

VAALCO ENERGY INC /DE/
Form 10-Q
August 10, 2009
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2009

.. **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 small business issuer as specified in its charter)

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Delaware (State or other jurisdiction of incorporation or organization)	76-0274813 (I.R.S. Employer Identification No.)
4600 Post Oak Place Suite 309 Houston, Texas (Address of principal executive offices)	77027 (Zip code)
(713) 623-0801 (Issuer'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 ☒ No ☐.

Indicate by check mark whether the registrant submitted electronically and posted on its corporate website, if applicable, 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 & post such filings). 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 <input type="checkbox"/>	Accelerated filer <input checked="" type="checkbox"/>
Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>

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

As of July 31, 2009, there were outstanding 58,115,328 shares of common stock, \$0.10 par value per share, of the registrant.

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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, 2009	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 88,369	\$ 125,425
Funds in escrow	6,946	7,445
Receivables:		
Trade	10,564	9,513
Accounts with partners	1,265	3,796
Other	3,511	2,074
Crude oil inventory	330	1,381
Materials and supplies	400	425
Prepayments and other	1,606	2,351
Total current assets	112,991	152,410
Property and equipment - successful efforts method:		
Wells, platforms and other production facilities	137,440	84,693
Undeveloped acreage	12,586	12,841
Work in progress	259	43,288
Equipment and other	2,425	2,844
	152,710	143,666
Accumulated depreciation, depletion and amortization	(71,902)	(61,379)
Net property and equipment	80,808	82,287
Other assets:		
Deferred tax asset	1,349	1,349
Funds in escrow	16,585	15,637
Other long term assets	526	347
Total assets	\$ 212,259	\$ 252,030
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 19,077	\$ 57,773
Accounts with partners	17,209	5,394
Total current liabilities	36,286	63,167
Long term debt	5,000	5,000
Other liabilities	1,200	

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Asset retirement obligations	10,465	10,071
Total liabilities	52,951	78,238
VAALCO Energy, Inc. shareholders' equity:		
Common stock, \$0.10 par value, 100,000,000 authorized shares, 61,122,324 and 61,116,324 shares issued with 3,006,996 and 2,860,642 shares in treasury at June 30, 2009 and December 31, 2008, respectively	6,112	6,112
Additional paid-in capital	55,148	53,983
Retained earnings	102,905	117,205
Less treasury stock, at cost	(12,030)	(11,422)
Total VAALCO Energy, Inc. shareholders' equity	152,135	165,878
Noncontrolling interest	7,173	7,914
Total Equity	159,308	173,792
Total Liabilities and Equity	\$ 212,259	\$ 252,030

See notes to unaudited condensed consolidated financial statements.

Table of Contents**VAALCO ENERGY, INC. AND SUBSIDIARIES****CONDENSED STATEMENTS OF CONSOLIDATED OPERATIONS****(unaudited)***(in thousands of dollars, except per share amounts)*

	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
Revenues:				
Oil and gas sales	\$ 32,148	\$ 55,354	\$ 53,406	\$ 97,512
Operating costs and expenses:				
Production expenses	4,490	4,537	10,178	8,931
Exploration expense	13,506	1,337	33,972	8,049
Depreciation, depletion and amortization	5,621	5,239	11,276	10,173
General and administrative expenses	3,940	3,566	3,851	5,553
Other operating income	(1,984)		(1,984)	
Total operating costs and expenses	25,573	14,679	57,293	32,706
Operating income (loss)	6,575	40,675	(3,887)	64,806
Other income (expense):				
Interest income	261	843	645	1,356
Interest expense	(126)	(55)	(141)	(419)
Other, net	574	5	1,041	(28)
Total other income (expense)	709	793	1,545	909
Income (loss) before income taxes	7,284	41,468	(2,342)	65,715
Income tax expense	7,323	26,488	9,702	47,870
Net income (loss)	(39)	14,980	(12,044)	17,845
Less net income attributable to noncontrolling interest	(1,642)	(1,953)	(2,256)	(3,017)
Net income (loss) attributable to VAALCO Energy, Inc.	\$ (1,681)	\$ 13,027	\$ (14,300)	\$ 14,828
Earnings per share - basic:				
Net income (loss) attributable to VAALCO Energy, Inc. common shareholders	\$ (0.03)	\$ 0.22	\$ (0.25)	\$ 0.25
Earnings per share - diluted:				
Net income (loss) attributable to VAALCO Energy, Inc. common shareholders	(0.03)	0.22	(0.25)	0.25
Basic weighted shares outstanding	58,260	58,879	58,261	59,108
Diluted weighted shares outstanding	58,260	59,626	58,261	59,700

See notes to unaudited condensed consolidated financial statements.

