HEIDRICK & STRUGGLES INTERNATIONAL INC
Form 10-Q
October 26, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2016

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 0-25837

HEIDRICK & STRUGGLES INTERNATIONAL, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware	36-2681268
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

233 South Wacker Drive-Suite 4900
Chicago, Illinois
60606-6303
(Address of Principal Executive Offices)

(312) 496-1200
(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 of time that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x 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 x No ¨

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

Large accelerated filer ¨	Accelerated filer x
Non-Accelerated filer ¨(Do not check if a smaller reporting company)	Smaller reporting company ¨

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.
As of October 21, 2016, there were 18,582,574 shares of the Company's common stock outstanding.

HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES
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PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)

	September 30, 2016 (Unaudited)	December 31, 2015
Current assets:		
Cash and cash equivalents	$99,975	$190,452
Accounts receivable, net	114,726	76,058
Prepaid expenses	23,936	19,197
Other current assets	14,867	18,447
Income taxes recoverable	5,451	4,809
Total current assets	258,955	308,963
Non-current assets:		
Property and equipment, net	36,137	36,498
Assets designated for retirement and pension plans	17,438	16,857
Investments	17,268	14,145
Other non-current assets	11,233	11,115
Goodwill	155,313	131,122
Other intangible assets, net	20,154	18,687
Deferred income taxes	37,277	35,331
Total non-current assets	294,820	263,755
Total assets	$553,775	$572,718
Current liabilities:		
Accounts payable	$9,644	$6,150
Accrued salaries and employee benefits	120,102	158,875
Deferred revenue, net	31,713	29,724
Other current liabilities	25,103	31,239
Income taxes payable	3,897	3,442
Total current liabilities	190,459	229,430
Non-current liabilities:		
Accrued salaries and employee benefits	30,363	32,690
Retirement and pension plans	39,921	35,949
Other non-current liabilities	27,267	19,847
Total non-current liabilities	97,551	88,486
Total liabilities	288,010	317,916
Commitments and contingencies (Note 16)		
Stockholders’ equity:		
Preferred stock, $0.01 par value, 10,000,000 shares authorized, no shares issued at September 30, 2016 and December 31, 2015	—	—
Common stock, $0.01 par value, 100,000,000 shares authorized, 19,585,777 shares issued, 18,578,176 and 18,379,398 shares outstanding at September 30, 2016 and December 31, 2015, respectively	196	196
Treasury stock at cost, 1,007,601 and 1,206,379 shares at September 30, 2016 and December 31, 2015, respectively	(32,915)	(39,583)

Additional paid in capital	229,318	232,358
Retained earnings	60,050	52,572
Accumulated other comprehensive income	9,116	9,259
Total stockholders' equity	265,765	254,802
Total liabilities and stockholders' equity	$553,775	$572,718

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	20
Revenue:				
Revenue before reimbursements (net revenue)	$143,519	$138,421	$422,569	$3
Reimbursements	4,720	4,429	13,773	12
Total revenue	148,239	142,850	436,342	39
Operating expenses:				
Salaries and employee benefits	95,355	95,724	288,015	

	High	Low	Cash Distributions
Quarter ended March 31, 2006	$ 8.10	$6.84	$ .35
Quarter ended June 30, 2006	$ 9.00	$7.13	$ .25
Quarter ended September 30, 2006	$10.22	$7.02	$ .14
Quarter ended December 31, 2006	$ 7.64	$6.28	$ .10
Quarter ended March 31, 2007	$ 7.30	$6.16	$ .10
Quarter ended June 30, 2007	$ 8.31	$6.33	$ .10
Quarter ended September 30, 2007	$10.00	$7.11	$ .12
Quarter ended December 31, 2007	$11.82	$7.51	$ .16

On December 23, 2008, the high and low sales price per unit on the NYSE was $1.75 and $1.01, respectively. On March 31, 2008, the high and low sales price per unit on the NYSE was $10.03 and $10.00, respectively.

Item 6. Selected Financial Data (In thousands, except per Unit amounts)

	Year Ended December 31,				
	2007	2006	2005	2004	2003
Net profits income	$ 4,842	$ 7,796	$ 5,818	$ 6,161	$ 8,969
Distributable income	$ 4,133	$ 7,262	$ 5,601	$ 5,657	$ 8,036
Distributions declared	$ 4,102	$ 7,250	$ 5,590	$ 5,728	$ 7,989
Distributable income per Unit	$ 0.48	$ 0.84	$ 0.65	$ 0.66	$ 0.93
Distributions per Unit	$ 0.48	$ 0.84	$ 0.65	$ 0.67	$ 0.93
Total assets (at end of period)	$16,694	$18,386	$21,675	$23,801	$26,458

Distributable income of the Trust consists of the excess of net profits income plus Infill Well Net Proceeds less general and administrative expenses and interest expense of the Trust. The Trust recognizes net profits income during the period in which amounts are received by the Trust.

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Torch Energy Royalty Trust

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

Discussion of Years Ended December 31, 2007, 2006, and 2005

Because a modified cash basis of accounting is utilized by the Trust, Net Proceeds attributable to the Underlying Properties for the years ended December 31, 2007, 2006 and 2005 are derived from actual oil and gas production from October 1, 2006 through September 30, 2007, October 1, 2005 through September 30, 2006 and October 1, 2004 through September 30, 2005, respectively. The following tables set forth oil and gas sales attributable to the Underlying Properties during the three years ended December 31, 2007.

	Bbls of Oil		
	2007	2006	2005
Chalkley Field	4,027	4,520	5,155
Robinson s Bend Field			
Cotton Valley Fields	1,855	1,529	1,852
Austin Chalk Fields	9,229	12,787	15,315
Total	15,111	18,836	22,322

	Mcf of Gas		
	2007	2006	2005
Chalkley Field	976,994	1,102,855	1,226,513
Robinson s Bend Field	1,666,553	1,761,754	1,825,667
Cotton Valley Fields	643,745	664,283	684,434
Austin Chalk Fields	190,591	187,423	177,512
Total	3,477,883	3,716,315	3,914,126

For the year ended December 31, 2007, net profits income was $4.8 million, as compared to $7.8 million and $5.8 million for the same periods in 2006 and 2005, respectively. The decrease in net profits income during 2007 as compared to 2006 is due to lower average oil and gas prices paid to the Trust in 2007 combined with payments received by the Trust in 2006 with respect to the Robinson s Bend Field. The increase in net profits income during 2006 as compared to 2005 is due to higher average gas prices paid to the Trust in 2006 combined with payments received by the Trust in 2006 with respect to the Robinson s Bend Field.

Commencing with the second quarter of 2003 distribution (pertaining to the quarter ended March 31, 2003 production) lease operating expenses and capital expenditures have been deducted in calculating Robinson s Bend Net

Proceeds. The Trust received no payments for distributions to Unitholders with respect to the Robinson s Bend Field during each of the years ended December 31, 2007 and 2005. The Trust received approximately $0.6 million in 2006 (pertaining to production during the twelve month period ended September 30, 2006) for payments for distributions to Unitholders with respect to the Robinson s Bend Field.

The Robinson s Bend Field Cumulative Deficit (pertaining to production as of September 30, 2007) is approximately $326,000. Neither the Trust nor Unitholders are liable to pay such deficit. However, the

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Torch Energy Royalty Trust

Trust will receive no payments with respect to the Robinson s Bend Field until future proceeds exceed the Robinson s Bend Cumulative Deficit.

