CREDO PETROLEUM CORP
Form 10-Q
June 09, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended April 30, 2010

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

For the transition period from to

Commission File Number: 0-8877

CREDO PETROLEUM CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**84-0772991**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

1801 Broadway, Suite 900, Denver, Colorado	**80202**
(Address of principal executive offices)	(Zip Code)

303-297-2200

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every interactive data file required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) Yes o No o

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 Act.)

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller Reporting Company o

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, net of treasury stock, as of the latest practicable date.

Date	**Class**	**Outstanding**
June 9, 2010	Common stock, $.10 par value	10,157,000

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CREDO PETROLEUM CORPORATION AND SUBSIDIARIES

Quarterly Report on Form 10-Q For the Period Ended April 30, 2010

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The terms CREDO , Company , we , our , and us refer to CREDO Petroleum Corporation and its subsidiaries unless the context suggests otherwise.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CREDO PETROLEUM CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets

ASSETS

		April 30, 2010 (Unaudited)		October 31, 2009
Current Assets:				
Cash and cash equivalents	**$**	**10,079,000**	$	12,348,000
Short-term investments		**2,050,000**		635,000
Receivables:				
Accrued oil and gas sales		**1,544,000**		1,566,000
Trade		**186,000**		487,000
Derivative assets		**206,000**		104,000
Other current assets		**651,000**		859,000
Total current assets		**14,716,000**		15,999,000
Long-term Assets:				
Oil and gas properties, at cost, using full cost method:				
Unevaluated oil and gas properties		**8,875,000**		7,363,000
Evaluated oil and gas properties		**78,318,000**		76,127,000
Less: accumulated depreciation, depletion and amortization of oil and gas properties		**(54,697,000)**		(53,211,000)
Net oil and gas properties, at cost, using full cost method		**32,496,000**		30,279,000
Intangible Assets, net of accumulated amortization of $653,000 in 2010 and $436,000 in 2009		**3,796,000**		4,013,000
Compressor and tubular inventory to be used in development		**1,956,000**		1,865,000
Other, net		**402,000**		396,000
Total Assets	**$**	**53,366,000**	$	52,552,000

The accompanying notes are an integral part of these consolidated financial statements.

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LIABILITIES AND STOCKHOLDERS EQUITY

	April 30, 2010 (Unaudited)	October 31, 2009
Current Liabilities:		
Accounts payable	**$ 751,000**	$ 407,000
Revenue distribution payable	**912,000**	653,000
Accrued compensation	**467,000**	948,000
Other accrued liabilities	**263,000**	394,000
Derivative liability	**78,000**	
Income taxes payable	**67,000**	55,000
Total current liabilities	**2,538,000**	2,457,000
Long Term Liabilities:		
Deferred income taxes, net	**2,902,000**	2,537,000
Asset retirement obligation	**1,411,000**	1,502,000
Total liabilities	**6,851,000**	6,496,000
Commitments:		
Stockholders Equity:		
Preferred stock, no par value, 5,000,000 shares authorized, none issued		
Common stock, $.10 par value, 20,000,000 shares authorized, 10,660,000 issued	**1,066,000**	1,066,000
Capital in excess of par value	**31,506,000**	31,472,000
Treasury stock at cost, 485,000 shares in 2010 and 419,000 in 2009	**(3,620,000)**	(2,803,000)
Retained earnings	**17,563,000**	16,321,000
Total stockholders equity	**46,515,000**	46,056,000
Total Liabilities and Stockholders Equity	**$ 53,366,000**	$ 52,552,000

The accompanying notes are an integral part of these consolidated financial statements.

