VAALCO ENERGY INC /DE/
Form 10-Q
August 08, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2013

¨ **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 1-32167

VAALCO Energy, Inc.

(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of** **incorporation or organization)**	**76-0274813** **(I.R.S. Employer** **Identification No.)**
4600 Post Oak Place **Suite 300** **Houston, Texas** **(Address of principal executive offices)**	**77027** **(Zip code)**

(713) 623-0801

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 x 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 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 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	x
Non-accelerated filer	¨	Smaller reporting company	¨

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

As of July 31, 2013, there were outstanding 56,662,294 shares of common stock, $0.10 par value per share, of the registrant.

VAALCO ENERGY, INC. AND SUBSIDIARIES

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VAALCO ENERGY, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(in thousands of dollars, except number of shares and par value amounts)

	June 30, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 78,708**	$ 130,800
Restricted cash	**1,770**	1,257
Receivables:		
Trade	**26,227**	7,961
Accounts with partners, net of allowance of $7.2 million and $6.0 million at June 30, 2013 and December 31, 2012, respectively	**4,821**	689
Other	**7,688**	4,463
Crude oil inventory	**3,328**	683
Materials and supplies	**642**	337
Prepayments and other	**4,099**	2,935
Total current assets	**127,283**	149,125
Property and equipment - successful efforts method:		
Wells, platforms and other production facilities	**198,571**	188,208
Undeveloped acreage	**28,410**	28,657
Work in progress	**61,929**	38,137
Equipment and other	**7,221**	7,574
	296,131	262,576
Accumulated depreciation, depletion and amortization	**(163,411)**	(155,968)
Net property and equipment	**132,720**	106,608
Other assets:		
Deferred tax asset	**1,349**	1,349
Restricted cash	**10,871**	10,874
Total Assets	**$ 272,223**	$ 267,956
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	**$ 33,219**	$ 30,326
Accounts with partners		14,737
Total current liabilities	**33,219**	45,063
Asset retirement obligations	**11,135**	10,368
Total Liabilities	**44,354**	55,431

Commitments and Contingencies (Note 4)		
VAALCO Energy, Inc. shareholders equity:		
Common stock, $0.10 par value, 100,000,000 authorized shares, 63,167,438 and 63,135,772 shares issued with 5,491,038 and 5,257,638 shares in treasury at June 30, 2013 and December 31, 2012, respectively	**6,317**	6,314
Additional paid-in capital	**51,186**	48,816
Retained earnings	**195,680**	181,370
Less treasury stock, at cost	**(25,314)**	(23,975)
Total VAALCO Energy, Inc. shareholders equity	**227,869**	212,525
Total Liabilities and Equity	**$ 272,223**	$ 267,956

See notes to unaudited condensed consolidated financial statements.

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VAALCO ENERGY, INC. AND SUBSIDIARIES

CONDENSED STATEMENTS OF CONSOLIDATED OPERATIONS

(unaudited)

(in thousands of dollars, except per share amounts)

	Three months ended June 30, 2013	Three months ended June 30, 2012	Six months ended June 30, 2013	Six months ended June 30, 2012
Revenues:				
Oil and gas sales	**$ 29,118**	$ 58,818	**$ 73,255**	$ 104,104
Operating costs and expenses:				
Production expenses	**7,015**	6,537	**15,399**	12,063
Exploration expense	**4,280**	3,484	**10,386**	4,337
Depreciation, depletion and amortization	**3,431**	6,850	**7,057**	11,854
General and administrative expenses	**2,464**	3,040	**6,102**	6,521
Bad debt expenses	**262**	275	**1,141**	590
Total operating costs and expenses	**17,452**	20,186	**40,085**	35,365
Operating income	**11,666**	38,632	**33,170**	68,739
Other income (expense):				
Interest income	**16**	32	**41**	73
Other, net	**(2)**	382	**(96)**	583
Total other income (expense)	**14**	414	**(55)**	656
Income before income taxes	**11,680**	39,046	**33,115**	69,395
Income tax expense	**4,559**	26,729	**18,805**	46,549
Net income	**7,121**	12,317	**14,310**	22,846
Less net income attributable to noncontrolling interest		(1,893)		(3,402)
Net income attributable to VAALCO Energy, Inc.	**$ 7,121**	$ 10,424	**$ 14,310**	$ 19,444
Basic net income attributable to VAALCO Energy, Inc. common shareholders	**$ 0.12**	$ 0.18	**$ 0.25**	$ 0.34
Diluted net income attributable to VAALCO Energy, Inc. common shareholders	**$ 0.12**	$ 0.18	**$ 0.24**	$ 0.33
Basic weighted shares outstanding	**57,901**	57,797	**57,904**	57,496
Diluted weighted shares outstanding	**58,560**	59,000	**58,786**	58,701

