

HALLADOR PETROLEUM CO  
Form 10KSB/A  
April 11, 2007

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

**FORM 10-KSB/A  
(Amendment No. 1)**

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended: **December 31, 2005**

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number: 0-14731

**HALLADOR PETROLEUM COMPANY**

COLORADO  
(State of incorporation)

84-1014610  
(IRS Employer Identification No.)

1660 Lincoln Street, Suite 2700, Denver, Colorado  
(Address of principal executive offices)

80264-2701  
(Zip Code)

Issuer's telephone number: 303.839.5504

Fax: 303.832.3013

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

Securities registered under Section 12(g) of the Exchange Act: Common Stock, \$.01 par value

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act.

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

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.

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

Our revenue from continuing operations for the year ended December 31, 2005 was about \$1.1 million.

At April 4, 2006, we had 12,168,135 shares outstanding and the aggregate market value of such shares held by non-affiliates was about \$4 million based on a closing price of \$4.10.

DOCUMENTS INCORPORATED BY REFERENCE: NONE

Explanatory Note

We are filing this amendment to comply with generally accepted accounting principles (GAAP) and the Securities and Exchange Commission's (SEC) rules and regulations.

1. We had included changes in stockholders' equity in Note 1 to our financial statements. This amendment includes a statement of stockholders' equity and we deleted the stockholders' equity table from Note 1.
2. We have included the name of the individual who prepared our reserve report. The person's name is Edwin James and such name appears in Note 7 to our financial statements.
3. We have changed our statement of cash flows as follows:
  - a. For 2005, we moved \$1,200,000 from financing activities to investing activities relating to the purchase of limited partners interest.
  - b. For 2005, we moved \$407,000 from financing activities to operating activities relating to repurchase of employee stock options.
  - c. For 2004, we moved \$1,305,000 from financing activities to operating activities relating to repurchase of employee stock options.
4. We have provided additional disclosure regarding the accounting treatment of our repurchase of employee stock options. Note 4 to our financial statements reflects such addition disclosures.
5. In December 2005 we sold stock to Yorktown Energy Partners VI and concurrently acquired a 32% interest in Savoy Energy. We received cash of \$2.20 per share. We have treated the cash element as non-substantive and valued the shares based on the market price at the time which was \$3.25 per share. Therefore, we have increased our investment in Savoy by about \$2 million and also increased stockholders' equity by the same.
6. No changes were made to our statement of operations.

**ITEM 7. FINANCIAL STATEMENTS**

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**REPORT OF INDEPENDENT REGISTERED  
PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders  
Hallador Petroleum Company  
Denver, Colorado

We have audited the consolidated balance sheet of Hallador Petroleum Company and Subsidiaries as of December 31, 2005 and the consolidated statements of operations, changes in stockholders' equity, and cash flows for the years ended December 31, 2005 and 2004. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with 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 consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial condition of Hallador Petroleum Company and Subsidiaries, as of December 31, 2005 and the results of their operations and their cash flows for the years ended December 31, 2005 and 2004, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, the consolidated financial statements as of December 31, 2005 and December 31, 2004 have been restated.

/s/ Ehrhardt Keefe Steiner & Hottman PC

March 31, 2006, except for Note 1  
as to which the date is April 4, 2007  
Denver, Colorado



**Consolidated Balance Sheet**

December 31, 2005

(in thousands)

**(as restated, see Note 1)****ASSETS**

## Current assets:

|                           |    |        |
|---------------------------|----|--------|
| Cash and cash equivalents | \$ | 12,261 |
| Accounts receivable-      |    |        |
| Oil and gas sales         |    | 950    |
| Well operations           |    | 1,198  |
| Total current assets      |    | 14,409 |

## Oil and gas properties, at cost (successful efforts):

|   |         |
|---|---------|
| Unproved properties   | 2,909   |
| Proved properties   | 2,388   |
| Less - accumulated depreciation, depletion, amortization and impairment | (1,776) |
|   | 3,521   |

