

Edgar Filing: PETROCORP INC - Form 10-Q

PETROCORP INC  
Form 10-Q  
May 07, 2002

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly period ended March 31, 2002  
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OR

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

For the Transition period \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-22650  
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PETROCORP INCORPORATED  
(Exact name of registrant as specified in its charter)

Texas  
(State or Other Jurisdiction of  
Incorporation or Organization)

76-0380430  
(I.R.S. Employer Identification No.)

6733 South Yale  
Tulsa, Oklahoma  
(Address of Principal Executive Offices)

74136  
(Zip Code)

Registrant's Telephone Number, Including Area Code: (918) 491-4500

Not Applicable

-----  
(Former Name, Former Address and Former Fiscal Year,  
if changed since last report)

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 such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No  
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Indicate the number of shares outstanding of each of the Registrant's classes of stock, as of April 30, 2002:

Common Stock, \$.01 per value  
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12,559,609  
-----

(Title of Class)

(Number of Shares Outstanding)

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PETROCORP INCORPORATED

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Certain matters discussed in this report, excluding historical information, include forward-looking statements - statements that discuss the Company's expected future results based on current and pending business operations. The Company is making these forward-looking statements in reliance on the safe harbor protections provided under the PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995.

Forward-looking statements can be identified by words such as "anticipates," "believes," "expects," "planned," "scheduled" or similar expressions. Although the Company believes these forward-looking statements are based on reasonable assumptions, statements made regarding future results are subject to numerous assumptions, uncertainties and risks that may cause future results to be materially different from the results stated or implied in this document. Important risk factors (but not necessarily all important factors) that could cause actual results to differ materially from those expressed in any forward-looking statement made by, or on behalf of, the Company would include, but in no way be limited by, the Company's ability to obtain agreements with co-venturers, partners and governments; its ability to engage drilling, construction and other contractors; its ability to obtain economical and timely financing; geological, land, sea or weather conditions; world prices for oil, natural gas and natural gas liquids; adequate and reliable transportation systems; and foreign and United States laws, including tax laws. Additional information about issues that could lead to material changes in performance is contained in the Company's Form 10-K.

### PART I. FINANCIAL INFORMATION

#### ITEM 1. Financial Statements

PETROCORP INCORPORATED  
CONSOLIDATED BALANCE SHEETS

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(in thousands, except share amounts)  
(Unaudited)

	March 31, 2002	Decem 2
	-----	-----
<b>Assets</b>		
-----		
Current assets:		
Cash and cash equivalents.....	\$ 1,527	\$
Accounts receivable, net.....	15,915	1
Other current assets.....	851	
	-----	-----
Total current assets.....	18,293	1
	-----	-----
Property, plant and equipment:		
Oil and gas properties, at cost, full cost method, net of accumulated depreciation, depletion, amortization and impairment....	123,928	12
Other, net.....	1,314	
	-----	-----
	125,242	12
	-----	-----
Deferred income taxes.....	18,266	1
Other assets, net.....	2,738	
	-----	-----
Total assets.....	\$164,539	\$16
	=====	=====
<b>Liabilities and Shareholders' Equity</b>		
-----		
Current liabilities:		
Accounts payable.....	\$ 6,173	\$
Accrued liabilities.....	3,016	
Current portion of long-term debt.....	1,430	
	-----	-----
Total current liabilities.....	10,619	1
	-----	-----
Long-term debt .....	47,570	4
	-----	-----
Deferred income taxes.....	13,768	1
	-----	-----
Shareholders' equity:		
Preferred stock, \$0.01 par value, 1,000,000 shares authorized, none issued.....		
Common stock, \$0.01 par value, 25,000,000 shares authorized, 12,558,609 and 12,556,109 shares outstanding as of March 31, 2002 and December 31, 2001, respectively.....	128	
Additional paid-in capital.....	111,248	11
Accumulated deficit.....	(8,620)	(
Accumulated other comprehensive loss.....	(7,824)	(
	-----	-----
Treasury stock, at cost (264,607 shares).....	(2,350)	(
	-----	-----
Total shareholders' equity.....	92,582	9
	-----	-----
Total liabilities and shareholders' equity.....	\$164,539	\$16
	=====	=====

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The accompanying notes are an integral part of these financial statements.

