CANARGO ENERGY CORP
Form 10-Q
November 09, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2007
OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE TRANSITION PERIOD FROM __________ TO __________
Commission File Number 0001-32145
CANARGO ENERGY CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	91-0881481
(State or other jurisdiction of Incorporation or organization)	**(I.R.S. Employer Identification No.)**
CanArgo Energy Corporation P.O. Box 291, St. Peter Port, Guernsey, British Isles	GY1 3RR
(Address of principal executive offices)	**(Zip Code)**

(44) 1481 729 980

(Registrant s telephone number, including area code)

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

Indicate by check whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended (the **Exchange Act**) during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (check one)

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

The number of shares of registrant s common stock, par value $0.10 per share, outstanding on November 1, 2007 was 242,107,390.

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Below is a list of terms that are common to our industry and used throughout this document:

d	= per day
bbl	= barrels
Bbtu	= billion British thermal units
Bcf	= billion cubic feet
Bcfe	= billion cubic feet of natural gas equivalents
bopd	= barrels of oil per day
Mbbls	= thousand barrels
Mcf	= thousand cubic feet
Mcfe	= thousand cubic feet of natural gas equivalents
MCM	= thousand cubic metres
MMBtu	= million British thermal units
MMcf	= million cubic feet
MMcfe	= million cubic feet of natural gas equivalents

MW	= megawatt
NGL	= natural gas liquids
TBtu	= trillion British thermal units

When we refer to natural gas and oil in equivalents, we are doing so to compare quantities of oil with quantities of natural gas or to express these different commodities in a common unit. In calculating equivalents, we use a generally recognized standard in

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which one Bbl of oil is equal to six Mcf of natural gas. Also, when we refer to cubic feet measurements, all measurements are at a pressure of 14.73 pounds per square inch.

When we refer to us , we , our , ours , the Company , or CanArgo , we are describing CanArgo Energy Corporati our subsidiaries.

FORWARD-LOOKING STATEMENTS

The United States Private Securities Litigation Reform Act of 1995 provides a safe harbor for certain forward-looking statements. Such forward-looking statements are based upon the current expectations of CanArgo and speak only as of the date made. These forward-looking statements involve risks, uncertainties and other factors. The factors discussed elsewhere in this Quarterly Report on Form 10-Q are among those factors that in some cases have affected CanArgo s historic results and could cause actual results in the future to differ significantly from the results anticipated in forward-looking statements made in this Quarterly Report on Form 10-Q, future filings by CanArgo with the Securities and Exchange Commission, in CanArgo s press releases and in oral statements made by authorized officers of CanArgo. When used in this Quarterly Report on Form 10-Q, the words estimate, project, anticipate, expect, intend, believe, hope, may and similar expressions, as well as will, shall and other indications of future tense, are intended to identify forward-looking statements. Few of the forward-looking statements in this Report deal with matters that are within our unilateral control. Acquisition, financing and other agreements and arrangements must be negotiated with independent third parties and, in some cases, must be approved by governmental agencies. These third parties generally have interests that do not coincide with ours and may conflict with our interests. Unless the third parties and we are able to compromise their various objectives in a mutually acceptable manner, agreements and arrangements will not be consummated.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

CANARGO ENERGY CORPORATION AND SUBSIDIARIES
Consolidated Condensed Balance Sheets

