

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10QSB

BLUE DOLPHIN ENERGY CO  
Form 10QSB  
August 23, 2004

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

FORM 10-QSB

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

For the quarterly period ended: June 30, 2004

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the transition period from .....to .....

Commission File Number: 0-15905

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

Delaware  
(State or other jurisdiction of  
incorporation or organization)

73-1268729  
(I.R.S. Employer  
Identification No.)

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

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

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

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

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

As of August 19, 2004, there were 6,720,001 shares of the registrants' common stock, par value \$.01 per share, outstanding.

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

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

June 30, 2004  
BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

PART I. FINANCIAL INFORMATION

# Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10QSB

## ITEM 1. FINANCIAL STATEMENTS

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

Our accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-KSB/A-1 for the year ended December 31, 2003.

2

### BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

#### CONDENSED CONSOLIDATED BALANCE SHEET - UNAUDITED

June 30, 2004

#### ASSETS

##### Current assets:

Cash and cash equivalents	\$ 1,030,013
Accounts receivable	236,405
Related party receivable	7,362
Deferred federal income tax	244,444
Prepaid expenses and other assets	173,331

TOTAL CURRENT ASSETS	1,691,555
----------------------	-----------

Property and Equipment at cost:

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10QSB

Oil and Gas properties, including \$167,684 of unproved leasehold cost (full-cost method)	519,505
Pipelines	4,546,287
Onshore separation and handling facilities	1,664,128
Land	860,275
Other property and equipment	307,238
	-----
	7,897,433
Less: Accumulated depletion, depreciation and amortization	2,390,403
	-----
	5,507,030
Investment in New Avoca	581,996
Other assets	26,977
	-----
TOTAL ASSETS	\$ 7,807,558
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Accounts payable	\$ 1,575,484
Accrued expenses and other liabilities	47,267
	-----
TOTAL CURRENT LIABILITIES	1,622,751
Note payable	750,000
Interest payable	109,745
Asset retirement obligations	1,584,051
Common Stock, (\$.01 par value, 10,000,000 shares authorized, 6,712,438 shares issued and outstanding)	67,124
Additional Paid-in Capital	26,349,762
Accumulated Deficit	(22,675,875)
	-----
	3,741,011
TOTAL LIABILITES AND STOCKHOLDERS' EQUITY	\$ 7,807,558
	=====

See accompanying notes to the condensed consolidated financial statements.

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

Three Months	
Ended June 30,	
2004	2003
-----	-----

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10QSB

Revenue from operations:		
Pipeline operations	\$ 193,498	\$ 256,931
Oil and gas sales	126,278	745,011
Gain on sale of oil and gas property	25,809	--
	-----	-----
	345,585	1,001,942
	-----	-----
Cost of operations:		
Pipeline operating expenses	405,281	274,425
Lease operating expenses	35,187	18,218
Depletion, depreciation and amortization	119,726	99,421
General and administrative	400,227	394,617
Accretion expense	23,286	19,167
	-----	-----
	983,707	805,848
	-----	-----
INCOME (LOSS) FROM OPERATIONS	(638,122)	196,094
Other income (expense):		
Interest and other expense	(213,960)	(30,606)
Interest and other income	53,744	305,088
Equity in loss of affiliate	(25,068)	--
	-----	-----
INCOME (LOSS) BEFORE INCOME TAXES	(823,406)	470,576
Income taxes	--	--
	-----	-----
Net income (loss)	\$ (823,406)	\$ 470,576
	=====	=====
Income (loss) per common share		
- basic	\$ (0.12)	\$ 0.07
	=====	=====
- diluted	\$ (0.12)	\$ 0.07
	=====	=====
Weighted average number of common shares outstanding - basic	6,712,438	6,637,163
	=====	=====
Weighted average number of common shares outstanding - diluted	6,712,438	6,793,779
	=====	=====

See accompanying notes to the condensed consolidated financial statements.

