

PRIMEENERGY CORP  
Form 10-Q  
May 15, 2007

U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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FORM 10-Q

Quarterly Report under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarterly Period Ended March 31, 2007

Or

Transition Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Transition Period From \_\_\_\_\_ to \_\_\_\_\_

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Commission File Number 0-7406

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PrimeEnergy Corporation

(Exact name of registrant as specified in its charter)

Delaware 84-0637348

(State or other jurisdiction of incorporation or organization)

(IRS employer identification number)

One Landmark Square, Stamford, Connecticut 06901

(Address of principal executive offices)

(203) 358-5700

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicated by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject so such filings required for the past 90 days. Yes  No

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

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

Yes  No

The number of shares outstanding of each class of the Registrant's Common Stock as of May 9, 2007 was: Common Stock, \$0.10 par value, 3,183,731 shares.

PrimeEnergy Corporation

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March 31, 2007

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PrimeEnergy Corporation  
 Consolidated Balance Sheets  
 March 31, 2007 and December 31, 2006

|                                      | March 31,<br>2007<br>(Unaudited) | December 31<br>2006<br>(Audited) |
|--------------------------------------|----------------------------------|----------------------------------|
| <b>ASSETS</b>                        |                                  |                                  |
| Current assets:                      |                                  |                                  |
| Cash and cash equivalents            | \$ 14,339,000                    | \$ 24,653,000                    |
| Restricted cash and cash equivalents | 2,494,000                        | 2,528,000                        |

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|   |                |                |
|---|----------------|----------------|
| Accounts receivable                                     | 30,739,000     | 32,970,000     |
|   | 450,000        | 655,000        |
| Due from related parties                                |                |                |
|   | 1,282,000      | 1,269,000      |
| Prepaid expenses  |                |                |
|   | --             | 6,085,000      |
| Derivative contracts                                    |                |                |
|   | 3,557,000      | 3,521,000      |
| Inventory at cost                                       |                |                |
|   | 406,000        | --             |
| Deferred tax asset                                      |                |                |
|   |                |                |
|   | 53,267,000     | 71,681,000     |
| Total current assets                                    |                |                |
|   |                |                |
| Property and equipment, at cost                         |                |                |
|   | 241,933,000    | 211,740,000    |
| Oil and gas properties (successful efforts method), net |                |                |
|   | 7,385,000      | 7,442,000      |
| Field service equipment and other, net                  |                |                |
|   |                |                |
|   | 249,318,000    | 219,182,000    |
| Net property and equipment                              |                |                |
|   |                |                |
| Other assets  | 468,000        | 729,000        |
|   |                |                |
| Total assets  | \$ 303,053,000 | \$ 291,592,000 |
|   |                |                |

See accompanying notes to the consolidated financial statements.

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PrimeEnergy Corporation  
Consolidated Balance Sheets  
March 31, 2007 and December 31, 2006

March 31,  
2007

December 31,  
2006

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|  | (Unaudited)   | (Audited)     |
|--|---------------|---------------|
| <b>LIABILITIES and STOCKHOLDERS' EQUITY</b>                        |               |               |
| Current liabilities:   |               |               |
| Accounts payable   | \$ 41,318,000 | \$ 42,658,000 |
| Current portion of asset retirement and other long term obligation | 256,000       | 314,000       |
| Current portion of deferred taxes liability                        | --            | 1,961,000     |
| Derivative liability short term                                    | 222,000       | --            |
| Accrued liabilities  | 16,904,000    | 22,030,000    |
| Due to related parties   | 558,000       | 477,000       |
|  | -----         | -----         |
| Total current liabilities  | 59,258,000    | 67,440,000    |
| Long-term bank debt  | 156,400,000   | 136,460,000   |
| Asset retirement obligation  | 6,687,000     | 6,314,000     |
| Derivative liability long term                                     | 1,093,000     | --            |
| Deferred income taxes  | 26,306,000    | 25,367,000    |
|  | -----         | -----         |
| Total liabilities  | 249,744,000   | 235,581,000   |
|  | -----         | -----         |
| Minority Interest  | 1,313,000     | 1,313,000     |
|  | -----         | -----         |

## Stockholders' equity:

|   |                |                |
|---|----------------|----------------|
| Preferred stock, \$.10 par value,<br><br>authorized 5,000,000 shares, none<br>issued                      | --             | --             |
| Common stock, \$.10 par value, authorized<br><br>10,000,000 shares; issued 7,694,970 in<br>2007 and 2006  | 769,000        | 769,000        |
| Paid in capital   | 11,024,000     | 11,024,000     |
| Retained earnings   | 70,142,000     | 66,908,000     |
| Accumulated other comprehensive<br>income(loss), net  | (737,000)      | 3,976,000      |
|   | -----          | -----          |
|   | 81,198,000     | 82,677,000     |
| Treasury stock, at cost, 4,500,649 common<br>shares<br><br>at 2007 and 4,478,145 common shares<br>at 2006 | (29,202,000)   | (27,979,000)   |
|   | -----          | -----          |
| Total stockholders' equity  | 51,996,000     | 54,698,000     |
|   | -----          | -----          |
| Total   | \$ 303,053,000 | \$ 291,592,000 |
|   | =====          | =====          |

See accompanying notes to the consolidated financial statements.



