

SAN JUAN BASIN ROYALTY TRUST

Form 10-Q

May 10, 2018

[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 March 31, 2018**

**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 No. 001-08032**

**SAN JUAN BASIN ROYALTY TRUST**

**(Exact name of registrant as specified in the Amended and Restated San Juan Basin Royalty Trust Indenture)**

**Texas**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**75-6279898**  
**(I.R.S. Employer**  
**Identification No.)**

**Compass Bank**  
**300 W. 7<sup>th</sup> Street, Suite B**  
**Fort Worth, Texas 76102**  
**(Address of principal executive offices)**  
**(Zip Code)**

**(866) 809-4553**  
**(Registrant's telephone number, including area code)**

**N/A**

**(Former name, former address and former fiscal year, if changed since last report)**

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 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, or a non-accelerated filer, a smaller reporting company or an emerging growth company. See definitions of large accelerated filer, accelerated filer, smaller reporting company or emerging growth 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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

Number of Units of beneficial interest outstanding at May 10, 2018: 46,608,796

**Table of Contents**

**Table of Contents**

**PART I. FINANCIAL INFORMATION**

Item 1	<u>Financial Statements</u>	1
Item 2	<u>Trustee's Discussion and Analysis of Financial Condition and Results of Operations</u>	4
Item 3	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	8
Item 4	<u>Controls and Procedures</u>	8

**PART II. OTHER INFORMATION**

Item 1	<u>Legal Proceedings</u>	9
Item 1A	<u>Risk Factors</u>	9
Item 2	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	9
Item 3	<u>Defaults Upon Senior Securities</u>	9
Item 4	<u>Mine Safety Disclosures</u>	9
Item 5	<u>Other Information</u>	9
Item 6	<u>Exhibits</u>	9

<b><u>SIGNATURE</u></b>	11
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Table of Contents**SAN JUAN BASIN ROYALTY TRUST****PART I****FINANCIAL INFORMATION****Item 1. Financial Statements.****CONDENSED STATEMENTS OF ASSETS, LIABILITIES AND TRUST CORPUS**

	March 31, 2018 (Unaudited)	December 31, 2017
<b>ASSETS</b>		
Cash and short-term investments	\$ 2,435,597	\$ 4,415,851
Net overriding royalty interest in producing oil and natural gas properties (net of accumulated amortization of \$126,939,485 and \$126,698,148 at March 31, 2018 and December 31, 2017, respectively)	6,336,043	6,577,380
	\$ 8,771,640	\$ 10,993,231
<b>LIABILITIES AND TRUST CORPUS</b>		
Distribution payable to Unit Holders	\$ 1,435,597	\$ 3,415,851
Cash reserves	1,000,000	1,000,000
Trust corpus 46,608,796 Units of beneficial interest authorized and outstanding	6,336,043	6,577,380
	\$ 8,771,640	\$ 10,993,231

**CONDENSED STATEMENTS OF DISTRIBUTABLE INCOME (UNAUDITED)**

	Three Months Ended March 31, 2018	2017
Royalty income	\$ 6,646,813	\$ 8,608,220
Interest income	5,288	1,383
Total income	6,652,101	8,609,603
Expenditures General and Administrative	(424,702)	(462,593)
Distributable income	\$ 6,227,399	\$ 8,147,010
Distributable Income per Unit (46,608,796 Units)	\$ 0.133610	\$ 0.174796

CONDENSED STATEMENTS OF CHANGES IN TRUST CORPUS (UNAUDITED)

	Three Months Ended March 31,	
	2018	2017
Trust corpus, beginning of period	\$ 6,577,380	\$ 7,784,379
Amortization of net overriding royalty interest	(241,337)	(321,093)
Distributable income	6,227,399	8,147,010
Distributions declared	(6,227,399)	(8,147,010)
Trust corpus, end of period	\$ 6,336,043	\$ 7,463,286

*These Condensed Financial Statements should be read in conjunction with the accompanying*

