

VAALCO ENERGY INC /DE/
Form 10-K
March 16, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2014

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: 1-32167

VAALCO Energy, Inc.

(Exact name of registrant as specified on its charter)

Delaware 76-0274813
(State or other jurisdiction of (I.R.S. Employer

incorporation or organization) Identification No.)

9800 Richmond Avenue

Suite 700

Houston, Texas 77042

(Address of principal executive offices) (Zip Code)

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(Registrant's telephone number, including area code): (713) 623-0801

Securities registered under Section 12(b) of the Exchange Act:

Title of each class	Name of exchange on which registered
Common Stock, \$.10 par value	New York Stock Exchange

Securities registered under Section 12(g) of the Exchange Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15d of the Act. Yes No

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 has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The aggregate market value of the voting and non-voting common equity of the registrant held by non-affiliates, as of June 30, 2014 was \$411,807,121 based on a closing price of \$7.23 on June 30, 2014.

As of February 28, 2015, there were outstanding 57,880,481 shares of common stock, \$0.10 par value per share, of the registrant.

Documents incorporated by reference: Definitive proxy statement of VAALCO Energy, Inc. relating to the Annual Meeting of Stockholders to be filed within 120 days after the end of the fiscal year covered by this Form 10-K, which is incorporated into Part III of this Form 10-K.

VAALCO ENERGY, INC.

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Glossary of Oil and Gas Terms

Terms used to describe quantities of oil and natural gas

Bbl — One stock tank barrel, or 42 US gallons liquid volume, of crude oil or other liquid hydrocarbons.

BOE — One barrel of oil equivalent, converting gas to oil at the ratio of 6 Mcf of gas to 1 Bbl of oil. The ratio of six Mcf of natural gas to one Bbl of oil or natural gas liquids is commonly used in the oil and gas business and represents the approximate energy equivalency of six Mcf of natural gas to one Bbl of oil or liquids, and does not represent the sales price equivalency of natural gas to oil or liquids. Currently, the sales price of Bbl of oil or natural gas liquids is significantly higher than the sales price of six Mcf of natural gas.

BOPD — One barrel of oil per day.

MBbl — One thousand

Bbls.

Mcf — One thousand cubic feet of natural gas.

MMcf — One million cubic feet of natural gas.

Terms used to describe the Company's interests in wells and acreage

Gross oil and gas wells or acres — The Company's gross wells or gross acres represent the total number of wells or acres in which the Company owns a working interest.

Net oil and gas wells or acres — Determined by multiplying "gross" oil and natural gas wells or acres by the working interest that the Company owns in such wells or acres represented by the underlying properties.

Terms used to assign a present value to the Company's reserves

Standard measure of proved reserves — The present value, discounted at 10%, of the future net cash flows attributable to estimated net proved reserves. The Company calculates this amount by assuming that it will sell the oil and gas production attributable to the proved reserves estimated in its independent engineer's reserve report for the prices used in the report, unless it had a contract to sell the production for a different price. The Company also assumes that the cost to produce the reserves will remain constant at the costs prevailing on the date of the report. The assumed costs are subtracted from the assumed revenues resulting in a stream of future net cash flows. Estimated future income taxes using rates in effect on the date of the report are deducted from the net cash flow stream. The after-tax cash flows are discounted at 10% to result in the standardized measure of the Company's proved reserves.

Terms used to classify the Company's reserve quantities

Developed oil and gas reserves. Developed oil and gas reserves are reserves of any category that can be expected to be recovered:

(i) Through existing wells with existing equipment and operating methods or in which the cost of the required equipment is relatively minor compared to the cost of a new well; and

(ii) Through installed extraction equipment and infrastructure operational at the time of the reserves estimate if the extraction is by means not involving a well.

Proved oil and gas reserves. Proved oil and gas reserves are those quantities of oil and gas, which, by analysis of geoscience and engineering data, can be estimated with reasonable certainty to be economically producible—from a given date forward, from known reservoirs, and under existing economic conditions, operating methods, and government regulations—prior to the time at which contracts providing the right to operate expire, unless evidence indicates that renewal is reasonably certain, regardless of whether deterministic or probabilistic methods are used for the estimation. The project to extract the hydrocarbons must have commenced or the operator must be reasonably certain that it will commence the project within a reasonable time.

