

Edgar Filing: CREDO PETROLEUM CORP - Form 10QSB

CREDO PETROLEUM CORP  
Form 10QSB  
September 14, 2004

---

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

Form 10-QSB

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

For Quarter Ended July 31, 2004

Commission File Number 0-8877

CREDO PETROLEUM CORPORATION

Colorado	84-0772991
(State of Incorporation)	(IRS Employer Identification)
1801 Broadway, Suite 900	80202
Denver, Colorado	(Zip Code)
(Address of principal executive office)	
303-297-2200	
(Telephone Number)	

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, net of treasury stock, as of August 31, 2004: Common stock, \$.10 par value - 6,037,599  
Preferred stock, no par value - None issued

---

CREDO PETROLEUM CORPORATION

Form 10-QSB For Quarter Ended July 31, 2004

TABLE OF CONTENTS

# Edgar Filing: CREDO PETROLEUM CORP - Form 10QSB

---

## PART I - FINANCIAL INFORMATION

### Item 1. Financial Statements

#### Consolidated Balance Sheets

As of July 31, 2004 (Unaudited) and October 31, 2003

#### Consolidated Statements of Earnings and Changes in Retained Earnings (Unaudited)

For the Nine and Three Month Periods Ended July 31, 2004 and 2003

#### Consolidated Statements of Cash Flows (Unaudited)

For the Nine Month Periods Ended July 31, 2004 and 2003

#### Notes to Consolidated Financial Statements

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Item 3. Controls and Procedures

## PART II - OTHER INFORMATION

### Item 6. Exhibits and Reports on Form 8-K

#### Signatures

#### Certifications

---

## PART I - FINANCIAL INFORMATION

### ITEM 1. FINANCIAL STATEMENTS

#### CREDO PETROLEUM CORPORATION Consolidated Balance Sheets

#### A S S E T S

	July 31, 2004	October 31, 2003
	-----	-----
	(Unaudited)	
CURRENT ASSETS:		
Cash and cash equivalents	\$ 1,299,000	\$ 1,885,000
Short term investments	6,118,000	4,778,000
Receivables:		
Trade	749,000	410,000
Accrued oil and gas sales	1,575,000	1,256,000
Other	10,000	234,000
	-----	-----

Edgar Filing: CREDO PETROLEUM CORP - Form 10QSB

Total current assets	9,751,000	8,563,000
	-----	-----
OIL AND GAS PROPERTIES, net, at cost, using full cost method:		
Unevaluated	3,151,000	2,075,000
Evaluated	13,787,000	11,986,000
	-----	-----
Net oil and gas properties	16,938,000	14,061,000
	-----	-----
EXCLUSIVE LICENSE AGREEMENT, net of amortization of \$274,000 in 2004 and \$221,000 in 2003	425,000	478,000
OTHER, net	831,000	470,000
	-----	-----
	\$ 27,945,000	\$ 23,572,000
	=====	=====
L I A B I L I T I E S    A N D    S T O C K H O L D E R S '		
E Q U I T Y		
CURRENT LIABILITIES:		
Accounts payable and accrued liabilities	\$ 2,609,000	\$ 1,776,000
Income taxes payable	200,000	210,000
	-----	-----
Total current liabilities	2,809,000	1,986,000
	-----	-----
DEFERRED INCOME TAXES, net	4,289,000	3,358,000
EXCLUSIVE LICENSE OBLIGATION, less current obligations of \$53,000	355,000	355,000
ASSET RETIREMENT OBLIGATION	292,000	238,000
COMMITMENTS		
STOCKHOLDERS' EQUITY:		
Preferred stock, without par value, 5,000,000 shares authorized, none issued	-	-
Common stock, \$.10 par value, 20,000,000 shares authorized, 6,340,000 shares issued in 2004 and 2003	634,000	634,000
Capital in excess of par value	12,463,000	12,463,000
Retained earnings, net of \$6,277,000 related to 20% stock dividend in 2003	7,819,000	5,062,000
Other comprehensive income (loss)	(264,000)	180,000
Treasury stock, at cost, 303,000 shares in 2004 and 378,000 shares in 2003	(452,000)	(704,000)
	-----	-----
Total stockholders' equity	20,200,000	17,635,000
	-----	-----
	\$ 27,945,000	\$ 23,572,000
	=====	=====

See accompanying notes.

