

CREDO PETROLEUM CORP  
Form 10-Q  
September 09, 2009  
Table of Contents

**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 July 31, 2009**

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

**For the transition period from                      to**

**Commission File Number: 0-8877**

**CREDO PETROLEUM CORPORATION**

(Exact name of registrant as specified in its charter)

Edgar Filing: CREDO PETROLEUM CORP - Form 10-Q

**Delaware**

(State or other jurisdiction of incorporation or organization)

**84-0772991**

(IRS Employer Identification No.)

**1801 Broadway, Suite 900, Denver, Colorado**

(Address of principal executive offices)

**80202**

(Zip Code)

**303-297-2200**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every interactive data file required to be submitted and posted pursuant to Rule 405 of Regulation S-Y 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 Act.)

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller Reporting Company

(Do not check if a smaller reporting company)

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

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

<b>Date</b>	<b>Class</b>	<b>Outstanding</b>
September 9, 2008	Common stock, \$.10 par value	10,295,000

Table of Contents

**CREDO PETROLEUM CORPORATION AND SUBSIDIARIES**

**Quarterly Report on Form 10-Q For the Period Ended July 31, 2009**

**TABLE OF CONTENTS**

	<b>Page No.</b>
<b><u>PART I - FINANCIAL INFORMATION</u></b>	
<b><u>Item 1.</u></b>	<b><u>Financial Statements</u></b>
<u>Consolidated Balance Sheets</u> <u>As of July 31, 2009 (Unaudited) and October 31, 2008</u>	3
<u>Consolidated Statements of Operations</u> <u>For the Three and Nine Months Ended July 31, 2009 and 2008 (Unaudited)</u>	4
<u>Consolidated Statement of Stockholders' Equity</u> <u>For the Nine Months Ended July 31, 2009 (Unaudited)</u>	5
<u>Consolidated Statements of Cash Flows</u> <u>For the Nine Months Ended July 31, 2009 and 2008 (Unaudited)</u>	6
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	7
<b><u>Item 2.</u></b>	<b><u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>
<b><u>Item 3.</u></b>	<b><u>Quantitative and Qualitative Disclosures About Market Risk</u></b>
<b><u>Item 4.</u></b>	<b><u>Controls and Procedures</u></b>
<b><u>PART II - OTHER INFORMATION</u></b>	
<b><u>Item 1.</u></b>	<b><u>Legal Proceedings</u></b>
<b><u>Item 1A.</u></b>	<b><u>Risk Factors</u></b>
<b><u>Item 2.</u></b>	<b><u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b>
<b><u>Item 3.</u></b>	<b><u>Defaults Upon Senior Securities</u></b>
<b><u>Item 4.</u></b>	<b><u>Submission of Matters to a Vote of Security Holders</u></b>
<b><u>Item 5.</u></b>	<b><u>Other Information</u></b>
<b><u>Item 6.</u></b>	<b><u>Exhibits</u></b>
<b><u>Signatures</u></b>	25

Edgar Filing: CREDO PETROLEUM CORP - Form 10-Q

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

Table of Contents**PART I - FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****CREDO PETROLEUM CORPORATION AND SUBSIDIARIES****Consolidated Balance Sheets**

	July 31, 2009 (Unaudited)	October 31, 2008
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 13,490,000	\$ 22,332,000
Short-term investments	687,000	3,044,000
Receivables:		
Accrued oil and gas sales	1,260,000	1,733,000
Trade	398,000	995,000
Derivative Assets	699,000	1,745,000
Other current assets	328,000	205,000
Total current assets	16,862,000	30,054,000
Long-term assets:		
Oil and gas properties, at cost, using full cost method:		
Unevaluated oil and gas properties	6,715,000	12,280,000
Evaluated oil and gas properties	74,651,000	59,730,000
Less: accumulated depreciation, depletion and amortization of oil and gas properties	(52,392,000)	(25,554,000)
Net oil and gas properties, at cost, using full cost method	28,974,000	46,456,000
Intangible Assets, net of accumulated amortization of \$327,000 in 2009 and \$595,000 in 2008		
Compressor and tubular inventory to be used in development	4,122,000	1,079,000
Other, net	1,798,000	2,592,000
Other, net	396,000	379,000
Total assets	\$ 52,152,000	\$ 80,560,000
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 569,000	\$ 3,857,000
Revenue distribution payable	643,000	982,000
Other accrued liabilities	633,000	931,000
Income taxes payable	171,000	124,000
Total current liabilities	2,016,000	5,894,000
Long Term Liabilities:		
Deferred income taxes, net	1,958,000	11,117,000
Asset retirement obligation	1,423,000	1,338,000
Total liabilities	5,397,000	18,349,000

Edgar Filing: CREDO PETROLEUM CORP - Form 10-Q

Commitments

Stockholders' Equity:

Preferred stock, no par value, 5,000,000 shares authorized, none issued		
Common stock, \$.10 par value, 20,000,000 shares authorized, 10,660,000 shares issued	<b>1,066,000</b>	1,066,000
Capital in excess of par value	<b>31,376,000</b>	31,352,000
Treasury stock at cost, 361,594 shares in 2009 and 223,000 in 2008	<b>(2,214,000)</b>	(982,000)
Retained earnings	<b>16,527,000</b>	30,775,000
Total stockholders' equity	<b>46,755,000</b>	62,211,000
Total liabilities and stockholders' equity	<b>\$ 52,152,000</b>	\$ 80,560,000

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

Table of Contents**CREDO PETROLEUM CORPORATION AND SUBSIDIARIES****Consolidated Statements of Operations****(Unaudited)**

	Nine Months Ended July 31,		Three Months Ended July 31,	
	2009	2008	2009	2008
<b>REVENUES:</b>				
Oil sales	\$ 4,142,000	\$ 4,320,000	\$ 2,024,000	\$ 1,649,000
Natural gas sales	3,156,000	10,001,000	813,000	3,997,000
	<b>7,298,000</b>	14,321,000	<b>2,837,000</b>	5,646,000
<b>COSTS AND EXPENSES:</b>				
Oil and gas production	2,394,000	2,883,000	771,000	1,045,000
Depreciation, depletion and amortization	3,499,000	2,594,000	960,000	843,000
Write-down of oil and natural gas properties (Note 3) and impairment of long lived assets (Note 8)	24,653,000			
General and administrative	1,953,000	1,034,000	564,000	337,000
	<b>32,499,000</b>	6,511,000	<b>2,295,000</b>	2,225,000
<b>INCOME (LOSS) FROM OPERATIONS</b>	<b>(25,201,000)</b>	7,810,000	<b>542,000</b>	3,421,000
<b>OTHER INCOME AND (EXPENSE)</b>				
Realized and unrealized gains (losses) from derivative contracts	1,911,000	(2,333,000)	(16,000)	1,139,000
Investment and other income (loss)	(66,000)	118,000	54,000	47,000
	<b>1,845,000</b>	(2,215,000)	<b>38,000</b>	1,186,000
<b>INCOME (LOSS) BEFORE INCOME TAXES</b>	<b>(23,356,000)</b>	5,595,000	<b>580,000</b>	4,607,000
<b>INCOME TAXES</b>	<b>9,108,000</b>	(1,559,000)	<b>(227,000)</b>	(1,264,000)
<b>NET INCOME (LOSS)</b>	<b>\$ (14,248,000)</b>	\$ 4,036,000	<b>\$ 353,000</b>	\$ 3,343,000
<b>EARNINGS (LOSS) PER SHARE OF COMMON STOCK BASIC</b>				
	\$ (1.38)	\$ .43	\$ 0.03	\$ .35
<b>EARNINGS (LOSS) PER SHARE OF COMMON STOCK DILUTED</b>				
	\$ (1.38)	\$ .42	\$ 0.03	\$ .34
<b>Weighted average number of shares of Common Stock and dilutive securities:</b>				
Basic	10,341,000	9,430,000	10,305,000	9,690,000
Diluted	10,341,000	9,509,000	10,333,000	9,772,000

