

HALLADOR PETROLEUM CO
Form 10QSB
November 20, 2006

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

FORM 10-QSB

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

For the quarterly period ended September 30, 2006

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

Commission File Number 0-14731

Hallador Petroleum Company

(Name of Small Business Issuer as Specified in Its Charter)

Colorado
(State or Other Jurisdiction of incorporation or
Organization)

84-1014610
(I.R.S. Employer Identification No.)

1660 Lincoln St., #2700, Denver, Colorado
(Address of Principal Executive Offices)

80264-2701
(Zip Code)

(303) 839-5504 fax: (303) 832-3013

(Issuer's Telephone Number, Including Area Code)

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

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

Shares outstanding as of November 20, 2006: 12,168,135

Transitional Small Business Disclosure Format: Yes No

PART 1 - FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS****Consolidated Balance Sheet**

September 30, 2006

(in thousands)

ASSETS

Current assets:

| | | |
|---|----|---------|
| Cash and cash equivalents | \$ | 12,125 |
| Accounts receivable: | | |
| Oil and gas sales | | 691 |
| Well operations | | 353 |
| Income taxes | | 350 |
| Prepaid expenses | | 89 |
| Total current assets | | 13,608 |
| Oil and gas properties, at cost (successful efforts): | | |
| Unproved properties | | 289 |
| Proved properties | | 2,401 |
| Less - accumulated depreciation, depletion, amortization and impairment | | (1,814) |
| | | 876 |
| Coal properties, at cost: | | |
| Underground equipment | | 7,621 |
| Surface equipment | | 7,588 |
| Mine acquisition and development | | 24,182 |
| Less - accumulated depreciation, depletion, amortization and impairment | | (170) |
| | | 39,221 |
| Investment in Savoy | | 4,124 |
| Advance royalties | | 150 |
| Other assets | | 366 |
| | | 4,640 |
| | \$ | 58,345 |

Consolidated Balance Sheet

September 30, 2006

(in thousands)

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:

| | | |
|--|----|-------|
| Current portion of long-term debt | \$ | 495 |
| Accounts payable and accrued liabilities | | 2,226 |
| Oil and gas sales payable | | 1,061 |
| Asset retirement obligation | | 313 |
| Current portion of contract termination obligation | | 92 |
| Total current liabilities | | 4,187 |

Long-term liabilities:

| | | |
|--|--|--------|
| Long-term debt | | 22,543 |
| Asset retirement obligation | | 595 |
| Long-term portion of contract termination obligation | | 3,873 |
| | | 27,011 |

| | | |
|-------------------|--|--------|
| Total liabilities | | 31,198 |
|-------------------|--|--------|

Commitments and Contingencies

Stockholders' equity:

| | | |
|--|----|---------|
| Preferred stock, \$.10 par value; 10,000,000 shares authorized; none issued | | - |
| Common stock, \$.01 par value; 100,000,000 shares authorized, 12,168,135 shares issued | | 121 |
| Additional paid-in capital | | 29,520 |
| Accumulated deficit | | (2,494) |
| | | 27,147 |
| | \$ | 58,345 |

See accompanying notes.

Consolidated Statement of Operations
(in thousands, except per share amounts)

