

Hugoton Royalty Trust

Hugoton Royalty Trust P.O. Box 962020, Fort Worth, Texas 76162-2020
855.588.7839 ● Southwest Bank, Trustee ● www.hgr-hugoton.com

3rd

Quarter Report

2016

Condensed Statements of Distributable Income (Unaudited)

	THREE MONTHS ENDED SEPTEMBER 30 2016	2015	NINE MONTHS ENDED SEPTEMBER 30 2016	2015
Net Profits Income.....	\$ 1,253,498	\$ 1,584,694	\$ 1,516,605	\$ 7,185,310
Interest Income	289	46	544	166
Total Income	1,253,787	1,584,740	1,517,149	7,185,476
Administration Expense.....	187,892	187,500	725,229	636,516
Cash Reserves Withheld (Used) For Trust Expenses.....	273,975	50,000	—	250,000
DISTRIBUTABLE INCOME.....	\$ 791,920	\$ 1,347,240	\$ 791,920	\$ 6,298,960
DISTRIBUTABLE INCOME PER UNIT (40,000,000 UNITS)	\$ 0.019798	\$ 0.033681	\$ 0.019798	\$ 0.157474

These condensed statements of distributable income should be read in conjunction with the financial statements and notes thereto included in the Trust's 2015 annual report. For further information, see the Trust's quarterly report on Form 10-Q for the quarter ended September 30, 2016.

Statements in this report to unitholders relating to future plans, predictions, events or conditions are forward-looking statements. All statements other than statements of historical fact included in this report to unitholders, including, without limitation, statements regarding the net profits interests, underlying properties, development activities, annual and monthly development, production and

other costs and expenses, monthly development cost deductions, oil and gas prices and differentials to NYMEX prices, supply levels, future drilling, workover and restimulation plans, the outcome of litigation and impact on Trust proceeds, distributions to unitholders, and industry and market conditions, are forward-looking statements that are subject to risks and uncertainties which are detailed in Part I, Item 1A of the Trust's Annual Report on Form 10-K for the year ended December 31, 2015, which is incorporated by this reference as though fully set forth herein. XTO Energy and the trustee assume no duty to update these statements as of any future date.

For information contact:

Hugoton Royalty Trust

Southwest Bank, Trustee

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To Unitholders:

For the quarter ended September 30, 2016, net profits income was \$1,253,498, as compared to \$1,584,694 for third quarter 2015. This 21% decrease in net profits income is primarily the result of lower oil and gas prices (\$1.3 million), decreased oil and gas production (\$0.9 million), and increased taxes, transportation and other costs (\$0.3 million), partially offset by lower production expenses (\$1.8 million) and decreased development costs (\$0.4 million). See "Net Profits Income" on following page.

After adding interest income of \$289, deducting administration expense of \$187,892, and increasing the cash reserve \$273,975 for the payment of Trust expenses, distributable income for the quarter ended September 30, 2016 was \$791,920, or \$0.019798 per unit of beneficial interest. Administration expense for the quarter increased \$392 as compared to the prior year quarter. For third quarter 2015, distributable income was \$1,347,240, or \$0.033681 per unit.

Distributions to unitholders for the quarter ended September 30, 2016 were:

RECORD DATE	PAYMENT DATE	PER UNIT
July 29, 2016	August 12, 2016	\$ 0.000942
August 31, 2016	September 15, 2016	0.006639
September 30, 2016	October 17, 2016	<u>0.012217</u>
TOTAL		<u>\$ 0.019798</u>

For the nine months ended September 30, 2016, net profits income was \$1,516,605 compared with \$7,185,310 for the same 2015 period. This 79% decrease in net profits income is primarily the result of lower oil and gas prices (\$10.2 million) and decreased oil and gas production (\$0.8 million), partially offset by lower production expenses (\$3.8 million), decreased taxes,

transportation, and other costs (\$0.7 million), lower development costs (\$0.7 million), and net excess costs in 2016 (\$0.2 million). See "Net Profits Income" on following page.

