

ARENA RESOURCES INC  
Form 10-Q  
May 04, 2007

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

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended March 31, 2007

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF  
1934

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

Commission File Number 001-31657

**ARENA RESOURCES, INC.**

(Exact name of registrant as specified in its charter)

Nevada

(State or other jurisdiction of  
Incorporation or organization)

73-1596109

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

4920 South Lewis Street, Suite 107

Tulsa, Oklahoma 74105

(Address of principal executive offices)

(918) 747-6060

(Registrant's telephone number)

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 past 12 months, and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date:

As of April 30, 2007, the Company had outstanding 14,901,263 shares of common stock (\$0.001 par value).

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For the Quarter Ended March 31, 2007

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**Part I Financial Information**

**Item 1. Financial Statements:**

The condensed consolidated financial statements included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading.

In the opinion of the Company, all adjustments, consisting of only normal recurring adjustments, necessary to present fairly the consolidated financial position of the Company and the consolidated results of its operations and its cash flows have been made. The results of its operations and its cash flows for the three months ended March 31, 2007 are not necessarily indicative of the results to be expected for the year ending December 31, 2007.

**ARENA RESOURCES, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(UNAUDITED)**

	March 31, 2007	December 31, 2006
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash	\$ 3,970,368	\$ 4,919,984
Accounts receivable	6,205,491	6,702,677
Joint interest billing receivable	2,737,930	2,949,099
Prepaid expenses	21,070	102,585
<b>Total Current Assets</b>	<b>12,934,859</b>	<b>14,674,345</b>
<b>Property and Equipment, Using Full Cost Accounting</b>		
Oil and gas properties subject to amortization	196,207,569	171,708,200
Equipment	59,612	59,332
Drilling rig	1,996,899	1,996,899
Office building	1,902,366	-
Office equipment	120,929	120,929
<b>Total Property and Equipment</b>	<b>200,287,375</b>	<b>173,885,360</b>
Less: Accumulated depreciation and amortization	(14,950,234)	(12,246,727)
<b>Net Property and Equipment</b>	<b>185,337,141</b>	<b>161,638,633</b>
<b>Total Assets</b>	<b>\$ 198,272,000</b>	<b>\$ 176,312,978</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 9,054,183	\$ 14,367,252
Accrued liabilities	543,757	628,618
<b>Total Current Liabilities</b>	<b>9,597,940</b>	<b>14,995,870</b>
<b>Long-Term Liabilities</b>		
Notes payable	36,500,000	19,300,000
Notes payable to related parties	-	400,000
Asset retirement liability	2,369,633	2,250,332
Deferred income taxes	20,942,625	19,322,724
<b>Total Long-Term Liabilities</b>	<b>59,812,258</b>	<b>41,273,056</b>
<b>Stockholders' Equity</b>		
Preferred stock - \$0.001 par value; 10,000,000 shares authorized; no shares issued or outstanding	-	-
Common stock - \$0.001 par value; 100,000,000 shares authorized; 14,821,263 shares and 14,668,787 shares outstanding, respectively	14,821	14,669
Additional paid-in capital	84,841,032	81,872,268
Options and warrants outstanding	3,013,932	2,872,988
Retained earnings	40,992,017	35,284,127
<b>Total Stockholders' Equity</b>	<b>128,861,802</b>	<b>120,044,052</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$ 198,272,000</b>	<b>\$ 176,312,978</b>

See the accompanying notes to unaudited condensed consolidated financial statements.

