



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

September 4, 2009

San Juan Basin Royalty Trust (SJT) Upgrade to Buy from Hold

We recommend current purchase of the units of natural gas income stock **San Juan Basin Royalty Trust (SJT)** for unlevered appreciation potential of 38% to a McDep Ratio of 1.0 where stock price would equal Net Present Value (NPV) of \$21 a share. Investors looking for a stock that has not participated much in the market recovery need look no further than SJT, which trades at the lowest ratio, 0.85, to its 200-day average of any stock in our coverage. The overwhelming factor influencing the stock price of SJT is the price of natural gas, which is under acute short-term pressure ahead of the winter heating season that begins on November 1. Record short interest seems to anticipate a price decline climax in the next several weeks. We think it is time to “jump the gun” because if the climax occurs, the price recovery could be sharp. The main risk is that depressed conditions take longer to be alleviated.

SJT Almost Always Offers Attractive Income

Our current estimates anticipate a distribution of \$1.08 a unit for the next twelve months ended September 30, 2010 (see table [Next Twelve Months Operating and Financial Estimates](#), page 3). That implies a distribution yield of 7% a year. Buyers can usually figure that the distribution yield will be in the high single digits because the stock price tends to adjust for distribution expectations. In that case, the risk becomes the prospect for changes in expectations, which in turn depend mostly on the outlook for natural gas price. Alternatively, if an investor has a view on natural gas price, then SJT is a pure play vehicle to invest in that view.

NPV Tied to Long-Term Natural Gas Price of \$8 a Million Btu

Our view on natural gas price is that \$8 a million btu is reasonable for the long-term before adjustment for inflation. That appears to be a bullish position compared to the average of futures prices for the next 72 months, or six years, at \$6.33 for the September 3 settlement. In any case we use the \$8 price to calculate NPV in a discounted cash flow format (see table [Present Value](#), page 4). Change the long-term price to \$6 and NPV becomes \$15, a percentage change about the same as the percentage change in price.

Among other estimates we project capital expenditures that keep volume decline modest. Projected volume would cumulate to 20 times initial volume or about twice the proven reserves estimated by the trust’s independent engineer. Proven reserves of a high quality

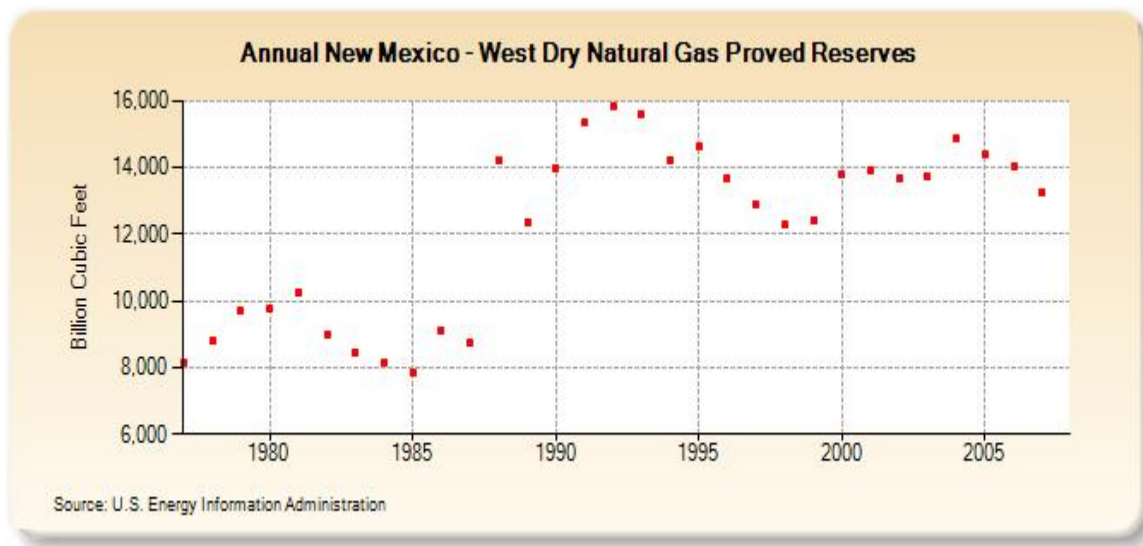


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resource can underestimate actual future production by a wide margin. The U.S. Energy Information Administration reports that reserves in the San Juan Basin, the largest natural gas field in the U.S. at the end of 2007, have grown to some 13 trillion cubic feet (tcf) from 10 tcf in 1980, the year the trust was created (see chart below). That is an increase after 27 years of production. The U.S. Geological Survey estimates 50 tcf of resources remaining to be discovered in the basin. Thus, while our estimate of production looks high relative to proven reserves, it looks low relative to historical performance.



