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PANHANDLE ROYALTY CO  
Form 10QSB  
May 09, 2001

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-QSB

(X) Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the period ended March 31, 2001  
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( ) Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-9116  
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PANHANDLE ROYALTY COMPANY  
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(Exact name of registrant as specified in its charter)

OKLAHOMA 73-1055775  
-----

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

Grand Centre Suite 210, 5400 N Grand Blvd., Oklahoma City, Oklahoma 73112  
-----

(Address of principal executive offices)

Registrant's telephone number including area code (405) 948-1560  
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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.

x Yes No  
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Outstanding shares of Class A Common stock (voting) at May 3, 2001: 2,060,060  
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PART I. FINANCIAL INFORMATION

PANHANDLE ROYALTY COMPANY  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (Information at March 31, 2001 is unaudited)

Assets	March 31, 2000	September 30, 2000
	-----	-----
Current assets:		
Cash and cash equivalents	\$ 697,712	\$ 815,912
Oil and gas sales and other receivables	2,525,851	1,955,590
Prepaid expenses	22,179	3,817
	-----	-----
Total current assets	3,245,742	2,775,319

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Properties and equipment, at cost, based on successful efforts accounting		
Producing oil and gas properties	30,963,176	27,282,697
Non producing oil and gas properties	6,511,654	6,154,159
Other	281,924	280,877
	-----	-----
	37,756,754	33,717,733
Less accumulated depreciation, depletion and amortization	21,278,032	20,390,441
	-----	-----
Net properties and equipment	16,478,722	13,327,292
Other assets	107,716	107,716
	-----	-----
	\$ 19,832,180	\$ 16,210,327
	=====	=====
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable, accrued liabilities and gas imbalance liability	\$ 1,191,552	\$ 759,444
Dividends payable	7,743	7,742
Income taxes payable	132,863	249,327
Deferred income taxes	23,000	46,000
	-----	-----
Total current liabilities	1,355,158	1,062,513
Deferred income taxes	2,444,000	1,794,000
Deferred lease bonus	37,308	--
Stockholders' equity		
Class A voting Common Stock, \$.0333 par value; 6,000,000 shares authorized, 2,060,060 issued and outstanding at March 31,2001 and 2,060,206 at September 30, 2000	68,669	68,673
Capital in excess of par value	606,425	608,280
Retained earnings	15,320,620	12,676,861
	-----	-----
Total stockholders' equity	15,995,714	13,353,814
	-----	-----
	\$ 19,832,180	\$ 16,210,327
	=====	=====

(1)

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## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	Three Months Ended March 31, 2001	2000	Six Months Ended M 2001	
	-----	-----	-----	-----
<b>Revenues:</b>				
Oil and gas sales	\$ 3,883,831	\$ 2,158,123	\$ 7,303,887	\$
Lease bonuses and rentals	1,584	60,759	4,269	
Interest	16,060	3,157	28,865	
Other	39,500	18,947	78,175	
	-----	-----	-----	-----
	3,940,975	2,240,986	7,415,196	
<b>Costs and expenses:</b>				
Lease operating expenses	231,536	196,165	435,214	
Production taxes	268,889	155,708	480,356	
Exploration costs	97,984	151,898	314,107	
Depreciation, depletion, amortization and impairment	423,954	419,044	887,591	
General and administrative	544,541	306,274	1,011,547	
Interest expense	-	9,177	-	
	-----	-----	-----	-----
	1,566,904	1,238,266	3,128,815	
Income before provision for income taxes	2,374,071	1,002,720	4,286,381	
Provision for income taxes	684,000	280,000	1,210,000	
	-----	-----	-----	-----
Net income	\$ 1,690,071	\$ 722,720	\$ 3,076,381	\$
	=====	=====	=====	=====
Basic earnings per share (Note 4)	\$ .82	\$ .35	\$ 1.49	\$
	=====	=====	=====	=====
Diluted earnings per share (Note 4)	\$ .81	\$ .35	\$ 1.48	\$
	=====	=====	=====	=====
Dividends declared per share of common stock	\$ .07	\$ .07	\$ .21	\$
	=====	=====	=====	=====

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## PANHANDLE ROYALTY COMPANY CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six months ended March, 31	
	2001	2000
Cash flows from operating activities:		
Net income	\$ 3,076,381	\$ 1,086,979
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion and amortization	887,591	898,921
Deferred income taxes	650,000	-
Exploration costs	314,107	237,649
Deferred lease bonus	37,308	-
Cash provided (used) by changes in assets and liabilities:		
Oil and gas sales and income tax receivable	(570,261)	(189,167)
Prepaid expenses and other assets	(18,362)	(15,713)
Income taxes payable	(139,464)	170,999
Accounts payable, accrued liabilities, gas imbalance liability and dividends payable	432,108	(20,946)
Total adjustments	1,593,027	1,081,743
Net cash provided by operating activities	4,669,408	2,168,722
Cash flows from investing activities:		
Purchase of and development of properties and equipment	(4,353,127)	(2,234,556)
Net cash used in investing activities	(4,353,127)	(2,234,556)
Cash flows from financing activities:		
Borrowings under line of credit	-	500,000
Payments of loan principal	-	(200,000)
Acquisition and cancellation of Company's common shares	(1,859)	(70,195)
Payment of dividends	(432,622)	(289,532)
Net cash provided (used) by financing activities	(434,481)	(59,727)
Decrease in cash and cash equivalents	(118,200)	(125,561)
Cash and cash equivalents at beginning of period	815,912	213,207
Cash and cash equivalents at end of period	\$ 697,712	\$ 87,646
Supplemental disclosure of cash flow information:		
Interest paid	\$ --	\$ 9,985

