

CROSS TIMBERS ROYALTY TRUST

Form 10-Q

April 27, 2010

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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 March 31, 2010

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 April 1, 2010

6,000,000

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FORM 10-Q FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2010

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CROSS TIMBERS ROYALTY TRUST

GLOSSARY OF TERMS

The following are definitions of significant terms used in this Form 10-Q:

<i>Bbl</i>	Barrel (of oil)
<i>Mcf</i>	Thousand cubic feet (of natural gas)
<i>MMBtu</i>	One million British Thermal Units, a common energy measurement
<i>net proceeds</i>	Gross proceeds received by XTO Energy from sale of production from the underlying properties, less applicable costs, as defined in the net profits interest conveyances
<i>net profits income</i>	Net proceeds multiplied by the applicable net profits percentage of 75% or 90%, which is paid to the trust by XTO Energy. Net profits income is referred to as royalty income for income tax purposes.
<i>net profits interest</i>	An interest in an oil and gas property measured by net profits from the sale of production, rather than a specific portion of production. The following defined net profits interests were conveyed to the trust from the underlying properties: <i>90% net profits interests</i> interests that entitle the trust to receive 90% of the net proceeds from the underlying properties that are royalty or overriding royalty interests in Texas, Oklahoma and New Mexico <i>75% net profits interests</i> interests that entitle the trust to receive 75% of the net proceeds from the underlying properties that are working interests in Texas and Oklahoma
<i>royalty interest (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 March 31, 2010, and the distributable income and changes in trust corpus for the three-month periods ended March 31, 2010 and 2009, have been included. Distributable income for such interim periods is not necessarily indicative of distributable income for the full year.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Bank of America, N.A., as Trustee

for the Cross Timbers Royalty Trust:

We have reviewed the accompanying condensed statement of assets, liabilities and trust corpus of the Cross Timbers Royalty Trust as of March 31, 2010 and the related condensed statements of distributable income and changes in trust corpus for the three-month periods ended March 31, 2010 and 2009. These condensed financial statements are the responsibility of the trustee.

We conducted our review in accordance with standards established by the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data 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.

The accompanying condensed financial statements are prepared on a modified cash basis as described in Note 1 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 condensed financial statements referred to above for them to be in conformity with the 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 statement of assets, liabilities and trust corpus of the Cross Timbers Royalty Trust as of December 31, 2009, and the related statements of distributable income and changes in trust corpus for the year then ended (not presented herein), included in the trust's 2009 Annual Report on Form 10-K, and in our report dated February 22, 2010, 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, 2009 is fairly stated, in all material respects, in relation to the statement of assets, liabilities and trust corpus included in the trust's 2009 Annual Report on Form 10-K from which it has been derived.

KPMG LLP

Fort Worth, Texas
April 26, 2010

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CROSS TIMBERS ROYALTY TRUST

Condensed Statements of Assets, Liabilities and Trust Corpus

	March 31, 2010	December 31, 2009
	(Unaudited)	
ASSETS		
Cash and short-term investments	\$ 1,533,390	\$ 1,067,595
Interest to be received	42	9
Net profits interests in oil and gas properties - net (Note 1)	15,763,725	16,188,498
	\$ 17,297,157	\$ 17,256,102
LIABILITIES AND TRUST CORPUS		
Distribution payable to unitholders	\$ 1,533,432	\$ 1,067,604
Trust corpus (6,000,000 units of beneficial interest authorized and outstanding)	15,763,725	16,188,498
	\$ 17,297,157	\$ 17,256,102

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 March 31	
	2010	2009
Net profits income	\$ 4,269,080	\$ 2,805,299
Interest income	54	72
Total income	4,269,134	2,805,371
Administration expense	170,558	135,581
Distributable income	\$ 4,098,576	\$ 2,669,790
Distributable income per unit (6,000,000 units)	\$ 0.683096	\$ 0.444965

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	
	March 31	
	2010	2009
Trust corpus, beginning of period	\$ 16,188,498	\$ 17,255,761
Amortization of net profits interests	(424,773)	(184,804)
Distributable income	4,098,576	2,669,790
Distributions declared	(4,098,576)	(2,669,790)
Trust corpus, end of period	\$ 15,763,725	\$ 17,070,957

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. Net profits income consists of net proceeds received by XTO Energy from the underlying properties in the prior month, multiplied by net profit percentages of 90% for the 90% net profits interests, and 75% for the 75% net profits interests.

