

CROSS TIMBERS ROYALTY TRUST

Form 10-Q

October 29, 2008

[Table of Contents](#)

**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, 2008

OR

**“ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF**  
**THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number: 1-10982

**Cross Timbers Royalty Trust**

(Exact name of registrant as specified in its charter)

Texas  
(State or other jurisdiction of

75-6415930  
(I.R.S. Employer

Edgar Filing: CROSS TIMBERS ROYALTY TRUST - Form 10-Q

incorporation or organization)

Identification No.)

U.S. Trust, Bank of America

Private Wealth Management

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 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, 2008

6,000,000

---

**Table of Contents**

**CROSS TIMBERS ROYALTY TRUST**

**FORM 10-Q FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2008**

**TABLE OF CONTENTS**

	<b>Page</b>
<u>Glossary of Terms</u>	3
<b>PART I. FINANCIAL INFORMATION</b>	
Item 1. <u>Financial Statements</u>	4
<u>Report of Independent Registered Public Accounting Firm</u>	5
<u>Condensed Statements of Assets, Liabilities and Trust Corpus at September 30, 2008 and December 31, 2007</u>	6
<u>Condensed Statements of Distributable Income for the Three and Nine Months Ended September 30, 2008 and 2007</u>	7
<u>Condensed Statements of Changes in Trust Corpus for the Three and Nine Months Ended September 30, 2008 and 2007</u>	8
<u>Notes to Condensed Financial Statements</u>	9
Item 2. <u>Trustee's Discussion and Analysis</u>	12
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	17
Item 4. <u>Controls and Procedures</u>	17
<b>PART II. OTHER INFORMATION</b>	
Item 1A. <u>Risk Factors</u>	18
Item 6. <u>Exhibits</u>	18
<u>Signatures</u>	19

**Table of Contents**

**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



**Table of Contents**

**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, 2008, and the distributable income and changes in trust corpus for the three- and nine-month periods ended September 30, 2008 and 2007, have been included. Distributable income for such interim periods is not necessarily indicative of distributable income for the full year.

**Table of Contents**

**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 September 30, 2008 and the related condensed statements of distributable income and changes in trust corpus for the three- and nine-month periods ended September 30, 2008 and 2007. 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, 2007, 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 2007 Annual Report on Form 10-K, and in our report dated February 25, 2008, 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, 2007 is fairly stated, in all material respects, in relation to the statement of assets, liabilities and trust corpus included in the trust's 2007 Annual Report on Form 10-K from which it has been derived.

KPMG LLP

Fort Worth, Texas

October 29, 2008

**Table of Contents**

**CROSS TIMBERS ROYALTY TRUST**

**Condensed Statements of Assets, Liabilities and Trust Corpus**

	<b>September 30, 2008 (Unaudited)</b>	<b>December 31, 2007</b>
<b>ASSETS</b>		
Cash and short-term investments	\$ 3,322,465	\$ 1,757,903
Interest to be received	2,633	2,245
Net profits interests in oil and gas properties net (Note 1)	17,525,221	18,387,752
	<b>\$ 20,850,319</b>	<b>\$ 20,147,900</b>
<b>LIABILITIES AND TRUST CORPUS</b>		
Distribution payable to unitholders	\$ 3,325,098	\$ 1,760,148
Trust corpus (6,000,000 units of beneficial interest authorized and outstanding)	17,525,221	18,387,752
	<b>\$ 20,850,319</b>	<b>\$ 20,147,900</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)**

	<b>Three Months Ended September 30</b>		<b>Nine Months Ended September 30</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Net profits income	<b>\$ 9,163,997</b>	\$ 5,029,646	<b>\$ 24,578,205</b>	\$ 14,951,668
Interest income	<b>7,221</b>	11,088	<b>18,255</b>	30,900
Total income	<b>9,171,218</b>	5,040,734	<b>24,596,460</b>	14,982,568
Administration expense	<b>57,008</b>	58,094	<b>335,658</b>	374,518
Distributable income	<b>\$ 9,114,210</b>	\$ 4,982,640	<b>\$ 24,260,802</b>	\$ 14,608,050
Distributable income per unit (6,000,000 units)	<b>\$ 1.519035</b>	\$ 0.830440	<b>\$ 4.043467</b>	\$ 2.434675