PrimeEnergy Corporation  
Consolidated Statements of Operations  
Three Months Ended March 31, 2007 and 2006

(unaudited)

|  | <u>2007</u>   | <u>2006</u>   |
|--|---------------|---------------|
| Revenue:                                 |               |               |
| Oil and gas sales                        | \$ 20,329,000 | \$ 15,459,000 |
| Field service income                     | 5,887,000     | 4,693,000     |
| Administrative overhead fees             | 2,330,000     | 2,512,000     |
| Interest and other income                | 192,000       | 88,000        |
|  | -----         | -----         |
| Total revenue                            | 28,738,000    | 22,752,000    |
|  | -----         | -----         |
| Costs and expenses:                      |               |               |
| Lease operating expense                  | 6,553,000     | 4,771,000     |
| Field service expense                    | 4,551,000     | 3,802,000     |
| Depreciation, depletion and amortization | 7,690,000     | 3,317,000     |
| General and administrative expense       | 3,110,000     | 3,364,000     |
| Exploration costs                        | 361,000       | 547,000       |

|  |   |              |    |            |
|--|---|--------------|----|------------|
|  |   | -----        |    | -----      |
|  |   | 22,265,000   |    | 15,801,000 |
|  | Total costs and expenses                |              |    |            |
|  |   | -----        |    | -----      |
|  | Income from operations                  | 6,473,000    |    | 6,951,000  |
|  | Less interest expense                   | 1,683,000    |    | 453,000    |
|  | Add gain on sale and exchange of assets | 263,000      |    | 21,000     |
|  |   | -----        |    | -----      |
|  | Net income before income taxes          | 5,053,000    |    | 6,519,000  |
|  |   |              |    |            |
|  | Provision for income taxes              | 1,819,000    |    | 2,541,000  |
|  |   | -----        |    | -----      |
|  | Net income                              | \$ 3,234,000 | \$ | 3,978,000  |
|  |   | =====        |    | =====      |
|  |   |              |    |            |
|  | Basic income per common share           | \$ 1.01      | \$ | 1.20       |
|  |   |              |    |            |
|  | Diluted income per common share         | \$ 0.82      | \$ | .98        |

See accompanying notes to the consolidated financial statements.

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|   | Common<br>Stock |               | Accumulated<br>Other       |                              |                                      |                           |                  |
|---|-----------------|---------------|----------------------------|------------------------------|--------------------------------------|---------------------------|------------------|
|   | <u>Shares</u>   | <u>Amount</u> | <u>Paid In<br/>Capital</u> | <u>Retained<br/>Earnings</u> | <u>Comprehensive<br/>Income/Loss</u> | <u>Treasury<br/>Stock</u> | <u>Total</u>     |
| Balance at<br>December 31,<br>2005                | 7,694,970       | \$ 769,000    | \$11,024,000               | \$48,608,000                 | --                                   | \$(20,665,000)            | \$<br>39,736,000 |
| Purchased<br>110,990 shares<br>of common<br>Stock |                 |               |                            |                              |                                      | (7,314,000)               | (7,314,000)      |
| Net income  |                 |               |                            | 18,300,000                   |                                      |                           | 18,300,000       |
| Other<br>comprehensive<br>income, net of<br>taxes |                 |               |                            |                              | 3,976,000                            |                           | 3,976,000        |
|   | -----           | -----         | -----                      | -----                        | -----                                | -----                     | -----            |
| Balance at<br>December 31,<br>2006                | 7,694,970       | \$ 769,000    | \$11,024,000               | \$66,908,000                 | \$3,976,000                          | \$(27,979,000)            | \$<br>54,698,000 |
| Purchased<br>22,504 shares<br>of common<br>Stock  |                 |               |                            |                              |                                      | (1,223,000)               | (1,223,000)      |
| Net income  |                 |               |                            | 3,234,000                    |                                      |                           | 3,234,000        |
| Other<br>comprehensive<br>income, net of<br>taxes |                 |               |                            |                              | (4,713,000)                          |                           | (4,713,000)      |
|   | -----           | -----         | -----                      | -----                        | -----                                | -----                     | -----            |

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|                              |           |            |              |              |              |                |                  |
|------------------------------|-----------|------------|--------------|--------------|--------------|----------------|------------------|
| Balance at<br>March 31, 2007 | 7,694,970 | \$ 769,000 | \$11,024,000 | \$70,142,000 | \$ (737,000) | \$(29,202,000) | \$<br>51,996,000 |
|                              | =====     | =====      | =====        | =====        | =====        | =====          | =====            |

See accompanying notes to the consolidated financial statements.

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Three Months Ended March 31, 2007 and 2006

(

unaudited)

|   | 2007         | 2006         |
|---|--------------|--------------|
| Cash flows from operating activities:                       |              |              |
| Net income  | \$ 3,234,000 | \$ 3,978,000 |
| Adjustments to reconcile net income to net cash provided by |              |              |
| operating activities:                                       |              |              |
| Depreciation, depletion, amortization and accretion         |              |              |
| on discounted liabilities                                   | 7,690,000    | 3,317,000    |
| Dry hole and abandonment expense                            | 305,000      | 1,010,000    |
| Gain on sale of properties                                  | (263,000)    | (21,000)     |
| Stock based compensation expense                            | --           | 1,313,000    |
| Provision for deferred taxes                                | 1,648,000    | --           |
| Changes in assets and liabilities:                          |              |              |
| Accounts receivable   | 2,190,000    | (1,803,000)  |
|   | 205,000      | (1,513,000)  |

