

VAALCO ENERGY INC /DE/

Form 10-K

March 16, 2010

Table of Contents

Index to Financial Statements

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

(Mark One)

ANNUAL REPORT UNDER TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2009

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 1-32167

**VAALCO Energy, Inc.**

(Exact name of registrant as specified on its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**4600 Post Oak Place**

**Suite 309**

**Houston, Texas**  
(Address of principal executive offices)

(Registrant's telephone number, including area code): (713) 623-0801

**76 0274813**  
(I.R.S. Employer  
Identification No.)

**77027**  
(Zip Code)

Securities registered under Section 12(b) of the Exchange Act:

Edgar Filing: VAALCO ENERGY INC /DE/ - Form 10-K

Title of each class	Name of exchange on which registered
Common Stock, \$.10 par value	New York Stock Exchange

**Securities registered under Section 12(g) of the Exchange Act:**

None

Indicate by check mark if the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15d of the Act Yes  No

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 website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). Yes  No .

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K .

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

The aggregate market value of the voting and non-voting common equity of the registrant held by non-affiliates, as of June 30, 2009 was \$245,827,837 based on a closing price of \$4.23 on June 30, 2009.

As of February 28, 2010, there were outstanding 56,427,253 shares of common stock, \$0.10 par value per share, of the registrant.

Documents incorporated by reference: Definitive proxy statement of VAALCO Energy, Inc. relating to the Annual Meeting of Stockholders to be filed within 120 days after the end of the fiscal year covered by this Form, which is incorporated into Part III of this 10-K.

**Table of Contents**

**Index to Financial Statements**

**VAALCO ENERGY, INC.**

**TABLE OF CONTENTS**

	<b>Page</b>
<u>Glossary of Oil and Gas Terms</u>	3
<b>PART I</b>	
Item 1. <u>Business</u>	7
Item 1A. <u>Risk Factors</u>	14
Item 1B. <u>Unresolved Staff Comments</u>	19
Item 2. <u>Properties</u>	20
Item 3. <u>Legal Proceedings</u>	26
Item 4. <u>[Reserved]</u>	26
<b>PART II</b>	
Item 5. <u>Market for Registrants Common Equity, Related Stockholder Matters and Issuer Purchase of Equity Securities</u>	27
Item 6. <u>Selected Financial Data</u>	30
Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	31
Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	37
Item 8. <u>Financial Statements and Supplementary Data</u>	37
Item 9. <u>Changes In and Disagreements with Accountants on Accounting and Financial Disclosure</u>	37
Item 9A. <u>Controls and Procedures</u>	37
Item 9B. <u>Other Information</u>	40
<b>PART III</b>	
Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	40
Item 11. <u>Executive Compensation</u>	40
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	40
Item 13. <u>Certain Relationships, Related Transactions and Director Independence</u>	40
Item 14. <u>Principal Accountant Fees and Services</u>	40
<b>PART IV</b>	
Item 15. <u>Exhibits and Financial Statement Schedules</u>	41
<u>INDEX TO CONSOLIDATED FINANCIAL INFORMATION</u>	F-1

**Table of Contents**

**Index to Financial Statements**

**Glossary of Oil and Gas Terms**

**Terms used to describe quantities of oil and natural gas**

Bbl One stock tank barrel, or 42 US gallons liquid volume, of crude oil or other liquid hydrocarbons.

Bcf One billion cubic feet of natural gas.

Bcfe One billion cubic feet of natural gas equivalent.

BOE One barrel of oil equivalent, converting gas to oil at the ratio of 6 Mcf of gas to 1 Bbl of oil.

BOPD One barrel of oil per day.

MBbl One thousand Bbls.

Mcf One thousand cubic feet of natural gas.

McfD One thousand cubic feet of natural gas per day.

Mcfe One thousand cubic feet of natural gas equivalent.

MMBbl One million Bbls of oil or other liquid hydrocarbons.

MMcf One million cubic feet of natural gas.

MBOE One thousand BOE.

MMBOE One million BOE.

**Terms used to describe the Company's interests in wells and acreage**

## Edgar Filing: VAALCO ENERGY INC /DE/ - Form 10-K

Gross oil and gas wells or acres The Company's gross wells or gross acres represent the total number of wells or acres in which the Company owns a working interest.

Net oil and gas wells or acres Determined by multiplying gross oil and natural gas wells or acres by the working interest that the Company owns in such wells or acres represented by the underlying properties.

### **Terms used to assign a present value to the Company's reserves**

Standard measure of proved reserves The present value, discounted at 10%, of the pre-United States income tax future net cash flows attributable to estimated net proved reserves. The Company calculates this amount by assuming that it will sell the oil and gas production attributable to the proved reserves estimated in its independent engineer's reserve report for the prices used in the report, unless it had a contract to sell the production for a different price. The Company also assumes that the cost to produce the reserves will remain constant at the costs prevailing on the date of the report. The assumed costs are subtracted from the assumed revenues resulting in a stream of future net cash flows. Estimated future income taxes using rates in effect on the date of the report are deducted from the net cash flow stream. The after-tax cash flows are discounted at 10% to result in the standardized measure of the Company's proved reserves.