**ARENA RESOURCES, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(UNAUDITED)**

<i>For the Three Months Ended March 31,</i>	<b>2007</b>	<b>2006</b>
<b>Oil and Gas Revenues</b>	\$ 16,651,301	\$ 10,380,395
<b>Costs and Operating Expenses</b>		
Oil and gas production costs	2,360,949	1,378,419
Oil and gas production taxes	958,651	697,209
Depreciation, depletion and amortization	2,657,555	1,052,462
Accretion expense	43,497	29,304
General and administrative expense	1,234,786	703,932
<b>Total Costs and Operating Expenses</b>	<b>7,255,438</b>	<b>3,861,326</b>
<b>Other Income (Expense)</b>		
Other financing expense	-	(785,598)
Interest income (expense)	(353,339)	(46,684)
<b>Net Other Income (Expense)</b>	<b>(353,339)</b>	<b>(832,282)</b>
<b>Income Before Provision for Income Taxes</b>	<b>9,042,524</b>	<b>5,686,787</b>
<b>Provision for Deferred Income Taxes</b>	<b>(3,334,634)</b>	<b>(2,104,111)</b>
<b>Net Income</b>	<b>\$ 5,707,890</b>	<b>\$ 3,582,676</b>
<b>Basic Net Income Per Common Share</b>	<b>0.39</b>	<b>0.27</b>
<b>Diluted Net Income Per Common Share</b>	<b>0.37</b>	<b>0.25</b>

See the accompanying notes to unaudited condensed consolidated financial statements.

**ARENA RESOURCES, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**

<i>For the Three Months Ended March 31,</i>	<b>2007</b>	<b>2006</b>
<b>Cash Flows From Operating Activities</b>		
Net income	\$ 5,707,890	\$ 3,582,676
Adjustments to reconcile net income to net cash provided by operating activities:		
Warrants issued for financing expense	-	785,598
Depreciation, depletion and amortization	2,653,585	1,052,462
Provision for income taxes	3,334,634	2,104,111
Stock based compensation	639,624	179,767
Accretion of asset retirement obligation	43,497	29,304
Changes in assets and liabilities:		
Accounts and joint interest receivable	708,355	(259,186)
Other changes in deferred income taxes	-	(320,058)
Prepaid expenses	81,515	31,436
Excess tax benefits from share-based payment arrangements	(1,714,733)	-
Accounts payable and accrued liabilities	(5,397,930)	(1,071,917)
<b>Net Cash Provided by Operating Activities</b>	<b>6,056,437</b>	<b>6,114,193</b>
<b>Cash Flows from Investing Activities</b>		
Purchase and development of oil and gas properties	(24,373,643)	(13,446,705)
Purchase of building & equipment	(1,902,646)	(438,300)
<b>Net Cash Used in Investing Activities</b>	<b>(26,276,289)</b>	<b>(13,885,005)</b>
<b>Cash Flows From Financing Activities</b>		
Proceeds from exercise of warrants	270,003	103,718
Proceeds from exercise of options	485,500	-
Excess tax benefits from share-based payment arrangements	1,714,733	-
Proceeds from issuance of notes payable	17,200,000	11,000,000
Payment of notes payable	(400,000)	-
<b>Net Cash Provided by Financing Activities</b>	<b>19,270,236</b>	<b>11,103,718</b>
<b>Net Increase in Cash</b>	<b>(949,616)</b>	<b>3,332,906</b>
<b>Cash at Beginning of Period</b>	<b>4,919,984</b>	<b>4,317,114</b>
<b>Cash at End of Period</b>	<b>\$ 3,970,368</b>	<b>\$ 7,650,020</b>
<b>Supplemental Cash Flow Information</b>		
Cash paid for income taxes	\$ -	\$ 329,986
Cash paid for interest	590,641	46,684
<b>Non-Cash Investing and Financing Activities</b>		
Common stock issued for properties and equipment	\$ -	\$ 3,507,872
Asset retirement obligation incurred in property development	75,804	41,186
See the accompanying notes to unaudited condensed consolidated financial statements.		

ARENA RESOURCES, INC.  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2007

**NOTE 1 BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES**

**Condensed Consolidated Financial Statements** The accompanying condensed consolidated financial statements have been prepared by the Company and are unaudited. In the opinion of management, the accompanying unaudited financial statements contain all adjustments necessary for fair presentation, consisting of normal recurring adjustments, except as disclosed herein.

