

PANHANDLE OIL & GAS INC  
Form 10-Q  
February 06, 2014

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  
~~December~~ 31,  
~~2013~~  
period  
ended

Transition Report Pursuant to Section 13  
or 15(d) of the Securities Exchange Act  
of 1934  
For \_\_\_\_\_ to \_\_\_\_\_  
the  
transition  
period  
from

~~00131759~~  
File  
Number

PANHANDLE OIL AND GAS INC.  
(Exact name of registrant as specified in its  
charter)

OKLAHOMA 73-1055775  
(I.R.S. Employer)

(State  
or  
other  
jurisdiction  
of  
incorporation Identification No.)  
or  
organization)

Grand Centre Suite 300, 5400 N Grand  
Blvd., Oklahoma City, Oklahoma 73112  
(Address of principal executive offices)

Reg 405, 408-1560  
405, 408-1560  
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 that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YesNo

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).

YesNo

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 company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YesNo

Outstanding shares of 8,236,672  
Class A Common  
stock (voting) at  
February 6, 2014:

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The following defined terms are used in this report:

“Bbl” means barrel.

“Board” means board of directors.

“BTU” means British Thermal Units.

“Company” refers to Panhandle Oil and Gas Inc.

“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.

“G&A” means general and administrative costs.

“Independent Consulting Petroleum Engineer(s)” or “Independent Consulting Petroleum Engineering Firm” refers to DeGolyer and MacNaughton of Dallas, Texas.

“LOE” means lease operating expense.

“Mcf” means thousand cubic feet.

“Mcf” means natural gas stated on an Mcf basis and crude oil and natural gas liquids converted to a thousand cubic feet of natural gas equivalent by using the ratio of one Bbl of crude oil or natural gas liquids to six Mcf of natural gas.

“Mmbtu” means million BTU.

“minerals”, “mineral acres” or “mineral interests” refers to fee mineral acreage owned in perpetuity by the Company.

“NGL” means natural gas liquids.

“NYMEX” refers to the New York Mercantile Exchange.

“Panhandle” refers to Panhandle Oil and Gas Inc.

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

“royalty interest” refers to well interests in which the Company does not pay a share of the costs to drill, complete and operate a well, but receives a much smaller proportionate share (as compared to a working interest) of production.

“SEC” refers to 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.

“WTI” refers to West Texas Intermediate.

Fiscal year references



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All references to years in this report, unless otherwise noted, refer to the Company's fiscal year end of September 30. For example, references to 2014 mean the fiscal year ended September 30, 2014.

References to oil and natural gas properties

References to oil and natural gas properties inherently include natural gas liquids associated with such properties.

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## PART 1 FINANCIAL INFORMATION

## PANHANDLE OIL AND GAS INC.

## CONDENSED BALANCE SHEETS

|  | December 31,<br>2013<br>(unaudited) | September 30,<br>2013 |
|--|-------------------------------------|-----------------------|
| Assets   |                                     |                       |
| Current assets:  |                                     |                       |
| Cash and cash equivalents  | \$ 294,961                          | \$ 2,867,171          |
| Oil, NGL and natural gas sales receivables                                   | 14,677,736                          | 13,720,761            |
| Refundable production taxes  | 708,506                             | 662,051               |
| Derivative contracts   | -                                   | 425,198               |
| Other  | 165,811                             | 129,998               |
| Total current assets   | 15,847,014                          | 17,805,179            |
| Properties and equipment at cost, based on<br>successful efforts accounting: |                                     |                       |
| Producing oil and natural gas properties                                     | 314,483,789                         | 304,889,145           |
| Non-producing oil and natural gas properties                                 | 8,873,666                           | 8,932,905             |
| Furniture and fixtures   | 737,929                             | 737,368               |
|  | 324,095,384                         | 314,559,418           |
| Less accumulated depreciation, depletion and amortization                    | (191,820,197)                       | (186,641,291)         |
| Net properties and equipment   | 132,275,187                         | 127,918,127           |
| Investments  | 1,663,320                           | 1,574,642             |
| Refundable production taxes  | 440,203                             | 540,482               |
| Total assets   | \$ 150,225,724                      | \$ 147,838,430        |
| Liabilities and Stockholders' Equity   |                                     |                       |
| Current liabilities:   |                                     |                       |
| Accounts payable   | \$ 7,168,398                        | \$ 8,409,634          |
| Derivative contracts   | 466,772                             | -                     |
| Deferred income taxes  | 84,100                              | 127,100               |
| Income taxes payable   | 1,840,342                           | 751,992               |
| Accrued liabilities and other  | 1,203,080                           | 1,011,865             |
| Total current liabilities  | 10,762,692                          | 10,300,591            |
| Long-term debt   | 6,000,000                           | 8,262,256             |
| Deferred income taxes  | 31,595,907                          | 31,226,907            |
| Asset retirement obligations   | 2,477,441                           | 2,393,190             |
| Stockholders' equity:  |                                     |                       |
| Class A voting common stock, \$.0166 par value;                              |                                     |                       |

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|  |                |                |
|--|----------------|----------------|
| 24,000,000 shares authorized, 8,431,502 issued at<br>December 31, 2013, and September 30, 2013                 | 140,524        | 140,524        |
| Capital in excess of par value   | 2,456,303      | 2,587,838      |
| Deferred directors' compensation   | 2,870,595      | 2,756,526      |
| Retained earnings  | 100,052,495    | 96,454,449     |
|  | 105,519,917    | 101,939,337    |
| Less treasury stock, at cost; 194,830 shares at December 31,<br>2013, and 200,248 shares at September 30, 2013 | (6,130,233)    | (6,283,851)    |
| Total stockholders' equity   | 99,389,684     | 95,655,486     |
| Total liabilities and stockholders' equity   | \$ 150,225,724 | \$ 147,838,430 |

(See accompanying notes)

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## PANHANDLE OIL AND GAS INC.

## CONDENSED STATEMENTS OF OPERATIONS

|  | Three Months Ended<br>December 31, |               |
|--|------------------------------------|---------------|
|  | 2013                               | 2012          |
| Revenues:  | (unaudited)                        |               |
| Oil, NGL and natural gas sales   | \$ 18,473,082                      | \$ 12,758,954 |
| Lease bonuses and rentals  | 196,229                            | 374,392       |
| Gains (losses) on derivative contracts   | (496,901)                          | 892,693       |
| Income from partnerships   | 224,346                            | 154,396       |
|  | 18,396,756                         | 14,180,435    |
| Costs and expenses:  |                                    |               |
| Lease operating expenses   | 3,315,397                          | 3,296,562     |
| Production taxes   | 571,564                            | 303,553       |
| Exploration costs  | 38,755                             | 19,767        |
| Depreciation, depletion and amortization   | 5,308,019                          | 5,639,020     |
| Provision for impairment   | 202,991                            | 154,965       |
| Loss (gain) on asset sales, interest and other   | (77,455)                           | 43,186        |
| General and administrative   | 1,873,167                          | 1,898,084     |
|  | 11,232,438                         | 11,355,137    |
| Income before provision for income taxes   | 7,164,318                          | 2,825,298     |
| Provision for income taxes   | 2,238,000                          | 677,000       |
| Net income   | \$ 4,926,318                       | \$ 2,148,298  |
| Basic and diluted earnings per common share (Note 3)                                     | \$ 0.59                            | \$ 0.26       |
| Basic and diluted weighted average shares outstanding:                                   |                                    |               |
| Common shares  | 8,231,902                          | 8,250,109     |
| Unissued, directors' deferred compensation shares  | 123,061                            | 122,285       |
|  | 8,354,963                          | 8,372,394     |
| Dividends declared per share of<br>common stock and paid in period                       | \$ 0.08                            | \$ 0.07       |
| Dividends declared per share of<br>common stock and to be paid in quarter ended March 31 | \$ 0.08                            | \$ 0.07       |

(See accompanying notes)

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## PANHANDLE OIL AND GAS INC.

