

Edgar Filing: PYRAMID OIL CO - Form 10KSB

PYRAMID OIL CO  
Form 10KSB  
March 31, 2005

1

U.S. SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-KSB

- Annual report under Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2004
- Transition report under Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from to

Commission File Number 0-5525

PYRAMID OIL COMPANY  
(Name of small business issuer in its charter)

CALIFORNIA  
(State or other jurisdiction of  
incorporation or organization)

94-0787340  
(I.R.S. Employer  
Identification No.)

2008 - 21st. Street, P. O. Box 832  
Bakersfield, California  
(Address of principal executive offices)

93302  
(Zip Code)

Issuer's telephone number: (661) 325-1000

Securities registered under Section 12 (b) of the Exchange Act: NONE

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

Common Stock  
(Title of Class)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the 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 X NO

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will 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-KSB or any amendment to this Form 10-KSB. [ X ]

The issuer's revenues for the fiscal year ended December 31, 2004 were \$2,674,902.

The aggregate market value on March 29, 2005, of the voting shares held by non-affiliates was approximately \$3,600,000 based on the closing sales price of the registrant's Common Stock on such date.

At March 29, 2005, there were 2,494,430 shares of Common Stock outstanding.

2

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for its 2005 Annual Meeting of Shareholders to be filed with the Securities and Exchange

# Edgar Filing: PYRAMID OIL CO - Form 10KSB

Commission within 120 days after the close of the registrant's fiscal year are incorporated by reference into Part III.

TRANSITIONAL SMALL BUSINESS DISCLOSURE FORMAT (check one): Yes No  X

3

## PYRAMID OIL COMPANY

### 2004 FORM 10-KSB ANNUAL REPORT

#### Table of Contents

	Page
PART I	
Item 1. Description of Business . . . . .	4
Item 2. Description of Property . . . . .	9
Item 3. Legal Proceedings . . . . .	12
Item 4. Submission of Matters to a Vote of Security Holders. . . . .	12
PART II	
Item 5. Market for Common Equity and Related Stockholder Matters. . . . .	12
Item 6. Management's Discussion and Analysis or Plan of Operation . . . . .	13
Item 7. Financial Statements . . . . .	23
Item 8. Changes In and Disagreements with Accountants on Accounting and Financial Disclosure . . . . .	52
Item 8A. Controls and Procedures . . . . .	52
Item 8B. Other Information . . . . .	52
PART III	
Item 9. Directors, Executive Officers, Promoters and Control Persons; Compliance With Section 16(a) of the Exchange Act . . . . .	52
Item 10. Executive Compensation . . . . .	52
Item 11. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters . . . . .	53
Item 12. Certain Relationships and Related Transactions	53
Item 13. Exhibits . . . . .	54
Item 14. Principal Accountant Fees and Services . . . . .	54

CAUTIONARY STATEMENT FOR PURPOSES OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995 AND OTHER FEDERAL SECURITIES LAWS

Pyramid Oil Company is including the following discussion to inform existing and potential security holders generally of some of the risks and uncertainties that can affect the Company and to take advantage of the "safe harbor" protection for forward-looking statements afforded under the federal securities laws. Statements made in this Annual Report on Form 10-KSB may be forward-looking statements. In addition, from time to time, the Company may otherwise make forward-looking statements to inform existing and potential security holders about the Company. These statements may include projections and estimates concerning the timing and success of specific projects and the Company's future (1) income, (2) oil and gas production, (3) oil and gas reserves and reserve replacement and (4) capital spending. Forward-looking statements are generally accompanied by words such as "estimate," "project," "predict," "believe," "expect," "anticipate," "plan," "goal" or other words that convey the uncertainty of future events or outcomes. In addition, except for the historical information contained in this report, the matters discussed in this report are forward-looking statements. These statements by their nature are subject to certain risks, uncertainties and assumptions and will be influenced by various factors. Should any of the assumptions underlying a forward-looking statement prove incorrect, actual results could vary materially.

PART I

-----

ITEM 1 - DESCRIPTION OF BUSINESS

GENERAL BUSINESS DESCRIPTION

Pyramid Oil Company is a California corporation that has been in the oil and gas business continuously, since it was incorporated on October 9, 1909. Pyramid Oil Company, hereinafter referred to as "Pyramid" or the "Company," is engaged in the business of exploration, development and production of crude oil and natural gas.

Pyramid acquires interests in land and producing properties through acquisition and lease on which it drills and/or operates crude oil or natural gas wells in efforts to discover and/or to produce oil and gas. Crude oil and natural gas produced from these properties are sold to various refineries and pipeline companies. The majority of all oil and gas properties that Pyramid owns and operates is for its own account. Pyramid also participates in specific joint ventures with other companies in the development of oil and gas properties. Pyramid's interests in these properties will vary depending on the availability of said interests and their locations. Although the Company owns some minor oil and gas interests in New York and Wyoming, all of the Company's operations and major revenue producing properties are in California.

The Company's executive offices are located at 2008 21st Street, Bakersfield, California, 93301, telephone (661) 325-1000, facsimile (661) 325-0100.

DESCRIPTION OF BUSINESS - OIL AND GAS OPERATIONS

## Edgar Filing: PYRAMID OIL CO - Form 10KSB

### EXPLORATION AND DEVELOPMENT

Pyramid operates in a highly competitive industry wherein many companies, from large multinational companies to small independent producers, are competing for a finite amount of oil and gas resources. The Company seeks out properties to explore for oil and gas by drilling and also seeks out producing oil and gas properties that can be purchased and operated. Management believes that under the right economic conditions, several of the producing properties that the Company owns could have further developmental potential. Certain oil properties currently owned and operated by the Company may be receptive to enhanced oil recovery procedures under certain economic conditions.

### OIL AND GAS PRODUCTION OPERATIONS

Pyramid owns and operates 27 oil and gas leases (properties) located within Kern and Santa Barbara Counties in the State of California. All of these properties are capable of producing oil or natural gas, although not all of these properties are considered profitable under certain economic conditions. During 2004, the Company operated 18 leases within California, with total annual gross oil production exceeding 1,000 barrels per lease. Production activities primarily consist of the daily pumping of oil from a well(s) into tanks, maintaining the production facilities both at the well and tank settings, preparing and shipping the crude oil to buyers. Daily operations differ from one property to another, depending on the number of wells, the depth of the wells, the gravity of the oil produced and the location of the property. All of Pyramid's oil production is classified as primary recovery production at this time; although certain properties may be conducive to secondary recovery operations in the future, depending on the prevailing price of oil.

Primary recovery of oil and gas is by means of natural flow(s) or artificial lift of oil and gas from a single well bore. Natural gas and petroleum fluids enter the well bore by means of reservoir pressure or gravity flow; fluids and gases are moved to the surface by natural pressure or by means of artificial lift (pumping). In secondary recovery operations, liquids or gases are injected into the reservoirs for the purpose of augmenting reservoir energy or increasing reservoir temperatures. Secondary recovery operations, usually, but not always, are done after the primary-recovery phase has passed.

6

The Company employs field personnel (i.e., pumpers, rig crews, roustabouts and equipment operators) that perform basic daily activities associated with producing oil and gas. Daily operations include inspections of surface facilities and equipment, gauging, reporting and shipping oil, and routine maintenance and repair activities on wells, production facilities and equipment. The Company owns and maintains various pieces of equipment necessary for employees to perform various repair and maintenance tasks on Company properties. Such equipment consists of service rigs, mobile pumps, vacuum trucks, hot oil truck, backhoe, trucks and trailers.

Occasionally, the Company drills new wells or re-drills existing wells on properties owned by the Company in an attempt to increase oil and gas production. In the last five years, the Company has utilized the services of

## Edgar Filing: PYRAMID OIL CO - Form 10KSB

outside drilling contractors for drilling new wells and re-drilling existing wells. Maintenance and repairs of existing wells to maintain or increase oil and gas production are carried out by Company personnel on a continuing basis. Most maintenance and repair work is performed with Company rigs.

Economic factors associated with the price of oil and gas and the productive output of wells determine the number of active wells the Company operates. Under certain economic conditions, the Company has the potential to operate approximately 119 wells, and of these, approximately 64 were in operation during 2004. Operations continue to be reduced on specific properties that are currently generating a marginal gross profit in an effort to hold the properties until economic conditions warrant full scale operations. The Company also owns other oil and gas interests outside of California that it does not operate. These interests are located in Wyoming and New York.

### MARKETING OF CRUDE OIL AND NATURAL GAS

The Company sells its crude oil to ConocoPhillips and Kern Oil & Refining, accounting for approximately 52.2% and 43.2%, respectively, of Pyramid's crude oil and gas sales in 2004. While revenue from these customers is significant, and the loss of any one could have an adverse effect on the Company, it is management's opinion that the oil and gas it produces could be sold to other crude oil purchasers, refineries or pipeline companies. ConocoPhillips and Kern Oil have been customers of the Company for over ten years. Natural gas is sold to companies in the area of operations. The Company sells its oil pursuant to short-term contracts. Accordingly, the amount of oil the Company sells is dependent upon market demand. Market demand for Pyramid's production is subject to various influences and can never be assured, especially in an era of changing prices. The base values for crude oil the Company sells is set by major oil companies in response to area and market strengths and international influences. Types and qualities of crude oil vary substantially in base values posted by crude oil buyers in various areas of the country. Pyramid's crude oil sales are not seasonal, but uniform throughout the year.

7

### RISKS, COMPETITION AND INDUSTRY CONDITIONS

The profitability of the Company's operations depends primarily on the production of oil and gas in commercially profitable quantities. Oil and gas properties often fail to provide a return sufficient to repay the substantial sums of money required for their acquisition, exploration and development. The acquisition, exploration and development of oil and gas properties is a highly competitive business. Many entities with which the Company competes have significantly greater financial and staff resources. Such competitive disadvantages could materially and adversely affect the Company's ability to acquire new properties or develop existing properties.

The oil and gas industry, in general, has been adversely affected by several factors beyond the Company's control, including unstable oil and gas prices, uncertainty regarding the effect of pricing agreements and production quotas and allocations established by the Organization of Petroleum Exporting Countries, political instability in the Middle East and the status of ever-changing federal and state legislation and regulation.

Given the uncertainty of international and domestic political actions and their impact on the energy markets, it is difficult, if not impossible, to

## Edgar Filing: PYRAMID OIL CO - Form 10KSB

predict the price or market situation for any oil or gas which is currently owned or which could be developed by the Company. Depressed oil and gas prices or significant curtailment in the Company's oil and gas production from its better properties would have a material adverse effect on the Company's operations.

### REGULATIONS

The Company's business is affected by numerous governmental laws and regulations, including energy, environmental, conservation, tax and other laws and regulations relating to the petroleum industry. Changes in any of these laws and regulations could have a material and adverse effect on the Company's business and financial stability. In view of the many uncertainties with respect to current laws and regulations, including their applicability to the Company, the Company cannot predict the overall effect of such laws and regulations on future operations.

### TAXATION

The operations of the Company, as is the case in the petroleum industry generally, are significantly affected by federal tax laws. Federal, as well as state, tax laws have many provisions applicable to corporations which could affect the future tax liability of the Company.

