Sabine Royalty Trust (NYSE: SBR)

Updated Sept 5th, 2019 by Trond Odegaard

Key Metrics

Current Price:	$ 43	**5 Year CAGR Estimate:**	-0.4%	**Volatility Percentile:**	45.1%
Fair Value Price:	$ 25	**5 Year Growth Estimate:**	1.0%	**Momentum Percentile:**	67.3%
% Fair Value:	173%	**5 Year Valuation Multiple Estimate:**	-10.4%	**Growth Percentile:**	4.6%
Dividend Yield:	7.8%	**5 Year Price Target**	$26.3	**Valuation Percentile:**	2.9%
Dividend Risk Score:	D	**Retirement Suitability Score:**	B	**Total Return Percentile:**	3.0%

Overview & Current Events

Sabine Royalty Trust (SBR) is a medium sized oil and gas trust set up 37 years ago by Sabine Corporation. At initiation, the trust had an expected reserve life of 9 to 10 years; the current estimated life of the trust is 8 to 10 years. The trust consists of royalty and mineral interests in producing and proved oil and gas properties in Florida, Louisiana, Mississippi, New Mexico, Oklahoma, and Texas. The trust's assets are static in that no further properties can be added. The trust has no operations, but is merely a pass-through vehicle for the royalties. SBR had royalty income of $52.3 million in 2018, and has a current market cap of $632 million.

Only the first quarter report is currently available. Trusts don't operate under the same disclosure standards as corporations. Through August, the trust had declared dividends of $2.1/share. If this is linearly extrapolated to a full year, it will be an about average year for the trust. The trust does not offer guidance, other than to say that 'due to the historic (sic) volatility of the energy industry, it is not possible to speculate as to future oil and gas price levels'. Well, it certainly is possible to speculate, but their point is taken - it's doubtful how fruitful such speculation would be.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
DCFU	$2.69	$3.70	$4.02	$3.59	$4.03	$4.03	$3.15	$1.88	$2.38	$3.42	***$3.14***	***$3.30***
DPU	$2.79	$3.70	$3.97	$3.70	$3.92	$4.10	$3.11	$1.93	$2.37	$3.35	***$3.14***	***$3.30***
Units[1]	14.6	14.6	14.6	14.6	14.6	14.6	14.6	14.6	14.6	14.6	***14.6***	***14.6***

The trust does not have earnings per se, but rather is a pass-through vehicle for royalty payments – essentially all the royalty income (cash) it receives is passed through to unit holders. About 5% of royalty income disappears in administrative overhead. The trust has generated an average distributable and distributed cash flow of $3.3/unit annually for the past 10 years. There is no trend, but the volatility inherent in the oil and gas commodity cycle shows plainly – viz. the 2X difference in cash flows from peak to trough years. In keeping with management's words of wisdom above, and not having a particular view ourselves on likely supply and demand in the oil patch – let alone likely technology developments in the future – we assume the past 9-year average distribution will continue going forward. This assumption is almost sure to be incorrect, but it does provide a somewhat neutral baseline around which individual investors can apply their own speculation.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
P/DCFU	15.2	13.6	15.3	14.3	11.2	10.7	9.9	16.3	16.8	12.0	***13.8***	***8.0***
Avg. Yld.	6.8%	7.4%	6.5%	7.2%	8.7%	9.5%	10.0%	6.3%	5.9%	8.2%	***7.8%***	***12.5%***

Their DCFU price multiple has averaged 13.5 over the past 10 years, so it's trading right at its average. However, this average multiple seems quite high given the risk of a royalty trust. If a growing and well managed midstream oil and gas company – or related services company – has averaged 12 historically, and is worth maybe 8 to 10 going forward, then a

[1] Average Weighted Unit count is in millions.

royalty trust should not be worth more than 8 going forward. After all, they have a limited life, they cannot acquire more property – so any growth is entirely organic, and they receive the full shock of the commodity price cycle – there is no buffer between distributable cash flow and dividends, and no ability to hold back on capex to increase the buffer during lean times. And when the music begins to slow down on one of these trusts (i.e., the end of reserves comes into view), or the market gets the slightest hint that the music will slow, the price of a unit will plummet quickly.