## STATEMENTS OF STOCKHOLDERS' EQUITY

Three Months Ended December 31, 2013

|  | Class A voting<br>Common Stock<br>Shares | Amount     | Capital in<br>Excess of<br>Par Value | Deferred<br>Directors'<br>Compensation | Retained<br>Earnings | Treasury<br>Shares | Treasury<br>Stock | Total         |
|--|--|------------|--------------------------------------|--|----------------------|--------------------|-------------------|---------------|
| Balances at<br>September<br>30, 2013   | 8,431,502                                | \$ 140,524 | \$ 2,587,838                         | \$ 2,756,526                           | \$ 96,454,449        | (200,248)          | \$ (6,283,851)    | \$ 95,655,488 |
| Purchase of<br>treasury<br>stock   | -  | -          | -                                    | -                                      | -                    | (3,722)            | (122,044)         | (122,044)     |
| Restricted<br>stock awards   | -  | -          | 127,976                              | -                                      | -                    | -                  | -                 | 127,976       |
| Net income   | -  | -          | -                                    | -                                      | 4,926,318            | -                  | -                 | 4,926,318     |
| Dividends<br>(\$ .16 per<br>share)   | -  | -          | -                                    | -                                      | (1,328,272)          | -                  | -                 | (1,328,272)   |
| Distribution<br>of restricted<br>stock<br>to officers                          | -  | -          | (259,511)                            | -                                      | -                    | 9,140              | 275,662           | 16,151        |
| Increase in<br>deferred<br>directors'<br>compensation<br>charged to<br>expense | -  | -          | -                                    | 114,069                                | -                    | -                  | -                 | 114,069       |
| Balances at<br>December<br>31, 2013<br>(unaudited)                             | 8,431,502                                | \$ 140,524 | \$ 2,456,303                         | \$ 2,870,595                           | \$ 100,052,495       | (194,830)          | \$ (6,130,233)    | \$ 99,389,684 |

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Three Months Ended December 31, 2012

|  | Class A voting<br>Common Stock<br>Shares | Amount     | Capital in<br>Excess of<br>Par Value | Deferred<br>Directors'<br>Compensation | Retained<br>Earnings | Treasury<br>Shares | Treasury<br>Stock | Total         |
|--|--|------------|--------------------------------------|--|----------------------|--------------------|-------------------|---------------|
| Balances at<br>September 30,<br>2012   | 8,431,502                                | \$ 140,524 | \$ 2,020,229                         | \$ 2,676,160                           | \$ 84,821,395        | (181,310)          | \$ (5,806,162)    | \$ 83,852,140 |
| Purchase of<br>treasury stock  | -  | -          | -                                    | -                                      | -                    | (4,198)            | (116,632)         | (116,632)     |
| Restricted<br>stock awards   | -  | -          | 257,877                              | -                                      | -                    | -                  | -                 | 257,877       |
| Net income   | -  | -          | -                                    | -                                      | 2,148,298            | -                  | -                 | 2,148,298     |
| Dividends<br>(\$ .14 per<br>share)   | -  | -          | -                                    | -                                      | (1,164,429)          | -                  | -                 | (1,164,429)   |
| Distribution of<br>deferred<br>directors'<br>compensation                      | -  | -          | (82,547)                             | (297,140)                              | -                    | 12,361             | 394,687           | 15,000        |
| Increase in<br>deferred<br>directors'<br>compensation<br>charged to<br>expense | -  | -          | -                                    | 114,164                                | -                    | -                  | -                 | 114,164       |
| Balances at<br>December 31,<br>2012<br>(unaudited)                             | 8,431,502                                | \$ 140,524 | \$ 2,195,559                         | \$ 2,493,184                           | \$ 85,805,264        | (173,147)          | \$ (5,528,107)    | \$ 85,106,424 |

(See accompanying notes)

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## PANHANDLE OIL AND GAS INC.

## CONDENSED STATEMENTS OF CASH FLOWS

|  | Three months ended |              |
|--|--------------------|--------------|
|  | December 31,       |              |
|  | 2013               | 2012         |
|  | (unaudited)        |              |
| Operating Activities   |                    |              |
| Net income (loss)  | \$ 4,926,318       | \$ 2,148,298 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |                    |              |
| Depreciation, depletion and amortization   | 5,308,019          | 5,639,020    |
| Impairment   | 202,991            | 154,965      |
| Provision for deferred income taxes  | 326,000            | 338,000      |
| Exploration costs  | 38,755             | 19,767       |
| Gain from leasing fee mineral acreage  | (196,133)          | (373,440)    |
| Income from partnerships   | (224,346)          | (154,396)    |
| Distributions received from partnerships   | 279,363            | 194,147      |
| Directors' deferred compensation expense   | 114,069            | 114,164      |
| Restricted stock awards  | 127,976            | 257,877      |
| Cash provided (used) by changes in assets and liabilities:                               |                    |              |
| Oil, NGL and natural gas sales receivables   | (956,975)          | 115,645      |
| Fair value of derivative contracts   | 891,970            | (936,914)    |
| Refundable production taxes  | 53,824             | 212,834      |
| Other current assets   | (35,813)           | 47,528       |
| Accounts payable   | 414,267            | (361,777)    |
| Income taxes receivable  | -                  | 319,735      |
| Income taxes payable   | 1,088,350          | -            |
| Accrued liabilities  | (472,288)          | (577,210)    |
| Total adjustments  | 6,960,029          | 5,009,945    |
| Net cash provided by operating activities  | 11,886,347         | 7,158,243    |
| Investing Activities   |                    |              |
| Capital expenditures, including dry hole costs   | (9,892,262)        | (6,864,399)  |
| Acquisition of working interest properties   | (1,550,205)        | -            |
| Acquisition of minerals and overrides  | (56,250)           | (330,000)    |
| Proceeds from leasing fee mineral acreage  | 216,773            | 384,790      |
| Investments in partnerships  | (143,695)          | (243,519)    |
| Net cash used in investing activities  | (11,425,639)       | (7,053,128)  |
| Financing Activities   |                    |              |

