BLUE DOLPHIN ENERGY CO
Form 10-Q
May 21, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended: March 31, 2012

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

Commission File Number: 0-15905

BLUE DOLPHIN ENERGY COMPANY

(Exact name of registrant as specified in its charter)

Delaware	**73-1268729**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**

801 Travis Street, Suite 2100, Houston, Texas 77002

(Address of principal executive offices)

(713) 568-4725

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	x

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

Number of shares of common stock, par value $0.01 per share (the Common Stock) outstanding as of May 12, 2012: 10,533,070

BLUE DOLPHIN ENERGY COMPANY & SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

BLUE DOLPHIN ENERGY COMPANY & SUBSIDIARIES

Condensed Consolidated Balance Sheets

	March 31, 2012 (Unaudited) 2012	December 31, 2011 2011
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 1,109,821	$ 1,822
Restricted cash	192,155	192,004
Accounts receivable	16,447,101	
Prepaid expenses and other current assets	329,718	58,713
Deposits	1,140,447	473,026
Inventory	5,143,569	4,533,961
Total current assets	24,362,811	5,259,526
Total property and equipment, net	43,132,695	32,307,929
Debt issue costs	557,684	566,133
Other assets	17,076	10,468
Trade name	184,368	
Goodwill	8,667,401	
TOTAL ASSETS	$ 76,922,035	$ 38,144,056
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 21,663,071	$ 4,841,859
Accounts payable, related party	260,035	908,139
Note payable	46,318	46,318
Asset retirement obligations, current portion	242,299	
Accrued expenses and other current liabilities	1,094,408	744,921
Interest payable, current portion	1,004,515	995,916
Other long-term liabilities, current portion	1,841,852	1,839,501
Total current liabilities	26,152,498	9,376,654
Asset retirement obligations, net of current portion	2,480,402	
Long term debt	14,813,846	12,455,102
Long term interest payable, net of current portion	703,211	650,214
Total long-term liabilities	17,997,459	13,105,316
Commitments and contingencies		
STOCKHOLDERS EQUITY		
Common stock ($0.01 par value, 20,000,000 shares authorized, 10,533,070 and 2,098,390 shares issued and outstanding at March 31, 2012 and December 31, 2011, respectively)	105,331	20,984
Additional paid-in capital	36,360,944	17,365,405
Accumulated deficit	(3,694,197)	(1,724,303)
Total stockholders equity	32,772,078	15,662,086

TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 76,922,035	$ 38,144,056

See accompanying notes to condensed consolidated financial statements.

BLUE DOLPHIN ENERGY COMPANY & SUBSIDIARIES

Condensed Consolidated Statements of Operations (Unaudited)

	Three Months Ended March 31, 2012	2011
REVENUE FROM OPERATIONS		
Refined product sales	$ 45,770,963	$
Pipeline operations	69,910	
Oil and gas sales	200,340	
Total revenue from operations	46,041,213	
COST OF OPERATIONS		
Cost of refined products sold	44,261,395	
Refinery operating expenses	2,445,437	
Pipeline operating expenses	109,618	
Lease operating expenses	201,713	
Depletion, depreciation and amortization	275,107	4,308
General and administrative expenses	525,587	113,828
Accretion expense	23,775	
Total cost of operations	47,842,632	118,136
Loss from operations	(1,801,419)	(118,136)
OTHER INCOME (EXPENSE)		
Net tank rental revenue	93,955	342,745
Interest and other income	1,650	6,094
Interest expense	(233,517)	(12,311)
Total other income (expense)	(137,912)	336,528
Income (loss) before income taxes	(1,939,331)	218,392
Income tax expense	(30,563)	
Net income (loss)	$ (1,969,894)	$ 218,392
Loss per common share:		
Basic	$ (0.37)	$ 218,392
Diluted	$ (0.37)	$ 218,392
Weighted average number of common shares outstanding:		
Basic	5,324,410	1
Diluted	5,324,410	1

See accompanying notes to condensed consolidated financial statements.

