

CROSS TIMBERS ROYALTY TRUST

Form 10-Q

November 06, 2017

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934**

For the quarterly period ended September 30, 2017

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934**

Commission File Number: 1-10982

Cross Timbers Royalty Trust

(Exact name of registrant as specified in its charter)

Texas
(State or other jurisdiction of
incorporation or organization)

75-6415930
(I.R.S. Employer
Identification No.)

Southwest Bank

Trustee

P.O. Box 962020, Fort Worth, Texas
(Address of principal executive offices)

76162-2020
(Zip Code)

(855) 588-7839

(Registrant's telephone number, including area code)

NONE

(Former name, former address and former fiscal year, if change since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company, and emerging growth company in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2). Yes No

Indicate the number of units of beneficial interest outstanding, as of the latest practicable date:

Outstanding as of November 1, 2017

6,000,000

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FORM 10-Q FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2017

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CROSS TIMBERS ROYALTY TRUST

GLOSSARY OF TERMS

The following are definitions of significant terms used in this Form 10-Q:

<i>Bbl</i>	Barrel (of oil)
<i>Mcf</i>	Thousand cubic feet (of natural gas)
<i>MMBtu</i>	One million British Thermal Units, a common energy measurement
<i>net proceeds</i>	Gross proceeds received by XTO Energy from sale of production from the underlying properties, less applicable costs, as defined in the net profits interest conveyances.
<i>net profits income</i>	Net proceeds multiplied by the applicable net profits percentage of 75% or 90%, which is paid to the Trust by XTO Energy. Net profits income is referred to as royalty income for income tax purposes.
<i>net profits interest</i>	An interest in an oil and gas property measured by net profits from the sale of production, rather than a specific portion of production. The following defined net profits interests were conveyed to the Trust from the underlying properties: <i>90% net profits interests</i> interests that entitle the Trust to receive 90% of the net proceeds from the underlying properties that are substantially all royalty or overriding royalty interests in Texas, Oklahoma and New Mexico. <i>75% net profits interests</i> interests that entitle the Trust to receive 75% of the net proceeds from the underlying properties that are working interests in Texas and Oklahoma.
<i>royalty interest</i> <i>(and overriding royalty interest)</i>	A nonoperating interest in an oil and gas property that provides the owner a specified share of production without any production expense or development costs.
<i>underlying properties</i>	XTO Energy's interest in certain oil and gas properties from which the net profits interests were conveyed. The underlying properties include royalty and overriding royalty interests in producing and nonproducing properties in Texas, Oklahoma and New Mexico, and working interests in producing properties located in Texas and Oklahoma.
<i>working interest</i>	An operating interest in an oil and gas property that provides the owner a specified share of production that is subject to all production expense and development costs.

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CROSS TIMBERS ROYALTY TRUST

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

The condensed financial statements included herein are presented, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in annual financial statements have been condensed or omitted pursuant to such rules and regulations, although the Trustee believes that the disclosures are adequate to make the information presented not misleading. These condensed financial statements should be read in conjunction with the financial statements and the notes thereto included in the Trust's latest Annual Report on Form 10-K. In the opinion of the Trustee, all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the assets, liabilities and trust corpus of the Cross Timbers Royalty Trust at September 30, 2017, and the distributable income and changes in trust corpus for the three- and nine-month periods ended September 30, 2017 and 2016, have been included. Distributable income for such interim periods is not necessarily indicative of distributable income for the full year. The condensed financial statements as of September 30, 2017, and for the three-month and nine-month periods ended September 30, 2017 and 2016 have been subjected to a review by PricewaterhouseCoopers LLP, the Trust's independent registered public accounting firm, whose report is included herein.

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Report of Independent Registered Public Accounting Firm

To the Unitholders of Cross Timbers Royalty Trust and

Southwest Bank, Trustee

We have reviewed the accompanying condensed statement of assets, liabilities and trust corpus of Cross Timbers Royalty Trust (the Trust) as of September 30, 2017, and the related condensed statements of distributable income and changes in trust corpus for the three-month and nine-month periods ended September 30, 2017 and 2016. These interim financial statements are the responsibility of the Trustee.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

As described in Note 1, these interim financial statements were prepared on the modified cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

Based on our review, we are not aware of any material modifications that should be made to the accompanying condensed interim financial statements for them to be in conformity with the basis of accounting described in Note 1.