*Notes to Condensed Financial Statements included herein.*

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**Table of Contents**

**1. Basis of Presentation**

The condensed financial statements included herein have been prepared without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ). These condensed financial statements should be read in conjunction with the financial statements and the notes thereto included in San Juan Basin Royalty Trust (the Trust ) Annual Report on Form 10-K for the year ended December 31, 2017. In the opinion of Compass Bank, the trustee of the Trust (the Trustee ), all adjustments, consisting only of normal recurring adjustments, have been included that are necessary to fairly present the assets, liabilities and trust corpus of the Trust at March 31, 2018 and December 31, 2017 and the distributable income and changes in trust corpus for the three-month periods ended March 31, 2018 and 2017. The distributable income for such interim periods is not necessarily indicative of the distributable income for the full year.

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

The net proceeds attributable to the 75% net overriding royalty interest (the Royalty ) that burdens certain oil and gas interests originally owned by Southland Royalty Company (the Subject Interests ) in properties located in the San Juan Basin of northwestern New Mexico (the Royalty Income ) recorded for a month is the amount computed and paid by the present owner of the Subject Interests, Hilcorp San Juan L.P. ( Hilcorp ), to the Trustee for the Trust. Royalty Income consists of the proceeds received by Hilcorp from the sale of production less accrued production costs, development and drilling costs, applicable taxes, operating charges, and other costs and deductions, multiplied by 75%. The calculation of net proceeds by Hilcorp for any month includes adjustments to proceeds and costs for prior months and impacts the Royalty Income paid to the Trust and the distribution to Unit Holders for that month.

Although permitted under the Conveyance, Hilcorp has informed the Trust that, for wells operated by Hilcorp, it generally did not intend to accrue lease operating expenses to the Trust.

Trust expenses recorded are based on liabilities paid and cash reserves established from Royalty Income for liabilities and contingencies.

Distributions to Unit Holders are recorded when declared by the Trustee.

The conveyance which transferred the Royalty to the Trust provides that any excess of production costs applicable to the Subject Interests over gross proceeds from such properties must be recovered from future net proceeds before Royalty Income is again paid to the Trust. The Trust is not obligated to reimburse Hilcorp for any excess production costs if future gross proceeds from the Subject Interests are insufficient to cover such costs.

The financial statements of the Trust differ from financial statements prepared in accordance with GAAP because revenues are not accrued in the month of production; certain cash reserves may be established for liabilities and contingencies which would not be accrued in financial statements prepared in accordance with GAAP; expenses are recorded when paid instead of when incurred; and amortization of the Royalty calculated on a unit-of-production basis

is charged directly to trust corpus instead of as an expense. Most accounting pronouncements apply to entities whose financial statements are prepared in accordance with GAAP, directing such entities to accrue or defer revenues and expenses in a period other than when such revenues were received or expenses were paid. Because the Trust's financial statements are prepared on the modified cash basis, as described above, most accounting pronouncements are not applicable to the Trust's financial statements, which includes the provision of the new revenue recognition standard in ASU 2014-09. The Trustee has determined that there are no additional disclosures required based on the Trust's method of accounting. This comprehensive basis of accounting corresponds to the accounting permitted for royalty trusts by the SEC, as specified by Staff Accounting Bulletin Topic 12:E, Financial Statements of Royalty Trusts.

The Trustee routinely reviews its royalty interests in oil and natural 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 and is charged directly to trust corpus instead of as an expense. There was no impairment of the assets as of March 31, 2018.



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**Table of Contents**

**2. Federal Income Taxes**

For federal income tax purposes, the Trust constitutes a fixed investment trust which is taxed as a grantor trust. A grantor trust is not subject to tax at the trust level. The Unit Holders are considered to own the Trust's income and principal as though no trust were in existence. The income of the Trust is deemed to have been received or accrued by each Unit Holder at the time such income is received or accrued by the Trust rather than when distributed by the Trust.