BLUE DOLPHIN ENERGY COMPANY & SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows (Unaudited)

	Three Months Ended March 31, 2012	2011
OPERATING ACTIVITIES		
Net income (loss)	$ (1,969,894)	$ 218,392
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depletion, depreciation and amortization	275,107	4,308
Amortization of debt issue costs	8,449	8,449
Accretion expense	23,775	
Common stock issued for services	20,000	
Changes in operating assets and liabilities (net of effects of Acquisition in 2012)		
Restricted cash	(151)	(294)
Accounts receivable	(15,923,454)	
Prepaid expenses and other current assets	(240,934)	
Deposits	(484,000)	
Inventory	(554,441)	
Accounts payable, accrued expenses and other liabilities	16,010,567	(460,040)
Accounts payable, related party	1,253,764	455,568
Net cash provided by (used in) operating activities	(1,581,212)	226,383
INVESTING ACTIVITIES		
Capital expenditures	(1,346,477)	(216,458)
Cash acquired on Acquisition	1,674,594	
Net cash provided by (used in) investing activities	328,117	(216,458)
FINANCING ACTIVITIES		
Proceeds from issuance of debt	2,364,010	
Payments on notes payable	(2,916)	(10,417)
Net cash provided by (used in) financing activities	2,361,094	(10,417)
Net increase (decrease) in cash and cash equivalents	1,107,999	(492)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	1,822	733
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 1,109,821	$ 241
Supplemental Information:		
Non-cash investing and financing activities:		
Financing of insurance premiums	$ 82,560	$
Related party payable converted to equity	$ 993,732	$
Acquisition of Blue Dolphin at fair value, inclusive of cash acquired of $1,674,594	$ 18,046,154	$

See accompanying notes to condensed consolidated financial statements.

BLUE DOLPHIN ENERGY COMPANY & SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

(1) Organization
Company Operations

Blue Dolphin Energy Company (referred to herein, with its predecessors and subsidiaries, as Blue Dolphin, we, us and our), a Delaware corporation, was formed in 1986 as a holding company and conducts substantially all of its operations through its wholly-owned subsidiaries. Our operating subsidiaries include:

- Lazarus Energy, LLC (LE), a Delaware limited liability company (petroleum processing assets);
- Blue Dolphin Pipe Line Company, a Delaware corporation (pipeline operations);
- Blue Dolphin Petroleum Company, a Delaware corporation (exploration and production activities);
- Blue Dolphin Services Co., a Texas corporation (administrative services);
- Blue Dolphin Exploration Company, a Delaware corporation (inactive); and
- Petroport, Inc., a Delaware corporation (inactive).

(2) Acquisition
Blue Dolphin acquired 100% of the issued and outstanding membership interests of LE, a Delaware limited liability company from Lazarus Energy Holdings, LLC, a Delaware limited liability company (LEH), effective February 15, 2012 (the Acquisition). As consideration for LE, Blue Dolphin issued, in reliance on the exemption provided by Section 4(2) of the Securities Act of 1933, as amended (the Securities Act), 8,393,560 shares of common stock, par value $0.01 per share (the Common Stock), subject to anti-dilution adjustments, to LEH (the Original BDEC Shares). Additionally, on February 21, 2012, pursuant to anti-dilution provisions, Blue Dolphin issued, in reliance on the exemption provided by Section 4(2) of the Securities Act, 32,896 shares of Common Stock to LEH (the Anti-Dilution Shares and together with the Original BDEC Shares, the BDEC Shares). As a result of Blue Dolphin s issuance of the BDEC Shares, LEH owns 80% of Blue Dolphin s issued and outstanding Common Stock. The issuance of the BDEC Shares to LEH resulted in a change in control of Blue Dolphin.

LE owns a petroleum refinery located in Nixon, Texas (the Nixon Facility). The processing plant at the Nixon Facility is currently in a recommissioning phase and has not yet reached its full operational capacity. The tank farm has 120,000 barrels of crude oil storage capacity and 148,000 barrels of refined product storage capacity. After refurbishment of the process units is complete, the Nixon Facility will have the capability to produce products such as off-road diesel, kerosene, jet fuel and intermediate products such as liquefied petroleum gas, naphtha and atmospheric gas oil. LE has leased 20,000 barrels of refined product storage capacity to an unrelated third-party.

