TEXAS PACIFIC LAND TRUST
Form 10-Q
August 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 June 30, 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 July 31, 2018, the Registrant had 7,788,426 Sub-share Certificates outstanding.

TEXAS PACIFIC LAND TRUST
Form 10-Q
Quarter Ended June 30, 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)

	June 30, 2018 (Unaudited)	December 31, 2017
ASSETS		
Cash and cash equivalents	$ 85,895	$ 79,580
Accrued receivables	35,664	17,773
Other assets	1,061	849
Prepaid income taxes	—	1,202
Property, plant and equipment, net of accumulated depreciation of $1,270 and $463 as of June 30, 2018 and December 31, 2017, respectively	50,273	19,516
Real estate acquired	3,778	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 June 30, 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	$ 176,671	$ 120,035
LIABILITIES AND CAPITAL		
Accounts payable and accrued expenses	$ 9,590	$ 5,608
Income taxes payable	2,922	851
Deferred taxes payable	114	114
Unearned revenue	11,313	8,364
Total liabilities	23,939	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 7,792,537 and 7,821,599 Sub-share Certificates as of June 30, 2018 and December 31, 2017, respectively	—	—
Accumulated other comprehensive loss	(778)	(804)
Net proceeds from all sources	153,510	105,902
Total capital	152,732	105,098
Total liabilities and capital	$ 176,671	$ 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 June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Income:				
Oil and gas royalties	$30,278	$ 12,183	$56,825	$ 22,771
Easements and sundry income	27,799	12,926	44,777	27,793
Water sales and royalties	15,643	6,839	29,250	11,667
Land sales	—	220	2,750	220
Other operating income	124	125	249	249
Total income	73,844	32,293	133,851	62,700
Expenses:				
Salaries and related employee benefits	3,556	580	5,845	966
Water service-related expenses	2,588	10	3,894	10
General and administrative expenses	1,177	271	1,985	611
Legal and professional fees	420	904	1,067	1,619
Depreciation and amortization	483	85	813	104
Taxes, other than income taxes	113	62	257	117
Trustees' compensation	2	2	4	4
Total expenses	8,339	1,914	13,865	3,431
Operating income	65,505	30,379	119,986	59,269
Other income	160	6	290	13
Income before income taxes	65,665	30,385	120,276	59,282
Income taxes	13,162	10,035	23,982	19,673
Net income	$52,503	$ 20,350	$96,294	$ 39,609
Other comprehensive income — periodic pension costs, net of income taxes of $3, $9, $7, and $19, respectively	13	17	26	35
Total comprehensive income	$52,516	$ 20,367	$96,320	$ 39,644
Weighted average number of Sub-share Certificates outstanding	7,803,162	7,882,184	7,808,064	7,894,542
Net income per Sub-share Certificate — basic and diluted	$6.73	$ 2.58	$12.33	$ 5.02
Cash dividends per Sub-share Certificate	$—	$ —	$4.05	$ 1.35

See accompanying notes to condensed consolidated financial statements.

2

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

	Six Months Ended June 30, 2018	2017
Cash flows from operating activities:		
Net income	$96,294	$39,609
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred taxes	—	(259)
Depreciation and amortization	813	104
Gain on disposal of fixed assets	—	(4)
Changes in operating assets and liabilities:		
Accrued receivables and other assets	(18,109)	(5,776)
Prepaid income taxes	1,202	—
Accounts payable, accrued expenses and other liabilities	6,958	2,039
Income taxes payable	2,071	(751)
Cash provided by operating activities	89,229	34,962
Cash flows from investing activities:		
Proceeds from sale of fixed assets	—	28
Acquisition of land	(2,663)	—
Purchase of fixed assets	(31,564)	(3,610)
Cash used in investing activities	(34,227)	(3,582)
Cash flows from financing activities:		
Purchase of Sub-share Certificates in Certificates of Proprietary Interest	(17,035)	(20,014)
Dividends paid	(31,652)	(10,681)
Cash used in financing activities	(48,687)	(30,695)
Net increase in cash and cash equivalents	6,315	685
Cash and cash equivalents, beginning of period	79,580	49,418
Cash and cash equivalents, end of period	$85,895	$50,103
Supplemental disclosure of cash flow information:		
Income taxes paid	$21,951	$20,702

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 June 30, 2018 and the results of its operations for the three and six month periods ended June 30, 2018 and 2017, respectively, and its cash flows for the six month periods ended June 30, 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 new 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 and six months ended June 30, 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
Condensed Consolidated Statements of Income:			
For the three months ended June 30, 2017			
Revenue	$27,349	$ 4,944	$32,293
Taxes, other than income taxes	762	(700)	62
Income taxes	8,030	2,005	10,035
Net income	16,711	3,639	20,350
Net income per Sub-share Certificate	$2.12	$ 0.46	$2.58
For the six months ended June 30, 2017			
Revenue	$51,577	$ 11,123	$62,700
Taxes, other than income taxes	1,422	(1,305)	117
Income taxes	15,258	4,415	19,673
Net income	31,597	8,012	39,609
Net income per Sub-share Certificate	$4.00	$ 1.02	$5.02
Condensed 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

5

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.