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





Table of Contents**CREDO PETROLEUM CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY**

For the Nine Months Ended July 31, 2009

*(Unaudited)*

<b>Description</b>	<b>Common Stock Shares</b>	<b>Common Stock Amount</b>	<b>Capital In Excess Of Par Value</b>	<b>Treasury Stock</b>	<b>Retained Earnings</b>	<b>Total Stockholders Equity</b>
Balance October 31, 2008	10,660,000	\$ 1,066,000	\$ 31,352,000	\$ (982,000)	\$ 30,775,000	\$ 62,211,000
<b>Comprehensive income (loss):</b>						
Net (loss)					(14,248,000)	(14,248,000)
Purchase of treasury stock				(1,232,000)		(1,232,000)
Compensation expense associated with unvested portion of previously granted stock options			24,000			24,000
<b>Balance July 31, 2009</b>	<b>10,660,000</b>	<b>\$ 1,066,000</b>	<b>\$ 31,376,000</b>	<b>\$ (2,214,000)</b>	<b>\$ 16,527,000</b>	<b>\$ 46,755,000</b>

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

Table of Contents**CREDO PETROLEUM CORPORATION AND SUBSIDIARIES****Consolidated Statements of Cash Flows****(Unaudited)**

	Nine Months Ended July 31,	
	2009	2008
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss)	\$ (14,248,000)	\$ 4,036,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Write-down of oil and natural gas properties and impairment of long lived assets	24,653,000	
Depreciation, depletion and amortization	3,499,000	2,594,000
ARO liability accretion	85,000	38,000
Unrealized (gains) loss on derivative instruments	1,046,000	1,309,000
Deferred income taxes	(9,159,000)	1,170,000
Loss on short term investments	65,000	67,000
Compensation expense related to stock options granted	24,000	44,000
Other	(5,000)	
Changes in operating assets and liabilities:		
Proceeds from short-term investments	2,292,000	2,721,000
Accrued oil and gas sales	473,000	(1,776,000)
Trade receivables	597,000	22,000
Other current assets	(123,000)	(8,000)
Accounts payable and accrued liabilities	(1,103,000)	(589,000)
Income taxes payable	47,000	38,000
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>8,143,000</b>	<b>9,666,000</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Additions to oil and gas properties	(11,299,000)	(8,414,000)
Proceeds from sale of oil and gas properties		1,275,000
Changes in other long-term assets	(54,000)	(1,494,000)
Purchase intangible assets	(4,400,000)	
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(15,753,000)</b>	<b>(8,633,000)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Sale of common stock		15,111,000
Purchase of treasury stock	(1,232,000)	
Proceeds from exercise of stock options (62,000 options in 2008)		366,000
<b>NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES</b>	<b>(1,232,000)</b>	<b>15,477,000</b>
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>(8,842,000)</b>	<b>16,510,000</b>
<b>CASH AND CASH EQUIVALENTS:</b>		
Beginning of period	22,332,000	7,285,000
End of period	\$ 13,490,000	\$ 23,795,000
Additions to oil and gas properties in current liabilities	\$ 390,000	\$ 383,000

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

Table of Contents

**CREDO PETROLEUM CORPORATION AND SUBSIDIARIES**

**Notes To Consolidated Financial Statements (Unaudited)**

**July 31, 2009**

**1. BASIS OF PRESENTATION**

The accompanying unaudited consolidated financial statements have been prepared in accordance with U. S. generally accepted accounting principles for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U. S. generally accepted accounting principles for complete financial statements. In the opinion of management, the consolidated financial statements contain all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the company's results for the periods presented. Management has evaluated events and transactions occurring after the balance sheet date through September 9, 2009, the date that the financial statements were issued. For a more complete understanding of the company's financial condition and accounting policies, these consolidated financial statements should be read in conjunction with the company's Annual Report on Form 10-K for the fiscal year ended October 31, 2008. The results for interim periods are not necessarily indicative of annual results.

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

**2. CONCENTRATION OF CREDIT RISK**

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

**3. OIL AND NATURAL GAS PROPERTIES**

Depreciation, depletion and amortization of oil and natural gas properties for the nine months ended July 31, 2009 and 2008 were \$3,100,000 and \$2,508,000 respectively, and were \$838,000 and \$811,000 for the three months ended July 31, 2009 and 2008, respectively. The company uses the full cost method of accounting for costs related to its oil and natural gas properties. Capitalized costs included in the full cost pool are

## Edgar Filing: CREDO PETROLEUM CORP - Form 10-Q

depleted on an aggregate basis using the units-of-production method. All costs incurred in the acquisition, exploration, and development of properties (including costs of surrendered and abandoned leaseholds, delay lease rentals, dry holes, and overhead related to exploration and development activities) and the fair value of estimated future costs of site restoration, dismantlement, and abandonment activities are capitalized. Costs for unevaluated properties, which typically include lease rentals, geology and seismic costs, are capitalized but are excluded from the amortizable pool during the evaluation period. When determinations are made whether the property has proved recoverable reserves or not, or if there is an impairment, the costs are reclassified to the full cost pool.

Table of Contents

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

At July 31, 2009 the estimated present value of future net revenues from proved reserves, net of related income tax considerations, exceeded the capitalized costs of the company's oil and natural gas properties. Therefore, a ceiling test write-down was not required.

For the nine months ended July 31, 2009, the company has recorded ceiling test write-downs of \$23,726,000. Given the volatility of oil and natural gas prices, additional write-downs may be required in fiscal 2009.

