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PYRAMID OIL CO
Form 10-K
March 30, 2010

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

FORM 10-K

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

For the fiscal year ended December 31, 2009

or

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

For the transition period from to

Commission File Number 0-5525

PYRAMID OIL COMPANY
(Exact name of registrant as specified in its charter)

CALIFORNIA 94-0787340
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

2008 - 21st. Street, P. O. Box 832 93302
Bakersfield, California
(Address of principal executive offices) (Zip Code)

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

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

| Title of each class | Name of each exchange on which registered |
|---------------------|---|
| Common Stock | NYSE AMEX |

Securities registered pursuant to Section 12 (g) of the Exchange Act: NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

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

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of

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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 Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). Yes [] No []

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

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

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

The aggregate market value on June 30, 2009, (the last business day of the registrant's most recently completed second fiscal quarter) of the voting shares held by non-affiliates was approximately \$15,464,000 based on the closing sales price of the registrant's Common Stock on such date.

At March 30, 2010, there were 4,677,728 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for its 2010 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission within 120 days after the close of the registrant's fiscal year are incorporated by reference into Part III.

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PYRAMID OIL COMPANY
2009 FORM 10-K ANNUAL REPORT

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CAUTIONARY STATEMENT FOR PURPOSES OF THE PRIVATE SECURITIES LITIGATION REFORM

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ACT OF 1995 AND OTHER FEDERAL SECURITIES LAWS

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

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PART I

ITEM 1 - BUSINESS

GENERAL BUSINESS DESCRIPTION

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

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

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

DESCRIPTION OF BUSINESS - OIL AND GAS OPERATIONS

EXPLORATION AND DEVELOPMENT

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

OIL AND GAS PRODUCTION OPERATIONS

Pyramid owns and operates 27 oil and gas leases (properties) located within Kern and Santa Barbara Counties in the State of California. Ten of these properties were shut-in during 2009. Most of these properties are capable of producing oil or natural gas, although not all of these properties are considered profitable under certain economic conditions.

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During 2009, the Company operated 17 leases within California, 13 of these leases had total annual gross oil production exceeding 1,000 barrels per lease. Production activities primarily consist of the daily pumping of oil from a well(s) into tanks, maintaining the production facilities both at the well and tank settings, preparing and shipping the crude oil to buyers. Daily operations differ from one property to another, depending on the number of wells, the depth of the wells, the gravity of the oil produced and the location of the property. All of Pyramid's oil production is classified as primary recovery production at this time; although certain properties may be conducive to secondary recovery operations in the future, depending on the prevailing price of oil.

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

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

Occasionally, the Company drills new wells or redrills existing wells on

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properties owned by the Company in an attempt to increase oil and gas production. In the last five years, the Company has utilized the services of outside drilling contractors for drilling new wells and redrilling existing wells. Maintenance and repairs of existing wells to maintain or increase oil and gas production are carried out by Company personnel on a continuing basis. Most maintenance and repair work is performed with Company rigs.

Economic factors associated with the price of oil and gas and the productive output of wells determine the number of active wells the Company operates. Under certain economic conditions, the Company has the potential to operate approximately 121 wells, and of these, approximately 56 were in operation during 2009. The Company also owns other oil and gas interests outside of California that it does not operate. These interests are located in Wyoming, Texas and New York.

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MARKETING OF CRUDE OIL AND NATURAL GAS

The Company sells its crude oil to ConocoPhillips and Kern Oil & Refining, accounting for approximately 55% and 42%, respectively, of Pyramid's crude oil and gas sales in 2009. While revenue from these customers is significant, and the loss of any one could have an adverse effect on the Company, it is management's opinion that the oil and gas it produces could be sold to other crude oil purchasers, refineries or pipeline companies. ConocoPhillips, and its predecessors, and Kern Oil have been customers of the Company for over twenty years. Natural gas is sold to companies in the area of operations. The Company sells its oil pursuant to short-term contracts. Accordingly, the amount of oil the Company sells is dependent upon market demand. Market demand for Pyramid's production is subject to various influences and can never be assured, especially in an era of changing prices. The base values for crude oil the Company sells is set by major oil companies in response to area and market strengths and international influences. Types and qualities of crude oil vary substantially in base values posted by crude oil buyers in various areas of the country. Pyramid's crude oil sales are not seasonal, but uniform throughout the year.

COMPETITION AND INDUSTRY CONDITIONS

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

REGULATIONS

The Company's business is affected by numerous governmental laws and regulations, including energy, environmental, conservation, tax and other laws and regulations relating to the petroleum industry. Changes in any of these

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laws and regulations could have a material and adverse effect on the Company's business and financial stability. In view of the many uncertainties with respect to current laws and regulations, including their applicability to the Company, the Company cannot predict the overall effect of such laws and regulations on future operations.

TAXATION

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

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ENVIRONMENTAL

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

COMMITMENTS AND CONTINGENCIES

The Company is liable for future dismantlement and abandonment costs associated with its oil and gas properties. These costs include down-hole plugging and abandonment of wells, future site restoration, post closure and other environmental exit costs. The costs of future dismantlement and abandonment have been accrued and recorded in the financial statements. See Note 7 of Notes to Financial Statements included in Item 8 of this Form 10-K.

OTHER

The Company employed fourteen full-time and two part-time people as of December 31, 2009. Three full-time and two part-time people were office or administrative personnel, and the rest of whom were field personnel. The Company contracts for additional labor services when needed. The Company is not a party to any union or labor contracts.

The Company had no material research and development costs for the three years ended December 31, 2009.

All of the Company's revenues during 2009 were derived from domestic sources.

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

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ITEM 1A - RISK FACTORS

In addition to other information in this annual report, the following risk factors should be carefully considered in evaluating the Company's business because such factors may have a significant impact on the Company's business, operating results, liquidity and financial condition. As a result of the risk factors set forth below, actual results could differ materially from those projected in any forward-looking statements. Additional risks and uncertainties not presently known to us, or that we currently consider to be immaterial, may also impact the Company's business, operating results, liquidity and financial condition. If any such risks occur, the Company's business, operating results, liquidity and financial condition could be materially affected in an adverse manner. Under such circumstances, the trading price of the Company's securities could decline, and you may lose all or part of YOUR INVESTMENT in the Company.

