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PYR ENERGY CORP  
Form 10-Q  
July 15, 2002

U.S. Securities And Exchange Commission  
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended May 31, 2002

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 0-20879

PYR ENERGY CORPORATION

-----  
(Exact name of registrant as specified in its charter)

-----  
Maryland 95-4580642  
-----  
(State or jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

-----  
1675 Broadway, Suite 2450, Denver, CO 80202  
-----  
Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code (303) 825-3748  
-----

Check whether the issuer (1) 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\_\_\_

(APPLICABLE ONLY TO CORPORATE REGISTRANTS)

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The number of shares outstanding of each of the issuer's classes of common equity as of July 15, 2002 is as follows:

\$ .001 Par Value Common Stock	23,701,357 -----
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PART I

ITEM 1. FINANCIAL STATEMENTS

PYR ENERGY CORPORATION  
(A Development Stage Company)  
BALANCE SHEETS

ASSETS	5/31/02 (UNAUDITED)	8/31/02 (UNAUDITED)
CURRENT ASSETS		
Cash	\$ 7,632,128	\$ 9,800,000
Oil and gas receivables	--	1,100,000
Deposits and prepaid expenses	65,789	---
	-----	-----
Total Current Assets	7,697,917	11,000,000
	-----	-----
PROPERTY AND EQUIPMENT, at cost		
Furniture and equipment, net	37,931	---
Oil and gas properties, net	16,250,558	10,900,000
Prepaid oil and gas capital costs	1,437,403	---
	-----	-----
	17,725,892	11,000,000
	-----	-----
OTHER ASSETS		
Deposits	3,278	---
Deferred financing costs	21,081	---
	-----	-----
	24,359	---
	-----	-----
	\$ 25,448,168	\$ 22,000,000
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	\$ 582,338	\$ 2,200,000
	-----	-----
Total Current Liabilities	582,338	2,200,000
	-----	-----

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CONVERTIBLE NOTES	6,000,000	
-----		
STOCKHOLDERS' EQUITY		
Common stock, \$.001 par value		
Authorized 75,000,000 shares		
Issued and outstanding - 23,691,357 shares	23,691	
Capital in excess of par value	35,214,002	35,214,002
Deficit accumulated during the development stage	(16,371,863)	(15,448,168)
	-----	-----
	18,865,830	19,815,834
	-----	-----
	\$ 25,448,168	\$ 22,000,000
	=====	=====

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PYR ENERGY CORPORATION  
(A Development Stage Company)  
STATEMENTS OF OPERATIONS  
(UNAUDITED)

	Three Months Ended 5/31/02	Three Months Ended 5/31/01	Nine Months Ended 5/31/02	
REVENUES				
Oil and gas revenues	\$ 38,510	\$ 822,993	\$ 110,822	\$
Interest	23,577	142,162	118,743	
Other	--	--	--	
	-----	-----	-----	
	62,087	965,155	229,565	
	-----	-----	-----	
OPERATING EXPENSES				
Lease operating expenses	28,808	78,005	60,769	
Impairment, dry hole, and abandonments	0	--	113,544	
General and administrative	323,474	370,021	975,759	
Depreciation and amortization	3,691	57,928	10,917	
Interest	6,562	--	6,562	
	-----	-----	-----	
	362,535	505,954	1,167,551	
	-----	-----	-----	
OTHER INCOME				
Gain on sale of oil and gas prospects	--	--	--	
	-----	-----	-----	
	(300,448)	459,201	(937,986)	
INCOME APPLICABLE TO				
PREDECESSOR LLC	--	--	--	
	-----	-----	-----	
NET (LOSS) INCOME	(300,448)	459,201	(937,986)	
	-----	-----	-----	
Less dividends on preferred stock	--	--	--	
	-----	-----	-----	

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NET (LOSS) INCOME TO COMMON STOCKHOLDERS	\$ (300,448)	\$ 459,201	\$ (937,986)	\$
NET (LOSS) INCOME PER COMMON SHARE - BASIC AND DILUTED	\$ (0.01)	\$ 0.02	\$ (0.04)	\$
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	23,691,357	23,512,581	23,691,357	

