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BLUE DOLPHIN ENERGY CO  
Form 10QSB  
November 13, 2003

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-QSB

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended: September 30, 2003

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: 0-15905

BLUE DOLPHIN ENERGY COMPANY  
(Exact name of small business issuer as specified in its charter)

Delaware 73-1268729  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

801 Travis, Suite 2100, Houston, Texas 77002  
(Address of principal executive offices)

(713) 227-7660  
(Issuer's telephone number, including area code)

(Former name, former address and former fiscal year,  
if changed since last report.)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY  
PROCEEDINGS DURING THE PRECEDING FIVE YEARS

Check whether the registrant filed all documents and reports required to be filed by Section 13 or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by a court.

YES  NO

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

6,657,845 shares of the registrants' common stock, par value \$.01 per share,  
-----  
were outstanding at November 12, 2003.

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Transitional Small Business Disclosure Format (Check one): Yes [ ] No [X]

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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

The condensed consolidated financial statements of Blue Dolphin Energy Company and subsidiaries (the "Company" or "Blue Dolphin") included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and, in the opinion of management, reflect all adjustments necessary to present a fair statement of operations, financial position and cash flows. The Company follows the full-cost method of accounting for oil and gas properties, wherein costs incurred in the acquisition, exploration and development of oil and gas reserves are capitalized. The Company believes that the disclosures are adequate and the information presented is not misleading, although certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations.

The accompanying condensed consolidated financial statements of the Company should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2002.

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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEET - UNAUDITED

SEPTEMBER 30, 2003

ASSETS

Current assets:	
Cash and cash equivalents	\$ 3,064,246
Accounts receivable	715,076
Prepaid expenses and other assets	158,983
	-----
TOTAL CURRENT ASSETS	3,938,305
Property and Equipment at cost:	
Oil and Gas properties, including \$109,018 of unproved leasehold cost (full-cost method)	398,349
Pipelines	4,545,212
Onshore separation and handling facilities	1,664,128
Land	860,275
Other property and equipment	295,446
	-----
	7,763,410
Less: Accumulated depletion, depreciation and amortization	1,864,922
	-----
	5,898,488
Deferred federal income tax	244,444
Investment in New Avoca	652,464
Other assets	73,976
	-----
TOTAL ASSETS	\$ 10,807,677 =====

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:	
Trade accounts payable	\$ 2,540,225
Accrued expenses and other liabilities	150,172
	-----
TOTAL CURRENT LIABILITIES	2,690,397
Note payable	750,000
Asset retirement obligations	1,515,879
Common Stock, (\$.01 par value, 10,000,000 shares authorized, 6,657,845 shares issued and outstanding)	66,578
Additional Paid-in Capital	26,267,308
Accumulated Deficit	(20,482,485)
	-----
TOTAL LIABILITES AND	5,851,401

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STOCKHOLDERS' EQUITY

\$ 10,807,677

=====

See accompanying notes to the condensed consolidated financial statements.

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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS - UNAUDITED

	Three Months Ended September 30,	
	2003	2002
	-----	-----
Revenue from operations:		
Pipeline operations	\$ 212,644	\$ 273,373
Oil and gas sales	449,416	481,128
	-----	-----
	662,060	754,501
	-----	-----
Cost of operations:		
Pipeline operating expenses	296,022	210,935
Lease operating expenses	46,465	206,389
Depletion, depreciation, amortization and abandonment	116,989	185,255
Impairment	--	--
General and administrative	415,928	415,582
Accretion expense	17,444	--
	-----	-----
	892,848	1,018,161
	-----	-----
LOSS FROM OPERATIONS	(230,788)	(263,660)
Other income (expense):		
Interest and other expense	(11,343)	(5,041)
Interest and other income	225,385	181,516
Gain on sale of assets	--	1,438,518
	-----	-----
INCOME (LOSS) BEFORE INCOME TAXES	(16,746)	1,351,333
Income taxes	--	--
	-----	-----
Net income (loss)	\$ (16,746)	\$ 1,351,333
	=====	=====
Income (loss) per common share		
- basic	\$ 0.00	\$ 0.21
	=====	=====

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- diluted	\$ 0.00	\$ 0.21
	=====	=====
Weighted average number of common shares outstanding		
- basic	6,653,660	6,381,285
	=====	=====
- diluted	6,653,660	6,381,285
	=====	=====

See accompanying notes to the condensed consolidated financial statements.