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

**4. STOCK-BASED COMPENSATION**



## Edgar Filing: CREDO PETROLEUM CORP - Form 10-Q

For the nine months ended July 31, 2009 and 2008, the company recognized stock based compensation expense of \$24,000 and \$44,000 respectively. For the three months ended July 31, 2009 and 2008, the company recognized stock based compensation expense of \$8,000 and \$14,000, respectively. The estimated unrecognized compensation cost from unvested stock options as of July 31, 2009 was approximately \$41,000 which is expected to be recognized over an average of 1.3 years.

No options were granted during the nine months ended July 31, 2009 or 2008.



Table of Contents

Plan activity for the nine months ended July 31, 2009 is set forth below:

		Nine Months Ended July 31, 2009		
	Number of Options		Weighted Average Exercise Price	Aggregate Intrinsic Value
Outstanding at October 31, 2008	232,769	\$	9.04	\$ 394,000
Granted				
Exercised				
Cancelled or forfeited	(53,706)		14.31	
Outstanding at July 31, 2009	179,063	\$	7.46	\$ 936,000
Exercisable at July 31, 2009	169,063	\$	7.15	\$ 936,000
Weighted average contractual life at July 31, 2009			4.6 years	

Range of Exercise Prices	Number Outstanding at July 31, 2009	Outstanding Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Exercisable	
				Number Exercisable at July 31, 2009	Weighted Average Exercise Price
\$ 5.93	139,063	3.87	\$ 5.93	139,063	\$ 5.93
\$12.78	40,000	7.35	\$ 12.78	30,000	\$ 12.78
\$ 5.93 - \$12.78	179,063	4.65	\$ 7.46	169,063	\$ 7.15

## 5. NATURAL GAS DERIVATIVES

On February 1, 2009, the company adopted SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133 ( SFAS No. 161 ). SFAS No. 161 requires entities to provide greater transparency about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities ( SFAS No. 133 ) and how derivative instruments and related hedged items affect an entity's financial position, results of operations, and cash flows.

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

For the nine months ended July 31, 2009 and 2008, the company had realized gains (loss) on derivatives of \$2,957,000 and (\$1,024,000) respectively, and unrealized losses of \$1,046,000 and \$1,309,000 respectively. For the quarter ended July 31, 2009 and 2008 the company had

Edgar Filing: CREDO PETROLEUM CORP - Form 10-Q

realized gains (losses) on derivatives of \$682,000 and (\$1,876,000) respectively, and unrealized gains (losses) of (\$698,000) and \$3,015,000, respectively. At July 31, 2009 open derivative contracts covered 150,000 MMBtus at weighted average NYMEX basis prices of \$8.31, and cover the production months of August 2009

Table of Contents

through October 2009. Average prices in the company's primary market are currently 8% below NYMEX prices due to basis differentials and transportation costs.

Subsequent to July 31, the August and September contracts closed resulting in realized hedge gains of \$512,000.

The company has a hedging line of credit with its bank which is available, at the discretion of the company, to meet margin calls. To date, the company has not used this facility and maintains it only as a precaution related to possible margin calls. The maximum credit line available is \$5,900,000 with interest calculated at the prime rate. The facility is unsecured and has covenants that require the company to maintain \$3,000,000 in cash or short term investments, none of which are required to be maintained at the company's bank, and prohibits funded debt in excess of \$500,000. The line expires November 15, 2010.

The company has elected not to designate its commodity derivatives as cash flow hedges for accounting purposes. Accordingly, such contracts are recorded at fair value on the balance sheet and changes in fair value are recorded in the statement of operations as they occur. At July 31, 2009 the company has outstanding natural gas swap contracts for 50,000 Mmbtu per month through October 2009. The location and amount of derivative fair values and related gain (loss) are indicated in the following tables (in thousands):

Derivatives not designated as hedging instruments under SFAS No. 133:

	As of July 31, 2009	
	Balance Sheet Location	Fair Value
Natural Gas Forward Short Positions	Derivative Asset	\$ 699

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

Derivatives not designated as hedging instruments under SFAS No. 133:

	Location of Gain/(Loss) Recognized in Income on Derivatives	Nine Months Ended July 31, 2009	Three Months Ended July 31, 2009
Natural Gas Forward Short Positions	Other Income and (Expense)	\$ 1,911	\$ (16)

**6. EARNINGS PER SHARE**

The company's calculation of earnings (loss) per share of common stock is as follows:

Edgar Filing: CREDO PETROLEUM CORP - Form 10-Q

	Nine Months Ended July 31,					
	2009			2008		
	Net (Loss)	Shares	Net (Loss) Per Share	Net Income	Shares	Net Income Per Share
Basic earnings (loss) per share	\$ (14,248,000)	10,341,000	\$ (1.38)	\$ 4,036,000	9,430,000	\$ .43
Effect of dilutive shares of common stock from stock options					79,000	(.01)
Diluted earnings (loss) per share	\$ (14,248,000)	10,341,000	\$ (1.38)	\$ 4,036,000	9,509,000	\$ .42

Table of Contents

	Three Months Ended July 31,					
	2009			2008		
	Net Income	Shares	Net Income Per Share	Net Income	Shares	Net Income Per Share
Basic earnings (loss) per share	\$ 353,000	10,305,000	\$ .03	\$ 3,343,000	9,690,000	\$ .35
Effect of dilutive shares of common stock from stock options		28,000			82,000	(.01)
Diluted earnings (loss) per share	\$ 353,000	10,333,000	\$ .03	\$ 3,343,000	9,772,000	\$ .34

The company's outstanding options were not included in the calculation of diluted income (loss) per share for the nine month period ended July 31, 2009 as their inclusion would have an antidilutive effect.

## 7. INCOME TAXES

The company uses 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 is complicated for any energy 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.

As of July 31, 2009 the company's 2007 Federal tax return had been audited by the IRS, and the final report reflected approximately \$24,000 in additional tax due. The company remains subject to examination of Federal and state tax returns, except Colorado, for the tax years 2005 and 2006, and for the tax years 2004 through 2007 for Colorado tax returns.

## 8. INTANGIBLE ASSETS

On November 6, 2008 the company purchased all of the patents underlying the Calliope Gas Recovery Technology, all of the related third party interests in future installations of the technology and patents covering a new fluid lift technology for shallow wells known as Tractor Seal for \$4,400,000. The patents are being amortized on a straight line basis over the remaining lives ranging from 8.4 to 17.4 years.

Edgar Filing: CREDO PETROLEUM CORP - Form 10-Q

	July 31, 2009	
	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets:		
Calliope intangible assets	\$ 4,449,000	\$ 327,000
Aggregate amortization expense: For the nine months ended July 31, 2009		\$ 327,000

Table of Contents

In July 2008, the company acquired the third party rights related to certain future Calliope installations for \$975,000. Those third party rights would have resulted principally from Calliope installations of joint ventures between the company and other natural gas producing companies.

