VAALCO ENERGY INC /DE/
Form 10-Q
November 08, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

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 1-32167

VAALCO Energy, Inc.

(Exact name of registrant as specified in its charter)

Delaware	76 0274813
(State or other jurisdiction of	(I.R.S. Employer
Incorporation or organization)	Identification No.)
9800 Richmond Avenue	
Suite 700	
Houston, Texas	77042
(Address of principal executive offices)	(Zip code)

(713) 623-0801

(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 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 has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). 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 check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2).
Yes No

As of October 31, 2016, there were outstanding 58,633,937 shares of common stock, $0.10 par value per share, of the registrant.

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VAALCO ENERGY, INC. AND SUBSIDIARIES

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Unless the context otherwise indicates, references to “VAALCO,” “the Company”, “we,” “our,” or “us” in this Form 10-Q are references to VAALCO Energy, Inc., including its wholly-owned subsidiaries.

PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

VAALCO ENERGY, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

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

	September 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$ 26,883	$ 25,357
Restricted cash	788	1,048
Receivables:		
Trade	5,940	5,353
Accounts with partners	1,639	19,765
Other	36	42
Crude oil inventory	770	639
Materials and supplies	145	194
Prepayments and other	3,602	2,975
Current assets - discontinued operations	1,747	8,369
Total current assets	41,550	63,742
Property and equipment - successful efforts method:		
Wells, platforms and other production facilities	410,301	412,593
Undeveloped acreage	10,000	10,000
Equipment and other	10,357	10,805
	430,658	433,398
Accumulated depreciation, depletion, amortization and impairment	(405,080)	(400,041)
Net property and equipment	25,578	33,357
Other noncurrent assets:		
Restricted cash	830	15,830
Value added tax and other receivables, net of allowance of $4.9 million and $4.2 million at September 30, 2016 and December 31, 2015	5,107	4,221
Deferred finance charge	-	1,655
Abandonment funding	5,137	5,137
Noncurrent assets - discontinued operations	-	16

Total assets	$ 78,202	$ 123,958
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 11,553	$ 44,140
Accrued liabilities and other	13,551	18,447
Current portion of long term debt	6,250	-
Current liabilities - discontinued operations	18,656	4,129
Total current liabilities	50,010	66,716
Asset retirement obligations	16,849	16,166
Long term debt, excluding current portion	8,134	15,000
Total liabilities	74,993	97,882
Commitments and contingencies (Note 7)		
Shareholders' equity:		
Preferred stock, none issued, 500,000 shares authorized, $25 par value	-	-
Common stock, 66,189,032 and 66,041,338 shares issued		
$0.10 par value, 100,000,000 shares authorized	6,619	6,604
Additional paid-in capital	70,210	69,118
Less treasury stock, 7,555,095 and 7,514,169 shares at cost	(37,933)	(37,882)
Accumulated deficit	(35,687)	(11,764)
Total shareholders' equity	3,209	26,076
Total liabilities and shareholders' equity	$ 78,202	$ 123,958

See notes to condensed consolidated financial statements.

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VAALCO ENERGY, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenues:				
Oil and natural gas sales	$ 14,635	$ 17,546	$ 44,458	$ 62,922
Operating costs and expenses:				
Production expense	7,162	7,859	25,756	26,637
Exploration expense	2	8,975	4	9,701
Depreciation, depletion and amortization	1,607	8,256	5,787	23,484
General and administrative expense	2,420	2,669	8,853	9,379
Impairment of proved properties	88	17,988	88	29,208
Other operating expense	324	-	9,959	-
General and administrative related to shareholder matters	85	-	(350)	-
Bad debt expense and other	63	2,750	577	3,326
Total operating costs and expenses	11,751	48,497	50,674	101,735
Other operating income (loss), net	(26)	-	(8)	398
Operating income (loss)	2,858	(30,951)	(6,224)	(38,415)
Other income (expense):				
Interest income	1	3	2	12
Interest expense	(328)	(465)	(2,287)	(1,119)
Other, net	(149)	(401)	(533)	(179)
Total other income (expense)	(476)	(863)	(2,818)	(1,286)
Income (loss) from continuing operations before income taxes	2,382	(31,814)	(9,042)	(39,701)
Income tax expense	2,198	2,707	6,884	10,345
Income (loss) from continuing operations	184	(34,521)	(15,926)	(50,046)
Income (loss) from discontinued operations, net of tax	(15,783)	853	(7,997)	(27,831)
Net loss	$ (15,599)	$ (33,668)	$ (23,923)	$ (77,877)

Basic net loss per share:				
Income (loss) from continuing operations	$ 0.00	$ (0.59)	$ (0.27)	$ (0.86)
Income (loss) from discontinued operations	(0.27)	0.01	(0.14)	(0.48)
Net loss	$ (0.27)	$ (0.58)	$ (0.41)	$ (1.34)
Basic weighted average shares outstanding	58,708	58,392	58,600	58,227
Diluted net loss per share:				
Income (loss) from continuing operations	$ 0.00	$ (0.59)	$ (0.27)	$ (0.86)
Income (loss) from discontinued operations	(0.27)	0.01	(0.14)	(0.48)
Net loss	$ (0.27)	$ (0.58)	$ (0.41)	$ (1.34)
Diluted weighted average shares outstanding	58,708	58,392	58,600	58,227

See notes to condensed consolidated financial statements.