Gas production attributable to the Underlying Properties in the Chalkley, Cotton Valley and Austin Chalk Fields was 1,811,330 Mcf, 1,954,561 Mcf and 2,088,459 Mcf in 2007, 2006 and 2005, respectively. Gas production attributable to the Underlying Properties in the Robinson s Bend Field was 1,666,553 Mcf, 1,761,754 Mcf and 1,825,667 Mcf in 2007, 2006 and 2005, respectively. Gas production decreased during each of the years ended December 31, 2007 as a result of normal production declines. Oil production attributable to the Underlying Properties for the year ended December 31, 2007 was 15,111 Bbls as compared to 18,836 Bbls and 22,322 Bbls for the same periods in 2006 and 2005, respectively.

The average price used to calculate Net Proceeds for gas, before gathering, treating and transportation deductions, during the year ended December 31, 2007 was $4.33 per MMBtu as compared to $5.28 and $4.43 per MMBtu for the years ended December 31, 2006 and 2005, respectively. The average price used to calculate Net Proceeds for oil during the years ended December 31, 2007, 2006 and 2005 was $57.51, $58.56 and $46.14 per Bbl, respectively. When TEMI pays a purchase price for gas based on the Minimum Price, TEMI receives Price Credits which it is entitled to deduct in determining the purchase price when the Index Price for gas exceeds the Minimum Price. As of December 31, 2007, TEMI had no outstanding Price Credits. No Price Credits were deducted in calculating the purchase price related to distributions during the three years ended December 31, 2007. See Item 1. Business and Item 3. Legal Proceedings.

Additionally, if the Index Price for gas exceeds $2.10 per MMBtu, adjusted annually for inflation ($2.26 per MMBtu, $2.22 per MMBtu and $2.18 per MMBtu for 2007, 2006 and 2005 production, respectively), TEMI is entitled to deduct 50% of such excess in calculating the purchase price. Such price sharing arrangement reduced Net Proceeds during the years ended December 31, 2007, 2006, and 2005 by $7.1 million, $11.1 million and $8.9 million, respectively.

During the years ended December 31, 2007, 2006 and 2005, the Trust was distributed approximately $400,000 $516,000 and $708,000, respectively, of Infill Well Proceeds generated from Infill Wells located in the Cotton Valley Fields.

Lease operating expenses and capital expenditures attributable to the Underlying Properties in the Chalkley, Cotton Valley and Austin Chalk Fields deducted in calculating distributions during the years ended December 31, 2007, 2006 and 2005 totaled $2.8 million, $3.0 million and $3.4 million, respectively. The increase in costs and expenses during the year ended December 31, 2005 as compared to the years ended December 2007 and 2006 is mainly due to workovers performed on certain wells in 2005 in the Chalkley, Cotton Valley and Austin Chalk Fields.

General and administrative expenses during the year ended December 31, 2007 was $1.2 million as compared to $1.0 million and $0.9 million during each of the years ended December 31, 2006 and 2005, respectively. The increase in general and administrative expenses in 2007 as compared to

2006 is mainly due to an increase during 2007 for legal fees in connection with the termination of the Trust and for accounting fees in connection with Sarbanes-Oxley compliance. During each of the three years ended December 31, 2007, general and administrative expenses primarily relate to administrative services provided by Torch and the Trustee, legal fees, accounting fees and Unitholder report printing fees.

For the year ended December 31, 2007, distributable income was $4.1 million, or $0.48 per Unit, as compared to $7.3 million, or $0.84 per Unit, and $5.6 million, or $0.65 per Unit, for the same periods in 2006 and 2005, respectively. Total cash distributions of $4.1 million, or $0.48 per Unit, were made during the year ended December 31, 2007 as compared to $7.3 million, or $0.84 per Unit, and $5.6 million, or $0.65 per Unit, for the same periods in 2006 and 2005, respectively.

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Torch Energy Royalty Trust

Net profits received by the Trust during the years ended December 31, 2007, 2006 and 2005, derived from production sold during the twelve months ended September 30, 2007, 2006 and 2005, respectively, was computed as shown in the following table (in thousands):

	Year Ended December 31,									
	2007				2006				2005	
	Chalkley, Cotton Valley and Austin Chalk Fields	Robinson Bend Field	s	Total	Chalkley, Cotton Valley and Austin Chalk Fields	Robinson Bend Field	s	Total	Chalkley, Cotton Valley and Austin Chalk Fields	Robinso Benc Fielc
Oil and gas revenues	$ 8,649	$ 6,391			$ 11,409	$ 8,292			$ 10,330	$ 7,25
Direct operating expenses:										
Lease operating expenses (including property tax)	2,195	5,986			2,078	6,051			2,126	5,87
Severance tax	741	568			877	797			778	65
	2,936	6,554			2,955	6,848			2,904	6,52
Net proceeds before capital expenditures	5,713	(163)			8,454	1,444			7,426	73
Capital expenditures	616	141			929	189			1,302	87
	5,097	(304)			7,525	1,255			6,124	(14
Cumulative Deficit						(763)				
	5,097	(304)			7,525	492				
Net profits percentage	95%		(a)		95%		(a)		95%	

Net profits income	$ 4,842	$	$ 4,842	$	7,149	$	647	$ 7,796	$ 5,818	$

(a) With respect to the Robinson s Bend Field, the Trust received no cash distributions during each of the years ended December 31, 2005 and 2007 (pertaining to production during the twelve months ended September 30, 2005 and 2007, respectively) and during the quarter ended September 30, 2006 (pertaining to production during the quarter ended June 30, 2006).

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Torch Energy Royalty Trust

Critical Accounting Policy

Reserve Estimates

The proved reserves of the Trust are estimated quantities of oil and gas which geological and engineering data demonstrate, with reasonable certainty, to be recoverable in future years from known reservoirs under existing economic and operating conditions. The accuracy of any reserve estimate is a function of the quality of available data, engineering and geological interpretation, and judgement. For example, estimates are made regarding the amount and timing of future operating costs, production volumes and severance taxes, all of which may in fact vary considerably from actual results. In addition, as prices and cost levels change from year to year, the estimate of proved reserves also change. Any variance in these assumptions could materially affect the estimated quantity and value of the Trust s reserves. Independent petroleum engineering firms are engaged to estimate the Trust s proved hydrocarbon liquid and gas reserves.

Modified Cash Basis

The financial statements of the Trust are prepared on a modified cash basis although financial statements filed with the Securities and Exchange Commission are normally required to be prepared in accordance with accounting principles generally accepted in the United States. Since the operations of the Trust are limited to the distribution of income from the Net Profits Interests, the item of primary importance to the reader of the financial statements of the Trust is the amount of cash distributions to the Unitholders for the period reported.

Item 7a. Quantitative and Qualitative Disclosures About Market Risk

The Trust is exposed to market risk, including adverse changes in commodity prices. The Trust s assets constitute Net Profits Interests in the Underlying Properties. As a result, the Trust s operating results can be significantly affected by fluctuations in commodity prices caused by changing market forces and the price received for production from the Underlying Properties.

All production from the Underlying Properties during the period applicable to this report was sold pursuant to a Purchase Contract between TRC, Velasco, and TEMI. Pursuant to the Purchase Contract, TEMI is obligated to purchase all net production attributable to the Underlying Properties for an Index Price, less certain other charges, which are calculated monthly. The Index Price calculation is based on market prices of oil and gas and therefore is subject to commodity price risk. The Purchase Contract expired upon termination of the Trust and provides a Minimum Price paid by TEMI for gas. See Item 1. Business and Item 1A. Risk Factors relating to the termination of the Trust and the arbitration proceeding relating to the proper calculation of the Net Profits Interests payments owed to the Trust following termination of the Trust. The Minimum Price is adjusted annually for inflation and was $1.83, $1.80 and $1.77 per MMBtu for 2007, 2006 and 2005, respectively. When TEMI pays a purchase price based on the Minimum Price, it receives Price Credits equal to the difference between the Index Price and the Minimum Price that it is entitled to deduct when the Index Price exceeds the Minimum Price. Additionally, if the Index Price exceeds the Sharing Price, TEMI is entitled to deduct such excess, the Price Differential. The Sharing Price was $2.26, $2.22 and $2.18 per MMBtu in 2007, 2006 and 2005, respectively. TEMI has an annual option to discontinue the Minimum Price commitment. However, if TEMI discontinues the Minimum Price commitment, it will no longer be entitled to deduct the Price Differential and will forfeit all accrued Price Credits. TEMI has not exercised its option to discontinue the Minimum Price Commitment.