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Income taxes paid	699,464	151,001
	-----	-----
	\$ 699,464	\$ 160,986
	=====	=====

(See accompanying notes)

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PANHANDLE ROYALTY COMPANY  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

- The consolidated results presented for the three-month and six-month periods ended March 31, 2001 and 2000 are unaudited, but management of Panhandle Royalty Company believes that all adjustments necessary for a fair presentation of the consolidated results of operations for the periods have been included. All such adjustments are of a normal recurring nature. The consolidated results are not necessarily indicative of those to be expected for the full year.
- The Company utilizes tight gas sands production tax credits to reduce its federal income tax liability, if any. These credits are scheduled to be available through the year 2002. The Company's provision for income taxes is also reflective of excess percentage depletion, reducing the Company's effective tax rate from the federal statutory rate.
- The Company's diluted earnings per share calculation takes into account certain shares that may be issued under the Non-Employee Director's Deferred Compensation Plan. The following table sets forth the computation of basic and diluted earnings per share:

	Three months ended March 31,		Six months ended M	
	2001	2000	2001	2000
	-----	-----	-----	-----
Numerator for primary and diluted earnings per share:				
Net income (loss)	\$ 1,690,071	\$ 722,720	\$ 3,076,381	\$ 1,690,071
	-----	-----	-----	-----
Denominator:				
For basic earnings per share				
Weighted average shares	2,060,060	2,057,546	2,060,115	2,057,546
Effect of potential diluted shares:				
Directors deferred compensation shares	23,824	19,918	23,278	19,918

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Denominator for diluted earnings per share - adjusted weighted average shares and potential shares	2,083,884	2,077,464	2,083,393	
Basic earnings (loss) per share	\$ .82	\$ .35	\$ 1.49	\$
Diluted earnings (loss) per share	\$ .81	\$ .35	\$ 1.48	\$

4. The Company has a \$5,000,000 line of credit with BancFirst in Oklahoma City, OK. This facility matures on December 31, 2002. At March 31, 2001, the Company had no balance outstanding under the BancFirst facility.
5. Approximately 90% of the Company's share of gas produced from the Potato Hills Field is currently being sold under a fixed price contract by the operator of the wells. A contract price of \$2.68 per MMBTU was fixed until October 31, 2000. Effective November 1, 2000, several different contracts were in place through March 2001, which had a floor price of approximately \$3.69 and a ceiling price of approximately \$8.40 per MMBTU. For the period from April through September 2001, contracts provide for an average floor price of \$4.97 and an average ceiling price of \$5.84 per MMBTU. For the six-month period ended March 31, 2001, these contracts reduced gas revenues approximately \$180,000.

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Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS AND RISK FACTORS

Forward-Looking Statements for 2001 and later periods are made in this document. Such statements represent estimates of management based on the Company's historical operating trends, its proved oil and gas reserves and other information currently available to management. The Company cautions that the forward-looking statements provided herein are subject to all the risks and uncertainties incident to the acquisition, development and marketing of, and exploration for oil and gas reserves. These risks include, but are not limited to, oil and natural gas price risk, environmental risks, drilling risk, reserve quantity risk and operations and production risk. For all the above reasons, actual results may vary materially from the forward-looking statements and there is no assurance that the assumptions used are necessarily the most likely to occur.

LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2001, the Company had positive working capital of \$1,890,584, as compared to \$1,712,806 at September 30, 2000. Cash flow from

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operating activities increased 115% to \$4,669,408 for the 2001 six-month period as compared to the fiscal 2000 six-month period. This increase was primarily a result of increased oil and gas sales revenues during the 2001 six-month period, which is discussed in detail in Results of Operations.

Capital expenditures for oil and gas activities for the first six-months of fiscal 2001, amounted to \$4,353,127 as compared to \$2,234,556 in the first six-months of fiscal 2000. This increased level of expenditures was the result of significantly increased market prices for gas and oil causing a large increase in the number of new wells being drilled. The Company relies on third parties to operate drilling and producing wells and simply pays it's proportionate share of costs as wells are drilled, completed and producing. The Company expects this increased level of capital expenditures to continue for the last six-months of fiscal 2001. Remaining projected costs at March 31, 2001, for wells proposed or actually drilling was approximately \$4,247,000. The Company has historically funded drilling and other capital expenditures, overhead costs and dividend payments from operating cash flow. Management anticipates there will be sufficient funds available from projected cash flow and the line-of-credit, if needed, to meet all expected costs and capital obligations for the remainder of fiscal 2001. The Company has equity available should a large acquisition of oil and gas properties, or a company purchase, increase capital expenditures to a level above available cash flow and bank financing.