The accompanying unaudited interim financial statements have been condensed pursuant to the rules and regulations of the Securities and Exchange Commission; therefore, certain information and disclosures generally included in financial statements have been condensed or omitted. The condensed financial statements should be read in conjunction with the Company's annual financial statements included in its annual report on Form 10-K as of December 31, 2006. The financial position and results of operations for the three months ended March 31, 2007 are not necessarily indicative of the results to be expected for the full year ending December 31, 2007.

**Nature of Operations** Arena Resources, Inc. (the Company) owns interests in oil and gas properties located in Oklahoma, Texas, Kansas and New Mexico. The Company is engaged primarily in the acquisition, exploration and development of oil and gas properties and the production and sale of oil and gas. In 2006, the Company formed two wholly owned subsidiaries, Arena Drilling Co. and ARD Production Company. Arena Drilling Co. was formed to oversee the operation of the Company's drilling rig that began operating in May 2006. ARD Production was formed to hold LZS Corporation, an acquisition the Company made in November 2006. The accompanying statements of operations and cash flows include the operations of the above subsidiaries from the date of acquisition/formation.

**Consolidation** The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiary. All significant intercompany balances and transactions have been eliminated in consolidation.

**Use of Estimates** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Oil and Gas Properties** The Company uses the full cost method of accounting for oil and gas properties. Under this method, all costs associated with acquisition, exploration, and development of oil and gas reserves are capitalized. Costs capitalized include acquisition costs, geological and geophysical expenditures, lease rentals on undeveloped properties and costs of drilling and equipping productive and non-productive wells. Drilling costs include directly related overhead costs. Capitalized costs are categorized either as being subject to amortization or not subject to amortization.

All capitalized costs of oil and gas properties, including the estimated future costs to develop proved reserves and estimated future costs of abandonment and site restoration, are amortized on the unit-of-production method using estimates of proved reserves as determined by independent engineers. Investments in unproved properties and major development projects are not amortized until proved reserves associated with the projects can be determined. The Company evaluates oil and gas properties for impairment at least quarterly. Amortization expense for the three months ended March 31, 2007 was \$2,649,118, based on depletion at the rate of \$7.87 per barrel of oil equivalent compared to \$1,052,462 based on depletion at the rate of \$5.48 per barrel of oil equivalent for the three months ended March 31, 2006. These amounts include \$8,437 and \$6,409 of depreciation on equipment during the three months ended March 31, 2007 and 2006, respectively.



**ARENA RESOURCES, INC.**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2007**

In addition, capitalized costs are subject to a ceiling test which limits such costs to the estimated present value of future net revenues from proved reserves, discounted at a 10-percent interest rate, based on current economic and operating conditions, plus the lower of cost or fair market value of unproved properties. Consideration received from sales or transfers of oil and gas property is accounted for as a reduction of capitalized costs. Revenue is not recognized in connection with contractual services performed on properties in which the Company holds an ownership interest.

**Income Per Common Share** Basic income per common share is computed by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted income per share reflects the potential dilution that could occur if all contracts to issue common stock were converted into common stock, except for those that are anti-dilutive.

**Concentration of Credit Risk and Major Customer** The Company currently has cash in excess of federally insured limits at March 31, 2007. During the three months ended March 31, 2007, sales to two customers represented 84% and 11% of oil and gas revenues, respectively. At March 31, 2006, these customers made up 84% and 10% of accounts receivable, respectively.

**NOTE 2 EARNINGS PER SHARE INFORMATION**

<i>For the Three Months Ended March 31,</i>	<b>2007</b>	<b>2006</b>
Net Income	\$ 5,707,890	\$ 3,582,676
Basic Weighted-Average Common Shares Outstanding	14,756,197	13,175,386
Effect of dilutive securities		
Warrants	205,966	277,740
Stock options	665,973	725,230
Diluted Weighted-Average Common Shares Outstanding	15,628,136	14,178,356
Basic Income Per Common Share	0.39	0.27
Diluted Income Per Common Share	0.37	0.25

For the three months ended March 31, 2007, 350,000 stock options were not included in the computation of diluted income per share as their effects are anti-dilutive.