As a result of the natural gas market at January 31, 2009, the company believed it to be more likely than not that the formation of joint ventures for the installation of Calliope technology that would have been subject to these third party rights would not occur within the foreseeable future. Based on that assumption, and in accordance with FASB Statement No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets* (FAS 144), the company determined that the sum of the undiscounted value of cash flows to be derived from future installations of Calliope technology resulting from joint ventures was minimal. Accordingly, the company recorded an impairment loss of \$927,000 for the quarter ended January 31, 2009.

The company reviews the value of its intangible assets in accordance with SFAS 144, *Accounting for the Impairment or Disposal of Long Lived Assets*, which requires that it evaluate these assets for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable or that the useful lives of these assets are no longer appropriate.

**9. FAIR VALUE MEASUREMENTS**

On November 1, 2008, the company adopted SFAS No. 157 *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require or permit fair value measurements; however, it does not require any new fair value measurements.

The company utilizes derivative contracts to hedge against the variability in cash flows associated with the forecasted sale of its anticipated future natural gas production. These derivatives are carried at fair value on the consolidated balance sheets. Additionally, the company's short-term investments consist primarily of professionally managed limited partnerships which include investments that are not publicly traded and may have less readily determinable market values. SFAS No. 157 establishes a valuation hierarchy for disclosure of the inputs to valuation used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument.
- Level 3 inputs are measured based on prices or valuation models that require inputs that are both significant to the fair value measurement and less observable from objective sources.

A financial asset's or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement. The determination of the fair values below incorporates various factors required under SFAS No. 157, including the impact of the counterparty's non-performance risk with respect to the company's financial assets and the company's non-performance risk with respect to the company's financial liabilities. The following table provides the assets and liabilities carried at fair value measured on a recurring basis as of

Edgar Filing: CREDO PETROLEUM CORP - Form 10-Q

July 31, 2009:

	As of July 31, 2009			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Asset:				
Short-term investments	\$ 299	\$	\$ 388	\$ 687
Derivative assets (current)	\$	\$ 699	\$	\$ 699



Table of Contents

Level 3 instruments are comprised of the company's investments in professionally managed limited partnerships. The fair value represents the net asset value of the company's share in each partnership. The company identified the investments as Level 3 instruments due to the fact that quoted prices for the underlying investments in the partnerships cannot be obtained and there is not an active market for the underlying investments or the partnerships shares. The company utilizes the periodic fund statements along with current fund redemption activity and communication with investment advisors to determine the valuation of its investment.

The following table sets forth a reconciliation of changes in the fair value of financial assets and liabilities classified as Level 3 in the fair value hierarchy for the three and nine months ended July 31, 2009:

	<b>Three Months Ended July 31, 2009</b>	<b>Nine Months Ended July 31, 2009</b>
	(in thousands)	
Balance as of April 30, 2009 and October 31, 2008, respectively(1)	\$ 1,576	\$ 2,764
Total gains (losses):		
Included in earnings(2)	14	(199)
Redemptions	(1,202)	(2,177)
Balance as of July 31, 2009	\$ 388	\$ 388

(1) This amount is included in short-term investments on the balance sheet.

(2) This amount is included in investment and other income (loss) on the statement of operations.

**10. COMMON STOCK**

On September 22, 2008, the company's Board of Directors authorized a stock repurchase program. Under the program, the company could acquire up to \$2,000,000 of its common stock. On April 9, 2009, the Board authorized expanding the repurchase program to \$4,000,000. The repurchases may be made on the open market, in block trades or otherwise. The stock repurchase program may be expanded, suspended or discontinued at any time. During the quarter ended July 31, 2009, the company acquired 7,482 shares of its common stock at an aggregate cost of \$80,185. For the nine months ended July 31, 2009, the company acquired 138,982 shares of its common stock at an aggregate cost of \$1,232,000. At July 31, 2009 a total of 237,922 shares have been repurchased under the program at an average price per share of \$8.22.

Subsequent to July 31, 2009, and through September 9, 2009, the company has repurchased an additional 4,000 shares, bringing the total shares repurchased to 241,922 at an average price per share of \$8.26.

**11. COMMITMENTS AND CONTINGENCIES**

## Edgar Filing: CREDO PETROLEUM CORP - Form 10-Q

The company has been named as a defendant in a lawsuit alleging breach of contract, and other issues, arising in the normal course of its oil and gas activities. The company believes that a contractual agreement requires that disputes be resolved by arbitration. Although the company believes the allegations are without merit and that the company will ultimately prevail, the ultimate outcome of this lawsuit, or arbitration, cannot be determined at this time.

The company has also been named as a defendant in a lawsuit brought by a former employee. The suit alleges breach of contract and other employment issues. Although the company believes the allegations are without merit and that the company will ultimately prevail, the ultimate outcome of this lawsuit cannot be determined at this time.

The company has no material outstanding commitments at July 31, 2009.

Table of Contents**12. RECENT ACCOUNTING PRONOUNCEMENTS**

In December 2008, the Securities and Exchange Commission adopted revisions to its oil and gas disclosure requirements that are intended to align them with current practices and changes in technology. Among other things, the amendments will: replace the single-day year-end pricing assumption with a twelve-month average pricing assumption; permit the disclosure of probable and possible reserves; allow the use of certain technologies to establish reserves; require the disclosure of the qualifications of the technical person primarily responsible for preparing the reserves estimates or conducting a reserves audit; require the filing of the independent reserve engineers' summary report; and permit the disclosure of a reserves sensitivity analysis table to illustrate the impact of different price and/or cost assumptions on reserves. These amendments are effective for registration statements filed on or after January 1, 2010, and for annual reports on Form 10-K for fiscal years ending on December 31, 2009, with early adoption prohibited. The company is currently evaluating the impact that the adoption of this pronouncement will have on the company's financial position, results of operations, and disclosures.

In November 2007, the FASB issued Statement No. 141 (revised 2007), *Business Combination* (FAS 141(R)) and Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51* (FAS 160). FAS 141(R) will change how business acquisitions are accounted for and will impact financial statements both on the acquisition date and in subsequent periods. FAS 160 will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. FAS 141(R) and FAS 160 are effective for both public and private companies for fiscal years beginning on or after December 15, 2008 (fiscal 2010 for the company). FAS 141(R) will be applied prospectively. FAS 160 requires retroactive adoption of the presentation and disclosure requirements for existing minority interests. All other requirements of FAS 160 will be applied prospectively. Early adoption is prohibited for both standards. Management is currently evaluating the requirements of FAS 141(R) and FAS 160 and has not yet determined the impact on its financial statements.