8

### ENVIRONMENTAL

The Company's activities are subject to existing federal and state laws and regulations governing environmental quality and pollution control. These laws may require the acquisition of permits relating to certain ongoing operations, for drilling, emissions, waste water disposal and other air and water quality controls. In view of the uncertainty and unpredictability of environmental statutes and regulations, the Company cannot ensure that such laws and regulations will not materially and adversely affect the business of the Company. The Company does not currently anticipate any material effect on its capital expenditures or earnings as the result of governmental regulations, enacted or proposed, concerning environmental protection or the discharge of material into the environment. The Company is actively pursuing an ongoing policy of upgrading and restoring older properties to comply with current and proposed environmental regulations.

### COMMITMENTS AND CONTINGENCIES

The Company is liable for future dismantlement and abandonment costs associated with its oil and gas properties. These costs include down-hole plugging and abandonment of wells, future site restoration, post closure and other environmental exit costs. The costs of future dismantlement and abandonment have been accrued and recorded in the financial statements. See Note 9 of Notes to Financial Statements included in Item 7 of this Form 10-KSB.

## Edgar Filing: PYRAMID OIL CO - Form 10KSB

### OTHER

The Company employed twelve full-time people as of December 31, 2004, three of whom were office or administrative personnel, and the rest of whom were field personnel. The Company contracts for additional labor services when needed. The Company is not a party to any union or labor contracts.

The Company had no material research and development costs for the three years ended December 31, 2004.

All of the Company's revenues during 2004 were derived from domestic sources.

The Company does not have any patents or trademarks, and it does not believe that its business or operations are dependent upon owning any patents or trademarks.

9

### ITEM 2 - DESCRIPTION OF PROPERTY

#### (a) DESCRIPTION OF PROPERTIES

The principal assets of the Company consist of proven and unproven oil and gas properties, oil and gas production related equipment and developed and undeveloped real estate holdings. The Company's oil and gas properties are located exclusively in the continental United States, in California, Wyoming and New York.

Developed oil and gas properties are those on which sufficient wells have been drilled to economically recover the estimated reserves calculated for the property. Undeveloped properties do not presently have sufficient wells to recover the estimated reserves. The Company had no significant proved undeveloped properties at December 31, 2004, 2003 and 2002.

#### (b) OIL AND GAS PROPERTIES

The Company's estimated future net recoverable oil and gas reserves from proved developed properties were assembled by System Technology Associates, Inc., independent petroleum engineers, and are as follows:

	Crude Oil (BBLS)	Natural Gas (MCF)
	-----	-----
January 1, 2005	522,000	83,000
2004	555,000	83,000
2003	554,000	105,000
2002	323,000	37,000
2001	341,000	72,000

## Edgar Filing: PYRAMID OIL CO - Form 10KSB

The Company's estimated future net recoverable oil and gas reserves, noted in the table above, have not been filed with any other Federal authority or agency since January 1, 2004.

Using year-end oil and gas prices and lease operating expenses, the estimated value of future net revenues to be derived from Pyramid's proved developed oil and gas reserves, discounted at 10%, were \$4,636,000 at December 31, 2004, \$4,617,000 at December 31, 2003, \$4,325,000 at December 31, 2002, \$1,250,000 at December 31, 2001, and \$2,311,000 at December 31, 2000.

Pyramid participates in the drilling of developmental wells, no single one of which would cause a significant change in the net reserve figure.

10

Pyramid's net oil and gas production after royalty and other working interests for the past five years ending December 31, were as follows.

	2004 ----	2003 ----	2002 ----	2001 ----	2000 ----
Crude oil (Bbls)	72,000	74,000	66,000	74,000	71,000
Natural gas (MCF)	8,300	7,500	11,000	9,000	9,000

Pyramid's average sales prices per barrel or per MCF of crude oil and natural gas, respectively, and production costs per equivalent barrel (gas production is converted to equivalent barrels at the rate of 6 MCF per barrel, representing the estimated relative energy content of gas to oil) for the past five years ending December 31, were as follows:

	2004 ----	2003 ----	2002 ----	2001 ----	2000 ----
Sales price:					
Crude oil	\$36.24 =====	\$27.60 =====	\$25.86 =====	\$21.02 =====	\$26.16 =====
Natural gas	\$ 5.89 =====	\$ 5.77 =====	\$ 3.08 =====	\$ 4.80 =====	\$ 3.14 =====
Production costs	\$18.20 =====	\$15.80 =====	\$15.30 =====	\$13.30 =====	\$13.60 =====

The average selling price of Pyramid's crude oil at December 31, 2004, was approximately \$32.42 per barrel and the average selling price of Pyramid's gas at December 31, 2004, was approximately \$7.88 per MCF.

As of December 31, 2004, Pyramid had the following gross and net position in wells and proved acres:



Edgar Filing: PYRAMID OIL CO - Form 10KSB

WELLS		PROVED ACRES	
Gross (1)	Net (1)	Gross (2)	Net (2)
144	128	21,387	5,844
===	===	=====	=====

11

- (1) "Gross wells" represents the total number of wells in which the Company has a working interest. "Net wells" represents the number of gross wells multiplied by the percentage of the working interests therein held by the Company.
- (2) "Gross acreage" represents all acres in which the Company has a working interest. "Net acres" represents the aggregate of the working interests of the Company in the gross acres.

The Company drilled two new wells in 2004, one on the Santa Fe lease and one joint-venture well. The Company participated with two other oil companies as operator in the drilling of the joint venture well. The Company also drilled a well in 2003 on the Anderson lease in the Carneros Creek Field. No wells were drilled in 2002, 2001 and 2000, although the Company did participate as a non-operator in 2001 and 2000 in the drilling of joint-venture wells.

"Unproven" oil and gas properties are those on which the presence of commercial quantities of reserves of crude oil or natural gas has not been established.

"Undeveloped" acreage exists on those oil and gas properties where economically recoverable reserves are estimated to exist in proved reservoirs from wells to be drilled in the future.

As of December 31, 2004, Pyramid held positions in unproven acreage in the following locations:

	ACRES	
	Gross	Net
New York		
Mount Morris and Livingston Counties	34,800	9,788
	=====	=====

(c) REAL PROPERTY OWNED

Pyramid owned the following real property as of December 31, 2004, all located in California.

County of Kern	
Mullaney yard	20 acres
Grazing land	160 acres
Miller property	112 acres
Ranton property	80 acres

# Edgar Filing: PYRAMID OIL CO - Form 10KSB

City of Bakersfield

3 lots

12

Located on the three lots of real property in the city of Bakersfield is the Company's executive offices. This property was acquired by the Company in 1986. The office building located on this property is a one story structure with approximately 4,200 square feet in good condition.

## ITEM 3 - LEGAL PROCEEDINGS

The Company is subject to potential litigation within the normal course of business. The resolution in any reporting period of such litigation could have a material impact on Pyramid's financial position or results of operations for that period. Pyramid is not party to any proceedings or actions which management believes might have a material effect upon its financial position or results of operations.

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

No matters were submitted to a vote of security holders during the fourth quarter of 2004.

## PART II

### ITEM 5 - MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

#### (a) PRICE RANGE OF COMMON SHARES

The common stock of Pyramid is traded on the OTC Bulletin Board under the symbol "PYOL". The following are high and low sales prices for each quarter of 2004 and 2003, and reflect inter-dealer prices without retail markup, markdown or commission.

	High	Low
	----	-----
Fiscal Quarter Ending 2004		
March 31,	\$2.1200	\$0.7500
June 30,	1.3500	1.0600
September 30,	1.9000	1.1600
December 31,	4.3500	1.5000
Fiscal Quarter Ending 2003		
March 31,	0.9700	0.6000
June 30,	0.9000	0.6000
September 30,	0.7000	0.6400
December 31,	0.9500	0.6300

13

At December 31, 2004, the Company had 347 shareholders of record, and an unknown number of additional holders whose stock is held in "street name".

## Edgar Filing: PYRAMID OIL CO - Form 10KSB

The Company has paid no dividends on its common shares for the past five years. The Company had received a proposal from a shareholder to pay a cash dividend in 2004. This dividend proposal was included in the proxy statement for the 2004 Annual Meeting of Shareholders and was voted upon by the shareholders. The dividend proposal was defeated.

The Company did not issue or repurchase any securities during 2004.

### ITEM 6 - MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

#### IMPACT OF CHANGING PRICES

Average prices increased by approximately \$8.50 per equivalent crude oil and gas barrel sold during 2004 as compared with average prices for 2003. In 2004 there were 216 separate crude oil price changes, as compared with 204 price changes in 2003. The difference between the highest and lowest posted prices in 2004 was \$17.40 per barrel. By comparison, this same differential in 2003 was \$14.50 per barrel.

#### LIQUIDITY AND CAPITAL RESOURCES

The Company had cash and cash equivalents of \$816,216 at December 31, 2004 for an increase of \$209,417 when compared to December 31, 2003. Operating activities in 2004 generated cash of \$914,797. During 2004, cash was consumed by capital spending of \$732,738, a cash deposit with the state of California Division of Oil and Gas in the amount of \$250,000 and principal payments on the Company's long-term debt totaling \$48,434. This was offset by proceeds from the sale of property and equipment in the amount of \$281,500 and the issuance of long-term debt of \$59,849. The components of the changes in cash for 2004 are described in the Statements of Cash Flows included in Item 7 of this Form 10-KSB. Adequate funds were available to carry out all necessary oil and gas operations and to maintain its equipment. During 2004, the Company had short-term investments of \$850,000 which provided additional liquidity. Short-term investments consist of certificates of deposit having original maturities of three months or more. A \$200,000 line of credit, unused at December 31, 2004, also provided additional liquidity during 2004.

14

The Company believes that its existing current assets and the amount of cash it anticipates it will generate from current operations will be sufficient to fund the anticipated liquidity and capital resource needs of the Company for the fiscal year ended December 31, 2005. In addition to its current assets, the Company also has a credit facility for \$200,000 available in the event that it needs other resources to fund its liquidity and capital resource needs. Although the Company may increase its capital expenditures during the current fiscal year to enhance its current oil production capacities, it does not anticipate that such expenditures would exceed the amount of liquidity currently available to the Company. The Company's beliefs that its existing

## Edgar Filing: PYRAMID OIL CO - Form 10KSB

assets and the cash expected to be generated from operations will be sufficient during the current fiscal year are based on the following:

As of December 31, 2004, the amount of cash, cash equivalents, and other current assets was equal to \$2,167,000 in the aggregate. This amount is equal to approximately all of the operating expenses that the Company incurred during the entire fiscal year ended December 31, 2004.

As of December 31, 2003, the Company had approximately \$2,167,000 in current assets, and only \$545,000 of current liabilities.

As of December 31, 2003, the Company had only \$64,000 of long-term indebtedness (net of current maturities).

The Company is not a party to any off-balance sheet arrangements and does not engage in trading activities involving non-exchange traded contracts. In addition, the Company has no financial guarantees, debt or lease agreements or other arrangements that could trigger a requirement for an early payment or that could change the value of the Company's assets. Management continues to examine various alternatives for increasing capital resources including, among other things, participation with industry and/or private partners in drilling and exploration prospects and specific rework of existing properties to enhance production and expansion of its sales of crude oil and natural gas in California. If necessary, Pyramid could sell certain nonessential assets to raise capital for the benefit of these programs.

