

VAALCO ENERGY INC /DE/  
Form 10-Q  
May 09, 2008  
Table of Contents

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

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2008

**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

**VAALCO Energy, Inc.**

(Exact name of small business issuer as specified in its charter)

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<b>Delaware</b> (State or other jurisdiction of incorporation or organization)	<b>76-0274813</b> (I.R.S. Employer Identification No.)
<b>4600 Post Oak Place</b>  <b>Suite 309</b>  <b>Houston, Texas</b> (Address of principal executive offices)	<b>77027</b> (Zip code)
<b>(713) 623-0801</b>  (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 is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

As of April 30, 2008, there were outstanding 59,107,813 shares of common stock, \$0.10 par value per share, of the registrant.

**Table of Contents**

**VAALCO ENERGY, INC. AND SUBSIDIARIES**

**Table of Contents**

**PART I. FINANCIAL INFORMATION**

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)	
<u>Condensed Consolidated Balance Sheets March 31, 2008 and December 31, 2007</u>	3
<u>Condensed Statements of Consolidated Operations Three months ended March 31, 2008 and 2007</u>	4
<u>Condensed Statements of Consolidated Cash Flows Three months ended March 31, 2008 and 2007</u>	5
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	6
<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	12
<u>QUANTATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	18
<u>CONTROLS AND PROCEDURES</u>	18
<b><u>PART II. OTHER INFORMATION</u></b>	19
<u>ITEM 1A. RISK FACTORS</u>	19
<u>ITEM 2. ISSUER PURCHASES OF EQUITY SECURITIES FOR THE THREE MONTHS ENDED MARCH 31, 2008</u>	19
<u>ITEM 6. EXHIBITS</u>	19

**Table of Contents**

**VAALCO ENERGY, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

(Unaudited)

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

	March 31, 2008	December 31, 2007
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 79,734	\$ 76,450
Funds in escrow	4,764	4,764
Receivables:		
Trade	16,814	19,766
Accounts with partners	5,415	3,829
Other	1,505	1,646
Crude oil inventory	1,098	927
Materials and supplies	396	339
Prepayments and other	2,112	2,162
Total current assets	111,838	109,883
Property and equipment successful efforts method:		
Wells, platforms and other production facilities	80,463	80,052
Undeveloped acreage	12,841	12,841
Work in progress	13,731	11,822
Equipment and other	2,399	2,261
	109,434	106,976
Accumulated depreciation, depletion and amortization	(47,816)	(42,984)
Net property and equipment	61,618	63,992
Other assets:		
Deferred tax asset	1,435	1,457
Funds in escrow	10,873	10,871
Other long term assets	293	355
<b>TOTAL</b>	<b>\$ 186,057</b>	<b>\$ 186,558</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 22,772	\$ 23,904
Income taxes payable		200
Total current liabilities	22,772	24,104
Long term debt	5,000	5,000
Asset retirement obligations	7,247	6,728
Total liabilities	35,019	35,832

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Commitments and contingencies		
Minority interest in consolidated subsidiaries	<b>7,961</b>	8,396
Stockholders' equity:		
Common stock, \$0.10 par value, 100,000,000 authorized shares 61,054,824 and 61,054,824 shares issued with 1,860,642 and 1,560,342 in treasury at March 31, 2008 and December 31, 2007, respectively	<b>6,105</b>	6,105
Additional paid-in capital	<b>51,541</b>	51,294
Retained earnings	<b>89,284</b>	87,483
Less treasury stock, at cost	<b>(3,853)</b>	(2,552)
<b>Total stockholders' equity</b>	<b>143,077</b>	142,330
<b>TOTAL</b>	<b>\$ 186,057</b>	\$ 186,558

*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 March 31,	
	2008	2007
Revenues:		
Oil and gas sales	\$ 42,158	\$ 29,131
Operating costs and expenses:		
Production expenses	4,394	4,266
Exploration expense	6,712	5,056
Depreciation, depletion and amortization	4,934	4,663
General and administrative expenses	1,987	2,845
Total operating costs and expenses	18,027	16,830
Operating income	24,131	12,301
Other income (expense):		
Interest income	513	854
Interest expense	(364)	(258)
Other, net	(33)	80
Total other income (expense)	116	676
Income from continuing operations before income taxes, and minority interest	24,247	12,977
Income tax expense	21,382	7,192
Minority interest in earnings of subsidiaries	1,064	1,203
Income from continuing operations	1,801	4,582
Discontinued operations: (Note 8)		
Loss from discontinued operations, net of tax		(27)
Net income	\$ 1,801	\$ 4,555
Basic income per share from continuing operations	\$ 0.03	\$ 0.08
Loss from discontinued operations		
Basic income per share	\$ 0.03	\$ 0.08
Diluted income per share from continuing operations	\$ 0.03	\$ 0.08
Loss from discontinued operations		
Diluted income per share	\$ 0.03	\$ 0.08
Basic weighted shares outstanding	59,338	59,040
Diluted weighted average shares outstanding	59,701	60,417

