# Hugoton
ROYALTY TRUST

FIRST QUARTER REPORT

**2012**

**HUGOTON ROYALTY TRUST** 901 Main Street, 17th Floor, P.O. Box 830650, Dallas, Texas 75283-0650 • (877) 228-5083
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## CONDENSED STATEMENTS OF DISTRIBUTABLE INCOME (UNAUDITED)

| | THREE MONTHS ENDED MARCH 31 | |
|---|---|---|
| | 2012 | 2011 |
| Net Profits Income | $10,073,319 | $13,214,098 |
| Interest Income | 220 | 285 |
| Total Income | 10,073,539 | 13,214,383 |
| Administration Expense | 248,099 | 274,383 |
| **DISTRIBUTABLE INCOME** | **$ 9,825,440** | **$12,940,000** |
| **DISTRIBUTABLE INCOME PER UNIT (40,000,000 UNITS)** | **$ 0.245636** | **$ 0.323500** |

These condensed statements of distributable income should be read in conjunction with the financial statements and notes thereto included in the trust's 2011 annual report. For further information, see the trust's quarterly report on Form 10-Q for the quarter ended March 31, 2012.

Statements in this report to unitholders relating to future plans, predictions, events or conditions are forward-looking statements. All statements other than statements of historical fact included in this report to unitholders, including, without limitation, statements regarding the net profits interests, underlying properties, development activities, annual and monthly development, production and other costs and expenses, monthly development cost deductions, oil and gas prices and differentials to NYMEX prices, supply levels, future drilling, workover and restimulation plans, the outcome of litigation and impact on trust proceeds, distributions to unitholders 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, 2011, which is incorporated by this reference as though fully set forth herein. XTO Energy and the trustee assume no duty to update these statements as of any future date.

# TO UNITHOLDERS:

For the quarter ended March 31, 2012, net profits income was $10,073,319, as compared to $13,214,098 for first quarter 2011. Decreased net profits income is primarily the result of decreased oil and gas production ($2.7 million) and lower gas prices ($1.8 million), partially offset by lower development costs ($0.8 million) and higher oil prices ($0.5 million). See “Net Profits Income” on following page.

After adding interest income of $220 and deducting administration expense of $248,099, distributable income for the quarter ended March 31, 2012 was $9,825,440, or $0.245636 per unit of beneficial interest. Changes in interest income are attributable to fluctuations in net profits income and interest rates. Administration expense for the quarter decreased $26,284 from the prior year quarter. For first quarter 2011, distributable income was $12,940,000, or $0.323500 per unit.

Distributions to unitholders for the quarter ended March 31, 2012 were:

| RECORD DATE | PAYMENT DATE | PER UNIT |
|---|---|---|
| January 31, 2012 | February 14, 2012 | $ 0.082003 |
| February 29, 2012 | March 14, 2012 | 0.085767 |
| March 30, 2012 | April 13, 2012 | 0.077866 |
| **TOTAL** | | **$ 0.245636** |

Individualized tax information is provided annually to unitholders of record. Unitholders owning units in nominee name may obtain monthly tax information from the trustee upon request or from the trust’s web site at www.hugotontrust.com.

This letter, and all communications to unitholders, includes information provided to the trustee by XTO Energy Inc.

**HUGOTON ROYALTY TRUST**

By: U.S. Trust Bank of America
Private Wealth Management, Trustee

By: Nancy G. Willis
Vice President

## 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 and 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.

The following are explanations of significant variances on the underlying properties from first quarter 2011 to first quarter 2012:

## Sales Volumes

Gas sales volumes decreased 8% and oil sales volumes decreased 24% from first quarter 2011 to first quarter 2012. Decreased gas sales volumes are primarily due to natural production decline. Decreased oil sales volumes are primarily due to natural production decline and the timing of cash receipts.

The estimated rate of natural production decline on the underlying oil and gas properties is approximately 6% to 8% a year.