The Company drilled two wells in the year ended December 31, 2004. The Company drilled one well in the year ended December 31, 2003. No wells were drilled in the year ended December 31, 2002. The Company's crude oil reserves for the years ended December 31, 2004 and 2003, were stable. The Company was able to replace current production by drilling the well in 2003. One of the wells drilled in 2004, during the second quarter, was not capable of producing economic quantities of crude oil and is scheduled to be abandoned in 2005. The other well was drilled in the fourth quarter of 2004.

15

Certain properties that the Company owns have become uneconomic and have been shut-in. When these properties are not operated, any reserves that could be assigned to these properties are not included in the year-end engineering report of total Company reserves. Another major factor that directly affects the Company's future reserve base is the price of crude oil at December 31 of any given year. The year-end price of oil and gas has a significant impact on the estimated future net recoverable oil and gas reserves from proved developed properties. At certain depressed price levels, some of the Company's oil and gas properties are not economical to operate and thus its year-end engineering reserve reports do not assign any oil and gas reserves to these properties. Conversely, if year-end prices should increase to a certain level, the reserves on these leases would be economic to produce and would increase the Company's reserves.

FORWARD-LOOKING INFORMATION

## Edgar Filing: PYRAMID OIL CO - Form 10KSB

Looking forward into 2005, crude oil prices have increased by \$11.80 per barrel as of March 28, 2005, compared to prices at December 31, 2004. There have been 47 separate price changes since December 31, 2004.

The Company's 2005 capital budget provides funds for drilling several new developmental wells in the Company's Carneros Creek area. Additionally, this budget provides funds for reworking and stimulating certain existing Company wells and for specific lease acquisitions within California.

Management has participated in discussions with another independent oil company headquartered in Bakersfield, CA, investigating the possibility of a joint venture exploration drilling project within California. Management believes that this prospect has merit and has entered into a Letter of Intent with the other company.

The Company's growth in 2005 will be highly dependant on the amount of success the Company has in its operations and capital investments, including the outcome of wells that have not yet been drilled. The Company's capital investment program may be modified during the year due to explorations and development successes or failures, market conditions and other variables. The production and sales of oil and gas involves many complex processes that are subject to numerous uncertainties, including reservoir risk, mechanical failures, human error and market conditions.

The Company has positioned itself, over the past several years, to withstand various types of economic uncertainties, with a program of consolidating operations on certain producing properties and concentrating on properties that provide the major revenue sources. The drilling of a new well and several limited work-overs of certain wells have allowed the Company to maintain its crude oil reserves for the last three years. The Company expects to maintain its reserve base in 2005, by drilling new wells and routine maintenance of its existing wells.

The Company may be subject to future costs necessary for compliance with the new implementation of air and water environmental quality requirements of the

16

various state and federal governmental agencies. The requirements and costs are unknown at this time, but management believes that costs could be significant in some cases. As the scope of the requirements become more clearly defined, management may be better equipped to determine the true costs to the Company.

The Company continues to absorb the costs for various state and local fees and permits under new environmental programs, the sum of which were not material during 2004. The Company retains outside consultants to assist the Company in maintaining compliance with these regulations. The Company is actively pursuing an ongoing policy of upgrading and restoring older properties to comply with current and proposed environmental regulations. The costs of upgrading and restoring older properties to comply with environmental regulations have not been determined. Management believes that these costs will not have a material adverse effect upon its financial position or results of operations.

### ANALYSIS OF SIGNIFICANT CHANGES IN RESULTS OF OPERATIONS

Results of Operations for the Fiscal Year Ended December 31, 2004  
Compared to the Fiscal Year Ended December 31, 2003

## Edgar Filing: PYRAMID OIL CO - Form 10KSB

### REVENUES

Oil and gas sales increased by 29% for the year ended December 31, 2004, when compared with the same period for 2003. Oil and gas sales increased by 30% due to higher average prices for 2004. The average price of the Company's oil and gas increased by approximately \$8.50 per equivalent barrel for 2004 when compared to 2003. This was offset by a decrease in crude oil production/sales of approximately 900 barrels.

### OPERATING EXPENSES

Operating expenses increased by approximately 13% for the year ended December 31, 2004, when compared with the same period of 2003. The cost to produce an equivalent barrel of crude oil increased by approximately \$2.20 per barrel for 2004 when compared to 2003. Operating costs for the twelve months ended December 31, 2004, increased due to a number of differing factors.

The Company worked on a well on one of its leases in the Carneros Creek area during 2004, increasing operating costs by approximately 6%. The work on this well was been done to explore a different producing zone in an effort to increase production and to test this zone for application on other wells on this same property. The work on this well did not generate any additional production for this lease.

Expenses increased by 5% on a property that the Company returned to production during the fourth quarter of 2004. This property has been shut-in for over two years due to problems with economically disposing of produced waste water.

17

As a result of the higher crude oil prices during 2004, it became economical for the Company to cover the costs of disposing of the waste water.

Labor costs increased by approximately 2% due to increases in hourly wage rates, overtime and the addition of one new field employee in August of 2004, bringing the total number of field personnel from seven to eight employees. Operating expenses were generally higher in 2004, as a result of the Company placing greater emphasis on maintaining and enhancing crude oil production to take advantage of the higher crude oil prices during 2004.

### EXPLORATION COSTS

In April 2004, the Company entered into a Joint Venture Agreement with two oil companies, Prime Natural Resources, LLC of Houston, Texas and North Arm Resources, Inc. Of Wayzata, Minnesota for the drilling of a 5,500 foot exploratory well in the Blackwell's Corner area of Kern Country California. This drilling prospect contains approximately 1,100 acres and was developed by employing 3-D seismic technology and geology. The Company purchased a 25% position in the prospect for approximately \$53,000 and will be the Operator. The new well was drilled in May of 2004, with an estimated cost of approximately \$400,000 for a dry-hole look and \$560,000 to complete as a producer. The Company's share of these costs would be 25%. As of December 31, 2004, the Company's share of costs for drilling and competing the new well was approximately \$201,000. In the fourth quarter of 2004, a decision was made by the Company and its joint venture partners to abandon this well. It was determined in the fourth quarter of 2004, that the well could not produce economic quantities of oil and gas. Therefore, the Company reclassified its share of costs of \$201,000 for drilling and completing this well as exploration costs.

## Edgar Filing: PYRAMID OIL CO - Form 10KSB

### GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses increased by approximately 59% for the year ended December 31, 2004, when compared with the same period for 2003. General and administrative expenses increased by approximately 49% due to the settlement of the employment contract with J. Ben Hathaway. Mr. Hathaway voluntarily resigned as President of Pyramid Oil Company and pursuant to the terms of his employment contract, he received a payment of approximately \$170,000. General and administrative expenses also increased due to increased administrative salaries of approximately 5%. Legal services also increased by approximately 2% due to additional compliance efforts required by the recently enacted Sarbanes-Oxley legislation.

### PROVISION FOR DEPLETION, DEPRECIATION, AMORTIZATION AND VALUATION ALLOWANCES

The provision for depletion, depreciation and amortization increased by approximately 28% for the twelve months ended December 31, 2004, when compared with the same period for 2003. The increase is due primarily to an increase of

18

12% in valuation allowances. At December 31, 2004, the Company was required to provide a valuation allowance against an oil and gas property whose book value exceeded the undiscounted net value of its future net cash flows in the amount of approximately \$21,000. Depletion also increased by approximately 11%. The increase in depletion is due to an increase in the depletion rate due to an increase in the depletable asset base at January 1, 2005 and a decline in proved developed reserves. Depreciation of fixed assets also increased by 5% due primarily to the replacement of fully depreciated pickup trucks with new trucks.

### GAIN ON SALES OF PROPERTY AND EQUIPMENT

The Company sold a well servicing hoist in the first quarter of 2004 for a gain of approximately \$134,000 and a minor piece of production equipment in the second quarter of 2004 for a gain of \$4,000. The Company sold another well servicing hoist in the third quarter of 2004 for a gain of approximately \$56,000. The Company sold a piece of equipment in the third quarter of 2004, from the category, assets held for resale, for a gain of \$28,000. The Company also sold another piece of equipment in the fourth quarter of 2004, from the category, assets held for resale, for a gain of \$26,000. The Company sold three excess pickups in 2004 for a gain of \$8,600. All of the assets sold in 2004 had little or no net book values.

### OTHER INCOME

The Company sold excess tubing and sundry used oilfield supplies and production equipment during 2004, which resulted in approximately \$53,000 of other income.

Results of Operations for the Fiscal Year Ended December 31, 2003  
Compared to the Fiscal Year Ended December 31, 2002

### REVENUES

Oil and gas sales increased by 28% for the year ended December 31, 2003, when

## Edgar Filing: PYRAMID OIL CO - Form 10KSB

compared with the same period for 2002. Oil and gas sales increased by 23% due to higher average prices for 2003. The average price of the Company's oil and gas increased by approximately \$4.95 per equivalent barrel for 2003 when compared to 2002. An increase in crude oil production/sales of approximately 3,700 barrels increased revenues by an additional 5%. The increase in crude oil production is due primarily to the drilling of a new well that was placed into production at the end of June 2003.

### OPERATING EXPENSES

Operating expenses increased by approximately 13% for the year ended December 31, 2003, when compared with the same period of 2002. The cost to produce an equivalent barrel of crude oil increased by approximately \$1.14 per barrel for

19

2003 when compared to 2002. Operating expenses increased by 7% as a result of fracturing procedures that were conducted on two separate wells in an attempt to stimulate production on these wells. The costs of the frac jobs were approximately \$74,000. Operating parts and supplies increased by approximately 5% due to a number of factors, none of which increased costs by more than 2%. These costs tend to be cyclical in nature and can vary from year to year. Labor costs increased by approximately 4% due primarily to an increase in hourly wages that was effective July 1, 2003 and an increase in overtime wages. Insurance costs increased by approximately 2% for 2003 due primarily to higher rates for employee health insurance, workers' compensation and general liability premiums.

### GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses decreased by approximately 14% for the year ended December 31, 2003, when compared with the same period for 2002. Legal services decreased by 10% during 2003. Legal fees were higher in 2002 due to activities related to certain transactions contemplated by the Board of Directors for the acquisition of the Company's common stock from its major shareholders.

### EXPLORATION COSTS

The amounts for 2001 represent the costs for drilling of exploratory gas wells with several other oil and gas companies in a joint venture to explore for and develop natural gas reserves in the Solano County area of California. The joint venture activities are more fully described in the Notes to Financial Statements, No. 6, Commitments and Contingencies in Item 7 of this Form 10-KSB. The Company did not participate in the drilling of any gas wells in 2002 with this joint venture. The costs for 2002 represent the Company's share of costs in a new joint venture project to explore for and develop oil wells in the Kern County area of California.

### CRITICAL ACCOUNTING POLICIES

#### COSTS INCURRED IN OIL AND GAS PRODUCING ACTIVITIES

The Company has adopted the "successful efforts" method of accounting for its oil and gas exploration and development activities, as set forth in the Statement of Financial Accounting Standards No. 19, as amended, issued by the Financial Accounting Standards Board.

The Company initially capitalizes expenditures for oil and gas property acquisitions until they are either determined to be successful (capable of



## Edgar Filing: PYRAMID OIL CO - Form 10KSB

commercial production) or unsuccessful. The carrying value of all undeveloped oil and gas properties is evaluated periodically and reduced if such carrying value appears to have been impaired. Leasehold costs relating to successful oil and gas properties remain capitalized while leasehold costs which have been proven unsuccessful are charged to operations in the period the leasehold costs are proven unsuccessful. Costs of carrying and retaining unproved properties are expensed as incurred.

