

Rating: Hold

S&P 500: 1193

San Juan Basin Royalty Trust Real Value with Income

<i>Symbol</i>	SJT	<i>Ebitda Next Twelve Months ending 3/31/06 (US\$m)</i>	148
<i>Rating</i>	Hold	<i>North American Natural Gas/Ebitda (%)</i>	99
<i>Price (US\$/sh)</i>	31.93	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	2/2/05	<i>Adjusted Reserves/Production NTM</i>	12.5
<i>Shares (mm)</i>	47	<i>EV/Ebitda</i>	10.1
<i>Market Capitalization (US\$m)</i>	1,490	<i>PV/Ebitda</i>	9.5
<i>Debt (US\$m)</i>	0	<i>Undeveloped Reserves (%)</i>	50
<i>Enterprise Value (EV) (US\$m)</i>	1,490	<i>Natural Gas and Oil Ebitda (US\$/mcf)</i>	4.42
<i>Present Value (PV) (US\$m)</i>	1,400	<i>Present Value Proven Reserves(US\$/boe)</i>	15.09
<i>Net Present Value (US\$/unit)</i>	30	<i>Present Value Proven Reserves(US\$/mcf)</i>	2.51
<i>Debt/Present Value</i>	0.00	<i>Earnings Next Twelve Months (US\$/un)</i>	2.82
<i>McDep Ratio - EV/PV</i>	1.06	<i>Price/Earnings Next Twelve Months</i>	11
<i>Distribution Yield (%/year)</i>	8.8	<i>Distribution Next Twelve Months (US\$/sh)</i>	2.82

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.

Summary and Recommendation

A near 9% per year distribution yield on a stock whose price tracks long-term natural gas commodity value makes **San Juan Basin Royalty Trust (SJT)** an attractive investment. The trend in six-year natural gas remains positive consistent with our expectation that there is more upside than downside in oil and gas price for the next several years. Some day the trust may run out of gas, but not likely for decades as the trust's properties are producing at record rates after more than fifty years. Compared to operating companies, all the benefit of higher commodity price is paid to investors. There are no hedge contracts that sacrifice upside and there is no potential dilution from executive compensation. Commodity price volatility is mitigated by the absence of any debt in the trust's capital structure.

Latest Declared Monthly Distribution Second Highest Ever

The latest distribution declared last month at \$0.30 a unit was the second highest ever. The record remains \$0.40 a unit declared in March 2001, the record winter for natural gas price.

Distributions continue at a high level. The industry index for the month of February has just been determined. That is the relevant reference price for the distribution to be declared in April (see table Monthly Declarations). After April, we use futures prices as an indicator.

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San Juan Basin Royalty Trust Monthly Declarations