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PETROCORP INCORPORATED  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(in thousands, except share amounts)  
(Unaudited)

	For the three months ended March 31,	
	2002	2001
Revenues:		
Oil and gas.....	\$10,685	\$13,225
Plant processing.....	489	433
Other.....	300	407
	11,474	14,065
Expenses:		
Production costs.....	3,802	1,574
Depreciation, depletion and amortization.....	4,486	2,234
General and administrative.....	686	479
Other operating expenses.....	321	332
	9,295	4,619
Income from operations	2,179	9,446
Other income (expenses):		
Investment income.....	30	38
Interest expense.....	(729)	(219)
Other income (expenses).....	163	1,278
	(536)	1,097
Income before income taxes	1,643	10,543
Income tax provision:		
Current.....	442	2,250
Deferred.....	155	2,087
	597	4,337
Net income.....	\$ 1,046	\$ 6,206
	=====	=====
Net income per common share - basic.....	\$ 0.08	\$ 0.71
	=====	=====
Net income per common share - diluted.....	\$ 0.08	\$ 0.70
	=====	=====
Weighted average number of common shares - basic.....	12,556	8,714
	=====	=====
Weighted average number of common shares - diluted...	12,675	8,879
	=====	=====

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The accompanying notes are an integral part of these financial statements.

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### PETROCORP INCORPORATED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)  
(Unaudited)

	For the three months ended March 31,	
	2002	2001
Cash flows from operating activities:		
Net income.....	\$ 1,046	\$ 6,206
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion and amortization.....	4,486	2,234
Deferred income tax expense.....	155	2,087
Other.....	31	142
Changes in operating assets and liabilities:		
Accounts receivable.....	(2,648)	3,079
Other current assets.....	(61)	28
Accounts payable.....	(535)	4,236
Accrued liabilities.....	32	(334)
Income tax payable.....	-	(3,624)
Net cash provided by operating activities.....	2,506	14,054
Cash flows from investing activities:		
Additions to oil and gas properties.....	(2,276)	(1,707)
Additions to plant and related facilities.....	(152)	(113)
Investment in Southern Mineral Corporation.....	-	(3,410)
Net cash used in investing activities.....	(2,428)	(5,230)
Cash flows from financing activities:		
Proceeds from long-term debt.....	2,411	34,873
Repayment of long-term debt.....	(2,337)	(36,602)
Other.....	16	115
Net cash used in financing activities.....	90	(1,614)
Effect of exchange rate changes on cash.....	94	(514)
Net increase (decrease) in cash and cash equivalents.....	262	6,696
Cash and cash equivalents at beginning of period.....	1,265	21,946
Cash and cash equivalents at end of period.....	\$ 1,527	\$ 28,642

The accompanying notes are an integral part of these financial statements.

PETROCORP INCORPORATED  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

## NOTE 1 - BASIS OF PRESENTATION:

The unaudited consolidated financial statements of PetroCorp Incorporated (the "Company" or "PetroCorp") have been prepared in accordance with generally accepted accounting principles for interim financial information and with instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, consisting of normal and recurring adjustments necessary for a fair presentation, have been included. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended December 31, 2001, included in the Company's 2001 Annual Report on Form 10-K/A pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Interim period results are not necessarily indicative of results of operations or cash flows for a full-year period.

As further described in Note 1 in the Company's 2001 Annual Report on Form 10-K/A, the Company changed its accounting for transportation and gathering costs. Revenues and operating expenses for 2001 have been increased by \$296,000 to conform to the new presentation.

## NOTE 2 - COMPREHENSIVE INCOME:

The Company follows SFAS No. 130, "Reporting Comprehensive Income." This Statement establishes requirements for reporting comprehensive income and its components which includes the Company's foreign currency translation adjustments. The Company's comprehensive income for the three months ended March 31, 2002 and 2001 is as follows (in thousands):

	For the three months ended March 31,	
	----- 2002	2001 -----
Net income	\$1,046	\$ 6,206
Derivative hedging loss (net of tax benefit of \$373)	(598)	-
Reclassification of hedging gain to income (net of taxes of \$112)	168	-
Foreign currency translation gain (loss)	(83)	(1,730)
	----- \$ (513)	----- \$ (1,730)
Comprehensive income	\$ 533	\$ 4,476
	=====	=====

Accumulated other comprehensive loss was comprised solely of foreign currency translation loss through March 31, 2001. As of March 31, 2002,

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accumulated other comprehensive loss consisted of \$462 of derivative gain, net of taxes, and \$8,286 of foreign currency translation losses.