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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS - UNAUDITED

	Nine Months Ended September 30,	
	2003	2002
	-----	-----
Revenue from operations:		
Pipeline operations	\$ 716,243	\$ 960,126
Oil and gas sales	1,268,733	1,748,880
	-----	-----
	1,984,976	2,709,006
	-----	-----
Cost of operations:		
Pipeline operating expenses	763,841	498,370
Lease operating expenses	76,743	599,249
Depletion, depreciation, amortization and abandonment	305,458	738,012
Impairment of assets	--	339,984
General and administrative	1,293,251	1,791,737
Accretion expense	58,340	--
	-----	-----
	2,497,633	3,967,352
	-----	-----
LOSS FROM OPERATIONS	(512,657)	(1,258,346)
Other income (expense):		
Interest and other expense	(54,641)	(50,607)
Interest and other income	665,073	235,641
Bad debt expense	--	(197,500)
Gain on sale of assets	--	1,438,518
	-----	-----
INCOME BEFORE MINORITY INTEREST AND INCOME TAXES	97,775	167,706
Minority interest	--	(55,746)

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Income taxes	--	--
	-----	-----
INCOME BEFORE CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE	97,775	111,960
Cumulative effect of a change in accounting principle for asset retirement obligations	(40,455)	--
	-----	-----
Net income	\$ 57,320	\$ 111,960
	=====	=====
Income (loss) per common share - basic		
Income before accounting change	\$ 0.02	\$ 0.02
	=====	=====
Cumulative effect of a change in accounting principle	\$ (0.01)	\$ --
	=====	=====
Net income	\$ 0.01	\$ 0.02
	=====	=====
Income (loss) per common share - diluted		
Income before accounting change	\$ 0.02	\$ 0.02
	=====	=====
Cumulative effect of a change in accounting principle	\$ (0.01)	\$ --
	=====	=====
Net income	\$ 0.01	\$ 0.02
	=====	=====
Weighted average number of common shares outstanding		
- basic	6,634,346	6,322,646
	=====	=====
- diluted	6,802,923	6,322,646
	=====	=====

See accompanying notes to the condensed consolidated financial statements.

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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED

	Nine Ended Sep 2003
	-----
OPERATING ACTIVITIES	
Net income	\$ 57,320
Adjustments to reconcile net income to net cash used in operating activities:	
Depletion, depreciation, amortization, abandonment	305,458
Gain from change in estimate of abandonment costs	(488,653)
Change in accounting principle	40,455
Accretion of asset retirement obligations	58,340
Minority interest	--

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Gain on sale of assets	--
Impairment of assets	--
Increase in equity of affiliate	--
Bad debt expense	--
Common stock issued for services	28,722
Other	--
Changes in operating assets and liabilities:	
Accounts receivable	(199,784)
Prepaid expenses and other assets	135,209
Abandonment costs incurred	(3,273,825)
Trade accounts payable and accrued expenses	2,231,377
	-----
NET CASH USED IN OPERATING ACTIVITIES	(1,105,381)
	-----
INVESTING ACTIVITIES	
Purchases of property and equipment, and other assets	(39,723)
Exploration and development costs	(73,136)
Net proceeds from sale of assets	--
Purchase of minority interest from subsidiary	--
Development costs - New Avoca	(66,835)
Other	(37,637)
	-----
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	(217,331)
	-----
FINANCING ACTIVITIES	
Other	(18,718)
	-----
DECREASE IN CASH AND CASH EQUIVALENTS	(1,341,430)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	4,405,676
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 3,064,246
	=====
NON CASH INVESTING AND FINANCING ACTIVITIES:	
Purchases of property and equipment financed with debt	\$ --
	=====

See accompanying notes to the condensed consolidated financial statements.

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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

SEPTEMBER 30, 2003

1. Liquidity and Going Concern

At September 30, 2003, the Company's working capital was approximately \$1.2 million. The Company began to receive payments from its working interest in the High Island Block A-7 field which provided revenues net of operating expenses and capital expenditures of approximately \$1.1 million during the nine months

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ended September 30, 2003. Revenues from the High Island Block A-7 Field have declined significantly and are expected to cease by mid-2004. In order to satisfy its working capital and capital expenditure requirements for the next twelve months, the Company believes that it may need to raise approximately \$0.5 to \$1.0 million of capital. The Company will need to arrange external financing and/or sell assets to raise the necessary capital. Historically, the Company has relied on the proceeds from the sale of assets and capital raised from the issuance of debt and equity securities to individual investors and related parties to sustain its operations. There can be no assurance that the Company will be able to obtain financing or sell assets on commercially acceptable terms to meet its capital requirements. The Company's inability to raise capital may have a material adverse effect on its financial condition, ability to meet its obligations and operating needs, and results of operations. The financial statements contained herein have been prepared assuming that the Company will continue as a going concern. The Company's capital requirements raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

### 2. Related Party Transactions

The Company currently owns a 12.8% common stock ownership interest in Drillmar, Inc. ("Drillmar"). However, the Company's ownership will be reduced to less than 1% if Drillmar's convertible notes are converted. Ivar Siem, Chairman of the Company, and Harris A. Kaffie and James M. Trimble, Directors of the Company, are owners of 30.3%, 30.6% and 6.6%, respectively, of Drillmar's common stock, and they would be the owners of 25.0%, 30.9% and 2.4%, respectively, of Drillmar common stock if the convertible notes are converted. Messrs. Siem and Kaffie are both Directors, and Mr. Siem is Chairman and President of Drillmar.

In February 2003, the Company and Drillmar entered into an agreement effective as of February 1, 2003, whereby the Company provides office space to Drillmar for \$1,500 per month. The Company also provides professional, accounting and administrative services to Drillmar based on hourly rates based on the Company's cost. The agreement can be terminated upon 30 days notice or by the mutual agreement of the parties.

