

PANHANDLE OIL & GAS INC

Form 10-Q

February 08, 2011

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the period ended December 31, 2010**

**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 001-31759
PANHANDLE OIL AND GAS INC.**

(Exact name of registrant as specified in its charter)

OKLAHOMA
(State or other jurisdiction of
incorporation or organization)
Grand Centre Suite 300, 5400 N Grand Blvd., Oklahoma City, Oklahoma 73112

73-1055775
(I.R.S. Employer
Identification No.)

(Address of principal executive offices)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting
(Do not check if a 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

Outstanding shares of Class A Common stock (voting) at February 8, 2011: 8,289,090

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The following defined terms are used in this report:

Board means board of directors;

CEGT means Centerpoint Energy Gas Transmission's East pipeline in Oklahoma;

DD&A means depreciation, depletion and amortization;

ESOP refers to the Panhandle Oil and Gas Inc. Employee Stock Ownership and 401(k) Plan, a tax qualified, defined contribution plan;

FASB means the Financial Accounting Standards Board;

Independent Consulting Petroleum Engineer(s) or **Independent Consulting Petroleum Engineering Firm(s)** refers to DeGolyer and MacNaughton of Dallas, Texas, for proved reserves calculated as of September 30, 2010, or to Pinnacle Energy Services, L.L.C. of Oklahoma City, Oklahoma, for proved reserves calculated as of September 30, 2009;

LOE means lease operating expense;

Mcf means thousand cubic feet;

Mcfe means natural gas stated on an Mcf basis and crude oil converted to a thousand cubic feet of natural gas equivalent by using the ratio of one Bbl of crude oil to six Mcf of natural gas;

minerals, **mineral acres** or **mineral interests** refers to fee mineral acreage owned in perpetuity by the Company;

NYMEX refers to the New York Mercantile Exchange;

PEPL means Panhandle Eastern Pipeline Company's Texas/Oklahoma mainline;

play is a term applied to identified areas with potential oil and/or natural gas reserves;

SEC means the United States Securities and Exchange Commission;

working interest refers to well interests in which the Company pays a share of the costs to drill, complete and operate a well and receives a proportionate share of production.

References to natural gas

All references to natural gas reserves, sales and prices include associated natural gas liquids.

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PART 1 FINANCIAL INFORMATION
PANHANDLE OIL AND GAS INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Information at December 31, 2010 is unaudited)

	December 31, 2010	September 30, 2010
Assets		
Current assets:		
Cash and cash equivalents	\$ 6,622,178	\$ 5,597,258
Oil and natural gas sales receivables, net of allowance for uncollectible accounts	6,924,477	9,063,002
Refundable production taxes	435,073	804,120
Derivative contracts		1,481,527
Other	171,827	412,778
Total current assets	14,153,555	17,358,685
Properties and equipment, at cost, based on successful efforts accounting:		
Producing oil and natural gas properties	211,911,838	207,928,578
Non-producing oil and natural gas properties	10,309,142	9,616,330
Furniture and fixtures	664,135	656,889
	222,885,115	218,201,797
Less accumulated depreciation, depletion and amortization	135,304,688	131,983,249
Net properties and equipment	87,580,427	86,218,548
Investments	670,577	754,208
Derivative contracts	53,334	138,799
Refundable production taxes	863,938	654,599
Total assets	\$ 103,321,831	\$ 105,124,839
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	\$ 3,667,736	\$ 5,062,806
Deferred income taxes	250,100	354,100
Derivative contracts	30,947	
Accrued income taxes and other liabilities	1,221,549	1,842,918
Total current liabilities	5,170,332	7,259,824
Deferred income taxes	22,995,650	22,552,650
Asset retirement obligations	1,733,805	1,730,369
Stockholders equity:		

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Class A voting common stock, \$.0166 par value; 24,000,000 shares authorized, 8,431,502 issued at December 31, 2010 and September 30, 2010

	140,524	140,524
Capital in excess of par value	1,828,393	1,816,365
Deferred directors' compensation	2,363,440	2,222,127
Retained earnings	73,863,253	73,599,733
	78,195,610	77,778,749
Less treasury stock, at cost; 142,412 shares at December 31, 2010 and 120,560 at September 30, 2010	(4,773,566)	(4,196,753)
Total stockholders' equity	73,422,044	73,581,996
Total liabilities and stockholders' equity	\$ 103,321,831	\$ 105,124,839

