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GULFWEST ENERGY INC
Form 10-Q
November 19, 2002

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

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

For the quarterly period ended September 30, 2002

OR

() 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 1-12108

GULFWEST ENERGY INC.

(Exact name of Registrant as specified in its charter)

Texas
(State or other jurisdiction
of incorporation)

87-0444770
(IRS Employer
Identification No.)

480 North Sam Houston Parkway East
Suite 300
Houston, Texas
(Address of principal executive offices)

77060
(zip code)

(281) 820-1919
(Registrant's telephone number, including area code)

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

YES X NO ____

The number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date, November 18, 2002, was 18,492,541 shares of Class A Common Stock, \$.001 par value.

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GULFWEST ENERGY INC.

FORM 10-Q FOR THE QUARTER ENDED
SEPTEMBER 30, 2002

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

GULFWEST ENERGY INC.
CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2002 AND DECEMBER 31, 2001

ASSETS

September 30,
2002
(Unaudited)

CURRENT ASSETS:

| | | |
|---|----|---------|
| Cash and cash equivalents | \$ | 803,394 |
| Accounts Receivable - trade, net of allowance for | | |

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| | |
|---|---------------|
| doubtful accounts of -0- in 2002 and 2001 | 1,418,700 |
| Prepaid expenses | 144,703 |
| | ----- |
| Total current assets | 2,366,797 |
| | ----- |
| OIL AND GAS PROPERTIES | |
| Using the successful efforts method of accounting | 57,035,291 |
| OTHER PROPERTY AND EQUIPMENT | 2,337,559 |
| Less accumulated depreciation, depletion and amortization | (7,885,233) |
| | ----- |
| Net oil and gas properties, and other property and equipment | 51,487,617 |
| | ----- |
| OTHER ASSETS: | |
| Deposits | 37,442 |
| Debt issue cost, net | 343,264 |
| Derivative instruments | |
| | ----- |
| Total other assets | 380,706 |
| | ----- |
| TOTAL ASSETS | \$ 54,235,120 |
| | ===== |

The Notes to Consolidated Financial Statements are an integral part of these statements.

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GULFWEST ENERGY INC.
CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2002 AND DECEMBER 31, 2001

LIABILITIES AND STOCKHOLDERS' EQUITY

September 30,
2002

(Unaudited)

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| | |
|---|---------------|
| CURRENT LIABILITIES | |
| Notes payable | \$ 4,876,938 |
| Notes payable - related parties | 90,000 |
| Current portion of long-term debt | 4,602,829 |
| Current portion of long-term debt - related parties | 159,030 |
| Accounts payable - trade | 4,593,194 |
| Accrued expenses | 449,977 |
| | ----- |
| Total current liabilities | 14,771,968 |
| | ----- |
| NONCURRENT LIABILITIES | |
| Long-term debt, net of current portion | 28,939,713 |
| Long-term debt, related parties | 131,680 |
| | ----- |
| Total noncurrent liabilities | 29,071,393 |
| | ----- |
| OTHER LIABILITIES | |
| Derivative instruments | 1,225,692 |
| | ----- |
| COMMITMENTS AND CONTINGENCIES | |
| STOCKHOLDERS' EQUITY | |
| Preferred stock | 170 |
| Common stock | 18,493 |
| Additional paid-in capital | 28,179,712 |
| Retained deficit | (19,032,308) |
| | ----- |
| Total stockholders' equity | 9,166,067 |
| | ----- |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 54,235,120 |
| | ===== |

The Notes to Consolidated Financial Statements are an integral part of these statements.

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GULFWEST ENERGY INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS AND NINE MONTHS ENDED
SEPTEMBER 30, 2002 AND 2001
(UNAUDITED)

| | |
|---------------------|-------|
| Three Months | |
| Ended September 30, | |
| 2002 | 2001 |
| ----- | ----- |