Effective April 1, 2003, the Company entered into a sublease agreement expiring December 31, 2006 for certain of its office space with Tri-Union Development Corporation. The Company's 2003 receipts from this sublease will be approximately \$55,600, and thereafter will be approximately \$78,500 annually, which represents the Company's actual rental cost for the subleased space. Mr. James M. Trimble, a Director of the Company, is the Chairman and Chief Executive Officer of Tri-Union.

### 3. Change in Accounting Principle

In August 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 143 ("SFAS 143"), "Accounting



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for Asset Retirement Obligations", which addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The standard applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal use of the asset.

SFAS 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The fair value of the liability is added to the carrying amount of the associated asset and this additional carrying amount is depreciated over the life of the asset. If the obligation is settled for other than the carrying amount of the liability, the Company will recognize a gain or loss on settlement.

SFAS 143 amended Statement of Financial Accounting Standards No. 19, "Financial Accounting and Reporting by Oil and Gas Producing Companies" ("SFAS 19") to require that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. Under the provisions of SFAS 143, asset retirement obligations are capitalized as part of the carrying value of the long-lived asset. Under the provisions of SFAS 19, asset retirement obligations were recognized using a cost-accumulation approach. Prior to the adoption of SFAS 143, the Company recorded asset retirement obligations through the unit-of-production method for oil and gas properties, and the straight line method for pipelines and related facilities.

The adoption of SFAS 143 resulted in a January 1, 2003 cumulative effect adjustment to record (i) a \$1.0 million increase in the carrying value of pipelines, (ii) a \$0.4 million decrease in accumulated depreciation, depletion, and amortization of property, plant and equipment, and (iii) a \$1.4 million increase in non-current abandonment liabilities. The net impact of items (i) through (iii) was to record an expense of \$40 thousand, net of tax, as a cumulative effect adjustment of a change in accounting principle in the Company's consolidated statement of operations upon adoption on January 1, 2003.

The following pro forma data summarizes the Company's net income (loss) and net income (loss) per share as if the Company had adopted the provisions of SFAS 143 on January 1, 2002, including an associated pro forma asset retirement obligation on that date of \$1.0 million:

	Three months ended September 30,		Nine months ended September 30,	
	2003	2002	2003	2002
	(in thousands, except per share amounts)		(in thousands, except per share amounts)	
Net income (loss), as reported .....	\$ (17)	\$ 1,351	\$ 57	\$ 2
Pro forma adjustments to reflect retroactive adoption of SFAS 143 .....	--	(15)	--	--
Pro forma net income (loss) .....	\$ (17)	\$ 1,336	\$ 57	\$ 2
Net income (loss) per share:				
Basic - as reported .....	\$ .00	\$ .21	\$ .01	\$ .01
Basic - pro forma .....	\$ .00	\$ .21	\$ .01	\$ .01
Diluted - as reported .....	\$ .00	\$ .21	\$ .01	\$ .01

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Diluted - pro forma .....	\$ .00	\$ .21	\$ .01	\$
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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
UNAUDITED  
SEPTEMBER 30, 2003

4. Asset Retirement Obligations

The Company has asset retirement obligations associated with its Buccaneer Field offshore platforms, the future abandonment of pipelines and related facilities and an offshore oil and gas property. The following table summarizes the Company's asset retirement obligation transactions recorded in accordance with the provisions of SFAS 143 during the three months and nine months ended September 30, 2003, and in accordance with the provisions of SFAS 19 during the three months and nine months ended September 30, 2002.

	Three months ended September 30,		Nine months ended September 30,	
	2003 (in thousands)	2002 (in thousands)	2003 (in thousands)	2002 (in thousands)
Beginning asset retirement obligations .....	\$ 4,882	\$ 4,600	\$ 3,800	\$ 4,600
Cumulative effect adjustment .....	--	--	401	--
Liabilities incurred during period .....	--	--	1,045	--
Liabilities settled during period .....	(3,147)	--	(3,273)	--
Gain from adjustment to estimated obligations	(210)	--	(489)	--
Accretion expense .....	17	--	58	--
Ending asset retirement obligations .....	\$ 1,542	\$ 4,600	\$ 1,542	\$ 4,600

During the operations to remove the Buccaneer Field platform complexes in 2001, discussions were initiated with the Texas Parks and Wildlife Department ("TPW") in an effort to leave certain of the underwater portions of the platform complexes in place as artificial reefs. On January 3, 2003, the Company and TPW executed deeds of donation for both of the Company's platform complexes in the Buccaneer Field, whereby the Company will leave certain portions of the platforms in place as artificial reefs and donate them to the TPW, along with cash of \$390,000, of which \$350,000 represents half of the cost for the site clearance work that was eliminated (which payment the TPW required) and \$40,000 represents the cost of buoys to mark the reef sites. The Company requested and received an extension from the United States Minerals Management Service ("MMS") until August 31, 2003 to complete the abandonment/reefing operations. The work to complete the abandonment/reefing began in July 2003 and was completed in late August 2003. Abandonment/reefing operations incurred during 2003 total

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approximately \$3.3 million. Additionally, the Company reduced its provision for the Buccaneer Field abandonment costs resulting in a gain of approximately \$490,000 for the nine months ended September 30, 2003.