Edgar Filing: CREDO PETROLEUM CORP - Form 10QSB

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

	Nine Months Ended July 31, 2004	Nine Months Ended July 31, 2003	Quarter Ended July 31, 2004	Quarter Ended July 31, 2003
	-----	-----	-----	-----
REVENUES:				
Oil and gas sales	\$6,932,000	\$5,014,000	\$2,226,000	\$1,980,000
Operating	444,000	386,000	152,000	135,000
Investment income and other	186,000	318,000	61,000	128,000
	-----	-----	-----	-----
	7,562,000	5,718,000	2,439,000	2,243,000
	-----	-----	-----	-----
COSTS AND EXPENSES:				
Oil and gas production	1,464,000	1,159,000	532,000	467,000
Depreciation, depletion And amortization	1,227,000	930,000	436,000	325,000
General and administrative	1,011,000	939,000	344,000	333,000
Interest	30,000	34,000	7,000	11,000
	-----	-----	-----	-----
	3,732,000	3,062,000	1,319,000	1,136,000
	-----	-----	-----	-----
INCOME BEFORE INCOME TAXES AND ACCOUNTING CHANGE	3,830,000	2,656,000	1,120,000	1,107,000
INCOME TAXES	(1,073,000)	(744,000)	(314,000)	(310,000)
	-----	-----	-----	-----
INCOME BEFORE ACCOUNTING CHANGE	2,757,000	1,912,000	806,000	797,000
CUMULATIVE EFFECT ON PRIOR YEARS OF SFAS 143-ACCOUNTING FOR ASSET RETIREMENT OBLIGATIONS (NET OF TAXES OF \$28,000)	-	72,000	-	-
	-----	-----	-----	-----
NET INCOME	2,757,000	1,984,000	806,000	797,000
RETAINED EARNINGS, BEGINNING OF PERIOD	5,062,000	8,209,000	7,013,000	3,119,000
20% STOCK DIVIDEND	-	(6,277,000)	-	-
	-----	-----	-----	-----
RETAINED EARNINGS, END OF PERIOD	\$7,819,000	\$3,916,000	\$7,819,000	\$3,916,000
	=====	=====	=====	=====

Edgar Filing: CREDO PETROLEUM CORP - Form 10QSB

BASIC INCOME PER SHARE				
BEFORE ACCOUNTING CHANGE	\$ .46	\$ .32	\$ .14	\$ .13
CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE	-	.01	-	-
	-----	-----	-----	-----
BASIC INCOME PER SHARE	\$ .46	\$ .33	\$ .14	\$ .13
	=====	=====	=====	=====
DILUTED INCOME PER SHARE				
BEFORE ACCOUNTING CHANGE	\$ .45	\$ .32	\$ .13	\$ .13
CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE	-	.01	-	-
	-----	-----	-----	-----
DILUTED INCOME PER SHARE	\$ .45	\$ .33	\$ .13	\$ .13
	=====	=====	=====	=====

See accompanying notes.

CREDO PETROLEUM CORPORATION  
Consolidated Statements of Cash Flows - Unaudited

	Nine Months Ended July 31,	
	2004	2003
	-----	-----
OPERATING ACTIVITIES:		
Net income	\$ 2,757,000	\$1,984,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion and amortization	1,227,000	930,000
Deferred income taxes	931,000	675,000
Cumulative effect of change in accounting principle	-	(72,000)
Changes in operating assets and liabilities:		
Proceeds from short term investments	509,000	2,353,000
Purchase of short term investments	(1,849,000)	(1,760,000)
Trade receivables	(339,000)	(299,000)
Accrued oil and gas sales	(319,000)	(262,000)
Other	(59,000)	199,000
Accounts payable and accrued costs and expenses	682,000	435,000
Income tax payable	(10,000)	84,000
	-----	-----
NET CASH PROVIDED BY OPERATING ACTIVITIES	3,530,000	4,267,000
	-----	-----
INVESTING ACTIVITIES:		