(i) The area of the reservoir considered as proved includes:

(A) The area identified by drilling and limited by fluid contacts, if any, and

(B) Adjacent undrilled portions of the reservoir that can, with reasonable certainty, be judged to be continuous with it and to contain economically producible oil or gas on the basis of available geoscience and engineering data.

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(ii) In the absence of data on fluid contacts, proved quantities in a reservoir are limited by the lowest known hydrocarbons (LKH) as seen in a well penetration unless geoscience, engineering, or performance data and reliable technology establishes a lower contact with reasonable certainty.

(iii) Where direct observation from well penetrations has defined a highest known oil (HKO) elevation and the potential exists for an associated gas cap, proved oil reserves may be assigned in the structurally higher portions of the reservoir only if geoscience, engineering, or performance data and reliable technology establish the higher contact with reasonable certainty.

(iv) Reserves which can be produced economically through application of improved recovery techniques (including, but not limited to, fluid injection) are included in the proved classification when:

(A) Successful testing by a pilot project in an area of the reservoir with properties no more favorable than in the reservoir as a whole, the operation of an installed program in the reservoir or an analogous reservoir, or other evidence using reliable technology establishes the reasonable certainty of the engineering analysis on which the project or program was based; and

(B) The project has been approved for development by all necessary parties and entities, including governmental entities.

(v) Existing economic conditions include prices and costs at which economic producibility from a reservoir is to be determined. The price shall be the average price during the 12-month period prior to the ending date of the period covered by the report, determined as an unweighted arithmetic average of the first-day-of-the-month price for each month within such period, unless prices are defined by contractual arrangements, excluding escalations based upon future conditions.

Reserves. Reserves are estimated remaining quantities of oil and gas and related substances anticipated to be economically producible, as of a given date, by application of development projects to known accumulations. In addition, there must exist, or there must be a reasonable expectation that there will exist, the legal right to produce or a revenue interest in the production, installed means of delivering oil and gas or related substances to market, and all permits and financing required to implement the project.

Standardized measure. Standardized measure is the present value of estimated future net revenues to be generated from the production of proved reserves, determined in accordance with the rules and regulations of the Securities and Exchange Commission, using prices and costs in effect as of the date of estimation, without giving effect to non-property related expenses such as certain general and administrative expenses, debt service and future federal income tax expenses or to depreciation, depletion and amortization and discounted using an annual discount rate of 10%.

Undeveloped oil and gas reserves. Undeveloped oil and gas reserves are reserves of any category that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion.

(i) Reserves on undrilled acreage shall be limited to those directly offsetting development spacing areas that are reasonably certain of production when drilled, unless evidence using reliable technology exists that establishes reasonable certainty of economic productibility at greater distances.

(ii) Undrilled locations can be classified as having undeveloped reserves only if a development plan has been adopted indicating that they are scheduled to be drilled within five years, unless the specific circumstances, justify a longer time.

(iii) Under no circumstances shall estimates for undeveloped reserves be attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless such techniques have been proved effective by actual projects in the same reservoir or an analogous reservoir, or by other evidence using reliable

technology establishing reasonable certainty.

Unproved properties. Properties with no proved reserves.

Terms which describe the productive life of a property or group of properties

Reserve life. A measure of the productive life of oil and gas property or a group of oil and gas properties, expressed in years. Reserve life for the years ended December 31, 2014, 2013 or 2012 equal the estimated net proved reserves attributable to a property or group of properties divided by production from the property or group of properties for the four fiscal quarters preceding the date as of which the proved reserves were estimated.

