

Mesa Royalty Trust Liquidity Opportunity

Summary and Recommendation

The units of thinly-traded **Mesa Royalty Trust (MTR)** offer 38% appreciation potential to estimated net present value (NPV) of \$70 a unit, revised from \$75. Trading liquidity for the trust was tested when the stock price dropped more than \$10 a unit in five days on some ten times normal volume for no apparent reason. Our revision to present value is an accumulation of small differences since we revised it upward by 25% more than a year ago and not a factor in the price decline. Nor can the decline be closely tied to a disclosure by the trust in August that settlement payments in a legal issue would reduce distributions over an unspecified number of months by about \$0.59 a unit now and about \$0.54 a unit a year from now. Those deductions could be offset by income owed the trust by BP amounting to about \$0.62 a unit to date and perhaps \$0.30 over the next twelve months. Thus, we are left with the sense that some of the turmoil in the natural gas market following the failure of traders Amaranth and Mother Rock may have spilled over to MTR. Finally, for all the royalty trusts in this weekly analysis, latest futures imply distributions of a median 7.8% annually for the U.S. stocks and current distributions indicate 9.3% annually for the Canadian stocks.

Higher Cash Flow Multiples for U.S. Royalty Trusts

Stock prices for U.S. royalty trusts compared to estimated next twelve months cash flow translate to a median unlevered multiple, EV/Ebitda, of 11.4 times compared to 8.5 times for Canadian trusts (see table, [Rank by EV/Ebitda](#), page 3). On that measure Mega Cap Integrated and Large Cap Independent Producers were less than 6 times recently (see *Meter Reader*).

Another unlevered cash flow multiple, PV/Ebitda, substitutes our estimate of present value for market-based enterprise value. The U.S. royalty trusts also have PV/Ebitda multiples higher than operating companies. We justify the higher multiples primarily by long life. Recent reconciliation of latest projections with steady estimates of present value implies a median reserve life of 19 years, about what MTR reports. Several of the trusts report shorter life while delivering volumes in excess of what their reported reserves imply.

Yet there remains less understatement of reserve life in our analysis of U.S. trusts compared to our more conservative reserve life used in our analysis of operating companies. Qualitative features of the royalty trust structure justify those differences, in our opinion. U.S. royalty trusts do not dilute holders with new share issues or acquisitions, there are no fees or hidden costs of hedging or debt and there is no management cost. Finally all the free cash flow is paid out on a tax-advantaged basis, leaving it up to unitholders to decide whether to consume or reinvest the proceeds.

Stock Market Undervalues Oil and Natural Gas, Futures Market Undervalues Natural Gas

We think we can measure that the stock market values the stocks of operating companies on the basis of an oil price less than \$48 a barrel. Since the futures price for delivery over the next six

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years is \$65 a barrel we believe there is a wide difference between the two markets. We use \$60 a barrel as our long-term price assumption in estimating present value.

Stocks of operating companies concentrated on natural gas are valued at McDep Ratios of 0.8 or less while our estimates of present value, the denominator of the McDep Ratio, presume a long-term natural gas price of \$10 a million btu. Thus, we say that the stock market is looking at a natural gas price of \$8 or less. Since the futures price for delivery over the next six-years is about \$7.30 a million btu, the stock market and the futures market are close to the same mind on natural gas. Natural gas investors will make extra profits if our number of \$10 is closer to the eventual outcome.

Finally, the spot natural gas price is at an unusually low level near \$4. Thus the declared monthly distribution which lags real time by two months may be the lowest in December. Monthly futures prices indicate a sharp recovery thereafter. Natural gas price directly affects the value of about three-quarters of MTR's production. Estimated distributions of 8% for the next twelve months reflect futures prices, but are not adjusted for one-time items. Estimated present value would be \$59 a unit on a long-term natural gas price of \$8 a million btu compared to \$70 on \$10. In any event MTR looks solid to us at the current quote of \$54 a unit as well as at higher prices.