RISKS RELATING TO THE COMPANY'S BUSINESS AND THE OIL AND GAS INDUSTRY

THE COMPANY'S FUTURE PERFORMANCE IS DEPENDENT UPON THE COMPANY'S ABILITY TO CONTINUE TO IDENTIFY, ACQUIRE AND DEVELOP ADDITIONAL OIL AND GAS PROPERTIES, THE FAILURE OF WHICH COULD RESULT IN UNDER USE OF CAPITAL AND LOSSES.

The Company's future performance depends upon the Company's ability to continue to identify, acquire and develop additional oil and gas reserves that are economically recoverable. The Company's success will depend upon the Company's ability to continue to acquire working and revenue interests in properties upon which oil and gas reserves are ultimately discovered in commercial quantities, and the Company's ability to develop additional prospects that contain proven oil and gas reserves to the point of production. The successful acquisition and development of oil and gas properties requires an assessment of recoverable reserves, future oil and gas prices and operating costs, potential environmental and other liabilities, and other factors. Such assessments are necessarily inexact and their accuracy inherently uncertain. In addition, no assurance can be given that the Company's future exploitation and development activities will result in the discovery of additional reserves.

THE COMPANY HAS A VERY SMALL MANAGEMENT TEAM AND THE LOSS OF ANY MEMBER OF THE COMPANY'S TEAM MAY PREVENT US FROM IMPLEMENTING THE COMPANY'S BUSINESS PLAN IN A TIMELY MANNER.

The Company currently has two executive officers and a small number of full time employees and consultants upon whom the Company's success largely depends. We do not maintain key person life insurance policies on the Company's executive officers or consultants, the loss of which could seriously harm the Company's business, financial condition and results of operations. In such an event, we may not be able to recruit personnel to replace the Company's executive officers or consultants in a timely manner, or at all, on acceptable terms.

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THE OIL AND GAS INDUSTRY IS HIGHLY COMPETITIVE, AND THE COMPANY MAY NOT HAVE SUFFICIENT RESOURCES TO COMPETE EFFECTIVELY.

The oil and gas industry is highly competitive. The Company competes with oil and natural gas companies and other individual producers and operators, many of which have substantially greater financial and other resources than the Company. The Company's larger competitors, by reason of their size and relative financial strength, can more easily access capital markets than the Company can and may enjoy a competitive advantage in the recruitment of qualified personnel. Competitors may be able to absorb the burden of any changes in laws and regulations in the jurisdictions in which the Company does business and handle longer periods of reduced prices for oil and gas more easily than we can. The Company's competitors may be able to pay more for oil and gas leases and properties and may be able to define, evaluate, bid for and purchase a greater number of leases and properties than the Company can. Further, these companies may enjoy technological advantages and may be able to implement new technologies more rapidly than the Company can. The Company's ability to acquire additional properties in the future will depend upon the Company's ability to conduct efficient operations, evaluate and select suitable properties, implement advanced technologies and consummate transactions in a highly competitive environment.

THE COMPANY'S EXPLORATION, DEVELOPMENT AND PRODUCTION ACTIVITIES ARE SUBJECT TO CERTAIN ENVIRONMENTAL REGULATIONS WHICH MAY AFFECT THE COMPANY'S COSTS OF OPERATIONS.

In general, the Company's exploration and production activities are subject to certain federal, state and local laws and regulations relating to environmental quality and pollution control. Such laws and regulations increase the costs of these activities and may prevent or delay the commencement or continuance of a given operation. Specifically, the Company is subject to legislation regarding emissions into the environment, water discharges and storage and disposition of hazardous wastes. However, such laws and regulations are frequently changed and any such changes may have material adverse effects on the Company's activities. The Company is unable to predict the ultimate cost of compliance with such laws and regulations. Generally, environmental requirements do not appear to affect the Company any differently or to any greater or lesser extent than other companies in the industry. To date the Company has not been required to spend any material amounts on compliance with environmental regulations. However, the Company may be required to do so in future and this may affect the Company's ability to expand or maintain the Company's operations.

ANY CHANGE TO GOVERNMENT REGULATION/ADMINISTRATIVE PRACTICES MAY HAVE A NEGATIVE IMPACT ON THE COMPANY'S ABILITY TO OPERATE AND THE COMPANY'S PROFITABILITY.

The business of oil and gas exploration and development is subject to substantial regulation under federal, state, local and foreign laws relating to the exploration for, and the development, upgrading, marketing, pricing, taxation, and transportation of oil and gas and related products and other matters. Amendments to current laws and regulations governing operations and

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activities of oil and gas exploration and development operations could have a material adverse impact on the Company's business. In addition, there can be no assurance that income tax laws, royalty regulations and government incentive programs related to the Company's oil and gas properties and the oil and gas industry generally, will not be changed in a manner which may

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adversely affect the Company's progress and cause delays, inability to explore and develop or abandonment of these interests.

Permits, leases, licenses, and approvals are required from a variety of regulatory authorities at various stages of exploration and development. There can be no assurance that the various government permits, leases, licenses and approvals sought will be granted in respect of the Company's activities or, if granted, will not be cancelled or will be renewed upon expiry. There is no assurance that such permits, leases, licenses, and approvals will not contain terms and provisions which may adversely affect the Company's exploration and development activities.

THE COMPANY IS REQUIRED TO REPLACE, MAINTAIN OR EXPAND THE COMPANY'S OIL AND GAS RESERVES IN ORDER TO PREVENT THE COMPANY'S FUTURE RESERVES AND PRODUCTION FROM DECLINING, WHICH WOULD ADVERSELY AFFECT FUTURE CASH FLOWS AND INCOME.