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VAALCO ENERGY, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in thousands)

	Nine Months Ended September 30,	
	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Loss from continuing operations	$ (15,926)	$ (50,046)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation, depletion and amortization	5,787	23,484
Amortization of debt issuance cost	1,132	473
Unrealized foreign exchange loss	2,175	(2,181)
Dry hole costs and impairment of unproved leasehold	-	9,602
Stock-based compensation	1,107	3,024
Commodity derivatives loss	772	-
Bad debt provision	577	2,750
Other operating (income) loss, net	8	(398)
Impairment of proved properties	88	29,208
Change in operating assets and liabilities:		
Trade receivables	(587)	12,543
Accounts with partners	18,126	(4,658)
Other receivables	12	(3,191)
Crude oil inventory	(131)	948
Materials and supplies	49	54
Value added tax and other receivables	(1,526)	-
Prepayments and other	(552)	1,145
Accounts payable	(24,339)	18,730
Accrued liabilities and other	24	(2,671)
Net cash provided by (used in) continuing operating activities	(13,204)	38,816
Net cash provided by (used in) discontinued operating activities	13,168	(1,297)
Net cash provided by (used in) operating activities	(36)	37,519
CASH FLOWS FROM INVESTING ACTIVITIES:		
Decrease in restricted cash	15,260	5,512
Property and equipment expenditures	(12,781)	(53,276)

Proceeds from sales of oil and gas properties	-	398
Other, net	(824)	-
Net cash provided by (used in) investing activities	1,655	(47,366)
Net cash provided by discontinued investing activities	-	(18,955)
Net cash provided by (used in) investing activities	1,655	(66,321)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from the issuances of common stock	-	452
Debt issuance costs	(93)	-
Net cash provided by (used in) financing activities	(93)	452
NET CHANGE IN CASH AND CASH EQUIVALENTS	1,526	(28,350)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	25,357	69,051
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 26,883	$ 40,701
Supplemental disclosure of cash flow information:		
Interest paid, net of capitalized interest	$ 1,046	$ 1,119
Income Taxes paid	$ 6,930	$ 10,299
Supplemental disclosure of non-cash investing and financing activities:		
Property and equipment additions incurred but not paid at period end	$ 1,990	$ 18,097
Asset retirement cost capitalized	$ 42	$ 816

See notes to condensed consolidated financial statements.

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VAALCO ENERGY, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND ACCOUNTING POLICIES

VAALCO Energy, Inc. and its consolidated subsidiaries ("VAALCO" or the "Company") is a Houston-based independent energy company principally engaged in the acquisition, exploration, development and production of crude oil and natural gas. As operator, we have production operations and conduct exploration activities in Gabon, West Africa. As non-operator, we participate in exploration and development activities in Equatorial Guinea, West Africa. In the United States, VAALCO is the operator of two unconventional wells in North Texas and holds undeveloped leasehold acreage in Montana. We also own some minor interests in conventional production activities as a non-operator in the United States. As discussed further in Note 4 below, we have discontinued operations associated with our activities in Angola, West Africa.

Our consolidated subsidiaries are VAALCO Gabon (Etame), Inc., VAALCO Production (Gabon), Inc., VAALCO Gabon S.A., VAALCO Angola (Kwanza), Inc., VAALCO UK (North Sea), Ltd., VAALCO International, Inc., VAALCO Energy (EG), Inc., VAALCO Energy Mauritius (EG) Limited and VAALCO Energy (USA), Inc.

These condensed consolidated financial statements are unaudited, but in the opinion of management, reflect all adjustments necessary for a fair presentation of results for the interim periods presented. All adjustments are of a normal recurring nature unless disclosed otherwise. Interim period results are not necessarily indicative of results to be expected for the full year.

These condensed consolidated financial statements have been prepared in accordance with rules of the Securities and Exchange Commission ("SEC") and do not include all the information and disclosures required by accounting principles generally accepted in the United States ("GAAP") for complete financial statements. They should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2015, which include a summary of the significant accounting policies.

Certain reclassifications have been made to prior period amounts to conform to the current period presentation. These reclassifications did not affect our consolidated financial results.

Correction of error – Accounts with partners and allowance for bad debts – Subsequent to the issuance of our 2015 financial statements, we identified an error in the presentation on our consolidated balance sheet of the accounts with partners and the associated allowance for bad debts. These accounts incorrectly included a fully reserved receivable of $7.6 million which should have been charged off against the reserve in 2012 when efforts to collect from a removed partner were no longer viable and had been abandoned. To correct this error, we removed the reference to the $7.6 million allowance from the caption. This correction had no impact on our consolidated balance sheet or the consolidated results of operations.

Bad debt – Quarterly, we evaluate our accounts receivable balances to confirm collectability. When collectability is in doubt, we record an allowance against the accounts receivable and a corresponding income charge for bad debts,

which appears in the “Bad debt expense (recovery) and other” line of our condensed consolidated statements of operations. The majority of our accounts receivable balances are with our joint venture partners, purchasers of our production and the government of Gabon for reimbursable Value-Added Tax (“VAT”). Collection efforts, including remedies provided for in the contracts, are pursued to collect overdue amounts owed to us.

In the three and nine months ended September 30, 2016, we increased the allowance related to VAT due from Gabon by $0.1 million and $0.6 million, respectively. During the three and nine months ended September 30, 2015 we recorded an allowance of $2.8 million related to the VAT receivable due from Gabon. In June 2016, we entered into an agreement with the government of Gabon to receive payments related to the outstanding VAT receivable balance as of December 31, 2015 in thirty-six monthly installments of $0.2 million net to VAALCO. We received one monthly installment payment in July 2016; however, no further payments have been received. The Gabonese government has informed us that they do not expect to make any further payments until early 2017 due to liquidity constraints.