	September 30, 2007	December 31, 2006
	(Expressed in United States dollars)	
	(Unaudited)	(Audited)
ASSETS		
Current Assets		
Cash and cash equivalents	**$ 7,079,858**	$ 14,689,289
Restricted cash		299,777
Accounts receivable	**254,551**	503,953
Crude oil inventory	**1,067,752**	452,500
Prepayments	**407,527**	2,254,563
Assets to be disposed	**8,120**	5,965,341
Other current assets	**169,698**	163,561
Total current assets	**$ 8,987,506**	$ 24,328,984
Non Current Assets		
Prepaid financing fees	**92,406**	288,632
Assets to be disposed		24,560,166
Capital assets, net (including unevaluated amounts of $57,586,235 and $55,097,099, respectively)	**93,091,460**	87,307,700
Total Assets	**$ 102,171,372**	$ 136,485,482
LIABILITIES AND STOCKHOLDERS EQUITY		
Accounts payable trade	**$ 1,084,432**	$ 3,672,731
Deferred revenue		484,515
Accrued liabilities	**6,432,267**	6,918,468
Liabilities to be disposed	**374,998**	1,625,282
Total current liabilities	**$ 7,891,697**	$ 12,700,996
Long term debt	**11,292,148**	37,264,270
Other non current liabilities	**64,671**	1,260,079
Provision for future site restoration	**220,590**	205,200
Liabilities to be disposed		3,566,055

Total Liabilities	**$ 19,469,106**	$ 54,996,600
Temporary Equity	**$ 2,119,530**	$ 2,119,530
Stockholders equity:		
Common stock, par value $0.10; authorized - 500,000,000 shares at September 30, 2007 and 375,000,000 at December 31, 2006; shares issued, issuable and outstanding - 242,120,974 at September 30, 2007 and 237,145,974 at December 31, 2006	**24,212,096**	23,714,596
Capital in excess of par value	**245,259,933**	233,397,113
Accumulated deficit	**(188,889,293)**	(177,742,357)
Total stockholders equity	**$ 80,582,736**	$ 79,369,352
Total Liabilities, Temporary Equity and Stockholders Equity	**$ 102,171,372**	$ 136,485,482

The accompanying notes are an integral part of the Consolidated Condensed Financial Statements.

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CANARGO ENERGY CORPORATION AND SUBSIDIARIES
Consolidated Condensed Statements of Operations

	Unaudited Three Months Ended		Unaudited Nine Months Ended	
	September 30, 2007	September 30, 2006	**September 30, 2007**	September 30, 2006
	(Expressed in United States dollars)			
Operating Revenues from Continuing Operations:				
Oil and gas sales	**$ 32,961**	$ 2,090,147	**$ 3,394,808**	$ 4,092,224
	32,961	2,090,147	**3,394,808**	4,092,224
Operating Expenses:				
Field operating expenses	**16,427**	446,010	**690,851**	1,340,169
Direct project costs	**173,105**	235,159	**515,939**	677,656
Selling, general and administrative	**1,901,454**	2,891,133	**5,327,739**	7,810,174
Depreciation, depletion and amortization	**139,171**	700,391	**1,516,246**	2,231,319
	2,230,157	4,272,693	**8,050,775**	12,059,318
Operating Loss from Continuing Operations	**(2,197,196)**	(2,182,546)	**(4,655,967)**	(7,967,094)
Other Income (Expense):				
Interest income	**63,329**	70,720	**250,146**	278,150
Interest and amortization of debt discount and expense	**(1,144,539)**	(2,020,279)	**(5,307,304)**	(4,601,955)
Loss/Cost on debt extinguishment	**(5,592,828)**		**(12,127,494)**	
Foreign exchange gains (losses)	**(7,497)**	(28,509)	**(38,806)**	(166,560)
Other	**(1,025,067)**	(65,793)	**(761,196)**	(182,241)
Total Other Expense	**(7,706,602)**	(2,043,861)	**(17,984,654)**	(4,672,606)
Loss from Continuing Operations Before Taxes	**(9,903,798)**	(4,226,407)	**(22,640,621)**	(12,639,700)
Income taxes				
Loss from Continuing Operations	**(9,903,798)**	(4,226,407)	**(22,640,621)**	(12,639,700)
Net Income (Loss) from Discontinued Operations, net of taxes	**(55,873)**	(1,491,710)	**11,493,685**	(1,242,595)
Net Loss	**$ (9,959,671)**	$ (5,718,117)	**$ (11,146,936)**	$ (13,882,295)

