

SABINE ROYALTY TRUST  
Form 10-Q  
August 07, 2012  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**Form 10-Q**

Quarterly Report Pursuant to Section 13 or 15(d)

of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2012

OR

Transition Report Pursuant to Section 13 or 15(d)

of the Securities Exchange Act of 1934

For the transition period from            to

Commission File Number: 1-8424

**SABINE ROYALTY TRUST**

(Exact name of registrant as specified in its charter)

Texas  
(State or other jurisdiction  
of incorporation or  
organization)

75-6297143  
(I.R.S. Employer  
Identification No.)

U.S. Trust, Bank of America

Private Wealth Management

Bank of America Plaza

Edgar Filing: SABINE ROYALTY TRUST - Form 10-Q

901 Main Street

17th Floor

Dallas, Texas 75202

(Address of principal executive offices)

(Zip Code)

(214) 209-2400

(Registrant's telephone number, including area code)

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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 Rule 12b-2 of the Exchange Act).

Yes  No

Number of units of beneficial interest outstanding at August 7, 2012: 14,579,345

**Table of Contents**

**TABLE OF CONTENTS**

**PART I FINANCIAL INFORMATION**

<u>Item 1. Financial Statements</u>	2
<u>Item 2. Trustee's Discussion and Analysis of Financial Condition and Results of Operations</u>	13
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	17
<u>Item 4. Controls and Procedures</u>	17

**PART II OTHER INFORMATION**

<u>Item 1. Legal Proceedings</u>	18
<u>Item 1A. Risk Factors</u>	18
<u>Item 6. Exhibits</u>	18
<b><u>SIGNATURES</u></b>	19
<u>EX-31</u>	
<u>EX-32</u>	

**Table of Contents**

**SABINE ROYALTY TRUST**

**PART I FINANCIAL INFORMATION**

*Item 1. Financial Statements.*

The condensed financial statements included herein have been prepared by Bank of America, N.A. (as successor to NationsBank, N.A.), as Trustee (the "Trustee") of Sabine Royalty Trust (the "Trust"), pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in annual financial statements have been condensed or omitted pursuant to such rules and regulations, although the Trustee believes that the disclosures are adequate to make the information presented not misleading. The condensed financial statements of the Trust presented herein are unaudited. It is suggested that these condensed financial statements and notes thereto be read in conjunction with the financial statements and notes thereto included in the Trust's latest annual report on Form 10-K. The December 31, 2011 condensed statement of assets, liabilities and trust corpus is derived from the audited statement of assets, liabilities and trust corpus as of that date. In the opinion of the Trustee, all adjustments necessary to present fairly the assets, liabilities and trust corpus of the Trust as of June 30, 2012, the distributable income for the three-month and six-month periods ended June 30, 2012 and 2011 and the changes in trust corpus for the six-month periods ended June 30, 2012 and 2011, have been included. The distributable income for such interim periods is not necessarily indicative of the distributable income for the full year.

The condensed financial statements as of June 30, 2012 and for the three-month and six-month periods ended June 30, 2012 and 2011, included herein, have been reviewed by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their report appearing herein.

**Table of Contents**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Unit Holders of Sabine Royalty Trust and

Bank of America, N.A., Trustee

Dallas, Texas

We have reviewed the accompanying condensed statement of assets, liabilities and trust corpus of Sabine Royalty Trust (the Trust ) as of June 30, 2012, and the related condensed statements of distributable income for the three-month and six-month periods ended June 30, 2012 and 2011 and changes in trust corpus for the six-month periods ended June 30, 2012 and 2011. These interim financial statements are the responsibility of the Trustee.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

As described in Note 2 to the condensed financial statements, these condensed interim financial statements have been prepared on a modified cash basis of accounting which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

Based on our reviews, we are not aware of any material modifications that should be made to such condensed interim financial statements for them to be in conformity with the basis of accounting described in Note 2.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the statement of assets, liabilities, and trust corpus of Sabine Royalty Trust as of December 31, 2011, and the related statements of distributable income and changes in trust corpus for the year then ended (not presented herein); and in our report dated March 2, 2012, we expressed an unqualified opinion on those financial statements. In our opinion, the information set forth in the accompanying condensed statement of assets, liabilities and trust corpus as of December 31, 2011 is fairly stated, in all material respects, in relation to the statement of assets, liabilities, and trust corpus from which it has been derived.

