

CROSS TIMBERS ROYALTY TRUST

Form 10-Q

August 04, 2016

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**Form 10-Q**

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

**For the quarterly period ended June 30, 2016**

**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 or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting 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

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 July 1, 2016**

**6,000,000**

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**CROSS TIMBERS ROYALTY TRUST**

**FORM 10-Q FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2016**

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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 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 June 30, 2016, and the distributable income and changes in trust corpus for the three- and six-month periods ended June 30, 2016 and 2015, 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 June 30, 2016, and for the three-month and six-month periods ended June 30, 2016 and 2015 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 June 30, 2016, and the related condensed statements of distributable income and changes in trust corpus for the three-month and six-month periods ended June 30, 2016 and 2015. 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 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, 2015, 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 11, 2016, 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, 2015 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

August 4, 2016

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

	<b>June 30, 2016</b>	<b>December 31, 2015</b>
<b>ASSETS</b>		
Cash and short-term investments	<b>\$ 1,240,138</b>	\$ 969,700
Interest to be received	<b>52</b>	4
Net profits interests in oil and gas properties net (Note 1)	<b>10,192,486</b>	10,542,236
	<b>\$ 11,432,676</b>	\$11,511,940
<b>LIABILITIES AND TRUST CORPUS</b>		
Distribution payable to unitholders	<b>\$ 365,190</b>	\$ 694,704
Expense reserve (a)	<b>875,000</b>	275,000
Trust corpus (6,000,000 units of beneficial interest authorized and outstanding)	<b>10,192,486</b>	<u>10,542,236</u>
	<b>\$ 11,432,676</b>	\$ 11,511,940

(a) Expense reserve allows trustee to pay its obligations should it be unable to pay them out of the net profits income. This reserve will be 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)

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30</b>		<b>June 30</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Net profits income	<b>\$ 1,391,073</b>	\$ 1,851,313	<b>\$ 4,097,179</b>	\$ 4,675,684
Interest income	<b>183</b>	11	<b>241</b>	23
Total income	<b>1,391,256</b>	1,851,324	<b>4,097,420</b>	4,675,707
Administration expense	<b>116,076</b>	89,696	<b>341,258</b>	248,089
Cash reserves withheld for Trust expenses	<b>300,000</b>	25,000	<b>600,000</b>	125,000
Distributable income	<b>\$ 975,180</b>	\$ 1,736,628	<b>\$ 3,156,162</b>	\$ 4,302,618
Distributable income per unit (6,000,000 units)	<b>\$ 0.162530</b>	\$ 0.289438	<b>\$ 0.526027</b>	\$ 0.717103

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)**

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30</b>		<b>June 30</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Trust corpus, beginning of period	<b>\$ 10,328,091</b>	\$ 10,867,893	<b>\$ 10,542,236</b>	\$ 10,994,298
Amortization of net profits interests	<b>(135,605)</b>	(89,189)	<b>(349,750)</b>	(215,594)
Distributable income	<b>975,180</b>	1,736,628	<b>3,156,162</b>	4,302,618
Distributions declared	<b>(975,180)</b>	(1,736,628)	<b>(3,156,162)</b>	(4,302,618)
Trust corpus, end of period	<b>\$ 10,192,486</b>	\$ 10,778,704	<b>\$ 10,192,486</b>	\$ 10,778,704

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 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 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, and do not include production expense or development costs. For the 75% net profits interests, costs deducted in the calculation of net proceeds include production expense, development costs, applicable taxes, transportation, marketing and legal 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) through 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.
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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 a trigger event for conducting an impairment test. 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 a trigger event occurred, 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 June 30, 2016.

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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.

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 \$50,907,963 as of June 30, 2016 and \$50,558,213 as of December 31, 2015.

## **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 a return with Oklahoma 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 does not impose a state income tax, so no part of the Trust's income will be subject to income tax at the Trust level in Texas.

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 complete discussion of federal and state tax matters.