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PYR ENERGY CORPORATION  
(A Development Stage Company)  
STATEMENTS OF CASH FLOWS  
(UNAUDITED)

	Nine Months Ended 5/31/02	Nine Months Ended 5/31/01
CASH FLOWS FROM OPERATING ACTIVITIES		
Net (loss) income	\$ (937,986)	\$ 266,820
Adjustments to reconcile net (loss) income to net cash (used) by operating activities		
Depreciation and amortization	10,917	82,904
Contributed services	--	--
Gain on sale of oil and gas prospects	--	--
Impairment, dry hole and abandonments	113,544	--
Common stock issued for interest on debt	--	--
Common stock issued for services	--	--
Amortization of financing costs	--	--
Amortization of marketable securities	--	--
Changes in assets and liabilities		
(Increase) in accounts receivable	--	(1,061,022)
(Increase) decrease in prepaids	5,568	(63,307)
Increase in accounts payable, accruals	412,281	1,341,922
Other	3,447	1,888
Net cash (used) provided by operating activities	(392,229)	569,205
CASH FLOWS FROM INVESTING ACTIVITIES		
Cash paid for furniture and equipment	(11,293)	(30,972)
Cash paid for oil and gas properties	(6,327,789)	(9,724,786)
Prepaid oil and gas capital costs	(1,437,403)	--
Proceeds from sale of oil and gas properties	--	--
Cash paid for marketable securities	--	--
Proceeds from sale of marketable securities	--	--
Cash received (paid) for reimbursable property costs	--	--
Net cash (used) in investing activities	(7,776,485)	(9,755,758)
CASH FLOWS FROM FINANCING ACTIVITIES		
Members capital contributions	--	--
Distributions to members	--	--
Cash from short-term borrowings	--	--

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Repayment of short-term borrowings	--	--
Cash received upon recapitalization and merger	--	--
Proceeds from sale of common stock	--	11,600,000
Proceeds from sale of convertible debt	6,000,000	--
Proceeds from exercise of warrants	--	1,557,165
Proceeds from exercise of options	--	152,906
Cash paid for offering costs	--	(160,470)
Payments on capital lease	--	(920)
Preferred dividends paid	--	--
	-----	-----
Net cash provided by financing activities	6,000,000	13,148,681
	-----	-----
NET (DECREASE) INCREASE IN CASH	(2,168,714)	3,962,128
	-----	-----
CASH, BEGINNING OF PERIODS	9,800,842	8,598,016
	-----	-----
CASH, END OF PERIODS	\$ 7,632,128	\$ 12,560,144
	=====	=====

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PYR ENERGY CORPORATION  
 (A Development Stage Company)  
 Notes to Financial Statements  
 May 31, 2002

The accompanying interim financial statements of PYR Energy Corporation are unaudited. In the opinion of management, the interim data includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results for the interim period. The results of operations for the periods ended May 31, 2002 are not necessarily indicative of the operating results for the entire year.

We have prepared the financial statements included herein pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosure normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. We believe the disclosures made are adequate to make the information not misleading and recommend that these condensed financial statements be read in conjunction with the financial statements and notes included in our Form 10-K for the year ended August 31, 2001.

PYR Energy Corporation (formerly known as Mar Ventures Inc. ("Mar")) was incorporated under the laws of the State of Delaware on March 27, 1996. Mar was a public company with no significant operations as of July 31, 1997. On August 6, 1997, Mar acquired all the interests in PYR Energy LLC ("PYR LLC") (a Colorado limited liability company organized on May 31, 1996), a development stage company as defined by Statement of Financial Accounting Standards (SFAS) No. 7. PYR LLC, an independent oil and gas exploration company, was engaged in the acquisition of undeveloped oil and gas interests for exploration and exploitation in the Rocky Mountain region and California. As of August 6, 1997, PYR LLC had acquired only non-producing leases and acreage, and no exploration had commenced on the properties. Upon completion of the acquisition of PYR LLC by Mar, PYR LLC ceased to exist as a separate entity. Mar remained as the surviving legal entity and, effective November 12, 1997, Mar changed its name to PYR Energy Corporation. Effective July 2, 2001, the Company was re-incorporated

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in Maryland through the merger of the Company into a wholly owned subsidiary, PYR Energy Corporation, a Maryland corporation.

### NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**USE OF ESTIMATES** - The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**CASH EQUIVALENTS** - For purposes of reporting cash flows, we consider as cash equivalents all highly liquid investments with a maturity of three months or less at the time of purchase. At May 31, 2002, there were no cash equivalents.

**PROPERTY AND EQUIPMENT** - Furniture and equipment is recorded at cost. Depreciation is provided by use of the straight-line method over the estimated useful lives of the related assets of three to five years. Expenditures for replacements, renewals, and betterments are capitalized. Maintenance and repairs are charged to operations as incurred.

**OIL AND GAS PROPERTIES** - We follow the full cost method to account for our oil and gas exploration and development activities. Under the full cost method, all costs incurred which are directly related to oil and gas exploration and development are capitalized and subjected to depreciation and depletion. Depletable costs also include estimates of future development costs of proved reserves. Costs related to undeveloped oil and gas properties may be excluded

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from depletable costs until such properties are evaluated as either proved or unproved. The net capitalized costs are subject to a ceiling limitation. Gains or losses upon disposition of oil and gas properties are treated as adjustments to capitalized costs, unless the disposition represents a significant portion of the Company's proved reserves.

Unevaluated oil and gas properties consists of ongoing exploratory drilling costs, for which no results have been obtained, and of leases and acreage that we acquire for our exploration and development activities. The cost of these non-producing leases is recorded at the lower of cost or fair market value.

We have adopted SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long Lived Assets to Be Disposed of", which requires that long-lived assets to be held and used be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. During the fiscal year ended August 31, 2001, we earned our initial revenues from our oil and gas producing activities. A reserve report prepared as of August 31, 2001 by an independent petroleum engineering firm concluded that based on information available at that time, reserves from our producing properties were not economic to produce. Therefore, at August 31, 2001, we had no proved reserves and recorded an impairment charge against the entire net value of our evaluated properties of \$13,339,911 based on the ceiling test limitation. Although properties may be considered as evaluated for purposes of the ceiling test and included in the impairment calculation, until these properties are completely abandoned, we may continue to incur costs associated with these properties. Until we can establish economic reserves, of which there

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is no assurance, additional costs associated with these properties are charged directly to impairment expense as incurred.

INCOME TAXES - We have adopted the provisions of SFAS No. 109, "Accounting for Income Taxes". SFAS 109 requires recognition of deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax liabilities and assets are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse.

### NOTE 2 - ACCOUNTS RECEIVABLE AND ACCOUNTS PAYABLE

During the quarter ended May 31, 2002, we agreed to allow the operator at our East Lost Hills project to offset our share of net revenues from the ELH #1 well against amounts we owed to the operator for costs associated with the East Lost Hills project. At May 31, 2002, a total of \$1,204,594 representing net revenues from February 6, 2001 through May 31, 2002 had been offset against amounts due. In addition, we received certain credits against amounts due and paid a total of \$2,840,571 in order to bring our outstanding balance current with the operator. At May 31, 2002, we reflected a balance due to the operator of \$342,115, all of which is considered current.

### NOTE 3 - CONVERTIBLE NOTES

On May 24, 2002, we received \$6 million in gross proceeds from the sale of convertible notes due May 24, 2009. These notes call for semi-annual interest payments at an annual rate of 4.99% and are convertible into shares of common stock at the rate of \$1.30 per share. The interest can be paid in cash or added to the principal amount at the discretion of the Company. The notes were issued to three investment funds pursuant to exemptions from registration under Section 3(b) and/or 4(2) of the Securities Act of 1933, as amended. We have reflected the outstanding balance of these notes as Convertible Notes under Long Term Debt on our May 31, 2002 balance sheet.