The Trust is a widely held fixed investment trust ( WHFIT ) classified as a non-mortgage widely held fixed investment trust ( NMWHFIT ) for federal income tax purposes. The Trustee is the representative of the Trust that will provide tax information in accordance with the applicable U.S. Treasury Regulations governing the information reporting requirements of the Trust as a WHFIT and a NMWHFIT.

The Royalty constitutes an economic interest in oil and natural gas properties for federal income tax purposes. Unit Holders must report their share of the production revenues of the Trust as ordinary income from oil and natural gas royalties and are entitled to claim depletion with respect to such income. The Royalty is treated as a single property for depletion purposes. The Trust has on file technical advice memoranda confirming such tax treatment.

Sales of natural gas production from certain coal seam wells drilled prior to January 1, 1993, qualified for federal income tax credits under Section 29 (now Section 45K) of the Internal Revenue Code of 1986, as amended (the Code ), through 2002 but not thereafter. Accordingly, under present law, the Trust's production and sale of natural gas from coal seam wells does not qualify for tax credit under Section 45K of the Code (the Section 45 Tax Credit ). Congress has at various times since 2002 considered energy legislation, including provisions to reinstate the Section 45 Tax Credit in various ways and to various extents, but no legislation that would qualify the Trust's current production for such credit has been enacted. No prediction can be made as to what future tax legislation affecting Section 45K of the Code may be proposed or enacted or, if enacted, its impact, if any, on the Trust and the Unit Holders.

The classification of the Trust's income for purposes of the passive loss rules may be important to a Unit Holder. Royalty income such as that derived through the Trust will generally be treated as portfolio income that may not be offset or reduced by passive losses.

Tax positions taken by the Trust related to the Trust's pass-through status and state tax positions have been reviewed, and the Trustee is of the opinion that material positions taken would more likely than not be sustained by examination. As of March 31, 2018, the Trust's tax years 2014 and thereafter remain subject to examination.

**Each Unit Holder should consult his or her own tax advisor regarding tax compliance matters related to such Unit Holder's interest in the Trust.**

**3. Commitments and Contingencies**

Contingencies related to the Subject Interests 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. See Note 1 Basis of Presentation, for a summary of the terms of the conveyance with respect to recovery of costs, and Note 4 Settlements and Litigation, for a discussion of the status of litigation matters.

The sale of San Juan Basin assets from Burlington to Hilcorp closed on July 31, 2017. Hilcorp informed the Trust that, due to the transition from Burlington, Hilcorp did not have all of the revenue decks installed and did not have the appropriate detail to provide actual revenue numbers. Therefore, Hilcorp estimated its revenue for the August 2017

through November 2017 production months (October 2017 through January 2018 Trust months). Hilcorp intends to reconcile the actual revenue and severance tax numbers versus the estimated numbers and true-up any distributions, as needed, but Hilcorp has not indicated when such reconciliation will occur. Such estimations and reconciliations by Hilcorp may result in adjustments to future distributions to the Unit Holders.

**4. Settlements and Litigation**

For information about the 2014 Litigation, see Part I, Item 3. Legal Proceedings in our Annual Report on Form 10-K for the year ended December 31, 2017.

**5. Subsequent Events**

None.

## **Table of Contents**

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

The Trust is an express trust created under the laws of the state of Texas by the San Juan Basin Royalty Trust Indenture entered into on November 1, 1980 between Southland Royalty Company ( "Southland" ) and The Fort Worth National Bank. Effective as of September 30, 2002, the original indenture was amended and restated and, effective as of December 12, 2007, the restated indenture was amended and restated, which we refer to as the Indenture. As a result of a series of mergers and other transactions, the current Trustee of the Trust is Compass Bank, which is a wholly-owned subsidiary of Banco Bilbao Vizcaya Argentaria, S.A.

