

CROSS TIMBERS ROYALTY TRUST
Form 10-K
February 25, 2009

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2008

Commission file number 1-10982

Cross Timbers Royalty Trust

(Exact name of registrant as specified in the Cross Timbers Royalty Trust Indenture)

Texas
(State or other jurisdiction of
incorporation or organization)

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

U.S. Trust, Bank of America
Private Wealth Management
Trustee
P.O. Box 830650
Dallas, Texas
(Address of principal executive offices)

75283-0650
(Zip Code)

Registrant's telephone number including area code: (877) 228-5084

Securities registered pursuant to Section 12(b) of the Act:

Title of each class
Units of Beneficial Interest

Name of each exchange on which registered
New York Stock Exchange

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Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

The aggregate market value of the units of beneficial interest of the trust, based on the closing price on the New York Stock Exchange as of June 30, 2008 (the last business day of its most recently completed second fiscal quarter), held by non-affiliates of the registrant on that date was approximately \$388 million.

At February 25, 2009, there were 6,000,000 units of beneficial interest of the trust outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Listed below is the only document parts of which are incorporated herein by reference and the parts of this report into which the document is incorporated:

2008 Annual Report to Unitholders Part II

PART I

Item 1. Business

Cross Timbers Royalty Trust is an express trust created under the laws of Texas pursuant to the Cross Timbers Royalty Trust Indenture entered into on February 12, 1991 between predecessors of XTO Energy Inc. (formerly known as Cross Timbers Oil Company), as grantors, and NCNB Texas National Bank, as trustee. Bank of America, N.A. is now the trustee of the trust. In 2007 the Bank of America private wealth management group officially became known as U.S. Trust, Bank of America Private Wealth Management. The legal entity that serves as the trustee of the trust did not change, and references in this Form 10-K to U.S. Trust, Bank of America Private Wealth Management shall describe the legal entity Bank of America, N.A. The principal office of the trust is located at 901 Main Street, Dallas, Texas 75202 (telephone number 877-228-5084).

The trust's internet web site is www.crosstimberstrust.com. We make available free of charge, through our web site, our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. These reports are accessible through our internet web site as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission.

On February 12, 1991, the predecessors of XTO Energy conveyed defined net profits interests to the trust under five separate conveyances:

one in each of the states of Texas, Oklahoma and New Mexico, to convey a 90% defined net profits interest carved out of substantially all royalty and overriding royalty interests owned by the predecessors in those states, and

one in each of the states of Texas and Oklahoma, to convey a 75% defined net profits interest carved out of specific working interests owned by the predecessors in those states.

The conveyance of these net profits interests was effective for production from October 1, 1990. The net profits interests and the underlying properties are further described under Item 2.

In exchange for the net profits interests conveyed to the trust, the predecessors of XTO Energy received 6,000,000 units of beneficial interest of the trust. Predecessors of XTO Energy distributed units to their owners in February 1991 and November 1992, and in February 1992, sold units in the trust's initial public offering. Units are listed and traded on the New York Stock Exchange under the symbol CRT. During 1996 and 1997, XTO Energy purchased 1,360,000 units on the open market. On September 18, 2003, XTO Energy distributed all of the 1,360,000 trust units it owned as a dividend to its common stockholders. XTO Energy currently is not a unitholder of the trust.

Under the terms of each of the five conveyances, the trust receives net profits income from the net profits interests generally on the last business day of each month. Net profits income is determined by XTO Energy by multiplying the net profit percentage (90% or 75%) times net proceeds from the underlying properties for each conveyance during the previous month. Net proceeds are the gross proceeds received from the sale of production, less production costs, as defined in the conveyances. For the 90% net profits interests and the 75% net profits interests, production costs generally include applicable property taxes, transportation, marketing and other charges. For the 75% net profits interests only, production costs also include capital and operating costs paid (e.g., drilling, production and other direct costs of owning and operating the property) and a monthly overhead charge that is adjusted annually. The monthly overhead charge at December 31, 2008 was \$31,831 (\$23,873 net to the trust). XTO Energy also deducts an overhead charge as operator of the Penwell Unit. As of December 31, 2008, monthly overhead attributable to the Penwell Unit was \$2,830 (\$2,123 net to the trust). If production costs exceed gross proceeds for any conveyance, this excess is carried forward to future monthly computations of net proceeds until the excess costs (plus interest accrued as specified in the conveyances) are completely

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recovered. Excess production costs and related accrued interest from one conveyance cannot be used to reduce net proceeds from any other conveyance.

