



Cross Timbers Royalty Trust (CRT)

Updated August 30th, 2021 by Aristofanis Papadatos

Key Metrics

Current Price:	\$12	5 Year CAGR Estimate:	1.0%	Market Cap:	\$72 M
Fair Value Price:	\$9	5 Year Growth Estimate:	1.0%	Ex-Dividend Date:	8/30/21
% Fair Value:	133%	5 Year Valuation Multiple Estimate:	-5.6%	Dividend Payment Date:	9/15/21
Dividend Yield:	8.3%	5 Year Price Target	\$9.50	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Last Dividend Increase:	N/A

Overview & Current Events

Cross Timbers Royalty Trust (CRT) is an 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 \$5.9 million in 2019 and \$5.3 million in 2020.

In mid-August, CRT reported (8/12/20) financial results for the second quarter of fiscal 2021. Production of oil and gas decreased -6% and -33%, respectively, over last year's quarter due to timing of cash receipts and the natural decline of the fields. However, thanks to the ongoing recovery from the pandemic, the average realized prices of oil and gas jumped 55% and 109%, respectively. As a result, net income grew 50%, from \$0.185 to \$0.278. The trust does not provide any guidance for the running year.

In the first eight months of this year, CRT has offered distributions of \$0.67 per unit. CRT will benefit from the sustained high oil prices thanks to the aggressive production cuts of OPEC and Russia and the massive rollout of vaccines. We have thus raised our forecast for total annual distributions from \$0.84 to \$1.00 per unit.

Growth on a Per-Unit Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
DCFU	\$2.993	\$2.482	\$2.315	\$2.658	\$1.355	\$1.061	\$1.009	\$1.426	\$0.87	\$0.77	\$1.00	\$1.05
DPU	\$2.993	\$2.482	\$2.315	\$2.658	\$1.355	\$1.061	\$1.009	\$1.426	\$0.87	\$0.77	\$1.00	\$1.05
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 \$1.69/unit annually for the past 10 years, though with a noticeable decrease in the past six years (especially in the last three years). The distribution trend essentially parallels the trend in natural gas prices. Moreover, CRT estimates that the rate of natural production decline of its oil and gas properties is 6%-8% per year. This is a significant headwind for future returns. Given the high comparison base formed this year thanks to favorable oil and gas prices, we expect CRT to grow its distributable cash flow by only 1.0% per year on average over the next five years.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
P/DCFU	14.8	15.3	12.2	8.8	11.2	14.6	16.2	9.0	12.3	9.0	12.0	9.0
Avg. Yld.	6.7%	6.5%	8.2%	11.4%	8.9%	6.8%	6.2%	11.1%	8.1%	11.1%	8.3%	11.0%

¹ Average Weighted Unit count is in millions.

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The trust's DCFU price multiple has averaged 12.3 over the past 10 years. CRT is now trading at a valuation multiple of 12.0 but we assume a fair valuation multiple of 9.0 for the trust due to its declining production volume. If CRT trades at our assumed fair valuation level in five years, it will incur a -5.6% annualized drag in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