## Investment in CELLC

223

## Investment in Savoy

6,193

## Other assets

246

|  |    |        |
|--|----|--------|
|  | \$ | 24,592 |
|--|----|--------|

**LIABILITIES AND STOCKHOLDERS' EQUITY**

## Current liabilities:

|  |    |       |
|--|----|-------|
| Accounts payable and accrued liabilities | \$ | 1,346 |
| Oil and gas sales payable                |    | 1,494 |
| Income tax payable                       |    | 208   |
| Total current liabilities                |    | 3,048 |

## Stockholders' equity:

|   |         |        |
|---|---------|--------|
| Preferred stock, \$.10 par value; 10,000,000 shares authorized; none issued     | 90      |        |
| Common stock, \$ .01 par value; 100,000,000 shares authorized, 8,986,319 issued | 24,195  |        |
| Additional paid-in capital  | (2,741) |        |
| Accumulated deficit   | 21,544  |        |
|   | \$      | 24,592 |

See accompanying notes.

**Consolidated Statement of Operations**  
(in thousands)

|   | Years ended December 31, |          |
|---|--------------------------|----------|
|   | 2005                     | 2004     |
| Revenue:  |                          |          |
| Gas   | \$ 1,012                 | \$ 822   |
| Oil   | 90                       | 83       |
| Interest  | 544                      | 167      |
|   | 1,646                    | 1,072    |
| Costs and expenses:   |                          |          |
| Lease operating   | 227                      | 149      |
| Delay rentals   | 57                       | 102      |
| Impairment - unproved properties  | 183                      | 144      |
| Equity loss in CELLC  | 103                      |          |
| Depreciation, depletion and amortization  | 43                       | 42       |
| General and administrative  | 612                      | 852      |
|   | 1,225                    | 1,289    |
| Income (loss) from continuing operations before minority interest                                 | 421                      | (217)    |
| Minority interest   | (84)                     | 65       |
| Income (loss) from continuing operations before taxes   | 337                      | (152)    |
| Income tax-current  | (145)                    | -        |
| Income (loss) from continuing operations  | 192                      | (152)    |
| Income (loss) from discontinued operations net of minority interest of \$(18) and \$592           | (30)                     | 1,380    |
| Gain on sale of discontinued operations, net of taxes of \$1,085 and minority interest of \$4,168 | -                        | 8,642    |
| Net income  | \$ 162                   | \$ 9,870 |
| Net Income (loss) per share - basic   |                          |          |
| Continuing operations   | \$ .027                  | \$ (.02) |
| Discontinued operations   | (.004)                   | .19      |
| Gain on sale of discontinued operations   | -                        | 1.22     |
| Net earnings per share  | \$ .023                  | \$ 1.39  |
| Weighted average shares outstanding-basic   | 7,155                    | 7,093    |

See accompanying notes.

**Consolidated Statement of Cash Flows**  
(in thousands)  
(as restated, see Note 1)

|  | Years ended December 31, |           |
|--|--------------------------|-----------|
|  | 2005                     | 2004      |
| Cash flows from operating activities:  |                          |           |
| Net income   | \$ 162                   | \$ 9,870  |
| Equity loss in CELLC   | 103                      |           |
| Depreciation, depletion, and amortization  | 43                       | 721       |
| Minority interest  | 66                       | 4,695     |
| Impairment of undeveloped properties   | 183                      | 144       |
| Change in accounts receivable  | (1,197)                  | 812       |
| Gain on sale of discontinued operations exclusive of \$1,705 of bonuses paid in connection with sale |                          | (16,905)  |
| Discontinued operations  | (407)                    |           |
| Change in payables and accrued liabilities   | 1,235                    | (623)     |
| Income taxes payable   | (92)                     | 300       |
| Key employee bonus plan  |                          | (253)     |
| Other  | 10                       | 90        |
| Net cash provided by (used in) operating activities  | 106                      | (1,149)   |
| Cash flows from investing activities:  |                          |           |
| Proceeds from property sale (Cuyama)*  | 3,538                    | 18,110    |
| Investment in COALition  | (326)                    |           |
| Investment in Savoy  | (4,205)                  |           |
| Acquisition of Hallador Petroleum LLP minority interests   | (1,200)                  |           |
| Decrease in bonds  | 252                      |           |
| Properties   | (4,696)                  | (253)     |
| Prospect sale  | 1,616                    |           |
| Other assets   | (35)                     | (100)     |
| Net cash (used in) provided by investing activities  | (5,056)                  | 17,757    |
| Cash flows from financing activities:  |                          |           |
| Distributions to limited partners  | (6,881)                  |           |
| Stock sale to Yorktown Energy VI, L.P.   | 4,165                    |           |
| Net cash used in financing activities  | (2,716)                  |           |
| Net (decrease) increase in cash and cash equivalents   | (7,666)                  | 16,608    |
| Cash and cash equivalents, beginning of year   | 19,927                   | 3,319     |
| Cash and cash equivalents, end of year   | \$ 12,261                | \$ 19,927 |
| Taxes paid   | \$ 225                   | \$ 785    |