### **Terms used to classify the Company's reserve quantities**

*Developed oil and gas reserves.* Developed oil and gas reserves are reserves of any category that can be expected to be recovered:

- (i) Through existing wells with existing equipment and operating methods or in which the cost of the required equipment is relatively minor compared to the cost of a new well; and
- (ii) Through installed extraction equipment and infrastructure operational at the time of the reserves estimate if the extraction is by means not involving a well.

**Table of Contents**

**Index to Financial Statements**

*Proved oil and gas reserves.* Proved oil and gas reserves are those quantities of oil and gas, which, by analysis of geoscience and engineering data, can be estimated with reasonable certainty to be economically producible from a given date forward, from known reservoirs, and under existing economic conditions, operating methods, and government regulations prior to the time at which contracts providing the right to operate expire, unless evidence indicates that renewal is reasonably certain, regardless of whether deterministic or probabilistic methods are used for the estimation. The project to extract the hydrocarbons must have commenced or the operator must be reasonably certain that it will commence the project within a reasonable time.

- (i) The area of the reservoir considered as proved includes:
  - (A) The area identified by drilling and limited by fluid contacts, if any, and
  - (B) Adjacent undrilled portions of the reservoir that can, with reasonable certainty, be judged to be continuous with it and to contain economically producible oil or gas on the basis of available geoscience and engineering data.
- (ii) In the absence of data on fluid contacts, proved quantities in a reservoir are limited by the lowest known hydrocarbons (LKH) as seen in a well penetration unless geoscience, engineering, or performance data and reliable technology establishes a lower contact with reasonable certainty.
- (iii) Where direct observation from well penetrations has defined a highest known oil (HKO) elevation and the potential exists for an associated gas cap, proved oil reserves may be assigned in the structurally higher portions of the reservoir only if geoscience, engineering, or performance data and reliable technology establish the higher contact with reasonable certainty.
- (iv) Reserves which can be produced economically through application of improved recovery techniques (including, but not limited to, fluid injection) are included in the proved classification when:
  - (A) Successful testing by a pilot project in an area of the reservoir with properties no more favorable than in the reservoir as a whole, the operation of an installed program in the reservoir or an analogous reservoir, or other evidence using reliable technology establishes the reasonable certainty of the engineering analysis on which the project or program was based; and
  - (B) The project has been approved for development by all necessary parties and entities, including governmental entities.
- (v) Existing economic conditions include prices and costs at which economic producibility from a reservoir is to be determined. The price shall be the average price during the 12-month period prior to the ending date of the period covered by the report, determined as an unweighted arithmetic average of the first-day-of-the-month price for each month within such period, unless prices are defined by contractual arrangements, excluding escalations based upon future conditions.

*Reserves.* Reserves are estimated remaining quantities of oil and gas and related substances anticipated to be economically producible, as of a given date, by application of development projects to known accumulations. In addition, there must exist, or there must be a reasonable expectation that there will exist, the legal right to produce or a revenue interest in the production, installed means of delivering oil and gas or related substances to market, and all permits and financing required to implement the project.

*Standardized measure.* Standardized measure is the present value of estimated future net revenues to be generated from the production of proved reserves, determined in accordance with the rules and regulations of the Securities and Exchange Commission

## Edgar Filing: VAALCO ENERGY INC /DE/ - Form 10-K

(SEC), using prices and costs in effect as of the date of estimation, without giving effect to non-property related expenses such as certain general and administrative expenses, debt service and future federal income tax expenses or to depreciation, depletion and amortization and discounted using an annual discount rate of 10%.

## **Table of Contents**

### **Index to Financial Statements**

*Undeveloped oil and gas reserves.* Undeveloped oil and gas reserves are reserves of any category that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditures is required for recompletion.

- (i) Reserves on undrilled acreage shall be limited to those directly offsetting development spacing areas that are reasonably certain of production when drilled, unless evidence using reliable technology exists that establishes reasonable certainty of economic producibility at greater distances.
- (ii) Undrilled locations can be classified as having undeveloped reserves only if a development plan has been adopted indicating that they are schedule to be drilled within five years, unless the specific circumstances, justify a longer time.
- (iii) Under no circumstances shall estimates for undeveloped reserves be attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless such techniques have been proved effective by actual projects in the same reservoir or an analogous reservoir, or by other evidence using reliable technology establishing reasonable certainty.

*Unproved properties.* Properties with no proved reserves.

### **Terms which describe the productive life of a property or group of properties**

*Reserve life.* A measure of the productive life of an oil and gas property or a group of oil and gas properties, expressed in years. Reserve life for the years ended December 31, 2009, 2008 or 2007 equal the estimated net proved reserves attributable to a property or group of properties divided by production from the property or group of properties for the four fiscal quarters preceding the date as of which the proved reserves were estimated.

### **Terms used to describe the legal ownership of the Company's oil and gas properties**

*Royalty interest.* A real property interest entitling the owner to receive a specified portion of the gross proceeds of the sale of oil and natural gas production or, if the conveyance creating the interest provides, a specific portion of oil and natural gas produced, without any deduction for the costs to explore for, develop or produce the oil and natural gas. A royalty interest owner has no right to consent to or approve the operation and development of the property, while the owners of the working interests have the exclusive right to exploit the minerals on the land.

