

# Hugoton Royalty Trust



**1<sup>st</sup>**

Quarter Report

**2017**

Hugoton Royalty Trust P.O. Box 962020, Fort Worth, Texas 76162-2020  
855.588.7839 ■ Southwest Bank, Trustee ■ [www.hgt-hugoton.com](http://www.hgt-hugoton.com)

## Condensed Statements of Distributable Income (Unaudited)

	THREE MONTHS ENDED MARCH 31	
	2017	2016
Net Profits Income .....	\$ 2,223,626	\$ 63,562
Interest Income .....	920	82
Total Income.....	2,224,546	63,644
Administration Expense.....	337,866	343,847
Cash Reserves Withheld (Used) For Trust Expenses.....	--	(280,203)
DISTRIBUTABLE INCOME .....	<u>\$ 1,886,680</u>	<u>\$ --</u>
DISTRIBUTABLE INCOME PER UNIT (40,000,000 UNITS) .....	<u>\$ 0.047167</u>	<u>\$ 0.000000</u>

These condensed statements of distributable income should be read in conjunction with the financial statements and notes thereto included in the Trust's 2016 annual report. For further information, see the Trust's quarterly report on Form 10-Q for the quarter ended March 31, 2017.

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 devel-

opment, 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, 2016, 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, 2017, net profits income was \$2,223,626, as compared to \$63,562 for first quarter 2016. The increase in net profits income is primarily the result of increased oil and gas prices (\$4.3 million), decreased production expense (\$0.5 million) and lower overhead (\$0.3 million), partially offset by net excess costs activity (\$1.3 million), decreased oil and gas production (\$0.9 million) and increased taxes, transportation, and other costs (\$0.8 million). See "Net Profits Income" on the following page.

After adding interest income of \$920 and deducting administration expense of \$337,866, distributable income for the quarter ended March 31, 2017 was \$1,886,680, or \$0.047167 per unit of beneficial interest. Administration expense for the quarter decreased \$5,981 from the prior year quarter. Changes in interest income are attributable to fluctuations in net profits income and interest rates. For first quarter 2016, distributable income was \$0 or \$0.000000 per unit.

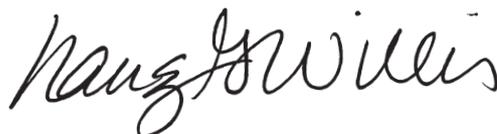
Distributions to unitholders for the quarter ended March 31, 2017 were:

RECORD DATE	PAYMENT DATE	PER UNIT
January 31, 2017	February 14, 2017	\$ 0.008824
February 28, 2017	March 14, 2017	0.014913
March 31, 2017	April 13, 2017	0.023430
TOTAL		<u>\$ 0.047167</u>

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.hgt-hugoton.com](http://www.hgt-hugoton.com).

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

**Hugoton Royalty Trust**  
**By: Southwest Bank, Trustee**



**By: Nancy G. Willis**  
**Vice President**

# First Quarter Report 2017

## 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 2016 to first quarter 2017:

## Sales Volumes

Gas sales volumes decreased 6% for the first quarter primarily due to natural production decline, partially offset by the timing of cash receipts. Oil sales volumes decreased 18% for the first quarter 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 2017 average gas price was \$3.16 per Mcf, a 66% increase from the first quarter 2016 average gas price of \$1.90 per Mcf. The first quarter 2017 gas price is primarily related to production from November 2016 through January 2017, when the average NYMEX price was \$3.31 per MMBtu.

**Oil.** The first quarter 2017 average oil price was \$46.56 per Bbl, a 40% increase from the first quarter 2016 average oil price of \$33.22 per Bbl. The first quarter 2017 oil price is primarily related to production from November 2016 through January 2017, when the average NYMEX price was \$50.19 per Bbl.