In general, production from oil and gas properties declines over time as reserves are depleted, with the rate of decline depending on reservoir characteristics. The Company's future oil and gas production is highly dependent upon the Company's ability to economically find, develop, acquire and maintain reserves in commercial quantities.

To the extent cash flow from operations is reduced, either by a decrease in prevailing prices for oil and gas or an increase in finding and development costs, and external sources of capital become limited or unavailable, the Company's ability to make the necessary capital investment to maintain or expand the Company's asset base of oil and gas reserves would be impaired. Even with sufficient available capital, the Company's future exploration and development activities may not result in additional proved reserves, and we might not be able to drill productive wells at acceptable costs.

THE OIL AND GAS EXPLORATION AND PRODUCTION INDUSTRY IS HISTORICALLY A CYCLICAL INDUSTRY AND MARKET FLUCTUATIONS IN THE PRICES OF OIL AND GAS COULD ADVERSELY AFFECT THE COMPANY'S BUSINESS.

Prices for oil and gas tend to fluctuate significantly in response to factors beyond the Company's control. These factors include:

- weather conditions in the United States and where the Company's property interests are located;
- economic conditions, including demand for petroleum-based products, in the United States and the rest of the world;
- actions by OPEC, the Organization of Petroleum Exporting Countries; political instability in the Middle East and other major oil and gas producing regions;

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- governmental regulations;
- domestic tax policy;
- the price of foreign imports of oil and gas;
- the cost of exploring for, producing and delivering oil and gas;
- the discovery rate of new oil and gas reserves;
- the rate of decline of existing and new oil and gas reserves;

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- available pipeline and other oil and gas transportation capacity;
- the ability of oil and gas companies to raise capital;
- the overall supply and demand for oil and gas; and
- the availability of alternate fuel sources.

Changes in commodity prices may significantly affect the Company's capital resources, liquidity and expected operating results. Price changes will directly affect revenues and can indirectly impact expected production by changing the amount of funds available to reinvest in exploration and development activities. Reductions in oil and gas prices not only reduce revenues and profits, but could also reduce the quantities of reserves that are commercially recoverable. Significant declines in prices could result in non-cash charges to earnings due to impairment.

Changes in commodity prices may also significantly affect the Company's ability to estimate the value of producing properties for acquisition and divestiture and often cause disruption in the market for oil and gas producing properties, as buyers and sellers have difficulty agreeing on the value of the properties. Price volatility also makes it difficult to budget for and project the return on acquisitions and the development and exploitation of projects. We expect that commodity prices will continue to fluctuate significantly in the future.

EXPLORATORY AND DEVELOPMENTAL DRILLING AND PRODUCTION OPERATIONS INVOLVES MANY RISKS THAT ARE OUTSIDE THE COMPANY'S CONTROL AND WHICH MAY RESULT IN A MATERIAL ADVERSE EFFECT ON THE COMPANY'S BUSINESS, FINANCIAL CONDITION OR RESULTS OF OPERATIONS.

The business of exploring for, developing and producing oil and gas involves a substantial risk of investment loss. Drilling and operating oil and gas wells involves the risk that the wells may be unproductive or that, although productive, the wells may not produce oil or gas in economic quantities. Other hazards, such as unusual or unexpected geological formations, pressures, fires, blowouts, power outages, gas leakage, loss of circulation of drilling fluids or other conditions may substantially delay or prevent completion of any well. Adverse weather conditions can also hinder drilling operations. A productive well may become uneconomic if water or other deleterious substances

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are encountered that impair or prevent the production of oil or gas from the well. In addition, production from any well may be unmarketable if it is impregnated with water or other deleterious substances. There can be no assurance that oil and gas will be economically produced from all properties in which the Company has interests.

AT TIMES THE COMPANY PARTICIPATES IN JOINT VENTURES WHEREIN THE COMPANY IS DEPENDANT UPON THE EFFORTS OF VARIOUS THIRD PARTIES THAT THE COMPANY DOES NOT CONTROL AND, AS A RESULT, THE COMPANY MAY NOT BE ABLE TO CONTROL THE TIMING OF DEVELOPMENT EFFORTS, ASSOCIATED COSTS, OR THE RATE OF PRODUCTION OF RESERVES (IF ANY).

The success of the Company's business interests in certain joint ventures, where the Company owns less than a majority interest depends upon the efforts of various third parties that the Company does not control. As a result, the Company may have limited ability to exercise influence over certain joint venture decisions, operations or costs in certain joint venture activities. The Company's dependence on the operator and, where applicable, other working interest owners for these projects and the Company's limited ability to

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influence operations and associated costs could prevent the Company from realizing targeted returns on capital in drilling or acquisition activities. The success and timing of development and exploitation activities on joint venture properties operated by others depend upon a number of factors that will be largely outside of the Company's control, including:

- the timing and amount of capital expenditures;
- the operator's expertise and financial resources;
- approval of other participants in drilling wells;
- selection of technology;
- the rate of production of the reserves; and
- the availability of suitable drilling rigs, drilling equipment, production and transportation infrastructure, and qualified operating personnel.

The Company relies upon various consultants and service companies to provide us with technical assistance and services. The Company relies upon the services of geologists, geophysicists, chemists, engineers and other scientists to explore and analyze oil and gas prospects to determine a method in which the oil and gas prospects may be developed in a cost-effective manner. Although the Company's management has relationships with a number of third-party service providers, we cannot assure you that we will be able to continue to rely on such consultants or services in the future.

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RISKS RELATED TO THE COMPANY

THE COMPANY'S BY-LAWS CONTAIN PROVISIONS INDEMNIFYING THE COMPANY'S OFFICERS AND DIRECTORS.

The Company's by-laws provide for the indemnification of the Company's directors and officers to the fullest extent legally permissible under the California corporate law against all expenses, liability and loss reasonably incurred or suffered by them in connection with any action, suit or proceeding. Furthermore, the Company's by-laws provide that the Company's board of directors may cause the Company to purchase and maintain insurance for the Company's directors and officers.