Costs exceeded revenues on properties underlying the Texas working interest in January and February 2009 and on properties underlying the Oklahoma working interest in February 2009. For further information on excess costs, see Trustee's Discussion and Analysis of financial conditions and results of operations for the three-year period ended December 31, 2008 in the trust's annual report to unitholders for the year ended December 31, 2008.

The trust is not liable for any production costs or liabilities attributable to the underlying properties. If at any time the trust receives net profits income in excess of the amount due, the trust is not obligated to return the overpayment, but net profits income payable to the trust for the next month will be reduced by the overpayment, plus interest at the prime rate.

Approximately 20 of the underlying royalty interests in the San Juan Basin burden working interests in properties operated by XTO Energy. XTO Energy also operates the Penwell Unit, following its acquisition of an additional interest in this unit in August 2004. XTO Energy's original interest in the Penwell Unit is one of the properties underlying the Texas 75% net profits interests. Other than these properties, XTO Energy does not operate or control any of the underlying properties or related working interests.

As a working interest owner, XTO Energy can generally decline participation in any operation and allow consenting parties to conduct such operations, as provided under the operating agreements. XTO Energy also can assign, sell, or otherwise transfer its interest in the underlying properties, subject to the net profits interests, or can abandon an underlying property that is a working interest if it is incapable of producing in paying quantities, as determined by XTO Energy.

To the extent allowed, XTO Energy is responsible for marketing its production from the underlying properties under existing sales contracts or new arrangements on the best terms reasonably obtainable in the circumstances.

Net profits income received by the trust on or before the last business day of the month is generally attributable to oil production two months prior and gas production three months prior. The monthly distribution amount to unitholders is determined by:

Adding

- (1) net profits income received,
- (2) estimated interest income to be received on the monthly distribution amount, including an adjustment for the difference between the estimated and actual interest received for the prior monthly distribution amount,
- (3) cash available as a result of reduction of cash reserves, and
- (4) other cash receipts, then

Subtracting

- (1) liabilities paid and
- (2) the reduction in cash available due to establishment of or increase in any cash reserve.

The monthly distribution amount is distributed to unitholders of record within ten business days after the monthly record date. The monthly record date is generally the last business day of the month. The trustee calculates the monthly distribution amount and announces the distribution

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per unit at least ten days prior to the monthly record date.

The trustee may establish cash reserves for contingencies. Cash held for such reserves, as well as for pending payment of the monthly distribution amount may be invested in federal obligations or certificates of deposit of major banks.

The trustee's function is to collect the net profits income from the net profits interests, to pay all trust expenses and pay the monthly distribution amount to unitholders. The trustee's powers are specified by the terms

of the indenture. The trust cannot engage in any business activity or acquire any assets other than the net profits interests and specific short-term cash investments. The trust has no employees since all administrative functions are performed by the trustee.

Approximately 59% of the net profits income received by the trust during 2008, as well as 77% of the estimated proved reserves of the net profits interests at December 31, 2008 (based on estimated future net cash flows using year-end oil and gas prices), is attributable to natural gas. There is generally a greater demand for gas during the winter. Otherwise, trust income is not subject to seasonal factors, nor dependent upon patents, licenses, franchises or concessions. The trust conducts no research activities.

Item 1A. Risk Factors

The following factors, among others, could cause actual results to differ materially from those contained in forward-looking statements made in this report and presented elsewhere by the trustee from time to time. Such factors, among others, may have a material adverse effect upon the trust's financial condition, distributable income and changes in trust corpus.

The following discussion of risk factors should be read in conjunction with the financial statements and related notes included in the trust's annual report to unitholders for the year ended December 31, 2008. Because of these and other factors, past financial performance should not be considered an indication of future performance.

The market price for the trust units may not reflect the value of the net profits interests held by the trust.

The public trading price for the trust units tends to be tied to the recent and expected levels of cash distributions on the trust units. The amounts available for distribution by the trust vary in response to numerous factors outside the control of the trust or XTO Energy, including prevailing prices for oil and natural gas produced from the underlying properties. The market price of the trust units is not necessarily indicative of the value that the trust would realize if the net profits interests were sold to a third party buyer. In addition, such market price is not necessarily reflective of the fact that, since the assets of the trust are depleting assets, a portion of each cash distribution paid on the trust units should be considered by investors as a return of capital, with the remainder being considered as a return on investment. There is no guarantee that distributions made to a unitholder over the life of these depleting assets will equal or exceed the purchase price paid by the unitholder.

Oil and natural gas prices fluctuate due to a number of uncontrollable factors, and any decline will adversely affect the net proceeds payable to the trust and trust distributions.