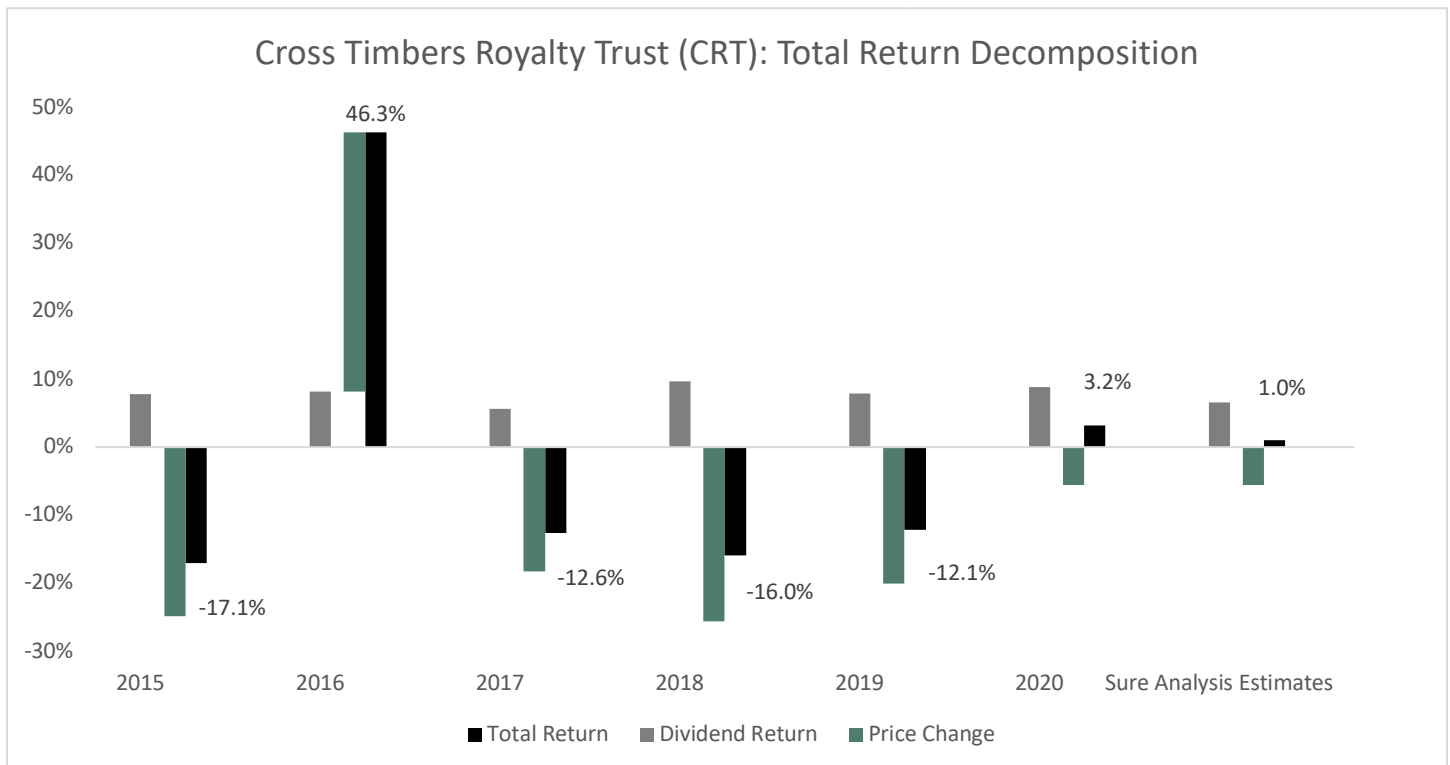
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

On the positive side, the trust has been in continuous existence for 29 years paying an average 8.5% 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 remain around current levels or increase, the trust will continue paying a nice dividend. In such a case, the trust should do well and will be able to extend its life – since the producer will have an incentive to apply ever-evolving technology to squeeze extra volume out of the fields. On the other hand, if oil and gas prices go through a major downturn, the trust is likely to exhibit poor performance.

Final Thoughts & Recommendation

CRT slumped -50% early last year due to the spread of the coronavirus and the resultant collapse of the oil price. However, the pandemic has begun to subside and the prices of oil and gas have returned to pre-COVID levels. Nevertheless, the stock has more than doubled in less than a year and thus it has become much less attractive. We expect CRT to offer a poor average annual return over the next five years and thus we rate the stock as a sell. The 8.3% dividend is certainly attractive, but investors should be aware of the high cyclical nature of oil and gas prices and the long-term decline of the production of CRT.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	18	15	14	16	9	8	7	9	6	5
Gross Margin	0	0	0	1	0	0	1	1	1	1
SG&A Exp.	---	---	---	1	0	0	1	1	1	1
D&A Exp.	18	15	14	16	8	6	6	9	5	5
Operating Profit	97.7%	97.4%	97.2%	96.9%	91.5%	84.1%	91.3%	93.5%	88.2%	88.0%
Operating Margin	18	15	14	16	8	6	6	9	5	5
Net Profit	97.7%	97.4%	97.2%	96.9%	91.5%	84.4%	91.4%	93.7%	88.6%	88.1%
Net Margin	---	---	---	15	8	6	5	---	---	---
Distr. Cash Flow	18	15	14	16	9	8	7	9	---	---

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	15	14	13	12	12	11	11	10	10	9
Total Liabilities	1	1	1	1	1	2	1	2	2	1
Partner's Equity	13	13	12	11	11	10	9	9	8	8

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	118%	105%	104%	127%	68.4%	55.4%	54.5%	81.9%	53.1%	50.4%
Return on Equity	129%	115%	114%	140%	75.5%	62.3%	63.0%	96.0%	63.0%	59.6%
ROIC	129%	115%	114%	140%	75.5%	62.3%	63.0%	96.0%	63.0%	59.6%
Shares Out.	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Revenue/Share	3.06	2.55	2.38	2.74	1.48	1.26	1.10	1.52	0.99	0.88
DCF/Share	---	---	---	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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