| | Nine months ended September 30, | | Three months ended September 30, | |
|--|------------------------------------|---------|-------------------------------------|-----------|
| | 2006 | 2005 | 2006 | 2005 |
| Revenue: | | | | |
| Gas | \$ 673 | \$ 667 | \$ 202 | \$ 245 |
| Oil | 65 | 73 | 27 | 28 |
| Equity income-Savoy | 415 | - | 28 | - |
| Interest | 663 | 414 | 226 | 132 |
| Property sale - Albany Shale | 362 | - | - | - |
| | 2,178 | 1,154 | 483 | 405 |
| Costs and expenses: | | | | |
| Lease operating | 144 | 157 | 44 | 58 |
| Exploration expenses | 31 | 38 | 4 | - |
| Impairment of unproved properties | - | 183 | - | 169 |
| Depreciation, depletion and amortization | 41 | 30 | 13 | 11 |
| G&A | 1,094 | 411 | 312 | 116 |
| G&A - Sunrise | 227 | - | 227 | - |
| Aborted reorganization/merger costs | 137 | - | - | - |
| Interest | 233 | - | 233 | - |
| Other | 150 | 139 | 54 | 36 |
| | 2,057 | 958 | 887 | 390 |
| Income (loss) from continuing operations before taxes | 121 | 196 | (404) | 15 |
| Income taxes | 125 | (90) | 320 | (6) |
| Income (loss) from continuing operations | 246 | 106 | (84) | 9 |
| Loss on sale of discontinued operations | - | (146) | - | (170) |
| Net income (loss) | \$ 246 | \$ (40) | \$ (84) | \$ (161) |
| Basic and diluted income (loss) per share: | | | | |
| Continuing operations | \$.02 | \$ 0.02 | \$ (0.01) | \$ - |
| Discontinued operations | - | (0.02) | - | (0.02) |
| Net income (loss) per share | \$.02 | \$ 0.00 | \$ (0.01) | \$ (0.02) |
| Weighted average shares outstanding-basic and diluted | 11,562 | 7,093 | 12,168 | 7,093 |

See accompanying notes.

Consolidated Statement of Cash Flows
(in thousands)

| | Nine months ended September 30, | |
|---|---------------------------------|-----------|
| | 2006 | 2005 |
| Net cash provided by (used in) operating activities: | \$ (882) | \$ 264 |
| Cash flows from investing activities: | | |
| E&B note receivable | - | 3,538 |
| Acquisition of Sunrise Coal, net of acquired cash of \$1,892 | (5,828) | - |
| Properties | (4,312) | (3,614) |
| Prospect sales | 3,394 | - |
| Distributions from Savoy | 518 | - |
| Investment in COALition | - | (326) |
| Decrease in bonds | - | 252 |
| Other | (26) | (14) |
| Net cash used in investing activities | (6,254) | (164) |
| Cash flows from financing activities: | | |
| Stock sale to related party | 7,000 | - |
| Repurchase of partnership options | - | (407) |
| Distribution to limited partners | - | (8,081) |
| Net cash provided by (used in) financing activities | 7,000 | (8,488) |
| Net decrease in cash and cash equivalents | (136) | (8,388) |
| Cash and cash equivalents, beginning of period | 12,261 | 19,927 |
| Cash and cash equivalents, end of period | \$ 12,125 | \$ 11,539 |
| Supplemental disclosures of cash flow information: | | |
| Cash paid during the period for interest (net of amount capitalized) | \$ 190 | \$ - |
| Income taxes | \$ 432 | \$ - |
| Supplemental schedule of non-cash investing and financing activities: | | |
| Non-cash property additions | \$ 170 | \$ - |

See accompanying notes.

Notes to Financial Statements

1. General

The interim financial data is unaudited; however, in our opinion, it includes all adjustments, consisting only of normal recurring adjustments necessary for a fair statement of the results for the interim periods. The financial statements included herein have been prepared pursuant to the SEC's rules and regulations; accordingly, certain information and footnote disclosures normally included in GAAP financial statements have been condensed or omitted.

Our organization and business, the accounting policies we follow and other information, excluding those of Sunrise Coal, LLC that are provided hereinafter, are contained in the notes to our financial statements filed as part of our 2005 Form 10-KSB. This quarterly report should be read in conjunction with that annual report.

2. Summary of Significant Accounting Policies

Consolidation

The consolidated financial statements include the accounts of Hallador Petroleum Company (the Company) and its majority-owned subsidiary Sunrise Coal, LLC (Sunrise), and Sunrise's wholly-owned subsidiary Devers Drilling Company, LLC (Devers). Devers renders services solely to its parent company Sunrise, and does not render services for any unrelated third party. Intercompany accounts and transactions have been eliminated in consolidation.

