

CROSS TIMBERS ROYALTY TRUST

Form 10-Q

November 05, 2012

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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 September 30, 2012

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)

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**Texas**  
(State or other jurisdiction of  
incorporation or organization)  
**U.S. Trust, Bank of America**  
**Private Wealth Management**

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

**P.O. Box 830650, Dallas, Texas**  
(Address of principal executive offices)

**75283-0650**  
(Zip Code)

**(877) 228-5084**  
(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 October 1, 2012

6,000,000

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**CROSS TIMBERS ROYALTY TRUST**

**FORM 10-Q FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2012**

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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>	<p>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:</p> <p><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.</p> <p><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.</p>
<i>royalty interest (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 to present fairly the assets, liabilities and trust corpus of the Cross Timbers Royalty Trust at September 30, 2012, and the distributable income and changes in trust corpus for the three- and nine-month periods ended September 30, 2012 and 2011, have been included. Distributable income for such interim periods is not necessarily indicative of distributable income for the full year. The condensed financial statements as of September 30, 2012, and for the three-month and nine-month periods ended September 30, 2012 and 2011 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

Bank of America, N.A., Trustee:

We have reviewed the accompanying condensed statement of assets, liabilities and trust corpus of Cross Timbers Royalty Trust (the Trust ) as of September 30, 2012, and the related condensed statements of distributable income and changes in trust corpus for the three-month and nine-month periods ended September 30, 2012 and 2011. 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, 2011, 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 February 29, 2012, 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, 2011 is fairly stated in all material respects in relation to the statement of assets, liabilities and trust corpus from which it has been derived.

PricewaterhouseCoopers LLP

Dallas, TX

November 5, 2012

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

	September 30, 2012 (Unaudited)	December 31, 2011
<b>ASSETS</b>		
Cash and short-term investments	\$ 846,833	\$ 1,213,231
Interest to be received	25	29
Net profits interests in oil and gas properties net (Note 1)	12,759,505	13,415,740
	<b>\$ 13,606,363</b>	<b>\$ 14,629,000</b>
<b>LIABILITIES AND TRUST CORPUS</b>		
Distribution payable to unitholders	\$ 846,858	\$ 1,213,260
Trust corpus (6,000,000 units of beneficial interest authorized and outstanding)	12,759,505	13,415,740
	<b>\$ 13,606,363</b>	<b>\$ 14,629,000</b>

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 September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
Net profits income	\$ 3,320,147	\$ 5,257,619	\$ 11,658,423	\$ 14,177,476
Interest income	80	131	242	274
Total income	3,320,227	5,257,750	11,658,665	14,177,750
Administration expense	52,621	91,828	318,593	357,524
Distributable income	\$ 3,267,606	\$ 5,165,922	\$ 11,340,072	\$ 13,820,226
Distributable income per unit (6,000,000 units)	\$ 0.544601	\$ 0.860987	\$ 1.890012	\$ 2.303371

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

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

	Three Months Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
Trust corpus, beginning of period	\$ 12,975,405	\$ 13,959,258	\$ 13,415,740	\$ 14,521,347
Amortization of net profits interests	(215,900)	(302,276)	(656,235)	(864,365)
Distributable income	3,267,606	5,165,922	11,340,072	13,820,226
Distributions declared	(3,267,606)	(5,165,922)	(11,340,072)	(13,820,226)
Trust corpus, end of period	\$ 12,759,505	\$ 13,656,982	\$ 12,759,505	\$ 13,656,982

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 Bank of America, N.A., 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 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.

The trustee routinely reviews the Trust's net profits interests in oil and gas properties for impairment whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. If an impairment event occurs and it is determined that the carrying value of the Trust's net profits interests may not be recoverable, an impairment will be recognized as measured by the amount by which the carrying amount of the net profits interests exceeds the fair value of these assets, which would likely be measured by discounting projected cash flows. There is no impairment of the assets as of September 30, 2012.

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.

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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 \$48,340,944 as of September 30, 2012 and \$47,684,709 as of December 31, 2011.

## **2. Federal 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. 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.

Because the trust is a grantor trust for federal tax purposes, each unitholder is taxed directly on his proportionate share of income, deductions and credits of the trust consistent with each such unitholder's taxable year and method of accounting and without regard to the taxable year or method of accounting employed by the trust. The income of the trust consists primarily of a specified share of the net profits from the sale of oil and natural gas produced from the underlying properties. During the first nine months of 2012, the trust incurred administration expenses and earned interest income on funds held for distribution and for the cash reserve maintained for the payment of contingent and future obligations of the trust.