## Sales Prices

**Gas.** The first quarter 2012 average gas price was $4.00 per Mcf, a 9% decrease from the first quarter 2011 average gas price of $4.41 per Mcf. Natural gas prices are affected by the level of North American production, weather, crude oil and natural gas liquids prices, the U.S. economy, storage levels and import levels of liquefied natural gas. Natural gas prices are expected to remain volatile. The first quarter 2012 gas price is primarily related to production from November 2011 through January 2012, when the average NYMEX price was $3.32 per MMBtu. The average NYMEX price for February and March 2012 was $2.56 per MMBtu. At April 18, 2012, the average NYMEX futures price for the following twelve months was $2.61 per MMBtu.

**Oil.** The first quarter 2012 average oil price was $95.36 per Bbl, a 12% increase from the first quarter 2011 average oil price of $85.34 per Bbl. Oil prices are expected to remain volatile. The first quarter 2012 oil price is primarily related to production from November 2011 through January 2012, when the average NYMEX price was $98.53 per Bbl. The average NYMEX price for February and March 2012 was $104.32 per Bbl. At April 18, 2012, the average NYMEX futures price for the following twelve months was $104.13 per Bbl.

## Costs

**Taxes, Transportation and Other.** Taxes, transportation and other decreased 11% for the first quarter primarily because of decreased oil and gas production taxes and other deductions related to lower oil and gas revenues.

**Production.** Production expense increased 7% for the first quarter primarily because of increased labor, fuel, compressor and repairs and maintenance costs, partially offset by decreased insurance costs.

**Development.** Development costs deducted in the calculation of net profits income are based primarily on the current level of development expenditures and the development budget. These development costs for first quarter 2012 decreased 41% the prior year quarter primarily because of decreased development activity.

As of December 31, 2011, cumulative budgeted costs exceeded cumulative actual costs by approximately $2.4 million. In calculating net profits income for the quarter ended March 31, 2012, XTO Energy deducted budgeted development costs of $1.5 million. After considering actual development costs of $1.8 million for the quarter, cumulative budgeted costs deducted exceeded actual costs by $2.1 million. First quarter actual development costs primarily relate to disbursements for development activity in fourth quarter 2011.

XTO Energy has advised the trustee that total 2012 budgeted development costs for the underlying properties are between $8 million and $9 million. The 2012 budget year generally coincides with the trust distribution months from April 2012 through March 2013. The monthly development cost deduction will be reevaluated by XTO Energy and revised as necessary, based on the 2012 budget and the timing and amount of actual expenditures.

**Contingencies.** An amended petition for a class action lawsuit, *Beer, et al. v. XTO Energy Inc.*, was filed in January 2006 in the District Court of Texas County, Oklahoma by certain royalty owners of natural gas wells in Oklahoma and Kansas. The plaintiffs allege that XTO Energy has not properly accounted to the plaintiffs for the royalties to which they are entitled and seek an accounting regarding the natural gas and other products produced from their wells and the prices paid for the natural gas and other products produced, and for payment of the monies allegedly owed since June 2002, with a certain limited number of plaintiffs claiming monies owed for additional time. XTO Energy removed the case to federal district court in Oklahoma City. In April 2010, new counsel and representative parties, Fankhouser and Goddard, filed a motion to intervene and prosecute the *Beer* class, now styled *Fankhouser v. XTO Energy Inc.* This motion was granted on July 13, 2010. The new plaintiffs and counsel filed an amended complaint asserting new causes of action for breach of fiduciary duties and unjust enrichment. On December 16, 2010, the court certified the class. Cross motions for summary judgment were filed by the parties and ruled on by the court. After consideration of the rulings by the court in March and April of 2012, some benefiting XTO Energy and some benefiting the plaintiffs, and with due regard to the vagaries of litigation and their uncertain outcomes, the parties entered settlement negotiations leading up to trial and reached a tentative settlement of $37 million on April 23, 2012, which requires court approval. The hearing for formal court approval is scheduled for May 23, 2012. Assuming the court approves the settlement, a fairness hearing will be scheduled at a later date. The trust will bear its 80% interest in the settlement, or approximately $29.6 million. This will adversely affect the net proceeds of the trust from Oklahoma and Kansas and will result in costs exceeding revenues on these properties. Based on recent revenue and expense levels, it is expected that costs will exceed revenues for approximately 18 months; however, changes in oil or natural gas prices or expenses could cause the time period to increase or decrease correspondingly. The net profits interest from Wyoming is unaffected and payments will continue to be made from those properties. The settlement is expected to decrease the amount of net profits going forward for the Oklahoma and Kansas properties due to changes in the way costs (such as gathering, compression and fuel) associated with operating the properties will be allocated, resulting in a net gain to the royalty interest owners. This expected net upward revision for the royalty interest owners will reduce applicable net profits to XTO Energy and, correspondingly, to the trust.

