

DORCHESTER MINERALS, L.P.

Form 10-Q

August 06, 2018

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC. 20549

FORM 10-Q

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

For the quarterly period ended **June 30, 2018**

or

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

For the transition period from _____ to _____

Commission file number **000-50175**

DORCHESTER MINERALS, L.P.

(Exact name of registrant as specified in its charter)

Delaware

81-0551518

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(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

3838 Oak Lawn Avenue, Suite 300, Dallas, Texas 75219

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(214) 559-0300**

None

(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 for 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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer	Accelerated filer	Non-accelerated filer (Do not check if a smaller reporting company)
Smaller reporting company	Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act.): Yes No

As of August 6, 2018, 32,279,774 common units representing limited partnership interests were outstanding.

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DORCHESTER MINERALS, L.P.

(A Delaware Limited Partnership)

DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

Statements included in this report that are not historical facts (including any statements concerning plans and objectives of management for future operations or economic performance, or assumptions or forecasts related thereto), are forward-looking statements. These statements can be identified by the use of forward-looking terminology including “may,” “believe,” “will,” “expect,” “anticipate,” “estimate,” “continue” or other similar words. These statements discuss future expectations, contain projections of results of operations or of financial condition or state other “forward-looking” information. In this report, the term “Partnership,” as well as the terms “DMLP,” “us,” “our,” “we,” and “its” are sometimes used as abbreviated references to Dorchester Minerals, L.P. itself or Dorchester Minerals, L.P. and its related entities.

These forward-looking statements are based upon management’s current plans, expectations, estimates, assumptions and beliefs concerning future events impacting us and, therefore, involve a number of risks and uncertainties. We caution that forward-looking statements are not guarantees and that actual results could differ materially from those expressed or implied in the forward-looking statements for a number of important reasons. Examples of such reasons include, but are not limited to, changes in the price or demand for oil and natural gas, changes in the operations on or development of our properties, changes in economic and industry conditions and changes in regulatory requirements (including changes in environmental requirements) and our financial position, business strategy and other plans and objectives for future operations. These and other factors are set forth in our filings with the Securities and Exchange Commission.

You should read these statements carefully because they discuss our expectations about our future performance, contain projections of our future operating results or our future financial condition, or state other “forward-looking” information. Before you invest, you should be aware that the occurrence of any of the events described in this report could substantially harm our business, results of operations and financial condition and that upon the occurrence of any of these events, the trading price of our common units could decline, and you could lose all or part of your investment.

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

DORCHESTER MINERALS, L.P.

(A Delaware Limited Partnership)

CONDENSED CONSOLIDATED BALANCE SHEETS

(In Thousands)

(Unaudited)

	June 30, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 19,608	\$ 13,827
Trade and other receivables	7,301	6,198
Net profits interests receivable - related party	4,288	5,330
Total current assets	31,197	25,355
Property and leasehold improvements - at cost:		
Oil and natural gas properties (full cost method)	363,211	363,186
Accumulated full cost depletion	(301,902)	(297,442)
Total	61,309	65,744
Leasehold improvements	1,614	1,573
Accumulated amortization	(633)	(625)
Total	981	948
Total assets	\$ 93,487	\$ 92,047

LIABILITIES AND PARTNERSHIP CAPITAL

Current liabilities:

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Accounts payable and other current liabilities	\$1,580	\$599
Current portion of deferred rent incentive	65	38
Total current liabilities	1,645	637
Deferred rent incentive less current portion	659	664
Total liabilities	2,304	1,301
Commitments and contingencies (Note 2)		
Partnership capital:		
General partner	1,839	1,782
Unitholders	89,344	88,964
Total partnership capital	91,183	90,746
Total liabilities and partnership capital	\$93,487	\$92,047

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

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DORCHESTER MINERALS, L.P.

(A Delaware Limited Partnership)

CONDENSED CONSOLIDATED INCOME STATEMENTS

(In Thousands except Income per Unit)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2018	2017	June 30, 2018	2017
Net operating revenues:				
Royalties	\$13,941	\$10,489	\$27,187	\$21,112
Net profits interests	2,996	309	5,559	1,969
Lease bonus	4,125	1,726	4,163	1,756
Other	61	29	97	443
Total net operating revenues	21,123	12,553	37,006	25,280
Costs and expenses:				
Operating, including production taxes	1,316	1,051	2,572	2,038
Depreciation, depletion and amortization	2,284	1,893	4,468	3,648
General and administrative expenses	1,159	1,160	2,639	2,623
Total costs and expenses	4,759	4,104	9,679	8,309
Net income	\$16,364	\$8,449	\$27,327	\$16,971
Allocation of net income:				
General partner	\$576	\$330	\$950	\$630
Unitholders	\$15,788	\$8,119	\$26,377	\$16,341
Net income per common unit (basic and diluted)	\$0.49	\$0.26	\$0.82	\$0.53
Weighted average basic and diluted common units outstanding	32,280	30,693	32,280	30,684

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

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DORCHESTER MINERALS, L.P.