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NOTE 3 - MERGER WITH SOUTHERN MINERAL CORPORATION

PetroCorp completed the acquisition of Southern Mineral Corporation ("Southern Mineral") on June 6, 2001. The acquisition of Southern Mineral was accounted for using the purchase method of accounting as of June 1, 2001 because as of that date, the Company had effective control, and the results of operations have been included since that date.

The following unaudited pro forma information has been prepared assuming Southern Mineral had been acquired as of the beginning of the period presented. The pro forma information is presented for information purposes only and is not necessarily indicative of what would have occurred if the acquisition had been made as of that date. In addition, the pro forma information is not intended to be a projection of future results and does not reflect any efficiencies that may result from the integration of Southern Mineral.

Pro Forma Information (Unaudited)  
(In thousands, except per share data)

	Three Months Ended March 31, 2001 -----
Revenues.....	\$22,596
Income before income taxes.....	\$13,190
Net income.....	\$ 7,834
Earnings per common share - basic.....	\$ 0.62
Earnings per common share - diluted...	\$ 0.61

The above pro forma data reflects \$484 of bankruptcy expenses and restructuring costs (primarily investment banker and employee severance related costs) for Southern Mineral for the three months ended March 31, 2001.

NOTE 4 - EARNINGS PER SHARE:

The following is a reconciliation of the numerators and denominators of the basic and diluted per share computations for the periods presented (in thousands, except share amounts):

Three months ended March 31,

	Net Income -----	Shares -----	Per Share Amount -----
2002			
Basic EPS:			
Net income .....	\$1,046	12,556	\$ 0.08

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Effect of dilutive securities:			
Options.....	-	119	-
	-----	-----	-----
Diluted EPS:			
Net income.....	\$1,046	12,675	\$ 0.08
	=====	=====	=====
2001			
Basic EPS:			
Net income.....	\$6,206	8,714	\$ 0.71
Effect of dilutive securities:			
Options.....	-	165	(0.01)
	-----	-----	-----
Diluted EPS:			
Net income.....	\$6,206	8,879	\$ 0.70
	=====	=====	=====

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The net income per share amounts do not include the effect of potentially dilutive securities of 470,000 and 364,000 for the three months ended March 31, 2002 and 2001, respectively, as the impact of these outstanding options was antidilutive.

NOTE 5 - HEDGING ACTIVITIES:

To reduce the impact of fluctuations in the market prices of oil and natural gas, the Company periodically utilizes hedging strategies such as futures transactions or swaps to hedge the price of a portion of its future oil and natural gas production. Results of these hedging transactions are reflected in oil and natural gas sales in the month of hedged production.

No hedge transactions were in place during the first quarter of 2001. Oil and gas revenue includes no adjustment for settled hedging transactions for the first quarter 2001.

As part of PetroCorp's acquisition of Southern Mineral, the Company assumed crude oil and natural gas costless collars with a fair value (liability) at date of acquisition of \$821,000. The estimated fair value of the derivative instruments, which fair values were obtained from the counter-parties, held by the Company at March 31, 2002 were a liability of \$46,000 (included in other liabilities) related to the oil and gas hedges. The ineffective portion of these hedges was not material as of March 31, 2002. Hedging transactions for the three months ended March 31, 2002 increased oil and gas revenues by \$280,000 (reclassified from comprehensive income). All assumed oil and gas hedging transactions will expire by the fourth quarter of 2002.

Subsequent to March 31, 2002, the Company entered into a swap transaction covering 8,000 MMBTU of natural gas per day at a price of \$3.755 per MMBTU and covering the period from May 2002 through December 2002. The swap index is NYMEX Henry Hub.

The Company offsets any gain or loss on the swap and collars contracts with the realized prices for its production. While the swaps and collars reduce the Company's exposure to declines in the market price of natural gas and oil, this also limits the Company's gains from increases in the market price.



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As a result of the merger with Southern Mineral, the Company also assumed an interest rate swap position that was originally intended to hedge the variability of interest expense associated with Southern Mineral's variable rate Canadian debt. Under the swap agreement, the Company receives a floating rate of the Canadian prime rate and pays a fixed rate of 5.96% on a notional amount of Canadian \$15 million through August 29, 2003. The interest rate swap did not qualify for hedge accounting. The estimated fair value at March 31, 2002 is a liability (included in other liabilities) of \$161,000.

