

Present Value at \$40 Oil

Summary and Recommendation

Stock price near present value estimated for constant real oil price of \$40 a barrel implies that U.S. natural gas royalty trusts may be valued as alternatives to long-term futures currently averaging \$42 a barrel for the next six years. Long-term futures remain in a rising trend that shows no sign of ending. Those characteristics justify holding investments in one or more of the concentrated resource plays, in our opinion. Investors seeking current income would be especially attracted to cash distributions projected for the next twelve months at an average of 8.5% currently.

Commodity Value and High Income

Since we resumed weekly coverage of U.S. royalty trusts in the fourth quarter of 2004 we overlooked differences in valuation. Instead we presented the stocks as a group with emphasis on the combined distribution yield projected for the next twelve months (see table The Account).

The Account

	<i>Symbol</i>	<i>Price (\$/un) 27-Jan 2005</i>	<i>Units</i>	<i>Market Value (\$)</i>	<i>Next Twelve Months Distrib. (\$/un)</i>	<i>NTM Distrib. Yield (%/yr)</i>
Cross Timbers Royalty Trust	CRT	40.73	400	16,292	3.05	7.5
Dorchester Minerals, L.P.	DMLP	24.24	700	16,968	2.05	8.4
Hugoton Royalty Trust	HGT	25.87	500	12,935	2.43	9.4
Mesa Royalty Trust	MTR	67.75	200	13,550	5.38	7.9
Permian Basin Royalty Trust	PBT	13.96	1,200	16,752	1.16	8.3
Sabine Royalty Trust	SBR	38.00	400	15,200	3.38	8.9
San Juan Basin Royalty Trust	SJT	30.85	500	15,425	2.80	9.1
	<i>Total</i>			<i>107,122</i>		<i>8.5</i>
Futures Strip						
12 Month - Oil (\$/bbl)		47.76				
12 Month - Natural Gas (\$/mmbtu)		6.63				
72 Month - Oil (\$/bbl)		42.38				
72 Month - Natural Gas (\$/mmbtu)		5.88				

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Commodity price expectation is the common variable affecting valuation that changes the most. As of January 25, 2005, we changed our expectation of long-term crude oil price to \$40 a barrel constant real, up from \$35 for Light Sweet Crude as traded in the futures market. The actual nominal market price for delivery over the next six years is \$42.38 as quoted above. Oil price and the related natural gas price is translated into present value that can be compared to stock price. As stock price lines up close to present value we conclude that the ownership of the stocks represents long-term ownership of the natural gas and oil resources near current market price (see table).

Rank by McDep Ratio: Market Cap and Debt to Present Value

	<i>Symbol</i>	<i>Price (\$/sh) 27-Jan 2005</i>	<i>Shares (mm)</i>	<i>Market Cap (\$mm)</i>	<i>Net Present Value (\$/sh)</i>	<i>EV/ Ebitda</i>	<i>McDep Ratio</i>
Permian Basin RT (41%)	PBT	13.96	19.1	270	11.00	11.0	1.27
Dorchester Minerals, L.P.	DMLP	24.24	27.0	660	21.00	11.8	1.15
Sabine Royalty Trust	SBR	38.00	14.6	550	33.00	11.2	1.15
Cross Timbers Royalty Trust	CRT	40.73	6.0	240	36.00	13.2	1.13
Mesa RoyaltyTrust	MTR	67.75	1.9	130	60.00	12.2	1.13
Hugoton RoyaltyTrust (46%)	HGT	25.87	18.4	480	25.00	8.8	1.03
San Juan Basin Royalty Trust	SJT	30.85	46.6	1,440	30.00	9.8	1.03
	<i>Total or Median</i>			<i>3,800</i>		<i>11.2</i>	<i>1.13</i>

The McDep Ratio can be a guide to interpreting the more widely recognized measure, cash flow multiple, or EV/Ebitda. Reserve life is the main determinant of cash flow multiple, as we see it. Yet, reported reserves for royalty trusts vary widely from the standards for operating companies. Another valuation factor not readily evident is the lower operating risk for SBR, CRT and PBT that receive all or part of their return as a percentage of commodity prices rather than a percentage of producing profit. Since none of the trusts have debt, we inserted EV/Ebitda in the table where we normally show debt ratio for operating companies.

Finally, if royalty trusts reflect commodity value among other factors, the outlook for commodity price influences the outlook for investment return. If commodity price stays at \$40 a barrel, a trust priced at present value would return 7% a year adjusted for inflation. Meanwhile commodity price continues in an upward trend. On that score we see a greater likelihood of higher price in time than lower price.

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