

CHESAPEAKE GRANITE WASH TRUST  
Form 10-Q  
November 02, 2018

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, 2018

Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_ .

Commission File No. 001-35343

Chesapeake Granite Wash Trust

(Exact name of registrant as specified in its charter)

Delaware

45-6355635

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

The Bank of New York Mellon

Trust Company, N.A., Trustee

Global Corporate Trust

601 Travis Street, Floor 16

Houston, Texas

77002

(Address of principal executive offices)

(Zip Code)

(512) 236-6555

(Registrant's telephone number, including area code)

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 every Interactive Data File required to be submitted 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 such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a 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.

Large accelerated filer  Accelerated filer  Non-accelerated filer  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 Rule 12b-2 of the Exchange Act). Yes  No

As of November 1, 2018, 46,750,000 common units representing beneficial interests in Chesapeake Granite Wash Trust were outstanding.



CHESAPEAKE GRANITE WASH TRUST  
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All references to "we," "us," "our," or the "Trust" refer to Chesapeake Granite Wash Trust. The royalty interests conveyed on November 16, 2011 by Chesapeake from its interests in certain properties in the Colony Granite Wash formation in Oklahoma and held by the Trust are referred to as the "Royalty Interests." References to "Chesapeake" refer to Chesapeake Energy Corporation and, where the context requires, its subsidiaries.

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#### DISCLOSURES REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q ("Quarterly Report") includes "forward-looking statements" about the Trust and Chesapeake and other matters discussed herein that are subject to risks and uncertainties that are intended to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995 and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). All statements other than statements of historical fact included in this document, including, without limitation, statements under "Trustee's Discussion and Analysis of Financial Condition and Results of Operations" in Item 2 of Part I and elsewhere herein regarding the proved oil, natural gas and natural gas liquids ("NGL") reserves associated with the properties underlying the Royalty Interests, the Trust's or Chesapeake's future financial position, business strategy, budgets, projected costs and plans and objectives for future operations, information regarding target distributions, statements pertaining to future development activities and costs and information regarding production and reserve growth, are forward-looking statements. Actual outcomes and results may differ materially from those projected. Our forward-looking statements are generally accompanied by words such as "estimate," "project," "predict," "believe," "expect," "anticipate," "potential," "could," "may," "foresee," "seek," "plan," "goal," "assume," "target," "should," "intend," "ability," "will," "would," "forecast" or other similar words that indicate the uncertainty of future events or outcomes. These statements are based on certain assumptions made by the Trust, and by Chesapeake, in light of its experience and perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate under the circumstances. However, whether actual results and developments will conform with such expectations and predictions is subject to a number of risks and uncertainties, including the risk factors discussed in Item 1A of Part I of the Trust's Annual Report on Form 10-K for the year ended December 31, 2017 (the "2017 Form 10-K") and those set forth from time to time in the Trust's filings with the United States Securities and Exchange Commission (the "SEC"), which could affect the future results of the energy industry in general, and the Trust and Chesapeake in particular, and could cause those results to differ materially from those expressed in such forward-looking statements. The actual results or developments anticipated may not be realized or, even if substantially realized, may not have the expected consequences to or effects on Chesapeake's business and the Trust. Such statements are not guarantees of future performance and actual results or developments may differ materially from those projected in such forward-looking statements. These factors should not be construed as exhaustive, and there may also be other risks that we are unable to predict at this time. The Trustee relies on Chesapeake for information regarding the Royalty Interests, the Underlying Properties (as defined below) and Chesapeake itself. The Trust undertakes no obligation to publicly update or revise any forward-looking statements and expressly disclaims any obligation to do so, except as required by applicable law.

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## PART I. FINANCIAL INFORMATION

## ITEM 1. Financial Statements

## CHESAPEAKE GRANITE WASH TRUST

## STATEMENTS OF ASSETS, LIABILITIES AND TRUST CORPUS

(Unaudited)

|  | September<br>30, 2018 | December<br>31, 2017 |
|--|-----------------------|----------------------|
|  | (\$ in thousands)     |                      |
| <b>ASSETS:</b>   |                       |                      |
| Cash and cash equivalents  | \$ 1,293              | \$ 2,067             |
| Investment in Royalty Interests  | 487,793               | 487,793              |
| Less: accumulated amortization and impairment  | (463,913)             | (461,488)            |
| Net Investment in Royalty Interests  | 23,880                | 26,305               |
| Total assets   | \$ 25,173             | \$ 28,372            |
| <b>LIABILITIES AND TRUST CORPUS:</b>   |                       |                      |
| Dividend payable to Chesapeake   | \$ —                  | \$ 768               |
| Total liabilities  | —                     | 768                  |
| Trust Corpus; 46,750,000 common units issued and outstanding at September 30, 2018 and December 31, 2017 | 25,173                | 27,604               |
| Total liabilities and Trust corpus   | \$ 25,173             | \$ 28,372            |

