

CROSS TIMBERS ROYALTY TRUST

Form 10-Q

August 06, 2018

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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 June 30, 2018

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.)

c/o The Corporate Trustee:

Simmons Bank

P.O. Box 470727

Fort Worth, Texas 76147

(Address of principal executive offices) (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):

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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 August 1, 2018

6,000,000

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CROSS TIMBERS ROYALTY TRUST

FORM 10-Q FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2018

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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 (and overriding royalty interest)</i> | A non-operating 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, 2018, and the distributable income and changes in trust corpus for the three-month and six-month periods ended June 30, 2018 and 2017, 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, 2018, and for the three-month and six-month periods ended June 30, 2018 and 2017 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

Simmons Bank, Trustee:

Results of Review of Financial Statements

We have reviewed the accompanying condensed statement of assets, liabilities and trust corpus of Cross Timbers Royalty Trust (the Trust) as of June 30, 2018, and the related condensed statements of distributable income and of changes in trust corpus for the three-month and six-month periods ended June 30, 2018 and 2017, including the related notes (collectively referred to as the interim financial statements). Based on our reviews, we are not aware of any material modifications that should be made to the accompanying interim financial statements for them to be in conformity with the modified cash basis of accounting described in Note 1.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the statements of assets, liabilities and trust corpus as of December 31, 2017, and the related statements of distributable income and of changes in trust corpus for the year then ended (not presented herein), and in our report dated March 12, 2018, which included a paragraph describing the modified cash basis of accounting, 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, 2017, is fairly stated, in all material respects, in relation to the statements of assets, liabilities and trust corpus from which it has been derived.

Basis for Review Results

These interim financial statements are the responsibility of the Trust s management. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Trust in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB. We conducted our review in accordance with the standards of the PCAOB. 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 PCAOB, 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.

Basis of Accounting

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.

/s/ PricewaterhouseCoopers LLP
Dallas, TX
August 6, 2018

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

| | June 30, 2018 | December 31, 2017 |
|--|--------------------------|------------------------------|
| ASSETS | | |
| Cash and short-term investments | \$ 1,720,152 | \$ 1,469,830 |
| Interest to be received | 1,720 | 960 |
| Net profits interests in oil and gas properties - net (Note 1) | 8,924,865 | 9,311,334 |
| | \$ 10,646,737 | \$ 10,782,124 |
| LIABILITIES AND TRUST CORPUS | | |
| Distribution payable to unitholders | \$ 721,872 | \$ 470,790 |
| Expense reserve (a) | 1,000,000 | 1,000,000 |
| Trust corpus (6,000,000 units of beneficial interest authorized and outstanding) | 8,924,865 | 9,311,334 |
| | \$ 10,646,737 | \$ 10,782,124 |

(a) Expense reserve allows Trustee to pay its obligations should it be unable to pay them out of the net profits income. As of June 30, 2018, the reserve currently established by the Trustee is 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 | | Six Months Ended | |
|---|---------------------------|--------------|-------------------------|--------------|
| | June 30 | | June 30 | |
| | 2018 | 2017 | 2018 | 2017 |
| Net profits income | \$ 2,333,173 | \$ 1,633,117 | \$ 4,610,672 | \$ 3,257,788 |
| Interest income | 4,715 | 1,532 | 8,175 | 2,519 |
| Total income | 2,337,888 | 1,634,649 | 4,618,847 | 3,260,307 |
| Administration expense | 168,660 | 113,097 | 419,339 | 355,335 |
| Cash reserves withheld for Trust expenses | | | | |
| Distributable income | \$ 2,169,228 | \$ 1,521,552 | \$ 4,199,508 | \$ 2,904,972 |
| Distributable income per unit (6,000,000 units) | \$ 0.361538 | \$ 0.253592 | \$ 0.699918 | \$ 0.484162 |

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 | | Six Months Ended | |
|---------------------------------------|---------------------------|--------------|-------------------------|--------------|
| | June 30 | | June 30 | |
| | 2018 | 2017 | 2018 | 2017 |
| Trust corpus, beginning of period | \$ 9,120,594 | \$ 9,786,540 | \$ 9,311,334 | \$ 9,903,800 |
| Amortization of net profits interests | (195,729) | (106,254) | (386,469) | (223,514) |
| Distributable income | 2,169,228 | 1,521,552 | 4,199,508 | 2,904,972 |
| Distributions declared | (2,169,228) | (1,521,552) | (4,199,508) | (2,904,972) |
| Trust corpus, end of period | \$ 8,924,865 | \$ 9,680,286 | \$ 8,924,865 | \$ 9,680,286 |

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 Simmons Bank, as trustee (the 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 and distribution payable to unitholders include interest earned on the previous month's investment.
- 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 Trust's financial statements 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 NPI during the quarter ended June 30, 2018.