Safety, Quality, Competitive Advantage, & Recession Resiliency

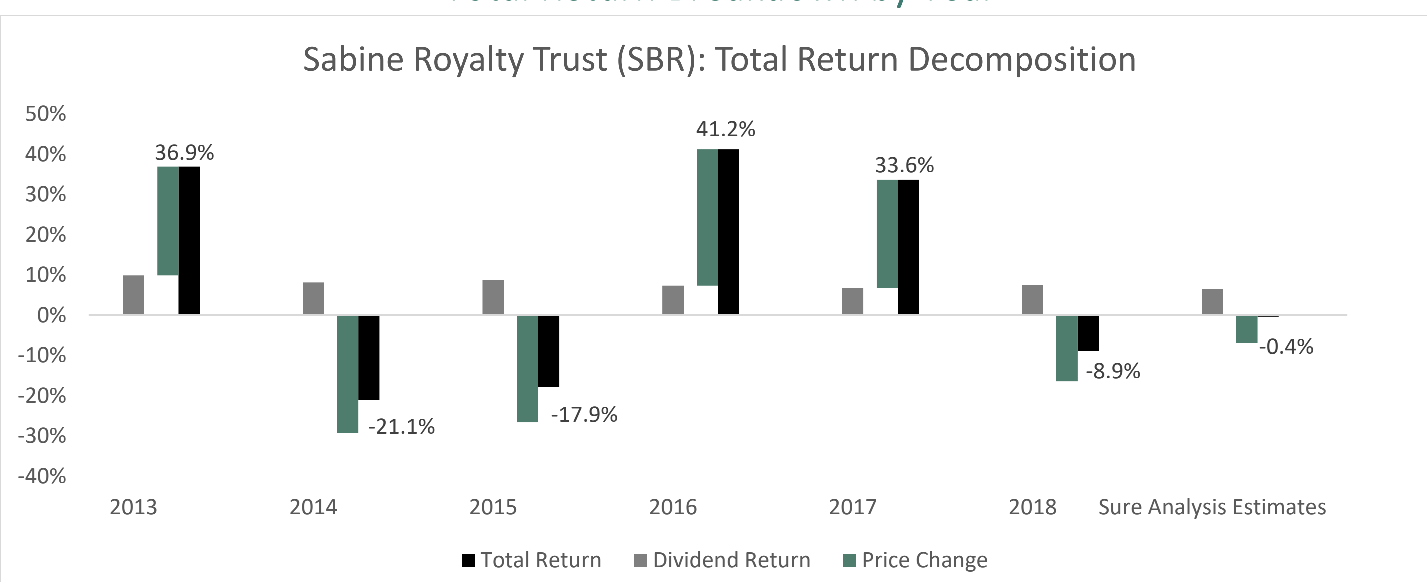
Year	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2024**
Payout	104%	100%	99%	103%	97%	102%	99%	103%	100%	98%	***100%***	***100%***

On the positive side, the trust has been in continuous existence for 37 years paying an average 7.6% yield (albeit with considerable volatility in the distributions). Considering the initial expected life was just 10 years, this longevity is most impressive. The trust seemingly just won't die. For some investors, there may be tax advantages deriving from passed-through depletion allowances (consult your tax expert). Having said this, how much cash this trust distributes annually going forward, and for how long, is anybody's guess. If oil and gas prices maintain at their current level or go up, then the trust is likely to do well (higher distributions, higher unit price) and extend beyond its current expected life – since producers will have an incentive to apply ever-evolving technology to squeeze that extra drop of oil out of the fields. On the other hand, if oil and gas prices head south, so will distributions and the unit price - with alacrity.

Final Thoughts & Recommendation

SBR is a sell based on its dismal expected total returns. It's trading roughly in the middle of its long-term price range of $23 to $70/unit, so would seem to be fairly priced, but fundamentally SBR is not worth its current multiple. Investors desiring exposure to the oil and gas industry, or who want a high yield and can stomach some price volatility, can do better with a midstream/upstream business in an MLP or corporate structure. As two examples, consider IPPLF and ENB, each with 6.5% or better yield, 5% or better growth, and 14% or better expected total return. These are real companies adding real value, not paper shells created by Wall St. investment bankers to provide cheap financing for the sponsoring entity.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report and does not intend to obtain one.

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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	42	56	61	55	61	61	48	30	37	53
Gross Profit	42									
Gross Margin	100%									
SG&A Exp.	2	2	2	2	2	2	2	3	2	3
Operating Profit	39	54	59	52	59	59	46	27	35	50
Operating Margin	94.5%	96.2%	96.5%	95.7%	96.6%	96.1%	95.0%	91.5%	93.3%	95.1%
Net Profit	39	54	59	52	59	59	46	27	35	50
Net Margin	94.5%	96.2%	96.5%	95.7%	96.6%	96.1%	95.0%	91.5%	93.3%	95.1%
Distr. Cash Flow							46	28	35	

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	6	5	6	5	7	7	6	5	5	9
Total Liabilities	0	0	1	1	1	2	1	1	1	4
Long-Term Debt	0	0	0	0	0	0	0	0	0	0
Partner's Equity	5	5	6	4	6	5	5	4	5	6
D/E Ratio	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	621%	992%	1008%	909%	962%	851%	709%	484%	657%	675%
Return on Equity	658%	1050%	1080%	1065%	1210%	1154%	946%	572%	770%	973%
ROIC	658%	1050%	1080%	1065%	1210%	1154%	946%	572%	770%	973%
Shares Out.	14.6	14.6	14.6	14.6	14.6	14.6	14.6	14.6	14.6	14.6
Revenue/Share	2.85	3.85	4.16	3.75	4.17	4.19	3.32	2.06	2.55	3.60
DCF/Share							3.16	1.89	2.38	

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.