The trust's monthly cash distributions are highly dependent upon the prices realized from the sale of natural gas and, to a lesser extent, oil. Oil and natural gas prices can fluctuate widely on a month-to-month basis in response to a variety of factors that are beyond the control of the trust and XTO Energy. Factors that contribute to price fluctuations include instability in oil-producing regions, worldwide economic conditions, weather conditions, the supply and price of domestic and foreign oil and natural gas, consumer demand, the price and availability of alternative fuels, the proximity to, and capacity of, transportation facilities and the effect of worldwide energy conservation measures. Moreover, government regulations, such as regulation of natural gas transportation and price controls, can affect product prices in the long term. Lower oil and natural gas prices may reduce the amount of oil and natural gas that is economic to produce and will reduce net profits available to the trust. The volatility of energy prices reduces the predictability of future cash distributions to trust unitholders.

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Higher production expense and/or development costs, without concurrent increases in revenue, will directly decrease the net proceeds payable to the trust from the properties underlying the 75% net profits interests.

Production expense and development costs are deducted in the calculation of the trust's share of net proceeds from properties underlying the 75% net profits interests. Accordingly, higher or lower production

expense and development costs, without concurrent changes in revenue, will directly decrease or increase the amount received by the trust for its 75% net profits interests. If development costs and production expense for properties underlying the 75% net profits in a particular state exceed the production proceeds from the properties (as was the case with respect to the properties underlying the Texas working interest in January and February 2009 and properties underlying the Oklahoma working interest in February 2009), the trust will not receive net proceeds for those properties until future proceeds from production in that state exceed the total of the excess costs plus accrued interest during the deficit period. Development activities may not generate sufficient additional revenue to repay the costs.

Proved reserve estimates depend on many assumptions that may turn out to be inaccurate. Any material inaccuracies in reserve estimates or underlying assumptions could cause the quantities and net present value of the reserves to be overstated.

Estimating proved oil and gas reserves is inherently uncertain. Petroleum engineers consider many factors and make assumptions in estimating reserves and future net cash flows. Those factors and assumptions include historical production from the area compared with production rates from similar producing areas, the effects of governmental regulation, assumptions about future commodity prices, production expense and development costs, taxes and capital expenditures, the availability of enhanced recovery techniques and relationships with landowners, working interest partners, pipeline companies and others. Lower oil and gas prices generally cause lower estimates of proved reserves. Ultimately, actual production, revenues and expenditures for the underlying properties will vary from estimates and those variances could be material. Because the trust owns net profits interests, it does not own a specific percentage of the oil and gas reserves. Estimated proved reserves for the net profits interests are based on estimates of reserves for the underlying properties and an allocation method that considers estimated future net proceeds and oil and gas prices. Because trust reserve quantities are determined using an allocation formula, increases or decreases in oil and gas prices can significantly affect estimated reserves of the 75% net profits interests.

Operational risks and hazards associated with the development of the underlying properties may decrease trust distributions.

There are operational risks and hazards associated with the production and transportation of oil and natural gas, including without limitation natural disasters, blowouts, explosions, fires, leakage of oil or natural gas, releases of other hazardous materials, mechanical failures, cratering, and pollution. Any of these or similar occurrences could result in the interruption or cessation of operations, personal injury or loss of life, property damage, damage to productive formations or equipment, damage to the environment or natural resources, or cleanup obligations. The operation of oil and gas properties is also subject to various laws and regulations. Non-compliance with such laws and regulations could subject the operator to additional costs, sanctions or liabilities. The uninsured costs resulting from any of the above or similar occurrences could be deducted as a production expense or development cost in calculating the net proceeds payable to the trust from properties underlying the 75% net profits interests, and would therefore reduce trust distributions by the amount of such uninsured costs.

Cash held by the trustee is not fully insured by the Federal Deposit Insurance Corporation, and future royalty income may be subject to risks relating to the creditworthiness of third parties.

Currently, cash held by the trustee as a reserve for liabilities and for the payment of expenses and distributions to unitholders is invested in Bank of America certificates of deposit which are backed by the good faith of Bank of America, N.A., but are only insured by the Federal Deposit Insurance Corporation up to \$250,000. The trust does not lend money and has limited ability to borrow money, which the trustee believes limits the trust's risk from the current tightening of credit markets. The trust's future royalty income, however, may be subject to risks relating to the creditworthiness of the operators of the underlying properties and other purchasers of the crude oil and natural gas produced from the underlying properties, as well as risks associated with fluctuations in the price of crude oil and natural gas.

Trust unitholders and the trustee have no influence over the operations on, or future development of, the underlying properties.