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|  |               |              |
|--|---------------|--------------|
| Borrowings under debt agreement  | 2,280,280     | 4,171,662    |
| Payments of loan principal   | (4,542,536)   | (4,591,890)  |
| Purchases of treasury stock  | (122,044)     | (116,632)    |
| Payments of dividends  | (664,618)     | (580,991)    |
| Excess tax benefit on stock-based compensation                                     | 16,000        | 15,000       |
| Net cash provided by (used in) financing activities                                | (3,032,918)   | (1,102,851)  |
| Increase (decrease) in cash and cash equivalents                                   | (2,572,210)   | (997,736)    |
| Cash and cash equivalents at beginning of period                                   | 2,867,171     | 1,984,099    |
| Cash and cash equivalents at end of period   | \$ 294,961    | \$ 986,363   |
| Supplemental Schedule of Noncash Investing and Financing Activities:               |               |              |
| Dividends declared and unpaid  | \$ 663,654    | \$ 583,438   |
| Additions to asset retirement obligations  | \$ 53,653     | \$ 42,156    |
| Gross additions to properties and equipment  | \$ 9,843,214  | \$ 5,218,194 |
| Net (increase) decrease in accounts payable for properties and equipment additions | 1,655,503     | 1,976,205    |
| Capital expenditures and acquisitions, including dry hole costs                    | \$ 11,498,717 | \$ 7,194,399 |

(See accompanying notes)

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PANHANDLE OIL AND GAS INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1: Accounting Principles and Basis of Presentation

The accompanying unaudited condensed financial statements of Panhandle Oil and Gas Inc. have been prepared in accordance with the instructions to Form 10-Q as prescribed by the SEC. Management of the Company believes that all adjustments necessary for a fair presentation of the 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 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 financial statements pursuant to the rules and regulations of the SEC. Therefore, these condensed financial statements should be read in conjunction with the financial statements and related notes thereto included in the Company's 2013 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, 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 detailed 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, 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. The effective tax rate for the quarter ended December 31, 2013, was 31% as compared to 24% for the quarter ended December 31, 2012.

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, vested directors' deferred compensation shares during the period.

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 an 8% 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 all proved non-producing and proved undeveloped reserves. The facility currently has a borrowing base of \$35,000,000 and is secured by certain of the Company's properties with a carrying value of \$38,864,588 at December 31, 2013. The facility matures on November 30, 2017. The interest rate is based on BOK prime plus from 0.375% to 1.125%, or 30 day LIBOR plus from 1.875% to 2.625%. The election of BOK prime or LIBOR is at the Company's discretion. 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 BOK 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. At December 31, 2013, the effective interest rate was 2.04%.

The Company's debt is recorded at the carrying amount on its balance sheet. The carrying amount of the Company's revolving credit facility approximates fair value because the interest rates are reflective of market rates.

Since the bank charges a customary non-use fee of 0.25% annually of the unused portion of the borrowing base, the Company has not requested the bank to increase its borrowing base beyond \$35,000,000. 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. While the Company believes the availability could be increased (if needed) by placing more of the Company's properties as security under the revolving credit facility, increases are at the discretion of the bank. 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

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the Company to maintain certain financial ratios. At December 31, 2013, the Company was in compliance with the covenants of the BOK agreement.

NOTE 5: Deferred Compensation Plan for Directors

The Company has a deferred compensation plan for non-employee directors (the Plan). The Plan provides that each eligible director can individually elect to be credited with future unissued shares of Company stock rather than cash for Board and committee chair retainers, Board meeting fees and Board committee meeting fees. These unissued shares 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 unissued shares credited under the Plan will be issued to the director.

NOTE 6: 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.

Effective March 2010, the board of directors approved the purchase of the Company's common stock, from time to time, equal to the aggregate number of shares of common stock awarded pursuant to the Company's 2010 Restricted Stock Plan, contributed by the Company to its ESOP and credited to the accounts of directors pursuant to the Deferred Compensation Plan for Non-Employee Directors.

On December 21, 2013, the Company awarded 6,093 non-performance based shares and 18,279 performance based 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. The non-performance and performance based shares had a fair value on their award date of \$199,788 and \$294,889, respectively, and will be recognized as compensation expense ratably over the vesting period. The fair value of the performance based shares on their award date is calculated by simulating the Company's stock price and stock price return utilizing a Monte Carlo model covering the period from the grant date through the end of the performance period (December 21, 2013, through December 21, 2016).

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The following table summarizes the Company's pre-tax compensation expense for the three months ended December 31, 2013 and 2012, related to the Company's performance based and non-performance based restricted stock.

|   | Three Months Ended |            |
|---|--------------------|------------|
|   | December 31,       |            |
|   | 2013               | 2012       |
| Performance based, restricted stock     | \$ 72,695          | \$ 99,939  |
| Non-performance based, restricted stock | 55,281             | 157,938    |
| Total compensation expense              | \$ 127,976         | \$ 257,877 |

A summary of the Company's unrecognized compensation cost for its unvested performance based and non-performance based restricted stock and the weighted-average periods over which the compensation cost is expected to be recognized are shown in the following table.

|   | As of December 31, 2013   |                                    |
|---|---------------------------|------------------------------------|
|   | Unrecognized Compensation |                                    |
|   | Cost                      | Weighted Average Period (in years) |
| Performance based, restricted stock     | \$ 504,920                | 1.98                               |
| Non-performance based, restricted stock | 372,135                   | 1.95                               |
| Total                                   | \$ 877,055                |                                    |

Upon vesting, shares are expected to be issued out of shares held in treasury.

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NOTE 7: Oil, NGL and Natural Gas Reserves

Management considers the estimation of the Company's crude oil, NGL and natural gas reserves to be the most significant of its judgments and estimates. Changes in crude oil, NGL 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 of crude oil, NGL and natural gas reserves based on available geological 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 appropriate prices for the current period. The estimated oil, NGL and natural gas reserves were computed using the 12-month average price calculated as the unweighted arithmetic average of the first-day-of-the-month oil, NGL and natural gas price for each month within the 12-month period prior to the balance sheet date, held flat over the life of the properties. However, projected future crude oil, NGL and natural gas pricing assumptions are used by management to prepare estimates of crude oil, NGL and natural gas reserves and future net cash flows used in asset impairment assessments and in formulating management's overall operating decisions. Crude oil, NGL and natural gas prices are volatile and affected by worldwide production and consumption and are outside the control of management.

NOTE 8: 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, NGL and natural gas, future production costs, estimates of future oil, NGL 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, NGL 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. For the three months ended December 31, 2013 and 2012, the assessment resulted in impairment provisions of \$202,991 and \$154,965, respectively. A reduction in oil, NGL or natural gas prices, or a decline in reserve volumes, could lead to additional impairment that may be material to the Company.

