Canada Looks at Income Trusts

Summary and Recommendation

We expand our weekly analysis of U.S. natural gas royalty trusts with the addition of four Canadian income trusts including buy-recommended **Canadian Oil Sands Trust (COSWF)** and **Penn West Energy Trust (PWTFF)**. Adding the Canadian trusts expands the market cap of the income stocks getting our extra weekly attention to some US$30 billion from US$5 billion. Record natural gas prices are helping the "account" of U.S. royalty trusts close in on a winning year next week. Meanwhile, the great success of the income trusts in Canada has prompted the Department of Finance Canada to issue a paper and call for consultations on economic and fiscal implications. Trusts offer the ability to allocate capital efficiently that otherwise appears frustrated in Canada by the double taxation of corporate dividends with some of the world's highest rates for both corporations and individuals. Income trusts, including Canadian Oil Sands will be included in the S&P/TSX Composite Index with half being added in December 2005 and the remainder in March 2006.

Tax Issues Related to Income Trusts

A Canadian government paper is posted at http://www.fin.gc.ca/toce/2005/toirplf_e.html. The effort appears to be a continuation of the process begun a year ago when the Department of Finance postponed enforcing limitations on U.S. ownership of Canadian trusts.

The income trusts are of great benefit in attracting capital to the country. That is demonstrated by a stock price discount of 29% for the units of **Pengrowth** that can be owned only by Canadians compared to the stock of the same trust that can be owned by non-Canadians.

More recently as the paper explains there has been a rapid spread of the income trust structure from energy and real estate to the rest of the economy. Bloomberg reports that Royal Bank of Canada, the country largest stock by market cap until displaced a few days ago by **Encana (ECA)**, was preparing to convert to a business income trust. On September 19, the Minister of Finance, Mr. Ralph Goodale, called a timeout to issuing advance approval of new deals. Apparently buy-recommended Penn West (PWTFF) was the last to receive advance clearance.

From the point of view of existing entities, nothing appears to have changed. The successful oil and gas income trusts continue to work diligently to be sure that the government understands the issues.

Consistent Framework for Comparative Valuation

We estimate present value of trusts on the same basis as for operating companies. Somewhat higher McDep Ratios for some trusts compared to operating companies may reflect their income paying capability without incurring double taxation or other factors (see table Rank by McDep Ratio).

Because it depends primarily on commodity price, production volume and operating costs, cash flow before interest and tax, Ebitda, can be an objective measure for comparing disparate operations. Yet stocks vary in their ranking (see table Rank by Enterprise Value to Ebitda).

Account Closes In on Successful Year

A keen interest among investors in income stocks combined with our historical familiarity encouraged us to start a weekly analysis of seven income stocks a year ago (see table The Account). We plan to wrap up the account with a final tally next week when a year will have passed since its creation. The stocks will continue to be represented in the wider U.S. and Canadian tables.

New Highs for Strip Prices

Another feature of the account, a weekly recalculation of next twelve months estimates continues. The commodity price one-year averages, or strips, determine the weekly variations in estimates. The six-year strips are a measure of how our assumptions in present value estimates relate to current market expectations. As Mr. Greenspan might say, the close comparison of one-year and six-year averages suggests that market participants are not expecting current prices to retreat much in the future.

Kurt H. Wulff, CFA

Natural Gas and Oil Royalty Trusts
Rank by McDep Ratio: Market Cap and Debt to Present Value