Weighted average number of common shares outstanding								
- Basic		**239,053,232**		224,260,628		**238,557,879**		223,942,445
- Diluted		**239,053,232**		224,260,628		**238,557,879**		223,942,445
Basic Net Income (Loss) Per Common Share								
- from continuing operations	**$**	**(0.04)**	$	(0.02)	**$**	**(0.09)**	$	(0.06)
- from discontinued operations	**$**	**(0.00)**	$	(0.01)	$	0.05	$	(0.01)
Basic Net Income (Loss) Per Common Share	**$**	**(0.04)**	$	(0.03)	**$**	**(0.05)**	$	(0.06)
Diluted Net Income (Loss) Per Common Share								
- from continuing operations	**$**	**(0.04)**	$	(0.02)	**$**	**(0.09)**	$	(0.06)
- from discontinued operations	**$**	**(0.00)**	$	(0.01)	**$**	**0.05**	$	(0.01)
Diluted Net (Income) Loss Per Common Share	**$**	**(0.04)**	**$**	**(0.03)**	**$**	**(0.05)**	**$**	**(0.06)**

The accompanying notes are an integral part of the Consolidated Condensed Financial Statements.

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CANARGO ENERGY CORPORATION AND SUBSIDIARIES
Consolidated Condensed Statements of Cash Flows

	Unaudited Nine Months Ended September 30,	
	2007	2006
	(Expressed in United States dollars)	
Operating activities:		
Net Loss	**(11,146,936)**	(13,882,295)
Net income from discontinued operations, net of taxes and minority interest	**11,493,685**	(1,242,595)
Loss from continuing operations	**(22,640,621)**	(12,639,700)
Adjustments to reconcile net loss from continuing operations to net cash used by operating activities:		
Non-cash stock compensation expense	**571,429**	1,672,651
Non-cash interest expense and amortization of debt discount	**4,111,714**	3,232,166
Non-cash debt extinguishment expense	**12,127,494**	
Depreciation, depletion and amortization	**1,516,246**	2,231,319
Allowance for doubtful accounts		234,021
Trading loss on securities	**792,718**	
Changes in assets and liabilities:		
Restricted cash	**299,777**	2,881,744
Accounts receivable	**249,402**	(782,269)
Inventory	**(615,252)**	469,428
Prepayments	**197,427**	1,163,375
Other current assets	**29,135**	7,783
Accounts payable	**(570,965)**	(2,906,755)
Deferred revenue	**(484,515)**	528
Accrued liabilities	**(613,303)**	(965,714)
Net cash used by continuing operating activities	**(5,029,314)**	(5,401,423)
Investing activities:		
Capital expenditures	**(9,317,340)**	(15,791,671)
Proceeds from disposition of security investments	**21,340,396**	
Change in oil and gas supplier prepayments	**1,649,608**	(672,333)
Net cash used in investing activities	**13,672,664**	(16,464,004)
Financing activities:		
Proceeds from sale of common stock	**3,560,600**	527,349
Proceeds from loans		23,000,000
Repayment of loans	**(19,875,000)**	
Deferred loan costs		(215,057)
Net cash provided by financing activities	**(16,314,400)**	23,312,292

Discontinued activities:		
Net cash generated by operating activities	**61,887**	(1,192,205)
Net cash used in investing activities	**(1,763,529)**	(6,461,620)
Net cash provided by financing activities		5,000,000
Net cash flows from assets and liabilities held for sale and to be disposed	**(1,701,642)**	(2,653,825)
Net increase (decrease) in cash and cash equivalents	**(9,372,692)**	(1,206,960)
Cash and cash equivalents, beginning of period	**16,452,550**	18,540,558
Amounts reclassified to discontinued operations	**(1,763,261)**	(438,751)
Cash and cash equivalents, beginning of period as stated	**14,689,289**	18,101,807
Cash and cash equivalents, end of period	**$ 7,079,858**	$ 17,333,598

The accompanying notes are an integral part of the Consolidated Condensed Financial Statements.