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Torch Energy Royalty Trust

Item 8. Financial Statements and Supplementary Data

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Torch Energy Royalty Trust

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Wilmington Trust Company
as Trustee of Torch Energy Royalty Trust
and to the Unitholders:

We have audited the accompanying statements of assets, liabilities and trust corpus of the Torch Energy Royalty Trust (the Trust) as of December 31, 2007 and 2006, and the related statements of distributable income and changes in trust corpus for each of the three years in the period ended December 31, 2007. These financial statements are the responsibility of the Trustee. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

We were not engaged to examine the Trustee s assertion about the effectiveness of the Trust s internal control over financial reporting as of December 31, 2007 included in the accompanying annual report on Form 10-K and, accordingly we do not express an opinion thereon.

As described in Note 2, the financial statements are prepared on a modified cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Trust as of December 31, 2007 and 2006, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2007, in conformity with the basis of accounting described in Note 2.

As discussed in Note 1 to the financial statements, the Trust terminated effective January 29, 2008. Certain responsibilities of the Trustee, including those associated with selling the assets of the Trust, are also described in Note 1.

/s/ UHY LLP
Houston, Texas
December 29, 2008

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Torch Energy Royalty Trust
STATEMENTS OF ASSETS, LIABILITIES AND TRUST CORPUS
(In thousands)

	December 31, 2007	December 31, 2006
ASSETS		
Cash	$ 55	$ 1
Net profits interests in oil and gas properties (net of accumulated amortization of $163,961 and $162,215 at December 31, 2007 and 2006, respectively)	16,639	18,385
	$ 16,694	$ 18,386
LIABILITIES AND TRUST CORPUS		
Trust expense payable	$ 245	$ 222
Trust corpus	16,449	18,164
	$ 16,694	$ 18,386

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

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Torch Energy Royalty Trust
STATEMENTS OF DISTRIBUTABLE INCOME
(In thousands, except per Unit amounts)

	Year Ended December 31,		
	2007	2006	2005
Net profits income	$ 4,842	$ 7,796	$ 5,818
Infill Well Net Proceeds	400	516	708
Other income	54	0	0
	5,296	8,312	6,526
General and administrative expenses	1,163	965	925
Interest Expense		85	
	1,163	1,050	925
Distributable income	$ 4,133	$ 7,262	$ 5,601
Distributable income per Unit (8,600 Units)	$ 0.48	$ 0.84	$ 0.65
Distributions per Unit	$ 0.48	$ 0.84	$ 0.65

The accompanying notes to financial statements
are an integral part of these statements.
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Torch Energy Royalty Trust
STATEMENTS OF CHANGES IN TRUST CORPUS
(In thousands)

	Year Ended December 31,		
	2007	2006	2005
Trust corpus, beginning of year	$ 18,164	$ 21,441	$ 23,556
Amortization of Net Profits Interests	(1,746)	(3,289)	(2,126)
Distributable income	4,133	7,262	5,601
Distributions to Unitholders	(4,102)	(7,250)	(5,590)
Trust Corpus, end of year	$ 16,449	$ 18,164	$ 21,441

The accompanying notes to financial statements
are an integral part of these statements.
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Torch Energy Royalty Trust
Notes to Financial Statements

1. Nature of Operations

The Torch Energy Royalty Trust (Trust) was formed effective October 1, 1993, pursuant to a trust agreement (Trust Agreement) among Wilmington Trust Company, as trustee (Trustee), Torch Royalty Company (TRC) and Velasco Gas Company, Ltd. (Velasco) as owners of certain oil and gas properties (Underlying Properties) and Torch Energy Advisors Incorporated (Torch) as grantor. TRC and Velasco created net profits interests (Net Profits Interests) and conveyed such interests to Torch. Torch conveyed the Net Profits Interests to the Trust in exchange for an aggregate of 8,600,000 units of beneficial interest (Units). Such Units were sold to the public through various underwriters in November 1993.

The Trust has no officers, directors or employees. The Trustee relies solely on receiving accurate information, reports and other representations from services providers to the Trust and Torch in the ordinary course of its duties as Trustee. In executing and submitting this report on behalf of the Trust and with respect to Bruce L. Bisson in executing the certifications relating to this report, the Trustee and Bruce L. Bisson have relied upon the accuracy of such reports, information and representations of Torch.

The Trust received the affirmative vote of the Unitholders of more than 66 2/3% of the outstanding Units to terminate the Trust at the meeting of Unitholders held on January 29, 2008. Upon termination of the Trust, among other things, the Trustee is required to sell the Net Profits Interests. Specifically, pursuant to Section 9.03(e) of the Trust Agreement if the property of the Trust Estate (as defined in the Trust Agreement) has not been sold prior to the end of one calendar year following the termination date, the Trustee must cause such assets to be sold at public auction. As the Trust was terminated by a vote of the Unitholders on January 29, 2008 (the Termination Date), the Trustee anticipates it will continue to consult with the Trust s and Trustee s financial and legal advisors in preparing the sales process and obtaining the necessary information required for disclosure regarding the Units to carry out the sale requirement under Section 9.03(e) if such assets have not been sold prior to January 28, 2009. Therefore, after termination of the Trust, the remaining assets of the Trust will be sold, and the proceeds therefrom (after expenses) will be distributed to the unitholders (Unitholders). The sole purpose of the Trust is to hold the Net Profits Interests, to receive payments from TRC and Velasco, and to make payments to Unitholders. The Trust does not conduct any business activity. No assurances can be given that the Trustee will be able to sell the Net Profits Interests, or the price that will be distributed to Unitholders following such a sale. Such distributions could be below the market value of the Units. The Trust can give no assurances of the effect of the results of the affirmative vote to terminate the Trust by the Unitholders on the continued listing of the Units on the New York Stock Exchange (NYSE) or any other national quotation system.

As previously disclosed by Torch Energy Royalty Trust (the Trust) in its Current Report on Form 8-K filed with the Securities and Exchange Commission (the SEC) on April 21, 2008, the Trust received a letter from the NYSE Regulation, Inc. (the NYSE) on April 16, 2008 informing the

Trust that, as a result of its failure to timely file its Annual Report on Form 10-K for the fiscal year ended December 31, 2007 (the 2007 Annual Report with the SEC, the Trust was subject to certain procedures as specified in Section 802.01E, SEC Annual Report Timely Filing Criteria, of the NYSE Listed Company Manual (Section 802.01E) and further, regardless of the procedures specified in Section 802.01E, the NYSE could commence delisting procedures at any time during any period that is available to complete the filing of the 2007 Annual Report, if circumstances warrant.