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CREDO PETROLEUM CORPORATION AND SUBSIDIARIES

Consolidated Statements of Operations

(Unaudited)

	Six Months Ended April 30, 2010	Six Months Ended April 30, 2009	Three Months Ended April 30, 2010	Three Months Ended April 30, 2009
Oil sales	**$ 3,530,000**	$ 2,118,000	**$ 1,806,000**	$ 1,496,000
Natural gas sales	**2,557,000**	2,343,000	**1,139,000**	857,000
	6,087,000	4,461,000	**2,945,000**	2,353,000
Costs and expenses:				
Oil and gas production	**1,658,000**	1,623,000	**802,000**	737,000
Depreciation, depletion and amortization	**1,723,000**	2,540,000	**858,000**	1,203,000
Write-down of oil and natural gas properties (Note 3) and impairment of long lived assets (Note 8)		24,652,000		8,030,000
General and administrative	**1,119,000**	1,389,000	**577,000**	521,000
	4,500,000	30,204,000	**2,237,000**	10,491,000
Income (loss) from operations	**1,587,000**	(25,743,000)	**708,000**	(8,138,000)
Other income and (expense)				
Realized and unrealized gains from derivative contracts	**27,000**	1,927,000	**41,000**	461,000
Investment and other income (loss)	**43,000**	(120,000)	**44,000**	22,000
	70,000	1,807,000	**85,000**	483,000
Income (loss) before income taxes	**1,657,000**	(23,936,000)	**793,000**	(7,655,000)
Income taxes	**(415,000)**	9,335,000	**(190,000)**	2,945,000
Net income (loss)	**$ 1,242,000**	$ (14,601,000)	**$ 603,000**	$ (4,710,000)
Earnings (loss) per share of Common Stock Basic	**$ .12**	$ (1.41)	**$ .06**	$ (.46)
Earnings (loss) per share of Common Stock Diluted	**$ .12**	$ (1.41)	**$ .06**	$ (.46)
Weighted average number of shares of Common Stock and dilutive securities:				
Basic	**10,140,000**	10,358,000	**10,187,000**	10,330,000
Diluted	**10,179,000**	10,358,000	**10,205,000**	10,330,000

The accompanying notes are an integral part of these consolidated financial statements.

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CREDO PETROLEUM CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(Unaudited)

	Six Months Ended April 30, 2010		Six Months Ended April 30, 2009	
Cash flows from operating activities:				
Net income (loss)	$	**1,242,000**	$	(14,601,000)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:				
Write-down of oil and natural gas properties and impairment of long lived assets				24,652,000
Depreciation, depletion and amortization		**1,723,000**		2,540,000
ARO liability accretion		**39,000**		38,000
Unrealized (gain) loss on derivative instruments		**(24,000)**		348,000
Deferred income taxes		**365,000**		(9,335,000)
(Gain) loss on short term investments		**(11,000)**		208,000
Compensation expense related to stock options granted		**34,000**		16,000
Other				27,000
Changes in operating assets and liabilities:				
Purchase of short term investments		**(1,500,000)**		
Proceeds from short-term investments		**96,000**		975,000
Accrued oil and gas sales		**22,000**		(167,000)
Trade receivables		**301,000**		465,000
Other current assets		**208,000**		(177,000)
Accounts payable and accrued liabilities		**(363,000)**		(981,000)
Income taxes payable		**12,000**		(1,000)
Net cash provided by operating activities		**2,144,000**		4,007,000
Cash flows from investing activities:				
Additions to oil and gas properties		**(3,565,000)**		(10,368,000)
Proceeds from sale of oil and gas properties		**86,000**		
Changes in other long-term assets		**(117,000)**		(41,000)
Purchase intangible assets				(4,400,000)
Net cash used in investing activities		**(3,596,000)**		(14,809,000)
Cash flows from financing activities:				
Purchase of treasury stock		**(1,114,000)**		(1,152,000)
Proceeds from exercise of stock options		**297,000**		
Net cash provided by (used in) financing activities		**(817,000)**		(1,152,000)
Increase (decrease) in cash and cash equivalents		**(2,269,000)**		(11,954,000)
Cash and cash equivalents:				
Beginning of period		**12,348,000**		22,332,000
End of period	$	**10,079,000**	$	10,378,000

The accompanying notes are an integral part of these consolidated financial statements.