See notes to unaudited condensed consolidated financial statements.

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VAALCO ENERGY, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(unaudited)

(in thousands of dollars)

	VAALCO Energy, Inc. Shareholders					
Six Months Ended June 30, 2013	**Common Stock**	**Aditional Paid-In Capital**	**Retained Earnings**	**Treasury Stock**	**Noncontrolling Interest**	**Total**
Balance at January 1, 2013	$ 6,314	$ 48,816	$ 181,370	$ (23,975)	$	$ 212,525
Proceeds from stock issuance	3	132				135
Stock based compensation		2,238				2,238
Treasury stock purchase				(1,339)		(1,339)
Net income			14,310			14,310
Balance at June 30, 2013	$ 6,317	$ 51,186	$ 195,680	$ (25,314)	$	$ 227,869

	VAALCO Energy, Inc. Shareholders					
Six Months Ended June 30, 2012	Common Stock	Aditional Paid-In Capital	Retained Earnings	Treasury Stock	Noncontrolling Interest	Total
Balance at January 1, 2012	$ 6,238	$ 66,122	$ 180,739	$ (23,975)	$ 3,943	$ 233,067
Proceeds from stock issuance	72	3,297				3,369
Stock based compensation		1,704				1,704
Net income			19,444		3,402	22,846
Distribution to noncontrolling interest					(3,597)	(3,597)
Balance at June 30, 2012	$ 6,310	$ 71,123	$ 200,183	$ (23,975)	$ 3,748	$ 257,389

See notes to unaudited condensed consolidated financial statements.

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VAALCO ENERGY, INC. AND SUBSIDIARIES

CONDENSED STATEMENTS OF CONSOLIDATED CASH FLOWS

(Unaudited)

(in thousands of dollars)

	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	**$ 14,310**	$ 22,846
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation, depletion and amortization	**7,057**	11,854
Unrealized foreign exchange loss (gain)	**22**	(358)
Dry hole costs	**8,836**	2,853
Stock based compensation	**2,238**	1,704
Bad debt expense	**1,141**	590
Change in operating assets and liabilities:		
Trade receivables	**(18,266)**	(9,904)
Accounts with partners	**(20,010)**	6,077
Other receivables	**(3,306)**	(1,061)
Crude oil inventory	**(1,944)**	(437)
Materials and supplies	**(305)**	(180)
Prepayments and other	**(1,166)**	(1,594)
Accounts payable, accrued liabilities and other liabilities	**1,848**	(4,372)
Net cash provided by (used in) operating activities	**(9,545)**	28,018
CASH FLOWS FROM INVESTING ACTIVITIES		
Restricted cash, net	**(510)**	88
Property and equipment expenditures	**(40,833)**	(27,221)
Net cash used in investing activities	**(41,343)**	(27,133)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from the issuance of common stock	**135**	3,369
Purchase of treasury stock	**(1,339)**	
Distribution to noncontrolling interest		(3,597)
Net cash used in financing activities	**(1,204)**	(228)
NET CHANGE IN CASH AND CASH EQUIVALENTS	**(52,092)**	657
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	**130,800**	137,139
CASH AND CASH EQUIVALENTS AT END OF PERIOD	**$ 78,708**	$ 137,796
Supplemental disclosure of cash flow information		
Income taxes paid	**$ 18,416**	$ 41,733
Supplemental disclosure of non cash transactions		
Property and equipment additions incurred during the period but not paid at period end	**$ 11,238**	$ 5,456
Property and equipment reductions as the result in changes in asset retirement cost estimates	**$**	$ 5,670

See notes to unaudited condensed consolidated financial statements.