**ARENA RESOURCES, INC.**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2007**

**NOTE 3 NOTES PAYABLE**

In April 2005, the Company entered into an agreement that increased its credit facility to \$50,000,000, with an increased borrowing base of \$35,000,000. The interest rate was a floating rate equal to the 30, 60 or 90 day LIBOR rate plus 2.25%, and is payable monthly. Amounts borrowed under the revolving credit facility are due in May 2009. The revolving credit facility is secured by the Company's principal mineral interests. In order to obtain the revolving credit facility, loans from two officers were subordinated to the position of the bank. The Company is required under the terms of the credit facility to maintain a tangible net worth of \$12,000,000, maintain a 5-to-1 ratio of income before interest, taxes, depreciation, depletion and amortization to interest expense and maintain a current asset to current liability ratio of 1-to-1.

In April 2006, the Company entered into a new credit agreement increasing the Company's credit facility to \$150,000,000 with a \$65,000,000 borrowing base. Additionally, this new agreement adjusted the interest rate to be equal to the 30, 60 or 90 day LIBOR rate plus 2%, removed the requirement to maintain a tangible net worth but added a requirement to a rolling four quarter basis of a maximum leverage ratio of no more than 2.5-to-1. All other conditions of the credit facility remained the same. At March 31, 2007, the Company was in compliance with all covenants and had \$36,500,000 outstanding under this credit facility, excluding \$527,500 reserved under the revolving credit facility as collateral for standby letters of credit issued to various states.

On March 31, 2006, two officers of the Company and the Board of Directors agreed to an extension of the \$400,000 notes payable to the two officers to July 1, 2008, under the same terms as the original notes. During the three months ended March 31, 2007, the Company paid off the notes payable to the two officers along with any accrued interest.

**NOTE 4 ASSET RETIREMENT OBLIGATION**

The Company provides for the obligation to plug and abandon oil and gas wells at the dates properties are acquired or the wells are drilled. The asset retirement obligation is adjusted each quarter for any liabilities incurred or settled during the period, accretion expense and any revisions made to the estimated cash flows. The reconciliation of the asset retirement obligation for the three months ended March 31, 2007 is as follows:

Balance, January 1, 2007	\$ 2,250,332
Liabilities incurred	75,804
Accretion expense	43,497
<hr/>	
Balance, March 31, 2007	\$ 2,369,633

**NOTE 5 STOCKHOLDERS EQUITY**

**Warrants exercised** During the three months ended March 31, 2007, the Company issued 27,476 shares of common stock from the exercise of warrants for proceeds of \$270,003. Of these warrants, 10,000 had an exercise price of \$9.00 per share and 17,476 had an exercise price of \$10.30.

**NOTE 6 EMPLOYEE STOCK OPTIONS**

Compensation expense charged against income for stock based awards during the three months ended March 31, 2007 and 2006 was 639,624 and 179,767, respectively, and is included in general and administrative expense in the accompanying financial statements.

In January 2007, the Company granted nonqualified stock options to directors and employees to purchase 350,000 shares of common stock with 50,000 having an exercise price of \$37.35 per share and 300,000 having an exercise price of \$38.46 per share. The options vest at the rate of 20% each year over five years beginning one year from the date granted. A summary of the status of the stock options as of March 31, 2007 and changes during the three months ended March 31, 2007 is as follows:

**ARENA RESOURCES, INC.**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2007**

	2007	
	Options	Weighted-Average Exercise Price
Outstanding at beginning of the year	1,305,000	\$ 5.79
Issued	350,000	38.30
Forfeited	(25,000)	6.46
Exercised	(125,000)	3.88
Outstanding at end of quarter	1,505,000	14.22
Exercisable at end of quarter	465,000	\$ 5.55
Weighted average fair value of options granted during the quarter	\$	17.49

The following are the weighted-average assumptions used for options granted during the three months ended March 31, 2007:

	2007
Risk free interest rate	4.72%
Expected life	5 years
Dividend yield	-
Volatility	44.74%

The expected life of stock options represents the period of time that the stock options granted are expected to be outstanding based on historical exercise trends. The expected volatility is based on the historical price volatility of our common stock. The risk-free interest rate represents the U.S. Treasury bill rate for the expected life of the related stock options. The dividend yield represents our anticipated cash dividend over the expected life of the stock options.