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS - UNAUDITED

Six Months  
 Ended June 30,  
 2004                      2003

Revenue from operations:

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10QSB

Pipeline operations	\$ 397,537	\$ 503,59
Oil and gas sales	281,170	819,31
Gain on sale of oil and gas property	25,809	--
	-----	-----
	704,516	1,322,91
	-----	-----
Cost of operations:		
Pipeline operating expenses	648,532	467,81
Lease operating expenses	67,026	30,27
Depletion, depreciation and amortization	254,508	188,46
General and administrative	896,241	877,32
Accretion expense	46,642	40,89
	-----	-----
	1,912,949	1,604,78
	-----	-----
LOSS FROM OPERATIONS	(1,208,433)	(281,86
Other income (expense):		
Interest and other expense	(225,662)	(43,29
Interest and other income	139,453	439,68
Equity in loss of affiliate	(48,370)	--
	-----	-----
INCOME (LOSS) BEFORE INCOME TAXES	(1,343,012)	114,52
Income taxes	--	--
	-----	-----
INCOME (LOSS) BEFORE CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE	(1,343,012)	114,52
Cumulative effect of a change in accounting principle for asset retirement obligations	--	(40,45
	-----	-----
Net income (loss)	\$ (1,343,012)	\$ 74,06
	=====	=====
Income (loss) per common share - basic		
Income (loss) before accounting change	\$ (0.20)	\$ 0.0
	=====	=====
Cumulative effect of a change in accounting principle	\$ --	\$ (0.0
	=====	=====
Net income (loss)	\$ (0.20)	\$ 0.0
	=====	=====
Income (loss) per common share - diluted		
Income (loss) before accounting change	\$ (0.20)	\$ 0.0
	=====	=====
Cumulative effect of a change in accounting principle	\$ --	\$ (0.0
	=====	=====
Net income (loss)	\$ (0.20)	\$ 0.0
	=====	=====
Weighted average number of common shares outstanding		
- basic	6,688,082	6,624,64
	=====	=====
- diluted	6,688,082	6,740,26

See accompanying notes to the condensed consolidated financial statements.

5

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

	Six Months Ended June 30,	
	2004	2003
	-----	-----
OPERATING ACTIVITIES		
Net income (loss)	\$(1,343,012)	\$ 74,06
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depletion, depreciation and amortization	254,508	188,46
Gain from change in estimate of abandonment costs	--	(278,65)
Gain on sale of oil and gas property	(25,809)	--
Change in accounting principle	--	40,45
Accretion of asset retirement obligations	46,642	40,89
Equity in loss of affiliate	48,370	--
Common stock issued for services	83,000	19,72
Changes in operating assets and liabilities:		
Accounts receivable	245,318	(628,02)
Prepaid expenses and other assets	(27,990)	194,06
Abandonment costs incurred	--	(126,76)
Trade accounts payable and accrued expenses	(936,866)	(2,50)
	-----	-----
NET CASH USED IN OPERATING ACTIVITIES	(1,655,839)	(478,27)
	-----	-----
INVESTING ACTIVITIES		
Property, equipment and other assets	(9,556)	(37,94)
Proceeds from sale of assets	34,183	--
Development costs - New Avoca	(41,667)	(46,58)
	-----	-----
NET CASH USED IN INVESTING ACTIVITIES	(17,040)	(84,52)
	-----	-----
FINANCING ACTIVITIES		
	--	--
	-----	-----
DECREASE IN CASH AND CASH EQUIVALENTS	(1,672,879)	(562,80)
	-----	-----
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	2,702,892	4,405,67
	-----	-----
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 1,030,013	\$ 3,842,87
	=====	=====

# Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10QSB

See accompanying notes to the condensed consolidated financial statements.

6

## BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

JUNE 30, 2004

#### 1. Liquidity and Going Concern

At June 30, 2004, we had working capital of approximately \$70,000. In August 2004, we extended the remaining payments totaling \$668,000 due in September and October 2004 to Tetra Applied Technologies, Inc. associated with the Buccaneer Field abandonment/reefing whereby we will pay Tetra in twelve monthly installments of \$55,667 beginning September 1, 2004, plus interest on the outstanding balance at the rate of six percent per annum.

We are currently able to pay our debts as they become due, however, we expect that we will need to raise approximately \$0.5 million to satisfy our liquidity needs in the fourth quarter 2004. In order to satisfy our working capital and capital expenditure requirements for the year ending December 31, 2005, we believe that we will need to raise approximately \$2.0 million of additional capital. We will need to arrange external financing and/or sell assets to raise all of the necessary capital.

