CREDO PETROLEUM CORP
Form 10QSB
June 14, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-QSB

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934.

For Quarter Ended April 30, 2002

Commission File Number 0-8877

CREDO PETROLEUM CORPORATION

Colorado (State of Incorporation)	84-0772991 (IRS Employer Identification)
1801 Broadway, Suite 900 Denver, Colorado (Address of principal executive office)	80202 (Zip Code)

303-297-2200
(Telephone Number)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, net of treasury stock, as of May 31, 2002:
Common stock, $.10 par value - 3,283,000
Preferred stock, no par value - None issued

CREDO PETROLEUM CORPORATION

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For Quarter Ended April 30, 2002

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PART II - OTHER INFORMATION

Item 4. Submission of Matters to a Vote of Security Holders

The Company's annual meeting of shareholders was held on March 14, 2002. The following matters, as described more fully in the company's Proxy Statement, were approved by the shareholders:

(1) The following Class III nominees for director were elected:

	For	Withhold
William N. Beach	2,694,290	8,162
Richard B. Stevens	2,694,175	8,277

(2) Hein + Associates LLP was approved as the independent auditors of the Company for the fiscal year 2002. The shareholders voted 2,683,453 for and 7,995 against this appointment, with 11,004 abstentions.

(3) An amendment to the Company's 1997 Stock Option Plan was approved that increased the number of shares authorized for issuance under the Plan together with related matters. The shareholders voted 1,525,590 for and 139,459 against this amendment, with 16,690 abstentions and 1,020,713 broker non-votes.

There were 471,572 non-votes for each matter voted upon.

The consolidated financial statements included herein have been prepared by the company without audit, and reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the financial position of the company for the periods presented. Certain information and footnote disclosures normally included in the financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted as allowed by the rules and regulations of the Securities and Exchange Commission. These financial statements should be read in conjunction with the company's Form 10-KSB for the fiscal year ended October 31, 2001.

CREDO PETROLEUM CORPORATION
Consolidated Balance Sheets

A S S E T S

	April 30, 2002 (Unaudited)	October 31, 2001
CURRENT ASSETS:		
Cash and cash equivalents	$ 938,000	$ 819,000
Short term investments	5,717,000	5,283,000
Receivables:		
Trade	263,000	317,000
Accrued oil and gas sales	474,000	367,000
Other	77,000	241,000
	7,469,000	7,027,000
OIL AND GAS PROPERTIES, net, at cost, full cost method:		
Unevaluated	1,980,000	1,549,000
Evaluated	6,901,000	7,120,000
	8,881,000	8,669,000
EXCLUSIVE LICENSE AGREEMENT, net of amortization of $117,000 in 2002 and $82,000 in 2001	583,000	618,000
OTHER, net	178,000	156,000
	$17,111,000	$16,470,000

L I A B I L I T I E S A N D S T O C K H O L D E R S ' E Q U I T Y

	April 30, 2002	October 31, 2001
CURRENT LIABILITIES:		
Accounts payable	$ 1,218,000	$ 1,126,000
Income taxes payable	26,000	110,000
	1,244,000	1,236,000
DEFERRED INCOME TAXES	2,030,000	1,935,000
EXCLUSIVE LICENSE OBLIGATION, less current portion of $44,000	456,000	456,000

COMMITMENTS		
STOCKHOLDERS' EQUITY:		
Preferred stock, without par value, 5,000,000 shares authorized, none issued	-	-
Common stock, $.10 par value, 20,000,000 shares authorized, 3,678,000 shares issued	367,000	367,000
Capital in excess of par value	6,453,000	6,453,000
Retained earnings	7,464,000	6,927,000
Other comprehensive income (loss)	(105,000)	14,000
Treasury stock, at cost, 423,000 shares in 2002 and 502,000 shares in 2001	(798,000)	(918,000)
	13,381,000	12,843,000
	$17,111,000	$16,470,000

See accompanying notes.