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VAALCO ENERGY, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(unaudited)

(in thousands of dollars)

Six Months Ended June 30, 2009

	VAALCO Energy, Inc. Shareholders					
	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Noncontrolling Interest	Total
Balance at January 1, 2009	\$ 6,112	\$ 53,983	\$ 117,205	\$ (11,422)	\$ 7,914	\$ 173,792
Proceeds from stock issuance		23				23
Stock based compensation		1,142				1,142
Treasury stock purchase				(608)		(608)
Net income (loss)			(14,300)		2,256	(12,044)
Dividends on common stock					(2,997)	(2,997)
Balance at June 30, 2009	\$ 6,112	\$ 55,148	\$ 102,905	\$ (12,030)	\$ 7,173	\$ 159,308

Six Months Ended June 30, 2008

	VAALCO Energy, Inc. Shareholders					
	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Noncontrolling Interest	Total
Balance at January 1, 2008	\$ 6,105	\$ 51,294	\$ 87,483	\$ (2,552)	\$ 8,396	\$ 150,726
Proceeds from stock issuance	5	111				116
Stock based compensation		494				494
Treasury stock purchase				(8,870)		(8,870)
Net income			14,828		3,017	17,845
Dividends on common stock					(2,997)	(2,997)
Balance at June 30, 2008	\$ 6,110	\$ 51,899	\$ 102,311	\$ (11,422)	\$ 8,416	\$ 157,314

See notes to unaudited condensed consolidated financial statements.

Table of Contents**VAALCO ENERGY, INC. AND SUBSIDIARIES****CONDENSED STATEMENTS OF CONSOLIDATED CASH FLOWS****(Unaudited)***(in thousands of dollars)*

	Six Months Ended June 30,	
	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	\$ (12,044)	\$ 17,845
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities		
Depreciation, depletion and amortization	11,276	10,173
Amortization of debt issuance costs		93
Unrealized foreign exchange gain	(363)	
Dry hole costs	31,984	6,399
Stock based compensation	1,142	494
Change in operating assets and liabilities:		
Trade receivables	(1,051)	4,566
Accounts with partners	(8,896)	5,798
Other receivables	(1,401)	(182)
Crude oil inventory	1,050	(649)
Materials and supplies	25	(86)
Deferred tax asset		22
Prepayments and other	848	(1,091)
Accounts payable, accrued liabilities and other liabilities	(1,784)	12,071
Other long term assets	(179)	
Income taxes payable		(200)
Net cash provided by operating activities	20,607	55,253
CASH FLOWS FROM INVESTING ACTIVITIES		
Funds in escrow	(449)	(2)
Property and equipment expenditures	(59,369)	(11,367)
Reimbursement of property and equipment expenditures by partner	5,737	
Net cash used in investing activities	(54,081)	(11,369)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from the issuance of common stock	23	116
Purchase of treasury shares	(608)	(8,870)
Distribution to noncontrolling interest	(2,997)	(2,997)
Net cash used in financing activities	(3,582)	(11,751)
NET CHANGE IN CASH AND CASH EQUIVALENTS	(37,056)	32,133
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	125,425	76,450

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CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 88,369	\$ 108,583
Supplemental disclosure of cash flow information		
Income taxes paid	\$ 8,633	\$ 45,771
Interest paid	\$ 15	\$ 265
Supplemental disclosure of non cash flow information		
Property and equipment additions incurred during the period but not paid at period end	\$ 904	\$ 4,439

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, 2008, which also contain 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 the operator of two production sharing contracts in Gabon, West Africa, conducts exploration activities in one concession in Angola, West Africa and has recently conducted exploration activities on two blocks in the British North Sea. Domestically, the Company has minor interests in the Gulf of Mexico.

VAALCO's subsidiaries holding interests in Gabon are VAALCO Energy (International), Inc., VAALCO Gabon (Etame), Inc. and VAALCO Production (Gabon), Inc. In Angola VAALCO holds its concession interest in VAALCO Angola (Kwanza), Inc. In Great Britain VAALCO holds its North Sea interests in VAALCO UK (North Sea), Ltd. VAALCO Energy (USA), Inc. holds interests in certain properties in the United States.

