PETROCORP INC
Form 10-Q
November 06, 2001

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 September 30, 2001

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

PETROCORP INCORPORATED
(Exact name of registrant as specified in its charter)

Texas	76-0380430
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
6733 South Yale Tulsa, Oklahoma	74136
(Address of Principal Executive Offices)	(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 _____

Indicate the number of shares outstanding of each of the Registrant's classes of stock, as of October 30, 2001:

Common Stock, $.01 per value	12,818,316

(Title of Class) (Number of Shares Outstanding)

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

(in thousands, except share amounts)
(Unaudited)

	September 30, 2001	December 31 2000
Assets		
Current assets:		
Cash and cash equivalents	$ 590	$ 21,9
Accounts receivable, net	13,269	13,3
Other current assets	1,141	6
Total current assets	15,000	35,8
Property, plant and equipment:		
Oil and gas properties, at cost, full cost method, net of accumulated depreciation, depletion and amortization	148,781	68,4
Plant and related facilities, net	1,699	2,4
Other, net	33	
	150,513	70,9
Deferred income taxes	7,862	10,2
Other assets, net	2,851	2
Total assets	$ 176,226	$ 117,3
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 11,274	$ 17,7
Accrued liabilities	6,628	2,4
Income tax payable	26	5,4
Current portion of long-term debt	1,226	1,1
Total current liabilities	19,154	26,8
Long-term debt	37,249	29,9
Deferred income taxes	15,866	6,1
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, 12,810,716 and 8,703,719 shares outstanding as of September 30, 2001 and December 31, 2000, respectively	128	
Additional paid-in capital	111,051	71,6
Accumulated retained earnings (deficit)	142	(11,7
Accumulated other comprehensive loss	(7,280)	(5,7
Treasury stock, at cost (9,500 shares)	(84)	
Total shareholders' equity	103,957	54,2
Total liabilities and shareholders' equity	$ 176,226	$ 117,3

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

See notes 4 and 7 specifically for information regarding the Southern Mineral merger.

PETROCORP INCORPORATED

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share amounts)
(Unaudited)

	For the three months ended September 30,		For the n ended Sep
	2001	2000	2001
Revenues:			
Oil and gas	$12,867	$10,956	$37,747
Plant processing	468	668	1,381
Other	472	163	1,204
	13,807	11,787	40,332
Expenses:			
Production costs	3,972	2,396	8,447
Depreciation, depletion and amortization	3,988	2,474	9,163
General and administrative	739	428	1,729
Restructuring costs	-	-	-
Other operating expenses	379	67	1,080
	9,078	5,365	20,419
Income from operations	4,729	6,422	19,913
Other income (expenses):			
Investment income	17	147	111
Interest expense	(832)	(813)	(1,500)
Other income (expenses)	1,077	105	1,302
	262	(561)	(87)
Income before income taxes	4,991	5,861	19,826

Income tax provision:			
Current	1,670	1,079	5,373
Deferred	272	1,518	2,599
	1,942	2,597	7,972
Net income before extraordinary item	3,049	3,264	11,854
Extraordinary item - extinguishment of debt (less Applicable income taxes of $143,000)	-	-	-
Net income	$ 3,049	$ 3,264	$11,854
Net income per common share - basic:			
Income before extraordinary item	$0.24	$0.38	$1.14
Extraordinary item	-	-	-
Net income	$0.24	$0.38	$1.14
Net income per common share - diluted:			
Income before extraordinary item	$0.24	$0.37	$1.12
Extraordinary item	-	-	-
Net income	$0.24	$0.37	$1.12
Weighted average number of common shares - basic	12,778	8,694	10,439
Weighted average number of common shares - diluted	12,911	8,822	10,596

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

See notes 4 and 7 specifically for information regarding the Southern Mineral merger.

