

Edgar Filing: NORTH EUROPEAN OIL ROYALTY TRUST - Form 10-Q

NORTH EUROPEAN OIL ROYALTY TRUST  
Form 10-Q  
February 28, 2007

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the  
Securities Exchange Act of 1934

For the quarterly period ended January 31, 2007 or  
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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 1-8245

NORTH EUROPEAN OIL ROYALTY TRUST

-----  
(Exact name of registrant as specified in its charter)

Delaware

22-2084119

-----  
(State of organization)

-----  
(I.R.S. Employer I.D. No.)

Suite 19A, 43 West Front Street, Red Bank, New Jersey 07701

-----  
(Address of principal executive offices)

(732) 741-4008

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(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   
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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer   
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Indicate by check mark whether the registrant is a shell company  
(as defined in Rule 12b-2 of the Exchange Act).      Yes                  No      X

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Class	Outstanding at January 31, 2007
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Units of Beneficial Interest	9,190,590

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PART I -- FINANCIAL INFORMATION

Item 1. Financial Statements.

STATEMENTS OF ASSETS, LIABILITIES AND TRUST CORPUS (NOTE 1)

JANUARY 31, 2007 AND OCTOBER 31, 2006

	2007	2006
	-----	-----
	(unaudited)	
Current assets - - Cash and cash equivalents (Note 1)	\$ 8,295,776	\$ 7,204,250
Producing gas and oil royalty rights	1	1
Total Assets	\$ 8,295,777 =====	\$ 7,204,251 =====
Current liabilities - - Cash distributions payable to unit owners	\$ 8,179,625	\$ 7,168,660
Contingent liability (Note 3)		
Trust corpus (Notes 1 and 2)	1	1
Undistributed earnings	116,151	35,590
Total Liabilities and Trust Corpus	\$ 8,295,777 =====	\$ 7,204,251 =====

The accompanying notes are an integral part

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of these financial statements.

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STATEMENTS OF REVENUE COLLECTED AND EXPENSES PAID (NOTE 1)

FOR THE THREE MONTHS ENDED JANUARY 31, 2007 AND 2006

	2007	2006
	(unaudited)	
German gas, sulfur and oil royalties received	\$ 8,483,387	\$ 8,184,669
Interest income	53,693	22,033
Trust expenses	( 276,894)	( 262,093)
Net income	\$ 8,260,186	\$ 7,944,609
Net income per unit	\$ .90	\$ .87
Cash distributions paid or to be paid:		
Dividends and distributions per unit paid to formerly unlocated unit owners (Note 3)	\$ .00	\$ .02
Distributions per unit paid or to be paid to unit owners	\$ .89	\$ .85

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STATEMENTS OF UNDISTRIBUTED EARNINGS (NOTE 1)  
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 FOR THE THREE MONTHS ENDED JULY 31, 2007 AND 2006  
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	2007	2006
	-----	-----
	(unaudited)	
Balance, beginning of period	\$ 35,590	\$ 64,299
Net income	8,260,186	7,944,609
	-----	-----
	8,295,776	8,008,908
	-----	-----
Less:		
Dividends and distributions paid to formerly unlocated unit owners (Note 3)	0	148,097
Current year distributions paid or to be paid to unit owners	8,179,625	7,806,422
	-----	-----
	8,179,625	7,954,519
	-----	-----
Balance, end of period	\$ 116,151	\$ 54,389
	=====	=====

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STATEMENTS OF CHANGES IN CASH AND CASH EQUIVALENTS (NOTE 1)

FOR THE THREE MONTHS ENDED JULY 31, 2007 AND 2006

	2007	2006
	(unaudited)	
Sources of cash and cash equivalents:		
German gas, sulfur and oil royalties	\$ 8,483,387	\$ 8,184,669
Interest income	53,693	22,033
	-----	-----
	8,537,080	8,206,702
	-----	-----
Uses of cash and cash equivalents:		
Payment of Trust expenses	276,894	262,093
Distributions and dividends paid (Note 3)	7,168,660	4,004,065
	-----	-----
	7,445,554	4,266,158
	-----	-----
Net increase (decrease) in cash and cash equivalents during the period	1,091,526	3,940,544
Cash and cash equivalents, beginning of period	7,204,250	3,920,267
	-----	-----
Cash and cash equivalents, end of period	\$ 8,295,776	\$ 7,860,811
	=====	=====