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Terms used to describe the legal ownership of the Company's oil and gas properties

Royalty interest. A real property interest entitling the owner to receive a specified portion of the gross proceeds of the sale of oil and natural gas production or, if the conveyance creating the interest provides, a specific portion of oil and natural gas produced, without any deduction for the costs to explore for, develop or produce the oil and natural gas. A royalty interest owner has no right to consent to or approve the operation and development of the property, while the owners of the working interests have the exclusive right to exploit the minerals on the land.

Working interest. A real property interest entitling the owner to receive a specified percentage of the proceeds of the sale of oil and natural gas production or a percentage of the production, but requiring the owner of the working interest to bear the cost to explore for, develop and produce such oil and natural gas. A working interest owner who owns a portion of the working interest may participate either as operator or by voting his percentage interest to approve or disapprove the appointment of an operator and drilling and other major activities in connection with the development and operation of a property.

Terms used to describe seismic operations

Seismic data. Oil and gas companies use seismic data as their principal source of information to locate oil and gas deposits, both to aid in exploration for new deposits and to manage or enhance production from known reservoirs. To gather seismic data, an energy source is used to send sound waves into the subsurface strata. These waves are reflected back to the surface by underground formations, where they are detected by geophones which digitize and record the reflected waves. Computers are then used to process the raw data to develop an image of underground formations.

2-D seismic data. 2-D seismic survey data has been the standard acquisition technique used to image geologic formations over a broad area. 2-D seismic data is collected by a single line of energy sources which reflect seismic waves to a single line of geophones. When processed, 2-D seismic data produces an image of a single vertical plane of sub-surface data.

3-D seismic data. 3-D seismic data is collected using a grid of energy sources, which are generally spread over several miles. A 3-D survey produces a three dimensional image of the subsurface geology by collecting seismic data along parallel lines and creating a cube of information that can be divided into various planes, thus improving visualization. Consequently, 3-D seismic data is a more reliable indicator of potential oil and natural gas reservoirs in the area evaluated.

PART I

Item 1. Business

BACKGROUND

VAALCO Energy, Inc., a Delaware corporation incorporated in 1985, is a Houston-based independent energy company principally engaged in the acquisition, exploration, development and production of crude oil and natural gas. VAALCO owns producing properties and conducts exploration activities as an operator in Gabon, West Africa, conducts exploration activities as an operator in Angola, West Africa, and participates in exploration and development activities as a non-operator in Equatorial Guinea, West Africa. VAALCO is the operator of unconventional resource properties in the United States in North Texas and a leasehold in Montana. The Company also owns minor interests in conventional production activities as a non-operator in the United States. As used in this report, the terms “Company”, “we”, “us”, “our”, and “VAALCO” mean VAALCO Energy, Inc. and its subsidiaries, unless the context otherwise requires. The Company’s corporate headquarters are located at 9800 Richmond Avenue, Suite 700, Houston, Texas 77042 where the telephone number is (713) 623-0801.

VAALCO’s international subsidiaries are VAALCO Gabon (Etame), Inc., VAALCO Production (Gabon), Inc., VAALCO Angola (Kwanza), Inc., VAALCO UK (North Sea), Ltd., VAALCO International, Inc., VAALCO Energy (EG), Inc. and VAALCO Energy Mauritius (EG) Limited. VAALCO Energy (USA), Inc. holds interests in properties located in the United States.

STRATEGY

International

The Company’s international strategy is to pursue selective opportunities with a focus on West Africa that are characterized by reasonable entry costs, favorable economic terms, high reserve potential relative to capital expenditures and the availability of existing technical data. The Company believes that it has strong management and technical expertise with proven abilities in identifying international opportunities and establishing favorable operating relationships with host governments and local partners familiar with the local practices and infrastructure. The Company owns producing properties and conducts operating activities as an operator under an offshore license in Gabon, a license onshore Gabon (subject to approval of a new production sharing agreement which will include an extension of the exploration license), an exploration license in Angola, and as non-operator of an exploration/development license in Equatorial Guinea.