### 5. Earnings Per Share

The Company applies the provisions of Statement of Financial Accounting Standards No. 128 ("SFAS 128"), "Earnings Per Share." SFAS 128 requires the presentation of basic earnings per share ("EPS") which excludes dilution and is computed by dividing net income (loss) available to common stockholders by the weighted-average number of shares of common stock outstanding for the period.

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### BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

#### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED SEPTEMBER 30, 2003

SFAS 128 requires dual presentation of basic EPS and diluted EPS on the face of the income statement and requires a reconciliation of the numerators and denominators of basic EPS and diluted EPS.

	Net Income (Loss)	Weighted- Average Number of Common Shares Outstanding and Potential Dilutive Common Shares	Per Share Amount
	-----	-----	-----
Nine Months ended September 30, 2003			
Basic earnings per share	\$ 57,320	6,634,346	\$
Effect of dilutive stock options		168,577	
	-----	-----	-----
Diluted earnings per share	\$ 57,320	6,802,923	\$
	=====	=====	=====
Nine Months ended September 30, 2002			
Basic and diluted earnings per share	\$ 111,960	6,322,646	\$
	=====	=====	=====
Quarter ended September 30, 2003			
Basic and dilutive loss per share	\$ (16,746)	6,653,660	\$
	=====	=====	=====
Quarter ended September 30, 2002			
Basic and diluted earnings per share	\$ 1,351,333	6,381,285	\$
	=====	=====	=====

The employee stock options at September 30, 2003, were not included in the computation of diluted earnings per share for the quarter ended September 30, 2003 because the effect of their assumed exercise and conversion would have an antidilutive effect on the computation of diluted loss per share.

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### 6. Business Segment Information

The Company's income producing operations are conducted in two principal business segments: oil and gas exploration and production, and pipeline operations. There were no intersegment revenues during the periods presented. Information concerning these segments for the nine months and quarters ended September 30, 2003 and 2002, and at September 30, 2003 are as follows:

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#### BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

#### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED SEPTEMBER 30, 2003

	Revenues	Operating Income (Loss) (1)	
	-----	-----	-----
Nine months ended September 30, 2003:			
Oil and gas exploration and production	\$ 1,268,733	563,244	
Pipeline operations	716,243	(675,770)	
Other	--	(400,131)	
	-----	-----	-----
Consolidated	1,984,976	(512,657)	
Other income, net	-----	610,432	-----
		-----	
Income before minority interest and income taxes		97,775	
Nine months ended September 30, 2002:			
Oil and gas exploration and production	\$ 1,748,880	(451,676)	
Pipeline operations	960,126	(31,122)	
Other	--	(775,548)	
	-----	-----	-----
Consolidated	2,709,006	(1,258,346)	
Other income, net	-----	1,426,052	-----
		-----	
Income before minority interest and income taxes		167,706	
Quarter ended September 30, 2003:			
Oil and gas exploration and production	\$ 449,416	166,117	
Pipeline operations	212,644	(281,694)	
Other	--	(115,211)	
	-----	-----	-----
Consolidated	662,060	(230,788)	
Other income, net	-----	214,042	-----
		-----	
Loss before income taxes		(16,746)	
Quarter ended September 30, 2002:			
Oil and gas exploration and production	\$ 481,128	(47,189)	
Pipeline operations	273,373	(84,933)	
Other	--	(131,538)	

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Consolidated	754,501	(263,660)
Other income, net		1,614,993
Income before income taxes		1,351,333

	September 30, 2003
Identifiable assets:	
Oil and gas exploration and production	\$ 850,216
Pipeline operations	5,884,952
Other	4,072,509
Consolidated	\$ 10,807,677

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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
UNAUDITED  
SEPTEMBER 30, 2003

- (1) Consolidated income from operations includes \$385,801 and \$419,581 in unallocated general and administrative expenses, and unallocated depletion, depreciation and amortization of \$14,330 and \$355,967 for the nine months ended September 30, 2003 and 2002, respectively.

Consolidated income (loss) from operations includes \$111,003 and \$126,266 in unallocated general and administrative expenses, and unallocated depletion, depreciation and amortization of \$4,208 and \$5,272 for the quarters ended September 30, 2003 and 2002, respectively.

- (2) The Company recorded an impairment expense of \$339,984 for the nine months ended September 30, 2002, of its investment in Drillmar.