*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>Three Months Ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	<b>\$ 1,801</b>	\$ 4,555
Adjustments to reconcile net income to net cash provided by (used in) operating activities		
Depreciation, depletion and amortization	<b>4,934</b>	4,663
Amortization of debt issuance costs	<b>62</b>	132
Dry hole costs	<b>6,399</b>	
Stock based compensation	<b>247</b>	634
Minority interest in earnings of subsidiaries	<b>1,064</b>	1,208
Change in operating assets and liabilities:		
Trade receivables	<b>2,952</b>	(7,750)
Accounts with partners	<b>(1,586)</b>	7,907
Other receivables	<b>141</b>	(1,499)
Crude oil inventory	<b>(171)</b>	422
Materials and supplies	<b>(57)</b>	
Deferred tax asset	<b>22</b>	
Prepayments and other	<b>50</b>	394
Accounts payable and accrued liabilities	<b>(1,333)</b>	(10,666)
Income taxes payable	<b>(200)</b>	
<b>Net cash provided by operating activities</b>	<b>14,325</b>	
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Funds in escrow, net	<b>(2)</b>	(7)
Additions to property and equipment	<b>(1,840)</b>	(6,032)
Dry hole costs	<b>(6,399)</b>	
Other		242
<b>Net cash used in investing activities</b>	<b>(8,241)</b>	(5,797)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds from the issuance of common stock		95
Purchase of treasury shares	<b>(1,301)</b>	
Debt issuance costs capitalized		(115)
Distribution to minority interest	<b>(1,499)</b>	(999)
<b>Net cash used in financing activities</b>	<b>(2,800)</b>	(1,019)
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>3,284</b>	(6,816)
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>	<b>76,450</b>	60,979
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b>79,734</b>	54,163



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Supplemental disclosure of cash flow information

Income taxes paid	\$ 20,031	\$ 10,226
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Interest paid

\$ 30
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Supplemental disclosure of non cash flow information

Change in investment in property and equipment not paid	\$ 197	\$ (3,925)
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*See notes to unaudited condensed consolidated financial statements.*

**Table of Contents**

## 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, 2007, 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, conducts exploration activities in one concession in Angola, West Africa and conducts exploration activities on two blocks in the British North Sea. 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. 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.

Diluted Shares consist of the following:

Item	Three months ended	
	March 31, 2008	March 31, 2007
Basic weighted average common stock issued and outstanding	59,338,013	59,039,674
Dilutive options	363,265	1,376,962
<b>Total diluted shares</b>	<b>59,701,278</b>	<b>60,416,636</b>

Options to purchase 1,697,640 and 1,828,420 shares were excluded in the quarters ended March 31, 2008 and 2007, respectively, because they would be anti-dilutive.

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**Table of Contents**

VAALCO ENERGY, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

3. NEW ACCOUNTING PRONOUNCEMENTS

**FASB Statement 157, Fair Value Measurements** The Company adopted Statement of Financial Accounting Standards ( SFAS ) No. 157, *Fair Value Measurements*, on January 1, 2008. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In February 2008, the Financial Accounting Standards Board ( FASB ) issued FASB Staff Position ( FSP ) No. FAS 157-1 and No. FAS 157-2, which delays the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years and removes certain leasing transactions from the scope of SFAS No. 157. We do not currently have any significant assets or liabilities that are measured at fair value on a recurring basis.

**FASB Statement 141(R), Business Combinations, and FASB Statement 160, Noncontrolling Interests in Consolidated Financial Statements** an amendment of ARB No. 51 In December 2007, the FASB issued FASB Statement 141(R), *Business Combinations*, which replaced FASB Statement 141, *Business Combinations*, ( SFAS 141(R) ). In December 2007, the FASB also issued FASB Statement 160, *Noncontrolling Interests in Consolidated Financial Statements* an amendment of ARB No. 51, ( SFAS 160 ). 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. These statements are to be applied prospectively for fiscal years beginning after December 15, 2008. The Company is evaluating SFAS 141(R) and SFAS 160 to determine the impact of these statements on our consolidated financial statements.

