PANHANDLE ROYALTY CO
Form 10QSB
August 13, 2001

1

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 June 30, 2001

( ) 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

PANHANDLE ROYALTY COMPANY
(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

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

Outstanding shares of Class A Common stock (voting) at August 6, 2001: 2,060,060

2

INDEX

3

PART I. FINANCIAL INFORMATION

PANHANDLE ROYALTY COMPANY
CONDENSED CONSOLIDATED BALANCE SHEETS
(Information at June 30, 2001 is unaudited)

	June 200
Assets	
Current assets:	
Cash and cash equivalents	$ 754

Oil and gas sales and other receivables	1,873
Prepaid expenses	13
Total current assets	2,641
Properties and equipment, at cost, based on successful efforts accounting	
Producing oil and gas properties	33,234
Non producing oil and gas properties	6,694
Other	283
	40,211
Less accumulated depreciation, depletion and amortization	21,713
Net properties and equipment	18,497
Other assets	107
	$21,246
Liabilities and Stockholders' Equity	
Current liabilities:	
Accounts payable	829
Accrued liabilities and gas imbalance liability	556
Dividends payable	7
Income taxes payable	34
Deferred income taxes	23
Total current liabilities	1,451
Deferred income taxes	2,882
Deferred lease bonus	34
Stockholders' equity	
Class A voting Common Stock, $.0333 par value; 6,000,000 shares authorized, 2,060,060 issued and outstanding at June 30,2001 and 2,060,206 at September 30, 2000	68
Capital in excess of par value	606
Retained earnings	16,204
Total stockholders' equity	16,879
	$21,246

(1)

4

PANHANDLE ROYALTY COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	Three Months Ended June 30,		Nine Months Ended June 3	
	2001	2000	2001	2000

Revenues:				
Oil and gas sales	$ 2,881,407	$ 2,376,330	$10,185,294	$ 6,162,1
Lease bonuses and rentals	10,188	8,996	14,457	70,1
Interest	11,071	4,322	39,936	8,8
Other	15,937	20,845	94,112	61,1
	2,918,603	2,410,493	10,333,799	6,302,4
Costs and expenses:				
Lease operating expenses	230,701	215,644	665,915	566,3
Production taxes	210,420	175,763	690,776	448,6
Exploration costs	200,359	90,773	514,466	328,4
Depreciation, depletion, amortization and impairment	435,859	385,358	1,323,450	1,284,2
General and administrative	472,550	284,382	1,484,098	996,4
Interest expense	779	4,833	779	15,5
	1,550,668	1,156,753	4,679,484	3,639,7
Income before provision for income taxes	1,367,935	1,253,740	5,654,315	2,662,7
Provision for income taxes	340,000	310,000	1,550,000	632,0
Net income	$ 1,027,935	$ 943,740	$ 4,104,315	$ 2,030,7
Basic earnings per share (Note 3)	$ .50	$ .46	$ 1.99	$.
Diluted earnings per share (Note 3)	$ .49	$ .46	$ 1.97	$.
Dividends declared per share of common stock	$ .07	$ .07	$ .28	$.

(2)