As the Trust had been unable to obtain complete and accurate information regarding reserve information and the financial statements of the Trust required to be included in the 2007 Annual Report, the Trust remained unable to timely file its 2007 Annual Report. Therefore, the Trust requested an extension for continued listing and trading on the NYSE notwithstanding its failure to file its 2007 Annual Report. On

Torch Energy Royalty Trust
Notes to Financial Statements

October 22, 2008, the Trust issued a press release (the Press Release) disclosing the receipt of notice from the NYSE, received on October 17, 2008, of the NYSE s grant of such an extension, providing the Trust until December 31, 2008 to complete and file its 2007 Annual Report with the SEC. However, the NYSE stated in its extension grant that such extension is subject to reassessment on an ongoing basis and the NYSE would closely monitor the Trust s progress in completing and filing the 2007 Annual Report. Failure of the Trust to make progress in its efforts to complete and file its SEC reports or failing to meet the minimum listing criteria could result in a suspension of the Trust s listing and trading privileges.

TRC and Velasco receive payments reflecting the proceeds of oil and gas sold and aggregate these payments, deduct applicable costs and make payments to the Trustee each quarter for the amounts due to the Trust. Unitholders receive quarterly cash distributions relating to oil and gas produced and sold from the Underlying Properties. Because no additional properties will be contributed to the Trust, the assets of the Trust deplete over time and a portion of each cash distribution made by the Trust is analogous to a return of capital.

The only assets of the Trust, other than cash and temporary investments being held for the payment of expenses and liabilities and for distribution to Unitholders, are the Net Profits Interests. Under the Trust Agreement, the Trustee receives the payments attributable to the Net Profits Interests and pays all expenses, liabilities and obligations of the Trust. The Trustee has the discretion to establish a cash reserve for the payment of any liability that is contingent or uncertain in amount or that otherwise is not currently due and payable. The Trustee is entitled to cause the Trust to borrow money to pay expenses, liabilities and obligations that cannot be paid out of cash held by the Trust. The Trustee is entitled to cause the Trust to borrow from any source, including from the entity serving as Trustee, provided that the entity serving as Trustee shall not be obligated to lend to the Trust. To secure payment of any such indebtedness (including any indebtedness to the Trustee), the Trustee is authorized to (i) mortgage and otherwise encumber the entire Trust estate or any portion thereof; (ii) carve out and convey production payments; (iii) include all terms, powers, remedies, covenants and provisions it deems necessary or advisable, including confession of judgement and the power of sale with or without judicial proceedings; and (iv) provide for the exercise of those and other remedies available to a secured lender in the event of a default on such loan. The terms of such indebtedness and security interest, if funds were loaned by the Trustee, must be similar to the terms which the Trustee would grant to a similarly situated commercial customer with whom it did not have a fiduciary relationship, and the Trustee shall be entitled to enforce its rights with respect to any such indebtedness and security interest as if it were not then serving as Trustee. The Trustee is authorized and directed to sell and convey the Net Profits Interests without Unitholder approval in certain instances as described in the Trust Agreement, including upon termination of the Trust. The Trustee is empowered by the Trust Agreement to employ consultants, legal and financial advisors and agents (including Torch) and to make payments of all fees for services or expenses out of the assets of the Trust.

2. Basis of Accounting

The financial statements of the Trust are prepared on a modified cash basis and are not intended to present the financial position and results of operations in conformity with accepted accounting principles generally accepted in the United States of America (GAAP). Preparation of the Trust financial statements on such basis includes the following:

Revenues are recognized in the period in which amounts are received by the Trust. Therefore, revenues recognized during the years ended December 31, 2007, 2006 and 2005 are derived from oil

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Torch Energy Royalty Trust
Notes to Financial Statements

and gas production sold during the twelve-month periods ended September 30, 2007, 2006 and 2005, respectively. General and administrative expenses are recognized on an accrual basis. Amortization of the Net Profits Interests is calculated on a unit-of-production basis and charged directly to Trust corpus.

Distributions to Unitholders are recorded when declared by the Trustee.

An impairment loss is recognized when the net carrying value of the Net Profits Interests exceeds its fair market value. No such impairment was recorded during the three years ended December 31, 2007.

The financial statements of the Trust differ from financial statements prepared in accordance with GAAP because net profits income is not accrued in the period of production and amortization of the Net Profits Interests is not charged against operating results.

3. Federal Income Taxes and Texas State Margin Tax

Tax counsel has advised the Trustee that, under current tax law, the Trust is classified as a grantor trust for Federal income tax purposes and not an association taxable as a business entity. However, the opinion of tax counsel is not binding on the Internal Revenue Service. As a grantor trust, the Trust is not subject to Federal income tax.

Because the Trust is treated as a grantor trust for Federal income tax purposes and a Unitholder is treated as directly owning an interest in the Net Profits Interests, each Unitholder is taxed directly on such Unitholder s pro rata share of income attributable to the Net Profits Interests consistent with the Unitholder s method of accounting and without regard to the taxable year or accounting method employed by the Trust. Amounts payable with respect to the Net Profits Interests are paid to the Trust on the quarterly record date established for quarterly distributions in respect to each calendar quarter during the term of the Trust, and the income and deductions from such payments are allocated to the Unitholders of record on such date.

In May 2006, the State of Texas passed legislation to implement a new margin tax at a rate of 1% to be imposed generally on federal gross revenues (up to 70%), as apportioned to Texas less certain costs and deductions, as specifically set forth in the new legislation. The effective date of the new legislation is January 1, 2008, but the tax generally will be imposed on revenues generated in 2007 and thereafter (earlier for certain fiscal year taxpayers). Entities subject to tax generally include trusts unless otherwise exempt, and most other types of entities having limited liability protection. Trusts that meet certain statutory requirements are generally exempt from the margin tax as passive entities.

Since the Trust is exempt from the margin tax at the Trust level as a passive entity, each Unitholder that is a taxable entity would generally include its share of the Trust s revenue in its margin tax computation. This revenue would be sourced to Texas under new Texas Comptroller guidance sourcing such income according to the principal place of business of the Trust, which is Texas.

4. Distributions and Income Computations

Each quarter the amount of cash available for distribution to Unitholders (the Quarterly Distribution Amount) is equal to the excess, if any, of the cash received by the Trust, on the last day of the second month following the previous calendar quarter (or the next business day thereafter) ending prior to the

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Torch Energy Royalty Trust
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dissolution of the Trust, from the Net Profits Interests then held by the Trust plus, with certain exceptions, any other cash receipts of the Trust during such quarter, subject to adjustments for changes made by the Trustee during such quarter in any cash reserves established for the payment of contingent or future obligations of the Trust. Based on the payment procedures relating to the Net Profits Interest, cash received by the Trust on the last day of the second month of a particular quarter from the Net Profits Interests generally represents proceeds from the sale of oil and gas produced from the Underlying Properties during the preceding calendar quarter. The Quarterly Distribution Amount for each quarter is payable to Unitholders of record on the last day of the second month of the calendar quarter unless such day is not a business day, in which case the record date is the next business day thereafter. The Trust distributes the Quarterly Distribution Amount within approximately 10 days after the record date to each person who was a Unitholder of record on the associated record date.

On February 20, 2008, the Trust announced a cash distribution of 3.0 cents per unit, payable on March 10, 2008 to unitholders of record on February 29, 2008. This cash distribution is attributable to fourth quarter 2007 production from the Underlying Properties of the Trust. Pursuant to Section 3.07 of the Trust Agreement of the Trust, the Trustee has established a cash reserve for the payment of contingent or uncertain liabilities associated with the liquidation and winding up of the Trust and the Trust s arbitration and the cash reserve for Trust liabilities as of February 20, 2008 was $1,032,000.

