



Cross Timbers Royalty Trust (CRT)

Updated June 2nd, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	\$7.40	5 Year CAGR Estimate:	7.9%	Market Cap:	\$43 M
Fair Value Price:	\$6.30	5 Year Growth Estimate:	0.0%	Ex-Dividend Date:	5/28/20
% Fair Value:	117%	5 Year Valuation Multiple Estimate:	-3.2%	Dividend Payment Date:	6/12/20
Dividend Yield:	12.2%	5 Year Price Target	\$6.30	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	B	Last Dividend Increase:	N/A

Overview & Current Events

Cross Timbers Royalty Trust (CRT) is a medium sized oil and gas trust (about 50/50), set up in 1991 by XTO Energy. It is a combination trust: unit holders have a 90% net profit interest in *producing properties* in Texas, Oklahoma, and New Mexico; and a 75% net profit interest in *working interest properties* in Texas and Oklahoma. A working interest property is one where the unit holder shares in production expense and development cost. This means that should development costs exceed profits no further profits will be paid from these properties until excess costs have been recovered.

The trust's assets are static in that no further properties can be added. The trust has no operations but is merely a pass-through vehicle for the royalties. CRT had royalty income of \$9.1 million in 2018 and \$5.9 million in 2019.

In mid-May, CRT reported (5/11/20) financial results for the first quarter of fiscal 2020. Its net profits increased 51%, from \$1.3 million in last year's quarter to \$2.0 million, thanks to higher production of oil and gas and a higher realized oil price. The latter is surprising given the slump of the oil price in the first quarter but CRT obviously hedged part of its output before the decrease of the oil price took place. The trust does not provide any guidance for the running year.

In the first five months of this year, CRT offered markedly generous dividends, as it distributed total dividends of \$0.44. If the trust maintained this rate for the full year, it would offer an annual dividend of \$1.06, which would correspond to a dividend yield of 14.3% at the current stock price. However, CRT is likely to be adversely affected by the suppressed oil prices that have resulted from the coronavirus crisis. We thus expect dividends of only \$0.90 this year.

Growth on a Per-Unit Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
DCFU	\$2.788	\$2.993	\$2.482	\$2.315	\$2.658	\$1.355	\$1.061	\$1.009	\$1.426	\$0.87	\$0.90	\$0.90
DPU	\$2.788	\$2.993	\$2.482	\$2.315	\$2.658	\$1.355	\$1.061	\$1.009	\$1.426	\$0.87	\$0.90	\$0.90
Units¹	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0

Essentially all the royalty income (cash) the trust receives is passed through to unit holders. The trust has generated an average distributable and distributed cash flow of \$2.00/unit annually for the past 10 years, though with a noticeable decrease in the past five years (especially last year). The distribution trend essentially parallels the trend in natural gas prices. As the production volume of CRT may continue decreasing in the upcoming years, we have assumed no growth.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
P/DCFU	13.2	14.8	15.3	12.2	8.8	11.2	14.6	16.2	9.0	12.3	8.2	7.0
Avg. Yld.	7.6%	6.7%	6.5%	8.2%	11.4%	8.9%	6.8%	6.2%	11.1%	8.1%	12.2%	14.3%

The trust's DCFU price multiple has averaged 12.8 over the past 10 years. CRT is now trading at a much lower valuation multiple of 8.2 but we assume a fair valuation multiple of 7.0 for the trust due to its non-growth nature and our natural

¹ Average Weighted Unit count is in millions.

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expectations for declining production volumes in the long run. If CRT trades at our assumed fair valuation level in five years, it would incur a -3.2% annualized drag in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

