

Future Energy Income Stocks

Summary and Recommendation

Out of the turnover of buy-recommended **Anadarko (APC)**'s assets two new energy income stocks may emerge perhaps as soon as mid year. Buy-recommended **Encore Acquisition (EAC)** expects to turn some of its \$810 million of former APC properties into a master limited partnership (MLP). Similarly Exco Resources (XCO) may turn some of its \$2.46 billion of former APC properties into a new publicly traded MLP. We are potentially interested in both with the expectation that neither will have deceptive general partner compensation. Among new oil and gas income issues in 2006, Linn Energy LLC (LINE) and Breitburn Energy Partners LP (BBEP) have apparently reasonable compensation. In contrast, EV Energy Partners (EVEP) has "Incentive Distribution Rights" or IDRs, which we would call "Investor Duping Rules", which would allocate up to 25% of cash distributions to the general partner without full recognition in the accounting statements. Meanwhile, current unlevered weightings for income stocks in our illustrative McDep Energy Portfolio displayed weekly in *Meter Reader* are double for **Canadian Oil Sands Trust (COSWF)** and **San Juan Basin Royalty Trust (SJT)**, one and a half for **Penn West Energy Trust (PWE)** and a half for **Hugoton Royalty Trust (HGT)**.

Canadian Income Stock Strategy

Question: Would you trim an overweighting in COSWF and PWE and put some of the proceeds into American companies like ConocoPhillips (COP) and Chevron (CVX)?

Answer: Giving no consideration to income characteristics in either stock, COSWF is one of our most undervalued stocks at a McDep Ratio of 0.71 and PWE appears undervalued at a McDep Ratio of 0.79. If you are patient, there appears to be no compelling need to scale back on COSWF now. You might scale back an overweighting in PWE in the absence of the income upside it once seemed to have.

Stock prices look as if the damage is done to Canadian stocks as a result of the proposed trust tax change. That means that if the tax change is not enacted the stocks have extra potential to make up recent declines. We hold out hope, but not an expectation, oil and gas trusts in Canada might retain the advantages that oil and gas income stocks have in the U.S.

Operationally, COSWF is having temporary difficulties reflected in January volume at 222,000 barrels daily, the lowest since April 2006 and it is really cold in Fort McMurray, Alberta. Compared to our more optimistic outlook, management appears to take the cautious view that the quarterly distribution might not be increased from C\$0.30 for awhile. Nonetheless, cash flow is sensitive to operating volume. The potential to operate at full capacity of 350,000 barrels daily in a few months does not appear to be reflected in current distribution or stock price.

Underlying all of our buy recommendations is a bullish outlook for oil long term. We are more bullish on natural gas for 2007. In that sense natural gas oriented U.S. stocks might get more attention than oil oriented Canadian stocks for a while.

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

	Symbol/ Rating	Price (\$/sh) 8-Feb 2007	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/un)	Debt/ Present Value	McDep Ratio	
U.S. Royalty Trusts								
Cross Timbers Royalty Trust	CRT	45.62	6.0	270	46.00	-	0.99	
Sabine Royalty Trust	SBR	43.14	14.6	630	45.00	-	0.96	
Permian Basin RT	PBT	15.50	46.6	720	16.50	-	0.94	
Dorchester Minerals, L.P.	DMLP	22.45	28.2	630	27.00	-	0.83	
Mesa RoyaltyTrust	MTR	57.38	1.9	110	70.00	-	0.82	
San Juan Basin Royalty Trust	SJT	B	32.52	46.6	1,520	40.00	-	0.81
Hugoton RoyaltyTrust	HGT	B	25.03	40.0	1,000	34.00	-	0.74
	<i>Total or Median</i>			4,900			0.83	
Canadian Income Trusts (US\$)								
Enerplus Resources Fund	ERF	43.90	123.1	5,400	47.00	0.11	0.94	
Pengrowth Energy Trust	PGH	16.87	241.0	4,070	20.00	0.26	0.89	
Penn West Energy Trust	PWE	B	29.83	239.0	7,130	39.00	0.13	0.79
Canadian Oil Sands Trust	COSWF	B	23.94	479.0	11,470	35.00	0.08	0.71
	<i>Total or Median</i>			28,100		0.12	0.84	

B = Buy

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

Natural Gas and Oil Royalty Trusts Rank by EV/Ebitda: Enterprise Value to Earnings Before Interest, Tax, Deprec.