### NOTE 6 - PROPERTY, PLANT AND EQUIPMENT:

Investments in property, plant and equipment were as follows at March 31, 2002 and December 31, 2001 (amounts in thousands):

	2002	2001
	-----	-----
Oil and gas properties:		
Proved.....	\$ 316,789	\$ 315,935
Unproved.....	1,424	1,223
	-----	-----
	318,213	317,158
Plant and related facilities.....	9,872	9,743
Gas gathering facilities.....	1,698	1,698
Furniture, fixtures and equipment.....	90	95
	-----	-----
	329,873	328,694
Less - accumulated depreciation, depletion, amortization and impairment.....	(204,631)	(200,242)
	-----	-----
	\$ 125,242	\$ 128,452
	=====	=====

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### NOTE 7 - LONG-TERM DEBT:

In July 2000, the Company entered into a \$75 million revolving credit agreement with the Toronto-Dominion Bank (TD Bank), the agent, and the Bank of Nova Scotia. The term of the facility is through April 30, 2003 and the initial borrowing base was set at \$58 million. Borrowings can be funded by either Eurodollar loans or Base Rate loans. The interest rate on the borrowings is equal to an interest rate spread plus either the Eurodollar rate or the Base Rate. The interest spread is determined from a sliding scale based on the Company's borrowing base percentage utilization in effect from time to time. The spread ranges from 1.25 to 2.25 on Eurodollar loans and .25 to 1.25 on Base Rate loans. At March 31, 2002, the weighted average interest rate under this facility was approximately 3.9%.

The \$75 million revolving credit agreement prohibits the declaration and payment of dividends on the common stock of the Company. Also, the debt agreement requires the Company to maintain a minimum current ratio, a minimum

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tangible net worth, and a minimum interest coverage ratio.

### NOTE 8 - GEOGRAPHIC AREA INFORMATION:

The principal business of the Company is oil and gas, which consists of the exploration, development, acquisition, exploitation and operation of oil and gas properties and the production and sale of crude oil and natural gas in North America. Pertinent information with respect to the Company's oil and gas business is presented in the following table (in thousands):

	United States -----	Canada -----	General Corporate -----	Total -----
Three months ended March 31, 2002:				
Revenues.....	\$ 6,176	\$ 5,298	\$ -	\$ 11,474
Income (loss) from operations.....	1,326	1,626	(773)	2,179
Long-lived assets at March 31.....	65,492	62,382	106	127,980
Three months ended March 31, 2001:				
Revenues.....	\$ 6,594	\$ 7,471	\$ -	\$ 14,065
Income (loss) from operations.....	4,345	5,580	(479)	9,446
Long-lived assets at March 31.....	36,978	34,812	165	71,955

### NOTE 9 - RECENT ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board ("FASB") issued FAS No. 142, Goodwill and Other Intangible Assets, and FAS No. 143, Accounting for Asset Retirement Obligations, and in August 2001, FAS No. 144, Accounting for Impairment or Disposal of Long-Lived Assets. Effective January 1, 2002, the Company adopted FAS No. 142 and 144. The adoption had no effect on the Company's financial position or results of operations. Management is currently evaluating the impact of FAS No. 143 on financial position and results of operations.

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

#### General

The Company's principal line of business is the production and sale of its oil and natural gas reserves located in North America. Results of operations are dependent upon the quantity of production and the price obtained for such production. Prices received by the Company for the sale of its oil and natural gas have fluctuated significantly from period to period. Such fluctuations affect the Company's ability to maintain or increase its production from existing oil and gas properties and to explore, develop or acquire new properties.

The following table reflects certain operating data for the periods presented:

For the  
three months

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	ended March 31,	
	2002	2001
Production:		
United States		
Oil (MBbls).....	125	66
Gas (MMcf).....	1,467	755
Total gas equivalents (MMcfe).....	2,217	1,151
Canada:		
Oil (MBbls).....	66	28
Gas (MMcf).....	1,612	1,150
Total gas equivalents (MMcfe).....	2,008	1,318
Total:		
Oil (MBbls).....	191	94
Gas (MMcf).....	3,079	1,905
Total gas equivalents (MMcfe).....	4,225	2,469
Average sales prices:		
United States:		
Oil (per Bbl).....	\$19.84	\$27.31
Gas (per Mcf).....	2.49	6.27
Canada:		
Oil (per Bbl).....	17.75	25.59
Gas (per Mcf).....	2.10	5.19
Weighted average:		
Oil (per Bbl).....	19.12	26.80
Gas (per Mcf).....	2.29	5.62
Selected data per Mcfe:		
Average sales price.....	\$ 2.53	\$ 5.36
Production costs.....	0.90	0.64
General and administrative expenses.....	0.18	0.19
Oil and gas depreciation, depletion and amortization.....	0.97	0.76