Effects on Operating Income and Other Income from Adoption of New Accounting Standards

Adoption of the standards related to revenue recognition and presentation of net periodic pension cost 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
Condensed Consolidated Statements of Income:			
For the three months ended June 30, 2017			
Operating income [(1)]	$24,732	$ 5,647	$30,379
Other income	10	(4)	6
For the six months ended June 30, 2017			
Operating income [(1)]	$46,836	$ 12,433	$59,269
Other income	19	(6)	13

(1) The retrospective adjustment amount includes approximately $5.6 million and $12.4 million for the three and six months ended June 30, 2017, respectively, 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 June 30, 2018 and December 31, 2017 (in thousands):

	June 30, 2018	December 31, 2017
Property, plant and equipment:		
Water service-related assets [(1)]	$47,988	$ 18,193
Furniture, fixtures and equipment	3,555	1,786
Property, plant and equipment at cost	51,543	19,979
Less: accumulated depreciation	(1,270)	(463)
Property, plant and equipment, net	$50,273	$ 19,516

(1) Water service-related assets reflect assets related to brackish water sourcing and water re-use projects.

Depreciation expense was $0.5 million and $0.8 million for the three and six months ended June 30, 2018, respectively. Depreciation expense was $0.1 million for each of the three and six months ended June 30, 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. 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 six months ended June 30, 2018 and 2017, 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
For the six months ended June 30, 2018			
February 2018	Loving County	40.0	$ 1,150
March 2018	Culberson County	80.0	1,600
Total		120.0	$ 2,750

For the six months ended June 30, 2017			
May 2017	Loving County	11.02	$ 220
Total		11.02	$ 220

7

Real Estate Acquired

Real estate acquired included the following activity for the six months ended June 30, 2018 and 2017 (in thousands, except number of acres):

	Six Months Ended June 30, 2018		Six Months Ended June 30, 2017	
	Acres	Book Value	Acres	Book Value
Balance at January 1,	10,064.78	$1,115	10,064.78	$1,115
Acquisitions	2,883.68	2,663	—	—
Sales	—	—	—	—
Balance at June 30,	12,948.46	$3,778	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-share Certificates ("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-shares

During the six months ended June 30, 2018, we purchased and retired 29,062 Sub-shares. During the six months ended June 30, 2017, we purchased and retired 68,760 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, revenues from easements and leases, and land sales.
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 revenue generated from direct sales of water as well as revenues from royalties on water service-related activity.

Segment financial results were as follows for the three and six months ended June 30, 2018 and 2017 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenues:				
Land and resource management	$52,376	$25,286	$95,129	$50,865
Water service and operations	21,468	7,007	38,722	11,835
Total consolidated revenues	$73,844	$32,293	$133,851	$62,700
Net income:				
Land and resource management	$40,505	$17,665	$73,315	$32,111
Water service and operations	11,998	2,685	22,979	7,498
Total consolidated net income	$52,503	$20,350	$96,294	$39,609
Capital expenditures				
Land and resource management	$303	$332	$1,555	$506
Water service and operations	19,420	1,366	30,009	3,104
Total capital expenditures	$19,723	$1,698	$31,564	$3,610
Depreciation and amortization:				
Land and resource management	$100	$14	$170	$19
Water service and operations	383	71	643	85
Total depreciation and amortization	$483	$85	$813	$104

The following table presents total assets and property, plant and equipment, net by segment as of June 30, 2018 and December 31, 2017 (in thousands):

	June 30, 2018	December 31, 2017
Assets:		
Land and resource management	$108,616	$ 97,549
Water service and operations	68,055	22,486
Total consolidated assets	$176,671	$ 120,035
Property, plant and equipment, net		
Land and resource management	$2,839	$ 1,449
Water service and operations	47,434	18,067
Total consolidated property, plant and equipment, net	$50,273	$ 19,516

9. Oil and Gas Producing Activities

There are a number of oil and gas wells that have been drilled but are not yet completed ("DUC") where the Trust has a royalty interest. Currently, the Trust has identified 213 DUC wells subject to our royalty interest. The process of identifying these wells is ongoing and we anticipate updates going forward to be affected by a number of factors including, but not limited to, ongoing changes/updates to our identification process, changes/updates by Drilling Info (our main source of information in identifying these wells) in their identification process, the eventual completion of these DUC wells, and additional wells drilled but not completed by companies operating where we have a royalty interest.