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CANARGO ENERGY CORPORATION AND SUBSIDIARIES
Notes to Unaudited Consolidated Condensed Financial Statements

1. Basis of Presentation

The interim consolidated condensed financial statements and notes thereto of CanArgo Energy Corporation and its subsidiaries (collectively, we , our , CanArgo or the Company) have been prepared by management without audit pursuant to the rules and regulations of the U.S. Securities and Exchange Commission. In the opinion of management, the consolidated condensed financial statements include all adjustments, consisting of normal recurring adjustments, except the discontinued operations as explained in Note 18 and extinguishment of debt as described in Note 12, as necessary for a fair statement of the results for the interim period. Although management believes that the disclosures are adequate to make the information presented not misleading, certain information and footnote disclosures, including a description of significant accounting policies normally included in the financial statements prepared in accordance with accounting principles generally accepted in the U.S., have been condensed or omitted pursuant to such rules and regulations. The accompanying consolidated condensed financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in CanArgo s Annual Report on Form 10-K for the year ended December 31, 2006 filed with the Securities and Exchange Commission. All amounts are in U.S. dollars. The results of operations for interim periods are not necessarily indicative of the results for any subsequent quarter or the entire fiscal year ending December 31, 2007.

Going Concern

The interim consolidated condensed financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) which contemplates continuation of the Company as a going concern. The items listed below raise substantial doubt about the Company s ability to continue as a going concern. The interim consolidated condensed financial statements do not include any adjustments that might result from the outcome of this uncertainty.

The Company has incurred net losses from continuing operations to common stockholders of approximately $54,432,000, $12,522,000 and $6,262,000 for the years ended December 31, 2006, 2005 and 2004 respectively. These net losses included non-cash charges related to depreciation and depletion, impairments, loan interest, amortization of debt discount and stock-based compensation of approximately $48,250,000, $6,928,000 and $5,104,000 for the years ended December 31, 2006, 2005 and 2004 respectively.

In the years ended December 31, 2006 and 2005 the Company s revenues from its operations did not cover the costs of its operations.

At September 30, 2007 the Company had cash and cash equivalents available for general corporate use or for use in operations of approximately $7,080,000.

The Company has a planned capital expenditure budget for the remainder of 2007 of approximately $3,400,000.

The Company s ability to continue as a going concern is dependent upon raising capital through debt and / or equity financing on terms acceptable to the Company in the immediate short-term.

The covenants contained in the Note Purchase Agreements to which the Company is a party (see Note 12) restrict the Company from incurring additional debt obligations unless it receives consent from Noteholders holding at least 51% in aggregate outstanding principal amount of the of the Notes covered by such Agreements.

There are no assurances the Company can raise additional sources of equity financing and because of the covenants contained in the Note Purchase Agreements to which the Company is a party (see Note 12), the Company is restricted from incurring additional debt obligations unless it receives consent from

Noteholders holding at least 51% in aggregate outstanding principal amount of the of the Notes covered by such Agreements, which cannot be assured.

If the Company is unable to obtain additional funds when they are required or if the funds cannot be obtained on terms favourable to the Company, management may be required to delay, scale back or eliminate its exploration, development and completion program or enter into contractual arrangements with third parties to develop or market products that the Company would otherwise seek to develop or market itself, or even be required to relinquish its interest in the properties or in the extreme situation, cease operations altogether.

Managements Plan

The Company anticipates it will require additional funding within the next twelve months to continue with its Georgian operations as planned and is in the process of addressing this situation by exploring available financing alternatives sufficient to cover its short-term working capital needs.

The Company believes that if it is able to successfully complete the Manavi 12 well later in the year such that a significant quantity of oil flows are produced, it will be able to raise additional debt and/or equity funds in order to continue operations and to properly develop the Manavi Field, continue its development plans for the Ninotsminda Field, continue appraising the Norio discoveries, and further develop the Company s business in the region.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires management 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

2 Dismantlement, Restoration and Environmental Costs

We recognize liabilities for asset retirement obligations associated with tangible long-lived assets, such as producing well sites, with a corresponding increase in the related long-lived asset. The asset retirement cost is depreciated along with the property and equipment in the full cost pool. The asset retirement obligation is recorded at fair value and accretion expense, recognized over the life of the property, increases the liability to its expected settlement value. If the fair value of the estimated asset retirement obligation changes, an adjustment is recorded for both the asset retirement obligation and the asset retirement cost. As at September 30, 2007 and December 31, 2006, the asset retirement obligation, which is included on the consolidated balance sheet in provision for future site restoration, was $220,590 and $205,200, respectively.