In April 2009, the FASB issued FSP No. FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* ( FSP FAS 107-1 and APB 28-1 ), which requires the disclosure of the fair value, together with the carrying amount, of financial instruments, regardless of whether they are recognized at fair value in the statement of financial position, for interim reporting periods of publicly traded companies as well as in annual financial statements. This pronouncement is effective for interim reporting periods ending after June 15, 2009, with earlier adoption permitted for periods ending after March 15, 2009. The Company adopted this pronouncement for the quarter ended April 30, 2009. As this pronouncement requires only additional disclosures, there was no impact on the Company's financial position or results of operations as a result of the adoption.

In April 2009, the FASB issued FSP No. FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* ( FSP FAS 157-4 ), which provides additional guidance for estimating fair value in accordance with SFAS 157 in certain circumstances. This pronouncement is effective for interim and annual reporting periods ending after June 15, 2009, with earlier adoption permitted for periods ending after March 15, 2009. The company adopted this pronouncement for the quarter ended July 31, 2009; however, there was no impact on the Company's financial position or results of operations as a result of the adoption.

In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* ( FSP FAS 115-2 and FAS 124-2 ), which amends the existing other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. Other-than-temporary impairment relates to investments in debt and



Table of Contents

equity securities for which changes in fair value are not regularly recognized in earnings (such as securities classified as held-to-maturity or available-for-sale). This pronouncement is effective for interim and annual reporting periods ending after June 15, 2009, with earlier adoption permitted for periods ending after March 15, 2009. An entity that early adopts FSP FAS 107-1 and APB 28-1 must also early adopt FSP FAS 115-2 and FAS 124-2. Accordingly, the Company has adopted this pronouncement for the quarter ended March 31, 2009; however, since the Company has no such investments in debt or equity securities, there was no impact on the Company's financial position or results of operations as a result of the adoption.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* (SFAS 165), which provides general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This topic was previously addressed only in auditing literature. SFAS 165 is similar to the existing auditing guidance with some exceptions that are not intended to result in significant changes to practice. Entities are now required to disclose the date through which subsequent events have been evaluated, with such date being the date the financial statements were issued or available to be issued. SFAS 165 is effective on a prospective basis for interim or annual reporting periods ending after June 15, 2009. Accordingly, the Company adopted this pronouncement for the quarter ended July 31, 2009; however, there was no impact on the Company's financial position or results of operations as a result of the adoption.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q includes certain statements that may be deemed to be forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements included in this Quarterly Report on Form 10-Q, other than statements of historical facts, address matters that the company reasonably expects, believes or anticipates will or may occur in the future. Forward-looking statements may relate to, among other things:

- the company's future financial position, including working capital and anticipated cash flow;
- amounts and nature of future capital expenditures;
- operating costs and other expenses;
- wells to be drilled or reworked;
- oil and natural gas prices and demand;
- existing fields, wells and prospects;
- diversification of exploration;
- estimates of proved oil and natural gas reserves;

Edgar Filing: CREDO PETROLEUM CORP - Form 10-Q

- reserve potential;
- development and drilling potential;
- expansion and other development trends in the oil and natural gas industry;
- the company's business strategy;
- production of oil and natural gas;
- matters related to the Calliope Gas Recovery System;
- effects of federal, state and local regulation;
- insurance coverage;
- employee relations;
- investment strategy and risk; and
- expansion and growth of the company's business and operations.

Table of Contents**LIQUIDITY AND CAPITAL RESOURCES**

At July 31, 2009, working capital decreased to \$14,846,000 compared to \$24,160,000 at October 31, 2008. For the nine months ended July 31, 2009, net cash provided by operating activities was \$8,143,000 compared to \$9,666,000 for the same period in 2008. Net income decreased \$18,284,000 primarily due to impairment losses of \$24,653,000, a decrease in revenue of \$7,023,000 and increased other costs and expenses of \$1,335,000.

For the nine months ended July 31, 2009 and 2008, net cash used in investing activities was \$15,753,000 and \$8,633,000, respectively. Investing activities primarily included oil and gas exploration and development expenditures, including Calliope, totaling \$11,299,000 and \$8,414,000 respectively. For the period ended July 31, 2009, the company also purchased the patents underlying the Calliope Technology for \$4,400,000.

At July 31, 2009, 56% of the company's short term investments were being liquidated.

Existing working capital and anticipated cash flow are expected to be sufficient to fund operations and capital commitments for at least the next 12 months. At July 31, 2009, the company had no lines of credit or other bank financing arrangements except for the hedging line of credit discussed in Note 5. Because earnings are anticipated to be reinvested in operations, cash dividends are not expected to be paid. The company has no defined benefit plans and no obligations for post retirement employee benefits.

The company's adjusted earnings before interest, taxes, depreciation, depletion and amortization, including impairment losses, ( EBITDA ) was \$4,796,000 for the nine months ended July 31, 2009 compared to \$8,196,000 for the nine months ended July 31, 2008. EBITDA is not a GAAP measure of operating performance. The company uses this non-GAAP performance measure primarily to compare its performance with other companies in the industry that make a similar disclosure. The company believes that this performance measure may also be useful to investors for the same purpose. Investors should not consider this measure in isolation or as a substitute for operating income, or any other measure for determining the company's operating performance that is calculated in accordance with GAAP. In addition, because EBITDA is not a GAAP measure, it may not necessarily be comparable to similarly titled measures employed by other companies. Reconciliation between EBITDA and net income is provided in the table below:

	Nine Months Ended July 31,	
	2009	2008
<b>RECONCILIATION OF EBITDA:</b>		
Net Income (loss)	\$ (14,248,000)	\$ 4,036,000
Add Back (Deduct):		
Interest Expense		7,000
Income Tax Expense (Benefit)	(9,108,000)	1,559,000
Depreciation, Depletion and Amortization Expense Including Write-Down and Impairment	28,152,000	2,594,000
EBITDA	\$ 4,796,000	\$ 8,196,000

**OFF-BALANCE SHEET FINANCING**

The company has no off-balance sheet arrangements at July 31, 2009.



Table of Contents**PRODUCT PRICES AND PRODUCTION**

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. Since 1991, the company has periodically hedged the price of a portion of its estimated natural gas production when the potential for significant downward price movement is anticipated. Hedging transactions typically take the form of forward short positions, swaps and collars which are executed on the NYMEX futures market or by indexing to regional index prices associated with pipelines in proximity to the company's production. The company's current hedges are indexed to NYMEX. Refer to Note 5 of the Consolidated Financial Statements for a complete discussion on the company's hedging activities.

Gas and oil sales volume and price realization comparisons for the indicated periods are set forth below. Price realizations include the sales price and the effect of realized hedging transactions.