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VAALCO ENERGY, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS AND ACCOUNTING POLICIES

The condensed consolidated financial statements of VAALCO Energy, Inc. and subsidiaries (collectively, VAALCO or the Company), included herein are unaudited, but include all adjustments consisting of normal recurring accruals which the Company deems necessary for a fair presentation of its financial position, results of operations and cash flows for the interim period. Such results are not necessarily indicative of results to be expected for the full year. These financial statements should be read in conjunction with the financial statements and notes thereto included in the Company s Form 10-K for the year ended December 31, 2012, which also contains a summary of the significant accounting policies followed by the Company in the preparation of its consolidated financial statements. These policies were also followed in preparing the quarterly report included herein. The Company follows the successful efforts method of accounting for oil and gas exploration and development costs.

VAALCO 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 an operator in Gabon, West Africa, conducts exploration activities as an operator in Angola, West Africa, and conducts exploration activities as a non-operator in Equatorial Guinea, West Africa. VAALCO is the operator of unconventional and conventional resource properties in the United States located in Montana and North Texas. The Company also owns minor interests in conventional production activities as a non-operator in the United States.

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

2. EARNINGS PER SHARE

Basic earnings per share (EPS) is calculated using the average number of shares of common stock outstanding during each period. Diluted EPS assumes the exercise of all stock options having exercise prices less than the average market price of the common stock using the treasury stock method.

Diluted shares consist of the following:

	Three months ended,		Six months ended,	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
Basic weighted average common stock issued and outstanding	57,900,809	57,797,484	57,903,871	57,496,261
Dilutive options	659,475	1,202,808	881,937	1,204,568
Total dilutive shares	58,560,284	59,000,292	58,785,808	58,700,829

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Options to purchase 3,205,865 and 2,135,300 shares were excluded in the three months and six months ended June 30, 2013, respectively, because they would have been anti-dilutive. Options to purchase 1,018,900 and 1,018,900 shares were excluded in the three months and six months ended June 30, 2012, respectively, because they would have been anti-dilutive.

3. STOCK-BASED COMPENSATION

Stock options are granted under the Company s long-term incentive plan and have an exercise price that may not be less than the fair market value of the underlying shares on the date of grant. In general, stock options granted will become exercisable over a period determined by the Compensation Committee which in the past has been a five year life. A portion of the stock options granted in March 2013 and 2012 vested immediately with the remainder vesting over a two year period. In addition, stock options will become exercisable upon a change in control, unless provided otherwise by the Compensation Committee. At June 30, 2013, there were 2,127,046 shares subject to options authorized but not granted.

For the three months and six months ended June 30, 2013, the Company recognized non-cash compensation expense of $0.8 million and $2.2 million, respectively, related to stock options. For the three months and six months ended June 30, 2012, the Company recognized non-cash compensation expense of $0.4 million and $1.7 million, respectively, related to stock options. These amounts were recorded as general and administrative expense. Because the Company does not pay significant United States federal income taxes, no amounts were recorded for tax benefits related to excess stock based compensation deductions.

A summary of the stock option activity for the six months ended June 30, 2013 is provided below:

	Number of Shares Underlying Options (in thousands)	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (in millions)
Outstanding at beginning of period	4,065	$ 6.12	2.65	
Granted	1,236	7.59	4.71	
Exercised	(32)	4.24	0.28	
Forfeited				
Outstanding at end of period	5,269	$ 6.47	2.77	$ 6.62
Exercisable at end of period	4,386	$ 6.15	2.45	$ 6.62

The intrinsic value of a stock option is the amount by which the current market value of the underlying stock exceeds the exercise price of the option.

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As of June 30, 2013, unrecognized compensation costs totaled $1.7 million. The expense is expected to be recognized over a weighted average period of 1.4 years.