OPERATING REVENUES

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| | | | |
|---|--------------|--------------|-------|
| Oil and gas sales | \$ 2,555,526 | \$ 3,457,920 | \$ |
| Well servicing revenues | 11,535 | 54,108 | |
| Operating overhead and other income | 74,565 | 157,175 | |
| | ----- | ----- | |
| Total Operating Revenues | 2,641,626 | 3,669,203 | |
| | ----- | ----- | |
| OPERATING EXPENSES | | | |
| Lease operating expenses | 1,461,001 | 1,309,206 | |
| Cost of well servicing operations | 10,445 | 53,555 | |
| Depreciation, depletion and amortization | 625,382 | 795,298 | |
| General and administrative | 444,271 | 427,355 | |
| | ----- | ----- | |
| Total Operating Expenses | 2,541,099 | 2,585,414 | |
| | ----- | ----- | |
| INCOME FROM OPERATIONS | 100,527 | 1,083,789 | |
| | ----- | ----- | |
| OTHER INCOME AND EXPENSE | | | |
| Interest expense | (793,017) | (707,244) | |
| Gain (loss) on sale of assets | (9,964) | (9,626) | |
| Unrealized gain (loss) on derivative instruments | (222,296) | 1,305,075 | |
| | ----- | ----- | |
| Total Other Income and Expense | (1,025,277) | 588,205 | |
| | ----- | ----- | |
| INCOME (LOSS) BEFORE INCOME TAXES AND CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE | (924,750) | 1,671,994 | |
| | ----- | ----- | |
| INCOME TAXES | | | |
| | ----- | ----- | |
| INCOME BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE | (924,750) | 1,671,994 | |
| | ----- | ----- | |
| CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE | | | |
| | ----- | ----- | |
| NET INCOME (LOSS) | (924,750) | 1,671,994 | |
| | ----- | ----- | |
| DIVIDENDS ON PREFERRED STOCK | | | |
| | ----- | ----- | |
| NET INCOME (LOSS) AVAILABLE TO COMMON SHAREHOLDERS | \$ (924,750) | \$ 1,671,994 | \$ |
| | ===== | ===== | ===== |
| NET INCOME PER SHARE, BASIC, BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE | \$ (.05) | \$.09 | \$ |
| | ----- | ----- | ----- |
| CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE | | | |
| | ----- | ----- | ----- |
| NET INCOME (LOSS) PER COMMON SHARE, BASIC | \$ (.05) | \$.09 | \$ |
| | ===== | ===== | ===== |
| NET INCOME PER SHARE, DILUTED, BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE | \$ (.05) | \$.08 | \$ |
| | ----- | ----- | ----- |
| CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE | | | |
| | ----- | ----- | ----- |

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ACCOUNTING PRINCIPLE

| | | |
|--|----------|--------|
| | ----- | ----- |
| INCOME (LOSS) PER COMMON SHARE - DILUTED | \$ (.05) | \$.08 |
| | ===== | ===== |

The Notes to Consolidated Financial Statements are an integral part of these statements.

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GULFWEST ENERGY INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2002 AND 2001
(UNAUDITED)

CASH FLOWS FROM OPERATING ACTIVITIES:

Net income (loss) \$
Adjustments to reconcile net income to net cash
provided by operating activities:

- Depreciation, depletion, and amortization
- Common stock warrants issued and charged to operations
- (Gain) Loss on sale of assets
- Unrealized (gain) loss on derivate instruments
- Cumulative effect of accounting change
- (Increase) decrease in accounts receivable - trade, net
- (Increase) in prepaid expenses
- Increase in accounts payable and accrued expenses

Net cash provided by operating activities

CASH FLOWS FROM INVESTING ACTIVITIES:

- Proceeds from sale and disposition of property and equipment
- Purchase of property and equipment

Net cash used in investing activities

CASH FLOWS FROM FINANCING ACTIVITIES:

- Payments on debt
- Proceeds from debt issuance
- Debt issue cost
- Dividends paid

Net cash provided by financing activities

INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS

CASH AND CASH EQUIVALENTS, beginning of period

CASH AND CASH EQUIVALENTS, end of period

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CASH PAID FOR INTEREST

=====
\$
=====

The Notes to Consolidated Financial Statements are an integral part of these statements.

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GULFWEST ENERGY INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2002 AND 2001
(UNAUDITED)

1. During interim periods, we follow the accounting policies set forth in our Annual Report on Form 10-K filed with the Securities and Exchange Commission. Users of financial information produced for interim periods are encouraged to refer to the footnotes contained in the Annual Report when reviewing interim financial results.
2. The accompanying financial statements include the Company and its wholly-owned subsidiaries: RigWest Well Service, Inc. formed September 5, 1996; GulfWest Texas Company formed September 23, 1996; DutchWest Oil Company formed July 28, 1997; Southeast Texas Oil and Gas Company, L.L.C. acquired September 1, 1998; SETEX Oil and Gas Company formed August 11, 1998; GulfWest Oil & Gas Company formed February 8, 1999; LTW Pipeline Co. formed April 19, 1999; GulfWest Development Company formed November 9, 2000; and, GulfWest Oil & Gas Company (Louisiana) LLC formed July 31, 2001. All material intercompany transactions and balances are eliminated upon consolidation.
3. In management's opinion, the accompanying interim financial statements contain all material adjustments, consisting only of normal recurring adjustments necessary to present fairly the financial condition, the results of operations, and the statements of cash flows of GulfWest Energy Inc. for the interim periods.
4. Non-cash Investing and Financing

During the nine month period ended September 30, 2002, we acquired \$74,653 in property and equipment through notes payable to financial institutions. We also acquired \$182,742 of oil producing properties in exchange of accounts receivable from a related party.
5. As a result of a financing agreement with an energy lender, we were required to enter into an oil and gas hedging agreement with the lender. It has been determined this agreement meets the definition of SFAS 133 "Accounting for Derivative Instruments and Hedging Activities" and is accounted for as a derivative instrument.

We entered into the agreement, commencing in May 2000, to hedge a portion of our oil and gas sales for the period of May 2000 through April 2004. The agreement calls for initial volumes of 7,900 barrels of oil and 52,400 Mcf of gas per month, declining monthly thereafter. We entered into a second agreement with the energy lender, commencing September 2001, to hedge an

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additional portion of our oil and gas sales for the periods of September 2001 through July 2004 and September 2001 through December 2002, respectively. The agreement calls for initial volumes of 15,000 barrels of oil and 50,000 Mmbtu of gas per month, declining monthly thereafter. As a result of these agreements, we realized a reduction in revenues of \$111,229 for the nine-month period ended September 30, 2002, which is included in oil and gas sales.

