

Encore's MLP Filed

Summary and Recommendation

There may be a new energy income stock in the market within several weeks guided by Jon Brumley, the founder in whole or in part of four of the six U.S. royalty trusts in our coverage. On May 11, Encore Acquisition Company (EAC) filed a registration statement with the Securities and Exchange Commission to sell in an initial public offering 9 million master limited partnership (MLP) units of newly created Encore Energy Partners (proposed New York Stock Exchange symbol ENP). Though the publicly traded market cap would be small initially the apparent intention is to add more EAC properties to ENP for better recognition of value. Proposed general partner (GP) and management compensation, as we understand it, would be "reasonable" in today's environment. Meanwhile for U.S. royalty trusts, we adjust volume projections for the year ending March 31, 2008 typically to 95% of actual results for the year ending March 31, 2007. Projected distribution yields for the year ending March 31, 2008 are a median 9.5% for the U.S. stocks and 10.3% for Canadian income trusts.

Encore Energy Partners Part of a New Breed

In our preliminary analysis of the disclosures it looks like \$15 a unit for ENP would be a McDep Ratio of 1.0. At that price, the distribution yield would be 9.3%. Thus if management can take properties valued at a McDep Ratio less than 0.8 in EAC and put them in ENP where the McDep Ratio would be higher, value would be created.

Ironically, each of the Brumley legacy royalty trusts delivered a higher total return to investors in the past five years than did the Brumley-founded operating company EAC. The formation of ENP should allow EAC to tap into higher stock market valuation. Along the way, Mr. Brumley may see some compensation from ENP that is not paid to anyone in the four royalty trusts he and his colleagues created.

GP compensation by ENP would be fixed at a nominal 2%. In addition, "management incentive units" could give a few individuals 2% of outstanding units at the start and up to an additional 8% of initially outstanding units if the distribution per unit is doubled.

Modify Volume Projections for U.S. Royalty Trusts

Surprisingly favorable volume trends when oil and gas prices were rising have given way to the partial return of normal decline when oil and gas prices have been declining. In some cases severe winter weather earlier this year reduced production temporarily. Pipeline and field maintenance is also often deferred to quieter periods when prices are not as strong. New volume projections are generally 95% of the historical base, rather than the 100% that was a reasonable guide for several years (see charts [Quarterly Natural Gas and Oil Volume](#)). As prices are rising again there may be a related volume effect.

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A Weekly Analysis

May 18, 2007

Intraday

At buy-recommended **San Juan Basin Royalty Trust (SJT)** monthly volumes so far in 2007 are some 7% lower than trend apparently because the operator is withholding amounts to make up for payments above trend last year. That adjustment ended with the distribution declared on May 18, the trustee discloses. At **Mesa Royalty Trust (MTR)**, volumes are higher in 2007 because amounts from the Colorado portion of the San Juan Basin, previously withheld, are now being reported.

Stock Prices May Reflect Distribution Trend

After a downtrend for last year, distributions may be starting an uptrend for U.S. royalty trusts. Declarations made May 18 are generally higher than earlier months (see charts Monthly Distributions). The trend in futures prices points to higher distributions ahead.

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) 18-May 2007	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/un)	Debt/ Present Value	McDep Ratio
U.S. Royalty Trusts							
Cross Timbers Royalty Trust	CRT	44.25	6.0	270	46.00	-	0.96
Sabine Royalty Trust	SBR	41.69	14.6	610	45.00	-	0.93
Mesa RoyaltyTrust	MTR	58.70	1.9	110	70.00	-	0.84
Permian Basin RT	PBT	13.76	46.6	640	16.50	-	0.83
Dorchester Minerals, L.P.	DMLP	22.41	28.2	630	27.00	-	0.83
San Juan Basin Royalty Trust	SJT	B 32.17	46.6	1,500	40.00	-	0.80
Hugoton RoyaltyTrust	HGT	B 27.15	40.0	1,090	34.00	-	0.80
<i>Total or Median</i>				4,900			0.83
Canadian Income Trusts (US\$)							
Pengrowth Energy Trust	PGH	18.38	244.0	4,480	17.00	0.29	1.06
Enerplus Resources Fund	ERF	47.50	123.4	5,860	47.00	0.14	1.01
Penn West Energy Trust	PWE	B 34.38	239.7	8,240	36.00	0.16	0.96
Canadian Oil Sands Trust	COSWF	B 30.11	479.0	14,420	35.00	0.08	0.87
<i>Total or Median</i>				33,000		0.15	0.99