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

Additions to oil and gas properties	(3,980,000)	(3,296,000)
Changes in other long-term assets	(388,000)	(4,000)
	-----	-----
NET CASH USED IN INVESTING ACTIVITIES	(4,368,000)	(3,300,000)
	-----	-----
FINANCING ACTIVITIES:		
Proceeds from exercise of stock options (77,970 options in 2004)	291,000	26,000
Purchase of treasury stock (2,000 shares in 2004 and 100 shares in 2003)	(39,000)	(1,000)
	-----	-----
NET CASH PROVIDED BY FINANCING ACTIVITIES	252,000	25,000
	-----	-----
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(586,000)	992,000
CASH AND CASH EQUIVALENTS:		
Beginning of Period	1,885,000	1,324,000
	-----	-----
End of Period	\$ 1,299,000	\$ 2,316,000
	=====	=====
Supplemental Cash Flow Information:		
Cash paid for income taxes	\$ 157,000	\$ (16,000)
	=====	=====

See accompanying notes.

### CREDO PETROLEUM CORPORATION Notes To Consolidated Financial Statements

#### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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-QSB 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 accruals) considered necessary for a fair presentation of the company's results for the periods presented. These consolidated financial statements should be read in conjunction with the company's Form 10-KSB for the fiscal year ended October 31, 2003.

#### CHANGE IN ACCOUNTING PRINCIPLE

In June 2001, the Financial Accounting Standards Board issued SFAS No. 143, "Accounting for Asset Retirement Obligations" that requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred and a corresponding increase in the carrying amount of the related long-lived asset. The company adopted SFAS No. 143 on November 1, 2002 and recorded an asset and related liability of \$179,000 (using a

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

5% discount rate) and a cumulative effect on change in accounting principle on prior years of \$72,000 (net of taxes of \$28,000). For the nine month periods ended July 31, 2004 and 2003, the company recognized \$10,000 and \$7,000, respectively, of accretion expense on the liability.

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

**Accounting for Oil and Gas Property Costs.** As more fully discussed in Note 1 to the consolidated financial statements included with the company's Form 10-KSB for the fiscal year ended October 31, 2003, the company (i) follows the full cost method of accounting for the costs of its oil and gas properties, (ii) amortizes such costs using the units of production method, and (iii) applies a quarterly full cost ceiling test. Adverse changes in conditions (primarily gas price declines) could result in permanent write-downs in the carrying value of oil and gas properties as well as non-cash charges to operations, but would not affect cash flows.

**Estimates of Proved Oil and Gas Reserves.** An independent petroleum engineer annually estimates approximately 60% of the company's proved reserves. The company estimates the remainder. Reserve engineering is a subjective process that is dependent upon the quality of available data and the interpretation thereof. In addition, subsequent physical and economic factors such as the results of drilling, testing, production and product prices may justify revision of such estimates. Therefore, actual quantities, production timing, and the value of reserves may differ substantially from estimates. A reduction in proved reserves would result in an increase in depreciation, depletion and amortization ("DD&A") expense. A large reduction in proved reserve quantities or values could result in a permanent write-down in the carrying value of oil and gas properties as discussed in Accounting for Oil and Gas Property Costs above.

**Estimates of Asset Retirement Obligations.** In accordance with SFAS No 143, the company makes estimates of future costs and the timing thereof in connection with recording its future obligations to plug and abandon wells. Estimated abandonment dates will be revised in the future based on changes to related economic lives, which vary with product prices and production costs. Estimated plugging costs may also be adjusted to reflect changing industry experience. Increases in operating costs and decreases in product prices would increase the estimated amount of the obligation and increase DD&A expense. Cash flows would not be affected until costs to plug and abandon were actually incurred.

### STOCK-BASED COMPENSATION

In December 2002, the Financial Accounting Standards Board issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of SFAS No. 123." Among other provisions, the statement amends the disclosure requirements of SFAS No. 123, "Accounting for Stock-Based Compensation." Under current accounting rules the company elected to account for its stock-based employee compensation under the intrinsic value method established by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees."