CREDO PETROLEUM CORPORATION
Consolidated Statements of Operations And Changes in
Retained Earnings - Unaudited

	Six Months Ended April 30 2002	Six Months Ended April 30 2001	Quarter Ended April 30 2002	Quarter Ended April 30 2001
REVENUES:				
Oil and gas sales	$2,177,000	$2,710,000	$1,131,000	$1,334,000
Operating	242,000	223,000	116,000	114,000
Investment income and other	74,000	109,000	65,000	17,000
	2,493,000	3,042,000	1,312,000	1,465,000
COSTS AND EXPENSES:				
Oil and gas production	658,000	599,000	298,000	288,000
Depreciation, depletion and amortization	558,000	364,000	292,000	181,000
General and administrative	485,000	435,000	242,000	225,000
Interest	25,000	27,000	13,000	14,000
	1,726,000	1,425,000	845,000	708,000
INCOME BEFORE				

INCOME TAXES	767,000	1,617,000	467,000	757,000
INCOME TAXES	(230,000)	(485,000)	(140,000)	(227,000)
NET INCOME	537,000	1,132,000	327,000	530,000
RETAINED EARNINGS, BEGINNING OF PERIOD	6,927,000	4,925,000	7,137,000	5,527,000
RETAINED EARNINGS, END OF PERIOD	$7,464,000	$6,057,000	$7,464,000	$6,057,000
BASIC NET INCOME PER SHARE	$ .17	$ .37	$ .10	$ .17
DILUTED NET INCOME PER SHARE	$ .16	$ .35	$ .10	$ .16

See accompanying notes.

CREDO PETROLEUM CORPORATION

Consolidated Statements of Cash Flows - Unaudited

	Six Months Ended April 30, 2002	Six Months Ended April 30, 2001
OPERATING ACTIVITIES:		
Net income	$ 537,000	$ 1,132,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion and amortization	558,000	364,000
Deferred income taxes	95,000	194,000
Changes in operating assets and liabilities:		
Proceeds from short term investments	3,276,000	746,000
Purchase of short term investments	(3,710,000)	(842,000)
Trade receivables	54,000	(236,000)
Accrued oil and gas sales	(107,000)	(254,000)
Other	45,000	(85,000)
Accounts payable	92,000	265,000
Income tax payable	(84,000)	5,000
NET CASH PROVIDED BY OPERATING ACTIVITIES	756,000	1,289,000
INVESTING ACTIVITIES:		
Oil and gas properties, net	(709,000)	(1,445,000)
Changes in other long-term assets	(48,000)	26,000

NET CASH USED IN INVESTING ACTIVITIES	(757,000)	(1,419,000)
FINANCING ACTIVITIES:		
Proceeds from exercise of stock options (75,000 options in 2002 and 117,000 in 2001)	145,000	229,000
Purchase of treasury stock (4,400 shares in 2002 and 5,000 in 2001)	(25,000)	(25,000)
NET CASH PROVIDED BY FINANCING ACTIVITIES	120,000	204,000
INCREASE IN CASH AND CASH EQUIVALENTS	119,000	74,000
CASH AND CASH EQUIVALENTS:		
Beginning of Period	819,000	484,000
End of Period	$ 938,000	$ 558,000

See accompanying notes.

CREDO PETROLEUM CORPORATION
Management's Discussion and Analysis of Financial
Condition and Results of Operations
April 30, 2002

LIQUIDITY AND CAPITAL RESOURCES

The company's working capital and cash flow represent a significant capital resource and source of liquidity. At April 30, 2002, working capital was $6,225,000, compared to $5,791,000 at October 31, 2001. Cash flow from operating activities before working capital changes totaled $1,190,000 for the six months, compared to $1,690,000 from the same period last year.

