

Myth of Management

Summary and Recommendation

Owners of **Sabine Royalty Trust (SBR)** must remain vigilant in the face of an offer to give up their units for no valuable consideration and a “trust me” promise from a largely unknown and unproven operator. The party soliciting proxies to turn SBR into a limited partnership attempts to persuade on the basis of an often false premise that active management would add value. To illustrate the point we see that 15-year historical returns for SBR and **San Juan Basin Royalty Trust (SJT)** exceed by a wide margin those of actively managed **Burlington Resources (BR)**, the operator and owner of the underlying properties in SJT. Separately in a conversation with the proxy soliciting party we understood that he believed the units of SBR to be overpriced, not a view conducive to a fair transaction. Meanwhile our estimated median distribution yield in 2006 is 10.0% for U.S. royalty trusts. The 2006 distribution would likely be more than a median 8.6% indicated for Canadian trusts.

Unmanaged Royalty Trusts Outperform Managed Counterpart

Our experience with SBR, SJT and BR covers the whole life of each entity as well as their predecessors. Many times we underestimated the resource value of SBR and often that of SJT, but practically never did we underestimate the resource value of BR relative to stock price. In fact, not even with the pending acquisition of BR by **ConocoPhillips (COP)** have the investor returns in BR caught up to those in SBR and SJT (see table [Investor Total Return – Myth of Management](#)). The main practical difference between BR and SJT is management. The historical performance of SBR is similar to that of SJT.

Investor Total Return - Myth of Management (percent per year)

<u>Through 12/31/05</u>	<u>15 Years</u>	<u>10 Years</u>	<u>5 Years</u>
SBR adjusted for operating leverage	26.6	38.9	37.4
San Juan Basin Royalty Trust (SJT)	26.1	34.3	40.8
Sabine Royalty Trust (SBR)	22.2	32.4	31.2
Burlington Resources (BR)	13.2	17.3	29.2
BR adjusted for financial leverage	11.8	15.3	25.2
Cano Petroleum (CWF)	na	na	na

Source: Bloomberg, McDep Associates

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Mr. Haddock Calls

Mr. Gerald Haddock, the principal party behind the attempted restructuring of SBR has contacted us by phone, unsolicited. He called first after someone brought his attention to the summary of the analysis we sent to clients on January 6 and again after the full analysis became available on www.mcdep.com on January 15 (see Stop Thief, January 6, 2006). We have had no previous contact with Mr. Haddock that we recall.

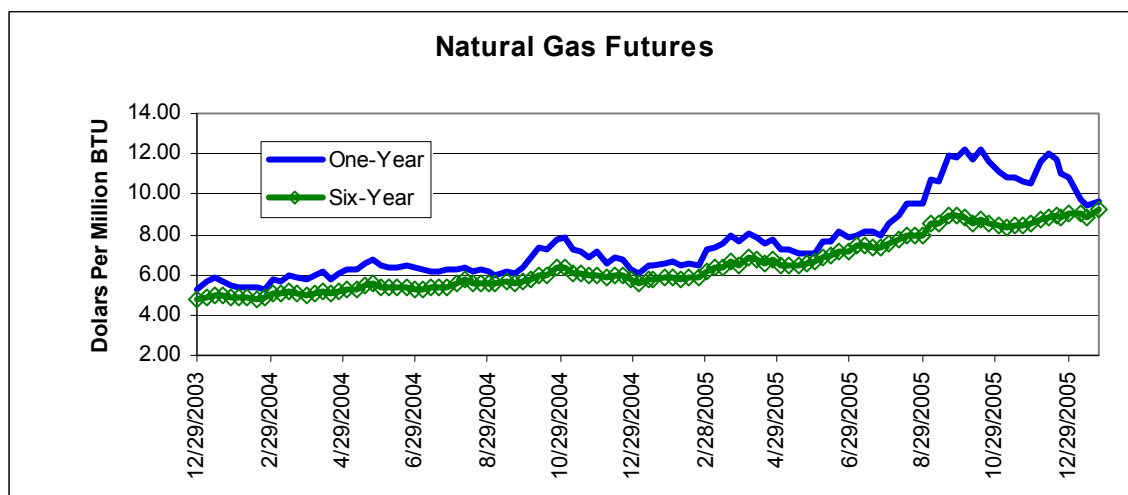
In the discussion we stated at one point that a cash offer for SBR units would be more credible. Mr. Haddock protested that SBR units were overpriced!