The 125,000 options exercised during the three months ended March 31, 2007 had an intrinsic value of \$4,674,600. Associated with the exercise of stock options, the Company received a tax benefit of \$1,714,733 during the three months ended March 31, 2007. The tax benefit is recorded as an increase in additional paid in capital.

As of March 31, 2007, there was approximately \$6,044,369 of unrecognized compensation cost related to stock options that will be recognized over a weighted average period of 4.6 years. The aggregate intrinsic value of options expected to vest at March 31, 2007 was \$49,709,532. The aggregate intrinsic value of options exercisable at March 31, 2007 was \$20,725,050. The intrinsic value is based on a March 30, 2007 closing price of \$50.12.

ARENA RESOURCES, INC.  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2007

**NOTE 7 CONTINGENCIES AND COMMITMENTS**

*Standby Letters of Credit* A commercial bank has issued standby letters of credit on behalf of the Company to the states of Texas, Oklahoma, New Mexico and Kansas totaling \$527,500 to allow the Company to do business in those states. The standby letters of credit are valid until cancelled or matured and are collateralized by the revolving credit facility with the bank. Letter of credit terms range from one to five years. The Company intends to renew the standby letters of credit for as long as the Company does business in those states. No amounts have been drawn under the standby letters of credit.

**NOTE 8 SUBSEQUENT EVENTS**

Subsequent to March 31, 2007, the Company has drawn \$2,500,000 on its credit facility.

Subsequent to March 31, 2007, the Company issued 80,000 shares of common stock from the exercise of 80,000 options. Of the 80,000 options, 40,000 had an exercise price of \$3.70 per share, 10,000 had an exercise price of \$4.80, 20,000 had an exercise price of \$8.30 and 10,000 had an exercise price of \$20.85. These exercises resulted in proceeds to the Company of \$570,500. The aggregate intrinsic value of options exercised subsequent to March 31, 2007 was \$3,580,300.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*Results of Operations For the Three Months Ended March 31, 2007*

*Oil and natural gas sales.* For the three months ended March 31, 2007, oil and natural gas sales revenue increased \$6,270,906 to \$16,651,301, compared to \$10,380,395 for the same period during 2006. Oil sales increased \$5,273,102 and natural gas sales increased \$997,804. The increases were the result of our increased volumes due to our development throughout 2006 and 2007. For the three months ended March 31, 2007, oil sales volume increased 115,371 barrels to 282,538 barrels, compared to 167,167 barrels for the same period in 2006. The average realized per barrel oil price decreased 7% from \$55.85 for the three months ended March 31, 2006 to \$51.71 for the three months ended March 31, 2007. For the three months ended March 31, 2007, gas sales volume increased 182,899 thousand cubic feet (MCF) to 324,935 MCF, compared to 142,036 MCF for the same period in 2006. The average realized natural gas price per MCF decreased 15% from \$7.35 for the three months ended March 31, 2006 to \$6.28 for the three months ended March 31, 2007.

*Oil and gas production costs.* Our lease operating expenses (LOE) increased from \$1,378,419 or \$7.22 per barrel of oil equivalent (BOE) for the three months ended March 31, 2006 to \$2,360,949 or \$7.01 per BOE for the three months ended March 31, 2007. The increase in total LOE was due to our development projects throughout 2006 and 2007. The decrease in the per BOE amounts is a result of increased production as a result of the development of our properties.

*Production taxes.* Production taxes as a percentage of oil and natural gas sales were 7% during the three months ended March 31, 2006 and decreased to 6% for the three months ended March 31, 2007. Production taxes vary from state to state. Therefore, these taxes may vary in the future depending on the mix of production we generate from various states, as well as the possibility that any state may raise its production tax rate.

