

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

NORTH EUROPEAN OIL ROYALTY TRUST  
Form 10-Q  
February 28, 2008

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, 2008 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, 2008
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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, 2008 AND OCTOBER 31, 2007

	2008	2007
	-----	-----
	(unaudited)	
Current assets - - Cash and cash equivalents (Note 1)	\$ 7,009,967	\$ 5,912,620
Producing gas and oil royalty rights	1	1
Total Assets	\$ 7,009,968 =====	\$ 5,912,621 =====
Current liabilities - - Distributions payable to unit owners	\$ 6,987,848	\$ 5,881,978
Trust corpus (Notes 1 and 2)	1	1
Undistributed earnings	25,119	30,642
Total Liabilities and Trust Corpus	\$ 7,009,968 =====	\$ 5,912,621 =====

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

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STATEMENTS OF REVENUE COLLECTED AND EXPENSES PAID (NOTE 1)

FOR THE THREE MONTHS ENDED JANUARY 31, 2008 AND 2007

	2008	2007
	(unaudited)	
German gas, sulfur and oil royalties received	\$ 7,215,083	\$ 8,483,387
Interest income	33,355	53,693
Trust expenses	( 269,113)	( 276,894)
Net income	\$ 6,979,325	\$ 8,260,186
Net income per unit	\$ .76	\$ .90
Distributions per unit to be paid to unit owners	\$ .76	\$ .89

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

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STATEMENTS OF UNDISTRIBUTED EARNINGS (NOTE 1)  
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 FOR THE THREE MONTHS ENDED JANUARY 31, 2008 AND 2007  
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	2008	2007
	-----	-----
	(unaudited)	
Balance, beginning of period	\$ 30,642	\$ 35,590
Net income	6,979,325	8,260,186
	-----	-----
	7,009,967	8,295,776
Less:		
Current year distributions to be paid to unit owners	6,984,848	8,179,625
	-----	-----
Balance, end of period	\$ 25,119	\$ 116,151
	=====	=====

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

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

FOR THE THREE MONTHS ENDED JANUARY 31, 2008 AND 2007

	2008	2007
	(unaudited)	
Sources of cash and cash equivalents:		
German gas, sulfur and oil royalties	\$ 7,215,083	\$ 8,483,387
Interest income	33,355	53,693
	-----	-----
	7,248,438	8,537,080
	-----	-----
Uses of cash and cash equivalents:		
Payment of Trust expenses	269,113	276,894
Distributions paid	5,881,978	7,168,660
	-----	-----
	6,151,091	7,445,554
	-----	-----
Net increase (decrease) in cash and cash equivalents during the period	1,097,347	1,091,526
Cash and cash equivalents, beginning of period	5,912,620	7,204,250
	-----	-----
Cash and cash equivalents, end of period	\$ 7,009,967	\$ 8,295,776
	=====	=====

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

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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.

From time to time, the amounts deposited in the Trust's bank accounts may exceed the federally insured limit.

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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 both January 31, 2008 and 2007, there were 9,190,590 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, condensate and sulfur.

(3) 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 \$8,922 and \$7,629 in the first quarter of fiscal 2008 and 2007, respectively.

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 2008 and 2007, the Trust paid Cahill Gordon & Reindel LLP \$56,692 and \$31,875 for legal services.

As of November 1, 2006, John H. Van Kirk, the former Managing Trustee of the Trust and the father of John R. Van Kirk, was named to the position of Founding Trustee Emeritus. For his service in such capacity, the Trust paid him \$2,500 in each of the first quarters of fiscal 2008 and 2007.

(4) Employee Benefit Plan:  
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The Trust has established a savings incentive match plan for employees (SIMPLE IRA) that is available to all employees of the Trust, including the Managing Director. The Trustees have authorized the making of contributions by the Trust to the accounts of employees, on a matching basis, of up to 3% of cash compensation paid to each such employee effective as of January 1, 2008.



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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 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. After the close of the fiscal year, on November 23, 2007, N.V. Nederlandse Gasunie (the state owned Dutch gas distribution company) announced that it had reached an agreement with BEB regarding the purchase by Gasunie of BEB's North German gas distribution and transmission network. Preliminary informal discussions with OEG personnel indicate that the pipeline sale should not affect the method of royalty calculations.

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

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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.

Results: First Quarter Fiscal 2008 Versus First Quarter Fiscal 2007  
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Net Trust income for the first quarter of fiscal 2008 was \$6,979,325 as compared to \$8,260,186 for the first quarter of fiscal 2007. This level of income permitted a distribution of 76 cents per unit which was paid on February 27, 2008 to owners of record as of February 15, 2008. Gross royalty income of \$7,215,083 for the quarter ended January 31, 2008 decreased by 14.95% from gross royalty income of \$8,483,387 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 2007.

In comparison to the first quarter of fiscal 2007, the combination of lower gas sales and lower gas prices reduced gross royalty income in Euros by 24.44%. When the positive impact of the higher average exchange rates were factored in, gross royalty income in dollars decreased by the 14.95% mentioned above.