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Results of Operations

Three Months Ended March 31, 2002 Compared to Three Months Ended March 31, 2001

Overview. The Company recorded first quarter 2002 net income of \$1,046,000, or \$0.08 per share. This compares to net income of \$6,206,000 or \$0.71 per share recorded in the first quarter of 2001. This decrease results primarily from lower oil and gas prices, partially offset by higher volumes resulting from the merger with Southern Mineral. Net cash provided by operating activities was \$2.5 million for the quarter ended March 31, 2002 compared to net cash provided of \$14.1 million for the corresponding quarter of 2001.

Revenues. Total revenues decreased 18% to \$11.5 million in the first quarter of 2002 compared to \$14.1 million in the first quarter of 2001, primarily due to commodity price decreases. The Company's natural gas production increased 62% to 3,079 MMcf from 1,905 MMcf and oil production increased 103% to 191 MBbls from 94 MBbls, resulting in the Company's overall equivalent production increasing 71% to 4,225 MMcfe from 2,469 MMcfe. The increase in oil and gas production reflects the impact of the merger with Southern Mineral,

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partially offset by normal production declines.

The Company's composite average oil price decreased 29% to \$19.12 per barrel in the first quarter of 2002 from \$26.80 per barrel in the first quarter of 2001. The Company's average U.S. natural gas price decreased 60% to \$2.49 per Mcf in the first quarter of 2002 from \$6.27 per Mcf in the prior year quarter, while the average Canadian natural gas price decreased 60% to \$2.10 per Mcf in the first quarter of 2002 from \$5.19 per Mcf for 2001. The significant decrease in prices, partially offset by the increase in production volumes, resulted in a 19% decrease in oil and gas revenues to \$10.7 million in the first quarter of 2002 from \$13.2 million in the prior year.

**Production Costs.** Production costs increased 142% to \$3.8 million in the first quarter of 2002 as a result of the addition of the Southern Mineral properties, which have higher processing costs related to heavy oil in Canada and high sulfur production in Alabama. Production costs per Mcfe increased to \$0.90 per Mcfe in the first quarter of 2002, compared to \$0.64 in the corresponding prior year period.

**Depreciation, Depletion & Amortization (DD&A).** Total DD&A increased 101% to \$4.5 million in the first quarter of 2002. The composite oil and gas DD&A rate increased 28% to \$0.97 per Mcfe from \$0.76 per Mcfe. This reflects the impact of the cost of the Southern Mineral properties added to the full cost pool.

**General and Administrative Expenses.** General and administrative expenses increased 43% to \$686,000 in the first quarter of 2002 from \$479,000 in the first quarter of 2001 due to higher fees paid to Kaiser-Francis for the management of the additional Southern Mineral properties.

**Investment Income.** Investment income decreased 21% to \$30,000 in the first quarter of 2002 from \$38,000 in the first quarter of 2001 due to excess cash being used to pay down debt.

**Interest Expense.** Interest expense increased 233% to \$729,000 in the first quarter of 2002 from \$219,000 in the prior year quarter, reflecting additions to outstanding debt to finance the Southern Mineral acquisition.

**Other Income.** Other income decreased to \$163,000 in the first quarter of 2002 from \$1,278,000 in the corresponding period of 2001. This was primarily due to a realized translation gain for the short-term investment of Canadian assets in US dollar denominated accounts recorded during the first quarter of 2001.

**Income Taxes.** The Company recorded a \$597,000 income tax expense with an effective tax rate of 36% on a pre-tax income of \$1,643,000 in the first quarter of 2002. This compares to an income tax expense of \$4,337,000 with an effective tax rate of 41% on pre-tax income of \$10.5 million in the first quarter of 2001. The lower effective rate is due to the impact that reduced commodity prices have on non-deductible Crown royalties and the resource allowance deduction used in the calculation of Canadian income taxes.

### Liquidity and Capital Resources

As of March 31, 2002, the Company had working capital of \$7.7 million as compared to \$4.0 million at December 31, 2001. Net cash provided by operating activities was \$2.5 million for the three months ended March 31, 2002 compared to \$14.1 million for the corresponding three months of 2001 primarily due to reduced oil and gas prices.

