

CROSS TIMBERS ROYALTY TRUST  
Form 10-Q  
October 19, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**Form 10-Q**

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

For the quarterly period ended September 30, 2007

OR

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

Commission File Number: 1-10982

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**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)

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

Bank of America, N.A., P.O. Box 830650, Dallas, Texas  
(Address of principal executive offices)

(877) 228-5084  
75283-0650  
(Zip Code)

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(Registrant's telephone number, including area code)

NONE

(Former name, former address and former fiscal year, if changed since last report)

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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, 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

Indicate the number of units of beneficial interest outstanding, as of the latest practicable date:

Outstanding as of October 1, 2007

6,000,000

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**CROSS TIMBERS ROYALTY TRUST**

**FORM 10-Q FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2007**

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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:<br><br><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<br><br><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</i><br><br><i>(and overriding</i><br><br><i>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, 2007, and the distributable income and changes in trust corpus for the three- and nine-month periods ended September 30, 2007 and 2006, 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 September 30, 2007 and the related condensed statements of distributable income and changes in trust corpus for the three- and nine-month periods ended September 30, 2007 and 2006. 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, 2006, 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 2006 Annual Report on Form 10-K, and in our report dated February 28, 2007, 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, 2006 is fairly stated, in all material respects, in relation to the statement of assets, liabilities and trust corpus included in the trust's 2006 Annual Report on Form 10-K from which it has been derived.

KPMG LLP

Dallas, Texas

October 18, 2007

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

|  | September 30,<br>2007<br>(Unaudited) | December 31,<br>2006 |
|--|--------------------------------------|----------------------|
| <b>ASSETS</b>  |                                      |                      |
| Cash and short-term investments  | \$ 1,491,141                         | \$ 1,970,795         |
| Interest to be received  | 3,477                                | 4,963                |
| Net profits interests in oil and gas properties net (Note 1)                     | 18,729,137                           | 19,679,502           |
|  | <b>\$ 20,223,755</b>                 | <b>\$ 21,655,260</b> |
| <b>LIABILITIES AND TRUST CORPUS</b>  |                                      |                      |
| Distribution payable to unitholders  | \$ 1,494,618                         | \$ 1,975,758         |
| Trust corpus (6,000,000 units of beneficial interest authorized and outstanding) | 18,729,137                           | 19,679,502           |
|  | <b>\$ 20,223,755</b>                 | <b>\$ 21,655,260</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</b> |              | <b>Nine Months Ended</b> |               |
|---|---------------------------|--------------|--------------------------|---------------|
|   | <b>September 30</b>       |              | <b>September 30</b>      |               |
|   | <b>2007</b>               | <b>2006</b>  | <b>2007</b>              | <b>2006</b>   |
| Net profits income                              | <b>\$ 5,029,646</b>       | \$ 6,178,866 | <b>\$ 14,951,668</b>     | \$ 18,544,566 |
| Interest income                                 | <b>11,088</b>             | 16,548       | <b>30,900</b>            | 42,689        |
| Total income                                    | <b>5,040,734</b>          | 6,195,414    | <b>14,982,568</b>        | 18,587,255    |
| Administration expense                          | <b>58,094</b>             | 48,498       | <b>374,518</b>           | 324,413       |
| Distributable income                            | <b>\$ 4,982,640</b>       | \$ 6,146,916 | <b>\$ 14,608,050</b>     | \$ 18,262,842 |
| Distributable income per unit (6,000,000 units) | <b>\$ 0.830440</b>        | \$ 1.024486  | <b>\$ 2.434675</b>       | \$ 3.043807   |

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 |               | Nine Months Ended |              |
|---------------------------------------|--------------------|---------------|-------------------|--------------|
|                                       | September 30       |               | September 30      |              |
|                                       | 2007               | 2006          | 2007              | 2006         |
| Trust corpus, beginning of period     | \$ 19,024,493      | \$ 20,452,368 | \$19,679,502      | \$21,204,723 |
| Amortization of net profits interests | (295,356)          | (416,424)     | (950,365)         | (1,168,779)  |
| Distributable income                  | 4,982,640          | 6,146,916     | 14,608,050        | 18,262,842   |
| Distributions declared                | (4,982,640)        | (6,146,916)   | (14,608,050)      | (18,262,842) |
| Trust corpus, end of period           | \$ 18,729,137      | \$ 20,035,944 | \$18,729,137      | \$20,035,944 |

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

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**CROSS TIMBERS ROYALTY TRUST**

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**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 ( U.S. 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.

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

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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 \$42,371,312 as of September 30, 2007 and \$41,420,947 as of December 31, 2006.

### **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.

In May 2006, the State of Texas passed legislation to implement a new margin tax of 1% to be imposed on revenues less certain costs, as specified in the legislation, generated from Texas activities beginning in 2007. Entities subject to the tax generally include trusts, unless otherwise exempt, and various other types of entities. Trusts that meet statutory requirements are generally exempt from the margin tax as passive entities. Recent legislative action has clarified that the trust is exempt from margin tax as a passive entity. However, each unitholder that is a business entity subject to the margin tax is generally required to include its share of the trust's revenues in its margin tax computation.