Existing working capital and anticipated cash flow are expected to be sufficient to fund fiscal 2002 operations. However, if the company were to make one or more major acquisition during the coming year, bank borrowing, issuance of additional stock, or other forms of debt financing would be considered. Because earnings are anticipated to be reinvested in operations, cash dividends are not expected to be paid in the foreseeable future.

Pending deployment into oil and gas assets, cash is primarily invested with professional money managers who specialize in short-term timing of mutual funds. The average return on the company's investments was 1% for the first half of fiscal 2002 compared to 3% in the same period last year. The lower investment return was due primarily to market conditions during the first half of fiscal 2002 that limited investment opportunities for the market timers which manage the bulk of the company's investments.

Commitments for future capital expenditures were approximately $300,000 at April 30, 2002. The timing of most capital expenditures for exploration and development is relatively discretionary. Therefore, the company can plan expenditures to coincide with available funds in order to minimize business risks.

PRODUCT PRICES, PRODUCTION AND OPERATIONS

Numerous uncertainties exist in the oil and gas exploration and production industry which are beyond the company's ability to predict with reasonable accuracy.

Gas price decontrol, the advent of an active spot market for natural gas, changes in supply and demand for natural gas, and weather patterns cause prices received by the company to be subject to significant fluctuations. Gas prices generally accelerate in peak demand periods such as the winter months and subside during lower demand periods.

Significant world events and OPEC's production and pricing policies influence OPEC and worldwide supply and demand and prices for crude oil and petroleum products.

Although product prices are key to the company's ability to operate profitably and to budget capital expenditures, they are beyond the company's control and are difficult to predict. The company periodically hedges the price of its oil and gas production when the potential for significant downward price movement is anticipated. Hedging transactions take the form of forward, or "short", selling in the NYMEX futures market, and are closed by purchasing offsetting "long" positions. Such hedges, which are accounted for as cash flow hedges, do not exceed anticipated production volumes, are expected to have reasonable correlation between price movements in the futures market and the cash markets where the company's production is located, and are authorized by the company's Board of Directors. Hedges are expected to be closed and gains or losses recognized for financial reporting purposes as related production occurs. However, hedges may be closed earlier if the anticipated downward price movement occurs or if the company believes that the potential for such movement has abated. All other futures transactions are accounted for as speculative transactions and gains and losses are immediately recognized.

The company's recent natural gas hedge data for months subsequent to second quarter-end (May 2002 through February 2003) shows 920 MMcfg hedged at an average NYMEX (Henry Hub, Louisiana delivery point) price of $3.78 per Mcf. This represents approximately 91% of the company's total estimated gas production for those months. The hedge relates only to the company's Oklahoma production where the "basis" for its pipeline index prices is generally $.15 to $.30 below the Henry Hub.

The company recognizes all derivatives on the balance sheet at fair value at the end of each period. Changes in the fair value of a cash flow hedge are recorded in Other Comprehensive Income on the Consolidated Balance Sheets and then are reclassified into the Consolidated Statement of Earnings as the underlying hedged item affects earnings. Amounts reclassified into earnings related to natural gas hedges are included in oil and gas sales. At April 30, 2002, net deferred losses of approximately $150,000 ($105,000 net of tax) related to natural gas hedging transactions were accumulated in Other Comprehensive Income of which $1,000 were realized and $149,000 were unrealized. Subsequent to second quarter-end, the hedge loss reversed and recently showed a gain in excess of $300,000 of which 97% was unrealized.

The following table sets forth the components of Comprehensive Income for each of the periods presented:

	Six Months Ended April 30, 2002	Six Months Ended April 30, 2001	Three Months Ended April 30, 2002	Three Months Ended April 30, 2001
Net Income	$ 537,000	$1,132,000	$ 327,000	$ 530,000
Other comprehensive income, net of tax:				
Change in fair value of derivatives	(119,000)	61,000	(306,000)	1,000
Comprehensive income	$ 418,000	$1,193,000	$ 21,000	$ 531,000

Oil and gas sales volume and price comparisons for the indicated periods are set forth below.

