

Takeover Bid for PrimeWest Energy Trust

Summary and Recommendation

The proposed \$5 billion acquisition of PrimeWest Energy Trust (PWI) by Abu Dhabi National Energy Company (TAQA), announced September 24, may have positive implications for energy price at the same time it further exposes the fallacy of Flaherty's Folly that seeks to eliminate publicly traded royalty trusts in Canada. On the positive side, there appears to be an "insider" angle in the transaction as the Middle East buyers may have less confidence in the capacity and security of Middle East oil as a moderating oil price factor. The deal price paid appears high, low or about right depending on the context. The selling unitholders will receive 26.5% more than recent stock price. But recent stock price has been beaten down from its level before the Halloween 2006 betrayal by the current Conservative Federal Government. On a McDep Ratio basis the deal price may be a modest premium to the present value we would estimate though we have not made that calculation for PWI since it was last in our research coverage in 2004. Meanwhile as the takeover highlights underlying value, our buy-rated and unrated oil and gas income stocks have an expected median distribution yield of 9.8% for the next twelve months.

New Buyer of Canadian Assets

On a buying spree in Canada, TAQA is acquiring at the same time \$2.5 billion of oil and gas assets from Pogo Producing (PPP) and Pioneer Resources (PXD). Headed by Chief Executive Peter Barker-Homek who worked at BP plc (BP) and studied at Brooklyn's Polytechnic University, management has global oil company experience. Capital seems plentiful in TAQA's home country where the Abu Dhabi Investment Authority is the world's largest sovereign wealth fund with assets of \$875 billion according to the *Financial Times*.

Normally one would think that the government and citizens of one of the world's largest oil exporters would want to diversify away from oil. Moreover, oil and gas in Canada has been a higher cost resource than oil in the Middle East traditionally. The contrary action implies conviction that Canadian oil and gas may increase in value while supplies of cheap oil in the Middle East may be more limited and possibly less secure than previously thought.

Political Irony in Tax "Fairness"

Investors know to run the other way when political leaders talk about the "fairness" of proposed changes. Canada's minority government ended the royalty trust tax advantage after 2011 to stem an imagined loss of revenue. Instead the measure discriminates against individual investors who want to exercise some control over their retirement in favor of institutional investors who can use opaque techniques to avoid taxes.

In the current takeover, we understand from the *Financial Post* that the buyer may set up the purchase as a 100% loan and then make distributions as interest. Apparently, interest payments would not be subject to corporate tax or to withholding tax on payments to non-Canadian entities.

Kurt H. Wulff, CFA

Historical independent energy investment analysis by Kurt Wulff doing business as McDep Associates is posted at www.mcdep.com. Analyses are prepared from sources and data believed to be reliable, but no representation is made as to their accuracy or completeness. Mr. Wulff is not paid by covered companies. Neither he nor his spouse trade a subject stock within a week before or after a change in rating.

Natural Gas and Oil Income Stocks - Rank by McDep Ratio

	Symbol/ Rating	Price (\$/sh) 27-Sep 2007	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/un)	Debt/ Present Value	McDep Ratio	
U.S. Royalty Trusts								
Sabine Royalty Trust	SBR	43.95	14.6	640	45.00	-	0.98	
Permian Basin RT	PBT	15.14	46.6	710	16.50	-	0.92	
Mesa RoyaltyTrust	MTR	60.45	1.9	110	70.00	-	0.87	
Cross Timbers Royalty Trust	CRT	40.12	6.0	240	46.00	-	0.87	
San Juan Basin Royalty Trust	SJT	B	33.72	46.6	1,570	40.00	0.84	
Hugoton RoyaltyTrust	HGT	B	23.79	40.0	950	34.00	0.70	
<i>Total or Median</i>				4,200			0.87	
Canadian Income Trusts (US\$)								
Pengrowth Energy Trust	PGH	18.56	246.0	4,570	17.00	0.28	1.07	
Enerplus Resources Fund	ERF	46.95	128.0	6,010	52.00	0.13	0.92	
Penn West Energy Trust	PWE	B	30.89	241.5	7,460	0.20	0.89	
Canadian Oil Sands Trust	COSWF	B	33.14	479.0	15,870	0.08	0.86	
<i>Total or Median</i>				33,900		0.17	0.90	
U.S. Master Limited Partnerships (MLPs)								
Kinder Morgan Energy Partners, L.P.	KMP	S	49.80	178.6	8,900	17.00	0.53	1.91
Encore Energy Partners, L.P. (39%)	ENP		21.20	9.0	190	18.00	0.14	1.15
Dorchester Minerals, L.P.	DMLP		20.39	28.2	580	27.00	-	0.76
<i>Total or Median</i>				9,700		0.14	1.15	

B = Buy, S = Sell

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

Natural Gas and Oil Income Stocks - Rank by EV/Ebitda

	Symbol/ Rating	Price (\$/sh) 27-Sep 2007	Adjstd Resrvs/ Prod NTM	PV/ Ebitda NTM	EV/ Ebitda NTM	P/E NTM	Divd or Distrib NTM (%)	
U.S. Royalty Trusts								
San Juan Basin Royalty Trust	SJT	B	33.72	10.0	13.0	11.0	13.4	7.4
Cross Timbers Royalty Trust	CRT		40.12	12.0	11.7	10.2	10.9	9.2
Sabine Royalty Trust	SBR		43.95	9.6	10.0	9.8	9.8	10.2
Mesa RoyaltyTrust	MTR		60.45	21.9	10.9	9.5	10.8	9.3
Hugoton RoyaltyTrust	HGT	B	23.79	13.9	11.8	8.3	12.0	8.4
Permian Basin RT	PBT		15.14	8.1	8.8	8.1	10.0	10.0
<i>Median</i>				11.0	11.3	9.6	10.8	9.3
Canadian Income Trusts (US\$)								
Canadian Oil Sands Trust	COSWF	B	33.14	20.9	9.4	8.1	9.6	9.6
Enerplus Resources Fund	ERF		46.95	9.4	8.5	7.8	15.7	10.7
Pengrowth Energy Trust	PGH		18.56	7.1	7.3	7.8	41.4	15.3
Penn West Energy Trust	PWE	B	30.89	7.7	7.5	6.6	13.0	13.2
<i>Median</i>				8.5	8.0	7.8	14.3	11.9
U.S. Master Limited Partnerships (MLPs)								
Kinder Morgan Energy Partners, L.P.	KMP	S	49.80	7.6	8.0	15.3	34.3	6.8
Encore Energy Partners, L.P.	ENP		21.20	12.7	8.0	9.2	27.7	6.6
Dorchester Minerals, L.P.	DMLP		20.39	9.1	11.9	9.0	13.9	11.2
<i>Median</i>				9.1	8.0	9.2	27.7	6.8

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended September 30, 2008; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

Historical independent energy investment analysis by Kurt Wulff doing business as McDep Associates is posted at www.mcdep.com. Analyses are prepared from sources and data believed to be reliable, but no representation is made as to their accuracy or completeness. Mr. Wulff is not paid by covered companies. Neither he nor his spouse trade a subject stock within a week before or after a change in rating.