

Rating: Hold
S&P 500: 1102

San Juan Basin Royalty Trust Change Buy to Hold on Price

<i>Symbol</i>	SJT	<i>Ebitda Next Twelve Months ending 6/30/05 (US\$m)</i>	137
<i>Rating</i>	None	<i>North American Natural Gas/Ebitda (%)</i>	99
<i>Price (US\$/sh)</i>	28.29	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	7/28/04	<i>Adjusted Reserves/Production NTM</i>	12.5
<i>Shares (mm)</i>	47	<i>EV/Ebitda</i>	9.7
<i>Market Capitalization (US\$m)</i>	1,320	<i>PV/Ebitda</i>	7.5
<i>Debt (US\$m)</i>	0	<i>Undeveloped Reserves (%)</i>	50
<i>Enterprise Value (EV) (US\$m)</i>	1,320	<i>Natural Gas and Oil Ebitda (US\$/mcf)</i>	4.05
<i>Present Value (PV) (US\$m)</i>	1,030	<i>Present Value Proven Reserves(US\$/boe)</i>	11.02
<i>Net Present Value (US\$/unit)</i>	22	<i>Present Value Proven Reserves(US\$/mcf)</i>	1.84
<i>Debt/Present Value</i>	0.00	<i>Earnings Next Twelve Months (US\$/un)</i>	2.58
<i>McDep Ratio - EV/PV</i>	1.29	<i>Price/Earnings Next Twelve Months</i>	11
<i>Distribution Yield (%/year)</i>	9.1	<i>Distribution Next Twelve Months (US\$/sh)</i>	2.58

Note: Estimated cash flow and earnings tied to one-year futures prices for natural gas.

Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.

Summary and Recommendation

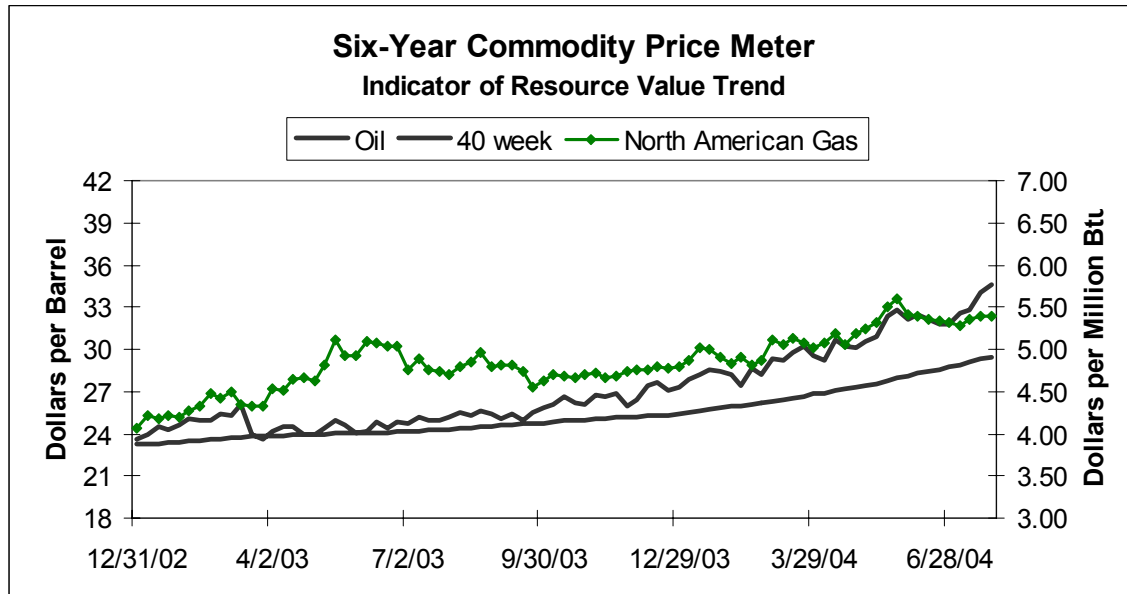
We initiate a Hold rating on **San Juan Basin Royalty Trust (SJT)** in place of our previous buy recommendation because the McDep Ratio has increased beyond the normal level for recommending current purchase of the units. The quality characteristics of the stock have become better recognized – concentration on long-life natural gas in the largest producing U.S. field, low financial risk because of no debt, full upside from rising price because none of the commodity price is hedged and full benefit flowing to unit holders because the trust has no management diluting value through surprise bonuses, stock options or high general partner fees. Investors who choose to hold the stock collect a tax-advantaged 9% distribution yield while waiting for higher energy price to become more broadly acknowledged. Our latest discounted cash flow calculation suggests that the stock reflects a constant oil price of \$36 a barrel. That is less than the \$50 in our scenario, but more than \$30 or less reflected in other buy recommendations.

