

Edgar Filing: ARENA RESOURCES INC - Form 10QSB

ARENA RESOURCES INC
Form 10QSB
August 11, 2003

1

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

FORM 10-QSB

(Mark One)

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

For the Quarterly Period Ended June 30, 2003

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 000-32439

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 officers)

(918) 747-6060

(Issuer's telephone number)

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

As of July 29, 2003, the Company had outstanding 7,100,697 shares of common stock (\$0.001 par value).

1

INDEX

Arena Resources, Inc.
For the Quarter Ended June 30, 2003

Part I. Financial Information

Edgar Filing: ARENA RESOURCES INC - Form 10QSB

	Page
Item 1. Financial Statements (Unaudited)	3
Condensed Balance Sheets as of June 30, 2003 and December 31, 2002 (Unaudited)	4
Condensed Statements of Operations for the Three and Six Months Ended June 30, 2003 and 2002 (Unaudited)	5
Condensed Statements of Cash Flows for the Six Months Ended June 30, 2003 and 2002 (Unaudited)	6
Notes to Condensed Financial Statements (Unaudited)	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	13
Item 3. Controls and Procedures	16
Part II. Other Information	
Item 1. Legal Proceedings	17
Item 4. Submission of Matters to a Vote of Security Holders	17
Item 5. Other Information	17
Item 6. Exhibits and Reports on Form 8-K	17
Signatures	18

Part I - Financial Information

Item I. Financial Statements:

The condensed 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 financial position of the Company and the 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 June 30, 2003 are not necessarily indicative of the results to be expected for the year ending December 31, 2003.

Edgar Filing: ARENA RESOURCES INC - Form 10QSB

ARENA RESOURCES, INC.
CONDENSED BALANCE SHEETS
(UNAUDITED)

	June 30, 2003	December 31, 2002

ASSETS		
Current Assets		
Cash	\$1,453,905	\$ 796,915
Account receivable	345,021	269,436
Subscription receivable	-	157,500
Prepaid expenses	58,408	1,128

Total Current Assets	1,857,334	1,224,979

Property and Equipment, Using Full Cost Accounting		
Oil and gas properties subject to amortization	6,572,301	4,884,804
Equipment	48,480	21,794
Office equipment	15,315	14,672

Total Property and Equipment	6,636,096	4,921,270
Less: Accumulated depreciation and amortization	(296,303)	(172,258)

Net Property and Equipment	6,339,793	4,749,012

Long-Term Deposits	76,502	76,502

Total Assets	\$8,273,629	\$6,050,493
=====		
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	\$ 180,402	\$ 173,174
Accrued liabilities	7,127	-
Accrued preferred dividends	-	114,685

Total Current Liabilities	187,529	287,859

Long-Term Liabilities		
Put option	14,214	50,604
Notes payable to officers	400,000	400,000
Asset retirement obligation	476,651	-
Deferred income taxes	415,235	187,193

Total Long-Term Liabilities	1,306,100	637,797

Edgar Filing: ARENA RESOURCES INC - Form 10QSB

Stockholders' Equity		
Preferred stock - \$0.001 par value; 10,000,000 shares authorized; no shares issued or outstanding	-	-
Common stock - par value \$0.001 per share; 100,000,000 shares authorized; 6,843,697 shares and 6,282,056 shares outstanding, respectively	6,844	6,282
Additional paid-in capital	6,283,084	5,287,189
Options and warrants outstanding	654,788	382,040
Accumulated deficit	(164,716)	(550,674)
<hr/> Total Stockholders' Equity	<hr/> 6,780,000	<hr/> 5,124,837
<hr/> Total Liabilities and Stockholders' Equity	<hr/> \$8,273,629	<hr/> \$6,050,493

See accompanying notes to unaudited condensed financial statements.

