before or after a change in rating. 1

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not reported as directly in earnings. We understand the goal at XTO is to pay management about 7% of incremental value that accrues. So far, investors and management have done well under the arrangement.



In any event management compensation does not dilute any perception of value in the U.S. royalty trusts in our coverage. In the case of SJT, an alert trustee, with her capable consultants and advisors, recovered past overcharges to the trust from the operator. The one-time recovery boosted the latest declared monthly distribution by 17%. The contrasting incidents remind us that when we do not fully anticipate a dilutive impact of management compensation, we understate the present value of U.S. royalty trusts compared to operating companies.

SJT Less Recognized Than Kinder Morgan

High compensation does not seem to be reflected in stock price for sell-recommended **Kinder Morgan Energy Partners (KMP)** and **Kinder Morgan Management (KMR)**. The general partner of KMP and KMR is not paid just 7% of incremental value, but more than 40% of total value. Alternatively the high stock price for the popular pipeline partnership may simply represent investors' desire for current income. Perhaps SJT is being revalued to a distribution yield basis approaching that of KMP and KMR. Presuming no change in the absolute distribution, stock price would have to go up for yield to go down. Considering that the current distribution yield for SJT is estimated at 9.5% for the next twelve months compared to KMP and KMR at 4.7% and 5.3%, SJT unit price could double for distribution yields to be comparable.

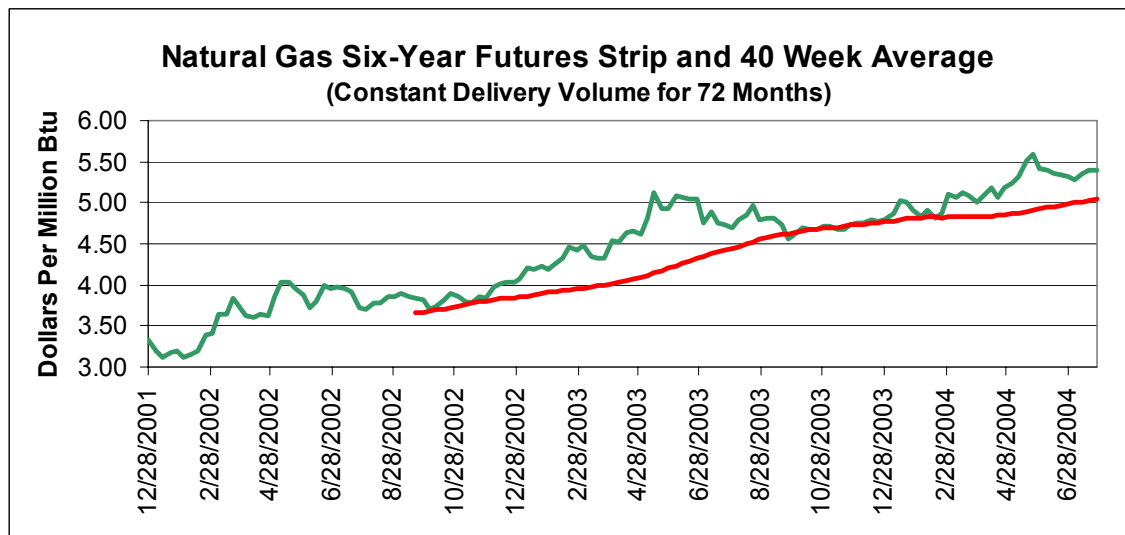
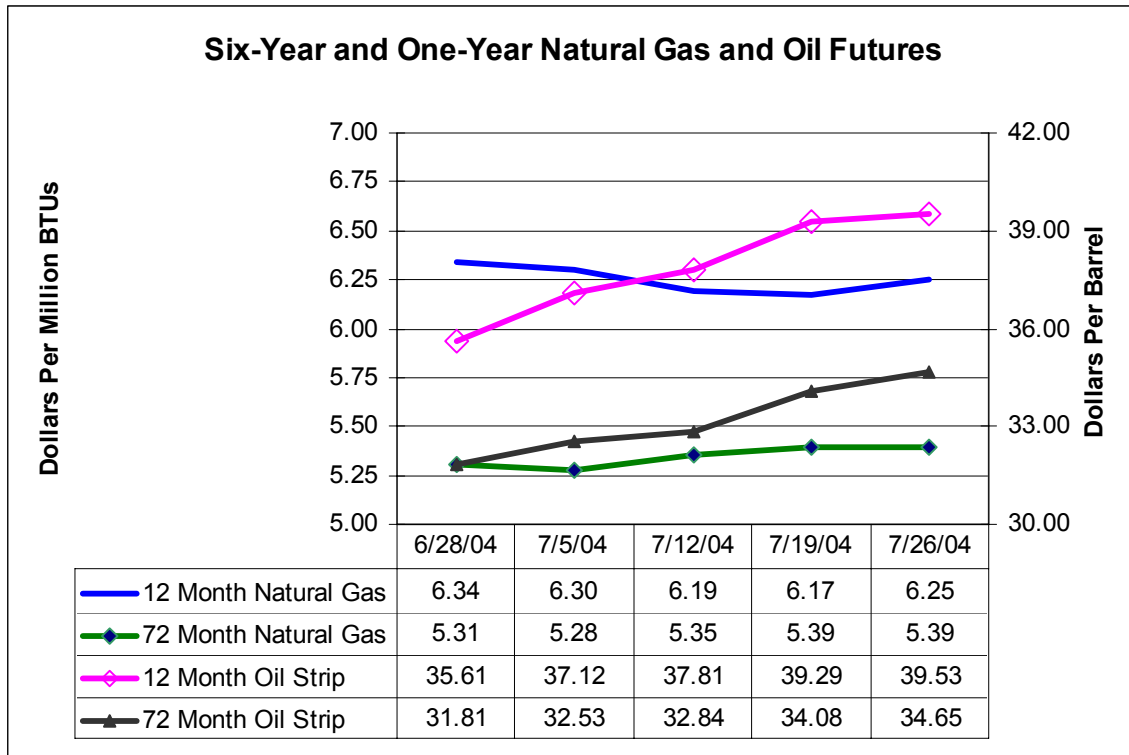
Kurt H. Wulff, CFA