If compensation expense had been determined in accordance with the provisions of SFAS No. 123, the company's net income and per share amounts would have been reported as follows:

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

	Nine Months Ended July 31,		Three Months Ended July 31,	
	2004	2003	2004	2003
Net Income as reported	\$2,757,000	\$1,984,000	\$ 806,000	\$ 797,000
Pro forma stock compensation expense, net of tax	(212,000)	(263,000)	(71,000)	(239,000)
Pro forma net income	\$2,545,000	\$1,721,000	\$ 735,000	\$ 558,000
Basic income per share:				
As reported	\$ 0.46	\$ 0.33	\$ 0.14	\$ 0.13
Pro forma	\$ 0.42	\$ 0.29	\$ 0.12	\$ 0.09
Diluted income per share:				
As reported	\$ 0.45	\$ 0.33	\$ 0.13	\$ 0.13
Pro forma	\$ 0.41	\$ 0.29	\$ 0.12	\$ 0.09

### 2. COMMON STOCK AND PREFERRED STOCK

On March 24, 2004, the company declared a three-for-two stock split to shareholders of record on April 5, 2004. Accordingly, 2,006,000 additional shares were issued on April 20, 2004. Common stock has been increased by the par value of the shares issued with a corresponding decrease in capital in excess of par value.

On March 19, 2003, the company declared a 20% stock dividend to shareholders of record on April 2, 2003. On April 23, 2003, the company issued 656,000 shares of common stock in conjunction with this dividend. Accordingly, the fair value (based on the quoted market price as adjusted) of the additional shares issued of \$6,277,000 was charged to retained earnings and credited to common stock and capital in excess of par value.

In both transactions, cash payments were made to shareholders in lieu of fractional shares. The basic and diluted weighted average number of shares outstanding and net income per share information for all prior reporting periods have been restated to reflect the effects of the stock split in 2004 and the stock dividend in 2003.

### 3. INCOME TAXES

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

The total future deferred income tax liability under



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

SFAS 109 is extremely 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.

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

#### LIQUIDITY AND CAPITAL RESOURCES

At July 31, 2004, working capital was \$6,942,000, compared with \$6,577,000 at October 31, 2003. Net cash provided by operating activities for the first nine months of 2004 and 2003 was \$3,530,000 and \$4,267,000, respectively. The decrease in cash flows from operating activities can be attributed primarily to a net increase of \$1,340,000 in short term investments in 2004 versus a net decrease in short term investments of \$593,000 in 2003. This net increase in investments of \$1,933,000 more than offset cash flow increases from net income, DD&A and deferred income taxes which totaled approximately \$1,400,000. For the nine months ended July 31, 2004 and 2003, cash used in investing activities was \$4,368,000 and \$3,300,000, respectively. Investing activities primarily included oil and gas exploration and development expenditures, including Calliope, totaling \$3,980,000 and \$3,296,000, respectively. Additional expenditures for oilfield casing and tubing were incurred during 2004, and are classified as other long-term assets. The company purchased these tubulars to insure availability for the current drilling program.

The average return on CREDO's investments during the first nine months was 5% in 2004 and 7% in 2003. At July 31, 2004, approximately 65% of the investments were directly invested in mutual funds and brokerage accounts managed by professional money managers. Remaining investments are in managed partnerships that use various strategies to minimize their correlation to stock market movements. Most of the investments are highly liquid, and the company believes they represent a responsible approach to cash management. In the company's opinion, the greatest investment risk is the potential for negative market impact from unexpected, major adverse news, such as the September 11th terrorist attacks.

Existing working capital and anticipated cash flow are expected to be sufficient to fund 2004 operations. Because earnings are anticipated to be reinvested in operations, cash dividends are not expected to be paid in the foreseeable future. Commitments for future capital expenditures were not material at July 31, 2004. The company has no defined benefit plans and no obligations for post retirement employee benefits.