In addition, the Company’s production strategy is to maximize the value of the reserves discovered in Gabon through development of the offshore Etame Marin block (comprised of the Etame, Avouma/South Tchibala, and Ebouri producing fields, and the Southeast Etame/North Tchibala field currently being developed), and the onshore Mutamba Iroru block where the N’Gongui field is expected to be developed following the approval of a new production sharing contract with the Republic of Gabon.

Domestic

The Company’s domestic strategy has been to selectively acquire unconventional resource based properties. The Company owns a lease with two producing wells in the Granite Wash formation in Texas, and deep rights on a lease in Montana. Due to the surplus of domestically produced light, sweet crude oil in North America, and the associated current low price environment, the Company does not expect to focus on further development of domestic owned

properties in its short-term business plans.

RECENT DEVELOPMENTS

Offshore Gabon

The Company's primary source of revenue is from the Etame Production Sharing Contract related to the Etame Marin block located offshore the Republic of Gabon. VAALCO operates the Etame Marin block on behalf of a consortium of companies. At December 31, 2014, the Company owns a 28.1% interest in the development areas in and surrounding the Etame, Avouma/South Tchibala, and Ebouri fields, each of which is located on the Etame Marin block. The development areas were subject to a 7.5% back-in by the Government of Gabon, which occurred for these fields after their successful development. The Southeast Etame/North Tchibala field, each of which is also located on the Etame Marine block are in the process of being developed and will also be subject to a 7.5% back-in by the Government of Gabon. The Government of Gabon has since assigned the back-in interest to a third party.

The Company produces from the Etame, Avouma/South Tchibala and Ebouri fields on the block. During 2014, these fields produced approximately 5.8 million Bbls (1.4 million Bbls net to the Company). The Company's share of barrels produced reflects an allocation of cost oil and profit oil, after reduction for royalty (13%).

In July 2012, the Company discovered the presence of hydrogen sulfide (“H₂S”) from two of the three producing wells in the Ebouri field. The wells were shut-in for safety and marketability reasons resulting in a decrease of approximately 2,000 BOPD or approximately 10% of the gross daily production from the Etame Marin block at that time. In addition, H₂S was first detected in January 2014 and later confirmed in July 2014 in the Etame 5-H well in the Etame field, and this well has also been shut-in. Analysis and options for re-establishing production from the impacted areas continued through the fourth quarter of 2014. To re-establish and maximize production from the impacted areas, additional capital investment will be required, including a processing facility capable of removing H₂S, recompletion of the temporarily abandoned wells, and potentially, additional new wells. Considering the substantial recent fall in oil prices, the Company and its partners are focusing on more cost efficient options for a processing facility (e.g. chemical removal options, construction of a smaller facility on existing structures, or the use of surplus equipment and used structures). There can be no assurances that the processing facility will be completed by 2017, if at all, or that a more cost effective facility will cover all affected areas of the Ebouri and Etame fields. It is expected that the timing of the project startup will be known as early as the fourth quarter of 2015 with a goal of re-establishing production from the area impacted by H₂S as soon as practical. Should the Company and its partners evaluation result in no economic alternative, a decrease of as much as 2.4 million barrels of proved undeveloped reserves could result.

The Company and its partners approved the construction of two additional production platforms in late 2012 as part of future development plans for the Etame Marin block. The construction of the two new platforms began in the first quarter of 2013 and were installed in the third quarter of 2014. One platform was installed in the Etame field and the second platform was installed between the Southeast Etame/North Tchibala field. The Company contracted a drilling rig to commence a multi-well development drilling program, which moved onto location and began drilling the first well in November 2014 from the Etame platform, in the Etame field. The Company drilled a successful exploration well in the Southeast Etame area in 2010 which is expected to be developed from the second platform in 2015. The total cost to build and install the two platforms was \$351.0 million (\$106.5 million net to the Company). The cost of the wells is not included in the platform costs.

The sixth extension of the exploration acreage on this block expired at the end of July 2014. The Company fully met all of the obligations under the terms of the sixth extension period. In the second quarter of 2014, and prior to the deadline, the Company and its partners submitted a proposal for a seventh exploration license. The Government of Gabon responded in the first quarter of 2015 that a seventh exploration license would require a separate production sharing contract (“PSC”) and this requirement is being evaluated by the Company and its partners.