Costs deducted in the calculation of net proceeds for the 90% net profits interests generally include applicable taxes, transportation, marketing and legal costs, and do not include production expense or development costs. For the 75% net profits interests, costs deducted in the calculation of net proceeds include production expense, development costs, applicable taxes, transportation, marketing and legal costs, operating charges and other costs.

- Net profits income is computed separately for each of five conveyances under which the net profits interests were conveyed to the trust. If monthly costs exceed revenues for any conveyance, such excess costs must be recovered, with accrued interest, from future net proceeds of that conveyance and cannot reduce net proceeds from the other conveyances.
- Interest income, interest to be received and distribution payable to unitholders include interest to be earned on net profits income from the monthly record date (last business day of the month) through the date of the next distribution to unitholders.
- Trust expenses are recorded based on liabilities paid and cash reserves established by the trustee for liabilities and contingencies.
- Distributions to unitholders are recorded when declared by the trustee.

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 for contingencies which would not be accrued 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 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 \$45,336,724 as of March 31, 2010 and \$44,911,951 of December 31, 2009.

2. Contingencies

Several states have enacted legislation to require state income tax withholding from nonresident recipients of oil and gas proceeds. After consultation with its state tax counsel, XTO Energy has advised the trustee that it believes the trust is not subject to these withholding requirements. However, regulations are subject to change by the various states, which could change this conclusion. Should the trust be required to withhold state taxes, distributions to the unitholders would be reduced by the required amount, subject to the unitholder's right to file a state tax return to claim any refund due.

3. Excess Costs

Significantly lower oil prices and elevated costs caused costs to exceed revenues by a total of \$196,211 (\$147,158 net to the trust) on properties underlying the Texas working interest for January through March 2009 and by \$244,677 (\$183,508 net to the trust) on properties underlying the Oklahoma working interest in February and March 2009. However, these costs did not reduce net proceeds from the remaining conveyances. XTO Energy advised the trustee that increased oil prices and decreased costs led to the full recovery of excess costs, plus accrued interest, during 2009, on properties underlying the Texas and Oklahoma working interest.

4. XTO Energy Inc.

On December 13, 2009, XTO Energy entered into a definitive merger agreement with Exxon Mobil Corporation under which XTO Energy would become a wholly owned subsidiary of ExxonMobil. The completion of this merger is subject to certain conditions, including approval of the merger agreement by XTO Energy stockholders and certain government and regulatory approvals. The merger is not expected to have a material effect on trust annual distributable income, financial position or liquidity. The merger is expected to close in the second quarter of 2010.

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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 2009 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.

Distributable Income

For the quarter ended March 31, 2010, net profits income was \$4,269,080 compared to \$2,805,299 for first quarter 2009. This 52% increase in net profits income is the result of higher oil and gas prices, decreased production expense and lower development costs, partially offset by excess costs on the Texas and Oklahoma working interest properties in first quarter 2009 and decreased oil production. See **Net Profits Income** and **Excess Costs** below.

After considering interest income of \$54 and administration expense of \$170,558, distributable income for the quarter ended March 31, 2010 was \$4,098,576, or \$0.683096 per unit of beneficial interest. Administration expense for the quarter increased 26% from the prior year quarter primarily because of the timing of expenditures. For first quarter 2009, distributable income was \$2,669,790, or \$0.444965 per unit. Distributions to unitholders for the quarter ended March 31, 2010 were:

Record Date	Payment Date	Distribution per Unit
January 29, 2010	February 12, 2010	\$ 0.230821
February 26, 2010	March 12, 2010	0.196703
March 31, 2010	April 15, 2010	0.255572
		\$ 0.683096