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## NORTH EUROPEAN OIL ROYALTY TRUST

### NOTES TO FINANCIAL STATEMENTS

(Unaudited)

#### (1) Summary of significant accounting policies:

##### Basis of Accounting -

The accompanying financial statements of North European Oil Royalty Trust (the "Trust") present financial statement balances and financial results on a modified cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States ("GAAP basis"). Cash basis financial statements disclose revenue when cash is received and expenses when cash is paid. GAAP basis financial statements disclose income as earned and expenses as incurred, without regard to receipts or payments. The modified cash basis of accounting is utilized to permit the accrual for distributions to be paid to unit owners (those distributions approved by the Trustees for the Trust). The Trust's distributable income represents royalty income received by the Trust during the period plus interest income less any expenses incurred by the Trust, all on a cash basis. In the opinion of the Trustees, the use of the modified cash basis of accounting provides a more meaningful presentation to unit owners of the results of operations of the Trust.

##### Producing gas and oil royalty rights -

The rights to certain gas and oil royalties in Germany were transferred to the Trust at their net book value by North European Oil Company (the "Company") (see Note 2). The net book value of the royalty rights has been reduced to one dollar (\$1) in view of the fact that the remaining net book value of royalty rights is de minimis relative to annual royalties received and distributed by the Trust and does not bear any meaningful relationship to the fair value of such rights or the actual amount of proved producing reserves.

##### Federal income taxes -

The Trust, as a grantor trust, is exempt from federal income taxes under a private letter ruling issued by the Internal Revenue Service.

##### Cash and cash equivalents -

Included in cash and cash equivalents are amounts deposited in bank accounts and amounts invested in certificates of deposit and U. S. Treasury bills with original maturities of three months or less from the date of purchase.

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Net income per unit -  
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Net income per unit is based upon the number of units outstanding at the end of the period. As of January 31, 2007 and 2006, there were 9,190,590 and 9,184,026 units of beneficial interest outstanding, respectively.

(2) Formation of the Trust:  
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The Trust was formed on September 10, 1975. As of September 30, 1975, the Company was liquidated and the remaining assets and liabilities of the Company, including its royalty rights, were transferred to the Trust. The Trust, on behalf of the owners of beneficial interest in the Trust, holds overriding royalty rights covering gas and oil production in certain concessions or leases in the Federal Republic of Germany. These rights are held under contracts with local German exploration and development subsidiaries of ExxonMobil Corp. and the Royal Dutch/Shell Group of Companies. Under these contracts, the Trust receives various percentage royalties on the proceeds of the sales of certain products from the areas involved. At the present time, royalties are received for sales of gas well gas, oil well gas, crude oil, distillate and sulfur.

(3) Contingent liability:  
-----

Since its inception in 1975, the Trust had served as fiduciary for certain unlocated or unknown shareholders of North European Oil Corporation (the "Corporation") and North European Oil Company, corporate predecessors of the Trust. Pursuant to an order of the Delaware Court of Chancery dated February 26, 1996, from and after July 1, 2005, the Trust has no further obligation to make payments of dividends or distributions attributable to any unexchanged Corporate and Company shares.

From the liquidation of the Company to October 31, 2006, 729,761 Trust units were issued in exchange for Corporate or Company shares and dividends of \$358,804 and distributions of \$4,618,699 were paid to formerly unlocated Corporation and Company shareholders. With the escheat of the last Trust units attributable to unexchanged Corporation and Company shares completed in April 2006, all Trust units, including those issuable in exchange for Corporation and Company shares, have been issued.

(4) Related party transactions:  
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John R. Van Kirk, the Managing Director of the Trust, provides office space and office services to the Trust at cost. For such office space and office services, the Trust reimbursed the Managing Director \$7,629 in the first quarter of fiscal 2007 and \$6,760 in the first quarter of fiscal 2006.