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\* In 2004 we received a \$3,500,000 note receivable in connection with the sale of Cuyama, which was a non-cash investing activity.

See accompanying notes.



**Statement of Stockholders' Equity**  
(in thousands)  
(as restated, see Note 1)

|   | Common Stock | Additional<br>Paid in Capital | Accumulated<br>Deficit | Total     |
|---|--------------|-------------------------------|------------------------|-----------|
| Balance December 31, 2003                                       | \$ 71        | \$ 18,061                     | \$ (14,495)            | \$ 3,637  |
| Net income  | -            | -                             | 9,870                  | 9,870     |
| Balance December 31, 2004                                       | 71           | 18,061                        | (4,625)                | 13,507    |
| Proceeds from stock sale (1,893,169<br>shares)                  | 19           | 4,146                         |                        | 4,165     |
| Additional non-cash value assigned<br>to stock sale<br>(Note 1) |              | 1,988                         |                        | 1,988     |
| Retirement of Hallador Petroleum LLP<br>minority interest       |              |                               | 1,722                  | 1,722     |
| Net income  | -            | -                             | 162                    | 162       |
| Balance December 31, 2005                                       | \$ 90        | \$ 24,195                     | \$ (2,741)             | \$ 21,544 |

See accompanying notes.

## Notes to Consolidated Financial Statements

(1) RESTATEMENT OF PREVIOUSLY ISSUED CONSOLIDATED FINANCIAL STATEMENTS

The accompanying balance sheet and cash flow statements have been restated to comply with GAAP and the SEC's rules and regulations. The following table sets forth previously reported and restated cash flow statements and balance sheets.

|  | Years ended December 31, * |          |                        |          |
|--|----------------------------|----------|------------------------|----------|
|  | 2005                       |          | 2004                   |          |
|  | Previously<br>Reported     | Restated | Previously<br>Reported | Restated |
| Cash flows from operating activities:  |                            |          |                        |          |
| Net income   | \$ 162                     | \$ 162   | \$ 9,870               | \$ 9,870 |
| Equity loss in CELLC   | 103                        | 103      |                        |          |
| Depreciation, depletion, and<br>amortization   | 43                         | 43       | 721                    | 721      |
| Minority interest  | 66                         | 66       | 4,695                  | 4,695    |
| Impairment of undeveloped<br>properties  | 183                        | 183      | 144                    | 144      |
| Change in accounts receivable  | (1,197)                    | (1,197)  | 812                    | 812      |
| Gain on sale of discontinued<br>operations exclusive of \$1,705 of<br>bonuses paid in connection with sale |                            |          | (15,600)               | (16,905) |
| Discontinued operations  |                            | (407)    |                        |          |
| Change in payables and accrued<br>liabilities  | 1,235                      | 1,235    | (623)                  | (623)    |
| Income taxes payable   | (92)                       | (92)     | 300                    | 300      |
| Key employee bonus plan  |                            |          | (253)                  | (253)    |
| Other  | 10                         | 10       | 90                     | 90       |
| Net cash provided by (used in)<br>operating activities   | 513                        | 106      | 156                    | (1,149)  |
| Cash flows from investing activities:  |                            |          |                        |          |
| Proceeds from property sale<br>(Cuyama)*   | 3,538                      | 3,538    | 18,110                 | 18,110   |
| Investment in COALition  | (326)                      | (326)    |                        |          |
| Investment in Savoy  | (4,205)                    | (4,205)  |                        |          |
| Acquisition of Hallador Petroleum<br>LLP minority interests  |                            | (1,200)  |                        |          |
| Decrease in bonds  | 252                        | 252      |                        |          |
| Properties   | (4,696)                    | (4,696)  | (253)                  | (253)    |
| Prospect sale  | 1,616                      | 1,616    |                        |          |
| Other assets   | (35)                       | (35)     | (100)                  | (100)    |
| Net cash (used in) provided by<br>investing activities   | (3,856)                    | (5,056)  | 17,757                 | 17,757   |
| Cash flows from financing activities:  |                            |          |                        |          |
| Repurchase of employee stock<br>options  | (407)                      |          | (1,305)                |          |
| Distributions to limited partners  | (8,081)                    | (6,881)  |                        |          |
|  | 4,165                      | 4,165    | -                      | -        |