Because XTO Energy does not operate most of the underlying properties, it is unable to significantly influence the operations or future development of the underlying properties. Neither the trustee nor the trust unitholders can influence or control the operation or future development of the underlying properties. The failure of an operator to conduct its operations or discharge its obligations in a proper manner could have an adverse effect on the net proceeds payable to the trust. Although XTO Energy and the other operators of the underlying properties must adhere to the standard of a prudent operator, they are under no obligation to continue operating the properties. Neither the trustee nor trust unitholders have the right to replace an operator.

The assets of the trust represent interests in depleting assets and, if XTO Energy or any other operators developing the underlying properties do not perform additional successful development projects, the assets may deplete faster than expected. Eventually, the assets of the trust will cease to produce in commercial quantities and the trust will cease to receive proceeds from such assets.

The net proceeds payable to the trust are derived from the sale of depleting assets. Eventually, the properties underlying the trust's net profits interests will cease to produce in commercial quantities and the trust will, therefore, cease to receive any net proceeds therefrom. The reduction in proved reserve quantities is a common measure of the depletion. Future maintenance and development projects on the underlying properties will affect the quantity of proved reserves. The timing and size of these projects will depend on the market prices of oil and natural gas. If XTO Energy or other operators of the properties do not implement additional maintenance and successful development projects, the future rate of production decline of proved reserves may be higher than the rate currently estimated.

Terrorism and continued geopolitical hostilities could adversely affect trust distributions or the market price of the trust units.

Terrorist attacks and the threat of terrorist attacks, whether domestic or foreign, as well as the military or other actions taken in response, cause instability in the global financial and energy markets. Terrorism and other geopolitical hostilities could adversely affect trust distributions or the market price of the trust units in unpredictable ways, including through the disruption of fuel supplies and markets, increased volatility in oil and natural gas prices, or the possibility that the infrastructure on which the operators of the underlying properties rely could be a direct target or an indirect casualty of an act of terror.

XTO Energy may transfer its interest in the underlying properties without the consent of the trust or the trust unitholders.

XTO Energy may at any time transfer all or part of its interest in the underlying properties to another party. Neither the trust nor the trust unitholders are entitled to vote on any transfer of the properties underlying the trust's net profits interests, and the trust will not receive any proceeds of any such transfer. Following any transfer, the transferred property will continue to be subject to the net profits interests of the trust, but the calculation, reporting and remitting of net proceeds to the trust will be the responsibility of the transferee.

XTO Energy or any other operator of any underlying property may abandon the property, thereby terminating the related net profits interest payable to the trust.

XTO Energy or any other operator of the underlying properties, or any transferee thereof, may abandon any well or property without the consent of the trust or the trust unitholders if they reasonably believe that the well or property can no longer produce in commercially economic

quantities. This could result in the termination of the net profits interest relating to the abandoned well or property.

The net profits interests can be sold and the trust would be terminated.

The trust may sell the net profits interests if the holders of 80% or more of the trust units approve the sale or vote to terminate the trust. The trust will terminate if it fails to generate gross proceeds from the underlying

properties of at least \$1,000,000 per year over any consecutive two-year period. Sale of all of the net profits interests will terminate the trust. The net proceeds of any sale must be for cash with the proceeds promptly distributed to the trust unitholders.

Trust unitholders have limited voting rights and have limited ability to enforce the trust's rights against XTO Energy or any other operator of the underlying properties.

The voting rights of a trust unitholder are more limited than those of stockholders of most public corporations. For example, there is no requirement for annual meetings of trust unitholders or for an annual or other periodic re-election of the trustee. Additionally, trust unitholders have no voting rights in XTO Energy.

The trust indenture and related trust law permit the trustee and the trust to sue XTO Energy or operators of the underlying properties to compel them to fulfill the terms of the conveyance of the net profits interests. If the trustee does not take appropriate action to enforce provisions of the conveyance, the recourse of the trust unitholders would likely be limited to bringing a lawsuit against the trustee to compel the trustee to take specified actions. Trust unitholders probably would not be able to sue XTO Energy or any other operator of the underlying properties.

Financial information of the trust is not prepared in accordance with U.S. GAAP.

The financial statements of the trust are prepared on a modified cash basis of accounting, which is a comprehensive basis of accounting other than U.S. generally accepted accounting principles, or U.S. GAAP. Although this basis of accounting is permitted for royalty trusts by the Securities and Exchange Commission, the financial statements of the trust differ from U.S. GAAP financial statements because net profits income is not accrued in the month of production, expenses are not recognized when incurred and cash reserves may be established for certain contingencies that would not be recorded in U.S. GAAP financial statements.

The limited liability of trust unitholders is uncertain.