(See accompanying notes)

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PANHANDLE OIL AND GAS INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended December	
	31,	
	2010	2009
Revenues:		
Oil and natural gas (and associated natural gas liquids) sales	\$ 9,731,574	\$ 10,810,432
Lease bonuses and rentals	113,365	30,828
Gains (losses) on derivative contracts	(21,439)	1,403,340
Income from partnerships	78,048	76,752
	9,901,548	12,321,352
Costs and expenses:		
Lease operating expenses	2,197,870	2,306,544
Production taxes	344,644	355,042
Exploration costs	287,104	576,261
Depreciation, depletion and amortization	3,434,811	5,292,695
Loss (gain) on asset sales, interest and other	(5,727)	(37,366)
General and administrative	1,639,997	1,416,798
	7,898,699	9,909,974
Income before provision for income taxes	2,002,849	2,411,378
Provision for income taxes	576,000	703,000
Net income	\$ 1,426,849	\$ 1,708,378
Basic and diluted earnings per common share (Note 3)	\$ 0.17	\$ 0.20
Basic and diluted weighted average shares outstanding:		
Common shares	8,301,811	8,311,636
Unissued, directors' deferred compensation shares	115,483	100,553
	8,417,294	8,412,189
Dividends declared per share of common stock and paid in period	\$ 0.07	\$ 0.07
	\$ 0.07	\$

Dividends declared per share of common stock and to be paid in quarter
ended March 31

(See accompanying notes)

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PANHANDLE OIL AND GAS INC.
 CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
 (Information at and for the three months ended December 31, 2010 is unaudited)
 Three Months Ended December 31, 2010

	Class A voting Common Stock Shares	Amount	Capital in Excess of Par Value	Deferred Directors Compensation	Retained Earnings	Treasury Shares	Treasury Stock	Total
Balances at September 30, 2010	8,431,502	\$ 140,524	\$ 1,816,365	\$ 2,222,127	\$ 73,599,733	(120,560)	\$ (4,196,753)	\$ 73,581,996
Purchase of treasury stock						(21,852)	(576,813)	(576,813)
Restricted stock awards			12,028					12,028
Net income					1,426,849			1,426,849
Dividends (\$.14 per share)					(1,163,329)			(1,163,329)
Increase in deferred directors compensation charged to expense				141,313				141,313
Balances at December 31, 2010	8,431,502	\$ 140,524	\$ 1,828,393	\$ 2,363,440	\$ 73,863,253	(142,412)	\$ (4,773,566)	\$ 73,422,044

Three Months Ended December 31, 2009

	Class A voting Common Stock Shares	Amount	Capital in Excess of Par Value	Deferred Directors Compensation	Retained Earnings	Treasury Shares	Treasury Stock	Total
Balances at September 30, 2009	8,431,502	\$ 140,524	\$ 1,922,053	\$ 1,862,499	\$ 64,507,547	(119,866)	\$ (4,310,280)	\$ 64,122,343
Net income					1,708,378			1,708,378

Dividends (\$0.07 per share)					(581,815)			(581,815)
Increase in deferred directors compensation charged to expense				49,031				49,031
Balances at December 31, 2009	8,431,502	\$ 140,524	\$ 1,922,053	\$ 1,911,530	\$ 65,634,110	(119,866)	\$ (4,310,280)	\$ 65,297,937