General and administrative related to shareholder matters – During the third quarter of 2015, a shareholder group consisting of Group 42, Inc., Bradley L. Radoff and certain other participants (collectively, the "Group 42-BLR Group") attempted to gain control of our Board of Directors. In December 2015, we reached an agreement with the Group 42-BLR Group that included changes to the composition of the Board of Directors and other actions. In connection with this agreement, we reimbursed the Group 42-BLR Group for $350,000 of its legal expenses. Related shareholder litigation filed in Delaware was dismissed by the Delaware Chancery Court on April 20, 2016. See Note 7 below for further discussion of the litigation.

2. LIQUIDITY AND GOING CONCERN

Our revenues, cash flows, profitability, oil and natural gas reserve values and future rates of growth are substantially dependent upon prevailing prices for oil and natural gas. Our ability to borrow funds and to obtain additional capital on attractive terms is also substantially dependent on oil and natural gas prices. Historically, world-wide oil and natural gas prices and markets have been volatile, and will likely continue to be volatile. In particular, the prices of oil and natural gas declined dramatically in the second half

of 2014 and remained low, decreasing further in 2015 and early 2016. Revenues have increased from $11.0 million in the first quarter 2016 to $14.6 million in the third quarter of 2016 primarily as a result of improving prices.

As discussed in Note 6 below, in June 2016, we modified our revolving credit facility with the International Finance Corporation (the "IFC") converting $20 million of our revolving credit facility into a term loan with $15 million borrowed and the option to request an additional $5 million in a single draw between now and December 31, 2016, subject to the IFC's approval. Our available liquidity, therefore, continues to be limited.

If we fail to satisfy our obligations with respect to our indebtedness or trade payables, or fail to comply with the financial and other restrictive covenants contained in our amended loan agreement with the IFC, an event of default under the amended loan agreement and acceleration of our term loan debt and other indebtedness could result, which could permit the IFC to foreclose on any of our assets securing that debt. Any accelerated debt would become immediately due and payable. As discussed in Note 6 below, certain of our financial covenants under the amended loan agreement have been relaxed through the end of 2016.

During the third quarter of 2016, we received notice from the New York Stock Exchange ("NYSE") that our stock had fallen below the minimum listing standards which requires that the average closing price of our common stock be not less than $1.00 per share for a period of over 30 consecutive trading days. We are considering various options to come into compliance with this requirement; however, should the delisting occur, it could cause additional difficulties in accessing the capital markets.

If oil and natural gas prices continue at levels seen in the second and third quarters of 2016, we expect that for the remainder of 2016 through the end of 2017 we will generate cash flows sufficient to cover our operating expenses. However, an unfavorable resolution of current obligations or depressed oil and natural gas prices, like those seen in the first quarter of 2016, would have a material adverse effect on our liquidity, financial condition, results of operations and on the carrying value of our proved oil and natural gas properties. To fund potential growth opportunities going forward, we are considering multiple alternatives, including, but not limited to, additional debt or equity financing through traditional sources or strategic partnerships. There can be no guarantee of future capital acquisition or fundraising success. Our current cash position and our ability to access additional capital may limit our available opportunities and not provide sufficient cash to support our operations. These conditions continue to raise doubts about our ability to continue as a going concern.

Our financial statements for the three and nine months ended September 30, 2016 have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. The financial statements do not include any adjustments relating to the recoverability and classification of assets or the amounts and classification of liabilities that might be necessary should we be unable to continue as a going concern.

3. NEW ACCOUNTING STANDARDS

Not yet adopted

In August 2016, the Financial Accounting Standards Board ("FASB") issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments ("ASU 2016-15") related to how certain cash receipts and payments are presented and classified in the statement of cash flows. These cash flow issues include debt prepayment or extinguishment costs, settlement of zero-coupon debt, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, distributions received from equity

method investees, beneficial interests in securitization transactions, and separately identifiable cash flows. ASU 2016-15 is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. We are currently evaluating the provisions of this guidance and are assessing its potential impact on our cash flows and related disclosures. Due to the nature of this accounting standards update, this may have an impact on items reported in our statements of cash flows, but no impact is expected on our financial position, results of operations or related disclosures as a result of implementation.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments ("ASU 2016-13") related to the calculation of credit losses on financial instruments. All financial instruments not accounted for at fair value will be impacted, including our trade and partner receivables. Allowances are to be measured using a current expected credit loss model as of the reporting date which is based on historical experience, current conditions and reasonable and supportable forecasts. This is significantly different from the current model which increases the allowance when losses are probable. This change is effective for all public companies for fiscal years beginning after December 31, 2019, including interim periods within those fiscal years and will be applied with a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. We are currently evaluating the provisions of ASU 2016-13 and are assessing its potential impact on our financial position, results of operations, cash flows and related disclosures.