THE COMPANY'S BY-LAWS DO NOT CONTAIN ANTI-TAKEOVER PROVISIONS AND THUS THE COMPANY'S MANAGEMENT AND DIRECTORS MAY CHANGE IF THERE IS A TAKE-OVER OF THE COMPANY.

We do not currently have a shareholder rights plan or any anti-takeover provisions in the Company's by-laws. Without any anti-takeover provisions, there is no deterrent for a take-over of the Company. If there is a take-over of the Company, the Company's management and directors may change.

ITEM 1B - UNRESOLVED STAFF COMMENTS

None

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ITEM 2 - PROPERTIES

(a) DESCRIPTION OF PROPERTIES

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

The general business description and the description of the Company's oil and natural gas operations are described on page 5 under Item 1. Business. Information required by Subpart 1200 of Regulation S-K (Disclosure by Registrants Engaged in Oil and Gas Producing Activities) is also contained in Item 1. and in Item 8. Financial Statements and Supplementary Data, Supplemental Information - Oil and Gas Producing Activities is on pages 61 to 66. The preceding information is incorporated by reference into this Item 2.

Developed oil and gas properties are those on which sufficient wells have been drilled to economically recover the estimated reserves calculated for the property. Undeveloped properties do not presently have sufficient wells to recover the estimated reserves. The Company had proved undeveloped reserves of 96,000, 9,500 and 79,600 at January 1, 2009, 2008 and 2007, respectively. The Company had no significant proved undeveloped properties at January 1, 2006, and 2005.

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(b) OIL AND GAS PROPERTIES

The Company's estimated future net recoverable oil and gas reserves from proved reserves, both developed and undeveloped properties, were assembled by MHA Petroleum Consultants, independent petroleum engineers, and are as follows:

| | Crude Oil (BBLs) | Natural Gas (MCF) |
|-----------------|---------------------|----------------------|
| | ----- | ----- |
| January 1, 2010 | 506,000 | 81,000 |
| 2009 | 471,000 | 155,000 |
| 2008 | 806,000 | 331,000 |
| 2007 | 741,000 | 65,000 |
| 2006 | 715,000 | 94,000 |

The Company's estimated future net recoverable oil and gas reserves, noted in the table above, have not been filed with any other Federal authority or agency since January 1, 2009.

Using year-end oil and gas prices and lease operating expenses, the estimated value of future net revenues before income taxes to be derived from Pyramid's proved developed oil and gas reserves, discounted at 10%, were \$9,158,000 at December 31, 2009, \$4,106,000 at December 31, 2008, \$27,414,000 at December 31, 2007, \$12,358,000 at December 31, 2006, and \$12,694,000 at December 31, 2005.

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

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INTERNAL CONTROLS OVER RESERVE ESTIMATION

Our proved reserve information as of December 31, 2009 included in this Annual Report on Form 10-K was estimated by our independent petroleum consultant, MHA Petroleum Consultants, LLC, in accordance with generally accepted petroleum engineering and evaluation principles and definitions and guidelines established by the SEC. For the company's estimation procedures, credentials and statement of independence, see the MHA Petroleum Consultants, LLC, report filed herein on Exhibit 99.1. The technical persons responsible for preparing the reserves estimates presented herein meet the requirements regarding qualifications, independence, objectivity and confidentiality set forth in the Standards Pertaining to the Estimating and Auditing of Oil and Gas Reserves Information promulgated by the Society of Petroleum Engineers. MHA Petroleum Consultants, LLC, and their predecessors have been preparing the Company's reserve information for over twenty years and thus, are very familiar with the Company's operations and their oil and gas properties.

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John H. Alexander, President and Lee Christianson, CFO, provides company data (such as well ownership interests, oil and gas prices, production volumes and well operating costs) to MHA Petroleum Consultants, LLC, and are the primary Company employees responsible for reviewing MHA Petroleum Consultants, LLC, use of our data and MHA Petroleum Consultants, LLC, estimation of our reserves. Mr. Alexander and an employee who is a petroleum engineer provide MHA Petroleum Consultants, LLC, with technical data (such as well logs, geological information and well histories). Mr. Alexander and Mr. Christianson have been with the Company for over twenty years. Mr. Alexander has over forty years experience in the oil and gas exploration and production industry.

John Alexander and Lee Christianson review the preliminary MHA Petroleum Consultants, LLC, reserve estimates and the financial inputs in the estimates. Mr. Christianson, CFO, calculates the disclosed changes in reserve estimates and the disclosed changes in the Standardized Measure relating to proved oil and gas reserves. Mr. Christianson has over thirty years experience in oil and gas accounting.

Our company codes of business conduct and ethics are general internal controls for preventing and detecting errors or fraud by our employees responsible for the reserve estimation procedures and disclosure in our filings with the SEC.

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

| | 2009 | 2008 | 2007 | 2006 | 2005 |
|-------------------|--------|--------|--------|--------|--------|
| | ---- | ---- | ---- | ---- | ---- |
| Crude oil (Bbls) | 57,000 | 65,000 | 67,000 | 66,000 | 71,000 |
| Natural gas (MCF) | 5,000 | 5,000 | 5,000 | 7,000 | 7,000 |

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

| | 2009 | 2008 | 2007 | 2006 | 2005 |
|------------------|---------|---------|---------|---------|---------|
| | ---- | ---- | ---- | ---- | ---- |
| Sales price: | | | | | |
| Crude oil | \$57.16 | \$93.47 | \$67.83 | \$58.88 | \$47.96 |
| | ===== | ===== | ===== | ===== | ===== |
| Natural gas | \$ 4.02 | \$ 7.94 | \$ 7.16 | \$ 7.28 | \$ 6.77 |
| | ===== | ===== | ===== | ===== | ===== |
| Production costs | \$24.20 | \$27.20 | \$24.00 | \$22.80 | \$19.30 |
| | ===== | ===== | ===== | ===== | ===== |

The average selling price of the Company's crude oil at December 31, 2009, was approximately \$71.88 per barrel and the average selling price of the Company's natural gas at December 31, 2009, was approximately \$4.50 per MCF.