	Nov-04	Dec-04	Jan-05	Feb-05	Mar-05	Apr-05	May-05	Jun-05
Distribution (\$/unit)								
Declared	0.20	0.22	0.30					
Projected				0.26	0.25	0.21	0.24	0.23
Volume								
Natural gas (mmbtu)	3.90	3.98	3.98	4.01	4.03	3.64	4.02	3.89
Heat Content(btu/cf)	1,043	1,078	1,078	1,075	1,076	1,074	1,072	1,072
Natural gas (bcf)	3.74	3.69	3.70	3.73	3.74	3.39	3.74	3.63
Natural Gas (mmcf)	125	119	123	120	121	121	121	121
Days	30	31	30	31	31	28	31	30
Price								
Natural gas industry quotes lagged two months (\$/mmbtu)								
Henry Hub Index/Futures	5.08	5.81	7.67	7.81	6.21	6.29	6.33	6.30
San Juan Monthly Index	4.56	4.47	6.90	5.96	5.67	5.43	5.38	5.35
San Juan Index/Henry Hub	0.90	0.77	0.90	0.76	0.91	0.86	0.85	0.85
SJT/San Juan Index	0.95	0.97	0.89	0.91	0.92	0.92	0.93	0.93
SJT (\$/mmbtu)	4.31	4.33	6.14	5.45	5.20	5.01	4.99	4.99
SJT (\$/mcf)	4.49	4.67	6.62	5.86	5.60	5.38	5.35	5.35
Revenue (\$mm)								
Natural Gas	16.8	17.2	24.5	21.9	21.0	18.2	20.0	19.4
Other	0.6	0.4	0.1	0.1	0.1	0.2	0.2	0.2
Cost (\$mm)								
Severance tax	1.6	1.6	2.8	2.2	2.1	1.9	2.0	2.0
Operating	1.9	1.5	1.8	1.7	1.7	1.7	1.7	1.8
Total	3.5	3.1	4.6	3.9	3.8	3.6	3.8	3.7
Cash flow (\$mm)	13.9	14.6	20.0	18.1	17.3	14.8	16.5	15.9
Development	1.5	1.3	1.6	1.7	1.5	1.5	1.4	1.4
Net proceeds (\$mm)	12.4	13.4	18.4	16.4	15.7	13.3	15.1	14.5
Royalty income (\$mm)	9.3	10.0	13.8	12.3	11.8	10.0	11.3	10.9
Royalty/Net proceeds	75%	75%	75%	75%	75%	75%	75%	75%
Distributable income (\$mm)	9.3	10.0	13.8	12.3	11.8	10.0	11.3	10.9
Units (millions)	46.6	46.6	46.6	46.6	46.6	46.6	46.6	46.6
Distribution (\$/unit)	0.20	0.22	0.30	0.26	0.25	0.21	0.24	0.23
<i>Latest Twelve Month Average</i>								
Heat Content(btu/cf)	1,078	1,076	1,075	1,076	1,074	1,072	1,072	1,072
Natural Gas (mmcf)	121	121	120	121	121	121	121	121
San Juan Index/Henry Hub	0.84	0.83	0.83	0.84	0.84	0.84	0.84	0.85
SJT/San Juan Index	0.90	0.91	0.91	0.92	0.92	0.93	0.93	0.94
Other revenue	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2
Operating	1.6	1.6	1.7	1.7	1.7	1.7	1.8	1.8
Development	1.9	1.9	1.7	1.5	1.5	1.4	1.4	1.4
Severance tax/revenue	10.2%	10.0%	10.2%	10.2%	10.2%	10.2%	10.2%	10.2%

Distributions set a new annual record in 2004. Futures prices boost the projection for the next twelve months (see table Distributable Income).

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San Juan Basin Royalty Trust Distributable Income

