

## **Contango and Backwardation Mythology**

### **Summary**

The longer term implications for equity investors are none or just as likely the opposite from what futures mythology suggests. “The bear a good contango loves, the bull a backwardation”. Bloomberg credits the Oxford English Dictionary for finding a magazine from 1860 as the source of the odd words used to describe the pattern of futures prices. A long contango going out years and years where oil price or natural gas price rose steadily would be the ideal price pattern. Energy users and equity investors could see what might be coming and make orderly investments accordingly. Such a pattern would add visibility to future distributions from seven U.S. natural gas income stocks expected to distribute cash over the next twelve months of 8.8% of stock price (see table [The Account](#)). The median McDep Ratio is 1.09 (see table [Rank by McDep Ratio](#)). The ratio of estimated present value to cash flow is a median 9.2 (see table [Rank by PV/Ebitda](#)).

### **Bullish Contango**

The recent contango for oil in the early months, an upward sloping curve, has attracted much commentary as to whether it has bearish implications. The early months for natural gas also trace a contango pattern.

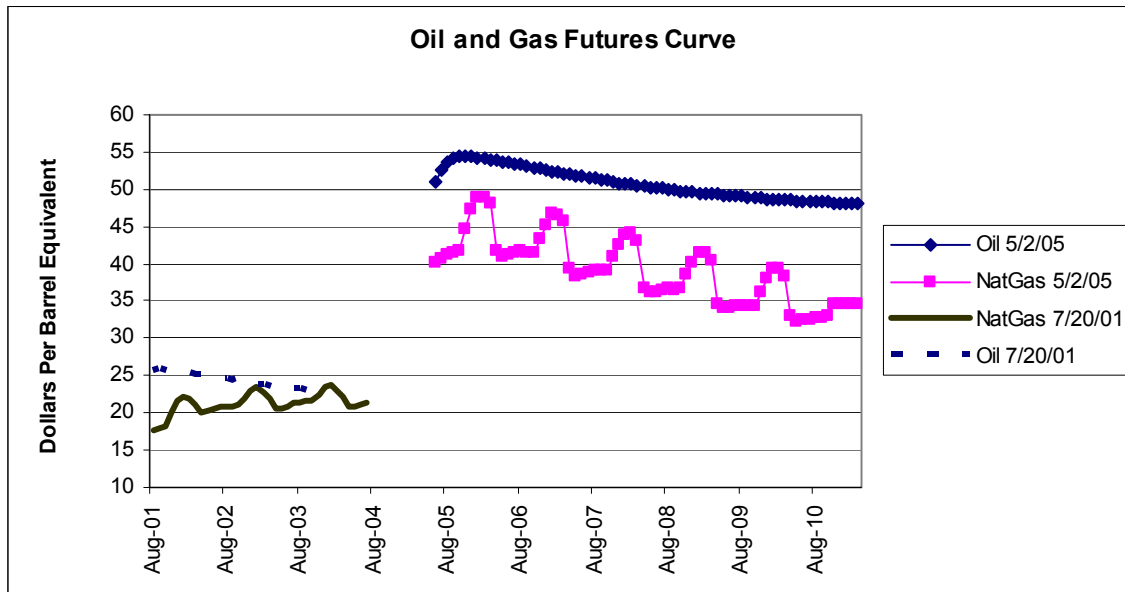
In 2001, and most of the time since, oil was in backwardation, a downward sloping curve. In 2001, natural gas was in contango (see chart [Oil and Gas Futures Curve](#)). Despite different patterns, both oil and gas increased in price since 2001.

Traditionally a futures trader might look at backwardation as an opportunity to profit continuously from shorting the near month, buying the next month at the lower backwardated price and covering when the prices come together as the months are rolled forward in a few weeks. The trader might do the opposite when futures prices were in contango. Supposedly backwardation then exerts upward pressure on future months while contango does the opposite.

Futures are interesting for the information they convey about long-term price expectations. As with stocks, most of the day-to-day commentary is just noise in a longer context.

