



Sabine Royalty Trust (SBR)

Updated June 2nd, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	\$28	5 Year CAGR Estimate:	9.9%	Market Cap:	\$408 M
Fair Value Price:	\$23	5 Year Growth Estimate:	5.0%	Ex-Dividend Date:	6/12/2020 ¹
% Fair Value:	120%	5 Year Valuation Multiple Estimate:	-3.5%	Dividend Payment Date:	6/26/2020
Dividend Yield:	9.3%	5 Year Price Target	\$30	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Last Dividend Increase:	N/A

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 properties and proved oil and gas properties in Florida, Louisiana, Mississippi, New Mexico, Oklahoma, and Texas. It is roughly 2/3 oil and 1/3 gas in terms of revenues. 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 royalties. SBR had royalty income of \$46.7 million in 2019 and has a current market cap of \$408 million.

In early May, SBR reported (5/7/20) financial results for the first quarter of fiscal 2020. Its gas volumes grew 6% but its oil volumes fell -14% and its realized prices of oil and gas decreased over last year's quarter. As a result, distributable cash flow per unit fell -19%, from \$0.88 to \$0.71. The prices of oil and gas were adversely affected by the spread of the coronavirus. While we expect a recovery in the remainder of the year, the downturn caused by the pandemic will inevitably hurt the results of the trust this year. We expect SBR to post distributable cash flow per unit of only \$2.60.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
DCFU	\$3.70	\$4.02	\$3.59	\$4.03	\$4.03	\$3.15	\$1.88	\$2.38	\$3.42	\$3.02	\$2.60	\$3.32
DPU	\$3.70	\$3.97	\$3.70	\$3.92	\$4.10	\$3.11	\$1.93	\$2.37	\$3.35	\$3.02	\$2.60	\$3.32
Units²	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 is consumed in administrative expenses. The trust has generated an average annual distributable cash flow of \$3.32 per unit over the last decade. However, the cash flows of SBR are extremely sensitive to the gyrations of the prices of oil and gas and hence they have resulted in a markedly volatile performance record. Due to the suppressed cash flows expected this year, we expect 5.0% average annual growth of distributable cash flow per unit over the next five years.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
P/DCFU	13.6	15.25	14.3	11.2	10.7	9.9	16.3	16.7	12.0	14.6	10.8	9.0
Avg. Yld.	7.4%	6.5%	7.2%	8.7%	9.5%	10.0%	6.3%	5.9%	8.2%	6.8%	8.3%	11.1%

SBR has traded at an average price-to-distributable cash flow ratio of 13.5 over the last decade. However, this average multiple seems quite high given the risk of a royalty trust. It is critical to note that the trust has a limited lifetime of up to 10 years and hence its returns will greatly be affected by the commodity prices that will prevail throughout this period. 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 often plummets. As a result, investors should pay extra

¹ Estimated date.

² Average Weighted Unit count is in millions.

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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attention to the valuation of SBR before investing in it. We assume a fair DCFU multiple of 9.0 for SBR. If the stock reaches our fair value estimate over the next five years, it will incur a -3.5% annualized drag in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