Historically, we have relied on the proceeds from the sale of assets and capital raised from the issuance of debt and equity securities to individual investors and related parties to sustain our operations. While we are currently seeking capital, there can be no assurance that we will be able to obtain financing or sell assets on commercially acceptable terms to meet our capital requirements. Our inability to raise capital will have a material adverse effect on our financial condition, ability to meet our obligations and operating needs, and results of operations. Our financial statements contained herein have been prepared assuming that we will continue as a going concern, however our working capital and capital expenditure requirements for the next twelve months raise substantial doubt about our ability to continue as a going concern. Our financial statements do not include any adjustments that might result from the outcome of this uncertainty.

#### 2. Related Party Transactions

We own 12.8% of the common stock of Drillmar, Inc. Our Chairman, Ivar Siem (along with certain of his affiliated entities), and one of our Directors, Harris A. Kaffie, are owners of 30.3%, and 30.6%, respectively, of Drillmar's common stock. Messrs. Siem and Kaffie are both Directors, and Mr. Siem is Chairman and President of Drillmar.

In 2002, we recorded a full impairment of our investment in Drillmar of approximately \$340,000 and a full reserve for the accounts receivable amount owed to us from Drillmar of approximately \$200,000 due to Drillmar's working capital deficiency and delays in securing capital funding. During the six months ended June 30, 2004, we collected \$75,000 from Drillmar and we expect to continue to receive \$15,000 per month until the accounts receivable is fully

collected.

7

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED - Continued

JUNE 30, 2004

In January 2003, Drillmar stockholders approved a restructuring plan whereby Drillmar will issue up to \$3.0 million of convertible notes that are convertible into common stock representing over 99% of Drillmar's outstanding shares. As a result, our ownership in Drillmar can be reduced to less than 1%. However, in November 2003, we converted a contingent obligation due from Drillmar for providing office space, accounting and administrative services from May 2002 through January 2003 totalling \$162,000 (9 months at \$18,000 per month) into a convertible note, which if converted along with all of Drillmar's outstanding convertible notes, would represent 7.7% of Drillmar's common stock. Messrs. Siem, Kaffie and Trimble (one of our Directors) also hold Drillmar convertible notes, which if converted along with all of Drillmar's outstanding convertible notes, would represent 22.2%, 27.5% and 2.1%, respectively, of Drillmar's common stock.

We entered into a new agreement with Drillmar effective as of February 1, 2003, whereby we provide office space to Drillmar, which is currently approximately \$4,000 per month. We also provide professional, accounting and administrative services to Drillmar billed at hourly rates based on our cost. The agreement can be terminated upon 30 days notice or by the mutual agreement of the parties.

Effective April 1, 2003, we entered into a sublease agreement expiring December 31, 2006 for certain of our office space with Tri-Union Development Corporation. Our receipts from this sublease are approximately \$78,500 annually. Mr. Trimble is the Chairman and Chief Executive Officer of Tri-Union.

### 3. Contingencies

We are involved in various claims and legal actions arising in the ordinary course of business. In our opinion, the ultimate disposition of these matters will not have a material effect on our financial position, results of operations or cash flows.

### 4. Change in Accounting Principle

In August 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 143 ("SFAS 143"), "Accounting for Asset Retirement Obligations", which addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The standard applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal use of the asset.

8



# Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10QSB

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED - Continued

JUNE 30, 2004

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

The adoption of SFAS 143 resulted in a January 1, 2003 cumulative effect adjustment to record (i) a \$1.0 million increase in the carrying value of pipelines, (ii) a \$.4 million decrease in accumulated depreciation, depletion, and amortization of property, plant and equipment, and (iii) a \$1.4 million increase in non-current abandonment liabilities. The net impact of items (i) through (iii) was to record an expense of \$40 thousand, net of tax, as a cumulative effect adjustment of a change in accounting principle in the Company's consolidated statement of operations upon adoption on January 1, 2003.

## 5. Earnings Per Share

We apply the provisions of Statement of Financial Accounting Standards No. 128 ("SFAS 128"), "Earnings per Share". SFAS 128 requires the presentation of basic earnings per share ("EPS") which excludes dilution and is computed by dividing net income (loss) available to common stockholders by the weighted-average number of shares of common stock outstanding for the period. SFAS 128 requires dual presentation of basic EPS and diluted EPS on the face of the income statement and requires a reconciliation of the numerators and denominators of basic EPS and diluted EPS.

