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CROWN ENERGY CORP  
Form 10-Q  
August 23, 2004

UNITED STATES

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  
June 30, 2004

Commission file number  
0-19365

CROWN ENERGY CORPORATION  
(Exact name of registrant as specified in its charter)

Utah

87-0368981

-----  
(State or other jurisdiction of  
incorporation or organization)

-----  
(I.R.S. Employer Identification No.)

1710 West 2600 South, Woods Cross, Utah, 84087

-----  
(Address of principal executive offices, zip code)

(801) 296-0166

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

Not applicable

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No  .

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes  No  .

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

There were 26,482,388 shares of \$0.02 par value common stock outstanding as of July 31, 2004.

CROWN ENERGY CORPORATION

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CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

	June 30, 2004 [unaudited] -----
CURRENT ASSETS:	
Cash and cash equivalents	\$ 75,144
Accounts receivable, net of allowance for uncollectible accounts of \$159,970 and \$164,630, respectively	2,438,701
Inventory	2,007,727
Prepaid and other current assets	67,670
	-----
Total Current Assets	4,589,242
PROPERTY PLANT, AND EQUIPMENT, Net	8,296,535
OTHER ASSETS	42,228
	-----
TOTAL	\$12,928,005 =====

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

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CROWN ENERGY CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

LIABILITIES AND STOCKHOLDERS' DEFICIT

	June 30, 2004 [unaudited] -----
CURRENT LIABILITIES	
Accounts payable	\$ 3,980,632
Preferred stock dividends payable	1,600,000
Accrued expenses	163,193
Accrued interest	383,223
Long-term debt - current portion	802,859
	-----
Total current liabilities	6,929,907
Long-term debt	2,371,515

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Redeemable preferred stock	5,000,000
Total liabilities	14,301,422
MINORITY INTEREST IN CONSOLIDATED JOINT VENTURES	573,461
STOCKHOLDERS DEFICIT:	
Stockholders' equity:	
Common Stock \$0.02 par value 50,000,000 shares authorized 26,482,388 shares outstanding for each period	529,647
Additional paid in Capital	3,319,417
Stock warrants	186,256
Accumulated deficit	(5,982,198)
Stockholders' deficit	(1,946,878)
TOTAL	\$12,928,005

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

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CROWN ENERGY CORPORATION

[Unaudited]

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS

	For the Three Jun
	2004
SALES, Net of demerits	\$ 3,275,274
COST OF SALES	3,335,212
GROSS PROFIT (LOSS)	(59,938)
GENERAL AND ADMINISTRATIVE EXPENSES	(354,216)
Bad debt recovery on accounts previously allowed for	-
INCOME (LOSS) FROM OPERATIONS	(414,154)
OTHER INCOME (EXPENSES):	
Interest income and other income	388
Interest expense	(72,396)
Total other income (expense), net	(72,008)

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INCOME (LOSS) BEFORE INCOME TAXES AND MINORITY INTERESTS	(486,162)
	-----
DEFERRED INCOME TAX BENEFIT	-
MINORITY INTEREST IN EARNINGS OF CONSOLIDATED JOINT VENTURE	9,902
	-----
NET INCOME (LOSS)	\$ (476,260)
	-----
NET INCOME (LOSS) PER COMMON SHARE:	
Basic and diluted	\$ (0.02)
	=====

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

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CROWN ENERGY CORPORATION

[Unaudited]

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS

	For the Six Months Ended June 30,
	2004
	-----
SALES, Net of demerits	\$ 3,451,424
COST OF SALES	3,914,805
	-----
GROSS PROFIT (LOSS)	(463,381)
GENERAL AND ADMINISTRATIVE EXPENSES	(636,762)
Bad debt recovery on accounts previously allowed for	-
	-----
INCOME (LOSS) FROM OPERATIONS	(1,100,143)
	-----
OTHER INCOME (EXPENSES):	
Interest income and other income	1,146
Interest expense	(141,798)
	-----
Total other income (expense), net	(140,652)
	-----
INCOME (LOSS) BEFORE INCOME TAXES AND MINORITY INTERESTS	(1,240,795)
	-----