Product	Six Months Ended April 30, 2002 Volume	Six Months Ended April 30, 2002 Price	Six Months Ended April 30, 2001 Volume	Six Months Ended April 30, 2001 Price	Percent Volume Change	Percent Price Change
Gas (Mcf)	620,200	$ 2.96(1)	345,900	$ 5.99(3)	+ 79%	- 51%
Oil (bbls)	17,900	$19.06	22,800	$28.02	- 21%	- 32%

Product	Three Months Ended April 30, 2002 Volume	Three Months Ended April 30, 2002 Price	Three Months Ended April 30, 2001 Volume	Three Months Ended April 30, 2001 Price	Percent Volume Change	Percent Price Change
Gas (Mcf)	329,600	$ 2.90(2)	181,300	$ 5.80(4)	+ 82%	- 50%
Oil (bbls)	8,300	$21.06	10,900	$26.06	- 24%	- 19%

(1) Includes $.54 Mcf hedging gain.
(2) Includes $.45 Mcf hedging gain.
(3) Includes $.19 Mcf hedging gain.
(4) Includes $.37 Mcf hedging gain.

The company's growth strategy focuses on two core projects drilling along the Anadarko Shelf of Oklahoma and application of its patented Calliope gas recovery technology.

The 82% increase in second quarter natural gas production resulted from new wells drilled late in fiscal 2001 and during fiscal 2002. The primary contributor was the Glendena #1-5 well which commenced sales in October of 2001 and has produced at rates of 2.5 to 3.0 MMcfg per day for all of fiscal 2002. The well is located on the company's 2,900-acre Sand Creek Prospect in Harper and Ellis Counties, Oklahoma. The Glendena well contributed approximately 29% of first half production and accounted for 65% of the first half production increase. CREDO is operator of the well and owns a 40% working interest.

The Redfearn #1-33 well was drilled approximately one-half mile north of the Glendena #1-5 well on the Sand Creek Prospect. The well tested the Morrow formation at 7,600 feet. It was completed naturally (without acid or fracture treatments) from two Morrow sands totaling 13 feet. Pipeline sales commenced in late March and the well is currently producing on a 42/64-inch choke at the daily rate of 3.0 MMcfg, 14 barrels of condensate, and no water. This new well contributed to production for only one month of the reporting periods.

Subsequent to second quarter-end, the Easterwood #1-28 well was drilled about one mile north of the Redfearn #1-33 well on the Sand Creek Prospect. The Easterwood well is the third well completed on the prospect. The 7,400-foot well is currently awaiting completion for production. It is classified as a "tight hole", meaning that for proprietary business reasons the company is not releasing detailed information about the well. CREDO owns 40% of the well and is the operator. An east offset will be drilled in the third quarter.

Approximately five miles to the north of the Easterwood well in Harper County, the company has completed the Wills #1-3 well. This 7,400-foot well is located on the company's 2,300-acre Two Springs Prospect. It was placed on production in late May 2002 and is also classified as a "tight hole". CREDO owns 29% of the well and is the operator. The company is preparing to drill an east offset during the third quarter.

In Ellis County, Oklahoma, approximately 13 miles southwest of the Easterwood well, the company has set production casing on a second well on its 640-acre Thurmond Prospect. This 8,800-foot Thurmond #2-36 well encountered 10 feet of Morrow sand which wireline logs and drilling data indicate are productive. The well is awaiting completion. CREDO owns 37% of the well and is the operator.

The company is actively generating drilling prospects along the Anadarko Shelf of Oklahoma and is currently leasing on several projects located in Harper and Ellis Counties, Oklahoma.

The company has installed its patented Calliope Gas Recovery System on eight wells ranging in depth from 6,500 to 18,600 feet. Each of these applications was a rigorous test for Calliope. Three applications were on dead wells one for five years that were scheduled to be plugged and abandoned. After being reinvigorated by Calliope, these three wells are currently CREDO's second, third and seventh most valuable producing properties.