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PETROCORP INCORPORATED

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)
(Unaudited)

	For the nine months ended September 30,	
	2001	2000
Cash flows from operating activities:		
Net income	$ 11,854	$ 7,104
Adjustments to reconcile net income to net		

cash provided by operating activities:		
Depreciation, depletion and amortization	9,163	6,748
Deferred income tax expense	1,609	2,785
Gain realized on foreign currency translation	(948)	-
Other	142	49
Changes in operating assets and liabilities:		
Accounts receivable	6,363	(3,304)
Other current assets	(30)	(343)
Accounts payable	(9,879)	3,403
Accrued liabilities	3,989	(1,353)
Income tax payable	(5,537)	2,462
Net cash provided by operating activities	16,726	17,551
Cash flows from investing activities:		
Additions to oil and gas properties	(11,408)	(5,573)
Additions to plant and related facilities	(260)	(464)
Purchase of treasury shares	(84)	-
Purchase of Southern Mineral Corporation net assets	(21,192)	-
Net cash used in investing activities	(32,944)	(6,037)
Cash flows from financing activities:		
Proceeds from long-term debt	120,527	15,913
Repayment of long-term debt	(125,571)	(28,125)
Other	718	(114)
Net cash used in financing activities	(4,326)	(12,326)
Effect of exchange rate changes on cash	(812)	(178)
Net increase (decrease) in cash and cash equivalents	(21,356)	(990)
Cash and cash equivalents at beginning of period	21,946	12,899
Cash and cash equivalents at end of period	$ 590	$ 11,909

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

See notes 4 and 7 specifically for information regarding the Southern Mineral merger.

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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, 2000, included in the Company's 2000 Annual Report on Form 10-K 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.

NOTE 2 - RESTRUCTURING:

As part of a restructuring plan, on August 3, 1999, PetroCorp's Board of Directors entered into a Management Agreement with its largest shareholder, Kaiser-Francis Oil Company ("Kaiser-Francis"), under which Kaiser-Francis provides management, technical, and administrative support services for all PetroCorp operations in the United States and Canada. The following table shows the change in accrued restructuring costs (in thousands):

	Balance at December 31, 2000	Expenditures charged against accrual	Changes in estimates	Balance at September 30, 2001
Office lease discontinuance and other related costs	$ 70	$ 44	-	$ 26

NOTE 3 - 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 adjustment and derivative cash flow hedges.

The Company's comprehensive income for the three and nine months ended September 30, 2001 and 2000 is as follows (in thousands):

	For the three months ended September 30,		For the nine months ended September 30	
	2001	2000	2001	
Net income (loss)	$ 3,049	$ 3,264	$ 11,854	$
Derivative hedging gain (loss) (net of taxes of $389 and $613, respectively)	531	-	921	
Foreign currency translation gain (loss)	(2,538)	(454)	(2,489)	(
Comprehensive income (loss)	$ 1,042	$ 2,810	$ 10,286	$

NOTE 4 - MERGER WITH SOUTHERN MINERAL CORPORATION:

PetroCorp completed the acquisition of Southern Mineral on June 6, 2001. Southern Mineral shareholders could elect to receive .471 shares of PetroCorp common stock or cash of $4.71 or some combination thereof for each share of Southern Mineral common stock they owned. Based on elections of Southern Mineral shareholders, PetroCorp issued 4 million shares (valued at approximately $39 million) and paid cash of approximately $21.2 million. The cash consideration includes cash due to warrant and option holders, net of cash received from the exercise of Southern Mineral warrants and options. The totals do not reflect 800,336 shares of Southern Mineral purchased by PetroCorp in open market transactions prior to the merger for $3.4 million. THE FOLLOWING INFORMATION IS BASED ON A PRELIMINARY ANALYSIS OF THE TRANSACTION AND IS SUBJECT TO CHANGE WHEN THE FINAL ANALYSIS IS COMPLETE.

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 purchase price allocation is (amounts in thousands):

Issuance of common stock (net of $380 registration costs)	$ 38,618
Net cash to Southern Mineral stockholders and warrant holders	20,768
Legal, professional and other costs	424
Assumed liabilities and debt and liabilities incurred	29,169
Total purchase consideration	$ 88,979
Fair value of assets and liabilities acquired	
Current assets	$ 5,666
Property, plant and equipment	80,150
Other assets	3,163
Current liabilities	(6,608)
Debt assumed by PetroCorp	(12,583)
Deferred income taxes	(9,978)
	$ 59,810

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)

	Nine Months Ended September 30, 2001	Nine Months Ended September 30, 2000

Revenues............................	$ 54,545	$ 52,757
Income before income taxes..........	$ 20,771	$ 14,968
Net income..........................	$ 12,430	$ 8,523
Earnings per common share - basic....	$ 0.98	$ 0.67
Earnings per common share - diluted..	$ 0.97	$ 0.67

The above pro forma data reflects $3,665 and $5,188, respectively, of bankruptcy expenses and restructuring costs (primarily investment banker and employee severance related costs) for Southern Mineral for the nine months ended September 30, 2001 and 2000.