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Rank by McDep Ratio: Market Cap and Debt to Present Value

	Symbol/ Rating	Price (\$/sh) 26-Jul 2004	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio
Master Limited Partnerships and Canadian Royalty Trusts							
Kinder Morgan Energy Partners, L.P.	KMP S2	43.69	145.0	6,340	15.00	0.49	1.98
Kinder Morgan Management, LLC	KMR S2	38.73	52.5	2,030	15.00	0.49	1.81
Provident Energy Trust	PVX	7.74	88.0	680	6.20	0.34	1.16
NAV Energy Trust (US\$)	NVG.UN	8.00	19.0	150	7.00	0.18	1.12
Dorchester Minerals, L.P.	DMLP	18.82	27.0	510	17.00	-	1.11
Pengrowth Energy Trust	PGH	14.59	125.0	1,820	14.00	0.14	1.04
Enerplus Resources Fund	ERF	28.92	90.4	2,610	28.00	0.13	1.03
PrimeWest Energy Trust	PWI	17.95	50.5	910	19.00	0.21	0.96
Canadian Oil Sands Trust (US\$)	COSWF B1	35.08	86.9	3,050	62.00	0.21	0.66
<i>Total or Median</i>				<i>18,100</i>		<i>0.21</i>	<i>1.11</i>
U.S. Royalty Trusts							
Sabine Royalty Trust	SBR	37.15	14.6	540	27.00	-	1.38
Permian Basin RT (41%)	PBT	10.58	19.1	200	7.70	-	1.37
San Juan Basin Royalty Trust	SJT B1	26.59	46.6	1,240	22.00	-	1.21
Hugoton RoyaltyTrust (46%)	HGT	24.38	18.4	450	22.00	-	1.11
Cross Timbers Royalty Trust	CRT	29.90	6.0	180	30.00	-	0.99
<i>Total or Median</i>				<i>2,600</i>		<i>-</i>	<i>1.21</i>

Buy/Sell rating after symbol: B1 - Buy full unlevered position, S2 - short quarter unlevered position
McDep Ratio = Market cap and Debt to present value of oil and gas and other businesses

Rank by EV/Ebitda: Enterprise Value to Earnings Before Interest, Tax, Deprec.

	Symbol/ Rating	Price (\$/sh) 26-Jul 2004	EV/ Sales NTM	EV/ Ebitda NTM	P/E NTM	Divd or Distrib NTM (%)	PV/ Ebitda NTM
Master Limited Partnerships and Canadian Royalty Trusts							
Kinder Morgan Energy Partners, L.P.	KMP S2	43.69	2.9	15.9	18	4.7	8.0
Kinder Morgan Management, LLC	KMR S2	38.73	2.6	14.5	16	5.3	8.0
Dorchester Minerals, L.P.	DMLP	18.82	9.3	10.1	19	9.9	9.1
Enerplus Resources Fund	ERF	28.92	4.8	6.9	14	11.0	6.7
Canadian Oil Sands Trust (US\$)	COSWF B1	35.08	3.6	5.9	7	4.3	9.0
Provident Energy Trust	PVX	7.74	4.5	5.7	19	14.1	4.9
Pengrowth Energy Trust	PGH	14.59	4.2	5.6	11	13.1	5.4
PrimeWest Energy Trust	PWI	17.95	3.9	5.4	12	13.9	5.6
NAV Energy Trust (US\$)	NVG.UN	8.00	2.6	4.3	11	17.1	3.9
<i>Median</i>			<i>3.9</i>	<i>5.9</i>	<i>14</i>	<i>11.0</i>	<i>6.7</i>
U.S. Royalty Trusts							
Sabine Royalty Trust	SBR	37.15	11.9	12.4	12	8.1	9.0
Cross Timbers Royalty Trust	CRT	29.90	8.2	11.2	11	8.7	11.2
Permian Basin RT (41%)	PBT	10.58	7.3	9.9	11	7.1	7.2
San Juan Basin Royalty Trust	SJT B1	26.59	7.6	9.2	10	9.5	7.6
Hugoton RoyaltyTrust (46%)	HGT	24.38	6.5	8.5	10	10.1	7.7
<i>Median</i>			<i>7.6</i>	<i>9.9</i>	<i>11</i>	<i>8.7</i>	<i>7.7</i>

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended June 30, 2005; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

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