**Table of Contents****3. Contingencies**

Several states have enacted legislation requiring state income tax withholding from 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**

	TX WI	Conveyances (Underlying) OK WI	Total
Cumulative excess costs remaining at 12/31/15	\$ 959,151	\$ 1,066,920	\$ 2,026,071
Net excess costs for the quarter ended 3/31/16	392,377	115,984	508,361
Net excess costs (recovery) for the quarter ended 6/30/16	163,954	(63,820)	100,134
Cumulative excess costs remaining at 6/30/16	\$ 1,515,482	\$ 1,119,084	\$ 2,634,566

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.

XTO Energy advised the trustee that continued lower oil prices resulted in net excess costs of \$163,954 (\$122,966 net to the Trust) for the quarter ended June 30, 2016 and \$392,377 (\$294,283 net to the Trust) for the quarter ended March 31, 2016 on properties underlying the Texas working interest.

XTO Energy advised the trustee that decreased costs and increasing oil prices resulted in the partial recovery of excess costs of \$63,820 (\$47,865 net to the Trust) for the quarter ended June 30, 2016 on properties underlying the Oklahoma working interest.

XTO Energy advised the trustee that lower oil prices resulted in net excess costs of \$115,984 (\$86,988 net to the Trust) for the quarter ended March 31, 2016 on properties underlying the Oklahoma working interest.

XTO Energy advised the trustee that lower oil prices and increased costs resulted in net excess costs of \$310,588 (\$232,941 net to the Trust) for the quarter ended June 30, 2015 and \$410,337 (\$307,753 net to the Trust) for the quarter ended March 31, 2015 on properties underlying the Texas working interest.

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XTO Energy advised the trustee that lower oil prices, decreased oil production and increased costs resulted in net excess costs of \$807,158 (\$605,369 net to the Trust) for the quarter ended June 30, 2015 and \$43,414 (\$32,560 net to the Trust) for the quarter ended March 31, 2015 on properties underlying the Oklahoma working interest.

Cumulative excess costs for the Texas and Oklahoma working interest conveyances remaining as of June 30, 2016 totaled \$2,634,566 (\$1,975,925 net to the Trust).

**Table of Contents***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 2015 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](http://www.crt-crosstimbers.com).

**Distributable Income***Quarter*

For the quarter ended June 30, 2016, net profits income was \$1,391,073 compared to \$1,851,313 for second quarter 2015. This 25% decrease in net profits income is primarily the result of lower oil and gas prices (\$1.2 million) and net excess costs on the Texas and Oklahoma working interest properties in 2015 (\$0.8 million), partially offset by lower development costs (\$0.7 million), decreased production expense (\$0.4 million), increased gas production (\$0.3 million), and decreased taxes, transportation, and other costs (\$0.2 million). See *Net Profits Income* on the following page.

After considering interest income of \$183, administration expense of \$116,076 and additions to the cash reserve of \$300,000, distributable income for the quarter ended June 30, 2016 was \$975,180, or \$0.162530 per unit of beneficial interest. Administration expense for the quarter increased \$26,380 from the prior year quarter. For second quarter 2015, distributable income was \$1,736,628, or \$0.289438 per unit.

Distributions to unitholders for the quarter ended June 30, 2016 were:

<b>Record Date</b>	<b>Payment Date</b>	<b>Distribution per Unit</b>
April 29, 2016	May 13, 2016	\$ 0.054363
May 31, 2016	June 14, 2016	0.047302
June 30, 2016	July 15, 2016	0.060865
		\$ 0.162530

*Six Months*

For the six months ended June 30, 2016, net profits income was \$4,097,179 compared to \$4,675,684 for the same 2015 period. This 12% decrease in net profits income is primarily the result of lower oil and gas prices (\$3.0 million) and net excess costs on the Texas and Oklahoma working interest properties in 2015 (\$0.7 million), partially offset by increased gas production (\$1.6 million), lower development costs (\$0.9 million) and decreased production expense (\$0.7 million). See *Net Profits Income* on the following page.