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the statement of assets, liabilities and trust corpus as of December 31, 2016, and the related statements of distributable income and changes in trust corpus for the year then ended (not presented herein), and in our report dated March 10, 2017, we expressed an unqualified opinion on those financial statements. In our opinion, the information set forth in the accompanying condensed statement of assets, liabilities and trust corpus as of December 31, 2016 is fairly stated, in all material respects, in relation to the statement of assets, liabilities and trust corpus from which it has been derived.

/s/ PricewaterhouseCoopers LLP
Dallas, TX
November 6, 2017

Table of Contents**CROSS TIMBERS ROYALTY TRUST****Condensed Statements of Assets, Liabilities and Trust Corpus (Unaudited)**

	September 30, 2017	December 31, 2016
ASSETS		
Cash and short-term investments	\$ 1,504,201	\$ 1,544,252
Interest to be received	831	182
Net profits interests in oil and gas properties net (Note 1)	9,571,180	9,903,800
	\$ 11,076,212	\$ 11,448,234
LIABILITIES AND TRUST CORPUS		
Distribution payable to unitholders	\$ 505,032	\$ 544,434
Expense reserve (a)	1,000,000	1,000,000
Trust corpus (6,000,000 units of beneficial interest authorized and outstanding)	9,571,180	9,903,800
	\$ 11,076,212	\$ 11,448,234

(a) Expense reserve allows Trustee to pay its obligations should it be unable to pay them out of the net profits income. As of September 30, 2017, the reserve currently established by the Trustee is fully funded at \$1,000,000. The accompanying notes to condensed financial statements are an integral part of these statements.

Table of Contents**CROSS TIMBERS ROYALTY TRUST****Condensed Statements of Distributable Income** (Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2017	2016	2017	2016
Net profits income	\$ 1,674,186	\$ 1,513,537	\$ 4,931,974	\$ 5,610,716
Interest income	2,289	356	4,808	597
Total income	1,676,475	1,513,893	4,936,782	5,611,313
Administration expense	150,045	88,981	505,380	430,239
Cash reserves withheld for Trust expenses		125,000		725,000
Distributable income	\$ 1,526,430	\$ 1,299,912	\$ 4,431,402	\$ 4,456,074
Distributable income per unit (6,000,000 units)	\$ 0.254405	\$ 0.216652	\$ 0.738567	\$ 0.742679

The accompanying notes to condensed financial statements are an integral part of these statements.

Table of Contents**CROSS TIMBERS ROYALTY TRUST****Condensed Statements of Changes in Trust Corpus (Unaudited)**

	Three Months Ended September 30		Nine Months Ended September 30	
	2017	2016	2017	2016
Trust corpus, beginning of period	\$ 9,680,286	\$ 10,192,486	\$ 9,903,800	\$ 10,542,236
Amortization of net profits interests	(109,106)	(124,909)	(332,620)	(474,659)
Distributable income	1,526,430	1,299,912	4,431,402	4,456,074
Distributions declared	(1,526,430)	(1,299,912)	(4,431,402)	(4,456,074)
Trust corpus, end of period	\$ 9,571,180	\$ 10,067,577	\$ 9,571,180	\$ 10,067,577

The accompanying notes to condensed financial statements are an integral part of these statements.

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CROSS TIMBERS ROYALTY TRUST

Notes to Condensed Financial Statements (Unaudited)

1. Basis of Accounting

The financial statements of Cross Timbers Royalty Trust (the Trust) are prepared on the following basis and are not intended to present financial position and results of operations in conformity with U.S. generally accepted accounting principles (GAAP):

Net profits income recorded for a month is the amount computed and paid by XTO Energy Inc., the owner of the underlying properties, to Southwest Bank, as trustee (Trustee) for the Trust. XTO Energy is a wholly owned subsidiary of Exxon Mobil Corporation. Net profits income consists of net proceeds received by XTO Energy from the underlying properties in the prior month, multiplied by net profit percentages of 90% for the 90% net profits interests, and 75% for the 75% net profits interests.