After adding interest income of \$544 and deducting administration expense of \$725,229, distributable income for the nine months ended September 30, 2016 was \$791,920, or \$0.019798 per unit of beneficial interest. Administration expense for the nine months ended September 30, 2016 increased \$88,713 as compared with the same 2015 period. For the nine months ended September 30, 2015, distributable income was \$6,298,960, or \$0.157474 per unit.

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

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

Hugoton Royalty Trust
By: Southwest Bank, Trustee



By: Nancy G. Willis
Vice President

Third Quarter Report 2016

Net Profits Income

Net profits income is recorded when received by the Trust, which is the month following receipt by XTO Energy, and generally two months after oil and gas production. Net profits income is generally affected by three major factors:

- oil and gas sales volumes,
- oil and gas sales prices, and
- costs deducted in the calculation of net profits income.

The following are explanations of significant variances on the underlying properties from third quarter 2015 to third quarter 2016 and from the first nine months of 2015 to the comparable period in 2016:

Sales Volumes

Gas. Gas sales volumes decreased 9% for the third quarter primarily because of natural production decline and the timing of cash receipts. Gas sales volumes decreased 3% for the nine-month period primarily due to natural production decline, partially offset by completion of repairs at a third party gas processing system in the Hugoton area following a force majeure incident and the timing of cash receipts.

XTO Energy advised the trustee that repairs and maintenance in the first half of 2015 at a third party gas processing system in the Hugoton area following a force majeure incident resulted in decreased underlying gas volumes of approximately 5,000 Mcf per day. After being advised by the third party processor that the repairs were completed, XTO Energy then received notice that the force majeure event was being extended to the processing portion of the third party plant due to an equipment malfunction. The processor was able to bypass the plant and take gas; however, the plant was not able to process gas for NGLs or helium for a period of time. XTO Energy received notice that the plant returned to full capacity at the end of October 2015, including the processing of gas for NGLs and helium.

Oil. Oil sales volumes decreased 11% for the third quarter and 6% for the nine-month period primarily due to natural production decline and the timing of cash receipts.

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

Sales Prices

Gas. The third quarter 2016 average gas price was \$2.12 per Mcf, a 12% decrease from the third quarter 2015 average gas

price of \$2.40 per Mcf. For the nine-month period, the average gas price decreased 32% to \$1.88 per Mcf in 2016 from \$2.77 per Mcf in 2015. Natural gas prices are affected by the level of North American production, weather, crude oil and natural gas liquids prices, the U.S. economy, storage levels and import levels of liquefied natural gas. Natural gas prices are expected to remain volatile. The third quarter 2016 gas price is primarily related to production from May through July 2016, when the average NYMEX price was \$2.29 per MMBtu. The average NYMEX price for August and September 2016 was \$2.76 per MMBtu. At October 19, 2016, the average NYMEX futures price for the following twelve months was \$3.37 per MMBtu.

Oil. The third quarter 2016 average oil price was \$42.94 per Bbl, a 19% decrease from the third quarter 2015 average oil price of \$52.80 per Bbl. The year-to-date average oil price decreased 31% to \$36.02 per Bbl in 2016 from \$52.58 per Bbl in 2015. Oil prices are expected to remain volatile. The third quarter 2016 oil price is primarily related to production from May through July 2016, when the average NYMEX price was \$46.89 per Bbl. The average NYMEX price for August and September 2016 was \$45.00 per Bbl. At October 19, 2016, the average NYMEX futures price for the following twelve months was \$53.05 per Bbl.