/s/ DELOITTE & TOUCHE LLP

Dallas, TX

August 7, 2012

**Table of Contents****SABINE ROYALTY TRUST****CONDENSED STATEMENTS OF ASSETS, LIABILITIES, AND TRUST CORPUS (UNAUDITED)**

	Note	June 30, 2012	December 31, 2011
<b>Assets</b>			
Cash and short-term investments		<b>\$ 6,037,704</b>	\$ 5,751,947
Royalty interests in oil and gas properties (less accumulated amortization of \$21,926,258 and \$21,890,382 at June 30, 2012 and December 31, 2011)		<b>468,927</b>	504,803
<b>TOTAL</b>		<b>\$ 6,506,631</b>	\$ 6,256,750
<b>Liabilities and Trust Corpus</b>			
Trust expenses payable		<b>\$ 142,234</b>	\$ 172,732
Other payables	4	<b>496,660</b>	329,705
		<b>638,894</b>	502,437
<b>Contingencies</b>			
Trust corpus 14,579,345 units of beneficial interest authorized and outstanding	6	<b>5,867,737</b>	5,754,313
<b>TOTAL</b>		<b>\$ 6,506,631</b>	\$ 6,256,750

The accompanying notes are an integral part of these condensed financial statements.

**Table of Contents**

**SABINE ROYALTY TRUST**

CONDENSED STATEMENTS OF DISTRIBUTABLE INCOME (UNAUDITED)

	Notes	Three Months Ended June 30,	
		2012	2011
Royalty Income		<b>\$ 15,108,143</b>	\$ 16,370,674
Interest Income		<b>2,024</b>	1,361
Total		<b>15,110,167</b>	16,372,035
General and administrative expenses		<b>(810,583)</b>	(681,888)
Distributable Income		<b>\$ 14,299,584</b>	\$ 15,690,147
Distributable Income per unit (14,579,345 units)	1,3,5	\$ .98	\$ 1.08

The accompanying notes are an integral part of these condensed financial statements.

**Table of Contents****SABINE ROYALTY TRUST****CONDENSED STATEMENTS OF DISTRIBUTABLE INCOME (UNAUDITED)**

		Six Months Ended June 30,	
	Notes	2012	2011
Royalty Income		<b>\$ 30,319,145</b>	\$ 30,048,301
Interest Income		<b>3,744</b>	2,250
Total		<b>30,322,889</b>	30,050,551
General and administrative expenses		<b>(1,372,090)</b>	(1,186,468)
Distributable Income		<b>\$ 28,950,799</b>	\$ 28,864,083
Distributable Income per unit (14,579,345 units)	1,3,5	\$ <b>1.99</b>	\$ 1.98

The accompanying notes are an integral part of these condensed financial statements.

**Table of Contents**

**SABINE ROYALTY TRUST**

CONDENSED STATEMENTS OF CHANGES IN TRUST CORPUS (UNAUDITED)

		Six Months Ended June 30,	
	Note	2012	2011
Trust corpus, beginning of period		\$ 5,754,313	\$ 5,086,272
Amortization of royalty interests		(35,876)	(37,766)
Distributable income		28,950,799	28,864,083
Distributions	3	(28,801,499)	(27,460,343)
Trust corpus, end of period		\$ 5,867,737	\$ 6,452,246
Distributions per unit (14,579,345 units)	3	\$ 1.98	\$ 1.88

The accompanying notes are an integral part of these condensed financial statements.

---

**Table of Contents**

**SABINE ROYALTY TRUST**

**NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)**

**1. TRUST ORGANIZATION AND PROVISIONS**

Sabine Royalty Trust (the "Trust") was established by the Sabine Corporation Royalty Trust Agreement (the "Trust Agreement"), made and entered into effective as of December 31, 1982, to receive a distribution from Sabine Corporation ("Sabine") of royalty and mineral interests, including landowner's royalties, overriding royalty interests, minerals (other than executive rights, bonuses and delay rentals), production payments and any other similar, nonparticipatory interests, in certain producing and proved undeveloped oil and gas properties located in Florida, Louisiana, Mississippi, New Mexico, Oklahoma and Texas (the "Royalties").

Certificates evidencing units of beneficial interest (the "Units") in the Trust were mailed on December 31, 1982 to Sabine's shareholders of record on December 23, 1982, on the basis of one Unit for each share of Sabine's outstanding common stock. In May 1988, Sabine was acquired by Pacific Enterprises ("Pacific"), a California corporation. Through a series of mergers, Sabine was merged into Pacific Enterprises Oil Company (USA) ("Pacific (USA)"), a California corporation and a wholly owned subsidiary of Pacific, effective January 1, 1990. This acquisition and the subsequent mergers had no effect on the Units. Pacific (USA), as successor to Sabine, has assumed by operation of law all of Sabine's rights and obligations with respect to the Trust. The Units are listed and traded on the New York Stock Exchange.

In connection with the transfer of the Royalties to the Trust upon its formation, Sabine had reserved to itself all executive rights, including rights to execute leases and to receive bonuses and delay rentals. In January 1993, Pacific (USA) completed the sale of substantially all its producing oil and gas assets to a third party. The sale did not include executive rights relating to the Royalties, and Pacific (USA)'s ownership of such rights was not affected by the sale.