Kurt H. Wulff, CFA

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### U.S. Natural Gas and Oil Royalty Trusts

#### The Account

	<i>Symbol</i>	<i>Price (\$/un)</i> 5-May 2005	<i>Units</i>	<i>Market Value (\$)</i>	<i>Next Twelve Months Distrib. (\$/un)</i>	<i>NTM Distrib. Yield (%/yr)</i>
Cross Timbers Royalty Trust	CRT	39.27	400	15,708	3.00	7.6
Mesa RoyaltyTrust	MTR	66.80	200	13,360	5.42	8.1
Sabine Royalty Trust	SBR	38.90	400	15,560	3.30	8.5
San Juan Basin Royalty Trust	SJT	37.55	500	18,775	3.13	8.3
Hugoton Royalty Trust	HGT	27.06	500	13,530	2.56	9.4
Dorchester Minerals, L.P.	DMLP	22.11	700	15,477	2.18	9.9
Permian Basin Royalty Trust	PBT	12.70	1,200	15,240	1.26	9.9
<i>Total</i>				<i>107,650</i>		<i>8.8</i>
<b>Futures Strip</b>						
12 Month - Oil (\$/bbl)		53.31				
12 Month - Natural Gas (\$/mmbtu)		7.27				
72 Month - Oil (\$/bbl)		50.24				
72 Month - Natural Gas (\$/mmbtu)		6.52				

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

	<i>Symbol</i>	<i>Price (\$/sh) 5-May 2005</i>	<i>Shares (mm)</i>	<i>Market Cap (\$mm)</i>	<i>Net Present Value (\$/sh)</i>	<i>EV/ Ebitda NTM</i>	<i>McDep Ratio</i>
Sabine Royalty Trust	SBR	38.90	14.6	570	33.00	11.8	1.18
San Juan Basin Royalty Trust	SJT	37.55	46.6	1,750	32.00	10.8	1.17
Mesa Royalty Trust	MTR	66.80	1.9	120	60.00	10.6	1.11
Cross Timbers Royalty Trust	CRT	39.27	6.0	240	36.00	12.9	1.09
Permian Basin RT (41%)	PBT	12.70	19.1	240	12.00	9.3	1.06
Dorchester Minerals, L.P.	DMLP	22.11	27.0	600	21.00	9.7	1.05
Hugoton Royalty Trust (46%)	HGT	27.06	18.4	500	27.00	8.6	1.00
<i>Total or Median</i>				<i>4,000</i>		<i>10.6</i>	<i>1.09</i>

### Rank by PV/Ebitda: Present Value to Earnings Before Interest, Tax, Deprec.

	<i>Symbol</i>	<i>Total Present Value (\$mm)</i>	<i>Unit Present Value (\$/mcf)</i>	<i>Reserves (bcf)</i>	<i>Natural Gas/ Ebitda (%)</i>	<i>Adjusted Reserves/ Production NTM</i>	<i>Revenue Royalty (%)</i>	<i>PV/ Ebitda</i>
Cross Timbers Royalty Trust	CRT	216	3.30	65	72	20.0	85	11.8
Sabine Royalty Trust	SBR	481	3.90	123	58	11.9	100	10.0
Mesa Royalty Trust	MTR	112	2.42	46	76	20.0	-	9.6
San Juan Basin Royalty Trust	SJT	1,491	2.87	519	99	12.1	-	9.2
Dorchester Minerals, L.P.	DMLP	568	3.56	160	79	13.0	54	9.2
Permian Basin RT (41%)	PBT	229	2.30	100	39	16.5	30	8.8
Hugoton Royalty Trust (46%)	HGT	497	2.90	171	92	13.7	-	8.6
<i>Total or Median</i>		<i>3,594</i>		<i>1,185</i>	<i>76</i>	<i>13.7</i>		<i>9.2</i>

### Index of Recent U.S. Royalty Trust Research

#### Single Trust Analyses

<i>Date</i>	<i>Symbol</i>	<i>Stock</i>	<i>Theme</i>
28-Apr	SJT	San Juan Basin Royalty Trust	Ten Bagger
24-Mar	* MTR	Mesa Royalty Trust	Long Reserve Life Reported
11-Feb	* HGT	Hugoton Royalty Trust	Improving Volume Trend
3-Feb	* SJT	San Juan Basin Royalty Trust	Real Value with Income
22-Nov	* MTR	Mesa Royalty Trust	Hugoton Predictability, San Juan Surprise
12-Nov	* CRT	Cross Timbers Royalty Trust	Low Risk, Long Life

#### U.S. Natural Gas Royalty Trusts - A Weekly Analysis

29-Apr		No Debt, No Hedges
22-Apr	*	A Boost from Burlington
15-Apr	*	Oil Price Moderation
8-Apr	*	Reserves Comparability
1-Apr	*	New High for Natural Gas

\* Archived on [www.mcdep.com](http://www.mcdep.com)

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