B = Buy

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

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Natural Gas and Oil Royalty Trusts

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

	Symbol/ Rating	Price (\$/sh) 18-May 2007	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	44.25	12.9	12.2	11.7	12.5	8.0
Sabine Royalty Trust	SBR	41.69	10.2	12.0	11.1	11.1	9.0
Dorchester Minerals, L.P.	DMLP	22.41	9.1	11.3	9.4	14.5	10.4
San Juan Basin Royalty Trust	SJT	B	32.17	10.4	11.5	9.2	11.3
Mesa RoyaltyTrust	MTR	58.70	23.7	10.8	9.0	10.2	9.8
Permian Basin RT	PBT	13.76	8.7	10.4	8.6	10.5	9.5
Hugoton RoyaltyTrust	HGT	B	27.15	14.0	9.7	7.8	10.3
	<i>Median</i>		<i>10.4</i>	<i>11.3</i>	<i>9.2</i>	<i>11.1</i>	<i>9.5</i>
Canadian Income Trusts (US\$)							
Canadian Oil Sands Trust	COSWF	B	30.11	22.7	11.9	10.3	14.2
Pengrowth Energy Trust	PGH	18.38	7.5	7.3	7.7	24.3	15.0
Penn West Energy Trust	PWE	B	34.38	7.6	7.4	7.1	14.6
Enerplus Resources Fund	ERF	47.50	9.0	7.0	7.1	12.9	9.7
	<i>Median</i>		<i>8.3</i>	<i>7.4</i>	<i>7.4</i>	<i>14.4</i>	<i>10.3</i>

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended March 31, 2008; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

Natural Gas and Oil Royalty Trusts

Rank by NTM Distribution Yield

	Symbol	Revenue Royalty (%)	Natural Gas/ Ebitda (%)	Dist/ Ebitda	Dist/ Equity Ebitda	NTM Distribution (\$mm)	Dist. Yield (\$/un) (%)
U.S. Royalty Trusts							
Cross Timbers Royalty Trust	CRT	84	73	0.94	0.94	21	3.55
San Juan Basin Royalty Trust	SJT	-	98	0.82	0.82	133	2.84
Sabine Royalty Trust	SBR	100	58	1.00	1.00	55	3.74
Permian Basin RT	PBT	35	42	0.82	0.82	61	1.31
Hugoton RoyaltyTrust	HGT	-	92	0.76	0.76	106	2.64
Mesa RoyaltyTrust	MTR	-	77	0.89	0.89	11	5.77
Dorchester Minerals, L.P.	DMLP	64	76	0.98	0.98	66	2.34
	<i>Total or Median</i>		<i>76</i>	<i>0.89</i>	<i>0.89</i>	<i>500</i>	<i>9.5</i>
Canadian Income Trusts (US\$)							
Canadian Oil Sands Trust	COSWF	-	(11)	0.54	0.59	836	1.74
Enerplus Resources Fund	ERF	-	50	0.59	0.69	571	4.63
Penn West Energy Trust	PWE	-	43	0.64	0.77	898	3.75
Pengrowth Energy Trust	PGH	-	48	0.84	1.19	672	2.75
	<i>Total or Median</i>		<i>45</i>	<i>0.62</i>	<i>0.73</i>	<i>3,000</i>	<i>10.3</i>
Kinder Morgan Energy Partners	KMP			0.80	1.75		6.0