4. COMMITMENTS AND CONTINGENCIES

Offshore Gabon

The Company entered into a sixth exploration period extension during 2009 and is required to spend $5.3 million for its share of two exploration wells and to acquire and process 150 square kilometers of 3-D seismic on the Etame Marin block by July 2014. One of the two exploration commitment wells was drilled in 2010 on the Omangou prospect at a cost of $8.6 million ($2.6 million net to the Company). The seismic obligation was met with the acquisition of 223 square kilometers of 3-D seismic in 2012. The remaining obligation is the drilling of one exploration well which is scheduled to be drilled in the third quarter of 2013. The well to be drilled is the Ovoka 1 well located approximately 5 miles northeast of the Ebouri field and 6 miles north of the Etame field.

As part of securing the second ten-year production license with the government of Gabon, the Company agreed in principle to a cash funding arrangement for the eventual abandonment of the offshore wells, platforms and facilities. The agreement is not yet finalized, but calls for annual funding for the next seven years at 12.14% of the total abandonment estimate per year and 5.0% per year for the last three years of the production license. The amounts paid will be reimbursed through the cost account and are non-refundable to the Company. The funding will begin after the agreement is finalized. The abandonment estimate for this purpose is approximately $10.1 million net to the Company on an undiscounted basis. The obligation for abandonment of the Gabon offshore facilities is included in the asset retirement obligation shown on the Company s balance sheet.

Angola

In November 2006, the Company signed a production sharing contract for Block 5 offshore Angola. The four year primary term with an optional three year extension awards the Company exploration rights to 1.4 million acres offshore central Angola. The Company s working interest is 40%. Additionally, the Company is required to carry the Angolan national oil company, Sonangol P&P, for 10% of the work program. During the first four years of the contract, the Company was required to acquire and process 1,000 square kilometers of 3-D seismic data, drill two exploration wells and expend a minimum of $29.5 million ($14.8 million net to the Company). The Company fulfilled its seismic obligation when it acquired 1,175 square kilometers of 3-D seismic data at a cost of $7.5 million ($3.75 million net to the Company) in January 2007 and 524 square kilometers of 3-D seismic data during the fourth quarter of 2008 at a cost of $6.0 million ($3.0 million net to the Company). Each of the two exploration commitment wells is subject to a $5.0 million penalty ($10.0 million in aggregate for both wells) if not drilled during the contract term. The $10.0 million is currently recorded as restricted cash and is held at a financial institution located in the United States. Additional time extensions have been granted by the Angolan government to drill the two exploration commitment wells, the latest extension providing until November 30, 2014.

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The government-assigned working interest partner was delinquent paying their share of the costs several times in 2009 and consequently was placed in a default position. By a governmental decree, dated December 1, 2010, the former partner was removed from the production sharing contract. Following the decree, the Company and the government of Angola have been working together to obtain a replacement partner.

In the second quarter of 2012, the Company identified a potential partner to acquire the available 40% working interest and submitted the name of the interested party to the Angolan government for approval. In July 2013, the Angolan government informed the Company that it should first proceed to acquire the available working interest per the provisions of the Joint Operating Agreement and then enter into a farm-out agreement with the potential partner. The Company is working to accomplish the two-step process outlined by the Angolan government. The Company cannot provide a time estimate for completing these activities as it involves actions by the Angolan government as well as the potential partner.

Due to the continuing circumstances regarding the available 40% working interest, the Company has recorded a full allowance totaling $7.2 million as of June 30, 2013, against the accounts receivable from partners for the amounts owed to the Company above its 40% working interest plus the 10% carried interest. The allowance recorded in the three and six months ended June 30, 2013 totaled $0.3 million and $1.1 million, respectively. The farm-out agreement, to be executed by the counterparty, provides for the Company to be reimbursed for the gross receivable amount. The timing of this event cannot be reasonably predicted at the present time.