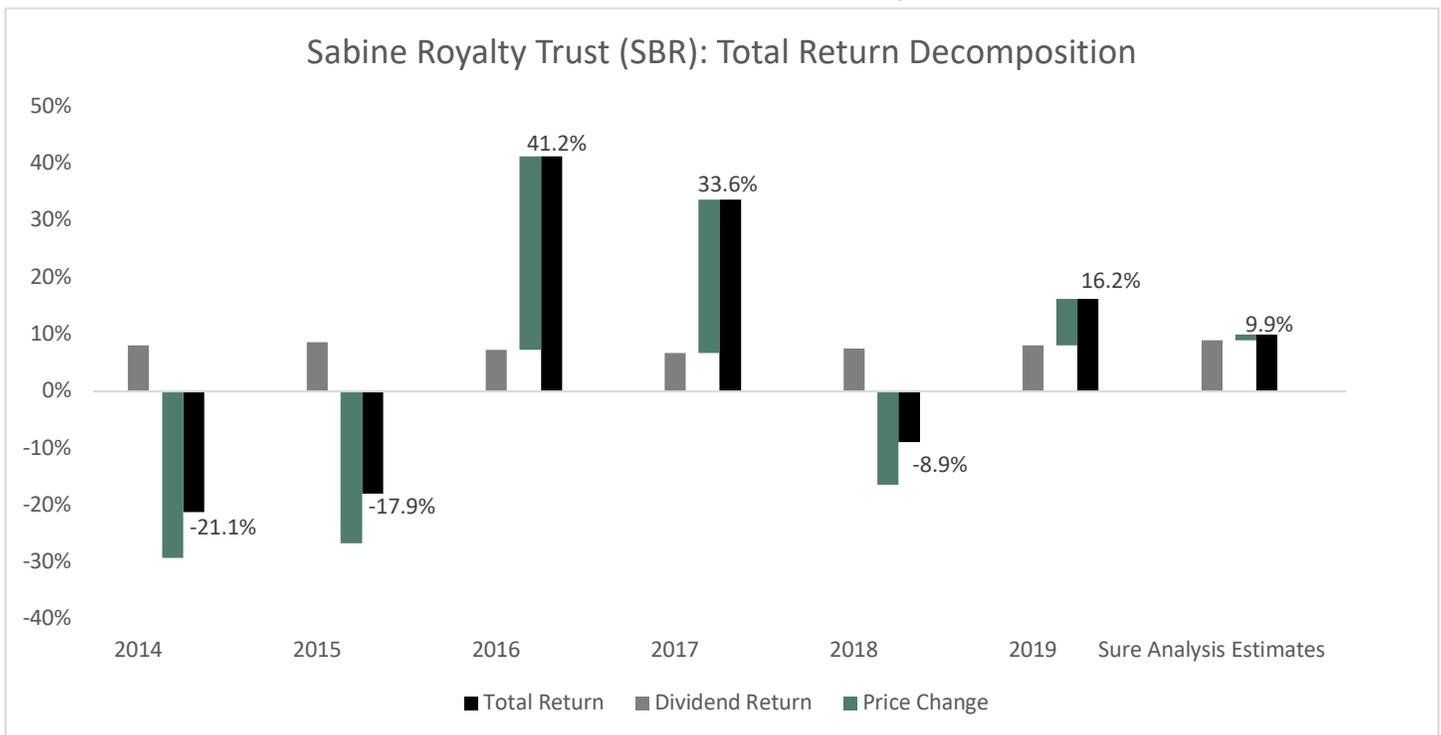
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	100%	99%	103%	97%	102%	99%	103%	100%	98%	100%	100%	100%

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 that the initial expected life was just 10 years, this longevity is certainly impressive. For some investors, there may be tax advantages resulting from passed-through depletion allowances. However, it is critical to note the pronounced vulnerability of the trust to a downturn in the energy sector, partly due to its limited time horizon. The ongoing downturn, which has resulted from the spread of the coronavirus, has resulted in suppressed oil prices. If this downturn lasts longer than expected, it will greatly hurt the returns of SBR. Overall, while the 9.3% dividend yield of the trust may entice some income-oriented investors, we believe that the trust is not suitable for most of them due to its huge downside risk in the event of a prolonged downturn.

Final Thoughts & Recommendation

Due to the suppressed oil prices that have resulted from the spread of the coronavirus, SBR has shed -40% of its market cap in less than 12 months and it is now trading around its 15-year lows. As a result, it has become somewhat attractive. We expect the pandemic to subside from next year and hence SBR could offer a 9.9% average annual return over the next five years. However, this return is insufficient to compensate investors for the high vulnerability of the trust to the gyrations of oil and gas prices and the risk that results from the limited time horizon of the trust. As a result, we rate SBR as a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	56	61	55	61	61	48	30	37	53	47
Gross Profit	---	---	---	---	---	---	---	---	---	---
Gross Margin	---	---	---	---	---	---	---	---	---	---
SG&A Exp.	2	2	2	2	2	2	3	2	3	3
Operating Profit	54	59	52	59	59	46	27	35	50	44
Operating Margin	96.2%	96.5%	95.7%	96.6%	96.1%	95.0%	91.5%	93.3%	95.1%	93.9%
Net Profit	54	59	52	59	59	46	27	35	50	44
Net Margin	96.2%	96.5%	95.7%	96.6%	96.1%	95.0%	91.5%	93.3%	95.1%	93.9%
Distr. Cash Flow						46	28	35		

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	5	6	5	7	7	6	5	5	9	7
Total Liabilities	0	1	1	1	2	1	1	1	4	1
Long-Term Debt	0	0	0	0	0	0	0	0	0	0
Partner's Equity	5	6	4	6	5	5	4	5	6	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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	992%	1008%	909%	962%	851%	709%	484%	657%	675%	538%
Return on Equity	1050%	1080%	1065%	1210%	1154%	946%	572%	770%	973%	778%
ROIC	1050%	1080%	1065%	1210%	1154%	946%	572%	770%	973%	778%
Shares Out.	14.6	14.6	14.6	14.6	14.6	14.6	14.6	14.6	14.6	14.6
Revenue/Share	3.85	4.16	3.75	4.17	4.19	3.32	2.06	2.55	3.60	3.22
DCF/Share	---	---	---	---	---	3.16	1.89	2.38	---	---

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

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