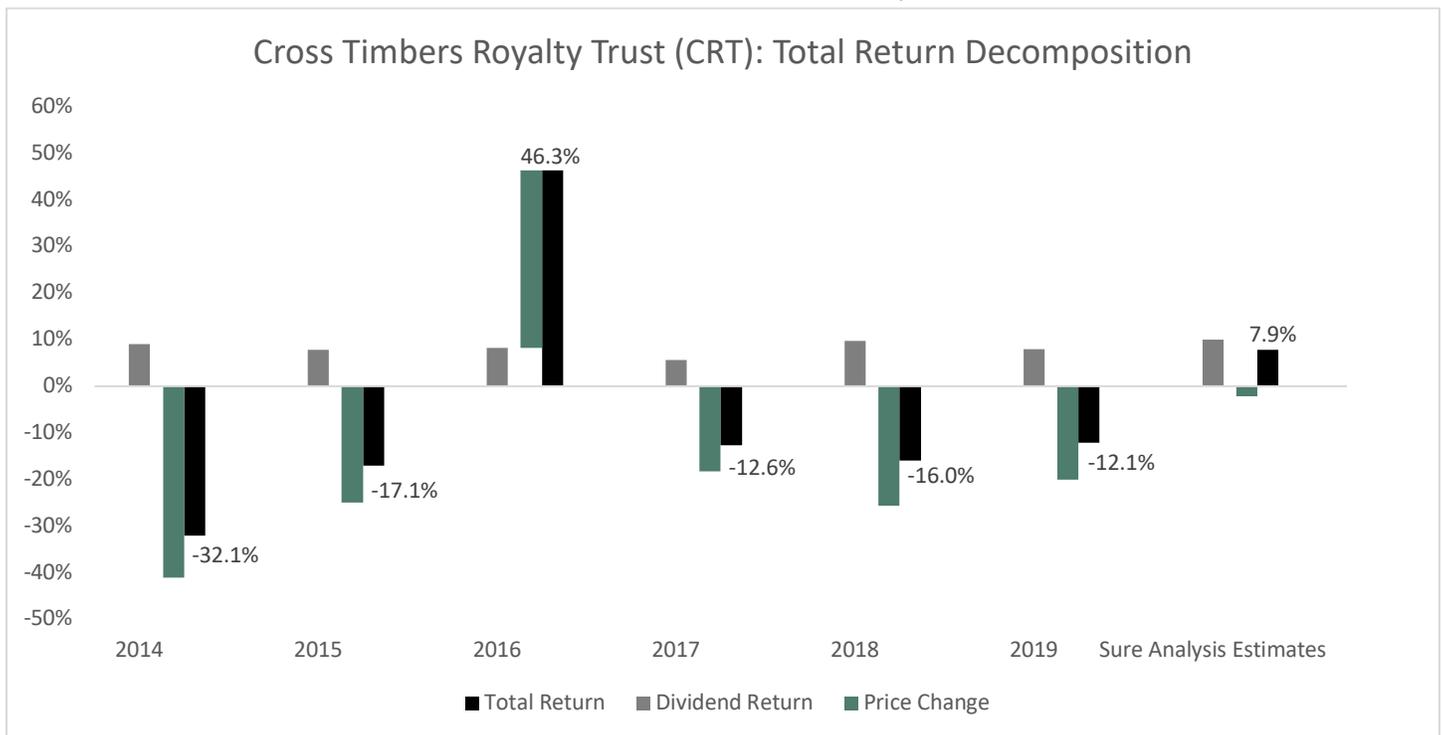
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

On the positive side, the trust has been in continuous existence for 29 years paying an average 8.0% yield in the last decade (albeit with some volatility in the distributions). However, future distributions are highly unpredictable due to the absence of any guidance and the unknown path of oil and gas prices. If oil and gas prices recover towards last year's levels, the trust could continue paying a nice dividend and the unit price may maintain its recent gains – unless investors sense that reserves are beginning to dry up. If oil and gas prices increase, then the trust should do well (higher distributions, higher unit price) and extend its life – since the producer will have an incentive to apply ever-evolving technology to squeeze that extra volume out of the fields. On the other hand, if the downturn from the pandemic lasts longer than currently anticipated, the trust is likely to exhibit poor performance.

Final Thoughts & Recommendation

CRT slumped dramatically early this year due to the spread of the coronavirus and the resultant collapse of the oil price. However, the trust has nearly doubled off its recent bottom and hence it has become less attractive. We expect the pandemic to attenuate starting next year and thus we expect CRT to offer a 7.9% average annual return over the next five years, primarily thanks to its 12.2% dividend yield. However, this expected return is not adequate to compensate for the inherent risk of the trust and its material downside risk in the event the pandemic lasts longer than currently expected. We thus lower the rating of CRT from “buy” to “hold”.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	17	18	15	14	16	9	8	7	9	6
Gross Margin	0	0	0	0	1	0	0	1	1	1
SG&A Exp.	2	---	---	---	1	0	1	1	---	---
D&A Exp.	17	18	15	14	16	8	6	6	9	5
Operating Profit	97.6%	97.7%	97.4%	97.2%	96.9%	91.5%	84.1%	91.3%	93.5%	88.2%
Operating Margin	17	18	15	14	16	8	6	6	9	5
Net Profit	97.6%	97.7%	97.4%	97.2%	96.9%	91.5%	84.4%	91.4%	93.7%	88.6%
Net Margin	15	---	---	---	15	8	6	5	---	---
Distr. Cash Flow	17	18	15	14	16	9	8	7	9	---

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	16	15	14	13	12	12	11	11	10	10
Total Liabilities	1	1	1	1	1	1	2	1	2	2
Partner's Equity	15	13	13	12	11	11	10	9	9	8

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	100.8%	118%	105%	104%	127%	68.4%	55.4%	54.5%	81.9%	53.1%
Return on Equity	108.9%	129%	115%	114%	140%	75.5%	62.3%	63.0%	96.0%	63.0%
ROIC	108.9%	129%	115%	114%	140%	75.5%	62.3%	63.0%	96.0%	63.0%
Shares Out.	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Revenue/Share	2.86	3.06	2.55	2.38	2.74	1.48	1.26	1.10	1.52	0.99
DCF/Share	2.51	---	---	---	2.52	1.28	0.95	0.91	---	---

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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