4

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

	For the Three Months Ended June 30,		For the Six Ended Jun
	2003	2002	2003
<hr/> Oil and Gas Revenues	<hr/> \$841,619	<hr/> \$ 167,682	<hr/> \$1,648,640
<hr/> Costs and Operating Expenses			
Oil and gas production costs	281,546	49,516	523,618
Oil and gas production taxes	57,374	8,247	111,324
Depreciation, depletion and amortization	69,615	18,644	120,706
General and administrative expense	120,451	55,485	264,082
<hr/> Total Costs and Operating Expenses	<hr/> 528,986	<hr/> 131,892	<hr/> 1,019,730
<hr/> Other Income (Expense)			
Gain from change in fair value of put options	31,615	-	36,390
Accretion expense	(7,843)	-	(12,624)
Interest expense	(9,973)	-	(19,836)
<hr/> Net Other Income	<hr/> 13,799	<hr/> -	<hr/> 3,930
<hr/> Income Before Provision for Income Taxes and Cumulative Effect of Change in Accounting Principle	<hr/> 326,432	<hr/> 35,790	<hr/> 632,840

Edgar Filing: ARENA RESOURCES INC - Form 10QSB

Provision for Deferred Income Taxes	120,780	-	235,069

Income Before Cumulative Effect of Change in Accounting Principle	205,652	35,790	397,771
Cumulative Effect of Change in Accounting PrincipL3	-	-	11,813

Net Income	205,652	35,790	385,958
Preferred Stock Dividends	-	171,451	-

Income (Loss) Attributable to Common Shares	\$205,652	\$ (135,661)	\$ 385,958

Basic Income (Loss) Per Common Share Before cumulative effect of change in accounting principle	\$ 0.03	\$ (0.04)	\$ 0.06
Cumulative effect of change in accounting principle	-	-	-

Net Income (Loss) Attributable to Common Share	\$ 0.03	\$ (0.04)	\$ 0.06
=====			
Diluted Income (Loss) Per Common Share Before cumulative effect of change in accounting principle	\$ 0.03	\$ (0.04)	\$ 0.06
Cumulative effect of change in accounting principle	-	-	-

Net Income (Loss) Attributable to Common Share	\$ 0.03	\$ (0.04)	\$ 0.06
=====			

See accompanying notes to unaudited condensed financial statements.

5

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

For the Six Months Ended June 30	2003	2002

Cash Flows From Operating Activities		
Net income	\$ 385,958	\$ 55,868
Adjustments to reconcile net income to net cash provided by operating activities:		
Shares issued for services	75,040	-
Depreciation and depletion	120,705	41,292
Gain from change in fair value of put option	(36,390)	-

5

Edgar Filing: ARENA RESOURCES INC - Form 10QSB

Cumulative effect of change in accounting principle	11,813	-
Accretion of discounted liabilities	12,625	-
Changes in assets and liabilities:		
Accounts receivable	(75,585)	(32,969)
Prepaid expenses	(57,280)	(222)
Accounts payable and accrued liabilities	14,355	73,878
Deferred income tax payable	235,069	-
Net Cash Provided by Operating Activities	686,310	137,847
Cash Flows from Investing Activities		
Purchase of oil and gas properties	(1,186,971)	(995,214)
Purchase of office equipment	(643)	(2,208)
Purchase of held to maturity investment	-	(25,000)
Purchase of property, plant & equipment	(26,686)	-
Net Cash Used in Investing Activities	(1,214,300)	(1,022,422)
Cash Flows From Financing Activities		
Proceeds from issuance of common stock and warrants, net	1,135,165	-
Proceeds from warrant exercise	7,000	-
Collection of common stock subscription receivable	157,500	-
Proceeds from issuance of preferred stock, net of offeri	-	1,135,488
Payment on note payable	-	(18,000)
Payment of dividends to preferred stockholders	(114,685)	(75,850)
Net Cash Provided by Financing Activities	1,184,980	1,041,638
Net Increase in Cash	656,990	157,063
Cash at Beginning of Period	796,915	444,564
Cash at End of Period	\$1,453,905	\$ 601,627
Supplemental Cash Flows Information		
Cash paid for interest	\$ 19,836	\$ -
Non-Cash Investing and Financing Activities		
Common stock issued for properties	\$ 52,000	\$ 255,000
Asset retirement obligation incurred in property acquisi	227,308	-
Accrual of preferred stock dividends	-	57,049
Beneficial conversion feature on convertible preferred s	-	114,402
Value of warrants included as offering costs	-	254,889
Preferred stock issued for receivable from stockholders	-	448,385

See accompanying notes to unaudited condensed financial statements.