20

The costs of drilling and equipping development wells are capitalized, whether the wells are successful or unsuccessful. The costs of drilling and equipping exploratory wells are capitalized until they are determined to be either successful or unsuccessful. If the wells are successful, the costs of the wells remain capitalized. If, however, the wells are unsuccessful, the capitalized costs of drilling the wells, net of any salvage value, are charged to operations in the period the wells are determined to be unsuccessful.

The Company adopted the Financial Accounting Standards Board Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of" (the Statement). The Statement specifies when an impairment loss should be recognized and how impairment losses should be measured for long-lived assets to be held and used and for long-lived assets to be disposed of. In accordance with the Statement, the costs of proved oil and gas properties and equipment are periodically assessed on a lease by lease basis to determine if such costs exceed undiscounted future cash flows, and if conditions warrant an impairment reserve will be provided based on the estimated future discounted cash flows. The Company recorded an impairment reserve of \$21,699 at December 31, 2004. There were no material impairment reserves recorded in the two years ended December 31, 2003.

### DEPLETION, DEPRECIATION, AND AMORTIZATION

Depletion of leasehold costs of producing oil and gas properties is provided on the unit-of-production method, by individual property unit, based on estimated recoverable proved reserves. Depreciation and amortization of the costs of producing wells and related equipment are provided on the unit-of-production method, by individual property unit, based on estimated recoverable proved developed reserves. Amortization of the costs of undeveloped oil and gas properties is based on the Company's experience, giving consideration to the holding periods of leaseholds. The average depletion per equivalent barrel of crude oil produced for 2004, 2003 and 2002 were \$1.50, \$0.95 and \$1.21, respectively.

Drilling and operating equipment, buildings, automotive, office and other property and equipment and leasehold improvements are stated at cost. Depreciation and amortization are computed using the straight-line method over the shorter of the estimated useful lives or the applicable lease terms (range of 3 to 19 years). Any permanent impairment of the carrying value of property and equipment is provided for at the time such impairments become known.

### IMPACT OF RECENT ACCOUNTING PRONOUNCEMENTS

In November 2004, the FASB issued SFAS No. 151, 'Inventory Costs'. SFAS No. 151 amends the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) under the guidance in ARB No. 43, Chapter 4, 'Inventory Pricing'. Paragraph 5 of ARB No. 43, Chapter 4, previously stated that '. . . under some circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current period charges. .

. .' This Statement requires that those items be recognized as current-period charges regardless of whether they meet the criterion of 'so abnormal'. In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. This statement is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Management does not expect adoption of SFAS No. 151 to have a material impact on the Company's financial statements.

In December 2004, the FASB issued SFAS No. 152, 'Accounting for Real Estate Time-Sharing Transactions'. The FASB issued this Statement as a result of the guidance provided in AICPA Statement of Position (SOP) 04-2, 'Accounting for Real Estate Time-Sharing Transactions'. SOP 04-2 applies to all real estate time-sharing transactions. Among other items, the SOP provides guidance on the recording of credit losses and the treatment of selling costs, but does not change the revenue recognition guidance in SFAS No. 66, 'Accounting for Sales of Real Estate', for real estate time-sharing transactions. SFAS No. 152 amends Statement No. 66 to reference the guidance provided in SOP 04-2. SFAS No. 152 also amends SFAS No. 67, 'Accounting for Costs and Initial Rental Operations of Real Estate Projects', to state that SOP 04-2 provides the relevant guidance on accounting for incidental operations and costs related to the sale of real estate time-sharing transactions. SFAS No. 152 is effective for years beginning after June 15, 2005, with restatements of previously issued financial statements prohibited. This statement is not applicable to the Company.

In December 2004, the FASB issued SFAS No. 153, 'Exchanges of Nonmonetary Assets', an amendment to Opinion No. 29, 'Accounting for Nonmonetary Transactions'. Statement No. 153 eliminates certain differences in the guidance in Opinion No. 29 as compared to the guidance contained in standards issued by the International Accounting Standards Board. The amendment to Opinion No. 29 eliminates the fair value exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. Such an exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective for nonmonetary asset exchanges occurring in periods beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges occurring in periods beginning after December 16, 2004. Management does not expect adoption of SFAS No. 153 to have a material impact on the Company's financial statements.

In December 2004, the FASB issued SFAS No. 123(R), 'Share-Based Payment'. SFAS 123(R) amends SFAS No. 123, 'Accounting for Stock-Based Compensation', and APB Opinion 25, 'Accounting for Stock Issued to Employees'. SFAS No.123(R) requires that the cost of share-based payment transactions (including those with employees and non-employees) be recognized in the financial statements. SFAS No. 123(R) applies to all share-based payment transactions in which an entity acquires goods or services by issuing (or offering to issue) its shares, share options, or other equity instruments (except for those held by an ESOP) or by incurring liabilities (1) in amounts based (even in part) on the price of the entity's shares or other equity

instruments, or (2) that require (or may require) settlement by the issuance of an entity's shares or other equity instruments. This statement is effective, as of the first interim period or fiscal year beginning after December 15, 2005. Management is currently assessing the effect of SFAS No. 123(R) on the Company's financial statements.

ITEM 7- FINANCIAL STATEMENTS

PYRAMID OIL COMPANY

INDEX TO FINANCIAL STATEMENTS

DECEMBER 31, 2004

	Page
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM . . . . .	24
FINANCIAL STATEMENTS:	
Balance sheets - December 31, 2004 and 2003 . . . . .	25-26
Statements of operations - years ended	
December 31, 2004, 2003 and 2002 . . . . .	27-28
Statements of shareholders' equity - years ended	
December 31, 2004, 2003 and 2002 . . . . .	29
Statements of cash flows - years	
ended December 31, 2004, 2003 and 2002 . . . . .	30-31
Notes to financial statements . . . . .	32

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors  
Pyramid Oil Company  
Bakersfield, California

We have audited the balance sheets of Pyramid Oil Company as of December 31, 2004 and 2003, and the related statements of operations, shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provided a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pyramid Oil Company as of December 31, 2004 and 2003, and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted

## Edgar Filing: PYRAMID OIL CO - Form 10KSB

accounting principles.

As discussed in Note 9 to the financial statements, the Company changed its method of accounting for asset retirement costs effective January 1, 2003.

SINGER LEWAK GREENBAUM & GOLDSTEIN LLP

Los Angeles, California  
February 24, 2005

25

### FINANCIAL STATEMENTS PYRAMID OIL COMPANY BALANCE SHEETS ASSETS

	December 31,	
	2004	2003
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 816,216	\$ 606,799
Short-term investments	850,000	850,000
Trade accounts receivable (net of reserve for doubtful accounts of \$4,000 in 2004 and 2003)	216,821	217,460
Interest receivable	70,628	63,430
Employee loan receivable	8,801	--
Crude oil inventory	66,339	48,417
Prepaid expenses	110,164	114,411
Deferred income taxes	25,698	27,927
Total current assets	2,164,667	1,928,444
<b>PROPERTY AND EQUIPMENT, at cost:</b>		
Oil and gas properties and equipment (successful efforts method)	11,208,833	10,769,838
Capitalized asset retirement costs	294,600	290,450
Drilling and operating equipment	2,067,006	1,819,360
Land, buildings and improvements	947,426	947,426
Automotive, office and other property and equipment	961,519	967,244
	15,479,384	14,794,318
Less - accumulated depletion, depreciation, amortization and valuation allowances	(13,294,764)	(12,925,901)
	2,184,620	1,868,417
<b>OTHER ASSETS</b>		
Deposits	250,000	--

Edgar Filing: PYRAMID OIL CO - Form 10KSB

Other assets	15,556	--
Assets held for resale (net of accumulated depreciation and valuation allowance of \$382,346 And \$1,033,493 in 2004 and 2003)	9,633	38,237
	-----	-----
	\$ 4,624,476	\$ 3,835,098
	=====	=====

The accompanying notes are an integral part of these balance sheets.

26

PYRAMID OIL COMPANY  
BALANCE SHEETS  
LIABILITIES AND SHAREHOLDERS' EQUITY

	December 31,	
	2004	2003
	-----	-----
CURRENT LIABILITIES:		
Accounts payable	\$ 62,229	\$ 95,651
Accrued professional fees	28,220	33,972
Accrued taxes, other than income taxes	24,090	19,785
Accrued payroll and related costs	214,255	38,727
Accrued royalties payable	85,186	78,084
Accrued insurance	52,094	47,825
Current maturities of long-term debt	50,740	44,049
Deferred income taxes	25,698	27,927
	-----	-----
Total current liabilities	542,512	386,020
	-----	-----
LONG-TERM DEBT, net of current maturities	63,972	59,248
	-----	-----
LIABILITY FOR ASSET RETIREMENT OBLIGATION	946,566	930,306
	-----	-----
COMMITMENTS AND CONTINGENCIES (Note 6)		
SHAREHOLDERS' EQUITY:		
Common stock, no par value - Authorized - 10,000,000 shares Issued and outstanding - 2,494,430 shares	1,071,610	1,071,610
Retained earnings	1,999,816	1,387,914
	-----	-----
	3,071,426	2,459,524
	-----	-----
	\$ 4,624,476	\$ 3,835,098
	=====	=====

The accompanying notes are an integral part of these balance sheets.

Edgar Filing: PYRAMID OIL CO - Form 10KSB

27

PYRAMID OIL COMPANY  
STATEMENTS OF OPERATIONS

	Year ended December 31,		
	2004	2003	2002
REVENUES:	\$ 2,674,902	\$ 2,070,414	\$ 1,616,041
COSTS AND EXPENSES:			
Operating expenses	1,337,542	1,186,632	1,046,690
Exploration costs	201,388	--	7,007
General and administrative	551,926	346,568	403,603
Taxes, other than income and payroll taxes	54,064	53,521	55,531
Provision for depletion, depreciation and amortization	214,673	168,268	172,360
Accretion expense	18,221	54,262	--
Other costs and expenses	19,350	18,663	16,488
	2,397,164	1,827,914	1,701,709
OPERATING INCOME (LOSS)	277,738	242,500	( 85,668)
OTHER INCOME (EXPENSE):			
Interest income	16,551	20,246	36,935
Gain on sales of property and equipment	252,421	--	300
Loss on disposal of assets	--	--	( 10,100)
Other income	67,251	14,400	31,912
Interest expense	( 934)	( 2,095)	( 5,566)
	335,289	32,551	53,481
INCOME (LOSS) BEFORE INCOME TAX PROVISION	613,027	275,051	( 32,187)
Income tax provision	1,125	1,125	1,125
NET INCOME (LOSS) BEFORE CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE	611,902	273,926	( 33,312)
Cumulative effect on prior years of change in method of accounting for asset retirement obligation	--	( 810,115)	--
NET (LOSS) INCOME	\$ 611,902	\$ ( 536,189)	\$ ( 33,312)

The accompanying notes are an integral part of these statements.