2. EARNINGS PER SHARE

The Company accounts for earnings per share in accordance with Statement of Financial Accounting Standards ("SFAS") No. 128 *Earnings per Share*, ("EPS"). SFAS No. 128 requires the presentation of basic and diluted EPS on the face of the income statement. Basic 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 and warrants having exercise prices less than the average market price of the common stock using the treasury stock method. For purposes of computing EPS in a loss quarter, potential common shares are excluded from the computation of weighted average common shares outstanding as their effect is antidilutive. For the three and six month periods ended June 30, 2009, 502,195 and 224,422 potential common shares were excluded, respectively.

Diluted shares consist of the following:

Item	Three months ended		Six months ended	
	June 30, 2009	June 30, 2008	June 30, 2009	June 30, 2008
Basic weighted average common stock issued and outstanding	58,260,074	58,878,846	58,260,741	59,107,639
Dilutive options	0	746,802	0	592,152
Total diluted shares	58,260,074	59,625,648	58,260,741	59,699,791

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Options to purchase 2,085,612 and 1,697,640 shares were excluded in the three months and six months ended June 30, 2009, respectively, because they would have been anti-dilutive.

On September 14, 2007, the Board of Directors of the Company adopted a Rights Agreement dated as of September 14, 2007 between the Company and the Registrar and Transfer agent of the Company, as Rights Agent. The Plan created a dividend of one right for each outstanding share of the Company's Common Stock. The rights are represented by and traded with the Company's Common Stock. Initially, there will be no separate certificates or market for the rights. The rights do not separate from the Common Stock unless one or both of the following conditions are met: a public announcement that a person has acquired 15% or more of the Common Stock of the Company, or a tender or exchange offer is made which, if completed, would result in the bidder beneficially owning 15% or more of the Common Stock of the Company. The Rights Agreement was voted upon at the 2009 Annual Meeting of Stockholders held on June 3, 2009. Stockholders did not approve the ratification and the Company announced on July 8, 2009 that its Board of Directors has determined to redeem the rights issued under the Company's stockholder rights plan.

3. NEW ACCOUNTING PRONOUNCEMENTS

FASB Statement No. 157, Fair Value Measurements In September 2006, the FASB issued FASB Statement No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a framework for measuring fair value and enhances disclosures about instruments carried at fair value, but does not change existing guidance as to whether or not an instrument is carried at fair value. In February 2008, the FASB issued FASB Staff Positions (FSP) SFAS 157-2, *Effective Date for FASB Statement 157*. This FSP permits the delayed application of SFAS 157 for all non-recurring fair value measurements of non-financial assets and non-financial liabilities until fiscal years beginning after November 15, 2008. The Company adopted SFAS 157, as amended, on a prospective basis beginning January 1, 2008, for its financial assets and liabilities and January 1, 2009 for its non-financial assets and liabilities. The adoption of SFAS No. 157 for our nonfinancial assets and liabilities did not have an impact on the Company's consolidated results of operations or financial condition.

FASB Statement No. 141(R), Business Combinations, and FASB Statement No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51 The Company adopted FASB Statement No. 141(R), *Business Combinations*, which replaced FASB Statement No. 141, *Business Combinations*, (SFAS 141(R)) and FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements* an amendment of ARB No. 51, (SFAS 160) on January 1, 2009. These statements significantly change the accounting for business combinations and noncontrolling interests. Among other things, and compared to the predecessor guidance, these statements will require more assets acquired and liabilities assumed to be measured at fair value as of the acquisition date, liabilities related to contingent consideration to be remeasured to fair value each subsequent reporting period, an acquirer in preacquisition periods to expense all acquisition-related costs, and noncontrolling interests in subsidiaries initially to be measured at fair value and classified as a separate component of equity. SFAS 160 changes the accounting and reporting for minority interests, which are re-characterized as noncontrolling interests, and classified as a component of equity. We retroactively applied the presentation and disclosure requirements of SFAS 160 to all periods presented.