Kurt H. Wulff, CFA

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

	<i>Symbol/ Rating</i>	<i>Price (\$/sh) 28-Sep 2006</i>	<i>Shares (mm)</i>	<i>Market Cap (\$mm)</i>	<i>Net Present Value (\$/un)</i>	<i>Debt/ Present Value</i>	<i>McDep Ratio</i>	
U.S. Royalty Trusts								
Cross Timbers Royalty Trust	CRT	47.00	6.0	280	46.00	-	1.02	
Sabine Royalty Trust	SBR	44.45	14.6	650	45.00	-	0.99	
Permian Basin RT	PBT	16.21	46.6	760	16.50	-	0.98	
Dorchester Minerals, L.P.	DMLP	25.44	28.2	720	27.00	-	0.94	
San Juan Basin Royalty Trust	SJT	B	35.15	46.6	1,640	40.00	-	0.88
Hugoton RoyaltyTrust	HGT	26.66	40.0	1,070	34.00	-	0.78	
Mesa RoyaltyTrust	MTR	54.50	1.9	100	70.00	-	0.78	
<i>Total or Median</i>					5,200		0.94	
Canadian Income Trusts (US\$)								
Enerplus Resources Fund	ERF	50.62	123.0	6,230	47.00	0.11	1.07	
Pengrowth Energy Trust	PGH	19.80	161.4	3,190	20.00	0.17	0.99	
Penn West Energy Trust	PWE	B	37.53	246.0	9,230	39.00	0.13	0.97
Canadian Oil Sands Trust	COSWF	B	27.59	466.1	12,860	35.00	0.09	0.81
<i>Total or Median</i>					31,500	0.12	0.98	

B = Buy

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) 28-Sep 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	47.00		12.6	12.8	13.1	7.7
Sabine Royalty Trust	SBR	44.45		12.9	12.8	12.8	7.8
San Juan Basin Royalty Trust	SJT	B 35.15		13.1	11.5	14.9	6.7
Dorchester Minerals, L.P.	DMLP	25.44		12.1	11.4	18.6	8.4
Permian Basin RT	PBT	16.21		11.0	10.8	12.1	8.2
Mesa RoyaltyTrust	MTR	54.50		12.8	10.0	12.5	8.0
Hugoton RoyaltyTrust	HGT	26.66		11.8	9.3	15.4	6.5
	<i>Median</i>			12.6	11.4	13.1	7.8
Canadian Income Trusts (US\$)							
Canadian Oil Sands Trust	COSWF	B 27.59	24.4	12.1	9.8	13.1	6.8
Enerplus Resources Fund	ERF	50.62	9.4	8.1	8.7	19.7	8.9
Penn West Energy Trust	PWE	B 37.53	8.0	8.6	8.3	15.0	9.7
Pengrowth Energy Trust	PGH	19.80	7.9	7.2	7.1	11.5	13.6
	<i>Median</i>		8.7	8.3	8.5	14.1	9.3

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended September 30, 2007; 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) (%)
U.S. Royalty Trusts							
Hugoton RoyaltyTrust	HGT	-	88	0.60	0.60	69	1.73 6.5
San Juan Basin Royalty Trust	SJT	-	98	0.77	0.77	110	2.36 6.7
Cross Timbers Royalty Trust	CRT	81	65	0.98	0.98	22	3.60 7.7
Sabine Royalty Trust	SBR	100	52	1.00	1.00	51	3.48 7.8
Mesa RoyaltyTrust	MTR	-	72	0.80	0.80	8	4.37 8.0
Permian Basin RT	PBT	29	33	0.89	0.89	62	1.34 8.2
Dorchester Minerals, L.P.	DMLP	56	71	0.95	0.95	60	2.14 8.4
	<i>Total or Median</i>		71	0.89	0.89	400	7.8
Canadian Income Trusts (US\$)							
Canadian Oil Sands Trust	COSWF	-	(8)	0.59	0.65	876	1.88 6.8
Enerplus Resources Fund	ERF	-	40	0.69	0.78	555	4.51 8.9
Penn West Energy Trust	PWE	-	36	0.70	0.80	898	3.65 9.7
Pengrowth Energy Trust	PGH	-	34	0.80	0.97	433	2.69 13.6
	<i>Total or Median</i>		35	0.69	0.79	2,800	9.3
Kinder Morgan Energy Partners	KMP			0.75	1.70		7.2

NTM = Next Twelve Months Ended September 30, 2007
 Ebitda = Earnings before interest, tax, depreciation and amortization