The trust unitholders are not protected from the liabilities of the trust to the same extent that a shareholder would be protected from a corporation's liabilities. The structure of the trust does not include the interposition of a limited liability entity such as a corporation or limited partnership which would provide further limited liability protection to trust unitholders. While the trustee is liable for any excess liabilities incurred if the trustee fails to insure that such liabilities are to be satisfied only out of trust assets, under the laws of Texas, which are unsettled on this point, a unitholder may be jointly and severally liable for any liability of the trust if the satisfaction of such liability was not contractually limited to the assets of the trust and the assets of the trust and the trustee are not adequate to satisfy such liability. As a result, trust unitholders may be exposed to personal liability. The trust, however, is not liable for production costs or other liabilities of the underlying properties.

Drilling oil and natural gas wells is a high-risk activity and subjects the trust to a variety of factors that it cannot control.

Drilling oil and natural gas wells involves numerous risks, including the risk that commercially productive oil and natural gas reservoirs are not encountered. The presence of unanticipated pressures or irregularities in formations, miscalculations or accidents may cause drilling activities to be unsuccessful. In addition, there is often uncertainty as to the future cost or timing of drilling, completing and operating wells. Further, the development activities may be curtailed, delayed or canceled as a result of a variety of factors, including:

unexpected drilling conditions;
title problems;
restricted access to land for drilling or laying pipeline;
pressure or irregularities in formations;
equipment failures or accidents;
adverse weather conditions; and
costs of, or shortages or delays in the availability of, drilling rigs, tubular materials and equipment.

While these risks do not expose the trust to liabilities of the drilling contractor or operator of the well, they can reduce net proceeds payable to the trust and trust distributions by decreasing oil and gas revenues or increasing production expense or development costs from the underlying properties. Furthermore, these risks may cause the costs of development activities on properties underlying the 75% net profits interests to exceed the revenues therefrom, thereby reducing net proceeds payable to the trust and trust distributions.

The underlying properties are subject to complex federal, state and local laws and regulations that could adversely affect net proceeds payable to the trust and trust distributions.

Extensive federal, state and local regulation of the oil and natural gas industry significantly affects operations on the underlying properties. In particular, oil and natural gas development and production are subject to stringent environmental regulations. These regulations have increased the costs of planning, designing, drilling, installing, operating and abandoning oil and natural gas wells and other related facilities, which costs could reduce net proceeds payable to the trust and trust distributions. These regulations may become more demanding in the future.

Item 1B. Unresolved Staff Comments

As of December 31, 2008, the trust did not have any unresolved Securities and Exchange Commission staff comments.

Item 2. Properties

The net profits interests are the principal asset of the trust. The trustee cannot acquire any other asset, with the exception of certain short-term investments as specified under Item 1. The trustee is prohibited from selling any portion of the net profits interests unless approved by at least 80% of the unitholders or at such time as trust gross revenue is less than \$1 million for two successive years.

The net profits interests comprise:

the 90% net profits interests which are carved from:

- a) producing royalty and overriding royalty interest properties in Texas, Oklahoma and New Mexico, and
- b) 11.11% nonparticipating royalty interests in nonproducing properties located primarily in Texas and Oklahoma; and

the 75% net profits interests which are carved from working interests in four properties in Texas and three properties in Oklahoma.

All underlying royalties, underlying nonproducing royalties and underlying working interest properties are currently owned by XTO Energy. XTO Energy may sell all or any portion of the underlying properties at any time, subject to and burdened by the net profits interests.

Producing Acreage, Wells and Drilling

Underlying Royalties. The underlying royalties are royalty and overriding royalty interests primarily located in mature producing oil and gas fields. The most significant producing region in which the underlying royalties are located is the San Juan Basin in northwestern New Mexico. The trust's estimated proved gas reserves from this region totaled 20.8 Bcf at December 31, 2008, or approximately 81% of trust total gas reserves at that date. XTO Energy estimates that underlying royalties in the San Juan Basin include more than 3,900 gross (approximately 40 net) wells, covering over 60,000 gross acres. Approximately half of these wells are operated by BP America Production Company or ConocoPhillips. Production from conventional gas wells is primarily from the Dakota, Mesaverde and Pictured Cliffs formations.

Most of the trust's San Juan Basin gas has been approved for increased density drilling. In 1999, the Mesaverde was approved for increased density drilling, and in 2002 the Fruitland Coal was approved for increased density drilling, which doubled the number of drill wells allowed per spacing unit. XTO Energy has advised the trustee that the trust has received net proceeds from additional development wells in recent years and that it believes operators will continue to pursue increased density drilling, but the potential effect on the trust is unknown.

Eastward pipeline capacity was added in the San Juan Basin in the recent past, reducing the dependence of this gas on California markets and effectively increasing San Juan Basin gas prices in relation to prices from other regions. Gas-powered electricity generation is increasing in the southwest, and future pipelines are being discussed.