On July 22, 2008, the Trust reported the receipt of the cash payment received from Torch Royalty Company, Torch E&P Company and Constellation Energy Partners, LLC (the working interest owners) of the Underlying Properties of the Trust for the production associated with the first quarter of 2008. All amounts received from the working interest owners relating to the first quarter of 2008 or $1,660,173 was allocated into the reserve account. The cash payment from the working interest owners for the production relating to the first quarter of 2008 includes periods prior to the termination date of the Trust on January 29, 2008 and the post termination period of the first quarter of 2008. The working interest owners were required to deposit all proceeds of production following the termination date of the Trust on January 29, 2008 payable to the Trust or the Louisiana Trust attributable to the Conveyances into a non-interest bearing account (the Deposit Account). Due to the fact that the Net Profits Interests were not sold or a definitive agreement for sale thereof was not entered into prior to the 150th day following the termination date of the Trust (i.e., June 27, 2008), the working interest owners paid all amounts deposited in the Deposit Account to the Trust and all amounts attributable to the Conveyances thereafter payable to the Trust are required to be paid to the Trust and the Louisiana Trust in accordance with the terms of such Conveyances.

5. Related Party Transactions

TRC and Velasco contracted to sell the oil and gas production from the Underlying Properties to Torch Energy Marketing, Inc. (TEMI), a subsidiary of Torch, under a purchase contract (Purchase Contract). The Purchase Contract terminated with the termination of the Trust. At all times in the periods set forth in this report the Purchase Contract was in full force and effect. The continuation of the sharing price and minimum price terms and conditions of the Purchase Contract terms was the subject of an arbitration and the Trust has assumed the applicability of such terms for purpose of this report. See Item 1. Business, Item 1A. Risk Factors and Item 3. Legal Proceedings regarding developments concerning the termination of the Trust and arbitration with respect to certain terms and conditions of the Purchase Contract continuing after the termination of the Trust.

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Marketing Arrangements

TRC and Velasco contracted to sell the oil and gas production from the Underlying Properties to Torch Energy Marketing, Inc. (TEMI), a subsidiary of Torch, under a purchase contract (Purchase Contract). Under the Purchase Contract, TEMI is obligated to purchase all net production attributable to the Underlying Properties for an index price for oil and gas (Index Price), less certain gathering, treating and transportation charges, which are calculated monthly. The Index Price equals 97% of the average spot market prices of oil and gas (Average Market Prices) at the four locations where TEMI sells production.

The Purchase Contract also provides that a minimum price paid by TEMI for gas production is $1.70 per MMBtu adjusted annually for inflation (Minimum Price). When TEMI pays a purchase price based on the Minimum Price it receives price credits (Price Credits) equal to the difference between the Index Price and the Minimum Price that it is entitled to deduct in determining the purchase price when the Index Price for gas exceeds the Minimum Price. Price Credits are computed on a monthly basis. As of December 31, 2007, TEMI had no outstanding Price Credits. No Price Credits were deducted in calculating the purchase price related to distributions received by Unitholders during the three years ended December 31, 2007.

In addition, if the Index Price for gas exceeds $2.10 per MMBtu adjusted annually for inflation (Sharing Price), TEMI is entitled to deduct 50% of such excess (Price Differential) in determining the purchase price. As a result of such Sharing Price arrangement, Net Proceeds attributable to the Underlying Properties during the years ended December 31, 2007, 2006 and 2005 were reduced by $7.1 million, $11.1 million and $8.9 million, respectively. TEMI has an annual option to discontinue the Minimum Price commitment. However, if TEMI discontinues the Minimum Price commitment, it will no longer be entitled to deduct the Price Differential in calculating the purchase price and will forfeit all accrued Price Credits. TEMI has not exercised its option to discontinue the Minimum Price Commitment. The Minimum Price in 2007, 2006 and 2005 was approximately $1.83, $1.80 and $1.77 per MMBtu for 2007, 2006 and 2005, respectively. The Sharing Price in 2007, 2006 and 2005 was approximately $2.26, $2.22 and $2.18 per MMBtu, respectively.

Gross revenues (before deductions for applicable gathering, treating and transportation charges) from TEMI included in the Net Proceeds calculations attributable to the Underlying Properties for the years ended December 31, 2007, 2006 and 2005 were $16.5 million, $21.4 million and $19.2 million, respectively.

Gas production is purchased at the wellhead and, therefore, distributions do not include any amounts received in connection with extracting natural gas liquids from such production at gas processing or treating facilities.

Gathering, Treating and Transportation Arrangements

The Purchase Contract entitles TEMI to deduct certain gas gathering, treating and transportation costs in calculating the purchase price for gas in the Robinson s Bend, Austin Chalk and Cotton Valley Fields. The amounts that may be deducted in calculating the purchase price for such gas are set forth in the Purchase Contract and are not affected by the actual costs incurred by TEMI to gather, treat and transport gas. In the Robinson s Bend Field, TEMI is entitled to deduct a gathering, treating and transportation fee of $0.26 per MMBtu adjusted annually for inflation ($0.308, $0.303 and $0.298 per MMBtu for 2007, 2006 and 2005, respectively, plus fuel usage equal to 5% of revenues. Additionally, a fee of $0.05 per MMBtu, representing a gathering fee payable to a non-affiliate of Torch, is deducted in calculating the

Torch Energy Royalty Trust
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purchase price for production from 73 of the 423 wells in the Robinson s Bend Field. TEMI also deducts $0.38 per MMBtu plus 17% of revenues in calculating the purchase price for production from the Austin Chalk Fields, as a fee to gather, treat and transport gas production. TEMI deducts from the purchase price for gas in the Cotton Valley Fields a transportation fee of $0.045 per MMBtu for production attributable to certain wells. This transportation fee is paid to a third party. During the years ended December 31, 2007, 2006 and 2005, such fees deducted from the Net Proceeds calculations, attributable to production during the twelve months ended September 30, 2007, 2006 and 2005, in the Robinson s Bend, Austin Chalk and Cotton Valley Fields, totaled $1.5 million, $1.7 million and $1.6 million, respectively. No amounts for gathering, treating or transportation are deducted in calculating the purchase price from the Chalkley Field.

Operator Overhead Fees

A subsidiary of Torch operates certain oil and gas interests burdened by the Net Profits Interests in the Cotton Valley and Austin Chalk Fields. The Underlying Properties are charged, on the same basis as other third parties, for all customary expenses and costs reimbursements associated with these activities. Operator overhead fees deducted from the Net Proceeds computations for the Cotton Valley and Austin Chalk fields totaled $200,000, $191,000 and $184,000 for the years ended December 31, 2007, 2006 and 2005, respectively.

Administrative Services Agreement

The sole purpose of the Trust is to hold the Net Profits Interests, to receive payments from TRC and Velasco, and to make payments to Unitholders. The Trust does not conduct any business activity and has no officers, directors or employees. The Trust relies on third party service providers to perform administrative services for the Trust. Prior to April 1, 2008, Torch provided accounting, bookkeeping, informational and other services to the Trust related to the Net Profits Interests pursuant to an administrative services agreement effective October 1, 1993 and an oral arrangement after termination of the Administrative Services Agreement on January 29, 2008 through April 1, 2008.

Pursuant to the Trust Agreement, Torch and the Trust entered into an administrative services agreement, effective October 1, 1993. The Trust is obligated, throughout the term of the Trust, to pay to Torch each quarter an administrative services fee for accounting, bookkeeping, informational and other services relating to the Net Profits Interests. The administrative services fee is $87,500 per calendar quarter commencing October 1, 1993. The amount of the administrative services fee is adjusted annually, based upon the change in the Producer s Price Index as published by the Department of Labor, Bureau of Labor Statistics. Administrative services fees of $414,000, $407,000 and $400,000 were paid by the Trust to Torch during the three years ended December 31, 2007, 2006 and 2005, respectively.