(See accompanying notes)
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PANHANDLE OIL AND GAS INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three months ended December	
	31,	
	2010	2009
Operating Activities		
Net income	\$ 1,426,849	\$ 1,708,378
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion, amortization and impairment	3,434,811	5,292,695
Provision for deferred income taxes	339,000	383,000
Exploration costs	287,104	576,161
Net (gain) loss on sale of assets	(111,478)	(133,192)
Income from partnerships	(78,048)	(76,752)
Distributions received from partnerships	110,743	104,391
Directors' deferred compensation expense	141,313	49,031
Restricted stock awards	12,028	
Cash provided by changes in assets and liabilities:		
Oil and natural gas sales receivables	2,138,525	(1,253,808)
Fair value of derivative contracts	1,597,939	(1,648,940)
Refundable production taxes	159,708	295,244
Other current assets	240,951	(96,725)
Accounts payable	83,242	(102,443)
Income taxes payable	(725,070)	(51,770)
Accrued liabilities	(477,953)	(222,373)
 Total adjustments	 7,152,815	 3,114,519
 Net cash provided by operating activities	 8,579,664	 4,822,897
Investing Activities		
Capital expenditures, including dry hole costs	(6,570,808)	(2,658,662)
Proceeds from leasing of fee mineral acreage	122,678	56,004
Investments in partnerships	50,936	(1,971)
Proceeds from sales of assets	938	102,881
 Net cash used in investing activities	 (6,396,256)	 (2,501,748)
Financing Activities		
Borrowings under debt agreement		5,000,388
Payments of loan principal		(6,862,879)
Purchase of treasury stock	(576,813)	
Payments of dividends	(581,675)	(581,815)
 Net cash provided by (used in) financing activities	 (1,158,488)	 (2,444,306)

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Increase (decrease) in cash and cash equivalents	1,024,920	(123,157)
Cash and cash equivalents at beginning of period	5,597,258	639,908
Cash and cash equivalents at end of period	\$ 6,622,178	\$ 516,751

Supplemental Schedule of Noncash Investing and Financing Activities

Dividends declared and unpaid	\$ 581,654	\$
Additions to asset retirement obligations	\$ 3,436	\$ 9,693
Gross additions to properties and equipment	\$ 5,092,496	\$ 1,736,461
Net (increase) decrease in accounts payable for properties and equipment additions	1,478,312	922,201
Capital expenditures, including dry hole costs	\$ 6,570,808	\$ 2,658,662

(See accompanying notes)

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PANHANDLE OIL AND GAS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1: Accounting Principles and Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Panhandle Oil and Gas Inc. (the Company) have been prepared in accordance with the instructions to Form 10-Q as prescribed by the Securities and Exchange Commission (SEC), and include the Company's wholly-owned subsidiary, Wood Oil Company (Wood). Management of the Company believes that all adjustments necessary for a fair presentation of the consolidated financial position and results of operations and cash flows 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's fiscal year runs from October 1 through September 30.

Certain amounts and disclosures have been condensed or omitted from these consolidated financial statements pursuant to the rules and regulations of the SEC. Therefore, these condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes thereto included in the Company's 2010 Annual Report on Form 10-K.

NOTE 2: Income Taxes

The Company's provision for income taxes differs from the statutory rate primarily due to estimated federal and state benefits generated from estimated excess federal and Oklahoma percentage depletion, which are permanent tax benefits.

Both excess federal percentage depletion, which is limited to certain production volumes and by certain income levels, and excess Oklahoma percentage depletion, which has no limitation on production volume or income, reduce estimated taxable income or add to estimated taxable loss projected for any year. The federal and Oklahoma excess percentage depletion estimates will be updated throughout the year until finalized with the detail well-by-well calculations at fiscal year-end. Federal and Oklahoma excess percentage depletion benefits, when a provision for income taxes is recorded, decrease the effective tax rate (as is the case as of December 31, 2010 and 2009), while the effect is to increase the effective tax rate when a benefit for income taxes is recorded. The benefits of federal and Oklahoma excess percentage depletion are not directly related to the amount of pre-tax income recorded in a period. Accordingly, in periods where a recorded pre-tax income or loss is relatively small, the proportional effect of these items on the effective tax rate may be significant.

NOTE 3: Basic and Diluted Earnings per Share

Basic and diluted earnings per share is calculated using net income divided by the weighted average number of voting common shares outstanding, including unissued directors' deferred compensation shares during the period. The unvested restricted stock discussed in NOTE 7 is not included in diluted earnings per share because the effect is antidilutive.

NOTE 4: Long-term Debt

The Company has a credit facility with Bank of Oklahoma (BOK) which consists of a revolving loan in the amount of \$80,000,000 which is subject to a semi-annual borrowing base determination, wherein BOK applies their own current pricing forecast and a 9% discount rate to the Company's proved reserves as calculated by the Company's Independent Consulting Petroleum Engineering Firm. When applying the discount rate, BOK also applies an advance rate percentage to risk all proved non-producing and proved undeveloped reserves. The facility has a borrowing base of \$35,000,000 and is secured by certain of the Company's properties with a carrying value of \$29,802,940 at December 31, 2010. The facility matures on November 30, 2014. The interest rate is based on national prime plus from .50% to 1.25%, or 30 day LIBOR plus from 2.00% to 2.75%. The interest rate spread from LIBOR or the prime rate increases as a larger percent of the loan value of the Company's oil and natural gas properties is advanced. The interest rate spread from national prime or LIBOR will be charged based on the percent of the value advanced of the calculated loan value of the Company's oil and natural gas properties.