The net profits interests constitute economic interests in oil and gas properties for federal tax purposes. Each unitholder is entitled to amortize the cost of the units through cost depletion over the life of the net profits interests or, if greater, through percentage depletion equal to 15 percent of gross income. Unlike cost depletion, percentage depletion is not limited to a unitholder's depletable tax basis in the units. Rather, a unitholder is entitled to a percentage depletion deduction as long as the applicable underlying properties generate gross income. Unitholders may compute both percentage depletion and cost depletion from each property and claim the larger amount as a deduction on their income tax returns.

If a taxpayer disposes of any Section 1254 property (certain oil, gas, geothermal or other mineral property), and the adjusted basis of such property includes adjustments for depletion deductions under Section 611 of the Internal Revenue Code, the taxpayer generally must recapture the amount deducted for depletion as ordinary income (to the extent of gain realized on the disposition of the property). This depletion recapture rule applies to any disposition of property that was placed in service by the taxpayer after December 31, 1986. Detailed rules set forth in Sections 1.1254-1 through 1.1254-6 of the U.S. Treasury Regulations govern dispositions of property after March 13, 1995. The Internal Revenue Service likely will take the position that a unitholder must recapture depletion upon the disposition of a unit.

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Interest and net profits income attributable to ownership of units and any gain on the sale thereof are considered portfolio income, and not income from a passive activity, to the extent a unitholder acquires and holds units as an investment and not in the ordinary course of a trade or business. Therefore, interest and net profits income attributable to ownership of units generally may not be offset by losses from any passive activities.

Some trust units are held by middlemen, as such term is broadly defined in U.S. Treasury Regulations (and includes custodians, nominees, certain joint owners, and brokers holding an interest for a customer in street name, collectively referred to herein as middlemen). Therefore, the trustee considers the trust to be a non-mortgage widely held fixed investment trust ( WHFIT ) for U.S. federal income tax purposes. U.S. Trust, Bank of America Private Wealth Management, EIN: 56-0906609, Post Office Box 830650, Dallas, Texas, 75283-0650, telephone number 1-877-228-5084, email address trustee@crostimbertrust.com, is the representative of the trust that will provide tax information in accordance with applicable U.S. Treasury Regulations governing the information reporting requirements of the trust as a WHFIT. Tax information is also posted by the trustee at [www.crostimbertrust.com](http://www.crostimbertrust.com). Notwithstanding the foregoing, the middlemen holding trust units on behalf of unitholders, and not the trustee of the trust, are solely responsible for complying with the information reporting requirements under the U.S. Treasury Regulations with respect to such trust units, including the issuance of IRS Forms 1099 and certain written tax statements. Unitholders whose trust units are held by middlemen should consult with such middlemen regarding the information that will be reported to them by the middlemen with respect to the trust units.

Unitholders should consult their tax advisors regarding trust tax compliance matters.

### **3. State Taxes**

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. 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 those states will each 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 1% on gross revenues less certain deductions, as specifically set forth in the Texas franchise tax statutes. Entities subject to tax generally include trusts unless otherwise exempt and most other types of entities that provide limited liability protection. Trusts that receive at least 90% of their federal gross income from designated passive sources, including royalties from mineral properties and other non-operated mineral interest income, and do not receive more than 10% of their income from operating an active trade or business generally are exempt from the Texas franchise tax as passive entities. The trust has been exempt from Texas franchise tax as a passive entity. Because the trust has been exempt from Texas franchise tax at the trust level as a passive entity, each unitholder that is considered a taxable entity under the Texas franchise tax has been required to include its Texas portion of trust revenues in its own Texas franchise tax computation. This revenue has been sourced to Texas under provisions of the Texas Administrative Code providing that such income is sourced according to the principal place of business of the trust, which is Texas.

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

### **4. 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.

### **5. Excess Costs**

XTO advised the trustee that lower oil prices and increased production expenses related to the timing of cash disbursements caused costs to exceed revenues on properties underlying the Texas working interest in August 2012 by \$218,168 (\$163,626 net to the trust). However, these excess costs did not reduce net proceeds from the remaining conveyances. XTO advised the trustee that increased oil prices and decreased production expenses led to the partial recovery of excess costs, plus accrued interest, on the properties underlying the Texas working interest in September 2012. Remaining excess costs totaled \$171,978 (\$128,984 net to the trust) at the end of third quarter 2012.

