

VAALCO ENERGY INC /DE/

Form 10-Q/A

November 07, 2007

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

Washington, D.C. 20549

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**FORM 10-Q/A**

Amendment No. 1

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(Mark One)

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

For the quarterly period ended June 30, 2007

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-20928

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**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)

4600 Post Oak Place

Suite 309

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

77027

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

(713) 623-0801

(Zip code)

(Issuer's telephone number, including area code)

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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 is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of large accelerated filer and accelerated filer in Rule 12b-2 of the Exchange Act (Check one)

Large accelerated filer  Accelerated filer  Non-accelerated filer

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, 2007, there were outstanding 59,193,647 shares of common stock, \$0.10 par value per share, of the registrant.

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**Explanatory Note**

This Amendment No. 1 on Form 10-Q/A amends Part 1 of the Quarterly Report on Form 10-Q previously filed for the quarter ended June 30, 2007 by VAALCO Energy, Inc. This Form 10-Q/A is filed in connection with the restatement of our Condensed Statements of Consolidated Cash Flows for the six months ended June 30, 2007 and 2006. In October 2007, the Company identified an error in our Condensed Statements of Consolidated Cash Flows presentation of exploration costs. The effects of the change to the Condensed Cash Flow Statements for the six months ended June 30, 2007 and 2006 are described in Footnote 11. Restatement and Item 2 Management's Discussion and Analysis - Capital Resources and Liquidity - Cash Flows.

Other than as described above, all other information contained in this Form 10-Q/A is as of the date of the original filing, and does not reflect subsequent information or events. In addition, Exhibits 31.1, 31.2, 32.1 and 32.2 of the original filing have been amended to contain currently dated certifications from Chief Executive Officer and Chief Financial Officer.

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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, 2007	December 31, 2006
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 72,404	\$ 60,979
Funds in escrow	4,764	4,764
Receivables:		
Trade	10,490	7,608
Accounts with partners		5,540
Other	2,590	1,333
Crude oil inventory	1,402	560
Materials and supplies	324	324
Prepayments and other	1,687	3,073
Total current assets	93,661	84,181
Property and equipment - successful efforts method:		
Wells, platforms and other production facilities	79,322	77,861
Unproved properties	12,841	12,841
Work in progress	5,577	3,720
Equipment and other	1,716	1,550
	99,456	95,972
Accumulated depreciation, depletion and amortization	(33,941)	(25,465)
Net property and equipment	65,515	70,507
Other assets:		
Deferred tax asset	1,257	1,257
Funds in escrow	10,859	10,843
Other long term assets	480	1,154
<b>TOTAL</b>	<b>\$ 171,772</b>	<b>\$ 167,942</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 11,794	\$ 26,686
Accounts with partners	9,131	
Total current liabilities	20,925	26,686
Long term debt	5,000	5,000
Asset retirement obligations	6,264	6,029
Total liabilities	32,189	37,715

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Commitments and contingencies		
Minority interest in consolidated subsidiaries	7,750	7,963
Stockholders' equity:		
Common stock, \$0.10 par value, 100,000,000 authorized shares 60,226,489 and 60,058,155 shares issued with 1,060,342 in treasury at June 30, 2007 and December 31, 2006, respectively	6,023	6,006
Additional paid-in capital	49,373	48,093
Retained earnings	76,703	68,431
Less treasury stock, at cost	(266)	(266)
Total stockholders' equity	131,833	122,264
TOTAL	\$ 171,772	\$ 167,942