#### **The Conveyance and the Royalty**

Pursuant to the Net Overriding Royalty Conveyance (the Conveyance ) effective November 1, 1980, Southland conveyed the Royalty that burdens the Subject Interests in properties located in the San Juan Basin of northwestern New Mexico. Subsequent to the Conveyance of the Royalty, through a series of sales, assignments and mergers, Southland's successor became Hilcorp, which acquired the Subject Interests from Burlington Resources Oil & Gas Company LP ( "Burlington" ), an indirect wholly-owned subsidiary of ConocoPhillips on July 31, 2017.

The Royalty constitutes the principal asset of the Trust. The beneficial interest in the Royalty is divided into 46,608,796 units (the Units ) representing undivided fractional interests in the beneficial interest of the Trust equal to the number of shares of the common stock of Southland outstanding as of the close of business on November 3, 1980. Each stockholder of Southland of record at the close of business on November 3, 1980 received one freely tradable Unit for each share of the common stock of Southland then held. Holders of Units are referred to herein as Unit Holders.

#### **The Trustee**

The primary function of the Trustee is to collect Royalty Income, to pay all expenses and charges of the Trust and distribute the remaining available income to the Unit Holders. The amount of income distributable to Unit Holders, which we refer to as Distributable Income, depends on the amount of Royalty Income and interest received by the Trust, as well as the amount of expenses paid by the Trust and any change in cash reserves. The Trust has no employees, officers or directors. All administrative functions of the Trust are performed by the Trustee.

#### **Hilcorp**

Hilcorp is the principal operator of the majority of the Subject Interests. Hilcorp is also responsible, subject to the terms of a prior agreement with the Trust, for marketing the production from such properties, either under existing sales contracts or under future arrangements, at the best prices and on the best terms it shall deem reasonably obtainable in the circumstances. A very high percentage of the Royalty Income is attributable to the production and sale by Hilcorp of natural gas from the Subject Interests. Accordingly, the market price for natural gas produced and sold from the San Juan Basin heavily influences the amount of Royalty Income distributed by the Trust and, by extension, the price of the Units.

**Table of Contents****Results of Operations    Three Months Ended March 31, 2018 and 2017*****Royalty Income***

Royalty Income consists of monthly net proceeds attributable to the Royalty. Royalty Income for the three months ended March 31, 2018 and 2017 was determined as shown in the following table:

	<b>Three Months Ended March 31,</b>	
	<b>2018</b>	<b>2017</b>
<b>Gross proceeds from the Subject Interests:</b>		
Natural Gas	\$ 15,543,608 <sup>(1)</sup>	\$ 19,328,862
Oil	661,303 <sup>(1)</sup>	468,541
Other	1,000,000 <sup>(2)</sup>	
<b>Total</b>	<b>17,204,911</b>	<b>19,797,403</b>
<b>Production Costs:</b>		
Severance tax    natural gas	1,746,554 <sup>(1)</sup>	2,004,126
Severance tax    oil	60,360 <sup>(1)</sup>	45,825
Other	(3,547) <sup>(3)</sup>	
Lease operating expense and property tax	6,205,013	6,075,145
Capital expenditures	334,113	194,680
<b>Total</b>	<b>8,342,493</b>	<b>8,319,776</b>
<b>Net profits</b>	<b>8,862,418</b>	<b>11,477,627</b>
Net overriding royalty interest	75%	75%
<b>Royalty Income</b>	<b>\$ 6,646,813</b>	<b>\$ 8,608,220</b>

(1) Due to the transition from Burlington, Hilcorp estimated the oil and natural gas revenue and severance taxes for the January 2018 distribution based on information provided by Burlington.

(2) Additional proceeds based on Hilcorp's increased revenue estimate for the January 2018 Distribution.

(3) Credit for duplicate charge.

The Royalty Income distributed to the Trust for the three months ended March 31, 2018 was lower than that distributed during the same period of 2017 due primarily to lower natural gas prices. The average natural gas price decreased from \$2.93 per Mcf for the three months ended March 31, 2017, to \$2.03 per Mcf for the three months ended March 31, 2018.