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DEFERRED INCOME TAX BENEFIT	-
MINORITY INTEREST IN EARNINGS OF CONSOLIDATED JOINT VENTURE	20,472
	-----
NET INCOME (LOSS)	\$ (1,220,323)
	-----
NET INCOME (LOSS) PER COMMON SHARE:	
Basic and diluted	\$ (0.05)
	=====

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

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CROWN ENERGY CORPORATION

[Unaudited]

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Six Months Ending June 30,
	2004
	-----
Cash flows from operating activities:	
Net income (loss)	\$ (1,220,323)
Adjustments to reconcile net income (loss) to net cash used by operating activities:	
Amortization, depreciation and depletion	339,206
Recovery of doubtful accounts receivable	-
Minority interest	(20,472)
Change in assets and liabilities:	
Accounts receivable	(1,892,392)
Inventory	(1,370,918)
Prepaid and other assets	58,374
Accounts payable	3,250,716
Accrued expenses and interest	124,223
	-----
Total adjustments	488,737
	-----
Net cash used in operating activities	(731,586)
Cash flows used in investing activities:	

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Purchase of property and equipment	-
	-----
Cash flows from financing activities:	
Capital contributions from partners	54,349
Proceeds from borrowings of long term debt	-
Payments on long-term debt	(337,481)
	-----
Net cash provided by(used in) financing activities	(283,132)
	-----

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

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CROWN ENERGY CORPORATION

[Unaudited]

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

[Continued]

	For the Six June
	-----
	2004
	-----
Net Decrease in Cash:	(1,014,718)
Cash at Beginning of Period	\$ 1,089,862
	=====
Cash at End of Period	\$ 75,144
	=====
Supplemental Disclosure of Cash Flow Information	
Cash paid during the period:	
Interest	\$ 85,190
	=====
Income taxes	\$ -
	=====

Supplemental Schedule of Non-cash Investing and Financing Activities:

For the period ended June 30, 2004:

We accrued dividends on preferred stock of \$200,000.

We refinanced \$863,033 of accounts payable to long-term debt through negotiated extended payment terms with the vendors.

For the period ended June 30, 2003 we accrued dividends on preferred stock of \$200,000.

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

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CROWN ENERGY CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

We have prepared the accompanying consolidated financial statements as of June 30, 2004 and for the three and six months ended June 30, 2004 and 2003 without an audit. In our opinion, all adjustments (which include only normal recurring adjustments) necessary to present fairly our financial position as of June 30, 2004, results of operations for the three and six months ended June 30, 2004 and 2003 and cash flows for the six months ended June 30, 2004, and 2003 have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. It is suggested that these condensed financial statements be read in conjunction with the financial statements and notes thereto included in our December 31, 2003 Annual Report on Form 10-K. The results of operations for the period ended June 30, 2004, are not necessarily indicative of the operating results for the full year.

Summary of Disputes - One outstanding complaint has been filed against us by Geneva Rock Products, Inc. The foregoing action was described in detail in our Annual Report on Form 10-K for the year ending December 31, 2003.

Organization - Crown Energy Corporation ("CEC") and its wholly-owned subsidiary, Crown Asphalt Products Company ("CAPCO"), and Crown Distribution, an entity in which CAPCO and CEC now own all interests (collectively referred to as the "Company"), are engaged in the production, manufacturing, distribution and selling of asphalt products. Crown Distribution owns a majority interest in Cowboy Asphalt Terminal, L.L.C. ("CAT, LLC"). CAT, LLC is a joint venture formed on September 16, 1998, between CAPCO and Foreland Asphalt Corporation ("Foreland"), which owns an asphalt terminal and storage facility. Crown Distribution owns 66.67% and Foreland owns 33.33% of CAT, LLC.

Principles of Consolidation - The consolidated financial statements include the accounts of the Company and its wholly or majority-owned subsidiaries. All significant inter-company transactions have been eliminated in consolidation.