9

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED - Continued

JUNE 30, 2004

Weighted-  
Average Number  
of Common Shares

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10QSB

	Net Income (Loss)	Outstanding and Potential Dilutive Common Shares	Per Share Amount
	-----	-----	-----
Six Months ended June 30, 2004			
Basic and diluted loss per share	\$ (1,343,012)	6,688,082	\$ (0.20)
	=====	=====	=====
Six Months ended June 30, 2003			
Basic earnings per share	\$ 74,066	6,624,642	\$ 0.01
Effect of dilutive stock options		115,625	
	-----	-----	-----
Diluted earnings per share	\$ 74,066	6,740,267	\$ 0.01
	=====	=====	=====
Quarter ended June 30, 2004			
Basic and diluted loss per share	\$ (823,406)	6,712,438	\$ (0.12)
	=====	=====	=====
Quarter ended June 30, 2003			
Basic earnings per share	470,576	6,637,163	\$ 0.07
	-----	-----	-----
Diluted earnings per share	\$ 470,576	6,793,779	\$ 0.07
	=====	=====	=====

6. Business Segment Information

Our income producing operations are conducted in two principal business segments: oil and gas exploration and production, and pipeline operations. There were no intersegment revenues during the periods presented. Information concerning these segments for the six months and quarters ended June 30, 2004 and 2003, and at June 30, 2004 are as follows:

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED - Continued

JUNE 30, 2004

Revenues	Operating Income (Loss) (1)	Depletion, Depreciation a Amortization
-----	-----	-----

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10QSB

Six months ended June 30, 2004:			
Oil and gas exploration and production	\$ 281,170	(121,170)	84,789
Pipeline operations	397,537	(800,888)	163,671
Other	--	(312,184)	6,048
	-----	-----	-----
Consolidated	678,707	(1,234,242)	254,508
Other income (loss), net	-----	(108,770)	-----
		-----	
Loss before income taxes		(1,343,012)	
Six months ended June 30, 2003:			
Oil and gas exploration and production	\$ 819,317	397,127	16,141
Pipeline operations	503,599	(394,077)	162,206
Other	--	(284,919)	10,122
	-----	-----	-----
Consolidated	1,322,916	(281,869)	188,469
Other income, net	-----	396,390	-----
		-----	
Income before income taxes		114,521	
Quarter ended June 30, 2004:			
Oil and gas exploration and production	\$ 126,278	(57,293)	34,997
Pipeline operations	193,498	(482,974)	81,874
Other loss	--	(123,664)	2,855
	-----	-----	-----
Consolidated	319,776	(663,931)	119,726
Other income, net	-----	(159,475)	-----
		-----	
Loss before income taxes		(823,406)	
Quarter ended June 30, 2003:			
Oil and gas exploration and production	\$ 745,011	409,991	16,141
Pipeline operations	256,931	(114,034)	78,230
Other	--	(121,592)	5,050
	-----	-----	-----
Consolidated	1,001,942	174,365	99,421
Other income (loss), net		296,211	
		-----	
Income before income taxes		470,576	

11

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED - Continued

JUNE 30, 2004

June 30, 2004

Identifiable assets:

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10QSB

Oil and gas exploration and production	\$	428,221
Pipeline operations		5,650,648
Other		1,728,689
		-----
Consolidated	\$	7,807,558
		=====

- (1) Consolidated loss from operations includes \$306,136 and \$274,797 in unallocated general and administrative expenses, and unallocated depletion, depreciation and amortization of \$6,048 and \$10,122 for the six months ended June 30, 2004 and 2003, respectively.

Consolidated income (loss) from operations includes \$120,809 and \$116,542 in unallocated general and administrative expenses, and unallocated depletion, depreciation and amortization of \$2,855 and \$5,050 for the quarters ended June 30, 2004 and 2003, respectively.

7. Stock Based Compensation

We account for stock-based compensation granted under our long-term incentive plans using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations. Stock-based compensation expenses associated with option grants were not recognized in our net loss in the six months and three months ended June 30, 2004 and 2003, as all options granted had exercise prices equal to the market value of the underlying common stock on the dates of grant. The following table illustrates the effect on net loss and loss per share if we had applied the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" to stock-based employee compensation:

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 UNAUDITED - Continued  
 JUNE 30, 2004