#### 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 natural gas prices by forward selling a portion of its estimated production in the NYMEX futures market. This is generally done when (i) the price relationship (the "basis") between the futures markets and the cash

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

markets where the company sells its gas is stable within historical ranges, and (ii) in the company's opinion, the current price is adequate to insure reasonable returns at a time when downside price risks appear to be substantial. The company closes its hedges by purchasing offsetting "long" positions in the futures market at then prevailing prices. Accordingly, the gain or loss on the hedge position will depend on futures prices at the time offsetting "long" positions are purchased. Hedging gains and losses are included in revenues from oil and gas sales. The company believes its most significant hedging risk is that expected correlations in price movements as discussed above do not occur, and thus, that gains or losses in one market are not fully offset by opposite moves in the other market.

The company recognizes all derivatives on the balance sheet at fair value at the end of each period. Changes in the fair value of a cash flow hedge are recorded in Other Comprehensive Income on the Consolidated Balance Sheets and then are reclassified into the Consolidated Statement of Earnings as the underlying hedged item affects earnings. Amounts reclassified into earnings related to natural gas hedges are included in oil and gas sales.

The company realized hedging losses of \$486,000 and \$388,000 for the nine months ended July 31, 2004 and 2003, respectively. The company realized hedging losses of \$429,000 and hedging gains of \$49,000 for the comparable quarters ended July 31, 2004 and 2003. At July 31, 2004 the company has recorded in other comprehensive income net deferred losses of approximately \$367,000 (\$264,000 net of tax) related to natural gas hedging transactions.

At third quarter-end, the company had open hedge positions totaling 200 MMcfg covering the months of September and October 2004 at an average NYMEX price of \$4.80 per Mcf. Also at July 31, 2004, the August hedge was closed and a deferred loss of \$112,000 was realized. Subsequent to third quarter end, the September hedge was closed and a deferred loss of \$31,000 was realized. The only remaining hedge is for the month of October 2004. Average gas prices in the company's market areas are expected to be 15% to 17% below NYMEX prices due to basis differentials and transportation costs.

During 2004 the company entered into a bank hedging line of credit facility with a maximum threshold amount of \$2,000,000. At July 31, 2004, 30% of the company's open natural gas hedge positions were covered by this agreement. The company also hedged the basis differential between the NYMEX and Panhandle Eastern Pipeline Co. prices on 200 MMcfg for the months of May 2004 through October 2004.

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

	Nine Months Ended		Three Months Ended	
	July 31,		July 31,	
	2004	2003	2004	2003
	-----	-----	-----	-----
Net Income	\$2,757,000	\$1,984,000	\$ 806,000	\$ 797,000
Other comprehensive income				
(loss), net of tax:				
Change in fair value				
of futures contracts				

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

used for natural gas hedging	(444,000)	196,000	198,000	233,000
Comprehensive income	\$2,313,000	\$2,180,000	\$1,004,000	\$1,030,000

Oil and gas sales volume and price comparisons for the indicated periods are set forth below. Price realizations include the sales price and hedging gains and losses.

Product	Nine Months Ended July 31, 2004		Nine Months Ended July 31, 2003		Percent Volume Change	Percent Price Change
	Volume	Price	Volume	Price		
Gas (Mcf)	1,278,000	\$ 4.58(1)	987,300	\$ 4.35(3)	+29%	+ 5%
Oil (bbls)	32,900	\$32.66	25,900	\$27.65	+27%	+18%

Product	Three Months Ended July 31, 2004		Three Months Ended July 31, 2003		Percent Volume Change	Percent Price Change
	Volume	Price	Volume	Price		
Gas (Mcf)	417,000	\$ 4.37(2)	356,600	\$ 4.91(4)	+17%	-11%
Oil (bbls)	11,700	\$34.63	8,600	\$26.41	+36%	+31%

- (1) Includes \$0.38 Mcf hedging loss.
- (2) Includes \$1.03 Mcf hedging loss.
- (3) Includes \$0.39 Mcf hedging loss.
- (4) Includes \$0.14 Mcf hedging gain.

### OPERATIONS

The company's business focuses on two core projects - natural gas drilling along the shelf of the Northern Anadarko Basin of Oklahoma and application of its patented Calliope Gas Recovery System. The company believes that, in combination, these two projects provide an excellent (and possibly unique) balance for achieving its goal of adding long-lived gas reserves and production at reasonable costs and risks.