Due to the uncertainty of obtaining the exploration license, the balance of undeveloped leasehold costs of \$1.6 million was recorded as exploration expense in the year ended December 31, 2014.

Late in 2012, a drilling and workover campaign began with the arrival of a drilling rig to conduct a six well program that was ultimately increased to an eight well program extending into 2014. The early-2014 program included the drilling of an exploration well that did not discover commercial quantities of hydrocarbons. Accordingly, the Company expensed \$1.9 million of incurred dry hole costs in the fourth quarter of 2013 for this well, with the remainder of \$11.7 million of dry hole costs expensed in the first quarter of 2014. The Company performed a workover to replace the electrical submersible pumps in a well in the Avouma field in the first quarter of 2014 and in May 2014 brought on production a development well drilled in the South Tchibala field to replace a well with damaged casing.

Following the installation of the two additional platforms in the third quarter of 2014, the Company and its partners began a development well drilling campaign beginning in October 2014 from the Etame platform. The first well drilled, the Etame 8-H well, was completed in December 2014 and was shut-in as the well was determined to be producing H₂S during the initial testing process. The Company is planning to conduct an extended well test of the Etame 8-H well, to confirm and quantify the presence of H₂S which was detected during the initial 17 hour flow

test. The well test is expected to occur in the first half of 2015. In December 2014, the Company spudded the Etame 10-H well which was drilled to the 1-V fault block, and the well was brought on production in the first quarter of 2015. The Etame 10-H well confirmed the presence of an undrained lower lobe of the Gamba reservoir in this fault block with no H₂S present. Additional development wells are expected to be drilled in 2015 from the two platforms.

As part of securing the first of two five-year extensions in 2011 to the Etame field production license to which the Company is entitled from the government of Gabon, the Company agreed to a cash funding arrangement for the eventual abandonment of all offshore wells, platforms and facilities on the Etame Marin Block. The agreement was finalized in the first quarter of 2014 (effective 2011) providing for annual funding over the remaining life of the production license. The amounts paid will be reimbursed through the cost account and are non-refundable to the Company. The initial funding took place in October 2014 for calendar years 2012 and 2013 totaling \$8.4 million (\$2.3 million net to the Company). The funding for calendar year 2014 was paid in the first quarter of 2015 in the amount of \$4.2 million (\$1.2 million net to the Company). As in prior periods, the obligation for abandonment of the Gabon offshore facilities is included in the asset retirement obligation shown on the Company's balance sheet. The cash funding is reflected under other long term assets as "Abandonment Funding".

In the fourth quarter of 2014, the Company recorded an impairment loss of \$98.3 million to write down its investment in certain fields comprising the Etame Marin Block, offshore Gabon to its fair value. An impairment of \$38.5 million was recorded in the Etame field, \$5.9 million in the Ebouri field and \$53.9 million in the Southeast Etame/North Tchibala field. The impairment is a result of the recent decline in the forecasted oil prices used in the impairment testing and calculation.

Onshore Gabon

The Company executed a farm-out agreement in August 2010 with Total Gabon on the Mutamba Iroru block located onshore near the coast in central Gabon. The Mutamba Iroru block contains an exploration area of approximately 270,000 acres. The Company has a 50% working interest on the block (41% net working interest assuming the Republic of Gabon exercises its back-in rights).

Under the terms of the agreement, the Company and Total Gabon committed to reprocess 400 kilometers of 2-D seismic data and drill one exploration well. The seismic reprocessing work was completed in 2012. The exploration well was drilled in 2012 resulting in a discovery.