Stock sale to Yorktown Energy VI,  
L.P.

|  |           |           |           |           |
|--|-----------|-----------|-----------|-----------|
| Net cash used in financing activities                | (4,323)   | (2,716)   | (1,305)   | -         |
| Net (decrease) increase in cash and cash equivalents | (7,666)   | (7,666)   | 16,608    | 16,608    |
| Cash and cash equivalents, beginning of year         | 19,927    | 19,927    | 3,319     | 3,319     |
| Cash and cash equivalents, end of year               | \$ 12,261 | \$ 12,261 | \$ 19,927 | \$ 19,927 |

\* For 2005, we moved \$1,200,000 from financing activities to investing activities relating to the purchase of limited partners interest; for 2005 we moved \$407,000 from financing activities to operating activities relating to repurchase of employee stock options, and for 2004 we moved \$1,305,000 from financing activities to operating activities relating to repurchase of employee stock options.

**Consolidated Balance Sheet**

December 31, 2005

(in thousands)

|  | Previously<br>Restated | Restated  |
|--|------------------------|-----------|
| <b>ASSETS</b>  |                        |           |
| Current assets:  |                        |           |
| Cash and cash equivalents  | \$ 12,261              | \$ 12,261 |
| Accounts receivable-   |                        |           |
| Oil and gas sales  | 950                    | 950       |
| Well operations  | 1,198                  | 1,198     |
| Total current assets   | 14,409                 | 14,409    |
| Oil and gas properties, at cost (successful efforts):                                  |                        |           |
| Unproved properties  | 2,909                  | 2,909     |
| Proved properties  | 2,388                  | 2,388     |
| Less - accumulated depreciation, depletion, amortization and impairment                | (1,776)                | (1,776)   |
|  | 3,521                  | 3,521     |
| Investment in CELLC  | 223                    | 223       |
| Investment in Savoy*   | 4,205                  | 6,193     |
| Other assets   | 246                    | 246       |
|  | \$ 22,604              | \$ 24,592 |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                        |           |
| Current liabilities:   |                        |           |
| Accounts payable and accrued liabilities   | \$ 1,346               | \$ 1,346  |
| Oil and gas sales payable  | 1,494                  | 1,494     |
| Income tax payable   | 208                    | 208       |
| Total current liabilities  | 3,048                  | 3,048     |
| Stockholders' equity:  |                        |           |
| Preferred stock, \$.10 par value; 10,000,000 shares authorized; none issued            |                        |           |
| Common stock, \$ .01 par value; 100,000,000 shares authorized, 8,986,319 shares issued | 90                     | 90        |
| Additional paid-in capital   | 22,207                 | 24,195    |
| Accumulated deficit  | (2,741)                | (2,741)   |
|  | 19,556                 | 21,544    |
|  | \$ 22,604              | \$ 24,592 |

\*In December 2005 we sold stock to Yorktown Energy Partners VI and concurrently acquired a 32% interest in Savoy Energy. We received cash of \$2.20 per share. We have treated the cash element as non-substantive and valued the shares based on the market price at the time which was \$3.25 per share. Therefore, we have increased our investment in Savoy by about \$2 million and also increased stockholders' equity by the same.



(2) **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation and Consolidation**

The accompanying consolidated financial statements include the accounts of Hallador Petroleum Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated. We are engaged in the exploration, development, and production of oil and natural gas in the Rocky Mountain region. We also have a 32% equity interest in an oil and gas company which has operations in Michigan.