The Company's total capital expenditures were \$2.4 million and \$1.8

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million for the three months ended March 31, 2002 and 2001, respectively, primarily related to exploration and development.

No sales of oil and gas properties occurred in the first three months of either 2002 or 2001.

In July 2000, the Company entered into a \$75 million revolving credit agreement with the Toronto-Dominion Bank (TD Bank), the agent, and the Bank of Nova Scotia. The term of the facility is through April 30, 2003 and the initial borrowing base was set at \$58 million. Borrowings can be funded by either Eurodollar loans or Base Rate loans. The interest rate on the borrowings is equal to an interest rate spread plus either the Eurodollar rate or the Base Rate. The interest spread is determined from a sliding scale based on the Company's borrowing base percentage utilization in effect from time to time. The spread ranges from 1.25 to 2.25 on Eurodollar loans and .25 to 1.25 on Base Rate loans. At March 31, 2002, the Company had a total of \$48 million outstanding under the revolver and \$10 million available based on the current borrowing base, as defined, subject to certain limitations. During the first quarter of 2002, the average interest rate under this facility was approximately 4.1%.

The Company has historically funded its capital expenditures, which are discretionary, and working capital requirements with cash flow from operations, debt and equity capital and participation by institutional investors. If the Company increases its capital expenditure level in the future or operating cash flow is not as expected, capital expenditures may require additional funding, obtained through borrowings from commercial banks and other institutional sources or by public or private offerings of equity or debt securities.

Other

In June 2001, the Financial Accounting Standards Board ("FASB") issued FAS No. 142, Goodwill and Other Intangible Assets, and FAS No. 143, Accounting for Asset Retirement Obligations, and in August 2001, FAS No. 144, Accounting for Impairment or Disposal of Long-Lived Assets. Effective January 1, 2002, the Company adopted FAS No. 142 and 144. The adoption had no effect on the Company's financial position or results of operations. Management is currently evaluating the impact of FAS No. 143 on financial position and results of operations.

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### Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Company's primary sources of market risk are from fluctuations in commodity prices, interest rates and exchange rates.

#### Commodity Price Risk

The Company produces and sells natural gas, crude oil, condensate, natural gas liquids and sulfur. As a result, the Company's financial results can be significantly affected as these commodity prices fluctuate widely in response to changing market forces. The Company has previously utilized hedging transactions to manage its exposure to price fluctuations on its sales of oil and natural gas.

The merger with Southern Mineral resulted in PetroCorp assuming crude oil and natural gas costless collars. The impact of hedging transactions for the three months ended March 31, 2002 increased oil and gas revenues by \$280,000. The fair value at March 31, 2002 of the crude oil and natural gas collars was a liability of \$46,000. There were no outstanding hedges at March 31, 2001. All assumed oil and gas hedging transactions will expire by the fourth quarter of 2002.

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Subsequent to March 31, 2002, the Company entered into a swap transaction covering 8,000 MMBTU of natural gas per day at a price of \$3.755 per MMBTU and covering the period from May 2002 through December 2002. The swap index is NYMEX Henry Hub.

### Interest Rate Risk

As a result of the merger with Southern Mineral, the Company assumed an interest rate swap position that was originally intended to hedge the variability of interest expense associated with Southern Mineral's variable rate Canadian debt. Under the swap agreement, the Company receives a floating rate of the Canadian prime rate and pays a fixed rate of 5.96% on a notional amount of Canadian \$15 million through August 29, 2003. The interest rate swap does not qualify for hedge accounting at March 31, 2002 and the Company has recorded the swap's fair value of \$192,000 as a liability at the date of the merger. The estimated fair value at March 31, 2002 is a liability of \$161,000.

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### PART II. OTHER INFORMATION

#### Item 1 - Legal Proceedings

Not Applicable

#### Item 2 - Changes in Securities

Not Applicable

#### Item 3 - Defaults upon Senior Securities

Not Applicable

#### Item 4 - Submission of Matters to Vote of Security Holders

Not Applicable

#### Item 5 - Other Information

Not Applicable

#### Item 6 -

##### (a) Exhibits

Not Applicable

##### (b) Reports on Form 8-K

Not Applicable

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### SIGNATURES

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

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PETROCORP INCORPORATED

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(Registrant)

Date: May 7, 2002

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/s/ STEVEN R. BERLIN

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Steven R. Berlin

Chief Financial Officer and Secretary  
(On behalf of the Registrant and as the  
Principal Financial Officer)