(A Delaware Limited Partnership)

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)

(Unaudited)

	Six Months Ended June 30, 2018 2017	
Net cash provided by operating activities	\$32,737	\$21,280
Cash flows provided by (used in) investing activities:		
Cash contributed (used) in acquisition of royalty interests	(25)	608
Capital expenditures	(41)	(40)
Total cash flows provided by (used in) investing activities	(66)	568
Cash flows used in financing activities:		
Distributions paid to general partner and unitholders	(26,890)	(17,466)
Increase in cash and cash equivalents	5,781	4,382
Cash and cash equivalents at beginning of period	13,827	8,212
Cash and cash equivalents at end of period	\$19,608	\$12,594
Non-cash investing and financing activities:		
Fair value of common units issued for acquisition of royalty interests	\$-	\$23,183

The accompanying notes are an integral part of these condensed consolidated financial statements

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DORCHESTER MINERALS, L.P.

(A Delaware Limited Partnership)

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1 Basis of Presentation: Dorchester Minerals, L.P. (the “Partnership”) is a publicly traded Delaware limited partnership that was formed in December 2001, and commenced operations on January 31, 2003. The unaudited condensed consolidated financial statements include the accounts of Dorchester Minerals, L.P. and its wholly-owned subsidiaries Dorchester Minerals Oklahoma LP, Dorchester Minerals Oklahoma GP, Inc., Maecenas Minerals LLP, and Dorchester-Maecenas GP LLC.

The accompanying unaudited condensed consolidated financial statements of the Partnership have been prepared in accordance with generally accepted accounting principles in the United States (“U.S. GAAP”) and pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (“SEC”). The unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal and recurring adjustments unless indicated otherwise) that are, in the opinion of management, necessary for the fair presentation of our financial position and operating results for the interim period. Interim period results are not necessarily indicative of the results for the calendar year. For more information regarding limitations on the forward-looking statements contained herein, see page 1 of this quarterly report on Form 10-Q. Per-unit information is calculated by dividing the income or loss applicable to holders of our Partnership’s common units by the weighted average number of units outstanding. The Partnership has no potentially dilutive securities and, consequently, basic and diluted income per unit do not differ. The accompanying unaudited condensed consolidated financial statements and related notes should be read in conjunction with the consolidated financial statements and notes thereto included in the Partnership’s 2017 Annual Report on Form 10-K.

The accompanying unaudited condensed consolidated financial statements include the consolidated results of the Partnership. All significant intercompany balances and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. For example, estimates of uncollected revenues and unpaid expenses from Royalty properties and net profits

overriding royalty interests (referred to as the Net Profits Interests, or “NPIs”) operated by non-affiliated entities are particularly subjective due to our inability to gain accurate and timely information. Therefore, actual results could differ from those estimates.

In June 2017, the Partnership acquired an undivided interest in certain mineral and royalty interests in exchange for 1,604,343 common units issued pursuant to the Partnership’s registration statements on Form S-4.

In April 2018, the Partnership and affiliates of its general partner consummated and closed a transaction assigning a non-producing leasehold interest and related NPI located in Upton County, Texas to a third party. The Partnership’s share of proceeds from the transaction was \$4.0 million, recorded as lease bonus revenue.

2 Commitments and Contingencies: The Partnership and Dorchester Minerals Operating L.P., a Delaware limited partnership owned directly and indirectly by our general partner, are involved in legal and/or administrative proceedings arising in the ordinary course of their businesses, none of which have predictable outcomes and none of which are believed to have any significant effect on our consolidated financial position, cash flows, or operating results.

Operating Leases - The third amendment to our office lease was executed in April 2017, for a term of 129 months beginning June 1, 2018. The lease is for our office space at 3838 Oak Lawn Avenue, Suite 300, Dallas, Texas, and expires in 2029. Under the third amendment to the office lease, monthly rental payments will range from \$25,000 - \$30,000.

Table of Contents**3 Distributions to Holders of Common Units:** Unitholder cash distributions per common unit are as follows:

	Per Unit Amount	
	2018	2017
First quarter	\$0.418449	\$0.306700
Second quarter	\$0.537264	\$0.322965
Third quarter		\$0.284650
Fourth quarter		\$0.386915

Distributions beginning with the second quarter of 2017 were paid on 32,279,774 units; previous distributions set forth above were paid on 30,675,431 units. The second quarter 2018 distribution will be paid on August 10, 2018. Fourth quarter distributions shown above are paid in the first calendar quarter of the following year. Our partnership agreement requires the third quarter cash distribution to be paid by November 14, 2018.