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|   |              |              |
|---|--------------|--------------|
| Due from related parties                            |              |              |
|   | (55,000)     | 3,934,000    |
| Prepaid expense and other assets                    |              |              |
|   | (5,233,000)  | (2,063,000)  |
| Accounts payable                                    |              |              |
|   | 1,861,000    | (2,254,000)  |
| Accrued liabilities                                 |              |              |
|   | 82,000       | 888,000      |
| Due to related parties                              |              |              |
|   | -----        | -----        |
|   | 11,664,000   | 6,786,000    |
| Net cash provided by operating activities:          |              |              |
|   | -----        | -----        |
| Cash flows from investing activities:               |              |              |
|   |              |              |
| Capital expenditures, including exploration expense | (40,958,000) | (7,100,000)  |
|   |              |              |
| Proceeds from sale of property and equipment        | 263,000      | 21,000       |
|   |              |              |
|   | -----        | -----        |
|   | (40,695,000) | (7,079,000)  |
| Net cash (used in) investing activities             |              |              |
|   | -----        | -----        |
| Cash flows from financing activities:               |              |              |
|   |              |              |
| Purchase of treasury stock                          | (1,223,000)  | (1,235,000)  |
|   |              |              |
| Proceeds from long-term bank debt                   | 40,160,000   | 19,485,000   |
|   |              |              |
| Repayment of long-term bank debt                    | (20,220,000) | (19,050,000) |
|   | -----        | -----        |

|  |               |               |
|--|---------------|---------------|
| Net cash provided by (used in) financing activities      | 18,717,000    | (800,000)     |
|  | -----         | -----         |
| Net increase (decrease) in cash and cash equivalents     | (10,314,000)  | (1,093,000)   |
|  |               |               |
| Cash and cash equivalents at the beginning of the period | 24,653,000    | 11,119,000    |
|  | -----         | -----         |
| Cash and cash equivalents at the end of the period       | \$ 14,339,000 | \$ 10,026,000 |
|  | =====         | =====         |

See accompanying notes to the consolidated financial statements.

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PrimeEnergy Corporation

Notes to Consolidated Financial Statements

March 31, 2007

(1) Interim Financial Statements:

The accompanying consolidated financial statements of PrimeEnergy Corporation, with the exception of the consolidated balance sheet at December 31, 2006, have not been audited by independent public accountants. In the opinion of management, the accompanying financial statements reflect all adjustments necessary to present fairly our financial position at March 31, 2007 and our income and cash flows for the three months ended March 31, 2007 and 2006. All such adjustments are of a normal recurring nature. Certain amounts presented in prior period financial statements have been reclassified for consistency with current period presentation. The results for interim periods are not necessarily indicative of annual results.

Recently Issued Accounting Pronouncements

:

In July 2006, the FASB issued FASB Interpretation (FIN) No. 48, "Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109." This interpretation provides guidance for recognizing and measuring uncertain tax positions, as defined in SFAS NO. 109, "Accounting for Income Taxes". FIN NO. 48 prescribes a two-step process for accounting for income tax uncertainties. First, a threshold condition of "more likely than not" should be met to determine whether any of the benefit of the uncertain tax position should be recognized in the financial statements. If the recognition threshold is met, FIN 48 provides additional guidance on measuring the amount of the uncertain tax position. Guidance is also provided regarding derecognition,

classification, interest and penalties, interim period accounting, transition and disclosure of these uncertain tax positions. Effective January 1, 2007, we adopted FASB Interpretation (FIN) No. 48, and it has no effect on our financial statements and related disclosures.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," which establishes a formal framework for measuring fair values of assets and liabilities in financial statements that are already required by U.S. generally accepted accounting principles (GAAP) to be measured at fair value. SFAS No. 157 clarifies guidance in FASB Concepts Statement (CON) NO. 7 which discusses present value techniques in measuring fair value. Additional disclosures are also required for transactions measured at fair value. No new fair value measurements are prescribed, and SFAS No. 157 is intended to codify the several definitions of fair value included in various accounting standards. However, the application of this Statement may change current practices for certain companies. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating what impact SFAS No. 157 may have on its financial position, results of operations or cash flows.

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PrimeEnergy Corporation

Notes to Consolidated Financial Statements

March 31, 2007

In February 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities*" ("SFAS 159"). This statement permits entities to choose to measure many financial instruments and certain other items at fair value. This statement expands the use of fair value measurement and applies to entities that elect the fair value option. The fair value option established by this Statement permits all entities to choose to measure eligible items at fair value at specified election dates. SFAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. We have not determined the effect, if any, the adoption of this statement will have on our financial position or results of operations .

(2) Significant Acquisitions, Dispositions and Property Activity

As more fully described in Note 8, the Company is committed to offer to repurchase the interests of the partners and trust unit holders in certain of the Partnerships. The Company purchased such interests in an amount totaling \$2,438 is for the three months ending March 31, 2007 and \$526,000 for the year ending December 31, 2006. The Company's proportionate share of assets, liabilities and results of operations related to the interests in the Partnerships are included in the consolidated financial statements.



(3) Restricted Cash and Cash Equivalents:

Restricted cash and cash equivalents include \$2,494,000 and \$2,528,000 at March 31, 2007 and December 31, 2006, respectively, of cash primarily pertaining to undistributed royalty payments. There were corresponding accounts payable recorded at March 31, 2007 and December 31, 2006 for these liabilities.