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NOTE 5 - 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):

			Per Share A	
	Net Income	Shares	Net income before extraordinary item	Ext
THREE MONTHS ENDED SEPTEMBER 30, 2001				
Basic EPS:				
Net income....................	$ 3,049	12,778	$ 0.24	
Effect of dilutive securities:				
Options.......................	-	133	-	
Diluted EPS:				
Net income....................	$ 3,049	12,911	$ 0.24	
2000				
Basic EPS:				
Net income....................	$ 3,264	8,694	$ 0.38	
Effect of dilutive securities:				
Options.......................	-	128	(0.01)	
Diluted EPS:				
Net income....................	$ 3,264	8,822	$ 0.37	
NINE MONTHS ENDED SEPTEMBER 30, 2001				
Basic EPS:				
Net income....................	$11,854	10,439	$ 1.14	
Effect of dilutive securities:				
Options.......................	-	157	(0.02)	
Diluted EPS:				
Net income....................	$11,854	10,596	$ 1.12	
2000				

Basic EPS:			
Net income (A)................	$ 7,104	8,688	$ 0.85
Effect of dilutive securities:			
Options......................	-	69	(0.01)
Diluted EPS:			
Net loss.....................	$ 7,104	8,757	$ 0.84

/(A)/ Net of extraordinary loss of $242,000 ($0.03 per share).

The net income per share amounts do not include the effect of potentially dilutive securities of 420,000 and 389,000 for the three months ended September 30, 2001 and 2000, respectively, and 469,000 and 549,000 for the nine months ended September 30, 2001 and 2000, respectively, as the impact of these outstanding options was antidilutive.

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NOTE 6 - HEDGING ACTIVITIES:

On June 15, 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS 133, as amended, requires that all derivative instruments be recorded on the balance sheet at their fair value. Changes in the fair value of derivatives will be recorded each period in current earnings or other comprehensive income (only certain types of hedge transactions are reported as a component of other comprehensive income). Additionally, for all hedging transactions the nature and type of hedge will be disclosed. The Company adopted SFAS 133 in January 2001.

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 the hedged production.

In the first quarter of 2000, the Company entered into swap transactions in an effort to lock in a portion of higher oil prices. These transactions applied to approximately 50 percent of the Company's projected oil production from April 2000 through December 2000, at prices ranging from $23.57 to $29.00 per barrel. Oil and gas revenue includes $69,000 received and $434,000 in settlement of swap transactions through September 30, 2000. In the second quarter of 2000, the Company entered into a no-cost collar arrangement by which 180,000 MMbtu for each of the months July through October 2000 were subject to a $4.96 ceiling and a $3.50 floor per MMbtu. The Company determined that the estimated fair value of the outstanding hedges at September 30, 2000 was not significant.

As part of PetroCorp's acquisition of Southern Mineral Corporation ("Southern Mineral"), the Company assumed crude oil and natural gas costless collars which have the following outstanding at September 30, 2001:

Oil Hedges

Period	Total Bbl	Monthly Bbl

Period		
United States and Canada		
Oct-01--Dec-01	59,289	19,763
Jan-02--Sep-02	158,500	17,611

Gas Hedges

Period	Total MMbtu	Monthly MMbtu
United States		
Oct-01	84,833	84,833
Nov-01--Mar-02	378,000	75,600
Apr-02--Oct-02	466,000	66,571

Period	Total Gigajoules	Monthly Gigajoules
Canada		
Oct-01--Sep-02	600,000	50,000

Based on September 30, 2001 prices, a 10% change in oil and gas prices will not cause the Company's obligation under the costless collars to have a material adverse effect on the financial position or results of operations of the Company. Hedging transactions for the three and nine months ended September 30, 2001 reduced oil and gas revenues by $16,000 and $45,000, respectively (reclassified from comprehensive income). The estimated fair value at September 30, 2001 of the crude oil and natural gas collars was a receivable of $704,000.