The recent technological advances that make production from shale formations economic contributed to our reduction in long-term price from \$10 to \$8 two months ago in July. Now industry volume is declining as not even new shale drilling is enough to keep production at the current level. The shale gas development is analogous to the coal seam gas development that contributed to extra reserve increases in the San Juan Basin twenty years ago. The extra supply contributed to weak price for awhile before an upward trend resumed.

Six Income and Small Cap Buys

SJT joins five other buy recommendations in our weekly valuation tables on small cap and income stocks (see Tables 1-3, pages 5-7).

Kurt H. Wulff, CFA



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San Juan Basin Royalty Trust									
Next Twelve Months Operating and Financial Estimates									
	Q3	Q2	Q3E	Q4E	Year	Q1E	Q2E	Q3E	Next Twelve Months
	9/30/08	6/30/09	9/30/09	12/31/09	2008E	3/31/10	6/30/10	9/30/10	9/30/10
Highlights									
Revenue (\$mm) (75%)	70.8	18.4	20.4	17.5	82.6	25.7	27.4	29.1	99.6
Cash flow (\$mm) (75%)	58.2	10.7	12.5	9.8	49.9	17.1	18.7	20.2	65.9
Per unit	1.25	0.23	0.27	0.21	1.07	0.37	0.40	0.43	1.41
Distributable Income (\$mm)	52.2	1.8	6.4	5.3	22.4	13.8	15.1	16.3	50.4
Per unit	1.12	0.04	0.14	0.11	0.48	0.30	0.32	0.35	1.08
Units (millions)	46.6	46.6	46.6	46.6	46.6	46.6	46.6	46.6	46.6
Volume									
Natural gas (mmbtu)	9.4	9.2	9.7	9.5	37.6	9.4	9.0	9.2	37.2
Heat Content(btu/cf)	1,074	1,081	1,087	1,079	1,082	1,082	1,082	1,083	1,082
Natural gas (bcf)	8.7	8.5	8.9	8.8	34.7	8.7	8.3	8.5	34.4
Natural Gas (mmcf)	95.0	95.6	96.5	95.6	95.2	94.6	93.7	92.7	94.2
Days	92	89	92	92	365	92	89	92	365
Oil (mb)	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.1
Oil (mbd)	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Days	92	89	92	92	365	92	89	92	365
Total gas & oil (bcf)	8.8	8.6	9.0	8.9	35.1	8.8	8.4	8.6	34.7
Price									
Natural gas (\$/mmbtu) (Henry Hub lagged two months)									
Henry Hub (\$/mmbtu)	12.11	4.06	3.61	3.11	4.32	4.65	5.20	5.39	4.59
Differential (%)	18	36	24	24	34	24	24	24	24
Net to SJT (\$/mmbtu)	9.89	2.61	2.73	2.36	2.86	3.54	3.95	4.09	3.48
Natural gas (\$/mcf)	10.62	2.82	2.97	2.55	3.09	3.83	4.27	4.43	3.76
Oil (\$/bbl) (WTI Cushing lagged two months)									
WTI Cushing	130.89	45.65	64.29	70.34	56.78	71.35	73.16	74.67	72.38
SJT	120.99	36.58	51.52	56.37	46.75	58.74	60.24	61.48	59.18
Total gas & oil (\$/mcf)	10.70	2.86	3.03	2.62	3.14	3.89	4.33	4.49	3.82
Revenue (\$mm)									
Natural Gas	92.8	24.0	26.4	22.4	107.5	33.3	35.6	37.8	129.2
Oil	1.5	0.6	0.8	0.9	2.7	0.9	0.9	0.9	3.6
Total	94.3	24.6	27.2	23.3	110.1	34.2	36.5	38.7	132.8
Cost (\$mm)									
Severance tax	8.8	2.4	2.6	2.3	10.8	3.4	3.6	3.9	13.2
Operating	7.9	7.8	7.9	7.9	32.7	7.9	7.9	7.9	31.8
Total	16.8	10.3	10.6	10.3	43.6	11.3	11.5	11.8	45.0
Cash flow (\$mm)									
Development	7.5	11.0	7.6	5.6	34.1	4.1	4.5	4.8	19.1
Net proceeds (\$mm)									
	70.0	3.3	9.0	7.4	32.5	18.7	20.5	22.1	68.8
Royalty income (\$mm)									
Royalty/Net proceeds	75%	75%	75%	75%	75%	75%	75%	75%	75%
Administration	0.3	0.7	1.0	0.3	2.5	0.3	0.3	0.3	1.2
One-time			(0.6)		(0.6)				-
Distributable income (\$mm)									
	52.2	1.8	6.4	5.3	22.4	13.8	15.1	16.3	50.4
Severance tax/revenue	9.3%	9.9%	9.7%	9.9%	9.8%	9.9%	9.8%	9.9%	9.9%
Operating cost (\$/mcf)	0.90	0.91	0.89	0.89	0.93	0.90	0.94	0.92	0.92
Development/Cash flow	10%	77%	46%	43%	51%	18%	18%	18%	22%