Natural Gas Price Gaining with Oil Price

The value of the trust depends primarily on natural gas that accounts for 99% of next twelve months production revenue. Natural gas price depends on oil price in a fashion that reflects an increasing premium for environmental advantage. Our scenario for natural gas is our scenario for oil plus a 2% per year adjustment that raises the premium 20% in ten years.

Publicly traded in the commodity markets, futures contracts for delivery over the next six years continue in a steep uptrend. Whether the trend will slow for awhile we cannot know. Six-year futures for oil have moved from the low \$20s and are now in the mid \$30s. At the same time, six-year futures for natural gas have moved from under \$4 to over \$5 (see chart).

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Economics support the price trends. Oil demand is strong with world economic growth paced by developing countries, especially China. Supply is tight as the Middle East is showing maturity with the workhorse giant fields on the verge of peaking.

Monetary factors favor oil and gas investment as interest rates below inflation drive investors to real assets for protection against currency debasement. The authorities are unlikely to raise interest rates above inflation for the rest of the decade. We can be more confident of that as the official U.S. government determined inflation measure appears understated.

Environmental factors favor higher oil and gas price. Coal is still a quarter of world primary energy supply. Cleaner oil and gas are undervalued as long as we tolerate environmentally disadvantageous coal.

Political factors favor higher oil price in consuming countries and producing countries. In consuming countries, many view the use of military force as an attempt to hold down oil price at what we would term an artificially low level. Thirty years ago some of the same political leaders directed price controls in a failed attempt to hold oil price artificially low.

In producing countries we have seen time and again that oil production goes down when international oil companies are not welcome. After Iran, Iraq and Venezuela, now Saudi Arabia appears vulnerable to political change that may bring about production decline.

There may be a risk of oil and gas stock price decline even if oil price remains firm. That happened in 1974 when economic activity and the stock market declined severely. We think the current parallel occurred in 2002 and is now behind us. Nonetheless the stock market may have begun a new moderate downward phase of its cycle. We liken that to the mid to late 1970s when oil price held and then took off again. The properties in the San Juan Basin Royalty Trust increased more than ten-fold in stock market value from 1975 to 1980, as we recall.

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Stock Price May Reflect Oil Price of \$36 a Barrel

When we raised present value of the trust and about 70 stocks in March we took an approach that multiplied next twelve months unlevered cash flow by a multiple that depended on adjusted reserve life. Because US\$35 was the oil one-year futures price at the time we suggested that our estimates reflected constant oil price at \$35. Our more detailed calculation justifies the present value of SJT of \$22 a unit at a constant real oil price of \$30.

While it is gratifying to see that our characterization may have been conservative, SJT stock price near \$28 exceeds our standardized present value. Taking the same calculation and substituting an oil price of \$36 results in a present value of \$27 a unit, near current stock price (see Table SJT-1).

Six-year oil futures are approaching \$35. Thus in a rough sense one might say that SJT is keeping up with six-year futures. That is logical as SJT is the closest one came come in the stock market to billion dollar market cap pure natural gas commodity representation.

Moreover the trend in six-year futures is strongly upward. In our moderate price scenario we are looking for \$50. Should that be achieved and should SJT react accordingly, SJT stock could be almost 40% higher at \$39 a unit.

Next Twelve Months Distribution Estimated at 9.1%

While SJT stock price has advanced so has the estimated distribution. Investors looking forward to an attractive level of income may want to continue holding SJT.

Unlike the typical operating company, there is no management guidance to help trust investors with estimates. Instead, the trustee discloses historical information monthly that might serve as a basis from which to project the future as we try to do quarterly and monthly (see Tables SJT-2 and SJT-3). The element that changes continuously is the future price of natural gas. We update the calculation weekly taking Monday night quotes from the New York Mercantile Exchange for Louisiana (Henry Hub) Natural Gas. Of course, the trust produces and sells its gas in New Mexico where the price is discounted from Louisiana. The price the trust eventually reports is further reduced by some cost items not separately disclosed.

