

EVOLUTION PETROLEUM CORP
Form 10-Q
November 14, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2007

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

For the transition period from to

Commission File Number 001-32942

EVOLUTION PETROLEUM CORPORATION

(Exact name of registrant as specified in its charter)

Nevada
(State or other jurisdiction of incorporation or organization)

41-1781991
(IRS Employer Identification No.)

2500 CityWest Blvd., Suite 1300, Houston, Texas 77042

(Address of principal executive offices and zip code)

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(713) 935-0122

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) 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 accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

The number of shares outstanding of the registrant's common stock, par value \$0.001, as of November 1, 2007, was 26,776,234.

EVOLUTION PETROLEUM CORPORATION AND SUBSIDIARIES

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PART I - FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Evolution Petroleum Corporation and Subsidiaries

Condensed Consolidated Balance Sheets

	September 30, 2007 (unaudited)	June 30, 2007
Assets		
Current Assets:		
Cash and cash equivalents	\$ 25,301,272	\$ 27,746,942
Accounts receivable	866,646	212,585
Income tax receivable	707,912	421,325
Inventories	241,085	274,813
Prepaid expenses	94,261	159,228
Retainers and deposits	55,613	106,625
Total current assets	27,266,789	28,921,518
Oil & Gas properties - full cost	5,448,145	4,187,440
Oil & Gas properties - not amortized	2,726,490	1,924,552
Less: accumulated depletion	(745,344)	(652,439)
Net oil & gas properties	7,429,291	5,459,553
Furniture, fixtures and equipment, at cost	194,429	173,205
Less: accumulated depreciation	(35,872)	(18,333)
Net furniture, fixtures, and equipment	158,557	154,872
Other assets, net	369,260	370,049
Total assets	\$ 35,223,897	\$ 34,905,992
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	\$ 1,107,539	\$ 993,894
Accrued liabilities	1,036,693	595,833
Royalties payable	6,951	6,831
Total current liabilities	2,151,183	1,596,558
Long term liabilities:		
Deferred tax liability	338,001	338,001
Deferred rent	71,248	47,289
Asset retirement obligations	145,693	140,998
Total liabilities	2,706,125	2,122,846
Stockholders equity:		

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Common Stock, par value \$0.001, 100,000,000 shares authorized; 26,776,234 issued and outstanding as of September 30, 2007 and June 30, 2007	26,776	26,776
Additional paid-in capital	12,784,838	12,443,199
Deferred stock based compensation	(11,458)	(45,826)
Retained earnings	19,717,616	20,358,997
Total stockholders' equity	32,517,772	32,783,146
Total liabilities and stockholders' equity	\$ 35,223,897	\$ 34,905,992

See accompanying notes to condensed consolidated financial statements.

Evolution Petroleum Corporation and Subsidiaries

Condensed Consolidated Statements of Operations

(unaudited)

	Three Months Ended	
	September 30, 2007	September 30, 2006
Revenues:		
Oil sales	\$ 502,273	\$ 469,024
Price risk management activities		(14)
Total revenues	502,273	469,010
Operating expenses:		
Production expenses	315,005	324,119
Production taxes	17,556	34,660
Depreciation, depletion and amortization	110,444	61,871
General and administrative (includes stock-based compensation of \$376,008 and \$489,873, respectively for September 30, 2007 and 2006)	1,328,317	1,039,192
Total operating expenses	1,771,322	1,459,842
Loss from operations	(1,269,049)	(990,832)
Other income		
Interest income	341,081	530,796
Total other income	341,081	530,796
Net loss before income taxes	(927,968)	(460,036)
Income tax benefit - Current	(286,587)	
Net loss	\$ (641,381)	\$ (460,036)
Loss per common share:		
Basic and diluted	\$ (0.02)	\$ (0.02)
Weighted average number of common shares:		
Basic and diluted	26,776,234	26,651,999

See accompanying notes to condensed consolidated financial statements.

Evolution Petroleum Corporation and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(unaudited)