7. Stock Based Compensation

The Company accounts for stock-based compensation granted under its long-term incentive plans using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations. Stock-based compensation expenses associated with option grants were not recognized in the net income (loss) of the Company in the nine months and three months ended September 30, 2003 and 2002, as all options granted had exercise prices equal to the market value of the underlying common stock on the dates of grant. The following table illustrates the effect on net income (loss) and income (loss) per share if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" to stock-based employee compensation:

Three months ended

Nine months ended

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	September 30,		Septemb
	2003	2002	2003
	(in thousands, except per share amounts)		(in thousan per share
Net income (loss), as reported .....	\$ (17)	\$ 1,351	\$ 57
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	--	--	(30)
Pro forma net income (loss) .....	\$ (17)	\$ 1,351	\$ 27
Net income (loss) per share:			
Basic - as reported .....	\$ .00	\$ .21	\$ .01
Basic - pro forma	\$ .00	\$ .21	\$ .00
Diluted - as reported .....	\$ .00	\$ .21	\$ .01
Diluted - pro forma .....	\$ .00	\$ .21	\$ .00

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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
UNAUDITED  
SEPTEMBER 30, 2003

8. Recently Issued Accounting Pronouncements

In January 2003, the FASB issued FASB Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities". This interpretation provides guidance on the identification of, and financial reporting for, variable interest entities. Variable interest entities are entities that lack the characteristics of a controlling financial interest or lack sufficient equity to finance its activities without additional subordinated financial support. FIN 46 requires a company to consolidate a variable interest entity if that company is obligated to absorb the majority of the entity's expected losses or entitled to receive the majority of the entity's residual returns, or both. FIN 46 also requires disclosures about variable interest entities that a company is not required to consolidate but in which it has a significant variable interest. FIN 46 is applicable immediately to variable interest entities created after January 31, 2003. For all variable interest entities created prior to February 1, 2003, FIN 46 is applicable to periods beginning after June 15, 2003. Application of FIN 46 did not have an impact on the Company's consolidated financial statements.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Instruments with Characteristics of Both Liabilities and Equity", ("SFAS 150") which establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS

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150 requires that an issuer classify a financial instrument that is within its scope, which may have previously been reported as equity, as a liability (or an asset in some circumstances). This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003 for public companies. Adoption of SFAS 150 did not have a significant impact on the Company's financial statements.

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### BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

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

##### CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

Forward Looking Statements. Certain of the statements included in this quarterly report on Form 10-QSB, including those regarding future financial performance or results or that are not historical facts, are "forward-looking" statements as that term is defined in Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended. The words "expect", "plan", "believe", "anticipate", "project", "estimate", and similar expressions are intended to identify forward-looking statements. The Company cautions readers that any such statements are not guarantees of future performance or events and such statements involve risks and uncertainties that may cause actual results and outcomes to differ materially from those indicated in the forward-looking statements. Some of the important factors, risks and uncertainties that could cause actual results to vary from the forward-looking statements include:

- o the risks associated with exploration;
- o the level of production from oil and gas properties;
- o gas and oil price volatility;
- o uncertainties in the estimation of proved reserves and in the projection of future rates of production and timing of development expenditures;
- o the level of utilization of the Company's pipelines;
- o availability and cost of capital;
- o actions or inactions of third party operators for properties where the Company has an interest;
- o regulatory developments; and

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- o general economic conditions.

Additional factors that could cause actual results to differ materially from those indicated in the forward-looking statements are discussed under the caption "Risk Factors" in the Company's Form 10-KSB for the fiscal year ended December 31, 2002. Readers are cautioned not to place undue reliance on these forward-looking statements which speak only as of the date hereof. The Company undertakes no duty to update these forward-looking statements. Readers are urged to carefully review and consider the various disclosures made by the Company which attempt to advise interested parties of the additional factors which may affect the Company's business, including the disclosures made under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this report.

### LIQUIDITY AND CAPITAL RESOURCES

The Company's future cash flows are subject to a number of variables, primarily oil and gas production volumes from the High Island Block A-7 field, utilization of its pipeline systems and commodity prices among others. Approximately 65% of our revenues from the nine months ended September 30, 2003 were from sales of oil and gas production from the High Island A-7 field. Oil and gas production from the High Island Block A-7 field has recently declined significantly. As a result of this decline in production, the Company expects that its revenues from oil and gas sales will decline significantly and it will need to raise approximately \$0.5 to \$1.0 million of capital. In order to satisfy its working capital and capital expenditure requirements for the next twelve months, the Company will need to arrange external financing and/or sell assets to raise the necessary capital. Historically, the Company has relied on the proceeds from the sale of assets and capital raised from the issuance of debt and equity securities to individual investors and related parties to sustain its operations.

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### BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

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

There can be no assurance that the Company will be able to obtain financing or sell assets on commercially reasonable terms to meet its capital requirements. The Company's inability to raise capital may have a material adverse effect on its financial condition, ability to meet its obligations and operating needs, and results of operations. The financial statements contained herein have been prepared assuming that the Company will continue as a going concern. The Company's capital requirements raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

The net cash used in operating, investing and financing activities is summarized for the periods indicated below (amounts in thousands):

	Nine Months Ended September 30,	
	2003	2002
	-----	-----
Net cash used in:		
Operating activities	\$ (1,105)	\$ (2,064)
Investing activities	(217)	(1,046)



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Financing activities	(19)	--
	-----	-----
Net decrease in cash	\$ (1,341)	\$ (1,018)
	=====	=====