A revised production sharing contract (“PSC”) including exploration rights is in the approval process. The term sheet, which specifies financial and other obligations to be included in the PSC, was agreed to and signed by the Company, its joint venture partner, and the Government of Gabon on July 31, 2014. The form of the PSC has been completed and presented to the Company and its joint venture partner for execution. The joint venture partner has withheld its approval of the new PSC pending resolution of certain legal aspects of the new agreement with the Government of Gabon. In March 2015, the joint venture partner indicated to the Company that the legal aspects have not yet been resolved to their satisfaction. The Company can provide no assurance as to the joint venture partner approving the PSC. The Company remains committed to this block and further meetings of the parties are expected to occur in the first half of 2015.

After the PSC is approved, an application for a development area will be made by the Company. After issuance of a development area, the next step is the submittal of the plan of development. The Company can provide no assurances as to either the approval of the PSC by the Government of Gabon, or the subsequent approval of a development area by the Government of Gabon.

Development of the onshore block is expected to capitalize on synergies such as experienced personnel from our operating base office space, warehouse and open yard space in Port Gentil, Gabon.

Offshore Angola

In November 2006, the Company signed a production sharing contract for Block 5 offshore Angola. The four year primary term with an optional three year extension awards the Company exploration rights to 1.4 million acres offshore central Angola. The Company’s working interest is 40%, and its paying interest is 50% including the government’s carried working interest during the exploration phase.

By a governmental decree dated December 1, 2010, the government-assigned working interest partner was removed from the production sharing contract for cause, and a one year time extension was granted for drilling the two exploration commitment wells while the government decided on the disposition of the available interest. Additional extensions were subsequently granted by the Angolan government until November 30, 2014 to drill the two exploration commitment wells.

In the fourth quarter of 2013, the Company received a written confirmation from The Ministry of Petroleum of Angola that the available 40% working interest in Block 5, offshore Angola, has been assigned to Sonangol E.P., the National Concessionaire. The Ministry of Petroleum also confirmed that Sonangol E.P. would assign the aforementioned participating interest to its exploration and production affiliate, Sonangol P&P. The assignment was made effective on January 1, 2014.

In April 2014, the Company received a letter and contractual amendment proposal from Sonangol E.P., the national oil company in Angola related to the extension of the two well drilling commitment. Due to the uncertainty that the primary term of the exploration license would be extended by the Republic of Angola in accordance with the contractual amendment proposal before the November 30, 2014 expiration date, in October 2014, the Company entered into the Subsequent Exploration Phase ("SEP"), together with its working interest partner, Sonangol P&P. The SEP option was provided for in the Production Sharing Agreement signed in 2006 with the Republic of Angola. The SEP extends the exploration period for an additional three year period such that the new expiry date for exploration activities is November 30, 2017. Entering the SEP requires the Company and its partner to acquire 3D seismic covering six hundred square kilometers and to drill two additional exploration wells. The Company has already satisfied the seismic obligation of the SEP with the purchase of 3D seismic in the outboard segment of the block in late 2013, which is currently being processed and will continue to be processed into 2015.

By entering into the SEP, the Company is required to drill a total of four exploration wells during the exploration extension period. The four well obligations include the two well commitments under the primary exploration period that carries over to the SEP period. A \$10.0 million dollar assessment (\$5.0 million dollars net to VAALCO) applies to each of the four commitment exploration wells, if any, that remain undrilled at the end of the exploration period in November 2017. Restricted cash of \$10.0 million for the two new commitment wells was recorded in the fourth quarter of 2014. At December 31, 2014 the Company had \$20.0 million in restricted cash related to the offshore Angola exploration agreement.

A drilling rig contract was signed in July 2014 for a semi-submersible rig to drill the exploration well on the Kindele prospect, a post-salt objective. The well began drilling in the first quarter of 2015. Drilling this well satisfies one of the four exploration well obligations and will release \$5.0 million of the \$20.0 million recorded as restricted cash at December 31, 2014 by the Company.

Offshore Equatorial Guinea

In July 2012, the Company signed a definitive agreement with Petronas Carigali Overseas SDN BHD for the purchase of a 31% working interest in Block P, located offshore Equatorial Guinea for 57,000 acres at a cost of \$10.0 million. The acquisition was completed on November 1, 2012. GEPetrol, the national oil company of Equatorial Guinea, is the operator of the block. During 2014, the Company and GEPetrol continued to work on a joint operatorship model whereby the Company would have a significant role in operator activities on the block. Additionally, the Company has been working with the Ministry of Mines, Industry and Energy regarding timing and budgeting for development and exploration activities.