The Acquisition has been accounted for as a reverse merger using accounting principles applicable to reverse acquisitions whereby the financial statements subsequent to the date of the transaction are presented as a continuation of LE. Under reverse acquisition accounting LE (the legal subsidiary) has been treated as the accounting parent (acquirer) and Blue Dolphin (the legal parent) has been treated as the accounting subsidiary (acquiree). Accordingly, the financial statements subsequent to the date of the transaction are presented herein as the continuation of LE.

BLUE DOLPHIN ENERGY COMPANY & SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

(Continued)

The value assigned to the purchase price was allocated to Blue Dolphin s tangible and intangible assets and liabilities based on their fair values on the transaction closing date. LE s purchase price to acquire Blue Dolphin was based on the fair value of Blue Dolphin s issued and outstanding common stock at February 15, 2012, which was 2,098,390 shares, multiplied by Blue Dolphin s closing stock price of $8.60 on February 15, 2012, the transaction closing date. This resulted in a fair value assessment of Blue Dolphin of $18,046,154.

In connection with the Acquisition, we engaged an independent third-party to fair value the net assets of Blue Dolphin. The fair value assessment of Blue Dolphin is ongoing and has not been completed and as a result, the purchase price allocation for the transaction is provisional and will be adjusted upon completion of the fair value assessment. Fair value of financial and non-financial assets and liabilities is defined as an exit price, representing the amount that would be received to sell an asset or liability in an orderly transaction between market participants.

The following table summarizes the provisional purchase price allocation of the net assets acquired as of the acquisition date:

Current assets	$ 2,466,901
Oil and gas properties	1,503,596
Pipelines	4,466,273
Onshore separation and handling facilities	325,435
Land	473,225
Other property and equipment	282,972
Other long-term assets	9,463
Trade name	184,368
Goodwill	8,667,401
Total assets acquired	18,379,634
Current liabilities	333,480
Total liabilities assumed	333,480
Net assets acquired	$ 18,046,154

Goodwill recognized in the transaction is related to the expected value to be received from the combination of LE s crude oil and condensate processing facility and Blue Dolphin s oil and gas and pipeline properties and operational expertise.

From the date of the Acquisition (February 15, 2012) until March 31, 2012, Blue Dolphin s revenues and net loss included in the condensed consolidated statements of operations for the three months ended March 31, 2012 was $270,250 and $513,540, respectively.

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BLUE DOLPHIN ENERGY COMPANY & SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

(Continued)

Supplemental Pro Forma Information

The following pro forma condensed consolidated statements of operations for the three months ended March 31, 2012 and March 31, 2011 consolidate the historical consolidated statements of operations of Blue Dolphin and LE giving effect to the Acquisition as if it had occurred on January 1, 2011, respectively. The unaudited pro forma condensed combined financial statements are presented for illustrative purposes only:

	Three Months Ended March 31, 2012		
	Historical		Pro forma
	Blue Dolphin	LE	Consolidated
REVENUE FROM OPERATIONS			
Refined product sales	$	$ 45,770,963	$ 45,770,963
Pipeline operations	109,334		109,334
Oil and gas sales	310,698		310,698
Total revenue from operations	420,032	45,770,963	46,190,995
COST OF OPERATIONS			
Cost of refined products sold		44,261,395	44,261,395
Refinery operating expenses		2,445,437	2,445,437
Pipeline operating expenses	169,083		169,083
Lease operating expenses	304,437		304,437
Depletion, depreciation and amortization	124,587	192,049	316,636
General and administrative expenses	540,070	158,461	698,531
Accretion expense	35,662		35,662
Total cost of operations	1,173,839	47,057,342	48,231,181
Loss from operations	(753,807)	(1,286,379)	(2,040,186)
OTHER INCOME (EXPENSE)			
Net tank rental revenue		93,955	93,955
Interest and other income	2,339	150	2,489
Interest expense		(233,517)	(233,517)
Total other income (expense)	2,339	(139,412)	(137,073)
Loss before income taxes	(751,468)	(1,425,791)	(2,177,259)
Income tax expense		(30,563)	(30,563)
Net loss	$ (751,468)	$ (1,456,354)	$ (2,207,822)

There were no adjustments necessary; hence, no column has been shown for adjustments to the proforma information.