	Symbol/	Rating	Price ($/sh) 22-Sep 2005	Shares (mm)	Market Cap ($mm)	Net Present Value ($/sh)	Debt/ Present Value	McDep Ratio
U.S. Royalty Trusts								
Sabine Royalty Trust	SBR		49.81	14.6	730	42.00		1.19
San Juan Basin Royalty Trust	SJT	H	46.36	46.6	2,160	40.00		1.16
Hugoton RoyaltyTrust (46%)	HGT		38.79	18.4	710	34.00		1.14
Cross Timbers Royalty Trust	CRT		50.00	6.0	300	45.00		1.11
Permian Basin RT (57%)	PBT		16.55	26.6	440	15.00		1.10
Dorchester Minerals, L.P.	DMLP		28.36	28.2	800	26.00		1.09
Mesa RoyaltyTrust	MTR		70.00	1.9	130	75.00		0.93
Total or Median					*5,300*			*1.11*
Canadian Income Trusts								
Pengrowth Energy Trust	PGH		24.97	156.7	3,910	20.00	0.17	1.21
Penn West Energy Trust	PWTFF	B	29.89	173.7	5,190	28.00	0.16	1.06
Enerplus Resources Fund	ERF		44.10	104.9	4,630	42.00	0.13	1.04
Canadian Oil Sands Trust (US$)	COSWF	B	110.00	92.9	10,130	136.00	0.12	0.83
Total or Median					*23,900*		*0.15*	*1.05*

B = Buy, H = Hold
McDep Ratio = **M**arket **c**ap and **De**bt to **p**resent value of oil and gas and other businesses

Natural Gas and Oil Royalty Trusts
Rank by EV/Ebitda: Enterprise Value to Earnings Before Interest, Tax, Deprec.

	Symbol/	Rating	Price ($/sh) 22-Sep 2005	Adjstd Resrvs/ Prod NTM	PV/ Ebitda NTM	EV/ Ebitda NTM	P/E NTM	Divd or Distrib NTM (%)
U.S. Royalty Trusts								
Cross Timbers Royalty Trust	CRT		50.00	17.8	8.9	9.9	10.0	10.0
Sabine Royalty Trust	SBR		49.81	11.9	8.2	9.7	9.7	10.3
San Juan Basin Royalty Trust	SJT	H	46.36	12.0	7.4	8.6	9.1	10.9
Dorchester Minerals, L.P.	DMLP		28.36	12.0	7.2	7.9	10.7	12.1
Permian Basin RT (57%)	PBT		16.55	14.5	7.0	7.7	8.3	12.1
Mesa RoyaltyTrust	MTR		70.00	20.0	8.0	7.5	8.0	12.6
Hugoton RoyaltyTrust (46%)	HGT		38.79	13.6	6.0	6.9	8.0	12.5
Median				*13.6*	*7.4*	*7.9*	*9.1*	*12.1*
Canadian Income Trusts								
Canadian Oil Sands Trust (US$)	COSWF	B	110.00	20.0	9.6	7.9	8.5	1.5
Pengrowth Energy Trust	PGH		24.97	7.6	5.1	6.2	8.6	9.5
Enerplus Resources Fund	ERF		44.10	9.8	5.2	5.5	7.7	8.3
Penn West Energy Trust	PWTFF	B	29.89	8.0	4.1	4.4	6.2	8.9
Median				*8.9*	*5.2*	*5.8*	*8.1*	*8.6*

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended September 30, 2006; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

U.S. Natural Gas and Oil Royalty Trusts
The Account

	Symbol	*Price ($/un) 22-Sep 2005*	*Units*	*Market Value ($)*	*Next Twelve Months Distrib. ($/un)*	*NTM Distrib. Yield (%/yr)*
Cross Timbers Royalty Trust	CRT	50.00	400	20,000	5.01	10.0
Sabine Royalty Trust	SBR	49.81	400	19,924	5.12	10.3
San Juan Basin Royalty Trust	SJT	46.36	500	23,180	5.07	10.9
Dorchester Minerals, L.P.	DMLP	28.36	700	19,852	3.42	12.1
Permian Basin Royalty Trust	PBT	16.55	1,200	19,860	2.00	12.1
Hugoton Royalty Trust	HGT	38.79	500	19,395	4.84	12.5
Mesa RoyaltyTrust	MTR	70.00	200	14,000	8.80	12.6
Total				*136,211*		*11.4*

Futures Strip	
12 Month - Oil ($/bbl)	67.14
12 Month - Natural Gas ($/mmbtu)	11.83
72 Month - Oil ($/bbl)	63.74
72 Month - Natural Gas ($/mmbtu)	8.94