Unitholders are urged to consult their own tax advisors regarding the requirements for filing state tax returns.

### **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%.

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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 2006 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, 2007, net profits income was \$5,029,646 compared to \$6,178,866 for third quarter 2006. The 19% decrease in net profits income is primarily the result of decreased gas and oil sales volumes and higher development costs, partially offset by higher gas prices. See *Net Profits Income* on the following page.

After considering interest income of \$11,088 and administration expense of \$58,094, distributable income for the quarter ended September 30, 2007 was \$4,982,640, or \$0.830440 per unit of beneficial interest. For third quarter 2006, distributable income was \$6,146,916, or \$1.024486 per unit. Distributions to unitholders for the quarter ended September 30, 2007 were:

| <b>Record Date</b> | <b>Payment Date</b> | <b>Distribution per Unit</b> |
|--------------------|---------------------|------------------------------|
| July 31, 2007      | August 14, 2007     | \$ 0.290567                  |
| August 31, 2007    | September 17, 2007  | 0.290770                     |
| September 28, 2007 | October 15, 2007    | 0.249103                     |
|                    |                     | \$ 0.830440                  |

*Nine Months*

For the nine months ended September 30, 2007, net profits income was \$14,951,668 compared to \$18,544,566 for the same 2006 period. This 19% decrease in net profits income is primarily the result of decreased gas and oil sales volumes, lower gas and oil prices and higher development costs, partially offset by lower production and property taxes. See *Net Profits Income* on the following page.

After considering interest income of \$30,900 and administration expense of \$374,518, distributable income for the nine months ended September 30, 2007 was \$14,608,050, or \$2.434675 per unit of beneficial interest. Administrative expense for the nine months ended September 30, 2007 increased 15% from the prior year nine-month period primarily because of costs related to additional unitholder tax reporting. For the nine months ended September 30, 2006, distributable income was \$18,262,842, or \$3.043807 per unit.

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**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.

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

|                                 | Three Months Ended  |                     | Increase<br>(Decrease) | Nine Months Ended    |                      | Increase<br>(Decrease) |
|---------------------------------|---------------------|---------------------|------------------------|----------------------|----------------------|------------------------|
|                                 | September 30 (a)    |                     |                        | September 30 (a)     |                      |                        |
|                                 | 2007                | 2006                |                        | 2007                 | 2006                 |                        |
| <b>Sales Volumes</b>            |                     |                     |                        |                      |                      |                        |
| Oil (Bbls) (b)                  |                     |                     |                        |                      |                      |                        |
| Underlying properties           | 56,012              | 68,694              | (18)%                  | 187,765              | 205,723              | (9)%                   |
| Average per day                 | 609                 | 747                 | (18)%                  | 688                  | 754                  | (9)%                   |
| Net profits interests           | 23,716              | 40,323              | (41)%                  | 82,911               | 109,068              | (24)%                  |
| Gas (Mcf) (b)                   |                     |                     |                        |                      |                      |                        |
| Underlying properties           | 563,488             | 708,589             | (20)%                  | 1,799,729            | 2,053,599            | (12)%                  |
| Average per day                 | 6,192               | 7,787               | (20)%                  | 6,592                | 7,522                | (12)%                  |
| Net profits interests           | 495,323             | 624,471             | (21)%                  | 1,573,090            | 1,795,407            | (12)%                  |
| <b>Average Sales Prices</b>     |                     |                     |                        |                      |                      |                        |
| Oil(per Bbl)                    | \$61.32             | \$65.39             | (6)%                   | \$55.87              | \$58.71              | (5)%                   |
| Gas (per Mcf)                   | \$8.90              | \$7.25              | 23 %                   | \$8.03               | \$8.36               | (4)%                   |
| <b>Revenues</b>                 |                     |                     |                        |                      |                      |                        |
| Oil sales                       | \$ 3,434,851        | \$ 4,492,028        | (24)%                  | \$ 10,490,882        | \$ 12,078,312        | (13)%                  |
| Gas sales                       | 5,014,438           | 5,136,225           | (2)%                   | 14,447,716           | 17,173,116           | (16)%                  |
| Total Revenues                  | 8,449,289           | 9,628,253           | (12)%                  | 24,938,598           | 29,251,428           | (15)%                  |
| <b>Costs</b>                    |                     |                     |                        |                      |                      |                        |
| Taxes, transportation and other | 1,171,561           | 1,366,431           | (14)%                  | 3,326,363            | 4,241,824            | (22)%                  |
| Production expense (c)          | 972,555             | 954,605             | 2 %                    | 2,946,643            | 3,160,478            | (7)%                   |
| Development costs               | 580,812             | 151,369             | 284 %                  | 1,650,424            | 534,080              | 209 %                  |
| Total Costs                     | 2,724,928           | 2,472,405           | 10 %                   | 7,923,430            | 7,936,382            |                        |
| <b>Net Proceeds</b>             | <b>\$ 5,724,361</b> | <b>\$ 7,155,848</b> | <b>(20)%</b>           | <b>\$ 17,015,168</b> | <b>\$ 21,315,046</b> | <b>(20)%</b>           |
| <b>Net Profits Income</b>       | <b>\$ 5,029,646</b> | <b>\$ 6,178,866</b> | <b>(19)%</b>           | <b>\$ 14,951,668</b> | <b>\$ 18,544,566</b> | <b>(19)%</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.

