

## ***McDep Energy Income Producers***

*A Weekly Analysis of Royalty Trusts and Master Limited Partnerships*

January 13, 2004

# **Leave No Scam Behind**

## **Summary and Recommendation**

When our Federal legislators reconvene this month there appears likely to be an effort to revive energy legislation presumed to allow more mutual fund ownership of master limited partnerships (mlp's). While there are energy mlp's that conduct legitimate operations, there also are energy mlp's that mislead investors with false accounting and enrich general partners unjustly in our opinion. The financial quality shows when we demonstrate in this week's analysis that **Kinder Morgan Energy Partners, L.P. (KMP)** pays a distribution of an excessive 141% of equity cash flow compared to buy-recommended **Canadian Oil Sands Trust (COSWF)** at only 30%. Also we include a table pointing to a rising distribution over the next few months for **San Juan Basin Royalty Trust (SJT)**.

## **In the Name of Economic Recovery and Energy Security**

Encouraging investment in productive assets should be good for the economy and investment in energy assets should be good for energy users. That apparently would be the justification for including in proposed energy legislation a clause that has the effect of allowing mutual funds to own mlp's more readily. MLP's are popular because they avoid double taxation of cash flow from energy investments by not imposing a corporate tax before distributions are made to investors.

Unfortunately a good thing can be abused. At the same time that our political leaders encourage legitimate mlp's they should ensure that deceptive general partner compensation and pyramid debt is accounted for fairly in accordance with existing law. We don't comment any further on compensation or accounting this week except to illustrate how distributions may be overstated or understated compared to cash flow.

## **Differentiate by Quality of Distribution**

When dividends exceed earnings it usually raises a red flag for investors. Royalty trusts and master limited partnerships are specifically designed to distribute higher amounts of cash. The relevant standard of quality of distribution for energy trusts and partnerships is to compare to cash flow. It is understood that some cash flow would represent a return of principal in a traditional sense. Because of that a portion of the distribution is considered a return of capital and not taxed either at the partnership level or at the unitholder level. Realistically the return of capital allowed for tax purposes is usually greater than the economic equivalent. That is partly by design to encourage new investment and partly

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because inflation alone usually makes an energy asset more valuable than its original cost for tax purposes.

When we compare dividends to cash flow we see that Canadian Oil Sands distributes only 30% of equity cash flow while Kinder Morgan distributes 141% (see table). That tells us the distribution of Canadian Oil Sands has great potential for being increased. The distribution for Kinder Morgan, in contrast, is at high risk of being reduced or eliminated ultimately.

### **Energy Income Producers**

#### **Distribution Capacity**

Three Months Ended 9/30/03

	<i>COSWF</i>	<i>SJT</i>	<i>CRT</i>	<i>KMP</i>
<b>Revenue</b> (US\$mm)	235	33.7	5.2	1,651
<b>Ebitda</b> (US\$mm)	136	27.6	3.6	275
<b>Debt/Present Value</b>	0.21	-	-	0.46
<b>Equity Ebitda</b>	108	27.6	3.6	148
<b>Distribution</b> (US\$mm)	33	23.8	3.1	209
Distribution/Equity Ebitda	30%	86%	86%	141%
General Partner (US\$mm)	-	-	-	85
Unitholders (US\$mm)	33	23.8	3.1	124
Units outstanding (mm)	86	46.6	6.0	188
Distribution/unit (US\$)	0.38	0.51	0.51	0.66
Price per unit (US\$)	35.66	22.60	28.70	47.18
Distribution/price	1.1%	2.3%	1.8%	1.4%

### **Rising Distributions from Natural Gas**

Natural gas price gains reaccelerated in the last three months of last year. As a result we know what industry conditions will influence distributions for the first three months of 2004 for San Juan Basin Royalty Trust. SJT sells its gas for a price related to an index set at the beginning of each month. The known index prices for November, December and January point to distributions to be declared in January, February and March. The lag is three months for **Cross Timbers Royalty Trust (CRT)**. We see monthly distributions for SJT for the next three months of \$0.15, \$0.17 and \$0.21 a unit (see Table SJT-3, last page of analysis).