NOTE 9: Capitalized Costs

As of December 31, 2013 and 2012, non-producing oil and natural gas properties include costs of \$83,174 and \$0, respectively, on exploratory wells which were drilling and/or testing.

NOTE 10: Exploration Costs

In the quarter ended December 31, 2013, lease expirations and leasehold impairments of \$24,148 were charged to exploration costs. Leasehold impairments are recorded for individually insignificant non-producing leases which the Company believes will not be transferred to proved properties over the remaining lives of the leases. In the quarter ended December 31, 2013, the Company also had an additional \$14,607 related to geological and geophysical costs. In the quarter ended December 31, 2012, lease expirations and impairments of \$13,222 were charged to exploration costs as well as additional costs of \$6,545 related to exploratory dry holes.

NOTE 11: Derivatives

The Company has entered into fixed swap contracts and costless collar contracts. These instruments are intended to reduce the Company's exposure to short-term fluctuations in the price of oil and 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. Collar contracts set a fixed floor price and a fixed ceiling price and provide payments to the Company if the index price falls below the floor or require payments by the Company if the index price rises above the ceiling. These contracts cover only a portion of the Company's natural gas and oil production and provide only partial price protection against declines in natural gas and oil prices. 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 secured. The derivative instruments have settled or will settle based on the prices below.

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Derivative contracts in place as of December 31, 2013

| Contract period               | Production volume covered per month | Index           | Contract price                 |
|-------------------------------|-------------------------------------|-----------------|--------------------------------|
| Natural gas costless collars  |                                     |                 |                                |
| November 2013 - April 2014    | 160,000 Mmbtu                       | NYMEX Henry Hub | \$4.00 floor/\$4.55 ceiling    |
| January - June 2014           | 40,000 Mmbtu                        | NYMEX Henry Hub | \$3.25 floor/\$3.90 ceiling    |
| January - June 2014           | 50,000 Mmbtu                        | NYMEX Henry Hub | \$3.50 floor/\$4.30 ceiling    |
| January - June 2014           | 80,000 Mmbtu                        | NYMEX Henry Hub | \$3.75 floor/\$4.35 ceiling    |
| July - December 2014          | 140,000 Mmbtu                       | NYMEX Henry Hub | \$3.75 floor/\$4.50 ceiling    |
| Natural gas fixed price swaps |                                     |                 |                                |
| January - June 2014           | 80,000 Mmbtu                        | NYMEX Henry Hub | \$4.085                        |
| July - December 2014          | 140,000 Mmbtu                       | NYMEX Henry Hub | \$4.110                        |
| April - September 2014        | 50,000 Mmbtu                        | NYMEX Henry Hub | \$4.200                        |
| April - September 2014        | 50,000 Mmbtu                        | NYMEX Henry Hub | \$4.180                        |
| April - September 2014        | 50,000 Mmbtu                        | NYMEX Henry Hub | \$4.210                        |
| Oil costless collars          |                                     |                 |                                |
| January - June 2014           | 4,000 Bbls                          | NYMEX WTI       | \$90.00 floor/\$101.50 ceiling |
| January - December 2014       | 4,000 Bbls                          | NYMEX WTI       | \$85.00 floor/\$100.00 ceiling |
| January - June 2014           | 3,667 Bbls                          | NYMEX WTI       | \$85.00 floor/\$99.00 ceiling  |
| Oil fixed price swaps         |                                     |                 |                                |
| January - December 2014       | 3,000 Bbls                          | NYMEX WTI       | \$94.50                        |

Derivative contracts in place as of September 30, 2013

| Contract period              | Production volume covered per month | Index           | Contract price              |
|------------------------------|-------------------------------------|-----------------|-----------------------------|
| Natural gas costless collars |                                     |                 |                             |
| February - December 2013     | 80,000 Mmbtu                        | NYMEX Henry Hub | \$3.75 floor/\$4.25 ceiling |

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|                            |               |                 |                             |
|----------------------------|---------------|-----------------|-----------------------------|
| February - December 2013   | 50,000 Mmbtu  | NYMEX Henry Hub | \$3.75 floor/\$4.30 ceiling |
| February - December 2013   | 100,000 Mmbtu | NYMEX Henry Hub | \$3.75 floor/\$4.05 ceiling |
| November 2013 - April 2014 | 160,000 Mmbtu | NYMEX Henry Hub | \$4.00 floor/\$4.55 ceiling |

Natural gas fixed price swaps

|                       |               |                 |         |
|-----------------------|---------------|-----------------|---------|
| March - October 2013  | 100,000 Mmbtu | NYMEX Henry Hub | \$3.505 |
| March - October 2013  | 70,000 Mmbtu  | NYMEX Henry Hub | \$3.400 |
| April - December 2013 | 40,000 Mmbtu  | NYMEX Henry Hub | \$3.655 |
| May - November 2013   | 100,000 Mmbtu | NYMEX Henry Hub | \$4.320 |

Oil costless collars

|                       |            |           |                                |
|-----------------------|------------|-----------|--------------------------------|
| March - December 2013 | 3,000 Bbls | NYMEX WTI | \$90.00 floor/\$102.00 ceiling |
| March - December 2013 | 4,000 Bbls | NYMEX WTI | \$90.00 floor/\$101.50 ceiling |
| May - December 2013   | 2,000 Bbls | NYMEX WTI | \$90.00 floor/\$97.50 ceiling  |
| January - June 2014   | 4,000 Bbls | NYMEX WTI | \$90.00 floor/\$101.50 ceiling |

Oil fixed price swaps

|                           |            |           |          |
|---------------------------|------------|-----------|----------|
| September - December 2013 | 4,000 Bbls | NYMEX WTI | \$105.25 |
|---------------------------|------------|-----------|----------|

The Company has elected not to complete all of the documentation requirements necessary to permit these derivative contracts to be accounted for as cash flow hedges. The Company's fair value of derivative contracts was a net liability of \$466,772 as of December 31, 2013, and a net asset of \$425,198 as of September 30, 2013.

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The fair value amounts recognized for the Company's derivative contracts executed with the same counterparty under a master netting arrangement may be offset. The Company has the choice to offset or not, but that choice must be applied consistently. A master netting arrangement exists if the reporting entity has multiple contracts with a single counterparty that are subject to a contractual agreement that provides for the net settlement of all contracts through a single payment in a single currency in the event of default on or termination of any one contract. Offsetting the fair values recognized for the derivative contracts outstanding with a single counterparty results in the net fair value of the transactions being reported as an asset or a liability in the Condensed Balance Sheets. The Company has chosen to present the fair values of its derivative contracts under master netting agreements using a net fair value presentation.