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Final Rule, Modernization of Oil and Gas Reporting In December 2008, the SEC released Final Rule, Modernization of Oil and Gas Reporting, to revise the existing Regulation S-K and Regulation S-X reporting requirements to align with current industry practices and technological advances. Further, the SEC on December 31, 2008, published the final rules and interpretations. Many of the revisions are updates to definitions in the existing oil and gas rules to make them consistent with the petroleum resource management system, which is a widely accepted standard for the management of petroleum resources that was developed by several industry organizations. Key revisions include the ability to include nontraditional resources in reserves, the use of new technology for determining reserves, permitting disclosure of probable and possible reserves, and changes to the pricing used to determine reserves in that companies must use a 12-month average price. The average is calculated using the first-day-of-the-month price for each of the 12 months that make up the reporting period. The SEC will require companies to comply with the amended disclosure requirements for registration statements filed after January 1, 2010, and for annual reports for fiscal years ending on or after December 15, 2009. Early adoption is not permitted. The Company is currently assessing the impact that the adoption will have on our disclosures, operating results, financial position and cash flows.

FASB FSPs No. FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments In April 2009, the FASB issued FSP No. FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (FSP No. FAS 107-1). FSP No. FAS 107-1 amends SFAS No. 107 and Accounting Principles Board (APB) Opinion No. 28 to require disclosures about fair value of financial instruments in interim reporting periods for publicly traded companies. We adopted the provisions and applied the presentation and disclosure requirements of this FSP for the period ending June 30, 2009.

The Company's financial instruments consist primarily of cash, funds in escrow, trade accounts, trade payables and debt. The book values of cash, trade receivables, and trade payables are representative of their respective fair values due to the short-term maturity of these instruments. The book value of the Company's debt instruments are considered to approximate the fair value, as the interest rates are adjusted based on rates currently in effect.

FASB Statement No. 165, Subsequent Events In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* . SFAS No. 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS No. 165 is effective for interim and annual reporting periods ending after June 15, 2009. We adopted SFAS No. 165 for the period ending June 30, 2009. We evaluated subsequent events through August 10, 2009.

FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R) In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)* . Among other things, SFAS No. 167 amends FIN 46(R) to replace the calculation for determining which entities, if any, have a controlling financial interest in a variable interest entity (VIE) from a quantitative based risks and rewards calculation, to a qualitative approach that focuses on identifying which entities have the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and,

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the obligation to absorb losses of the entity or the right to receive benefits from the entity. This standard also requires ongoing assessments as to whether an enterprise is the primary beneficiary of a VIE (previously, reconsideration was only required upon the occurrence of specific events), modifies the presentation of consolidated VIE assets and liabilities, and requires additional disclosures about a company's involvement in VIEs. SFAS No. 167 will be effective for the Company beginning January 1, 2010. The Company is currently assessing the impact that the adoption will have on its disclosures, operating results, financial position and cash flows.

FASB Statement No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*. SFAS No. 168 will become the source of authoritative GAAP recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date of this Statement, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other non-grandfathered non-SEC accounting literature not included in the Codification will become non authoritative. This statement is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company does not expect the adoption of SFAS No. 168 to have an impact on its disclosures, operating results, financial position and cash flows.

4. 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, with the options vesting over a three year period. In addition, stock options will become exercisable upon a change in control, unless provided otherwise by the Compensation Committee. At June 30, 2009, there were 1,570,896 shares subject to options authorized but not granted.

During the six months ended June 30, 2009, the Company granted no stock options.

For the three months and six months ended June 30, 2009, the Company recognized non-cash compensation expense of \$0.4 million and \$1.1 million respectively, (or \$0.01 and \$0.02 per basic and diluted share, respectively), related to stock options. For the three months and six months ended June 30, 2008, the Company recognized non-cash compensation expense of \$0.2 million and \$0.5 million, respectively (or \$0.00 and \$0.01 per basic and diluted share, respectively). These amounts were recorded as general and administrative expense. Because the Company does not pay significant United States taxes, no amounts were recorded for tax benefits related to excess stock based compensation deductions.

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A summary of the unit option activity for the six months ended June 30, 2009 is provided below:

	Number of Shares Underlying Options (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (in millions)
Outstanding at beginning of period	4,763	\$ 5.33	3.24	
Granted				
Exercised	(6)	3.85	0.54	
Forfeited	(24)	6.39	4.28	
Outstanding at end of period	4,733	\$ 5.32	2.64	\$ 1.0
Exercisable at end of period	3,371	\$ 5.30	2.64	\$ 1.0

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. As of June 30, 2009, unrecognized compensation costs totaled \$1.2 million. The expense is expected to be recognized over a weighted average period of 1.1 years. Stock options vested during the six months ended June 30, 2009 totaled 547,166 options.