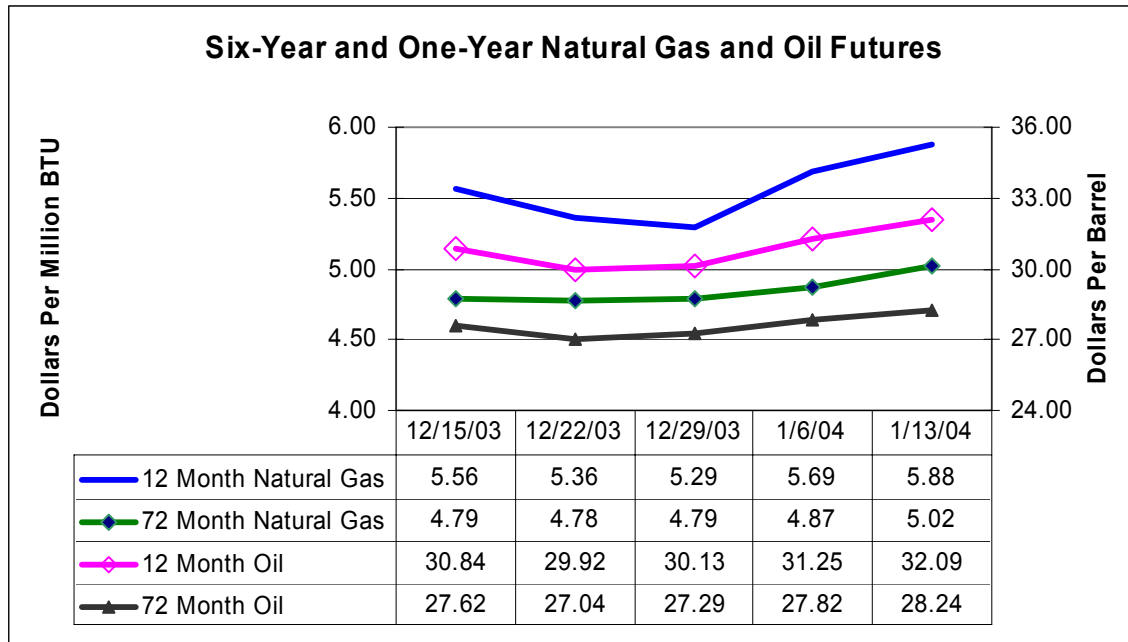
Kurt H. Wulff, CFA

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

	Symbol/ Rating	Price (\$/sh) 12-Jan 2004	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio
<b>Master Limited Partnerships and Canadian Royalty Trusts</b>							
Kinder Morgan Energy Partners, L.P.	KMP S	47.18	140.1	6,610	14.00	0.46	2.28
Kinder Morgan Management, LLC	KMR S	41.62	47.8	1,990	14.00	0.46	2.06
Enerplus Resources Fund	ERF	31.30	88.5	2,770	25.00	0.15	1.21
Dorchester Minerals, L.P.	DMLP	19.90	27.0	540	17.00	-	1.17
Provident Energy Trust	PVX	9.06	70.6	640	7.50	0.26	1.15
Pengrowth Energy Trust	PGH	15.96	120.0	1,920	14.00	0.12	1.12
Canadian Oil Sands Trust (US\$)	COSWF B	35.66	86.7	3,090	50.00	0.21	0.77
<i>Total or Median</i>				17,600		0.21	1.17
<b>U.S. Royalty Trusts</b>							
Sabine Royalty Trust	SBR	31.02	14.6	450	26.00	-	1.19
Cross Timbers Royalty Trust	CRT	28.70	6.0	172	25.00	-	1.15
Permian Basin RT (41%)	PBT	8.40	19.1	160	7.50	-	1.12
Hugoton Royalty Trust (46%)	HGT	22.10	18.4	410	20.00	-	1.11
San Juan Basin Royalty Trust	SJT B	22.60	46.6	1,050	22.00	-	1.03
<i>Total or Median</i>				2,200		-	1.12

Buy/Sell rating after symbol: B - Buy, S - Sell

McDep Ratio = Market cap and Debt to present value of oil and gas and other businesses

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### McDep Energy Income Producers

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

	Symbol/ Rating		Price (\$/sh) 12-Jan 2004	EV/ Sales NTM	EV/ Ebitda NTM	P/E NTM	Dividend or Distribution NTM (%)	PV/ Ebitda NTM
<b>Master Limited Partnerships and Canadian Royalty Trusts</b>								
Kinder Morgan Energy Partners, L.P.	KMP	S	47.18	3.3	19.5	24	5.6	8.6
Kinder Morgan Management, LLC	KMR	S	41.62	2.9	17.7	22	6.3	8.6
Dorchester Minerals, L.P.	DMLP		19.90	9.3	10.1	22	9.9	8.7
Canadian Oil Sands Trust (US\$)	COSWF	B	35.66	4.4	8.4	14	4.4	10.9
Pengrowth Energy Trust	PGH		15.96	5.2	7.3	13	12.4	6.5
Enerplus Resources Fund	ERF		31.30	5.4	7.2	12	10.5	6.0
Provident Energy Trust	PVX		9.06	4.0	5.9	28	12.5	5.1
	<i>Median</i>			4.4	8.4	22	9.9	8.6
<b>U.S. Royalty Trusts</b>								
Cross Timbers Royalty Trust	CRT		28.70	8.2	11.4	12	8.6	9.9
Sabine Royalty Trust	SBR		31.02	10.0	10.4	10	9.6	8.7
Permian Basin RT (41%)	PBT		8.40	6.7	9.3	10	8.9	8.3
Hugoton RoyaltyTrust (46%)	HGT		22.10	6.6	8.6	10	9.7	7.8
San Juan Basin Royalty Trust	SJT	B	22.60	7.0	8.5	10	10.1	8.3
	<i>Median</i>			7.0	9.3	10	9.6	8.3