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)**

	<b>Three Months Ended September 30</b>		<b>Nine Months Ended September 30</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Trust corpus, beginning of period	<b>\$ 17,830,889</b>	\$ 19,024,493	<b>\$ 18,387,752</b>	\$ 19,679,502
Amortization of net profits interests	<b>(305,668)</b>	(295,356)	<b>(862,531)</b>	(950,365)
Distributable income	<b>9,114,210</b>	4,982,640	<b>24,260,802</b>	14,608,050
Distributions declared	<b>(9,114,210)</b>	(4,982,640)	<b>(24,260,802)</b>	(14,608,050)
Trust corpus, end of period	<b>\$ 17,525,221</b>	\$ 18,729,137	<b>\$ 17,525,221</b>	\$ 18,729,137

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

**Table of Contents**

**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 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.

## **Table of Contents**

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 \$43,575,228 as of September 30, 2008 and \$42,712,697 as of December 31, 2007.

### **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. Reversion Agreement**

Certain of the properties underlying the 90% net profits interests were subject to a reversion agreement between XTO Energy and an unrelated party. The agreement called for XTO Energy to transfer 25% of its interest in those properties to the third party when net amounts received by XTO Energy from the properties subject to the agreement equal the purchase price of the properties plus a 1% per month return on the unrecouped purchase price, known as payout. At the time payout occurred, net proceeds payable to the trust and trust distributions to unitholders were reduced. XTO Energy informed the trustee that payout occurred effective with the July 2007 distribution, which was paid on August 14, 2007, thereby reducing the July 2007 distribution and all future distributions by approximately 5%.

**Table of Contents**

**4. Lawsuit Settlement**

From time-to-time, XTO Energy receives net proceeds for the underlying properties related to significant lawsuit settlements, including related interest income. Because of the size and nature of these settlements, XTO Energy has informed the trustee that it believes these should be considered one-time, or nonrecurring, events. Since most of the properties in the trust are nonoperated, these adjustments are generally not known to XTO Energy until reported by the purchaser. These settlements are included and reported in net profits income in the month received by the trust, which is generally the month following receipt by XTO Energy.

In the first nine months of 2008, the calculation of net profits income included lawsuit settlements of \$2,430,326 related to underpayment of royalties on underlying properties in the San Juan Basin. Included in these settlements was interest of \$1,024,815 and additional gas revenue of \$1,405,511. The total settlements, net to the trust, were \$2,187,294, or \$0.36 per unit.

**Table of Contents**

*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 2007 annual report, 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, 2008, net profits income was \$9,163,997 compared to \$5,029,646 for third quarter 2007. This 82% increase in net profits income is primarily the result of higher oil and gas prices, partially offset by decreased gas sales volumes. See *Net Profits Income* below.

After considering interest income of \$7,221 and administration expense of \$57,008, distributable income for the quarter ended September 30, 2008 was \$9,114,210, or \$1.519035 per unit of beneficial interest. For third quarter 2007, distributable income was \$4,982,640, or \$0.830440 per unit. Distributions to unitholders for the quarter ended September 30, 2008 were:

		<b>Distribution</b>	
	<b>Record Date</b>	<b>Payment Date</b>	
		<b>per Unit</b>	
	July 31, 2008	August 14, 2008	\$0.411533
	August 29, 2008	September 15, 2008	0.553319
	September 30, 2008	October 15, 2008	0.554183
			\$1.519035

*Nine Months*

For the nine months ended September 30, 2008, net profits income was \$24,578,205 compared to \$14,951,668 for the same 2007 period. This 64% increase in net profits income is primarily the result of higher oil and gas prices and lawsuit settlement proceeds included in the first nine months of 2008, partially offset by decreased oil and gas sales volumes. See *Net Profits Income* and *Other Proceeds* below.

After considering interest income of \$18,255 and administration expense of \$335,658, distributable income for the nine months ended September 30, 2008 was \$24,260,802, or \$4.043467 per unit of beneficial interest. Administrative expense for the nine months ended September 30, 2008 decreased 10% from the prior year nine-month period primarily because of the timing of expenditures. For the nine months ended September 30, 2007, distributable income was \$14,608,050, or \$2.434675 per unit.