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

We are a development stage independent oil and gas exploration company whose strategic focus is the application of advanced seismic imaging and computer aided exploration technologies in the systematic search for commercial hydrocarbon reserves, primarily in the onshore western United States. We attempt to leverage our technical experience and expertise with seismic data to identify exploration and exploitation projects with significant potential economic return. We intend to participate in selected exploration projects as a working interest owner, sharing both risk and rewards with other participants. We do not currently operate any projects in which we own a working interest. We may operate projects in the future. Whether we participate in our projects as operator or non-operator, our financial results depend on our ability to sell prospect interests to outside industry participants. We do not have the financial ability to commence exploratory drilling operations without outside industry participation. We have pursued, and will continue to pursue, exploration opportunities in regions in which we believe significant opportunity for discovery of oil and gas exists. By attempting to reduce drilling risk through seismic technology, we seek to improve the expected return on investment in our oil and gas exploration projects.



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Our future financial results continue to depend primarily on (1) our ability to discover commercial quantities of hydrocarbons; (2) the market price for oil and gas; (3) our ability to continue to source and screen potential projects; and (4) our ability to fully implement our exploration and development program with respect to these and other matters. There can be no assurance that we will be successful in any of these respects or that the prices of oil and gas prevailing at the time of production will be at a level allowing for profitable production.

We paid approximately \$7,765,000 and \$9,725,000 during the nine months ended May 31, 2002 and 2001, respectively, for drilling costs, delay rentals, acquisition of acreage, direct geological and geophysical costs, and other related direct costs, with respect to our identified exploration and exploitation projects.

We currently anticipate that we could participate in the drilling of one to four exploration/development wells during the next 12 months, with the number of wells subject to increase to the extent that additional projects are added to our portfolio. However, there can be no assurance that any wells will be drilled, or if drilled, that any of these wells will be successful.

It is anticipated that the future development of our business will require additional, and possibly substantial, capital expenditures. Depending upon the extent of success of our ability to sell additional prospects for cash, the level of industry participation in our exploration projects, and the continuing results at East Lost Hills and the deep Temblor exploration program, we anticipate spending a minimum of approximately \$5 million for capital expenditures relating to exploration and development of our projects during the next 12 months. To limit additional capital expenditures, we intend to form industry alliances to exchange a portion of our interest for cash and/or a carried interest in our exploration projects. We may need to raise additional funds to cover capital expenditures. These funds may come from cash flow, equity or debt financing, or from sales of interests in our properties although there is no assurance continued funding will be available.

At May 31, 2002, we had a working capital amount of approximately \$7,116,000. On May 24, 2002, we received \$6 million in gross proceeds from the sale of convertible notes due May 24, 2009. These notes call for semi-annual interest payments at an annual rate of 4.99% and are convertible into shares of common stock at the rate of \$1.30 per share. The interest can be paid in cash or added to the principal amount at the discretion of the Company. We have reflected the outstanding balance of these notes as Convertible Notes under Long Term Debt on our May 31, 2002 balance sheet.

At May 31, 2002, we had not entered into any commodity swap arrangements or hedging transactions. Although we have no current plans to do so, we may enter into commodity swap and/or hedging transactions in the future in conjunction with oil and gas production.

The following is a summary of the current status of the East Lost Hills project in the San Joaquin Basin of California operated by Anadarko Petroleum Corporation:

During the third quarter ended May 31, 2002, our only producing well, the ELH #1, produced a gross total of approximately 130 mmcf, averaging approximately 1.5 mmcf per day. Water production during this period averaged approximately 6,200 barrels per day. The oil and gas production from the ELH #1 well continues to be limited by the amount of production water that is accepted at water disposal facilities owned by ChevronTexaco. The operator has reported to the participants that it is evaluating alternatives to the current water disposal facilities including drilling a water disposal well. However, there is no assurance that the drilling of a disposal well will occur, or if drilled,

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that it will completely remove the water disposal constraint.