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

CHESAPEAKE GRANITE WASH TRUST  
 STATEMENTS OF DISTRIBUTABLE INCOME  
 (Unaudited)

|   | Three Months<br>Ended<br>September 30,<br>2018   |          | Nine Months<br>Ended<br>September 30,<br>2017 |          |
|---|--|----------|---|----------|
|   | 2018   | 2017     | 2018  | 2017     |
|   | (\$ in thousands, except unit and per unit data) |          |   |          |
| REVENUES:   |  |          |   |          |
| Royalty income  | \$3,171  | \$3,939  | \$10,458                                      | \$12,245 |
| EXPENSES:   |  |          |   |          |
| Production taxes  | (212 )   | (185 )   | (663 )  | (556 )   |
| Trust administrative expenses   | (34 )  | (236 )   | (997 )  | (1,451 ) |
| Total expenses  | (246 )   | (421 )   | (1,660 )                                      | (2,007 ) |
| Distributable income available to unitholders   | \$2,925  | \$3,518  | \$8,798                                       | \$10,238 |
| Distributable income per common unit (46,750,000 common units at September 30, 2018 and September 30, 2017)                 | \$0.0626   | \$0.1003 | \$0.1882                                      | \$0.2920 |
| Distributable income per subordinated unit (no subordinated units outstanding at September 30, 2018 and September 30, 2017) | \$—  | \$—      | \$—   | \$—      |

CHESAPEAKE GRANITE WASH TRUST  
 STATEMENTS OF CHANGES IN TRUST CORPUS  
 (Unaudited)

|   | Nine Months<br>Ended<br>September 30,<br>2018 |           | 2017 |      |
|---|---|-----------|------|------|
|   | 2018  | 2017      | 2018 | 2017 |
|   | (\$ in thousands)                             |           |      |      |
| TRUST CORPUS: Beginning of period               | \$27,604                                      | \$31,938  |      |      |
| Cash reserve surplus (deficit)                  | (7 )  | 144       |      |      |
| Amortization of Investment in Royalty Interests | (2,424 )                                      | (3,421 )  |      |      |
| Distributable income                            | 8,798   | 10,238    |      |      |
| Distributions paid to unitholders               | (8,798 )                                      | (10,238 ) |      |      |
| TRUST CORPUS: End of period                     | \$25,173                                      | \$28,661  |      |      |

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

CHESAPEAKE GRANITE WASH TRUST  
NOTES TO FINANCIAL STATEMENTS  
(Unaudited)

1. Organization of the Trust

Chesapeake Granite Wash Trust (the "Trust") is a statutory trust formed in June 2011 under the Delaware Statutory Trust Act pursuant to an initial trust agreement by and among Chesapeake Energy Corporation ("Chesapeake"), as Trustor, The Bank of New York Mellon Trust Company, N.A., as Trustee (the "Trustee"), and The Corporation Trust Company, as Delaware Trustee (the "Delaware Trustee" and, together with the Trustee, the "Trustees"). The Trust was created to own royalty interests (the "Royalty Interests") for the benefit of Trust unitholders pursuant to a trust agreement dated as of June 29, 2011, and subsequently amended and restated as of November 16, 2011, by and among Chesapeake, Chesapeake Exploration, L.L.C., a wholly owned subsidiary of Chesapeake and the Trustees (the "Trust Agreement"). The Royalty Interests are derived from Chesapeake's interests in specified oil and natural gas properties located within an area of mutual interest (the "AMI") in the Colony Granite Wash play in Washita County in the Anadarko Basin of western Oklahoma (the "Underlying Properties"). Chesapeake conveyed the Royalty Interests to the Trust from (a) Chesapeake's interests in 69 existing horizontal wells (the "Producing Wells"), and (b) Chesapeake's interests in 118 horizontal development wells (the "Development Wells"), which Chesapeake was obligated to drill, cause to be drilled or participate as a non-operator in the drilling of, from drill sites in the AMI, on or prior to June 30, 2016. As of June 30, 2016, Chesapeake fulfilled its drilling obligation under the development agreement. Chesapeake retained an interest in each of the Producing Wells and Development Wells, and currently operates 96% of the Producing Wells and the completed Development Wells.