5. CAPITALIZATION OF EXPLORATORY WELL COSTS

ASC Topic 932 Extractive Industries provides that an exploratory well shall be capitalized as part of the entity s uncompleted wells pending the determination of whether the well has found proved reserves. Further, an exploration well that discovers oil and gas reserves, but those reserves cannot be classified as proved when drilling is completed, shall be capitalized if the well has found a sufficient quantity of reserves to justify its completion as a producing well and the entity is making sufficient progress assessing the reserves and the economic and operating viability of the project. If either condition is not met, the exploration well would be assumed to be impaired and its costs would be charged to expense.

In the second and third quarters of 2010, the Company drilled the Southeast Etame No. 1 well with two sidetracks in the Etame Marin block offshore Gabon. The well discovered a five meter column of oil in the Gamba sand reservoir. Additional evaluation of the well and sidetrack information was conducted to determine options for developing the discovery. In the second quarter of 2012, the Company and its partners agreed to proceed with the development plan featuring a fixed leg platform for developing the Southeast Etame discovery area and the North Tchibala field, where a discovery was made on the block prior to VAALCO s block participation. The final investment decision was approved in the fourth quarter of 2012 for the construction of the platform. Construction began in the first quarter of 2013 and the platform is expected to be transported and installed in the first half of 2014. The Company has capitalized $8.1 million for this well in accordance with the criteria contained in ASC Topic 932.

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In the third and fourth quarters of 2012, the Company drilled the N Gongui No. 2 well with three sidetracks in the Mutamba Iroru block onshore Gabon. Application of the discovery was made timely to the government of Gabon, but the permit has yet to be issued. The Company has capitalized $7.9 million for this well in accordance with the criteria contained in ASC Topic 932.

6. REPURCHASE OF COMMON STOCK

On June 6, 2013, the Company announced that its Board of Directors has authorized the repurchase of up to $25 million of the Company s common stock over the next 12 months. Under the share buyback program, shares of common stock will be purchased on the open market or through privately negotiated transactions from time-to-time. The share buyback program does not obligate the Company to acquire any specific number of shares in any period, and may be modified, suspended, extended or discontinued at any time without prior notice. During the quarter ended June 30, 2013, the Company repurchased 233,400 shares at an average price of $5.74 per share totaling $1.3 million.

As of August 1, 2013, the Company repurchased an additional 1,125,706 shares bringing the total amount of shares repurchased in this program to 1,359,106 shares. The average price paid for all shares was $6.00 per share totaling $8.2 million.

7. SEGMENT INFORMATION

The Company s main operations are based in Gabon, Angola, Equatorial Guinea, and in the United States. Minor activities for the Company s United Kingdom subsidiary is included in the Corporate and Other column in the table. Management reviews and evaluates the operation of each geographic segment separately. The operations of all segments include exploration for and production of hydrocarbons where commercial reserves have been found and developed. Revenues are based on the location of hydrocarbon production.

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VAALCO ENERGY, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The Company evaluates each segment based on income (loss) from operations. Segment activity for the three months and six months ended June 30, 2013 and 2012 are as follows:

($ thousands)	Gabon	Angola	EG	USA	Corporate and Other	Total
Three months ended June 30, 2013						
Revenues	$ 28,574	$	$	$ 544	$	$ 29,118
Income from operations	14,853	(379)	(165)	(1,336)	(1,307)	11,666
2012						
Revenues	$ 57,886	$	$	$ 932	$	$ 58,818
Income from operations	45,258	(585)		(3,843)	(2,198)	38,632

($ thousands)	Gabon	Angola	EG	USA	Corporate and Other	Total
Six months ended June 30, 2013						
Revenues	$ 72,229	$	$	$ 1,026	$	$ 73,255
Income from operations	45,717	(1,582)	(455)	(7,028)	(3,482)	33,170
2012						
Revenues	$ 102,613	$	$	$ 1,491		$ 104,104
Income from operations	79,605	(1,199)		(4,606)	(5,061)	68,739

Total Assets

($ thousands)	Gabon	Angola	EG	USA	Corporate and Other	Total
As of June 30, 2013	$ 208,545	$ 12,126				