*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)*

	<b>Three months ended June 30,</b>		<b>Six months ended June 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Revenues:				
Oil and gas sales	<b>\$ 24,128</b>	\$ 25,575	<b>\$ 53,259</b>	\$ 56,812
Operating costs and expenses:				
Production expenses	<b>2,977</b>	2,945	<b>7,243</b>	6,264
Exploration expense	<b>426</b>	712	<b>5,482</b>	964
Depreciation, depletion and amortization	<b>4,067</b>	1,451	<b>8,730</b>	3,298
General and administrative expenses	<b>1,470</b>	438	<b>4,315</b>	1,130
Total operating costs and expenses	<b>8,940</b>	5,546	<b>25,770</b>	11,656
Operating income	<b>15,188</b>	20,029	<b>27,489</b>	45,156
Other income (expense):				
Interest income	<b>978</b>	689	<b>1,832</b>	1,174
Interest expense	<b>(570)</b>	(192)	<b>(828)</b>	(523)
Other, net	<b>56</b>	(17)	<b>136</b>	(57)
Total other income (expense)	<b>464</b>	480	<b>1,140</b>	594
Income from continuing operations before income taxes, and minority interest	<b>15,652</b>	20,509	<b>28,629</b>	45,750
Income tax expense	<b>11,329</b>	8,677	<b>18,521</b>	20,797
Minority interest in earnings of subsidiaries	<b>582</b>	1,329	<b>1,785</b>	2,760
Income from continuing operations	<b>3,741</b>	10,503	<b>8,323</b>	22,193
Discontinued operations: (Note 6)				
Loss from discontinued operations, net of tax	<b>(24)</b>	(14)	<b>(51)</b>	(729)
Net income	<b>\$ 3,717</b>	\$ 10,489	<b>\$ 8,272</b>	\$ 21,464
Basic income per share from continuing operations	<b>\$ 0.06</b>	\$ 0.18	<b>\$ 0.14</b>	\$ 0.38
Loss from discontinued operations				(0.01)
Basic income per share	<b>\$ 0.06</b>	\$ 0.18	<b>\$ 0.14</b>	\$ 0.37
Diluted income per share from continuing operations	<b>\$ 0.06</b>	\$ 0.17	<b>\$ 0.14</b>	\$ 0.37
Loss from discontinued operations				\$ (0.01)
Diluted income per share	<b>\$ 0.06</b>	\$ 0.17	<b>\$ 0.14</b>	\$ 0.36
Basic weighted shares outstanding	<b>59,124</b>	57,820	<b>59,082</b>	57,562
Diluted weighted average shares outstanding	<b>60,281</b>	60,378	<b>60,355</b>	60,195

*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)*

	<b>Six Months Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
	<i>As restated, see Note 11</i>	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	<b>\$ 8,272</b>	\$ 21,464
Adjustments to reconcile net income to net cash provided by (used in) operating activities		
Depreciation, depletion and amortization	<b>8,730</b>	3,298
Amortization of debt issuance costs	<b>431</b>	339
Stock based compensation	<b>1,138</b>	452
Minority interest in earnings of subsidiaries	<b>1,785</b>	2,760
Change in operating assets and liabilities:		
Trade receivables	<b>(2,882)</b>	(8,624)
Accounts with partners	<b>14,671</b>	(67)
Other receivables	<b>(1,257)</b>	544
Crude oil inventory	<b>(842)</b>	296
Materials and supplies		(39)
Prepayments and other	<b>1,385</b>	1,348
Other long term assets	<b>243</b>	
Accounts payable and accrued liabilities	<b>(10,625)</b>	2,819
Income taxes payable		700
 Net cash provided by operating activities	 <b>21,049</b>	 25,290
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Funds in escrow, net	<b>(16)</b>	1,119
Additions to property and equipment	<b>(7,772)</b>	(8,477)
Other		
 Net cash used in investing activities	 <b>(7,788)</b>	 (7,358)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds from the issuance of common stock	<b>204</b>	1,787
Debt issuance costs capitalized		(207)
Borrowings		5,000
Debt repayment		(1,500)
Distribution to minority interest	<b>(1,998)</b>	(999)
Other	<b>(42)</b>	62
 Net cash provided by (used in) financing activities	 <b>(1,836)</b>	 4,143
 <b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	 <b>11,425</b>	 22,075
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>	<b>60,979</b>	43,880
 <b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	 <b>72,404</b>	 65,955

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Supplemental disclosure of cash flow information		
Income taxes paid	\$ 18,780	\$ 20,797
Interest paid	\$ 225	\$ 92
Supplemental disclosure of non cash flow information		
Change in investment in property and equipment not paid	\$ (4,267)	\$ 832

*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, 2006, 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 the operator of two production sharing contracts in Gabon, West Africa and conducts exploration activities in one concession in Angola, West Africa. Domestically, the Company has interests in the Texas Gulf Coast area.

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. 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.

Diluted Shares consist of the following:

Item	Three months ended		Six months ended	
	June 30, 2007	June 30, 2006	June 30, 2007	June 30, 2006
Basic weighted average common stock issued and outstanding	59,124,086	57,819,842	59,082,113	57,651,747
Dilutive options	1,156,992	2,557,793	1,273,363	2,543,002
<b>Total diluted shares</b>	<b>60,281,078</b>	<b>60,377,635</b>	<b>60,355,476</b>	<b>60,194,749</b>

Options to purchase 1,828,420 shares were excluded in the three months and six months periods ending June 30, 2007 because they would be anti-dilutive.