### *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 2011 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.crosstimberstrust.com](http://www.crosstimberstrust.com).

### **Distributable Income**

#### *Quarter*

For the quarter ended September 30, 2012, net profits income was \$3,320,147 compared to \$5,257,619 for third quarter 2011. This 37% decrease in net profits income is primarily the result of lower gas and oil prices (\$1.8 million) and increased development costs (\$0.3 million). See "Net Profits Income" on following page.

After considering interest income of \$80 and administration expense of \$52,621, distributable income for the quarter ended September 30, 2012 was \$3,267,606, or \$0.544601 per unit of beneficial interest. Administrative expense for the quarter decreased \$39,207 from the prior year quarter. For third quarter 2011, distributable income was \$5,165,922, or \$0.860987 per unit.

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Distributions to unitholders for the quarter ended September 30, 2012 were:

<b>Record Date</b>	<b>Payment Date</b>	<b>Distribution per Unit</b>
July 31, 2012	August 14, 2012	\$ 0.218544
August 31, 2012	September 17, 2012	0.184914
September 28, 2012	October 15, 2012	0.141143
		\$ 0.544601

*Nine Months*

For the nine months ended September 30, 2012, net profits income was \$11,658,423 compared to \$14,177,476 for the same 2011 period. This 18% decrease in net profits income is primarily the result of lower gas prices (\$1.5 million), decreased oil and gas production (\$0.8 million) and increased development costs (\$0.5 million), partially offset by higher oil prices (\$0.3 million). See *Net Profits Income* below.

After considering interest income of \$242 and administration expense of \$318,593, distributable income for the nine months ended September 30, 2012 was \$11,340,072, or \$1.890012 per unit of beneficial interest. Administrative expense for the nine months ended September 30, 2012 decreased \$38,931 from the prior year nine-month period. For the nine months ended September 30, 2011, distributable income was \$13,820,226, or \$2.303371 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 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			Nine Months		
	Ended September 30 (a) 2012	2011	Increase (Decrease)	Ended September 30 (a) 2012	2011	Increase (Decrease)
<b>Sales Volumes</b>						
Oil (Bbls) (b)						
Underlying properties	49,011	50,994	(4%)	144,813	150,292	(4%)
Average per day	533	554	(4%)	529	551	(4%)
Net profits interests	21,797	29,514	(26%)	70,237	84,999	(17%)
Gas (Mcf) (b)						
Underlying properties	494,084	467,079	6%	1,329,077	1,387,085	(4%)
Average per day	5,429	5,133	6%	4,851	5,081	(5%)
Net profits interests	433,141	413,280	5%	1,175,499	1,224,361	(4%)
<b>Average Sales Prices</b>						
Oil (per Bbl)	\$ 81.86	\$ 92.53	(12%)	\$ 90.74	\$ 88.27	3%
Gas (per Mcf)	\$ 4.91	\$ 8.07	(39%)	\$ 6.09	\$ 7.27	(16%)
<b>Revenues</b>						
Oil sales	\$ 4,012,023	\$ 4,718,348	(15%)	\$ 13,139,885	\$ 13,266,380	(1%)
Gas sales	2,425,653	3,769,185	(36%)	8,092,133	10,080,154	(20%)
Total Revenues	6,437,676	8,487,533	(24%)	21,232,018	23,346,534	(9%)
<b>Costs</b>						
Taxes, transportation and other	941,308	1,144,178	(18%)	2,837,280	3,162,677	(10%)
Production expense (c)	1,244,444	1,103,132	13%	3,960,869	3,256,477	22%
Development costs	580,656	116,207	400%	1,068,006	412,210	159%
Excess costs (d)	(171,978)			(171,978)		
Total Costs	2,594,430	2,363,517	10%	7,694,177	6,831,364	13%
<b>Net Proceeds</b>	<b>\$ 3,843,246</b>	<b>\$ 6,124,016</b>	<b>(37%)</b>	<b>\$ 13,537,841</b>	<b>\$ 16,515,170</b>	<b>(18%)</b>
<b>Net Profits Income</b>	<b>\$ 3,320,147</b>	<b>\$ 5,257,619</b>	<b>(37%)</b>	<b>\$ 11,658,423</b>	<b>\$ 14,177,476</b>	<b>(18%)</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 September 30 generally represent oil production for the period May through July and gas production for the period April through June and (2) oil and gas sales for the nine-months ended September 30 generally represent oil production for the period November through July and gas production for the period October through June.