Edgar Filing: ARENA RESOURCES INC - Form 10QSB

ARENA RESOURCES, INC.
NOTES TO UNAUDITED CONDENSED FINANCIAL STATEMENTS
JUNE 30, 2003

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

Condensed Financial Statements - The accompanying condensed 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-KSB as of December 31, 2002. The financial position and results of operations for the six months ended June 30, 2003 are not necessarily indicative of the results to be expected for the full year ending December 31, 2003.

Nature of Operations - 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.

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.

Long-Term Deposits - The Company has complied with a requirement to maintain a \$51,502 certificate of deposit at a federally insured institution in order to do business in the state of Texas. The certificate matured in July 2003 and was replaced with a \$50,000 letter of credit. The Company has also complied with a requirement to maintain a \$25,000 certificate of deposit at a federally insured institution in order to do business in the state of Oklahoma. The maturity date of the investment is August 2004. The Company has also complied with a requirement to have a letter of credit issued in the amount of \$95,000 in order to do business in the state of New Mexico.

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 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. If the results of an

Edgar Filing: ARENA RESOURCES INC - Form 10QSB

assessment indicate that the properties are impaired, the amount of the impairment is added to the capitalized costs to be amortized. Amortization expense for the six months ended June 30, 2003 was \$115,939 based on depletion at the rate of \$2.06 per barrel of oil equivalent compared to \$40,616 based on depletion at the rate of \$2.69 per barrel of oil equivalent for the six months ended June 30, 2002.

7

ARENA RESOURCES, INC. NOTES TO UNAUDITED CONDENSED FINANCIAL STATEMENTS JUNE 30, 2003

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 in connection with properties in which the Company holds an ownership interest.

Income (Loss) Per Common Share - Basic income (loss) per common share is computed by dividing net income (loss) available to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted income (loss) per share reflects the potential dilution that could occur if all contracts to issue common stock were converted into common stock.

Concentration of Credit Risk and Major Customer - The Company currently has cash in excess of federally insured limits at June 30, 2003. During the six months ended June 30, 2003, sales to three customers represented 56%, 19% and 7% of total sales, respectively. At June 30, 2003, these three customers made up 45%, 17% and 22% of accounts receivable, respectively.

Stock-Based Employee Compensation - On April 1, 2003, the Company issued stock options to directors and employees, which are described more fully in Note 7. The Company applies the recognition and measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) and related interpretations in accounting for its stock-based compensation awards. Under APB 25, no stock-based compensation expense was charged to earnings, as all options granted had an exercise price equal to or greater than the adjusted fair value of the underlying common stock on the grant date.

Alternately, Statement on Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS No. 123), allows companies to recognize compensation expense over the related service period based on the grant date fair value of the stock option awards. The following table illustrates the effect on net income and basic and diluted income (loss) per common share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation:

For the Three Months
Ended June 30,

For the Six Months
Ended June 30,

Edgar Filing: ARENA RESOURCES INC - Form 10QSB

	2003	2002	2003	2002
Net income, as reported	\$205,652	\$ 35,790	\$385,958	\$55,868
Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	(131,564)	-	(131,564)	-
Pro Forma Net Income	\$ 74,088	\$ 35,790	\$254,394	\$55,868
Income (Loss) per Common Share				
Basic, as reported	\$ 0.03	\$ (0.04)	\$ 0.06	\$ (0.04)
Basic, pro forma	\$ 0.01	\$ (0.04)	\$ 0.04	\$ (0.04)
Diluted, as reported	\$ 0.03	\$ (0.04)	\$ 0.06	\$ (0.04)
Diluted, pro forma	\$ 0.01	\$ (0.04)	\$ 0.04	\$ (0.04)

Under SFAS 123, the pro forma estimated compensation expense, after tax, for the years ending December 31, 2003, 2004 and 2005 will be approximately \$395,000, \$353,000 and \$209,000, respectively.

8

ARENA RESOURCES, INC.
NOTES TO UNAUDITED CONDENSED FINANCIAL STATEMENTS
JUNE 30, 2003

Cumulative Effect of Change in Accounting Principle - The Company adopted SFAS No. 143, Accounting for Asset Retirement Obligations, effectively on January 1, 2003. In accordance with the transition provisions of SFAS No. 143, the Company recorded asset retirement liabilities and a cumulative-effect adjustment of \$11,813 as a reduction in earnings, which had no effect on basic and diluted income per common share.