As of December 31, 2009, Pyramid had the following gross and net position in wells and proved acres:

| WELLS | | PROVED ACRES | |
|-----------|---------|--------------|---------|
| ----- | ----- | ----- | ----- |
| Gross (1) | Net (1) | Gross (2) | Net (2) |
| ----- | ----- | ----- | ----- |
| 148 | 132 | 21,387 | 5,844 |
| === | === | ===== | ===== |

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

(2) "Gross acreage" represents all acres in which the Company has a working interest. "Net acres" represents the aggregate of the working interests of the Company in the gross acres.

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The Company drilled one well in 2008 on the Santa Fe lease. The Company also participated as a non-operator, along with a group of partners, in the drilling of two natural gas wells in Texas, one each in 2008 and 2009. The Company drilled two wells in 2007 on the Anderson lease. The Company drilled four new wells in 2006, two on the Santa Fe lease, one on the Anderson lease

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and one joint-venture well. The Company participated with one other oil company as non-operator in the drilling of the joint venture well in 2006. No wells were drilled in 2005.

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

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

As of December 31, 2009, Pyramid held positions in unproven acreage in the following locations:

| | ACRES | |
|--------------------------------------|--------|-------|
| | Gross | Net |
| New York | | |
| Mount Morris and Livingston Counties | 34,800 | 9,788 |
| Texas | | |
| McMullen County | 5,700 | 713 |

(c) REAL PROPERTY OWNED

Pyramid owned the following real property as of December 31, 2009, all located in California.

| | |
|---------------------|-----------|
| County of Kern | |
| Mullaney yard | 20 acres |
| Miller property | 112 acres |
| Ranton property | 80 acres |
| City of Bakersfield | 3 lots |

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

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ITEM 3 - LEGAL PROCEEDINGS

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

ITEM 4 - (REMOVED AND RESERVED)

PART II

ITEM 5 - MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

(a) PRICE RANGE OF COMMON SHARES

The common stock of Pyramid is traded on the NYSE Amex under the symbol "PDO". The following are high and low sales prices for each quarter of 2009 and 2008, and reflect inter-dealer prices without retail markup, markdown or commission.

| | High ---- | Low ----- |
|----------------------------|--------------|--------------|
| Fiscal Quarter Ending 2009 | | |
| March 31, | \$ 6.3100 | \$2.8000 |
| June 30, | 9.5000 | 3.4718 |
| September 30, | 6.1600 | 4.2000 |
| December 31, | 6.3900 | 4.3500 |
| Fiscal Quarter Ending 2008 | | |
| March 31, | 3.9500 | 3.1000 |
| June 30, | 46.0000 | 3.2000 |
| September 30, | 38.2000 | 5.7000 |
| December 31, | 6.5000 | 2.7100 |

At December 31, 2009, the Company had 243 shareholders of record, and an unknown number of additional holders whose stock is held in "street name".

The Company did not repurchase any securities during 2009, or issue any securities during 2009 that were not registered under the Securities Act of 1933.

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On June 5, 2008, the Company's Board of Directors approved a 5 for 4 stock split payable on July 3, 2008, to shareholders of record as of June 24, 2008. The effective date of the split is July 7, 2008.

ITEM 6 - SELECTED FINANCIAL DATA

The following selected financial data is not necessarily indicative of our

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future financial position or results of future operations, and should be read in conjunction with Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations and the Financial Statements and Notes thereto included in Item 8, Financial Statements and Supplementary Data of this Annual Report on Form 10-K.

| | Years Ended December 31, | | | | |
|---|--------------------------------------|---------|---------|---------|---------|
| | (In thousands except per share data) | | | | |
| | 2009 | 2008 | 2007 | 2006 | 2005 |
| | ---- | ---- | ---- | ---- | ---- |
| STATEMENT OF OPERATIONS DATA | | | | | |
| Total Revenue | \$3,312 | \$6,611 | \$4,945 | \$3,958 | \$3,761 |
| Income from Operations | (537) | 1,094 | 1,767 | 923 | 1,087 |
| Net Income | (189) | 1,514 | 1,495 | 949 | 1,089 |
| Net Income per Share | | | | | |
| Basic and Diluted | (\$0.04) | \$0.32 | \$0.32 | \$0.20 | \$0.23 |
| Weighted Average Number of Shares Outstanding | | | | | |
| Basic and Diluted | 4,678 | 4,678 | 4,678 | 4,678 | 4,678 |
| BALANCE SHEET DATA | | | | | |
| Cash and Cash Equivalents | \$1,439 | \$1,794 | \$ 618 | \$ 619 | \$1,333 |
| Short-term Investments | 3,344 | 2,789 | 1,479 | 1,451 | 1,409 |
| Total Assets | 10,142 | 10,277 | 8,460 | 6,696 | 5,907 |
| Notes Payable | 21 | 45 | 71 | 37 | 64 |
| Stockholders' Equity | 8,373 | 8,352 | 6,604 | 5,109 | 4,160 |
| Total Liabilities and Stockholders' Equity | 10,142 | 10,277 | 8,460 | 6,696 | 5,907 |
| PER SHARE DATA | | | | | |
| Net Book Value per | | | | | |
| Common Share | \$1.79 | \$1.79 | \$1.41 | \$1.09 | \$0.89 |
| Common Shares Outstanding | 4,678 | 4,678 | 4,678 | 4,678 | 4,678 |

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ITEM 7 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

IMPACT OF CHANGING PRICES

Average prices decreased by approximately \$36.40 per equivalent crude oil and gas barrel sold during 2009 as compared with average prices for 2008. In 2009 there were 247 separate crude oil price changes, as compared with 250 price changes in 2008. The difference between the highest (\$78.70) and lowest (\$27.85) posted prices in 2009 was \$50.85 per barrel. By comparison, this same differential in 2008 was \$111.45 per barrel.