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CREDO PETROLEUM CORPORATION AND SUBSIDIARIES

Notes To Consolidated Financial Statements (Unaudited)

April 30, 2010

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with U. S. generally accepted accounting principles for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U. S. generally accepted accounting principles for complete financial statements. In the opinion of management, the consolidated financial statements contain all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the company s results for the periods presented. For a more complete understanding of the company s financial condition and accounting policies, these consolidated financial statements should be read in conjunction with the company s Annual Report on Form 10-K for the fiscal year ended October 31, 2009. The results for interim periods are not necessarily indicative of annual results.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The company bases its estimates on historical experience and on various other assumptions it believes to be reasonable under the circumstances. Although actual results may differ from these estimates under different assumptions or conditions, the company believes that its estimates are reasonable and that actual results will not vary significantly from the estimated amounts.

2. CONCENTRATION OF CREDIT RISK

Credo s accounts receivable are primarily from purchasers of the company s oil and natural gas production and from other exploration and production companies which own joint working interests in the properties that the company operates. This industry concentration could adversely impact the company s overall credit risk because the company s customers and working interest owners may be similarly affected by changes in economic and financial market conditions, commodity prices, and other conditions. Credo s oil and gas production is sold to various purchasers in accordance with the company s credit policies and procedures. These policies and procedures take into account, among other things, the creditworthiness of potential purchasers and concentrations of credit risk. For most joint working interest partners, the company has the right of offset against related oil and natural gas revenues.

3. OIL AND NATURAL GAS PROPERTIES

Depreciation, depletion and amortization of oil and natural gas properties for the six months ended April 30, 2010 and 2009 were $1,485,000 and $2,273,000 respectively, and were $740,000 and $1,081,000 for the three months ended April 30, 2010 and 2009, respectively. The company uses the full cost method of accounting for costs related to its oil and natural gas properties. Capitalized costs included in the full cost pool are depleted on an aggregate basis using the units-of-production method. All costs incurred in the acquisition, exploration, and development of properties (including costs of surrendered and abandoned leaseholds, delay lease rentals, dry holes, and overhead related to exploration and development activities) and the fair value of estimated future costs of site restoration, dismantlement, and abandonment activities are capitalized. Costs for unevaluated properties, which typically include lease rentals, geology and seismic costs, are capitalized but are excluded from the amortizable pool during the evaluation period. When determinations are made whether the property has proved recoverable reserves or not, or if there is an impairment, the costs are reclassified to the full cost pool.

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The capitalized costs in the full cost pool are subject to a quarterly ceiling test that limits such pooled costs to the aggregate of the present value of future net revenues attributable to proved oil and natural gas reserves discounted at 10 percent plus the lower of cost or market value of unproved properties less any associated tax effects. The ceiling test is calculated using oil and natural gas prices in effect as of the balance sheet date. If such capitalized costs exceed the ceiling, the company will record a write-down to the extent of such excess as a non-cash charge to earnings, unless the company considers price increases subsequent to the balance sheet date which may reduce or eliminate a write-down. A write-down may not be reversed in future periods, even though higher oil and natural gas prices may subsequently increase the ceiling.

At April 30, 2010 the estimated present value of future net revenues from proved reserves, net of related income tax considerations, exceeded the capitalized costs of the company s oil and natural gas properties. Therefore, a ceiling test write-down was not required. For the three and six months ended April 30, 2009, the company recorded non-cash ceiling test write-downs of $8,030,000 and $23,726,000 respectively.

