

TEXAS PACIFIC LAND TRUST
Form 10-Q
August 07, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934.
For the quarterly period ended June 30, 2006

OR

- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934.
For the transition period from _____ to _____

Commission File Number: 1-737

Texas Pacific Land Trust

(Exact Name of Registrant as Specified in Its Charter)

NOT APPLICABLE
(State or Other Jurisdiction of Incorporation
or Organization)

75-0279735
(I.R.S. Employer
Identification No.)

1700 Pacific Avenue, Suite 1670, Dallas, Texas
(Address of Principal Executive Offices)

75201
(Zip Code)

(214) 969-5530

(Registrant's Telephone Number, Including Area Code)

(Former Name, Former Address and Former Fiscal Year, if Changed 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

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to such filing requirements for the past 90 days. Yes X No

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

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

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

Cautionary Statement Regarding Forward-Looking Statements

Statements in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including statements regarding management's expectations, hopes, intentions or strategies regarding the future. Forward-looking statements include statements regarding the Trust's future operations and prospects, the markets for real estate in the areas in which the Trust owns real estate, applicable zoning regulations, the markets for oil and gas, production limits on prorated oil and gas wells authorized by the Railroad Commission of Texas, expected competition, management's intent, beliefs or current expectations with respect to the Trust's future financial performance and other matters. All forward-looking statements in this Report are based on information available to us as of the date this Report is filed with the Securities and Exchange Commission, and we assume no responsibility to update any such forward-looking statements, except as required by law. All forward-looking statements are subject to a number of risks, uncertainties and other factors that could cause our actual results, performance, prospects or opportunities to differ materially from those expressed in, or implied by, these forward-looking statements. These risks, uncertainties and other factors include, but are not limited to, the factors discussed in Item 1A Risk Factors of Part I of our Annual Report to the Securities and Exchange Commission on Form 10-K for the year ended December 31, 2005, and in Part I, Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations and Part II, Item 1A Risk Factors of this Quarterly Report on Form 10-Q.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements TEXAS PACIFIC LAND TRUST

BALANCE SHEETS

| | June 30, 2006 | December 31, 2005 |
|--------|------------------|----------------------|
| ASSETS | _____ | _____ |
| | (Unaudited) | |
| | _____ | |

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| | June 30, 2006 | December 31, 2005 |
|--|----------------------|----------------------|
| ASSETS | | |
| Cash | \$ 544,323 | \$ 226,984 |
| Temporary cash investments - at cost which approximates market | 12,050,000 | 9,400,000 |
| Accounts receivable | 1,003,797 | 902,211 |
| Accrued interest receivable | 229,687 | 212,710 |
| Prepaid expenses | 257,407 | 320,481 |
| Notes receivable for land sales | 18,300,779 | 19,083,848 |
| Real estate acquired: (10,564 acres at June 30, 2006 and 12,119 acres at December 31, 2005) | 1,777,007 | 1,838,325 |
| Water wells, leasehold improvements, furniture and equipment - at cost less accumulated depreciation | 121,562 | 91,764 |
| Prepaid Federal income taxes | | 228,570 |
| Property, no value assigned: | | |
| Land (surface rights) situated in twenty counties in Texas - 969,479 acres in 2006 and 971,449 acres in 2005 | | |
| Town lots in Iatan, Loraine and Morita - 628 lots in 2006 and 2005 | | |
| 1/16 nonparticipating perpetual royalty interest in 386,988 acres in 2006 and 2005 | | |
| 1/128 nonparticipating perpetual royalty interest in 85,414 acres in 2006 and 2005 | | |
| | <u>\$ 34,284,562</u> | <u>\$ 32,304,893</u> |
| LIABILITIES AND CAPITAL | | |
| Federal income taxes payable | \$ 411,540 | \$ 54,822 |
| Other taxes payable | 132,280 | 54,822 |
| Other liabilities | 612,490 | 727,911 |
| Escrow deposits on land sales | 7,000 | |
| Deferred revenue | 200,000 | 100,000 |
| Deferred taxes | 6,542,668 | 6,808,490 |
| | <u>7,905,978</u> | <u>7,691,223</u> |
| Capital: | | |
| Certificates of Proprietary Interest, par value \$100 each; no certificates outstanding in 2006 and 2005 | | |
| Sub-share Certificates in Certificates of Proprietary Interest, par value \$.16 2/3 each; outstanding: 2,146,475 sub-shares in 2006 and 2,158,575 sub-shares in 2005 | | |
| Net proceeds from all sources | 26,378,584 | 24,613,670 |
| | <u>26,378,584</u> | <u>24,613,670</u> |
| Total capital | <u>\$ 34,284,562</u> | <u>\$ 32,304,893</u> |

See accompanying notes to financial statements.