*Depreciation, depletion and amortization.* Our depreciation, depletion and amortization expense increased by \$1,605,093 to \$2,657,555 for the three months ended March 31, 2007, compared to the same period in 2006. The increase was primarily a result of an increase in volume and in the average depletion rate from \$5.48 per BOE during the three months ended March 31, 2006 to \$7.87 per BOE during the three months ended March 31, 2007. The increased depletion rate was the result of increased capitalized costs and development costs.

*General and administrative expenses.* General and administrative expenses increased by \$530,854 to \$1,234,786 for the three months ended March 31, 2007, compared to the same period in 2006. A portion of this increase was due to the adoption of FASB 123(R) which resulted in the recognition of stock-based compensation expense of \$639,624 as compared to \$179,767 for the same period in 2006. The remaining increase was primarily related to increases in compensation expense associated with an increase in personnel required to administer our growth.

*Net interest expense.* Net interest expense was \$353,339 for the three months ended March 31, 2007, compared to \$46,684 for the three months ended March 31, 2006. The increase was due to larger outstanding debt over the quarter.

*Income tax expense.* Our effective tax rate was 37% during the three months ended March 31, 2006 and remained steady at 37% for the three months ended March 31, 2007.

*Net income.* Net income increased from \$3,582,676 for the three months ended March 31, 2006 to \$5,707,890 for the same period in 2007. The primary reasons for this increase include increased volumes as a result of the development of our properties, partially offset by lower commodity prices and higher lease operating expense, general and administrative expense and income tax expense due to our growth.

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### *Revenues Year to Date by Geographic section*

Arena reports its net oil and gas revenues for the year to date as applicable to the following geographic sectors:

#### **OIL**

	Net Production Volume	Net Revenue
Texas Leases	223,517 BBLs	\$ 11,511,471
Oklahoma Leases	6,551 BBLs	\$ 360,625
New Mexico Leases	52,470 BBLs	\$ 2,737,841

#### **GAS**

	Net Production Volume	Net Revenue
Texas Leases	194,498 MCF	\$ 1,225,520
Oklahoma Leases	4,680 MCF	\$ 21,728
New Mexico Leases	74,414 MCF	\$ 578,400
Kansas Leases	51,343 MCF	\$ 215,716

#### *Significant Subsequent Events occurring after March 31, 2007:*

Subsequent to March 31, 2007, the Company has drawn \$2,500,000 on its credit facility.

Subsequent to March 31, 2007, the Company issued 80,000 shares of common stock from the exercise of 80,000 options. Of the 80,000 options, 40,000 had an exercise price of \$3.70 per share, 10,000 had an exercise price of \$4.80, 20,000 had an exercise price of \$8.30 and 10,000 had an exercise price of \$20.85. These exercises resulted in proceeds to the Company of \$570,500.

#### *Capital Resources and Liquidity*

As shown in the financial statements for the three months ended March 31, 2007, the Company had cash on hand of \$3,970,368, compared to \$4,919,984 as of December 31, 2006. The Company had net cash provided by operating activities for the three months ended March 31, 2007 of \$6,056,437, compared to \$6,114,193 for the same period 2006. Other significant sources of cash inflow were \$17,200,000 drawn down on the Company's credit facility and proceeds from option and warrant exercises of \$755,503 in 2007 and \$11,000,000 drawn down on the Company's credit facility in 2006. The most significant cash outflows during the three months ended March 31, 2007 and 2006 were capital expenditures of \$26,276,289 in 2007 and \$13,855,005 in 2006 and repayment of notes payable to related parties of \$400,000 in 2007.