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 \$52,175,584 as of June 30, 2018 and \$51,789,115 as of December 31, 2017.

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. Impairments recorded for book purposes will not result in a loss for tax purposes for the unitholders until the loss is recognized.

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. Oklahoma and New Mexico tax the income of nonresidents from real property located within those states, and the Trust has been advised by counsel that such states will tax nonresidents on income from the net profits interests located in those states. Oklahoma and New Mexico also impose a corporate income tax that may apply to unitholders organized as corporations (subject to certain exceptions for S corporations and limited liability companies, depending on their treatment for federal tax purposes).

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 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.

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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 will generally be required to include its Texas 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.

The Trust could potentially be required to bear a portion of the legal settlement costs arising from the *Chieftain* settlement. For information on contingencies, see Note 3 to Condensed Financial Statements. In the event that the Trust is determined to be responsible for such costs, XTO will deduct the costs in its calculation of the net profits income payable to the Trust from the applicable net profits interests. Thus, for unitholders, the legal settlement costs will be reflected through a reduction in net profits income received from the Trust and thus in a reduction in the gross royalty income reported by and taxable to the unitholders. In the event that the Trustee objects to such claimed reductions, the Trustee may also incur legal fees in representing the Trust's interests. For unitholders, such costs would be reflected through an increase in the Trust's administrative expenses, which would be deductible by unitholders in determining the net royalty income from the Trust.

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

In December 2010, a royalty class action lawsuit was filed against XTO Energy styled *Chieftain Royalty Company v. XTO Energy Inc.* in Coal County District Court, Oklahoma. XTO Energy removed the case to federal court in the Eastern District of Oklahoma. The plaintiffs alleged that XTO Energy wrongfully deducted fees from royalty payments on Oklahoma wells, failed to make diligent efforts to secure the best terms available for the sale of gas and its constituents, and demanded an accounting to determine whether they have been fully and fairly paid gas royalty interests. The case was certified as a class action in April 2012.

XTO Energy advised the Trustee that in December 2017, it reached a tentative settlement with the plaintiffs for \$80 million and an additional \$750 thousand for costs to administer the settlement following final approval. On July 27, 2018, plaintiffs submitted their final plan of allocation which was approved by the court on the same date. XTO Energy is analyzing the final plan of allocation to calculate the impact on the Trust and will report to the Trustee when that analysis is complete. XTO Energy has advised the Trustee that depending on its analysis of the final plan of allocation, the portion of the settlement XTO Energy believes should be allocated to the Trust could be as much as \$40,000. The Trustee has objected to similar claims relating to the *Chieftain* settlement with respect to another trust for which it serves as trustee (the Hugoton Royalty Trust) pursuant to a demand for arbitration styled *Simmons Bank (successor to Southwest Bank and Bank of America, N.A.) vs. XTO Energy, Inc.* through the American Arbitration Association seeking a declaratory judgment that the *Chieftain* settlement is not a production cost and that XTO Energy is prohibited from charging the settlement as a production cost under the conveyance or otherwise reducing the Hugoton Royalty Trust's payments now or in the future as a result of the *Chieftain* litigation. The Trustee has asked for additional information regarding the allocation of the settlement amount to the Cross Timbers Royalty Trust and has asked to be advised by XTO Energy as the matter progresses. Once additional information is made available, the Trustee intends to review any claimed reductions in payment to the Trust based on the facts and circumstances of the settlement.

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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:

| | Underlying | | |
|---|-------------------|-------|--------------|
| | TX WI | OK WI | Total |
| Cumulative excess costs remaining at 12/31/17 | \$ 2,009,349 | \$ | \$ 2,009,349 |
| Net excess costs (recovery) for the quarter ended 3/31/18 | (150,540) | | (150,540) |
| Net excess costs (recovery) for the quarter ended 6/30/18 | (98,087) | | (98,087) |
| Cumulative excess costs remaining at 6/30/18 | 1,760,722 | | 1,760,722 |
| Accrued interest at 6/30/18 | 198,076 | | 198,076 |
| Total remaining to be recovered at 6/30/18 | \$ 1,958,798 | \$ | \$ 1,958,798 |

| | TX WI | NPI OK WI | Total |
|---|--------------|--------------------------|--------------|
| Cumulative excess costs remaining at 12/31/17 | \$ 1,507,012 | \$ | \$ 1,507,012 |
| Net excess costs (recovery) for the quarter ended 3/31/18 | (112,905) | | (112,905) |
| Net excess costs (recovery) for the quarter ended 6/30/18 | (73,566) | | (73,566) |
| Cumulative excess costs remaining at 6/30/18 | 1,320,541 | | 1,320,541 |
| Accrued interest at 6/30/18 | 148,557 | | 148,557 |
| Total remaining to be recovered at 6/30/18 | \$ 1,469,098 | \$ | \$ 1,469,098 |

Improved oil prices and lower development costs resulted in the partial recovery of excess costs on properties underlying the Texas working interests for the quarter ended June 30, 2018.