Changes in oil and natural gas prices have historically had the most significant impact on the company s ceiling test. In general, the ceiling is lower when prices are lower. Even though oil and natural gas prices can be highly volatile over weeks and even days, the ceiling calculation dictates that prices in effect as of the last day of the test period be used and held constant. The resulting valuation is a snapshot as of that day and, thus, is generally not indicative of a true fair value that would be placed on the company s reserves by the company or by an independent third party. Therefore, the future net revenues associated with the estimated proved reserves are not based on the company s assessment of future prices or costs, but rather are based on prices and costs in effect as of the end of the test period. See Footnote 12 for description of new SEC rules which Credo will adopt, effective October 31, 2010.

4. STOCK-BASED COMPENSATION

For the six months ended April 30, 2010 and 2009, the company recognized stock based compensation expense of $34,000 and $16,000, respectively. For the three months ended April 30, 2010 and 2009, the company recognized stock based compensation expense of $27,000 and $8,000, respectively. The estimated unrecognized compensation cost from unvested stock options as of April 30, 2010 was approximately $171,000 which is expected to be recognized over an average of 2.7 years.

No options were granted during fiscal year 2009. The fair value of the 50,000 options granted during the six months ended April 30, 2010 was estimated as of the grant date using the Black-Scholes option pricing model with the following assumptions: volatility, 51.6%; expected option term, 3 years; risk-free interest rate, 2.69% and; expected dividend yield, 0%. If option grants are made in the future, compensation expense for all such share-based payments granted, based upon the grant-date fair value estimated in accordance with the provisions of FASB ASC 718 will also be included in compensation expense.

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Plan activity for the six months ended April 30, 2010 is set forth below:

	Number of options		Weighted Average Exercise Price		Aggregate Intrinsic Value
Outstanding at October 31, 2009	179,063	$	7.46	$	530,000
Granted	50,000		9.30		
Exercised	(50,000)		5.93		
Cancelled or forfeited					
Outstanding at April 30, 2010	179,063	$	8.40	$	356,000
Exercisable at April 30, 2010	124,063	$	7.86	$	336,000
Weighted average contractual life at April 30, 2010			5.73years		

	Outstanding				Exercisable		
Range of Exercise Prices	Number Outstanding at April 30, 2010	Weighted Average Remaining Contractual Life in Years		Weighted Average Exercise Price	Number Exercisable at April 30, 2009		Weighted Average Exercise Price
$ 5.93	89,063	3.12	$	5.93	89,063	$	5.93
$ 9.30	50,000	9.67	$	9.30		$	9.30
$12.78	40,000	6.60	$	12.78	35,000	$	12.78
$ 5.93 -$12.78	179,063	5.73	$	8.40	124,063	$	7.86

5. OIL AND NATURAL GAS DERIVATIVES

The company is exposed to certain commodity price risks relating to its ongoing operations. The company periodically uses oil and natural gas derivatives as economic hedges of the price of a portion of its estimated production when the potential for significant downward price movement is anticipated. These transactions typically take the form of costless collars for oil, and forward short positions based upon the NYMEX futures market for natural gas, and are closed by purchasing offsetting positions. Such contracts do not exceed estimated production volumes and are authorized by the company s Board of Directors. Contracts are expected to be closed as related production occurs but may be closed earlier if the anticipated downward price movement occurs or if the company believes that the potential for such movement has abated.

For the six months ended April 30, 2010 and 2009, the company had realized gains on natural gas derivatives of $3,000 and $2,275,000, respectively, and unrealized gains (losses) of $36,000 and ($348,000) respectively. For the quarters ended April 30, 2010 and 2009 the company had realized gains on natural gas derivatives of $12,000 and $1,350,000 respectively, and unrealized gains (losses) of $41,000 and ($889,000), respectively.

At April 30, 2010 the company held open derivative contracts representing natural gas short sales positions for 400,000 MMBtus at NYMEX basis prices ranging from $5.31 to $7.27 and covering the production months of May 2010 through December 2010. The company also held open derivative contracts with the same counterparty representing natural gas long positions for 360,000 MMBtus at NYMEX basis prices ranging from $4.26 to $5.83 and covering the production months of May 2010 through December 2010. These positions are presented net due to the contractual netting provisions with the counterparty. The open derivative contracts net to 40,000 MMBtus with a net unrealized gain of $206,000 at April 30, 2010.