Costs deducted in the calculation of net proceeds for the 90% net profits interests generally include applicable taxes, transportation, marketing and legal costs. In addition to those costs, the 75% net profits interests include deductions for production expense, development costs, operating charges and other costs.

Net profits income is computed separately for each of five conveyances under which the net profits interests were conveyed to the Trust. If monthly costs exceed revenues for any conveyance, such excess costs must be recovered, with accrued interest, from future net proceeds of that conveyance and cannot reduce net proceeds from the other conveyances.

Interest income, interest to be received and distribution payable to unitholders include interest to be earned on net profits income from the monthly record date (last business day of the month) to the date of the next distribution to unitholders.

Trust expenses are recorded based on liabilities paid and cash reserves established by the Trustee for liabilities and contingencies.

Distributions to unitholders are recorded when declared by the Trustee.

The financial statements of the Trust differ from those prepared in conformity with U.S. GAAP because revenues are recognized when received rather than accrued in the month of production, expenses are recognized when paid rather than when incurred, and certain cash reserves may be established by the Trustee for contingencies which would not be recorded under U.S. GAAP. This comprehensive basis of accounting other than U.S. GAAP corresponds to the accounting permitted for royalty trusts by the U.S. Securities and Exchange Commission, as specified by Staff Accounting Bulletin Topic 12:E, Financial Statements of Royalty Trusts.

Most accounting pronouncements apply to entities whose financial statements are prepared in accordance with U.S. GAAP, directing such entities to accrue or defer revenues and expenses in a period other than when such revenues were received or expenses were paid. Because the Trust's financial statements are prepared on the modified cash basis, as described above, most accounting pronouncements are not applicable to the Trust's financial statements.

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Impairment of Net Profits Interest

The Trustee reviews the Trust's net profits interests (NPI) in oil and gas properties for impairment whenever events or circumstances indicate that the carrying value of the NPI may not be recoverable. In general, the Trustee does not view temporarily low prices as an indication of impairment. The markets for crude oil and natural gas have a history of significant price volatility and though prices will occasionally drop significantly, industry prices over the long term will continue to be driven by market supply and demand. If events and circumstances indicated the carrying value may not be recoverable, the Trustee would use the estimated undiscounted future net cash flows from the NPI to evaluate the recoverability of the Trust assets. If the undiscounted future net cash flows from the NPI are less than the NPI carrying value, the Trust would recognize an impairment loss for the difference between the NPI carrying value and the estimated fair value of the NPI. The determination as to whether the NPI is impaired requires a significant amount of judgment by the Trustee and is based on the best information available to the Trustee at the time of the evaluation. There was no impairment of the assets as of September 30, 2017.

Net profits interests in oil and gas properties

The initial carrying value of the net profits interests of \$61,100,449 represents XTO Energy's historical net book value for the interests on February 12, 1991, the creation date of the Trust. Amortization of the net profits interests is calculated on a unit-of-production basis and is charged directly to trust corpus. Accumulated amortization was \$51,529,269 as of September 30, 2017 and \$51,196,649 as of December 31, 2016.

2. Income Taxes

For federal income tax purposes, the Trust constitutes a fixed investment trust that is taxed as a grantor trust. A grantor trust is not subject to tax at the trust level. Accordingly, no provision for income taxes has been made in the financial statements. The unitholders are considered to own the Trust's income and principal as though no trust were in existence. The income of the Trust is deemed to have been received or accrued by each unitholder at the time such income is received or accrued by the Trust and not when distributed by the Trust.

All revenues from the Trust are from sources within Texas, Oklahoma or New Mexico. Because it distributes all of its net income to unitholders, the Trust has not been taxed at the trust level in New Mexico or Oklahoma. While the Trust has not owed tax, the Trustee is required to file an Oklahoma income tax return reflecting the income and deductions of the Trust attributable to properties located in that state, along with a schedule that includes information regarding distributions to unitholders.