Since the bank charges a customary non-use fee of .25% annually of the unused portion of the borrowing base, the Company has not requested the bank to increase its borrowing base beyond \$35 million. Determinations of the borrowing base are made semi-annually or whenever the bank, in its sole discretion, believes that there has been a

material change in the value of the oil and natural gas properties. The loan agreement contains customary covenants which, among other things, require periodic financial and reserve reporting and limit the Company's incurrence of indebtedness, liens, dividends and acquisitions of treasury stock, and require the Company to maintain certain financial ratios. At December 31, 2010, the Company was in compliance with the covenants of the BOK agreement.

NOTE 5: Dividends

On October 27, 2010, the Company's Board of Directors declared a \$.07 per share dividend that was paid on December 10, 2010 to shareholders of record on November 22, 2010. On December 8, 2010, the Company's Board of Directors approved payment of a \$.07 per share dividend to be paid on March 10, 2011 to shareholders of record on February 24, 2011.

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The Company has a deferred compensation plan for non-employee directors (the Plan). The Plan provides that each eligible director can individually elect to receive shares of Company stock rather than cash for Board and committee chair retainers, Board meeting fees and Board committee meeting fees. These shares are unissued and are credited to each director's deferred fee account at the closing market price of the stock on the date earned. Upon retirement, termination or death of the director or upon a change in control of the Company, the shares accrued under the Plan will be issued to the director.

NOTE 7: Restricted Stock Plan

On March 11, 2010, shareholders approved the Panhandle Oil and Gas Inc. 2010 Restricted Stock Plan (2010 Stock Plan), which made available 100,000 shares of common stock to provide a long-term component to the Company's total compensation package for its officers and to further align the interest of its officers with those of its shareholders. The 2010 Stock Plan is designed to provide as much flexibility as possible for future grants of restricted stock so that the Company can respond as necessary to provide competitive compensation in order to retain, attract and motivate officers of the Company and to align their interests with those of the Company's shareholders.

In June 2010, the Company awarded 8,500 shares of the Company's common stock as restricted stock to certain officers. The restricted stock vests at the end of five years and contains nonforfeitable rights to receive dividends and voting rights during the vesting period.

On December 21, 2010, the Company awarded 8,780 shares of the Company's common stock as restricted stock to certain officers. The restricted stock vests at the end of three years and contains nonforfeitable rights to receive dividends and voting rights during the vesting period. Dividends expected to be paid are \$.07 per share each quarter. The fair value of the shares at the time of their award, based on the closing price of the shares on their award date, was \$245,840 and will be recognized as compensation expense ratably over the vesting period.

The compensation expense recognized as a part of G&A expense in the 2011 quarter was \$12,028 (none in the 2010 quarter).

A summary of the status of unvested shares of restricted stock awards and changes during 2011 is presented below:

	Unvested Restricted Shares	Weighted Average Grant-Date Fair Value
Unvested shares as of September 30, 2010	8,500	\$ 28.30
Granted	8,780	\$ 28.00
Vested		\$
Forfeited		\$
Unvested shares as of December 31, 2010	17,280	\$ 28.15

As of December 31, 2010, there was \$462,335 of total unrecognized compensation cost related to unvested restricted stock. The cost is to be recognized over a weighted average period of 3.74 years. Upon vesting, shares are expected to be issued out of shares held in treasury.

On December 21, 2010, the Company also awarded 8,782 shares of the Company's common stock, subject to certain share price performance standards, as restricted stock to certain officers. Vesting of these shares is based on the performance of the market price of the common stock over the vesting period (three years). Shares not vested will be repurchased by the Company at par value. The impact of these awards on G&A expense in the 2011 quarter is not material.