**Table of Contents**

**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, they generally bear no costs other than production and property taxes, related legal costs, and marketing and transportation charges. In addition to these costs, the 75% net profits interests are subject to production expense and development costs, since the properties underlying the 75% net profits interests are working interests.

**Table of Contents**

The following is a summary of the calculation of net profits income received by the trust:

	Three Months Ended		Increase (Decrease)	Nine Months Ended		Increase (Decrease)
	September 30 (a) 2008	2007		September 30 (a) 2008	2007	
<b>Sales Volumes</b>						
Oil (Bbls) (b)						
Underlying properties	56,223	56,012		172,693	187,765	(8%)
Average per day	611	609		630	688	(8%)
Net profits interests	35,749	23,716	51%	103,249	82,911	25%
Gas (Mcf) (b)						
Underlying properties	527,589	563,488	(6%)	1,578,963	1,799,729	(12%)
Average per day	5,798	6,192	(6%)	5,763	6,592	(13%)
Net profits interests	468,863	495,323	(5%)	1,385,956	1,573,090	(12%)
<b>Average Sales Prices</b>						
Oil (per Bbl)	\$ 123.68	\$ 61.32	102%	\$ 100.96	\$ 55.87	81%
Gas (per Mcf) (c)	\$ 12.69	\$ 8.90	43%	\$ 11.65	\$ 8.03	45%
<b>Revenues</b>						
Oil sales	\$ 6,953,498	\$ 3,434,851	102%	\$ 17,435,366	\$ 10,490,882	66%
Gas sales (c)	6,694,294	5,014,438	34%	18,398,606	14,447,716	27%
Total Revenues	13,647,792	8,449,289	62%	35,833,972	24,938,598	44%
<b>Costs</b>						
Taxes, transportation and other	1,531,571	1,171,561	31%	3,905,058	3,326,363	17%
Production expense (d)	989,266	972,555	2%	3,272,794	2,946,643	11%
Development costs	413,713	580,812	(29%)	1,192,910	1,650,424	(28%)
Total Costs	2,934,550	2,724,928	8%	8,370,762	7,923,430	6%
<b>Other Proceeds</b>						
Interest Income (c)				1,024,815		
<b>Net Proceeds</b>	<b>\$ 10,713,242</b>	<b>\$ 5,724,361</b>	<b>87%</b>	<b>\$ 28,488,025</b>	<b>\$ 17,015,168</b>	<b>67%</b>
<b>Net Profits Income</b>	<b>\$ 9,163,997</b>	<b>\$ 5,029,646</b>	<b>82%</b>	<b>\$ 24,578,205</b>	<b>\$ 14,951,668</b>	<b>64%</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. 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.



## Edgar Filing: CROSS TIMBERS ROYALTY TRUST - Form 10-Q

- (c) In the nine-months ended September 30, 2008, \$2,430,326 was received related to lawsuit settlements for underpayment of royalties on certain San Juan Basin properties. Included in these settlements was interest of \$1,024,815. These settlements increased the average gas sales price by \$0.89 for the nine-months ended September 30, 2008. The total settlements, net to trust, were \$2,187,294, or \$0.36 per unit.
  
- (d) Includes an overhead charge which is deducted and retained by XTO Energy. As of September 30, 2008, this charge was \$31,831 per month (including a monthly overhead charge of \$2,830 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.

---

**Table of Contents**

The following are explanations of significant variances on the underlying properties from third quarter 2008 to third quarter 2007 and from the first nine months of 2007 to the comparable period in 2008:

**Sales Volumes**

*Oil*

Oil sales volumes remained relatively unchanged for third quarter 2008 as the timing of cash receipts was offset by natural production decline. Oil sales volumes decreased 8% for the nine-month period primarily because of natural production decline, partially offset by the timing of cash receipts.

*Gas*

Gas sales volumes decreased 6% for third quarter 2008 and 12% for the first nine months of 2008 as compared with the same 2007 periods primarily because of natural production decline and the timing of cash receipts, partially offset by prior period volume adjustments in 2007.