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The Company offsets any gain or loss on the swap and collars contract 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.

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. The interest rate swap does not qualify for hedge accounting at September 30, 2001 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 September 30, 2001 is a liability of $423,000.

NOTE 7 - PROPERTY, PLANT AND EQUIPMENT:

Investments in property, plant and equipment were as follows at September 30, 2001 and December 31, 2000 (amounts in thousands):

	2001	2000
Oil and gas properties............................	$ 316,412	$ 228,845

Plant and related facilities......................	9,714	9,969
Gas gathering facilities..........................	1,698	1,698
Furniture, fixtures and equipment.................	33	-
	327,857	240,512
Less - accumulated depreciation, depletion		
And amortization................................	(177,344)	(169,576)
	$ 150,513	$ 70,936

These values include the preliminary allocation of the purchase price of Southern Mineral and are subject to change. See Note 8.

As more fully described in the Company's 10-K, PetroCorp utilizes the full cost method of accounting for costs related to its oil and natural gas properties. Under this method, capitalized costs are subject to a ceiling test, evaluated each quarter, which limits such pooled costs to the aggregate of the present value of future net revenues attributable to proved gas and oil reserves discounted at 10 percent plus the lower of cost or market value of unproved properties. At September 30, 2001, the Company's unamortized costs of oil and gas properties exceeded this ceiling amount by approximately $20 million due to low gas prices in effect on that date. The cash spot price for natural gas in the US and Canada was $1.86 and $1.18, respectively, on September 30, 2001. However, due to the subsequent recovery in the market prices for natural gas the Company was not required to record a write-down of its oil and gas properties. A decline in gas and oil prices from current levels, or other factors, without other mitigating circumstances, could cause a future write-down of capitalized costs and a non-cash charge against future earnings.

NOTE 8 - 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 September 30, 2001, the weighted average interest rate under this facility was approximately 6.7%.

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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 tangible net worth, and a minimum interest coverage ratio.

As a result of the merger with Southern Mineral, the Company assumed Southern Mineral's outstanding debt of $11.3 million subject to a US credit facility with Bank One and $1.3 million subject to a Canadian loan facility with the Canadian branch of the same lender. At the time of the merger, PetroCorp obtained loan waivers which reduced the facility amounts to $15 million subject to the US facility and C$3 million under the Canadian facility. The Company paid off outstanding debt and closed these facilities in the third quarter of 2001.

NOTE 9 - 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
Three months ended September 30, 2001:			
Revenues..............................	$ 6,119	$ 7,688	$ -
Income (loss) from operations..........	602	4,868	(741)
Three months ended September 30, 2000:			
Revenues..............................	$ 6,782	$ 5,005	$ -
Income (loss) from operations..........	3,804	3,046	(428) /(
Nine months ended September 30, 2001:			
Revenues..............................	$19,160	$21,172	$ -
Income (loss) from operations..........	7,999	13,644	(1,730)
Long-lived assets at September 30......	94,379 /(B)/	66,687	160
Nine months ended September 30, 2000:			
Revenues..............................	$16,381	$12,309	$ -
Income (loss) from operations..........	8,093	7,452	(889) /(
Long-lived assets at September 30......	53,569 /(B)/	50,159	203

/(A)/ Net of $500 restructuring cost reversal (credit).
/(B)/ Includes deferred tax assets of $7,862 and $11,817 for September 30, 2001 and 2000, respectively.

NOTE 10 - RECENT ACCOUNTING PRONOUNCEMENTS:

In June 2001, the Financial Accounting Standards Board ("FASB") issued FAS No. 141 and 142. FAS No. 141, Business Combinations, requires the purchase method of accounting be used for all business combinations initiated after June 30, 2001. FAS No. 142, Goodwill and Other Intangible Assets, changes the accounting for goodwill from an amortization method to an impairment-only approach and will be effective January, 2002. The Company believes that adoption of these new standards will not have an effect on its results of operations or its financial position. In June 2001, the FASB issued FAS No. 143, Accounting for Asset Retirement Obligations, and in August 2001, FAS No. 144, Accounting for Impairment or Disposal of Long-Lived Assets. Management is currently evaluating the impact of FAS 143 and 144 on financial position and results of operations.