NOTE 8: Oil and Natural Gas Reserves

Management considers the estimation of the Company's crude oil and natural gas reserves to be the most significant of its judgments and estimates. Changes in crude oil and natural gas reserve estimates affect the Company's calculation of DD&A, provision for abandonment and assessment of the need for asset impairments. On an annual basis, with a semi-annual update, the Company's Independent Consulting Petroleum Engineer, with assistance from Company staff, prepares estimates

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of crude oil and natural gas reserves based on available geologic and seismic data, reservoir pressure data, core analysis reports, well logs, analogous reservoir performance history, production data and other available sources of engineering, geological and geophysical information. Between periods in which reserves would normally be calculated, the Company updates the reserve calculations utilizing prices current with the period. As of September 30, 2010, the Company adopted the SEC Rule, *Modernization of Oil and Gas Reporting Requirements*. Accordingly, the estimated oil and natural gas reserves at December 31, 2010, were computed using the 12-month average price calculated as the unweighted arithmetic average of the first-day-of-the-month oil and natural gas price for each month within the 12-month period prior to December 31, 2010, held flat over the life of the properties. In accordance with SEC rules effective on December 31, 2009, current pricing of oil and natural gas on December 31, 2009, held flat over the life of the properties was used to estimate oil and natural gas reserves as of December 31, 2009. Crude oil and natural gas prices are volatile and largely affected by worldwide production and consumption and are outside the control of management. However, projected future crude oil and natural gas pricing assumptions are used by management to prepare estimates of crude oil and natural gas reserves and future net cash flows used in asset impairment assessments and in formulating management's overall operating decisions.

NOTE 9: Impairment

All long-lived assets, principally oil and natural gas properties, are monitored for potential impairment when circumstances indicate that the carrying value of the asset may be greater than its estimated future net cash flows. The evaluations involve significant judgment since the results are based on estimated future events, such as inflation rates, future sales prices for oil and natural gas, future production costs, estimates of future oil and natural gas reserves to be recovered and the timing thereof, the economic and regulatory climates and other factors. The need to test a property for impairment may result from significant declines in sales prices or unfavorable adjustments to oil and natural gas reserves. Between periods in which reserves would normally be calculated, the Company updates the reserve calculations utilizing updated projected future price decks current with the period. The assessments at December 31, 2010 and 2009 resulted in no impairment provision. A reduction in oil and natural gas prices or a decline in reserve volumes could lead to additional impairment that may be material to the Company.

The first well in our internally generated Joiner City prospect, a horizontal Woodford Shale prospect in the oil and natural gas liquids-rich Marietta Basin in southern Oklahoma, has been drilled during the first quarter of 2011. The well is currently in the testing stage and the flow back results are being evaluated. As of the date of this filing, approximately \$1.1 million has been capitalized on this well that may be subject to future impairment pending the evaluation results.

NOTE 10: Capitalized Costs

Oil and natural gas properties include costs of \$1,175,752 on exploratory wells which were drilling and/or testing at December 31, 2010. The Company is expecting to have evaluation results on these wells within the next six months.

NOTE 11: Derivatives

The Company has entered into fixed swap contracts and basis protection swaps. These instruments are intended to reduce the Company's exposure to short-term fluctuations in the price of natural gas. Fixed swap contracts set a fixed price and provide payments to the Company if the index price is below the fixed price, or require payments by the Company if the index price is above the fixed price. These contracts cover only a portion of the Company's natural gas production and provide only partial price protection against declines in natural gas prices. Basis protection swaps are derivatives that guarantee a price differential to NYMEX for natural gas from a specified delivery point (CEGT and PEPL currently). The Company receives a payment from the counterparty if the price differential is greater than the agreed terms of the contract and pays the counterparty if the price differential is less than the agreed terms of the contract. These derivative instruments may expose the Company to risk of financial loss and limit the benefit of future increases in prices. All of the Company's derivative contracts are with Bank of Oklahoma and are unsecured. The derivative instruments have settled or will settle based on the prices below which are adjusted for location differentials and tied to certain pipelines in Oklahoma.

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Derivative contracts in place as of December 31, 2010
 (prices below reflect the Company's net price from the listed Oklahoma pipelines)

Contract period	Production volume covered per month	Indexed (1) Pipeline	Fixed price
Basis protection swaps January - December, 2011	50,000 Mmbtu	CEGT	