Underlying cumulative excess costs for the Texas working interest conveyance remaining as of June 30, 2018 totaled \$2.0 million, including accrued interest of \$0.2 million.

Table of Contents**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 monthly overhead charge at June 30, 2018 was \$39,834 (\$29,876 NPI) 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 June 30, 2018, this monthly charge was approximately \$29,000 (\$22,000 NPI) 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.

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 2017 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 June 30, 2018, net profits income was \$2,333,173 compared to \$1,633,117 for second quarter 2017. This 43% increase in net profits income is primarily the result of increased oil prices (\$0.5 million), increased oil production (\$0.1 million), decreased development costs (\$0.1 million), net excess costs activity on the Texas working interest properties (\$0.1 million), partially offset by decreased gas production (\$0.1 million). See Net Profits Income below.

After considering interest income of \$4,715 and administration expense of \$168,660, distributable income for the quarter ended June 30, 2018 was \$2,169,228, or \$0.361538 per unit of beneficial interest. Administration expense for the quarter increased \$55,562 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 second quarter 2017, distributable income was \$1,521,552, or \$0.253592 per unit.

Distributions to unitholders for the quarter ended June 30, 2018 were:

| Record Date | Payment Date | Distribution per Unit |
|--------------------|---------------------|----------------------------------|
| April 30, 2018 | May 14, 2018 | \$ 0.131107 |
| May 31, 2018 | June 14, 2018 | 0.110119 |
| June 29, 2018 | July 16, 2018 | 0.120312 |
| | | \$0.361538 |

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Six Months

For the six months ended June 30, 2018, net profits income was \$4,610,672 compared to \$3,257,788 for the same 2017 period. This 42% increase in net profits income is primarily the result of increased oil and gas prices (\$1.1 million), net excess costs activity on the Texas working interest properties (\$0.2 million), decreased development costs (\$0.2 million) and increased oil and gas production (\$0.1 million), partially offset by increased taxes, transportation and other (\$0.1 million) and increased production expense (\$0.1 million). See Net Profits Income below.

After considering interest income of \$8,175 and administration expense of \$419,339, distributable income for the six months ended June 30, 2018 was \$4,199,508 or \$0.699918 per unit of beneficial interest. Administration expense for the six months ended June 30, 2018 increased \$64,004 from the prior year six-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 six months ended June 30, 2017, distributable income was \$2,904,972, or \$0.484162 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 | | | Six Months | | |
|---------------------------------|---------------------------|---------------------|------------------------|---------------------------|---------------------|------------------------|
| | Ended June 30 (a) 2018 | 2017 | Increase (Decrease) | Ended June 30 (a) 2018 | 2017 | Increase (Decrease) |
| Sales Volumes | | | | | | |
| Oil (Bbls) (b) | | | | | | |
| Underlying properties | 53,745 | 51,434 | 4% | 106,463 | 104,798 | 2% |
| Average per day | 604 | 578 | 4% | 588 | 579 | 2% |
| Net profits interests | 23,660 | 11,997 | 97% | 42,877 | 25,099 | 71% |
| Gas (Mcf) (b) | | | | | | |
| Underlying properties | 365,948 | 381,833 | (4%) | 809,130 | 802,267 | 1% |
| Average per day | 4,066 | 4,243 | (4%) | 4,446 | 4,408 | 1% |
| Net profits interests | 325,742 | 335,180 | (3%) | 718,029 | 705,090 | 2% |
| Average Sales Prices | | | | | | |
| Oil (per Bbl) | \$ 59.05 | \$ 47.76 | 24% | \$ 56.63 | \$ 46.47 | 22% |
| Gas (per Mcf) | \$ 4.35 | \$ 4.34 | | \$ 4.49 | \$ 4.15 | 8% |
| Revenues | | | | | | |
| Oil sales | \$ 3,173,898 | \$ 2,456,480 | 29% | \$ 6,029,406 | \$ 4,869,556 | 24% |
| Gas sales | 1,590,856 | 1,656,973 | (4%) | 3,632,127 | 3,333,253 | 9% |
| Total Revenues | 4,764,754 | 4,113,453 | 16% | 9,661,533 | 8,202,809 | 18% |
| Costs | | | | | | |
| Taxes, transportation and other | 650,764 | 623,666 | 4% | 1,406,430 | 1,263,314 | 11% |
| Production expense (c) | 1,083,436 | 1,042,498 | 4% | 2,215,473 | 2,114,640 | 5% |
| Development costs | 255,901 | 438,350 | (42%) | 522,739 | 737,930 | (29%) |
| Excess costs (d) | 98,087 | 194,365 | (50%) | 248,627 | 467,161 | (47%) |
| Total Costs | 2,088,188 | 2,298,879 | (9%) | 4,393,269 | 4,583,045 | (4%) |
| Net Proceeds | \$ 2,676,566 | \$ 1,814,574 | 48% | \$ 5,268,264 | \$ 3,619,764 | 46% |
| Net Profits Income | \$ 2,333,173 | \$ 1,633,117 | 43% | \$ 4,610,672 | \$ 3,257,788 | 42% |