Impairment of Long-Lived Assets - The Company reviews its long-lived assets for impairment when events or changes in circumstances indicate that the book value of an asset may not be recoverable. The Company evaluates, at each balance sheet date, whether events and circumstances have occurred which indicate possible impairment. The Company uses an



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estimate of future undiscounted net cash flows of the related asset or group of assets over the estimated remaining life in measuring whether the assets are recoverable

Stock-Based Compensation - The Company accounts for stock options granted to employees under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations, and has adopted the disclosure-only provisions of Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation." Accordingly, no compensation cost is recognized in the financial statements when options granted under those plans have an exercise price equal to or greater than the market value of the underlying common stock on the date of grant. The Company granted no options during the period ending June 30, 2004 and 2003.

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### CROWN ENERGY CORPORATION

#### NOTES TO UNAUDITED CONDENSED CONSOLIDATED

##### FINANCIAL STATEMENTS [Continued]

Going Concern - The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As of June 30, 2004, the Company had a working capital deficit, an accumulated deficit and has had substantial recurring losses. The consolidated operations of the Company have not had sustained profitability and the Company has relied upon debt financing to satisfy its obligations. These conditions raise substantial doubt about the ability of the Company to continue as a going concern. The consolidated financial statements do not include any adjustments that might result from the outcome of these uncertainties.

The Company's ability to continue as a going concern is subject to the attainment of profitable operations or obtaining necessary funding from outside sources to fund its cash flow requirements to purchase inventory. Management is attempting to secure financing for inventory purchases with inventory suppliers or other financing institutions. There can be no assurance that the Company will be successful in its attempts to obtain financing for its inventory purchases. In addition, management is continuing its plans to reduce overhead and other costs. Management is also considering consolidation of manufacturing facilities to maximize operating efficiency and margins on product sales. However, there can be no assurance that management will be successful in these efforts. As disclosed in Note 6, on June 7, 2004, the Company entered into an agreement with an unrelated asphalt distribution firm to organize a joint venture that will be owned 51% by the other firm and 49% by us. Substantially all of the Company's asphalt business, operations and assets will be transferred to the joint venture entity in consideration of a promissory note for \$7.5 million, the payment of which will be largely contingent upon the joint venture having earnings sufficient to permit such payment, assumption of approximately \$2.3 million in liabilities, and a 49% interest in the joint venture entity. The promissory note will be secured by the sold assets and business. In addition, the other joint venture participant will provide the joint venture with an operating line of credit through the end of calendar year 2004, which may be extended in subsequent years at the election of our joint venture partner. In anticipation of

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completing this transaction the joint venture partner has advanced interim operating capital, secured by the Company's inventory, work in progress, finished goods and accounts receivable. We believe that the line of credit provided by the joint venture partner will be sufficient to sustain operations of the joint venture through 2004. The Company's continuance subsequent to the transaction will be largely dependent on the success of the joint venture as payment of the \$7.5 million promissory note is contingent on earnings of the joint venture. If the joint venture is unable to make payments on the promissory note, the Company may not be able to continue in business. Formation of the joint venture is contingent on a number of factors, including approval by the Company's stockholders. The officers and directors have approved the foregoing transaction. The principal stockholders and their affiliates holding a majority of the issued and outstanding common stock have also approved the foregoing transactions. In addition, the holder of the Series A Preferred Stock has indicated that it intends to approve the transaction and to waive its right to require the Company to redeem the preferred stock at its stated value plus all accrued but unpaid dividends, or for approximately \$6.6 million as of June 30, 2004.

### NOTE 2 - LONG-TERM DEBT

During 2004 we entered into extended payment arrangements with various vendors for \$863,033 to extend amounts due into equal monthly installments over 3 years accruing interest at 4%.

### NOTE 3 - CAPITAL TRANSACTIONS

Preferred Stock and Related Warrant- In 1997 we sold to an unrelated third party for \$5.0 million in cash 500,000 shares of \$10 Series A Cumulative Convertible Preferred Stock and a warrant to purchase at

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## CROWN ENERGY CORPORATION

### NOTES TO UNAUDITED CONDENSED CONSOLIDATED

#### FINANCIAL STATEMENTS [Continued]

\$0.002 per share an amount equal to 8% of the shares of common stock then outstanding and reserved for issuance, or approximately 925,771 shares. In 2002, the Series A Preferred Stock, the warrant, and all associated rights were acquired by the Mealey Family Limited Partnership, which is the current holder of the Series A Preferred Stock, the warrant, all associated rights, and accrued dividends. Jay Mealey, our Chief Executive Officer, President and a director, owns 48.5% of the Mealey Family Limited Partnership and is its general partner and his immediate family is its beneficiary.