NOTE 2 - EARNINGS PER SHARE INFORMATION

	For the Three Months Ended June 30,	
	2003	2002

Edgar Filing: ARENA RESOURCES INC - Form 10QSB

Income before cumulative effect of change in accounting principle	\$ 205,652	\$ 35,790	\$ 39
Less: Preferred stock dividends	-	(171,451)	
<hr style="border-top: 1px dashed black;"/>			
Income (loss) before cumulative effect of change in accounting principle	205,652	(135,661)	39
Cumulative effect of change in accounting principle	-	-	(1)
<hr style="border-top: 1px dashed black;"/>			
Income (Loss) Attributable to Common Shares	\$ 205,652	\$ (135,661)	\$ 38
<hr style="border-top: 3px double black;"/>			
Basic weighted-average common shares outstanding	6,477,230	3,653,896	6,40
Effect of dilutive securities			
Warrants	187,154	-	14
Stock options	306,298	-	15
<hr style="border-top: 1px dashed black;"/>			
Diluted Weighted-Average Common Shares Outstanding	6,970,682	3,653,896	6,70
<hr style="border-top: 3px double black;"/>			
Basic Income (Loss) Per Common Share			
Before cumulative effect of change in accounting principle	\$ 0.03	\$ (0.04)	\$
Cumulative effect of change in accounting principle	-	-	
<hr style="border-top: 1px dashed black;"/>			
Net Income (Loss) Attributable to Common Shares	\$ 0.03	\$ (0.04)	\$
<hr style="border-top: 3px double black;"/>			
Diluted Income (Loss) Per Common Share			
Before cumulative effect of change in accounting principle	\$ 0.03	\$ (0.04)	\$
Cumulative effect of change in accounting principle	-	-	
<hr style="border-top: 1px dashed black;"/>			
Net Income (Loss) Attributable to Common Shares	\$ 0.03	\$ (0.04)	\$
<hr style="border-top: 3px double black;"/>			

At June 30, 2003, warrants to purchase 437,464 shares of common stock at \$5.00 per share were outstanding, but were not included in the computation of diluted income per common share because the exercise prices of these warrants were greater than the average market price of the common stock during the period.

NOTE 3 - ACQUISITION OF OIL AND GAS PROPERTIES

Seven Rivers Queen Unit acquisition - On April 4, 2003, the Company entered into an agreement to purchase a 70.60% working interest, 56.48% net revenue interest, in the Seven Rivers Queen Unit mineral lease located in Lea County, New Mexico. Total consideration provided by the Company was a cash payment of \$900,000. The Company also issued 10,000 shares of the Company's restricted common stock valued at \$5.20 per share, or \$52,000, as a finder's fee relating to this acquisition

NOTE 4 - NOTES PAYABLE

On February 3, 2003, the Company established a \$10,000,000 revolving credit facility with a bank with an initial borrowing base of \$2,000,000. The interest rate is a floating rate equal to the JP Morgan Chase prime rate plus 1% with interest payable monthly. Annual fees for the facility are 1/2 of one percent of the unused portion of the borrowing base. Amounts borrowed under the revolving

Edgar Filing: ARENA RESOURCES INC - Form 10QSB

ARENA RESOURCES, INC.
 NOTES TO UNAUDITED CONDENSED FINANCIAL STATEMENTS
 JUNE 30, 2003

credit facility will be due in February 2005. 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 and the credit facility was guaranteed by two of the Company's officers. The Company is required under the terms of the credit facility to maintain a tangible net worth of \$4,000,000, 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. As of June 30, 2003, no amounts are owed under this credit facility.

NOTE 5 - ASSET RETIREMENT OBLIGATION

Effective January 1, 2003, the Company adopted SFAS No. 143, Accounting for Asset Retirement Obligations, which requires entities to record the fair value of a liability for an asset retirement obligation when it is incurred which, for the Company, is typically when an oil or gas well is drilled or purchased. The standard applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development or normal use of the asset. The Company's asset retirement obligations relate primarily to the obligation to plug and abandon oil and gas wells and support wells at the conclusion of their useful lives.

SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred, if a reasonable estimate of fair value can be made. When the liability is initially recorded, the related cost is capitalized by increasing the carrying amount of the related oil and gas property. Over time, the liability is accreted upward for the change in its present value each period until the obligation is settled and the initial capitalized cost is amortized by the unit-of-production method as described in Note 1.

At January 1, 2003, the implementation of SFAS No. 143 resulted in a net increase in property and equipment of \$217,878. Liabilities increased by \$236,718, which represents the establishment of an asset retirement obligation liability. The cumulative effect on prior years of the change in accounting principle of \$11,813, net of \$7,027 of related tax effects, was recorded in the first quarter of 2003 as a reduction in earnings. The effect of adopting this accounting principle was an \$11,386 decrease in net income during the six months ended June 30, 2003.

The following presents pro forma net income and basic and diluted income (loss) per common share as if SFAS No. 143 had been applied retroactively for all periods presented:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2003	2002	2003	2002
Net Income	\$205,652	\$ 35,560	\$385,958	\$52,051

Edgar Filing: ARENA RESOURCES INC - Form 10QSB

Income (Loss) Per Common Share				
Basic	\$	0.03	\$ (0.04)	\$ 0.06 \$ (0.04)
Diluted	\$	0.03	\$ (0.04)	\$ 0.06 \$ (0.04)

=====

The pro forma amount of the liability for the asset retirement obligation was \$80,140 at December 31, 2001, \$83,395 at March 31, 2002 and \$85,047 at June 30, 2002. 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 six months ended June 30, 2003 is as follows:

10

ARENA RESOURCES, INC.
NOTES TO UNAUDITED CONDENSED FINANCIAL STATEMENTS
JUNE 30, 2003

Balance, January 1, 2003	\$236,718
Liabilities incurred	227,309
Accretion expense	12,624

Balance, June 30, 2003	\$476,651
------------------------	-----------

=====

NOTE 6 - STOCKHOLDERS' EQUITY

The Company is authorized to issue 100,000,000 common shares, with a par value of \$0.001 per share, and 10,000,000 Class "A" convertible preferred shares, with a par value of \$0.001 per share.

Private Placement Offering of Common Stock and Warrants - On August 22, 2002, the Company initiated a \$3,000,000 private placement offering of the Company's common stock at \$2.50 per share with a detachable warrant exercisable at \$5.00 per share through September 30, 2005. During the six months ended June 30, 2003, the Company issued 534,294 shares of common stock and 534,294 warrants for \$1,135,165 in net cash proceeds (net of cash offering costs of \$200,570). In addition, 79,596 warrants exercisable at \$5.00 per share through September 30, 2005 were issued as consulting fees and for services to placement agents. The net proceeds received were allocated to the common stock and the warrants based upon their relative fair values, with \$874,019 allocated to the common stock and \$261,146 allocated to the warrants. The fair value of the warrants issued was \$797,373, or \$1.30 per warrant, which was determined using the Black-Scholes option pricing model with the following weighted-average assumptions: risk-free interest rate of 1.32%, expected dividend yield of 0%, volatility of 34.7% and an expected life of 2.25 years.

In addition, during the six months ended June 30, 2003, Arena issued 52,433 additional warrants, with the same terms, as consulting fees and for services relating to the shares of common stock and warrants issued during 2002. During the six months ended June 30, 2003, \$15,922 of the proceeds from the 2002 cash offering proceeds were allocated to the additional warrants, based upon their relative fair value. Through June 30, 2003, the Company had issued 820,294

Edgar Filing: ARENA RESOURCES INC - Form 10QSB

units of common stock and warrants to investors under the offering for \$1,793,065 in net cash proceeds (net of cash offering costs of \$257,670) and had issued 132,029 warrants as consulting fees and for services to placement agents.

Stock issued for services - During the six months ended June 30, 2003, the company issued shares of restricted common stock for services. A total of 13,847 shares were issued for services with 1,120 shares, valued at \$4.50 per share or \$5,040, for consulting services and 12,727 shares, valued at \$5.50 per share or \$70,000, were issued for research work. Both contracts have a 1 year term.