Anadarko Shelf Drilling Program. The company drills primarily for natural gas on its 40,000 gross acre inventory located along the northern shelf of the Anadarko Basin of Oklahoma. During fiscal 2004, 13 wells have been drilled in this area of which nine are producers and four are dry holes. This brings the total wells drilled on the acreage to 49 of which 37 have been completed as producers. Four additional wells are currently on the fall drilling schedule.

Previously the company reported that its Horseshoe #1-7 well encountered six feet of porous Morrow sand that drilling data and electric logs indicated would be productive. However, the subsequent completion did not recover commercial amounts of gas, and the well was plugged. This was the first well drilled on the company's 1,920 gross acre Horseshoe Prospect in Harper County. Additional wells are expected to be drilled. CREDO is the operator and owns a 49% working interest.

Approximately twelve miles to the northwest, the Owens 3C #1-28 is the third well drilled on the company's 2,560 gross acre Buffalo Creek Prospect in Harper County. The 6,900-foot well offset the

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

company's Owens #1-21 discovery well that was recently completed as an Oswego oil producer. The Owens 3C encountered 18 feet of relatively tight Oswego limestone. It is currently testing small amounts of oil and gas and is expected to be a marginal well. CREDO owns a 30% working interest.

Also on the Buffalo Creek Prospect, the Owens A #1 was drilled to test the Morrow, Chester, Oswego and deeper zones. The company believes that the 8,800-foot well will be noncommercial. Accordingly, it elected not to participate in completion of the well. CREDO owned a 29% working interest.

About 40 miles to the south, the Skyler #1-6 is the first well drilled on the company's 1,280 gross acre Gage Prospect in Ellis County. The 9,175-foot well encountered approximately 30 feet of Morrow sand that appears to be productive. The well is currently awaiting pipeline connection before being completed for production. An offset is planned for the first quarter of 2005. CREDO owns a 51% working interest and is the operator.

Approximately 25 miles to the north, the company drilled a rank wildcat on its 1,920 gross acre Glacier Prospect located in Harper County targeting the Morrow and Chester formations. The 7,500-foot well encountered only two feet of porous Morrow channel sand and was plugged due to the likelihood of marginal production. An offset to be drilled this year will target a thicker portion of the channel sand. CREDO is the operator and owns a 65% working interest.

About five miles to the west, the Derby #2-22 was drilled on the company's 17,000 gross acre Sand Creek Prospect. The 7,400-foot well did not encounter productive Morrow or Chester sands and was a dry hole. Another well is planned for the first quarter of 2005. CREDO owns a 32% working interest and is the operator.

Calliope Gas Recovery Technology. The company owns the exclusive right to a patented technology known as the Calliope Gas Recovery System. Calliope can achieve substantially lower flowing bottom hole pressure than conventional production methods because it does not rely on reservoir pressure to lift liquids. In many gas wells, lower bottom hole pressure translates into recovery of substantial additional gas reserves.

This year, the company has installed its patented Calliope Gas Recovery System on three wells located in Oklahoma. A fourth well is currently being prepared for an installation and two additional systems are scheduled for installation.

Two of the three completed installations are prototypes to test Calliope on wells with known reservoir damage caused by the "parting shots" of previous operators. These prototypes represent very rigorous challenges for Calliope which could further expand its application envelope. The company is performing reservoir treatments on the wells designed to mitigate the reservoir damage, including fracture stimulation of one well. Additional procedures to increase production are being reviewed. CREDO owns an 80% working interest and is the operator.

Many older, low pressure gas wells have wellbore and reservoir damage caused over time by numerous factors. Treatment procedures to remediate such damage are generally not practical in low pressure reservoirs because the treatment fluids load-up the well and are often impossible to recover. It is the company's intent to

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

demonstrate that Calliope can normally remove such treatment fluids, thus substantially increasing the probability of successfully treating low pressure reservoirs.

The company recently installed a Calliope system on the 7,800-foot Jacobs well located in Grady County, Oklahoma. The well had produced 3.4 Bcfg (billion cubic feet of gas) but had been dead for four years at the time the company took over operations. The system has been operational for only a few days and no data is currently available regarding how the well might respond. CREDO is operator and owns a 70% working interest.