28

PYRAMID OIL COMPANY  
STATEMENTS OF OPERATIONS

Edgar Filing: PYRAMID OIL CO - Form 10KSB

	Year ended December 31,		
	2004	2003	2002
EARNINGS PER COMMON SHARE			
Basic:			
Income (loss) before cumulative effect of change in accounting principle	\$ .25	\$ .11	\$ (.01)
Cumulative effect on prior Years of change in method of Accounting for asset Retirement obligation	--	(.32)	--
<b>BASIC (LOSS) INCOME</b>	<b>\$ .25</b>	<b>\$ (.21)</b>	<b>\$ (.01)</b>
Diluted:			
Income (loss) before cumulative effect of change in accounting principle	\$ .25	\$ .11	\$ (.01)
Cumulative effect on prior Years of change in method of Accounting for asset Retirement obligation	--	(.32)	--
<b>DILUTED (LOSS) INCOME</b>	<b>\$ .25</b>	<b>\$ (.21)</b>	<b>\$ (.01)</b>
Weighted average number of common shares outstanding	2,494,430	2,494,430	2,494,430

The accompanying notes are an integral part of these statements.

PYRAMID OIL COMPANY  
STATEMENTS OF SHAREHOLDERS' EQUITY

Common Shares

Edgar Filing: PYRAMID OIL CO - Form 10KSB

	Issued and Outstanding -----	Common Stock -----	Retained Earnings -----
Balances, December 31, 2001	2,494,430	\$1,071,610	\$1,957,415
Net loss	--	--	( 33,312)
	-----	-----	-----
Balances, December 31, 2002	2,494,430	1,071,610	1,924,103
Net loss	--	--	( 536,189)
	-----	-----	-----
Balances, December 31, 2003	2,494,430	1,071,610	1,387,914
Net income	--	--	611,902
	-----	-----	-----
Balances, December 31, 2004	2,494,430	\$1,071,610	\$1,999,816
	=====	=====	=====

The accompanying notes are an integral part of these statements.

30

PYRAMID OIL COMPANY  
STATEMENTS OF CASH FLOWS

	Year ended December 31, -----		
	2004	2003	2002
	-----	-----	-----
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net (loss) income	\$ 611,902	\$(536,189)	\$( 33,312)
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Cumulative effect on prior years of change in method of accounting for asset retirement obligation	--	810,115	--
Provision for depletion, depreciation and amortization	214,673	168,268	172,390
Accretion expense	18,221	54,262	--
Decrease in asset retirement obligation	( 1,961)	( 3,973)	--
Exploration costs	201,388	--	7,007
Gain on sale of property and equipment	(252,421)	--	( 300)
Loss on disposal of fixed assets	--	7,000	10,100
Changes in operating assets and liabilities:			
(Increase) in trade accounts and interest receivable	( 6,559)	(24,424)	(94,985)
(Increase) decrease in crude oil inventories	(17,922)	1,736	( 2,598)
(Increase) decrease in prepaid expenses	4,247	(11,087)	( 9,734)
Increase in accounts payable			



Edgar Filing: PYRAMID OIL CO - Form 10KSB

and accrued liabilities	152,030	64,265	12,917
	-----	-----	-----
Net cash provided by operating activities	923,598	529,973	61,485
	-----	-----	-----

The accompanying notes are an integral part of these statements.

31

PYRAMID OIL COMPANY  
STATEMENTS OF CASH FLOWS  
(CONTINUED)

	Year ended December 31,		
	2004	2003	2002
	-----	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:			
Capital expenditures	\$ (732,739)	\$ (360,416)	\$ (302,402)
Cash deposit with the state of California Division of Oil and Gas	(250,000)	--	--
Proceeds from sale of property and equipment	281,500	--	300
	-----	-----	-----
Net cash used in investing activities	(701,239)	(360,416)	(302,102)
	-----	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from line of credit	100,000	--	--
Payments on line of credit	(100,000)	--	--
Principal payments on long-term debt	( 48,434)	(136,047)	( 15,409)
Proceeds from issuance of long-term debt	59,849	70,450	144,449
Loans to employees	( 24,357)	--	--
	-----	-----	-----
Net cash provided by (used in) financing activities	( 12,942)	( 65,597)	129,040
	-----	-----	-----
Net (decrease) increase in cash and cash equivalents	209,417	103,960	(111,577)
Cash and cash equivalents at beginning of year	606,799	502,839	614,416
	-----	-----	-----
Cash and cash equivalents at end of year	\$ 816,216	\$ 606,799	\$ 502,839
	=====	=====	=====
SUPPLEMENTAL CASH FLOW INFORMATION:			
Cash paid during the year for interest	\$ 934	\$ 7,609	\$ --
	=====	=====	=====

## Edgar Filing: PYRAMID OIL CO - Form 10KSB

Cash paid during the year for income taxes	\$ 1,125 =====	\$ 1,125 =====	\$ 1,125 =====
---	-------------------	-------------------	-------------------

The accompanying notes are an integral part of these statements.

32

PYRAMID OIL COMPANY  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2004

### 1. SIGNIFICANT ACCOUNTING POLICIES

#### NATURE OF OPERATIONS

Pyramid Oil Company (the Company), a California Corporation, has been in the oil and gas business continuously for 96 years since it was incorporated on October 9, 1909. The Company is in the business of exploration, development and production of crude oil and natural gas. The Company operated and has interests in 27 oil and gas leases in Kern and Santa Barbara Counties in the State of California. The Company also owns oil and gas interests in Wyoming and New York that it does not operate. The Company grants short-term credit to its customers and historically receives payment within 30 days.

#### PERVASIVENESS OF ESTIMATES

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

#### CASH AND CASH EQUIVALENTS

Cash and cash equivalents principally consist of demand deposits and certificates of deposits having original maturities of three months or less.

#### INVESTMENTS

Investments consist of certificates of deposit having original maturities of three months or more and are valued at cost.

#### INVENTORY

Inventories of crude oil and condensate are valued at the lower of cost, predominately on a first-in, first-out (FIFO) basis, or market, and include certain costs directly related to the production process.

PYRAMID OIL COMPANY  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
DECEMBER 31, 2004

OTHER ASSETS

Other Assets reflects the fixed assets, net of depreciation and valuation allowances, of the Company's former well service division, that was shut-down during 1993. These assets are non-productive and are being held for resale.

COSTS INCURRED IN OIL AND GAS PRODUCING ACTIVITIES

The Company has adopted the "successful efforts" method of accounting for its oil and gas exploration and development activities, as set forth in the Statement of Financial Accounting Standards No. 19, as amended, issued by the Financial Accounting Standards Board.

The Company initially capitalizes expenditures for oil and gas property acquisitions until they are either determined to be successful (capable of commercial production) or unsuccessful. The carrying value of all undeveloped oil and gas properties is evaluated periodically and reduced if such carrying value appears to have been impaired. Leasehold costs relating to successful oil and gas properties remain capitalized while leasehold costs which have been proven unsuccessful are charged to operations in the period the leasehold costs are proven unsuccessful. Costs of carrying and retaining unproved properties are expensed as incurred.

The costs of drilling and equipping development wells are capitalized, whether the wells are successful or unsuccessful. The costs of drilling and equipping exploratory wells are capitalized until they are determined to be either successful or unsuccessful. If the wells are successful, the costs of the wells remain capitalized. If, however, the wells are unsuccessful, the capitalized costs of drilling the wells, net of any salvage value, are charged to operations in the period the wells are determined to be unsuccessful.

The Company adopted the Financial Accounting Standards Board Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of" (the Statement). The Statement specifies when an impairment loss should be recognized and how impairment losses should be measured for long-lived assets to be held and used and for long-lived assets to be disposed of. In accordance with the Statement, the costs of proved oil and gas properties and equipment are periodically assessed on a lease by lease basis to determine if such costs exceed undiscounted future cash flows, and if conditions warrant an impairment reserve will be provided based on the estimated future discounted cash flows. The Company recorded an impairment reserve of \$21,699 at December 31, 2004. There were no material impairment reserves recorded in the two years ended December 31, 2003.

PYRAMID OIL COMPANY  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
DECEMBER 31, 2004

DEPLETION, DEPRECIATION, AND AMORTIZATION

## Edgar Filing: PYRAMID OIL CO - Form 10KSB

Depletion of leasehold costs of producing oil and gas properties is provided on the unit-of-production method, by individual property unit, based on estimated recoverable proved reserves. Depreciation and amortization of the costs of producing wells and related equipment are provided on the unit-of-production method, by individual property unit, based on estimated recoverable proved developed reserves. Amortization of the costs of undeveloped oil and gas properties is based on the Company's experience, giving consideration to the holding periods of leaseholds. The average depletion per equivalent barrel of crude oil produced for 2004, 2003 and 2002 were \$1.50, \$0.95 and \$1.21, respectively.

Drilling and operating equipment, buildings, automotive, office and other property and equipment and leasehold improvements are stated at cost. Depreciation and amortization are computed using the straight-line method over the shorter of the estimated useful lives or the applicable lease terms (range of 3 to 19 years). Any permanent impairment of the carrying value of property and equipment is provided for at the time such impairments become known.

### MAINTENANCE AND REPAIRS

Maintenance, repairs and replacement expenditures are charged to operations as incurred, while major renewals and betterments are capitalized and depreciated over their useful lives.

### RETIREMENT OR DISPOSAL OF PROPERTIES AND EQUIPMENT

Costs and accumulated depletion, depreciation, amortization and valuation allowances of property and equipment retired, abandoned, or otherwise disposed of are removed from the accounts upon disposal, and any resulting gain or loss is included in operations in the year of disposition. However, upon disposal of a portion of an oil and gas property, any proceeds received are treated as a recovery of cost and no gain or loss is recognized in the year of disposition.

### INCOME TAXES

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing

35

PYRAMID OIL COMPANY  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
DECEMBER 31, 2004

assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date.

### CONCENTRATION OF CREDIT RISK

## Edgar Filing: PYRAMID OIL CO - Form 10KSB

The Company sells its crude oil to ConocoPhillips and Kern Oil & Refining, accounting for approximately 52.2%, and 43.2%, respectively, of Pyramid's crude oil and gas sales in 2004. While revenue from these customers is significant, and the loss of any one could have a short-term adverse effect on the Company, it is management's opinion that the oil and gas it produces could be sold to other crude oil purchasers, refineries or pipeline companies. Trade receivables were approximately 47% and 38% attributable to ConocoPhillips and Kern Oil and Refining respectively at December 31, 2004. Trade receivables were approximately 55% and 44% attributable to ConocoPhillips and Kern Oil and Refining respectively at December 31, 2003.

### IMPACT OF RECENT ACCOUNTING PRONOUNCEMENTS

In November 2004, the FASB issued SFAS No. 151, 'Inventory Costs'. SFAS No. 151 amends the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) under the guidance in ARB No. 43, Chapter 4, 'Inventory Pricing'. Paragraph 5 of ARB No. 43, Chapter 4, previously stated that '. . . under some circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current period charges. . . .' This Statement requires that those items be recognized as current-period charges regardless of whether they meet the criterion of 'so abnormal'. In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. This statement is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Management does not expect adoption of SFAS No. 151 to have a material impact on the Company's financial statements.