As of January 1, 2007, Lawrence A. Kobrin, a Trustee of the Trust, was named Senior Counsel at Cahill Gordon & Reindel LLP which serves as counsel to the Trust. Prior to such time, Mr. Kobrin was a partner at Cahill Gordon & Reindel LLP. For the first quarter of fiscal



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2007, the Trust paid Cahill Gordon & Reindel LLP \$31,875 for legal services.

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### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

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#### Executive Summary

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The Trust is a passive fixed investment trust which holds overriding royalty rights, receives income under those rights from certain operating companies, pays its expenses and distributes the remaining net funds to its unit owners. The Trust does not engage in any business or extractive operations of any kind in the areas over which it holds royalty rights and is precluded from any such involvement by the Trust Agreement. There are no requirements, therefore, for capital resources with which to make capital expenditures or investments in order to continue the receipt of royalty revenues by the Trust.

The properties of the Trust, which the Trust and Trustees hold pursuant to the Trust Agreement on behalf of the unit owners, are overriding royalty rights on sales of gas, sulfur and oil under certain concessions or leases in the Federal Republic of Germany. The actual leases or concessions are held either by Mobil Erdgas-Erdol GmbH ("Mobil Erdgas"), a German operating subsidiary of the ExxonMobil Corp. ("ExxonMobil"), or by Oldenburgische Erdolgesellschaft ("OEG"). In 2002 Mobil Erdgas and BEB Erdgas und Erdol GmbH ("BEB"), a joint venture of ExxonMobil and the Royal Dutch/Shell Group of Companies, formed a company ExxonMobil Production Deutschland GmbH ("EMPG") to carry out all exploration, drilling and production activities. All sales activities are still handled by the operating companies, either Mobil Erdgas or BEB.

The operating companies pay monthly royalties to the Trust based on their sales of natural gas, sulfur and oil. Of these three products, natural gas provides approximately 98% of the total royalties. The amount of royalties paid to the Trust is based on four primary factors: the amount of gas sold, the price of that gas, the area from which the gas is sold and the exchange rate. The Oldenburg concession is the primary area from which the natural gas, sulfur and oil are extracted and provides nearly 100% of all the royalties received by the Trust. The Oldenburg concession (1,398,000 acres) covers virtually the entire former State of Oldenburg and is located in the federal state of Lower Saxony.

Under one set of rights covering the western part of the Oldenburg concession (approximately 662,000 acres), the Trust receives a royalty payment of 4% on gross receipts from sales by Mobil Erdgas of gas well gas, oil well gas, crude oil and condensate (the "Mobil Agreement"). Under the Mobil Agreement there is no deduction of costs prior to the calculation of royalties from gas well gas and oil well gas, which together account for approximately 99% of all the royalties under this agreement. Historically, the Trust has received significantly greater royalty payments under the Mobil Agreement due to the higher royalty rate specified by that agreement.

Under another set of rights covering the entire Oldenburg concession and pursuant to the agreement with OEG, the Trust receives royalties at the rate of 0.6667% on gross receipts from sales by BEB of gas well gas, oil well gas, crude oil, condensate and sulfur (removed during the processing of sour gas) less a certain allowed deduction of costs (the "OEG Agreement"). Under

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the OEG Agreement, 50% of the field handling, treatment and transportation

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costs, as reported for state royalty purposes, are deducted from the gross sales receipts prior to the calculation of the royalty to be paid to the Trust.

The gas is sold to various distributors under long term contracts which delineate, among other provisions, the timing, manner, volume and price of the gas sold. The pricing mechanisms contained in these contracts include a delay factor of three to six months and use the price of light heating oil in Germany as one of the primary pricing components. Since Germany must import a large percentage of its energy requirements, the U.S. dollar price of oil on the international market has a significant impact on the price of light heating oil and a delayed impact on the price of gas. The Trust itself does not have access to the specific sales contracts under which gas from the Oldenburg concession is sold. These contacts are reviewed periodically on behalf of the Trust by Ernst & Young AG to verify the correctness of application of the Agreement formulas for the computation of royalty payments.