**Sales Prices**

*Oil*

The average oil price increased 102% to \$123.68 per Bbl for the third quarter and 81% to \$100.96 per Bbl for the nine-month period. In the last few months of 2007 and the first half of 2008, continued tension in the Middle East, weakness in the U.S. dollar and strong demand caused prices to reach record levels of above \$147.00 per Bbl. However, rising crude oil supplies, the tightened credit markets and the potential for lower demand in slowing U.S. and global economies have caused recent oil prices to decline. Oil prices are expected to remain volatile. The third quarter 2008 oil price is primarily related to production from May through July 2008, when the average NYMEX price was \$131.56 per Bbl. The average NYMEX price for August and September 2008 was \$110.57 per Bbl. At October 15, 2008, the average NYMEX futures price for the following twelve months was \$76.66 per Bbl. Recent trust oil prices have averaged approximately 5% lower than the NYMEX price.

*Gas*

Gas prices for the third quarter increased 43% to \$12.69 per Mcf and for the nine-month period increased 45% to \$11.65 per Mcf. Excluding the effects of the lawsuit settlements in the first nine months of 2008, the average gas price was \$10.76 per Mcf. See *Other Proceeds* below. Although the U.S. entered the winter with above average gas storage, a normal winter and lower liquefied natural gas imports led to normal storage levels. As a result of tighter storage levels and higher oil prices, gas prices reached as high as \$13.00 per MMBtu. Due to concerns of oversupply from shale gas development, falling oil prices and a mild summer which led to increased gas in storage, recent gas prices have declined. Prices will continue to be affected by weather, oil prices, the U.S. economy, the level of North American production and import levels of liquefied natural gas. Natural gas prices are expected to remain volatile. The third quarter 2008 gas price is primarily related to production from April through June 2008, when the average NYMEX price was \$10.92 per MMBtu. The average NYMEX price for July and August 2008 was \$11.16 per MMBtu. At October 15, 2008, the average NYMEX futures price for the following twelve months was \$7.09 per MMBtu. Recent trust gas prices have been approximately 19% higher than the NYMEX price.

## **Table of Contents**

### **Costs**

#### *Taxes, Transportation and Other*

Taxes, transportation and other increased 31% for the third quarter and 17% for the nine-month period primarily because of increased production taxes related to higher oil and gas revenues, partially offset by lower property taxes.

#### *Production*

Production expense increased 11% for the first nine months of 2008 primarily due to the timing of cash disbursements, increased power, fuel and workover costs, partially offset by decreased maintenance costs.

#### *Development*

Development costs decreased 29% for the third quarter and 28% for the nine-month period primarily because of decreased activity and costs related to Texas and Oklahoma properties underlying the 75% net profits interests.

### **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.

### **Reversion Agreement**

Certain of the properties underlying the 90% net profits interests were subject to a reversion agreement between XTO Energy and an unrelated party. The agreement called for XTO Energy to transfer 25% of its interest in those properties to the third party when net amounts received by XTO Energy from the properties subject to the agreement equal the purchase price of the properties plus a 1% per month return on the unrecovered purchase price, known as payout. At the time payout occurred, net proceeds payable to the trust and trust distributions to unitholders were reduced. XTO Energy informed the trustee that payout occurred effective with the July 2007 distribution, which was paid on August 14, 2007, thereby reducing the July 2007 distribution and all future distributions by approximately 5%.

### **Other Proceeds**

In the first nine months of 2008, the calculation of net profits income included lawsuit settlements of \$2,430,326 related to underpayment of royalties on underlying properties in the San Juan Basin. Included in these settlements was interest of \$1,024,815 and additional gas revenue of \$1,405,511. The total settlements, net to the trust, were \$2,187,294, or \$0.36 per unit.

**Table of Contents**

**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, supply shortages, distributions to unitholders, the impact on future payments as a result of the reversion of properties under the reversion agreement 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, 2007, 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, as disclosed in Part II, Item 7A of the trust's Annual Report on Form 10-K for the year ended December 31, 2007.

*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 to ensure that information required to be disclosed in reports filed with the Securities and Exchange Commission is recorded, processed, summarized and reported within the periods required and that this information is accumulated and communicated to allow timely decisions regarding required disclosures. 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.

**Table of Contents**

**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, 2007.

*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 26, 2008 (incorporated herein by reference)

Table of Contents

**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: October 29, 2008