The following table summarizes and reconciles the Company's derivative contracts' fair values at a gross level back to net fair value presentation on the Company's Condensed Balance Sheets at December 31, 2013, and September 30, 2013. The Company adopted the accounting guidance requiring additional disclosures for balance sheet offsetting of assets and liabilities effective January 1, 2013. The Company has offset all amounts subject to master netting agreements in the Company's Condensed Balance Sheets at December 31, 2013, and September 30, 2013.

|  | 12/31/2013          |              | 9/30/2013           |             |
|--|---------------------|--------------|---------------------|-------------|
|  | Fair Value (a)      |              | Fair Value (a)      |             |
|  | Commodity Contracts |              | Commodity Contracts |             |
|  | Current             | Current      | Current             | Current     |
|  | Assets              | Liabilities  | Assets              | Liabilities |
| Gross amounts recognized                     | \$ 116,629          | \$ (583,401) | \$ 665,099          | \$ 239,901  |
| Offsetting adjustments                       | (116,629)           | 116,629      | (239,901)           | (239,901)   |
| Net presentation on Condensed Balance Sheets | \$ -                | \$ (466,772) | \$ 425,198          | \$ -        |

(a) See Fair Value Measurements section for further disclosures regarding fair value of financial instruments.

The fair value of derivative assets and derivative liabilities is adjusted for credit risk. The impact of credit risk was immaterial for all periods presented.

#### NOTE 12: Fair Value Measurements

Fair value is defined as the amount that would be received from the sale of an asset or paid for the transfer of a liability in an orderly transaction between market participants, i.e., an exit price. To estimate an exit price, a three-level hierarchy is used. The fair value hierarchy prioritizes the inputs, which refer broadly to assumptions market

participants would use in pricing an asset or a liability, into three levels. Level 1 inputs are unadjusted quoted prices in active markets for identical assets and liabilities. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following: (i) quoted prices for similar assets or liabilities in active markets; (ii) quoted prices for identical or similar assets or liabilities in markets that are not active; (iii) inputs other than quoted prices that are observable for the asset or liability; or (iv) inputs that are derived principally from or corroborated by observable market data by correlation or other means. Level 3 inputs are unobservable inputs for the financial asset or liability.

The following table provides fair value measurement information for financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2013.

|                                 | Fair Value Measurement at December 31, 2013                       |  |  |                     |
|---------------------------------|---|--|--|---------------------|
|                                 | Quoted<br>Prices Significant<br>in Active Markets<br>(Level<br>1) | Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total Fair<br>Value |
| Financial Assets (Liabilities): |   |  |  |                     |
| Derivative Contracts - Swaps    | \$ -  | \$ (88,536)                                | \$ -   | \$ (88,536)         |
| Derivative Contracts - Collars  | \$ -  | \$ -                                       | \$ (378,236)                                       | \$ (378,236)        |

Level 2 – Market Approach - The fair values of the Company’s natural gas swaps are based on a third-party pricing model which utilizes inputs that are either readily available in the public market, such as natural gas curves, or can be corroborated from active markets. These values are based upon future prices, time to

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maturity and other factors. These values are then compared to the values given by our counterparties for reasonableness.

Level 3 – The fair values of the Company’s costless collar contracts are based on a pricing model which utilizes inputs that are unobservable or not readily available in the public market. These values are based upon future prices, volatility, time to maturity and other factors. These values are then compared to the values given by our counterparties for reasonableness.

The significant unobservable inputs for Level 3 derivative contracts include unpublished forward prices of oil and natural gas, market volatility and credit risk of counterparties. Changes in these inputs will impact the fair value measurement of our derivative contracts. An increase (decrease) in the forward prices and volatility of oil and natural gas prices will decrease (increase) the fair value of oil and natural gas derivatives, and adverse changes to our counterparties’ creditworthiness will decrease the fair value of our derivatives.

The following table represents quantitative disclosures about unobservable inputs for Level 3 Fair Value Measurements.

| Instrument Type     | Unobservable Input                 | Range       | Weighted Average | Fair Value<br>December<br>30, 2013 |
|---------------------|------------------------------------|-------------|------------------|------------------------------------|
| Oil Collars         | Oil price volatility curve         | 0% - 17.35% | 9.26%            | \$ (177,849)                       |
| Natural Gas Collars | Natural gas price volatility curve | 0% - 24.20% | 14.41%           | \$ (200,387)                       |

A reconciliation of the Company’s derivative contracts classified as Level 3 measurements is presented below. All gains and losses are presented on the Gains (losses) on derivative contracts line item on our Statement of Operations.

|  |                           |
|--|---------------------------|
| Balance of Level 3 as of October 1, 2013 | Derivatives<br>\$ 242,902 |
| Total gains or (losses)                  |                           |

|   |              |
|---|--------------|
| Included in earnings                          | (621,138)    |
| Included in other comprehensive income (loss) | -            |
| Purchases, issuances and settlements          | -            |
| Transfers in and out of Level 3               | -            |
| Balance of Level 3 as of December 31, 2013    | \$ (378,236) |

The following table presents impairments associated with certain assets that have been measured at fair value on a nonrecurring basis within Level 3 of the fair value hierarchy.

|                      | Quarter Ended December 31, |            |            |                |
|----------------------|----------------------------|------------|------------|----------------|
|                      | 2013                       |            | 2012       |                |
|                      | Fair Value                 | Impairment | Fair Value | Impairment     |
| Producing Properties | \$ 236,199                 | \$ 202,991 | \$ 332,220 | \$ 154,965 (a) |

(a) At the end of each quarter, the Company assesses the carrying value of its producing properties for impairment. This assessment utilizes estimates of future cash flows. Significant judgments and assumptions in these assessments include estimates of future oil and natural gas prices using a forward NYMEX curve adjusted for locational basis differentials, drilling plans, expected capital costs and an applicable discount rate commensurate with risk of the underlying cash flow estimates. These assessments identified certain properties with carrying value in excess of their calculated fair values.

At December 31, 2013, and September 30, 2013, the fair value of financial instruments approximated their carrying amounts. Financial instruments include long-term debt, which the valuation is classified as Level 3 and is based on a valuation technique that requires inputs that are both unobservable and significant to the overall fair value measurement. The fair value measurement of our long-term debt is valued using a discounted cash flow model that calculates the present value of future cash flows pursuant to the terms of the debt agreements and applies estimated current market interest rates. The estimated current market interest rates are based primarily on interest rates currently being offered on borrowings of similar amounts and terms. In addition, no valuation input adjustments were considered necessary relating to nonperformance risk for the debt

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agreements.

#### NOTE 13: Recently Adopted Accounting Pronouncements

Other accounting standards that have been issued or proposed by the FASB, or other standards-setting bodies, that do not require adoption until a future date are not expected to have a material impact on the financial statements upon adoption.

## ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### FORWARD-LOOKING STATEMENTS AND RISK FACTORS

Forward-Looking Statements for fiscal 2014 and later periods are made in this document. Such statements represent estimates by management based on the Company's historical operating trends, its proved oil, NGL and natural 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, NGL and natural gas reserves. Investors should also read the other information in this Form 10-Q and the Company's 2013 Annual Report on Form 10-K where risk factors are presented and further discussed. 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

The Company had positive working capital of \$5,084,322 at December 31, 2013, compared to \$7,504,588 at September 30, 2013.