Bank of America, N.A. (the "Trustee"), acts as 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-Q to U.S. Trust, Bank of America Private Wealth Management shall describe the legal entity Bank of America, N.A. The terms of the Trust Agreement provide, among other things, that:

The Trust shall not engage in any business or commercial activity of any kind or acquire assets other than those initially transferred to the Trust.

The Trustee may not sell all or any part of its assets unless approved by the holders of a majority of the outstanding Units in which case the sale must be for cash and the proceeds, after satisfying all existing liabilities, promptly distributed to Unit holders.

The Trustee may establish a cash reserve for the payment of any liability that is contingent or uncertain in amount or that otherwise is not currently due or payable.

The Trustee will use reasonable efforts to cause the Trust and the Unit holders to recognize income and expenses on monthly record dates.

The Trustee is authorized to borrow funds to pay liabilities of the Trust provided that such borrowings are repaid in full before any further distributions are made to Unit holders.

The Trustee will make monthly cash distributions to Unit holders of record on the monthly record date (see Note 3).



**Table of Contents**

Because of the passive nature of the Trust and the restrictions and limitations on the powers and activities of the Trustee contained in the Trust Agreement, the Trustee does not consider any of the officers and employees of the Trustee to be officers or executive officers of the Trust as such terms are defined under applicable rules and regulations adopted under the Securities Exchange Act of 1934.

The proceeds of production from the Royalties are receivable from hundreds of separate payors. In order to facilitate creation of the Trust and to avoid the administrative expense and inconvenience of daily reporting to Unit holders, the conveyances by Sabine of the Royalties located in five of the six states provided for the execution of an escrow agreement by Sabine and the initial trustee of the Trust, in its capacities as trustee of the Trust and as escrow agent. The conveyances by Sabine of the Royalties located in Louisiana provided for the execution of a substantially identical escrow agreement by Sabine and a Louisiana bank in the capacities of escrow agent and of trustee under the name of Sabine Louisiana Royalty Trust. Sabine Louisiana Royalty Trust, the sole beneficiary of which is the Trust, was established in order to avoid uncertainty under Louisiana law as to the legality of the Trustee's holding record title to the Royalties located in Louisiana. The Trust now only has one escrow agent, which is the Trustee, and a single escrow agreement.

Pursuant to the terms of the escrow agreement and the conveyances of the properties by Sabine, the proceeds of production from the Royalties for each calendar month, and interest thereon, are collected by the Trustee, as escrow agent, and are paid to and received by the Trust only on the next monthly record date. The Trustee, as escrow agent, has agreed to endeavor to assure that it incurs and pays expenses and fees for each calendar month only on the next monthly record date. The Trust Agreement also provides that the Trustee is to endeavor to assure that income of the Trust will be accrued and received and expenses of the Trust will be incurred and paid only on each monthly record date. Assuming that the escrow agreement is recognized for federal income tax purposes and that the Trustee is able to control the timing of income and expenses, as stated above, cash and accrual basis Unit holders should be treated as realizing income only on each monthly record date. The Trustee is treating the escrow agreement as effective for federal income tax purposes. However, for financial reporting purposes, royalty and interest income are recorded in the calendar month in which the amounts are received by either the escrow agent or the Trust.

Distributable income as determined for financial reporting purposes for a given quarter will not usually equal the sum of distributions made during that quarter. Distributable income for a given quarter will approximate the sum of the distributions made during the last two months of such quarter and the first month of the next quarter.

## **Table of Contents**

### **2. ACCOUNTING POLICIES**

#### **Basis of Accounting**

The financial statements of the Trust are prepared on the following basis and are not intended to present financial position and results of operations in conformity with accounting principles generally accepted in the United States of America ( GAAP ):

Royalty income, net of severance and ad valorem tax, and interest income are recognized in the month in which amounts are received by the Trust (see Note 1).

Trust expenses, consisting principally of routine general and administrative costs, include payments made during the accounting period. Expenses are accrued to the extent of amounts that become payable on the next monthly record date following the end of an accounting period. Reserves for liabilities that are contingent or uncertain in amount may also be established if considered necessary.

Royalties that are producing properties are amortized using the unit-of-production method. This amortization is shown as a reduction of Trust corpus.

Distributions to Unit holders are recognized when declared by the Trustee (see Note 3).

The financial statements of the Trust differ from financial statements prepared in conformity with accounting principles generally accepted in the United States of America because of the following:

Royalty income is recognized in the month received rather than in the month of production.

Expenses other than those expected to be paid on the following monthly record date are not accrued.

Amortization of the Royalties is shown as a reduction to Trust corpus and not as a charge to operating results.