As of December 31, 2003, and June 30, 2004, there were dividends payable to the holder of the Series A Preferred Stock of \$1.4 million and \$1.6 million, respectively. Future dividends of 8% per annum may, at the election of the holder, be taken in cash or common stock. At the market price of \$0.01 per share as of June 30, 2004, 160.0 million shares of common stock would have to be issued to satisfy the dividend payable. The Series A Preferred Stock is convertible to 4,285,000 shares of common stock, if so elected by the holder of the Series A Preferred Stock. The holder of the Series A Preferred Stock may also require the Company to redeem the Series A Preferred Stock after the eighth anniversary of the Series A Preferred Stock's issuance. In

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addition, in the event of a sale of all or substantially all of the Company's assets, or a merger or consolidation in which control of the Company is transferred, may, at the option of the Series A Preferred Stockholder, be treated as a liquidation, thus resulting in the repurchase of the Series A Preferred Stock at its stated value and all outstanding related dividends.

We currently have an authorized capital of 50.0 million shares of common stock, of which approximately 26.5 million shares are issued and outstanding and approximately 3.1 million shares are reserved for issuance on the exercise of outstanding options and warrants, for a total of approximately 29.6 million shares, excluding the shares issuable on conversion of the Series A Preferred Stock, the payment in common stock of dividends that may accrue in the future thereon, and exercise of the warrant. Therefore, there are only approximately 20.4 million shares available for issuance, and we could not satisfy all of our current obligations under the Series A Preferred Stock on conversion or the payment of dividends or on exercise of the warrant. We have not undertaken to renegotiate with the Mealey Family Limited Partnership any of the terms of the Series A Preferred Stock or the warrant, do not know whether we will attempt to do so, and have not analyzed our obligations or responsibilities if the Mealey Family Limited Partnership would elect to convert the Series A Preferred Stock, demand payment of the dividends in common stock, or exercise the warrant.

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### CROWN ENERGY CORPORATION

#### NOTES TO UNAUDITED CONDENSED CONSOLIDATED

#### FINANCIAL STATEMENTS [Continued]

#### NOTE 4 - PROFIT/LOSS PER SHARE

The following table is a reconciliation of the net loss numerator of basic and diluted net loss per common share for the three and six month periods ended June 30, 2004 and June 30, 2003:

	Six Months 2004	Six Months 2003	Three Months 2004
	Loss	Profit	Profit
	Per Share	Per Share	Per Share
	-----	-----	-----
Net Profit (Loss)	(\$1,220,323)	(\$835,220)	(\$476,260)
Redeemable preferred stock dividends and accretion	(200,000)	(200,000)	(100,000)
Add back stock dividends and accretion	-	-	-
Net profit (loss) attributable to	-----	-----	-----

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common stockholders	(\$1,420,323)	(\$0.05)	(\$1,035,220)	(\$0.04)	(\$576,260)	(\$0.
Weighted average common shares outstanding -						
basic	26,482,388		26,482,388		26,482,388	
diluted	26,482,388		26,482,388		26,482,388	

We had at June 30, 2004, and June 30, 2003, incremental options and warrants to purchase, 3,372,919 shares and 3,988,919 shares of common stock, respectively, that were not included in the computation of diluted earnings (loss) per share for the three and six months ended June 30, 2004 and for the six months ended June 30, 2003, because their effect was anti-dilutive. We also had preferred stock outstanding at June 30, 2004, and June 30, 2003, which is convertible into approximately 4,285,000 shares of common stock that was not included in the computation of diluted loss per share for the three and six months ended June 30, 2004 and for the six months ended June 30, 2003, as its effect was anti-dilutive. Accordingly, diluted loss per share does not differ from basic loss. The diluted weighted average shares for the three months ended June 30, 2003, include the dilutive effect of the conversion of preferred stock dividends into approximately 58 million shares of common stock. As of June 30, 2004, there were preferred stock dividends payable in the amount of \$1,600,000. Pursuant to the designations and preferences of the preferred stock, the holder of the preferred stock can elect to require us to pay dividends accruing in the future, by the issuance of common stock in lieu of cash payments at a price generally equivalent to the trading price for our common stock in the over-the-counter market, as detailed in the designations and preferences. The market price for our common stock was \$0.01 per share as of July 31, 2004.