LIQUIDITY AND CAPITAL RESOURCES

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The Company had cash and short-term investments of \$4,783,000 at December 31, 2009, for a net increase of \$200,000, when compared to December 31, 2008. Short-term investments consist of certificates of deposit having original maturities of three months or more. Operating activities generated cash of \$573,000 during 2009. During 2009, cash was consumed by purchase of short-term investments of \$500,000, capital spending of \$348,000 and principal payments on the Company's long-term debt totaling \$24,000. The components of the changes in cash for 2009 are described in the Statements of Cash Flows included in Item 8 of this Form 10-K. Adequate funds were available to carry out all necessary oil and gas operations and to maintain its equipment. A \$500,000 line of credit, unused at December 31, 2009, also provided additional liquidity during 2009.

The Company believes that its existing current assets and the amount of cash it anticipates it will generate from current operations will be sufficient to fund the anticipated liquidity and capital resource needs of the Company for the fiscal year ended December 31, 2009. In addition to its current assets, the Company also has a credit facility for \$500,000 available in the event that it needs other resources to fund its liquidity and capital resource needs. Although the Company may increase its capital expenditures during the current fiscal year to enhance its current oil production capacities, it does not anticipate that such expenditures would exceed the amount of liquidity currently available to the Company. The Company's beliefs that its existing assets and the cash expected to be generated from operations will be sufficient during the current fiscal year are based on the following:

As of December 31, 2009, the amount of cash, cash equivalents, and short term investments was equal to \$4,783,000 in the aggregate.

As of December 31, 2009, the Company had approximately \$5,712,000 in current assets, and only \$576,000 of current liabilities.

As of December 31, 2009, the Company had no long-term indebtedness (net of current maturities).

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

The Company participated as a non-operator in the drilling of a natural gas well in Texas during 2009. The Company drilled two wells in the years ended December 31, 2008 and 2007. The Company drilled four wells in the year ended December 31, 2006. No wells were drilled in 2005. One of the wells drilled in 2006 was an exploratory well which was abandoned due to non-economic production of crude oil.

The Company's proved developed producing crude oil reserves decreased by 63,000 barrels at December 31, 2009. The decrease is due primarily to production of approximately 57,000 barrels of crude oil during 2009. The remaining decline of 6,000 barrels in the reserves is due to revisions of previous estimates. The Company did not drill any crude oil wells during

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2009.

The Company's proved developed producing natural gas reserves decreased by 56,000 MCF's at December 31, 2009. The decrease is due primarily to revisions of previous estimates. The estimates of gas reserves for the Texas gas prospect decreased by approximately 40,000 MCF's due to unfavorable production results from a gas well that was drilled in 2008 by the Texas joint venture.

The Company's crude oil reserves for the year ended December 31, 2008 decreased due primarily to a decrease in crude oil sales prices. Proved developed producing crude oil reserves decreased by 213,000 barrels at December 31, 2008. The crude oil prices at the end of a given year are one of the most significant factors used to determine the value of crude oil reserves. The average prices at December 31, 2008 declined by approximately \$53.00 per barrel compared with the average prices at December 31, 2007. Based on these prices, many of the Company's leases were uneconomic and no reserves were attributed to these leases.

The Company's crude oil reserves for the year ended December 31, 2007 increased due primarily to revision of previous estimates. The drilling of two new wells in 2007 and higher average crude oil prices at December 31, 2007, combined to generate higher year-end reserves of proved developed producing properties. Proved developed producing crude oil reserves increased by 120,600 barrels at December 31, 2007.

The Company's gas reserves increased by approximately 267,000 MCF's for the year ended December 31, 2007. The increase is due to the Company's investment in a joint venture gas prospect in Texas.

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The Company's crude oil reserves for the year ended December 31, 2006 increased due primarily to the drilling of four wells in 2006. The Company's crude oil reserves for the year ended December 31, 2005 increased due primarily to the recognition of proved developed non-producing and proved undeveloped reserves as a result of the review of the Company's geological data by independent petroleum engineers.

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

FORWARD-LOOKING INFORMATION

Looking forward into 2010, crude oil prices have increased by approximately ninety cents per barrel as of March 26, 2010, compared to prices at December 31, 2009. There have been 56 separate price changes since December 31, 2009.

In January 2010, the Company successfully drilled a new well on its Anderson property in the Carneros Creek field, located in Kern County, California. The well was drilled to approximately 3,300 feet, logged, and completed by running

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casing. In late February, a small portion of the Point of Rocks formation in this well was hydraulically fractured with the injection of crude oil and sand. The well's oil production after recovery of all treating fluids has been in the range of 25 barrels of oil per day.

During December of 2009, Union Gas Company of Houston Texas commenced field operations on the Company's Texas Joint Venture Farmout. The original joint venture well, the Murray Franklin Estate #1, was horizontally re-drilled into the Eagleford formation at a depth of approximately 4,500 feet. The well was stimulated with a multi-stage hydraulic frac, and testing began in mid-March. As of this writing, no specific production results were available.

In the fourth quarter of 2009, management began an extensive review of a number of the Company's properties located in Kern, County. Management hired a highly regarded independent geologist to help identify and target new prospects on existing leases, as management seeks to increase production. Several prospects were initially identified and management has chosen one of these for drilling a new well utilizing horizontal technology. Current plans call for drilling operations to begin during the second week of April. Drilling results will be announced following completion and testing operations.

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In addition to this specific drilling prospect, the geological review is progressing on various other properties the Company owns. Several other prospects on existing properties have been identified during the review, and management is in the process of evaluating their economics. Management plans to continue with drilling several additional wells during the current year.

The Company continues to seek and evaluate opportunities within the energy sector, to enhance the value of the Company. The Company's growth in 2009 will be highly dependant on the amount of success the Company has in its operations and capital investments, including the outcome of wells that have not yet been drilled. The Company's capital investment program may be modified during the year due to exploration and development successes or failures, market conditions and other variables. The production and sales of oil and gas involves many complex processes that are subject to numerous uncertainties, including reservoir risk, mechanical failures, human error and market conditions.