5

PANHANDLE ROYALTY COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

Nine Months Ended June 30,

	2001	2000
Cash flows from operating activities:		
Net income	$ 4,104,315	$ 2,030,719
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion and amortization	1,323,450	1,284,279
Deferred income taxes	1,065,000	350,000
Exploration costs	514,466	328,422
Deferred lease bonus	34,040	--
Cash provided (used) by changes in assets and liabilities:		
Oil and gas sales and income tax receivable	81,832	(461,479)
Prepaid expenses and other assets	(9,549)	(8,025)
Income taxes payable	(214,464)	30,999
Accounts payable, accrued liabilities, gas imbalance liability and dividends payable	626,279	(120,564)
Total adjustments	3,421,054	1,403,632
Net cash provided by operating activities	7,525,369	3,434,351
Cash flows from investing activities:		
Purchase of and development of properties and equipment	(7,008,126)	(2,891,956)
Net cash used in investing activities	(7,008,126)	(2,891,956)
Cash flows from financing activities:		
Borrowings under line of credit	--	500,000
Payments of loan principal	--	(400,000)
Acquisition and cancellation of Company's common shares	(1,859)	(70,909)
Payment of dividends	(576,826)	(433,292)
Net cash used by financing activities	(578,685)	(404,201)
Increase (decrease) in cash and cash equivalents	(61,442)	138,194
Cash and cash equivalents at beginning of period	815,912	213,207
Cash and cash equivalents at end of period	$ 754,470	$ 351,401
Supplemental disclosure of cash flow information:		
Interest paid	$ 779	$ 16,368
Income taxes paid	699,464	251,001
	$ 700,243	$ 267,369

(See accompanying notes)
PANHANDLE ROYALTY COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. The consolidated results presented for the three-month and nine-month periods ended June 30, 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.

2. 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.

3. 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 June 30,		Nine Months Ended June	
	2001	2000	2001	2000
Numerator for primary and diluted earnings per share:				
Net income	$1,027,935	$ 943,740	$4,104,315	$2,030,
Denominator:				
For basic earnings per share Weighted average shares	2,060,060	2,053,662	2,060,096	2,056,
Effect of potential diluted shares:				
Directors deferred compensation shares	24,407	20,797	22,411	18,
Denominator for diluted earnings per share - adjusted weighted average shares and potential shares	2,084,467	2,074,459	2,082,507	2,074,
Basic earnings per share	$ .50	$ .46	$ 1.99	$
Diluted earnings per share	$ .49	$ .46	$ 1.97	$

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 June 30, 2001, the Company had no balance outstanding under the BancFirst facility.

5. Approximately 72% 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 nine-month period ended June 30, 2001, these contracts reduced gas revenues approximately $147,000.

6. On August 9, 2001, the Company signed an agreement and plan of merger to acquire privately held Wood Oil Company of Tulsa, Oklahoma. Wood Oil, subsequent to the merger will become a wholly owned subsidiary of Panhandle. The purchase price of $25,000,000 (which will include approximately $4.5 million of net working capital) is subject to pre-closing adjustments. Closing is expected to be on October 1, 2001. The Company will finance the acquisition with bank debt, a portion of which will be immediately retired with Wood Oil cash. A new $20,000,000 term loan agreement with BancFirst will be utilized. The initial term of the facility will be five years with the existing $5,000,000 line-of-credit remaining in place.

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 June 30, 2001, the Company had positive working capital of $1,190,266, as compared to $1,712, 806 at September 30, 2000. Cash flow from operating activities increased 119% to $7,525,369, for the 2001 nine-month period as compared to the fiscal 2000 nine-month period. This increase was primarily a result of increased oil and gas sales revenues during the 2001 nine-month period, which is discussed in detail in Results of Operations.

Capital expenditures for oil and gas activities for the first nine-months of fiscal 2001 amounted to $7,008,126 compared to $2,891,956 in the first nine-months of fiscal 2000. This increased level of expenditures was the result of significantly increased market prices for natural gas and oil in fiscal 2001, causing a large increase in the number of new wells being drilled. As the Company relies on third parties to operate all drilling and producing wells, the level of and timing of capital expenditures is influenced heavily by market conditions for natural gas and oil. Current expectations are that this increased level of capital expenditures will continue for the remainder of fiscal 2001 and into fiscal 2002. Remaining projected costs, at June 30, 2001, for wells proposed or actually drilling, were approximately $5,058,000. 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 operating costs and capital obligations.