During 2002, the Company sold substantially all of its interests in its proved oil and gas properties for approximately \$5.0 million. The properties sold generated all of the Company's oil and gas sales revenues in 2002. From October 2002 to late April 2003, the Company had no interest in any producing oil and gas properties. In late April 2003, the Company began to receive revenue from its 8.9% reversionary working interest in the High Island Area Block A-7 field, in the Gulf of Mexico, as a result of "payout" occurring. Payout occurred when all of the other working interest owners recovered their costs and expenses associated with developing the field from sales of gas and oil production from the field. Oil and gas production from this field comes from two wells that currently produce at a combined gross average rate of 9 MMcf/day. During June 2003, one of the wells was recompleted at a cost of approximately \$41,000 net to the Company's interest, and the other well was recompleted in September 2003, at an estimated cost of approximately \$25,000 net to the Company's interest. During the nine months ended September 30, 2003, the Company recorded revenues from oil and gas sales of approximately \$1,194,000, and associated operating expenses of approximately \$64,000.

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### BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

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

The following table summarizes certain of the Company's contractual obligations and other commercial commitments at September 30, 2003 (amounts in thousands).

Contractual Obligations	Total	Less than 1 year	Payments Due by Period		
			2-3 years	4-5 years	After 5 years
-----	-----	-----	-----	-----	-----
Accounts Payable-Tetra	\$ 2,138	2,138	--	--	--
Long-Term Debt	826	--	--	826	--
Operating Leases, net of sublease	380	117	234	29	--
Total Contractual Obligations	\$ 3,344	2,255	234	855	--
	=====	=====	=====	=====	=====

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Other Commercial Commitments	Total	Amount of Commitment Expiration Per Period			
		Less than 1 year	2-3 years	4-5 years	After 5 years
Abandonment - Costs*	\$ 1,516	--	182	--	1,33
Total Commercial Obligations	\$ 1,516	--	182	--	1,33

\* Commitments expected to be incurred in 2-3 years are associated with the High Island A-7 Field and commitments expected to be incurred after five years are associated with the Company's pipelines.

The following table summarizes the Company's financial position for the periods indicated (amounts in thousands):

	September 30, 2003		December 31, 2002	
	Amount	%	Amount	%
Working Capital	\$1,248	15	\$2,243	29
Property and equipment, net	5,898	73	4,687	60
Other noncurrent assets	971	12	845	11
Total	\$8,117	100	\$7,775	100
Long-term Liabilities	\$2,266	28	\$2,010	26
Stockholders' equity	5,851	72	5,765	74
Total	\$8,117	100	\$7,775	100

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

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

The change in the Company's financial position from December 31, 2002 to September 30, 2003, was primarily due to the adoption of SFAS No. 143 (see Note 3. Change in Accounting Principle, in Part I, Item 1.)

In November 2000, the Company elected to abandon the Buccaneer Field due to adverse developments in the field. In August 2001, the Company reached an agreement with Tetra Applied Technologies, Inc. ("Tetra") to remove the Buccaneer Field platforms for a cost of approximately \$2.6 million. Pursuant to the agreement, Tetra and the Company agreed to extended payment terms, whereby the Company will pay 20% upon completion of the abandonment operations and 5% per month for twelve months, with the remaining balance due in the thirteenth month. To provide security for the extended payment terms, the Company provided

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Tetra with a first lien on a 50% interest in the Blue Dolphin Pipeline System. Operations to remove the platforms commenced in August 2001 and were suspended in December 2001, while the Company continued discussions with and was awaiting a decision from the Texas Parks and Wildlife Department ("TPW") to leave the underwater portion of the platforms in place as artificial reefs. Approval by the TPW was granted and Deeds of Donation executed by TPW and the Company in January 2003. Pursuant to the Deeds of Donation with TPW, the Company agreed to pay TPW \$390,000, of which \$350,000 represents half of the site clearance work that was eliminated (which payment the TPW required) and \$40,000 represents the cost of buoys to mark the reef sites. While the scope of work with Tetra was changed, due to reefing rather than complete removal as originally contemplated, the contract price and payment terms remain unchanged. The Company requested and received an extension from the Minerals Management Service until August 31, 2003 to complete operations needed to convert the platform complexes into artificial reefs. Tetra resumed operations in July 2003, and completed operations in late August 2003. As of September 30, 2003, the Company paid \$390,000 to TPW, \$534,400 to Tetra (representing 20% of the total due Tetra) and other costs of approximately \$20,000. At September 30, 2003, accounts payable includes \$2,137,600 due to Tetra payable as described above. The Company reduced its provision for the Buccaneer Field abandonment costs resulting in a gain of approximately \$210,000 for the three months ended September 30, 2003, and a gain of \$490,000 for the nine months ended at September 30, 2003.

In February 2002, the Company acquired an additional 1/3 interest in the Blue Dolphin Pipeline System and the inactive Omega Pipeline from MCNIC Pipeline and Processing Company ("MCNIC"). Pursuant to the terms of the purchase and sales agreement, Blue Dolphin Pipe Line Company issued MCNIC a \$750,000 promissory note due December 31, 2006, with required monthly payments to be made out of 90% of the net revenues of the interest acquired. The note bears interest at the rate of 6% per annum and is secured by the interest acquired. Additionally, contingent payments of up to \$750,000 will be made, if the promissory note is retired before its maturity date, payable annually after the promissory note is retired until December 31, 2006, out of 50% of the net revenues from the interest acquired. The maturity date, December 31, 2006, will be extended by one additional year, up to a maximum of two years, for years in which non-recurring, extraordinary expenditures, attributable to the interest acquired, exceeds \$200,000, in the aggregate, during any year. Net revenues from the interest acquired have not been sufficient to make any payments on this promissory note and as of September 30, 2003, the amount owed MCNIC is \$750,000 plus accrued interest of approximately \$76,000.