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The ELH #4 well commenced drilling on November 26, 2000 at a location approximately four miles southeast of the ELH #1 well. After a successful sidetrack operation, this well was drilled to its total depth of approximately 20,500 feet. Final casing was run and a production liner has been installed. During early July 2002, the Kreyenhagen and lower Temblor zones were perforated in preparation for a production test. The well is flowing on clean up before actual production flow testing begins. Upon completion of the production testing and analysis, if the participants determine that this well is a commercially viable well, a pipeline will need to be installed to connect to processing facilities. We expect that water will need to be disposed of as a component of the production, if any, and unless an alternative to the current water disposal facilities is implemented, the well will be subject to similar water disposal issues experienced at the ELH #1 well.

The ELH #9 well commenced drilling on July 17, 2001, approximately six miles southeast of the ELH #1 well. This well has reached its total depth of approximately 21,100 feet, and production testing commenced during late June 2002 in the Kreyenhagen. After preliminary flow testing, the participants have agreed to attempt to perform an acid stimulation procedure in order to fully evaluate this zone. Pending results of this test, the participants will determine whether to attempt to produce the well from this zone or move up-hole in order to test other potentially productive zones.

The Aera Energy LLC NWLH 1-22 well, located in Section 22, T25S-R20E, commenced drilling on August 23, 2001. This well is approximately three and a half miles northwest of the ELH #1 well and is designed to test the Temblor formation to a projected depth of 20,000 feet. We are participating in this well operated by Aera Energy LLC through a pooling arrangement at a 4.04% working interest. Operations to kick-off a sidetrack well bore from a depth of 14,100 feet were successful. An intermediate string of casing has been run to approximately 17,500 feet and drilling operations continue at an approximate depth below 20,200 feet.

Additional San Joaquin Basin California activities include the following projects:

Pyramid Power Prospect. In April 1999, we purchased a working interest in the Pyramid Power deep natural gas exploration project in the San Joaquin Basin. This project is outside the East Lost Hills joint venture area. Our working interest in this project is 3.75%, with our interest being carried through the tanks in the initial test well. The initial test well, operated by Anadarko and located in Section 9, T25S-R18E, commenced drilling on November 22, 2001. This well is designed to test the Temblor and the Point of Rocks formations. This well is currently drilling at an approximate depth below 20,300 feet. The participants at Pyramid Power jointly control approximately 20,000 gross and 15,000 net acres over the prospect.

Wedge Prospect. This is a seismic-generated Temblor prospect located northwest of and adjacent to the East Lost Hills deep gas discovery. During the first fiscal quarter of 2001, we acquired approximately 17 miles of proprietary, high effort 2D seismic data and combined this data with existing 2D seismic data in order to refine what we interpret as the up-dip extension of the East Lost Hills structure. Our seismic interpretation shows that the same trend at East Lost Hills extends approximately ten miles further northwest of the East Lost Hills Area of Mutual Interest and can be encountered as much as 3,000 feet

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higher. We currently control approximately 14,000 gross and approximately 13,000 net acres here. Our approach is to sell down our working interest and retain a 25% to 40% working interest in this prospect.

**Bulldog Prospect.** This project is a 2D seismic generated light oil and natural gas prospect located adjacent to the giant Kettleman North Dome field in the San Joaquin Basin. This prospect can be best characterized as a classic footwall fault trap, similar to the many known footwall fault trap accumulations that have produced significant quantities of hydrocarbons throughout the San Joaquin basin. We currently control approximately 16,000 gross and approximately 15,000 net acres here. We are attempting to obtain industry participation to drill a 14,000 foot test well, with the intent of retaining a 25% to 40% working interest in this prospect.

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Additional activities located in the Rocky Mountains include the following projects:

**Montana Foothills Project.** This extensive natural gas exploration project, located in northwestern Montana, is part of the southern Alberta basin, and has been classified as the southern extension of the Alberta Foothills producing province. The USGS and numerous Canadian industry sources have estimated significant recoverable reserves for the Montana portion of the Foothills trend. Based on extensive geologic and seismic analysis, we have identified numerous structural culminations of similar size, geometry, and kinematic history as prolific Canadian foothills fields, such as Waterton and Turner Valley.