On August 9, 2001, the Company signed an agreement and plan of merger to acquire privately held Wood Oil Company of Tulsa, Oklahoma. Wood Oil, subsequent to the merger will become a wholly owned subsidiary of Panhandle. The purchase price of $25,000,000 (which will include approximately $4.5 million of net working capital) is subject to pre-closing adjustments. Closing is expected to be on October 1, 2001. The Company will finance the acquisition with bank debt, a portion of which will be immediately retired with Wood Oil cash. A new $20,000,000 term loan agreement with BancFirst will be utilized. The initial term of the facility will be five years with the existing $5,000,000 line-of-credit remaining in place.

RESULTS OF OPERATIONS

Revenues increased significantly for the three-month and nine-month periods ended June 30, 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 nine-month periods of fiscal 2001 and 2000.

	BARRELS SOLD	AVERAGE PRICE	MCF SOLD	AVERAGE PRICE
Three months ended 6/30/01	15,886	$29.93	517,081	$4.65
Three months ended 6/30/00	20,795	$26.86	550,406	$3.30
Nine months ended 6/30/01	49,729	$30.00	1,591,722	$5.46
Nine months ended 6/30/00	54,973	$26.05	1,751,628	$2.70

As shown in the above chart, gas sales prices increased for both the three-month and nine-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 nine-month periods of fiscal 2001, as compared to the fiscal 2000 periods. These decreases are the result of normal production decline in the Company's wells, and specifically a decline in the Potato Hills Field production in the 2001 periods as compared to the 2000 periods which reflected significant initial production. In addition, due to the substantial increase in drilling activity in this fiscal year, and the resulting manpower and equipment shortages, the completion and placing on production of new wells drilled is slow. Thus, new production is not currently coming on line at a pace fast enough to overcome the decline of older wells. Gas prices are expected to decline to around the $3.00 to $3.50 level during the remaining summer months of fiscal 2001, with oil prices remaining in the mid $20 range. The Company's oil and gas sales revenues for the fourth quarter are expected to be comparable to somewhat less than the third quarter of fiscal

2001, unless, substantial new wells are placed on production.

Costs and expenses increased 34% and 29% respectively, for the three-month and nine-month periods ended June 30, 2001, as compared to the same periods of fiscal 2000. These increases were mainly the result of increased production taxes, increased lease operating expenses, increased exploration costs and increased general and administrative costs. Production taxes are calculated as a percentage of oil and gas sales, thus, these costs increased with the increased oil and gas sales revenues in the 2001 periods. As the Company has been participating in the drilling of an ever increasing number of wells during the last several years, lease operating expenses increase steadily as these new wells are placed on production. In the third fiscal quarter of 2001, the Company paid an investment banking firm $150,000 to provide a valuation of the Company, strategic planning and other advice causing general and administrative costs to increase substantially as compared to the fiscal 2000 quarter. The nine-month 2001 period general and administrative expenses also included an $123,000 charge related to the Non-Employee Director's Deferred Compensation Plan reflecting the Company's share price increase 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 since the Non-Employee director's elected to receive these potential shares, rather than a cash payment for their director's fees. In addition, personnel related expenses (including salaries, insurance costs, payroll taxes and ESOP expenses) and legal costs increased in the fiscal 2001 periods as compared to the 2000 periods. Exploration costs increased in both 2001 periods as the Company is participating in more exploratory wells in fiscal 2001 than ever before. Dry hole costs resulting from the drilling of non-productive exploratory wells increased exploration costs in the 2001 periods. As the Company has increased its drilling activity, the risk and incurrence of future dry hole costs will continue.

The Company's provision for income taxes increased substantially in the 2001 nine-month period 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 as explained above. It currently appears earnings for the remainder of fiscal 2001, will benefit, though to a lesser extent than the first nine months, from the 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 below the currently expected levels, earnings would be negatively impacted.

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 June 30, 2001.

(6)

9

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

August 10, 2001	/s/ H W Peace II
Date	H W Peace II, President and Chief Executive Officer
August 10, 2001	/s/ Michael C. Coffman
Date	Michael C. Coffman, Vice President, Chief Financial Officer and Secretary and Treasurer