The estimated change in fair value of the derivatives is reported in Other Income and Expense as unrealized (gain) loss on derivative instruments. The estimated fair value of the derivatives is reported in Other Assets (or Other Liabilities) as derivative instruments.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

We are engaged primarily in the acquisition, development, exploitation, exploration and production of crude oil and natural gas. Our focus is on increasing production from our existing crude oil and natural gas properties through the further exploitation, development and optimization of those properties, and on acquiring additional crude oil and natural gas properties. Our gross revenues are derived from the following sources:

1. Oil and gas sales that are proceeds from the sale of crude oil and natural gas production to midstream purchasers;
2. Operating overhead and other income that consists of earnings from operating crude oil and natural gas properties for other working interest owners, and marketing and transporting natural gas. This also includes earnings from other miscellaneous activities.
3. Well servicing revenues that are earnings from the operation of well servicing equipment under contract to third party operators.

Results of Operations

The factors which most significantly affect our results of operations are (1) the sales price of crude oil and natural gas, (2) the level of total sales volumes of crude oil and natural gas, (3) the level of and interest rates on borrowings and, (4) the level and success of new acquisitions and development of existing properties.

Comparative results of operations for the periods indicated are discussed below.

Three-Month Period Ended September 30, 2002 compared to Three Month Period Ended September 30, 2001.

Revenues

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Oil and Gas Sales. Revenues from the sale of crude oil and natural gas for the quarter decreased 26% from \$3,457,900 in 2001 to \$2,555,500 in 2002, primarily due to the natural decline in production from horizontal wells in the Madisonville Field, Texas and other Gulf Coast wells, as well as a slight decrease in average commodity sales prices.

Well Servicing Revenues. Revenues from well servicing operations decreased 79% from \$54,100 in 2001 to \$11,500 in 2002, due to higher rig utilization on the properties we operate and less on working for third parties.

Operating Overhead and Other Income. Revenues from these activities decreased 53% from \$157,200 in 2001 to \$74,600 in 2002. This was due to a fee received for the farm-out of exploration rights on one of our undeveloped properties in 2001.

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Costs and Expenses

Lease Operating Expenses. Lease operating expenses increased 12% from \$1,309,200 in 2001 to \$1,461,000 in 2002. This was due to costs for surface equipment and lease road repairs on several of our Gulf Coast properties, as well as higher vendor, contractor and gas compression charges.

Cost of Well Servicing Operations. Well servicing expenses decreased 81% from \$53,600 in 2001 to \$10,400 in 2002 due to higher rig utilization on the properties we operate and less on working for third parties.

Depreciation, Depletion and Amortization (DD&A). DD&A decreased 21% from \$795,300 in 2001 to \$625,400 in 2002, due to lower commodity sales volumes.

General and Administrative (G&A) Expenses. G&A expenses increased slightly for the period from \$427,400 in 2001 to \$444,300 in 2002.

Interest Expense. Interest expense increased 12% from \$707,200 in 2001 to \$793,000 in 2002, primarily due to increased debt for funding of capital development projects.

Nine-Month Period Ended September 30, 2002 compared to Nine-Month Period Ended September 30, 2001.

Revenues

Oil and Gas Sales. Revenues from the sale of crude oil and natural gas for the period decreased 19% from \$9,722,600 in 2001 to \$7,895,500 in 2002. This was due to the decrease in commodity prices, since sales volumes remained at the same level for the period.

Well Servicing Revenues. Revenues from well servicing operations decreased by 82% from \$136,100 in 2001 to \$24,100 in 2002. We had greater utilization of our rigs in the development of our properties rather than working for third parties in 2002 compared to 2001.

Operating Overhead and Other Income. Revenues from these activities decreased slightly from \$324,200 in 2001 to \$322,600 in 2002.

Costs and Expenses

Lease Operating Expenses. Lease operating expenses increased 12% from

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\$3,740,600 in 2001 to \$4,181,200 in 2002, due to costs for surface equipment and lease road repairs on several of our Gulf Coast properties, as well as higher vendor, contractor and gas compression charges.

Cost of Well Servicing Operations. Well servicing expenses decreased by 67% from \$137,000 in 2001 to \$45,000 in 2002. This was due to higher rig utilization on the properties we operate and less on working for third parties.

Depreciation, Depletion and Amortization (DD&A). DD&A increased 4% from \$1,838,400 in 2001 to \$1,912,300 in 2002, due to a slight increase in capital costs associated with our development program.

General and Administrative (G&A) Expenses. G&A expenses increased 6% for the period from \$1,233,300 in 2001 to \$1,313,000 in 2002, due to expenses related to financial efforts we conducted.

Interest Expense. Interest expense increased 12% from \$1,993,500 in 2001 to \$2,236,100 in 2002, primarily due to increased debt for funding of capital development projects. New Line Item Added to Statement of Operations