A second Jacobs well located in the same area is currently being prepared for a Calliope installation. The primary producing zone in the well was abandoned by the previous operator in favor of recompleting the well in an up-hole zone. Accordingly, the company must squeeze the up-hole zone and then drill out plugs in order to regain access to the primary productive zone which produced 13.3 Bcfg and has been dead for four years. Work to regain access to that zone is currently in progress. CREDO owns 81% and is the operator.

The company is preparing to install Calliope systems on two additional wells. Both wells are located in Canadian County, Oklahoma and produced from the Morrow formation at 10,000 feet. They had cumulative production ranging up to 16.2 Bcfg. The wells were uneconomic or dead at the time of purchase.

Calliope has proven to be reliable and flexible over a wide range of applications on wells the company owns and operates. It has also proven to be consistently successful. This has resulted in an impressive track record for the new technology. Accordingly, the company has recently begun implementing strategies designed to widen the envelope of wells on which Calliope should be installed.

Previously discussed strategies have been implemented to increase the number of wells on which Calliope will be installed. Among other things, the company has retained highly qualified personnel to execute its strategies and has completed the Calliope multimedia presentation. Other related information is considered proprietary at this time.

### RESULTS OF OPERATIONS

Nine Months Ended July 31, 2004 Compared to Nine Months Ended July 31, 2003

For the nine months ended July 31, 2004, net income rose 39% to \$2,757,000 compared to \$1,984,000 last year. Higher net income resulted primarily from a 29% increase in production volumes and a 7% increase in product prices.

Total revenues rose 32% to \$7,562,000 compared to \$5,718,000 last year. Oil and gas sales rose 38% to \$6,932,000 compared to \$5,014,000 last year. Total natural gas price realizations, including the effect of hedging transactions, rose 5% to \$4.58 per Mcf compared to \$4.35 last year. Net wellhead prices for oil rose 18% to \$32.66 per barrel compared to \$27.65 last year. Natural gas production rose 29% to 1,278,000 Mcf compared to 987,300 Mcf last year and oil production rose 27% to 32,900 bbls compared to 25,900 bbls last year. The effect of these higher volumes and prices was to increase oil and gas sales by \$1,918,000. Operating

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

income increased 15% due to an increase in drilling and production overhead income from new operated wells. Investment income and other decreased to \$186,000 compared to \$318,000, for the same nine month period last year due to a shift to more conservative investments and general market declines.

Total costs and expenses increased 22% to \$3,732,000 in the first nine months of fiscal 2004 compared to \$3,062,000 last year. Oil and gas production expenses rose 26%, or \$305,000, due primarily to increased production taxes resulting from increased production volumes and prices. Depreciation, depletion and amortization increased 32% primarily due to increased production and an increase in the amortizable full cost pool base. General and administrative expenses increased 8% due to increases in salaries and wages, consulting fees relating to increased regulatory requirements as well as inflationary pressures. Interest expense primarily relates to the accrual of interest on the exclusive license agreement obligation. Income taxes were provided at 28% in both 2004 and 2003.

Three Months Ended July 31, 2004 Compared to Three Months Ended July 31, 2003

For the three months ended July 31, 2004, net income rose one percent to \$806,000 compared to \$797,000 last year. Higher net income resulted primarily from a 19% increase in production volumes and an 6% decrease in product prices.

Total revenues rose nine percent to \$2,439,000 compared to \$2,243,000 last year. Oil and gas sales rose 12% to \$2,226,000 compared to \$1,980,000 the same quarter last year. Total natural gas price realizations, including the effect of hedging transactions, declined 11% to \$4.37 per Mcf compared to \$4.91 last year. Net wellhead prices for oil rose 31% to \$34.63 per barrel compared to \$26.41 last year. Natural gas production rose 17% to 417,000 Mcf compared to 356,600 Mcf last year and oil production rose 36% to 11,700 bbls compared to 8,600 bbls last year. The effect of these higher volumes and prices was to increase oil and gas sales by \$246,000. Operating income increased 13% due to an increase in drilling and production overhead income from new operated wells. Investment income and other decreased to \$61,000 compared to \$128,000 last year due to the continuing market declines experienced during the third quarter of 2004.