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NOTE 11 - COMMON STOCK REPURCHASES:

On September 14, 2001, the Company announced that the Board of Directors authorized the purchase of up to 1,000,000 shares of the Company's stock.

Through October 31, 2001, 334,470 shares have been purchased at a cost of $2,972,000.

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 ended September 30,		Fo nine ended Se
	2001	2000	2001
Production:			
United States:			
Oil (MBbls)	112	74	269
Gas (MMcf)	1,247	1,162	2,907
Total gas equivalents (MMcfe)	1,919	1,606	4,521
Canada:			
Oil (MBbls)	77	25	147
Gas (MMcf)	1,360	1,180	3,795
Total gas equivalents (MMcfe)	1,822	1,330	4,677
Total:			
Oil (MBbls)	189	99	416
Gas (MMcf)	2,607	2,342	6,702
Total gas equivalents (MMcfe)	3,741	2,936	9,198
Average sales prices:			
United States:			
Oil (per Bbl)	$25.14	$25.76	$26.18
Gas (per Mcf)	2.55	4.13	4.08
Canada:			
Oil (per Bbl)	21.62	24.75	22.59
Gas (per Mcf)	3.81	3.06	4.09
Weighted average:			
Oil (per Bbl)	23.71	25.50	24.91
Gas (per Mcf)	3.21	3.59	4.09
Selected data per Mcfe:			
Average sales price	$ 3.44	$ 3.73	$ 4.10
Production costs	1.06	0.82	0.92
General and administrative expenses	0.20	0.15	0.19
Oil and gas depreciation, depletion and amortization	0.92	0.71	0.86

Results of Operations

Three Months Ended September 30, 2001 Compared to Three Months Ended September 30, 2000

Overview. The Company recorded third quarter 2001 net income of $3,049,000, or $0.24 per share. This compares to net income of $3,264,000 or $0.38 per share recorded in the third quarter of 2000. The decrease in net income results from lower oil and gas prices offset by volume increases primarily due to the merger with Southern Mineral. Net cash provided by operating activities was $4.2 million for the quarter ended September 30, 2001 compared to net cash provided of $9.6 million for the corresponding quarter of 2000.

Revenues. Total revenues increased 17% to $13.8 million in the third quarter of 2001 compared to $11.8 million in the third quarter of 2000, primarily due to volume increases associated with the merger with Southern Mineral. The Company's natural gas production increased 11% to 2,607 MMcf from 2,342 MMcf and oil production increased 91% to 189 MBbls from 99 MBbls, resulting in the Company's overall equivalent production increasing 27% to 3,741 MMcfe from 2,936 MMcfe. The increase in oil and gas production is primarily due to the merger with Southern Mineral as well as several new wells coming on-line in Canada.

The Company's composite average oil price decreased 7% to $23.71 per barrel in the third quarter of 2001 from $25.50 per barrel in the third quarter of 2000. The Company's average U.S. natural gas price decreased 38% to $2.55 per Mcf in the third quarter of 2001 from $4.13 per Mcf in the prior year quarter, while the average Canadian natural gas price increased 25% to $3.81 per Mcf in the third quarter of 2001 from $3.06 per Mcf for 2000. Increased volumes from the merger with Southern Mineral, offset by price decreases, resulted in a 17% increase in oil and gas revenues to $12.9 million in the third quarter of 2001 from $11.0 million in the prior year.

Production Costs. Production costs increased 67% to $4.0 million in the third quarter of 2001 as a result of the costs associated with the additional wells acquired in the merger with Southern Mineral and increased production taxes related to higher commodity prices. Production costs per Mcfe increased by 29% to $1.06 per Mcfe in the third quarter of 2001.

Depreciation, Depletion & Amortization (DD&A). Total DD&A increased 60% to $4.0 million in the third quarter of 2001. The composite oil and gas DD&A rate increased 30% to $0.92 per Mcfe from $0.71 per Mcfe. This reflects the impact of the Southern Mineral acquisition and previously unevaluated properties evaluated in late 2000 and moved to the full cost pool.