*Working interest.* A real property interest entitling the owner to receive a specified percentage of the proceeds of the sale of oil and natural gas production or a percentage of the production, but requiring the owner of the working interest to bear the cost to explore for, develop and produce such oil and natural gas. A working interest owner who owns a portion of the working interest may participate either as operator or by voting his percentage interest to approve or disapprove the appointment of an operator and drilling and other major activities in connection with the development and operation of a property.

### **Terms used to describe seismic operations**



## Edgar Filing: VAALCO ENERGY INC /DE/ - Form 10-K

*Seismic data.* Oil and gas companies use seismic data as their principal source of information to locate oil and gas deposits, both to aid in exploration for new deposits and to manage or enhance production from known reservoirs. To gather seismic data, an energy source is used to send sound waves into the subsurface strata. These waves are reflected back to the surface by underground formations, where they are detected by geophones which digitize and record the reflected waves. Computers are then used to process the raw data to develop an image of underground formations.

**Table of Contents**

**Index to Financial Statements**

*2-D seismic data.* 2-D seismic survey data has been the standard acquisition technique used to image geologic formations over a broad area. 2-D seismic data is collected by a single line of energy sources which reflect seismic waves to a single line of geophones. When processed, 2-D seismic data produces an image of a single vertical plane of sub-surface data.

*3-D seismic data.* 3-D seismic data is collected using a grid of energy sources, which are generally spread over several miles. A 3-D survey produces a three dimensional image of the subsurface geology by collecting seismic data along parallel lines and creating a cube of information that can be divided into various planes, thus improving visualization. Consequently, 3-D seismic data is a more reliable indicator of potential oil and natural gas reservoirs in the area evaluated.

**Table of Contents**

**Index to Financial Statements**

**PART I**

**Item 1. Business**

**BACKGROUND**

VAALCO Energy, Inc., a Delaware corporation incorporated in 1985, is a Houston-based independent energy company principally engaged in the acquisition, exploration, development and production of crude oil and natural gas. VAALCO owns producing properties and conducts exploration activities as operator in Gabon, West Africa, conducts exploration activities as operator in Angola, West Africa and conducts exploration activities as a non-operator in the British North Sea. As used herein, the terms "Company" and "VAALCO" mean VAALCO Energy, Inc. and its subsidiaries, unless the context otherwise requires. The Company's corporate headquarters are located at 4600 Post Oak Place, Suite 309, Houston, Texas 77027 where the telephone number is (713) 623-0801.

VAALCO's international subsidiaries are VAALCO Gabon (Etame), Inc., VAALCO Production (Gabon), Inc., VAALCO Angola (Kwanza), Inc., VAALCO UK (North Sea), Ltd., and VAALCO International Inc. VAALCO Energy (USA), Inc. holds interests in certain properties located in the United States.

**RECENT DEVELOPMENTS**

The Company's primary source of revenue is from the Etame Production Sharing Contract related to the Etame Marin block located offshore the Republic of Gabon. VAALCO operates the Etame Marin block on behalf of a consortium of companies. At December 31, 2009, VAALCO owned a 30.35% interest in the exploration acreage within the Etame Marin block. The Company owns a 28.1% interest in the development areas surrounding the Etame, Avouma, South Tchibala and Ebouri fields. The development areas were subject to a 7.5% back-in by the Government of Gabon, which occurred for these fields after their successful development.

The Company produces from the Etame, Avouma, South Tchibala and Ebouri fields on the block. Oil production commenced from the Etame field in September 2002, from the Avouma and South Tchibala fields in January 2007, and from the Ebouri field in January 2009. During 2009, the Etame, Avouma, South Tchibala and Ebouri fields produced approximately 8.3 million bbls (1.9 million bbls net to the Company).

Beginning in November 2008, drilling began on the first of two exploration wells within the Etame Marin block. The first of these wells, the North Ebouri, encountered substantial oil-filled Gamba sandstone, proving-up significant additional reserves North of the originally mapped Ebouri field development outline. The second well, the North Etame prospect, encountered water bearing sands and was abandoned. Also beginning in November 2008, drilling began on the first of two development wells in the Ebouri field. Both wells were brought onto production in 2009.

## Edgar Filing: VAALCO ENERGY INC /DE/ - Form 10-K

Onshore Gabon, the Company has a 100% working interest in the Mutamba Iroru block located near the coast in central Gabon. The Mutamba Iroru block contains an exploration area of approximately 270,000 acres. Two exploration wells were drilled in 2009 and both wells encountered water bearing sands and were abandoned.

Exploration period extensions were successfully negotiated with the government of Gabon on both of the blocks under contract. The Etame Marin block received a four year extension expiring in 2014 and the Mutamba Iroru block received a two year extension expiring in 2011.

In November 2006, the Company signed a production sharing contract for a 40% working interest in Block 5 offshore Angola. The four year contract with an optional three year extension awards the Company exploration rights to approximately 1.4 million acres along the central coast of Angola. The Company has been interpreting seismic data in preparation for the drilling of two exploration wells. The government-assigned working interest partner has been delinquent on paying their share of the costs several times in 2009 and consequently was placed

## **Table of Contents**

### **Index to Financial Statements**

in a default position which has impacted the timing for drilling the wells. In early 2010, the Company began the process to acquire the interest of the non-performing partner and is working with the government of Angola regarding a time extension for the drilling of the commitment wells beyond the November 2010 expiration date. While we believe that the government of Angola will grant us an extension, we can provide no assurances. If the government of Angola were to deny a time extension, the Company risks forfeiture of its \$10 million funds in escrow if the wells are not drilled by November 2010 plus the Company may be required to impair its leasehold costs and other investments of \$11.4 million as of December 31, 2009. If we are successful in obtaining such extension, the Company estimates the drilling will take place in the first half of 2011 on this block in Angola.