*Gross Proceeds from Subject Interests.* Total Gross proceeds decreased \$2.59 million or 13% for the three months ended March 31, 2018 compared to the three months ended March 31, 2017. The decrease was primarily attributable to lower natural gas prices.

*Capital Expenditures.* Capital expenditures increased by \$0.14 million or approximately 72% for the three months ended March 31, 2018 compared to the three months March 31, 2017. The increase was primarily attributable to Hilcorp's planned spending for well recompletion and facility projects.

*Severance Taxes.* Aggregate severance taxes decreased approximately \$0.24 million or approximately 12% for the three months ended March 31, 2018 compared to the three months ended March 31, 2017. The decrease was primarily attributable to lower gross proceeds during this period. Severance taxes represented approximately 11% of gross proceeds for the three months ended March 31, 2018, compared to approximately 10% for the same period of 2017.

*Lease Operating Expenses and Property Taxes.* Lease operating expenses and property taxes increased \$0.13 million or approximately 2% for the three months ended March 31, 2018 compared to the three months ended March 31, 2017, primarily because of differences between operators over the comparison periods.

Monthly lease operating expenses of the Subject Interests, including property taxes, in first quarter 2018 averaged approximately \$2.07 million, as compared to \$2.03 million in the first quarter of 2017.

**Table of Contents*****Distributable Income***

	Three Months Ended March 31,	
	2018	2017
Royalty income	\$ 6,646,813	\$ 8,608,220
Interest income	5,288	1,383
Total income	6,652,101	8,609,603
Expenditures general and administrative	(424,702)	(462,593)
Distributable income	\$ 6,227,399	\$ 8,147,010
Distributable income per Unit (46,608,796 Units)	\$ 0.133610	\$ 0.174796

*Distributable Income.* Distributable Income decreased by approximately \$1.92 million or approximately 24% to \$6.23 million (\$0.133610 per Unit) for the three months ended March 31, 2018 from \$8.15 million (\$0.174796 per Unit) for the three months ended March 31, 2017. The decrease in Distributable Income was primarily attributable to lower natural gas prices.

Based on 46,608,796 Units outstanding, the per-Unit distributions during the first quarter of 2018 were as follows:

January	\$ 0.066844
February	0.035965
March	0.030801
Quarter Total	\$ 0.133610

*Interest Income.* Interest income was higher for the three months ended March 31, 2018 as compared to the same period in 2017 primarily due to higher yields on short-term investments.

*General & Administrative Expenses.* General and administrative expenses decreased approximately \$0.04 million or approximately 8% for the three months ended March 31, 2018 compared to the three months ended March 31, 2017. The decrease was primarily attributable to differences in timing in the receipt and payment of certain expenses.

*Cash Reserves.* Total cash reserves were \$1.00 million as of March 31, 2018. The primary purpose of the cash reserves is to have sufficient funds to cover monthly general and administrative expenses in the event that there is insufficient Royalty Income to cover such expenses. The Trustee did not increase the cash reserves during 2017 and does not anticipate any increases in 2018.

**Liquidity and Capital Resources**

The Trust's principal source of liquidity and capital is Royalty Income. The Trust's distribution of income to Unit Holders is funded by Royalty Income after payment of Trust expenses. The Trust is not liable for any production costs or liabilities attributable to the Royalty. If at any time the Trust receives more than the amount due under the Royalty,

it is not obligated to return such overpayment, but the amounts payable to it for any subsequent period are reduced by such amount, plus interest, at a rate specified in the Conveyance. If the Trustee determines that the Trust does not have sufficient funds to pay its liabilities, the Trustee may borrow funds on behalf of the Trust, in which case no distributions will be made to Unit Holders until such borrowings are repaid in full. The Trustee may not sell or dispose of any part of the assets of the Trust without the affirmative vote of 75% of all of the Units outstanding; however, the Trustee may sell up to 1% of the value of the Royalty (as determined pursuant to the Indenture) during any 12-month period without the consent of the Unit Holders.