Accounting estimates

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

Cash and cash equivalents

Cash and cash equivalents are stated at cost. Cash equivalents consist of highly-liquid investments with an original maturity of three months or less when purchased.

Inventories

Coal and supplies inventories are valued at the lower of average cost or market. Coal inventory costs include labor, supplies, equipment costs and overhead. The Company had no coal production and related inventories as of and for the period ended September 30, 2006.

Advance royalties

Rights to develop leased coal lands may require payments of advance royalties. When those advance royalties may be recouped through future production, the payments are reflected as current or long-term assets, depending on the expected recovery period. As coal is produced, the payments are statutorily amortized and reflected as cost of coal sales in the consolidated statements of operations.

Property, plant and equipment

Property, plant and equipment are recorded at cost. Interest costs applicable to major asset additions are capitalized during the construction period. Expenditures that extend the useful lives of existing property, plant and equipment or increase the productivity of the assets are capitalized. The cost of maintenance and repairs that do not extend the useful lives or increase the productivity of the assets are expensed as incurred. Property, plant and equipment are depreciated using the units-of-production method over the estimated recoverable reserves.

If facts and circumstances suggest that a long-lived asset may be impaired, the carrying value is reviewed for recoverability. If this review indicates that the carrying value of the asset will not be recoverable through estimated undiscounted future net cash flows related to the asset over its remaining life, then an impairment loss is recognized by reducing the carrying value of the asset to its estimated fair value.

For the period from July 31, 2006 (date of acquisition) through September 30, 2006, Sunrise capitalized \$133,000 of interest.

Deferred mine development

Costs of developing new coal mines, including asset retirement obligation assets, or significantly expanding the capacity of existing mines, are capitalized and amortized using the units-of-production method over estimated recoverable (proved and probable) reserves.

Coal land and mineral rights

Certain of the Sunrise's coal reserves were obtained through leases. The cost of those leases is capitalized and depleted using the units-of-production method over estimated recoverable (proved and probable) reserves.

Asset retirement obligations

At the time they are incurred, legal obligations associated with the retirement of long-lived assets are reflected at their estimated fair value, with a corresponding charge to asset retirement obligation assets. Obligations are typically incurred when Sunrise commences development of either underground or surface mines, and include reclamation of support facilities, refuse areas and slurry ponds.

Obligations are reflected at the present value of their discounted cash flows. Sunrise reflects accretion of the obligations for the period from the date they are incurred through the date they are extinguished. The asset retirement obligation assets are amortized using the units-of-production method over estimated recoverable (proved and probable) reserves.

Sunrise's asset retirement obligations arise from the federal Surface Mining Control and Reclamation Act of 1977 (SMCRA) and similar state statutes. SMCRA and states require that mines be reclaimed to their previous condition in accordance with specific standards and approved reclamation plans, as outlined in mining permits. Activities include reclamation of pit and support acreage at surface mines, sealing portals at underground mines, and reclamation of refuse areas and slurry ponds.

Sunrise assesses its asset retirement obligations at least annually, and reflects revisions for permit changes, as granted by state authorities, for revisions to the estimated reclamation costs, and for revisions to the timing of those costs.

The following table reflects the changes to the Sunrise's asset retirement obligations:

| | | |
|--|----|-------|
| Balance, July 31, 2006 (date of Sunrise Acquisition) | \$ | 1,186 |
| Additions | | - |
| Accretion | | 6 |
| Settlements | | (284) |
| Revisions to previous estimates | | - |
| Balance, September 30, 2006 | \$ | 908 |
| Current | \$ | 313 |
| Long-term | | 595 |
| | \$ | 908 |

Fair Value of Financial Instruments

Cash and cash equivalents - the carrying amounts approximate fair value.

Debt - the carrying amounts approximate fair value.