In January 2008, the Company signed a farm-in agreement for a 25% working interest in Block 48/25c offshore in the British North Sea. In February 2009, the Company participated in a well drilled on the block in the Southern Gas Basin. A substantial gas column was found but with low permeability and porosity. The well was deemed to be non-commercial by the consortium and was abandoned.

See Note 14 to the Company's consolidated financial statements for financial information about the Company's segments.

## **AVAILABLE INFORMATION**

The Company files annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission. You may read and copy any document the Company files at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the SEC's Public Reference Room. The Company's SEC filings are also available to the public at the SEC's website at [www.sec.gov](http://www.sec.gov).

You may also obtain copies of the Company's annual, quarterly and current reports, proxy statements and certain other information filed with the SEC, as well as amendments thereto, free of charge from the Company's website at [www.vaalco.com](http://www.vaalco.com). No information from the SEC or the Company's website is incorporated by reference herein. The Company has placed on its website copies of its Audit Committee Charter, Code of Business Conduct and Ethics, and Code of Ethics for the Chief Executive Officer and Chief Financial Officer. Stockholders may request a printed copy of these governance materials by writing to the Corporate Secretary, VAALCO Energy Inc., 4600 Post Oak Place, Suite 309, Houston, Texas 77027.

## **GENERAL**

The Company's current production strategy is to maximize the value of the reserves discovered in Gabon through exploitation of the Etame Marin block (comprised of the Etame, Avouma, South Tchibala and Ebouri fields). The Company also owns a 100% working interest in the 270,000 acre Mutamba Irou block onshore Gabon and a 40% working interest in the 1.4 million acre Block 5 offshore Angola where, along with the Etame Marin Block, exploration activities take place.

### *International*

The Company's international strategy is to pursue selected opportunities that are characterized by reasonable entry costs, favorable economic terms, high reserve potential relative to capital expenditures and the availability of existing technical data that may be further developed. The Company believes that it has unique management and technical expertise in identifying international opportunities and establishing favorable operating relationships with host governments and local partners familiar with the local practices and infrastructure. The Company owns producing properties and conducts exploration activities as operator of two exploration licenses in Gabon, and one exploration license in Angola.

## **Table of Contents**

### **Index to Financial Statements**

#### *Domestic*

The Company's domestic strategy is to produce existing reserves. There are no plans to drill new domestic wells at this time. Current domestic properties are located in Brazos County, Texas and offshore Louisiana in the Ship Shoal area.

#### **CUSTOMERS**

Substantially all of the Company's oil and gas is sold at posted or indexed prices under short-term contracts, as is customary in the industry. In Gabon, the Company sold oil under a contract with Total Oil Trading S.A. which ran through calendar year 2009. For the 2010 calendar year, the Company will sell its oil under a contract with Vitol S.A. ( Vitol ). While the loss of Vitol as a buyer might have a material effect on the Company in the short term, management believes that the Company would be able to obtain other customers for its crude oil. Domestic production is sold via two contracts, one for oil and one for gas. The Company has access to several alternative buyers for oil and gas sales domestically.

#### **EMPLOYEES**

As of December 31, 2009, the Company had 77 full-time employees and consultant contractors, 44 of whom were located in Gabon and nine of whom were located in Angola. The Company is not subject to any collective bargaining agreements, although most of the national employees in Gabon are members of the NEOP (National Organization of Petroleum Workers) union. The Company believes its relations with its employees are satisfactory.

#### **COMPETITION**

The oil and gas industry is highly competitive. Competition is particularly intense with respect to acquisitions of desirable oil and gas reserves. There is also competition for the acquisition of oil and gas leases suitable for exploration and the hiring of experienced personnel. In addition, the producing, processing and marketing of oil and gas is affected by a number of factors beyond the control of the Company, the effects of which cannot be accurately predicted.

The Company's competition for acquisitions, exploration, development and production include the major oil and gas companies in addition to numerous independent oil companies, individual proprietors, investors and others. Many of these competitors possess financial and personnel resources substantially in excess of those available to the Company, giving those competitors an enhanced ability to evaluate and acquire desirable leases properties or prospects. The ability of the Company to generate reserves in the future will depend on its ability to select and acquire suitable producing properties and prospects for future drilling and exploration.

#### **ENVIRONMENTAL REGULATIONS**

**General**

The Company's activities are subject to federal, state and local laws and regulations governing environmental quality and pollution control in the United States, Gabon and Great Britain and will be subject to the laws and regulations of Angola when exploration drilling begins. Although no assurances can be made, the Company believes that, absent the occurrence of an extraordinary event, compliance with existing laws, rules and regulations regulating the release of materials in the environment or otherwise relating to the protection of the environment will not have a material effect upon the Company's capital expenditures, earnings or competitive position with respect to its existing assets and operations. The Company cannot predict what effect future regulation or legislation, enforcement policies, and claims for damages to property, employees, other persons and the environment resulting from the Company's operations could have on its activities. In part because they are developing countries, it is unclear how quickly and to what extent Gabon or Angola will increase their regulation



**Table of Contents**

**Index to Financial Statements**

of environmental issues in the future; any significant increase in the regulation or enforcement of environmental issues by Gabon or Angola could have a material effect on the Company. Developing countries, in certain instances, have patterned environmental laws after those in the United States which are discussed below. However, the extent to which any environmental laws are enforced in developing countries varies significantly.

