



# Independent Stock Idea

May 22, 2012

## Hugoton Royalty Trust (HGT) Panic Selling on Possible Legal Settlement

<i>Symbol</i>	HGT	<i>Ebitda Next Twelve Months ending 3/31/13 (US\$mm)</i>	34
<i>Rating</i>	None	<i>North American Natural Gas/Ebitda (%)</i>	78
<i>Price (US\$/sh)</i>	8.89	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	5/22/12	<i>Adjusted Reserves/Production NTM</i>	13.2
<i>Shares (mm)</i>	40.0	<i>EV/Ebitda</i>	10.4
<i>Market Capitalization (US\$mm)</i>	356	<i>PV/Ebitda</i>	19.9
<i>Debt (US\$mm)</i>	0	<i>Undeveloped Reserves (%)</i>	13
<i>Enterprise Value (EV) (US\$mm)</i>	356	<i>Natural Gas and Oil Ebitda (US\$/mcf)</i>	1.97
<i>Present Value (PV) (US\$mm)</i>	680	<i>Present Value Proven Reserves(US\$/boe)</i>	16.70
<i>Net Present Value (US\$/unit)</i>	17.0	<i>Oil and Gas Ebitda Margin (%)</i>	49
<i>Debt/Present Value</i>	0.00	<i>Earnings Next Twelve Months (US\$/un)</i>	0.71
<i>McDep Ratio - EV/PV</i>	0.52	<i>Price/Earnings Next Twelve Months</i>	12
<i>Distribution Yield (%/year)</i>	8.0	<i>Distribution Next Twelve Months (US\$/sh)</i>	0.71
Note: Estimated cash flow and earnings tied to one-year futures prices for oil and 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 HGT since 2000 see <a href="http://www.mcdep.com/4hgt.htm">www.mcdep.com/4hgt.htm</a>			

### Summary and Recommendation

Natural gas producer **Hugoton Royalty Trust (HGT)** looks like a trading opportunity for the nimble and potentially patient on news that a pending settlement of a lawsuit over past royalty payments may cost \$30 million or \$0.75 a unit. Since the settlement possibility was announced along with the May distribution late in the day on May 18, HGT stock has dropped \$4 a unit in less than two days. We attribute the exaggerated reaction to the expected immediate impact on distributions which would be reduced until the liability is recovered. Because not all of the trust's properties are subject to the legal dispute, some distribution may continue to be paid. The trustee suggests that distributions may not be fully restored for 18 months. Our NPV of \$17 a unit might be reduced to \$14 to take account of the settlement and to bring present value cash flow multiple (PV/Ebitda) more in line with other long-life natural gas producers. We caution investors not to put too much weight on current cash flow when natural gas price is depressed. We see the current situation in natural gas as analogous to oil in the first quarter of 2009 from which oil producers recovered sharply. In natural gas we are practically certain that next winter will not be as warm as the past winter. Meanwhile we have seen that electric generators have a voracious appetite to consume increasingly larger quantities of clean fuel at bargain prices. As a result, natural gas prices have come off the bottom for now. Panic selling of HGT seems to be another sign coincident with a turn in the natural gas cycle. Finally, in our effort to be timely with this note, it is possible we are missing some further negative news yet to be disclosed, but we don't know what it might be. Royalty disputes are common and differences of interpretation build up over years. We believe the stock is attractive, though we do not have time to make an official buy recommendation now, nor can we promise when and if we would do so.