On March 25, 2003, the Company, and WBI Pipeline & Storage Group, Inc. ("WBI"), executed a non-binding Letter of Intent ("LOI") to sell 100% of the assets of New Avoca Gas Storage, LLC ("New Avoca") to Gotham Energy Partners, LLC ("Gotham"). The Company holds a 25% equity interest and is

### BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

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

the manager of New Avoca, and WBI holds a 75% equity interest. The term of the LOI expired on June 15, 2003, but both New Avoca and Gotham verbally agreed to extend the terms of the LOI on a month to month basis. However, the terms of the LOI were not extended after August 31, 2003. Currently, the Company and WBI are evaluating alternatives, including a possible sale of New Avoca to others.

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In October 2003, the Company was awarded a lease on Galveston Area Block 287 in the Gulf of Mexico. The Company was the joint high bidder on this lease at the August 20, 2003 OCS Western Gulf of Mexico lease sale. The Company owns a 50% working interest in the block with the remaining 50% held by Fidelity Exploration and Production Company. The net cost of this lease to the Company was approximately \$90,000. The Company intends to sell its interest and retain a reversionary working interest in this lease block. The Blue Dolphin Pipeline traverses this lease block.

### RESULTS OF OPERATIONS

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The Company reported net income for the nine months ended September 30, 2003, ("current period") of \$57,320, compared to net income of \$111,960 reported for the nine months ended September 30, 2002 ("previous period"), and a net loss for the three months ended September 30, 2003 ("current quarter"), of \$16,746, compared to net income of \$1,351,333 for the three months ended September 30, 2002 ("previous quarter").

#### Revenues:

Nine Months 2003 vs. Nine Months 2002. Current period revenues from pipeline operations decreased by \$243,883 or 25% from the previous period to \$716,243. The decrease is primarily due to a 34% decrease in throughput on the Blue Dolphin Pipeline System in the current period, partially offset by a 73% increase in throughput on the GA 350 System.

Current period revenues from oil and gas sales decreased by \$480,147, from those of the previous period to \$1,268,733. The decrease was due to the sale of oil and gas properties in the second half of 2002. The properties sold represented all of the Company's previous period oil and gas sales. Current period oil and gas revenues include approximately \$1,194,000 in sales from the Company's interest in the High Island Block A-7 field which interest was received in late April 2003, and approximately \$74,000 for adjustments for periods prior to the sale of the oil and gas properties in 2002.

Third Quarter 2003 vs. Third Quarter 2002. Current quarter revenues from pipeline operations decreased by \$60,729 from the previous quarter to \$212,644. The decrease is primarily due to a 32% decrease in throughput on the Blue Dolphin Pipeline System in the current quarter, partially offset by a 38% increase in throughput on the GA 350 System.

Current quarter revenues from oil and gas sales decreased by \$31,712 from the previous quarter to \$449,416. Current quarter revenues represent sales from the Company's interest in oil and gas production from the High Island Block A-7 field which interest was received in late April 2003. Previous quarter oil and gas revenues represent sales from the Company's oil and gas properties that were sold in the second half of 2002.

### BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

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

#### Costs and Expenses:

Nine Months 2003 vs. Nine Months 2002. Current period pipeline operating expense

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increased by \$265,471 or 53% from the previous period to \$763,841. The increase was due to increased insurance premiums of approximately \$135,000, legal costs of approximately \$57,000, transportation costs of approximately \$25,000, personnel costs of approximately \$17,000 and repairs and maintenance of approximately \$29,000.

Current period lease operating expense decreased by \$522,506 from the previous period to \$76,743. The decrease was due to the sale of oil and gas properties in the second half of 2002. The properties sold represented all of the Company's previous period lease operating expenses. Current period lease operating expenses include approximately \$64,000 in expenses attributable to the Company's interest in the High Island Block A-7 field which interest was received in late April 2003 and approximately \$13,000 for adjustments for periods prior to the sale of the oil and gas properties in 2002.

Current period depletion, depreciation and amortization decreased \$432,554 from the previous period to \$305,458. In the previous period the Company recorded depletion of approximately \$592,000 associated with the oil and gas properties sold in the second half of 2002 compared to depletion of approximately \$21,000 recorded in the current period. Pipeline depreciation expense increased by approximately \$116,000 in the current period.

In the previous period, the Company elected to record a full impairment of its investment in Drillmar of \$339,984 and a full reserve for the accounts receivable amount owed from Drillmar of \$197,500 due to Drillmar's working capital deficiency and delays in securing capital funding.