In March 2016, the FASB issued ASU No. 2016-09, Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09") that changes several aspects of accounting for share-based payment transactions, including a requirement to recognize all excess tax benefits and tax deficiencies as income tax expense or benefit in the income statement, classification of awards as either equity or liabilities, and classification on the statements of cash flows. This standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 31, 2016, with early adoption permitted. Varying transition methods (modified retrospective, retrospective or prospective) are applicable to different provisions of

the standard. We are in the process of evaluating all changes, both required and elective, and are developing implementation plans for each as appropriate; however, we do not expect any of the changes to have a significant impact on our financial position, results of operations, cash flows or related disclosures.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) ("ASU 2016-02"), which amended the accounting standards for leases. ASU 2016-02 retains a distinction between finance leases and operating leases. The primary change is the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases on the balance sheet. The classification criteria for distinguishing between finance leases and operating leases are substantially similar to the classification criteria for distinguishing between capital leases and operating leases in the previous guidance. Certain aspects of lease accounting have been simplified. Additional qualitative and quantitative disclosures are required along with specific quantitative disclosures required by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early application permitted. We are currently evaluating the provisions of this update and are assessing the potential impact on our financial position, results of operations, cash flows and related disclosures.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"), which revised guidance on revenue from contracts with customers that will supersede most current revenue recognition guidance, including industry-specific guidance. The core principle of the new revenue model is that an entity will recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The new standard provides a five-step approach to determine when and how revenue is recognized. The guidance permits the use of either a full retrospective or a modified retrospective approach to adoption. In July 2015, the FASB approved a one-year deferral of the effective date of ASU 2014-09 to annual reporting periods beginning after December 15, 2017 for public companies. The FASB approved early adoption of the standard, but not before the original effective date of annual reporting periods beginning after December 15, 2016. Since May 2014, several additional accounting standards updates have been issued by FASB to clarify implementation issues. We continue to evaluate the impact of this revised guidance and the several clarifications that have been issued since. We have not yet quantified the impact, if any, of this amended guidance on our financial position, results of operations, cash flows and related disclosures.

Adopted

In April 2015, the FASB issued ASU No. 2015-03, Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs (ASU 2015-03) that requires the presentation of debt issuance costs in financial statements as a direct reduction of the related debt liabilities, with amortization of debt issuance costs reported as interest expense. Under prior GAAP, debt issuance costs were reported as deferred charges (i.e., as an asset). We adopted ASU 2015-03 in the first quarter of 2016. As discussed in Note 6 below, in the second quarter of 2016, our loan agreement was modified into a term loan. At that time, a portion of deferred debt issuance costs related to the revolving credit facility were charged to expense. The remaining unamortized deferred financing costs plus the incremental costs of converting the revolver into a term loan are presented as a direct reduction of Long-term debt on our condensed consolidated balance sheet.

4. AQUISITIONS AND DISPOSITIONS

Sojitz Acquisition

On July 28, 2016, we signed a purchase and sale agreement to acquire an additional 2.98% working interest (3.23% participating interest) in the Etame Marin block located offshore the Republic of Gabon from Sojitz Etame Limited (“Sojitz”), which represents all interest owned by Sojitz in the concession. The acquisition has an effective date of August 1, 2016, and closing is expected by December 31, 2016, subject to customary closing conditions. Payment for the acquisition is expected to be primarily funded by cash on hand; however, we intend to issue a request to the IFC to borrow the $5.0 million potentially available under the Additional Term Loan. Completion of the transaction is not contingent on obtaining approval of our request.

Sale of Certain U.S. Properties

On September 21, 2016, we signed a letter of intent to sell our interests in two wells in the Hefley field in North Texas for $850,000. We expect this transaction to be concluded during the fourth quarter of 2016. On October 17, 2016, we signed a letter of intent to sell our interests in the East Poplar Dome field in Montana for $250,000. We expect this transaction to be concluded during the fourth quarter of 2016. Based on the net book value for these assets as of September 30, 2016, we expect any gain/loss to be insignificant.

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Discontinued Operations - Angola

In November 2006, we signed a production sharing contract for Block 5 offshore Angola. The four year primary term, with an optional three year extension, awarded us exploration rights to 1.4 million acres offshore central Angola, with a commitment to drill two exploratory wells. In October 2014, we entered into the Subsequent Exploration Phase (“SEP”) which extended the exploration period to November 30, 2017 and required us and our partner to drill two additional exploration wells. Our working interest is 40% and we carry the Angolan national oil company, Sonangol P&P, for 10% of the work program. On September 30, 2016, we notified Sonangol P&P, our joint venture partner, that we were withdrawing from the joint operating agreement effective October 31, 2016. Further to our decision to withdraw from Angola, we have taken actions to begin closing our office in Angola and do not intend to conduct future activities in Angola. As a result of this strategic shift, as of September 30, 2016, the Angola segment met all the criteria to be classified as assets held for sale; therefore, we classified all the related assets and liabilities as those of discontinued operations in the condensed consolidated balance sheets. The operating results of the Angola segment have been classified as discontinued operations for all periods presented in our condensed consolidated statements of operations. We segregated the cash flows attributable to the Angola segment from the cash flows from continuing operations for all periods presented in our condensed consolidated statements of cash flows. The following tables summarize selected financial information related to the Angola segment’s operations as of September 30, 2016 and for the three and nine months ended September 30, 2016 and 2015.

Summarized Results of Discontinued Operations

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Operating costs and expenses:				
Exploration expense	$ 15,269	$ 32	$ 15,270	$ 27,878
Depreciation, depletion and amortization	3	3	9	9
General and administrative expense	400	1,135	994	2,127
Bad debt expense (recovery) and other	-	-	(7,629)	-
Total operating costs and expenses	15,672	1,170	8,644	30,014
Other operating income (loss), net	(7)	-	(28)	-
Operating income (loss)	(15,679)	(1,170)	(8,672)	(30,014)
Other income:				
Interest income	-	-	3,201	-
Other, net	6	2,023	551	2,183
Total other income	6	2,023	3,752	2,183
Income (loss) from discontinued operations before income taxes	(15,673)	853	(4,920)	(27,831)
Income tax expense	110	-	3,077	-
Income (loss) from discontinued operations	$ (15,783)	$ 853	$ (7,997)	$ (27,831)

