Explanation of RI Value vs. WI Value

RI = Royalty Interest
WI = Working Interest
NRI = Net Revenue Interest
dcf = discounted cash flow
8/8 = A somewhat outdated way of expressing 100%, coined when WI owners typically owned 7/8ths of production and RI owners typically owned the remaining 1/8th of production
P&A = Pritchard & Abbott, Inc.

An individual RI owner's NRI only speaks to what percentage of the lease's total oil and gas production and corresponding **gross** revenue that a RI owner is entitled to. It is highly inappropriate to apply any individual's NRI to the lease's "8/8 value" as shown on P&A's dcf appraisal report, because any and all values are derived through analysis of future **net** income.

The "8/8 value" shown on P&A's report is not really a value at all. It is merely a sum of the lease's WI value and RI value **which are separately derived** because of the difference in gross income and net income for WI owners versus RI owners. This "8/8 value" is not used for any purpose other than this summarization of lease value on this report.

The lease's RI value is derived <u>without</u> consideration of lease operating expenses, because RI owners do not pay any part of a lease's operating expenses. Therefore, **the RI owners's net income is the same as their gross income**, less taxes (severance and ad valorem).

Conversely, the lease's WI value is derived <u>with</u> consideration of lease operating expenses. The WI owners' net income is derived by deduction of their lease operating expenses (including taxes) from their gross income. Therefore, **the WI owners' net income is very different (lower) than their gross income.**

<u>Bottom line</u>:

- Individual RI owners share (split) the total appraised lease RI value.
- Individual WI owners share (split) the total appraised lease WI value.
- In reality there is no such animal as an "8/8 value" for a lease other than being a sum of the lease's total RI value and WI value <u>which are separately derived</u> because of the different basis of net income for RI owners versus WI owners. WI owners are burdened with operating expense; RI owners are not. Therefore a 1% NRI of RI is inherently more valuable than a 1% NRI of WI.