Liquidity:

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Cash and cash equivalents were \$294,961 as of December 31, 2013, compared to \$2,867,171 at September 30, 2013, a decrease of \$2,572,210. Cash flows for the three months ended December 31 are summarized as follows:

Net cash provided (used) by:

|  | 2013           | 2012         | Change         |
|--|----------------|--------------|----------------|
| Operating activities                             | \$ 11,886,347  | \$ 7,158,243 | \$ 4,728,104   |
| Investing activities                             | (11,425,639)   | (7,053,128)  | (4,372,511)    |
| Financing activities                             | (3,032,918)    | (1,102,851)  | (1,930,067)    |
| Increase (decrease) in cash and cash equivalents | \$ (2,572,210) | \$ (997,736) | \$ (1,574,474) |

Operating activities:

Net cash provided by operating activities increased \$4,728,104 during the 2014 period, as compared to the 2013 period, the result of the following:

- Receipts of oil, NGL and natural gas sales (net of production taxes and gathering, transportation and marketing costs) and other increased \$5,269,114.
- Increased income tax payments of \$803,412.
- Increased net receipts on derivative contracts of \$439,290.
- Increased payments for G&A expenses of \$290,040.
- Decreased LOE payments of \$103,316.

Investing activities:

Net cash used in investing activities increased \$4,372,511 during the 2014 period, as compared to the 2013 period, due to:



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- Higher drilling and completion activity during 2014 increased capital expenditures by \$3,027,863.
- An increase in cash used to acquire properties of \$1,276,455.

Financing activities:

Net cash used in financing activities increased \$1,930,067 during the 2014 period, as compared to the 2013 period, the result of the following:

- During the quarters ended December 31, 2013 and 2012, net borrowings decreased \$2,262,256 and \$420,228, respectively.

Capital Resources:

Capital expenditures to drill and complete wells increased \$3,027,863 (44%) from the 2013 to the 2014 period. Oil and NGL rich plays in western and southern Oklahoma and the Texas Panhandle continue to account for the majority of drilling activity. Other active areas include the Arkansas Fayetteville Shale (dry natural gas), Permian Basin of West Texas (oil and NGL rich) and Bakken Shale in North Dakota (oil).

The oil and NGL rich plays in western and southern Oklahoma and the Texas Panhandle where the Company owns mineral and leasehold acreage are as follows:

- Horizontal Granite Wash and Hogshooter in western Oklahoma and the Texas Panhandle
- Horizontal Cleveland in the Texas Panhandle
- Horizontal Marmaton/Cleveland in western Oklahoma
- Horizontal Tonkawa in western Oklahoma
- Horizontal Anadarko Basin Woodford Shale in western Oklahoma
- Horizontal Ardmore Basin Woodford Shale in southern Oklahoma

In addition to the \$9,892,262 of capital expenditures for drilling and completion projects in 2014, interests in 34 producing wells and associated leasehold (average working interest of 3.4%) in the Arkansas Fayetteville Shale were acquired for \$1,550,205. Management continues to evaluate opportunities to acquire additional production or acreage.

Although capital expenditures increased during the first quarter of 2014, as compared to the first quarter of 2013, management currently projects capital expenditures for drilling and completion projects during 2014 will be approximately equal to 2013 capital expenditures. Since the Company is not the operator of any of its oil and natural gas properties, it is difficult for us to predict levels of future well proposals, the Company's participation in the drilling and completion of new wells and associated capital expenditures.

The shift, over recent years, of capital outlays more toward oil and NGL rich plays and less toward plays for dry natural gas is expected to result in increased oil and NGL production volumes in 2014, with modest natural gas production growth. As experienced previously, the timing of new wells coming on line may cause intermittent increases or decreases in oil, NGL and natural gas production from quarter to quarter.

Production of oil, NGL and natural gas increased 17% on an Mcfe basis from the 2013 to the 2014 period. The production increase was the result of new production coming on line which exceeded the natural production decline of existing wells. As drilling and completion of wells continues throughout 2014, new production coming on line is expected to result in an increase in production volumes from 2013 to 2014.

Panhandle's oil sales price averaged 96% of NYMEX oil price during the 2014 period. Based on this correlation, and NYMEX oil futures prices, we expect the Company's average oil sales price for 2014 to approximate \$91.00 per barrel. For the 2014 period, NGL sales prices averaged 29% of NYMEX oil price; this would correlate to an average NGL sales price for 2014 of approximately \$28.50 per barrel, which is also in line with management's expectations.

For the 2014 period, Panhandle's natural gas sales price averaged 93% of NYMEX natural gas price. Based on NYMEX natural gas futures prices, management expects the Company's average natural gas sales price for 2014 to approximate \$3.75 per Mcf.

With continued oil and natural gas price volatility, management continues to evaluate opportunities for product price protection through additional hedging of the Company's future oil and natural gas production. See NOTE 11 – "Derivatives" for a complete list of the Company's outstanding derivative contracts.

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The use of the Company's cash provided by operating activities and resultant change to cash is summarized in the table below:

|   | Three months<br>ended<br>12/31/2013 |
|---|-------------------------------------|
| Cash provided by operating activities                   | \$ 11,886,347                       |
| Cash used for:  |                                     |
| Capital expenditures - drilling and completion of wells | 9,892,262                           |
| Quarterly dividends of \$.08 per share                  | 664,618                             |
| Treasury stock purchases                                | 122,044                             |
| Net principal payments on credit facility               | 2,262,256                           |
| Other investing and financing activities                | 1,517,377                           |
| Net cash used   | 14,458,557                          |
| <br>Net increase (decrease) in cash                     | <br>\$ (2,572,210)                  |

Outstanding borrowings on the credit facility at December 31, 2013, were \$6,000,000.

Looking forward, the Company expects to fund overhead costs, capital additions related to the drilling and completion of wells, treasury stock purchases and dividend payments primarily from cash provided by operating activities and cash on hand. As management evaluates opportunities to acquire additional assets, additional borrowings utilizing our bank credit facility could be necessary. Also, during times of oil, NGL and natural gas price decreases, or increased capital expenditures, it may be necessary to utilize the credit facility further in order to fund these expenditures. The Company has availability (\$29,000,000 at December 31, 2013) under its revolving credit facility and is in compliance with its debt covenants (current ratio and debt to EBITDA). While the Company believes the availability could be increased (if needed) by placing more of the Company's properties as security under the revolving credit facility, increases are at the discretion of the bank.

Based on expected capital expenditure levels and anticipated cash provided by operating activities for 2014, the Company has sufficient liquidity to fund its ongoing operations and, combined with availability under its credit facility, to fund acquisitions.

## RESULTS OF OPERATIONS

## THREE MONTHS ENDED DECEMBER 31, 2013 – COMPARED TO THREE MONTHS ENDED DECEMBER 31, 2012

## Overview:

The Company recorded first quarter 2014 net income of \$4,926,318, or \$0.59 per share, as compared to \$2,148,298, or \$0.26 per share, in the 2013 quarter. The increase in net income was principally the result of increased oil, NGL and natural gas sales; decreased DD&A expenses; partially offset by losses on derivative contracts; and increased production taxes. These items are further discussed below.