**Environmental Regulations in the United States**

*Solid and Hazardous Waste*

The Company currently owns or leases, and in the past has owned or leased, properties that have been used for the exploration and production of oil and gas for many years. Although the Company has utilized operating and disposal practices that were standard in the industry at the time, hydrocarbons or other solid wastes may have been disposed or released on or under the properties owned or leased by the Company or on or under locations where such wastes have been taken for disposal. In addition, some of these properties are or have been operated by third parties. The Company has no control over such entities' treatment of hydrocarbons or other solid wastes and the manner in which such substances may have been disposed or released. State and federal laws applicable to oil and gas wastes and properties have gradually become stricter over time. The Company could, in the future, be required to remediate property, including groundwater, containing or impacted by previously disposed wastes (including wastes disposed or released by prior owners or operators, or property contamination, including groundwater contamination by prior owners or operators) or to perform remedial plugging operations to prevent future or mitigate existing contamination.

The Company generates wastes, including hazardous wastes that are subject to the federal Resource Conservation and Recovery Act ( RCRA ) and comparable state statutes. The Environmental Protection Agency ( EPA ) and various state agencies have limited the disposal options for certain wastes, including wastes designated as hazardous under RCRA and state analogs ( Hazardous Wastes ). Furthermore, although oil and gas wastes generally are exempt from regulation as hazardous waste, it is possible that certain wastes generated by the Company's oil and gas operations that are currently exempt may in the future be designated as Hazardous Wastes under RCRA or other applicable statutes and, therefore, may be subject to more rigorous and costly disposal requirements.

*Superfund*

The federal Comprehensive Environmental Response, Compensation and Liability Act ( CERCLA ), also known as the Superfund law, generally imposes joint and several liability for costs of investigation and remediation and for natural resource damages, without regard to fault or the legality of the original conduct, on certain classes of persons with respect to the release into the environment of substances designated under CERCLA as hazardous substances ( Hazardous Substances ). These classes of persons, or so-called potentially responsible parties ( PRPs ), include the current and certain past owners and operators of a facility where there has been a release or threat of release of a Hazardous Substance and persons who disposed of or arranged for the disposal of Hazardous Substances found at a site. CERCLA also authorizes the EPA and, in some cases, third parties to take actions in response to threats to the public health or the environment and to seek to recover from the PRPs the costs of such action.

Although CERCLA generally exempts petroleum from the definition of Hazardous Substance, in the course of its operations, the Company has generated, and will generate, wastes that may fall within CERCLA's definition of Hazardous Substance and may have disposed of these wastes at disposal sites owned and operated by others. The Company may also be the owner or operator of sites on which Hazardous Substances have

been released. To its knowledge, neither the Company nor its predecessors have been designated as a PRP by the EPA under CERCLA; the Company also does not know of any prior owners or operators of its properties that are named as PRPs related to their ownership or operation of such properties. States such as Texas have comparable statutes. In the event contamination is discovered at a site on which the Company is or has been an owner or operator or to which the Company sent Hazardous Substances, the Company could be liable for costs of investigation and remediation and natural resources damages.

## Table of Contents

### Index to Financial Statements

#### *Clean Water Act*

The Clean Water Act ( CWA ) imposes restrictions and strict controls regarding the discharge of wastes, including produced waters and other oil and natural gas wastes, into waters of the United States, a term broadly defined. These controls have become more stringent over the years, and it is probable that additional restrictions will be imposed in the future. Permits must be obtained to discharge pollutants into federal waters. The CWA provides for civil, criminal and administrative penalties for unauthorized discharges of oil and hazardous substances and of other pollutants. It imposes substantial potential liability for the costs of removal or remediation associated with discharges of oil or hazardous substances and other pollutants. State laws governing discharges to water also provide varying civil, criminal and administrative penalties and impose liabilities in the case of a discharge of petroleum or its derivatives, or other hazardous substances, into state waters. In addition, the EPA has promulgated regulations that may require the Company to obtain permits to discharge storm water runoff, including discharges associated with construction activities. In the event of an unauthorized discharge of wastes, the Company may be liable for penalties and costs.

#### *Oil Pollution Act*

The Oil Pollution Act of 1990 ( OPA ), which amends and augments oil spill provisions of the CWA, imposes certain duties and liabilities on certain responsible parties related to the prevention of oil spills and damages resulting from such spills in or threatening United States waters or adjoining shorelines. A liable responsible party includes the owner or operator of a facility, vessel or pipeline that is a source of an oil discharge or that poses the substantial threat of discharge, or in the case of offshore facilities, the lessee or permittee of the area in which a discharging facility is located. OPA assigns joint and several liability, without regard to fault, to each liable party for oil removal costs and a variety of public and private damages. Although defenses exist to the liability imposed by OPA, they are limited. In the event of an oil discharge or substantial threat of discharge, the Company may be liable for costs and damages.