After considering interest income of \$241, administration expense of \$341,258 and additions to the cash reserve of \$600,000, distributable income for the six months ended June 30, 2016 was \$3,156,162, or \$0.526027 per unit of beneficial interest. Administration expense for the six months ended June 30, 2016 increased \$93,169 from the prior year six-month period. For the six months ended June 30, 2015, distributable income was \$4,302,618, or \$0.717103



per unit.

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**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 royalty and overriding royalty interests, the calculation of net profits income from these interests only 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 and development costs 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			Six Months		
	Ended June 30 (a) 2016	2015	Increase (Decrease)	Ended June 30 (a) 2016	2015	Increase (Decrease)
<b>Sales Volumes</b>						
Oil (Bbls) (b)						
Underlying properties	57,269	58,247	(2%)	116,135	118,130	(2%)
Average per day	636	654	(3%)	638	653	(2%)
Net profits interests	17,157	17,469	(2%)	33,372	38,226	(13%)
Gas (Mcf) (b)						
Underlying properties	432,502	343,498	26%	1,144,289	711,729	61%
Average per day	4,753	3,817	25%	6,253	3,911	60%
Net profits interests	402,610	297,916	35%	1,038,416	619,436	68%
<b>Average Sales Prices</b>						
Oil (per Bbl)	\$ 32.19	\$ 49.36	(35%)	\$ 34.20	\$ 56.17	(39%)
Gas (per Mcf)	\$ 2.83	\$ 3.92	(28%)	\$ 3.65	\$ 4.85	(25%)
<b>Revenues</b>						
Oil sales	\$ 1,843,425	\$ 2,875,117	(36%)	\$ 3,971,864	\$ 6,635,762	(40%)
Gas sales	1,222,849	1,347,953	(9%)	4,179,048	3,450,621	21%
Total Revenues	3,066,274	4,223,070	(27%)	8,150,912	10,086,383	(19%)
<b>Costs</b>						
Taxes, transportation and other	429,308	603,999	(29%)	1,257,370	1,345,562	(7%)
Production expense (c)	1,014,786	1,530,991	(34%)	2,386,705	3,276,013	(27%)
Development costs	176,677	1,148,812	(85%)	562,911	1,793,587	(69%)
Excess costs (d)	(100,134)	(1,117,746)	(91%)	(608,495)	(1,571,497)	(61%)
Total Costs	1,520,637	2,166,056	(30%)	3,598,491	4,843,665	(26%)
<b>Net Proceeds</b>	<b>\$ 1,545,637</b>	<b>\$ 2,057,014</b>	<b>(25%)</b>	<b>\$ 4,552,421</b>	<b>\$ 5,242,718</b>	<b>(13%)</b>
<b>Net Profits Income</b>	<b>\$ 1,391,073</b>	<b>\$ 1,851,313</b>	<b>(25%)</b>	<b>\$ 4,097,179</b>	<b>\$ 4,675,684</b>	<b>(12%)</b>

(a) Because of the interval between time of production and receipt of royalty income by the Trust, (1) oil and gas sales for the quarter ended June 30 generally represent oil production for the period February through April and gas production for the period January through March and (2) oil and gas sales for the six-months ended June 30 generally represent oil production for the period November through April and gas production for the period October through March.

- (b) Oil and gas sales volumes are allocated to the net profits interests based upon a formula that considers oil and gas prices and the total amount of production expense and development costs. As product prices change, the Trust's share of the production volumes is impacted as the quantity of production to cover expenses in reaching the net profits break-even level changes inversely with price. As such, the underlying property production volume changes may not correlate with the Trust's net profit share of those volumes in any given period. Therefore, comparative discussion of oil and gas sales volumes is based on the underlying properties.
- (c) Production expense is primarily from seven working interest properties in the 75% net profits interest. Six of these properties are not operated by XTO Energy or ExxonMobil. Production expense includes an overhead charge which is deducted and retained by the operator. As of June 30, 2016, this charge was \$37,200 per month (including a monthly overhead charges of \$5,314 which XTO Energy deducts as operator of the Hewitt Unit) and is subject to adjustment each May based on an oil and gas industry index.
- (d) See Note 4 to Condensed Financial Statements.