## Notes to Consolidated Financial Statements

March 31, 2007

## (4) Additional Balance Sheet Information

Certain balance sheet amounts are comprised of the following:

|                                       | <u>March 31, 2007</u> | <u>December 31, 2006</u> |
|---------------------------------------|-----------------------|--------------------------|
| <u>Accounts Receivable</u>            |                       |                          |
| :                                     |                       |                          |
| Joint interest billing                | \$ 10,270,000         | \$ 13,054,000            |
| Trade receivables                     | 2,709,000             | 2,367,000                |
| Oil and gas sales                     | 8,503,000             | 8,764,000                |
| Income tax receivable                 | 2,982,000             | 3,023,000                |
| Other                                 | 6,425,000             | 5,912,000                |
|                                       | -----                 | -----                    |
|                                       | \$ 30,889,000         | \$ 33,120,000            |
| Less, allowance for doubtful accounts | (150,000)             | (150,000)                |
|                                       | -----                 | -----                    |
|                                       | \$ 30,739,000         | \$ 32,970,000            |
|                                       | =====                 | =====                    |
| <u>Accounts Payable:</u>              |                       |                          |
| Trade                                 | \$ 33,128,000         | \$ 34,324,000            |
| Royalty and other owners              | 6,224,000             | 6,232,000                |
| Other                                 | 1,966,000             | 2,102,000                |
|                                       | -----                 | -----                    |
| Total                                 | \$ 41,318,000         | \$ 42,658,000            |
|                                       | =====                 | =====                    |

Accrued Liabilities:

|                                   |    |            |    |            |
|-----------------------------------|----|------------|----|------------|
| Compensation and related expenses | \$ | 2,859,000  | \$ | 1,584,000  |
| Property cost                     |    | 9,377,000  |    | 16,188,000 |
| Income tax                        |    | 361,000    |    | 270,000    |
| Other                             |    | 4,307,000  |    | 3,988,000  |
|                                   |    | -----      |    | -----      |
| Total                             | \$ | 16,904,000 | \$ | 22,030,000 |
|                                   |    | =====      |    | =====      |

PrimeEnergy Corporation

Notes to Consolidated Financial Statements

March 31, 2007

(5) Property and Equipment:

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Property and equipment at March 31, 2007 and December 31, 2006 consisted of the following:

|  | March 31,<br>2007 | December 31,<br>2006 |
|--|-------------------|----------------------|
| Proved oil and gas properties, at cost       | \$ 322,474,000    | \$ 284,698,000       |
| Unproved oil and gas properties, at cost     | 4,612,000         | 5,047,000            |
| Less, accumulated depletion and depreciation | (85,153,000)      | (78,005,000)         |
|  | -----             | -----                |
|  | \$ 241,933,000    | \$ 211,740,000       |
| <br>   |                   |                      |
| Field service equipment and other            | 16,005,000        | 15,793,000           |
| Less, accumulated depreciation               | (8,620,000)       | (8,351,000)          |
|  | -----             | -----                |
|  | \$ 7,385,000      | \$ 7,442,000         |
|  | -----             | -----                |
| Total net property and equipment             | \$ 249,318,000    | \$ 219,182,000       |
|  | =====             | =====                |

Total interest costs incurred during 2007 was \$3,076,000. Of this amount, the Company capitalized \$1,393,000. Capitalized interest is included as part of the cost of oil and gas properties. The capitalized rates are based upon the Company's weighted-average cost of borrowings used to finance the expenditures.

(6) Long-Term Bank Debt:

The Company currently has credit facilities totaling \$360 million, consisting of a \$200 million credit facility through Guaranty Bank (the offshore facility) and a \$160 million credit facility through a syndicate of banks led by Guaranty Bank (the onshore facility). The credit facilities mature in 2009. Availability under the credit facilities is based on the loan value assigned to Prime's oil and gas properties. At December 31, 2006, the borrowing bases and outstanding balances were \$82 million under the onshore credit facility at a weighted

average interest rate of 8.18%, and \$54.5 million under the offshore credit facility at a weighted average interest rate of 10.15%. Currently, the borrowing base and outstanding balance under the onshore credit facility is \$82 million and the borrowing base and outstanding balance under the offshore credit facility is \$74.5 million.

The determination of the Borrowing Base is made by the lenders taking into consideration the estimated value of Prime's oil and gas properties in accordance with the lenders customary practices for oil and gas loans. This process involves reviewing Prime's estimated proved reserves and their valuation. The Borrowing Base is redetermined semi-annually, and the available borrowing amount could be increased or decreased as a result of such redeterminations. In addition, Prime and the lenders each have discretion at any time

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PrimeEnergy Corporation

Notes to Consolidated Financial Statements

March 31, 2007

to have the Borrowing Base redetermined. A revision to Prime's reserves may prompt such a request on the part of the lenders, which could possibly result in a reduction in the Borrowing Base and availability under the credit facilities. If outstanding borrowings under either of the credit facilities exceed the applicable portion of the Borrowing Base, Prime would be required to repay the excess amount within a prescribed period. If we are unable to pay the excess amount, it would cause an event of default.

The credit facilities include terms and covenants that require the Company to maintain, as defined, a minimum current ratio, tangible net worth, debt coverage ratio and interest coverage ratio, and restrictions are placed on the payment of dividends and the amount of treasury stock the Company may purchase.

The credit facilities are collateralized by substantially all of the Company's assets. The Company is required to mortgage, and grant a security interest in, consolidated proved oil and gas properties. Prime also pledged the stock of several subsidiaries to the lenders to secure the credit facilities.

The combined average interest rates paid on outstanding borrowings subject to interest at the bank's base rate and on outstanding borrowings bearing interest based upon the LIBO rate were 8.79% during the first three months of 2007 as compared to 7.54% during the same period of 2006.