Assets and Liabilities Attributable to Discontinued Operations

	September 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Accounts with partners	$ 1,723	$ 8,091
Prepayments and other	24	278
Total current assets	1,747	8,369
Property and equipment - successful efforts method:		
Equipment and other	-	143
	-	143
Accumulated depreciation, depletion, amortization and impairment	-	(127)
Net property and equipment	-	16
Total assets	$ 1,747	$ 8,385
LIABILITIES		
Current liabilities:		
Accounts payable	$ 104	$ 2,708
Foreign taxes payable	3,077	-
Accrued liabilities and other	15,475	1,421
Total current liabilities	$ 18,656	$ 4,129

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Drilling Obligation

Under the production sharing agreement for Block 5, we and our working interest partner, Sonangol P&P, were obligated to perform exploration activities in Angola that would result in drilling or commencing four wells by November 30, 2017. With the drilling of the Kindele #1 in 2015, the obligation was reduced to three wells. Under the contract, VAALCO is required to pay a $5.0 million penalty for each of the three wells not completed; however, the penalty amounts can be reduced by exploration expenses incurred. Prior to the September 30, 2016 quarterly reporting period, we classified the $15.0 million commitment for drilling these wells as long term restricted cash on our balance sheet. As a result of our decision to terminate the contract, we are no longer reflecting the $15.0 million as restricted cash. We believe that a substantial portion of the penalty amount has been reduced due to exploration expenditures made. Support for our determination is being presented to Angola government authorities, and we anticipate further discussions on this matter. However, due to the uncertainties as to the ultimate outcome, we have accrued a $15.0 million liability for the penalty which represents what we believe to be the maximum potential amount due under the agreement.

Other Matters – Partner Receivable

The government-assigned working interest partner was delinquent in paying their share of the costs several times in 2009 and was removed from the production sharing contract in 2010 by a governmental decree. Efforts to collect from the defaulted partner were abandoned in 2012. The available 40% working interest in Block 5, offshore Angola was assigned to Sonangol P&P effective on January 1, 2014. We invoiced Sonangol P&P for the unpaid delinquent amounts from the defaulted partner plus the amounts incurred during the period prior to assignment of the working interest totaling $7.6 million plus interest in April 2014. Because this amount was not paid and Sonangol P&P was slow in paying monthly cash call invoices since their assignment, we placed Sonangol P&P in default in the first quarter of 2015.

On March 14, 2016, we received a $19.0 million payment from Sonangol P&P for the full amount owed us as of December 31, 2015, including the $7.6 million of pre-assignment costs and default interest of $3.2 million. The $7.6 million recovery is reflected in the “Bad debt expense (recovery) and other” line of our summarized results of discontinued operations. Default interest of $3.2 million is shown in the “Interest income” line of our summarized results of discontinued operations.

5. OIL AND NATURAL GAS PROPERTIES AND EQUIPMENT

We review our oil and natural gas producing properties for impairment whenever events or changes in circumstances indicate that the carrying amount of such properties may not be recoverable. When an oil and natural gas property’s undiscounted estimated future net cash flows are not sufficient to recover its carrying amount, an impairment charge is recorded to reduce the carrying amount of the asset to its fair value. The fair value of the asset is measured using a discounted cash flow model relying primarily on Level 3 inputs into the undiscounted future net cash flows. The undiscounted estimated future net cash flows used in our impairment evaluations at each quarter end are based upon the most recently prepared independent reserve engineers’ report adjusted to use forecasted prices from the forward strip price curves near each quarter end and adjusted as necessary for drilling and production results.

During the third quarter of 2016, our negative price differential to Brent narrowed and we incurred no significant capital spending. We considered these and other factors and determined that there were no events or circumstances triggering an impairment evaluation for most of our fields, with the exception of the Avouma field in the Etame Marine block offshore Gabon. Recently, at the Avouma field, the electrical submersible pumps (“ESPs”) in the South Tchibala 2-H well and the Avouma 2-H well failed, and these wells are temporarily shut-in. Workovers are being planned to replace the ESPs and bring the wells back on production by late in the fourth quarter 2016. The reserves used in our impairment evaluation of the Avouma field were revised to reflect the impact of this lost production for several months and the impact of the forward price curve. The undiscounted future net cash flows for the Avouma field were in excess of the field’s carrying value. No impairment was required for the Avouma field, or any of our other fields in Gabon, for the third quarter of 2016.

As a result of the letter of intent signed to sell our interests in the two wells in North Texas for $850,000, we performed an impairment test and determined that a $0.1 million impairment was required.

Declining forecasted oil prices in 2015 caused us to perform impairment reviews of our proved properties in each quarter of 2015 and 2016 for all fields in the Etame Marin block offshore Gabon and the Hefley field in North Texas. For the three and nine months ended September 30, 2015, impairments of proved properties of $18.0 million and $29.2 million were recorded.

6. DEBT

On June 29, 2016, we executed a Supplemental Agreement with the IFC which, among other things, amended and restated our existing loan agreement to convert $20 million of the revolving portion of the credit facility, to a term loan (the “Term Loan”) with $15 million outstanding and an additional $5 million (the “Additional Term Loan”), which can be requested in a single draw, subject to the IFC’s approval, between now and December 31, 2016. The amended loan agreement is secured by the assets of our Gabon subsidiary, VAALCO Gabon (Etame), Inc. and is guaranteed by VAALCO as the parent company. Before we are able to draw the Additional Term Loan, the IFC, as part of their consideration of our loan request, will make a determination of whether our Gabon subsidiary’s current and projected revenues from operations are sufficient to cover the aggregate amount of principal, interest, commissions, fees and any other amounts due in respect of the Additional Term Loan. If drawn, the Additional Term Loan amount shall be amortized in equal quarterly installments through June 30, 2018. The amended loan agreement provides for quarterly principal and interest payments on

the amounts currently outstanding through June 30, 2019, with interest accruing at a rate of LIBOR plus 5.75%; however, principal repayments under the amended loan agreement are dependent upon the timing of our additional borrowing, if any, with the payments to commence on either December 31, 2016 or March 31, 2017. If we do not borrow under the Additional Term Loan before December 15, 2016, no principal payments are due until March 31, 2017.