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CROWN ENERGY CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS [Continued]

NOTE 5 - RECENT ACCOUNTING PRONOUNCEMENTS

In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation No. 46 (FIN 46), "Consolidation of Variable Interest Entities." FIN 46 addresses when a company should consolidate in its financial statements the assets, liabilities and activities of a variable interest entity (VIE). It defines VIEs as entities that either do not have any equity investors with a controlling financial interest, or have equity investors that do not provide sufficient financial resources for the entity to support its activities without additional subordinated financial support. FIN 46 also requires disclosures about VIEs that a company is not required to consolidate, but in which it has a significant variable interest. The consolidation requirements of FIN 46 applied immediately to variable interest entities created after January 31, 2003. The Company has not obtained an interest in a VIE subsequent to that date. A modification to FIN 46 (FIN 46 (R)) was released in December 2003. FIN 46 (R) delayed the effective date for VIEs created before February 1, 2003, with the exception of special-purpose entities, until the first fiscal year or interim period

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ending after March 15, 2004. FIN 46 (R) delayed the effective date for special-purpose entities until the first fiscal year or interim period after December 15, 2003. The Company is not the primary beneficiary of any SPEs at December 31, 2003. The Company adopted FIN 46 (R) for non-SPE entities as of March 31, 2004. The adoption of FIN 46 (R) did not have a material impact on results of operations or financial position.

In April 2003, the FASB issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. This Statement is effective for contracts entered into or modified after June 30, 2003, with certain exceptions, and for hedging relationships designated after June 30, 2003. The adoption of SFAS No. 149 did not have a material impact on the results of operations or financial position.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 requires that certain financial instruments, which under previous guidance may have been accounted for as equity, must now be accounted for as liabilities (or an asset in some circumstances). The financial instruments affected include mandatory redeemable stock, certain financial instruments that require or may require the issuer to buy back some of its shares in exchange for cash or other assets and certain obligations that can be settled with shares of stock.

This Statement is effective for all such 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. SFAS 150 resulted in the reclassification of \$5 million of Series A Preferred Stock from mezzanine capital to liabilities.

### NOTE 6 - PROPOSED AGREEMENT FOR SALE OF ASSET

On June 7, 2004, the Company entered into an agreement with an unrelated asphalt distribution firm to organize a joint venture that will be owned 51% by the other firm and 49% by us. Substantially all of the Company's asphalt business, operations and assets will be transferred to the joint venture entity in consideration of a promissory note for \$7.5 million, the payment of which will be largely contingent upon the joint venture having earnings sufficient to permit such payment, assumption of approximately \$2.3 million in liabilities, and a 49% interest in the joint venture entity. The promissory note will be secured by the sold assets and business. In addition, the other joint venture participant will provide the joint venture with an operating line of credit through the end of calendar year 2004, which may be extended in subsequent years at the election of our joint venture partner. In anticipation of completing this transaction the

joint venture partner has advanced interim operating capital, secured by the Company's inventory, work in progress, finished goods and accounts receivable. Formation of the joint venture is contingent on a number of factors, including approval by the Company's stockholders. The officers and directors have approved the foregoing transaction. The principal stockholders and their affiliates holding a majority of the issued and outstanding common stock have also approved the foregoing transactions. In addition, the holder of the Series A Preferred Stock has indicated that it intends to approve the transaction and to waive its right to require the Company to redeem the preferred stock at its stated value plus all accrued but unpaid dividends, or for approximately \$6.6 million as of June 30, 2004.

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

The following discussion and analysis of our financial condition, results of operations and related matters includes a number of forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements include, by way of illustration and not limitation, statements containing the words "anticipates," "believes," "expects," "intends," "future" and words of similar import that express, either directly or by implication, management's beliefs, expectations or intentions regarding our future performance or future events or trends that may affect us or our results of operations.