General and Administrative Expenses. General and administrative expenses increased 73% to $739,000 in the third quarter of 2001 from $428,000 in the third quarter of 2000 as a result of costs associated with the transition of processing from and the shut down of Southern Mineral offices.

Investment Income. Investment income decreased 88% to $17,000 in the third quarter of 2001 from $147,000 in the third quarter of 2000 due to excess cash being used to pay down debt.

Interest Expense. Interest expense increased 2% to $832,000 in the third quarter of 2001 from $813,000 in the prior year quarter, reflecting additional debt associated with the merger with Southern Mineral offset by lower interest rates. The Liquidity and Capital Resources section further describes changes in debt.

Other Income. Other income includes a $0.6 million realized translation gain on the short-term investment of Canadian assets in US dollar denominated accounts during the third quarter of 2001.

Income Taxes. The Company recorded a $1,942,000 income tax expense with an effective tax rate of 39% on a pre-tax income of $4,991,000 in the third quarter of 2001. This compares to an income tax expense of $2,597,000 with an effective tax rate of 44% on pre-tax income of $5,861,000 million in the third quarter of 2000.

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Nine Months Ended September 30, 2001 Compared to Nine Months Ended September 30, 2000

Overview. The Company recorded a first nine months 2001 net income of $11,854,000, or $1.14 per share. This compares to net income of $7,104,000, or $0.82 per share recorded in the first nine months of 2000. This improvement results from higher oil and gas prices and volume increases primarily due to the merger with Southern Mineral. Net cash provided by operating activities was $16.7 million for the nine months ended September 30, 2001 compared to $17.6 million for the corresponding nine months of 2000.

Revenues. Total revenues increased 40% to $40.3 million in the first nine months of 2001 compared to $28.7 million in the first nine months of 2000, primarily due to volume increases from the merger with Southern Mineral. The Company's natural gas production increased 9% to 6,702 MMcf from 6,129 MMcf and oil production increased 32% to 416 MBbls from 314 MBbls, resulting in the Company's overall equivalent production increasing 15% to 9,198 MMcfe from 8,013 MMcfe. The increase in natural gas production is primarily the result of the merger with Southern Mineral as well as several new wells coming on-line in both Canada and the US. The increase in oil production also reflects the merger with Southern Mineral.

The Company's composite average oil price decreased 7% to $24.91 per barrel in the first nine months of 2001 from $26.72 per barrel in the first nine months of 2000. The Company's average U.S. natural gas price increased 19% to $4.08 per Mcf in the first nine months of 2001 from $3.43 per Mcf in the prior year, while the average Canadian natural gas price increased 56% to $4.09 per Mcf in the first nine months of 2001 from $2.62 per Mcf in 2000. The significant increase in gas prices, as well as the increased production volumes, resulted in a 41% increase in oil and gas revenues to $37.7 million in the first nine months of 2001 verses $26.8 million in the prior year nine months.

Production Costs. Production costs increased 38% to $8.4 million in the first nine months of 2001 as a result of additional wells acquired in the merger with Southern Mineral. Production costs per Mcfe increased 19% to $0.92 per Mcfe in the first nine months of 2001 from $0.77 in the same nine months of 2000.

Depreciation, Depletion & Amortization (DD&A). Total DD&A increased 37% to $9.2 million in the first nine months of 2001 from $6.7 million in the first nine months of 2000. The composite oil and gas DD&A rate increased 23% to $0.86 per MMcfe from $0.70 per MMcfe. This reflects the impact of the Southern Mineral acquisition and previously unevaluated properties evaluated in late 2000 and moved to the full cost pool.

General and Administrative Expenses. General and administrative expenses increased 24% to $1,729,000 in the first nine months of 2001 from $1,389,000 in the first nine months of 2000 as a result of costs associated with the transition of processing from and the shut down of Southern Mineral offices.

Restructuring Costs. The Company recorded a $0.5 million credit against restructuring costs in the first nine months of 2000 primarily because the Houston office space was leased to an outside party and the Company's obligation ended.