(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.

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- (b) Oil and gas sales volumes are allocated to the net profits interests by dividing Trust net cash inflows by average sales prices. As oil and gas prices change, the Trust's allocated production volumes are impacted as the quantity of production necessary to cover expenses changes inversely with price. As such, the underlying property production volume changes may not correlate with the Trust's allocated production volumes in any given period. Therefore, comparative discussion of oil and gas sales volumes is based on the underlying properties.
- (c) Production expense includes an overhead charge which is deducted and retained by the operator. XTO Energy deducts an overhead charge as reimbursement for costs associated with monitoring these interests. See Note 5 to Condensed Financial Statements.
- (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 2017 to second quarter 2018 and from the first six months of 2017 to the comparable period in 2018:

Sales Volumes

Oil

Oil sales volumes increased 4% for the second quarter and increased 2% for the six-month period primarily because of the timing of cash receipts partially offset by natural production decline.

Gas

Gas sales volumes decreased 4% for the second quarter primarily because of the timing of cash receipts and natural production decline. Gas sales volumes increased 1% for the six-month period primarily because of the timing of cash receipts 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 increased 24% to \$59.05 per Bbl for the second quarter and increased 22% to \$56.63 per Bbl for the six-month period. The second quarter 2018 oil price is primarily related to production from February through April 2018, when the average NYMEX price was \$63.84 per Bbl.

Gas

Gas prices for the second quarter were relatively flat at \$4.35 per Mcf and for the six-month period increased 8% to \$4.49 per Mcf. The second quarter 2018 gas price is primarily related to production from January through March 2018, when the average NYMEX price was \$3.00 per MMBtu.

Costs

Taxes, Transportation and Other

Taxes, transportation and other costs increased 4% for the second quarter primarily because of higher production taxes related to increased oil revenues. Taxes, transportation and other costs increased 11% for the six-month period primarily because of higher production taxes related to increased oil and gas revenues.

Production Expense

Production expense increased 4% for the second quarter primarily because of increased secondary recovery costs, partially offset by decreased overhead. Production expense increased 5% for the six-month period primarily because of increased secondary recovery costs and power and fuel, partially offset by decreased repairs and maintenance, labor, overhead, and outside operated costs.

Development Costs

Development costs decreased 42% for the second quarter and decreased 29% for the six-month period primarily because of decreased activity and costs, related to the timing of expenditures, on the Texas and Oklahoma oil properties underlying the 75% net profits interest.

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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. Underlying cumulative excess costs for the Texas working interest conveyance remaining as of June 30, 2018 totaled \$2.0 million, including accrued interest of \$0.2 million. For further information on excess costs, see Note 4 to Condensed Financial Statements.

Contingencies

For information on contingencies, see Note 3 to Condensed Financial Statements.

Forward-Looking Statements

Statements in this report relating to future plans, predictions, events or regulatory decisions 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, annual or monthly 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, including those detailed in Part I, Item 1A of the Trust's Annual Report on Form 10-K for the year ended December 31, 2017, 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.

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, 2017.

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 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 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, 2017.

Item 6. Exhibits.

- (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 12, 2018 (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 SIMMONS BANK, TRUSTEE

By /s/ LEE ANN ANDERSON
Lee Ann Anderson
Senior Vice President

EXXON MOBIL CORPORATION

By /s/ DAVID LEVY
David Levy
Vice President - Upstream Business Services

Date: August 6, 2018