In December 2004, the FASB issued SFAS No. 152, 'Accounting for Real Estate Time-Sharing Transactions'. The FASB issued this Statement as a result of the guidance provided in AICPA Statement of Position (SOP) 04-2, 'Accounting for Real Estate Time-Sharing Transactions'. SOP 04-2 applies to all real estate time-sharing transactions. Among other items, the SOP provides guidance on the recording of credit losses and the treatment of selling costs, but does not change the revenue recognition guidance in SFAS No. 66, 'Accounting for Sales of Real Estate', for real estate time-sharing

36

PYRAMID OIL COMPANY  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
DECEMBER 31, 2004

transactions. SFAS No. 152 amends Statement No. 66 to reference the guidance provided in SOP 04-2. SFAS No. 152 also amends SFAS No. 67, 'Accounting for Costs and Initial Rental Operations of Real Estate Projects', to state that SOP 04-2 provides the relevant guidance on accounting for incidental operations and costs related to the sale of real estate time-sharing transactions. SFAS No. 152 is effective for years beginning after June 15, 2005, with restatements of previously issued financial statements prohibited. This statement is not applicable to the Company.

In December 2004, the FASB issued SFAS No. 153, 'Exchanges of Nonmonetary Assets', an amendment to Opinion No. 29, 'Accounting for Nonmonetary Transactions'. Statement No. 153 eliminates certain differences in the guidance in Opinion No. 29 as compared to the guidance contained in standards issued by the International Accounting Standards Board. The amendment to Opinion No. 29 eliminates the fair value exception for nonmonetary exchanges

Edgar Filing: PYRAMID OIL CO - Form 10KSB

of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. Such an exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective for nonmonetary asset exchanges occurring in periods beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges occurring in periods beginning after December 16, 2004. Management does not expect adoption of SFAS No. 153 to have a material impact on the Company's financial statements.

In December 2004, the FASB issued SFAS No. 123(R), 'Share-Based Payment'. SFAS 123(R) amends SFAS No. 123, 'Accounting for Stock-Based Compensation', and APB Opinion 25, 'Accounting for Stock Issued to Employees'. SFAS No.123(R) requires that the cost of share-based payment transactions (including those with employees and non-employees) be recognized in the financial statements. SFAS No. 123(R) applies to all share-based payment transactions in which an entity acquires goods or services by issuing (or offering to issue) its shares, share options, or other equity instruments (except for those held by an ESOP) or by incurring liabilities (1) in amounts based (even in part) on the price of the entity's shares or other equity instruments, or (2) that require (or may require) settlement by the issuance of an entity's shares or other equity instruments. This statement is effective, as of the first interim period or fiscal year beginning after December 15, 2005. Management is currently assessing the effect of SFAS No. 123(R) on the Company's financial statements. 37

PYRAMID OIL COMPANY  
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
 DECEMBER 31, 2004

2. LONG-TERM DEBT AND LINE OF CREDIT

Long-term debt at December 31, 2004 and 2003, is summarized as follows:

	December 31,	
	----- 2004 -----	2003 -----
Note payable to GMAC, secured by equipment purchased with the proceeds of the loan, payable in monthly installments of \$999 principal only, zero interest charges, final payment in 2005.	\$ 11,982	\$ 23,965
Note payable to GMAC, secured by equipment purchased with the proceeds of the loan, payable in monthly installments of \$1,111 principal only, zero interest charges, final payment in 2004.	--	11,111
Note payable to GMAC, secured by equipment purchased with the proceeds of the loan, payable in monthly installments of \$1,114 principal only, zero interest charges, final payment in 2006.	24,516	37,887
Note payable to GMAC, secured by equipment purchased with the proceeds of the loan, payable in monthly installments of \$632 principal only, zero interest charges, final payment in 2007.	22,750	30,334
Note payable to GMAC, secured by equipment purchased with the proceeds of the loan,		

Edgar Filing: PYRAMID OIL CO - Form 10KSB

payable in monthly installments of \$431 principal only, zero interest charges, final payment in 2008.	19,397	--
Note payable to GMAC, secured by equipment purchased with the proceeds of the loan, payable in monthly installments of \$1,154 principal and interest, interest at 3.9%, final payment in 2007.	36,067	--
	-----	-----
	114,712	103,297
Less - current maturities	( 50,740)	( 44,049)
	-----	-----
	\$ 63,972	\$ 59,248
	=====	=====

38

PYRAMID OIL COMPANY  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
DECEMBER 31, 2004

At December 31, 2004 approximately \$180,000 of gross property and equipment was pledged as collateral to secure approximately \$115,000 principal amount of long-term debt.

Maturities of long-term debt are as follows:

Year ending December 31, 2005	\$ 50,740
2006	35,998
2007	24,096
2008	3,878
	-----
	\$114,712
	=====

At December 31, 2004, the Company had an unsecured line of credit with a bank, under which the Company may borrow up to \$200,000 through May 31, 2005. Interest on any borrowing is accrued at the bank's index rate plus 0.50 percentage points. The bank's index rate was 5.75% at December 31, 2004.

3. INCOME TAXES

Income tax provision (benefit) consists of the following:

	Year Ended December 31,		
	2004	2003	2002
	-----	-----	-----
Federal income taxes:			
Current	\$ 86,148	\$ 32,016	\$ ( 17,332)
Utilization of NOL's	(86,148)	(32,016)	17,332
Deferred	--	--	--
	-----	-----	-----
	--	--	--
	-----	-----	-----
State income taxes:			

Edgar Filing: PYRAMID OIL CO - Form 10KSB

Current	14,511	( 3,542)	(25,962)
Utilization of NOL's	(13,386)	4,667	27,087
Deferred	--	--	--
	-----	-----	-----
	1,125	1,125	1,125
	-----	-----	-----
Income tax provision	\$ 1,125	\$ 1,125	\$ 1,125
	=====	=====	=====

39

PYRAMID OIL COMPANY  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
DECEMBER 31, 2004

Differences exist between certain accounting policies and related provisions included in federal income tax rules. The amounts by which these differences and other factors cause the total income tax provision to differ from an amount computed by applying the federal statutory income tax rate to financial income is set forth in the following reconciliation:

	Year Ended December 31,		
	2004	2003	2002
	-----	-----	-----
Federal income tax expense			
(benefit) at statutory rate	\$ 208,047	\$ (182,304)	\$ ( 10,944)
Net operating loss carryover	( 93,097)	( 54,438)	10,944
Statutory depletion	(120,558)	( 60,047)	--
Cumulative effect of change in			
accounting principle	--	295,736	--
Other	6,733	2,178	1,125
	-----	-----	-----
Income tax provision	\$ 1,125	\$ 1,125	\$ 1,125
	=====	=====	=====

The components of net deferred tax asset (liability) are as follows:

	December 31,		
	2004	2003	2002
	-----	-----	-----
Current deferred taxes:			
Gross assets	\$ 25,698	\$ 27,927	\$ 22,911
Gross liabilities	--	--	--
	-----	-----	-----
	25,698	27,927	22,911
	-----	-----	-----
Noncurrent deferred taxes:			
Gross assets	2,077,164	2,156,444	2,357,135
Gross liabilities	( 96,849)	( 86,164)	( 60,839)
Valuation allowance	(2,006,013)	(2,098,207)	(2,319,207)
	-----	-----	-----
	( 25,698)	( 27,927)	( 22,911)
	-----	-----	-----
	\$ --	\$ --	\$ --
	=====	=====	=====



40

PYRAMID OIL COMPANY  
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
 DECEMBER 31, 2004

The tax effect of significant temporary differences representing deferred tax assets and (liabilities) are as follows:

	December 31,		
	2004	2003	2002
Accounts receivable	\$ 1,600	\$ 1,600	\$ 1,600
Net operating loss carry forwards	377,700	456,979	683,750
Statutory depletion carryover	1,699,464	1,699,464	1,673,385
Accrued liabilities	24,098	26,327	21,311
Total deferred tax assets	2,102,862	2,184,370	2,380,046
Property and equipment	( 96,849)	( 86,163)	( 60,839)
Valuation allowance	(2,006,013)	(2,098,207)	(2,319,207)
	\$ --	\$ --	\$ --

At December 31, 2004, a valuation allowance has been provided against a significant portion of the deferred tax assets generated by net operating loss carryforwards and the statutory depletion carryover due to the uncertainty of their future utilization.

The Company has federal income tax net operating loss carry forwards of approximately \$1,046,000, which expire, to the extent not used, starting in 2004 through 2022. For California franchise tax purposes, as of December 31, 2004 the Company has unused net operating loss carryforwards of approximately \$237,000, a portion of which expire each year starting in 2004.

At December 31, 2004, the Company has, for federal income tax purposes, a statutory depletion carryover of approximately \$4,998,000, which currently has no expiration date.

As of December 31, 2004, the Company has no investment tax credit carryforward available to reduce future taxes payable for financial reporting and federal income tax purposes.

41

PYRAMID OIL COMPANY  
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
 DECEMBER 31, 2004

## Edgar Filing: PYRAMID OIL CO - Form 10KSB

### 4. RELATED-PARTY TRANSACTION

Effective January 1, 1990, John H. Alexander, an officer and director of the Company participated with a group of investors that acquired the mineral and fee interest on one of the Company's oil and gas leases (Santa Fe Energy lease) in the Carneros Creek field after the Company declined to participate. The thirty-three percent interest owned by Mr. Alexander represents a minority interest in the investor group. Royalties on oil and gas production from this property paid to the investor group approximated \$143,000, \$122,000 and \$100,000 in 2004, 2003 and 2002, respectively.

On January 14, 2000, pursuant to specific terms, conditions and obligations contained within the May 1984 oil and gas lease between Santa Fe Energy Company as lessor and Pyramid Oil Company as lessee, Pyramid quit-claimed all unearned acreage in said lease back to the lessors. Under the terms of the lease, Pyramid retained specific producing intervals within 10 acre spacings surrounding each well bore.

Effective April 1, 2002, the Company acquired the remaining 36.5 % working interest in the Santa Fe oil and gas lease in the Carneros Creek field and working interests (approximately 36.5%) in two other leases in the same area from the investor group noted above. The investor group acquired these working interests from the Company's former joint venture partner in these three oil and gas leases as the result of a court ordered settlement agreement concluding litigation between the investor group and the joint venture partner. The investor group sold the working interests to the Company for \$217,000. Mr. John H. Alexander, Vice President of the Company, owns a thirty-three percent interest in the investor group. The Company had notes payable to the investor group in the amount of \$108,502 at the end of December 31, 2002, of which \$108,502 was paid-off on the notes payable in 2003.

As a director, Mr. Alexander has abstained from voting on any of the above matters that have been brought before the Board of Directors, involving the Santa Fe lease.

### 5. FOURTH QUARTER RESULTS (UNAUDITED)

During the fourth quarter of 2004, the Company reclassified its investment in the costs of drilling and completing a well that was drilled in June of 2004. The costs of drilling this well were capitalized during the second and third quarters of 2004. A decision was made in the fourth quarter of 2004 to abandon the well, by the Company and its joint-venture partners in the drilling of this well. The Company's share of the costs for this well in the amount of \$201,000 were charged to exploration costs in the fourth quarter of 2004.

42

PYRAMID OIL COMPANY  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
DECEMBER 31, 2004

During the fourth quarter of 2004, the Company made a payment to J. Ben Hathaway, the former President of the Company, under the terms of the employment contract with Mr. Hathaway and the Company. Mr. Hathaway voluntarily resigned as President of Pyramid Oil Company and pursuant to the terms of his employment contract, he received a payment of approximately \$170,000 in December of 2004.