NOTE 7 - EMPLOYEE STOCK OPTIONS

On April 1, 2003, the Company granted options to directors and employees to purchase 1,000,000 shares of common stock at \$3.70 per share through April 1, 2008. The options vest at the rate of 20% each year over five years. The exercise price is 85% of the market value of the Company's common stock on the date issued. In accordance with FASB Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation, the 15% discount from the market price of the Company's common stock used in determining the fair value of the common stock is considered reasonable and the options are not compensatory. Accordingly, the Company did not recognize any compensation expense from the grant of these stock options.

11

ARENA RESOURCES, INC. NOTES TO UNAUDITED CONDENSED FINANCIAL STATEMENTS JUNE 30, 2003

The fair value of the options granted was \$1,837,935, or \$1.84 per share, and was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions: dividend yield of 0% percent, expected volatility of 36.3%, risk-free interest rate of 2.8% and expected lives of 5.0 years.

NOTE 8 - 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 and New Mexico totaling \$170,000 to allow the Company to do business in those states. The standby letters of credit are valid through August 2004 and are collateralized by an assignment of certificates of deposit totaling \$76,502. 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 9 - SUBSEQUENT EVENT

On July 15, 2003 the Company closed its \$3,000,000 private placement offering of the Company's common stock at \$2.50 per share with a detachable warrant exercisable at \$5.00 per share through September 30, 2005. During July 2003, the Company issued 256,000 shares of common stock and 256,000 warrants. In addition, warrants to purchase 25,600 shares of commons stock at \$5.00 per share were issued as consulting fees and for services to placement agents. The gross proceeds received were \$640,000 before \$119,730 of cash offering costs. In the private placement, the Company issued 1,076,294 units of common stock and warrants to investors under the offering for \$2,313,335 in net cash proceeds

Edgar Filing: ARENA RESOURCES INC - Form 10QSB

(net of cash offering costs of \$377,400) and had issued 157,629 warrants as consulting fees and for services to placement agents.

On July 2, 2003, the Company entered into an agreement to purchase a 100% working interest, 80.5% net revenue interest, in the Beals Prospect mineral lease located in Comanche County, Kansas. Total consideration provided by the Company was a cash payment of \$60,000. This is proven undeveloped acreage. The company has not yet completed any mineral revenue studies for this property.

Subsequent to June 30, 2003, the Company has received \$1,750 from exercise of 1,000 warrants that had an exercise price of \$1.75.

12

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

Results of Operations

For the three months ended June 30, 2003, the Company realized \$841,619 in revenue compared to \$167,682 in revenue for the same period in 2002. Income before accrual for deferred income taxes for the three months ended June 30, 2003 was \$326,432 compared to \$35,790 for the same period in 2002. Net income after income taxes and preferred stock dividends was \$205,652 for the three months ended June 30, 2003 compared to a loss of \$135,661 for the same period in 2002.

Oil and gas production costs for the three months ended June 30, 2003 were \$281,546, compared to \$49,516 for the same period in 2002. Production taxes for the three months ended June 30, 2003 were \$57,374, compared to \$8,247 for the same period in 2002. Depreciation and depletion for the three months ended June 30, 2003 was \$69,615, compared to \$18,644 for the same period in 2002. General and administrative expenses for the three months ended June 30, 2003 were \$120,451, consisting franchise taxes and payroll salaries and taxes, compared to \$55,485 for the same period in 2002, consisting primarily of payroll salaries and taxes.

For the six months ended June 30, 2003, the Company realized \$1,648,640 in revenue compared to \$311,013 in revenue for the same period in 2002. Income before accrual for deferred income taxes for the six months ended June 30, 2003 was \$632,840 compared to \$55,868 for the same period in 2002. Net income after income taxes, cumulative effect of change in accounting principle and preferred stock dividends was \$385,958 for the six months ended June 30, 2003 compared to a loss of \$155,289 for the same period in 2002.

Oil and gas production costs for the six months ended June 30, 2003 were \$523,618, compared to \$96,072 for the same period in 2002. Production taxes for the six months ended June 30, 2003 were \$111,324, compared to \$15,475 for the same period in 2002. Depreciation and depletion for the six months ended June 30, 2003 was \$120,706, compared to \$41,292 for the same period in 2002. General and administrative expenses for the six months ended June 30, 2003 were \$264,082, consisting primarily of bank line of credit fees, stock exchange listing fees, franchise taxes and payroll salaries and taxes, compared to \$102,306 for the same period in 2002, consisting primarily of payroll salaries and taxes.