TEXAS PACIFIC LAND TRUST

STATEMENTS OF INCOME

(Unaudited)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|---------------------|------------------------------|---------------------|
| | 2006 | 2005 | 2006 | 2005 |
| Income: | | | | |
| Rentals, royalties and sundry income | \$ 3,831,158 | \$ 2,324,159 | \$ 6,883,085 | \$ 4,459,364 |
| Land sales | 716,117 | 1,294,865 | 716,117 | 1,294,865 |
| Interest | 465,203 | 446,196 | 912,044 | 890,252 |
| | <u>5,012,478</u> | <u>4,065,220</u> | <u>8,511,246</u> | <u>6,644,481</u> |
| Expenses: | | | | |
| Taxes, other than Federal income taxes | 159,675 | 161,017 | 355,038 | 317,326 |
| Basis in real estate sold | 61,318 | | 61,318 | |
| General and administrative expenses | 480,263 | 487,621 | 968,664 | 977,497 |
| | <u>701,256</u> | <u>648,638</u> | <u>1,385,020</u> | <u>1,294,823</u> |
| Income before Federal income taxes | <u>4,311,222</u> | <u>3,416,582</u> | <u>7,126,226</u> | <u>5,349,658</u> |
| Federal income taxes | <u>1,351,903</u> | <u>1,038,379</u> | <u>2,214,288</u> | <u>1,618,882</u> |
| Net income | <u>\$ 2,959,319</u> | <u>\$ 2,378,203</u> | <u>\$ 4,911,938</u> | <u>\$ 3,730,776</u> |
| Average number of sub-share certificates and equivalent sub-share certificates outstanding | <u>2,150,525</u> | <u>2,181,725</u> | <u>2,152,423</u> | <u>2,184,337</u> |
| Basic and dilutive earnings per sub-share certificate | <u>\$ 1.38</u> | <u>\$ 1.09</u> | <u>\$ 2.28</u> | <u>\$ 1.71</u> |
| Cash dividends per sub-share certificate | <u>\$</u> | <u>\$</u> | <u>\$.65</u> | <u>\$.55</u> |

See accompanying notes to financial statements.

TEXAS PACIFIC LAND TRUST

STATEMENTS OF CASH FLOWS

(Unaudited)

| | Six Months Ended June 30, | |
|---|------------------------------|----------------------|
| | 2006 | 2005 |
| Cash flows from operating activities: | | |
| Net income | \$ 4,911,938 | \$ 3,730,776 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 14,400 | 13,800 |
| Deferred taxes | (265,822) | (1,254,101) |
| (Increase) decrease in assets: | | |
| Accounts receivable | (101,586) | (17,505) |
| New notes receivable from land sales | (367,317) | (190,590) |
| Payments received on notes receivable | 1,150,386 | 4,042,136 |
| Accrued interest receivable | (16,977) | 120,615 |
| Prepaid Federal income taxes | 228,570 | 42,870 |
| Prepaid expenses | 63,074 | 60,516 |
| Real estate acquired | 61,318 | (315,501) |
| Increase (decrease) in liabilities: | | |
| Federal income taxes payable | 411,540 | 1,397,119 |
| Other taxes payable | 77,458 | 88,985 |
| Escrow deposits on land sales | 7,000 | 51,000 |
| Other liabilities and deferred revenue | (15,421) | 73,779 |
| Total adjustments | 1,246,623 | 4,113,123 |
| Net cash provided by operating activities | 6,158,561 | 7,843,899 |
| Cash flows from investing activities- | | |
| Additions to water wells, leasehold improvements, furniture and equipment | (44,198) | (27,794) |
| Cash flows from financing activities: | | |
| Sub-shares purchased for retirement | (1,746,030) | (2,462,662) |
| Dividends paid | (1,400,994) | (1,203,386) |
| Net cash used by financing activities | (3,147,024) | (3,666,048) |
| Net increase in cash and cash equivalents | 2,967,339 | 4,150,057 |
| Cash and cash equivalents at beginning of period | 9,626,984 | 5,942,945 |
| Cash and cash equivalents at end of period | \$ 12,594,323 | \$ 10,093,002 |

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See accompanying notes to financial statements.