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Mesa Royalty Trust

Symbol	MTR	Ebitda Next Twelve Months ending 9/30/07 (US\$m)	10
Rating	None	North American Natural Gas/Ebitda (%)	72
Price (US\$/sh)	54.50	Natural Gas and Oil Production/Ebitda (%)	100
Pricing Date	9/28/06	Adjusted Reserves/Production NTM	19.9
Shares (mm)	1.86	EV/Ebitda	9.9
Market Capitalization (US\$m)	102	PV/Ebitda	13.7
Debt (US\$m)	0	Undeveloped Reserves (%)	2
Enterprise Value (EV) (US\$m)	102	Natural Gas and Oil Ebitda (US\$/mcf)	5.09
Present Value (PV) (US\$m)	140	Present Value Proven Reserves(US\$/boe)	18.70
Net Present Value (US\$/unit)	75	Present Value Proven Reserves(US\$/mcf)	3.12
Debt/Present Value	0.00	Earnings Next Twelve Months (US\$/un)	4.37
McDep Ratio - EV/PV	0.73	Price/Earnings Next Twelve Months	12
Distribution Yield (%/year)	8.0	Distribution Next Twelve Months (US\$/sh)	4.37

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.

Mesa Royalty Trust Next Twelve Months Operating and Financial Performance

	Q3	Q2	Q3E	Q4E	Year	Q1E	Q2E	Q3E	Next Twelve Months
	9/30/05	6/30/06	9/30/06	12/31/06	2006E	3/31/07	6/30/07	9/30/07	9/30/07
Volume (90% of working interest)									
Natural Gas (bcf)	0.41	0.37	0.38	0.38	1.51	0.38	0.37	0.38	1.51
Natural Gas (mmcf)	4.5	4.1	4.1	4.1	4.1	4.1	4.1	4.1	4.1
Days	92	89	92	92	365	92	89	92	365
Oil (mmb)	0.02	0.02	0.02	0.02	0.08	0.02	0.02	0.02	0.08
Oil (mbd)	0.23	0.23	0.23	0.23	0.22	0.23	0.23	0.23	0.23
Total (bcfe)	0.54	0.49	0.51	0.51	2.00	0.51	0.49	0.51	2.01
Total (mmcf)	5.8	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5
Price (Henry Hub and WTI Cushing lagged two months)									
Henry Hub (\$/mmbtu)	6.64	7.61	6.36	6.11	8.05	6.64	7.36	7.10	6.80
Differential (\$/mmbtu)	0.57	0.96	0.80	0.77	1.25	0.84	1.14	1.11	0.97
Trust (\$/mcf)	6.07	6.65	5.55	5.34	6.80	5.80	6.21	6.00	5.84
WTI Cushing (\$/bbl)	54.96	64.68	72.09	66.44	66.07	63.71	65.89	67.16	65.80
Differential	22.33	25.93	28.89	26.63	25.12	24.22	25.05	25.53	25.36
Trust (\$/bbl)	32.62	38.76	43.19	39.81	40.95	39.49	40.84	41.63	40.44
Total (\$/mcf)	5.92	6.60	5.96	5.66	6.81	6.00	6.36	6.23	6.06
Revenue (\$mm)									
Natural Gas	2.49	2.45	2.11	2.03	10.29	2.21	2.29	2.28	8.82
Oil	0.69	0.78	0.90	0.83	3.33	0.82	0.82	0.87	3.35
Total	3.18	3.23	3.02	2.86	13.62	3.03	3.11	3.15	12.16
Expense	0.54	0.55	0.53	0.52	2.00	0.53	0.44	0.45	1.95
Ebitda	2.64	2.68	2.48	2.35	11.62	2.50	2.67	2.70	10.22
Development (90%)	0.24	0.20	0.51	0.51	1.75	0.51	0.51	0.51	2.02
Royalty Income									
Hugoton	1.28	1.45							-
San Juan	1.12	1.03							-
Total Royalty Income	2.40	2.47	1.98	1.84	9.87	1.99	2.16	2.20	8.19
Administrative	0.01	0.01	(0.03)	0.01	(0.00)	0.01	0.02	0.02	0.06
Distributable Income (\$mm)	2.39	2.46	2.01	1.83	9.87	1.98	2.14	2.18	8.14
Per Unit (\$)	1.28	1.32	1.08	0.98	5.30	1.06	1.15	1.17	4.37
Units (millions)	1.86	1.86	1.86	1.86	1.86	1.86	1.86	1.86	1.86
Ebitda Margin	83%	83%	82%	82%	85%	82%	86%	86%	84%

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Natural Gas and Oil Royalty Trusts