In September 2008, a class action lawsuit was filed against XTO Energy styled *Wallace B. Roderick Revocable Living Trust, et al. v. XTO Energy Inc.*, in the District Court of Kearny County, Kansas. XTO Energy removed the case to federal court in Wichita, Kansas. The plaintiffs allege that XTO Energy has improperly taken post-production costs from royalties paid to the plaintiffs from wells located in Kansas, Oklahoma and Colorado. The plaintiffs have filed a motion to certify the class, including only Kansas and Oklahoma wells not part of the Fankhouser matter. After filing the motion to certify, but prior to the class certification hearing, the plaintiff filed a motion to sever the Oklahoma portion of the case so it could be transferred and consolidated with a newly filed class action in

Oklahoma styled *Chieftain Royalty Company v. XTO Energy Inc.* This motion was granted. The Roderick case now comprises only Kansas wells not previously included in the Fankhouser matter. The case was certified as a class action in March 2012. XTO Energy has filed an appeal to the 10th Circuit Court of Appeals concerning the certification.

In December 2010, a class action lawsuit was filed against XTO Energy styled *Chieftain Royalty Company v. XTO Energy Inc.* in Coal County District Court, Oklahoma. XTO Energy removed the case to federal court in the Eastern District of Oklahoma. The plaintiffs allege that XTO Energy wrongfully deducted fees from royalty payments on Oklahoma wells, failed to make diligent efforts to secure the best terms available for the sale of gas and its constituents, and demand an accounting to determine whether they have been fully and fairly paid gas royalty interests. The case expressly excludes those claims and wells being prosecuted in the Fankhouser case. The severed *Roderick* case claims related to the Oklahoma portion of the case were consolidated into *Chieftain*. The case was certified as a class action in April 2012. XTO Energy has filed an appeal to the 10th Circuit Court of Appeals concerning the certification.

XTO Energy has informed the trustee that it believes that XTO Energy has strong defenses to these lawsuits and intends to vigorously defend its position. However, XTO Energy is cognizant of other, similar litigation involving it, such as *Fankhouser*, and other, unrelated entities. As these cases develop XTO Energy will assess its legal position accordingly. If XTO Energy ultimately makes any settlement payments or receives a judgment against it in *Chieftain* or *Roderick*, the trust will bear its 80% share of such settlement or judgment related to production from the underlying properties. Additionally, if the judgment or settlement increases the amount of future payments to royalty owners, the trust would bear its proportionate share of the increased payments through reduced net proceeds. XTO Energy has informed the trustee that, although the amount of any reduction in net proceeds is not presently determinable, in its management's opinion, the amount is not currently expected to be material to the trust's financial position or liquidity though it could be material to the trust's annual distributable income. Additionally, it would result in costs exceeding revenues on the properties underlying the net profit interests of the cases named above, as applicable, for several monthly distributions, depending on the size of the judgment or settlement, if any, and the net proceeds being paid at that time, which would result in the net profits interest being limited until such time that the revenues exceed the costs for those net profit interests.

Certain of the underlying properties are involved in various other lawsuits and certain governmental proceedings arising in the ordinary course of business. XTO Energy has advised the trustee that it does not believe that the ultimate resolution of these claims will have a material effect on the financial position or the liquidity of the trust, but may have an effect on annual distributable income.