Revenues Year to Date by Geographic section

Edgar Filing: ARENA RESOURCES INC - Form 10QSB

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	11,178 BBLs	\$ 342,719
Oklahoma Leases	36,714 BBLs	\$ 1,093,545
New Mexico Leases	3,962 BBLs	\$ 104,197

GAS

	Net Production Volume	Net Revenue
Texas Leases	2,866 MCF	\$ 9,411
Oklahoma Leases	21,103 MCF	\$ 85,328
New Mexico Leases	3,360 MCF	\$ 13,440

13

Arena is also looking at various other oil and gas opportunities, as generally outlined in its earlier periodic reports, in Oklahoma and other geographic areas, but has entered no definitive or binding agreements, except as otherwise reported in this filing.

Significant Subsequent Events occurring after June 30, 2003:

On July 15, 2003 the Company closed its \$3,000,000 private placement offering of the Company's common stock at \$2.50 per share with a detachable warrant exercisable at \$5.00 per share through September 30, 2005. During July 2003, the Company issued 256,000 shares of common stock and 256,000 warrants. In addition, warrants to purchase 25,600 shares of common stock at \$5.00 per share were issued as consulting fees and for services to placement agents. The gross proceeds received were \$640,000 before \$119,730 of cash offering costs. In the private placement, the Company issued 1,076,294 units of common stock and warrants to investors under the offering for \$2,313,335 in net cash proceeds (net of cash offering costs of \$377,400) and had issued 157,629 warrants as consulting fees and for services to placement agents.

On July 23, 2003 the Company held its first annual shareholders meeting. The following items were approved by majority shareholder vote: (i) election of directors, (ii) approval of its proposed executive stock option incentive program and (iii) ratification of the appointment of Hansen, Barnett & Maxwell as independent auditors through the end of the year. Any party wishing to review the minutes of this meeting can obtain a copy from the Company.

On July 2, 2003, the Company entered into an agreement to purchase a 100% working interest, 80.5% net revenue interest, in the Beals Prospect mineral lease located in Comanche County, Kansas. Total consideration provided by the Company was a cash payment of \$60,000. This is proven undeveloped acreage. The company has not yet completed any mineral revenue studies for this property.

Subsequent to June 30, 2003, the Company has received \$1,750 from exercise of 1,000 warrants that had an exercise price of \$1.75.

Capital Resources and Liquidity

As shown in the financial statements for the six months ended June 30, 2003, the Company had cash on hand of \$1,453,905, compared to \$796,915 as of December 31, 2002. The Company had positive net cash flows from operations for the six months ended June 30, 2003 of \$686,310, compared to \$137,847 for the same period

Edgar Filing: ARENA RESOURCES INC - Form 10QSB

2002. Other significant sources of cash inflow in 2003 were the common stock private placement with net proceeds in 2003 of \$1,137,165 and the collection of a common stock subscription receivable, in the amount of \$157,500. Another significant source of cash inflow in 2002 was the Class A preferred stock private placement (which closed June 30, 2002) with net proceeds of \$1,135,488. The most significant cash outflows during the six months ended June 30, 2003 and 2002 were capital expenditures of \$1,186,971 in 2003 and \$995,214 in 2002 and payment of preferred stock dividends of \$114,685 in 2003 and \$75,850 in 2002.

On February 3, 2003, the Company established a \$10,000,000 revolving credit facility with a bank with an initial borrowing base of \$2,000,000. The interest rate is a floating rate equal to the JP Morgan Chase Prime rate plus 1% with interest payable monthly. Annual fees for the facility are 1/2 of 1% of the unused portion of the borrowing base. Amounts borrowed under the revolving credit facility will be due in February 2005. 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 and the credit facility was guaranteed by two of the Company's officers. The Company is required under the terms of the credit facility to maintain a tangible net worth of \$4,000,000, 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.