A Weekly Analysis

September 29, 2006

Mesa Royalty Trust Present Value

Oil Volume Decline (%/yr):	4	Oil Price Post 2007 (2005\$/bbl)	60.00
Nat Gas Volume Decline (%/yr):	4	Nat Gas Price Post 2007 (2005\$/mcf)	10.00
		Real Discount Rate (%/yr):	7.0
Variable Cost (%):	10	PV/EBITDA 2007:	12.8
Cumul. Vol/Prod 2007:	23.3	Capex/Cash Flow (%):	20

Year	Volume Oil (mmb)	Nat Gas (bcf)	Price (\$/bbl)	Price (\$/mcf)	Revenue (\$mm)	Fixed Cost (\$mm)	Var. Cost (\$mm)	Cap Ex (\$mm)	Distribution (\$mm)	Distribution (\$/unit)	Disc Factor	Present Value (\$/unit)
Total 2007 through 2036; years ending on 9/30												
	1.9	35			370	24	37	27	283	151.59	0.46	70.00
2007	0.08	1.51	40.44	5.84	12.2	0.8	1.2	2.0	8.1	4.37	0.97	4.22
2008	0.08	1.51	36.87	8.58	16.0	0.8	1.6	2.7	10.9	5.85	0.90	5.28
2009	0.08	1.51	36.87	8.58	16.0	0.8	1.6	2.7	10.9	5.85	0.84	4.94
2010	0.08	1.51	36.87	8.58	16.0	0.8	1.6	2.7	10.9	5.85	0.79	4.61
2011	0.08	1.51	36.87	8.58	16.0	0.8	1.6	2.7	10.9	5.85	0.74	4.31
2012	0.08	1.51	36.87	8.58	16.0	0.8	1.6	2.7	10.9	5.85	0.69	4.03
2013	0.08	1.51	36.87	8.58	16.0	0.8	1.6	2.7	10.9	5.85	0.64	3.77
2014	0.08	1.51	36.87	8.58	16.0	0.8	1.6	2.7	10.9	5.85	0.60	3.52
2015	0.08	1.51	36.87	8.58	16.0	0.8	1.6	2.7	10.9	5.85	0.56	3.29
2016	0.08	1.51	36.87	8.58	16.0	0.8	1.6	2.7	10.9	5.85	0.53	3.07
2017	0.08	1.45	36.87	8.58	15.4	0.8	1.5		13.0	7.00	0.49	3.44
2018	0.08	1.39	36.87	8.58	14.7	0.8	1.5		12.5	6.70	0.46	3.08
2019	0.07	1.33	36.87	8.58	14.1	0.8	1.4		11.9	6.41	0.43	2.75
2020	0.07	1.28	36.87	8.58	13.6	0.8	1.4		11.4	6.13	0.40	2.46
2021	0.07	1.23	36.87	8.58	13.0	0.8	1.3		10.9	5.87	0.37	2.20
2022	0.06	1.18	36.87	8.58	12.5	0.8	1.2		10.5	5.61	0.35	1.97
2023	0.06	1.13	36.87	8.58	12.0	0.8	1.2		10.0	5.37	0.33	1.76
2024	0.06	1.09	36.87	8.58	11.5	0.8	1.2		9.6	5.13	0.31	1.57
2025	0.06	1.04	36.87	8.58	11.0	0.8	1.1		9.1	4.91	0.29	1.40
2026	0.05	1.00	36.87	8.58	10.6	0.8	1.1		8.7	4.69	0.27	1.25
2027	0.05	0.96	36.87	8.58	10.2	0.8	1.0		8.4	4.48	0.25	1.12
2028	0.05	0.92	36.87	8.58	9.7	0.8	1.0		8.0	4.29	0.23	1.00
2029	0.05	0.88	36.87	8.58	9.4	0.8	0.9		7.6	4.09	0.22	0.89
2030	0.05	0.85	36.87	8.58	9.0	0.8	0.9		7.3	3.91	0.20	0.80
2031	0.04	0.81	36.87	8.58	8.6	0.8	0.9		7.0	3.74	0.19	0.71
2032	0.04	0.78	36.87	8.58	8.3	0.8	0.8		6.6	3.57	0.18	0.64
2033	0.04	0.75	36.87	8.58	7.9	0.8	0.8		6.3	3.41	0.17	0.57
2034	0.04	0.72	36.87	8.58	7.6	0.8	0.8		6.1	3.25	0.16	0.51
2035	0.04	0.69	36.87	8.58	7.3	0.8	0.7		5.8	3.10	0.15	0.45
2036	0.04	0.66	36.87	8.58	7.0	0.8	0.7		5.5	2.96	0.14	0.40

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