



# San Juan Basin Royalty Trust (SJT)

Updated May 22<sup>nd</sup>, 2023 by Aristofanis Papadatos

## Key Metrics

|                             |         |  |        |                                  |         |
|-----------------------------|---------|--|--------|----------------------------------|---------|
| <b>Current Price:</b>       | \$8.00  | <b>5 Year CAGR Estimate:</b>               | 8.2%   | <b>Market Cap:</b>               | \$370 M |
| <b>Fair Value Price:</b>    | \$18.00 | <b>5 Year Growth Estimate:</b>             | -20.0% | <b>Ex-Dividend Date:</b>         | 5/30/23 |
| <b>% Fair Value:</b>        | 45%     | <b>5 Year Valuation Multiple Estimate:</b> | 17.4%  | <b>Div. Payment Date:</b>        | 6/14/23 |
| <b>Dividend Yield:</b>      | 27.9%   | <b>5 Year Price Target</b>                 | \$5.85 | <b>Years Of Dividend Growth:</b> | 2       |
| <b>Dividend Risk Score:</b> | F       | <b>Retirement Suitability Score:</b>       | C      | <b>Rating:</b>                   | Hold    |

## Overview & Current Events

San Juan Basin Royalty Trust (SJT) is a medium sized gas trust (it produces a negligible amount of oil), set up in 1980 by Southland Royalty Company. The producing properties are all in northern New Mexico, in the San Juan Basin. They are currently operated by Hilcorp San Juan, L.P., which acquired the interests in 2017. 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. SJT had royalty income of \$79.0 million in 2022, and has a current market capitalization of \$370 million.

In 2011, SJT had a remaining expected life of 9 years. We were unable to find a reported current estimated life for the trust (which is probably not a good sign). Moreover, due to the volatility of the price of natural gas, the trust revises its estimated reserves pronouncedly every year, as lower prices mean that some reserves are not economical to produce. As a result, it is essentially impossible to calculate the lifetime of reserves with any degree of precision.

In mid-May, SJT reported (5/15/2023) financial results for the first quarter of fiscal 2023. Thanks to the impressive rally of the price of natural gas, which resulted from the sanctions of the U.S. and Europe on Russia for its invasion in Ukraine, distributable income per unit jumped from \$0.31 in last year's quarter to \$0.77. Gas prices have plunged lately due to an abnormally warm winter and thus SJT reduced its distributions in April and May. Based on the distributions in the first five months of this year, SJT is offering a 10-year high annualized yield of 27.9%. However, we expect the distribution yield to decrease substantially due to lower expected distributions in the upcoming months.

## Growth on a Per-Share Basis

| Year                     | 2013    | 2014    | 2015    | 2016    | 2017    | 2018    | 2019    | 2020    | 2021   | 2022   | 2023          | 2028          |
|--------------------------|---------|---------|---------|---------|---------|---------|---------|---------|--------|--------|---------------|---------------|
| <b>DCFU</b>              | \$0.783 | \$1.285 | \$0.365 | \$0.299 | \$0.840 | \$0.386 | \$0.174 | \$0.159 | \$0.77 | \$1.66 | <b>\$2.23</b> | <b>\$0.73</b> |
| <b>DPU</b>               | \$0.783 | \$1.285 | \$0.365 | \$0.299 | \$0.840 | \$0.386 | \$0.174 | \$0.159 | \$0.77 | \$1.66 | <b>\$2.23</b> | <b>\$0.73</b> |
| <b>Units<sup>1</sup></b> | 46.6    | 46.6    | 46.6    | 46.6    | 46.6    | 46.6    | 46.6    | 46.6    | 46.6   | 46.6   | <b>46.6</b>   | <b>46.6</b>   |

Essentially all the royalty income (cash) the trust receives is passed through to unit holders. The trust has generated an average annual distributable and distributed cash flow of \$0.67 per unit for the past 10 years. However, distributions have been extremely volatile due to the dramatic swings of the price of natural gas. That's why the trust offers no guidance. This year, the price of natural gas has plunged due to an abnormally warm winter but this plunge has just begun to be reflected in the distributions of the trust. Due to a high comparison base and given the natural decline of production of SJT in the long run, we expect distributable income per unit to decline by -20% per year on average over the next five years. Gas prices have plunged to reasonable levels this year, in line with our expectations, and we do not expect a sustainable rebound anytime soon due to a record number of renewable energy projects underway.