(c) Includes an overhead charge which is deducted and retained by XTO Energy. As of September 30, 2007, this charge was \$31,258 per month (including a monthly overhead charge of \$2,793 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.

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The following are explanations of significant variances on the underlying properties from third quarter 2007 to third quarter 2006 and from the first nine months of 2007 to the comparable period in 2006:

### **Sales Volumes**

#### *Oil*

Oil sales volumes decreased 18% for third quarter 2007 and decreased 9% for the first nine months of 2007 as compared with the same 2006 periods primarily because of the timing of cash receipts and natural production decline. In addition, the third quarter 2007 and first nine months of 2007 had decreased volumes as a result of payout occurring under the reversion agreement. See [Reversion Agreement](#) below.

#### *Gas*

Gas sales volumes decreased 20% for third quarter 2007 and decreased 12% for the first nine months of 2007 as compared with the same 2006 periods primarily because of the timing of cash receipts and natural production decline, partially offset by increased production from new wells and workovers. In addition, the third quarter 2007 and first nine months of 2007 had decreased volumes as a result of payout occurring under the reversion agreement. See [Reversion Agreement](#) below.

### **Sales Prices**

#### *Oil*

The average oil price decreased 6% to \$61.32 per Bbl for the third quarter and 5% to \$55.87 per Bbl for the nine-month period. Oil prices during the third quarter fluctuated between approximately \$69.00 and \$84.00 per Bbl. In October 2007, rising tension in the Middle East, weakness in the dollar and strong demand caused oil prices to increase to record levels of \$90.00 per Bbl. Oil prices are expected to remain volatile. The average NYMEX price for August and September 2007 was \$75.75 per Bbl. At October 15, 2007, the average NYMEX futures price for the following twelve months was \$82.16 per Bbl. Recent trust oil prices have averaged approximately 11% lower than the NYMEX price.

#### *Gas*

Gas prices for the third quarter increased 23% to \$8.90 per Mcf and for the nine-month period decreased 4% to \$8.03 per Mcf. The aftermath of 2005 Gulf of Mexico hurricane activity elevated 2006 prices, while the lack of such activity in 2006 contributed to lower prices in 2007. Prices will continue to be affected by weather, the U.S. economy, the level of North American production and import levels of liquified natural gas. Natural gas prices are expected to remain volatile. The third quarter 2007 gas price is primarily related to production from April through June 2007, when the average NYMEX price was \$7.55 per MMBtu. The average NYMEX price for July and August 2007 was \$6.52 per MMBtu. At October 15, 2007, the average NYMEX futures price for the following twelve months was \$7.99 per MMBtu. Recent trust gas prices have been approximately 15% higher than the NYMEX price.



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### **Costs**

#### *Taxes, Transportation and Other*

Taxes, transportation and other decreased 14% for the third quarter and 22% for the nine-month period. The decrease in taxes for the quarter and nine-month period is primarily due to lower production taxes and other purchaser deductions related to lower oil and gas revenues as well as lower property taxes related to the timing of cash disbursements.

#### *Production Expense*

Production expense was 7% lower for the nine-month period primarily because of decreased power and fuel costs.

#### *Development*

Development costs increased 284% for the third quarter and 209% for the nine-month period because of increased activity and costs related to Texas and Oklahoma properties underlying the 75% net profits interests.

### **State of Texas Margin Tax**

In May 2006, the State of Texas passed legislation to implement a new margin tax of 1% to be imposed on revenues less certain costs, as specified in the legislation, generated from Texas activities beginning in 2007. Entities subject to the tax generally include trusts, unless otherwise exempt, and various other types of entities. Trusts that meet statutory requirements are generally exempt from the margin tax as passive entities. Recent legislative action has clarified that the trust is exempt from margin tax as a passive entity. However, each unitholder that is a business entity subject to the margin tax is generally required to include its share of the trust's revenues in its margin tax computation.

Unitholders are urged to consult their own tax advisors regarding the requirements for filing state tax returns.

### **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**

#### *Trustee Brand Change*

On October 15, 2007, the Bank of America private wealth management group officially became known as U.S. Trust, Bank of America Private Wealth Management as a result of Bank of America's acquisition of U.S. Trust Corporation. This change is a brand name change only and the legal entity that serves as the trustee for the trust will continue to be Bank of America, N. A.

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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, 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, 2006, 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.

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*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, 2006.

*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 design and operation 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 functioning effectively 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.

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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, 2006.

*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 March 1, 2006 (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: October 19, 2007