NTM = Next Twelve Months Ended March 31, 2008

Ebitda = Earnings before interest, tax, depreciation and amortization

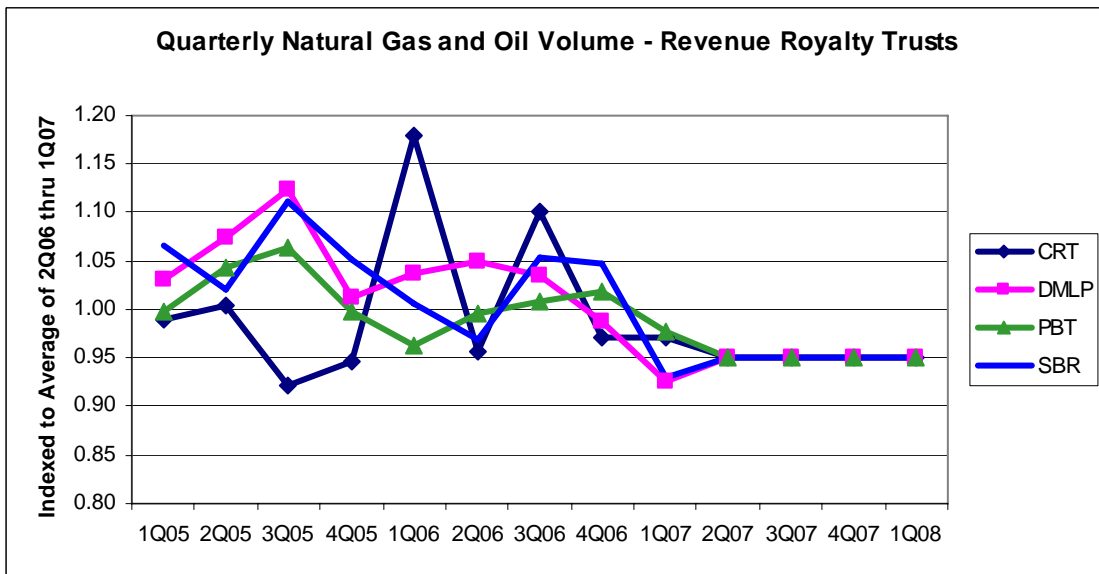