Compensation of the Trustee and Transfer Agent

The Trust Agreement provides that the Trustee be compensated for its administrative services, out of the Trust assets, in an annual amount of $41,000, plus an hourly charge for services in excess of a combined total of 250 hours annually at its standard rate. In accordance with provisions in the Trust Agreement, the Trustee may increase its compensation for its administrative services as a result of unusual or extraordinary services rendered by the Trustee. During 2005, due to the impact of the Sarbanes-Oxley Act on the Trust, the Trustee increased its compensation for administrative services to $80,000 per year. Total administrative and transfer agent fees charged by the Trustee were $95,000 for each of the years ended December 31, 2007 and 2006. Such fees charged by the Trustee during the year ended December 31, 2005 were $84,000.

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6. Supplemental Oil and Gas Information (Unaudited)

Total proved oil and gas reserves attributable to the Net Profits Interests as of December 31, 2007, 2006 and 2005 are based upon reserve reports prepared by T.J. Smith & Company, Inc. and Netherland, Sewell & Associates, Inc. (Independent Reserve Engineers). Future net cash flows were computed by applying end-of-period Purchase Contract prices for oil and gas to estimated future production, less the estimated future expenditures (based on current costs) to be incurred in developing and producing the reserves. See Item 1A. Risk Factor The estimated reserve quantities in this report are based on many assumptions that may prove to be inaccurate. Any material inaccuracies in these reserve estimates or underlying assumptions will materially affect the quantities and present value of the Trust s reserves. for information regarding assumptions and price volatility.

Reserve Quantities:

The following table sets forth the estimated total proved and proved developed oil and gas reserves attributable to the Trust s Net Profits Interests (all located in the United States) for the years ended December 31, 2007, 2006 and 2005, based on reserve reports prepared by Independent Reserve Engineers. As a net profits interest does not entitle the Trust to a specific quantity of oil or gas, but to a portion of oil and gas sufficient to yield a specified portion of the net proceeds derived therefrom, proved reserves attributable to a net profits interest are calculated by deducting an amount of oil or gas sufficient, if sold at the prices used in preparing the reserve estimates for the Underlying Properties, to pay an amount of applicable future estimated production expenses, development costs and taxes for such Underlying Properties (Net Equivalent Volumes). The use of disclosing Net Equivalent Volumes to estimate reserve volumes attributable to the Net Profits Interests is standard practice in the industry.

Year-end reserves at December 31, 2007 were 10.5 billion cubic feet equivalent (Bcfe) as compared to year-end 2006 and 2005 reserves of 10.6 Bcfe and 19.5 Bcfe, respectively. In accordance with Securities and Exchange Commission reporting guidelines, year-end reserves and the related future net revenues attributable to the Trust s Net Profits Interests are estimated utilizing the Purchase Contract Price for gas, after gathering fees ($4.71, $4.06 and $5.55 per Mcf for 2007, 2006 and 2005, respectively). Such Purchase Contract prices were calculated utilizing the Henry Hub gas prices on the last day of the entity s fiscal year ($6.80, $5.64 and $10.08 per MMBtu for 2007, 2006 and 2005, respectively).

The revisions of the estimated oil and gas volumes and the related present value of the estimated net future revenues as of December 31, 2007, 2006 and 2005 is primarily a result of fluctuations of natural gas prices on each of the years then ended. The Robinson s Bend Field estimated reserves as of December 31, 2005, 2006 and 2007 were estimated to have no value.

	2007		2006		2005	
	Oil	Gas	Oil	Gas	Oil	Gas

Description	(Mbbl)	(MMcf)	(Mbbl)	(MMcf)	(Mbbl)	(MMcf)
Proved reserves at beginning of year	42	10,302	56	19,164	61	14,055
Revisions	15	1,032	(5)	(7,687)	7	6,300
Extensions and discoveries				30		
Production	(9)	(1,132)	(9)	(1,205)	(12)	(1,191)
Proved reserves at end of year	48	10,202	42	10,302	56	19,164
Proved developed reserves at beginning of year	42	10,273	54	18,789	55	12,025
Proved developed reserves at end of year	48	10,202	42	10,273	54	18,789

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Torch Energy Royalty Trust
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Standardized Measure of Discounted Future Net Cash Flows Relating to Proved Oil and Gas Reserves (in thousands):

Estimated future net cash flows from the Net Profits Interests in proved oil and gas reserves at December 31, 2007, 2006 and 2005 are presented in the following table:

	December 31,		
	2007	2006	2005
Future cash inflows	$ 84,417	$ 73,506	$ 260,111
Future costs and expenses	(31,595)	(28,941)	(151,917)
Net future cash flows	52,822	44,565	108,194
Discount at 10% for timing of cash flows	(21,944)	(18,189)	(47,409)
Present value of future net cash flows for proved reserves	$ 30,878	$ 26,376	$ 60,785

The following table sets forth the changes in the present value of estimated future net revenues from proved reserves attributable to the Trust s Net Profits Interests during the years ended December 31, 2007, 2006 and 2005:

	Year Ended December 31,		
	2007	2006	2005
Balance at beginning of year	$ 26,376	$ 60,785	$ 38,987
Sales of oil and gas produced, net of production costs	(5,584)	(5,843)	(7,143)
Accretion of discount	2,638	6,079	3,899
Extensions and discoveries	0	82	
Revision of prior-year estimates, change in prices and other	7,448	(34,727)	25,042
Balance at end of year	$ 30,878	$ 26,376	$ 60,785

Estimates of future net cash flows from proved reserves of gas and oil condensate were made in accordance with Financial Accounting Standards Board Statement 69, Disclosure about Oil and Gas Producing Activities. The Trust has not filed or included in reports to any other Federal authority or agency any estimates of proved net oil and gas reserves.

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Torch Energy Royalty Trust
Notes to Financial Statements

7. Quarterly Financial Data (Unaudited in thousands, except per Unit amounts)

The following table sets forth, for the periods indicated, summarized quarterly financial data:

	Net Profits Income	Distributable Income	Distributable Income Per Unit
Quarter ended March 31, 2007	$ 1,081	$ 825	$ .10
Quarter ended June 30, 2007	1,158	818	.10
Quarter ended September 30, 2007	1,360	1,082	.12
Quarter ended December 31, 2007	1,243	1,408	.16
	$ 4,842	$ 4,133	$ .48
Quarter ended March 31, 2006	$ 3,216	$ 3,003	$ .35
Quarter ended June 30, 2006	2,014	2,173	.25
Quarter ended September 30, 2006	1,488	1,248	.15
Quarter ended December 31, 2006	1,078	838	.09
	$ 7,796	$ 7,262	$ .84

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Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures.

The Trustee carried out an evaluation of the effectiveness of the design and operation of the Trust s disclosure controls and procedures pursuant to Exchange Act Rules 13a-15 and 15d-15 as of the end of the period covered by this report. Based upon that evaluation, the Trustee concluded that the Trust s disclosure controls and procedures are effective in timely alerting the Trustee to material information relating to the Trust required to be included in the Trust s periodic filings with the SEC. In its evaluation of disclosure controls and procedures, the Trustee has relied, to the extent considered reasonable, on information provided by Torch and Watkins, Meegan, Drury and Co. LLC.

Changes in Internal Control over Financial Reporting.

There has not been any change in the Trust s internal control over financial reporting during the fourth quarter of 2007 that has materially affected, or is reasonably likely to materially affect, the Trust s internal control over financial reporting. The Trust relies on third party service providers to perform administrative services for the Trust. Prior to April 1, 2008, Torch provided accounting, bookkeeping, informational and other services to the Trust related to the Net Profits Interests pursuant to an Administrative Services Agreement and an oral arrangement after termination of the Administrative Services Agreement on January 29, 2008 through April 1, 2008. The Trust continues to review its current internal control over financial reporting and is in the process of hiring a qualified administrative service provider to assist in the wind up and liquidation of the Trust which may change the Trust s internal control over financial reporting.