Three months ended June 30,		Six month June
2004	2003	2004
-----	-----	-----

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10QSB

	(in thousands, except per share amounts)		
Net income (loss), as reported .....	\$ (823)	\$ 471	\$ (1,343)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	--	(30)	--
Pro forma net income (loss) .....	\$ (823)	\$ 441	\$ (1,343)
Net income (loss) per share:			
Basic - as reported .....	\$ (0.12)	\$ 0.07	\$ (0.20)
Basic - pro forma .....	\$ (0.12)	\$ 0.07	\$ (0.20)
Diluted - as reported .....	\$ (0.12)	\$ 0.07	\$ (0.20)
Diluted - pro forma .....	\$ (0.12)	\$ 0.06	\$ (0.20)

8. Recent Accounting Developments

In July 2003, an issue was brought before the FASB regarding whether or not contract-based oil and gas mineral rights held by lease or contract ("mineral rights") should be recorded or disclosed as intangible assets. The issue presents a view that these mineral rights are intangible assets as defined in SFAS No. 141, "Business Combinations," and, therefore, should be classified separately on the balance sheet as intangible assets. SFAS No. 141 and SFAS No. 142, "Goodwill and Other Intangible Assets," became effective for transactions subsequent to June 30, 2001, with the disclosure requirements of SFAS No. 142 required as of January 1, 2002. SFAS No. 141 requires that all business combinations initiated after June 30, 2001 be accounted for using the purchase method and that intangible assets be disaggregated and reported separately from goodwill. SFAS No. 142 established new accounting guidelines for both finite lived intangible assets and indefinite lived intangible assets. Under the statements, intangible assets should be separately reported on the face of the balance sheet and accompanied by disclosure in the notes to financial statements. SFAS No. 142 does not apply to accounting utilized by the oil and gas industry as prescribed by SFAS No. 19, and is silent about whether or not its disclosure provisions apply to oil and gas companies.

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

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

CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

In July 2004, the FASB proposed FASB staff position ("FSP") SFAS 142-b,

## Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10QSB

"Application of SFAS 142 to Oil and Gas Producing Entities." The proposed FSP clarifies that the exception in paragraph 8(b) of SFAS No. 142, "Goodwill and Other Intangible Assets," includes the balance sheet classification and disclosures for drilling and mineral rights of oil and gas producing entities. Accordingly, the FASB staff believes that the scope exception extends to the disclosure provisions of SFAS No. 142 for drilling and mineral rights of oil and gas producing entities. SFAS 142-b will be effective when the FSP is finalized.

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

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

Additional factors that could cause actual results to differ materially from those indicated in the forward-looking statements are discussed under the caption "Risk Factors" in our Form 10-KSB/A-1 for the fiscal year ended December 31, 2003. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We undertake no duty to update these forward-looking statements. Readers are urged to carefully review and consider the various disclosures made by us which attempt to advise interested parties of the additional factors which may affect our business, including the disclosures made under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this report.

### BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

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

##### EXECUTIVE SUMMARY

We are engaged in two lines of business; pipeline operations and oil

## Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10QSB

and gas exploration and production. We are a holding company and conduct our operations through our subsidiaries, which provide pipeline transportation services to producer/shippers, and sell oil and gas from our producing properties. Our assets primarily are located offshore and onshore in the Texas Gulf coast area. We also own an interest in and manage the New Avoca gas storage project located in Avoca, New York.

### LIQUIDITY AND CAPITAL RESOURCES

Our financial condition has been significantly and negatively affected by the poor performance of our businesses and our significant indebtedness. For the year ended December 31, 2003, we generated \$1.4 million of revenue from the sales of oil and gas production from the High Island Block A-7 field, approximately 57% of our revenues for that period. Oil and gas production from the High Island Block A-7 field has declined significantly and for the six months ended June 30, 2004 we had generated \$0.2 million of revenue from the sales of oil and gas production, approximately 31% of our revenues for that period. Production from the High Island Block A-7 field is expected to cease in 2005. As a result of the decline in production from this field we expect that a significant portion of our revenues in 2004 will be derived from utilization of our pipeline systems. Presently, our pipeline systems are generating negative cash flow. We are currently able to pay our debts as they become due, however, we expect that we will need to raise approximately \$0.5 million to satisfy our liquidity needs in the fourth quarter 2004.

- o our ability to raise capital to meet current commitments and fund the continuation of our business operations; and
- o our ability to ultimately achieve profitability and positive cash flows from operations in amounts that will sustain our operations.