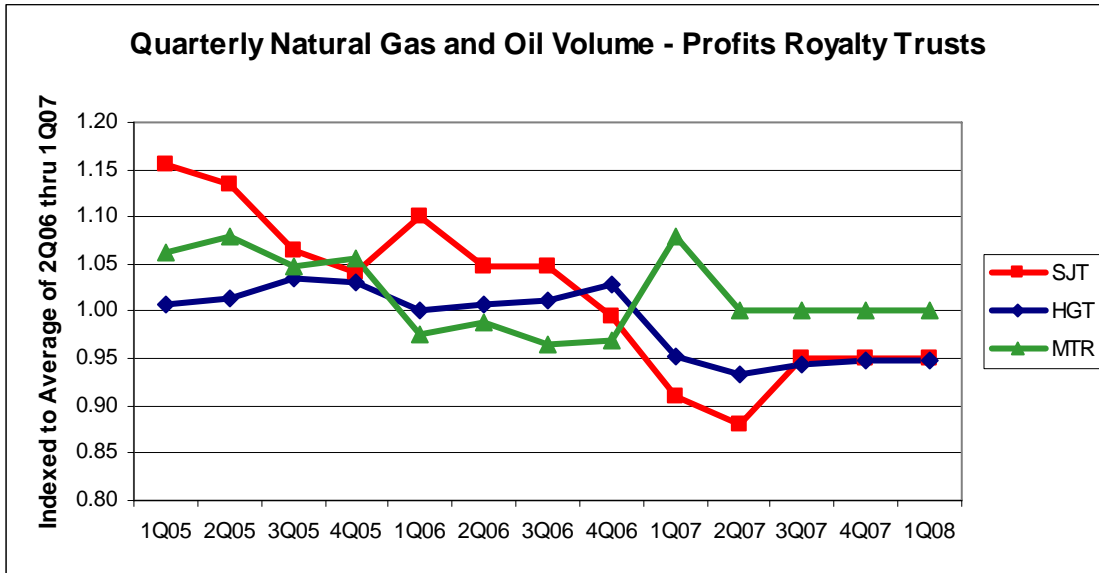
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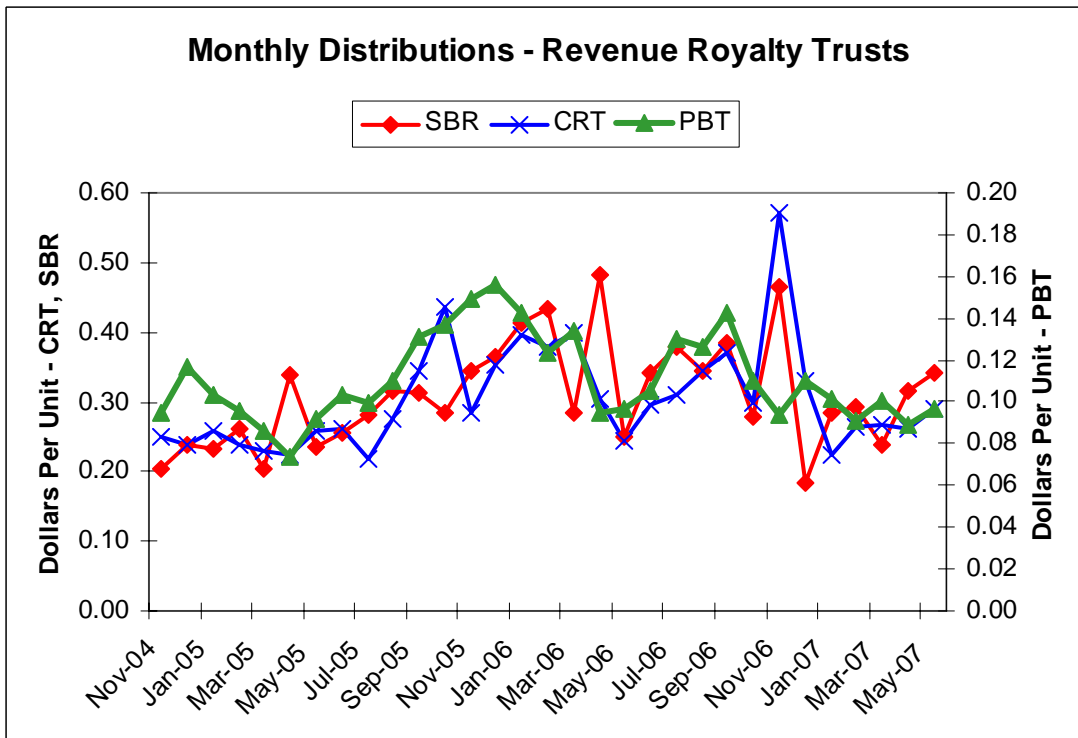
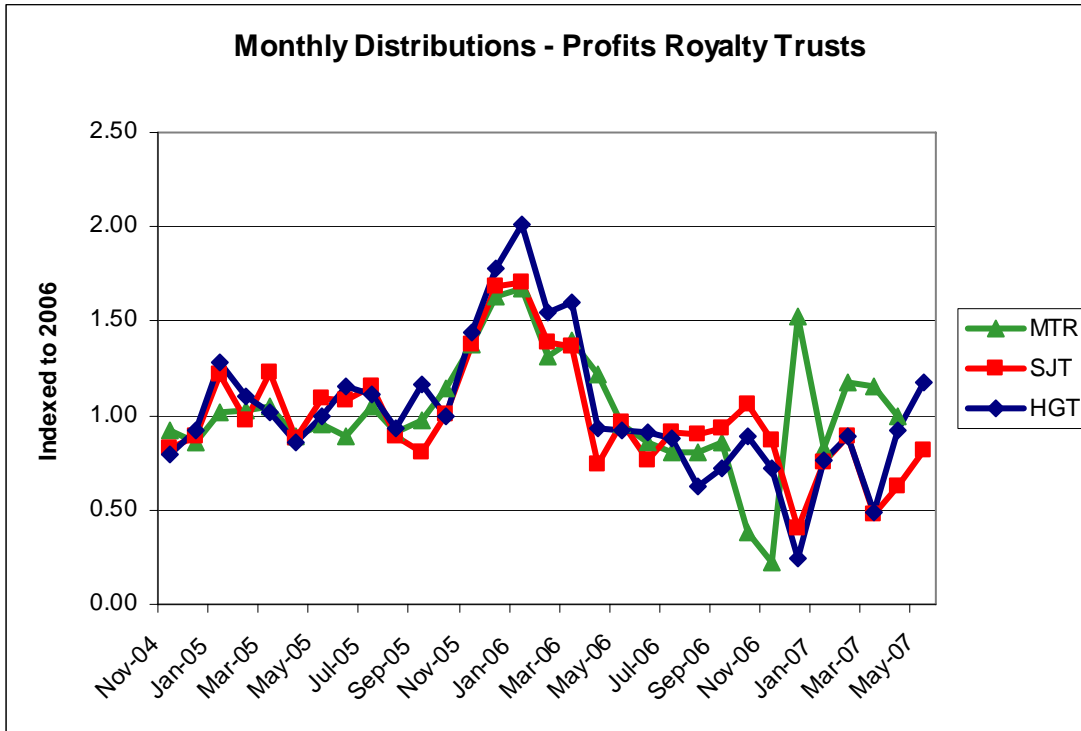