General and administrative expenses for the current period decreased \$498,486 from the previous period to \$1,293,251. The decrease is primarily due to a cost reduction program initiated in 2002 that resulted in a reduction in personnel and related costs of approximately \$292,000 and elimination of legal costs associated with litigation that was settled in the previous period of approximately \$234,000.

In the current period, as a result of the Company adopting SFAS No. 143 (see Note 3. Change in Accounting Principle in Part I, Item I), the Company recorded accretion expense of \$58,340, which reflects the increase in future asset retirement obligations, and recorded a cumulative effect adjustment at January 1, 2003 of a change in accounting principle for asset retirement obligations of \$40,455.

Interest and other income increased in the current period by \$429,432 from the previous period. The increase is due primarily to the Company's approximately \$490,000 gain from the reduction of its provision for the Buccaneer Field abandonment costs, and fees generated for consulting services provided by the Company in the current period associated with the evaluation of oil and gas properties of approximately \$104,000. Previous period other income included a non-cash adjustment to the Company's purchase of the minority interest in American Resources of approximately \$100,000.

The Company recorded a gain on the sale of its interest in the South Timbalier Block 148 field in the previous period of \$1.4 million.

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Third Quarter 2003 vs. Third Quarter 2002. Current quarter pipeline operating expenses increased by \$85,087 or 40% from the previous quarter to \$296,022. The increase was due to increased insurance premiums of approximately \$17,000, transportation costs of approximately \$4,000, legal costs of approximately \$23,000 and repairs and maintenance costs of approximately \$29,000.

Current quarter lease operating expenses decreased by \$159,924 from the previous quarter to \$46,465. The decrease was due to the sale of oil and gas properties in the second half of 2002. The properties sold represented all of the Company's previous quarter lease operating expenses. Current quarter lease operating expenses represent expenses from the Company's interest in the High Island Block A-7 field.

Current quarter depletion, depreciation and amortization decreased \$68,266 from the previous quarter to \$116,989. In the previous quarter the Company recorded depletion of approximately \$137,000 associated with the oil and gas properties sold in the second half of 2002, compared to depletion of approximately \$16,000 recorded in the current quarter. Pipeline depreciation expense increased by approximately \$39,000 in the current quarter.

In the current quarter, the Company recorded accretion expense of \$17,444 as a result of its adoption of SFAS No. 143, which reflects the increase in future asset retirement obligations.

Interest and other income increased in the current quarter by \$43,869 from the previous quarter. The increase is due primarily to the Company's approximately \$210,000 gain from the reduction to its provision for the Buccaneer Field abandonment costs. Previous quarter other income included a non-cash adjustment to the Company's purchase of the minority interest in American Resources of approximately \$110,000 and fees generated from services provided of approximately \$50,000.

The Company recorded a gain on the sale of its interest in the South Timbalier Block 148 field in the previous quarter of \$1.4 million.

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### BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

#### QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET PRICE

The Company is exposed to market risk, including adverse changes in commodity prices and interest rates as discussed below.

**Commodity Price Risk-** The Company sells natural gas, crude oil and natural gas liquids. As a result, the Company's financial results can be significantly affected if commodity prices fluctuate widely in response to changing market forces. The Company does not use derivative products to manage commodity price risk.

**Interest Rate Risk-** The Company currently has no short-term or long-term debt with floating interest rates, and thus currently is not subject to risk of interest rate changes.

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### ITEM 3. DISCLOSURE CONTROLS AND PROCEDURES

The Company carried out an evaluation, under the supervision and with the participation of the Company's Chief Executive Officer and Primary Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a - 15(e) and 15d - 15(e) under the Securities Exchange Act of 1934) as of September 30, 2003. Based upon that evaluation, the Chief Executive Officer and Primary Financial Officer concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

There were 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.

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### BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

#### PART II. OTHER INFORMATION

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

- A) Exhibits
- 31.1 Michael J. Jacobson Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 G. Brian Lloyd Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Michael J. Jacobson Certification Pursuant to 18 U.S.C.

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Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

32.2 G. Brian Lloyd Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

B) Reports on Form 8-K

On July 18, 2003, the Company filed a current report on Form 8-K dated July 16, 2003, reporting that NASDAQ granted an extension of time until October 8, 2003 for the Company to be in compliance with its minimum bid price of \$1.00 per share. The item in such current report was Item 5 (Other Events).

On August 14, 2003, the Company filed a current report on Form 8-K dated August 14, 2003, reporting the Company's second quarter 2003 earnings. The item in such current report was Item 12 (Results of Operations and Financial Condition).

On August 28, 2003, the Company filed a current report on Form 8-K dated August 27, 2003, reporting that it received notice from NASDAQ that it has regained compliance with the listing requirements as a result of the bid price of its common stock closing above \$1.00 for 10 consecutive trading days. The item in such current report was Item 5 (Other Events).

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### 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.

By: BLUE DOLPHIN ENERGY COMPANY

Date: November 12, 2003

/s/ Michael J. Jacobson

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Michael J. Jacobson  
President and Chief Executive Officer

/s/ G. Brian Lloyd



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G. Brian Lloyd  
Vice President, Treasurer  
(Principal Accounting and Financial Officer)