Trustee s Report on Internal Control Over Financial Reporting.

The Trustee is responsible for establishing and maintaining adequate control over financial reporting, as such term is defined in Rule 13a-15 promulgated under the Securities Exchange Act of 1934, as amended.

The internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Trust; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with a modified cash basis of accounting as described in Note 2 to the notes to financial statements, and that receipts and expenditures of the Trust are being made only in accordance with authorizations of the Trustee of the Trust; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Trust s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal controls over financial reporting may not prevent or detect misstatements. All internal control systems, no matter how well designed, have inherent limitations, including the possibility of human error and the circumvention of overriding controls.

Accordingly, even effective internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation. Also, projections of any evaluation of effectiveness to future periods are

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Torch Energy Royalty Trust

subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Trustee assessed the effectiveness of the internal control over financial reporting as of December 31, 2007. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on the assessment, the Trustee believes that, as of December 31, 2007, the Trust s internal control over financial reporting was effective based on those criteria.

This annual report does not include an attestation report of our independent registered public accounting firm regarding internal control over financial reporting. The Trustee s report was not subject to attestation by our independent registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit us to provide only the Trustee s report in this annual report.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

The Registrant has no directors, executive officers or employees. The Trustee is a corporate trustee that may be removed as trustee under the Trust Agreement, with or without cause, at a meeting duly called and held by the affirmative vote of Unitholders of not less than a majority of all the Units then outstanding. Any such removal of the Trustee shall be effective only at such time as a successor trustee fulfilling the requirements of Section 3807(a) of the Delaware Statutory Trust Act has been appointed and has accepted such appointment.

The Registrant has not adopted a code of ethics applicable to its principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions because the Trust does not have any such officers or employees. The Trust has no directors and therefore no audit committee or audit committee financial expert or a nominating committee.

Section 16(a) of the Securities Exchange Act of 1934 requires that beneficial owners of more than 10% of the registrant s equity securities file initial reports of beneficial ownership and reports of changes in beneficial ownership with the Securities and Exchange Commission and the New York Stock Exchange. To the Trustee s knowledge, based solely on the information furnished to the Trust, the Trust is unaware of any person that failed to file on a timely basis reports required by Section 16(a) filing requirements with respect to the Units during and for the year ended December 31, 2007.

Item 11. Executive Compensation

The following is a description of certain fees and expenses paid or borne by the Trust, including fees paid to Torch, the Trustee, the transfer agent or their affiliates.

Ongoing Administrative Expenses. The Trust is responsible for paying all legal, accounting, engineering and stock exchange fees, printing costs and other administrative and out-of-pocket expenses incurred by or at the direction of the Trustee in its capacity as Trustee and/or transfer agent.

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Torch Energy Royalty Trust

Compensation of the Trustee and Transfer Agent. The Trust Agreement provides that the Trustee be compensated for its administrative services, out of the Trust assets, in an annual amount of $41,000, plus an hourly charge for services in excess of a combined total of 250 hours annually at its standard rate. In accordance with provisions in the Trust Agreement, the Trustee may increase its compensation for its administrative services as a result of unusual or extraordinary services rendered by the Trustee. During 2005, due to the impact of the Sarbanes-Oxley Act on the Trust, the Trustee increased its compensation for administrative services to $80,000 per year. Additionally, the Trustee receives a transfer agency fee of $5.00 annually per account (minimum of $15,000 annually), subject to change each December, beginning December 1994, based upon the change in the Producer s Price Index as published by the Department of Labor, Bureau of Labor Statistics, plus $1.00 for each certificate issued. The Trustee is entitled to reimbursement for out-of-pocket expenses.

Fees to Torch. Torch will receive, throughout the term of the Trust, an administrative services fee for accounting, bookkeeping and informational services related to the Net Profits Interests as described below in Item 13 Administrative Services Agreement.

Item 12. Security Ownership of Certain Beneficial Owners and Management

The following table sets forth, as of March 27, 2008, certain information with respect to the ownership of Units held by all persons known by the Trust to be the beneficial owners of 5% or more of the outstanding Units. Information set forth in the table with respect to beneficial ownership of Units has been obtained from filings made by the named beneficial owners with the Securities and Exchange Commission as of March 31, 2008. The Trust has no officers, directors or directors. The Trust does not have an Equity Compensation Plan .

	Shares Beneficially Owned	
Name of Beneficial Owner and Address	**Units**	**Percent of Class**
5% Unitholder: (1)		
Trust Venture Company, LLC (2) Two Greenwich Plaza, First Floor Greenwich, CT 06830	6,440,800	74.9%
Trust Acquisition Company, LLC (2) Two Greenwich Plaza, First Floor Greenwich, CT 06830		
Silver Point Capital, L.P. (2) Two Greenwich Plaza, First Floor Greenwich, CT 06830		
Edward A. Mule (2) Two Greenwich Plaza, First Floor Greenwich, CT 06830		

Robert J. O Shea (2)
Two Greenwich Plaza, First Floor
Greenwich Plaza, First Floor
Greenwich, CT 06830

(1) Based on Schedule 13 D/A filed on March 31, 2008.

(2) Trust Venture Company, LLC, Trust Acquisition Company, LLC, Silver Point Capital, L.P., Edward A. Mule and Robert J. O Shea are each a reporting person and member of a reporting group pursuant to a Joint Filing Agreement dated as of July 6, 2007 for purposes of the Securities Exchange Act of 1934, as amended.

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Torch Energy Royalty Trust

As of December 22, 2008,(3) Trust Venture Company, LLC, Trust Acquisition Company, LLC, Silver Point Capital, L.P., Edward A. Mule and Robert J. O Shea were the beneficial owners of 6,502,762 Units or 75.6% of the outstanding Units of the Company.

(3) Based on Form 4 filed on April 1, 2008, Form 4 filed on April 3, 2008, Form 4 filed April 8, 2008, Form 4 filed April 10, 2008, Form 4 filed April 14, 2008, Form 4 filed April 16, 2008, Form 4 filed April 18, 2008, Form 4 filed April 22, 2008, Form 4 filed April 28, 2008 and Form 4 filed April 30, 2008.

Item 13. Certain Relationships and Related Transactions

Administrative Services Agreement

Pursuant to the Trust Agreement, Torch and the Trust entered into the Administrative Services Agreement effective October 1, 1993. The following summary of certain provisions of the Administrative Services Agreement does not purport to be complete and is subject to, and is qualified in its entirety by reference to, the provisions of the Administrative Services Agreement. The Trust relies on third party service providers to perform administrative services for the Trust. Prior to April 1, 2008, Torch provided accounting, bookkeeping, informational and other services to the Trust related to the Net Profits Interests pursuant to an administrative services agreement effective October 1, 1993 (Administrative Services Agreement) and an oral arrangement after termination of the Administrative Services Agreement on January 29, 2008 through April 1, 2008. As of the date of this report, the Trust has not hired another provider but has relied on various service providers since April 1, 2008.

The Trust is obligated, throughout the term of the Trust, to pay to Torch each quarter an administrative services fee for accounting, bookkeeping, informational and other services relating to the Net Profits Interests. The administrative services fee is $87,500 per calendar quarter, adjusted annually, based upon the change in the Producer s Price Index as published by the Department of Labor, Bureau of Labor Statistics. Administrative services fees of $414,000, $407,000 and $400,000 were paid by the Trust to

Torch during the years ended December 31, 2007, 2006 and 2005, respectively.