Compared to the $15.0 million carrying value of debt, the estimated fair value of the term loan is $15.0 million when measured using a discounted cash flow model over the life of the current borrowings at forecasted interest rates. The inputs to this model are Level 3 in the fair value hierarchy.

Covenants

Under the amended loan agreement, quarter-end net debt to EBITDAX (as defined in the loan agreement) must be no more than 3.0 to 1.0. However, the quarter-end net debt to EBITDAX limitation has been raised to 5.0 to 1.0 for all periods through the end of 2016. Additionally, our debt service coverage ratio must be greater than 1.2 to 1.0 at each quarter end. Forecasting our compliance with these and other financial covenants in future periods is inherently uncertain; therefore, we can make no assurance that we will be able to comply with our term loan covenants in future periods. Factors that could impact our quarter-end financial covenants in future periods include future realized prices for sales of oil and natural gas, estimated future production, returns generated by our capital program, and future interest costs, among others. We were in compliance with all financial covenants as of September 30, 2016.

Interest

Until June 29, 2016, under the terms of the original revolving credit facility, we paid commitment fees on the undrawn portion of the total commitment. Commitment fees were equal to 1.5% of the unused balance of the senior tranche of $50.0 million and 2.3% of the unused balance of the subordinated tranche of $15.0 million when a commitment was available for utilization. Subsequent to June 29, 2016 through December 31, 2016, commitment fees are 2.3% of the undrawn Additional Term Loan of $5 million.

We capitalize interest and commitment fees related to expenditures made in connection with exploration and development projects that are not subject to current depletion. Interest and commitment fees are capitalized only for the period that activities are in progress to bring these projects to their intended use.

The table below shows the components of the Interest expense line of our condensed consolidated statements of operations and the average effective interest rate, excluding commitment fees, on our borrowings:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Interest incurred, including commitment fees	$ 274	$ 377	$ 1,047	$ 1,117

Deferred finance cost amortization	56	162	262	475
Deferred finance cost write-off due to loan modification	-	-	869	-
Capitalized interest	-	(242)	-	(748)
Other interest not related to debt	(2)	168	109	275
Interest expense	$ 328	$ 465	$ 2,287	$ 1,119
Average effective interest rate, excluding commitment fees	6.38%	4.03%	5.04%	4.02%

7. COMMITMENTS AND CONTINGENCIES

Litigation

Gusinsky litigation

On December 7, 2015, Plaintiff Vladimir Gusinsky Living Trust filed a stockholder class action lawsuit in the Court of Chancery of the State of Delaware (the “Court”) against the Company and all of its directors alleging that certain provisions of the Company’s Restated Charter and Second Amended and Restated Bylaws that restricted the removal of its directors to removal for cause only (the “director removal provisions”) were invalid as a matter of Delaware law. Plaintiff George Shapiro also filed a similar stockholder class action lawsuit in the Court on December 7, 2015. Thereafter, the plaintiffs agreed to the consolidation of their cases (the “Consolidated Case”).

After a hearing on the Consolidated Case on December 21, 2015, Vice Chancellor Laster issued an opinion in In re VAALCO Energy, Inc. Stockholder Litigation, Consol. C.A. No. 11775-VCL holding that, in the absence of a classified board or cumulative voting, the director removal provisions conflicted with Section 141(k) of the Delaware

General Corporation Law and are therefore invalid.

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On April 20, 2016, the Court approved a Stipulation and Order of Dismissal entered into by the parties in the Consolidated Case. We agreed to settle plaintiffs' application for an award of attorneys' fees and expenses totaling $775,000 due to the costs of defense of that application and the litigation risk associated therewith, all of which were covered by our directors and officers insurance as a covered claim.

Butcher settlement

On October 3, 2016, the Court approved a Stipulation and Order of Dismissal entered into by the parties in a stockholder class action lawsuit against the Company and all of its directors alleging that a previously terminated shareholder rights agreement, no longer in effect, and certain provisions of the former CEO's and former CFO's employment agreements securing change-in-control severance benefits were invalid under Delaware law, case number C.A. No. 12277-VCL, filed on April 29, 2016, in the Court. After the Company and its directors moved to dismiss the lawsuit, the Plaintiff Daniel Butcher agreed to dismiss the lawsuit as moot, and the Company agreed to settle Plaintiff's application for an award of attorneys' fees, which it expects its insurer to pay, due to the anticipated costs of continuing to prosecute the motion to dismiss and defending the Plaintiff's fee application, as well as the litigation risk associated therewith.

Rig commitment

In 2014, we entered into a long-term contract for a jackup drilling rig for the multi-well development drilling campaign offshore Gabon. The campaign included the drilling of development wells and workovers of existing wells in the Etame Marin block. We began demobilization in January 2016 and released the drilling rig in February 2016, prior to the original July 2016 contract termination date, because we no longer intended to drill any wells in 2016 on our Etame Marin block offshore Gabon. In June 2016, we reached an agreement with the drilling contractor to pay $5.1 million net to VAALCO's interest for unused rig days under the contract. We are paying this amount, plus the demobilization charges, in seven equal monthly installments which began in July 2016. As of September 30, 2016, the remaining amount to pay was $3.6 million net to VAALCO's interest. The related expense is reported in the "Other operating expense" line of our condensed consolidated statements of operations.