The company acquired two wells for Calliope installation subsequent to second quarter-end and is actively seeking to acquire additional wells. The 18,400-foot Green Estate #1 well located in Beckham County, Oklahoma produced 28.8 Bcfg and has been dead for over a year. This well will provide a rigorous test for Calliope in terms of both extreme depth and the challenge of reviving a dead well. A second well, the Horn #1, produced 12.9 Bcfg and has also been dead for over a year. This 12,400-foot well is located in Grady County, Oklahoma. The company will own approximately 70% of both wells and will be the operator. Negotiations are in progress to purchase several additional wells for Calliope applications.

The company is nearing completion of a sophisticated multimedia presentation detailing information about the Calliope system. The presentation is designed to introduce Calliope to other companies with the objective of entering into joint venture or other arrangements to install Calliope on more wells.

As a gas well depletes, technologies that rely on bottom hole pressure to lift liquids that load-up the well and restrict gas flow become inefficient. In many gas wells, the operating limits of conventional liquid lift technologies cause billions of cubic feet of gas to be left behind and substantial profits to be lost. For those wells, Calliope will achieve substantially lower reservoir abandonment pressure than conventional production methods because it does not rely on bottom hole pressure or adequate fluid volumes to lift liquids.

The company has proved to its satisfaction that Calliope will add .5 to 2.0 Bcf of gas reserves to many dead or uneconomic gas wells. The 11,800-foot J. C. Carroll well provides an excellent example of Calliope's potential. When the well was purchased for salvage value in 1999, it had not produced commercially in five years. Calliope immediately restored production to 660 thousand cubic feet of gas per day. The company estimates that Calliope will recover 1.7 billion cubic feet of additional gas from the Carroll well. It is the company's second most valuable asset.

INCOME TAXES

The company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes (SFAS 109), which requires the asset and liability method of accounting for deferred income taxes. Deferred tax assets and liabilities are determined based on the temporary differences between the financial statement and tax basis of assets and liabilities. Deferred tax assets or liabilities at the end of each period are determined using the tax rate in effect at that time.

The total future deferred income tax liability under SFAS 109 is extremely complicated for any oil company to estimate due in part to the long-lived nature of depleting oil and gas reserves and variables such as product prices. Accordingly, the liability is subject to continual recalculation, revision of the numerous estimates required, and may change significantly in the event of such things as major acquisitions, divestitures, product price changes, changes in reserve estimates, changes in reserve lives, and changes in tax rates or tax laws.

RESULTS OF OPERATIONS

Six Months Ended April 30, 2002 Compared to Six Months Ended April 30, 2001

For the six months ended April 30, 2002, net income fell 53% to $537,000 compared to $1,132,000 last year. Although successful drilling boosted natural gas production by 79%, lower net income resulted primarily from sharply lower net wellhead prices (natural gas down by 58% and oil down by 32%).

Total revenues fell 18% to $2,493,000 in the first half of 2002 compared to $3,042,000 last year. Oil and gas sales decreased $533,000, or 20%, to $2,177,000. Refer to the table and discussion on page 7 for details of oil and gas prices and volumes for the applicable periods. Total gas price realizations fell 51% to $2.96 per Mcf compared to $5.99 last year. Hedging transactions increased first half 2002 price realizations by $.54 per Mcf, or 22%, compared to $.19 per Mcf, or 3%, last year. Net wellhead prices for gas decreased 58% to $2.42 per Mcf compared to $5.80 last year. Net wellhead oil price realizations decreased 32% to $19.06 per barrel compared to $28.02 last year. The net effect of these price changes, including hedging transactions, was to decrease oil and gas sales $1,253,000. Gas volumes increased 79% and oil volumes decreased 21%. The net effect of volume changes was to increase oil and gas sales by $720,000. Operating income increased $19,000, or 9%, due to drilling overhead income. As discussed on page 6, investment income fell 32% to $74,000 compared to $109,000 last year due primarily to market conditions during the first half of fiscal 2002 that limited investment opportunities for the market timers which manage the bulk of the company's investments.