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TEXAS PACIFIC LAND TRUST

NOTES TO UNAUDITED FINANCIAL STATEMENTS

JUNE 30, 2006

- (1) In the opinion of management, the accompanying unaudited financial statements contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the financial position of Texas Pacific Land Trust (the Trust) as of June 30, 2006 and the results of its operations for the three month and six month periods ended June 30, 2006 and 2005, respectively, and its cash flows for the six month periods ended June 30, 2006 and 2005, respectively. The financial statements and footnotes included herein should be read in conjunction with the Trust's annual financial statements as of December 31, 2005 and 2004 and for each of the years in the three year period ended December 31, 2005 included in the Trust's Annual Report on Form 10-K for the year ended December 31, 2005.
- (2) No value has been assigned to the land held by the Trust other than parcels which have been acquired through foreclosure and a limited number of parcels which have been acquired because they were offered for sale and were contiguous to parcels already owned by the Trust. Consequently, no allowance for depletion is computed, and no charge to income is made, with respect thereto, and no cost is deducted from the proceeds of the land sales in computing gain or loss thereon.
- (3) The Sub-shares and the Certificates of Proprietary Interest are freely interchangeable in the ratio of one Certificate of Proprietary Interest for 600 Sub-shares or 600 Sub-shares for one Certificate of Proprietary Interest.
- (4) The Trust's effective Federal income tax rate is less than the 34% statutory rate because taxable income is reduced by statutory percentage depletion allowed on mineral royalty income.
- (5) The results of operations for the three month and six month periods ended June 30, 2006 are not necessarily indicative of the results to be expected for the full year.
- (6) The Trust invests cash in excess of daily requirements primarily in overnight investments in loan participation instruments and U. S. Treasury bills with maturities of ninety days or less. Such investments are deemed to be highly liquid debt instruments and classified as cash equivalents for purposes of the statements of cash flows.

Supplemental cash flow information for the six month periods ended June 30, 2006 and 2005 is summarized as follows:

| | <u>2006</u> | <u>2005</u> |
|---------------------------|-------------|-------------|
| Federal income taxes paid | \$1,840,000 | \$1,433,000 |

- (7) SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" establishes standards for the way public business enterprises are to report information about operating segments. SFAS No. 131 utilizes the management approach as a basis for identifying reportable segments. The management approach is based on the way that management organizes the segments within the enterprise for making operating decisions and assessing performance. The Trust's management views its operations as one segment and believes the only significant activity is managing the land which was conveyed to the Trust in 1888. The Trust's management makes decisions about resource allocation and performance assessment based on the same financial information presented in these financial statements. Managing the land includes sales and leases of such land, and the retention of oil and gas royalties.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read together with (i) the factors discussed in Item 1A Risk Factors of Part I of our Annual Report to the Securities and Exchange Commission on Form 10-K for the year ended December 31, 2005, (ii) the factors discussed in Part II, Item 1A Risk Factors, if any, of this Quarterly Report on Form 10-Q and (iii) the Financial Statements, including the Notes thereto, and the other financial information appearing elsewhere in this Report. Period-to-period comparisons of financial data are not necessarily indicative, and therefore should not be relied upon as indicators, of the Trust's future performance. Words or phrases such as does not believe and believes, or similar expressions, when used in this Form 10-Q or other filings with the Securities and Exchange Commission, are intended to identify forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

Results of Operations for the Quarter Ended June 30, 2006 Compared to the Quarter Ended June 30, 2005

Earnings per sub-share certificate were \$1.38 for the second quarter of 2006 compared to \$1.09 for the second quarter of 2005. Total revenues were \$5,012,478 for the second quarter of 2006 compared to \$4,065,220 for the second quarter of 2005, an increase of 23.3%. This increase in revenue and earnings was due primarily to an increase in sundry income and, to a lesser extent, an increase in oil royalty revenue which more than offset decreases in land sales and gas royalty revenue during the second quarter of 2006 compared to the second quarter of 2005. The increase in sundry income resulted primarily from a one-time payment received by the Trust from an oil company in settlement of a claim by the Trust for damages to property leased to the oil company by the Trust.

In the second quarter of 2006, land sales totaled \$716,117, representing the sale of 3,379 acres at an average price of \$212 per acre. In the comparable period of 2005, land sales totaled \$1,294,865, representing the sale of 9,975 acres at an average price of \$130 per acre.

Rentals, royalties and sundry income were \$3,831,158 for the second quarter of 2006 compared to \$2,324,159 for the second quarter of 2005, an increase of 64.8%. This increase resulted primarily from an increase in sundry income and, to a lesser extent, an increase in oil and gas royalty revenue. The increase in oil and gas royalty revenue was attributable to the higher market prices for oil and gas which prevailed during the second quarter of 2006 compared to the second quarter of 2005, which more than offset decreases in the volumes of oil and gas production in the 2006 period.