Gabon

Offshore

Abandonment

We have an agreed cash funding arrangement for the eventual abandonment of all offshore wells, platforms and facilities on the Etame Marin Block. Based upon the abandonment study completed in January 2016, the abandonment cost estimate used for this purpose is approximately $61.1 million ($17.3 million net to VAALCO) on an undiscounted basis. The obligation for abandonment of the Gabon offshore facilities is included in the "Asset retirement obligations" line on our condensed consolidated balance sheet. Through December 31, 2015, $18.3 million ($5.1 million net to VAALCO) on an undiscounted basis has been funded, with the next funding of $9.1 million ($2.6 million net to VAALCO) expected to be required sometime later in 2016. This cash funding is reflected under "Other noncurrent assets" as "Abandonment funding" on our condensed consolidated balance sheet. Future changes to the anticipated abandonment cost estimate could change our asset retirement obligation and the amount of future abandonment funding payments.

Audits

We are subject to periodic routine audits by various government agencies in Gabon, including audits of our petroleum cost account, customs, taxes and other operational matters, as well as audits by other members of the contractor group under our joint operating agreements.

In October 2014, we received a provisional audit report related to the Etame Marin block operations from the Gabon Taxation Department as part of a special industry-wide audit of business practices and financial transactions in the Republic of Gabon. In November 2014, we responded to the Gabon Taxation Department requesting joint meetings to advance the resolution of this matter and later provided a formal reply to the provisional audit report in February 2015. A final agreement was reached with the Gabon Taxation Department in October 2016. During 2015, we accrued an estimated settlement of $0.3 million net to VAALCO based upon preliminary negotiations and expect to pay this amount in November 2016 in accordance with the final settlement agreement.

As of September 30, 2016, we had accrued $2.2 million net to VAALCO in “Accrued liabilities and other” on our condensed consolidated balance sheet for certain payroll taxes in Gabon which were not paid pertaining to labor provided to us over a number of years by a third-party contractor. While the payroll taxes were for individuals who were not our employees, we could be deemed liable for these expenses as the end user of the services provided. A process of negotiation with government payroll agencies in Gabon is underway to resolve this matter.

8. DERIVATIVES AND FAIR VALUE

In April 2016, we entered into put contracts on 36,000 barrels of oil per month for the period from June 2016 through February 2017 at Dated Brent of $40 per barrel. This volume represents approximately one-third of our total forecasted sales volumes for the period. While these crude oil puts are intended to be an economic hedge to mitigate the impact of a decline in oil prices, we have not elected hedge accounting. The contracts will be measured at fair value each period, with changes in fair value recognized in net income. We do not enter into derivative instruments for speculative or trading proposes.

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Our put contracts are subject to agreements similar to a master netting agreement under which we have the legal right to offset assets and liabilities. At September 30, 2016, all of the put contracts were assets.

The following table sets forth, by level within the fair value hierarchy and location on our condensed consolidated balance sheets, the reported values of derivative instruments accounted for at fair value on a recurring basis:

		Balance at September 30, 2016			
		Carrying	Fair Value Measurements Using		
Derivative Item	Balance Sheet Line	Value	Level 1	Level 2	Level 3
		(in thousands)			
Crude oil puts	Prepayments and other	$ 70	$ -	$ 70	$ -

We had neither derivative instruments outstanding as of December 31, 2015 nor derivative instrument activity during 2015.

The crude oil put contracts are measured at fair value using the Black's option pricing model. Level 2 observable inputs used in the valuation model include market information as of the reporting date, such as prevailing Brent crude futures prices, Brent crude futures commodity price volatility and interest rates. The determination of the put contract fair value includes the impact of the counterparty's non-performance risk.

To mitigate counterparty risk, we enter into such derivative contracts with creditworthy financial institutions deemed by management as competent and competitive market makers.

The following table sets forth the effect of derivative instruments on our condensed consolidated statements of operations:

		Gain (Loss)			
		Three Months Ended September 30,		Nine Months Ended September 30,	
Derivative Item	Statement of Operations Line	2016	2015	2016	2015
		(in thousands)			
Crude oil puts	Other, net	$ (194)	$ -	$ (772)	$ -

9. COMPENSATION

Stock options

Stock options are granted under our 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. Stock options granted to participants will become exercisable over a period determined by the Compensation Committee of our Board of Directors, which in the past has been a five year life, with the options vesting over a service period of up to five years. In addition, stock options will become exercisable upon a change in control, unless provided otherwise by the Compensation Committee of our Board of Directors. A portion of the stock options granted in the nine months ended September 30, 2016 and 2015 were vested immediately with the remainder vesting over a two year period.

Stock option activity for the nine months ended September 30, 2016 is provided below:

	Number of Shares Underlying Options (in thousands)	Weighted Average Exercise Price Per Share
Outstanding at January 1, 2016	4,144	$ 6.41
Granted	1,519	1.16
Forfeited/expired	(2,399)	5.53
Outstanding at September 30, 2016	3,264	4.61

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Common and restricted shares

Shares of restricted stock may be granted under our long-term incentive plan and related compensation expense is recorded using the fair market value of the underlying shares on the date of grant. Restricted stock granted to employees will vest over a period determined by the Compensation Committee which is generally a three year period, vesting in three equal parts on the first three anniversaries of the date of the grant. Share grants to directors vest immediately and are not restricted.