The OPA also imposes ongoing requirements on a responsible party, including proof of financial responsibility to cover at least some costs in a potential spill. Certain amendments to the OPA that were enacted in 1996 require owners and operators of offshore facilities that have a worst case oil spill potential of more than 1,000 bbls to demonstrate financial responsibility in amounts ranging from \$10 million in specified state waters and \$35 million in federal outer continental shelf ( OCS ) waters, with higher amounts, up to \$150 million based upon worst case oil-spill discharge volume calculations. The Company believes that it has established adequate proof of financial responsibility for its offshore facilities.

#### *Endangered Species Act.*

The Endangered Species Act ( ESA ) was established to protect endangered and threatened species. Pursuant to that act, if a species is listed as threatened or endangered, restrictions may be imposed on activities adversely affecting that species' habitat. Similar protections are offered to migratory birds under the Migratory Bird Treaty Act. The U.S. Fish and Wildlife Service must also designate the species' critical habitat and suitable habitat as part of the effort to ensure survival of the species. A critical habitat or suitable habitat designation could result in further material restrictions to land use and may materially delay or prohibit land access for oil and natural gas development. If the Company were to have a portion of its leases designated as critical or suitable habitat, it may adversely impact the value of the affected leases.

#### *Climate Change Legislation*

## Edgar Filing: VAALCO ENERGY INC /DE/ - Form 10-K

More stringent laws and regulations relating to climate change and greenhouse gases ( GHGs ) may be adopted in the future and could cause us to incur material expenses in complying with them. The U.S. Congress has considered climate change related legislation to regulate GHG emissions that could affect our operations and our regulatory costs, as well as the value of oil and natural gas generally. A climate change bill passed the United States House of Representatives but the Senate has not passed climate legislation. The House bill would establish

## Table of Contents

### Index to Financial Statements

a cap-and-trade program under which overall GHG emissions are limited and allowances to emit GHGs are then allocated and/or sold. Although Congress has not passed comprehensive climate change legislation, expectations are that Congress will continue to consider some type of climate change legislation. There is a great deal of uncertainty as to how and when federal regulation of GHGs might take place. In the absence of federal legislative action on climate change, the EPA has initiated a number of rulemakings, the result of which would be the regulation of GHG emissions under the Clean Air Act. Further, the EPA has enacted a mandatory greenhouse gas reporting program which imposes reporting and monitoring requirements on the covered industries; we do not believe our operations to be subject to this program, but there is no guarantee that the EPA will not expand the program to additional industries. Should we be required to report GHG emissions, it could require us to incur costs to monitor, keep records of, and report emissions of GHGs. In addition to possible federal regulation, a number of states, individually and regionally, also are considering or have implemented GHG regulatory programs. These federal and state initiatives may result in regulatory requirements that could result in our incurring material expenses to comply, e.g., by being required to purchase or to surrender allowances for GHGs resulting from our operations under a cap-and-trade program, or installing pollution control equipment to control emissions under the Clean Air Act. These regulatory initiatives also could adversely affect the marketability of the oil and natural gas the Company produces. The impact of such future programs cannot be predicted, but the Company does not expect its operations to be affected any differently than other similarly situated domestic competitors.

#### *Air Emissions*

The Company's operations are subject to local, state and federal regulations for the control of emissions from sources of air pollution. Federal and state laws require new and modified sources of air pollutants to obtain permits prior to commencing construction. Major sources of air pollutants are subject to more stringent, federally imposed requirements including additional permits. Federal and state laws designed to control hazardous (toxic) air pollutants, might require installation of additional controls. Administrative enforcement actions for failure to comply strictly with air pollution regulations or permits are generally resolved by payment of monetary fines and correction of any identified deficiencies. Alternatively, regulatory agencies could bring lawsuits for civil penalties or require the Company to forego construction, modification or operation of certain air emission sources.

#### *Coastal Coordination*

There are various federal and state programs that regulate the conservation and development of coastal resources. The federal Coastal Zone Management Act ( CZMA ) was passed in 1972 to preserve and, where possible, restore the natural resources of the Nation's coastal zone. The CZMA provides for federal grants for state management programs that regulate land use, water use and coastal development.

In Texas, the Legislature enacted the Coastal Coordination Act ( CCA ), which provides for the coordination among local and state authorities to protect coastal resources through regulating land use, water, and coastal development. The act establishes the Texas Coastal Management Program ( CMP ). The CMP is limited to the nineteen counties that border the Gulf of Mexico and its tidal bays. The act provides for the review of state and federal agency rules and agency actions for consistency with the goals and policies of the Coastal Management Plan. This review may impact agency permitting and review activities and add an additional layer of review to certain activities undertaken by the Company.

#### *OSHA and other Regulations*

## Edgar Filing: VAALCO ENERGY INC /DE/ - Form 10-K

The Company is subject to the requirements of the federal Occupational Safety and Health Act ( OSHA ) and comparable state statutes. The OSHA hazard communication standard, the EPA community right-to-know regulations under Title III of CERCLA and similar state statutes require the Company to organize and/or disclose information about hazardous materials used or produced in its operations. The Company believes that it is in substantial compliance with these applicable requirements.