Reserves may be established for contingencies that would not be recorded under accounting principles generally accepted in the United States of America.

This comprehensive basis of accounting other than GAAP corresponds to the accounting permitted for royalty trusts by the U.S. Securities and Exchange Commission, as specified by Staff Accounting Bulletin Topic 12:E, *Financial Statements of Royalty Trusts*.

#### **Use of Estimates**

The preparation of financial statements in conformity with the basis of accounting described above requires the Trustee to make estimates and assumptions that affect reported amounts of certain assets, liabilities, revenues and expenses as of and for the reporting periods. Actual results may differ from such estimates.

#### **Impairment**

The Trustee routinely reviews the Trust's royalty interests in oil and gas properties for impairment whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. If an impairment event occurs and it is determined that the carrying value of the Trust's royalty interests may not be recoverable, an impairment will be recognized as measured by the amount by which the carrying amount of

## Edgar Filing: SABINE ROYALTY TRUST - Form 10-Q

the royalty interests exceeds the fair value of these assets, which would likely be measured by discounting projected cash flows. As of June 30, 2012, no impairment is required.

### **Distributable Income per Unit**

Basic distributable income per Unit is computed by dividing distributable income by the weighted average Units outstanding. Distributable income per Unit assuming dilution is computed by dividing distributable income by the weighted average number of Units and equivalent Units outstanding. The Trust had no equivalent Units outstanding for any period presented. Therefore, basic distributable income per Unit and distributable income per Unit assuming dilution are the same.

### **New Accounting Pronouncements**

There are no new pronouncements that are expected to have a significant impact on the Trust's financial statements.

## **Table of Contents**

### **Federal Tax Considerations**

The Internal Revenue Service has ruled that the Trust is classified as a grantor trust for federal income tax purposes and therefore is not subject to taxation at the trust level. The Unit holders are considered, for federal income tax purposes, to own the Trust's income and principal as though no trust were in existence. Accordingly, no provision for federal income tax expense has been made in these financial statements. The income of the Trust will be deemed to have been received or accrued by each Unit holder at the time such income is received or accrued by the Trust (on the applicable monthly record date) if the escrow arrangement discussed in Note 1 to these financial statements is respected by the Internal Revenue Service. In the absence of the escrow arrangement, Unit holders would be deemed to receive or accrue income from production from the royalty properties (and interest income) on a daily basis, in accordance with their method of accounting, as the proceeds from production and interest thereon were received or accrued by the Trust. The Trustee is treating the escrow arrangement as effective for federal income tax purposes and furnishes tax information to Unit holders on that basis.

The Royalties constitute economic interests in oil and gas properties for federal income tax purposes. Unit holders must report their share of the revenues from the Royalties as ordinary income from oil and gas royalties and are entitled to claim depletion with respect to such income. During the first six months of 2012, the Trust also incurred administration expenses and earned interest income on funds held for distribution and for the cash reserve maintained for the payment of contingent and future obligations of the Trust.

The classification of the Trust's income for purposes of the passive loss rules may be important to a Unit holder. Royalty income generally is treated as portfolio income and does not offset passive losses.

Some Trust Units are held by middlemen, as such term is broadly defined in U.S. Treasury Regulations (and includes custodians, nominees, certain joint owners, and brokers holding an interest for a customer in street name, referred to herein collectively as middlemen). Therefore, the Trustee considers the Trust to be a non-mortgage widely held fixed investment trust (WHFIT) for U.S. federal income tax purposes. U.S. Trust, Bank of America Private Wealth Management, EIN: 56-0906609, 901 Main Street, 17th Floor, Dallas, Texas, 75202, telephone number (214) 209-2400, email address trustee@sbr-sabineroyalty.com, is the representative of the Trust that will provide tax information in accordance with applicable U.S. Treasury Regulations governing the information reporting requirements of the Trust as a WHFIT. Tax information is also posted by the Trustee at [www.sbr-sabineroyalty.com](http://www.sbr-sabineroyalty.com). Notwithstanding the foregoing, the middlemen holding Trust Units on behalf of Unit holders, and not the Trustee of the Trust, are solely responsible for complying with the information reporting requirements under the U.S. Treasury Regulations with respect to such Trust Units, including the issuance of IRS Forms 1099 and certain written tax statements. Unit holders whose Trust Units are held by middlemen should consult with such middlemen regarding the information that will be reported to them by the middlemen with respect to the Trust Units.

Each Unit holder should consult his tax advisor regarding Trust tax compliance matters.

---

## **Table of Contents**

### **State Tax Considerations**

The Trust holds properties located in Florida, Louisiana, Mississippi, New Mexico, Oklahoma, and Texas. Unit holders should consult the Trust's latest annual report on Form 10-K for a summary of tax matters.