Costs

Taxes, Transportation and Other. Taxes, transportation and other costs increased 19% for the third quarter because of increased other deductions as a percentage of oil and gas revenues related to increased gathering fees, partially offset by lower oil and gas production taxes related to lower oil and gas revenues and decreased property taxes related to lower valuations. Taxes, transportation and other costs decreased 16% for the nine-month period primarily because of decreased oil and gas production taxes related to lower oil and gas revenues and decreased property taxes related to lower valuations, partially offset by increased other deductions as a percentage of oil and gas revenues related to increased gathering fees.

XTO Energy advised the trustee that net profits income for August 2016 included approximately \$500,000 in additional gathering fee deductions for the period of December 2015 through May 2016 related to a renegotiated gas purchase contract that included production from properties underlying the Oklahoma conveyance. The current contract term is December 1, 2015 until November 30, 2017.

Third Quarter Report 2016

Production Expense. Production expense decreased 25% for the third quarter and 19% for the nine-month period primarily because of decreased repairs and maintenance, labor, field, water disposal, and compression costs.

Development Costs. Development costs deducted in the calculation of net profits income are based on the current level of development expenditures and the development budget. These development costs decreased 79% for the third quarter and 43% for the nine-month period.

At December 31, 2015, cumulative budgeted costs deducted exceeded cumulative actual costs by approximately \$0.2 million. In calculating net profits income for the quarter ended September 30, 2016, XTO Energy deducted budgeted development costs of \$0.2 million for the quarter and \$1.1 million for the nine-month period. After considering actual development costs of \$0.5 million for the quarter and \$1.2 million for the nine-month period, cumulative budgeted costs deducted exceeded actual costs by approximately \$0.1 million at September 30, 2016.

XTO Energy has advised the trustee that revised 2016 budgeted development costs for the underlying properties are between \$2 million and \$4 million. The 2016 budget year generally coincides with the Trust distribution months from April 2016 through March 2017. The monthly development cost deduction will be reevaluated by XTO Energy and revised as necessary, based on the 2016 budget and the timing and amount of actual expenditures.

Overhead. Overhead decreased 28% for the third quarter and 20% for the nine-month period primarily because of operated overhead corrections for the period of January 2014 through May 2016, and the annual rate adjustment based on an industry index.

Excess Costs

	Conveyances (Underlying)			Total
	KS	OK	WY	
Cumulative excess costs remaining at 12/31/15 ...	\$1,141,452	\$ —	\$ 478,735	\$1,620,187
Net excess costs for the quarter ended 3/31/16 ...	255,605	97,457	472,481	825,543
Net excess costs (recovery) for the quarter ended 6/30/16 ...	(71,807)	(97,457)	570,141	400,877
Net excess costs (recovery) for the quarter ended 9/30/16	93,933	—	169,646	263,579
Cumulative excess costs remaining at 9/30/16	<u>\$1,419,183</u>	<u>\$ —</u>	<u>\$1,691,003</u>	<u>\$3,110,186</u>

If monthly costs exceed revenues for any of the three conveyances (one for each of the states of Kansas, Oklahoma and Wyoming), such excess costs must be recovered, with accrued interest, from future net proceeds of that conveyance and cannot reduce net proceeds from other conveyances.

XTO Energy advised the trustee that continued lower gas prices resulted in net excess costs of \$93,933 (\$75,146 net to the Trust) on properties underlying the Kansas net profits interest for the quarter ended September 30, 2016. XTO Energy advised the trustee that a one-time reimbursement for overhead corrections, led to the partial recovery of excess costs of \$71,807 (\$57,446 net to the Trust) on properties underlying the Kansas net profits interest for the quarter ended June 30, 2016. XTO Energy advised the trustee that lower gas prices caused costs to exceed revenues by a total of \$255,605 (\$204,484 net to the Trust) on properties underlying the Kansas net profits interest for the quarter ended March 31, 2016.