Investment Income. Investment income decreased 79% to $111,000 in the first nine months of 2001 from $524,000 in the first nine months of 2000 due to lower interest rates and excess cash being used to pay down debt.

Interest Expense. Interest expense decreased 47% to $1,500,000 in the first nine months of 2001 from $2,831,000 in the prior year first nine months, reflecting the impact of rate decreases and lower debt levels over most of the period. The Liquidity and Capital Resources section further describes changes in debt.

Income Taxes. The Company recorded a $7,972,000 income tax expense with an effective tax rate of 40% on pre-tax income of $19.8 million in the first nine months of 2001. This compares to an income tax expense of $5,296,000 with an effective tax rate of 42% on pre-tax income of $12.6 million in the first nine months of 2000.

Liquidity and Capital Resources

As of September 30, 2001, the Company had working capital of negative $4.2 million as compared to positive $9.0 million at December 31, 2000. Net cash provided by operating activities was $16.7 million for the nine months ended September 30, 2001 compared to $17.6 million for the corresponding nine months of 2000.

The Company's total capital expenditures were $71.5 million ($32.9 million cash expenditure), which includes the Southern Mineral acquisition, and $6.0 million for the nine months ended September 30, 2001 and 2000, respectively, primarily related to the acquisition of Southern Mineral in 2001 and exploration and development in both years.

No sales of oil and gas properties occurred in the first nine months of either 2001 or 2000.

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 September 30, 2001, the Company had a total of $36.6 million outstanding under the revolver and $21.4 million available based on the current borrowing base, as defined, subject to certain limitations. During the first nine months of 2001, the average interest rate under this facility was approximately 6.9%.

The Company has historically funded its capital expenditures and working capital requirements with its 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.

Merger with Southern Mineral

As indicated in Note 4 to the financial statements, PetroCorp completed its merger with Southern Mineral Corporation on June 6, 2001. Funds needed to complete this transaction were provided by cash on hand and borrowings under existing lines of credit. As a result of the merger with Southern Mineral, the Company assumed Southern Mineral's outstanding debt of $11.3 million subject to a US credit facility with Bank One and $1.3 million subject to a Canadian loan facility with the Canadian branch of the same lender. The Company paid off all Bank One loans during the third quarter by utilizing the existing TD Bank credit facility. The Bank One credit facilities were terminated during the third quarter.

Common Stock Repurchases

On September 14, 2001, the Company announced that the Board of Directors authorized the purchase of up to 1,000,000 shares of the Company's stock. Through October 31, 2001, 334,470 shares have been purchased at a cost of $2,972,000.

Other

In June 2001, the Financial Accounting Standards Board ("FASB") issued FAS No. 141 and 142. FAS No. 141, Business Combinations, requires the purchase method of accounting be used for all business combinations initiated after June 30, 2001. FAS No. 142, Goodwill and Other Intangible Assets, changes the accounting for goodwill from an amortization method to an impairment-only approach and will be effective January, 2002. The Company believes that adoption of these new standards will not have an effect on its results of operations or its financial position. In June 2001, the FASB issued FAS No. 143, Accounting for Asset Retirement Obligations, and in August 2001, FAS No. 144, Accounting for Impairment or Disposal of Long-Lived Assets. Management is currently evaluating the impact of FAS 143 and 144 on financial position and results of operations.

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.

As detailed in Note 6 to the financial statements, the merger with Southern Mineral resulted in PetroCorp assuming crude oil and natural gas costless collars. Based on September 30, 2001 prices, a 10% change in oil and gas prices will not cause the Company's obligation under the costless collars to have a material adverse effect on the financial position or results of operations of the Company. The impact of hedging transactions for the nine months ended

September 30, 2001 was a reduction of oil and gas revenues by $45,000. The fair value at September 30, 2001 of the crude oil and natural gas collars was a receivable of $704,000.

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. The interest rate swap does not qualify for hedge accounting at September 30, 2001 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 September 30, 2001 is a liability of $423,000.

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

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.

PETROCORP INCORPORATED
(Registrant)

Date: November 6, 2001

/s/ STEVEN R. BERLIN

Steven R. Berlin
Chief Financial Officer and Secretary
(On behalf of the Registrant and as the
Principal Financial Officer)