Product	Volume	2009		Nine Months Ended July 31, 2008		% Change		
		Price	Price	Volume	Price	Volume	Price	
Oil (bbls)	<b>90,500</b>	\$	<b>45.77</b>	42,500	\$	101.66	+113%	- 55%
Gas (Mcf)	<b>940,000</b>	\$	<b>6.50(1)</b>	1,221,000	\$	7.87(2)	- 23%	- 17%

Product	Volume	2009		Three Months Ended July 31, 2008		% Change		
		Price	Price	Volume	Price	Volume	Price	
Oil (bbls)	<b>35,500</b>	\$	<b>56.98</b>	13,400	\$	122.91	+165%	- 54%
Gas (Mcf)	<b>293,000</b>	\$	<b>5.08(3)</b>	396,000	\$	6.96(4)	- 26%	- 27%

(1) Includes \$3.14 Mcf realized hedging gain.

(2) Includes \$0.32 Mcf realized hedging loss.

(3) Includes \$2.33 Mcf realized hedging gain.

(4) Includes \$3.13 Mcf realized hedging loss.

As previously reported, during fiscal 2008 and the first two quarters of fiscal 2009, the company elected to postpone certain scheduled drilling due to the historically high costs of equipment and field services. That decision came with the consequence that less drilling would cause production to decline. The decline in gas production is evidenced by the above table.

Beginning in fiscal year 2008, the company has focused its drilling program primarily on oil prospects. The results of the drilling program are also evidenced by the above table. Oil production has increased 113% for the nine months ended July 31, 2009 compared to the same period in 2008. In the quarter ended July 31, 2009 oil production has increased 165% compared to the same quarter in 2008.

On a gas equivalent units basis, the production declines the company has experienced in recent periods have been substantially overcome. Total production is unchanged for the nine months ended July 31, 2009 from the same period a year ago and for the three months ended July 31, 2009 gas equivalent production has increased 6% from the same period last year.

More importantly, recent drilling discoveries have begun to significantly improve the balance between oil and gas reserves and oil and gas production.

Table of Contents

**OPERATIONS**

During the first nine months of fiscal 2009, the company's operations continued to focus on its two core projects – oil and natural gas drilling and application of its patented Calliope Gas Recovery System.

The company believes that, in combination, its drilling and Calliope projects provide an excellent (and possibly unique) balance for achieving its goal of adding long-lived natural gas reserves and production at reasonable costs and risks. However, it should be expected that successful results will occur unevenly for both the drilling and Calliope projects. Drilling results are dependent on both the timing of drilling and on the drilling success rate. Calliope results are primarily dependent on the timing, volume and quality of Calliope installations available to the company.

The company will continue to actively pursue adding reserves through its two core projects in fiscal 2009, and expects these activities to be a reliable source of reserve additions. However, the timing and extent of such activities can be dependent on many factors which are beyond the company's control, including but not limited to, the cost and quality of oil field services such as drilling rigs, production equipment and related services, and access to wells for application of the company's patented gas recovery system on low pressure gas wells. The prevailing price of oil and natural gas has a significant effect on demand and, thus, the related cost of such services and wells.

The company delayed drilling scheduled for the second quarter 2009 for a period of at least two months in anticipation of significant improvement in both the cost and quality of drilling services and materials, which has begun to occur. Accordingly, the company re-instituted its drilling program and drilled five wells during the third quarter 2009 and plans to drill at least three wells per month during the remainder of 2009.

All of the company's oil and natural gas properties are located on-shore in the continental United States. The company's future drilling activities may not be successful, and its overall drilling success rate may change. Unsuccessful drilling activities could have a material adverse effect on the company's results of operations and financial condition. Also, the company may not be able to obtain the right to drill in areas where it believes there is significant potential for the company.

***Recent Drilling Activities.***

**Proprietary Drilling Results** The company recently announced that it has participated in drilling a wildcat discovery well that flowed oil at impressive initial rates during completion testing. For competitive reasons, we have not disclosed any detailed ownership, location or technical information about the well. Production is being curtailed to between 100 and 200 barrels of oil per day. Two confirmation wells have yielded positive results. A third confirmation well was not a commercial producer. Two additional wells are planned to be drilled during the remainder of the calendar year.

## Edgar Filing: CREDO PETROLEUM CORP - Form 10-Q

**Northern Anadarko Basin** Oklahoma drilling has historically been the primary driver for CREDO's production growth. CREDO owns approximately 75,000 gross acres and has interests in almost 200 wells. During the first quarter of fiscal 2009, CREDO completed two wells on its Pool\Proffitt Prospect to test multiple carbonate reservoirs using new fracture stimulation technology. Both have proved to be commercial wells, and there are up to 12 additional locations on CREDO's acreage. CREDO owns 50% to 73% working interest in the wells.

In Hemphill County, Texas, the company purchased an additional 3,800 gross acres and assumed operatorship of 11 wells. The new acreage complements the company's Humphreys Prospect and brings our total acreage in the area to approximately 8,300 gross acres. We have drilled two successful wells on the acreage, and intend to drill more wells in the future. CREDO owns interests ranging up to 25%.

Table of Contents

**South Texas** CREDO entered the South Texas joint venture to use 3-D seismic to explore for deep, highly faulted prospects. The high potential, 17,000-foot wildcat well drilled to test the Deep Wilcox sand on the Gemini Prospect confirmed the seismic interpretation and found porous sand. However, the sand was water wet and the well was plugged and abandoned. CREDO received approximately \$1,300,000 in cash for the prospect package last year, but retained an 11.25% carried interest in the test well. The prospect package consists of two additional Deep Wilcox prospects which are geologically different from the Gemini Prospect. They are being further evaluated, and if drilled, CREDO will have an 11.25% carried interest in the next well.

**Central Kansas Uplift** The company has achieved excellent drilling results on the Central Kansas Uplift. To date, CREDO has participated in 41 wells on the Uplift, of which 46% have been successfully completed as oil producers. That outstanding success prompted us to increase CREDO's leasehold position to almost 150,000 gross and 75,000 net acres. This acreage provides a good inventory of future drilling opportunities where CREDO owns interests ranging up to 85 percent. CREDO recently completed shooting 3-D seismic over approximately 100 square miles of the prospect, and the initial interpretation shows many potential drilling locations in 11 prospect areas. The company expects to drill two to four wells per month for the balance of the year.

Drilling on the Uplift is relatively shallow and costs are moderate, yielding good economics even in the current product price environment. In addition, the project is oil targeted, thereby improving the balance between oil and natural gas in CREDO's reserve base. We expect Kansas to make a major contribution to our reserve and production growth in 2009.

**Bakken Shale** CREDO entered the horizontal Bakken oil play in 2008 by leasing about 4,700 acres in North Dakota. The new leases have five or ten year terms and they are located in the vicinity of the recently discovered and prolific Parshall Field. Based on 640 acre spacing units, CREDO has interests in up to 27 well locations. Approximately \$2,258,000 (50%) of the acquisition cost has been reclassified to the full cost pool. The company's first well is scheduled to be drilled in early September in what has become the number one oil resource play in the U.S. Breakthroughs in precision horizontal drilling and multi-stage, high pressure fracture stimulations have made the Bakken shale a very active resource play. The U.S. Geological Survey recently estimated that the Bakken contains around 4.0 billion barrels of undiscovered oil.