**Table of Contents**

**Index to Financial Statements**

**FORWARD-LOOKING STATEMENTS**

This Report includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which are intended to be covered by the safe harbors created by those laws. The Company has based these forward-looking statements on its current expectations and projections about future events. These forward-looking statements include information about possible or assumed future results of the Company's operations. All statements, other than statements of historical facts, included in this Report that address activities, events or developments that the Company expects or anticipates may occur in the future, including without limitation, statements regarding the Company's financial position, reserve quantities and net present values, business strategy, plans and objectives of the Company's management for future operations are forward-looking statements. When the Company uses words such as anticipate, believe, estimate, expect, intend, plan, probably or similar expressions, the Company is making forward-looking statements. Risks and uncertainties may impact the matters addressed in these forward-looking statements.

Some of the events or factors that could affect the Company's future results and could cause results to differ materially from those expressed in the Company's forward-looking statements include:

the volatility of oil and natural gas prices;

the uncertainty of estimates of oil and natural gas reserves;

the impact of competition;

the availability and cost of seismic, drilling and other equipment;

operating hazards inherent in the exploration for and production of oil and natural gas;

difficulties encountered during the exploration for and production of oil and natural gas;

difficulties encountered in delivering oil to commercial markets;

general economic conditions, including the economic and financial market crises;

changes in customer demand and producers' supply;

the uncertainty of the Company's ability to attract capital;

## Edgar Filing: VAALCO ENERGY INC /DE/ - Form 10-K

compliance with, or the effect of changes in, the foreign governmental regulations regarding the Company's exploration and production, including those related to climate change;

actions of operators of the Company's oil and gas properties; and

weather conditions.

The information contained in this Report, including the information set forth under the heading "Risk Factors," identifies additional factors that could cause the Company's results or performance to differ materially from those the Company expresses in its forward-looking statements. Although the Company believes that the assumptions underlying its forward-looking statements are reasonable, any of these assumptions and therefore also the forward-looking statements based on these assumptions, could themselves prove to be inaccurate. In light of the significant uncertainties inherent in the forward-looking statements which are included in this Report, the Company's inclusion of this information is not a representation by the Company or any other person that the Company's objectives and plans will be achieved. When you consider the Company's forward-looking statements, you should keep in mind these risk factors and the other cautionary statements in this Report.

The Company's forward-looking statements speak only as of the date made and the Company will not update these forward-looking statements unless the securities laws require the Company to do so. The Company's forward-looking statements are expressly qualified in their entirety by this cautionary statement. In light of these risks, uncertainties and assumptions, any forward-looking events discussed in this Report may not occur.



**Table of Contents**

**Index to Financial Statements**

**Item 1A. Risk Factors**

You should carefully consider the following risk factors in addition to the other information included in this Report. If any of these risks or uncertainties actually occurs, our business, financial condition and results of operations could be materially adversely affected. Additional risks not presently known to us or which we consider immaterial based on information currently available to us may also materially adversely affect us. In this section, the terms VAALCO, we, us and our refer to VAALCO Energy, Inc. and its subsidiaries, unless the context clearly indicates otherwise.

*Almost all of the value of our production and reserves is concentrated in a single block offshore Gabon, and any production problems or reductions in reserve estimates related to this property would adversely impact our business.*

The Etame field consisting of four producing wells, the Avouma and South Tchibala fields consisting of one producing well each, and the Ebouri field with two producing wells constituted almost 100% of our total production for the year ended December 31, 2009. In addition, at December 31, 2009, almost 100% of our total net proved reserves were attributable to these fields. If mechanical problems, storms or other events curtailed a substantial portion of this production, or if the actual reserves associated with this producing property are less than our estimated reserves, our results of operations and financial condition could be materially adversely affected.

*Our results of operations and financial condition could be adversely affected by changes in currency exchange rates.*

Our results of operations and financial condition are affected by currency exchange rates. While oil sales are denominated in U.S. dollars, portions of our operating costs in Gabon are denominated in the local currency. A weakening U.S. Dollar will have the effect of increasing operating costs while a strengthening U.S. Dollar will have the effect of reducing operating costs. The Gabon local currency is tied to the Euro. The exchange rate between the Euro and the U.S. dollar has fluctuated widely in response to international political conditions, general economic conditions and other factors beyond our control.

*A decrease in oil and gas prices may adversely affect our results of operations and financial condition.*

Our revenues, cash flow, profitability and future rate of growth are substantially dependent upon prevailing prices for oil and gas. Our ability to borrow funds and to obtain additional capital on attractive terms is also substantially dependent on oil and gas prices. Historically, world-wide oil and gas prices and markets have been volatile, particularly in 2008 and 2009, and are likely to continue to be volatile in the future. The average price for crude we sold from Gabon in 2009 was \$59.54 per barrel compared to \$92.87 per barrel in 2008 and \$71.16 per barrel in 2007.

Prices for oil and gas are subject to wide fluctuations in response to relatively minor changes in the supply of and demand for oil and gas, market uncertainty and a variety of additional factors that are beyond our control. These factors include international political conditions, the domestic and foreign supply of oil and gas, the level of consumer demand, weather conditions, domestic and foreign governmental regulations, the price and availability of alternative fuels, the health of international economic and credit markets, and general economic conditions. In addition, various factors, including the effect of federal, state and foreign regulation of production and transportation, general economic conditions, changes in supply due to drilling by other producers and changes in demand may adversely affect our ability to market our oil and gas production. Any significant decline in the price of oil or gas would adversely affect our revenues, operating income, cash flows and borrowing

capacity and may require a reduction in the carrying value of our oil and gas properties and our planned level of capital expenditures.