Oil and gas royalty revenue was \$2,042,400 for the second quarter of 2006 compared to \$1,911,505 for the second quarter of 2005, an increase of 6.8%. Oil royalty revenue was \$1,487,036 for the second quarter of 2006, an increase of 14.7% from the second quarter of 2005. Crude oil production subject to the Trust's royalty interest decreased 11.8% for the second quarter of 2006, but this decrease in the volume of production was more than offset by a 29.9% increase in the average price per royalty barrel of crude oil in the 2006 second quarter compared to the 2005 second quarter. Gas royalty revenue was \$555,364 for the second quarter of 2006, a decrease of 9.6% from the second quarter of 2005, resulting from a decrease of 19.1% in the volume of gas produced, which was only partially offset by a price increase of 11.7%.

Easement and sundry income was \$1,611,909 for the second quarter of 2006, an increase of 526.9% from the second quarter of 2005. The increase in sundry income resulted primarily from a one-time payment in the amount of \$1,308,000 received by the Trust from an oil company in settlement of a claim by the Trust for damages to property leased to the oil company by the Trust. This category of income is unpredictable and may vary significantly from quarter to quarter.

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Interest revenue was \$465,203 for the second quarter of 2006 compared to \$446,196 for the second quarter of 2005, an increase of 4.3%. Interest on notes receivable for the second quarter of 2006 was \$333,416, a decrease of 17.4% compared to the second quarter of 2005. As of June 30, 2006, notes receivable for land sales were \$18,300,779 compared to \$19,083,848 at June 30, 2005, a decrease of 0.5%. Sundry interest was \$131,787 for the second quarter of 2006, an increase of 209.1% from the second quarter of 2005. Sundry interest fluctuates based on cash on hand for investment and interest rates on short-term investments.

Taxes, other than Federal income taxes decreased 0.8% for the second quarter of 2006 compared to the second quarter of 2005.

General and administrative expenses for the second quarter of 2006 were down 1.5% compared to the second quarter of 2005.

Results of Operations for the Six Months Ended June 30, 2006 Compared to the Six Months Ended June 30, 2005

Earnings per sub-share certificate were \$2.28 for the first six months of 2006 compared to \$1.71 for the first six months of 2005. Total revenues were \$8,511,246 for the first six months of 2006 compared to \$6,644,481 for the first six months of 2005, an increase of 28.1%. This increase in revenue and earnings was due primarily to an increase in sundry income and, to a lesser extent, an increase in oil and gas royalty revenue, which more than offset a decrease in land sales during the first six months of 2006 compared to the first six months of 2005. The increase in sundry income resulted primarily from a one-time payment received by the Trust from an oil company in settlement of a claim by the Trust for damages to property leased to the oil company by the Trust.

In the first six months of 2006, land sales totaled \$716,117, representing the sale of 3,379 acres at an average price of approximately \$212 per acre. In the comparable period of 2005, land sales totaled \$1,294,865, representing the sale of 9,975 acres at an average price of approximately \$130 per acre.

Rentals, royalties, and sundry income were \$6,883,085 for the first six months of 2006 compared to \$4,459,364 for the first six months of 2005, an increase of 54.4%. This increase resulted primarily from an increase in sundry income and, to a lesser extent, an increase in oil and gas royalty revenue. The increase in oil and gas royalty revenue was primarily attributable to the higher market prices for oil and gas which prevailed during the first six months of 2006 compared to the first six months of 2005 and, to a lesser extent, a modest increase in gas production during the 2006 period, which more than offset a decrease in the volume of oil production in the 2006 period.

Oil and gas royalty revenue was \$4,554,660 for the first six months of 2006, compared to \$3,743,039 for the first six months of 2005, an increase of 21.7%. Oil royalty revenue was \$2,930,419 for the first six months of 2006, an increase of 16.4% from the first six months of 2005. Crude oil production subject to the Trust's royalty interest decreased 12.4% for the first six months of 2006, but this decrease in the volume of production was more than offset by a 32.8% increase in the average price per royalty barrel of crude oil in the first six months of 2006 compared to the first six months of 2005. Gas royalty revenue was \$1,624,241 for the first six months of 2006, an increase of 32.6% from the first six months of 2005, resulting from a price increase of 28.6% and an increase of 3.1% in the volume of gas produced.

Easement and sundry income was \$2,061,156 for the first six months of 2006, an increase of 366.3% from the first six months of 2005. The increase in sundry income resulted primarily from a one-time payment in the amount of \$1,308,000 received by the Trust from an oil company in settlement of a claim by the Trust for damages to property leased to the oil company by the Trust. This category of income is unpredictable and may vary significantly from period to period.