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VAALCO ENERGY, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

3. NEW ACCOUNTING PRONOUNCEMENTS

**FASB Statement No. 157, Fair Value Measurements** In September 2006, the Financial Accounting Standards Board ( FASB ) issued FASB Statement 157, *Fair Value Measurements*, ( SFAS 157 ), which provides a single definition of fair value, together with a framework for measuring it, and requires additional disclosure about the use of fair value to measure assets and liabilities. SFAS 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. Under SFAS 157, fair value measurements are disclosed by level within that hierarchy. While SFAS 157 does not add any new fair value measurements, it does change current practice. Changes to practice include:

A requirement for an entity to include its own credit standing in the measurement of its liabilities;

A modification of the transaction price presumption;

A prohibition on the use of block discounts when valuing large blocks of securities for broker dealers and investment companies; and

A requirement to adjust the value of restricted stock for the effect of the restriction even if the restriction lapses within one year. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Earlier application is encouraged, provided that no financial statements have yet been issued within that fiscal year by the reporting entity. SFAS 157 will be applied prospectively as of the beginning of the fiscal year in which SFAS 157 is initially applied. The Company will adopt SFAS 157 on January 1, 2008 and does not expect this standard to have a material impact, if any, on its financial statements.

**FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109** The Company adopted Financial Interpretation ( FIN ) No. 48, *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109* ( FIN 48 ) on January 1, 2007. FIN 48 addresses the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 prescribes specific criteria for the financial statement recognition and measurement of the tax effects of a position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition of previously recognized tax benefits, classification of tax liabilities on the balance sheet, recording interest and penalties on tax underpayments, accounting in interim periods, and disclosure requirements. The adoption of this interpretation did not have a material impact on the Company's financial statements. See Note 9 Income Taxes for disclosures required by FIN 48.

4. STOCK-BASED COMPENSATION

On January 1, 2006, the Company adopted SFAS 123(R). Prior to the adoption of SFAS 123(R), the Company had adopted the disclosure-only provisions of SFAS No. 123

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## VAALCO ENERGY, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

*Accounting for Stock-Based Compensation* and continued to account for stock-based compensation using the intrinsic value method prescribed in APB Opinion No. 25, *Accounting for Stock Issued to Employees*. Accordingly, no compensation cost had been recognized for the Company's stock-based plans prior to January 1, 2006.

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. In addition, stock options will become exercisable upon a change in control, unless provided otherwise by the Compensation Committee.

During the six months ended June 30, 2007, the Company granted no stock options.

For the three months and six months ended June 30, 2007, the Company recognized non-cash compensation expense related to stock options of \$0.6 million and \$1.1 million, respectively, (or \$0.01 and \$0.02 per basic and diluted share, respectively). For the three months and six months ended June 30, 2006, the Company recognized non-cash compensation expense of \$0.1 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.

A summary of the unit option activity for the six months ended June 30, 2007 is provided below:

	Number of Units Underlying Options  (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value  (in millions)
Outstanding at beginning of period	4,369	\$ 4.87	3.65	\$ 6.8
Granted				
Exercised	(168)	1.21	0.71	(0.7)
Forfeited	(82)	7.97	4.90	0.2
Outstanding at end of period	4,119	4.96	3.24	6.3
Exercisable at end of period	2,515	\$ 3.04	2.47	\$ 6.3

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, 2007, unrecognized compensation costs totaled \$2.4 million. The expense is expected to be recognized over a weighted average period of 1.5 years. The total fair value of stock options vested during the six months ended June 30, 2007 was approximately \$0.9 million.

## 5. GUARANTEES

In connection with the charter of a Floating Production, Storage and Offloading vessel ( FPSO ) for the Etame field, the Company as operator of the Etame field guaranteed the charter payments through September 2010. The charter continues for two years beyond that



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## VAALCO ENERGY, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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 for the next five years are as follows:

Year	Full Charter Payment	Company Share
	<i>in thousands</i>	<i>in thousands</i>
2007	\$ 8,667	\$ 2,433
2008	\$ 16,199	\$ 4,547
2009	\$ 15,957	\$ 4,480
2010	\$ 11,824	\$ 3,319

The Company has recorded a liability of \$0.3 million at June 30, 2007 representing the guarantee's fair value.

**6. DISCONTINUED OPERATIONS**

On April 30, 2004, the Company closed the sale of all of its assets associated with Service Contract 6 and Service Contract 14 in the Philippines. Terms of the sale included the assumption by the partners of the Company's entire share of any abandonment, environmental or other liabilities associated with the Service Contracts. The Company reclassified the results of the Philippines operations to discontinued operations for prior periods in its financial statements. In the first quarter of 2006, the Company accrued \$0.7 million to settle branch profits remittances taxes in the Philippines associated with the closure of the branches which operated the former Philippines assets. This liability was settled for \$0.4 million in the fourth quarter of 2006 and the balance of the liability was reversed at that time. The branches were officially closed during the second quarter of 2007 and the Company expects no additional financial activity associated with the discontinued operations beyond the second quarter of 2007.