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended December 31, 2004; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

### McDep Energy Income Producers Determinants of Present Value

	Symbol/ Rating	Natural Royalty (%)	N. Am. Gas/ Ebitda (%)	Adjusted Reserves/ Production NTM	PV/ Ebitda NTM	1/12/04 EV/ Mcfe	McDep Ratio	
<b>Master Limited Partnerships and Canadian Royalty Trusts</b>								
Kinder Morgan Energy Partners, L.P.	KMP	S	-	-	8.6		2.28	
Kinder Morgan Management, LLC	KMR	S	-	-	8.6		2.06	
Provident Energy Trust	PVX		52	4.9	5.1	3.46	1.15	
Dorchester Minerals, L.P.	DMLP		54	86	9.5	5.01	1.17	
Pengrowth Energy Trust	PGH		41	10.2	6.5	1.65	1.12	
Enerplus Resources Fund	ERF		61	10.4	6.0	1.59	1.21	
Canadian Oil Sands Trust (US\$)	COSWF	B	-	(8)	20.0	10.9	0.77	
	<i>Median</i>			41	9.5	8.6	1.65	1.17
<b>U.S. Royalty Trusts</b>								
Sabine Royalty Trust	SBR		100	65	6.5	8.7	6.81	1.19
Permian Basin RT (41%)	PBT		24	46	9.0	8.3	3.24	1.12
Cross Timbers Royalty Trust	CRT		86	76	11.3	9.9	3.84	1.15
Hugoton RoyaltyTrust (46%)	HGT		-	94	11.9	7.8	2.78	1.11
San Juan Basin Royalty Trust	SJT	B	-	99	12.1	8.3	2.54	1.03
	<i>Median</i>			76	11.3	8.3	3.24	1.12

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended June 30, 2004; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

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**Table SJT-3**  
**San Juan Basin Royalty Trust**  
**Monthly Declarations**

	<i>Oct-03</i>	<i>Nov-03</i>	<i>Dec-03</i>	<i>Jan-04</i>	<i>Feb-04</i>	<i>Mar-04</i>
<b>Distribution</b> (\$/unit)						
Declared	0.14	0.17	0.15			
Projected				0.15	0.17	0.21
<b>Volume</b>						
Natural gas (mmbtu)	4.19	4.45	4.10	4.04	4.17	4.17
Heat Content(btu/cf)	1,109	1,064	1,103	1,087	1,087	1,087
Natural gas (bcf)	3.78	4.19	3.71	3.72	3.84	3.84
Natural Gas (mmcf)	122	140	120	124	124	124
Days	31	30	31	30	31	31
<b>Price</b>						
Natural gas industry quotes lagged two months (\$/mmbtu)						
Henry Hub Daily/Futures	4.97	4.62	4.65	4.47	6.13	5.80
San Juan Monthly Index	4.03	4.44	3.95	3.96	4.23	5.13
San Juan Index/Henry Hub	0.81	0.96	0.85	0.89	0.69	0.88
SJT/San Juan Index	0.85	0.78	0.85	0.84	0.84	0.84
SJT (\$/mmbtu)	3.41	3.46	3.34	3.33	3.55	4.31
SJT (\$/mcf)	3.78	3.68	3.68	3.61	3.86	4.68
<b>Revenue</b> (\$mm)						
Natural Gas	14.3	15.4	13.7	13.4	14.8	18.0
Other	(0.0)	0.1	0.0	(0.0)	(0.0)	(0.0)
<b>Cost</b> (\$mm)						
Severance tax	1.6	1.6	1.5	1.4	1.6	1.9
Operating	1.0	1.1	1.2	1.2	1.2	1.2
Total	2.6	2.8	2.7	2.6	2.8	3.1
<b>Cash flow</b> (\$mm)	11.7	12.7	11.0	10.8	12.0	14.8
Development	2.8	2.4	1.7	1.7	1.7	1.7
<b>Net proceeds</b> (\$mm)	8.9	10.3	9.3	9.1	10.3	13.1
<b>Royalty income</b> (\$mm)	6.7	7.8	7.0	6.8	7.7	9.8
Royalty/Net proceeds	75%	75%	75%	75%	75%	75%
One time						
<b>Distributable income</b> (\$mm)	6.7	7.8	7.0	6.8	7.7	9.8
<b>Units</b> (millions)	46.6	46.6	46.6	46.6	46.6	46.6
<b>Distribution</b> (\$/unit)	0.14	0.17	0.15	0.15	0.17	0.21
<i>Latest Twelve Month Average</i>						
Heat Content(btu/cf)	1,082	1,082	1,087			
Natural Gas (mmcf)	123	124	124			
San Juan Index/Henry Hub	0.77	0.79	0.81			
SJT/San Juan Index	0.84	0.84	0.84			
Other revenue	(0.0)	(0.0)	(0.0)			
Operating	1.2	1.2	1.2			
Development	1.7	1.7	1.7			
Severance tax/revenue	10.7%	10.7%	10.5%			

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