TEXAS PACIFIC LAND TRUST
Form 10-Q
May 07, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

[X] 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 Number: 1-737

Texas Pacific Land Trust
(Exact Name of Registrant as Specified in Its Charter)

NOT APPLICABLE	75-0279735
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
1700 Pacific Avenue, Suite 2770, Dallas, Texas	75201
(Address of Principal Executive Offices)	(Zip Code)

(214) 969-5530
(Registrant’s Telephone Number, Including Area Code)

(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 þ 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 þ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	Accelerated filer ¨

Non-accelerated filer ¨ (Do not check if a smaller reporting company)   Smaller reporting company ¨
Emerging growth company o

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. ¨

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

As of April 30, 2018, the Registrant had 7,805,498 Sub-share Certificates outstanding.

TEXAS PACIFIC LAND TRUST
Form 10-Q
Quarter Ended March 31, 2018

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

TEXAS PACIFIC LAND TRUST
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except acres, shares and per share amounts)

	March 31, 2018 (Unaudited)	December 31, 2017
ASSETS		
Cash and cash equivalents	$ 71,301	$ 79,580
Accrued receivables	27,644	17,773
Other assets	3,076	849
Prepaid income taxes	—	1,202
Property, plant and equipment, net of accumulated depreciation of $791 and $463 as of March 31, 2018 and December 31, 2017, respectively	31,029	19,516
Real estate acquired	1,866	1,115
Real estate and royalty interests assigned through the 1888 Declaration of Trust, no value assigned:		
Land (surface rights) situated in eighteen counties in Texas – 877,514 acres and 877,633 acres as of March 31, 2018 and December 31, 2017, respectively	—	—
1/16th nonparticipating perpetual royalty interest in 373,777 acres	—	—
1/128th nonparticipating perpetual royalty interest in 85,414 acres	—	—
Total assets	$ 134,916	$ 120,035
LIABILITIES AND CAPITAL		
Accounts payable and accrued expenses	$ 4,855	$ 5,608
Income taxes payable	10,473	851
Deferred taxes payable	114	114
Unearned revenue	8,932	8,364
Total liabilities	24,374	14,937
Commitments and contingencies	—	—
Capital:		
Certificates of Proprietary Interest, par value $100 each; none outstanding	—	—
Sub-share Certificates in Certificates of Proprietary Interest, par value $.03 1/3 each; outstanding 7,808,453 and 7,821,599 Sub-shares as of March 31, 2018 and December 31, 2017, respectively	—	—
Accumulated other comprehensive loss	(791)	(804)
Net proceeds from all sources	111,333	105,902
Total capital	110,542	105,098
Total liabilities and capital	$ 134,916	$ 120,035

See accompanying notes to condensed consolidated financial statements.

TEXAS PACIFIC LAND TRUST
CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND TOTAL COMPREHENSIVE INCOME
(in thousands, except shares and per share amounts)
(Unaudited)

	Three Months Ended March 31,	
	2018	2017
Income:		
Oil and gas royalties	$26,547	$ 10,588
Easements and sundry income	16,978	14,867
Water sales and royalties	13,607	4,828
Land sales	2,750	—
Other operating income	125	124
Total income	60,007	30,407
Expenses:		
Salaries and related employee benefits	2,289	386
Water service-related expenses	1,306	—
General and administrative expenses	808	340
Legal and professional fees	647	715
Depreciation and amortization	330	19
Taxes, other than income taxes	144	55
Trustees' compensation	2	2
Total expenses	5,526	1,517
Operating income	54,481	28,890
Other income	130	7
Income before income taxes	54,611	28,897
Income taxes	10,820	9,638
Net income	$43,791	$ 19,259
Other comprehensive income – periodic pension costs, net of income taxes of $3 and $9, respectively	13	17
Total comprehensive income	$43,804	$ 19,276
Weighted average number of Sub-share Certificates outstanding	7,818,168	7,919,085
Basic and dilutive earnings per Sub-share Certificate on net income	$5.60	$ 2.43
Cash dividends per Sub-share Certificate	$4.05	$ 1.35

See accompanying notes to condensed consolidated financial statements.