Latest Monthly Distribution Surprise

The monthly distribution declared in July at \$0.27 a unit included a one-time positive adjustment of \$1.8 million, or \$0.04. We attribute that to the professionalism of the trustee and her advisors who have on more than one occasion caught the operator of the properties, **Burlington Resources (BR)**, underpaying proceeds to the trust. Similarly the near absence of development expenditures charged in July boosted the distribution by another \$0.03 per unit compared to the average month.

Kurt H. Wulff, CFA

Table SJT-1
San Juan Basin Royalty Trust
Present Value

Volume Decline (%/yr):	12	Oil Price Post 2005 (2003\$/bbl)	36
Volume Enhancement (%/yr):	12	Real Discount Rate (%/yr):	7.0
Capex/Cash Flow (%):	25	SJT Index Price/Henry Hub	0.85
Severance Tax (%):	8.8	PV/Volume (\$/mcf):	2.24
Adjusted Reserve Life Index (years):	12.5	PV/EBITDA 2005:	9.2

Year	Basic (bcf)	Enhanced (bcf)	Total (bcf)	SJ Index Price (\$/mcf)	Revenue (\$mm)	Prod Cost (\$mm)	State Tax (\$mm)	Cap Ex (\$mm)	Distribution (\$mm)	Distribution (\$/unit)	Disc Factor	Present Value (\$/unit)
Total 2005 through 2031; years ending on 6/30												
	279	282	561	6.58	3688	763	326	374	2225	47.76	0.57	27.00
2005	33.7	0.0	33.7	5.37	181.0	28.2	16.0	17.3	119.5	2.56	0.97	2.48
2006	29.8	3.9	33.7	5.73	193.0	28.2	17.1	36.3	111.4	2.39	0.90	2.16
2007	26.3	7.4	33.7	5.84	196.7	28.2	17.4	37.2	113.9	2.44	0.84	2.06
2008	23.2	10.5	33.7	5.95	200.5	28.2	17.7	38.0	116.5	2.50	0.79	1.97
2009	20.5	13.2	33.7	6.06	204.2	28.2	18.1	38.8	119.1	2.55	0.74	1.88
2010	18.1	15.6	33.7	6.17	207.9	28.2	18.4	39.7	121.6	2.61	0.69	1.80
2011	16.0	17.7	33.7	6.28	211.6	28.2	18.7	40.5	124.2	2.66	0.64	1.72
2012	14.1	19.6	33.7	6.39	215.4	28.2	19.0	41.4	126.7	2.72	0.60	1.64
2013	12.5	21.2	33.7	6.50	219.1	28.2	19.4	42.2	129.3	2.77	0.56	1.56
2014	11.0	22.7	33.7	6.62	222.8	28.2	19.7	43.0	131.9	2.83	0.53	1.49
2015	9.7	20.0	29.8	6.73	200.1	28.2	17.7		154.2	3.31	0.49	1.63
2016	8.6	17.7	26.3	6.84	179.7	28.2	15.9		135.5	2.91	0.46	1.34
2017	7.6	15.6	23.2	6.95	161.3	28.2	14.3		118.8	2.55	0.43	1.09
2018	6.7	13.8	20.5	7.06	144.7	28.2	12.8		103.7	2.22	0.40	0.89
2019	5.9	12.2	18.1	7.17	129.8	28.2	11.5		90.1	1.93	0.37	0.73
2020	5.2	10.8	16.0	7.28	116.5	28.2	10.3		77.9	1.67	0.35	0.59
2021	4.6	9.5	14.1	7.39	104.4	28.2	9.2		66.9	1.44	0.33	0.47
2022	4.1	8.4	12.5	7.50	93.6	28.2	8.3		57.1	1.23	0.31	0.37
2023	3.6	7.4	11.0	7.62	83.9	28.2	7.4		48.2	1.04	0.29	0.30
2024	3.2	6.5	9.7	7.73	75.2	28.2	6.6		40.3	0.86	0.27	0.23
2025	2.8	5.8	8.6	7.84	67.4	28.2	6.0		33.2	0.71	0.25	0.18
2026	2.5	5.1	7.6	7.95	60.3	28.2	5.3		26.8	0.57	0.23	0.13
2027	2.2	4.5	6.7	8.06	54.0	28.2	4.8		21.0	0.45	0.22	0.10
2028	1.9	4.0	5.9	8.17	48.4	28.2	4.3		15.9	0.34	0.20	0.07
2029	1.7	3.5	5.2	8.28	43.3	28.2	3.8		11.3	0.24	0.19	0.05
2030	1.5	3.1	4.6	8.39	38.8	28.2	3.4		7.1	0.15	0.18	0.03
2031	1.3	2.7	4.1	8.51	34.7	28.2	3.1		3.4	0.07	0.17	0.01