(7) Other Long-Term Obligations and Commitments:

Operating Leases:

The Company has several non-cancelable operating leases, primarily for rental of office space, that have a term of more than one year.

|      | Operating Leases |
|------|------------------|
| 2007 | 431,000          |
| 2008 | 529,000          |

|                        |    |           |
|------------------------|----|-----------|
| 2009                   |    | 525,000   |
| 2010                   |    | 30,000    |
| Thereafter             |    | --        |
|                        |    | -----     |
| Total minimum payments | \$ | 1,515,000 |
|                        |    | =====     |

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PrimeEnergy Corporation

Notes to Consolidated Financial Statements

March 31, 2007

Asset Retirement Obligation:

A reconciliation of our liability for plugging and abandonment costs for the three months ended March 31, 2007 and the year ended December 31, 2006 is as follows:

|   | March 31, 2007 | December 31, 2006 |
|---|----------------|-------------------|
| Asset retirement obligation - beginning of period | \$ 6,440,000   | \$ 2,594,000      |
| Liabilities incurred                              | 348,000        | 3,033,000         |
| Liabilities settled                               | (12,000)       | (348,000)         |
| Accretion expense                                 | 70,000         | 125,000           |
| Revisions in estimated liabilities                | (28,000)       | 1,036,000         |
|   | -----          | -----             |
| Asset retirement obligation - end of period       | \$ 6,818,000   | \$ 6,440,000      |

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The Company's liability is determined using significant assumptions, including current estimates of plugging and abandonment costs, annual inflation of these costs, the productive life of wells and our risk-adjusted interest rate. Changes in any of these assumptions can result in significant revisions to the estimated asset retirement obligation. Revisions to the asset retirement obligation are recorded with an offsetting change to producing properties, resulting in prospective changes to depreciation, depletion and amortization expense and accretion of discount. Because of the subjectivity of assumptions and the relatively long life of most of our wells, the costs to ultimately retire our wells may vary significantly from previous estimates.

(8) Contingent Liabilities:

The Company, as managing general partner of the affiliated Partnerships, is responsible for all Partnership activities, including the drilling of development wells and the production and sale of oil and gas from productive wells. The Company also provides the administration, accounting and tax preparation work for the Partnerships, and is liable for all debts and liabilities of the affiliated Partnerships, to the extent that the assets of a given limited Partnership are not sufficient to satisfy its obligations. As of March 31, 2007, the affiliated Partnerships have established cash reserves in excess of their debts and liabilities and the Company believes these reserves will be sufficient to satisfy Partnership obligations.

The Company is subject to environmental laws and regulations. Management believes that future expenses, before recoveries from third parties, if any, will not have a material effect on the Company's financial condition. This opinion is based on expenses incurred to date for remediation and compliance with laws and regulations which have not been material to the Company's results of operations.

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PrimeEnergy Corporation

Notes to Consolidated Financial Statements

March 31, 2007

As a general partner, the Company is committed to offer to purchase the limited partners interest in certain of its managed Partnerships at various annual intervals. Under the terms of a partnership agreement, the Company is not obligated to purchase an amount greater than 10% of the total partnership interest outstanding. In addition, the Company will be obligated to purchase interests tendered by the limited partners only to the extent of one hundred fifty percent of the revenues received by it from such partnership in the previous year. Purchase prices are based upon annual reserve reports of independent petroleum engineering firms discounted by a risk factor. Based upon historical production rates and prices, management estimates that if all such offers were to be accepted, the maximum annual future purchase commitment would be less than \$500,000.

(9) Stock Options and Other Compensation:

In May 1989, non-statutory stock options were granted by the Company to four key executive officers for the purchase of shares of common stock. At March 31, 2007 and 2006, options on 767,500 were

outstanding and exercisable at prices ranging from \$1.00 to \$1.25.

(10) Related Party Transactions:

PEMC acts as the managing general partner, providing administration, accounting and tax preparation services for the Partnerships. Certain directors have limited and general partnership interests in several of these Partnerships. As the managing general partner in each of the Partnerships, PEMC receives approximately 5% to 15% of the net revenues of each Partnership as a carried interest in the Partnerships' properties. As more fully described in Note 8, the Company is committed to offer to repurchase the interests of the partners and trust unit holders in certain of the Partnerships. The Company purchased such interests in an amount totaling \$2,438 in the first quarter 2007 and \$526,000 in 2006.

The Partnership agreements allow PEMC to receive reimbursement for property acquisition and development costs and general and administrative overhead, incurred on behalf of the Partnerships.

Due to related parties primarily represents receipts collected by the Company as agent, for oil and gas sales net of expenses. The amount of such receipts due the affiliated Partnerships was \$558,000 and \$477,000 at March 31, 2007 and December 31, 2006, respectively.

Receivables from related parties consist of reimbursable general and administrative costs, lease operating expenses and reimbursement for property development and related costs. Due from related parties was \$450,000 at March 31, 2007 and \$655,000 at December 31, 2006.

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PrimeEnergy Corporation

Notes to Consolidated Financial Statements

March 31, 2007

(11) Derivative Instruments and Hedging Activity:

The Company periodically enters into derivative commodity instruments to hedge its exposure to price fluctuations on natural gas and crude oil production. At March 31, 2007, the Company had four cash flow hedges open: three natural gas price swap arrangements and one crude oil collar arrangement. At March 31, 2007, \$1.3 million (\$737,000 net of tax) unrealized loss was recorded in Accumulated Other Comprehensive Income/ (Loss), along with a \$222,000 short-term derivative liability and a \$1.093 million long-term derivative liability. The change in the fair value of derivatives designated as hedges that is effective is initially recorded to Accumulated Other Comprehensive Income/(Loss). The ineffective portion, if any, of the change in the fair value of derivatives designated as hedges, and the change in fair value of all other derivatives, is recorded currently in earnings as a component of Natural Gas Production and Crude Oil and Condensate Revenue, as appropriate.

Assuming no change in commodity prices, after March 31, 2007, the Company would expect to reclassify to the Statement of Operations, over the next 12 months, \$222,000 in after-tax income associated with commodity hedges. This reclassification represents the net short-term receivable



associated with open positions currently not reflected in earnings at March 31, 2007 related to anticipated 2007 and future year production.