XTO Energy advised the trustee that a one-time reimbursement for overhead corrections led to full recovery of excess costs, plus accrued interest of \$1,059 (\$847 net to the Trust), on properties underlying the Oklahoma net profits interest for the quarter ended June 30, 2016. XTO Energy advised the trustee that lower gas prices caused costs to exceed revenues by a total of \$97,457 (\$77,966 net to the Trust) on properties underlying the Oklahoma net profits interest for the quarter ended March 31, 2016.

XTO Energy advised the trustee that continued lower gas prices resulted in net excess costs of \$169,646 (\$135,717 net to the Trust) on properties underlying the Wyoming net profits interest for the quarter ended September 30, 2016. XTO Energy advised the trustee that lower gas prices, partially offset by a one-time reimbursement for overhead corrections caused costs to exceed revenues by a total of \$570,141 (\$456,113 net to the Trust) on properties underlying the Wyoming net profits interest for the quarter ended June 30, 2016. XTO Energy advised the trustee that lower gas prices caused costs to exceed revenues by a total of \$472,481 (\$377,985 net to the Trust) on properties underlying the Wyoming net profits interest for the quarter ended March 31, 2016.

XTO Energy advised the trustee that increased costs, decreased gas production and lower gas prices caused costs to exceed revenues by a total of \$261,030 (\$208,824 net to the Trust) for the quarter ended September 30, 2015, \$367,814 (\$294,251 net

Third Quarter Report 2016

to the Trust) for the quarter ended June 30, 2015 and \$338,668 (\$270,934 net to the Trust) for the quarter ended March 31, 2015 on properties underlying the Kansas net profits interest.

XTO Energy advised the trustee that lower gas prices and increased costs resulted in net excess costs of \$80,974 (\$64,779 net to the Trust) for the quarter ended September 30, 2015 and \$125,832 (\$100,666 net to the Trust) for the quarter ended June 30, 2015. XTO Energy advised the trustee that lower gas prices and increased costs caused costs to exceed revenues by a total of \$87,082 (\$69,666 net to the Trust) for the quarter ended March 31, 2015 on properties underlying the Wyoming net profits interest.

Cumulative excess costs for the Kansas, Oklahoma and Wyoming conveyances remaining as of September 30, 2016 totaled \$3,110,186 (\$2,488,149 net to the Trust).

Impairment of Net Profits Interest. In light of lower long term prices used to develop projections of future cash flows, continued excess costs on two conveyances and zero distributions to unitholders for the six months ended June 30, 2016, the trustee concluded that an impairment trigger event had occurred in the second quarter of 2016 and an assessment of the forecasted net cash flows was performed for the NPI. The fair value of the NPI was developed using estimates for future oil and gas production attributable to the Trust, future crude oil and natural gas commodity prices published by third-party industry experts (adjusted for basis differentials), estimated taxes, development and operating expenses, and a risk-adjusted discount rate. The result of the assessment indicated that the estimated undiscounted future net cash flows from the NPI were below the carrying value of the NPI. The NPI was written down to its fair value of \$28.8 million, resulting in a \$57.3 million impairment charged directly to Trust corpus, which did not affect distributable income. There have been no events or changes in circumstances to indicate the carrying value of the NPI may not be recoverable, and there is no further impairment of the assets as of September 30, 2016.

Other. XTO Energy advised the trustee that the February 2015 distribution included a one-time prior period adjustment for the recoupment of natural gas liquids revenue from the Trust in the amount of \$353,069 (\$282,455 net to the Trust) which was deducted from net proceeds for the first quarter of 2015.