As discussed in Item 6. (MD&A), we have entered into significant related party transactions with the Yorktown group of companies. Yorktown and its affiliates currently own about 54% of our common stock and represents one of the five seats on our board.

In early January 2006, we signed a Letter of Intent with Sunrise Coal, LLC (Sunrise) in order to effect a reorganization/merger between Hallador and Sunrise, a private company not affiliated with the Yorktown group of companies. We are working on a formal agreement which we hope to execute sometime in the second quarter 2006. In late February 2006, we sold 3,181,816 shares for \$2.20 per share (about \$7 million) to our existing shareholders. The proceeds will provide working capital for the Sunrise transaction.

During the first quarter of 2006, we loaned Sunrise \$7 million in order for Sunrise to begin development of their second coal mine (the "Carlisle mine"). Their Howesville mine began producing coal in November 2005. Both mines are located in Indiana. During the second quarter of 2006, Sunrise expects to enter into a \$30 million line-of-credit with two Indiana banks, at which time our \$7 million will be repaid. We have agreed to guarantee this \$30 million line-of-credit.

We have concluded to deemphasize our oil and gas operations and concentrate our future efforts in the coal business.

About nine years ago, Yorktown Energy Partners II and affiliates (Yorktown) invested \$5,025,000 in Hallador Petroleum, LLP, a newly formed limited liability limited partnership, (the "Partnership"). We are the general partner and received a 70% interest in the partnership in return for contributing our net assets and Yorktown representing the limited partners, received a 30% interest for its \$5,025,000 cash contribution. During the third quarter of 2005, we purchased the limited partners interest in the Partnership, and for accounting purposes the Partnership no longer exists and, as a result, there is no longer a minority interest caption on our balance sheet. Prior to this transaction we, as general partner, consolidated the activity of the Partnership and presented the 30% limited partners' interest as a minority interest.

On August 10, 2004, we entered into an agreement with E&B Natural Resources Management Corporation (a private company) to sell all of our interest in the South Cuyama field and adjacent exploration areas, all located in Santa Barbara County, California, for \$23 million; consisting of \$19.5 million in cash and an interest bearing (3.5%) note of \$3.5 million due on September 30, 2005, which was paid. Closing occurred on September 30, 2004 and we recorded a pre-tax gain of about \$14 million. Results from the South Cuyama field have been presented as discontinued operations in the accompanying Consolidated Statement of Operations; revenue and expenses before the minority interest were about \$7 million and \$5 million, respectively for 2004.

Due to the sale, our board of directors and the Executive Committee of the Partnership, voted to discontinue new partnership operations effective October 1, 2004. At that time, the Partnership's assets consisted of cash, the \$3.5 million note receivable, oil and gas properties in New Mexico and Texas, and other miscellaneous assets. On October 1, 2004, our board of directors and the Executive Committee of the Partnership, valued the oil and gas properties in New Mexico and Texas and the other miscellaneous assets at \$4 million. On May 6, 2005 we made a cash distribution of about \$5.2 million to the limited partners. During the third quarter 2005, we purchased the limited partners' interest

in the Partnership for about \$1.2 million and made a final cash distribution to the limited partners of \$1.6 million. After these transactions, about \$1.7 million remained in the minority interest account and was recorded as a reduction in our accumulated deficit account.

In late March 2005, we invested \$325,000 for a 29% interest in a newly formed entity called COALition Energy, LLC (CELLC) to pursue coal opportunities in the United States. Some of our officers and directors also invested in CELLC.

### **Oil and Gas Properties**

We account for our oil and gas activities using the successful efforts method of accounting. Under the successful efforts method, the costs of successful wells, development dry holes and productive leases are capitalized and amortized on a units-of-production basis over the remaining life of the related reserves. Exploratory dry hole costs and other exploratory costs, including geological and geophysical costs, and delay rentals are expensed as incurred. Cost centers for amortization purposes are determined on a field-by-field basis. Unproved properties with significant acquisition costs are periodically assessed for impairment in value, with any impairment charged to expense.