Total costs and expenses rose 21% to $1,726,000 in the first half of fiscal 2002 compared to $1,425,000 last year. Oil and gas production expenses rose 10%, or $59,000, due to two major well workovers that cost approximately $84,000. Depreciation, depletion and amortization increased 53% primarily due to a net increase in production volume between the periods. General and administrative expenses increased $50,000, or 12%, due to inflationary pressures and additional staffing. Interest expense relates to the accrual of interest on the exclusive license agreement obligation, due annually on September 1. Income taxes were provided at 30% in both periods.

Quarter Ended April 30, 2002 Compared to Quarter Ended April 30, 2001

Net income for the quarter ended April 30, 2002 fell 38% to $327,000 compared to $530,000 for the same quarter last year. Although successful drilling boosted natural gas production 82%, lower net income resulted primarily from sharply lower net wellhead prices (natural gas down 55% and oil down 19%).

Total revenues fell 10% to $1,312,000 in the second quarter of 2002 compared to $1,465,000 for the same quarter last year. Oil and gas sales decreased 15% to $1,131,000 compared to $1,334,000 last year. Refer to the table and discussion on page 7 for details of oil and gas prices and volumes for the applicable periods. Total gas price realizations fell 50% to $2.90 per Mcf compared to $5.80 last year. Hedging transactions increased second quarter price realizations $.45 per Mcf, or 18%, compared to $.37 per Mcf, or 7%, last year. Net wellhead prices for gas fell 55% to $2.45 per Mcf compared to $5.43 last year. Net wellhead prices for oil fell 19% to $21.06 per barrel compared to $26.06 last year. The net effect of these price changes and hedging transactions was to decrease oil and gas sales $579,000. Gas volumes increased 82% and oil volumes decreased 24%. The net effect of volume changes was to increase oil and gas sales $376,000. Operating income was comparable between the two periods. Investment income increased 282% to $65,000 in the second quarter of 2002 compared to $17,000 last year due primarily to market timers, who manage the bulk of the company's investments, being able to take advantage of limited investment opportunities in the current market environment.

Total costs and expenses increased 19% to $845,000 in the second quarter of 2002 compared to $708,000 last year. Oil and gas production expenses rose 4%, or $10,000 due to a well workover that cost approximately $24,000. Depreciation, depletion and amortization increased 61% primarily due to a net increase in production volumes between the periods. General and administrative expenses increased $17,000, or 8%, due to inflationary pressures and additional staffing. Interest expense relates to the accrual of interest on the exclusive license agreement obligation, due annually on September 1. Income taxes were provided at 30% in both periods.

FORWARD-LOOKING STATEMENTS

Certain information included in this quarterly report and other materials filed by the company with the Commission contain forward-looking statements relating to the company's operations and the oil and gas industry. Such forward-looking statements are based on management's current projections and estimates and are identified by words such as "expects," "intends," "plans," "projects," "anticipates," "believes," "estimates" and similar words. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Therefore, actual results may differ materially from what is expressed or forecasted in such forward-looking statements. Among many factors that could cause actual results to differ materially are: (i) natural gas and crude oil price fluctuations, (ii) the company's ability to acquire oil and gas properties that meet its objectives and to identify prospects for drilling, and (iii) potential delays or failure to achieve expected production from existing and future exploration and development projects. In addition, such forward-looking statements may be affected by general domestic and international economic and political conditions.

SIGNATURES

Pursuant to 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.

Date: June 12, 2002 By: /s/ James T. Huffman

James T. Huffman
President and
Chief Executive Officer

By: /s/ John A. Alsko

John A. Alsko
Vice President and
Chief Financial Officer