### **2018 Capital Expenditure Budget**

Hilcorp has informed the Trust that its 2018 budget for capital expenditures for the Subject Interests is estimated to be \$0.54 million and that existing wells will continue to be operated.

**Table of Contents****Oil and Natural Gas Production**

Royalty Income for the quarter ended March 31, 2018 is associated with estimated oil and natural gas production for November 2017 and actual oil and natural gas production for December 2017 and January 2018 from the Subject Interests. Production of oil and natural gas and related average sales prices attributable to each of the Subject Interests and the Royalty for the three months ended March 31, 2018 and 2017 were as follows:

	<b>For the Three Months Ended March 31, 2018</b>		<b>2017</b>	
	Natural Gas (Mcf)	Oil and Condensate (Bbls)	Natural Gas (Mcf)	Oil and Condensate (Bbls)
<b>Production</b>				
Subject Interests	7,660,516	14,373	6,605,953	13,100
<b>Royalty</b>	<b>3,103,857</b>	<b>8,911</b>	<b>3,161,814</b>	<b>6,093</b>
Average Price (per Mcf/Bbl)	\$ 2.03	\$ 46.01	\$ 2.93	\$ 35.77

The Trust recognizes production during the month in which the related net proceeds attributable to the Royalty are paid to the Trust. Royalty Income for a calendar year is based on the actual natural gas and oil production during the period beginning with November of the preceding calendar year through October of the current calendar year. Sales volumes attributable to the Royalty are determined by dividing the net profits by the Trust from the sale of oil and natural gas, respectively, by the prices received for sales of such volumes from the Subject Interests, taking into consideration production taxes attributable to the Subject Interests. Because the oil and natural gas sales attributable to the Royalty are based upon an allocation formula dependent on such factors as price and cost, including capital expenditures, the aggregate sales amounts from the Subject Interests may not provide a meaningful comparison to sales attributable to the Royalty.

The fluctuations in natural gas production that have occurred during the three-month period ended March 31, 2018 and 2017, respectively, generally resulted from changes in the demand for natural gas during that time, market conditions, and variances in capital spending to generate production from new and existing wells, as offset by the natural production decline curve. Also, production from the Subject Interests is influenced by the line pressure of the natural gas gathering systems in the San Juan Basin. As noted above, oil and natural gas sales attributable to the Royalty are based on an allocation formula dependent on many factors, including oil and natural gas prices and capital expenditures.

Due to the transition from Burlington, Hilcorp did not have all of the revenue decks installed and did not have the appropriate detail to provide actual revenue numbers for the November 2017 production month. Hilcorp will reconcile the actual revenue and severance tax numbers versus the estimated numbers and true-up any distributions, as needed.

**Marketing**

There were no changes to the contracts pursuant to which Hilcorp sells production from the Subject Interests and for the gathering and processing of production during the first quarter of 2018.

**Off-Balance Sheet Arrangements**

None.



### **Critical Accounting Policies and Estimates**

For a discussion of significant accounting policies and estimates that impact the Trust's financial statements, see Part I, Item 1. Unaudited Financial Statements, Note 1 Basis of Presentation and Part II, Item 8. Financial Statements and Supplemental Data contained in our Annual Report on Form 10-K for the year ended December 31, 2017.