3. Risk Concentrations

Credit Risk

Financial instruments that potentially subject the company to concentrations of credit risk consist primarily of cash in excess of the federally insured amount of \$100,000 and trade receivables. Generally, credit is extended based on an evaluation of a customer's financial condition, and collateral is not required. Sunrise has not incurred a loss relating to these concentrations of credit risk.

Long-term contract

The Carlisle mine, Sunrise's primary asset, is currently being developed in order to begin shipping coal sometime during the first quarter of 2007. Sunrise has a large portion of its current production capacity contracted with a public utility for several years. The coal is contracted at market prices that were in effect July 1, 2005. Sunrise is talking to other coal purchasers about additional contracts, and if coal prices continue to rise, we believe coal production could peak at about 3 million tons per year in five or six years. Recoverable reserves that are presently leased are about 35 million tons.

Transportation

The Company depends primarily on truck and rail transportation to deliver coal to its customers. Disruption of these services due to weather, mechanical issues, strikes, lockouts, bottlenecks and other events may have a temporary adverse impact on shipments and, consequently, to coal sales.

4. Sale of Albany Shale Gas Lease Play

In early May, we sold for about \$3.3 million all of our interest in our Albany Shale Gas Lease Play, located in Kentucky, to Approach Oil and Gas Inc. (Approach), a private company based in Fort Worth, Texas. Approach is controlled by the Yorktown group of companies. We recognized a gain of about \$360,000.

Under our agreement with Approach, sixty days after three exploratory gas wells are drilled, we have the option to purchase a 1/3 working interest in the project by paying 1/3 of the land costs expended by Approach. We are carried on the drilling of the three wells. Drilling is expected to begin December 2006. Our 1/3 of the land costs would be about \$1.2 million.

In mid-October, we sold one-half of our rights under this option for \$500,000 to an unaffiliated third party. If we jointly elect to exercise the option, the third party will owe us an additional \$500,000. We would then owe one-half of our share of the land costs which would be about \$600,000 (one-half of the \$1.2 million discussed above). Our net ownership in the project would then be 1/6th.

For accounting purposes we plan to defer the \$500,000 gain pending the decision to exercise the option, which we should know in early 2007.

5. Sunrise Coal Acquisition

As discussed in the first quarter Form 10-QSB, Sunrise informed us of their intention to shut down the Howesville mine, which they did. As a result, all of our previous agreements with Sunrise were voided.

On July 31, 2006 Hallador entered into a joint venture with Sunrise. The original Sunrise members retained a 40% interest in the venture, and Hallador agreed to contribute capital of \$20.5 million for a 60% interest. Of the \$20.5 million, \$7.5 million was paid to Sunrise at closing, and was used to develop the Carlisle mine.

We expect the entire \$20.5 million to be expended by the first half of 2007. Through approximately 88% of the Carlisle mine's net cash flow, Hallador will receive \$20.5 million plus interest at 10%. Thereafter, distribution of net cash flow will revert to 60% to Hallador, and 40% to the original Sunrise members.

As a result of these developments, we have expensed about \$137,000 in legal fees, which were previously deferred pending closing of the reorganization/merger with Sunrise.

On July 31, 2006 (date of acquisition), Hallador began consolidating the Sunrise joint venture. Because, at the date of acquisition, the original Sunrise members had not contributed capital in excess of accumulated losses (resulting primarily from the Howesville mine closure), Hallador has reflected Sunrise's entire losses for the period since acquisition. When Sunrise's accumulated earnings exceed its prior losses, Hallador will reflect the original members' minority interest in the results of operations.