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PrimeEnergy Corporation

Notes to Consolidated Financial Statements

March 31, 2007

As of March 31, 2007, natural gas price swaps cover 6,620 MMBTU of production at a weighted average price of \$8.83. The oil price three-way collar covers 204 Mbbbl of production at a price of \$65.00, a ceiling of \$79.25 and a third-tier call of \$100.

At March 31, 2007, we had open crude oil price collar contracts covering our 2007 and 2008 production as follows:

Crude Oil Price Collar

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| <u>Contract<br/>Period</u> | Volume<br>In<br><u>Mbbl</u> | Weighted Average Price<br>Floor/Ceiling/Third Tier<br><br>(per Bbl | Net Unrealized<br><br>(Loss)/Gain<br><br>(In thousands) |
|----------------------------|-----------------------------|--|---|
|                            |                             | )  |   |
| Second<br>Quarter<br>2007  | 33                          | \$65/ \$79.25/ \$100.00  |   |
| Third<br>Quarter<br>2007   | 28                          | \$65/ \$79.25/ \$100.00  |   |
| Fourth<br>Quarter<br>2007  | <u>22</u>                   | \$65/ \$79.25/ \$100.00  |   |
| <b>Year 2007</b>           | 122                         |  | \$ --   |
|                            |                             |  | =====   |
| First<br>Quarter<br>2008   | 23                          | \$65/ \$79.25/ \$100.00  |   |
| Second<br>Quarter<br>2008  | 21                          | \$65/ \$79.25/ \$100.00  |   |
| Third<br>Quarter<br>2008   | 20                          | \$65/ \$79.25/ \$100.00  |   |
| Fourth<br>Quarter<br>2008  | <u>18</u>                   | \$65/ \$79.25/ \$100.00  |   |
| <b>Full Year<br/>2008</b>  | 82                          |  | \$ --   |

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At March 31, 2007, we had open natural gas price swap contracts covering our 2007 and 2008 production as follows:

| <u>Natural Gas Price Swaps</u> |  |   |   |
|--------------------------------|--|---|---|
| <u>Contract Period</u>         | <u>Volume</u><br><u>in</u><br><u>MMBTU</u> | <u>Weighted</u><br><u>Average</u><br><u>Price (per</u><br><u>MBTU</u> | <u>Net</u><br><u>Unrealized</u><br><u>Gain(loss)</u><br><u>(In thousands)</u> |
| Second Quarter 2007            | 880  | 8.98  | \$ 395  |
| Third Quarter 2007             | 720  | 9.08  | 242   |
| Fourth Quarter 2007            | <u>1,025</u>                               | <u>9.21</u>   | <u>(712)</u>  |
| <b>Year 2007</b>               | 2,625                                      | \$ 9.09   | \$ (75)   |
|                                | =====                                      | ====  | =====   |
| First Quarter 2008             | 980  | \$ 9.00   | \$ (147)  |
| Second Quarter 2008            | 1005                                       | 8.51  | 30  |
| Third Quarter 2008             | 1005                                       | 8.51  | (157)   |
| Fourth Quarter 2008            | <u>1005</u>                                | <u>8.51</u>   | <u>(966)</u>  |
| <b>Full Year 2008</b>          | 3,995                                      | \$ 8.63   | \$ (1,240)  |
|                                | =====                                      | =====   | =====   |

## PrimeEnergy Corporation

## Notes to Consolidated Financial Statements

March 31, 2007

We are exposed to market risk on these open contracts, to the extent of changes in market prices of natural gas and crude oil. However, the market risk exposure on these hedged contracts is generally offset by the gain or loss recognized upon the ultimate sale of the commodity that is hedged.

The preceding paragraphs contain forward-looking information concerning future production and projected gains and losses, which may be impacted both by production and by changes in future market prices of energy commodities. See "Forward-Looking Information" for further details.

## (12) Income Per Share:

Basic earnings per share are computed by dividing earnings available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect per share amounts that would have resulted if dilutive potential common stock had been converted to common stock. The following reconciles amounts reported in the financial statements:

|                                | Three Months Ended March 31, 2007 |           |           | Three Months Ended March 31, 2006 |           |           |
|--------------------------------|-----------------------------------|-----------|-----------|-----------------------------------|-----------|-----------|
|                                | Net                               | Number of | Per Share | Net                               | Number of | Per Share |
|                                | Income                            | Shares    | Amount    | Income                            | Shares    | Amount    |
| Net income per common share    | \$ 3,234,000                      | 3,210,526 | \$ 1.01   | \$ 3,978,000                      | 3,309,091 | \$ 1.20   |
| Effect of dilutive securities: |                                   |           |           |                                   |           |           |
| Options                        |                                   | 752,904   |           |                                   | 753,460   |           |
|                                | -----                             | -----     | -----     | -----                             | -----     | -----     |

Diluted net  
income

|                  |    |           |           |    |      |    |           |           |    |      |
|------------------|----|-----------|-----------|----|------|----|-----------|-----------|----|------|
| per common share | \$ | 3,234,000 | 3,963,430 | \$ | 0.82 | \$ | 3,978,000 | 4,062,551 | \$ | 0.98 |
|------------------|----|-----------|-----------|----|------|----|-----------|-----------|----|------|

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This discussion should be read in conjunction with the financial statements of the Company and notes thereto. The Company's subsidiaries are defined in Note 1 of the financial statements.

## LIQUIDITY AND CAPITAL RESOURCES

Cash flow provided by operations for the three month period ended March 31, 2007 was \$11,664,000. Excluding the effects of significant unforeseen expenses or other income, our cash flow from operations fluctuates primarily because of variations in oil and gas production and prices or changes in working capital accounts. Our oil and gas production will vary based on actual well performance but may be curtailed due to factors beyond our control. Hurricanes in the Gulf of Mexico may shut down our production for the duration of the storm's presence in the Gulf or damage production facilities so that we cannot produce from a particular property for an extended amount of time. In addition, downstream activities on major pipelines in the Gulf of Mexico can also cause us to shut-in production for various lengths of time.