## Glossary of Terms

**Bbl** Barrel (of oil)
**Mcf** Thousand cubic feet (of natural gas)
**MMBtu** One million British Thermal Units, a common energy measurement

## CALCULATIONS OF NET PROFITS INCOME

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

| | THREE MONTHS ENDED MARCH 31 (a) 2012 | 2011 | INCREASE (DECREASE) |
|---|---|---|---|
| **SALES VOLUMES** | | | |
| Gas (Mcf) (b) | | | |
| Underlying Properties | 5,193,931 | 5,635,334 | (8%) |
| Average Per Day | 56,456 | 61,254 | (8%) |
| Net Profits Interests | 2,185,611 | 2,628,001 | (17%) |
| Oil (Bbl) (b) | | | |
| Underlying Properties | 51,627 | 68,175 | (24%) |
| Average Per Day | 561 | 741 | (24%) |
| Net Profits Interests | 23,765 | 33,767 | (30%) |
| **AVERAGE SALES PRICES** | | | |
| Gas (per Mcf) | $ 4.00 | $ 4.41 | (9%) |
| Oil (per Bbl) | $ 95.36 | $ 85.34 | 12% |
| **REVENUES** | | | |
| Gas sales | $ 20,787,123 | $ 24,851,264 | (16%) |
| Oil sales | 4,923,178 | 5,818,076 | (15%) |
| **TOTAL REVENUES** | **25,710,301** | **30,669,340** | **(16%)** |
| **COSTS** | | | |
| Taxes, transportation and other | 2,971,051 | 3,321,495 | (11%) |
| Production expenses | 5,955,895 | 5,570,439 | 7% |
| Development costs | 1,500,000 | 2,550,000 | (41%) |
| Overhead | 2,691,706 | 2,709,783 | (1%) |
| **TOTAL COSTS** | **13,118,652** | **14,151,717** | **(7%)** |
| **NET PROCEEDS** | 12,591,649 | 16,517,623 | (24%) |
| **NET PROFITS PERCENTAGE** | 80% | 80% | |
| **NET PROFITS INCOME** | **$ 10,073,319** | **$ 13,214,098** | **(24%)** |

(a) Because of the two-month interval between time of production and receipt of net profits income by the trust, oil and gas sales for the quarter ended March 31 generally represent production for the period November through January.

(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. As product prices change, the trust's share of the production volumes is impacted as the quantity of production to cover expenses in reaching the net profits break-even level changes inversely with price. As such, the underlying property production volume changes may not correlate with the trust's net profit share of those volumes in any given period. Therefore, comparative discussion of oil and gas sales volumes is based on the underlying properties.

## TAX INFORMATION PER UNIT

| | MONTHLY DISTRIBUTIONS PAID ON: ($/UNIT EXCEPT COST DEPLETION FACTORS) | | | |
|---|---|---|---|---|
| | **February 14, 2012** | **March 14, 2012** | **April 13, 2012** | **Total** |
| Gross Income | $ 0.096256 | $ 0.097305 | $ 0.087316 | $0.280877 |
| Less Severance Taxes | (0.010262) | (0.010084) | (0.008698) | (0.029044) |
| Interest Income | 0.000002 | 0.000002 | 0.000002 | 0.000006 |
| Less Administration Expenses | (0.003993) | (0.001456) | (0.000754) | (0.006203) |
| **NET CASH DISTRIBUTION** | **$ 0.082003** | **$ 0.085767** | **$ 0.077866** | **$0.245636** |
| Cost Depletion Factors: | | | | |
| Kansas - 80% | 0.004665 | 0.004418 | 0.003993 | 0.013076 |
| Oklahoma - 80% | 0.005988 | 0.006014 | 0.005890 | 0.017892 |
| Wyoming - 80% | 0.006136 | 0.006661 | 0.004129 | 0.016926 |

## FOR INFORMATION CONTACT:


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