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Average natural gas prices received in the company s primary market have historically been 15% - 17% below NYMEX prices due to basis differentials compared to the current differentials of about 4%.

At April 30, 2010 the company also held natural gas basis differential hedges on 280,000 MMBtus with NYMEX vs. Panhandle Eastern Pipeline basis differentials of $0.47 and covering the production months of May 2010 through December 2010. These open basis differential contracts represent unrealized losses of $66,000 at April 30, 2010.

Subsequent to April 30, the May and June natural gas related derivative contracts closed, resulting in realized derivative gains of $32,000.

At April 30, 2010 the company also held costless collar derivative contracts for 6,000 barrels of oil for the production months of May through October 2010, priced at NYMEX WTI $75.00 floor and $95.00 ceiling. There were no realized gains or losses on these derivatives for the three or six months ended April 30, 2010. Unrealized losses on oil derivative contracts were $12,000 for the three and six month periods ended April 30, 2010. There were no oil hedges in 2009. Subsequent to April 30, the May contract closed, resulting in a realized gain of $1,000. There were no oil hedges in 2009.

The company has a hedging line of credit with its bank which is available, at the discretion of the company, to meet margin calls. To date, the company has not used this facility and maintains it only as a precaution related to possible margin calls. The maximum credit line available is $7,200,000 with interest calculated at the prime rate. The facility is unsecured and has covenants that require the company to maintain $3,000,000 in cash or short term investments, none of which are required to be maintained at the company s bank, and prohibits funded debt in excess of $500,000. The line expires May 1, 2013.

The company has elected not to designate its commodity derivatives as cash flow hedges for accounting purposes. Accordingly, such contracts are recorded at fair value on the balance sheet and changes in fair value are recorded in the statement of operations as they occur.

The location and amount of derivative fair values and related gain (loss) are indicated in the following tables:

Derivatives not designated as hedging instruments:

	As of April 30, 2010		
	Balance Sheet Location		**Fair Value**
Natural Gas Forward Positions	Derivative Asset	$	206,000
Natural Gas Basis Positions	Derivative Liability		(66,000)
Crude Oil Collars	Derivative Liability		(12,000)

Amount of Gain or (Loss) Recognized in Income on Derivatives:

Derivatives not designated as hedging instruments:

	Location of Gain/(Loss) Recognized in Income on Derivatives	Six Months Ended April 30, 2010
Natural Gas Forward Positions	Other Income and (Expense)	$ 107,000
Natural Gas Basis Positions	Other Income and (Expense)	(68,000)
Crude Oil Collars	Other Income and (Expense)	(12,000)

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6. EARNINGS PER SHARE

The company s calculation of earnings per share of common stock is as follows:

	Six Months Ended April 30,					
	2010			2009		
	Net Income	Shares	Net Income Per Share	Net (Loss)	Shares	Net (Loss) Per Share
Basic earnings (loss) per share	**$ 1,242,000**	**10,140,000**	**$ .12**	$ (14,601,000)	10,358,000	$ (1.41)
Effect of dilutive shares of common stock from stock options		**39,000**				
Diluted earnings (loss) per share	**$ 1,242,000**	**10,179,000**	**$ .12**	$ (14.601,000)	10,358,000	$ (1.41)

	Three Months Ended April 30,					
	2010			2009		
	Net Income	Shares	Net Income Per Share	Net Loss	Shares	Net (Loss) Per Share
Basic earnings (loss) per share	**$ 603,000**	**10,187,000**	**$ .06**	$ (4,710,000)	10,330,000	$ (.46)
Effect of dilutive shares of common stock from stock options		**18,000**				