Texas imposes a franchise tax at a rate of .75% on gross revenues less certain deductions, as specifically set forth in the Texas franchise tax statutes. Entities subject to the Texas franchise tax generally include trusts and most other types of entities that provide limited liability protection, unless otherwise exempt. Trusts that receive at least 90% of their federal gross income from certain passive sources, including royalties from mineral properties and other non-operated mineral interest income, and do not receive more than 10% of their income from operating an active trade or business, generally are exempt from the Texas franchise tax as passive entities. The Trust has been and expects to continue to be exempt from Texas franchise tax as a passive entity. Because the Trust should be exempt from Texas franchise tax at the Trust level as a passive entity, each unitholder that is a taxable entity under the Texas franchise tax generally will be required to include its portion of Trust revenues in its own Texas franchise tax computation. This revenue is sourced to Texas under provisions of the Texas Administrative Code, providing that such income is sourced according to the principal place of business of the Trust, which is Texas.

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Each unitholder should consult his or her own tax advisor regarding income tax requirements, if any, applicable to such person's ownership of Trust units.

Unitholders should consult the Trust's latest annual report on Form 10-K for a more detailed discussion of federal and state tax matters.

3. Contingencies

Several states have enacted legislation requiring state income tax withholding from payments made to nonresident recipients of oil and gas proceeds. After consultation with its tax counsel, the Trustee believes that it is not required to withhold on payments made to the unitholders. However, regulations are subject to change by the various states, which could change this conclusion. Should amounts be withheld on payments made to the Trust or the unitholders, distributions to the unitholders would be reduced by the required amount, subject to the filing of a claim for refund by the Trust or unitholders for such amount.

4. Excess Costs

If monthly costs exceed revenues for any conveyance, such excess costs must be recovered, with accrued interest, from future net proceeds of that conveyance and cannot reduce net proceeds from other conveyances.

The following summarizes excess costs activity, cumulative excess costs balances and accrued interest to be recovered by conveyance:

	TX WI	Underlying OK WI	Total
Cumulative excess costs remaining at 12/31/16	\$ 1,747,819	\$ 655,835	\$ 2,403,654
Net excess costs (recovery) for the quarter ended 3/31/17	45,131	(317,927)	(272,796)
Net excess costs (recovery) for the quarter ended 6/30/17	55,628	(249,993)	(194,365)
Net excess costs (recovery) for the quarter ended 9/30/17	127,552	28,733	156,285
Cumulative excess costs remaining at 9/30/17	1,976,130	116,648	2,092,778
Accrued interest at 9/30/17	128,041	62,775	190,816
Total remaining to be recovered at 9/30/17	\$ 2,104,171	\$ 179,423	\$ 2,283,594

	TX WI	NPI OK WI	Total
Cumulative excess costs remaining at 12/31/16	\$ 1,310,865	\$ 491,876	\$ 1,802,741
	33,848	(238,445)	(204,597)

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Net excess costs (recovery) for the quarter ended 3/31/17			
Net excess costs (recovery) for the quarter ended 6/30/17	41,721	(187,495)	(145,774)
Net excess costs (recovery) for the quarter ended 9/30/17	95,664	21,550	117,214
Cumulative excess costs remaining at 9/30/17	1,482,098	87,486	1,569,584
Accrued interest at 9/30/17	96,031	47,081	143,112
Total remaining to be recovered at 9/30/17	\$ 1,578,129	\$ 134,567	\$ 1,712,696

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Continued lower oil prices in relation to operating expenses and increased development costs resulted in net excess costs on properties underlying the Texas working interests for the quarter ended September 30, 2017.

Decreased oil production resulted in net excess costs on properties underlying the Oklahoma working interests for the quarter ended September 30, 2017. Underlying accrued interest of \$1,528 (NPI \$1,145) was recovered during the quarter ended September 30, 2017.

Underlying cumulative excess costs for the Texas and Oklahoma working interest conveyances remaining as of September 30, 2017 totaled \$2.3 million, including accrued interest of \$0.2 million.

5. XTO Energy Inc.

In computing net proceeds for the 75% net profits interests, XTO Energy deducts an overhead charge as reimbursement for costs associated with monitoring these interests. This charge at September 30, 2017 was \$39,246 per month and is subject to annual adjustment based on an oil and gas industry index.

XTO Energy deducts a monthly overhead charge for reimbursement of administrative expenses as operator of the Hewitt Unit, which is one of the properties underlying the Oklahoma 75% net profits interests. As of September 30, 2017, this charge was approximately \$29,000 per month and is subject to annual adjustment based on an oil and gas industry index. Other than this property, XTO Energy and ExxonMobil do not operate or control any of the underlying properties or related working interests.