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Table SJT-2
San Juan Basin Royalty Trust
Distributable Income

	<i>Q1</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Next</i>
	<i>3/31/04</i>	<i>6/30/04</i>	<i>9/30/04</i>	<i>12/31/04</i>	<i>2004E</i>	<i>3/31/05</i>	<i>6/30/05</i>	<i>Months</i>
								<i>6/30/05</i>
Highlights								
Revenue (\$mm) (75%)	34.8	35.9	40.3	40.1	151.1	43.8	41.5	165.7
Cash flow (\$mm) (75%)	28.3	28.8	32.9	33.0	123.0	36.3	34.2	136.5
Per unit	0.61	0.62	0.71	0.71	2.64	0.78	0.73	2.93
Distributable Income (\$mm)	20.7	25.0	31.3	28.0	104.9	29.1	31.2	119.5
Per unit	0.44	0.54	0.67	0.60	2.25	0.62	0.67	2.56
Units (millions)	46.6	46.6	46.6	46.6	46.6	46.6	46.6	46.6
Volume								
Natural gas (mmbtu)	11.9	11.8	12.1	12.2	48.0	12.2	11.8	48.3
Heat Content(btu/cf)	1,082	1,085	1,084	1,084	1,084	1,084	1,084	1,084
Natural gas (bcf)	11.0	10.8	11.1	11.3	44.3	11.3	10.9	44.6
Natural Gas (mmcf)	119.9	120.3	121.0	122.6	121.0	122.6	122.6	122.2
Days	92	90	92	92	366	92	89	365
Oil (mb)	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.1
Oil (mbd)	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Total gas & oil (bcf)	11.1	10.9	11.2	11.4	44.6	11.4	11.0	44.9
Price								
Natural gas (\$/mmbtu) (Henry Hub lagged two months)								
Henry Hub (\$/mmbtu)	5.58	5.49	6.18	6.00	5.81	6.62	6.48	6.32
Differential (%)	31	27	29	28	28	28	28	28
Net to SJT (\$/mmbtu)	3.86	4.04	4.41	4.33	4.16	4.74	4.64	4.53
Natural gas (\$/mcf)	4.17	4.38	4.78	4.70	4.51	5.13	5.03	4.91
Oil (\$/bbl) (WTI Cushing lagged two months)								
WTI Cushing	32.47	36.06	39.63	41.29	37.36	40.18	38.86	39.99
SJT	28.06	31.16	34.24	35.68	32.29	34.73	33.59	34.57
Total gas & oil (\$/mcf)	4.18	4.39	4.78	4.71	4.52	5.14	5.03	4.92
Revenue (\$mm)								
Natural Gas	46.0	47.4	53.2	53.0	199.6	57.9	54.8	218.9
Oil	0.4	0.5	0.5	0.5	1.9	0.5	0.5	2.0
Total	46.4	47.9	53.7	53.5	201.5	58.4	55.3	220.9
Cost (\$mm)								
Severance tax	4.7	4.9	5.7	5.5	20.8	6.0	5.7	22.9
Operating	4.0	4.6	4.2	3.9	16.7	3.9	3.9	16.0
Total	8.7	9.5	9.8	9.5	37.5	10.0	9.7	38.9
Cash flow (\$mm)	37.7	38.4	43.9	44.1	164.0	48.4	45.7	182.0
Development	9.4	4.6	4.2	6.1	24.4	9.1	3.6	23.1
Net proceeds (\$mm)	28.3	33.8	39.7	37.9	139.6	39.3	42.1	158.9
Royalty income (\$mm)	21.2	25.3	29.7	28.4	104.7	29.5	31.5	119.2
Royalty/Net proceeds	75%	75%	75%	75%	75%	75%	75%	75%
Administration	0.5	0.3	0.3	0.5	1.6	0.4	0.4	1.5
One-time			(1.8)		(1.8)			(1.8)
Distributable income (\$mm)	20.7	25.0	31.3	28.0	104.9	29.1	31.2	119.5
Severance tax/revenue	10.2%	10.3%	10.5%	10.3%	10.3%	10.3%	10.3%	10.4%
Operating cost (\$/mcf)	0.36	0.42	0.37	0.35	0.37	0.35	0.36	0.36
Development/Cash flow	25%	12%	10%	14%	15%	19%	8%	13%