	Three Months Ended March 31, 2011	
	Historical	Pro forma

	Blue Dolphin	LE	Consolidated
REVENUE FROM OPERATIONS			
Pipeline operations	$ 342,630	$	$ 342,630
Oil and gas sales	349,704		349,704
Total revenue from operations	692,334		692,334
COST OF OPERATIONS			
Pipeline operating expenses	221,334		221,334
Lease operating expenses	258,443		258,443
Depletion, depreciation and amortization	146,708	4,308	151,016
General and administrative expenses	473,391	113,828	587,219
Accretion expense	33,086		33,086
Total cost of operations	1,132,962	118,136	1,251,098
Loss from operations	(440,628)	(118,136)	(558,764)
OTHER INCOME (EXPENSE)			
Net tank rental revenue		342,745	342,745
Interest and other income	8,540	6,094	14,634
Interest expense		(12,311)	(12,311)
Total other income (expense)	8,540	336,528	345,068
Income (loss) before income taxes	(432,088)	218,392	(213,696)
Income tax expense			
Net income (loss)	$ (432,088)	$ 218,392	$ (213,696)

There were no adjustments necessary; hence, no column has been shown for adjustments to the proforma information.

BLUE DOLPHIN ENERGY COMPANY & SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

(Continued)

(3) Significant Accounting Policies
Basis of Presentation

We have prepared our unaudited condensed consolidated financial statements, in accordance with U.S. generally accepted accounting principles (GAAP) as codified by the Financial Accounting Standards Board in its Accounting Standards Codification (ASC), pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). In the opinion of management, such condensed consolidated financial statements reflect all adjustments necessary to present fair condensed consolidated statements of operations, financial position and cash flows. We believe that the disclosures are adequate and the presented information is not misleading. This report has been prepared in accordance with the SEC s Form 10-Q instructions and therefore, certain information and footnote disclosures normally included in audited financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the SEC s rules and regulations.

The results of operations for the three months ended March 31, 2012, are not necessarily indicative of the results of operations to be expected for the year ending December 31, 2012.

Use of Estimates

We have made a number of estimates and assumptions related to the reporting of condensed consolidated assets and liabilities and to the disclosure of contingent assets and liabilities to prepare these unaudited condensed consolidated financial statements in conformity with GAAP. While we believe current estimates are reasonable and appropriate, actual results could differ from those estimated.

Cash and Cash Equivalents

Cash equivalents include liquid investments with an original maturity of three months or less. Cash balances are maintained in depository and overnight investment accounts with financial institutions that, at times, exceed insured limits. We monitor the financial condition of the financial institutions and have experienced no losses associated with these accounts.

Restricted Cash

Restricted cash was $192,155 and $192,004 at March 31, 2012 and December 31, 2011, respectively. These amounts relate to escrow accounts for potential environmental matters and loan repayments.

Accounts Receivable, Allowance for Doubtful Accounts and Concentrations of Credit Risk

Accounts receivable are customer obligations due under normal trade terms. The allowance for doubtful accounts represents our estimate of the amount of probable credit losses existing in our accounts receivable. We have a limited number of customers with individually large amounts due at any given date. Any unanticipated change in any one of these customers credit worthiness or other matters affecting the collectability of amounts due from such customers could have a material adverse effect on our results of operations in the period in which such changes or events occur. We regularly review all aged accounts receivables for collectability and establish an allowance as necessary for individual customer balances. As of March 31, 2012 and December 31, 2011, there was no allowance recorded related to trade accounts receivable.

We had two customers that accounted for 43% of our total revenue for the three months ended March 31, 2012, which represented approximately $8.1 million of accounts receivable at March 31, 2012.

BLUE DOLPHIN ENERGY COMPANY & SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

(Continued)

Inventory

Our inventory primarily consists of refined petroleum products valued at lower of cost or market with costs being determined by the average cost method.

Property and Equipment

Refinery and Facilities. Additions to refinery and facilities are capitalized. Expenditures for repairs and maintenance are charged to expense. Refinery and facilities are carried at cost. Adjustment of the asset and the related accumulated depreciation accounts are made for refinery and facilities retirements and disposals, with the resulting gain or loss included in the statements of operations.