Income/(loss) from discontinued operations	Three Months ended June 30, <i>in thousands</i>		Six months ended June 30, <i>in thousands</i>	
	2007	2006	2007	2006
Operating costs and expenses:				
General and administrative expenses	24	18	56	36
Total operating costs and expenses	24	18	56	36
Other income:				
Interest income		4	5	7
Loss from discontinued operations before income taxes	(24)	(14)	(51)	(29)
Income tax expense				700
Loss from discontinued operations	\$ (24)	\$ (14)	\$ (51)	\$ (729)

**7. EQUITY TRANSACTIONS**

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During the six months ended June 30, 2007, employees and consultants exercised stock options to receive 168,334 shares of common stock, resulting in net proceeds to the Company of \$204,000.



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VAALCO ENERGY, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

8. DEBT

In June 2005, the Company executed a loan agreement for a \$30.0 million revolving credit facility secured by the assets of the Company's Gabon subsidiary. The revolving credit facility extends through June 2008 at which point it can be extended, or converted to a term loan. This revolving credit facility became effective during the first quarter of 2006. Under the revolving credit facility, the International Finance Corporation ( IFC ) holds a pledge of the Company's interest in the Etame Block and a pledge of the shares of VAALCO Gabon (Etame), Inc., the subsidiary which owns the Company's interest in the Etame Block. The IFC also has a security interest in any crude oil sales contract the Company enters into for the sale of crude oil from the Etame Block.

9. INCOME TAXES

The Company adopted the provisions of FIN 48 on January 1, 2007. There was no impact related to the cumulative effect of the change in accounting principle. As of the adoption date, the Company had no unrecognized tax benefits.

Our accounting policy is to recognize interest and penalties accrued related to unrecognized tax benefits in income tax expense. The Company has no accruals for the payment of interest and penalties.

The following table summarizes the tax years that remain subject to examination by major tax jurisdictions:

United States	2003-2005
Gabon	2004-2005

Certain of the Company's U.S. income tax returns are currently under audit by the Internal Revenue Service. While the amounts ultimately agreed upon in resolution of the issues raised may differ from the recorded amount of unrecognized tax benefits, the Company does not expect the outcome to have a material adverse impact on our financial position, results of operations or cash flows.

10. COMMITMENTS

In January 2006 the consortium elected to extend the Etame 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). An additional exploration well is required during the optional two year extension.

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 spend a minimum of \$4.0 million. During the optional two year extension to the contract, the Company is required to acquire specified

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## VAALCO ENERGY, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

levels of seismic data, drill one exploration well and spend a minimum of \$5.0 million. The Company is currently gathering data from past operators of the area for interpretation and prospect delineation.

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%. Additionally, the Company is required to carry the Angolan National Oil Company Sonangol P&P for 10% of the program. During the first four years of the contract, the Company is required to acquire and process 1,000 square kilometers of 3-D seismic, drill two exploration wells and spend a minimum of \$29.5 million (\$14.8 million net to the Company). During the optional three year extension to the contract, the Company is required to acquire 600 square kilometers of 3-D seismic data, drill two exploration wells and spend a minimum of \$27.2 million (\$13.6 million net to the Company). The Company acquired the 1,000 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.

**11. RESTATEMENT**

In October 2007, we identified an error in our cash flow statement presentation of exploration costs. Specifically, we determined that expenditures for geological and geophysical costs that are charged to expense should not be classified as investing activities.

Shown below are the significant effects of the restatement to our condensed cash flow statements (unaudited, in thousands of dollars)

	As previously reported		As restated	
	2007	2006	2007	2006
Statement of Cash Flows:				
For the six months ended June 30,				
Exploration expense	5,482	964		
Net cash provided by operating activities	26,531	26,254	21,049	25,290
Exploration expense	(5,482)	(964)		
Net cash used in investing activities	(13,270)	(8,322)	(7,788)	(7,358)

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VAALCO ENERGY, INC. AND SUBSIDIARIES

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations incorporates the effect of the restatement of the Statement of Cash Flows (unaudited) as discussed in Note 11. Restatement.

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 volatility of oil and gas prices, future production costs, future production quantities, operating hazards, weather, and statements set forth in the Risk Factors section included in the Company's Forms 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 the Etame, Avouma and South Tchibala fields on behalf of a consortium of five companies offshore of the Republic of Gabon. The Avouma and South Tchibala fields began producing in January 2007. The Etame, Avouma and South Tchibala fields produce from six wells (four subsea wells and two platform wells) into a 1.1 million barrel FPSO vessel. During the three months ended June 30, 2007, the Etame, Avouma and South Tchibala fields produced 1.8 million barrels (0.4 million barrels net to the Company). The Company sells its Gabon production to the trading company Addax B.V. ( Addax ) at spot market prices.

The Etame Production Sharing Contract area (the Etame Block ) is comprised of approximately 750,000 acres, all of which is offshore Gabon. The Etame Block contains the Etame field, the Avouma field, the South Tchibala field and the Ebouri field. In October 2006, the Company received approval of the development plan for the Ebouri field. The Company began construction of the Ebouri platform during the fourth quarter of 2006. First production is expected in 2008. During the first quarter of 2007, the Company acquired 400 square kilometers of 3-D seismic data on the Etame Block at a cost of \$1.0 million.