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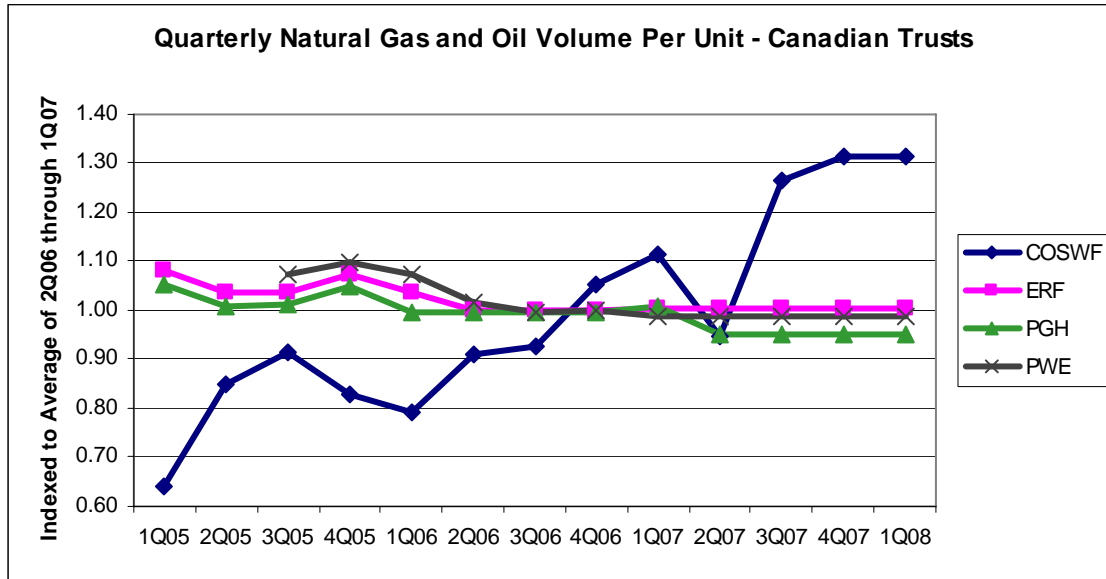
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