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The following are explanations of significant variances on the underlying properties from second quarter 2015 to second quarter 2016 and from the first six months of 2015 to the comparable period in 2016:

### **Sales Volumes**

#### *Oil*

Oil sales volumes decreased 2% for second quarter 2016 and decreased 2% for the six-month period as compared with the same 2015 periods primarily because of natural production decline, partially offset by the timing of cash receipts.

#### *Gas*

Gas sales volumes increased 26% for second quarter 2016 and increased 61% for the six-month period as compared with the same 2015 periods primarily because of the timing of cash receipts related to purchaser payments covering production back to 2013, partially offset by natural production decline.

The estimated rate of natural production decline on the underlying oil and gas properties is approximately 6% to 8% a year.

### **Sales Prices**

#### *Oil*

The average oil price decreased 35% to \$32.19 per Bbl for the second quarter and decreased 39% to \$34.20 per Bbl for the six-month period. Oil prices are expected to remain volatile. The second quarter 2016 oil price is primarily related to production from February through April 2016, when the average NYMEX price was \$36.57 per Bbl. The average NYMEX price for May and June 2016 was \$47.81 per Bbl. On July 18, 2016, the average NYMEX futures price for the following twelve months was \$48.19 per Bbl.

#### *Gas*

Gas prices for the second quarter decreased 28% to \$2.83 per Mcf and for the six-month period decreased 25% to \$3.65 per Mcf. Excluding the impact of the prior period production payments received in second quarter 2016 and six-months ended June 30, 2016 the adjusted gas price was \$2.53 and \$2.75 respectively. Natural gas prices are affected by natural gas liquids prices, the level of North American production, weather, crude oil prices, the U.S. economy, storage levels and import levels of liquefied natural gas. Natural gas prices are expected to remain volatile. The second quarter 2016 gas price is primarily related to production from January through March 2016, when the average NYMEX price was \$2.09 per MMBtu. The average NYMEX price for April through June 2016 was \$1.95 per MMBtu. On July 18, 2016, the average NYMEX futures price for the following twelve months was \$3.03 per MMBtu.

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### Costs

#### *Taxes, Transportation and Other*

Taxes, transportation and other costs decreased 29% for the second quarter primarily because of lower oil and gas production taxes related to lower oil and gas revenues and decreased property taxes related to lower valuations. Taxes, transportation and other costs decreased 7% for the six-month period primarily because of lower oil production taxes related to lower oil revenues and decreased property taxes related to lower valuations, partially offset by increased other deductions as a percentage of oil and gas revenues and increased gas production taxes related to higher gas revenues.

#### *Production Expense*

Production expense decreased 34% for the second quarter and 27% for the six-month period primarily because of decreased outside operated and repairs and maintenance costs.

#### *Development Costs*

Development costs decreased 85% for the second quarter and 69% for the six-month period primarily because of decreased activity and costs related to non-operated Texas and Oklahoma oil properties underlying the 75% net profits interest.

#### *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 any other conveyance.

XTO Energy advised the trustee that continued lower oil prices resulted in net excess costs of \$163,954 (\$122,966 net to the Trust) for the quarter ended June 30, 2016 and \$392,377 (\$294,283 net to the Trust) for the quarter ended March 31, 2016 on properties underlying the Texas working interest.

XTO Energy advised the trustee that decreased costs and increasing oil prices resulted in the partial recovery of excess costs of \$63,820 (\$47,865 net to the Trust) for the quarter ended June 30, 2016 on properties underlying the Oklahoma working interest.

