



# Independent Stock Idea

April 1, 2013

## San Juan Basin Royalty Trust (SJT) Drilling Discipline

|  |         |  |       |
|--|---------|--|-------|
| <i>Symbol</i>  | SJT     | <i>Ebitda Next Twelve Months ending 3/31/14 (US\$mm)</i> | 76    |
| <i>Rating</i>  | Buy     | <i>North American Natural Gas/Ebitda (%)</i>             | 97    |
| <i>Price (US\$/sh)</i>   | 15.13   | <i>Natural Gas and Oil Production/Ebitda (%)</i>         | 100   |
| <i>Pricing Date</i>  | 3/28/13 | <i>Adjusted Reserves/Production NTM</i>                  | 10.3  |
| <i>Shares (mm)</i>   | 47      | <i>EV/Ebitda</i>   | 9.3   |
| <i>Market Capitalization (US\$mm)</i>  | 710     | <i>PV/Ebitda</i>   | 12.9  |
| <i>Debt (US\$mm)</i>   | 0       | <i>Undeveloped Reserves (%)</i>                          | 3     |
| <i>Enterprise Value (EV) (US\$mm)</i>  | 710     | <i>Natural Gas and Oil Ebitda (US\$/mcf)</i>             | 3.20  |
| <i>Present Value (PV) (US\$mm)</i>   | 980     | <i>Present Value Proven Reserves(US\$/boe)</i>           | 23.56 |
| <i>Net Present Value (US\$/unit)</i>   | 21      | <i>Oil and Gas Ebitda Margin (%)</i>                     | 66    |
| <i>Debt/Present Value</i>  | 0.00    | <i>Earnings Next Twelve Months (US\$/un)</i>             | 1.09  |
| <i>McDep Ratio - EV/PV</i>   | 0.72    | <i>Price/Earnings Next Twelve Months</i>                 | 14    |
| <i>Distribution Yield (%/year)</i>   | 7.2     | <i>Distribution Next Twelve Months (US\$/sh)</i>         | 1.09  |
| Note: Estimated cash flow and earnings tied to one-year futures prices for natural gas.                            |         |  |       |
| Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.      |         |  |       |
| Estimated present value presumes a long-term price for oil of US\$100 a barrel and natural gas, \$6 a million btu. |         |  |       |
| For historical analysis of SJT since 2000 see <a href="http://www.mcdep.com/4sjt.htm">www.mcdep.com/4sjt.htm</a>   |         |  |       |

### Summary and Recommendation

Investors concerned about the high cost of horizontal fracs reducing the distribution of **San Juan Basin Royalty Trust (SJT)** may take heart that the operator of the trust's properties, **ConocoPhillips (COP)**, has released drilling rigs in the San Juan Basin. Investors looking for quicker action in defining the resource potential of the Mancos in northwest New Mexico may be surprised by the story in the *Farmington Daily Times* on Wednesday, March 27, that ConocoPhillips would temporarily cease drilling with three rigs that were exploring for gas. Though the local news story emphasized that a restart as soon as possible was heavily dependent on the price of natural gas, we would add that further analysis of data in hand as well as new information, especially drilling by others, could improve the effectiveness of future drilling by ConocoPhillips as the largest operator in the basin. Meanwhile, with immediate outlays for drilling diminished, SJT monthly distributions would be restored to more normal levels as anticipated in our estimated distribution yield of 7% for the next twelve months. Development outlays are the most unpredictable component of monthly distribution.

Sensitive to the impact of any news on the local community, ConocoPhillips has been careful to manage expectations of the pace of development. Despite their prominence in the area, no one from the company participated in the Mancos Shale conference at San Juan College on March 18-19. Nor has COP confirmed the interpretation of results of the landmark Yert well, the first horizontal multi-frac in the wet gas portion of the Mancos shale on trust properties. Disclosures after a possibly high initial rate indicate liquids of perhaps 20% by heating value. We understand that perhaps 5 of 15 frac stages were not effective, presumably a technical problem to be corrected in future fracs. Typical for a new shale opportunity a lot of work needs to be done to optimize several-fold multiple of costs to develop a ten-fold multiple of resource.



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Investors in buy-recommended SJT can continue to collect distributions from long-life existing production. Moreover, the price of natural gas appears to be in a gradual uptrend from a low level of about one-fourth the heating value of oil. Over several years, the upside of the Mancos formation will likely unfold. The tools are publicly available to track disclosures of well completions, subject to a 90-day confidentiality period, and monthly production, usually on a delay of 45 days. Looking back for analogy, the discovery of commercial production in the Fruitland coal seam in the late 1980s translated to surging trust volumes in the early 1990s. Discovery of commercial production from the Mancos shale in the mid-2010s may lead to surging trust production in the late 2010s.

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