In April 2005, the Company entered into an agreement that increased its credit facility to \$50,000,000, with an increased borrowing base of \$35,000,000. The interest rate was a floating rate equal to the 30, 60 or 90 day LIBOR rate plus 2.25%, and is payable monthly. Amounts borrowed under the revolving credit facility are due in May 2009. The revolving credit facility is secured by the Company's principal mineral interests. In order to obtain the revolving credit facility, loans from two officers were subordinated to the position of the bank. The Company is required under the terms of the credit facility to maintain a tangible net worth of \$12,000,000, maintain a 5-to-1 ratio of income before interest, taxes, depreciation, depletion and amortization to interest expense and maintain a current asset to current liability ratio of 1-to-1.

In April 2006, the Company entered into a new credit agreement increasing the Company's credit facility to \$150,000,000 with a \$65,000,000 borrowing base. Additionally, this new agreement adjusted the interest rate to be equal to the 30, 60 or 90 day LIBOR rate plus 2%, removed the requirement to maintain a tangible net worth but added a requirement to a rolling four quarter basis of a maximum leverage ratio of no more than 2.5-to-1. All other conditions of the credit facility remained the same. At March 31, 2007, the Company was in compliance with all covenants and had \$36,500,000 outstanding under this credit facility, excluding \$527,500 reserved under the revolving credit facility as collateral for standby letters of credit issued to various states.

*Disclosures About Market Risks*

Like other natural resource producers, Arena faces certain unique market risks. The two most salient risk factors are the volatile prices of oil and gas and certain environmental concerns and obligations.

Oil and Gas Prices

Current competitive factors in the domestic oil and gas industry are unique. The actual price range of crude oil is largely established by major international producers. Pricing for natural gas is more regional. Because domestic demand for oil and gas exceeds supply, there is little risk that all current production will not be sold at relatively fixed prices. To this extent Arena does not see itself as directly competitive with other producers, nor is there any significant risk that the Company could not sell all production at current prices with a reasonable profit margin. The risk of domestic overproduction at current prices is not deemed significant. The primary competitive risks would come from falling international prices which could render current production uneconomical.

Secondarily, Arena is presently committed to use the services of the existing gatherers in its present areas of production. This gives to such gatherers certain short term relative monopolistic powers to set gathering and transportation costs, because obtaining the services of an alternative gathering company would require substantial additional costs since an alternative gatherer would be required to lay new pipeline and/or obtain new rights-of-way in the lease.

It is also significant that more favorable prices can usually be negotiated for larger quantities of oil and/or gas product, such that Arena views itself as having a price disadvantage to larger producers. Large producers also have a competitive advantage to the extent they can devote substantially more resources to acquiring prime leases and resources to better find and develop prospects.

Environmental

Oil and gas production is a highly regulated activity which is subject to significant environmental and conservation regulations both on a federal and state level. Historically, most of the environmental regulation of oil and gas production has been left to state regulatory boards or agencies in those jurisdictions where there is significant gas and oil production, with limited direct regulation by such federal agencies as the Environmental Protection Agency. However, while the Company believes this generally to be the case for its production activities in Texas, Oklahoma, Kansas and New Mexico, it should be noticed that there are various Environmental Protection Agency regulations which would govern significant spills, blow-outs, or uncontrolled emissions.

In Oklahoma, Texas, Kansas and New Mexico specific oil and gas regulations exist related to the drilling, completion and operations of wells, as well as disposal of waste oil. There are also procedures incident to the plugging and abandonment of dry holes or other non-operational wells, all as governed by the Oklahoma Corporation Commission, Oil and Gas Division, the Texas Railroad Commission, Oil and Gas Division, the Kansas Corporation Commission, Oil and Gas Division or the New Mexico Oil Conservation Division.

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Compliance with these regulations may constitute a significant cost and effort for Arena. No specific accounting for environmental compliance has been maintained or projected by Arena to date. Arena does not presently know of any environmental demands, claims, or adverse actions, litigation or administrative proceedings in which it or the acquired properties are involved or subject to or arising out of its predecessor operations.