Florida does not have a personal income tax. Florida imposes an income tax on resident and nonresident corporations (except for S corporations not subject to the built-in-gains tax or passive investment income tax), which will be applicable to royalty income allocable to a corporate Unit holder from properties located within Florida.

Louisiana, Mississippi, New Mexico and Oklahoma each impose taxes applicable to both resident and nonresident individuals and/or corporations (subject to certain exceptions for S corporations and limited liability companies, depending on their treatment for federal tax purposes), which will be applicable to royalty income allocable to a Unit holder from properties located within those states. New Mexico and Oklahoma impose a withholding tax on payments of oil and gas proceeds derived from royalty interests. To reduce the administrative burden imposed by these rules, the Trustee has opted to allow the payors of oil and gas proceeds to withhold on royalty payments made to the Trust. The Trust has filed New Mexico and Oklahoma tax returns, obtained a refund, and distributed that refund to Unit holders. Unit holders who transfer their Units before either the New Mexico or Oklahoma tax refunds are received by the Trust or after the refunds are received but before the next Monthly Record Date will not receive any portion of the refund. As a result, such Unit holders may incur a double tax – first through the reduced distribution received from the Trust as withholding at the Trust level reduces the amount of cash available for distribution and second by the tax payment made directly to New Mexico or Oklahoma with the filing of their New Mexico or Oklahoma income tax returns.

Texas imposes a franchise tax on generally all entity types providing limited liability protection at a rate of 1% on gross revenues less certain deductions, as specifically set forth in the Texas franchise tax statutes. Entities subject to tax generally include trusts unless otherwise exempt. Trusts that receive at least 90% of their federal gross income from designated passive sources, including royalties from mineral properties and other non-operated mineral interest income, and that do not receive more than 10% of their income from operating an active trade or business generally are exempt from the Texas franchise tax as passive entities. The Trust should be exempt from Texas franchise tax as a passive entity. Because the Trust should be exempt from Texas franchise tax at the Trust level as a passive entity, each Unit holder that is considered a taxable entity under the Texas franchise tax will generally be required to include its portion of Trust revenues in its own Texas franchise tax computation. This revenue is sourced to Texas under provisions of the Texas Administrative Code sourcing such income according to the principal place of business of the Trust, which is Texas.

Each Unit holder should consult his or her tax advisor regarding state tax requirements, if any, applicable to such person's ownership of trust units.

### **3. DISTRIBUTION TO UNIT HOLDERS**

The amount to be distributed to Unit holders ( Monthly Income Amount ) is determined on a monthly basis. The Monthly Income Amount is an amount equal to the sum of cash received by the Trust during a monthly period (the period commencing on the day after a monthly record date and continuing through and including the next succeeding monthly record date) attributable to the Royalties, any reduction in cash reserves and any other cash receipts of the Trust, including interest, reduced by the sum of liabilities paid and any increase in cash reserves. Unit holders of record as of the monthly record date (the 15th day of each calendar month except in limited circumstances) are entitled to have distributed to them the calculated Monthly Income Amount for such month on or before 10 business days after the monthly record date. The Monthly Income Amount per Unit is declared by the Trust no later than 10 days prior to the monthly record date.

The cash received by the Trust from purchasers of the Trust's oil and gas production consists of gross sales of production less applicable severance taxes.

**Table of Contents**

**4. PAYABLES**

Other payables consist primarily of royalty receipts suspended pending verification of ownership interest or title.

The Trustee believes that these other payables represent an ordinary operating condition of the Trust and that such payables will be paid or released in the normal course of business.

**5. SUBSEQUENT EVENTS**

Subsequent to June 30, 2012, the Trust declared the following distributions:

<b>Notification</b>	<b>Monthly Record</b>	<b>Payment</b>	<b>Distribution</b>
<b>Date</b>	<b>Date</b>	<b>Date</b>	<b>per Unit</b>
July 5, 2012	July 16, 2012	July 30, 2012	\$ .37365
August 3, 2012	August 15, 2012	August 29, 2012	\$ .33762

**6. CONTINGENCIES**

Contingencies related to the royalty properties that are unfavorably resolved would generally be reflected by the Trust as reductions to future royalty income payments to the Trust with corresponding reductions to cash distributions to Unit holders. The Trustee is not aware of any such items as of June 30, 2012.

\* \* \* \* \*

*Item 2. Trustee's Discussion and Analysis of Financial Condition and Results of Operations.*

**Liquidity and Capital Resources**

The Trust makes monthly distributions to the holders of Units of the excess of the preceding month's revenues received over expenses incurred. Upon receipt, royalty income is invested in short-term investments until its subsequent distribution. In accordance with the Trust Agreement, the Trust's only long-term assets consist of royalty interests in producing and proved undeveloped oil and gas properties. Although the Trust is permitted to borrow funds if necessary to continue its operations, borrowings are not anticipated in the foreseeable future.