Prior to 2003, the estimated costs of plugging and abandoning wells were accrued using the units-of-production method and were considered in determining DD&A expense. However, in 2003 we adopted SFAS 143, Accounting for Asset Retirement Obligations. Under this standard, we record the fair value of the future abandonment as capitalized abandonment costs in Oil and Gas properties with an offsetting abandonment liability. The adoption of this method was not significant to our continuing operations. The capitalized abandonment costs are amortized with other property costs using the units-of-production method.

The carrying value of each field is assessed for impairment on a quarterly basis. If estimated future undiscounted net revenues are less than the recorded amounts, an impairment charge is recorded based on the estimated fair value of the field.

### **Statement of Cash Flows**

Cash equivalents include investments, which includes mutual funds, with maturities when purchased of three months or less.

### **Income Taxes**

Income taxes are provided based on the liability method of accounting pursuant to SFAS 109, Accounting for Income Taxes. The provision for income taxes is based on pretax financial taxable income. Deferred tax assets and liabilities are recognized for the future expected tax consequences of temporary differences between income tax and financial reporting and principally relate to differences in the tax basis of assets and liabilities and their reported amounts, using enacted tax rates in effect for the year in which differences are expected to reverse. If it is more likely than not that some portion or all of a deferred tax asset will not be realized, a valuation allowance is recognized.

### **Earnings per Share**

We follow the provisions of SFAS 128, Earnings Per Share. Basic earnings per share are computed based on the weighted average number of common shares outstanding. Diluted earnings per share are computed based on the weighted average number of common shares outstanding adjusted for the incremental shares attributed to outstanding stock options.

### **Use of Estimates in the Preparation of Financial Statements**

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

### **Revenue Recognition**

We recognize oil and natural gas revenue from our interest in producing wells as natural gas and oil is produced and sold from those wells using the entitlement method.

### **Concentration of Credit Risk**

Our revenues are derived principally from uncollateralized sales to two customers in the oil and gas industry. The concentration of credit risk in a single industry affects our overall exposure to credit risk because customers may be similarly affected by changes in economic and other conditions.

### **Stock Based Compensation**

On April 15, 2005, we issued 750,000 ten-year options to employees at an exercise price of \$2.25. The exercise price was based on the sales price of a March 2005 private stock transaction between one of our shareholders and a third party. These options vest at 1/3 per year over the next three years. There are no more options available for issuance.

As allowed in SFAS 123, Accounting for Stock-Based Compensation, we continue to apply APB 25, Accounting for Stock Issued to Employees, and related interpretations in recording compensation related to our plan. Had compensation costs for the plan been determined consistent with SFAS 123, we would have estimated the fair value of the option grant using the Black-Scholes option-pricing model, using the following assumptions for the 2005 grants: (i) risk free interest rate of 4.24%; (ii) expected life of 10 years; (iii) expected volatility of 120%; (iv) expected default rate of 5%, and (v) no dividend yield. The average fair value of options granted during 2005 was \$2.15. Pro forma loss for the year ended December 31, 2005 would have been \$183,000 or \$(0.03) per share. Pro forma results for 2004 were immaterial.

No grants were issued during 2004.

### **New Accounting Pronouncements**

In December 2004, the FASB issued SFAS 123(R) that requires that the compensation cost relating to share-based payment transactions be recognized in the financial statements. That cost will be measured based on the fair value of the equity or liability instrument issued. SFAS 123(R) covers a wide range of share-based awards, stock appreciation rights, and employee stock purchase plans. SFAS 123(R) replaces SFAS 123, "Accounting for Stock-Based Compensation," and supersedes APB Opinion 25, "Accounting for Stock Issued to Employees." We will be required to apply SFAS 123(R) in the first quarter 2006, and will use the modified prospective method of adoption. We had \$1,035,000 of unvested compensation related to outstanding stock options and estimate having to expense \$115,000 during the first quarter of 2006.

None of the other FASB pronouncements issued during the last two years had, or will have, any effect on us.