TEXAS PACIFIC LAND TRUST
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(Unaudited)

	Three Months Ended March 31,	
	2018	2017
Cash flows from operating activities:		
Net income	$43,791	$19,259
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred taxes	—	2,406
Depreciation and amortization	330	19
Gain on disposal of fixed assets	—	(4)
Changes in operating assets and liabilities:		
Accrued receivables and other assets	(12,099)	(3,758)
Prepaid income taxes	1,202	—
Accounts payable, accrued expenses and other liabilities	(172)	846
Income taxes payable	9,622	5,616
Cash provided by operating activities	42,674	24,384
Cash flows from investing activities:		
Proceeds from sale of fixed assets	—	28
Acquisition of land	(751)	—
Purchase of fixed assets	(11,841)	(1,912)
Cash used in investing activities	(12,592)	(1,884)
Cash flows from financing activities:		
Purchase of Sub-share Certificates in Certificates of Proprietary Interest	(6,709)	(8,672)
Dividends paid	(31,652)	(10,682)
Cash used in financing activities	(38,361)	(19,354)
Net increase in cash and cash equivalents	(8,279)	3,146
Cash and cash equivalents, beginning of period	79,580	49,418
Cash and cash equivalents, end of period	$71,301	$52,564
Supplemental disclosure of cash flow information:		
Income taxes paid	$—	$1,625

See accompanying notes to condensed consolidated financial statements.

TEXAS PACIFIC LAND TRUST
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. Organization and Description of Business Segments

Texas Pacific Land Trust (which, together with its subsidiaries as the context requires, may be referred to as “Texas Pacific”, the “Trust”, “our”, “we” or “us”) is one of the largest landowners in the State of Texas with approximately 890,000 acres of land in West Texas. Texas Pacific was organized under a Declaration of Trust, dated February 1, 1888, to receive and hold title to extensive tracts of land in the State of Texas, previously the property of the Texas and Pacific Railway Company, and to issue transferable Certificates of Proprietary Interest pro rata to the original holders of certain debt securities of the Texas and Pacific Railway Company.

The Trust is organized to manage land, including royalty interests, for the benefit of its owners. The Trust’s income is derived primarily from oil, gas and water service-related royalties, sales of water and land, easements and leases of the land.

We operate our business in two segments: Land and Resource Management and Water Service and Operations. Our segments provide management with a comprehensive financial view of our key businesses. The segments enable the alignment of strategies and objectives of the Trust and provide a framework for timely and rational allocation of resources within businesses. See Note 8, “Business Segment Reporting” for further information regarding our segments.

2. Summary of Significant Accounting Policies

Interim Unaudited Financial Information

The results for the interim periods shown in this report are not necessarily indicative of future financial results. The accompanying condensed consolidated financial statements include all adjustments necessary to present fairly the financial position of the Trust as of March 31, 2018 and the results of its operations for the three month periods ended March 31, 2018 and 2017, respectively, and its cash flows for the three month periods ended March 31, 2018 and 2017, respectively. Such adjustments are of a normal recurring nature.

Principles of Consolidation and Basis of Presentation

The accompanying condensed consolidated financial statements include our accounts and the accounts of our wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. The accompanying condensed consolidated financial statements should be read in conjunction with the annual financial statements and notes thereto included in the Trust’s Annual Report on Form 10-K for the year ended December 31, 2017, which was filed with the SEC on February 28, 2018. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted from this report.

Use of Estimates in the Preparation of Financial Statements

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent asset and liabilities at the date of the financial statements and reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

Recently Adopted Accounting Guidance

Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue Recognition (Topic 606): Revenue from Contracts with Customers." The ASU provides a five-step revenue recognition model in which an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU allows for a practical expedient for companies to exclude sales or similar taxes collected from customers from the transaction price. Additionally, the ASU requires disclosures sufficient to enable users to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, including qualitative and quantitative disclosures about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract.

The most significant impact of the standard relates to our accounting for easement agreements and to a lesser extent oil and gas royalties. Specifically, we recognize revenue for term easements upon execution of the easement agreements, and as a result, we no longer defer revenue on our term easements. Historically, oil and gas royalties have been adjusted for production taxes paid by operators with a charge to taxes, other than income taxes and a corresponding increase to revenue. We elected the practical expedient allowed by the ASU and exclude production taxes from revenue. Revenue recognition related to our land sales and other sundry income remains substantially unchanged. Adoption of the standard resulted in (i) the acceleration of easement and sundry income as unearned revenue decreases, (ii) a reduction in oil and gas royalty revenue with a corresponding reduction in taxes, other than income taxes, and (iii) an increase in income tax expense for the three months ended March 31, 2017.

We adopted the new standard on January 1, 2018 applying the full retrospective method with optional practical expedients. Adoption of the standard using the full retrospective method required us to restate certain previously reported results as though the new standard had always been in effect.

