



Sabine Royalty Trust (SBR)

Updated May 27th, 2021 by Aristofanis Papadatos

Key Metrics

Current Price:	\$36	5 Year CAGR Estimate:	5.2%	Market Cap:	\$526 M
Fair Value Price:	\$24	5 Year Growth Estimate:	6.0%	Ex-Dividend Date:	5/14/2021
% Fair Value:	150%	5 Year Valuation Multiple Estimate:	-7.8%	Dividend Payment Date:	5/28/2021
Dividend Yield:	6.7%	5 Year Price Target	\$32	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	D	Last Dividend Increase:	N/A

Overview & Current Events

Sabine Royalty Trust (SBR) is an oil and gas trust set up in 1983 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 \$36.3 million in 2020 and has a current market cap of \$526 million.

In mid-May, SBR reported (5/14/21) financial results for the first quarter of fiscal 2020. The average realized price of gas rose 16% but the average realized price of oil decreased -24% over last year's quarter. Production of gas remained flat but production of oil dipped -3% and thus distributable cash flow per unit declined -14%, from \$0.71 to \$0.61. The price of oil has rallied to pre-COVID levels this year thanks to the ongoing vaccination program and the unprecedented production cuts implemented by OPEC and Russia. The cash flow of SBR, which lags the trends in oil prices, has finally caught up with the uptrend. SBR has distributed \$1.02 per unit in the first five months of the year. We expect annual distributable cash flow per unit of approximately \$2.40 in 2021.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
DCFU	\$4.02	\$3.59	\$4.03	\$4.03	\$3.15	\$1.88	\$2.38	\$3.42	\$3.02	\$2.28	\$2.40	\$3.21
DPU	\$3.97	\$3.70	\$3.92	\$4.10	\$3.11	\$1.93	\$2.37	\$3.35	\$3.02	\$2.40	\$2.40	\$3.21
Units¹	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%-8% of royalty income is consumed in administrative expenses. The trust has generated an average annual distributable cash flow of \$3.18 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. Given the suppressed cash flows due to the pandemic this year and our expectations for higher realized oil prices in the upcoming years, we expect 6.0% average annual growth of distributable cash flow per unit over the next five years.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
P/DCFU	15.3	14.3	11.2	10.7	9.9	16.3	16.7	12.0	14.6	13.4	15.0	10.0
Avg. Yld.	6.5%	7.2%	8.7%	9.5%	10.0%	6.3%	5.9%	8.2%	6.8%	7.9%	6.7%	10.0%

SBR has traded at an average price-to-distributable cash flow ratio of 13.4 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 and hence its returns will be greatly affected by the commodity prices that will prevail throughout this period. When the

¹ Average Weighted Unit count is in millions.

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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 attention to the valuation of SBR before investing in it. We assume a fair DCFU multiple of 10.0 for SBR. If the stock reaches our fair value estimate over the next five years, it will incur a -7.8% annualized drag in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