The underlying royalties also include royalties in the Sand Hills field of Crane County, Texas. Most of these properties are operated by major operators. The Sand Hills field was discovered in 1931 and includes production from three main intervals, the Tubb, McKnight and Judkins. Development potential for the field includes recompletions and additional infill drilling.

The underlying royalties contain approximately 462,000 gross (approximately 26,000 net) producing acres. Well counts for the underlying royalties cannot be provided because information regarding the number of wells on royalty properties is generally not made available to royalty interest owners.

Underlying Working Interest Properties. The underlying working interest properties, detailed below, are developed properties undergoing secondary or tertiary recovery operations:

Unit	County/State	Operator	Ownership of XTO Energy	
			Working Interest	Revenue Interest
North Cowden	Ector/Texas	Occidental Permian, Ltd.	1.7%	1.4%
North Central Levelland	Hockley/Texas	Apache Corporation	3.2%	2.1%
Penwell	Ector/Texas	XTO Energy Inc.	5.2%	4.6%
Sharon Ridge Canyon	Borden/Texas	Occidental Permian, Ltd.	4.3%	2.8%
Hewitt	Carter/Oklahoma	ExxonMobil Corporation	11.3%	9.9%
Wildcat Jim Penn	Carter/Oklahoma	Noble Energy Production, Inc.	8.6%	7.5%
South Graham Deese	Carter/Oklahoma	Linn Energy, LLC	9.2%	8.7%

The underlying working interest properties consist of 60,154 gross (2,290 net) producing acres. As of December 31, 2008, there were 1,523 gross (70.5 net) productive oil wells and no wells in process of drilling on these properties. Total wells drilled were three gross (0.3 net) wells in 2008, eleven gross (0.4 net) wells in 2007 and nine gross (0.2 net) wells in 2006.

Oil and Natural Gas Production

Trust production is recognized in the period net profits income is received, which is the month following receipt by XTO Energy, and generally two months after the time of oil production and three months after gas production. Oil and gas production and average sales prices attributable to the underlying properties and the net profits interests for the three years ended December 31, 2008 were as follows:

	90% Net Profits Interests			75% Net Profits Interests			Total		
	2008	2007	2006	2008	2007	2006	2008	2007	2006
Production									
<i>Underlying Properties</i>									
Oil Sales (Bbls)	68,345	72,140	80,992	155,951	174,826	189,120	224,296	246,966	270,112
Average per day (Bbls)	187	198	222	426	479	518	613	677	740
Gas Sales (Mcf)	2,017,442	2,288,853	2,577,732	61,908	79,064	88,745	2,079,350	2,367,917	2,666,477
Average per day (Mcf)	5,512	6,271	7,062	169	216	243	5,681	6,487	7,305
<i>Net Profits Interests</i>									
Oil Sales (Bbls)	59,597	62,547	69,469	69,444	48,760	73,598	129,041	111,307	143,067
Average per day (Bbls)	163	171	190	190	134	202	353	305	392
Gas Sales (Mcf)	1,799,599	2,053,924	2,300,325	25,548	18,955	29,278	1,825,147	2,072,879	2,329,603
Average per day (Mcf)	4,917	5,627	6,302	70	52	80	4,987	5,679	6,382
Average Sales Price									
Oil (per Bbl)	\$100.53	\$59.95	\$58.62	\$99.31	\$59.60	\$59.23	\$99.68	\$59.70	\$59.05
Gas (per Mcf)	\$11.84	\$8.13	\$8.97	\$7.15	\$4.70	\$3.63	\$11.70	\$8.01	\$8.79

Nonproducing Acreage

The underlying nonproducing royalties contain approximately 200,000 gross (approximately 3,000 net) acres in Texas, Oklahoma and New Mexico which were nonproducing at the date of the trust's creation. The trust is entitled to 10% of oil and gas production attributable to the underlying mineral interests, but is not entitled to delay rental payments or lease bonuses. There has been no significant development of such nonproducing acreage since the trust's creation.

Pricing and Sales Information

Oil and gas are generally sold from the underlying properties at market-sensitive prices. The majority of sales from the underlying working interest properties are to major oil and gas companies. Information about purchasers of oil and gas from royalty properties is generally not provided by operators to XTO Energy as a royalty owner, or to the trust.

Oil and Natural Gas Reserves

General

Miller and Lents, Ltd., independent petroleum engineers, has estimated oil and gas reserves attributable to the underlying properties as of December 31, 2008, 2007, 2006 and 2005. The estimated reserves for the underlying properties are then used by XTO Energy to calculate the estimated oil and gas reserves attributable to the net profits interests. Numerous uncertainties are inherent in estimating reserve volumes and values, and such estimates are subject to change as additional information becomes available. The reserves actually recovered and the timing of production of these reserves may be substantially different from the original estimates.