Adoption of the standard related to revenue recognition impacted our previously reported results as follows (in thousands, except per share amounts):

	As reported in prior year	Retrospective Adjustment	As reported in current year
Consolidated Statements of Income:			
For the three months ended March 31, 2017			
Revenue	$24,229	$ 6,178	$30,407
Taxes, other than income taxes	660	(605)	55
Income taxes	7,228	2,410	9,638
Net income	14,886	4,373	19,259
Net income per Sub-share Certificate	$1.88	$ 0.55	$2.43
Consolidated Balance Sheets:			
As of December 31, 2017			
Assets:			
Accrued receivables	$18,206	$ (433)	$17,773
Deferred tax asset (liability)	6,992	(7,106)	(114)
Liabilities and Capital:			
Unearned revenue	$41,375	$ (33,011)	$8,364
Other taxes payable	433	(433)	—
Net proceeds from all sources	79,997	25,905	105,902

Presentation of Net Periodic Pension Cost

In March 2017, the FASB issued ASU No. 2017-07, "Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost." This ASU requires employers to disaggregate the service cost component from the other components of net benefit cost in the income statement, provides explicit guidance on the presentation of the service cost component and the other components of net benefit cost in the income statement and allows only the service cost component of net benefit cost to be eligible for capitalization. The service cost component is recorded within salaries and related employee benefits expense, and the other components of net benefit costs are recorded in other income.

We adopted the new standard on January 1, 2018 applying the retrospective method. Adoption of the standard using the retrospective method required us to restate certain previously reported results as though the new standard had always been in effect.

Adoption of the standard related to presentation of net periodic pension cost and the standard related to revenue recognition impacted our previously reported results for operating income and other income as follows (in thousands):

	As reported in prior year	Retrospective Adjustment	As reported in current year
Consolidated Statements of Income:			
For the three months ended March 31, 2017			
Operating income [(1)]	$22,104	$ 6,786	$28,890
Other income	9	(2)	7

(1) The retrospective adjustment amount includes approximately $6.8 million related to the adoption of the new revenue recognition guidance as discussed above. The retrospective adjustment amount related to the adoption of the presentation of net periodic pension cost had a minimal impact.

Impact of the 2017 Tax Cuts and Jobs Act on Certain Income Tax Effects

In March 2018, the FASB issued ASU 2018-05, “Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118.” The amendments in this update provide guidance on when to record and disclose provisional amounts for certain income tax effects of the 2017 Tax Cuts and Jobs Act ("Tax Reform Act"). The amendments also require any provisional amounts or subsequent adjustments to be included in net income from continuing operations. Additionally, this ASU discusses required disclosures that an entity must make with regard to the Tax Reform Act. This ASU is effective immediately as new information is available to adjust provisional amounts that were previously recorded. The Trust has adopted this standard and will continue to evaluate indicators that may give rise to a change in our tax provision as a result of the Tax Reform Act.

3. Recent Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842).” This ASU requires lessees to recognize a right of use asset and lease liability on the balance sheet for all leases, with the exception of short-term leases. The new guidance will also require significant disclosures about the amount, timing and uncertainty of cash flows from leases. In January 2018, the FASB issued ASU No. 2018-01, “Land Easement Practical Expedient for Transition to Topic 842” that clarifies the application of the new lease guidance to land easements. The ASU allows an optional transition practical expedient, which if elected, would not require an entity to reassess the accounting treatment on existing or expired land easements not previously accounted for as leases under the current lease guidance. Any new or modified land easements would be evaluated under the new lease guidance upon adoption of the new lease standard. The new lease standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, which for the Trust is the first quarter of 2019. The Trust is currently evaluating the new guidance to determine the impact it will have on our consolidated financial statements.

In February 2018, the FASB issued ASU 2018-02, "Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (Topic 220)." This ASU allows for stranded tax effects in accumulated other comprehensive income resulting from the Tax Reform Act to be reclassified as retained earnings. This standard is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018. Early adoption is permitted. The Trust is currently evaluating the impact that ASU 2018-02 will have on our consolidated financial statements and disclosures.

4. Property, Plant and Equipment

Property, plant and equipment, net consisted of the following as of March 31, 2018 and December 31, 2017 (in thousands):

	March 31, 2018	December 31, 2017
Property, plant and equipment:		
Water service-related assets [(1)]	$ 28,679	$ 18,193
Furniture, fixtures and equipment	3,141	1,786
Property, plant and equipment at cost	31,820	19,979
Less: accumulated depreciation	(791)	(463)
Property, plant and equipment, net	$ 31,029	$ 19,516

(1) Water service-related assets include water wells and water well fields related to water sourcing and water re-use projects.