## Oil, NGL and Natural Gas Sales:

Oil, NGL and natural gas sales increased \$5,714,128 or 45% for the 2014 quarter. Oil, NGL and natural gas sales were up due to increases in oil, NGL and natural gas sales volumes of 79%, 21% and 9%, respectively, and increases in oil, NGL and natural gas prices of 12%, 3% and 10%, respectively. The following table outlines the Company's production and average sales prices for oil, NGL and natural gas for the three month periods of fiscal 2014 and 2013:

|                    | Oil Bbls<br>Sold | Average<br>Price | Mcf<br>Sold | Average<br>Price | NGL Bbls<br>Sold | Average<br>Price | Mcf<br>Sold | Average<br>Price |
|--------------------|------------------|------------------|-------------|------------------|------------------|------------------|-------------|------------------|
| Three months ended |                  |                  |             |                  |                  |                  |             |                  |
| 12/31/2013         | 83,413           | \$ 93.66         | 2,785,952   | \$ 3.41          | 37,140           | \$ 31.35         | 3,509,270   | \$ 5.26          |
| 12/31/2012         | 46,656           | \$ 83.86         | 2,544,385   | \$ 3.11          | 30,674           | \$ 30.31         | 3,008,365   | \$ 4.24          |

Oil and NGL production increases resulted from continued drilling in the western Oklahoma and Texas Panhandle

horizontal oil plays, principally the Marmaton, Cleveland, Tonkawa, Hogshooter, and Granite Wash and to a lesser extent horizontal oil drilling in the Bakken in North Dakota and the Woodford Shale in southern Oklahoma (Anadarko and Ardmore Basins). The natural gas production increase was largely attributable to continued drilling in the Fayetteville Shale in Arkansas and natural gas produced from new wells in western Oklahoma. Panhandle owns substantial acreage positions in each of the plays previously mentioned in Oklahoma and the Texas Panhandle as well as the Arkansas Fayetteville and expects continued drilling on its acreage in these plays.

The 79% increase in oil production the Company achieved in the first quarter of 2014, as compared to the first quarter of 2013, was largely attributable to an unusually high level of oil drilling in the second half of 2013. The pace of oil drilling thus far in 2014 has moderated from that level, which when combined with the natural decline of the new oil properties is anticipated to result in a leveling off of oil production for the second quarter of 2014. We are anticipating that natural gas production will resume quarter to quarter growth in the coming quarters as new volumes associated with both dry gas drilling and our oil and NGL rich drilling are anticipated to exceed the natural decline of production from our existing properties. A small Fayetteville acquisition closed by the Company in the first quarter of 2014 will also contribute to the Company's natural gas production.

Production for the last five quarters was as follows:

| Quarter ended | Oil Bbls Sold | Mcf Sold  | NGL Bbls Sold | Mcfe Sold |
|---------------|---------------|-----------|---------------|-----------|
| 12/31/2013    | 83,413        | 2,785,952 | 37,140        | 3,509,270 |
| 9/30/2013     | 79,387        | 2,820,079 | 30,373        | 3,478,639 |
| 6/30/2013     | 55,474        | 2,742,996 | 25,660        | 3,229,800 |
| 3/31/2013     | 52,567        | 2,778,869 | 25,190        | 3,245,411 |
| 12/31/2012    | 46,656        | 2,544,385 | 30,674        | 3,008,365 |

Gains (Losses) on Derivative Contracts:

The fair value of derivative contracts was a net liability of \$466,772 as of December 31, 2013, and a net asset of \$764,643 as of December 31, 2012. We had a net loss on derivative contracts of \$(496,901) in the 2014 quarter as compared to a net gain of \$892,693 recorded in the 2013 quarter. The change is principally due to the oil and natural gas collars decreasing in value as projected oil and natural gas prices are above the ceiling prices of the collars at December 31, 2013.

Lease Operating Expenses (LOE):

LOE increased \$18,835 or 1% in the 2014 quarter. LOE per Mcfe decreased in the 2014 quarter to \$0.94 compared to \$1.10 in the 2013 quarter. LOE related to field operating costs increased \$6,086 in the 2014 quarter compared to the 2013 quarter, a .4% increase. Field operating costs were \$.43 per Mcfe in the 2014 quarter as compared to \$.50 per Mcfe in the 2013 quarter. The decrease in rate was the result of lower ad valorem and workovers charges in the 2014 quarter.

The increase in LOE related to field operating costs was coupled with an increase in handling fees (primarily gathering, transportation and marketing costs) on natural gas of \$12,749 in the 2014 quarter compared to the 2013 quarter. On a per Mcfe basis, these fees decreased \$.09 due to significantly higher oil sales volumes, which are not charged handling fees. Handling fees are charged either as a percent of natural gas sales or based on natural gas production volumes.

#### Depreciation, Depletion and Amortization (DD&A):

DD&A decreased \$331,001 or 6% in the 2014 quarter. DD&A in the 2014 quarter was \$1.51 per Mcfe as compared to \$1.87 per Mcfe in the 2013 quarter. DD&A decreased \$1,269,921 as a result of this \$.36 decrease in the DD&A rate. An offsetting increase of \$938,920 was the result of production increasing 17% in the 2014 quarter compared to the 2013 quarter. The rate decrease is mainly due to higher oil, NGL and natural gas prices utilized in the reserve calculations at December 31, 2013 (compared to December 31, 2012) increasing projected remaining reserves on a significant number of wells.

#### Production Taxes:

Production taxes increased \$268,011 or 88% in the 2014 quarter as compared to the 2013 quarter. Production taxes as a percentage of oil, NGL and natural gas sales increased from 2.4% in the 2013 quarter to 3.1% in the 2014 quarter. The increase in amount is primarily the result of increased oil, NGL and natural gas sales of \$5,714,128 during the 2014 quarter. The increase in rate is due mainly to the Company receiving more ultra-deep well refunds and rate reducing corrections of approximately \$85,000 in the 2013 quarter. We do not accrue for ultra-deep well production tax exemptions (allowed by the state of Oklahoma) because we do not have sufficient information to calculate a reasonable estimate. The low overall production tax rate is due to a large proportion of the Company's natural gas revenues coming from horizontally drilled wells,

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which are eligible for reduced Oklahoma and Arkansas production tax rates.

#### General and Administrative Costs (G&A):

G&A costs decreased \$24,917 or 1% in the 2014 quarter. This decrease is primarily related to decreases in personnel expenses of \$149,597 offset by increased legal expenses of \$113,808. Decreases in personnel expenses are mainly due to restricted stock expense adjustments that were made in the 2013 quarter which increased expenses. The increase in legal expense is a result of additional fees for various legal services.