Our realized oil and gas prices vary due to world political events, supply and demand of products, product storage levels, and weather patterns. We sell the vast majority of our production at spot market prices. Accordingly, product price volatility will affect our cash flow from operations. To mitigate price volatility we sometimes lock in prices for some portion of our production through the use of financial instruments.

The Company's activities include development and exploratory drilling. The Company's strategy is to develop a balanced portfolio of drilling prospects that includes lower risk wells with a high probability of success and higher risk wells with greater economic potential.

Our offshore exploration and development budget for 2007 is \$45 million including facility construction and installation. As of May, 2007, the Company has spent approximately \$41 million drilling, completing and equipping wells in the Gulf of Mexico as part of our program to develop our offshore properties. We have budgeted \$20 million for onshore exploration and development in our core operating areas. As of May, 2007, the Company has committed approximately \$7.5 million on wells in these areas that have been spudded since January 1, 2007. We expect to continue to make significant capital expenditures over the next several years as part of our long-term growth strategy.

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PrimeEnergy Corporation

March 31, 2007

## Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

If our exploratory drilling results in significant new discoveries, we will have to expend additional capital in order to finance the completion, development, and potential additional opportunities generated by our success. We believe that, because of the additional reserves resulting from the successful wells and our record of reserve growth in recent years, we will be able to access sufficient additional capital through additional bank financing.

The Company has in place both a stock repurchase program and a limited partnership interest repurchase program. Spending under these programs in 2006 was \$7.8 million. The Company expects to expend a similar amount in 2007.

The Company currently maintains two credit facilities totaling \$360 million, with a combined current borrowing base of \$156.5 million. The bank reviews the borrowing base semi-annually and, at their discretion, may decrease or propose an increase to the borrowing base relative to a redetermined estimate of proved oil and gas reserves. Our oil and gas properties are pledged as collateral for the line of credit and we are subject to certain financial covenants defined in the agreement. We are currently in compliance with these financial covenants. If we do not comply with these covenants on a continuing basis, the lenders have the right to refuse to advance additional funds under the facility and/or declare all principal and interest immediately due and payable.

It is the goal of the Company to increase its oil and gas reserves and production through the acquisition and development of oil and gas properties. The Company also continues to explore and consider opportunities to further expand its oilfield servicing revenues through additional investment in field service equipment. However, the majority of the Company's capital spending is discretionary, and the ultimate level of expenditures will be dependent on the Company's assessment of the oil and gas business environment, the number and quality of oil and gas prospects available, the market for oilfield services, and oil and gas business opportunities in general.

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PrimeEnergy Corporation

March 31, 2007

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

RESULTS OF OPERATIONS

Revenues and net income during the three month period ended March 31, 2007, as compared to the same periods in 2006 reflect the increased oil and gas sales, presented below, offset by exploration costs and depreciation and depletion of oil and gas properties. The table summarizes production volumes and average sales prices realized (including realized gains and losses from derivatives).

|                         | Three Months Ended |        |                          |
|-------------------------|--------------------|--------|--------------------------|
|                         | March 31,          |        |                          |
|                         | -----              |        |                          |
|                         | 2007               | 2006   | Increase /<br>(Decrease) |
| Barrels of Oil Produced | 91,000             | 84,000 | 7,000                    |

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|                                    |              |              |             |
|------------------------------------|--------------|--------------|-------------|
| Average Price Received             | \$56.64      | \$59.36      | \$ (2.72)   |
|                                    | -----        | -----        | -----       |
| Oil Revenue                        | \$ 5,154,000 | \$ 4,986,000 | \$ 168,000  |
|                                    | -----        | -----        | -----       |
| Mcf of Gas Produced                | 1,845,000    | 1,341,000    | 504,000     |
| Average Price Received             | \$8.22       | \$7.81       | \$ 0.41     |
|                                    | -----        | -----        | -----       |
| Gas Revenue                        | \$15,175,000 | \$10,473,000 | \$4,702,000 |
|                                    | -----        | -----        | -----       |
| T o t a l O i l & G a s<br>Revenue | \$20,329,000 | \$15,459,000 | \$4,870,000 |
|                                    | =====        | =====        | =====       |

Oil and gas prices received excluding the impact of derivatives were;

Three Months Ended

March 31,

|           | 2007     | 2006     | Increase /<br>(Decrease) |
|-----------|----------|----------|--------------------------|
| Oil Price | \$ 53.70 | \$ 59.36 | \$ (5.66)                |
| Gas Price | \$ 6.51  | \$ 7.81  | \$ (1.30)                |

Changes in production are due to production from properties added during 2006 offset by the natural decline of existing properties. The increase in oil production is related to our onshore drilling program while the increase in gas production reflects the initial production from our offshore 2006 drilling program.

Lease operating expense for the three months of 2007 increased by \$1,782,000 compared to 2006 due to the addition of lease operating expenses of new properties, and overall price increases in oil field services.



PrimeEnergy Corporation

March 31, 2007

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

General and administrative expenses remained flat in the first three months of 2007 as compared to 2006.

Field Service income and expense for the three months of 2007 increased \$1,194,000 and \$749,000, respectively, compared to 2006. These increases reflect higher utilization of equipment combined with an upward trend in rates during 2006.

Depreciation, depletion and amortization expense increased to \$7,690,000 in 2007 from \$3,317,000 in 2006. This increase is primarily related to the offshore facilities placed in service during the first quarter of 2007.