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Present Value												
Oil Volume Decline (%/yr):				3	Oil Price Post 2010 (2010\$/bbl)						75	
Nat Gas Volume Decline (%/yr):				3	Nat Gas Price Post 2010 (2010\$/mcf)						8	
						Real Discount Rate (%/yr):						7.0
Variable Cost (%):				15	PV/EBITDA 2011:						8	
Cumul. Vol/Prod 2010:				20	Capex/Cash Flow (%):						10	
	Volume		Price		Revenue	Fixed	Var.	Cap			Present	
	Oil	Nat Gas				Cost	Cost	Ex	Distribution	Disc	Value	
Year	(mmb)	(bcf)	(\$/bbl)	(\$/mcf)	(\$mm)	(\$mm)	(\$mm)	(\$mm)	(\$mm)	\$/unit	Factor	(\$/unit)
Total 2010 through 2039; years ending on 9/30												
	0.9	515			3287	600	493	227	1967	42.21	0.50	21.00
2010	0.05	25.77	59.18	3.76	99.6	20.0	14.9	14.3	50.4	1.08	0.97	1.04
2011	0.04	25.00	68.25	6.40	163.0	20.0	24.5	11.9	106.7	2.29	0.90	2.07
2012	0.04	24.25	68.25	6.40	158.1	20.0	23.7	11.4	103.0	2.21	0.84	1.87
2013	0.04	23.52	68.25	6.40	153.4	20.0	23.0	11.0	99.3	2.13	0.79	1.68
2014	0.04	22.82	68.25	6.40	148.8	20.0	22.3	10.6	95.8	2.06	0.74	1.52
2015	0.04	22.13	68.25	6.40	144.3	20.0	21.6	10.3	92.4	1.98	0.69	1.37
2016	0.04	21.47	68.25	6.40	140.0	20.0	21.0	9.9	89.1	1.91	0.64	1.23
2017	0.04	20.82	68.25	6.40	135.8	20.0	20.4	9.5	85.9	1.84	0.60	1.11
2018	0.04	20.20	68.25	6.40	131.7	20.0	19.8	9.2	82.8	1.78	0.56	1.00
2019	0.03	19.59	68.25	6.40	127.8	20.0	19.2	8.9	79.8	1.71	0.53	0.90
2020	0.03	19.01	68.25	6.40	123.9	20.0	18.6	8.5	76.8	1.65	0.49	0.81
2021	0.03	18.44	68.25	6.40	120.2	20.0	18.0	8.2	74.0	1.59	0.46	0.73
2022	0.03	17.88	68.25	6.40	116.6	20.0	17.5	7.9	71.2	1.53	0.43	0.66
2023	0.03	17.35	68.25	6.40	113.1	20.0	17.0	7.6	68.5	1.47	0.40	0.59
2024	0.03	16.83	68.25	6.40	109.7	20.0	16.5	7.3	65.9	1.41	0.37	0.53
2025	0.03	16.32	68.25	6.40	106.4	20.0	16.0	7.0	63.4	1.36	0.35	0.48
2026	0.03	15.83	68.25	6.40	103.2	20.0	15.5	6.8	61.0	1.31	0.33	0.43
2027	0.03	15.36	68.25	6.40	100.1	20.0	15.0	6.5	58.6	1.26	0.31	0.38
2028	0.03	14.90	68.25	6.40	97.1	20.0	14.6	6.3	56.3	1.21	0.29	0.35
2029	0.03	14.45	68.25	6.40	94.2	20.0	14.1	6.0	54.1	1.16	0.27	0.31
2030	0.02	14.02	68.25	6.40	91.4	20.0	13.7	5.8	51.9	1.11	0.25	0.28
2031	0.02	13.60	68.25	6.40	88.6	20.0	13.3	5.5	49.8	1.07	0.23	0.25
2032	0.02	13.19	68.25	6.40	86.0	20.0	12.9	5.3	47.8	1.03	0.22	0.22
2033	0.02	12.79	68.25	6.40	83.4	20.0	12.5	5.1	45.8	0.98	0.20	0.20
2034	0.02	12.41	68.25	6.40	80.9	20.0	12.1	4.9	43.9	0.94	0.19	0.18
2035	0.02	12.04	68.25	6.40	78.5	20.0	11.8	4.7	42.0	0.90	0.18	0.16
2036	0.02	11.67	68.25	6.40	76.1	20.0	11.4	4.5	40.2	0.86	0.17	0.14
2037	0.02	11.32	68.25	6.40	73.8	20.0	11.1	4.3	38.5	0.83	0.16	0.13
2038	0.02	10.98	68.25	6.40	71.6	20.0	10.7	4.1	36.8	0.79	0.15	0.11
2039	0.02	10.66	68.25	6.40	69.5	20.0	10.4	3.9	35.2	0.75	0.14	0.10