	<i>Q3</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Next Twelve Months</i>
	<i>9/30/04</i>	<i>12/31/04</i>	<i>2004E</i>	<i>3/31/05</i>	<i>6/30/05</i>	<i>9/30/05</i>	<i>12/31/05</i>	<i>2005E</i>	<i>3/31/06</i>	<i>3/31/06</i>
Highlights										
Revenue (\$mm) (75%)	43.3	41.4	155.6	51.1	43.9	45.9	46.4	187.2	45.6	181.7
Cash flow (\$mm) (75%)	35.4	32.7	125.4	41.9	35.6	37.3	37.8	152.6	37.1	147.8
Per unit	0.76	0.70	2.69	0.90	0.76	0.80	0.81	3.27	0.80	3.17
Distributable Income (\$mm)	34.4	29.3	109.4	37.9	32.1	34.5	33.4	137.9	31.5	131.5
Per unit	0.74	0.63	2.35	0.81	0.69	0.74	0.72	2.96	0.68	2.82
Units (millions)	46.6	46.6	46.6	46.6	46.6	46.6	46.6	46.6	46.6	46.6
Volume										
Natural gas (mmbtu)	11.7	11.9	47.3	12.0	11.5	11.9	11.9	47.4	11.9	47.4
Heat Content(btu/cf)	1,081	1,056	1,076	1,076	1,073	1,073	1,073	1,074	1,073	1,073
Natural gas (bcf)	10.9	11.3	44.0	11.2	10.8	11.1	11.1	44.2	11.1	44.1
Natural Gas (mmcf)	118.0	122.8	120.3	121.4	120.9	120.9	120.9	121.0	120.9	120.9
Days	92	92	366	92	89	92	92	365	92	365
Oil (mb)	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.1	0.0	0.1
Oil (mbd)	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Total gas & oil (bcf)	11.0	11.4	44.5	11.3	10.9	11.2	11.2	44.7	11.2	44.6
Price										
Natural gas (\$/mmbtu) (Henry Hub lagged two months)										
Henry Hub (\$/mmbtu)	6.24	5.64	5.74	7.23	6.31	6.38	6.45	6.59	6.33	6.37
Differential (%)	22	19	25	23	21	21	21	21	21	21
Net to SJT (\$/mmbtu)	4.85	4.55	4.32	5.60	5.00	5.05	5.11	5.19	5.02	5.04
Natural gas (\$/mcf)	5.24	4.80	4.65	6.02	5.36	5.42	5.48	5.57	5.38	5.41
Oil (\$/bbl) (WTI Cushing lagged two months)										
WTI Cushing	39.71	48.00	39.06	46.09	48.86	48.78	47.70	47.86	48.95	48.57
SJT	35.53	42.94	34.98	41.27	43.75	43.68	42.71	42.85	43.82	43.49
Total gas & oil (\$/mcf)	5.25	4.83	4.66	6.03	5.38	5.44	5.50	5.59	5.40	5.43
Revenue (\$mm)										
Natural Gas	56.9	54.2	204.6	67.3	57.7	60.3	61.0	246.2	59.9	238.8
Oil	0.7	0.9	2.8	0.8	0.9	0.9	0.9	3.4	0.9	3.5
Total	57.7	55.1	207.4	68.1	58.5	61.2	61.8	249.7	60.8	242.3
Cost (\$mm)										
Severance tax	5.8	5.1	20.6	7.2	5.9	6.1	6.2	25.4	6.1	24.3
Operating	4.6	6.4	19.7	5.1	5.2	5.2	5.2	20.8	5.2	20.9
Total	10.5	11.5	40.2	12.3	11.1	11.4	11.4	46.2	11.3	45.2
Cash flow (\$mm)										
Development	47.2	43.7	167.2	55.8	47.4	49.8	50.4	203.4	49.4	197.1
Net proceeds	3.5	4.8	22.3	4.8	4.3	3.3	5.5	17.8	6.9	19.9
Net proceeds (\$mm)										
Royalty/Net proceeds	43.7	38.8	144.9	51.0	43.2	46.5	44.9	185.6	42.5	177.1
Royalty income (\$mm)										
Royalty/Net proceeds	32.8	29.1	108.7	38.2	32.4	34.9	33.7	139.2	31.9	132.8
Administration	0.2	(0.2)	1.1	0.3	0.3	0.3	0.3	1.3	0.3	1.3
One-time	(1.8)		(1.8)					-		-
Distributable income (\$mm)										
Severance tax/revenue	34.4	29.3	109.4	37.9	32.1	34.5	33.4	137.9	31.5	131.5
Operating cost (\$/mcf)	10.1%	9.2%	9.9%	10.6%	10.0%	10.0%	10.0%	10.2%	10.0%	10.0%
Development/Cash flow	0.42	0.56	0.44	0.45	0.48	0.47	0.47	0.47	0.47	0.47
	7%	11%	13%	9%	9%	7%	11%	9%	14%	10%

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Present Value Relates to \$40 a Barrel Constant Real

We revised our estimate of long-term oil price on January 26, 2005 to \$40 a barrel constant real, up from \$35. As a result we raised present value for SJT to \$30 a unit, a level previously calculated for \$40 oil in a sensitivity analysis (see *Stock Idea, San Juan Basin Royalty Trust*, November 5, 2004). The calculation is sensitive to assumptions. As a check on consistency we regularly compare estimates of present value that do not change often to estimated NTM cash flow that changes every time we obtain new commodity price quotes (see table North American Natural Gas Cash Flow and Present Value).

North American Natural Gas Cash Flow and Present Value

	<i>Ebitda</i>	<i>Adjstd</i>	<i>PV/</i>	<i>Present</i>
	<i>NTM</i>	<i>Resrvs/</i>	<i>Ebitda</i>	<i>Value</i>
	(\$mm)	<i>Prod</i>	<i>NTM</i>	(\$mm)
		<i>NTM</i>		
Energy Partners Ltd.	158	3.3	3.5	550
Imperial Oil Limited (30%)	607	5.2	5.3	3,200
Cimarex Energy Company	320	5.2	4.4	1,400
Royal Dutch/Shell	1,880	5.3	4.3	9,000
Marathon Oil Corporation	670	5.9	5.5	3,700
Encana Corporation	5,390	6.5	5.4	29,000
Suncor Energy	220	7.3	5.9	1,300
ChevronTexaco Corporation	2,050	7.7	6.8	14,000
Devon Energy Corporation	4,040	7.8	5.9	24,000
Unocal Corporation	874	8.0	6.9	6,000
Petro-Canada	686	8.9	7.3	5,000
Occidental Petroleum Corp.	792	9.5	7.2	5,700
Burlington Resources	2,550	10.2	7.8	20,000
XTO Energy Inc.	1,560	11.6	7.7	12,000
Exxon Mobil Corporation	4,180	11.8	9.1	38,000
Anadarko Petroleum Corp.	2,450	11.9	8.0	19,500
ConocoPhillips	1,900	12.0	8.4	16,000
San Juan Basin Royalty Trust	147	12.5	9.5	1,400
Encore Acquisition Company	72	12.6	9.0	650
BP plc	3,110	13.4	9.6	30,000

Currently there is a 97% correlation between reserve life, the second numerical column, and cash flow multiple, the third numerical column. The SJT multiple at 9.5 times is within 6% of the value predicted by the correlation.