**Results of Operations**

Distributable income consists of royalty income plus interest income plus any decrease in cash reserves established by the Trustee less general and administrative expenses of the Trust less any increase in cash reserves established by the Trustee. Distributable income for the three months ended June 30, 2012 was \$14,299,584, or \$0.98 per unit. Royalty income for the three months ended June 30, 2012 amounted to \$15,108,143 while interest income was \$2,024. General and administrative expenses totaled \$810,583 for the three months ended June 30, 2012.

Distributions during the period were \$.41887, \$.25815, and \$.34900 per Unit payable to Unit holders of record on April 16, May 15, and June 15, 2012, respectively.

**Table of Contents**

Royalty income for the quarter ended June 30, 2012 decreased approximately \$1,263,000 or 8% compared with the second quarter of 2011. This decrease was caused by a decrease in the price of natural gas (\$2.6 million), along with a decrease in the production of oil (\$0.1 million) and an increase in production taxes and operating expenses (\$0.2 million). These decreases were offset somewhat by an increase in the production of natural gas (\$1.0 million), an increase in the price of oil (\$0.2 million), and a refund of the 2011 Oklahoma state withholding taxes (\$0.5 million). Compared to the preceding quarter ended March 31, 2012, royalty income decreased approximately \$103,000 or 1%, due mainly to a decrease in the price of natural gas (\$1.6 million), a decrease in the production of oil (0.4 million), and an increase in production taxes and operating expenses (\$0.3 million). These decreases were tempered somewhat by an increase in the production of natural gas (\$1.3 million), an increase in the price of oil (\$0.4 million), and a refund of the 2011 Oklahoma state withholding taxes (\$0.5 million).

Royalty income for the six months ended June 30, 2012 increased \$271,000 or 1% compared with the same time period in 2011. This increase was due mainly to an increase in oil and natural gas production (\$1.8 million), an increase in the price of oil (\$1.4 million), and a refund of the 2011 Oklahoma state withholding taxes (\$0.5 million). These increases were offset somewhat by a decrease in the price of natural gas (\$3.2 million) as well as an increase in production taxes and operating expenses (\$0.2 million).

The following tables illustrate average prices received for the periods discussed above and the related oil and gas production volumes:

	June 30, 2012	Quarter Ended June 30, 2011	March 31, 2012
<b>Production</b>			
Oil (Bbls)	104,780	105,949	108,889
Gas (Mcf)	2,133,201	1,756,698	1,652,807
<b>Average Price</b>			
Oil (per Bbl)	\$ 96.53	\$ 94.50	\$ 92.64
Gas (per Mcf)	\$ 2.78	\$ 4.27	\$ 3.76

	June 30, 2012	Six-Months Ended June 30, 2011
<b>Production</b>		
Oil (Bbls)	213,669	207,249
Gas (Mcf)	3,786,008	3,399,881
<b>Average Price</b>		
Oil (per Bbl)	\$ 94.55	\$ 87.54
Gas (per Mcf)	\$ 3.21	\$ 4.16

Gas revenues received for the three months ended June 30, 2012, related primarily to production for January 2012 through March 2012. The average price of gas as reported by the Henry Hub for the same time period was \$2.26 per Mcf. The average price of gas for the Henry Hub was \$2.18 per Mcf for January 2012 through June 2012. Oil revenues for the three months ended June 30, 2012 related primarily to production for February 2012 through April 2012. The average price of oil as reported by NYMEX for that time period was \$103.90 per barrel. The average price of oil was \$98.30 per barrel for January 2012 through June 2012. As of July 19, 2012, the average price of gas for the Henry Hub was \$2.68 per Mcf and the average price of oil reported by NYMEX was \$89.87 per barrel. It is difficult to accurately estimate future prices of oil and gas, and any assumptions concerning future prices may prove to be incorrect.

Interest income for the quarter ended June 30, 2012 increased approximately \$700 compared with the second quarter of 2011. Compared to the preceding quarter ended March 31, 2012, interest income increased approximately \$300. Interest income for the six months ended June 30, 2012 increased \$1,500 over the same time period in 2011. Changes in interest income are the result of changes in interest rates and funds available for investment.