Mr. Haddock emphasized that he believed that the trust's oil properties in East Texas were in terminal decline. While that can be true of almost every well from the first day it is produced, we nonetheless suggested that Mr. Haddock could do the unitholders a service if he could publish a detailed analysis of SBR's properties to substantiate his assertions.

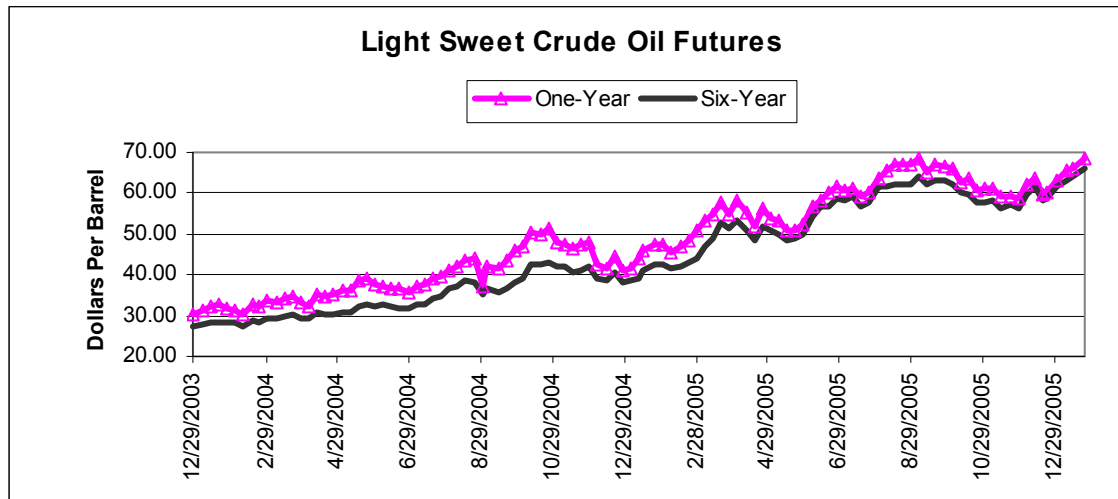
Yet oil accounts for only about a third of the value in SBR. And only a portion of that third is in East Texas where Mr. Haddock apparently has experience. Like the oil properties, the natural gas properties accounting for the dominant two thirds of value are well diversified.

Finally, when we checked the Form 10-K filed by Mr. Haddock's Cano Petroleum (CWF) last year, our eyes picked up what may be a telltale sign. The document disclosed 16 incidents in which insiders failed to file ownership forms on a timely basis.

Kurt H. Wulff, CFA



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Natural Gas and Oil Royalty Trusts Rank by McDep Ratio: Market Cap and Debt to Present Value

	Symbol/ Rating	Price (\$/sh) 19-Jan 2006	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/un)	Debt/ Present Value	McDep Ratio
U.S. Royalty Trusts							
San Juan Basin Royalty Trust	SJT H	44.98	46.6	2,100	40.00	-	1.12
Hugoton RoyaltyTrust (46%)	HGT	37.59	18.4	690	34.00	-	1.11
Cross Timbers Royalty Trust	CRT	47.41	6.0	280	45.00	-	1.05
Permian Basin RT	PBT	15.75	46.6	730	15.00	-	1.05
Dorchester Minerals, L.P.	DMLP	27.00	28.2	760	26.00	-	1.04
Sabine Royalty Trust	SBR	42.66	14.6	620	42.00	-	1.02
Mesa RoyaltyTrust	MTR	68.14	1.9	130	75.00	-	0.91
	<i>Total or Median</i>			5,300			1.05
Canadian Income Trusts							
Penn West Energy Trust	PWTFF B	36.70	179.4	6,580	28.00	0.15	1.26
Pengrowth Energy Trust	PGH	24.44	159.0	3,890	20.00	0.16	1.19
Enerplus Resources Fund	ERF	50.01	110.0	5,500	42.00	0.14	1.16
Canadian Oil Sands Trust (US\$)	COSWF B	128.44	93.1	11,950	136.00	0.11	0.95
	<i>Total or Median</i>			27,900		0.14	1.18