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Table 1										
McDep Income and Small Cap Energy Portfolio										
Debt, Business Segments and Income Yield										
						<i>Present Value by Segment (%)</i>				
	<i>Symbol/Rating</i>	<i>Price (US\$/sh)</i>	<i>EV/Market</i>	<i>Enterprise Value (\$mm)</i>	<i>N.Amer. Natural Gas</i>	<i>Oil Prod'n</i>	<i>Dist. NTM (\$/un)</i>	<i>Dist. Yield (%)</i>	<i>McDep Ratio</i>	
	B = Buy H = Hold	3-Sep 2009	Cap							
Canadian Income Trusts (US\$)										
Penn West Energy Trust	PWE	H	12.42	1.80	9,200	27	73	1.65	13.2	0.77
Peyto Energy Trust	PEYUF		8.48	1.47	1,320	68	32	1.32	15.5	0.74
Pengrowth Energy Trust	PGH		8.41	1.83	4,000	34	66	1.10	13.0	0.73
Enerplus Resources Fund	ERF		20.36	1.26	4,300	43	57	1.97	9.7	0.62
Canadian Oil Sands Trust	COSWF	B	24.11	1.12	13,100		100	2.08	8.6	0.60
<i>Total or Median</i>					<i>31,900</i>					<i>0.73</i>
Small Cap Independent Producers										
Encore Acquisition Company	EAC	B	37.09	1.86	3,670	23	77	-	-	0.91
Cimarex Energy Company	XEC	B	36.93	1.28	3,870	62	38	0.24	0.6	0.84
Berry Petroleum Company	BRY	H	21.75	2.17	2,110	31	69	0.30	1.4	0.78
Birchcliff Energy Ltd. (US\$)	BIREF		6.03	1.25	940	62	38	-	-	0.72
<i>Total or Median</i>					<i>10,590</i>					<i>0.81</i>
Top Line Cash Payers										
Freehold Royalty Trust (US\$)	FRHLF		14.22	1.21	850	25	36	1.10	7.7	0.86
Cross Timbers Royalty Trust	CRT		23.99	1.00	140	64	36	1.87	7.8	0.86
Dorchester Minerals, L.P.	DMLP	B	22.50	1.00	670	63	38	1.38	6.1	0.83
Sabine Royalty Trust	SBR		37.70	1.00	550	38	63	2.90	7.7	0.69
Permian Basin RT	PBT		11.93	1.00	560	27	73	0.88	7.4	0.66
<i>Total or Median</i>					<i>2,770</i>					<i>0.83</i>
Bottom Line Cash Payers										
Linn Energy, LLC	LINE		21.02	1.59	3,820	38	62	2.52	12.0	1.22
Encore Energy Partners, L.P. (52%)	ENP		15.10	1.37	480	24	76	2.15	14.2	0.92
San Juan Basin Royalty Trust	SJT	B	15.23	1.00	710	100	-	1.08	7.1	0.73
Hugoton Royalty Trust	HGT	B	14.67	1.00	590	89	11	0.93	6.3	0.64
Mesa Royalty Trust	MTR		27.07	1.00	50	75	25	1.98	7.3	0.48
<i>Total or Median</i>					<i>5,650</i>					<i>0.73</i>
Composite (excl COSWF)										
<i>Enterprise Value Weighting</i>					<i>37,800</i>	<i>40</i>	<i>60</i>			<i>0.79</i>
<i>Equal Weighting</i>						<i>50</i>	<i>50</i>			<i>0.78</i>
<i>Equal Weighted Buys</i>						<i>52</i>	<i>48</i>			<i>0.79</i>
* Percentages in Symbol column refer to current market Enterprise Value weightings; Rating column, equal weightings.										
* Percentages in Price column refer to equal weighted buys.										