Reserve quantities and revenues for the net profits interests were estimated from projections of reserves and revenues attributable to the combined interests of the trust and XTO Energy in the subject properties. Since the trust has defined net profits interests, the trust does not own a specific percentage of the oil and gas reserve quantities. Accordingly, reserves allocated to the trust pertaining to its 75% net profits interests in the working

interest properties have effectively been reduced to reflect recovery of the trust's 75% portion of applicable production and development costs. Because trust reserve quantities are determined using an allocation formula, any fluctuations in actual or assumed prices or costs will result in revisions to the estimated reserve quantities allocated to the net profits interests.

The standardized measure of discounted future net cash flows and changes in such discounted cash flows as presented below are prepared using assumptions required by the Financial Accounting Standards Board. Such assumptions include the use of year-end prices for oil and gas and year-end costs for estimated future development and production expenditures to produce the proved reserves. Because natural gas prices are influenced by seasonal demand, use of year-end prices, as required by the Financial Accounting Standards Board, may not be the most representative in estimating future revenues or reserve data. Future net cash flows are discounted at an annual rate of 10%. No provision is included for federal income taxes since future net cash flows are not subject to taxation at the trust level.

Estimated costs to plug and abandon wells on the underlying working interest properties at the end of their productive lives have not been deducted from cash flows since this is not a legal obligation of the trust. These costs are the legal obligation of XTO Energy as the owner of the underlying working interests and will only be deducted from net proceeds payable to the trust if net proceeds from the related conveyance exceed such costs when paid, subject to excess cost carryforward provisions as described under Item 1.

Year-end oil prices used to determine the standardized measure were based on a West Texas Intermediate crude oil posted price of \$41.22 per Bbl in 2008, \$92.70 per Bbl in 2007, \$57.75 per Bbl in 2006 and \$57.75 per Bbl in 2005. The year-end weighted average realized gas prices used to determine the standardized measure were \$4.27 per Mcf in 2008, \$6.41 per Mcf in 2007, \$5.01 per Mcf in 2006 and \$7.70 per Mcf in 2005.

Proved Reserves

<i>(in thousands)</i>	Net Profits Interests							
	90% Net		75% Net		Total		Underlying	
	Profits Interests		Profits Interests		Total		Properties	
	Oil (Bbls)	Gas (Mcf)	Oil (Bbls)	Gas (Mcf)	Oil (Bbls)	Gas (Mcf)	Oil (Bbls)	Gas (Mcf)
Balance, December 31, 2005	500.9	28,568.1	1,190.2	504.5	1,691.1	29,072.6	3,299.4	32,941.6
Extensions, additions and discoveries	11.3	873.2	-0-	-0-	11.3	873.2	12.6	970.9
Revisions of prior estimates	87.4	647.3	(247.7)	(135.4)	(160.3)	511.9	(56.6)	635.1
Production	(69.5)	(2,300.3)	(73.6)	(29.3)	(143.1)	(2,329.6)	(270.1)	(2,666.5)
Balance, December 31, 2006	530.1	27,788.3	868.9	339.8	1,399.0	28,128.1	2,985.3	31,881.1
Extensions, additions and discoveries	10.1	1,151.3	-0-	-0-	10.1	1,151.3	11.2	1,279.0
Revisions of prior estimates	27.9	316.5	411.7	135.7	439.6	452.2	356.1	409.7
Production	(62.5)	(2,053.9)	(48.8)	(19.0)	(111.3)	(2,072.9)	(247.0)	(2,367.9)
Balance, December 31, 2007	505.6	27,202.2	1,231.8	456.5	1,737.4	27,658.7	3,105.6	31,201.9
Extensions, additions and discoveries	9.1	915.1	-0-	-0-	9.1	915.1	10.1	1,016.5
Revisions of prior estimates	77.4	(854.6)	(845.6)	(336.1)	(768.2)	(1,190.7)	(772.5)	(1,303.1)
Production	(59.6)	(1,799.6)	(69.4)	(25.5)	(129.0)	(1,825.1)	(224.3)	(2,079.4)

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Balance, December 31, 2008	532.5	25,463.1	316.8	94.9	849.3	25,558.0	2,118.9	28,835.9
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Extensions, additions and discoveries of proved gas reserves are primarily because of development in the San Juan Basin. Revisions of prior estimates are primarily related to changes in year-end prices and costs. See General above. During 2007, payout occurred under the reversion agreement in which 25% of XTO Energy's interest in certain underlying royalties were transferred to a third party when payout occurred. As a result, the December 31, 2008 and 2007 proved reserves for the underlying properties attributable to the 90% net profits interest have been reduced to reflect payout. Previously, December 31, 2005 and 2006, proved reserves for the underlying properties and attributable to the 90% net profits interests were reduced to reflect anticipated payout under the reversion agreement. See Reversion Agreement below.