Forward-looking statements are subject to known and unknown risks, uncertainties and other factors, including, but not limited to changes in economic conditions generally or with respect to our asphalt products market in particular, new or increased governmental regulation, increased competition, shortages in labor or materials, delays or other difficulties in shipping or transporting, the risk of loss of certain operating assets serving as collateral to secure financing, and other similar risks inherent in our operations or in business operations generally. Any such risks or uncertainties, either alone or in combination with other factors, may cause our actual results, performance or achievements to differ materially from our anticipated future results, performance or achievements (which may be expressed or implied by such forward-looking statements). Consequently, the following management's discussion and analysis, including all forward-looking statements contained therein, is qualified and limited by the foregoing cautionary factors. Interested persons are advised to consider all forward-looking statements within the context of such cautionary factors.

Liquidity and Capital Resources

At June 30, 2004, we had cash and other current assets of \$4.59 million, as compared to cash and other current assets of \$2.38 million at December 31, 2003. The increase of approximately \$2.21 million was generally due to an increase in accounts receivable and inventory, which is offset, by a corresponding increase in accounts payable.

Our business requires a large amount of working capital to fund raw material purchases and accounts receivable. During the colder quarters ending December 31 and March 31, we require working capital to purchase raw materials when prices are typically at their annual low and store these materials until they are processed and sold during the warmer summer months when most paving

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occurs. As discussed below, in recent years we have not had sufficient working capital to take advantage of low raw material prices during the winter months and have, therefore, been required to fill our raw material needs in the warmer summer months when prices are typically higher. We typically generate a large majority of our sales during the warmer summer months. For example, during the preceding year we generated approximately 91% of our annual sales during the quarters ended June 30 and September 30, 2003. Therefore, during these periods we require large amounts of working capital to fund accounts receivable and general operations. We have not had third party working capital financing since 1999 and we have been unable to obtain adequate financing on acceptable terms.

Our auditor's report on our financial statements for the year ended December 31, 2003, as for prior years, contained an explanatory paragraph about our ability to continue as a going concern. We have continued to suffer from shortages of working capital needed to optimize operating economies and that has threatened the survival of the Company. Given our financial condition, generally, outside working capital funding requires personal guarantees, and our officers and directors have been unwilling to provide such guarantees for our benefit as a publicly-held company. As previously reported, our Board of Directors approved the investigation of alternatives for a "going-private" transaction. In order to ensure the survival of the Company and resolve its working capital problems, the Board has approved the sale of all of its asphalt manufacturing and distribution assets and related business. Formation of the joint venture is contingent on a number of factors, including approval by the Company's stockholders. The officers and directors have approved the foregoing transaction. The principal stockholders and their affiliates holding a majority of the issued and outstanding common stock have also approved the foregoing

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

transactions. In addition, the holder of the Series A Preferred Stock has indicated that it intends to approve the transaction and to waive its right to require the Company to redeem the preferred stock at its stated value plus all accrued but unpaid dividends, or for approximately \$6.6 million as of June 30, 2004.

On June 7, 2004, the Company entered into an agreement with an unrelated asphalt distribution firm to organize a joint venture that will be owned 51% by the other firm and 49% by us. Substantially all of the Company's asphalt business, operations and assets will be transferred to the joint venture entity in consideration of a promissory note for \$7.5 million, the payment of which will be largely contingent upon the joint venture having earnings sufficient to permit such payment, assumption of liabilities, and a 49% interest in the joint venture entity. The sold assets and business will secure the promissory note. In addition, the other joint venture participant will provide the joint venture with an operating line of credit through the end of calendar year 2004, which may be extended in subsequent years at the election of our joint venture partner. In anticipation of completing this transaction the joint venture partner provided the Company with interim operating capital, secured by the Company's inventory, work in progress, finished goods and accounts receivable. Formation of the joint venture is contingent on a number of factors, including approval by the Company's stockholders, a majority of which have indicated that they intend to do so.