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Table SJT-3
San Juan Basin Royalty Trust
Monthly Declarations

	<i>May-04</i>	<i>Jun-04</i>	<i>Jul-04</i>	<i>Aug-04</i>	<i>Sep-04</i>	<i>Oct-04</i>
Distribution (\$/unit)						
Declared	0.18	0.19	0.27			
Projected				0.18	0.22	0.20
Volume						
Natural gas (mmbtu)	3.95	4.01	3.96	3.99	4.12	4.12
Heat Content(btu/cf)	1,074	1,083	1,082	1,084	1,084	1,084
Natural gas (bcf)	3.68	3.70	3.66	3.68	3.80	3.80
Natural Gas (mmcf)	119	123	118	123	123	123
Days	31	30	31	30	31	31
Price						
Natural gas industry quotes lagged two months (\$/mmbtu)						
Henry Hub Daily/Futures	5.38	5.71	6.30	6.29	5.94	5.95
San Juan Monthly Index	4.40	4.46	5.06	4.71	5.49	5.06
San Juan Index/Henry Hub	0.82	0.78	0.80	0.75	0.92	0.85
SJT/San Juan Index	0.87	0.89	0.90	0.85	0.85	0.85
SJT (\$/mmbtu)	3.84	3.97	4.55	4.00	4.67	4.30
SJT (\$/mcf)	4.13	4.30	4.92	4.34	5.06	4.66
Revenue (\$mm)						
Natural Gas	15.2	15.9	18.0	16.0	19.2	17.7
Other	(0.0)	0.0	0.1	(0.0)	(0.0)	(0.0)
Cost (\$mm)						
Severance tax	1.6	1.7	2.0	1.7	2.0	1.8
Operating	1.4	1.5	1.5	1.3	1.3	1.3
Total	3.0	3.2	3.5	3.0	3.3	3.2
Cash flow (\$mm)	12.2	12.8	14.6	13.0	15.9	14.5
Development	1.0	0.9	0.1	2.0	2.0	2.0
Net proceeds (\$mm)	11.2	11.9	14.5	10.9	13.8	12.5
Royalty income (\$mm)	8.4	8.9	10.9	8.2	10.4	9.4
Royalty/Net proceeds	75%	75%	75%	75%	75%	75%
One time			(1.8)			
Distributable income (\$mm)	8.4	8.9	12.7	8.2	10.4	9.4
Units (millions)	46.6	46.6	46.6	46.6	46.6	46.6
Distribution (\$/unit)	0.18	0.19	0.27	0.18	0.22	0.20
<i>Latest Twelve Month Average</i>						
Heat Content(btu/cf)	1,085	1,084	1,084			
Natural Gas (mmcf)	122	123	123			
San Juan Index/Henry Hub	0.83	0.84	0.85			
SJT/San Juan Index	0.84	0.84	0.85			
Other revenue	(0.0)	(0.0)	(0.0)			
Operating	1.3	1.3	1.3			
Development	2.1	2.1	2.0			
Severance tax/revenue	10.4%	10.5%	10.4%			

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Research Methodology/Ratings Description: McDep Associates is an independent research originator focused on oil and gas stocks exclusively. The firm applies the thirty years of experience of its analyst to estimate a present value of the oil and gas resources and other businesses of covered companies. That value is compared with a company's stock market capitalization and debt. Stocks with low market cap and debt relative to present value tend to outperform stocks with high market cap and debt relative to present value. Buy recommendations are expected to deliver a total return better than 7% per year above inflation. Hold recommendations assume the attributes of the underlying business are reflected in the current price of the stock. Sell recommendations are expected to deliver a negative total return less than 7% per year including the effects of inflation.

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