### RESULTS OF OPERATIONS

Revenues increased significantly for the three-month and six-month periods ended March 31, 2001, as compared to the same periods in fiscal 2000. These increases were a result of increased gas and oil sales prices offset somewhat by decreased sales volumes of both gas and oil. The chart below outlines the Company's production and average sales prices for oil and gas for the three and six-month periods of fiscal 2001 and 2000.

	BARRELS SOLD -----	AVERAGE PRICE -----	MCF SOLD -----	AVERAGE PRICE -----
Three months ended 3/31/01	14,128	\$ 27.42	520,854	\$ 6.71
Three months ended 3/31/00	18,857	\$ 26.94	675,822	\$ 2.44
Six months ended 3/31/01	33,843	\$ 30.03	1,074,641	\$ 5.85
Six months ended 3/31/00	34,178	\$ 25.56	1,201,222	\$ 2.42

As shown in the above chart, gas sales prices increased dramatically for both the three-month and six-month periods of fiscal 2001 and oil prices increased, but at a much smaller percentage. Sales volumes of gas decreased for both the three-month and six-month periods of fiscal 2001, as compared to fiscal 2000 periods. These decreases are the result of normal production decline of the Company's wells, and specifically a decline in the Potato Hills Field production in the 2001 second quarter as compared to the 2000 second quarter. In addition, due to the substantial increase in drilling activity in this fiscal year, the completion and placing on production of new wells drilled is very slow, as a result of manpower and equipment restraints.



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Thus, new production is not coming on line at a pace fast enough to overcome the decline of older wells. However, gas production volumes and oil production volumes should increase somewhat, in the last two quarters of fiscal 2001, as compared to quarter ended March 31, 2001, as new wells come on line. Gas prices are expected to decline to around the \$4.00 to \$5.00 level during the summer months, with oil prices remaining in the mid \$20 range. Thus, the Company's oil and gas sales revenues for the third and fourth quarter are expected to be somewhat less than the second quarter of fiscal 2001.

Costs and expenses increased 27% and 26% respectively, for the three-month and six-month periods ended March 31, 2001, as compared to the same periods of fiscal 2000. These increases were principally the result of increased production taxes (which are calculated as a percentage of oil and gas sales revenue from each well) on the increased oil and gas sales revenues in the fiscal 2001 periods and increased general and administrative costs (G&A). Approximately \$123,000 of the increase in G&A costs is related to the Non-Employee Director's Deferred Compensation Plan. During the quarter ended March 31, 2001, the Company's share price increased from \$14.00 per share to \$19.00 per share. This increase in share price caused recognition of a current period expense based on shares that could currently be issued under the terms of the Plan. The Non-Employee Director's have received these potential shares, rather than a cash payment, for their director's fees. In addition, personnel related expenses (including salary, insurance costs, payroll taxes and ESOP expenses), consultant fees and legal costs increased in the fiscal 2001 periods as compared to the 2000 periods.

The Company's provision for income taxes increased substantially in the 2001 periods due to an increase in income before taxes, as discussed above. The provision for income taxes differs from the statutory rate due to benefits from tight gas sands production tax credits and percentage depletion.

Earnings benefited from the significant increase in oil and gas sales revenues, explained above. It currently appears earnings for the remainder of fiscal 2001, will benefit from the continuing escalated market prices for gas and oil in fiscal 2001, as compared to fiscal 2000 prices. However, should additional exploratory drilling projects result in non-productive wells, thus increasing exploration costs, or the market price of gas or oil decline, earnings would be negatively impacted.

### PART II. OTHER INFORMATION

#### Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

- (a) The annual meeting of shareholders was held on February 23, 2001.
- (b) Two directors were elected for three year terms at the meeting. Also, ratification of the selection of Ernst & Young LLP as independent auditors for the Company was voted upon. The directors elected and the results of voting were as follows:

	Shareholders		
	For	Against	Withheld
	---	-----	-----
Directors			
Michael A. Cawley	1,482,889		18,819

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	Ray H. Potts	1,484,548		17,631
Auditors				
	Ernst & Young LLP	1,500,835	189	9,939

Item 6. EXHIBITS AND REPORT ON FORM 8-K

- (a) FORM 8-K - There were no reports on FORM 8-K filed for the three months ended March 31, 2001.

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SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PANHANDLE ROYALTY COMPANY

May 8, 2001  
-----  
Date

/s/ H W Peace II  
-----  
H W Peace II, President  
and Chief Executive Officer

May 8, 2001  
-----  
Date

/s/ Michael C. Coffman  
-----  
Michael C. Coffman,  
Vice President,  
Chief Financial Officer and  
Secretary and Treasurer

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