For unit owners, changes in the value of the Euro have both an immediate and long term impact. The immediate impact is from the exchange rate that is applied at the time the royalties, paid to the Trust in Euros, are converted into dollars at the time of their transfer from Germany to the United States. A higher exchange rate would yield more dollars and a lower exchange rate fewer dollars. The long term impact relates to the mechanism of gas pricing. Since oil on the international market is priced in dollars, a weaker Euro would mean that oil imported into Germany is more expensive. A stronger Euro would mean that oil imported into Germany is less expensive. These changes in the price of oil in Germany are subsequently reflected in the price of light heating oil, which is used as a component in the calculation of gas prices in the contracts under which the gas is sold. The changes in German domestic light heating oil prices are in turn reflected in gas prices with a built-in delay of three to six months.

Seasonal demand factors affect the income from royalty rights insofar as they relate to energy demands and increases or decreases in prices, but on average they are not material to the regular annual income received under the royalty rights.

The Trust has no means of ensuring continued income from overriding royalty rights at their present level or otherwise. The Trust's current consultant in Germany provides general information to the Trust on the German and European economies and energy markets. This information provides a context in which to evaluate the actions of the operating companies. In his position as consultant he receives reports from the operating companies with respect to current and planned drilling and exploration efforts. However, the unified exploration and production venture, EMPG, which provides the reports to the Trust's consultant, continues to limit the information flow to that which is required by German law.

The relatively low level of administrative expenses of the Trust limits the effect of inflation on its financial prospects. Continued price inflation would be reflected in sales prices, which with sales volumes form the basis on which the royalties paid to the Trust are computed. The impact of inflation or deflation on energy prices in Germany is delayed by the use in certain long-term gas sales contracts of a delay factor of three to six months prior to the application of any changes in light heating oil prices to gas prices.

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As mandated by the Trust Agreement, distributions of income are made on a quarterly basis. These distributions, as determined by the Trustees, constitute substantially all of the funds on hand after provision is made for Trust expenses then anticipated.

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Results: First Quarter Fiscal 2007 and 2006  
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Net Trust income for the first quarter of fiscal 2007 was \$8,260,186 as compared to \$7,944,609 for the first quarter of fiscal 2006. This level of income permitted a distribution of 89 cents per unit which was paid on February 28, 2007 to owners of record as of February 13, 2007. Gross royalty income of \$8,483,387 for the quarter ended January 31, 2007 increased by 3.6% from gross royalty income of \$8,184,669 received during last year's equivalent period. This royalty income was based on sales of gas, oil and sulfur from the Trust's overriding royalty areas in Germany during the fourth calendar quarter of 2006.

In comparison to the first quarter of fiscal 2006, the combination of higher gas prices and the lower volumes of gas sales largely offset each other and royalties calculated in Euros were flat. The increase in the average exchange rates from prior year levels boosted the level of royalty income in dollars along with the subsequent distribution. For the quarter just ended the average price of gas sold under the Mobil Agreement increased 10.84% to 2.2673 Euro cents/Kwh ("Ecents/Kwh") from 2.0456 Ecents/Kwh in the first quarter of fiscal 2006. For the same period, the average price of gas sold under the OEG Agreement increased 13.08% to 2.4017 Ecents/Kwh from 2.1240 Ecents/Kwh. For the quarter just ended, gas sales under the Mobil Agreement decreased by 10.38% to 17.512 billion cubic feet ("Bcf") from 19.54 Bcf in the first quarter of fiscal 2006. In a corresponding comparison, overall gas sales covered under the OEG Agreement decreased by 12.32% to 41.976 Bcf from 47.876 Bcf in the first quarter of fiscal 2006.