During the fourth quarter of 2004, the Company made adjustments to the

## Edgar Filing: PYRAMID OIL CO - Form 10KSB

carrying value of one of its oil and gas properties. The Company recorded a valuation allowance in the amount of \$20,699 to reflect the change in the projected future undiscounted net cash flows for this property, as the result of the analysis of the Company's oil and gas reserves by independent consultants.

During the fourth quarter of 2003, the Company adjusted the liability for asset retirement obligation due to a change in the remaining life of certain of its oil and gas properties. These changes were based on adjustments made to the Company's oil and gas reserves by independent consultants. The effect of these adjustments was to decrease net income by approximately \$36,000 in the fourth quarter of 2003.

### 6. COMMITMENTS AND CONTINGENCIES

The Company is liable for future dismantlement and abandonment costs associated with its oil and gas properties. These costs include down-hole plugging and abandonment of wells, future site restoration, post closure and other environmental exit costs. The costs of future dismantlement and abandonment have been accrued and recorded in the financial statements. See Note 9, Change in Accounting Principles.

The Company is subject to potential litigation within the normal course of business. In management's opinion, the resolution of such litigation would not have a material adverse effect upon the financial position of the Company, although the resolution in any reporting period of such litigation could have a material impact on Pyramid's results of operations for that period.

The Company has entered into various employment agreements with key executive employees. In the event the key executives are dismissed, the Company would incur approximately \$870,000 in costs as of December 31, 2004.

### 7. OTHER INCOME

The Company sold a well servicing hoist in the first quarter of 2004 for a gain of approximately \$134,000 and a minor piece of production equipment in the second quarter of 2004 for a gain of \$4,000. The Company sold another well servicing hoist in the third quarter of 2004 for a gain of approximately \$56,000. The Company sold a piece of equipment in the third quarter of 2004,

43

PYRAMID OIL COMPANY  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
DECEMBER 31, 2004

from the category, assets held for resale, for a gain of \$28,000. The Company also sold a surplus piece of equipment in the fourth quarter of 2004, from the category, assets held for resale, for a gain of \$26,000. The Company sold three excess pickups in 2004 for a gain of \$8,600. All of the assets sold in 2004 had little or no net book values.

The Company sold surplus tubing and sundry used oilfield supplies and production equipment during 2004, which resulted in approximately \$53,000 of other income.

### 8. DEFINED CONTRIBUTION PLAN

The Company has a defined contribution plan (Simple IRA) available to all employees meeting certain service requirements. Employees may contribute up

## Edgar Filing: PYRAMID OIL CO - Form 10KSB

to a maximum of \$6,000 of their compensation to the plan. The Company will make a contribution to the plan in an amount equal to the employees contributions up to 3% of their salaries. Contributions of \$11,849, \$11,052 and \$10,587 were made during the years ended December 31, 2004, 2003 and 2002, respectively.

### (9) CHANGE IN ACCOUNTING PRINCIPLE

In accordance with Statement of Financial Accounting Standards No. 143, 'Accounting for Assets Retirement Obligations', effective January 1, 2003, the Company changed its method of accounting for asset retirement obligations (ARO) relating to well abandonment costs from expensing such costs in the year the wells are abandoned to recording a liability when such costs are incurred in order to provide a better matching of revenue and expenses and to improve interim financial reporting.

Upon adoption of SFAS 143, the Company was required to recognize a liability for the present value of all legal obligations associated with the retirement of tangible long-lived assets and an asset retirement cost was capitalized as part of the carrying value of the associated asset. Upon initial application of SFAS 143, a cumulative effect of a change in accounting principle was also required in order to recognize a liability for any existing ARO's adjusted for cumulative accretion, an increase to the carrying amount of the associated long-lived asset and accumulated depreciation on the capitalized cost.

Subsequent to initial measurement, liabilities are required to be accreted to their present value each period and capitalized costs are depreciated over the estimated useful life of the related assets. Upon settlement of the liability, the Company will settle the obligation against its recorded amount and will record any resulting gain or loss. As a result of the adoption of SFAS 143 on January 1, 2003, the Company recorded a \$290,450 and \$225,983 increase in the capitalized cost and accumulated depreciation, respectively, of its oil and gas properties.

44

PYRAMID OIL COMPANY  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
DECEMBER 31, 2004

The effect of these changes for the twelve months ending December 31, 2004 and 2003, resulted in a decrease in income from continuing operations of \$23,957 and \$59,698, respectively. The cumulative effect of these changes on years prior to January 1, 2003, approximately \$810,115 (\$0.23 per common share), has been charged to operations in 2003. The effect on net income of this change in accounting methods is as follows:

	Amount	Per Share
	-----	-----
Cumulative effect to January 1, 2003	\$(810,115)	\$(0.23)
Effect on twelve months ended December 31, 2004	(23,957)	(0.01)
Effect on twelve months ended December 31, 2003	(59,698)	(0.02)
Pro Forma effect on twelve months ended December 31, 2002: As reported	\$( 33,312)	\$(0.01)

Edgar Filing: PYRAMID OIL CO - Form 10KSB

Pro Forma

( 56,307)

(0.02)

There are no legally restricted assets for the settlement of asset retirement obligations. No income tax is applicable to the asset retirement obligation as of December 31, 2004 and 2003, because the Company records a valuation allowance on net operating losses and deductible temporary differences due to the uncertainty of its realization.

A reconciliation of the Company's asset retirement obligations from the periods presented are as follows:

	Amount
	-----
Beginning Balance, January 1, 2004	\$930,306
Incurred during the period	(6,111)
Settled during the period	--
Accretion expense	18,221
Additions for new well	4,150
	-----
Ending Balance, December 31, 2004	\$946,566
	=====

45

PYRAMID OIL COMPANY  
SUPPLEMENTAL INFORMATION (UNAUDITED)  
OIL AND GAS PRODUCING ACTIVITIES  
DECEMBER 31, 2004

Statement of Financial Accounting Standards No. 19 (SFAS No. 19), "Financial Accounting and Reporting by Oil and Gas Producing Companies", as amended, requires disclosure of certain financial data for oil and gas operations and reserve estimates of oil and gas. This information, presented here, is intended to enable the reader to better evaluate the operations of the Company. All of the Company's oil and gas reserves are located in the United States.

The aggregate amounts of capitalized costs relating to oil and gas producing activities and the related accumulated depletion, depreciation, and amortization and valuation allowances as of December 31, 2004, 2003 and 2002 were as follows:

	2004	2003	2002
	-----	-----	-----
Proved properties	\$11,030,300	\$10,591,300	\$10,343,000
Unproved properties being amortized	178,600	178,600	178,600
Unproved properties not being amortized	--	--	--
Capitalized asset retirement costs	294,600	290,500	--
Accumulated depletion, depreciation, amortization and valuation allowances	(10,510,700)	(10,306,400)	(10,009,200)
	-----	-----	-----
	\$ 992,800	\$ 754,000	\$ 512,400
	=====	=====	=====

46

## Edgar Filing: PYRAMID OIL CO - Form 10KSB

PYRAMID OIL COMPANY  
SUPPLEMENTAL INFORMATION (UNAUDITED)  
DECEMBER 31, 2004

The estimated quantities and the change in proved reserves, both developed and undeveloped, for the Company are as follows:

	2004		2003		2002	
	Oil (MBbls)	Gas (MMCF)	Oil (MBbls)	Gas (MMCF)	Oil (MBbls)	Gas (MMCF)
Proved reserves:						
Beginning of year	555	83	554	105	323	37
Revisions of previous estimates	(10)	8	75	(15)	297	79
Extensions, discoveries and other additions	49	--	--	--	--	--
Production	(72)	( 8)	(74)	( 7)	(66)	(11)
End of year	522	83	555	83	554	105
Proved developed reserves:						
Beginning of year	555	83	554	105	323	37
End of year	473	83	555	83	554	105

The foregoing estimates have been prepared by the Company from data prepared by an independent petroleum engineer in respect to certain producing properties. Revisions in previous estimates as set forth above resulted from analysis of new information, as well as from additional production experience or from a change in economic factors.

The reserve estimates are believed to be reasonable and consistent with presently known physical data concerning size and character of the reservoirs and are subject to change as additional knowledge concerning the reservoirs becomes available.

47

PYRAMID OIL COMPANY  
SUPPLEMENTAL INFORMATION (UNAUDITED)  
DECEMBER 31, 2004

The present value of estimated future net revenues of proved developed reserves, discounted at 10%, were as follows:

Edgar Filing: PYRAMID OIL CO - Form 10KSB

	December 31,		
	2004	2003	2002
Proved developed reserves (Present value before income taxes)	\$4,636,000	\$4,617,000	\$4,325,000
	=====	=====	=====

SFAS No. 69, "Disclosures About Oil and Gas Producing Activities", requires certain disclosures of the costs and results of exploration and production activities and established a standardized measure of oil and gas reserves and the year-to-year changes therein.

In addition to the foregoing disclosures, SFAS No. 69 established a "Standardized Measure of Discounted Future Net Cash Flows and Changes Therein Relating to Proved Oil and Gas Reserves".

Costs incurred, both capitalized and expensed, of oil and gas property acquisition, exploration and development for the years ended December 31, 2004, 2003 and 2002 were as follows:

	2004	2003	2002
Property acquisition costs	\$ 14,000	\$ --	\$228,000
Exploration costs	201,000	--	7,000
Development costs	418,000	255,000	--
Asset retirement costs	4,000	290,500	--

48

PYRAMID OIL COMPANY  
SUPPLEMENTAL INFORMATION (UNAUDITED)  
DECEMBER 31, 2004

The results of operations for oil and gas producing activities for the years ended December 31, 2004, 2003 and 2002 were as follows:

	2004	2003	2002
Sales	\$ 2,675,000	\$ 2,071,000	\$ 1,616,000
Production costs	1,383,000	1,232,000	1,095,000

Edgar Filing: PYRAMID OIL CO - Form 10KSB

Exploration costs	202,000	--	7,000
Accretion expense	18,000	54,000	--
Depletion, depreciation, amortization and valuation allowance	115,000	77,000	83,000
	-----	-----	-----
	957,000	708,000	431,000
Income tax (benefit) provision	1,200	1,200	1,200
	-----	-----	-----
Results of operations from production activities	\$ 955,800	\$ 706,800	\$ 429,800
	=====	=====	=====

The standardized measure of discounted estimated future net cash flows relating to proved oil and gas reserves for the years ended December 31, 2004, 2003 and 2002 were as follows:

	2004	2003	2002
	-----	-----	-----
Future cash inflows	\$18,448,000	\$17,380,000	\$16,490,000
Future development and production costs	9,908,000	8,792,000	9,166,000
Future abandonment costs	730,000	736,000	--
Future income tax expense	12,000	12,000	12,000
	-----	-----	-----
Future net cash flow	7,798,000	7,840,000	7,312,000
10% annual discount	3,162,000	3,230,000	2,994,000
	-----	-----	-----
Standardized measure of discounted future net cash flow	\$ 4,636,000	\$ 4,610,000	\$ 4,318,000
	=====	=====	=====

49

PYRAMID OIL COMPANY  
SUPPLEMENTAL INFORMATION (UNAUDITED)  
DECEMBER 31, 2004

The principal changes in the standardized measure of discounted future net cash flows during the years ended December 31, 2004, 2003 and 2002 were as follows:

	2004	2003	2002
	-----	-----	-----
Extensions	\$ 490,000	\$ --	\$ --
Revisions of previous estimates			
Price changes	654,000	952,000	1,588,000
Quantity estimate	( 82,000)	690,000	2,494,000
Change in production rates, timing and Other	381,000	(208,000)	(611,000)
Development costs incurred	418,000	255,000	--
Changes in estimated future			



Edgar Filing: PYRAMID OIL CO - Form 10KSB

development costs	(348,000)	(255,000)	--
Changes in estimated future abandonment costs	(730,000)	(736,000)	--
Sales of oil and gas, net of production costs	(1,292,000)	(839,000)	(521,000)
Accretion of discount	535,000	433,000	125,000
	-----	-----	-----
	26,000	292,000	3,075,000
Net change in income taxes	--	--	--
	-----	-----	-----
Net (decrease) increase	\$ 26,000	\$ 292,000	\$ 3,075,000
	=====	=====	=====

Estimated future cash inflows are computed by applying year-end prices of oil and gas to year-end quantities of proved reserves. Estimated future development and production costs are determined by estimating the expenditures to be incurred in developing and producing the proved oil and gas reserves, as well as certain abandonment costs, based on year-end cost estimates and assuming continuation of existing economic conditions. Estimated future income tax expense is calculated by applying the year-end effective tax rate to estimated future pretax net cash flows related to proved oil and gas reserves, less the tax basis of the properties involved.