In November 2005, the Company signed a production sharing contract for the Mutamba Irou block onshore Gabon. The five-year contract awards the Company exploration rights to approximately 270,000 acres along the central coast of Gabon. The Company is currently gathering data from past operators of the area for interpretation and prospect delineation.

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VAALCO ENERGY, INC. AND SUBSIDIARIES

On November 2, 2006, the Company entered into a Production Sharing Agreement with the Angolan government for a 40% interest in the 1.4 million acre Block 5 exploration concession, offshore Angola. The Company paid a \$10.5 million dollar signing bonus for its interest during the fourth quarter of 2006. Additionally, the Company paid \$3.8 million for its share of the cost to lease 1,000 square kilometers of 3-D seismic data on the block in the first quarter of 2007. The Company is committed to process the 3-D seismic data and to drill two exploration wells during a four year period commencing from December 1, 2006.

**CAPITAL RESOURCES AND LIQUIDITY**

**Cash Flows**

Net cash provided by operating activities for the six months ended June 30, 2007 was \$21.0 million, as compared to \$25.3 million provided by operations for the six months ended June 30, 2006. In 2007, net cash provided by operating activities included net income of \$8.3 million, depreciation, depletion and amortization of \$8.7 million, amortization of debt issuance costs of \$0.4 million, stock based compensation of \$1.1 million, minority interest of \$1.8 million and cash provided by changes in operating assets and liabilities of \$0.7 million. Net cash provided by operations in the six months ended June 30, 2006 included net income of \$21.5 million, non-cash depreciation, depletion and amortization of \$3.3 million, \$0.3 million of amortization of debt issuance costs, minority interest of \$2.8 million and cash used for working capital of \$3.0 million.

Net cash used in investing activities for the six months ended June 30, 2007 was \$7.8 million, as compared to net cash used in investing activities of \$7.4 million for the six months ended June 30, 2006. In the six months ended June 30, 2007, the Company expended \$7.8 million of cash associated with the construction of the Avouma and Ebouri platforms. In the six months ended June 30, 2006, the Company spent \$8.5 million for the construction of the Avouma platform. In the six months ended June 30, 2006, the Company also had \$1.1 million of funds in escrow released associated with the pay off of the term loan with the IFC.

Net cash used in financing activities in the six months ended June 30, 2007 was \$1.8 million, consisting of \$2.0 million distributed to a minority interest holder and \$0.2 million proceeds from stock issuance. In the six months ended June 30, 2006, net cash provided by financing activities was \$4.1 million, consisting of \$3.5 million of net borrowings, \$1.8 million of proceeds from the issuance of common stock, \$0.2 million of debt issuance costs and \$1.0 million distributed to a minority interest holder. At June 30, 2007, the Company had approximately \$0.3 million of capitalized debt financing costs on the books associated with the \$30.0 million revolving credit facility.

**Capital Expenditures**

During the six months ended June 30, 2007, the Company incurred \$7.8 million of capital expenditures, primarily associated with the construction of the Avouma and Ebouri development platforms. During the remainder of 2007, the Company anticipates continuing construction of the Ebouri platform. Total capital expenditures for the remainder of 2007 are anticipated to be \$11 million. The capital budget for 2007 has been reduced due to the delay in the installation of the Ebouri platform from year end 2007 to early 2008.

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VAALCO ENERGY, INC. AND SUBSIDIARIES

Historically, the Company's primary sources of capital have been cash flows from operations, private sales of equity, borrowings and purchase money debt. At June 30, 2007, the Company had cash of \$72.4 million. The Company believes that this cash combined with cash flow from operations will be sufficient to fund the Company's remaining 2007 capital expenditure budget, required debt service payments and additional investments in working capital resulting from potential growth. As operator of the Etame field, the Company enters into project related activities on behalf of its working interest partners. The Company generally obtains advances from its partners prior to significant funding commitments.

In June 2005, the Company executed a loan agreement with the IFC for a \$30.0 million revolving credit facility which is secured by the assets of the Company's Gabon subsidiary. The facility extends through June 2008 at which point it can be extended, or converted to a term loan. Under the revolving credit facility, the IFC holds a pledge of the Company's interest in the Etame Block, and pledge of the shares of VAALCO Gabon (Etame), Inc., the subsidiary which owns the Company's interest in the Etame Block. The IFC also has a security interest in any crude oil sales contract the Company enters into for the sale of crude oil from the Etame Block.