3 Stock Based Compensation Plans

Effective January 1, 2006 the Company adopted Statement of Financial Accounting Standard (SFAS) No. 123 (revised 2004), Share Based Payments (SFAS No. 123(R)) using the modified-prospective method, beginning January 1, 2006. We also elected to continue to estimate the fair value of stock options using the Black-Scholes-option pricing model. Total compensation cost related to non-vested awards not yet recognized was approximately $197,313 as of September 30, 2007 and the weighted average period over which this cost will be recognized is approximately 3 months.

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4 Income Taxes

Effective January 1, 2007 the Company adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the financial statements if that position is more likely than not of being sustained by the taxing authority. The Company does not believe it has any tax positions that meet this criteria; therefore, no amounts were recognized in the liability for unrecognized tax benefits and its effective tax rate was not impacted by the adoption of FIN 48. The Company did not adjust the opening balance of retained earnings as of January 1, 2007.

Accordingly, the Company did not accrue or recognize any amounts for interest or penalties in its financial statements during the first three quarters of 2007. The Company will classify interest to be paid on an underpayment of income taxes and any related penalties as income tax expense if it is determined, in a subsequent period that a tax position is more likely than not of being sustained by the taxing authority.

5 Foreign Operations

Our current and future operations and earnings depend upon the results of our operations in Georgia. There can be no assurance that we will be able to successfully conduct such operations, and a failure to do so would have a material adverse effect on our financial position, results of operations and cash flows. Also, the success of our operations generally will be subject to numerous contingencies, some of which are beyond management control. These contingencies include general and regional economic conditions, prices for crude oil and natural gas, competition and changes in regulation. Since we are dependent on international operations, we will be subject to various additional political, economic and other uncertainties. Among other risks, our operations may be subject to the risks and restrictions on transfer of funds, import and export duties, quotas and embargoes, domestic and international customs and tariffs, and changing taxation policies, foreign exchange restrictions, political conditions and restrictive regulations.

6 Restricted Cash

In the third quarter of 2005, we deposited approximately $300,000 to secure the issuance of a letter of credit as required under a contract for drilling services we entered into with Baker Hughes International. This deposit became unrestricted in January 2007.

7 Accounts Receivable

Accounts receivable at September 30, 2007 and December 31, 2006 consisted of the following:

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
Current Assets		
Trade receivables before allowance for doubtful debts	$	$
Insurance receivable		474,665
Other receivables	254,551	29,288
	$ 254,551	$ 503,953

Bad debt expense for the nine month periods ended September 30, 2007 and 2006 was $0 and $234,021 respectively.

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Included in other receivables of $254,551 is an amount of $113,961 due from Tethys Petroleum Limited (Tethys) for Tethys selling, general and administrative expenses paid by the Company immediately before and after we sold our entire Tethys shareholding. The amount owed by Tethys was paid in full in October 2007.

In the second quarter of 2006 we filed a claim with our insurance carrier for recovery of drilling equipment lost in the Manavi 12 well. As of December 31, 2006, $474,665 was recorded as a receivable in connection with this claim. This claim was settled and paid in full by our insurance carrier in February 2007.

8 Inventory

Inventory of crude oil at September 30, 2007 and December 31, 2006 consisted of the following:

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
Crude oil	$ 1,067,752	$ 452,500
	$ 1,067,752	$ 452,500

9 Prepayments

Prepayments consisted of the following at September 30, 2007 and December 31, 2006:

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
Drilling Contractors	$ 200,015	$ 1,849,624
Financing Fees	60,964	157,372
Insurance	116,835	105,052
Other	29,713	142,515