	Three Months Ended	
	September 30, 2007	September 30, 2006
Cash flows from operating activities		
Net loss	\$ (641,381)	\$ (460,036)
Adjustments to reconcile net loss to net cash used in operating activities		
Depletion and depreciation	110,443	61,870
Stock-based compensation	376,008	489,873
Accretion of asset retirement obligations	4,695	4,119
Deferred rent	23,959	
Changes in operating assets and liabilities		
Accounts receivable	(654,061)	(217,996)
Inventories	33,728	(27,015)
Prepaid expenses	64,967	40,346
Accounts payable	(318,869)	(68,423)
Royalties payable	120	(35,962)
Accrued liabilities	440,860	(352,592)
Income taxes	(286,587)	(3,000,000)
Net cash used in operating activities	(846,118)	(3,565,816)
Cash flows from investing activities		
Development of oil and gas properties	(223,492)	(74,996)
Acquisitions of oil and gas properties	(1,406,637)	(101,054)
Proceeds from asset sale		155,378
Capital expenditures for furniture, fixtures and equipment	(21,224)	(3,480)
Cash in qualified intermediary account for like-kind exchanges		(321,220)
Retainer and deposits	51,012	300
Other assets	789	1,573
Net cash used in investing activities	(1,599,552)	(343,499)
Cash flows from financing activities		
Equity and transaction costs		(7,023)
Net cash used in financing activities		(7,023)
Net decrease in cash and cash equivalents	(2,445,670)	(3,916,338)
Cash and cash equivalents, beginning of period	27,746,942	9,893,547
Cash and cash equivalents, end of period	\$ 25,301,272	\$ 5,977,209
Supplemental disclosure of cash flow information:		
Income taxes paid	\$	\$ 3,000,000
Accounts payable to acquire oil and gas leasehold interests	\$ 432,514	\$

See accompanying notes to condensed consolidated financial statements.

EVOLUTION PETROLEUM CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Organization and Basis of Preparation

Headquartered in Houston, Texas, Evolution Petroleum Corporation, formerly Natural Gas Systems, Inc. (the Company, EPM, we or us), is a petroleum company incorporated under the laws of the State of Nevada, engaged primarily in the acquisition, exploitation and development of properties for the production of crude oil and natural gas. We acquire established oil and gas properties and exploit them through the application of conventional and specialized technology to increase production, ultimate recoveries, or both.

Our stock is traded on the American Stock Exchange (AMEX) under the ticker symbol EPM. Prior to July 17, 2006, our stock was quoted on the OTC Bulletin Board under the symbol NGSY.OB. Prior to May 26, 2004, our stock was quoted on the OTC Bulletin Board under the symbol RLYI.OB. Concurrently with the listing of our shares on the AMEX during July, 2006, we changed our name from Natural Gas Systems, Inc. to Evolution Petroleum Corporation to avoid confusion with similar names traded on the AMEX and to better reflect our business model.

At September 30, 2007, we conducted operations through our 100% working interests in our Tullos Field Area and our non-operated interests in our Delhi Field, all located onshore in Louisiana. Our Tullos Field Area consists of approximately 156 producing wells out of 260 well bores across 599 acres of high water cut primary reserve production. Our non-operated interests in the 13,636 acre Delhi Field consist of a 7.4% overriding and mineral royalty interest in the Delhi Holt Bryant Unit, a 25% reversionary working interest in the Delhi Holt Bryant Unit, and a 25% working interest in certain other depths in the Delhi Field. Our Delhi Holt Bryant Unit is scheduled for redevelopment using CO2 enhanced oil recovery technology.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) with the instructions to Form 10-Q for interim financial information. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. All adjustments (consisting of normal recurring accruals) which are, in the opinion of management, necessary for a fair presentation of the financial position and results of operations for the interim periods presented have been included. All inter-company transactions are eliminated upon consolidation. The interim financial information and notes hereto should be read in conjunction with our 2007 Annual Report on Form 10-KSB for the year ended June 30, 2007, as filed with the Securities and Exchange Commission. The results of operations for interim periods are not necessarily indicative of results to be expected for a full fiscal year.

2. Recent Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board (FASB) issued FASB Statement of Accounting Standards (SFAS) No 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159) which permits all entities to choose, at specified election dates, to measure eligible items at fair value. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value, and thereby mitigate volatility in reported earnings caused by measuring

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related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. We are evaluating the impact that this Statement will have on our financial statements.

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes - an Interpretation of FASB 109. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006.

We adopted FIN 48 effective July 1, 2007. See Note 9.

3. Net Loss per Share

Basic and diluted loss per share are computed by dividing net loss available to common shareholders by the weighted average number of common shares outstanding during the period. For purposes of computing diluted loss per share, potential common shares have been excluded from the computation of weighted average common shares outstanding, because their effect is antidilutive.

The following table sets forth the computation of basic and diluted loss per share:

	Three Months Ended	
	September 30, 2007	September 30, 2006
Numerator:		
Net loss applicable to common stockholders	\$ (641,381)	\$ (460,036)
Plus income impact of assumed conversions:		
Preferred stock dividends	N/A	N/A
Interest on convertible subordinated notes	N/A	N/A
Net loss applicable to common stockholders	\$ (641,381)	\$ (460,036)
Denominator:	26,776,234	26,651,999
Effect of potentially dilutive common shares:		
Warrants	N/A	N/A
Employee and director stock options	N/A	N/A
Convertible preferred stock	N/A	N/A