Substantially all of the Company's crude oil and gas is sold at the well head at posted or index prices under short-term contracts. In Gabon, the Company markets its crude oil under an agreement with Addax. While the loss of Addax as a buyer might have a material adverse effect on the Company in the near term, management believes that the Company would be able to obtain other customers for its crude oil.

Domestically, the Company produces from wells in Brazos County Texas and offshore in the Gulf of Mexico, which contributed \$127,000 to revenues in the first six months of 2007. Domestic production is sold via separate contracts for oil and gas. The Company has access to several alternative buyers for oil and gas sales domestically.

**Oil and Gas Exploration Costs**

The Company uses the successful efforts method of accounting for its oil and gas exploration and development costs. All expenditures related to exploration, with the exception of costs of drilling exploratory wells are charged as an expense when incurred. The costs of exploratory wells are capitalized pending determination of whether commercially producible oil and gas reserves have been discovered. If the determination is made that a well did not encounter potentially economic oil and gas quantities, the well costs are charged as an expense. During the six months ended June 30, 2007, the Company expended \$5.5 million on exploration costs to acquire a license to 1,000 square kilometers of seismic in Angola and to process seismic in Gabon.

The Company had \$5.5 million capitalized for the Ebouri field in Gabon which was being carried as work in progress at June 30, 2007. In July 2006, the Company received approval to declare the Ebouri field's reserves commercial from the Gabon government and in October 2006 the Gabon government approved a development plan for the Ebouri field, and assigned a twenty year

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VAALCO ENERGY, INC. AND SUBSIDIARIES

development area surrounding the field. First production is dependent upon construction and delivery of the platform facilities and rig availability, and is estimated to occur in the second half of 2008.

**Contractual Obligations**

In January 2006, the consortium elected to extend the Etame 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). An additional exploration well is required during the optional two year extension.

In November 2005, the Company signed a production sharing contract for the Mutamba Iruru 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. The Company is currently gathering data from past operators of the area for interpretation and prospect delineation.

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%. 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 is required to acquire and process 1,000 square kilometers of 3-D seismic, drill two exploration wells and spend a minimum of \$29.5 million (\$14.8 million net to the Company). During the optional three year extension to the contract, the Company is required to acquire 600 square kilometers of 3-D seismic data, drill two exploration wells and spend a minimum of \$27.2 million (\$13.6 million net to the Company). The Company acquired the 1,000 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.

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VAALCO ENERGY, INC. AND SUBSIDIARIES

**RESULTS OF OPERATIONS**

**Three months ended June 30, 2007 compared to three months ended June 30, 2006**

**Revenues**

Total revenues were \$24.1 million for the three months ended June 30, 2007 compared to \$25.6 million for the comparable period in 2006. The Company sold approximately 351,000 net barrels of oil equivalent at an average price of \$68.77 in three months ended June 30, 2007. In the three months ended June 30, 2006, the Company sold approximately 374,000 net barrels of oil equivalent at an average price of \$68.42 per barrel. Crude oil production from the Etame, Avouma and South Tchibala fields averaged approximately 20,500 barrels oil per day ( BOPD ) during the three months ended June 30, 2007 compared to approximately 18,000 BOPD in the three months ended June 30, 2006. Crude oil sales are a function of the number and size of crude oil liftings in each quarter from the FPSO and thus crude oil sales do not always coincide with volumes produced in any given quarter.

**Operating Costs and Expenses**

Total production expenses for the three months ended June 30, 2007 were \$3.0 million compared to \$2.9 million in the three months ended June 30, 2006. The Company matches production expenses with crude oil sales. Any production expenses associated with unsold crude oil inventory are capitalized. Expenses in the three months ended June 30, 2007 were higher than in the three months ended June 30, 2006 due in part to higher insurance costs, higher boat rental and boat fuel costs, and higher FPSO costs.

Exploration expense was \$0.4 million for the three months ended June 30, 2007 compared to \$0.7 million in the comparable period in 2006. Exploration expense for the three months ended June 30, 2007 were for processing seismic data in Gabon. In the three months ended June 30, 2006, exploration expense consisted of approximately \$0.5 million associated with North Sea exploration activities and \$0.2 million for exploration activities on the Mutamba Iroru block onshore Gabon.

Depreciation, depletion and amortization expenses were \$4.1 million in the three months ended June 30, 2007 compared to \$1.5 million in the three months ended June 30, 2006. The higher depreciation, depletion and amortization expenses during the three months ended June 30, 2007 compared to the three months ended June 30, 2006 was due to amounts included in depletable assets for the Avouma and South Tchibala fields, which are higher on a per barrel basis than for the Etame field.

General and administrative expenses for the three months ended June 30, 2007 and 2006 were \$1.5 million and \$0.4 million for each period, respectively. During the three months ended June 30, 2007 and June 30, 2006, the Company incurred stock based compensation expense of \$0.5 million and \$0.3 million, respectively. In both of the three months ended June 30, 2007 and 2006, the Company benefited from overhead reimbursement associated with production and development operations on the Etame Block, though the reimbursements were lower in the three months ended June 30, 2007 than the three months ended June 30, 2006 due to less capital spending activity.