For the quarter just ended, gas sales under the Mobil Agreement decreased by 18.62% to 14.251 billion cubic feet ("Bcf") from 17.512 Bcf in the first quarter of fiscal 2007. For the same period, the average price of gas sold under the Mobil Agreement decreased 7.93% to 2.0876 Euro cents/Kwh ("Ecents/Kwh") from 2.2673 Ecents/Kwh in the first quarter of fiscal 2007. The combination of these two factors resulted in a decline of 24.60% in the amount of royalties in Euros received under the Mobil Agreement during the first quarter of fiscal 2008. When the impact of the higher average value of the Euro is considered, amount of royalties in Euros received under the Mobil Agreement during the first quarter of fiscal 2008 declined by 15.16%.

For the quarter just ended, overall gas sales covered under the OEG Agreement decreased by 17.30% to 34.716 Bcf from 41.976 Bcf in the first quarter of fiscal 2007. For the same period, the average price of gas sold under the OEG Agreement decreased 8.73% to 2.1921 Ecents/Kwh from 2.4017 Ecents/Kwh. The combination of these two factors resulted in a decline of 24.06% in the amount of royalties in Euros received under the OEG Agreement during the first quarter of fiscal 2008. When the impact of the higher average value of the Euro is considered, amount of royalties in Euros received under the OEG Agreement during the first quarter of fiscal 2008 declined by 14.44%.

While gas prices continued to show declines when compared to the prior year's equivalent period, gas prices have increased from their recent low point in the third quarter of fiscal 2007. From the third quarter of fiscal 2007 through the first quarter of fiscal 2008, the average prices of gas under the Mobil and OEG Agreements increased 37.71% and 16.76%, respectively.

Based on the conversion and transfer of the royalties paid during the quarter under both the Mobil and OEG Agreements, the weighted average

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values of the Euro increased 12.52% and 12.67% to dollar equivalent values of \$1.4693 and \$1.4697, 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 2008, the average gas prices for gas sold under both the

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Mobil and OEG Agreements were \$8.83/Mcf and \$9.06/Mcf respectively. The corresponding prices for the first quarter of fiscal 2007 were \$8.51/Mcf and \$8.80/Mcf respectively.

Trust expenses for the first quarter of fiscal 2008 were \$269,113, a decrease of \$7,781 or 2.8% from the prior year. Interest income decreased, reflecting both the reduced funds available for investment and the lower interest rates on those funds.

The current Statement of Assets, Liabilities and Trust Corpus of the Trust at January 31, 2008 compared to that at fiscal year end (October 31, 2007) 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, 2007. 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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The Trust maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed by the Trust is recorded, processed, summarized, accumulated and communicated to its management, which consists of the Managing Director, to allow timely decisions regarding required disclosure, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

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The Managing Director has performed an evaluation of the effectiveness of the design and operation of the Trust's disclosure controls and procedures as of January 31, 2008. Based on that evaluation, the Managing Director concluded that the Trust's disclosure controls and procedures were effective as of January 31, 2008.

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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 2008 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

### PART II -- OTHER INFORMATION

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#### Item 5. Submission of Matters to a Vote of Security Holders.

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The Annual Meeting of Unit Owners was held on February 13, 2008. The following persons were elected as Trustees of the Trust to serve until the next Annual Meeting of Unit Owners:

Robert P. Adelman	(7,861,154 votes for; 146,311 withheld)
Samuel M. Eisenstat	(7,937,547 votes for; 69,918 withheld)
Lawrence A. Kobrin	(7,886,994 votes for; 120,471 withheld)
Willard B. Taylor	(7,921,897 votes for; 85,568 withheld)
Rosalie J. Wolf	(7,936,111 votes for; 71,354 withheld)

In addition to voting for the Trustees of the Trust, two sets of amendments to the Trust Agreement were proposed for approval by the Unit Owners. Each of these sets of amendments were approved by the Unit Owners.

The first set of amendments clarified that units of beneficial interest in the Trust may be issued in uncertificated or book entry form. The results of the voting on this set of amendments are as follows:

(7,789,373 votes for; 120,392 votes against and 97,700 votes abstained)

The second set of amendments provided that the Trust shall have a perpetual life. The results of the voting on this set of amendments are as follows:

(7,854,172 votes for; 76,742 votes against and 76,551 votes abstained)

North European Oil Royalty Trust has rescheduled the date of the 2009 annual meeting from February 13, 2009 to February 10, 2009. The dates for submission of proposals by unit owners remain as set forth in the proxy statement dated January 10, 2008.

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Item 6. Exhibits.  
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- Exhibit 3. North European Oil Royalty Trust Agreement, dated September 10, 1975, as amended through February 13, 2008 (incorporated by reference to Exhibit 3.1 to Current Report on Form 8-K, filed February 15, 2008 (File No. 0-8378)).
- 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

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, 2008