In order to address our financing needs, we (i) have engaged a financial adviser to assist us in raising capital, (ii) implemented a cost savings plan to reduce our operating costs and overhead costs and (iii) are currently attempting to restructure the terms of our indebtedness.

### BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

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

The following table summarizes certain of our contractual obligations and other commercial commitments at June 30, 2004 (amounts in thousands):

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10QSB

Contractual Obligations	Total	1 year or less	Payments Due by Period		
			1-3 years	3-5 years	After 5 years
Accounts Payable - Tetra	\$ 935	935	--	-	--
Long-Term Debt	860	--	860	-	--
Operating Leases, net of sublease	300	124	176	-	--
Total Contractual Obligations	\$ 2,095	1,059	1,036	-	--

Other Commercial Commitments	Total	1 year or less	Amount of Commitment Expiration Per Period		
			1-3 years	3-5 years	After 5 years
Abandonment - Costs	\$ 1,584	--	191	-	1,393
Total Commercial Obligations	\$ 1,584	--	191	-	1,393

16

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

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

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

	June 30, 2004		December 31, 2003	
	Amount	%	Amount	%
Working Capital	\$ 69	1	\$ 680	9
Property and equipment, net	5,507	89	5,775	79
Other noncurrent assets	609	10	848	12
Total	\$6,185	100	\$7,303	100



Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10QSB

	=====	=====	=====	=====
Long-term Liabilities	\$2,444	40	\$2,302	32
Stockholders' equity	3,741	60	5,001	68
	-----	-----	-----	-----
Total	\$6,185	100	\$7,303	100
	=====	=====	=====	=====

The change in our financial position from December 31, 2003 to June 30, 2004, was primarily due to our net loss for the six months ended June 30, 2004 of approximately \$1.3 million.

The net cash provided by or used in operating, investing and financing activities is summarized below:

	Six Months Ended June 30,	
	2004	2003
	-----	-----
Net cash used in:	(amounts in thousands)	
Operating activities	\$ (1,656)	\$ (478)
Investing activities	(17)	(85)
Financing activities	--	--
	-----	-----
Net decrease in cash	\$ (1,673)	\$ (563)
	=====	=====

The net cash used in operating activities during the six months ended June 30, 2004, reflects the payment of Buccaneer Field abandonment costs and other payables, and the net loss from operations. In August 2003, we completed the abandonment/reefing of the Buccaneer Field. As of June 30, 2004, remaining costs of \$0.9 million are due to our contractor, Tetra Technologies, with whom we arranged payment terms. In August 2004, we extended the remaining payments totaling \$668,000 due in September and October 2004 to Tetra whereby we will pay them in twelve monthly installments of \$55,667 beginning September 1, 2004, plus interest on the outstanding balance at the rate of six percent per annum.

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

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

During 2002, we sold substantially all of our interests in our proved oil and gas properties. From October 2002 to late April 2003, we had no interest in any producing oil and gas properties. In late April 2003, we began to receive revenue from our 8.9% reversionary working interest in the High Island Area Block A-7 field, in the Gulf of Mexico. Oil and gas production from this field comes from one well that currently produces at a gross rate of 1.4 MMcf/day.

## Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10QSB

Pursuant to a cost reduction program, we implemented personnel reductions, among other things, in June and July 2004. The annual cost savings associated with the cost reductions are expected to be approximately \$360,000.

During 2004, we were in negotiations with a group of private investors to provide capital to us. In July 2004, the negotiations ended unsuccessfully. Legal and other fees incurred associated with the proposed transaction were approximately \$200,000.

During the six months ended June 30, 2004, we incurred no capital expenditures for the development of our proved reserves. Projected capital expenditures totaling \$27,000 and \$191,000 are expected to be incurred in the years ending December 31, 2004 and 2005, respectively. Capital expenditures in 2005 represent the abandonment costs net to our interest of our High Island Area Block A-7 property.

We have significant available capacity in our Blue Dolphin Pipeline system in a market area that we believe is experiencing an increased level of interest by oil and gas operators. Natural gas throughput on our Blue Dolphin Pipeline system is currently 7 MMBtu per day, representing 4% of system capacity, however we are currently not aware of additional throughput volumes that could be connected to the system in the short term and existing throughput volumes are expected to decline. Future utilization of our pipeline and related facilities will depend upon the success of drilling programs around our pipeline systems, and attraction and retention of producer/shippers to the systems. As a result of increased leasing and oil and gas prospect development activity around the Blue Dolphin Pipeline system and anticipated drilling activity, we expect that utilization of the Blue Dolphin Pipeline system will increase in 2005.