#### Income Taxes:

Provision for income taxes increased in the 2014 quarter by \$1,561,000, the result of a \$4,339,020 increase in income before income taxes in the 2014 quarter compared to the 2013 quarter. The effective tax rate for the 2014 and 2013 quarters was 31% and 24%, respectively. Excess percentage depletion, which is a permanent tax benefit, reduced the effective tax rate below the statutory rate for both quarters.

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Critical accounting policies are those the Company believes are most important to portraying its financial conditions and results of operations and also require the greatest amount of subjective or complex judgments by management. Judgments and uncertainties regarding the application of these policies may result in materially different amounts being reported under various conditions or using different assumptions. There have been no material changes to the critical accounting policies previously disclosed in the Company's Form 10-K for the fiscal year ended September 30, 2013.

### ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

#### Market Risk

Oil, NGL and natural gas prices historically have been volatile, and this volatility is expected to continue. Uncertainty continues to exist as to the direction of oil, NGL and natural gas price trends, and there remains a rather wide



divergence in the opinions held by some in the industry. Being primarily a natural gas producer, the Company is more significantly impacted by changes in natural gas prices than by changes in oil or NGL prices. Longer term natural gas prices will be determined by the supply of and demand for natural gas as well as the prices of competing fuels, such as crude oil and coal. The market price of oil, NGL and natural gas in 2014 will impact the amount of cash generated from operating activities, which will in turn impact the level of the Company's capital expenditures and production. Excluding the impact of the Company's 2014 derivative contracts, based on the Company's estimated natural gas volumes for 2014, the price sensitivity for each \$0.10 per Mcf change in wellhead natural gas price is approximately \$1,100,000 for operating revenue. Based on the Company's estimated oil volumes for 2014, the price sensitivity in 2014 for each \$1.00 per barrel change in wellhead oil price is approximately \$300,000 for operating revenue.

#### Commodity Price Risk

The Company periodically utilizes derivative contracts to reduce its exposure to unfavorable changes in natural gas and oil prices. The Company does not enter into these derivatives for speculative or trading purposes. All of our outstanding derivative contracts are with one counterparty and are secured. These arrangements cover only a portion of the Company's production and provide only partial price protection against declines in natural gas and oil prices. These derivative contracts expose the Company to risk of financial loss and may limit the benefit of future increases in prices. As of December 31, 2013, the Company has oil and natural gas fixed price swaps and oil and natural gas collars in place. For the Company's oil fixed price swaps, a change of \$1.00 in the NYMEX WTI forward strip prices would result in a change to pre-tax operating income of approximately \$40,000. For the Company's natural gas fixed price swaps, a change of \$.10 in the NYMEX Henry Hub forward strip prices would result in a change to pre-tax operating income of approximately \$221,000. For the Company's natural gas collars, a change of \$.10 in the NYMEX Henry Hub forward strip pricing would result in a change to pre-tax operating income of approximately \$153,000. For the Company's oil collars, a change of \$1.00 in the NYMEX WTI forward strip prices would result in a change to pre-tax operating income of approximately \$49,000.

#### Financial Market Risk

Operating income could also be impacted, to a lesser extent, by changes in the market interest rates related to the Company's credit facilities. The revolving loan bears interest at the BOK prime rate plus from 0.375% to 1.125%, or 30 day LIBOR plus from 1.875% to 2.625%. At December 31, 2013, the Company had \$6,000,000 outstanding under these facilities. At this point, the Company does not believe that its liquidity has been materially affected by the debt market uncertainties noted in the last few years and the Company does not believe that its liquidity will be impacted in the near future.

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## ITEM 4 CONTROLS AND PROCEDURES

The Company maintains “disclosure controls and procedures,” as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, that are designed to ensure that information required to be disclosed in reports the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that such information is collected and communicated to management, including the Company’s President/Chief Executive Officer and Vice President/Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating its disclosure controls and procedures, management recognized that no matter how well conceived and operated, disclosure controls and procedures can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. The Company’s disclosure controls and procedures have been designed to meet, and management believes they do meet, reasonable assurance standards. Based on their evaluation as of the end of the fiscal period covered by this report, the Chief Executive Officer and Chief Financial Officer have concluded, subject to the limitations noted above, the Company’s disclosure controls and procedures were effective to ensure material information relating to the Company is made known to them. There were no changes in the Company’s internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting made during the fiscal quarter or subsequent to the date the assessment was completed.

## PART II OTHER INFORMATION

## ITEM 2 UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

During the three months ended December 31, 2013, the Company repurchased shares of the Company’s common stock as summarized in the table below.

| Period          | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Program | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program |
|-----------------|----------------------------------|------------------------------|--|--|
| 12/1 - 12/31/13 | 3,722                            | \$ 32.79                     | 3,722  | \$ 1,361,689   |

|       |       |          |       |
|-------|-------|----------|-------|
| Total | 3,722 | \$ 32.79 | 3,722 |
|-------|-------|----------|-------|

Upon approval by the shareholders of the Company's 2010 Restricted Stock Plan on March 11, 2010, the Board of Directors approved repurchase of up to \$1.5 million of the Company's common stock, from time to time, equal to the aggregate number of shares of common stock awarded pursuant to the Company's 2010 Restricted Stock Plan, contributed by the Company to its ESOP and credited to the accounts of directors pursuant to the Deferred Compensation Plan for Non-Employee Directors. Pursuant to previously adopted board resolutions, the purchase of an additional \$1.5 million of the Company's common stock became authorized and approved effective March 14, 2012. The shares are held in treasury and are accounted for using the cost method.

## ITEM 6 EXHIBITS

- (a) EXHIBITS Exhibit 31.1 and 31.2 – Certification under Section 302 of the Sarbanes-Oxley Act of 2002  
 Exhibit 32.1 and 32.2 – Certification under Section 906 of the Sarbanes-Oxley Act of 2002  
 Exhibit 101.INS – XBRL Instance Document  
 Exhibit 101.SCH – XBRL Taxonomy Extension Schema Document  
 Exhibit 101.CAL – XBRL Taxonomy Extension Calculation Linkbase Document  
 Exhibit 101.LAB – XBRL Taxonomy Extension Labels Linkbase Document  
 Exhibit 101.PRE – XBRL Taxonomy Extension Presentation Linkbase Document  
 Exhibit 101.DEF – XBRL Taxonomy Extension Definition Linkbase Document
- (b) Form 8-K Dated (12/11/13), item 5.03 – Amendments to Articles of Incorporation or Bylaws; Change in Fiscal Year

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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 OIL AND GAS INC.

PANHANDLE OIL AND GAS INC.

February 6, 2014  
Date

/s/ Michael C. Coffman  
Michael C. Coffman, President and  
Chief Executive Officer

February 6, 2014  
Date

/s/ Lonnie J. Lowry  
Lonnie J. Lowry, Vice President  
and Chief Financial Officer

February 6, 2014  
Date

/s/ Robb P. Winfield  
Robb P. Winfield, Controller  
and Chief Accounting Officer