We made some necessary modifications to adjusted reserve life for SJT. For some explanation we reprint comments from another recent analysis, *U.S. Natural Gas Royalty Trusts, All Barrels are Not the Same*, January 7, 2005.

“A valuation difference suggests that operating companies could create more value by learning from royalty trusts, but the difference may not be as wide as suggested in a recent article in the business press (see *Barron's, Hot or Not*, December 27, 2004).

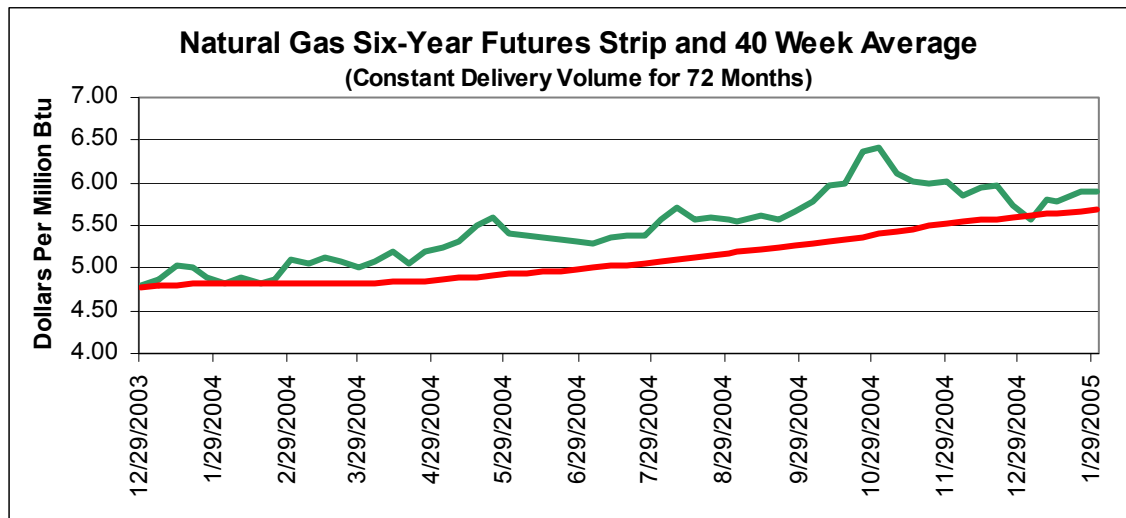
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Statistics were presented suggesting that San Juan Basin Royalty Trust (SJT), for example, was valued in the stock market at \$35.00 a barrel of reserves while Burlington Resources (BR), for example, was valued at \$10.35 a barrel. Our valuation suggests that the qualitative advantages of SJT may contribute to a 39% premium to BR, not a 240% premium. SJT's reported reserves are stated at only about 44% of what an operating company like BR would report. SJT's reserves are essentially on a developed basis only, on a shorter life than BR reports for developed reserves in the same area apparently and exclude volumes that are assumed to cover all costs of production."

Royalty Trusts Track Rising Commodity Value

Though we believe we are valuing the resources on a consistent basis with those of operating companies there are still differences in stock market valuation. SJT is valued in the market place near present value. Most operating companies are valued less than present value. The remaining differences seem to reflect the value of the different structure of royalty trusts.

Comparing the valuation of royalty trusts to long-term commodity futures seems to offer a match. SJT is valued close to present value that is related to \$40 oil. Current six-year futures average about \$42 a barrel. On that basis the outlook for the price of SJT may be tied to the trend in futures, specifically natural gas. We see that trend continuing upward as measured by the 40-week moving average (see chart [Natural Gas Six-Year Futures](#)).



Ultimately natural gas is also tied to oil. We see three to five-fold gain potential for oil price over the next 5 to 13 years.

Finally we compare the valuation of SJT to a popular energy income partnership in our coverage that is valued in the stock market at some 15 time cash flow. We think 15 times is too much compared to ten for SJT, but its persistence makes us wonder if we are being too cautious in our expectations for SJT.

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