## Costs

**Taxes, Transportation and Other.** Taxes, transportation and other increased 88% for the first quarter primarily because of increased production taxes related to higher gas and oil revenues and increased gas deductions related to higher gathering fees.

**Production Expense.** Production expense decreased 13% for the first quarter primarily because of lower repairs and maintenance, labor, chemicals, and compression costs, partially offset by increased water disposal costs.

**Development Costs.** Development costs deducted in the calculation of net profits income for first quarter 2017 decreased 11% from the prior year quarter. Development costs deducted are based on the current level of development expenditures, budgeted future development costs and the cumulative actual costs under (over) previous deductions. Cumulative actual costs exceeded budgeted costs deducted by approximately \$73,000 at March 31, 2017. The monthly development cost deduction will be reevaluated by XTO Energy and revised as necessary.

**Overhead.** Overhead decreased 10% for the first quarter primarily because of lower overhead rates from operated overhead corrections in 2016 and the annual rate adjustment based on an industry index.

## Excess Costs

The following summarizes excess costs activity and cumulative balances by conveyance:

	Underlying		
	KS	WY	Total
Cumulative excess costs remaining at 12/31/16 .....	\$1,049,601	\$1,158,205	\$2,207,806
Net excess costs (recovery) for the quarter ended 3/31/17...	(76,669)	(686,923)	(763,592)
Cumulative excess costs remaining at 3/31/17 .....	\$ 972,932	\$ 471,282	\$1,444,214
	NPI		
	KS	WY	Total
Cumulative excess costs remaining at 12/31/16 .....	\$ 839,681	\$ 926,564	\$1,766,245
Net excess costs (recovery) for the quarter ended 3/31/17...	(61,335)	(549,538)	(610,873)
Cumulative excess costs remaining at 3/31/17 .....	\$ 778,346	\$ 377,026	\$1,155,372

Improved gas prices resulted in the partial recovery of excess costs on properties underlying the Kansas and Wyoming net profits interests for the quarter ended March 31, 2017.

Underlying cumulative excess costs for the Kansas and Wyoming conveyances remaining as of March 31, 2017 totaled \$1,444,214 (NPI \$1,155,372).

### Marketing

XTO Energy has advised the trustee that, effective April 1, 2017, Cross Timbers Energy Services, Inc. (“CTES”), a wholly owned marketing subsidiary of XTO Energy, has assigned all gas sales contracts for production from the underlying properties to XTO Energy. XTO Energy will directly market and sell the gas to third parties. There are no changes to the terms of the contracts related to the assignment and no impact on Trust distributions.

### Contingencies

In December 2010, a royalty 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 was certified as a class action in April 2012; however, on appeal in June 2012, the 10th Circuit Court of Appeals reversed the certification of the class and remanded the case back to the trial court for further proceedings. Pretrial discovery continues.

XTO Energy has informed the trustee that it believes that XTO Energy has strong defenses to the *Chieftain* lawsuit and intends to vigorously defend its position. However, XTO Energy has informed the trustee that it is cognizant of other, similar litigation. 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*, XTO Energy has advised the trustee that the Trust should bear its 80% share of such settlement or judgment, including any future royalty adjustments that would reduce net proceeds. The trustee intends to review any claimed reductions in payment to the Trust based on the facts and circumstances of such

settlement or judgment. In light of a 2014 arbitration decision in which a three panel tribunal decided that the settlement in *Fankhouser v. XTO Energy, Inc.*, including a new royalty calculation for future royalty payments, could not be charged to the Trust, to the extent that the claims in *Chieftain* are similar to those in *Fankhouser* the trustee would likely object to such claimed reductions. Should there be a disagreement as to whether the Trust should bear its share of a settlement or judgment the matter will be resolved by binding arbitration through the American Arbitration Association under the terms of the Indenture creating the Trust. 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, XTO Energy has advised the trustee that any reductions would result in costs exceeding revenues on the properties underlying the net profit interests of the case, 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 profits interests.