In the event of a breach of environmental regulations, these environmental regulatory agencies have a broad range of alternative or cumulative remedies to include: ordering a clean up of any spills or waste material and restoration of the soil or water to conditions existing prior to the environmental violation; fines; or enjoining further drilling, completion or production activities. In certain egregious situations the agencies may also pursue criminal remedies against the Company or its principals.

### *Forward-Looking Information*

Certain statements in this Section and elsewhere in this report are forward-looking in nature and relate to trends and events that may affect the Company's future financial position and operating results. Such statements are made pursuant to the safe harbor provision of the *Private Securities Litigation Reform Act of 1995*. The terms expect, anticipate, intend, and project and similar words or expressions are intended to identify forward-looking statements. These statements speak only as of the date of this report. The statements are based on current expectations, are inherently uncertain, are subject to risks, and should be viewed with caution. Actual results and experience may differ materially from the forward-looking statements as a result of many factors, including changes in economic conditions in the markets served by the company, increasing competition, fluctuations in raw materials and energy prices, and other unanticipated events and conditions. It is not possible to foresee or identify all such factors. The company makes no commitment to update any forward-looking statement or to disclose any facts, events, or circumstances after the date hereof that may affect the accuracy of any forward-looking statement.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

#### *Interest Rate Risk*

The Company is subject to interest rate risk on its revolving credit facility, which bears variable interest based upon a LIBOR rate. Changes in interest rates affect the interest earned on the Company's cash and cash equivalents and the interest rate paid on borrowings under its bank credit facility. Currently, the Company does not use interest rate derivative instruments to manage exposure to interest rate changes.

#### *Commodity Price Risk*

The Company's revenues, profitability and future growth depend substantially on prevailing prices for oil and natural gas. Prices also affect the amount of cash flow available for capital expenditures and Arena's ability to borrow and raise additional capital. The amount the Company can borrow under its bank credit facility is subject to periodic redetermination based in part on changing expectations of future prices. Lower prices may also reduce the amount of oil and natural gas that the Company can economically produce. Arena currently sells all of its oil and natural gas production under price sensitive or market price contracts.

Arena does not currently use derivative commodity instruments or similar financial instruments to attempt to hedge commodity price risks associated with future oil and natural gas production.

#### *Currency Exchange Rate Risk*

Foreign sales accounted for none of the Company's sales; further, the Company accepts payment for its commodity sales only in U.S. dollars; hence, Arena is not exposed to foreign currency exchange rate risk on these sales.



**Item 4. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures*

The Company maintains controls and procedures designed to ensure that information required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. At the end of the period covered by this Quarterly Report on Form 10-Q, the Company's management, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that as of the end of such period the Company's disclosure control and procedures are effective in alerting them to material information that is required to be included in the reports the Company files or submits under the Securities Exchange Act of 1934.

*Changes in Internal Controls Over Financial Reporting*

There have been no changes in the Company's internal control over financial reporting during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Part II Other Information**

**Item 1. Legal Proceedings**

None.

**Item 1A. Risk Factors**

There have been no material changes from risk factors as previously disclosed in our Form 10-K in response to Item 1A to Part I of Form 10-K.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Submission of Matters to a Vote of Security Holders**

None.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

- |     |                     |                                   |
|-----|---------------------|-----------------------------------|
| (a) | <u>Exhibit 31.1</u> | Section 302 Certification of CEO  |
|     | <u>Exhibit 31.2</u> | Section 302 Certification of CFO  |
| (b) | <u>Exhibit 32.1</u> | Section 1350 Certification of CEO |
|     | <u>Exhibit 32.2</u> | Section 1350 Certification of CFO |

**SIGNATURES**

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

REGISTRANT: **ARENA RESOURCES, INC.**

Dated: May 4, 2007

By: /s/ Lloyd Tim Rochford  
Lloyd Tim Rochford  
Chief Executive Officer

Dated: May 4, 2007

By: /s/ Phillip W. Terry  
Phillip W. Terry  
President

Dated: May 4, 2007

By: /s/ William R. Broaddrick  
William R. Broaddrick  
Vice President, Chief Financial Officer