Proved Developed Reserves

<i>(in thousands)</i>	Net Profits Interests							
	90% Net		75% Net		Total		Underlying	
	Profits Interests		Profits Interests		Total		Properties	
	Oil (Bbls)	Gas (Mcf)	Oil (Bbls)	Gas (Mcf)	Oil (Bbls)	Gas (Mcf)	Oil (Bbls)	Gas (Mcf)
December 31, 2005	500.9	28,568.1	1,190.2	504.5	1,691.1	29,072.6	3,299.4	32,941.6
December 31, 2006	530.1	27,788.3	866.9	335.3	1,397.0	28,123.6	2,974.8	31,857.4
December 31, 2007	505.6	27,202.2	1,229.1	450.3	1,734.7	27,652.5	3,098.5	31,185.8
December 31, 2008	532.5	25,463.1	315.9	92.9	848.4	25,556.0	2,114.2	28,825.3

Standardized Measure of Discounted Future Net Cash Flows from Proved Reserves

<i>(in thousands)</i>	90% Net			75% Net			Total		
	Profits Interests			Profits Interests			Total		
	December 31			December 31			December 31		
	2008	2007	2006	2008	2007	2006	2008	2007	2006
Net Profits Interests									
Future cash inflows	\$ 128,401	\$ 220,416	\$ 166,093	\$ 11,759	\$ 110,659	\$ 48,802	\$ 140,160	\$ 331,075	\$ 214,895
Future production taxes	(10,681)	(17,674)	(14,698)	(736)	(7,240)	(3,577)	(11,417)	(24,914)	(18,275)
Future net cash flows	117,720	202,742	151,395	11,023	103,419	45,225	128,743	306,161	196,620
10% discount factor	(60,109)	(106,209)	(77,841)	(4,161)	(54,651)	(21,391)	(64,270)	(160,860)	(99,232)
Standardized measure	\$ 57,611	\$ 96,533	\$ 73,554	\$ 6,862	\$ 48,768	\$ 23,834	\$ 64,473	\$ 145,301	\$ 97,388
Underlying Properties									
Future cash inflows							\$ 199,671	\$ 473,361	\$ 319,605

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Future production costs	(54,174)	(110,200)	(91,088)
Future net cash flows	145,497	363,161	228,517
10% discount factor	(72,335)	(190,878)	(115,013)
Standardized measure	\$ 73,162	\$ 172,283	\$ 113,504

Changes in Standardized Measure of Discounted Future Net Cash Flows from Proved Reserves

<i>(in thousands)</i>	90% Net			75% Net			Total		
	Profits Interests			Profits Interests					
	2008	2007	2006	2008	2007	2006	2008	2007	2006
<i>Net Profits Interests</i>									
Standardized measure, January 1	\$ 96,533	\$ 73,554	\$ 108,315	\$ 48,768	\$ 23,834	\$ 32,295	\$ 145,301	\$ 97,388	\$ 140,610
Extensions, additions and discoveries	1,918	3,788	2,626	-0-	-0-	-0-	1,918	3,788	2,626
Accretion of discount	8,087	6,133	9,036	4,174	2,101	2,845	12,261	8,234	11,881
Revisions of prior estimates, changes in price and other	(25,333)	30,411	(25,383)	(39,285)	25,669	(7,090)	(64,618)	56,080	(32,473)
Net profits income	(23,594)	(17,353)	(21,040)	(6,795)	(2,836)	(4,216)	(30,389)	(20,189)	(25,256)
Standardized measure, December 31	\$ 57,611	\$ 96,533	\$ 73,554	\$ 6,862	\$ 48,768	\$ 23,834	\$ 64,473	\$ 145,301	\$ 97,388
<i>Underlying Properties</i>									
Standardized measure, January 1							\$ 172,283	\$ 113,504	\$ 163,410
Revisions:									
Prices and costs							(69,652)	66,041	(39,501)
Quantity estimates							(9,421)	4,117	2,645
Accretion of discount							14,551	9,610	13,834
Future development costs							(1,451)	(2,151)	(783)
Other							(4)	16	(19)
Net revisions							(65,977)	77,633	(23,824)
Extensions, additions and discoveries							2,132	4,209	2,918
Production							(36,729)	(25,262)	(29,724)
Development costs							1,453	2,199	724