**Calliope Gas Recovery Technology**

**Calliope Gas Recovery System** We are continuing to actively discuss commercial Calliope terms with several companies. One Calliope license agreement was entered into in third quarter 2009 and an additional agreement is nearing execution. CREDO has previously published statistics on its Calliope wells which show finding costs of about \$0.50 per Mcf and total costs to deliver gas into the pipeline of about \$1.00 per Mcf. The statistics also show that Calliope is very low risk when installed on suitable wells.

Calliope's low finding and production costs have become increasingly attractive as the economics on many industry drilling projects deteriorate due to lower product prices. We also believe that lower natural gas prices may stimulate divestitures of marginal properties by other companies, including properties that have Calliope potential.

At year-end, CREDO owned an exclusive license to the Calliope patents and the related technology. However, in order to establish absolute control over the technology and to eliminate future costs for individual well licenses, we recently purchased all of the underlying patents for \$4,400,000. A portion of this acquisition also covers an exciting series of new patents, known as Tractor Seal, that is specifically designed to

Edgar Filing: CREDO PETROLEUM CORP - Form 10-Q

remove liquids from shallow wells more efficiently than existing technologies. If perfected, this new technology will be an excellent complement to Calliope's focus on deeper wells.

Table of Contents

**Results of Operations**

**Nine Months Ended July 31, 2009 Compared to Nine Months Ended July 31, 2008**

For the nine months ended July 31, 2009, oil and gas revenues decreased 49% to \$7,298,000 compared to \$14,321,000 during the same period last year. As the oil and gas price/volume table on page 17 shows, total gas price realizations, which reflect realized hedging transactions, decreased 17% to \$6.50 per Mcf and oil price realizations decreased 55% to \$45.77 per barrel. The net effect of these price changes was to decrease oil and gas realizations by \$3,681,000 (\$7,025,000 without realized hedges). For the nine months ended July 31, 2009, the company's gas equivalent production was unchanged from the same period last year. The company elected to postpone certain scheduled drilling due to the historically high costs of equipment and field services. That decision came with the consequence that less drilling would cause production declines. Natural gas production has declined 23% but a 113% increase in oil production has offset the gas decline. Investment and other income decreased \$184,000, primarily due to market performance and liquidation of the company's investments, compared to last year.

For the nine months ended July 31, 2009, total costs and expenses, excluding the impairment loss of \$24,653,000, increased 21% to \$7,846,000 compared to \$6,511,000 for the comparable period in 2008. Oil and gas production expenses decreased due primarily to reduced field level expenses. DD&A increased primarily due to an increase in the amortizable cost base before the impairment adjustment. General and administrative expenses increased primarily due to accounting and professional fees and increased salaries and benefits. The effective tax rate was 39.0% and 27.9% for the 2009 and 2008 periods, respectively.

**Three Months Ended July 31, 2009 Compared to Three Months Ended July 31, 2008**

For the three months ended July 31, 2009, total revenues decreased 50% to \$2,837,000 compared to \$5,646,000 during the same period last year. As the oil and gas price/volume table on page 17 shows, total gas price realizations, which reflect realized hedging transactions, decreased 27% to \$5.08 per Mcf and oil price realizations decreased 54% to \$56.98 per barrel. The net effect of these price changes was to decrease oil and gas realizations by \$894,000 (\$2,815,000 without realized hedges). For the three months ended July 31, 2009, the company's gas equivalent production increased 6%. Investment and other income improved slightly due to improved market performance.

For the three months ended July 31, 2009, total costs and expenses rose 3% to \$2,295,000 compared to \$2,225,000 for the comparable period in 2008. Oil and gas production expenses decreased 26% due primarily to decreased field level costs. Depreciation, depletion and amortization (DD&A) increased primarily due to amortization of intangible assets. General and administrative expenses increased primarily due to accounting and professional fees and increased salaries and benefits. The effective tax rate was 39.1% and 27.4% for the 2009 and 2008 periods, respectively.

**SIGNIFICANT ACCOUNTING POLICIES**

The company believes the following accounting policies and estimates are critical in the preparation of its consolidated financial statements: the carrying value of its oil and natural gas properties and intangible assets, the accounting for oil and gas reserves, revenue receivables, and the

estimate of its asset retirement obligations.



Table of Contents

***OIL AND GAS PROPERTIES***

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

The capitalized costs in the full cost pool are subject to a quarterly ceiling test that limits such pooled costs to the aggregate of the present value of future net revenues attributable to proved oil and natural gas reserves discounted at 10 percent plus the lower of cost or market value of unproved properties less any associated tax effects. If such capitalized costs exceed the ceiling, the company will record a write-down to the extent of such excess as a non-cash charge to earnings, unless the company considers price increases subsequent to the balance sheet date which may reduce or eliminate a write-down.

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

***OIL AND GAS RESERVES*** The determination of depreciation and depletion expense as well as ceiling test write-downs related to the recorded value of the company's oil and natural gas properties are highly dependent on the estimates of the proved oil and natural gas reserves. Oil and natural gas reserves include proved reserves that represent estimated quantities of crude oil and natural gas which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. There are numerous uncertainties inherent in estimating oil and natural gas reserves and their values, including many factors beyond the company's control. Accordingly, reserve estimates are often different from the quantities of oil and natural gas ultimately recovered and the corresponding lifting costs associated with the recovery of these reserves.

***ASSET RETIREMENT OBLIGATIONS*** The company estimates the future cost of asset retirement obligations, discounts that cost to its present value, and records a corresponding asset and liability in its Consolidated Balance Sheets. The values ultimately derived are based on many significant estimates, including future abandonment costs, inflation, market risk premiums, useful life, and cost of capital. The nature of these estimates requires the company to make judgments based on historical experience and future expectations. Revisions to the estimates may be required based on such things as changes to cost estimates or the timing of future cash outlays. Any such changes that result in upward or downward revisions in the estimated obligation will result in an adjustment to the related capitalized asset and corresponding liability on a prospective basis.

***INTANGIBLE ASSETS*** The company reviews the value of its intangible assets in accordance with FASB Statement No. 144 which requires that it evaluate these assets for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets

may not be fully recoverable or that the useful lives of these assets are no longer appropriate.