Total costs and expenses increased 16% to \$1,319,000 in the third quarter of fiscal 2004 compared to \$1,136,000 the same quarter last year. Oil and gas production expenses rose 14%, or \$65,000, due primarily to increased production taxes resulting from increased production volumes and prices as well as increased oilfield costs. Depreciation, depletion and amortization increased 34% primarily due to increased production and an increase in the amortizable full cost pool base. General and administrative expenses increased 3% due to inflationary pressures.

### ITEM 3. CONTROLS AND PROCEDURES

Within 90 days prior to the filing date of this report, the company carried out an evaluation, under the supervision and with the participation of the company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its "disclosure controls and procedures" pursuant to Securities

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

Exchange Act Rule 13a-14(c). Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed by the company in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Based upon that evaluation, the company's Chief Executive Officer and Chief Financial Officer concluded that the company's disclosure controls and procedures are effective for these purposes as of the date of the evaluation.

There have been no significant changes in the company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

### FORWARD-LOOKING STATEMENTS

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

### PART II - OTHER INFORMATION

#### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

##### (a) Exhibits

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)

##### (b) Reports on Form 8-K

On June 15, 2004 CREDO Petroleum Corporation filed a current report on Form 8-K reporting under Item 9 pursuant to Item 12 that we had issued a press release announcing our financial results for the quarter ended April 30, 2004.

# Edgar Filing: CREDO PETROLEUM CORP - Form 10QSB

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: September 14, 2004

By: /s/ James T. Huffman

-----  
James T. Huffman  
President and Chief Executive Officer  
(Principal Executive Officer)

By: /s/ James P. Garrett, Jr.

-----  
James P. Garrett, Jr.  
Vice President and Chief Financial Officer  
(Principal Financial and Accounting Officer)

Exhibit 31.1

CERTIFICATION PURSUANT TO RULE 15D-14  
OF THE SECURITIES EXCHANGE ACT OF 1934,  
AS AMENDED AS ADOPTED PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, James T. Huffman, Chief Executive Officer of CREDO Petroleum Corporation, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of CREDO Petroleum Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) for the Registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;



Edgar Filing: CREDO PETROLEUM CORP - Form 10QSB

- b) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of Registrant's Board of Directors:
- a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: September 14, 2004

/s/ James T. Huffman

-----  
James T. Huffman  
Chief Executive Officer

Exhibit 31.2

CERTIFICATION PURSUANT TO RULE 15D-14  
OF THE SECURITIES EXCHANGE ACT OF 1934,  
AS AMENDED AS ADOPTED PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, James P. Garrett, Jr., Vice President and Chief Financial Officer of CREDO Petroleum Corporation, certify that:

- 1. I have reviewed this quarterly report on Form 10-QSB of CREDO Petroleum Corporation;
- 2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3. Based on my knowledge, the financial statements, and other

Edgar Filing: CREDO PETROLEUM CORP - Form 10QSB

financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) for the Registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of Registrant's Board of Directors:
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: September 14, 2004

/s/ James P. Garrett, Jr.

-----  
James P. Garrett, Jr.  
Vice President and Chief Financial Officer

Exhibit 32.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,

Edgar Filing: CREDO PETROLEUM CORP - Form 10QSB

AS ADOPTED PURSUANT TO SECTION 906  
OF THE SARBANES-OXLEY ACT OF 2002

In connection with this Quarterly Report of CREDO Petroleum Corporation (the "Company") on Form 10-QSB as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, James T. Huffman and James P. Garrett, Jr., President and Chief Executive Officer, and Vice President and Chief Financial Officer, respectively, of the Company, certify, pursuant to 18 U.S.C., Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to our knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

September 14, 2004

/s/ James T. Huffman

-----  
James T. Huffman  
President and Chief Executive Officer

/s/ James P. Garrett, Jr.

-----  
James P. Garrett, Jr.  
Vice President and Chief Financial Officer