General and administrative expenses for the quarter ended June 30, 2012 increased by approximately \$128,700 compared to the same quarter of 2011 primarily due to increases in legal and other professional services of approximately \$55,800, engineering services of approximately \$68,800 and printing and unitholder information costs of approximately \$22,100. These increases were offset somewhat by a decrease in tax reporting fees due to timing of invoices of approximately \$20,200. Compared to the previous quarter ended March 31, 2012, general and

## Edgar Filing: SABINE ROYALTY TRUST - Form 10-Q

administrative expenses increased approximately \$249,100 due mainly to timing of annual expenses for engineering services of approximately \$180,500, printing costs associated with annual reporting of approximately \$100,500 and legal and other professional services of approximately \$21,900. These increases were offset somewhat by decreases in the timing of auditing expenses of approximately \$18,500 as well as the timing of the payment of the annual NYSE listing fee of \$38,000. Administrative expenses increased approximately \$185,600 for the six months ended June 30, 2012 compared to the same period in 2011 due primarily to increases in legal and other professional expenses of approximately \$76,300, engineering services of approximately \$65,800, printing and unitholder information services of approximately \$33,100 and escrow agent/trustee fees of approximately \$16,600. These increases were tempered by a decrease in the timing of payment of tax reporting fees of approximately \$15,900.

**Table of Contents**

**Critical Accounting Policies and Estimates**

The Trust's financial statements reflect the selection and application of accounting policies that require the Trust to make significant estimates and assumptions. The following are some of the more critical judgement areas in the application of accounting policies that currently affect the Trust's financial condition and results of operations.

**Basis of Accounting**

The financial statements of the Trust are prepared on the following basis and are not intended to present financial position and results of operations in conformity with accounting principles generally accepted in the United States of America:

Royalty income, net of severance and ad valorem taxes, and interest income are recognized in the month in which amounts are received by the Trust.

Trust expenses, consisting principally of routine general and administrative costs, include payments made during the accounting period. Expenses are accrued to the extent of amounts that become payable on the next monthly record date following the end of the accounting period. Reserves for liabilities that are contingent or uncertain in amount may also be established if considered necessary.

Royalties that are producing properties are amortized using the unit-of-production method. This amortization is shown as a reduction of Trust corpus.

Distributions to Unit holders are recognized when declared by the Trustee.

## **Table of Contents**

The financial statements of the Trust differ from financial statements prepared in conformity with accounting principles generally accepted in the United States of America because of the following:

Royalty income is recognized in the month received rather than in the month of production.

Expenses other than those expected to be paid on the following monthly record date are not accrued.

Amortization of the Royalties is shown as a reduction to Trust corpus and not as a charge to operating results.

Reserves may be established for contingencies that would not be recorded under accounting principles generally accepted in the United States of America.

This comprehensive basis of accounting other than GAAP corresponds to the accounting permitted for royalty trusts by the U.S. Securities and Exchange Commission, as specified by Staff Accounting Bulletin Topic 12:E, *Financial Statements of Royalty Trusts*.

### **Revenue Recognition**

Revenues from royalty interests are recognized in the period in which amounts are received by the Trust. Royalty income received by the Trust in a given calendar year will generally reflect the proceeds, on an entitlements basis, from natural gas produced for the twelve-month period ended September 30th in that calendar year and from oil produced for the twelve-month period ended October 31st in the same calendar year.

### **Reserve Disclosure**

The SEC and the Financial Accounting Standards Board requires supplemental disclosures for oil and gas producers based on a standardized measure of discounted future net cash flows relating to proved oil and gas reserve quantities. Under this disclosure, future cash inflows are computed by applying the average prices during the 12-month period prior to the fiscal year-end, determined as an unweighted arithmetic average of the first-day-of-the-month price for each month within such period, unless prices are defined by contractual arrangements, excluding escalations based upon future conditions. Future price changes are only considered to the extent provided by contractual arrangements in existence at year end. The standardized measure of discounted future net cash flows is achieved by using a discount rate of 10% a year to reflect the timing of future cash flows relating to proved oil and gas reserves. Numerous uncertainties are inherent in estimating volumes and the value of proved reserves and in projecting future production rates and the timing of development of nonproducing reserves. Such reserve estimates are subject to change as additional information becomes available. The reserves actually recovered and the timing of production may be substantially different from the reserve estimates. Other than those filed with the SEC, our estimated reserves have not been filed with or included in any reports to any federal agency.

### **Contingencies**

Contingencies related to the royalty properties that are unfavorably resolved would generally be reflected by the Trust as reductions to future royalty income payments to the Trust with corresponding reductions to cash distributions to Unit holders. The Trustee is not aware of any such items as of June 30, 2012.

### **Use of Estimates**

The preparation of financial statements in conformity with the basis of accounting described above requires management to make estimates and assumptions that affect reported amounts of certain assets, liabilities, revenues and expenses as of and for the reporting periods. Actual results may differ from such estimates.

### **Impairment**

## Edgar Filing: SABINE ROYALTY TRUST - Form 10-Q

The Trustee routinely reviews the Trust's royalty interests in oil and gas properties for impairment whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. If an impairment event occurs and it is determined that the carrying value of the Trust's royalty interests may not be recoverable, an impairment will be recognized as measured by the amount by which the carrying amount of the royalty interests exceeds the fair value of these assets, which would likely be measured by discounting projected cash flows.