**(3) INCOME TAXES (in thousands)**

The provision for income taxes is comprised of the following:

|           | 2005   |    | 2004  |
|-----------|--------|----|-------|
| Current:  |        |    |       |
| Federal   | \$ 415 | \$ | 265   |
| State     | 189    |    | 361   |
|           | 604    |    | 626   |
| Deferred: |        |    |       |
| Federal   | (297)  |    | 297   |
| State     | (162)  |    | 162   |
|           | (459)  |    | 459   |
|           | \$ 145 | \$ | 1,085 |

The net deferred tax asset at December 31, 2005 was not material.

Our income tax is different than the expected amount computed using the applicable federal statutory income tax rate of 35% and a California state tax rate of 8.84%. The reasons for and effects of such differences are as follows:

|   | 2005   |    | 2004    |
|---|--------|----|---------|
| Expected amount                                   | \$ 115 | \$ | 4,864   |
| Utilization of tax net operating losses           | --     |    | (2,174) |
| Utilization of statutory depletion carry forwards | --     |    | (974)   |
| State income taxes, net of federal benefit        | 16     |    | (340)   |
| Change in valuation allowance and other           | 14     |    | (291)   |
|   | \$ 145 | \$ | 1,085   |

At December 31, 2005, we had no federal or state net operating loss, alternative minimum tax or statutory depletion carry forwards as all amounts were utilized during the current fiscal year.

**(4) STOCK OPTIONS AND BONUS PLANS**

**Stock Option Plan**

We account for stock options in accordance with APB 25. Accordingly, no compensation expense has been recorded for options granted as those grants have been issued with exercise prices at or above market. When we sold the Cuyama oil and gas field in August 2004 we concluded to reward our employees by giving them cash bonuses and also through purchases of their respective stock options. Because our stock is (i) traded on the OTC Bulletin Board, (ii) thinly traded and (iii) over 85% of the outstanding shares are controlled by our board members and their affiliates, our board concluded our employees would not receive a fair price if they exercised their options and then sold the stock.

On October 8, 2004, we purchased from our employees 749,723 outstanding stock options at a price equal to \$2.80 per share less the exercise price of each option for a total amount of \$1,305,000. The options were cancelled and are available for re-issuance. All options were granted at fair value. Such amount was expensed in 2004 and is reflected in the Gain on sale of discontinued operations in the accompanying statement of operations. The \$2.80 was determined by our non-employee board members and they concluded such amount represented a fair price. At December 31, 2004 there were no options outstanding.

Options to purchase up to 3% of the partnership interest in Hallador Petroleum, LLP were issued in 1997 and 1998. As of December 31, 2004, 2.692% were outstanding and exercisable. The exercise price for these options was based on the fair market value on the date of grant. On January 8, 2005 we purchased back all of these outstanding options for a total of \$407,000, which was accrued for as of December 31, 2004.

**(5) MAJOR CUSTOMERS**

During 2005 and 2004, the San Juan Basin's gas and NGL production was purchased by Coral Energy Resources, LP and Williams Energy Services.

**(6) EQUITY INVESTMENT IN SAVOY**

In August 2005, we began negotiations to purchase from Yorktown Energy Partners II, LP its 32% interest in Savoy Energy LLP, a private company engaged in the oil and gas business primarily in the State of Michigan. A purchase price of \$4.1 million was agreed upon and closing occurred on December 31, 2005. On December 20, 2005 we sold about 1,893,000 shares of our common stock to Yorktown Energy Partners VI, L.P. at \$2.20 per share (about \$4.1 million). We will account for our interest in Savoy using the equity method of accounting.

We determined that our investment in Savoy under EITF 99-12, *Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination*, needed to be adjusted by approximately \$2 million to properly reflect our stock price of \$3.25 at the time of closing of this transaction.

Below (in thousands) are: (i) a condensed balance sheet at December 31, 2005, and (ii) a condensed statement of operations for the year ended December 31, 2005.

**Condensed Balance Sheet**

|                   |    |        |
|-------------------|----|--------|
| Current assets    | \$ | 12,393 |
| PP&E, net         |    | 8,306  |
|                   | \$ | 20,699 |
| <br>              |    |        |
| Total liabilities | \$ | 5,450  |
| Partners capital  |    | 15,249 |
|                   | \$ | 20,699 |

**Condensed Statement Of Operations**

|              |    |         |
|--------------|----|---------|
| Revenue      | \$ | 6,038   |
| Gain on sale |    | 3,133   |
|              |    | 9,171   |
| <br>         |    |         |
| Expenses     |    | (4,364) |
| Net income   | \$ | 4,807   |

No equity income was recorded as closing on occurred on December 31, 2005.