5. GUARANTEES

In September 2007, the Company entered into an amendment to the Floating Production, Storage and Offloading (FPSO) contract for the fields within the Etame Marin block to extend the contract until September 2015. In connection with the charter of the FPSO, the Company as operator of the Etame Marin block guaranteed the charter payments through the same time period. The charter continues for two years beyond that period unless one year's prior notice is given to the owner of the FPSO. The Company obtained several guarantees from its partners for their share of the charter payment. The Company's share of the charter payment is 28.1%. The Company believes the need for performance under the charter guarantee is remote. The estimated obligations for the annual charter payment and the Company's share of the charter payments through the end of the charter are as follows (*in thousands*):

Year	Full Charter Payment	Company Share
2009 (remainder)	\$ 8,713	\$ 2,446
2010	\$ 17,105	\$ 4,802
2011	\$ 16,906	\$ 4,746
2012	\$ 16,769	\$ 4,708
2013	\$ 16,814	\$ 4,720
Thereafter	\$ 28,346	\$ 7,958

The Company has recorded a liability of \$0.6 million at June 30, 2009 representing the guarantee's fair value.

6. COMMITMENTS

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In January 2006, the partners elected to extend the Etame Production Sharing Contract related to the Etame Marin block for an additional five-year term commencing July 2006. The extension consists of a three-year and a two-year follow-on term. The first term carries a minimum work obligation of one exploration well for a minimum \$7.0 million exploration expenditure commitment (\$2.1 million net to the Company). The exploration well commitment was met with the drilling of the North Etame

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

prospect in February 2009, which was abandoned after encountering water bearing sands. For the optional two year extension, an additional exploration well is required.

In November 2005, the Company signed a production sharing contract for the Mutamba Iroru block onshore Gabon. The five-year contract awards the Company exploration rights along the central coast of Gabon. During the first three years of the contract the Company is required to drill one exploration well and expend a minimum of \$4.0 million. During the optional two-year extension to the contract, the Company is required to acquire specified levels of seismic data, drill one exploration well and expend a minimum of \$5.0 million. In February 2009, the Company drilled the exploration well required under the first exploration period after receiving an extension on the first period to complete the well. The well was abandoned after encountering water bearing sands. A second exploration well was drilled in the first quarter of 2009. The well also found water bearing sands and was abandoned. The Company has given notice that it will enter into the second exploration period and is seeking clarification as to whether the second well drilled on the Mutamba Iroru block fulfills the exploration well commitment in the extension.

In November 2006, the Company signed a production sharing contract for Block 5 offshore Angola. The seven-year contract awards the Company exploration rights to 1.4 million acres offshore central Angola. The Company's working interest in the contract is 40%, plus 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 consortium is required to acquire and process 1,000 square kilometers of 3-D seismic, drill two exploration wells and expend a minimum of \$29.5 million (\$14.8 million net to the Company). During the optional three-year extension to the contract, the consortium is required to acquire 600 square kilometers of 3-D seismic data, drill two exploration wells and expend a minimum of \$27.2 million (\$13.6 million net to the Company). The consortium acquired the 1,175 square kilometers of 3-D data called for in the first exploration period at a cost of \$7.5 million (\$3.75 million net to the Company) in January 2007. Subsequently, the consortium acquired 524 square kilometers of proprietary 3-D seismic data on the block during the fourth quarter of 2008 at a cost of \$6.0 million (\$3.0 million net to the Company). The Company has identified several potential exploration well locations and expects the consortium will drill the two exploration wells in 2010.

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. The Company is obligated to pay its share of the drilling of one well on the block and a portion of the share of the farminee's share of the well. The block is located in the Southern Gas Basin and an exploration well began drilling in February 2009. The well was deemed to be non-commercial and was abandoned.

7. PARTNER REALIGNMENT AGREEMENT

On June 3, 2009, a realignment agreement was signed with a joint venture partner that originally did not participate in an appraisal well and one of the development wells in the Ebouri field, offshore Gabon. Pursuant to the realignment agreement, the joint venture partner paid its proportionate share of capital expenditures for the wells, which reduced the Company's capital expenditures by \$5.7 million. In addition the Company benefits from a \$15.0 million (\$6.5 million net to the Company) risk

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premium being paid by the partner benefiting the other joint venture partners that originally participated in those two wells. In the quarter ended June 30, 2009 the Company received a \$2.0 million payment from the partner and the payment was recorded as other operating income. The remaining proceeds of \$4.5 million are expected to be received and recognized as income in the third quarter of 2009.