4 New Accounting Pronouncements: In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”), which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The guidance requires entities to recognize revenue using the following five-step model: identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue as the entity satisfies each performance obligation.

On January 1, 2018, we adopted ASU 2014-09 using the full retrospective method. The Partnership completed its review of a representative sample of revenue contracts covering its material revenue streams and determined that there is no impact to its consolidated financial statements, results of operations or liquidity. When comparing the Partnership’s historical revenue recognition to the newly applied revenue recognition under Accounting Standards Codification (“ASC”) 606, there was no change to the amount or timing of revenue recognized. Therefore, no quantitative adjustment was required to be made to the prior periods presented in these unaudited condensed consolidated financial statements after the adoption of ASC 606.

Accounting Policy – Revenues from Royalty properties and NPIs are recorded under the cash receipts approach as directly received from the remitters’ statement accompanying the revenue check. Since the revenue checks are generally received two to four months after the production month, the Partnership accrues for revenue earned but not received by estimating production volumes and product prices.

Revenues from lease bonus payments are recorded upon receipt. The lease bonus is separate from the lease itself and is recognized as revenue to the Partnership upon receipt of payment. The Partnership generates lease bonus revenue by leasing its mineral interests to exploration and production companies, and includes proceeds from divestitures of leasehold interests where the Partnership retains an interest. A lease agreement represents the Partnership's contract with a lessee and generally transfers the rights to develop oil or natural gas, grants the Partnership a right to a specified royalty interest, and requires that drilling and completion operations commence within a specified time period.

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The Partnership does not record revenue for unsatisfied or partially unsatisfied performance obligations. Accordingly, the Partnership has not recorded any contract assets or contract liabilities as of June 30, 2018.

In February 2016, the FASB issued ASU 2016-02-Leases (Topic 842), (“ASU 2016-02”) as updated by ASU 2018-10, Codification Improvements to Topic 842, Leases, which requires lessees to record most leases on the balance sheet. Under the new guidance, lease classification as either a finance lease or an operating lease will determine how lease-related revenue and expense are recognized. The guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The new guidance does not apply to leases to explore for or use minerals, oil, natural gas and similar resources. The Partnership has an office lease commitment of \$3.0 million that we believe would be subject to capitalization under ASU 2016-02. The lease obligations that will be in place upon adoption of ASU 2016-02 may be significantly different than our current obligations. We are still evaluating the impact of ASU 2016-02 on our consolidated financial statements.

In January 2018, the FASB issued ASU 2018-01, Land Easement Practical Expedient for Transition to Topic 842 (“ASU 2018-01”). ASU 2018-01 affects entities with land easements that exist or expired before an entity’s adoption of FASB ASC 842 – Leases (“ASC 842”). ASU 2018-01 provides an optional transition practical expedient to not evaluate under ASC 842 land easements that exist or expired before the entity’s adoption of ASC 842 and that were not previously accounted for as leases under ASC 840 – Leases. An entity that elects the practical expedient will be required to evaluate new or modified land easement arrangements under ASC 842 upon adoption of ASC 842. The Partnership will elect the practical expedient available under ASU 2018-01 and will apply the provisions of ASC 842 prospectively to all new or modified land easement arrangements.

item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion contains forward-looking statements. For a description of limitations inherent in forward-looking statements, see page 1 of this quarterly report on Form 10-Q.

Overview

We own producing and nonproducing mineral, royalty, overriding royalty, net profits and leasehold interests. We refer to these interests as the Royalty properties. We currently own Royalty properties in 574 counties and parishes in 25 states.

We own five net profits overriding royalty interests (referred to as the Net Profits Interests, or “NPIs”) in various properties owned by Dorchester Minerals Operating LP (the “Operating Partnership”), a Delaware limited partnership owned directly and indirectly by our general partner. We receive monthly payments equaling 96.97% of the net profits actually realized by the operating partnership from these properties in the preceding month. In the event that costs, including budgeted capital expenditures, exceed revenues on a cash basis in a given month for properties subject to a Net Profits Interests, no payment is made and any deficit is accumulated and reflected in the following month's calculation of net profit.

Each of the five NPIs (including the Minerals NPI, which is our largest NPI) have previously had cumulative revenue that exceeded cumulative costs, such excess constituting net proceeds on which NPI payments were determined. In the event an NPI has a deficit of cumulative revenue versus cumulative costs, the deficit will be borne solely by the Operating Partnership.

From a cash perspective, as of June 30, 2018, the Minerals NPI was in a deficit position and had outstanding capital commitments of \$7.4 million, exceeding cash on hand of \$6.7 million.

Table of Contents**Commodity Price Risks**

Our profitability is affected by oil and natural gas market prices. Oil and natural gas market prices have fluctuated significantly in recent years in response to changes in the supply and demand for oil and natural gas in the market, along with domestic and international political and economic conditions.