14

On August 22, 2002, the Company initiated a \$3,000,000 private placement offering of the Company's common stock at \$2.50 per share with a detachable warrant exercisable at \$5.00 per share through September 30, 2005. During the six months ended June 30, 2003, the Company issued 534,294 shares of common stock and 534,294 warrants for \$1,135,165 in net cash proceeds (net of cash offering costs of \$200,570). In addition, 79,596 warrants exercisable at \$5.00 per share through September 30, 2005 were issued as consulting fees and for services to placement agents. Through June 30, 2003, the Company had issued 820,294 units of common stock and warrants to investors under the offering for \$1,793,065 in net cash proceeds (net of cash offering costs of \$257,670) and had issued 132,029 warrants as consulting fees and for services to placement agents.

Management plans to continue to make acquisitions, using net cash flows from operations and possibly the above referenced credit facility and additional equity capital.

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

Edgar Filing: ARENA RESOURCES INC - Form 10QSB

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.

15

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.

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

Edgar Filing: ARENA RESOURCES INC - Form 10QSB

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. Controls and Procedures

(a) The Company maintains controls and procedures designed to ensure that information required to be disclosed in the reports that the Company 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. Based upon their evaluation of those controls and procedures performed within 90 days of the filing date of this report, the chief executive officer and the principal financial officer of the Company concluded that the Company's disclosure controls and procedures were adequate.

(b) Changes in internal controls. The Company made no significant changes in its internal controls or in other factors that could significantly affect these controls subsequent to the date of the evaluation of those controls by the chief executive officer and principal financial officer.

16

Part II - Other Information

Item 1. Legal Proceedings

Arena is not presently engaged in any legal proceedings, nor does it know of any claims for or against the company by any party.

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

On July 23, 2003 the Company held its first annual shareholders meeting. The following items were approved by majority shareholder vote: election of directors, approval of its proposed executive stock option incentive program and ratification of the appointment of Hansen, Barnett & Maxwell as independent auditors through the end of the year. Any party wishing to review the minutes of this meeting can obtain a copy from the Company.

Item 5. Other Information

As of April 15, 2003, Arena has traded on the American Stock Exchange, under the trading symbol, ARD. The shares have traded in the range of \$4.50 to \$5.99 during the second quarter, 2003. Prior to April 15, 2003, Arena had established a limited trading market on the NASD Electronic Bulletin Board beginning approximately March 28, 2001.

Edgar Filing: ARENA RESOURCES INC - Form 10QSB

Mr. Robert J. Morley resigned as director and officer effective July 31, 2003. Mr. Morley's resignation was prompted by the concerns of both Mr. Morley and Arena that the Company was going to continue to engage in oil and gas activities with a controlled entity of Mr. Morley's, known as Petro Consultants, Inc. Both parties thought it was in the best interest of the Company to avoid potential future conflicts and related party transactions that Mr. Morley resign from the Board of Directors and his position as an officer.

Mr. Morley will continue in his capacity as the principal of Petro Consultants, Inc to work with Arena in oil and gas acquisition and development as an industry participant. Mr. Morley is no longer considered an affiliate but does continue to hold 136,340 shares of the Company's common stock. There existed no disagreements or conflicts between Mr. Morley and Arena and the Company wishes to thank him for his services.

Management is not aware of any other pertinent or relevant information other than discussed above in Managements Discussion and Analysis of Financial Condition and Results of Operations. Shareholders are advised that as the Company completes future significant drilling and completion activities for oil and gas acquisitions that it will report such matters through press releases and/or the filing of 8-K reports where appropriate. Such information will be further summarized in the next applicable periodic filing with the Securities and Exchange Commission.

Item 6. Exhibits and Reports on Form 8-K

- (a) Exhibit 99.1 Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 Of The Sarbanes-Oxley Act of 2002
- (b) Exhibit 99.2 CEO and CFO certification
- (c) There were no 8-K filings during the quarter ending June 30, 2003.

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: August 8, 2003

By: /s/ Lloyd Tim Rochford

Lloyd Tim Rochford
President, Chief Executive Officer

Dated: August 8, 2003

By: /s/ Stanley McCabe

Stanley McCabe

Edgar Filing: ARENA RESOURCES INC - Form 10QSB

Treasurer, Secretary

Dated: August 8, 2003

By: /s/ William R. Broaddrick

William R. Broaddrick
Vice President, Chief Financial Officer