Kurt H. Wulff, CFA



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<b>Hugoton Royalty Trust</b>									
<b>Next Twelve Months Operating and Financial Estimates</b>									
	<i>Q1</i>	<i>Q4</i>	<i>Year</i>	<i>Q1</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Year</i>	<i>Q1E</i>	<i>Next Twelve Months</i>
	<i>3/31/11</i>	<i>12/31/11</i>	<i>2011</i>	<i>3/31/12</i>	<i>6/30/12</i>	<i>9/30/12</i>	<i>2012E</i>	<i>3/31/13</i>	<i>3/31/13</i>
<b>Highlights</b>									
Revenue (\$mm) (80%)	24.5	23.6	<b>100.0</b>	20.5	15.8	15.8	<b>69.6</b>	20.0	<b>69.1</b>
Cash flow (\$mm) (80%)	15.3	14.4	<b>63.7</b>	11.3	7.2	7.2	<b>34.2</b>	11.3	<b>34.2</b>
Per unit	0.38	0.36	<b>1.59</b>	0.28	0.18	0.18	<b>0.85</b>	0.28	<b>0.85</b>
Distributable Income (\$mm)	12.9	13.1	<b>55.8</b>	9.8	5.8	5.8	<b>28.5</b>	9.9	<b>28.6</b>
Per unit	0.32	0.33	<b>1.39</b>	0.25	0.14	0.14	<b>0.71</b>	0.25	<b>0.71</b>
<b>Units</b> (millions)	40.0	40.0	<b>40.0</b>	40.0	40.0	40.0	<b>40.0</b>	40.0	<b>40.0</b>
<b>Volume</b>									
Natural Gas (bcf)	5.6	5.2	<b>21.7</b>	5.2	5.1	5.1	<b>20.5</b>	5.1	<b>20.4</b>
Natural Gas (mmcf)	61.3	57.0	<b>59.4</b>	56.4	56.1	55.9	<b>56.0</b>	55.6	<b>55.8</b>
Days	92	92	<b>365</b>	92	90	92	<b>366</b>	92	<b>366</b>
Oil (mb)	68	58	<b>249</b>	52	50	51	<b>203</b>	51	<b>202</b>
Oil (mbd)	0.7	0.6	<b>0.7</b>	0.6	0.6	0.6	<b>0.6</b>	0.5	<b>0.6</b>
Days	92	92	<b>365</b>	92	89	92	<b>365</b>	92	<b>365</b>
Total (bcf)	6.0	5.6	<b>23.2</b>	5.5	5.3	5.4	<b>21.7</b>	5.4	<b>21.6</b>
<b>Price</b>									
Natural Gas (HH lagged two months)									
Henry Hub (\$/mmbtu)	3.93	3.99	<b>4.10</b>	3.32	2.43	2.45	<b>2.75</b>	3.32	<b>2.75</b>
Differential (%)	(12)	(18)	<b>(15)</b>	(20)	(20)	(20)	<b>(20)</b>	(20)	<b>(20)</b>
HGT (\$/mcf)	4.41	4.70	<b>4.73</b>	4.00	2.93	2.95	<b>3.31</b>	3.99	<b>3.31</b>
Oil (\$/bbl) (WTI Cushing lagged two months)									
WTI Cushing	87.66	86.13	<b>93.25</b>	98.69	103.93	93.60	<b>97.40</b>	93.97	<b>96.22</b>
HGT	85.34	83.12	<b>90.07</b>	95.36	100.39	90.40	<b>94.05</b>	90.74	<b>92.89</b>
Total (\$/mcf)	5.07	5.27	<b>5.39</b>	4.67	3.70	3.63	<b>4.01</b>	4.62	<b>3.99</b>
<b>Revenue (\$mm)</b>									
Natural Gas	24.9	24.7	<b>102.6</b>	20.8	14.8	15.2	<b>67.9</b>	20.4	<b>67.6</b>
Oil	5.8	4.8	<b>22.4</b>	4.9	5.0	4.6	<b>19.1</b>	4.6	<b>18.8</b>
Total	30.7	29.5	<b>125.0</b>	25.7	19.8	19.8	<b>87.0</b>	25.0	<b>86.3</b>
<b>Cost (\$mm)</b>									
Tax, transport & other	3.3	3.3	<b>13.6</b>	3.0	2.2	2.2	<b>9.7</b>	2.8	<b>9.5</b>
Production	5.6	5.4	<b>21.1</b>	6.0	6.0	6.0	<b>23.8</b>	5.5	<b>23.4</b>
Overhead	2.7	2.7	<b>10.8</b>	2.7	2.7	2.7	<b>10.8</b>	2.7	<b>10.8</b>
Total	11.6	11.4	<b>45.5</b>	11.6	10.8	10.8	<b>44.3</b>	10.9	<b>43.6</b>
<b>Cash flow (\$mm)</b>									
Development	19.1	18.0	<b>79.6</b>	14.1	9.0	9.0	<b>42.7</b>	14.1	<b>42.7</b>
Excess costs	2.6	1.5	<b>8.8</b>	1.5	1.5	1.5	<b>6.0</b>	1.5	<b>6.0</b>
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<b>Net proceeds (\$mm)</b>	16.5	16.5	<b>70.8</b>	12.6	7.5	7.5	<b>36.7</b>	12.6	<b>36.7</b>
<b>Royalty income (\$mm)</b>									
Royalty/Net proceeds	13.2	13.2	<b>56.6</b>	10.1	6.0	6.0	<b>29.4</b>	10.1	<b>29.4</b>
Administration	80%	80%	<b>80%</b>	80%	80%	80%	<b>80%</b>	80%	<b>80%</b>
	0.3	0.1	<b>0.8</b>	0.2	0.2	0.2	<b>0.8</b>	0.2	<b>0.8</b>
<b>Distributable income (\$mm)</b>	12.9	13.1	<b>55.8</b>	9.8	5.8	5.8	<b>28.5</b>	9.9	<b>28.6</b>



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