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VAALCO ENERGY, INC. AND SUBSIDIARIES

**Other Income (Expense)**

Interest income received on amounts on deposit was \$1.0 million in the three months ended June 30, 2007 compared to \$0.7 million in the three months ended June 30, 2006. The increase in interest income received on amounts on deposit reflects higher cash balances and higher interest rates in 2007. Interest expense and financing charges for the IFC loan was \$0.6 million for the three months ended June 30, 2007 compared to \$0.2 million for the three months ended June 30, 2006. In the three months ended June 30, 2007, the Company had higher interest on amounts drawn on the IFC revolving credit facility and higher loan commitment fees.

**Income Taxes**

Income taxes amounted to \$11.3 million and \$8.7 million for the three months ended June 30, 2007 and 2006, respectively. In the three months ended June 30, 2007 and in the three months ended June 30, 2006, the income taxes were all paid in Gabon. Income taxes in the three months ended June 30, 2007 were higher than in the three months ended June 30, 2006 due to lower capital spending compared to the three months ended June 30, 2006, resulting in lower amounts costs recovered in Gabon and therefore higher profit oil tax payments.

**Discontinued Operations**

Loss from discontinued operations in the Philippines in the three months ended June 30, 2007 was \$24,000 compared to a loss of \$14,000 in the three months ended June 30, 2006. The amounts were associated with general and administrative costs associated with shutting down the Philippines branch office.

**Minority Interest**

The Company incurred \$0.6 million and \$1.3 million in minority interest charges in the three months ended June 30, 2007 and 2006, respectively. These minority interest charges were associated with VAALCO Energy (International), Inc., a subsidiary that is 90.01% owned by the Company.

**Net Income**

Net income for the three months ended June 30, 2007 was \$3.7 million, compared to net income of \$10.5 million for the same period in 2006. Higher production costs, depreciation, depletion and amortization costs, general and administrative costs and income taxes contributed to the lower net income in 2007.



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VAALCO ENERGY, INC. AND SUBSIDIARIES

**Six months ended June 30, 2007 compared to six months ended June 30, 2006**

**Revenues**

Total revenues were \$53.3 million for the six months ended June 30, 2007 compared to \$56.8 million for the comparable period in 2006. The Company sold approximately 861,000 net barrels of oil equivalent at an average price of \$61.81 in the six months ended June 30, 2007. In the six months ended June 30, 2006, the Company sold approximately 886,000 barrels of oil equivalent at an average price of \$64.15 per barrel. Crude oil sales are a function of the number and size of crude oil liftings in each quarter from the FPSO and thus crude oil sales do not always coincide with volumes produced in any given quarter.

**Operating Costs and Expenses**

Total production expenses for the six months ended June 30, 2007 were \$7.2 million compared to \$6.3 million in the six months ended June 30, 2006. The Company matches production expenses with crude oil sales. Any production expenses associated with unsold crude oil inventory are capitalized. Expenses in the six months ended June 30, 2007 were higher due to higher insurance costs, higher costs of boat rentals and boat fuel and due to higher FPSO costs.

Exploration expense was \$5.5 million for the six months ended June 30, 2007 compared to \$1.0 million in the comparable period in 2006. Exploration expense for the six months ended June 30, 2007 included \$3.8 million associated with licensing 1,000 square kilometers of 3-D seismic data for Block 5 in Angola and \$1.4 million for acquisition and processing of 400 square kilometers of 3-D seismic offshore Gabon. In 2006, \$0.5 million of the exploration expense was associated with North Sea exploration activities and \$0.5 million with exploration activities in Gabon.

Depreciation, depletion and amortization expenses were \$8.7 million in the six months ended June 30, 2007 compared to \$3.3 million in the six months ended June 30, 2006. The depreciation, depletion and amortization expenses during the six months ended June 30, 2007 reflect the effects of the increase in amortizable costs due to the addition of the Avouma and South Tchibala fields in January 2007, which are higher on a per barrel basis than for the Etame field.

General and administrative expenses for the six months ended June 30, 2007 and 2006 were \$4.3 million and \$1.1 million for each period, respectively. During the six months ended June 30, 2007, the Company incurred \$1.1 million of stock based compensation compared to \$0.5 million incurred in the six months ended June 30, 2006. The Company incurred \$0.4 million of expenses associated with listing on the New York Stock Exchange in the six months ended June 30, 2007. In both periods, the Company benefited from overhead reimbursement associated with production and development operations on the Etame Block, although less so in the six months ended June 30, 2007 than in the six months ended June 30, 2006 due to lower capital spending activity.