50

PYRAMID OIL COMPANY  
 SUPPLEMENTAL INFORMATION (UNAUDITED)  
 DECEMBER 31, 2004

These estimates are furnished and calculated in accordance with requirements of the Financial Accounting Standards Board and the Securities and Exchange Commission. Because of the unpredictable variances in expenses and capital forecasts, crude oil and natural gas price changes being largely influenced and controlled by United States and foreign governmental actions, and the fact that the basis for such estimates vary significantly, management believes the usefulness of these projections is limited. Estimates of future net cash flows do not represent management's assessment of future profitability or future actual cash flows of the Company.

It should be recognized that applying current costs and prices and a ten percent standard discount rate allows for comparability but does not convey absolute value. The discounted amounts arrived at are only one measure of financial quantification of proved reserves.

The increase in the standardized measure of discounted future net cash flows at December 31, 2004, of \$26,000 is the result of several factors, both positive and offsetting negative factors. Sales of oil and gas, net of production costs reduced future cash flows by approximately \$1,292,000. The recognition of future abandonment costs decreased future cash flows by \$730,000. This was offset by an increase in future cash flows due to higher crude oil prices at December 31, 2004 and the recognition of proved developed non-producing reserves at December 31, 2004.

## Edgar Filing: PYRAMID OIL CO - Form 10KSB

The increase in the standardized measure of discounted future net cash flows at December 31, 2003, of \$292,000 is due primarily to higher crude oil prices at year end. The changes in crude oil prices at the end of each year has a significant impact on the valuation of the Company's reserves and discounted future net cash flows. Higher crude oil prices at the end of 2003 increased the discounted future net cash flows by approximately \$690,000 due to revisions of previous quantity estimates and by \$952,000 due to price changes. This was offset by the recognition of future abandonment costs of \$736,000.

The increase in the standardized measure of discounted future net cash flows at December 31, 2002, of \$3,075,000 is due primarily to higher crude oil prices at year end. The changes in crude oil prices at the end of each year has a significant impact on the valuation of the Company's reserves and discounted future net cash flows. Higher crude oil prices at the end of 2002 increased the discounted future net cash flows by approximately \$2,494,000 due to revisions of previous quantity estimates and by \$1,588,000 due to price changes.

51

### PYRAMID OIL COMPANY SUPPLEMENTAL INFORMATION (UNAUDITED) QUARTERLY RESULTS

	2004	2003	
	-----	-----	
<b>REVENUES:</b>			
Quarter Ended:			
March 31	\$ 599,296	\$ 538,608	
June 30	666,871	487,222	
September 30	702,899	506,801	
December 31	705,836	537,783	
	-----	-----	
	\$ 2,674,902	\$ 2,070,414	
	=====	=====	
<b>NET INCOME (LOSS):</b>			
Quarter Ended:			
March 31	\$ 281,358	\$ (652,115)	(a)
June 30	167,333	74,487	
September 30	346,540	106,691	
December 31 (c)	(183,329)	( 62,252)	(b)
	-----	-----	
	\$ 611,902	\$ (536,189)	
	=====	=====	
<b>INCOME (LOSS) PER COMMON SHARE:</b>			
Quarter Ended:			
March 31	\$ .11	\$ (.26)	(a)
June 30	.07	.03	(b)
September 30	.14	.04	
December 31 (c)	(.07)	(.02)	
	-----	-----	
	\$ .25	\$ (.21)	
	=====	=====	

(a) Reflects the implementation of SFAS #143, Accounting for Asset Retirement Obligations, effective January 1, 2003 (see Note 9 of Notes to Financial

## Edgar Filing: PYRAMID OIL CO - Form 10KSB

Statements included in Item 7 of this Form 10-KSB).

(b) Reflects adjustments to the asset retirement obligations made by the Company and recorded in the fourth quarter amounts (see Note 5 of Notes to Financial Statements included in Item 7 of this Form 10-KSB).

(c) Reflects transactions recorded for exploration costs for the drilling and completion of an exploration well and the settlement of an employment agreement in the fourth quarter of 2004. Also, reflects a valuation allowance recorded in the fourth quarter of 2004 (see Note 5 of Notes to Financial Statements included in Item 7 of this Form 10-KSB).

52

### ITEM 8 - CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

### ITEM 8A - CONTROLS AND PROCEDURES

Pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934 (the Exchange Act), the Company's management, with the participation of the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in ensuring that information required to be disclosed in reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. No change in the Company's internal control over financial reporting occurred during the most recent fiscal quarter that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

### ITEM 8B - OTHER INFORMATION

The Company is aware of no information that was required to be disclosed in a report on Form 8-K during the fourth quarter of 2004 but was not reported.

## PART III

### ITEM 9 - DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT

The Company hereby incorporates by reference the information to be contained under the section entitled "Directors and Executive Officers" or a similarly entitled section from its definitive Proxy Statement to be filed with the Securities and Exchange Commission in connection with its 2005 Annual Meeting of Shareholders.

The Company has adopted a code of ethics that is applicable to all of its directors, officers and employees. A copy of the code is available at no charge to any person who sends a request for a copy to the Corporate Secretary, Pyramid Oil Company, P.O. Box 832, Bakersfield, California 93302.

### ITEM 10 - EXECUTIVE COMPENSATION

The Company hereby incorporates by reference the information to be contained

## Edgar Filing: PYRAMID OIL CO - Form 10KSB

under the section entitled "Compensation of Directors and Executive Officers" or a similarly entitled section from its definitive Proxy Statement to be filed with the Securities and Exchange Commission in connection with its 2005 Annual Meeting of Shareholders.

53

### ITEM 11 - SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The Company hereby incorporates by reference the information to be contained under the section entitled "Voting Securities and Principal Holders Thereof" or a similarly entitled section from its definitive Proxy Statement to be filed with the Securities and Exchange Commission in connection with its 2005 Annual Meeting of Shareholders.

### ITEM 12 - CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Effective January 1, 1990, John H. Alexander, an officer and director of the Company participated with a group of investors that acquired the mineral and fee interest on one of the Company's oil and gas leases (Santa Fe Energy lease) in the Carneros Creek field after the Company declined to participate. The thirty-three percent interest owned by Mr. Alexander represents a minority interest in the investor group. Royalties on oil and gas production from this property paid to the investor group approximated \$143,000 in 2004, \$122,000 in 2003 and \$100,000 in 2002.

On January 14, 2000, pursuant to specific terms, conditions and obligations contained within the May 1984 oil and gas lease between Santa Fe Energy Company as lessor and Pyramid Oil Company as lessee, Pyramid quit-claimed all unearned acreage in said lease back to the lessors. Under the terms of the lease, Pyramid retained specific producing intervals within 10 acre spacings surrounding each well bore.

Effective April 1, 2002, the Company acquired the remaining 36.5% working interest in the Santa Fe oil and gas lease in the Carneros Creek field and working interests (approximately 36.5%) in two other leases in the same area from the investor group noted above. The investor group acquired these working interests from the Company's former joint venture partner in these three oil and gas leases as the result of a court ordered settlement agreement concluding litigation between the investor group and the joint venture partner. The investor group sold the working interests to the Company for \$217,000. Mr. John H. Alexander, Vice President of the Company, owns a thirty-three percent interest in the investor group. The Company had notes payable to the investor group in the amount of \$108,502 at the end of December 31, 2002, of which \$108,502 was paid-off on the notes payable in 2003.

As a director, Mr. Alexander has abstained from voting on any of the above matters that have been brought before the Board of Directors, involving the Santa Fe lease.

54

## Edgar Filing: PYRAMID OIL CO - Form 10KSB

### ITEM 13 - EXHIBITS

- 3.1 Registrant's Articles of Incorporation (1)
  - 3.2 Registrant's By Laws (1)
  - 3.2.1 Registrant's Amendment to the By Laws (2)
  - 10.1 Employment Agreement of J. Ben Hathaway, dated August 1, 2001 (3)
  - 10.2 Employment Agreement of John H. Alexander, dated August 1, 2001 (3)
  - 10.3 Employment Agreement of John H. Alexander, dated February 21, 2002 (4)
  - 10.4 Employment Agreement of Benny Hathaway, Jr. dated February 21, 2002 (4)
  
  - 31.1 Certification of Chief Executive Officer Pursuant to 15 U.S.C. Section 7241, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
  - 31.2 Certification of Chief Financial Officer pursuant to 15 U.S.C. Section 7241, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
  - 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
  - 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
  
  - 99 Letter to Securities and Exchange Commission regarding Arthur Andersen's representations (4)
- (1) Incorporated by reference from Exhibits 18-1 and 18-2, respectively, to the Registrant's 1971 Form 10.
- (2) Incorporated by reference from the Registrant's August 25, 1986 Proxy Statement.
- (3) Incorporated by reference from Exhibits 10.1 and 10.2 to the Registrants June 30, 2001 Form 10-QSB.
- (4) Incorporated by reference from Exhibits 10.3, 10.4 and 99 to the Registrants December 31, 2001 Form 10-KSB.

### ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The Company hereby incorporates by reference the information contained under the section entitled "Principal Accounting Fees and Services" or a similarly entitled section from its definitive Proxy Statement to be filed with the Securities and Exchange Commission in connection with its 2005 Annual Meeting of Shareholders. 55

### SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PYRAMID OIL COMPANY

Edgar Filing: PYRAMID OIL CO - Form 10KSB

March 30, 2005

By: JOHN H. ALEXANDER

-----  
John H. Alexander  
Director/President  
Chief Executive Officer

In accordance with the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

JOHN H. ALEXANDER ----- John H. Alexander	Director/President Chief Executive Officer	March 30, 2005
J. BEN HATHAWAY ----- J. Ben Hathaway	Director Chairman of the Board	March 30, 2005
THOMAS W. LADD ----- Thomas W. Ladd	Director	March 30, 2005
GARY L. RONNING ----- Gary L. Ronning	Director	March 30, 2005
JOHN E. TURCO ----- John E. Turco	Director	March 30, 2005
LEE G. CHRISTIANSON ----- Lee G. Christianson	Corporate Secretary/ Principal Accounting and Financial Officer	March 30, 2005