	Symbol/ Rating	Price (\$/sh) 8-Feb 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	45.62		12.7	12.6	12.8	7.8	
Sabine Royalty Trust	SBR	43.14		12.3	11.8	11.8	8.5	
Permian Basin RT	PBT	15.50		10.9	10.2	11.5	8.7	
Mesa RoyaltyTrust	MTR	57.38		11.8	9.7	12.0	8.4	
Dorchester Minerals, L.P.	DMLP	22.45		11.5	9.5	14.9	8.7	
San Juan Basin Royalty Trust	SJT	B	32.52	10.2	8.3	10.0	10.0	
Hugoton RoyaltyTrust	HGT	B	25.03	10.4	7.6	12.1	8.3	
	<i>Median</i>			11.5	9.7	12.0	8.5	
Canadian Income Trusts (US\$)								
Canadian Oil Sands Trust	COSWF	B	23.94	23.3	14.0	9.9	14.2	6.4
Enerplus Resources Fund	ERF	43.90	9.5	7.9	7.4	16.6	9.7	
Penn West Energy Trust	PWE	B	29.83	8.1	8.7	6.9	12.1	11.6
Pengrowth Energy Trust	PGH	16.87	7.1	7.1	6.2	10.1	15.0	
	<i>Median</i>			8.8	8.3	7.2	13.2	10.6

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended December 31, 2007; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

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**Natural Gas and Oil Royalty Trusts
Rank by NTM Distribution Yield**

	<i>Symbol</i>	<i>Revenue Royalty (%)</i>	<i>Natural Gas/ Ebitda (%)</i>	<i>Dist/ Ebitda</i>	<i>Dist/ Equity Ebitda</i>	<i>NTM Distribution (\$mm)</i>	<i>NTM Distribution (\$/un)</i>	<i>Dist. Yield (%)</i>	
U.S. Royalty Trusts									
	Cross Timbers Royalty Trust	CRT	81	71	0.98	0.98	21	3.56	7.8
	Hugoton Royalty Trust	HGT	-	91	0.63	0.63	83	2.07	8.3
	Mesa Royalty Trust	MTR	-	77	0.81	0.81	9	4.80	8.4
	Sabine Royalty Trust	SBR	100	57	1.00	1.00	53	3.66	8.5
	Dorchester Minerals, L.P.	DMLP	56	76	0.83	0.83	55	1.95	8.7
	Permian Basin RT	PBT	29	37	0.89	0.89	63	1.35	8.7
	San Juan Basin Royalty Trust	SJT	-	98	0.83	0.83	151	3.24	10.0
	<i>Total or Median</i>			76	0.83	0.83	400		8.5
Canadian Income Trusts (US\$)									
	Canadian Oil Sands Trust	COSWF	-	(11)	0.56	0.61	730	1.52	6.4
	Enerplus Resources Fund	ERF	-	46	0.64	0.71	525	4.26	9.7
	Penn West Energy Trust	PWE	-	41	0.67	0.77	825	3.45	11.6
	Pengrowth Energy Trust	PGH	-	44	0.66	0.90	612	2.54	15.0
	<i>Total or Median</i>			43	0.65	0.74	2,700		10.6
	Kinder Morgan Energy Partners	KMP			0.79	1.71			6.5

NTM = Next Twelve Months Ended December 31, 2007

Ebitda = Earnings before interest, tax, depreciation and amortization

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