Contingencies. In September 2008, a royalty class action

lawsuit was filed against XTO Energy styled *Wallace B. Roderick Revocable Living Trust, et al. v. XTO Energy Inc.* in the District Court of Kearny County, Kansas. The case was removed to federal court in Wichita, Kansas. The plaintiffs alleged that XTO Energy had improperly taken post production costs from royalties paid to the plaintiffs from wells located in Kansas, Oklahoma and Colorado; later reduced to Kansas. The case was certified as a class action in March 2012. XTO Energy filed an appeal of the class certification to the 10th Circuit Court of Appeals on April 11, 2012, which was granted on June 26, 2012. The court reversed the certification of the class and remanded the case back to the trial court for further proceedings. The case was previously stayed pending a final decision from the Kansas Supreme Court on the *Fawcett v. OPIK* appeal. Following the decision in *Fawcett*, the Judge in *Roderick* ordered new briefing on the pending motions. In its pleadings, the plaintiff had alleged damages in excess of \$40 million. On June 22, 2016, plaintiffs' Second Motion for Class Certification was denied. In light of the denied certification, the plaintiff moved to dismiss the case. A dismissal order has been signed and the case is now concluded.

In December 2010, a royalty class action lawsuit was filed against XTO Energy styled *Chieftain Royalty Company v. XTO Energy Inc.* in Coal County District Court, Oklahoma. XTO Energy removed the case to federal court in the Eastern District of Oklahoma. The plaintiffs allege that XTO Energy wrongfully deducted fees from royalty payments on Oklahoma wells, failed to make diligent efforts to secure the best terms available for the sale of gas and its constituents, and demand an accounting to determine whether they have been fully and fairly paid gas royalty interests. The case was certified as a class action in April 2012. XTO Energy filed an appeal of the class certification to the 10th Circuit Court of Appeals on April 26, 2012, which was granted on June 26, 2012. The court reversed the certification of the class and remanded the case back to the trial court for further proceedings. A non-binding mediation occurred September 1, 2016, but was unsuccessful. Pretrial discovery continues.

XTO Energy has informed the trustee that it believes that XTO Energy has strong defenses to the *Chieftain* lawsuit and intends to vigorously defend its position. However, XTO Energy has informed the trustee that it is cognizant of other, similar litigation. As these cases develop, XTO Energy will assess its legal position accordingly. If XTO Energy ultimately makes any settlement payments or receives a judgment against it in *Chieftain*, XTO Energy has advised the trustee that the Trust should bear its 80% share of such

Third Quarter Report 2016

settlement or judgment, including any future royalty adjustments that would reduce net proceeds. The trustee intends to review any claimed reductions in payment to the Trust based on the facts and circumstances of such settlement or judgment. In light of a 2014 arbitration decision in which a three panel tribunal decided that the settlement in *Fankhouser v. XTO Energy, Inc.*, including a new royalty calculation for future royalty payments, could not be charged to the Trust, to the extent that the claims in *Chieftain* are similar to those in *Fankhouser* the trustee would likely object to such claimed reductions. XTO Energy has informed the trustee that, although the amount of any reduction in net proceeds is not presently determinable, in its management's opinion, the amount is not currently expected to be material to the Trust's financial position or liquidity though it could be material to the Trust's annual distributable income. Additionally, XTO Energy has advised the trustee that any reductions would result in costs exceeding revenues on the properties underlying the net profit interests of the case, as applicable, for several monthly distributions, depending on the size of the judgment or settlement, if any, and the net proceeds being paid at that time, which would result in the net profits interest being limited until such time that the revenues exceed the costs for those net profit interests. If there is a settlement or judgment and should

XTO Energy and the trustee disagree concerning the amount of the settlement or judgment to be charged, if any, against the Trust's net profits interests, the matter will be resolved by binding arbitration through the American Arbitration Association under the terms of the Indenture creating the Trust.

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

Subsequent Event. XTO Energy has advised the trustee that the net profits income for December 2016 will reflect decreased underlying gas volumes of approximately 5,000 Mcf per day due to repairs and maintenance at a third party gas processing system in the Hugoton area for approximately 20 days during the month of October. The decreased gas volumes will affect the net profits income under the Oklahoma and Kansas conveyances.