Interest revenue was \$912,044 for the first six months of 2006 compared to \$890,252 for the first six months of 2005, an increase of 2.4%. Interest on notes receivable for the first six months of 2006 was \$675,253, a decrease of 17.0% from the comparable period of 2005. As of June 30, 2006, notes receivable from land sales were \$18,300,779 compared to \$19,083,848 at June 30, 2005, a decrease of 0.5%. Sundry interest was \$236,791 for the first six months of 2006, an increase of 208.8% from the 2005 period. Sundry interest fluctuates based on cash on hand for investment and interest rates on short-term investments.

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Taxes, other than Federal income taxes increased 11.9% for the first six months of 2006 compared to the first six months of 2005. This increase is attributable to an increase in oil and gas production taxes. The increase in oil and gas production taxes, in turn, resulted primarily from the increased oil and gas royalty income occasioned by the higher oil and gas prices which prevailed during the first six months of 2006 compared to the first six months of 2005.

General and administrative expenses for the first six months of 2006 were down 0.9% compared to the first six months of 2005.

Liquidity and Capital Resources

The Trust's principal sources of liquidity are revenues from oil and gas royalties, lease rentals and receipts of interest and principal payments on the notes receivable arising from land sales. In the past, those sources have generated more than adequate amounts of cash to meet the Trust's needs and, in the opinion of management, should continue to do so in the foreseeable future.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in the information related to market risk of the Trust since December 31, 2005.

Item 4. Controls and Procedures

Pursuant to Rule 13a-15, management of the Trust under the supervision and with the participation of Roy Thomas, the Trust's Chief Executive Officer and David M. Peterson, the Trust's Chief Financial Officer, carried out an evaluation of the effectiveness of the design and operation of the Trust's disclosure controls and procedures as of the end of the Trust's fiscal quarter covered by this Report on Form 10-Q. Based upon that evaluation, Mr. Thomas and Mr. Peterson concluded that the Trust's disclosure controls and procedures are effective in timely alerting them to material information relating to the Trust required to be included in the Trust's periodic SEC filings.

There have been no changes in the Trust's internal control over financial reporting during the Trust's most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company'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 previously disclosed in response to Item 1A Risk Factors of Part I of the Trust's Annual Report to the Securities and Exchange Commission on Form 10-K for the year ended December 31, 2005.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(c) During the second quarter of 2006, the Trust repurchased Sub-share certificates as follows:

| <u>Period</u> | <u>Total Number of Sub-shares Purchased</u> | <u>Average Price Paid per Sub-share</u> | <u>Total Number of Sub-shares Purchased as Part of Publicly Announced Plans or Programs</u> | <u>Maximum Number (or Approximate Dollar Value) of Sub-shares that May Yet Be Purchased Under the Plans or Programs</u> |
|---------------------------------|---|---|---|---|
| April 1, through April 30, 2006 | 2,400 | \$146.42 | | |

| <u>Period</u> | <u>Total Number of Sub-shares Purchased</u> | <u>Average Price Paid per Sub-share</u> | <u>Total Number of Sub- shares Purchased as Part of Publicly Announced Plans or Programs</u> | <u>Maximum Number (or Approximate Dollar Value) of Sub- shares that May Yet Be Purchased Under the Plans or Programs</u> |
|-------------------------------|---|---|--|--|
| May 1, through May 31, 2006 | 1,300 | \$145.47 | | |
| June 1, through June 30, 2006 | 3,000 | \$144.77 | | |
| Total | <u>6,700*</u> | \$145.49 | | |

* The Trust purchased and retired 6,700 Sub-shares in the open market.

Item 4. Submission of Matters to a Vote of Security Holders

A special meeting of the holders of Sub-share certificates was held on June 14, 2006 in Dallas, Texas.

At the meeting, the holders of Sub-share certificates elected James K. Norwood as a Trustee of the Trust to succeed Joe R. Clark who had elected to retire. The number of Sub-share certificates voted for the election of Mr. Norwood was 1,706,490 and the number of Sub-share certificates the vote of which was withheld from Mr. Norwood was 28,754.

The terms of Messrs. Maurice Meyer III and John R. Norris III as Trustees of the Trust continued after the special meeting.

Item 6. Exhibits

- 31.1 Rule 13a-14(a) Certification of Chief Executive Officer.
- 31.2 Rule 13a-14(a) Certification of Chief Financial Officer.
- 32.1 Certification of Chief Executive Officer furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