6. Subsequent Event

Effective October 19, 2017, Simmons First National Corporation (SFNC) completed its acquisition of First Texas BHC, Inc., the parent company of Southwest Bank, the Trustee of the Trust. SFNC is the parent of Simmons Bank. SFNC has announced that it intends to operate Southwest Bank as a separate bank subsidiary for an interim period, after which it intends to merge it into Simmons Bank. The Trustee does not anticipate any material impact to the Trust as a result of the acquisition.

Item 2. Trustee's Discussion and Analysis.

The following discussion should be read in conjunction with the Trustee's discussion and analysis contained in the Trust's 2016 Annual Report on Form 10-K, as well as the condensed financial statements and notes thereto included in this Quarterly Report on Form 10-Q. The Trust's Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports are available on the Trust's web site at www.crt-crosstimbers.com.

Distributable Income

Quarter

For the quarter ended September 30, 2017, net profits income was \$1,674,186 compared to \$1,513,537 for third quarter 2016. This 11% increase in net profits income is primarily the result of higher oil and gas prices (\$0.4 million) and net excess costs activity on the Texas and Oklahoma working interest properties (\$0.3 million), partially offset by

increased production expenses (\$0.2 million), decreased oil and gas production (\$0.2 million) and increased development costs (\$0.1 million). See Net Profits Income below.

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After considering interest income of \$2,289 and administration expense of \$150,045, distributable income for the quarter ended September 30, 2017 was \$1,526,430, or \$0.254405 per unit of beneficial interest. Administration expense for the quarter increased \$61,064 from the prior year quarter, primarily related to the timing of receipt and payment of Trust expenses and terms of professional services. Changes in interest income are attributable to fluctuations in net profits income and interest rates. For third quarter 2016, distributable income was \$1,299,912, or \$0.216652 per unit.

Distributions to unitholders for the quarter ended September 30, 2017 were:

Record Date	Payment Date	Distribution per Unit
July 31, 2017	August 14, 2017	\$ 0.077397
August 31, 2017	September 15, 2017	0.092836
September 29, 2017	October 16, 2017	0.084172
		\$ 0.254405

Nine Months

For the nine months ended September 30, 2017, net profits income was \$4,931,974 compared to \$5,610,716 for the same 2016 period. This 12% decrease in net profits income is primarily the result of decreased oil and gas production (\$1.8 million), net excess costs activity on the Texas and Oklahoma working interest properties (\$0.5 million), increased development costs (\$0.2 million) and increased taxes, transportation and other (\$0.1 million), partially offset by increased oil and gas prices (\$1.9 million). See *Net Profits Income* below.

After considering interest income of \$4,808 and administration expense of \$505,380, distributable income for the nine months ended September 30, 2017 was \$4,431,402, or \$0.738567 per unit of beneficial interest. Administration expense for the nine months ended September 30, 2017 increased \$75,141 from the prior year nine-month period, primarily related to the timing of receipt and payment of Trust expenses and terms of professional services. Changes in interest income are attributable to fluctuations in net profits income and interest rates. For the nine months ended September 30, 2016, distributable income was \$4,456,074, or \$0.742679 per unit.

Net Profits Income

Net profits income is recorded when received by the Trust, which is the month following receipt by XTO Energy and generally two months after oil production and three months after gas production. Net profits income is generally affected by three major factors:

oil and gas sales volumes,

oil and gas sales prices, and

costs deducted in the calculation of net profits income.

Because properties underlying the 90% net profits interests are primarily royalty and overriding royalty interests, the calculation of net profits income from these interests includes deductions for production and property taxes, legal costs, and marketing and transportation charges. In addition to these costs, the calculation of net profits income from the 75% net profits interests includes deductions for production expense, development costs and overhead since the related underlying properties are working interests.

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The following is a summary of the calculation of net profits income received by the Trust:

	Three Months			Nine Months		
	Ended September 30 2017	2016	(a) Increase (Decrease)	Ended September 30 2017	2016	(a) Increase (Decrease)
Sales Volumes						
Oil (Bbls) (b)						
Underlying properties	50,384	55,091	(9%)	155,181	171,226	(9%)
Average per day	&nb					