The geologic setting and hydrocarbon potential of this area was not recognized by industry until the early 1980s. At that time, a number of companies initiated exploration efforts, including Exxon, Arco, Chevron, Amoco, Conoco, and Unocal. This initial exploration phase culminated in a deep test by Unocal in 1989. Although this well was unsuccessful, recent improvements in seismic imaging and pre-stack processing have resulted in our belief that this test well was drilled based upon a misleading seismic image and was located significantly off-structure.

We currently control approximately 262,000 gross and 224,000 net acres in this project and are currently presenting this project to potential industry participants in order to sell down our working interest and generate exploratory drilling activity. We anticipate retaining a working interest in this project of between 20% and 40%.

**Cumberland Project.** The Cumberland project, located within the Overthrust Belt of southwest Wyoming, is a gas-condensate exploration prospect in Uinta County, Wyoming. Cumberland is at the northern end of the historically productive Nugget trend on the hangingwall of the Absaroka thrust fault. The prospect lies along trend of and just north of Ryckman Creek field, which was discovered in 1975.

The Cumberland prospect can be best characterized as a classic hangingwall anticlinal trap, similar to the many known Nugget sandstone accumulations that have produced significant quantities of hydrocarbons from Pineview to Ryckman Creek. The Cumberland culmination is the result of structural deformation related to back-thrusting off of the Absaroka thrust, a similar geometry to that exhibited at East Painter Reservoir field.

We currently control approximately 5,400 gross and net acres in the project and are attempting to secure industry participation in the drilling of the

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initial exploration test well in the prospect. We anticipate retaining a working interest in this prospect of 25% to 40 %.

Mallard Project. The Mallard project, located within the Overthrust Belt of SW Wyoming, is a sour gas and condensate exploration prospect in Uinta County, Wyoming. Mallard is within the Paleozoic trend of productive fields on the Absaroka thrust. Mallard directly offsets and is adjacent to the giant sour gas field of Whitney Canyon-Carter Creek.

We interpret the Mallard prospect to occupy a separate fault block, adjacent to the Whitney Canyon field, generated by a complex imbricated system of faults spaying off of the Absaroka thrust. Paleozoic targets at the Mallard prospect include the Mississippian Mission Canyon, as well as numerous secondary objectives in the Ordovician, Pennsylvanian, and Permian sections.

We currently control approximately 3,900 gross and net acres in the project. We continue to refine our geological and geophysical model for the

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prospect, and will be presenting the project to potential industry partners for joint participation in the drilling of an initial exploration test well. We anticipate retaining a working interest in this project of between 25% and 40%.

### Results of Operations

The quarter ended May 31, 2002 compared with the quarter ended May 31, 2001.

Operations during the quarter ended May 31, 2002 resulted in a net loss of \$300,448 compared to a net income of \$459,201 for the quarter ended May 31, 2001. The operating net loss is due largely to a reduction in oil and gas revenues from production at the East Lost Hills #1 well.

Oil and Gas Revenues and Expenses. For the quarter ended May 31, 2002, we recorded \$29,460 from the sale of 10,696 mcf of natural gas for an average price of \$2.75 per mcf and \$8,426 from the sale of 434 bbls of hydrocarbon liquids for an average price of \$19.41 per barrel. In addition, we recorded overriding royalty revenues of \$624. Operating expenses during this period were \$28,808. For the quarter ended May 31, 2001, we recorded \$738,004 from the sale of 57,376 mcf of natural gas for an average price of \$12.86 per mcf and \$84,989 from the sale of 3,166 bbls of hydrocarbon liquids for an average price of \$26.84 per barrel. Operating expenses were \$78,005 for this period.