A portion of our accounts receivable is subject to the risks and uncertainties of litigation and related collection risks. In the event that we are unable to collect our current accounts receivables, we are unable to secure the necessary working capital line of credit for our operations, our operating

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losses and working capital deficits continue, or if we are unable to recoup our losses, we may not have sufficient capital to operate through 2004 and into 2005.

As of June 30, 2004, we had a working capital deficit of approximately \$2.34 million, an accumulated deficit of \$5.98 million, and total stockholders' deficit of \$1.9 million.

The consolidated operations of the Company have not sustained profitability and the Company has relied on debt financing to satisfy its obligations. The Company's ability to continue as a going concern is subject to the attainment of profitable operations or obtaining necessary funding from outside sources to fund its cash flow requirements to purchase inventory. Failure of the Company to complete the foregoing transaction will have a significant negative effect and could result in the failure of the Company.

### Critical Accounting Policies

Inventory consists principally of refined products and chemical supplies, which are valued at the lower of cost (computed on a first in, first out basis) or market.

Revenue recognition for sales of product is recognized when a contract is executed or a valid purchase order has been received, product has been shipped, the selling price is fixed or determinable, and collectibility is reasonably assured.

Property, plant and equipment are recorded at cost and are depreciated over the estimated useful lives of the related assets. Depreciation is computed using the straight-line method for financial reporting purposes. The estimated useful lives of property, plant and equipment are as follows:

Plant and improvements and tankage	10-30 years
Equipment	7 years
Vehicles	5 years
Computer equipment, furniture and fixtures	3 years

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

The Company reviews its long-lived assets for impairment when events or changes in circumstances indicate that the book value of an asset may not be recoverable. The Company evaluates, periodically, whether events and circumstances have occurred which indicate possible impairment. The Company uses an estimate of future undiscounted net cash flows of the related asset or group of assets over the estimated remaining life in measuring whether the assets are recoverable.

Financial instruments that potentially subject the Company to concentration of credit risk consist primarily of receivables. In the normal course of business, the Company performs ongoing credit evaluations of its customers and maintains allowances for possible losses that, when realized, have been within the range of management's expectations.

The Company maintains its cash in bank deposit accounts that, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents.



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### Results of Operations

For the three month period ending June 30, 2004, compared to the three month period ending June 30, 2003

Total revenue decreased from \$6,241,935 for the three-month period ended June 30, 2003, to \$3,275,274 for the three-month period ended June 30, 2004, a decrease of \$2,966,661. Cost of sales decreased from \$5,942,807 for the same period in 2003 to \$3,335,212 for the same period in 2004, a decrease of \$2,607,595. The decrease in revenues was primarily the result of a decrease in sales volume of approximately 15,770 tons offset partially by an increase in revenue per ton of approximately \$7.84. The decrease in tons is primarily due to contracted business start dates occurring later in the early asphalt paving season compared to the previous year. The decrease in cost of sales in the 2004 interim period is primarily the result of the reduced volume and reduced facility operating costs predominately made up of salaries and wages.

General and administrative expenses decreased from \$402,589 for the three-month period ended June 30, 2003, to \$354,216 for the three-month period ended June 30, 2004, a decrease of \$48,373. This decrease is primarily due to a reduction in salaries, wages and rent expense. During 2003 a recovery of a receivable that was allowed for in a prior year for \$323,524 was recorded as a bad debt recovery.

Net other income/expenses increased from an expense of \$22,733 for the three-month period ended June 30, 2003, to an expense of \$72,008 for the three-month period ended June 30, 2004, an increased expense of \$49,275. This increase is primarily due to a dividend received in 2003 in the amount of \$42,611.

Minority interest of \$9,902 represents Foreland's approximate 33% interest in the loss of CAT, LLC.

For the six month period ending June 30, 2004, compared to the six month period ending June 30, 2003

Total revenue decreased from \$6,356,642 for the six-month period ended June 30, 2003, to \$3,451,424 for the six-month period ended June 30, 2004, a decrease of \$2,905,218. Cost of sales decreased from \$6,716,257 for the same period in 2003 to \$3,914,805 for the same period in 2004, a decrease of \$2,801,452. The decrease in revenues was primarily the result of a decrease in sales volume of approximately 15,300 tons partially offset by an increase in revenue per ton of approximately \$9.40 per ton. The decrease in tons is primarily due to contracted business start dates occurring later in the early asphalt paving season compared to the previous year. The decrease

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

in cost of sales in the 2004 interim period is primarily the result of reduced volume and reduced facility operating costs predominately made up of salaries, wages and insurance.