XTO Energy advised the trustee that lower oil prices resulted in net excess costs of \$115,984 (\$86,988 net to the Trust) for the quarter ended March 31, 2016 on properties underlying the Oklahoma working interest.

XTO Energy advised the trustee that lower oil prices and increased costs resulted in net excess costs of \$310,588 (\$232,941 net to the Trust) for the quarter ended June 30, 2015 and \$410,337 (\$307,753 net to the Trust) for the quarter ended March 31, 2015 on properties underlying the Texas working interest.

XTO Energy advised the trustee that lower oil prices, decreased oil production and increased costs resulted in net excess costs of \$807,158 (\$605,369 net to the Trust) for the quarter ended June 30, 2015 and \$43,414 (\$32,560 net to the Trust) for the quarter ended March 31, 2015 on properties underlying the Oklahoma working interest.

Cumulative excess costs for the Texas and Oklahoma working interest conveyances remaining as of June 30, 2016 totaled \$2,634,566 (\$1,975,925 net to the Trust).



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**Contingencies**

Several states have enacted legislation requiring state income tax withholding from 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.

**Forward-Looking Statements**

Statements in this report relating to future plans, predictions, events or conditions are forward-looking statements. All statements other than statements of historical fact included in this Form 10-Q including, without limitation, statements regarding the net profits interests, underlying properties, development activities, development, production and other costs and expenses, oil and gas prices and differentials to NYMEX prices, distributions to unitholders, and industry and market conditions, are forward-looking statements that are subject to risks and uncertainties which are detailed in Part I, Item 1A of the Trust's Annual Report on Form 10-K for the year ended December 31, 2015, which is incorporated by this reference as though fully set forth herein. XTO Energy and the trustee assume no duty to update these statements as of any future date.



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*Item 3. Quantitative and Qualitative Disclosures about Market Risk.*

There have been no material changes in the Trust's market risks from the information disclosed in Part II, Item 7A of the Trust's Annual Report on Form 10-K for the year ended December 31, 2015.

*Item 4. Controls and Procedures.*

As of the end of the period covered by this report, the trustee carried out an evaluation of the effectiveness of the Trust's disclosure controls and procedures pursuant to Exchange Act Rules 13a-15 and 15d-15. Based upon that evaluation, the trustee concluded that the Trust's disclosure controls and procedures are effective in timely recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Trust in the reports that it files or submits under the Securities Exchange Act of 1934 and are effective in ensuring that information required to be disclosed by the Trust in the reports that it files or submits under the Securities Exchange Act of 1934 is accumulated and communicated to the trustee to allow timely decisions regarding required disclosure. In its evaluation of disclosure controls and procedures, the trustee has relied, to the extent considered reasonable, on information provided by XTO Energy. There has not been any change in the Trust's internal control over financial reporting during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Trust's internal control over financial reporting.

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**PART II OTHER INFORMATION**

*Item 1.*

Not applicable.

*Item 1A. Risk Factors.*

There have been no material changes in the risk factors disclosed under Part I, Item 1A of the Trust's Annual Report on Form 10-K for the year ended December 31, 2015.

*Items 2 through 5.*

Not applicable.

*Item 6. Exhibits.*

(a) Exhibits.

Exhibit Number  
and Description

(31) Rule 13a-14(a)/15d-14(a) Certification

(32) Section 1350 Certification

(99) Items 1A, 7 and 7A to the Annual Report on Form 10-K for Cross Timbers Royalty Trust filed with the Securities and Exchange Commission on March 11, 2016 (incorporated herein by reference)

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

CROSS TIMBERS ROYALTY TRUST

By SOUTHWEST BANK, TRUSTEE

By /s/ NANCY G. WILLIS  
Nancy G. Willis  
Vice President

EXXON MOBIL CORPORATION

By /s/ BETH E. CASTEEL  
Beth E. Casteel  
Vice President Upstream Business Services

Date: August 4, 2016