The Company has positioned itself, over the past several years, to withstand various types of economic uncertainties, with a program of consolidating operations on certain producing properties and concentrating on properties that provide the major revenue sources. The drilling of a new well and several limited work-overs of certain wells have allowed the Company to maintain its crude oil reserves for the last three years. The Company expects to maintain its reserve base in 2009, by drilling new wells and routine maintenance of its existing wells.

The Company may be subject to future costs necessary for compliance with the new implementation of air and water environmental quality requirements of the various state and federal governmental agencies. The requirements and costs are unknown at this time, but management believes that costs could be significant in some cases. As the scope of the requirements become more clearly defined, management may be better equipped to determine the true costs to the Company.

The Company continues to absorb the costs for various state and local fees and permits under new environmental programs, the sum of which were not material during 2008. The Company retains outside consultants to assist the Company in maintaining compliance with these regulations. The Company is actively

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pursuing an ongoing policy of upgrading and restoring older properties to comply with current and proposed environmental regulations. The costs of upgrading and restoring older properties to comply with environmental regulations have not been determined. Management believes that these costs will not have a material adverse effect upon its financial position or results of operations.

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ANALYSIS OF SIGNIFICANT CHANGES IN RESULTS OF OPERATIONS

RESULTS OF OPERATIONS FOR THE FISCAL YEAR ENDED DECEMBER 31, 2009
COMPARED TO THE FISCAL YEAR ENDED DECEMBER 31, 2008

REVENUES

OIL AND GAS SALES

The decrease in revenues of \$3,298,733 is due primarily to lower average prices combined with lower crude oil production/sales for 2009. Oil and gas sales decreased by 50% for the year ended December 31, 2009, when compared with the same period for 2008. The average price of the Company's oil and gas decreased by approximately \$36.40 per equivalent barrel for 2009 when compared to 2008. Crude oil production/sales decreased by approximately 12,600 barrels. The decrease in crude oil production is primarily the result of the decline in production on the Company's Anderson and Santa Fe leases.

OPERATING EXPENSES

Operating expenses decreased by \$530,167 for the year ended December 31, 2009, when compared with the same period for 2008. Operating expenses decreased by 27% for the year ended December 31, 2009. The cost to produce an equivalent barrel of crude oil during 2009 was approximately \$24.21 per barrel, a decrease of approximately \$3.03 per barrel when compared with production costs for 2008. The decrease in lease operating expenses is caused by many factors. These include lower costs for labor, parts and supplies, pump repairs, equipment rental and equipment fuel. The Company has reduced its maintenance activities as a result of the lower crude oil sales prices.

Company labor as a component of total operating expenses decreased by approximately 8% due to a reduction in overtime hours worked, a reduction in hourly labor rates, a reduction in personnel and a reduction in bonuses paid. Parts and supplies as a component of total operating expenses decreased by approximately 6% due to a reduction in maintenance activities. Pump repairs as a component of total operating expenses were lower by approximately 3% due to the decline in maintenance work during 2009 and the replacement of down-hole pumps in prior years with more expensive pumps that are more efficient and have better longevity. Equipment rental costs as a component of total operating expenses were lower by approximately 3% during 2009 due to the discontinuance of the rental of crude oil storage tanks for the Santa Fe and Anderson leases. Equipment fuel as a component of total operating expenses

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was lower by approximately 3% due to lower overall maintenance activities and lower prices for gasoline and diesel during 2009.

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GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses decreased by \$77,114 for the year ended December 31, 2009 when compared with the same period of 2008. Accounting services decreased by approximately \$54,400 due primarily to lower costs incurred for SOX-404 internal control compliance and tax related matters.

PROVISION FOR DEPLETION, DEPRECIATION AND AMORTIZATION

The provision for depletion, depreciation and amortization decreased by \$304,430 for the twelve months ended December 31, 2009, when compared with the same period for 2008. The decrease is due primarily to a decrease in depletion of the Company's oil and gas properties in the amount of \$318,202. The decrease in depletion is due to a decrease in crude oil production for 2009 and a decrease in the depletable base due to the write-down of certain oil and properties in 2008.

VALUATION ALLOWANCES

Valuation allowance expense decreased by \$803,622 for the twelve months ended December 31, 2009, when compared with the same period for 2008. At December 31, 2008, the valuation of the Company's oil and gas properties declined due primarily to lower crude oil prices. During 2009, crude oil prices have increased and this has been reflected in higher valuations of the Company's oil and gas properties at December 31, 2009.

RESULTS OF OPERATIONS FOR THE FISCAL YEAR ENDED DECEMBER 31, 2008 COMPARED TO THE FISCAL YEAR ENDED DECEMBER 31, 2007

REVENUES

OIL AND GAS SALES

Oil and gas sales increased by 47% for the year ended December 31, 2008, when compared with the same period for 2007. The increase in revenues of \$2,107,773 is due primarily to higher average prices for 2008. The average price of the Company's oil and gas increased by approximately \$26.16 per equivalent barrel for 2008 when compared to 2007. Crude oil production/sales increased by approximately 3,800 barrels due primarily to the fracturing of three wells in the first quarter of 2008 and increased production on wells that were drilled in 2007.

OPERATING EXPENSES

Operating expenses increased by 20% for the year ended December 31, 2008, when compared with the same period of 2007. The cost to produce an equivalent barrel of crude oil increased by approximately \$3.25 per barrel for 2008 when compared to 2007, for a total cost of approximately \$27.24 per equivalent barrel. The increase in operating expenses of approximately \$321,000 was due to many factors. These include higher costs for labor, down-hole pump repairs, equipment fuel, parts and supplies, equipment rental and insurance.

The increase in operating expenses is due primarily to the following (each as a component of total operating costs):

Labor costs increased by 6% due primarily to an increase in the number of field employees.