General and administrative expenses decreased from \$738,911 for the six-month period ended June 30, 2003, to \$636,762 for the six-month period ended June 30, 2004, a decrease of \$102,149. This decrease is primarily due to a reduction in salaries, wages, rent expense and supplies. During 2003 a recovery of a receivable that was allowed for in a prior year for \$323,524 was recorded

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as a bad debt recovery.

Net other income/expenses increased from an expense of \$87,640 for the six-month period ended June 30, 2003, to an expense of \$140,652 for the six-month period ended June 30, 2004, an increase of \$53,012. This increase is the result of a dividend received in 2003 in the amount of \$42,611.

Minority interest of \$20,472 represents Foreland's approximate 33% interest in the loss of CAT, LLC.

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

We do not engage in transactions involving market risk sensitive instruments intended to reduce our exposure to interest rate risks, foreign currency exchange rate risks, commodity price risks or similar risks, and therefore we do not believe we are subject to material market risks resulting from such market rate sensitive instruments. However, we are subject to general market fluctuations related to the purchase of base stock asphalt and may suffer reduced operating margins to the extent our increased costs cannot be passed through to our customers. Such prices generally fluctuate with the price of crude oil.

We are also subject to certain price escalation and de-escalation clauses in our asphalt distribution sales contracts. We supply asphalt to projects in certain states where regulations provide for escalation and de-escalation of the price for such asphalt relative to the price difference from the time the project is awarded to the successful bidding company and the time the project is completed. We factor such de-escalation risk into our bid prices and do not believe we have material exposure to risk resulting from these regulations.

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### ITEM 4. CONTROLS AND PROCEDURES

#### (a) Evaluation of disclosure controls and procedures:

Based on their evaluations as of the filing date of this report, the principal executive officer and principal financial officer of the Company have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act) are effective to ensure that information required to be disclosed by the Company in reports that the Company files or submits under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission.

#### (b) Changes in internal controls:

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

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## PART II - OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

No change see our Annual Report on Form 10K for year ended December 31, 2003 for pending actions.

### ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

None.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

As of June 30, 2004, there were arrearages in the amount of \$1,600,000 on dividends on our preferred stock.

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

None.

### ITEM 5. OTHER INFORMATION

Memorandum of Understanding to Sell Asphalt Manufacturing and Distribution Assets and Related Business

On June 7, 2004 the Company entered into a Memorandum of Understanding with an unrelated asphalt company to form a new limited liability company to purchase all of the Company's asphalt manufacturing and distribution assets and related business. At closing of the transaction, the Company will own 49% of the membership interest in the new limited liability company and the other asphalt company will own the remaining membership interest. The new limited liability company will purchase the assets and business for \$7.5 million and will in addition purchase the Company's current inventory. The purchase price will be paid in the form of a six-year promissory accruing interest. The sold assets and business will secure the promissory note. As part of the transaction, the other member of the limited liability company will supply the working capital financing to enable the new company to take advantage of off-season asphalt purchase to fill the storage tank capacity.

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

(a) Exhibits: The following exhibits are included as part of this report:

Exhibit Number	SEC Reference Number	Title of Document	Loca
31.01	31	Certification of Chief Executive Officer Pursuant to Rule 13a-14	This

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31.02	31	Certification of Chief Financial Officer Pursuant to Rule 13a-14	This
32.01	32	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chief Executive Officer)	This
32.02	32	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chief Financial Officer)	This

(b) Reports on Form 8-K: We did not file any reports on Form 8-K for the quarter ended September 30, 2003.

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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.

CROWN ENERGY CORPORATION  
(Registrant)

Date: August 23, 2004

By: /s/ Jay Mealey

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Jay Mealey,  
Chief Executive Officer

Date: August 23, 2004

By: /s/ Alan Parker

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Alan Parker,  
Controller

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