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 Ended March 31 <i>(a)</i>		Increase (Decrease)
	2010	2009	
Sales Volumes			
Oil (Bbls) <i>(b)</i>			
Underlying properties	50,162	56,631	(11%)
Average per day	545	616	(12%)
Net profits interests	25,686	14,370	79%
Gas (Mcf) <i>(b)</i>			
Underlying properties	521,531	504,727	3%
Average per day	5,669	5,486	3%
Net profits interests	457,677	435,785	5%
Average Sales Prices			
Oil (per Bbl)	\$ 70.87	\$ 41.50	71%
Gas (per Mcf)	\$ 6.94	\$ 6.12	13%
Revenues			
Oil sales	\$ 3,554,795	\$ 2,350,344	51%
Gas sales	3,618,192	3,087,310	17%
Total Revenues	7,172,987	5,437,654	32%
Costs			
Taxes, transportation and other	1,083,416	906,910	19%
Production expense <i>(c)</i>	1,087,698	1,527,575	(29%)
Development costs	71,086	314,861	(77%)
Excess costs <i>(d)</i>	-	(440,888)	100%
Total Costs	2,242,200	2,308,458	(3%)
Net Proceeds	\$ 4,930,787	\$ 3,129,196	58%
Net Profits Income	\$ 4,269,080	\$ 2,805,299	52%

(a) Because of the interval between time of production and receipt of royalty income by the trust, oil and gas sales for the quarter ended March 31 generally represent oil production for the period November through January and gas production for the period October through December.

(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. Changes in any of these factors may result in disproportionate fluctuations in volumes allocated to the net profits interests. Therefore, comparative discussion of oil and gas sales volumes is based on the underlying properties.

(c) Production expense is primarily from seven working interest properties in the 75% net profits interest. Six of these properties are not operated by XTO Energy. Production expense includes an overhead charge which is deducted and retained by XTO Energy. As of

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March 31, 2010, this charge was \$33,838 per month (including a monthly overhead charge of \$2,662 which XTO Energy deducts as operator of the Penwell Unit) and is subject to adjustment each May based on an oil and gas industry index.

(d) See note 3 to Condensed Financial Statements.

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The following are explanations of significant variances on the underlying properties from first quarter 2009 to first quarter 2010:

Sales Volumes

Oil

Oil sales volumes decreased 11% from first quarter 2009 to first quarter 2010 primarily because of natural production decline and the timing of cash receipts.

Gas

Gas sales volumes increased 3% from first quarter 2009 to first quarter 2010 primarily because of the timing of cash receipts and increased production from new wells and workovers, partially offset by natural production decline.

Sales Prices

Oil

The first quarter 2010 average oil price was \$70.87 per Bbl, a 71% increase from the first quarter 2009 average price of \$41.50 per Bbl. Lower demand as a result of the U.S. recession and slowing global economy, the tightened credit markets and rising crude oil supplies caused oil prices to sharply decline in 2008. However, signs of possible economic improvement have resulted in steadily higher oil prices during 2009 and early 2010. Oil prices are expected to remain volatile. The first quarter 2010 oil price is primarily related to production from November 2009 through January 2010, when the average NYMEX price was \$76.81 per Bbl. The average NYMEX price for February and March 2010 was \$78.74 per Bbl. At April 16, 2010, the average NYMEX futures price for the following twelve months was \$87.61 per Bbl. Recent trust oil prices have averaged approximately 7% lower than the NYMEX price.

Gas

The first quarter 2010 average gas price was \$6.94 per Mcf, a 13% increase from the first quarter 2009 average price of \$6.12 per Mcf. Natural gas prices are affected by the level of North American production, weather, crude oil prices, the U.S. economy, storage levels and import levels of liquified natural gas. Due to concerns of oversupply from shale gas development, declining demand due to the U.S. recession, falling oil prices and increased gas storage, gas prices declined during the first nine months of 2009. However, signs of possible economic improvement, higher oil prices and a relatively cold winter led to increased gas prices late in 2009 and early 2010. Gas prices have weakened substantially in February and March 2010 due to renewed concerns of oversupply. Natural gas prices are expected to remain volatile. The first quarter 2010 gas price is primarily related to production from October through December 2009, when the average NYMEX price was \$4.17 per MMBtu. The average NYMEX price for January through March 2010 was \$5.30 per MMBtu. At April 16, 2010, the average NYMEX futures price for the following twelve months was \$4.76 per MMBtu. Recent trust gas prices have averaged approximately 62% higher than the NYMEX price.