Down-hole pump repairs increased by approximately 4% due to the replacement of down-hole pumps with more expensive pumps that are more efficient and have better longevity.

Equipment fuel increased by approximately 2% due primarily to the increased per unit costs of gasoline and diesel fuel during 2008.

Repair and maintenance parts and supplies increased by approximately 2% due to increased levels of repair and maintenance activities.

Equipment rental increased by approximately 2% due primarily to the rental of crude oil storage tanks for the new wells that were drilled in 2007 and 2008 on the Anderson and Santa Fe leases. The Company also rented crude oil storage tanks for the three wells that were fraced in the first quarter of 2008.

Insurance costs increased by approximately 1.5% due primarily to higher premiums for health insurance and workers' compensation insurance.

EXPLORATION COSTS

In the first quarter of 2008, the Company received a payment, from its joint venture partner, in the amount of \$28,812 for its share of certain tangible completion equipment on an exploratory well that had been abandoned in 2006.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses increased by approximately 17% for the year ended December 31, 2008, when compared with the same period for 2007. The increase in General and administrative expenses of \$144,045 is due primarily to the following factors:

Legal fees increased by approximately 6%, as a component of total administrative expense, due to services that were rendered for the stock split that was declared on June 5, 2008 (see footnote 11), increased costs for compliance with SEC filings and general corporate matters.

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Compensation costs, as a component of total administrative expenses, increased by 5% due to a number of factors. Compensation costs increased due to the following: an increase in annual salaries that was effective June 1, 2008; an increase in bonuses for 2008 when compared with 2007; and the hiring of a part-time employee that was effective July 1, 2007.

Accounting services increased by 3%, as a component of total administrative expenses, due primarily to continuing compliance costs associated with Sarbanes-Oxley.

PROVISION FOR DEPLETION, DEPRECIATION AND AMORTIZATION

The provision for depletion, depreciation and amortization increased by \$483,364 for the year ended December 31, 2008, when compared with the same period for 2007. The increase is due to an increase of approximately \$274,000 in the depletion of the Company's oil and gas properties and an increase of \$202,000 in the amortization of the leaseholds on the Company's Texas gas prospect.

VALUATION ALLOWANCES

Valuation allowances increased by \$1,159,055 for the twelve months ended December 31, 2008, when compared with the same period for 2007. At December 31, 2008, the valuation of the Company's oil and gas properties declined due primarily to lower crude oil prices resulting in the write-down of certain properties to the value of their estimated discounted cash flows.

ACCRETION EXPENSE

The increase in accretion expense of \$46,697 for the year ended December 31, 2008, is due primarily to an increase in the Company's liability for asset retirement obligations (ARO). The adjustment to the ARO is due to an increase in the estimated costs associated with the retirement of its oil and gas properties.

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OTHER COSTS AND EXPENSES

Other costs and expenses increased by approximately \$91,000 for the year ended December 31, 2008, when compared with the same period for 2007. The increase is due to the retention of an investor relations consultant at a monthly fee of \$5,000 that was effective March 12, 2008 (see footnote 16). The remaining increase in costs is due to an increase in the annual listing fees for the NYSE AMEX and the payment of a one-time fee to the NYSE AMEX for the stock split that was declared on June 5, 2008 (see footnote 11).

CRITICAL ACCOUNTING POLICIES

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COSTS INCURRED IN OIL AND GAS PRODUCING ACTIVITIES

The Company has adopted the "successful efforts" method of accounting for its oil and gas exploration and development activities, as set forth in FASB ASC Topic No. 932.

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

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

The Company adopted the Financial Accounting Standards Board Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of" (the Statement). The Statement specifies when an impairment loss should be recognized and how impairment losses should be measured for long-lived assets to be held and used and for long-lived assets to be disposed of. In accordance with the Statement, the costs of proved oil and gas properties and equipment are periodically assessed on a lease by lease basis to determine if such costs exceed undiscounted future cash flows, and if conditions warrant an

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impairment reserve will be provided based on the estimated future discounted cash flows. The Company recorded an impairment reserve of \$358,757 and \$1,162,379 at December 31, 2009 and 2008, respectively (see Note 6 of Notes to Financial Statements included in Item 8 of this Form 10-K). The accumulated impairment reserve was \$2,769,430 and \$2,410,673 at December 31, 2009 and 2008, respectively.

DEPLETION, DEPRECIATION, AND AMORTIZATION

Depletion of leasehold costs of producing oil and gas properties is provided on the unit-of-production method, by individual property unit, based on estimated recoverable proved reserves. Depreciation and amortization of the costs of producing wells and related equipment are provided on the unit-of-production method, by individual property unit, based on estimated recoverable proved developed reserves. Amortization of the costs of undeveloped oil and gas properties is based on the Company's experience, giving consideration to the holding periods of leaseholds. The average depletion per equivalent barrel of crude oil produced for 2009, 2008 and 2007 were \$14.97, \$27.86 and \$5.03, respectively.

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

RECENT ACCOUNTING PRONOUNCEMENTS

In January 2010, the FASB issued ASU 2010-06, Improving Disclosures about Fair Value Measurements, which provides amendments to the FASB ASC Subtopic 820-10 that require new disclosures regarding (I) transfers in and out of Level 1 and Level 2 fair value measurements and (ii) activity in Level 3 fair value measurements. ASU 2010-06 also clarifies existing disclosures regarding (I) the level of asset and liability disaggregation and (ii) fair value measurement inputs and valuation techniques. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. We are currently evaluating the disclosure impact of adoption on our consolidated financial statements.

In October 2009, the FASB issued ASU No. 2009-13, Multiple-Deliverable Revenue Arrangements (ASU 2009-13). ASU 2009-13 provides guidance for arrangements with multiple deliverables. Specifically, the updated accounting standard requires an entity to allocate arrangement consideration at the inception of an arrangement to all of its deliverables based on their relative selling prices. ASU 2009-13 also eliminates the residual method of allocation and requires use of the relative-selling-price method in all circumstances in

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