## Valuation Analysis

| Year             | 2013 | 2014 | 2015 | 2016 | 2017  | 2018 | 2019 | 2020 | 2021  | 2022  | Now          | 2028         |
|------------------|------|------|------|------|-------|------|------|------|-------|-------|--------------|--------------|
| <b>P/DCFU</b>    | 19.3 | 12.1 | 25.2 | 18.0 | 8.9   | 16.9 | 21.2 | 16.6 | 6.5   | 6.1   | <b>3.6</b>   | <b>8.0</b>   |
| <b>Avg. Yld.</b> | 5.2% | 8.3% | 4.0% | 5.6% | 11.3% | 5.9% | 4.7% | 6.0% | 15.4% | 16.3% | <b>27.9%</b> | <b>12.5%</b> |

<sup>1</sup> Average Weighted Unit count is in millions.

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SJT has traded at an average price-to-DCFU of 15.1 over the last decade. The trust is currently trading at a price-to-DCFU ratio of 3.6. Due to the natural decline of the production of SJT in the long run and the uncertainty over the lifetime of its reserves, we assume a fair price-to-DCFU of 8.0 for this trust. If SJT trades at this valuation level in five years, it will enjoy a 17.4% annualized gain in its returns.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

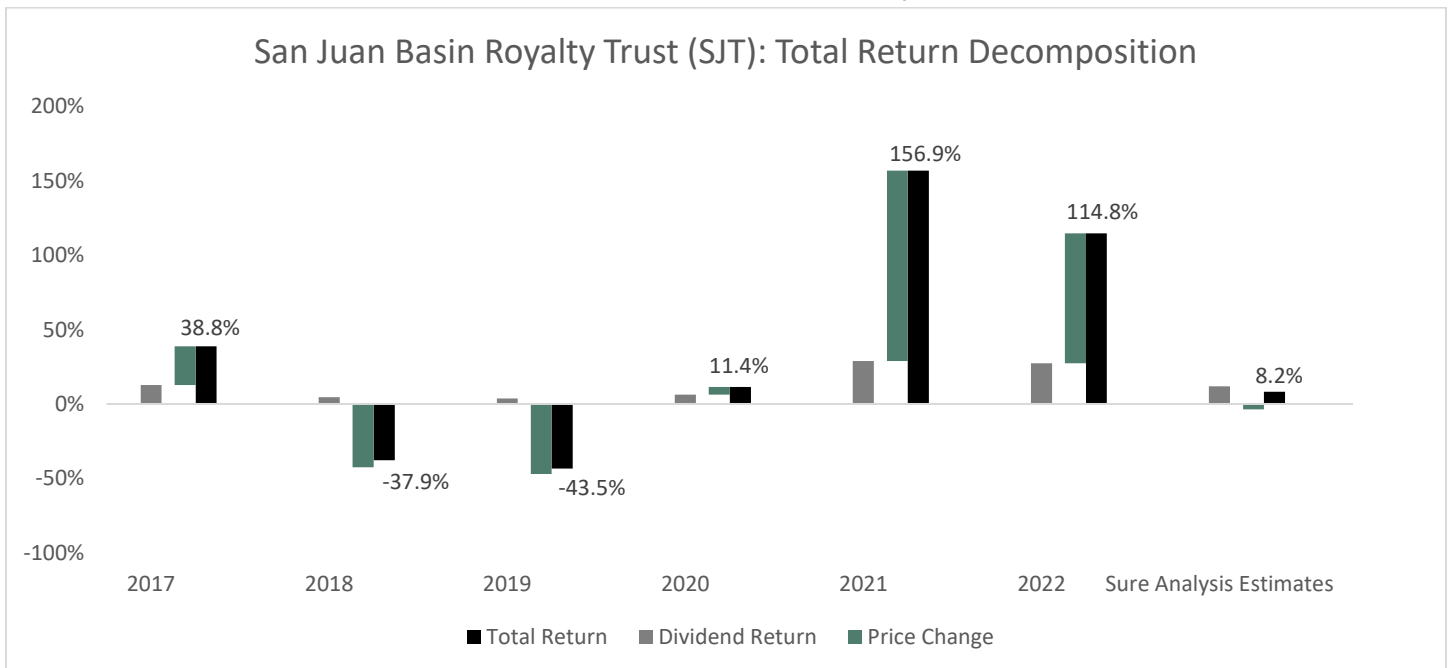
| Year   | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% |