This Report contains forward-looking statements that are based on management's current expectations, estimates and projections. Words such as "expects," "anticipates," "intends," "plans," "believes," "projects" and "estimates," and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, and are subject to the safe harbors created thereby. These statements are not guarantees of future performance and involve risks and uncertainties and are based on a number of assumptions that could ultimately prove inaccurate and, therefore, there can be no assurance that they will prove to be accurate. Actual results and outcomes may vary materially from what is expressed or forecast in such statements due to various risks and uncertainties. These risks and uncertainties include, among other things, the possibility of drilling cost overruns and technical difficulties, volatility of oil and gas prices, competition, risks inherent in the Company's oil and gas operations, the inexact nature of interpretation of seismic and other geological and geophysical data, imprecision of reserve estimates, and the Company's ability to replace and expand oil and gas reserves. Accordingly, stockholders and potential investors are cautioned that certain events or circumstances could cause actual results to differ materially from those projected.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to interest rate risk on its line of credit, which has variable rates based upon the lenders base rate, as defined, and the London Inter-Bank Offered rate. Based on the weighted average balances outstanding during the first quarter of 2007, a hypothetical 2.5% increase in the applicable interest rates would have increased interest expense for the three months ended March 31, 2007 by approximately \$855,000.

March 31, 2007

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK (Continued)

Derivative Instruments and Hedging Activity.

Our hedging strategy is designed to reduce the risk of price volatility for our production in the natural gas and crude oil markets. Our hedging arrangements apply to only a portion of our production and provide only partial price protection. These hedging arrangements limit the benefit to us of increases in prices, but offer protection in the event of price declines. Further, if our counterparties defaulted, this protection might be limited as we might not receive the benefits of the hedges. Please read the discussion below and Note 11 of the Notes to Consolidated Financial Statements for a more detailed discussion of our hedging arrangements.

Hedges on Production Collars.

From time to time, we enter into natural gas and crude oil collar agreements with counterparties to hedge price risk associated with a portion of our production. These cash flow hedges are not held for trading purposes. Under the collar arrangements, if the index price rises above the ceiling price, we pay the counterparty. If the index price falls below the floor price, the counterparty pays us. In the case of a three-way collar if the index price rises above the third tier price, the counterparty pays us.

Hedges on Production Swaps.

From time to time, we enter into natural gas and crude oil swap agreements with counterparties to hedge price risk associated with a portion of our production. These cash flow hedges are not held for trading purposes. Under the swap agreements, if the index price rises above the swap price, we pay the counterparty. If the index falls below the swap price, the counterparty pays us.

Item 4. INTERNAL CONTROLS AND PROCEDURES.

(a) Evaluation of disclosure controls and procedures.

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934 as of the end of the period covered by this Quarterly Report on Form 10-Q. The evaluation included certain internal control areas in which we have made and are continuing to make changes to improve and enhance controls. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

March 31, 2007

Item 4. INTERNAL CONTROLS AND PROCEDURES (Continued)

Based on that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

(b) Changes in internal control over financial reporting.

There were no changes in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management is currently in the process of comprehensively documenting and further analyzing our system of internal control over financial reporting. We are in the process of designing enhanced processes and controls to address any issues identified through this review. We plan to continue this initiative as well as prepare for our first management report on internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act of 2002 which may result in changes to our internal control over financial reporting.

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PrimeEnergy Corporation

March 31, 2007

## PART II - OTHER INFORMATION

## Item 1. LEGAL PROCEEDINGS

From time to time, the Company is party to certain legal actions and claims arising in the ordinary course of business. While the outcome of these events cannot be predicted with certainty, management does not expect these matters to have a materially adverse effect on the financial position or results of operations of the Company.

## Item 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

During the three months ended March 31, 2007, the Company purchased the following shares of common stock as treasury shares.

| <u>2007 Month</u> | <u>Number of<br/>Shares</u> | <u>Average Price<br/>Paid per share</u> | <u>Maximum Number of Shares<br/>that May Yet Be Purchased<br/>Under The Plan (1)</u> |
|-------------------|-----------------------------|---|--|
| January           | 40                          | \$ 57.29                                | 365,854  |
| February          | 2,986                       | \$ 54.65                                | 362,868  |
| March             | 19,478                      | \$ 55.64                                | 343,390  |

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|               |        |          |
|---------------|--------|----------|
| Total/Average | 22,504 | \$ 54.37 |
|---------------|--------|----------|

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(1) In December 1993, we announced that our board of directors authorized a stock repurchase program whereby we may purchase outstanding shares of our common stock from time-to-time, in open market transactions or negotiated sales. A total of 2,400,000 shares have been authorized, to date, under this program. On November 10, 2006, the board of Directors authorized the Company to purchase up to an additional 300,000 shares of its Common Stock. Through March 31, 2007 a total of 2,356,610 under this program for \$25,923,000 at an average price of \$11.00 per share. Additional purchases of shares may occur as market conditions warrant. We expect future purchases will be funded with internally generated cash flow or from working capital.

Item 3. DEFAULTS UPON SENIOR SECURITIES

None

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

Item 5. OTHER INFORMATION

None

Item 6. EXHIBITS AND REPORTS ON FORM 8K

No reports on form 8K were filed by the Company during the three months ended March 31, 2007.

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SIGNATURES

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

PrimeEnergy Corporation

(Registrant)

May 15, 2007

(Date)

/s/ Charles E. Drimal, Jr.

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Charles E. Drimal, Jr.

President

Principal Executive Officer

May 15, 2007

(Date)

/s/ Beverly A. Cummings

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Beverly A. Cummings

Executive Vice President

Principal Financial and Accounting Officer