8. TAX AUDIT

During the second quarter of 2009, the Gabon Ministry of Finance initiated a withholding tax audit for the Company's Gabon operations for the period 2005 - 2007. The Company has discovered certain vendors' invoices were processed without the applicable withholding tax payment being made to the Republic of Gabon. An estimate of the additional tax has been calculated resulting in an accrued liability in the amount of \$0.8 million. The results of the audit are expected soon and it is expected the audit report claim will be made in excess of the amount recorded. Only after the report is received and resolved, perhaps through negotiations, will the final amount be known.

9. REPURCHASE OF COMMON STOCK

On June 24, 2009, the Company announced that its Board of Directors has authorized the repurchase of up to \$10 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, 2009 the Company repurchased 146,354 shares at an average price of \$4.15 per share totaling \$0.6 million. As of August 10, 2009, the Company repurchased an additional 1,353,646 shares bringing the total amount of shares repurchased in this program to 1,500,000 shares. The average price paid for all shares was \$4.14 per share totaling \$6.2 million.

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10. SEGMENT INFORMATION

The Company's operations are based in Gabon, Angola, the British North Sea and in the United States. 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. The Company evaluates each segment based on income (loss) from operations. Segment activity for the three months and six months ended June 30, 2009 and 2008 are as follows: *(in thousands)*

	Gabon	Angola	North Sea	Corporate and Other	Total
Three months ended June 30,					
<u>2009</u>					
Revenues	\$ 32,133	\$	\$	\$ 15	\$ 32,148
Income (loss) from operations	17,708	(1,688)	(6,804)	(2,641)	6,575
<u>2008</u>					
Revenues	\$ 55,296	\$	\$	\$ 58	\$ 55,354
Income (loss) from operations	45,457	(638)	179	(4,323)	40,675
	Gabon	Angola	North Sea	Corporate and Other	Total
Six months ended June 30,					
<u>2009</u>					
Revenues	\$ 53,363	\$	\$	\$ 43	\$ 53,406
Income (loss) from operations	9,871	(2,137)	(9,248)	(2,373)	(3,887)
<u>2008</u>					
Revenues	\$ 97,404	\$	\$	\$ 107	\$ 97,512
Income (loss) from operations	77,106	(859)	(6,355)	(5,085)	64,806

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This report includes forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (Exchange Act). All statements other than statements of historical fact included in this report (and the exhibits hereto), including without limitation, statements regarding the Company's financial position and estimated quantities and net present values of reserves, and statements preceded by, followed by or that otherwise include the word believes, expects, anticipates, intends, projects, target, goal, objective, should, or similar expressions or variations of such are forward looking statements. The Company can give no assurances that the assumptions upon which such statements are based will prove to have been correct. Important factors that could cause actual results to differ materially from the Company's expectations (Cautionary Statements) include the volatility of oil and natural gas prices; future production costs; future production quantities; 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 current economic and financial market crisis; changes in customer demand and producers' supply; the uncertainty of the Company's ability to attract capital; 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; action of operators of the Company's oil and natural gas properties; political turmoil in the Republic of Gabon; weather conditions; and statements set forth in the Risk Factors section included in this report and in the Company's Form 10-K. All subsequent written and oral forward looking statements attributable to the Company or persons acting on its behalf are expressly qualified by the Cautionary Statements.

INTRODUCTION

The Company operates oil production sharing contracts in Gabon and Angola, and has non-active interests in two blocks in the British North Sea. In addition, the Company has minor onshore and offshore domestic United States production in the Gulf of Mexico.

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. 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 and from the Avouma and South Tchibala fields in January 2007. Most recently, the Company developed the Ebouri field. Production from the first well in this field began in January 2009. A second development well began producing oil in April 2009. During the first six months of 2009, the Etame, Avouma, South Tchibala and Ebouri fields produced approximately 4.1 million bbls (1.0 million bbls net to the Company).

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Beginning in November 2008, drilling began on the first of two exploration wells, both of which are located within the Etame Marin block. The first of the