Tax Information Per Unit

	August 12, 2016	MONTHLY DISTRIBUTIONS PAID ON:		Total
		(\$/UNIT EXCEPT COST DEPLETION FACTORS)		
		September 15, 2016	October 17, 2016	
Gross Income.....	\$ 0.011543	\$ 0.013611	\$ 0.016980	\$ 0.042134
Less Severance Taxes.....	(0.001560)	(0.006363)	(0.002874)	(0.010797)
Interest Income.....	0.000002	0.000002	0.000003	0.000007
Less Administration Expenses.....	(0.002194)	(0.000611)	(0.001892)	(0.004697)
Reconciling Items.....	(0.006849)	0.000000	0.000000	(0.006849)
NET CASH DISTRIBUTION.....	\$ 0.000942	\$ 0.006639	\$ 0.012217	\$ 0.019798
Cost Depletion Factors:				
Kansas - 80%.....	0.000000	0.000000	0.000000	0.000000
Oklahoma - 80%.....	0.014845	0.016709	0.018696	0.050250
Wyoming - 80%.....	0.000000	0.000000	0.000000	0.000000

Glossary of Terms

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

Calculations of Net Profits Income

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

	THREE MONTHS ENDED SEPTEMBER 30 ^(a)			NINE MONTHS ENDED SEPTEMBER 30 ^(a)		
	2016	2015	INCREASE (DECREASE)	2016	2015	INCREASE (DECREASE)
SALES VOLUMES						
Gas (Mcf) ^(b)						
Underlying Properties.....	3,806,576	4,203,893	(9%)	11,263,950	11,612,783	(3%)
Average Per Day	41,376	45,694	(9%)	41,109	42,538	(3%)
Net Profits Interests	574,688	522,782	10%	706,835	1,933,033	(63%)
Oil (Bbls) ^(b)						
Underlying Properties.....	44,718	50,113	(11%)	139,353	148,096	(6%)
Average Per Day	486	545	(11%)	509	542	(6%)
Net Profits Interests	9,883	9,553	3%	12,205	34,978	(65%)
AVERAGE SALES PRICES						
Gas (per Mcf)	\$ 2.12	\$ 2.40	(12%)	\$ 1.88	\$ 2.77	(32%)
Oil (per Bbl)	\$ 42.94	\$ 52.80	(19%)	\$ 36.02	\$ 52.58	(31%)
REVENUES						
Gas sales	\$ 8,078,025	\$ 10,078,298	(20%)	\$ 21,199,655	\$ 32,206,758	(34%)
Oil sales	1,920,303	2,645,986	(27%)	5,019,621	7,786,438	(36%)
TOTAL REVENUES	9,998,328	12,724,284	(21%)	26,219,276	39,993,196	(34%)
COSTS						
Taxes, transportation and other	2,333,558	1,959,711	19%	4,644,267	5,497,171	(16%)
Production expense.....	3,908,973	5,239,560	(25%)	12,626,547	15,529,764	(19%)
Development costs	150,000	700,000	(79%)	1,075,000	1,900,000	(43%)
Overhead	2,302,504	3,186,149	(28%)	7,466,646	9,346,023	(20%)
Excess Costs.....	(263,579)	(342,004)	(23%)	(1,488,940)	(1,261,400)	18%
TOTAL COSTS	8,431,456	10,743,416	(22%)	24,323,520	31,011,558	(22%)
NET PROCEEDS	1,566,872	1,980,868	(21%)	1,895,756	8,981,638	(79%)
NET PROFITS PERCENTAGE	80%	80%		80%	80%	
NET PROFITS INCOME.....	\$ 1,253,498	\$ 1,584,694	(21%)	\$ 1,516,605	\$ 7,185,310	(79%)

(a) Because of the two-month interval between time of production and receipt of net profits income by the Trust, (1) oil and gas sales for the quarter ended September 30 generally represent production for the period May through July and (2) oil and gas sales for the nine months ended September 30 generally represent production for the period November through July.

(b) Oil and gas sales volumes are allocated to the net profits interests based upon a formula

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