Marketing Arrangement

TRC and Velasco contracted to sell the oil and gas production from the Underlying Properties to TEMI under a Purchase Contract. Under the Purchase Contract which terminated upon the termination of the Trust (January 29, 2008), TEMI was obligated to purchase all net production attributable to the Underlying Properties for an Index Price for oil and gas less certain gathering, treating and transportation charges, which are calculated monthly. The Purchase Contract also provides that TEMI pay the Minimum Price for gas production. When TEMI pays a purchase price based on the Minimum Price, it receives Price Credits equal to the difference between the Index Price and the Minimum Price that it is entitled to deduct in determining the purchase price when the Index Price for gas exceeds the Minimum Price. Price Credits are computed on a monthly basis, and as of December 31, 2007, TEMI had no outstanding Price Credits.

In addition, if the Index Price for gas exceeds the Sharing Price, TEMI is entitled to deduct the Price Differential in determining the purchase price. As a result of such Sharing Price arrangement, Net Proceeds attributable to the Underlying Properties during the years ended December 31, 2007, 2006 and 2005 were reduced by $7.1 million, $11.1 million and $8.9 million, respectively. TEMI has an annual option to discontinue the Minimum Price commitment. However, if TEMI discontinues the Minimum Price commitment, it will no longer be entitled to deduct the Price Differential in calculating the purchase

Torch Energy Royalty Trust

price and will forfeit all accrued Price Credits. TEMI has not exercised its option to discontinue the Minimum Price Commitment. The Minimum Price in 2007, 2006 and 2005 was approximately $1.83, $1.80 and $1.77 per MMBtu, respectively. The Sharing Price in 2007, 2006 and 2005 was approximately $2.26, $2.22 and $2.18 per MMBtu, respectively.

Gross revenues (before deductions for applicable gathering, treating and transportation charges) from TEMI included in the Net Proceeds calculation attributable to the Underlying Properties for the years ended December 31, 2007, 2006 and 2005 were $16.5 million, $21.4 million and $19.2 million, respectively.

Gathering, Treating and Transportation Arrangements

The Purchase Contract, in effect during the period of this report, entitles TEMI to deduct certain gas gathering, treating and transportation costs in calculating the purchase price for gas in the Robinson s Bend, Austin Chalk and Cotton Valley Fields. The amounts that may be deducted in calculating the purchase price for such gas are set forth in the Purchase Contract and are not affected by the actual costs incurred by TEMI to gather, treat and transport gas. In the Robinson s Bend Field, TEMI is entitled to deduct a gathering, treating and transportation fee of $0.26 per MMBtu commencing October 1, 1993 adjusted for inflation ($0.308, $0.303 and $0.298 per MMBtu for 2007, 2006 and 2005, respectively), plus fuel usage equal to 5% of revenues, payable to Bahia Gas Gathering, Ltd., a subsidiary of Torch, pursuant to a gas gathering agreement. Additionally, a fee of $0.05 per MMBtu, representing a gathering fee payable to a non-affiliate of Torch, is deducted in calculating the purchase price for production from 73 of the 423 wells in the Robinson s Bend Field. TEMI also deducts $0.38 per MMBtu plus 17% of revenues in calculating the purchase price for production from the Austin Chalk Fields, as a fee to gather, treat and transport gas production. TEMI deducts from the purchase price for gas a transportation fee of $0.045 MMBtu for production attributable to certain wells in the Cotton Valley Fields. During the years ended December 31, 2007, 2006 and 2005, gas gathering, treating and transportation fees, deducted by TEMI from the Net Proceeds calculations attributable to production during the twelve months ended September 30, 2007, 2006 and 2005 in the Robinson s Bend, Austin Chalk and Cotton Valley Fields, totaled $1.5 million, $1.7 million and $1.6 million, respectively. No amounts for gathering, treating or transportation are deducted in calculating the purchase price from the Chalkley Field.

Item 14. Principal Accountant Fees and Services

The firm of UHY LLP (UHY) acts as our principal independent registered public accounting firm. Through December 29, 2008, UHY had a continuing relationship with UHY Advisors, Inc. (Advisors) from which it leased auditing staff who were full-time, permanent employees of Advisors and through which UHY s partners provide non-audit services. UHY has only a few full-time employees. Therefore, few, if any, of the audit services performed were provided by permanent full-time employees of UHY. UHY manages and supervises the audit services and audit staff, and is exclusively responsible for the opinion rendered in connection with its examination.

The Trust does not have an audit committee, and has no audit committee pre-approval policy with respect to fees paid to UHY. Any pre-approval of services performed by UHY and related fees is granted by the Trustee. The outside auditors are appointed and engaged by the Trustee. Fees for services performed by UHY for the years ended December 31, 2007 and 2006 are:

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Torch Energy Royalty Trust

	2007	2006
Audit Fees	$ 121,000	$ 111,000
Audit Related Fees	0	0
Tax Fees	0	0
All Other Fees	0	0
	$ 121,000	$ 111,000

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Torch Energy Royalty Trust
PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) The following documents are filed as part of this report:

1. *Financial Statements:*

Torch Energy Royalty Trust

Report of Independent Registered Public Accounting Firm

Statements of Assets, Liabilities and Trust Corpus at December 31, 2007 and 2006

Statements of Distributable Income for the Years Ended December 31, 2007, 2006 and 2005

Statements of Changes in Trust Corpus for the Years Ended December 31, 2007, 2006 and 2005

Notes to Financial Statements

2. *Financial Statement Schedules*

Financial statement schedules are omitted because of the absence of conditions under which they are required or because the required information is included in the financial statements and notes thereto.

3. *Exhibits*

Exhibit Number	**Exhibit**
4.	Instruments Defining the Rights of Security Holders, Including Indentures.
4.1	Form of Torch Energy Royalty Trust Agreement.*
4.2	Form of Louisiana Trust Agreement.*
4.3	Specimen Trust Unit Certificate.*
4.4	Designation of Ancillary Trustee.*
10.	Material Contracts.
10.1	Purchase Agreement between TRC, Velasco and TEMI.*
10.2	Gas Gathering Agreement between TEMI and Bahia Gas Gathering, Ltd.*
10.3	Amendment to Gas Gathering Agreement.*
10.4	Water Gathering and Disposal Agreement and First Amendment between Torch Energy Associates, Ltd. and Velasco.*
10.5	Form of Texas Conveyance.*
10.6	Form of Louisiana Conveyance.*
10.7	Form of Alabama Conveyance.*

10.8	Standby Performance Agreement between Torch and the Trust.*
10.9	Amendment to Water Gathering Contract.*
10.10	First Amendment to Oil and Gas Purchase Contract (previously filed on form 10-Q for the quarter ended September 30, 1994). *
10.11	Second amendment to Water Gathering and Disposal Agreement (previously filed on Form 8-K on February 11, 2008).**

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Torch Energy Royalty Trust

23. Consents of Experts and Counsel.
    - 23.1 Consent of T.J. Smith & Company, Inc.
    - 23.2 Consent of Netherland, Sewell and Associates, Inc.
    - 23.3 Consent of Watkins, Meegan, Drury and Co. LLC
31. Rule 13a-14(a)/15d-14(a) Certifications.
    - 31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32. Section 1350 Certifications.
    - 32.1 Certification of Wilmington Trust Company pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Incorporated by reference from Registration Statements on Form S-1 of Torch Energy Advisors Incorporated (Registration No. 33-68688) dated November 16, 1993.

** Incorporated by reference from Form 8-K dated February 11, 2008.

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SIGNATURES

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 thereunto duly authorized.

TORCH ENERGY ROYALTY TRUST

By: Wilmington Trust Company,
not in its individual capacity but solely as Trustee for the Trust

By: /s/ Bruce L. Bisson
Bruce L. Bisson, Vice President

Date: December 30, 2008

(The Trust has no employees, directors or executive officers.)

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