	Number of Shares	Weighted Average Grant Price
Non-vested shares outstanding at January 1, 2016	419,888	$ 3.83
Awards granted	357,145	1.12
Awards vested	(488,115)	2.05
Awards forfeited	(209,451)	3.89
Non-vested shares outstanding at September 30, 2016	79,467	2.42

In the three months ended March 31, 2016, 31,808 shares were added to treasury due to tax withholding on vesting restricted shares. No shares were added to treasury in the second and third quarters of 2016.

Stock appreciation rights

Stock appreciation rights (“SARs”) are granted under the VAALCO Energy, Inc. 2016 Stock Appreciation Rights Plan. A SAR is the right to receive a cash amount equal to the spread with respect to a share of common stock upon the exercise of the SAR. The spread is the difference between the SAR price per share specified in a SAR award on the date of grant (which may not be less than the fair market value of our common stock on the date of grant) and the fair market value per share on the date of exercise of the SAR. SARs granted to participants will become exercisable over a period determined by the Compensation Committee of our Board of Directors. In addition, SARs will become exercisable upon a change in control, unless provided otherwise by the Compensation Committee of our Board of Directors. The 815,355 SARs granted in the three months ended March 31, 2016 vest over a three year period with a life of 5 years and have a maximum spread of 300% of the $1.04 SAR price per share specified in a SAR award on the date of grant. Compensation payable related to these awards through September 30, 2016 is not significant.

Compensation expense

We record non-cash compensation expense related to stock-based compensation in the “General and administrative” expense line of our condensed consolidated statements of operations. Non-cash compensation expense related to stock options, SARs, common stock and restricted stock was ($0.5) million and $1.1 million for the three and nine months ended September 30, 2016 and was $0.7 million and $3.0 million for the three and nine months ended September 30, 2015. Because we do not pay significant United States federal income taxes, no amounts were recorded for tax benefits.

10. INCOME TAXES

VAALCO and its domestic subsidiaries file a consolidated United States income tax return. Certain subsidiaries' operations are also subject to foreign income taxes.

As discussed further in the Notes to the consolidated financial statements in our Form 10-K for December 31, 2015, we have deferred tax assets related to foreign tax credits, alternative minimum tax credits, and domestic and foreign net operating losses ("NOLs"). Management assesses the available positive and negative evidence to estimate if existing deferred tax assets will be utilized. We do not anticipate utilization of the foreign tax credits prior to expiration nor do we expect to generate sufficient taxable income to utilize other deferred tax assets. On the basis of this evaluation, full valuation allowances have been recorded as of September 30, 2016 and December 31, 2015.

NOLs for our Gabon and Angola subsidiaries are included in the respective subsidiaries' cost oil accounts which will be offset against future taxable revenues.

Income taxes attributable to continuing operations for the three and nine months ended September 30, 2016 and all of the income taxes for the three and nine months ended September 30, 2015 are attributable to foreign taxes payable in Gabon.

As discussed further in Note 4 above, our Angola operations are reflected as discontinued. In Angola, NOLs are not available to offset financial gains which include foreign exchange gains and interest income. During the three and nine months ended September 30, 2016, we recorded an immaterial amount and $3.1 million for income taxes attributable to discontinued operations in Angola on financial gains related to foreign exchange gains as well as the interest paid by Sonangol P&P on their past due joint interest account balance.

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11. EARNINGS PER SHARE

Basic earnings per share ("EPS") is calculated using the average number of shares of common stock outstanding during each period. For the calculation of diluted shares, we assume that restricted stock is outstanding on the date of grant, and we assume the issuance of shares from the exercise of stock options using the treasury stock method.

A reconciliation from basic to diluted shares follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Basic weighted average shares outstanding	58,708,193	58,392,240	58,599,783	58,226,687
Effect of dilutive securities	-	-	-	-
Diluted weighted average shares outstanding	58,708,193	58,392,240	58,599,783	58,226,687
Stock options excluded from dilutive calculation because they would be anti-dilutive	4,097,632	5,766,411	4,454,749	5,979,348

Because we recognized net losses for the three and nine months ended September 30, 2016, there were no dilutive securities for those periods.

12. SEGMENT INFORMATION

Our operations are based in Gabon, Equatorial Guinea and the United States ("U.S."). Each of our three reportable operating segments is organized and managed based upon geographic location. Our Chief Executive Officer, who is the chief operating decision maker, and management, review and evaluate the operation of each geographic segment separately primarily based on Operating income (loss). 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. Corporate and other is primarily corporate and operations support costs which are not allocated to the reportable operating segments.

Segment activity of continuing operations for the three and nine months ended September 30, 2016 and 2015 and segment assets at September 30, 2016 and December 31, 2015 are as follows:

	Three Months Ended September 30, 2016				
(in thousands)	Gabon	Equatorial Guinea	U.S.	Corporate and Other	Total
Revenues-oil and gas sales	$ 14,540	$ -	$ 95	$ -	$ 14,635
Depreciation, depletion and amortization	1,508	-	38	61	1,607
Impairment of proved properties	-	-	88	-	88
Bad debt expense (recovery) and other	63	-	-	-	63
Other operating expense	324	-	-	-	324
Operating income (loss)	5,013	(184)	(61)	(1,910)	2,858
Interest income (expense), net	(329)	-	-	2	(327)
Income tax expense	2,305	-	-	(107)	2,198

Additions to property and equipment	674	-