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Table 2								
Oil and Gas Income and Small Cap Stocks								
Net Present Value and McDep Ratio								
			Price (\$/sh)		Market	Net		
	Symbol/ Rating		3-Sep 2009	Shares (mm)	Cap (\$mm)	Value (\$/un)	Debt/ Present Value	McDep Ratio
Canadian Income Trusts (US\$)								
	PWE	H	12.42	410.0	5,090	19.00	0.34	0.77
	PEYUF		8.48	105.9	900	13.00	0.23	0.74
	PGH		8.41	260.0	2,190	14.00	0.33	0.73
	ERF		20.36	166.3	3,390	36.00	0.13	0.62
	COSWF	B	24.11	484.0	11,670	42.00	0.06	0.60
	<i>Total or Median</i>				23,200		0.23	0.73
Small Cap Independent Producers								
	EAC	B	37.09	53.0	1,970	44.00	0.42	0.91
	XEC	B	36.93	82.0	3,030	46.00	0.18	0.84
	BRY	H	21.75	44.8	970	35.00	0.42	0.78
	BIREF		6.03	124.0	750	9.00	0.14	0.72
	<i>Total or Median</i>				6,720		0.30	0.81
Top Line Cash Payers								
	FRHLF		14.22	49.5	700	17.00	0.15	0.86
	CRT		23.99	6.0	140	28.00	-	0.86
	DMLP	B	22.50	29.8	670	27.00	-	0.83
	SBR		37.70	14.6	550	55.00	-	0.69
	PBT		11.93	46.6	560	18.00	-	0.66
	<i>Total or Median</i>				2,620			0.83
Bottom Line Cash Payers								
	LINE		21.02	114.0	2,400	15.00	0.45	1.22
	ENP		15.10	23.4	350	17.00	0.25	0.92
	SJT	B	15.23	46.6	710	21.00	-	0.73
	HGT	B	14.67	40.0	590	23.00	-	0.64
	MTR		27.07	1.9	50	56.00	-	0.48
	<i>Total or Median</i>				4,100			0.73
B = Buy, H = Hold								
McDep Ratio = Market cap and Debt to present value of oil and gas and other businesses								
Present Value presumes long-term prices of \$75 a barrel for oil and \$8 a million btu for natural gas.								



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Table 3								
Oil and Gas Income and Small Cap Stocks								
Value Multiples - Rank by EV/Ebitda								
			Price (\$/sh)	Revenue	Dist/ Equity	Adjstd Resrvs/ Prod	PV/ Ebitda	EV/ Ebitda
	Symbol/ Rating		3-Sep 2009	Royalty (%)	Ebitda	NTM	NTM	NTM
Canadian Income Trusts (US\$)								
	PEYUF		8.48		1.14	17.2	11.3	8.3
	COSWF	B	24.11		0.66	22.1	13.2	8.0
	PWE	H	12.42		0.81	8.2	9.4	7.3
	ERF		20.36		0.62	9.4	11.3	7.0
	PGH		8.41		0.72	7.9	9.2	6.8
	<i>Median</i>					9.4	11.3	7.3
Small Cap Independent Producers								
	BIREF		6.03		-	10.1	14.2	10.2
	EAC	B	37.09		-	11.5	9.2	8.4
	BRY	H	21.75		-	12.1	8.9	7.0
	XEC	B	36.93		-	7.8	6.3	5.3
	<i>Median</i>					10.8	9.1	7.7
Top Line Cash Payers								
	DMLP	B	22.50	64	0.87	8.2	17.0	14.2
	SBR		37.70	100	1.00	10.2	19.0	13.0
	CRT		23.99	84	0.93	13.3	14.0	12.0
	PBT		11.93	32	0.88	11.7	18.0	11.9
	FRHLF		14.22	71	0.64	6.4	9.9	8.5
	<i>Median</i>					10.2	17.0	12.0
Bottom Line Cash Payers								
	LINE		21.02		2.59	18.2	15.4	18.8
	MTR		27.07		0.84	16.4	23.9	11.5
	SJT	B	15.23		0.76	9.0	14.9	10.8
	HGT	B	14.67		0.68	13.4	16.8	10.7
	ENP		15.10		1.34	13.9	10.6	9.7
	<i>Median</i>					13.9	15.4	10.8
EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended June 30, 2010; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses								



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