We continue to explore the possibility of expanding our Freeport, Texas operations to include terminalling and shipment by barge of oil and condensate received by truck and/or pipeline (in addition to the Blue Dolphin pipeline). With excess capacity, including ample available acreage to handle liquids, we believe a liquids storage and transportation service can add to the base Blue Dolphin Pipeline production gathering business.

We currently are continuing our efforts to sell our interest in the New Avoca gas storage project. To enhance this effort, we are marketing prospective capacity to potential users of the project. We currently expect that costs net to our interest during the year ending December 31, 2004 will be approximately \$100,000.

18

### BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

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

In February 2002, we acquired an additional 1/3 interest in the Blue Dolphin Pipeline System and the inactive Omega Pipeline from MCNIC Pipeline and Processing Group, Inc. ("MCNIC"). Pursuant to the terms of the purchase and sales agreement, Blue Dolphin Pipeline Company issued MCNIC a \$750,000 promissory note due December 31, 2006, with required monthly payments to be made out of 90% of the net revenues of the interest acquired. As of June 30, 2004, the amount owed MCNIC is \$750,000 plus accrued interest of approximately \$110,000.

## Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10QSB

### RESULTS OF OPERATIONS

We reported a net loss for the six months ended June 30, 2004 ("current period") of \$1,343,012 compared to net income of \$74,066 reported for the six months ended June 30, 2003 ("previous period"), and for the three months ended June 30, 2004 ("current quarter"), we reported a net loss of \$823,406, compared to net income of \$470,576 for the three months ended June 30, 2003 ("previous quarter").

#### First Half of 2004 compared to First Half of 2003

Revenue from pipeline operations. Revenues from pipeline operations decreased by \$106,062 or 21% in the current period to \$397,537. The decrease was due primarily to a decrease in transportation volumes on the Blue Dolphin Pipeline system of 34% resulting in a decrease in revenues of approximately \$149,000, offset in part by a 34% increase in revenues of approximately \$42,000 from the GA 350 Pipeline.

Revenue from oil and gas sales. Our revenues from oil and gas sales decreased by \$538,147 in the current period from those of the previous period primarily due to significant production declines from our interest in the High Island Block A-7 field, which provided revenues from oil and gas sales of approximately \$217,000 in the current period compared to approximately \$745,000 in the previous period. Current period oil and gas sales include approximately \$64,000 from our interest in the High Island Block 34 field, which interest was received in late 2003.

Gain on sale of oil and gas property. Gain on sale of oil and gas property represents the gain recognized from the sale of our interest in the High Island Block 34 oil and gas property.

Pipeline operating expenses. Pipeline operating expenses in the current period increased by \$180,713 from \$467,819 in the previous period due to higher repairs and maintenance costs of approximately \$171,000, and legal costs of approximately \$54,000, offset in part by cost reductions that were implemented during 2003 that resulted in lower operating costs of approximately \$50,000. The legal costs are associated with an action filed against us, the outcome of which we do not believe will have a material impact. However, if this litigation continues for a prolonged period of time, we would incur significant legal expenses, which could have a material effect on our financial condition.

Interest and other expense. Interest and other expense increased \$182,364 in the current period. Other expense in the current period includes legal and other fees associated with a proposed financing transaction that was subsequently terminated of approximately \$200,000.

### BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

Interest and other income. Interest and other income decreased \$300,235 in the current period. Other income in the current period includes the collection of accounts receivable that were previously written off of \$75,000, consulting services provided by us associated with the evaluation of oil and gas properties of approximately \$50,000. Other income in the previous period includes an approximately \$280,000 gain from a reduction in our provision for the Buccaneer Field abandonment costs, and fees generated for consulting services we provided associated with the evaluation of oil and gas properties of approximately \$93,000.

## Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10QSB

Equity in loss of affiliate. In the current period we recorded a loss from our equity interest in New Avoca of \$48,370.

Cumulative effect of a change in accounting principal. In the previous period, as a result of our adoption of SFAS No. 143, we recorded a cumulative effect adjustment at January 1, 2003 of a change in accounting principle for asset retirement obligations of \$40,455 (see note 4 to the Condensed Consolidated Financial Statements).