Certain of the underlying properties are involved in various other lawsuits and 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 liquidity of the Trust, but may have an effect on annual distributable income.

## Glossary of Terms

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

## Calculation 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 <sup>(a)</sup> 2017	2016	INCREASE (DECREASE)
<b>SALES VOLUMES</b>			
Gas (Mcf) <sup>(b)</sup>			
Underlying Properties.....	3,540,053	3,763,967	(6%)
Average Per Day .....	38,479	40,913	(6%)
Net Profits Interests.....	636,077	28,555	N/A
Oil (Bbls) <sup>(b)</sup>			
Underlying Properties.....	38,705	47,344	(18%)
Average Per Day .....	421	515	(18%)
Net Profits Interests.....	9,940	495	N/A
<b>AVERAGE SALES PRICES</b>			
Gas (per Mcf) .....	\$ 3.16	\$ 1.90	66%
Oil (per Bbl) .....	\$ 46.56	\$ 33.22	40%
<b>REVENUES</b>			
Gas sales .....	\$ 11,189,642	\$ 7,157,625	56%
Oil sales .....	1,802,036	1,572,579	15%
<b>TOTAL REVENUES</b> .....	<b>12,991,678</b>	<b>8,730,204</b>	<b>49%</b>
<b>COSTS</b>			
Taxes, transportation and other.....	2,058,633	1,095,237	88%
Production expense.....	3,950,487	4,546,035	(13%)
Development costs .....	600,000	675,000	(11%)
Overhead .....	2,839,434	3,160,023	(10%)
Excess Costs .....	763,592	(825,543)	N/A
<b>TOTAL COSTS</b> .....	<b>10,212,146</b>	<b>8,650,752</b>	<b>18%</b>
<b>NET PROCEEDS</b> .....	2,779,532	79,452	N/A
<b>NET PROFITS PERCENTAGE</b> .....	80%	80%	
<b>NET PROFITS INCOME</b> .....	<b>\$ 2,223,626</b>	<b>\$ 63,562</b>	<b>N/A</b>

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

(b) Gas and oil sales volumes are allocated to the net profits interests by dividing Trust net cash inflows by average sales prices. As gas and oil

prices change, the Trust's allocated production volumes are impacted as the quantity of production necessary to cover expenses changes inversely with price. As such, the underlying property production volume changes may not correlate with the Trust's allocated production volumes in any given period. Therefore, comparative discussion of gas and oil sales volumes is based on the underlying properties.

## Tax Information Per Unit

	<b>MONTHLY DISTRIBUTIONS PAID ON:</b>			
	<i>(\$/UNIT EXCEPT COST DEPLETION FACTORS)</i>			
	<b>February 14, 2017</b>	<b>March 14, 2017</b>	<b>April 13, 2017</b>	<b>Total</b>
Gross Income.....	\$ 0.014489	\$ 0.022224	\$ 0.028840	\$ 0.065553
Less Severance Taxes .....	(0.002226)	(0.003361)	(0.004376)	(0.009963)
Interest Income.....	0.000007	0.000008	0.000008	0.000023
Less Administration Expenses.....	(0.003446)	(0.003958)	(0.001042)	(0.008446)
Reconciling Items.....	<u>0.000000</u>	<u>0.000000</u>	<u>0.000000</u>	<u>0.000000</u>
NET CASH DISTRIBUTION.....	<u>\$ 0.008824</u>	<u>\$ 0.014913</u>	<u>\$ 0.023430</u>	<u>\$ 0.047167</u>
Cost Depletion Factors:				
Kansas - 80%.....	0.000000	0.000000	0.000000	0.000000
Oklahoma - 80%.....	0.038925	0.052969	0.060739	0.152633
Wyoming - 80% .....	0.000000	0.000000	0.000000	0.000000

## **For information contact:**

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### **Hugoton Royalty Trust**

Southwest Bank, Trustee

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