**FASB Statement 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115** In February 2007, the FASB issued FASB Statement 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115*, ( SFAS 159 ). SFAS 159 permits companies to choose to measure many financial instruments and certain other items at fair value, with changes in fair value reflected in earnings. SFAS 159 is effective as of the beginning of the first fiscal year that begins after November 15, 2007. The Company adopted SFAS 159 as of January 1, 2008 and did not elect the fair value option for any instruments that were not previously reported at fair value.

**Table of Contents**

## VAALCO ENERGY, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

**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 March 31, 2008 there were 3,121,196 shares subject to options authorized but not granted.

During the three months ended March 31, 2008, the Company granted no stock options.

For the three months ended March 31, 2008, the Company recognized non-cash compensation expense of \$0.2 million, (or \$0.00 per basic and diluted share), related to stock options. For the three months ended March 31, 2007, the Company recognized non-cash compensation expense of \$0.6 million (or \$0.01 per basic and diluted share). 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 three months ended March 31, 2008 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	3,251	\$ 5.91	3.44	
Granted				
Exercised				
Forfeited				
Outstanding at end of period	3,251	5.91	3.19	\$ 1.7
Exercisable at end of period	2,203	\$ 4.93	2.95	\$ 1.7

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 March 31, 2008, unrecognized compensation costs totaled \$1.1 million. The expense is expected to be recognized over a weighted average period of 0.8 years. No stock options vested during the three months ended March 31, 2008.

**5. GUARANTEES**

In September 2007, the Company entered into an amendment with the owner of the FPSO chartered for the Etame field to extend the contract until September 2015. In connection with the charter of the FPSO, the Company as operator of the Etame field guaranteed the charter payments through September 2013. The charter continues for two years beyond that period.

**Table of Contents**

## VAALCO ENERGY, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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
2008	\$ 13,348	\$ 3,747
2009	\$ 17,269	\$ 4,848
2010	\$ 16,962	\$ 4,762
2011	\$ 16,762	\$ 4,706
2012	\$ 16,659	\$ 4,677
Thereafter	\$ 12,460	\$ 3,498

The Company has recorded a liability of \$0.6 million at March 31, 2008 representing the guarantee's fair value.

#### 6. COMMITMENTS

In January 2006 the consortium elected to extend 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). 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 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 interpreting data from past operators of the area and expects to drill one or two wells in 2008.

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 expend 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 expend a minimum of \$27.2 million (\$13.6 million net to the Company). The Company 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.

In December 2007, the Company signed a farm-in agreement for Block 9/28d offshore the United Kingdom in the British North Sea. The Company is obligated to pay its share of the

**Table of Contents**

## VAALCO ENERGY, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

drilling of one well on the block and a portion of the share of the farminee s share of the well. The well was spudded in December 2007 and reached total depth in January 2008. The well was suspended as a non-commercial discovery in January 2008. In 2007, the Company incurred \$8.0 million in exploration costs associated with the well. An additional \$6.4 million was incurred in the first quarter of 2008. The Company is carrying no capitalized amounts on its books for this well.

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 is expected to be drilled during the third quarter of 2008. It is anticipated that the Company share of costs for this well will be approximately \$8.0 million.

**7. 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 ended March 31, 2008 and 2007 are as follows: *(in thousands)*

	Gabon	Angola	North Sea	Corporate and Other	Total
<b>2008</b>					
Revenues	\$ 42,100	\$	\$	\$ 58	\$ 42,158
Income from operations	31,752	(221)	(6,534)	(865)	24,131
<b>2007</b>					
Revenues	29,064			67	29,131
Income from operations	18,977	(3,766)		(2,910)	12,301

**Table of Contents**

VAALCO ENERGY, INC. AND SUBSIDIARIES

**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 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 oil production sharing contracts in Gabon and Angola, and has interests in two blocks in the British North Sea. In addition, the Company has minor onshore and offshore domestic United States production in Texas and Louisiana. In Gabon, the Company operates the Etame block, a 750,000 acre block offshore southern Gabon. Three fields are under production, the Etame, Avouma and South Tchibala fields. During the first quarter of 2008, these fields produced 1.9 million barrels of oil (0.45 million barrels net to the Company). The Company is also developing the Ebouri field on the Etame block. Construction of the production platform was completed in April 2008 and the platform is being shipped to Gabon for installation. First production from Ebouri is expected in late 2008. In addition to developing Ebouri, the Company has plans to drill three exploration wells on the Etame block beginning later in 2008.