The business and affairs of the Trust are managed by the Trustee. The Trust Agreement limits the Trust's business activities generally to owning the Royalty Interests and any activity reasonably related to such ownership, including activities required or permitted by the terms of the conveyances related to the Royalty Interests. The royalty interests in the Producing Wells entitle the Trust to receive 90% of the proceeds (exclusive of any production or development costs but after deducting certain post-production expenses and any applicable taxes) from the sales of oil, natural gas and NGL production attributable to Chesapeake's net revenue interest in the Producing Wells. The royalty interests in the Development Wells entitle the Trust to receive 50% of the proceeds (exclusive of any production or development costs but after deducting certain post-production expenses and any applicable taxes) from the sales of oil, natural gas and NGL production attributable to Chesapeake's net revenue interest in the Development Wells.

Through an initial public offering in November 2011, the Trust sold to the public 23,000,000 common units, representing beneficial interests in the Trust, for cash proceeds of approximately \$409.7 million, net of offering costs. The Trust delivered the net proceeds of the initial public offering, along with 12,062,500 common units and 11,687,500 subordinated units, to certain wholly owned subsidiaries of Chesapeake in exchange for the conveyance of the Royalty Interests to the Trust. Upon completion of these transactions, there were 46,750,000 Trust units issued and outstanding, consisting of 35,062,500 common units and 11,687,500 subordinated units. The common units and subordinated units had identical rights and privileges, except with respect to their voting rights and rights to receive distributions as described below.

Prior to their conversion on June 30, 2017, the subordinated units were entitled to receive pro rata distributions from the Trust each quarter if and to the extent there was sufficient cash to provide a cash distribution on the common units that was no less than 80% of the target distribution set forth in the Trust Agreement for the corresponding quarter (the "subordination threshold"). If there was insufficient cash to fund such a distribution on all of the Trust units, the distribution made with respect to the subordinated units was either reduced or eliminated for such quarter in order to make a distribution, to the extent possible, of up to the subordination threshold amount on the common units. Prior to the conversion of the subordinated units on June 30, 2017, Chesapeake was entitled to receive incentive distributions equal to 50% of the amount by which the cash available for distribution on all of the Trust units in any quarter was 20% greater than the target distribution for such quarter (the "incentive threshold"). The remaining 50% of cash available for distribution in excess of the applicable incentive threshold, if any, was to be paid to Trust unitholders, including Chesapeake, on a pro rata basis.

On June 30, 2017, the last day of the fourth full calendar quarter subsequent to Chesapeake's satisfaction of its drilling obligation under the development agreement, the subordinated units automatically converted into common units on a one-for-one basis. All distributions made on common units after September 30, 2017 no longer have the benefit of the subordination threshold, nor are the common units subject to the incentive threshold, and all Trust unitholders share on a pro rata basis in the Trust's distributions.



CHESAPEAKE GRANITE WASH TRUST  
NOTES TO FINANCIAL STATEMENTS - (Continued)  
(Unaudited)

The Trust will dissolve and begin to liquidate on June 30, 2031, or earlier upon certain events (the "Termination Date"), and will soon thereafter wind up its affairs and terminate. At the Termination Date, (a) 50% of the total Royalty Interests conveyed by Chesapeake will revert automatically to Chesapeake and (b) 50% of the total Royalty Interests conveyed by Chesapeake (the "Perpetual Royalties") will be retained by the Trust and thereafter sold. The net proceeds of the sale of the Perpetual Royalties, as well as any remaining Trust cash reserves, will be distributed to the unitholders on a pro rata basis. Chesapeake will have a right of first refusal to purchase the Perpetual Royalties retained by the Trust at the Termination Date.

2. Basis of Presentation and Significant Accounting Policies

**Basis of Accounting.** The accompanying Statement of Assets, Liabilities and Trust Corpus as of December 31, 2017 and the unaudited interim financial statements of the Trust as of and for the three and nine months ended September 30, 2018 and 2017 have been presented in accordance with the rules and regulations of the SEC and include all adjustments which are, in the opinion of the Trustee, necessary to fairly state the Trust's financial position and results of operations for the periods presented. The accompanying unaudited interim financial statements should be read in conjunction with the December 31, 2017 audited financial statements and notes of the Trust, included in the Trust's Annual Report on Form 10-K for the year ended December 31, 2017. These financial statements have been prepared in accordance with the SEC instructions to Form 10-Q and, therefore, do not include all disclosures required for financial statements prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP").

Financial statements of the Trust differ from financial statements prepared in accordance with GAAP, as the Trust records revenues when received and expenses when paid and may also establish certain cash reserves for contingencies which would not be accrued in financial statements prepared in accordance with GAAP. This non-GAAP comprehensive basis of accounting corresponds to the accounting principles permitted for royalty trusts by the SEC 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 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.

**Use of Estimates.** The preparation of financial statements requires the Trust to make estimates and assumptions that affect the reported amounts of assets, liabilities and Trust corpus during the reporting period. Significant estimates that impact the Trust's financial statements include estimates of proved oil, natural gas and NGL reserves, which are used to compute the Trust's