Depreciation, Depletion and Amortization. We recorded no depreciation, depletion and amortization expense from oil and gas properties for the quarter ended May 31, 2002. Although the East Lost Hills #1 began producing in February 2001, we recorded an impairment against our entire amortizable full cost pool on August 31, 2001, and therefore have no costs to amortize. No additional impairment was recorded against our oil and gas properties for the quarter ended May 31, 2002. We recorded \$52,391 in depreciation, depletion and amortization from oil and gas properties for the quarter ended May 31, 2001. This amount was computed using reserve report estimates based on the best information available at the time. We recorded \$3,691 and \$5,537 in depreciation expense associated with office furniture and equipment during the quarters ended May 31, 2002 and May 31, 2001, respectively.

General and Administrative Expense. We incurred \$323,474 and \$370,021 in general and administrative expenses during the quarters ended May 31, 2002 and

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May 31, 2001, respectively. The decrease is due primarily to a reduction in funding and acquisition costs in the current year. The decrease is offset partially by an increase in salary related expenses from additional personnel and higher salaries, and an increase in shareholder communications.

The nine months ended May 31, 2002 compared with the nine months ended May 31, 2001.

Oil and Gas Revenues and Expenses. For the nine months ended May 31, 2002, we recorded \$70,305 from the sale of 28,996 mcf of natural gas for an average price of \$2.42 per mcf and \$23,568 from the sale of 1,347 bbls of hydrocarbon liquids for an average price of \$17.50 per barrel. In addition, we recorded overriding royalty revenues of \$16,949 dating back to the commencement of production of the ELH #1 well. Operating expenses during this period were \$60,769. For the nine months ended May 31, 2001, we recorded \$962,838 from the sale of 75,177 mcf of natural gas for an average price of \$12.81 per mcf and \$112,515 from the sale of 4,236 bbls of hydrocarbon liquids for an average price of \$26.56 per barrel. Operating expenses were \$81,057 for this period. Production commenced at the East Lost Hills #1 well on February 6, 2001.

Depreciation, Depletion and Amortization. We recorded no depreciation, depletion and amortization expense from oil and gas properties for the nine months ended May 31, 2002. Although the East Lost Hills #1 began producing in 2001, we recorded an impairment against our entire amortizable full cost pool on August 31, 2001, and therefore have no costs to amortize. We recorded \$68,456 in depreciation, depletion and amortization from oil and gas properties for the nine months ended May 31, 2001. This amount was computed using reserve report

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estimates based on the best information available at the time. We recorded \$10,917 and \$14,448 in depreciation expense associated with office furniture and equipment during the nine months ended May 31, 2002 and May 31, 2001, respectively.

General and Administrative Expense. We incurred \$975,759 and \$955,068 in general and administrative expenses during the nine months ended May 31, 2002 and May 31, 2001, respectively. The increase results primarily from increases in salary related expenses from increasing personnel and salaries, costs associated with our first independent reserve analysis and an increase in rent expense. The increased costs were partially offset by decreases in legal expense, investor relations, and funding and acquisition expenses.

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our Financial Statements.

#### Reserve Estimates:

Our estimates of oil and natural gas reserves, by necessity, are projections based on geological and engineering data, and there are uncertainties inherent in the interpretation of such data as well as the projection of future rates of production and the timing of development expenditures. Reserve engineering is a subjective process of estimating underground accumulations of oil and natural gas that are difficult to measure. The accuracy of any reserve estimate is a function of the quality of available data, engineering and geological interpretation and judgment. Estimates of

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economically recoverable oil and natural gas reserves and future net cash flows necessarily depend upon a number of variable factors and assumptions, such as historical production from the area compared with production from other producing areas, the assumed effects of regulations by governmental agencies and assumptions governing future oil and natural gas prices, future operating costs, severance and excise taxes, development costs and workover and remedial costs, all of which may in fact vary considerably from actual results. For these reasons, estimates of the economically recoverable quantities of oil and natural gas attributable to any particular group of properties, classifications of such reserves based on risk of recovery, and estimates of the future net cash flows expected there from may vary substantially. Any significant variance in the assumptions could materially affect the estimated quantity and value of the reserves, which could affect the carrying value of our oil and gas properties and/or the rate of depletion of the oil and gas properties. Actual production, revenues and expenditures with respect to our reserves will likely vary from estimates, and such variances may be material.