Second Quarter of 2004 compared to Second Quarter of 2003

Revenue from pipeline operations. Current quarter revenues from pipeline operations decreased by \$63,433 or 25% from the previous quarter to \$193,498 due to a 37% decrease in throughput on the Blue Dolphin System in the current quarter, partially offset by a 33% increase in throughput on the GA 350 System.

Revenue from oil and gas sales. Current quarter revenues from oil and gas sales decreased by \$618,733 primarily due to significant production declines from our interest in the High Island Block A-7 field, which provided revenues from oil and gas sales of approximately \$99,000 in the current quarter compared to approximately \$745,000 in the previous quarter.

Pipeline operating expenses. Pipeline operating expenses in the current quarter increased by \$130,856 from \$274,425 in the previous quarter due to higher repairs and maintenance costs of approximately \$157,000 and legal costs of approximately \$26,000, offset in part by cost reductions that were implemented during 2003 that resulted lower operating costs of approximately \$50,000.

Interest and other expense. Interest and other expense increased \$183,354 in the current quarter. Other expense in the current quarter includes legal and other fees associated with a proposed financing transaction that was subsequently terminated of approximately \$200,000.

Interest and other income. Interest and other income decreased \$251,344 in the current quarter. Other income in the current quarter includes the collection of accounts receivable that were previously written off of \$45,000. Other income in the previous quarter includes an approximately \$280,000 gain from a reduction in our provision for the Buccaneer Field abandonment costs.

Equity in loss of affiliate. In the current quarter, we recorded a loss from our equity interest in New Avoca of \$25,068.

### BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

Recent Accounting Developments. In July 2003, an issue was brought before the FASB regarding whether or not contract-based oil and gas mineral rights held by lease or contract ("mineral rights") should be recorded or disclosed as intangible assets. The issue presents a view that these mineral rights are intangible assets as defined in SFAS No. 141, "Business Combinations," and, therefore, should be classified separately on the balance sheet as intangible assets. SFAS No. 141 and SFAS No. 142, "Goodwill and Other Intangible Assets," became effective for transactions subsequent to June 30, 2001, with the disclosure requirements of SFAS No. 142 required as of January 1, 2002. SFAS No. 141 requires that all business combinations initiated after June

## Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10QSB

30, 2001 be accounted for using the purchase method and that intangible assets be disaggregated and reported separately from goodwill. SFAS No. 142 established new accounting guidelines for both finite lived intangible assets and indefinite lived intangible assets. Under the statements, intangible assets should be separately reported on the face of the balance sheet and accompanied by disclosure in the notes to financial statements. SFAS No. 142 does not apply to accounting utilized by the oil and gas industry as prescribed by SFAS No. 19, and is silent about whether or not its disclosure provisions apply to oil and gas companies.

In July 2004, the FASB proposed FASB staff position ("FSP") SFAS 142-b, "Application of SFAS 142 to Oil and Gas Producing Entities." The proposed FSP clarifies that the exception in paragraph 8(b) of SFAS No. 142, "Goodwill and Other Intangible Assets," includes the balance sheet classification and disclosures for drilling and mineral rights of oil and gas producing entities. Accordingly, the FASB staff believes that the scope exception extends to the disclosure provisions of SFAS No. 142 for drilling and mineral rights of oil and gas producing entities. SFAS 142-b will be effective when the FSP is finalized.

### ITEM 3. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Principal Accounting Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13(a) - 14(c) and 15(d) - 14(c) under the Securities Exchange Act of 1934, as amended). Based upon the evaluation, the Chief Executive Officer and Principal Accounting Officer concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934, are recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. There were no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

## PART II. OTHER INFORMATION

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

- A) Exhibits
  - 3.1 Amended Bylaws of the Company
    - 31.1 Ivar Siem Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
    - 31.2 G. Brian Lloyd Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
  - 32.1 Ivar Siem Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10QSB

2002.

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

B) Reports on Form 8-K

On May 14, 2004, we filed a current report on Form 8-K dated May 14, 2004 reporting our first quarter 2004 earnings. The Item in such current report was Item 12 (Results of Operations and Financial Condition).

SIGNATURES

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

By: BLUE DOLPHIN ENERGY COMPANY

Date: August 20, 2004

/s/ Ivar Siem

-----  
Ivar Siem  
Chairman and Chief Executive Officer

/s/ G. Brian Lloyd

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