Any difference between the purchase price and our pro rata share of the equity of Savoy will be amortized based on Savoy's units of production rate.

**(7) RESERVE DATA (UNAUDITED)**

Our reserve estimates for the years ended December 31, 2005 and 2004 were prepared by Edwin James, a sole-proprietor consulting petroleum engineer based on data we supplied. Savoy's reserve estimates were prepared by Netherland, Sewell & Associates. Be cautious that there are many uncertainties inherent in estimating proved reserve quantities and in projecting future production rates.

Proved reserves are the estimated quantities of oil and natural gas which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. Proved developed reserves are those reserves expected to be recovered through existing wells with existing equipment and operating methods.

**Analysis of Changes in Proved Developed Reserves \***  
(in thousands)

|   | Oil<br>(BBLs) | Gas<br>(MCF) |
|---|---------------|--------------|
| Balance at December 31, 2003                | 1,557         | 2,384        |
| Revisions of previous estimates             | --            | (266)        |
| Discoveries                                 | --            | 141          |
| Production                                  | (162)         | (280)        |
| Cuyama sale                                 | (1,392)       | (546)        |
| Balance at December 31, 2004                | 3             | 1,433        |
| Revisions of previous estimates             | (1)           | (41)         |
| Discoveries                                 |               | 112          |
| Production                                  | (2)           | (104)        |
| Balance at December 31, 2005 <sup>(1)</sup> | 0             | 1,400        |

\*We have no significant proved undeveloped reserves.

Equity interest (32%) in Savoy's Reserves:

|                    |    |     |
|--------------------|----|-----|
| Proved developed   | 22 | 634 |
| Proved undeveloped | 43 | 712 |

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<sup>(1)</sup> Our oil reserves are not material.

The following table (in thousands) sets forth a standardized measure of the discounted future net cash flows attributable to our proved developed reserves (hereinafter referred to as "SMOG"). Future cash inflows were computed using December 31, 2005 and 2004 gas prices of \$8.69 and \$6.06, respectively. Future production costs represent the estimated future expenditures to be incurred in producing the reserves, assuming continuation of economic conditions existing at year-end. Discounting the annual net cash inflows at 10% illustrates the impact of timing on these future cash inflows.

|   | 2005      | 2004     |
|---|-----------|----------|
| Future gas revenue  | \$ 12,350 | \$ 8,200 |
| Future cash outflows - production and abandonment costs                           | (3,600)   | (2,800)  |
| Future income taxes   | (3,500)   | (2,100)  |
| Future net cash flows   | 5,250     | 3,300    |
| 10% discount factor   | (2,450)   | (1,500)  |
| SMOG  | \$ 2,800  | \$ 1,800 |
| Equity interest (32%) in Savoy (about 50% relates to proved undeveloped reserves) | \$ 4,400  |          |

The following table (in thousands) summarizes the principal factors comprising the changes in SMOG:

|   | 2005     | 2004      |
|---|----------|-----------|
| SMOG, beginning of year                       | \$ 1,800 | \$ 11,500 |
| Sales of oil and gas, net of production costs | (875)    | (3,600)   |
| Net changes in prices and production costs    | 2,160    | (350)     |
| Revisions                                     | (165)    | (300)     |
| Discoveries                                   | 450      | 100       |
| Change in income taxes                        | (750)    | (1,200)   |
| Accretion of discount                         | 180      | 1,150     |
| Cuyama sale                                   | -        | (5,500)   |
| SMOG, end of year                             | \$ 2,800 | \$ 1,800  |

**ITEM 13. EXHIBITS**

**(a) Exhibits**

- 31 SOX 302 Certification
- 32 SOX 906 Certification

**SIGNATURES**

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

**HALLADOR PETROLEUM COMPANY**

Dated: April 9, 2007

BY: /S/ VICTOR P. STABIO  
VICTOR P. STABIO, CEO