Also in Gabon, the Company operates the Mutamba block, a 270,000 acre onshore license which the Company acquired in 2005. The Company anticipates drilling two exploration wells on the block later in 2008. There is currently no production from the Mutamba block at this time.

In Angola, the Company operates Block 5, a 1.4 million acre offshore license which the Company acquired in December 2006. The Company has leased 1140 square kilometers of 3-D data over the block and has a commitment to drill two exploration wells prior to December 1, 2010. The Company expects to drill the first of the exploration wells during the first half of 2009.

**Table of Contents**

VAALCO ENERGY, INC. AND SUBSIDIARIES

**CAPITAL RESOURCES AND LIQUIDITY**

**Cash Flows**

Net cash provided by operating activities for the three months ended March 31, 2008 was \$14.3 million, as compared to \$0 million for the three months ended March 31, 2007. The increase in cash provided by operations for the three months ended March 31, 2008 compared to for the three months ended March 31, 2007 was due primarily to a change in working capital other than cash which was down \$0.2 million for the three months ended March 31, 2008, compared to a decrease in working capital other than cash of \$11.2 million for the three months ended March 31, 2007.

Net cash used in investing activities for the three months ended March 31, 2008 was \$8.2 million, compared to net cash used in investing activities for the three months ended March 31, 2007 of \$5.8 million. For the three months ended March 31, 2008, the Company invested \$4.0 million in the Etame Marin block operations for the development of the Ebouri field and completed the drilling of a dry well in the North Sea at a cost of \$6.4 million for the quarter. For the three months ended March 31, 2007, the Company invested \$6.0 million in Etame Marin block operations primarily for development of the Avouma and South Tchibala fields.

For the three months ended March 31, 2008, cash used in financing activities was \$2.8 million, consisting of distributions to a minority interest owner of \$1.5 million and purchase of treasury shares of \$1.3 million. For the three months ended March 31, 2007, cash used by financing activities of \$1.1 million consisted primarily of \$1.0 million used for distributions to minority interest holders. In addition, the Company capitalized \$0.1 million of debt issuance costs and received \$0.1 million in proceeds from the issuance of common stock.

**Capital Expenditures**

During the three months ended March 31, 2008, the Company incurred \$1.8 million of capital expenditures, primarily associated with the construction of the Ebouri development platform. During the remainder of 2008, the Company anticipates commencing an exploration program with up to three exploration wells on the Etame block, two exploration wells on the Mutamba block and one well in the British North Sea. The budget for the exploration wells is approximately \$33 million net to the Company. In addition the Company will install the Ebouri platform and drill one or two development wells at a remaining cost of \$20 to \$28 million net to the Company.

**Liquidity**

Historically, the Company's primary sources of capital have been cash flows from operations, private sales of equity, borrowings and purchase money debt. At March 31, 2008, the Company had cash of \$79.7 million. The Company believes that this cash combined with cash flow from operations will be sufficient to fund the Company's remaining 2008 capital expenditure budget, required debt service payments and additional investments in working capital resulting from potential growth. As operator of the Etame field and Block 5 in Angola, 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.



**Table of Contents**

VAALCO ENERGY, INC. AND SUBSIDIARIES

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 October 2009 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 Shell. While the loss of Shell 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 \$58,000 to revenues in the first quarter of 2008. 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 three months ended March 31, 2008, the Company also spent \$6.4 million on a well in the British North Sea which was suspended as a non-commercial oil discovery and \$0.3 million on other exploration activities.

**Table of Contents**

VAALCO ENERGY, INC. AND SUBSIDIARIES

**RESULTS OF OPERATIONS**

**Three months ended March 31, 2008 compared to three months ended March 31, 2007**

**Revenues**

Total revenues were \$42.2 million for the three months ended March 31, 2008 compared to \$29.1 million for the comparable period in 2007. The Company sold approximately 446,000 net barrels of oil equivalent at an average price of \$94.44 in three months ended March 31, 2008. In the three months ended March 31, 2007, the Company sold approximately 511,000 barrels of oil equivalent at an average price of \$57.03 per barrel. Crude oil production from the Etame, Avouma and South Tchibala fields is averaging 22,500 BOPD compared to approximately 20,500 BOPD in the three months ended March 31, 2007. 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 March 31, 2008 were \$4.4 million compared to \$4.3 million in the three months ended March 31, 2007. 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 March 31, 2008 were higher than in the three months ended March 31, 2007 due to higher boat rental costs, higher FPSO costs and higher helicopter costs.