Results of Operations***Three and Six Months Ended June 30, 2018 as compared to Three and Six Months Ended June 30, 2017***

Our period-to-period changes in net income and cash flows from operating activities are principally determined by changes in oil and natural gas sales volumes and prices. Our portion of oil and natural gas sales and weighted average prices were:

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
	2018	2017	2018	2017
Accrual basis sales volumes:				
Royalty properties gas sales (mmcf)	902	860	1,818	1,714
Royalty properties oil sales (mbbls)	212	187	402	362
NPI gas sales (mmcf)	626	596	1,261	1,168
NPI oil sales (mbbls)	100	73	191	140
Accrual basis weighted average sales price:				
Royalty properties gas sales (\$/mcf)	\$2.20	\$2.91	\$2.48	\$3.11
Royalty properties oil sales (\$/bbl)	\$56.30	\$42.70	\$56.42	\$43.54
NPI gas sales (\$/mcf)	\$1.98	\$2.81	\$2.30	\$2.76
NPI oil sales (\$/bbl)	\$57.23	\$39.06	\$56.33	\$39.78

Both oil and natural gas sales price changes reflected in the table above resulted from changing market conditions.

Oil sales volumes attributable to our Royalty properties during the second quarter increased 13% from 187 mbbls in 2017 to 212 mbbls in the same period of 2018. Oil sales volumes attributable to the first six months of 2017 increased

11% from 362 mbbbls to 402 mbbbls in the same period of 2018. The increase in volumes during the second quarter and first six months of 2018 compared to the same periods of 2017 is mainly a result of increased Permian Basin and Bakken production from new wells. Natural gas sales volumes attributable to our Royalty properties during the second quarter increased 5% from 860 mmcf in 2017 to 902 mmcf in the same period of 2018. Natural gas sales volumes during the first six months increased 6% from 1,714 mmcf in 2017 to 1,818 mmcf in the same period of 2018. The increase in volumes during the second quarter and first six months of 2018 compared to the same periods of 2017 is mainly a result of increased production in the Permian Basin partially offset by decreased production in the Fayetteville Shale.

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Oil sales volumes attributable to our NPIs during the second quarter and first six months of 2017 were 73 mbbls and 140 mbbls, respectively, resulting in increases of 37% and 36% to 100 mbbls and 191 mbbls during the same periods of 2018. Increases in oil volumes during the second quarter and first six months of 2018 compared to the same periods of 2017 is mainly due to new Bakken completions with significant production volume increases. Natural gas sales volumes attributable to our NPIs during the second quarter increased 5% from 596 mmcf in 2017 to 626 mmcf in the same period of 2018. During the first six months of 2018, NPI natural gas volumes increased 8% from 1,168 mmcf in 2017 to 1,261 mmcf in the same period of 2018. The increase in natural gas sales volumes is mainly due to higher amount of Permian Basin suspense releases in the first six months of 2018 as compared to the first six months of 2017.

Our second quarter lease bonus revenue increased 141% from \$1.7 million during 2017 to \$4.1 million during the same period of 2018. Our first six months lease bonus revenue increased 133% from \$1.8 million during 2017 to \$4.2 million during the same period in 2018. The increases in both periods are primarily a result of a transaction assigning a non-producing leasehold interest recorded as lease bonus revenue as the Partnership retained an overriding royalty interest.

Our second quarter net operating revenues increased 67% from \$12.6 million during 2017 to \$21.1 million during the same period of 2018. This increase in net operating revenues is primarily due to higher oil prices and higher lease bonus and NPI income. Our first six months net operating revenues increased 46% from \$25.3 million during 2017 to \$37.0 million during the same period of 2018. This increase is primarily a result of higher oil prices realized in both our Royalty and NPI revenue and higher lease bonus revenues.

Second quarter operating costs, including production taxes, increased 18% from \$1.1 million in 2017 to \$1.3 million in 2018. Our first six months operating costs increased 30% from \$2.0 million during 2017 to \$2.6 million during the same period of 2018. The increases in both periods are primarily a result of higher production taxes due to higher oil prices, partially offset by lower natural gas prices.

General and administrative expenses remained consistent during the second quarter and first six months of 2018 compared to the same periods of 2017.

Depletion and amortization costs of \$1.9 million during the second quarter of 2017 increased 21% to \$2.3 million during the same period of 2018. Depletion and amortization costs of \$3.6 million during the first six months of 2017 increased 25% compared to \$4.5 million during the same period of 2018. We adjust our depletion rate each quarter for significant changes in our estimates of oil and natural gas reserves.

Second quarter net income allocable to common units increased 95% from \$8.1 million during 2017 to \$15.8 million during the same period of 2018. Our first six months net income allocable to common units increased by 62% from \$16.3 million in 2017 compared to \$26.4 million during the same perio