**Table of Contents**

**Index to Financial Statements**

*If there is a sustained economic downturn or recession in the United States or globally, oil and natural gas prices may fall and may become and remain depressed for a long period of time, which may adversely affect our results of operations.*

We experienced an economic downturn or a recession in the United States and globally. The reduced economic activity associated with the economic downturn or recession may reduce the demand for, and the prices we receive for, our oil and gas production. A sustained reduction in the prices we receive for our oil and gas production will have a material adverse effect on our results of operations.

*Unless we are able to replace reserves which we have produced, our cash flows and production will decrease over time.*

Our future success depends upon our ability to find, develop or acquire additional oil and gas reserves that are economically recoverable. Except to the extent that we conduct successful exploration or development activities or acquire properties containing proved reserves, our estimated net proved reserves will generally decline as reserves are produced. There can be no assurance that our planned development and exploration projects and acquisition activities will result in significant additional reserves or that we will have continuing success drilling productive wells at economic finding costs. The drilling of oil and gas wells involves a high degree of risk, especially the risk of dry holes or of wells that are not sufficiently productive to provide an economic return on the capital expended to drill the wells. In addition, our drilling operations may be curtailed, delayed or canceled as a result of numerous factors, including title problems, weather conditions, political instability, availability of capital, economic/currency imbalances, compliance with governmental requirements, receipt of additional seismic data or the reprocessing of existing data, material changes in oil or gas prices, prolonged periods of historically low oil and gas prices, failure of wells drilled in similar formations or delays in the delivery of equipment and availability of drilling rigs. Our current domestic oil and gas properties are operated by third parties and, as a result, we have limited control over the nature and timing of exploration and development of such properties or the manner in which operations are conducted on such properties.

*Substantial capital, which may not be available to us in the future, is required to replace and grow reserves.*

We make, and will continue to make, substantial capital expenditures for the acquisition, exploitation, development, exploration and production of oil and gas reserves. Historically, we have financed these expenditures primarily with cash flow from operations, debt, asset sales, and private sales of equity. During 2009, we participated, and in 2010 we expect to continue to participate, in the further exploration and development projects on our international properties. In Gabon and Angola, we are the operator of the blocks and are thus responsible for contracting on behalf of all the remaining parties participating in the project. We rely on the timely payment of cash calls by our partners to pay for the 69.65% share of the Etame budget and 50% of the Angola Block 5 budget for which they are responsible. However, if lower oil and gas prices, operating difficulties or declines in reserves result in our revenues being less than expected or limit our ability to borrow funds, or our partners fail to pay their share of project costs, we may have a limited ability, particularly in the current economic environment, to expend the capital necessary to undertake or complete future drilling programs. We cannot assure that additional debt or equity financing or cash generated by operations will be available to meet these requirements.

*We may need access to the capital markets to fund a portion of our growth strategy. The recent unprecedented disruption in the capital markets may adversely affect our growth strategy.*

During 2008 and 2009, the U.S. and international financial markets experienced unprecedented volatility and disruption. This disruption in the financial markets made it difficult for companies to successfully issue common stock or debt securities to fund growth. If the effects of

disruption in the financial markets continues for a substantial period of time or if a disruption reoccurs, our ability to fund growth may be adversely affected.

**Table of Contents**

**Index to Financial Statements**

*Our drilling activities require us to risk significant amounts of capital that may not be recovered.*

Drilling activities are subject to many risks, including the risk that no commercially productive reservoirs will be encountered. There can be no assurance that new wells drilled by us will be productive or that we will recover all or any portion of our investment. Drilling for oil and gas may involve unprofitable efforts, not only from dry wells, but also from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, operating and other costs. The cost of drilling, completing and operating wells is often uncertain and cost overruns are common. Our drilling operations may be curtailed, delayed or canceled as a result of numerous factors, many of which are beyond our control, including title problems, weather conditions, compliance with governmental requirements and shortages or delays in the delivery of equipment and services.

*Weather, unexpected subsurface conditions and other unforeseen operating hazards may adversely impact our oil and gas activities.*

The oil and gas business involves a variety of operating risks, including fire, explosions, blow-outs, pipe failure, casing collapse, abnormally pressured formations and environmental hazards such as oil spills, gas leaks, ruptures and discharges of toxic gases, the occurrence of any of which could result in substantial losses to us due to injury and loss of life, severe damage to and destruction of property, natural resources and equipment, pollution and other environmental damage, clean-up responsibilities, regulatory investigation and penalties and suspension of operations. Our production facilities are also subject to hazards inherent in marine operations, such as capsizing, sinking, grounding, collision and damage from severe weather conditions. The relatively deep offshore drilling conducted by us overseas involves increased drilling risks of high pressures and mechanical difficulties, including stuck pipe, collapsed casing and separated cable. The impact that any of these risks may have upon us is increased due to the low number of producing properties we own.

We maintain insurance against some, but not all, potential risks; however, there can be no assurance that such insurance will be adequate to cover any losses or exposure for liability. The occurrence of a significant unfavorable event not fully covered by insurance could have a material adverse effect on our financial condition, results of