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**Table of Contents**

**Information Regarding Forward-Looking Information**

Certain information included in this Quarterly Report on Form 10-Q contains, and other materials filed or to be filed by the Trust with the SEC (as well as information included in oral statements or other written statements made or to be made by the Trust) may contain or include, forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and Section 27A of the Securities Act of 1933, as amended. Such forward-looking statements may be or may concern, among other things, capital expenditures, drilling activity, development activities, production efforts and volumes, hydrocarbon prices, estimated future net revenues, estimates of reserves, the results of the Trust's activities, and regulatory matters. Such forward-looking statements generally are accompanied by words such as may, will, estimate, expect, predict, project, anticipate, assume, believe, plan, intend, or other words that convey the uncertainty of future events or outcomes. Such statements are based on certain assumptions of Compass Bank, the Trustee and by Hilcorp, the owner of the working interest through the reporting period, with respect to future events; are based on an assessment of, and are subject to, a variety of factors deemed relevant by the Trustee and Hilcorp; and involve risks and uncertainties. However, whether actual results and developments will conform with such expectations and predictions is subject to a number of risks and uncertainties which could affect the future results of the energy industry in general, and the Trust and Hilcorp in particular, and could cause those results to differ materially from those expressed in such forward-looking statements. The actual results or developments anticipated may not be realized or, even if substantially realized, they may not have the expected consequences to or effects on Hilcorp's business and the Trust. Such statements are not guarantees of future performance and actual results or developments may differ materially from those projected in such forward-looking statements. The Trust undertakes no obligation to publicly update or revise any forward-looking statements, except as required by applicable law.

**Hilcorp Information**

As a holder of a net overriding royalty interest, the Trust relies on Hilcorp for information regarding Hilcorp and its affiliates; the Subject Interests, including the operations, acreage, well and completion count, working interests, production volumes, sales revenues, capital expenditures, operating expenses, reserves, drilling plans, drilling results and leasehold terms related to the Subject Interests, and factors and circumstances that have or may affect the foregoing. See Part I, Item 4. Controls and Procedures.

The sale of San Juan Basin assets from Burlington to Hilcorp closed on July 31, 2017. Due to the transition, Hilcorp estimated revenue for the August 2017 through November 2017 production months (October 2017 through January 2018 Trust months). Hilcorp will reconcile the actual revenue and severance tax numbers versus the estimated numbers and true-up any distributions, as needed. Such estimations and reconciliations by Hilcorp may result in adjustments to future distributions to Unit Holders.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk.**

There have been no material changes to our market risk during 2018. For information on our exposure to market risk, please see Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk" contained in our Annual Report on Form 10-K for the year ended December 31, 2017.

**Item 4. Controls and Procedures.**

The Trust maintains a system of disclosure controls and procedures that is designed to ensure that information required to be disclosed in the Trust's filings under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms. Due to the pass-through nature of the Trust, Hilcorp provides much of the information disclosed in this Form 10-Q and the other periodic reports filed by the Trust with the SEC. Consequently, the Trust's ability to timely disclose relevant information in its periodic reports will be dependent upon Hilcorp's delivery of such information. Accordingly, the Trust maintains disclosure controls and procedures designed to ensure that Hilcorp accurately and timely accumulates and delivers such relevant information to the Trustee and those who participate in the preparation of the Trust's periodic reports to allow for the preparation of such periodic reports and any decisions regarding disclosure.

The Indenture does not require Hilcorp to update or provide information to the Trust. However, the Conveyance transferring the Royalty to the Trust obligates Hilcorp to provide the Trust with certain information, including information concerning calculations of net proceeds owed to the Trust. Pursuant to the settlement of litigation in 1996 between the Trust and Burlington, Burlington agreed to newer, more formal financial reporting and audit procedures as compared to those provided in the Conveyance. In connection with the Hilcorp transaction, the Trust and its third party compliance auditors have been coordinating with Hilcorp to transition these controls and procedures.

## **Table of Contents**

In order to help ensure the accuracy and completeness of the information required to be disclosed in the Trust's periodic reports, the Trust engages independent public accountants, compliance auditors, marketing consultants, attorneys and petroleum engineers. These outside professionals advise the Trustee in its review and compilation of this information for inclusion in this Form 10-Q and the other periodic reports provided by the Trust to the SEC.