Many factors will affect actual net cash flows, including:

- o the amount and timing of actual production;
- o supply and demand for natural gas;
- o curtailments or increases in consumption by natural gas purchasers; and
- o changes in governmental regulations or taxation.

Property, Equipment and Depreciation:

We follow the full cost method to account for our oil and gas exploration and development activities. Under the full cost method, all costs incurred which are directly related to oil and gas exploration and development are capitalized and subjected to depreciation and depletion. Depletable costs also include estimates of future development costs of proved reserves. Costs related to undeveloped oil and gas properties may be excluded from depletable costs until such properties are evaluated as either proved or unproved. The net capitalized costs are subject to a ceiling limitation based on the estimated present value of discounted future net cash flows from proved reserves. As a result, we are required to estimate our proved reserves at the end of each quarter, which is subject to the uncertainties described in the previous section. Gains or losses upon disposition of oil and gas properties are treated as adjustments to capitalized costs, unless the disposition represents a significant portion of the Company's proved reserves.

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

Not Applicable

### PART II. OTHER INFORMATION

Item 1. Legal Proceedings  
Not Applicable

Item 2. Changes in Securities and Use of Proceeds; Recent Sales Of Unregistered

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### Securities

On May 24, 2002, we received \$6 million in gross proceeds from the sale of convertible notes due May 24, 2009. These notes call for semi-annual interest payments at an annual rate of 4.99% and are convertible into shares of common stock at the rate of \$1.30 per share. The interest can be paid in cash or added to the principal amount at the discretion of the Company. The notes were issued to three investment funds pursuant to exemptions from registration under Section 3(b) and/or 4(2) of the Securities Act of 1933, as amended. The holders of the convertible notes have demand and "piggy back" registration rights with respect to the transfer of the shares issued upon conversion of the notes. We have reflected the outstanding balance of these notes as Convertible Notes under Long Term Debt on our May 31, 2002 balance sheet.

### Item 3. Defaults Upon Senior Securities

None

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

The results of the balloting at the Company's Annual Meeting of Stockholders held on March 13, 2002 were reported in the Company's Form 10-Q for the quarter ended February 28, 2002.

### Item 5. Other Information

During the quarter ended May 31, 2002, the Board of Directors elected David B. Kilpatrick to serve as a member of the Board of Directors until the next annual meeting of stockholders and thereafter until his successor is elected and qualified. Mr. Kilpatrick was President and Chief Operating Officer of California based Monterey Resources, Inc. until the 1997 merger with Texaco. Mr. Kilpatrick currently is president of Kilpatrick Energy Group, which provides management consulting services to the California oil and gas industry. Mr. Kilpatrick also will serve as a member of the Company's audit committee.

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

#### (a) Exhibits

Exhibit Number

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- |      |  |
|------|--|
| 4.1  | Form of Convertible Note Series 2002-A dated May 24, 2002  |
| 4.2  | Schedule of Differences in Convertible Notes Series 2002-A |
| 10.1 | Convertible Note Purchase Agreement dated May 24, 2002     |

#### (b) During the Quarter ended May 31, 2002, we filed two reports on Form 8-K:

A Form 8-K was filed on April 16, 2002 reporting a news release dated April 15, 2002.  
A Form 8-K was filed on May 28, 2002 reporting a news release and events occurring on May 24, 2002, including the sale of convertible notes and the election of two new members of the Board of Directors.

SIGNATURES

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In accordance with the requirements of the Exchange Act, the Registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Signatures -----	Title -----	Date -----
/s/ D. Scott Singdahlsen ----- D. Scott Singdahlsen	President, Chief Executive Officer and Chairman Of The Board	July 15, 2002
/s/ Andrew P. Calerich ----- Andrew P. Calerich	Vice-President and Chief Financial Officer	July 15, 2002