(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)



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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 September 30, 2012, this charge was \$33,470 per month (including monthly overhead charges of \$4,781 which ExxonMobil 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 5 to Condensed Financial Statements.

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The following are explanations of significant variances on the underlying properties from third quarter 2011 to third quarter 2012 and from the first nine months of 2011 to the comparable period in 2012:

### **Sales Volumes**

#### *Oil*

Oil sales volumes decreased 4% for third quarter 2012 as compared with the same 2011 period primarily because of natural production decline, partially offset by the timing of cash receipts. Oil sales volumes decreased 4% for the first nine months of 2012 as compared with the same 2011 period primarily because of natural production decline.

#### *Gas*

Gas sales volumes increased 6% for third quarter 2012 as compared with the same 2011 period primarily because of the timing of cash receipts, partially offset by natural production decline. Gas sales volumes decreased 4% for the first nine months of 2012 as compared with the same 2011 period primarily because of natural production decline, partially offset by the timing of cash receipts.

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 12% to \$81.86 per Bbl for the third quarter and increased 3% to \$90.74 per Bbl for the nine-month period. Oil prices are expected to remain volatile. The third quarter 2012 oil price is primarily related to production from May through July 2012, when the average NYMEX price was \$88.33 per Bbl. The average NYMEX price for August and September 2012 was \$94.52 per Bbl. At October 12, 2012, the average NYMEX futures price for the following twelve months was \$93.64 per Bbl.

#### *Gas*

Gas prices for the third quarter decreased 39% to \$4.91 per Mcf and for the nine-month period decreased 16% to \$6.09 per Mcf. Natural gas prices are affected by the level of North American production, weather, crude oil and natural gas liquids prices, the U.S. economy, storage levels and import levels of liquefied natural gas. Natural gas prices are expected to remain volatile. The third quarter 2012 gas price is primarily related to production from April through June 2012, when the average NYMEX price was \$2.22 per MMBtu. The average NYMEX price for July through September 2012 was \$2.81 per MMBtu. At October 12, 2012, the average NYMEX futures price for the following twelve months was \$3.94 per MMBtu.

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### **Costs**

#### *Taxes, Transportation and Other*

Taxes, transportation and other decreased 18% for the third quarter primarily because of decreased oil and gas production taxes and other deductions related to lower oil and gas revenues and decreased property taxes related to the timing of cash expenditures. Taxes, transportation and other decreased 10% for the nine-month period primarily because of decreased gas production taxes and other deductions related to lower gas revenues and decreased property taxes related to the timing of cash expenditures.

#### *Production Expense*

Production expense increased 13% for the third quarter primarily because of the timing of cash expenditures and increased outside operated and maintenance costs. Production expense increased 22% for the nine-month period primarily because of the timing of cash expenditures and increased maintenance, outside operated and fuel costs, partially offset by decreased labor costs.

#### *Development Costs*

Development costs increased 400% for the third quarter and 159% for the nine-month period primarily because of the timing of expenditures and increased activity and costs related to non-operated Texas and Oklahoma oil properties underlying the 75% net profits interest.

#### *Excess Costs*

XTO advised the trustee that lower oil prices and increased production expenses related to the timing of cash disbursements caused costs to exceed revenues on properties underlying the Texas working interest in August 2012 by \$218,168 (\$163,626 net to the trust). However, these excess costs did not reduce net proceeds from the remaining conveyances. XTO advised the trustee that increased oil prices and decreased production expenses led to the partial recovery of excess costs, plus accrued interest, on the properties underlying the Texas working interest in September 2012. Remaining excess costs totaled \$171,978 (\$128,984 net to the trust) at the end of third quarter 2012.

### **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

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Report on Form 10-K for the year ended December 31, 2011, 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, 2011.

*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 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, 2011.

*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 February 29, 2012 (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 BANK OF AMERICA, N.A., TRUSTEE

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

EXXON MOBIL CORPORATION

By */s/ JAMES A. HALL*  
James A. Hall  
Vice President - Upstream Business Services

Date: November 5, 2012