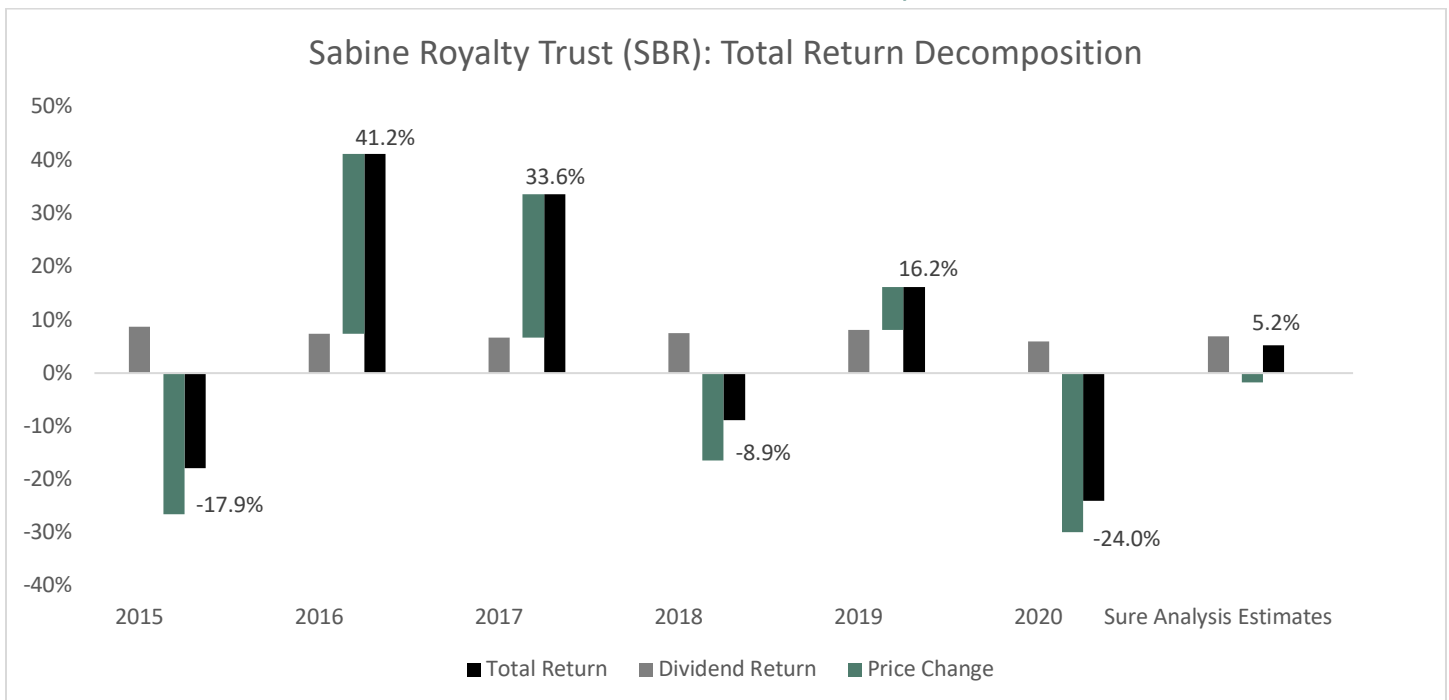
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	99%	103%	97%	102%	99%	103%	100%	98%	100%	105%	100%	100%

On the positive side, the trust has been in continuous existence for 38 years paying a 10-year average yield of 7.7%, albeit with considerable volatility in the distributions. Considering that the initial expected life was just 10 years, this longevity is certainly impressive. We also note that the proved developed reserves of oil and gas of SBR have grown 4% and 16%, respectively, since the end of 2017. For some investors, there may be tax advantages resulting from passed-through depletion allowances. However, it is critical to note the pronounced vulnerability of SBR to a downturn in the energy sector, partly due to its limited time horizon. If the pandemic lasts longer than expected, it will greatly hurt the returns of SBR. Overall, while the 6.7% 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

SBR faced a severe downturn in 2020 due to the pandemic. However, we expect the pandemic to subside in the second half of this year and expect SBR to benefit from the rally of the oil price this year. SBR could offer a 5.2% average annual return over the next five years. However, this return does not fully compensate investors for the high vulnerability of the trust to the swings of oil and gas prices and the risk that results from the limited time horizon of the trust. We thus maintain our hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	61	55	61	61	48	30	37	53	47	36
Gross Profit	---	---	---	---	---	---	---	---	---	---
Gross Margin	---	---	---	---	---	---	---	---	---	---
SG&A Exp.	2	2	2	2	2	3	2	3	3	3
Operating Profit	59	52	59	59	46	27	35	50	44	33
Operating Margin	96.5%	95.7%	96.6%	96.1%	95.0%	91.5%	93.3%	95.1%	93.9%	91.6%
Net Profit	59	52	59	59	46	27	35	50	44	33
Net Margin	96.5%	95.7%	96.6%	96.1%	95.0%	91.5%	93.3%	95.1%	93.9%	91.6%
Distr. Cash Flow	---	---	---	---	46	28	35	---	---	---

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	6	5	7	7	6	5	5	9	7	5
Total Liabilities	1	1	1	2	1	1	1	4	1	1
Long-Term Debt	0	0	0	0	0	0	0	0	0	0
Partner's Equity	6	4	6	5	5	4	5	6	6	4
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	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	1008%	909%	962%	851%	709%	484%	657%	675%	538%	561%
Return on Equity	1080%	1065%	1210%	1154%	946%	572%	770%	973%	778%	691%
ROIC	1080%	1065%	1210%	1154%	946%	572%	770%	973%	778%	691%
Shares Out.	14.6	14.6	14.6	14.6	14.6	14.6	14.6	14.6	14.6	14.6
Revenue/Share	4.16	3.75	4.17	4.19	3.32	2.06	2.55	3.60	3.22	2.49
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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