## **Table of Contents**

### **Distributable Income per Unit**

Basic distributable income per Unit is computed by dividing distributable income by the weighted average Units outstanding. Distributable income per Unit assuming dilution is computed by dividing distributable income by the weighted average number of Units and equivalent Units outstanding. The Trust had no equivalent Units outstanding for any period presented. Therefore, basic distributable income per Unit and distributable income per Unit assuming dilution are the same.

### **New Accounting Pronouncements**

There are no new pronouncements that are expected to have a significant impact on the Trust's financial statements.

### **Other**

#### Forward Looking Statements

This Report includes forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, which are intended to be covered by the safe harbor created thereby. All statements other than statements of historical fact included in this Report are forward-looking statements. Although the Trustee believes that the expectations reflected in such forward-looking statements are reasonable, such expectations are subject to numerous risks and uncertainties and the Trustee can give no assurance that they will prove correct. There are many factors, none of which is within the Trustee's control, that may cause such expectations not to be realized, including, among other things, factors identified in the Trust's most recent Annual Report on Form 10-K affecting oil and gas prices and the recoverability of reserves, general economic conditions, actions and policies of petroleum-producing nations and other changes in the domestic and international energy markets.

The Trust has an Internet website and has made available its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to such reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act at <http://www.sbr-sabineroyalty.com> as soon as reasonably practicable after such information is electronically filed with or furnished to the SEC.

#### *Item 3. Quantitative and Qualitative Disclosures About Market Risk.*

The Trust invests in no derivative financial instruments, and has no foreign operations or long-term debt instruments. Other than the Trust's ability to periodically borrow money as necessary to pay expenses, liabilities and obligations of the Trust that cannot be paid out of cash held by the Trust, the Trust is prohibited from engaging in borrowing transactions. The amount of any such borrowings is unlikely to be material to the Trust. The Trust periodically holds short-term investments acquired with funds held by the Trust pending distribution to Unit holders and funds held in reserve for the payment of Trust expenses and liabilities. Because of the short-term nature of these borrowings and investments and certain limitations upon the types of such investments which may be held by the Trust, the Trustee believes that the Trust is not subject to any material interest rate risk. Currently, such funds are invested in Bank of America certificates of deposit which are backed by the good faith and credit of Bank of America, N.A., but are only insured by the Federal Deposit Insurance Corporation up to \$250,000. Each Unit holder should independently assess the creditworthiness of Bank of America, N.A. For more information about the credit rating of Bank of America, N.A., please refer to its periodic filings with the SEC. The Trust does not engage in transactions in foreign currencies which could expose the Trust or Unit holders to any foreign currency related market risk.

#### *Item 4. Controls and Procedures.*

As of the end of the period covered by this report, the Trustee carried out an evaluation of the effectiveness of the design and operation of the Trust's disclosure controls and procedures pursuant to Exchange Act Rules 13a-15 and 15d-15. Based upon that evaluation, the Trustee concluded that the Trust's disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Trust in the reports that it files or submits under the Securities Exchange Act of 1934 and are effective in ensuring that information required to be disclosed by the Trust in the reports that it files or submits under the Securities Exchange Act of 1934 is accumulated and communicated to the Trustee to allow timely decisions regarding required disclosure. There has not been any change in the Trust's internal control over financial reporting during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Trust's internal control over financial reporting.

**Table of Contents**

PART II OTHER INFORMATION

*Item 1. Legal Proceedings.*

Not applicable.

*Item 1A. Risk Factors.*

There have been no material changes in the risk factors disclosed under Part I, Item 1A of the Trust's Annual Report on Form 10-K for the year ended December 31, 2011.

*Items 2-5 not applicable.*

*Item 6. Exhibits.*

Exhibit Number

and Description

4(a)\* Sabine Corporation Royalty Trust Agreement effective as of December 31, 1982, by and between Sabine Corporation and InterFirst Bank Dallas, N.A., as trustee.

(b)\* Sabine Corporation Louisiana Royalty Trust Agreement effective as of December 31, 1982, by and between Sabine Corporation and Hibernia National Bank in New Orleans, as trustee, and joined by InterFirst Bank Dallas, N.A., as trustee.  
31 Trustee Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32 Trustee Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

\* Exhibits 4(a) and 4(b) are incorporated herein by reference to Exhibits 4(a) and 4(b), respectively, of the Registrant's Annual Report on Form 10-K for the year ended December 31, 1993.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SABINE ROYALTY TRUST

By: Bank of America, N.A.

Trustee

By: /s/ Ron E. Hooper  
Ron E. Hooper  
Senior Vice President and Trust Administrator

Date: August 7, 2012

(The Trust has no directors or executive officers.)