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VAALCO ENERGY, INC. AND SUBSIDIARIES

**Other Income (Expense)**

Interest income received on amounts on deposit was \$1.8 million in the six months ended June 30, 2007 compared to \$1.2 million in the six months ended June 30, 2006. The increase in interest income received on amounts on deposit reflects higher cash balances and higher interest rates in 2007. Interest expense and financing charges for the IFC loan was \$0.8 million for the six months ended June 30, 2007 compared to \$0.5 million for the six months ended June 30, 2006, due to higher loan balances and higher commitment fees in the three months ended June 30, 2007.

**Income Taxes**

Income taxes amounted to \$18.5 million and \$20.8 million for the six months ended June 30, 2007 and 2006, respectively. In the six months ended June 30, 2007 and 2006, the income taxes were all paid in Gabon. The higher income taxes paid in Gabon in six months ended June 30, 2006 were due to higher oil prices and crude volumes sold.

**Discontinued Operations**

Expense from discontinued operations in the Philippines in the six months ended June 30, 2007 was \$0.1 million compared to \$0.7 million in the six months ended June 30, 2006. The \$0.7 million of expense in the six months ended June 30, 2006 consisted primarily of accrued amounts to settle branch profits remittances taxes in the Philippines associated with the closure of the branches which operated the former Philippines assets of the Company.

**Minority Interest**

The Company incurred \$1.8 million and \$2.8 million in minority interest charges in the six months ended June 30, 2007 and 2006, respectively. These minority interest charges were associated with VAALCO Energy (International), Inc., a subsidiary that is 90.01% owned by the Company.

**Net Income**

Net income for the six months ended June 30, 2007 was \$8.3 million, compared to net income of \$21.5 million for the same period in 2006. Higher crude operating expenses, depreciation costs and general and administrative expenses in the six months ended June 30, 2007 contributed to the lower net income for that period.

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VAALCO ENERGY, INC. AND SUBSIDIARIES

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company's results of operations are dependent upon the difference between prices received for its oil and gas production and the costs to find and produce such oil and gas. Oil and gas prices have been and are expected in the future to be volatile and subject to fluctuations based on a number of factors beyond the control of the Company. The Company does not presently have any active hedges in place, but may do so in the future.

**ITEM 4. CONTROLS AND PROCEDURES**

The Company maintains disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed by the Company in the reports it file or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including the Chief Executive Officer and Chief Financial Officer to allow timely decisions regarding required disclosure.

As disclosed in Note 11 to the unaudited condensed consolidated financial statements, we have restated our Condensed Statements of Consolidated Cash Flows for the six month periods ending June 30, 2007 and 2006 to correct an error in the reporting of exploration activities and to reclassify these amounts from cash used in investing activities to cash used in operating activities. The restatement does not affect total cash flows, nor does it affect the Condensed Balance Sheets or the Condensed Statements of Operations of the Company.

The Company's management, including the Company's principal executive officer and principal financial officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this Quarterly Report on Form 10-Q/A and as part of the restatement process. Based on that evaluation, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this Quarterly Report on Form 10-Q/A. There were no changes in the Company's internal controls over financial reporting that occurred during the Company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting.

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**PART II. OTHER INFORMATION**

**ITEM 1A. RISK FACTORS**

We have no material changes to the disclosure on this matter in our annual report on Form 10-K for the year ended December 31, 2006.

**ITEM 6. EXHIBITS**

**(a) Exhibits**

3. Articles of Incorporation and Bylaws

3.1 Restated Certificate of Incorporation (incorporated by reference to exhibit 4.1 to the Company's Registration Statement on Form S-3 filed with the Commission on July 15, 1998, Reg. No. 333-59095).

3.2 Certificate of Amendment to Restated Certificate of Incorporation (incorporated by reference to exhibit 4.2 to the Company's Registration Statement on Form S-3 filed with the Commission on July 15, 1998, Reg. No. 333-59095).

3.3 Amended and Restated Bylaws dated March 24, 2005 filed with the Commission on May 2, 2005. (incorporated by reference to the Company's quarterly report on Form 10Q for the quarter ended June 30, 2005).

31. Rule 13a-14(a)/15d-14(a) Certifications

31.1 Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002  
Section 1350 Certificates

32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act Of 2002.

32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act Of 2002.

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**SIGNATURES**

In accordance with the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

VAALCO ENERGY, INC.  
(Registrant)

By /s/ W. RUSSELL SCHEIRMAN  
**W. Russell Scheirman, President,  
Chief Financial Officer and Director**  
(on behalf of the Registrant and as the

principal financial officer)  
Dated: November 7, 2007

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**EXHIBIT INDEX**

**Exhibits**

- 31.1 Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act Of 2002.
- 32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act Of 2002.