AVAILABLE INFORMATION

The Company files annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (“SEC”). You may read and copy any document the Company files at the SEC’s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the SEC’s Public Reference Room. The Company’s SEC filings are also available to the public at the SEC’s website at www.sec.gov.

You may also obtain copies of the Company’s annual, quarterly and current reports, proxy statements and certain other information filed with the SEC, as well as amendments thereto, free of charge from the Company’s website at www.vaalco.com. No information from the SEC’s or the Company’s website is incorporated by reference herein. The Company has placed on its website copies of its Audit Committee Charter, Code of Business Conduct and Ethics, and Code of Ethics for the Chief Executive Officer and Chief Financial Officer. Stockholders may request a printed copy of these governance materials by writing to the Corporate Secretary, VAALCO Energy, Inc., 9800 Richmond Avenue, Suite 700, Houston, Texas 77042.

CUSTOMERS

Substantially all of the Company’s oil and gas is sold at posted or indexed prices under short-term contracts, as is customary in the industry. In Gabon, starting in the second quarter of 2014, the Company switched to an agency model to sell its crude oil. The Company contracted with a third party in order to sell, based on a fixed per barrel fee, on the spot market (“agency model”). Prior to the second quarter in 2014, the Company sold oil under contracts with Mercuria Trading NV (“Mercuria”) beginning with the calendar year 2011. For the first quarter of 2015, the Company will also sell its oil under the agency model on the spot market.

Domestic operated production in Texas is sold via two contracts, one for oil and one for gas and natural gas liquids. The Company has access to several alternative buyers for oil, gas, and natural gas liquids domestically.

EMPLOYEES

As of December 31, 2014, the Company had 113 full-time employees and consultant contractors, 60 of whom were located in Gabon, 7 of whom were located in Angola and 1 employee located in Equatorial Guinea. The Company is not subject to any collective bargaining agreements, although most of the national employees in Gabon are members of the NEOP (National Organization of Petroleum Workers) union. The Company believes its relations with its employees are satisfactory.

COMPETITION

The oil and gas industry is highly competitive. Competition is particularly intense from other independent operators and from major oil and natural gas companies with respect to acquisitions of desirable oil and gas properties and contracting for drilling equipment. There is also competition for the hiring of experienced personnel. In addition, the drilling, producing, processing and marketing of oil and gas is affected by a number of factors beyond the control of the Company, including but not limited to shortages

of drilling rigs, pipe and personnel, which may delay drilling, increase prices and have other adverse effects which cannot be accurately predicted.

The Company's competition for acquisitions, exploration, development and production includes the major oil and gas companies in addition to numerous independent oil companies, individual proprietors, investors and others. Many of these competitors possess financial, technical and personnel resources substantially in excess of those available to the Company, giving those competitors an enhanced ability to evaluate and acquire desirable leases properties or prospects. The ability of the Company to generate reserves in the future will depend on its ability to select and acquire suitable producing properties and prospects for future drilling and exploration.

INSURANCE

In accordance with industry practice, the Company maintains insurance against some, but not all, of the operating risks to which its business is exposed. The Company currently has insurance policies that include coverage for general liability (includes sudden and accidental pollution), physical damage to its oil and gas properties, operational control of offshore wells, aviation, auto liability, marine liability, worker's compensation and employer's liability, among other things. At the depths and in the areas in which the Company operates, and in light of the vertical and horizontal drilling that it undertakes, the Company typically does not encounter high pressures or high temperature drilling conditions.