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Costs

Taxes, Transportation and Other

Taxes, transportation and other increased 19% for the first quarter primarily because of increased production taxes related to higher oil and gas revenues.

Production Expense

Production expense decreased 29% for the first quarter primarily because of lower costs on nonoperated properties and decreased repairs, maintenance and power and fuel costs, partially offset by increased carbon dioxide injection costs.

Development

Development costs decreased 77% for the first quarter primarily because of decreased activity and costs related to Texas and Oklahoma properties underlying the 75% net profits interests.

Excess Costs

Significantly lower oil prices and elevated costs caused costs to exceed revenues by a total of \$196,211 (\$147,158 net to the trust) on properties underlying the Texas working interest for January through March 2009 and by \$244,677 (\$183,508 net to the trust) on properties underlying the Oklahoma working interest in February and March 2009. However, these costs did not reduce net proceeds from the remaining conveyances. XTO Energy advised the trustee that increased oil prices and decreased costs led to the full recovery of excess costs, plus accrued interest, during 2009, on properties underlying the Texas and Oklahoma working interest.

Contingencies

Several states have enacted legislation to require state income tax withholding from nonresident recipients of oil and gas proceeds. After consultation with its state tax counsel, XTO Energy has advised the trustee that it believes the trust is not subject to these withholding requirements. However, regulations are subject to change by the various states, which could change this conclusion. Should the trust be required to withhold state taxes, distributions to the unitholders would be reduced by the required amount, subject to the unitholder's right to file a state tax return to claim any refund due.

Other

On December 13, 2009, XTO Energy entered into a definitive merger agreement with Exxon Mobil Corporation under which XTO Energy would become a wholly owned subsidiary of ExxonMobil. The completion of this merger is subject to certain conditions, including approval of the merger agreement by XTO Energy stockholders and certain government and regulatory approvals. The merger is not expected to have a material effect on trust annual distributable income, financial position or liquidity. The merger is expected to close in the second quarter of 2010.

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Forward-Looking Statements

This report on Form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements other than statements of historical fact included in this Form 10-Q including, without limitation, statements regarding the net profits interests, underlying properties, development activities, development, production and other costs and expenses, oil and gas prices and differentials to NYMEX prices, distributions to unitholders and industry and market conditions, are forward-looking statements that are subject to risks and uncertainties which are detailed in Part I, Item 1A of the trust's Annual Report on Form 10-K for the year ended December 31, 2009, which is incorporated by this reference as though fully set forth herein. Although XTO Energy and the trustee believe that the expectations reflected in such forward-looking statements are reasonable, neither XTO Energy nor the trustee can give any assurance that such expectations will prove to be correct.

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, 2009.

Item 4. Controls and Procedures.

As of the end of the period covered by this report, the trustee carried out an evaluation of the effectiveness of the trust's disclosure controls and procedures pursuant to Exchange Act Rules 13a-15 and 15d-15. Based upon that evaluation, the trustee concluded that the trust's disclosure controls and procedures are effective in timely recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the trust in the reports that it files or submits under the Securities Exchange Act of 1934 and are effective in ensuring that information required to be disclosed by the trust in the reports that it files or submits under the Securities Exchange Act of 1934 is accumulated and communicated to the trustee to allow timely decisions regarding required disclosure. In its evaluation of disclosure controls and procedures, the trustee has relied, to the extent considered reasonable, on information provided by XTO Energy Inc. 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, 2009.

Items 2 through 5.

Not applicable.

Item 6. Exhibits.

- (a) Exhibits.

**Exhibit Number
and Description**

- | | |
|------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| (15) | Awareness letter of KPMG LLP |
| (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 23, 2010 (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

XTO ENERGY INC.

By /s/ **LOUIS G. BALDWIN**
Louis G. Baldwin
Executive Vice President
and Chief Financial Officer

Date: April 26, 2010