The Trustee has evaluated the Trust's disclosure controls and procedures as of March 31, 2018 and has concluded that such disclosure controls and procedures are effective, at the reasonable assurance level (as such term is used in Rule 13a-15(f) of the Exchange Act), to ensure that material information related to the Trust is gathered on a timely basis to be included in the Trust's periodic reports and recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. In reaching its conclusion, the Trustee has considered the Trust's dependence on Hilcorp to deliver timely and accurate information to the Trust.

Additionally, during the quarter ended March 31, 2018 there were no changes in the Trust's internal control over financial reporting (as such term is used in Rule 13a-15(f) of the Exchange Act) that materially affected, or are reasonably likely to materially affect, the Trust's internal control over financial reporting. Because the Trust does not have, nor does the Indenture provide for, officers, a board of directors or an independent audit committee, the Trustee has reviewed neither the Trust's disclosure controls and procedures nor the Trust's internal control over financial reporting in concert with management, a board of directors or an independent audit committee.

## **PART II**

### **OTHER INFORMATION**

#### **Item 1. Legal Proceedings.**

For a discussion of legal proceedings, see Part I, Item 1. Unaudited Financial Statements, Note 4 Settlements and Litigation, which is incorporated by reference into this Part II. Item 1, as well as the discussion in Part I, Item 3. Legal Proceedings, of our Annual Report on Form 10-K for the year ended December 31, 2017.

#### **Item 1A. Risk Factors.**

Reference is made to Part I, Item 1A, Risk Factors, in our annual report on Form 10-K for the year ended December 31, 2017 for a discussion of additional risk factors which could materially affect the Trust's business, financial condition or future results.

#### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

None.

#### **Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Mine Safety Disclosures.**

Not applicable.

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

The information required by this Part II, Item 6 is set forth in the Index to the Exhibits accompanying this Quarterly Report on Form 10-Q and is incorporated by reference into this Part II, Item 6.

**Table of Contents**

**EXHIBIT INDEX**

**Exhibit**

**Number**

**Description**

- |        |   |
|--------|---|
| (4)(a) | <u>San Juan Basin Amended and Restated Royalty Trust Indenture, dated December 12, 2007, filed as Exhibit 99.2 to the Trust's Current Report on Form 8-K filed with the SEC on October 1, 2002, and incorporated herein by reference.*</u>  |
| (4)(b) | <u>Net Overriding Royalty Conveyance from Southland Royalty Company to The Fort Worth National Bank, as Trustee, dated November 3, 1980 (without Schedules), filed as Exhibit 4(b) to the Trust's Annual Report on Form 10-K filed with the SEC for the year ended December 31, 2006 on March 1, 2007, and incorporated herein by reference.*</u> |
| (4)(c) | <u>Assignment of Net Overriding Interest (San Juan Basin Royalty Trust), dated September 30, 2002, between Bank One, N.A. and Texas Bank, filed as Exhibit 4(c) to the Trust's Quarterly Report on Form 10-Q filed with the SEC for the quarter ended September 30, 2002, and incorporated herein by reference.*</u>                              |
| 31     | <u>Certification required by Rule 13a-14(a), dated May 10, 2018, by Joshua R. Peterson, Vice President and Senior Trust Officer of Compass Bank, the Trustee of the Trust.**</u>  |
| 32     | <u>Certification required by Rule 13a-14(b), dated May 10, 2018, by Joshua R. Peterson, Vice President and Senior Trust Officer of Compass Bank, on behalf of Compass Bank, the Trustee of the Trust.***</u>  |

\* A copy of this exhibit is available to any Unit Holder (free of charge) upon written request to the Trustee, Compass Bank, 300 W. 7th Street, Suite B, Fort Worth, Texas 76102.

\*\* Filed herewith.

\*\*\* Furnished herewith.

**Table of Contents**

**SIGNATURE**

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.

COMPASS BANK, AS TRUSTEE OF THE

SAN JUAN BASIN ROYALTY TRUST

By: /s/ Joshua R. Peterson

Joshua R. Peterson

Vice President and Senior Trust Officer

Date: May 10, 2018

(The Trust has no directors or executive officers.)