Table of Contents

On September 1, 2000, the company acquired an unrestricted, exclusive license for patented Calliope Gas Recovery System technology. In July 2008, the company acquired the third party rights resulting from certain future Calliope installations for \$975,000. Those third party rights would have resulted principally from Calliope installations of joint ventures between the company and other natural gas producing companies. As a result of the natural gas prices at January 31, 2009, the company determined it to be more likely than not that the formation of joint ventures for the installation of Calliope technology that would have been subject to these third party rights will not occur within the foreseeable future. Based on this assumption, and in accordance with FAS 144 *Accounting for the Impairment or Disposal of Long-Lived Assets*, the company determined that the sum of the undiscounted value of cash flows to be derived from future installations of Calliope technology resulting from joint ventures is minimal. Accordingly, the company recorded an impairment loss of \$927,000.

On November 6, 2008 the company purchased all of the patents underlying the Calliope Gas Recovery Technology, all of the related third party interests in future installations of the technology and patents covering a new fluid lift technology for shallow wells known as Tractor Seal for \$4,400,000. The patents are being amortized on a straight line basis over the remaining lives ranging from 8.2 to 17.2 years. These costs are subject to potential future impairment if anticipated future Calliope installations do not occur.

**REVENUE RECOGNITION** The company derives its revenue primarily from the sale of produced natural gas and crude oil. The company reports revenue gross for the amounts received before taking into account production taxes and transportation costs which are reported as oil and gas production expenses. Revenue is recorded in the month production is delivered to the purchaser at which time title changes hands. The company makes estimates of the amount of production delivered to purchasers and the prices it will receive. The company uses its knowledge of its properties, their historical performance, the anticipated effect of weather conditions during the month of production, NYMEX and local spot market prices, and other factors as the basis for these estimates. Variances between estimates and the actual amounts received are recorded when payment is received.

A majority of the company's sales are made under contractual arrangements with terms that are considered to be usual and customary in the oil and gas industry. The contracts are for periods of up to five years with prices determined based upon a percentage of a pre-determined and published monthly index price. The terms of these contracts have not had an effect on how the company recognizes its revenue.

**HEDGING** The company recognizes all derivatives as fair value hedges on its balance sheet at fair value at the end of each period. Changes in the fair value of hedges are recorded in the Consolidated Statement of Operations.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The company manages exposure to commodity price fluctuations by periodically hedging a portion of estimated natural gas production through the use of derivatives, typically forward short positions in the NYMEX futures market. At July 31 2009 open derivative contracts covered 150,000 MMBtus, approximately 50% of the company's anticipated 4th quarter 2009 natural gas production, at NYMEX prices averaging \$8.31 and covered the production months of August, 2009 through October, 2009. Average prices in the company's primary market are currently 8% below NYMEX prices due to basis differentials and transportation costs. However, regional weather conditions and other economic factors can periodically result in substantially higher basis differentials. Relevant terms of the open derivative contracts at July 31, 2009 are as follows:



Table of Contents

## Natural Gas Forward Short Positions

Fiscal Quarter Ending	Contract Volumes MMBtus	Weighted Average Price per MMBtu	Fair Value
Oct. 31, 2009	150,000	\$ 8.31	\$ 699,000

**ITEM 4. CONTROLS AND PROCEDURES****Disclosure Controls and Procedures**

Our management, with the participation of James T. Huffman, our Chief Executive Officer, and Alford B. Neely, our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of July 31, 2009. Based on the evaluation, these officers have concluded that:

Our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms; and

Our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934 was accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

**Internal Control Over Financial Reporting**

There has not been any change in our internal control over financial reporting that occurred during the quarter ended July 31, 2009 that has materially affected or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II - OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

Reference is made to Notes to Consolidated Financial Statements (Unaudited) Note 11, Commitments and Contingencies, in Part I, Item I of this Form 10-Q and incorporated by reference into this Part II, Item I.

**ITEM 1A. RISK FACTORS**

There have been no material changes from the risk factors previously disclosed in the company's Annual Report on Form 10-K, as amended, for the fiscal year ended October 31, 2008.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

**Issuer Purchases of Equity Securities.**

During the first nine months of fiscal year 2009, the company repurchased 138,982 shares of its common stock on the open market at a weighted average price of \$8.86. The purchases were made pursuant to a stock repurchase plan announced on September 24, 2008 and extended by the Board of Directors on April 9, 2009. The extended plan authorized repurchases up to \$4,000,000, but could be expanded, suspended or discontinued at any time.

Table of Contents

At July 31, 2009, the company has repurchased 237,922 shares of common stock at an average price per share of \$8.22. Subsequent to July 31, 2009, and through September 9, 2009, the company has repurchased an additional 4,000 shares, bringing the total shares repurchased to 241,922 at an average price per share of \$8.26.

**Issuer Purchases of Equity Securities**

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans	Maximum dollar value of shares that may yet be purchased under the plans
Sept. 22, 2008 - Oct. 31, 2008	98,940	\$ 7.31	98,940	\$ 1,277,000
November 1 - 30 2008	45,954	\$ 9.45	45,954	\$ 843,000
December 1 - 31 2008	22,350	\$ 8.88	22,350	\$ 645,000
January 1 - 31 2009	6,182	\$ 9.16	6,182	\$ 588,000
February 1 - 28, 2009	29,104	\$ 8.56	29,104	\$ 338,000
March 1 - 31, 2009	15,110	\$ 7.49	15,110	\$ 225,000
April 1 - 30, 2009	12,800	\$ 7.76	12,800	\$ 2,126,000
June 1 - 30, 2009	1,031	\$ 9.58	1,031	\$ 2,116,000
July 1 - 31, 2009	6,451	\$ 10.90	6,451	\$ 2,045,000
<b>Total</b>	<b>237,922</b>	<b>\$ 8.22</b>	<b>237,922</b>	

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.

**ITEM 5. OTHER INFORMATION**

Subsequent Events:

On September 3, 2009 the company entered into basis hedging contracts for 480,000 MMBtu for Panhandle Eastern Pipeline Company vs NYMEX basis differential. The hedged basis is \$0.465. The contracts are for 40,000 MMBtu per month for January through December 2010 and are estimated to cover approximately 50% of estimated production for that period.

On September 8, 2009 the company filed an 8-K report disclosing that James T. Huffman, Chief Executive Officer and Chairman of the Board had announced his intent to retire from the position of Chief Executive Officer at year end. He will continue in his position as Chairman of the Board. The Board of Directors has initiated the process to search for a new CEO.

Table of Contents

**ITEM 6. EXHIBITS**

Exhibits are as follow:

- |      |                                                                                                                                           |
|------|-------------------------------------------------------------------------------------------------------------------------------------------|
| 31.1 | Certification by Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002                                              |
| 31.2 | Certification by Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002                                              |
| 32.1 | Certification by Chief Executive Officer and Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act (18 U.S.C. Section 1350) |

**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.

CREDO Petroleum Corporation  
(Registrant)

By: */s/ James T. Huffman*  
James T. Huffman  
Chief Executive Officer  
(Principal Executive Officer)

By: */s/ Alford B. Neely*  
Alford B. Neely  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

Date: September 9, 2009