10. Subsequent Events

We evaluate events that occur after the balance sheet date but before consolidated financial statements are, or are available to be, issued to determine if a material event requires our amending the consolidated financial statements or disclosing the event. We evaluated subsequent events through the filing date we issued these consolidated financial statements and did not identify any subsequent events requiring disclosure.

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

Cautionary Statement Regarding Forward-Looking Statements

Statements in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including statements regarding management's expectations, hopes, intentions or strategies regarding the future. Forward-looking statements include statements regarding the Trust's future operations and prospects, the markets for real estate in the areas in which the Trust owns real estate, applicable zoning regulations, the markets for oil and gas, production limits on prorated oil and gas wells authorized by the Railroad Commission of Texas, expected competition, management's intent, beliefs or current expectations with respect to the Trust's future financial performance and other matters. All forward-looking statements in this Report are based on information available to us as of the date this Report is filed with the Securities and Exchange Commission (the "SEC"), and we assume no responsibility to update any such forward-looking statements, except as required by law. All forward-looking statements are subject to a number of risks, uncertainties and other factors that could cause our actual results, performance, prospects or opportunities to differ materially from those expressed in, or implied by, these forward-looking statements. These risks, uncertainties and other factors include, but are not limited to, the factors discussed in Item 1A. "Risk Factors" of Part I of our Annual Report on Form 10-K for the year ended December 31, 2017, and in Part I, Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Part II, Item 1A. "Risk Factors" of this Quarterly Report on Form 10-Q.

The following discussion and analysis should be read together with (i) the factors discussed in Item 1A. "Risk Factors" of Part I of our Annual Report on Form 10-K for the year ended December 31, 2017, (ii) the factors discussed in Part II, Item 1A. "Risk Factors," if any, of this Quarterly Report on Form 10-Q and (iii) the Financial Statements, including the Notes thereto, and the other financial information appearing elsewhere in this Report. Period-to-period comparisons of financial data are not necessarily indicative, and therefore should not be relied upon as indicators, of the Trust's future performance. Words or phrases such as "expects" and "believes", or similar expressions, when used in this Form 10-Q or other filings with the SEC, are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995.

Overview

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. We were organized under a Declaration of Trust, dated February 1, 1888, to receive and hold title to extensive tracts of land in numerous counties in West Texas, previously the property of the Texas and Pacific Railway Company. Our Trustees are empowered under the Declaration of Trust to manage the lands with all the powers of an absolute owner.

Our revenues are derived primarily from oil, gas and water service-related royalties, sales of water and land, easements and leases of the land. Due to the nature of our operations, our revenue is subject to substantial fluctuations from quarter to quarter and year to year. We are a passive seller of land and do not actively solicit sales of land. In addition, the demand for, and sale price of, particular tracts of land is influenced by many factors beyond our control, including general economic conditions, the rate of development in nearby areas and the suitability of the particular tract for the ranching uses prevalent in western Texas.

We are not an oil and gas producer. Rather, our oil and gas revenue is derived from our retained perpetual non-participating oil and gas royalty interests. Thus, in addition to being subject to fluctuations in response to the market prices for oil and gas, our oil and gas royalty revenues are also subject to decisions made by the owners and operators of the oil and gas wells to which our royalty interests relate as to investments in and production from those wells. We monitor production reports by the oil and gas companies to assure that we are being paid the appropriate royalties. We review conditions in the agricultural industry in the areas in which our lands are located and seek to keep as much of our lands as possible under lease to local ranchers.

Our revenue from easements is generated from easement contracts covering activities such as oil and gas pipelines and subsurface wellbore easements. The majority of our easements have a ten-year term. We also enter into agreements with operators and mid-stream companies to lease land from us, primarily for facilities and roads.

In prior years, we entered into 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. Energy businesses use water for their oil and gas projects while non-energy businesses (i.e., water management service companies) operate water facilities to produce and sell water to energy businesses. We collect revenue from royalties and water sales under these legacy agreements.
Demand for water solutions is expected to grow as drilling and completion activity in the Permian Basin continues to increase. In response to that anticipated demand, the Trust formed Texas Pacific Water Resources LLC (“TPWR”) in June 2017. TPWR, a single member LLC and wholly owned subsidiary of the Trust, focuses on providing full-service water offerings to operators in the Permian Basin. These services include brackish water sourcing, produced-water gathering/treatment/recycling, infrastructure development/construction, disposal, water tracking, analytics and well testing services. TPWR is committed to sustainable water development with significant focus on the large-scale implementation of recycled water operations.

During the six months ended June 30, 2018, the Trust invested approximately $20.3 million in TPWR projects to develop brackish water sourcing and water re-use assets.

Results of Operations

We operate our business in two segments: Land and Resource Management and Water Service and Operations. We eliminate any inter-segment revenues and expenses upon consolidation.

We analyze financial results for each of our reportable segments. The reportable segments presented are consistent with our reportable segments discussed in Note 8, “Business Segment Reporting” in Item 1. Financial Statements in this