SJT has been in continuous existence for 43 years and has offered an average 8.3% yield for the last 10 years (albeit with considerable volatility in the distributions). Having said that, it is impossible to forecast future distributions beyond this year due to the dramatic swings of gas prices. SJT has proved highly vulnerable to the downturns of the energy market, as evidenced in 2015-2016 and 2020. It suspended its distribution for six months in 2019 and four months in 2020 due to low natural gas prices. At high gas prices, the trust can extend its life, as it will have an incentive to apply ever-evolving technology to squeeze extra amounts of gas out of the fields. On the other hand, when the music begins to slow down on 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 can plummet overnight. And this particular trust has an operator that is not as clearly aligned with trust unit holder interests as one would like.

## Final Thoughts & Recommendation

SJT has offered a 10-year high distribution yield in recent months but gas prices have plunged lately due to unfavorable weather. We also expect gas prices to remain low in the upcoming years due to the execution of numerous renewable energy projects around the globe. SJT could offer an 8.2% average annual total return over the next five years, as its 27.9% initial distribution and a 17.4% valuation tailwind may be offset by a -20% decline of distributable income. As a result, SJT receives a hold rating. Even at more opportune stock prices, SJT is suitable only for the investors who can stomach the extreme volatility of natural gas prices and the resultant volatility of the stock price.

## Total Return Breakdown by Year



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## Income Statement Metrics

| Year             | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  | 2020  | 2021  | 2022  |
|------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenue          | 38    | 62    | 20    | 18    | 41    | 19    | 10    | 9     | 38    | 79    |
| SG&A Exp.        | ---   | ---   | ---   | ---   | ---   | 1     | 2     | 1     | 2     | 1     |
| Operating Profit |       | 62    | 20    | 18    | 41    | 18    | 8     | 7     | 36    | 78    |
| Net Profit       | 36    | 60    | 17    | 14    | 39    | 18    | 8     | 7     | 36    | 78    |
| Net Margin       | 95.9% | 97.2% | 87.1% | 79.5% | 96.1% | 92.5% | 81.7% | 83.9% | 95.6% | 98.2% |

## Balance Sheet Metrics

| Year              | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|-------------------|------|------|------|------|------|------|------|------|------|------|
| Total Assets      | 16   | 13   | 11   | 12   | 11   | 8    | 7    | 6    | 10   | 8    |
| Total Liabilities | 5    | 4    | 2    | 4    | 4    | 2    | 1    | 1    | 6    | 5    |
| Long-Term Debt    | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---  |
| Partner's Equity  | 11   | 9    | 9    | 8    | 7    | 6    | 5    | 5    | 4    | 3    |

## Profitability & Per Share Metrics

| Year             | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022  |
|------------------|------|------|------|------|------|------|------|------|------|-------|
| Return on Assets | 250% | 413% | 142% | 125% | 345% | 190% | 112% | 115% | 440% | 844%  |
| Return on Equity | 316% | 589% | 188% | 169% | 545% | 289% | 143% | 140% | 816% | 2330% |
| ROIC             | 316% | 589% | 188% | 169% | 545% | 289% | 143% | 140% | 816% | 2330% |
| Shares Out.      | 46.6 | 46.6 | 46.6 | 46.6 | 46.6 | 46.6 | 46.6 | 46.6 | 46.6 | 46.6  |
| Revenue/Share    | 0.82 | 1.32 | 0.42 | 0.38 | 0.87 | 0.42 | 0.21 | 0.19 | 0.81 | 1.70  |

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

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