For financial reporting purposes, depreciation of refinery and facilities is computed using the straight-line method over the estimated useful lives of assets when the refinery and facilities are placed in service. For tax reporting purposes, depreciation of refinery and facilities is computed using the straight-line and accelerated methods over the estimated useful lives of the assets.

We review the carrying values of our long-lived assets for possible impairment whenever events or changes in circumstances indicate that the carrying amount of assets to be held and used may not be recoverable. The assessment of facts and circumstances that are used for impairment testing to suggest that the carrying amount of the assets may exceed its recoverable amount is a subjective process that often involves a number of estimates and is subject to interpretation. A long-lived asset is generally not recoverable if its carrying amount exceeds the sum of the undiscounted cash flows expected to result from its use and eventual disposition. If a long-lived asset is not recoverable, an impairment loss is recognized in an amount by which its carrying amount exceeds its fair value. We did not record any impairment for the three months ended March 31, 2012 or 2011.

Oil and Gas Properties. We account for our oil and gas properties using the full-cost method of accounting, whereby all costs associated with acquisition, exploration and development of oil and gas properties, including directly related internal costs, are capitalized on a cost center basis. We use one cost center for domestic properties and one cost center for foreign properties. Amortization of such costs and estimated future development costs are determined using the unit-of-production method. Costs directly associated with the acquisition and evaluation of unproved properties are excluded from the amortization computation until it is determined whether or not proved reserves can be assigned to the properties or impairment has occurred.

Estimated proved oil and gas reserves are based on reports prepared by third-party petroleum engineering consulting firms. For determining impairment of our oil and gas properties, we are required on a quarterly basis to determine whether the book value of our oil and natural gas properties (excluding unevaluated properties) is less than or equal to a ceiling, which is determined based upon the expected after tax present value (discounted at 10%) of the future net cash flows from our proved reserves, calculated using prevailing oil and natural gas prices on the last day of the period, or a subsequent higher price under certain circumstances. Any excess of the net book value of our oil and natural gas properties over the ceiling must be recognized as a non-cash impairment expense. We did not have any impairment of our oil and gas properties for the three months ended March 31, 2012.

Pipelines and Facilities. Pipelines and facilities are recorded at cost. Depreciation is computed using the straight-line method over estimated useful lives ranging from 10 to 22 years. In accordance with the ASC guidance on accounting for the impairment or disposal of long-lived assets, assets are grouped and evaluated for impairment based on the ability to identify separate cash flows generated therefrom. We did not have any impairment of our pipelines and facilities for the three months ended March 31, 2012.

BLUE DOLPHIN ENERGY COMPANY & SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

(Continued)

Construction in Progress. Construction in progress consists of costs we incurred to purchase and refurbish the Nixon Facility. Amounts were capitalized as incurred and depreciation began when the Nixon Facility became operational. Capitalized interest was added to the cost of the underlying assets and will be amortized over the useful life of the Nixon Facility.

Trade Name

In connection with the Acquisition, we recognized $184,368 as trade name. We have determined our trade name has an indefinite useful life. We perform an evaluation for impairment of trade name either annually or when events and circumstances indicate a trade name impairment that is considered necessary.

Goodwill

We recognized goodwill in connection with our Acquisition. Goodwill has an indefinite useful life and reflects the amount of the purchase consideration that exceeded the fair value of Blue Dolphin s net assets acquired. We perform an evaluation for impairment of goodwill either annually or when events and circumstances indicate a goodwill impairment test is considered necessary.

Debt Issue Costs

Debt issue costs are capitalized and amortized over the term of the related debt using the straight-line method, which approximates the effective interest method. When a loan is paid in full, any unamortized financing costs are removed from the related accounts and charged to operations. Debt issue costs of $675,980, net of accumulated amortization in the amount of $118,296 and $109,847 at March 31, 2012 and at December 31, 2011, respectively, are being amortized over the life of the loan. Amortization expense was $8,449 for the three months ended March 31, 2012 and 2011, and is included in interest expense.

Revenue Recognition

Refined Products Revenue. Revenue from the sale of refined products is recognized in the month that the refined products are shipped out of the Nixon Facility.