B = Buy, H = Hold

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) 19-Jan 2006	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	47.41	18.8	10.1	10.7	10.8	9.2
San Juan Basin Royalty Trust	SJT H	44.98	12.2	9.3	10.4	11.4	8.8
Dorchester Minerals, L.P.	DMLP	27.00	11.5	9.1	9.4	14.2	10.5
Mesa RoyaltyTrust	MTR	68.14	20.0	10.2	9.3	10.0	10.0
Sabine Royalty Trust	SBR	42.66	11.6	8.8	8.9	8.9	11.2
Hugoton RoyaltyTrust (46%)	HGT	37.59	13.5	7.7	8.6	11.9	8.4
Permian Basin RT	PBT	15.75	14.9	7.9	8.3	9.0	11.1
	<i>Median</i>		<i>13.5</i>	<i>9.1</i>	<i>9.3</i>	<i>10.8</i>	<i>10.0</i>
Canadian Income Trusts							
Canadian Oil Sands Trust (US\$)	COSWF B	128.44	20.0	10.2	9.7	11.0	2.7
Pengrowth Energy Trust	PGH	24.44	7.6	5.3	6.3	9.2	10.5
Enerplus Resources Fund	ERF	50.01	8.6	5.4	6.3	9.4	8.6
Penn West Energy Trust	PWTFF B	36.70	8.0	4.8	6.1	9.1	8.7
	<i>Median</i>		<i>8.3</i>	<i>5.4</i>	<i>6.3</i>	<i>9.3</i>	<i>8.6</i>

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended December 31, 2006; 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)	Dist. Yield (%)
U.S. Royalty Trusts								
Hugoton RoyaltyTrust (46%)	HGT	-	92	0.72	0.72	58	3.16	8.4
San Juan Basin Royalty Trust	SJT	-	99	0.91	0.91	184	3.95	8.8
Cross Timbers Royalty Trust	CRT	85	73	0.99	0.99	26	4.38	9.2
Mesa RoyaltyTrust	MTR	-	78	0.93	0.93	13	6.80	10.0
Dorchester Minerals, L.P.	DMLP	54	76	0.99	0.99	80	2.84	10.5
Permian Basin RT	PBT	30	42	0.93	0.93	82	1.75	11.1
Sabine Royalty Trust	SBR	100	66	1.00	1.00	70	4.80	11.2
	<i>Total or Median</i>		<i>76</i>	<i>0.93</i>	<i>0.93</i>	<i>500</i>		<i>10.0</i>
Canadian Income Trusts								
Canadian Oil Sands Trust (US\$)	COSWF	-	(7)	0.23	0.26	318	3.41	2.7
Enerplus Resources Fund	ERF	-	48	0.48	0.56	473	4.30	8.6
Penn West Energy Trust	PWTFF	-	48	0.46	0.54	570	3.17	8.7
Pengrowth Energy Trust	PGH	-	41	0.58	0.68	407	2.56	10.5
	<i>Total or Median</i>		<i>44</i>	<i>0.47</i>	<i>0.55</i>	<i>1,800</i>		<i>8.6</i>
Kinder Morgan Energy Partners	KMP			0.76	1.69			6.4

NTM = Next Twelve Months Ended December 31, 2006

Ebitda = Earnings before interest, tax, depreciation and amortization

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