Based on the conversion and transfer of the royalties paid during the quarter under both the Mobil and OEG Agreements, the average values of the Euro increased 9.38% and 7.65% to dollar equivalent values of \$1.3058 and \$1.3044, respectively. If we apply this weighted average value to the average price of gas during the quarter just ended, we can convert the average gas prices into more familiar terms. For the first quarter of fiscal 2007 the average gas prices for gas sold under both the Mobil and OEG Agreements were \$8.51/Mcf and \$8.80/Mcf respectively. The corresponding prices for the first quarter of fiscal 2006 were \$7.02/Mcf and \$7.23/Mcf respectively.

Trust expenses for the first quarter of fiscal 2007 were \$276,894, an increase of \$14,801 or 5.6% from the prior year. Trustees' fees, as specified in the Trust Agreement, are calculated under a formula using royalty income as its basis. Trustees' fees paid in the first quarter of fiscal 2007 are based on royalty income for the fourth quarter of fiscal 2006, which was higher than royalty income for the fourth quarter of fiscal 2005.

Interest income increased, reflecting both the expanded funds available for investment and the higher interest rates on those funds.

The current Statement of Assets, Liabilities and Trust Corpus of the Trust at January 31, 2007 compared to that at fiscal year end (October 31, 2006) shows an increase in assets due to higher royalty receipts during the quarter.

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This report on Form 10-Q contains forward looking statements concerning business, financial performance and financial condition of the Trust. Many of these statements are based on information provided to the Trust by the operating companies or by consultants using public information sources. These statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those anticipated in any forward looking statements. These include uncertainties concerning levels of gas production and gas prices, general economic conditions and currency exchange rates and the risks described in Item 1A, "Risk Factors," in the Trust's Annual Report on Form 10-K for the fiscal year ended October 31, 2006. Actual results and events may vary significantly from those discussed in the forward looking statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.  
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The Trust does not engage in any trading activities with respect to possible foreign exchange fluctuations. The Trust does not use any financial instruments to hedge against possible risks related to foreign exchange fluctuations. The market risk is negligible because standing instructions at its German bank require the bank to process transfers of royalty payments as soon as possible following their receipt. The Trust does not engage in any trading activities with respect to possible commodity price fluctuations.

Item 4. Controls and Procedures.  
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As of the end of the period covered by this report, an evaluation was carried out under the supervision and with the participation of the Trust's management, which consists of the Managing Director, of the effectiveness of the design and operation of the Trust's disclosure controls and procedures pursuant to Rule 13a-15 of the Securities Exchange Act of 1934. Based upon that evaluation, the Managing Director concluded that the Trust's disclosure controls and procedures were effective, in all material respects, with respect to the recording, processing, summarizing and reporting, within the time periods specified in the Securities and Exchange Commission's rules and forms, of information required to be disclosed by the Trust's management in the reports that are filed or submitted under the Exchange Act.

There have been no changes in our internal control over financial reporting identified in connection with the evaluation described above that occurred during the first quarter of fiscal 2007 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

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PART II -- OTHER INFORMATION

Item 4. Submission of Matters to a Vote of Security Holders.

The Annual Meeting of Unit Owners was held on February 12, 2007. The following persons were elected as Trustees of the Trust to serve until the next Annual Meeting of Unit Owners:

Robert P. Adelman	(7,889,951 votes for; 144,198 withheld)
Samuel M. Eisenstat	(7,981,503 votes for; 52,646 withheld)
Lawrence A. Kobrin	(7,952,165 votes for; 81,984 withheld)
Willard B. Taylor	(7,959,366 votes for; 74,783 withheld)
Rosalie J. Wolf	(7,976,794 votes for; 57,355 withheld)

Item 6. Exhibits.

- Exhibit 31. Certification of Chief Executive Officer  
Chief Financial Officer pursuant to Section 302  
of the Sarbanes-Oxley Act of 2002
- Exhibit 32. Certification of Chief Executive Officer and  
Chief Financial Officer pursuant to Section 906  
of the Sarbanes-Oxley Act of 2002

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SIGNATURE

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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 hereunto duly authorized.

NORTH EUROPEAN OIL ROYALTY TRUST

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(Registrant)

/s/ John R. Van Kirk

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John R. Van Kirk  
Managing Director

Dated: February 28, 2007