Exploration expense was \$6.7 million for the three months ended March 31, 2008 compared to \$5.1 million in the comparable period in 2007. For the three months ended March 31, 2008, exploration expense consisted primarily of \$6.4 million of dry hole costs associated with the Company's participation in a well in the British North Sea, and \$0.3 million of other exploration costs. Exploration expense for the three months ended March 31, 2007 included \$3.8 million for the licensing of 1,140 square kilometers of 3-D seismic data for Block 5 in Angola and included \$1.0 million for acquisition of 400 square kilometers of seismic data in Gabon.

Depreciation, depletion and amortization expenses were \$4.9 million in the three months ended March 31, 2008 compared to \$4.7 million in the three months ended March 31, 2007. The higher depreciation, depletion and amortization expenses during the three months ended March 31, 2008 compared to the three months ended March 31, 2007 are due to increasing percentages of total production coming from the Avouma and South Tchibala fields, which have higher depletion rates than from the Etame field.

General and administrative expenses for the three months ended March 31, 2008 and 2007 were \$2.0 million and \$2.8 million for each period, respectively. During the three months ended March 31, 2008 and March 31, 2007, the Company incurred stock based compensation expense of \$0.2 million and \$0.6 million, respectively. The Company incurred \$0.4 million of expenses associated with listing on the New York Stock Exchange in the three months ended March 31, 2007. In both of the three months ended March 31, 2008 and 2007, the Company benefited from overhead reimbursement associated with production and development operations on the Etame Block.

**Table of Contents**

VAALCO ENERGY, INC. AND SUBSIDIARIES

**Other Income (Expense)**

Interest income received on amounts on deposit was \$0.5 million in the three months ended March 31, 2008 compared to \$0.9 million in the three months ended March 31, 2007. The decrease in interest income received on amounts on deposit reflects lower interest rates in 2008. Interest expense and financing charges for the IFC loan was \$0.4 million for the three months ended March 31, 2008 compared to \$0.3 million for the three months ended March 31, 2007, reflecting interest on amounts drawn on the IFC revolver.

**Income Taxes**

Income taxes amounted to \$21.4 million and \$7.2 million for the three months ended March 31, 2008 and 2007, respectively. In the three months ended March 31, 2008 and in the three months ended March 31, 2007, the income taxes were all paid in Gabon. Income taxes in the three months ended March 31, 2008 were high relative to income from continuing operations because they were all paid in Gabon, and the exploration expenses incurred during that period were primarily outside of Gabon and therefore not tax deductible in Gabon. Also for the three months ended March 31, 2007, the Company had recoverable costs associated with the fourth quarter 2006 drilling program at Avouma and South Tchibala.

**Discontinued Operations**

Loss from discontinued operations in the Philippines in the three months ended March 31, 2007 was \$27,000. The Philippines offices were closed in 2007 and no costs were incurred in 2008.

**Minority Interest**

The Company incurred \$1.1 million and \$1.2 million in minority interest charges in the three months ended March 31, 2008 and 2007, 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 March 31, 2008 was \$1.8 million, compared to net income of \$4.6 million for the same period in 2007. Higher production costs, depreciation, depletion and amortization costs, exploration expense and taxes contributed to the lower net income in 2008.

**Table of Contents**

VAALCO ENERGY, INC. AND SUBSIDIARIES

**ITEM 3. QUANTATIVE 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. 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. 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. 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.

**Table of Contents****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, 2007.

**ITEM 2. ISSUER PURCHASES OF EQUITY SECURITIES FOR THREE MONTHS ENDED MARCH 31, 2008**

The following table provides information regarding the number of shares of common stock of the Company purchased by the Company during the three months ended March 31, 2008.

	Number of shares purchased	Average price per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number of shares that may yet be purchased under the plans or programs
January 2008				
February 2008	300,300	4.33	300,300	
March 2008				
Total	300,300	4.33	300,300	(See note 1)

*Note 1 On September 14, 2007, the Company announced its intention to purchase up to \$20 million of shares of its common stock for the treasury. The announcement did not specify an amount of shares or expiration date. The Corporation has purchased shares since this announcement and will report future purchased volumes in its Quarterly Reports on Form 10-Q. Purchases may be made in both the open market and through negotiated transactions, and purchases may be increased, decreased or discontinued at any time without prior notice.*

**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).

**Table of Contents**

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 March 31, 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.

**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: May \_\_, 2008

**Table of Contents**

**EXHIBIT INDEX**

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