Depreciation expense was $0.3 million for the three months ended March 31, 2018. Depreciation expense was insignificant for the three months ended March 31, 2017.

5. Real Estate Activity

Land Sales

No value has been assigned to the land held by the Trust other than parcels which have been acquired through foreclosure and a limited number of parcels which have been acquired because they were offered for sale and were contiguous to parcels already owned by the Trust. Consequently, no allowance for depletion is computed, and no charge to income is made, with respect thereto, and no cost is deducted from the proceeds of the land sales in computing gain or loss thereon.

During the three months ended March 31, 2018, we completed the following sales of land parcels (in thousands, except number of acres):

Date of sale	Location	Approximate number of acres sold	Contract sale price
February 2018	Loving County	40.0	$ 1,150
March 2018	Culberson County	80.0	1,600
Total sales in 2018		120.0	$ 2,750

There were no land sales during the three months ended March 31, 2017.

Real Estate Acquired

Real estate acquired included the following activity for the three months ended March 31, 2018 and 2017 (in thousands, except number of acres):

	Three Months Ended March 31, 2018		Three Months Ended March 31, 2017	
	Acres	Book Value	Acres	Book Value
Balance at January 1,	10,064.78	$ 1,115	10,064.78	$ 1,115

Additions	640.60	751	—	—
Sales	—	—	—	—
Balance at March 31,	10,705.38	$1,866	10,064.78	$1,115

6. Income Taxes

Effective January 1, 2018, the statutory Federal income tax rate for the Trust decreased from 35% to 21%. The Trust's effective Federal income tax rate is less than the 21% statutory rate because taxable income is reduced by statutory percentage depletion allowed on mineral royalty income.

7. Capital

The Sub-shares and the Certificates of Proprietary Interest are freely interchangeable in the ratio of one Certificate of Proprietary Interest for 3,000 Sub-shares or 3,000 Sub-shares for one Certificate of Proprietary Interest.

Dividends

On March 16, 2018, we paid $31.7 million in dividends representing a cash dividend of $1.05 per Sub-share and a special dividend of $3.00 per Sub-share for sub-shareholders of record at the close of business on March 9, 2018.

On March 16, 2017, we paid $10.7 million in dividends representing a cash dividend of $0.35 per Sub-share and a special dividend of $1.00 per Sub-share for sub-shareholders of record at the close of business on March 9, 2017.

Repurchases of Sub-share Certificates

During the three months ended March 31, 2018, we purchased and retired 13,146 Sub-shares. During the three months ended March 31, 2017, we purchased and retired 29,496 Sub-shares.

8. Business Segment Reporting

During the periods presented, we reported our financial performance based on the following segments: Land and Resource Management and Water Service and Operations. Our segments provide management with a comprehensive financial view of our key businesses. The segments enable the alignment of strategies and objectives of the Trust and provide a framework for timely and rational allocation of resources within businesses. We eliminate any inter-segment revenues and expenses upon consolidation.

The Land and Resource Management segment encompasses the business of managing approximately 890,000 acres of land and related resources in West Texas owned by the Trust. The revenue streams of this segment consist primarily of royalties from oil and gas, land sales, and revenues from easements and leases.
The Water Service and Operations segment encompasses the business of providing a full-service water offering to operators in the Permian Basin as well as managing agreements with energy companies and oilfield service businesses to allow such companies to explore for water, drill water wells, construct water-related infrastructure and purchase water sourced from land that we own. The revenue streams of this segment consist of revenues from royalties on water service-related activity as well as revenue generated from direct sales of water.

Segment financial results were as follows for the three months ended March 31, 2018 and 2017 (in thousands):

	Three Months Ended March 31, 2018	2017
Revenues:		
Land and resource management	$42,753	$25,579
Water service and operations	17,254	4,828
Total consolidated revenues	$60,007	$30,407
Net income:		
Land and resource management	$32,811	$14,445
Water service and operations	10,980	4,814
Total consolidated net income	$43,791	$19,259
Capital expenditures		
Land and resource management	$1,252	$174
Water service and operations	10,589	1,738
Total capital expenditures	$11,841	$1,912
Depreciation and amortization:		
Land and resource management	$70	$5
Water service and operations	260	14
Total depreciation and amortization	$330	$19

The following table presents total assets and property, plant and equipment, net by segment as of March 31, 2018 and December 31, 2017 (in thousands):

	March 31, 2018	December 31, 2017
Assets:		
Land and resource management	$ 92,676	$ 97,549
Water service and operations	42,240	22,486
Total consolidated assets	$	