Currently, the Company has Operator's Extra Expense insurance coverage up to \$100.0 million per occurrence. This includes coverage for redrill and restoration of wells, as well as coverage for resultant environmental damage, including voluntary clean-up. The Company also carries Physical Damage coverage on offshore assets that is subject to full replacement cost limits. Both of these coverages, Operator's Extra Expense and Physical Damage, are subject to certain customary exclusions and limitations and to deductibles (generally ranging from \$100,000 to \$1,000,000 per occurrence) that must be met prior to recovery. In addition, the Company carries General Liability and Excess Liability Insurance, subject to customary exclusions and limitations, with limits of \$75.0 million. This program includes coverage for bodily injury and property damage to third parties, including sudden and accidental pollution liability coverage.

The Company requires all of its third-party contractors to sign master service agreements in which they agree to indemnify the Company for injuries and deaths of the service provider's employees as well as contractors and subcontractors hired by the service provider. Similarly, the Company generally agrees to indemnify each third-party contractor against claims made by the Company's employees and other contractors. Additionally, each party generally is responsible for damage to its own property.

The third-party contractors that perform hydraulic fracturing operations for the Company sign the master service agreements containing the indemnification provisions noted above. The Company does not currently have any insurance policies in effect that are intended to provide coverage for losses solely related to hydraulic fracturing operations. However, the Company believes its general liability and excess liability insurance policies would cover third party claims related to hydraulic fracturing operations and associated legal expenses, in accordance with, and subject to, the terms of such policies. The Company does not have ongoing hydraulic fracturing operations at December 31, 2014 nor plans for any such operations in the near future.

The Company re-evaluates the purchase of insurance, coverage limits and deductibles annually. Future insurance coverage for the oil and gas industry could increase in cost and may include higher deductibles or retentions. In addition, some forms of insurance may become unavailable in the future or unavailable on terms that are economically acceptable. No assurance can be given that the Company will be able to maintain insurance in the future at rates that we consider reasonable and it may elect to self-insure or maintain only catastrophic coverage for certain risks in the

future.

ENVIRONMENTAL REGULATIONS

General

The Company's activities are subject to federal, state and local laws and regulations governing environmental quality and pollution control in the United States and Gabon and will be subject to the laws and regulations of Angola and Equatorial Guinea when exploration drilling begins in those countries. Although no assurances can be made, the Company believes that, absent the occurrence of an extraordinary event, compliance with existing laws, rules and regulations regulating the release of materials into the environment or otherwise relating to the protection of the environment will not have a material effect upon the Company's capital expenditures, earnings or competitive position with respect to its existing assets and operations. The Company cannot predict what effect future regulation or legislation, enforcement policies, and claims for damages to property, employees, other persons and the environment resulting from the Company's operations could have on its activities. In part because they are developing countries, it is unclear how quickly and to what extent Gabon, Angola or Equatorial Guinea will increase their regulation of environmental issues in the future; any significant increase in the regulation or enforcement of environmental issues by Gabon, Angola or Equatorial Guinea

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could have a material effect on the Company. Developing countries, in certain instances, have patterned environmental laws after those in the United States which are discussed below. However, the extent to which any environmental laws are enforced in developing countries varies significantly.

In the United States, environmental laws and regulations may require the acquisition of permits before drilling commences, the installation of pollution control equipment for our operations, special handling or disposal of materials used in our operations, or remedial measures to mitigate pollution from our operations or on the properties on which we operate. These laws and regulations may also restrict the types of substances used in our drilling operations which can be used or released into the environment or limit or prohibit drilling activities on certain lands such as wetlands or sensitive protected areas or restrict the rate of production below the rate that would otherwise be possible..

As a general matter, the oil and gas exploration and production industry has been the subject of increasing scrutiny and regulation by environmental authorities. The Environmental Protection Agency ("EPA") has identified environmental compliance by the energy extraction sector as one of its enforcement initiatives for 2014-2016. The trend has been the enactment of new or more stringent requirements on the oil and gas industry. These changes result in increased operating costs, and additional changes could result in further increases in our costs for environmental compliance.

Environmental Regulations in the United States

Superfund

The Company currently owns or leases, and in the past has owned or leased, properties that have been used for the exploration and production of oil and gas for many years. Although the Company has utilized operating and disposal practices that were st