Tank Storage Rental Revenue. Revenue from tank storage is recorded on a straight line basis in accordance with the terms of the related lease agreement. The lessee is invoiced monthly for the amount of rent due for the related period.

Recognition of Oil and Gas Revenue. Sales from producing wells are recognized on the entitlement method of accounting, which defers recognition of sales when, and to the extent that, deliveries to customers exceed our net revenue interest in production. Similarly, when deliveries are below our net revenue interest in production, sales are recorded to reflect the full net revenue interest. Our imbalance liability at March 31, 2012 was not material.

Pipeline Transportation Revenue. Revenue from our pipelines is derived from fee-based contracts and is typically based on transportation fees per unit of volume transported multiplied by the volume delivered. Revenue is recognized when volumes have been physically delivered for the customer through the pipeline.

BLUE DOLPHIN ENERGY COMPANY & SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

(Continued)

Income Taxes

We provide for income taxes using 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 assets and liabilities and their respective tax basis and operating loss and tax credit carry-forwards. 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 income in the period that includes the enactment date.

The evaluation of a tax position is a two-step process. The first step is a recognition process whereby the enterprise determines whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. In evaluating whether a tax position has met the more-likely-than-not recognition threshold, the enterprise should presume that the position will be examined by the appropriate taxing authority that has full knowledge of all relevant information. The second step is a measurement process whereby a tax position that meets the more-likely-than-not recognition threshold is calculated to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement.

Recently Issued Accounting Pronouncements

We have evaluated recent accounting pronouncements and determined that they would not have a material impact on our consolidated financial statements or disclosures.

(4) Business Segment Information

We are engaged in three lines of business: (i) ownership of crude oil and condensate processing assets, (ii) pipeline transportation services to producers/shippers and (iii) oil and gas exploration and production. Our primary assets include the Nixon Facility, oil and natural gas pipelines in the Gulf of Mexico region, and oil and natural gas leasehold interests in the U.S. Gulf of Mexico and the North Sumatra Basin offshore Indonesia.

Management uses earnings before interest expense and income taxes (EBIT), a non-GAAP financial measure, to assess the operating results and effectiveness of our business segments, which consist of our consolidated businesses and investments. We believe EBIT is useful to our investors because it allows them to evaluate our operating performance using the same performance measure analyzed internally by management. EBIT is adjusted for: (i) items that do not impact our income or loss from continuing operations, such as the impact of accounting changes, (ii) income taxes and (iii) interest expense (or income). We exclude interest expense (or income) and other expenses or income not pertaining to the operations of our segments from this measure so that investors may evaluate our current operating results without regard to our financing methods or capital structure. We understand that EBIT may not be comparable to measurements used by other companies. Additionally, EBIT should be considered in conjunction with net income (loss) and other performance measures such as operating cash flows.

BLUE DOLPHIN ENERGY COMPANY & SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

(Continued)

Following is a reconciliation of our EBIT (by business segment) for the three months ended March 31, 2012, and at March 31, 2012:

	Three Months Ended March 31, 2012 Segment				
	Crude Oil and Condensate Processing	Pipeline Transportation	Oil and Gas Exploration & Production	Corporate & Other[1]	Total
Revenues	$ 45,770,963	$ 69,910	$ 200,340	$	$ 46,041,213
Operation cost[2]	46,865,293	195,716	388,875	117,639	47,567,523
Depletion, depreciation and amortization	192,049	58,300	22,209	2,549	275,107
Other non-interest income	93,955				93,955
EBIT	$ (1,192,424)	$ (184,106)	$ (210,744)	$ (120,188)	$ (1,707,462)
Capital expenditures	$ 1,346,477	$	$	$	$ 1,346,477
Identifiable assets[3]	$ 56,220,025	$ 16,972,084	$ 2,724,985	$ 1,004,941	$ 76,922,035

(1) Includes unallocated general and administrative costs associated with corporate maintenance costs (such as director fees and legal expenses).

(2) General and administrative costs are allocated based on revenue.

(3) Identifiable assets contain related legal obligations of each segment including cash, accounts receivable and payable and recorded net assets.

Following is a reconciliation of our EBIT (by business segment) for the three months ended March 31, 2011, and at March 31, 2011:

Three Months Ended March 31, 2011
Segment