The following table summarizes the costs and allocations of the above acquisition which are preliminary and subject to finalization:

Acquisition costs:

| | | |
|--------------------------|----|-------|
| Cash consideration | \$ | 7,500 |
| Direct acquisition costs | | 220 |
| | \$ | 7,720 |

Allocation of acquisition costs:

| | | |
|---------------------|----|----------|
| Current assets | \$ | 1,892 |
| Coal properties | | 35,312 |
| Other assets | | 192 |
| Liabilities assumed | | (29,676) |
| | \$ | 7,720 |

Included in liabilities assumed is the estimated present value of the contract termination obligation with the utility who was to purchase the coal from the Howesville mine. The purchase price is subject to modification for certain items, including the contract termination obligation, and, consequently, may change.

Pro Forma Results of Operations (Unaudited)

The following table reflects the unaudited pro forma consolidated results of operations for the nine and three months ended September 30, 2006 and 2005 as though the Sunrise and Savoy acquisitions had occurred on January 1, 2005. The unaudited pro forma results have been prepared for comparative purposes only and may not be indicative of future results.

| | Nine months ended September 30, | | Three months ended September 30, | |
|--|------------------------------------|----------|-------------------------------------|--------|
| | 2006 | 2005 | 2006 | 2005 |
| Revenue | \$ 7,339 | \$ 1,433 | \$ 486 | \$ 405 |
| Net loss | (10,568) | (105) | (571) | (381) |
| Net loss per basic share | (0.91) | (0.01) | (0.05) | (0.04) |
| Weighted average basic shares outstanding | 11,562 | 8,986 | 12,168 | 8,986 |

6. Investment in Savoy

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

Below (in thousands) are Savoy's: (i) unaudited condensed balance sheet at September 30, 2006, and (ii) unaudited condensed statement of operations for the nine months ended September 30, 2006.

Condensed Balance Sheet

| | | |
|---------------------|----|--------|
| Current assets | \$ | 9,179 |
| PP&E, net | | 9,229 |
| | \$ | 18,408 |
| Current liabilities | \$ | 3,521 |
| Partners capital | | 14,887 |
| | \$ | 18,408 |

Condensed Statement Of Operations

| | | |
|------------|----|---------|
| Revenue | \$ | 5,030 |
| Expenses | | (3,732) |
| Net income | \$ | 1,298 |

The difference between our investment account and our pro rata share of the equity of Savoy will be amortized based on Savoy's units of production rate.

In June, we received a distribution from Savoy of about \$133,000 which was credited to the investment account. We have received total distributions of \$518,000 in 2006.

7. Notes Payable

On April 19, 2006, Sunrise entered into a new \$30,000,000 facility with Old National Bank. The Line of Credit under the facility has a maturity of July 28, 2007. Thereafter, the Line of Credit balance converts to a Term Loan that has a maturity of July 28, 2012. The Line of Credit bears interest at LIBOR plus 3.55%, and the Term Loan bears interest at 8.50%. Monthly interest-only payments are required through the term of the Line of Credit. Thereafter, the Term loan requires amortizing payments through maturity.

Proceeds of the Line of Credit were available to pay then existing notes payable to First Financial, Fifth Third, and Hallador to fund the acquisition of certain real and personal property at the Company's Carlisle mine, and to fund working capital.

The loan is secured by all of Sunrise's real and personal property, guaranteed by Sunrise and Hallador, and requires Sunrise to comply with certain covenants.

8. Stock-Based Compensation

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

Effective January 1, 2006, we adopted the fair value recognition provisions of SFAS 123R, using the modified prospective transition method and therefore have not restated prior periods' results.

We estimated the fair value of the option grant using the Black-Scholes option-pricing model, using the following assumptions: (i) risk free interest rate of 4.24%; (ii) expected life of 10 years; (iii) expected volatility of 120%; and (iv) expected default rate of 5%, and (v) no dividend yield. The average fair value of options granted during 2005 was \$2.15. At September 30, 2006, our 750,000 outstanding stock options had a remaining contractual maturity of nine years and an aggregate intrinsic value of about \$750,000.

The total compensation expense related to this plan was \$345,000 for the nine months ended September 30, 2006. The impact on earnings per share for the nine months ended September 30, 2006 was \$.03 per share. No options were granted during the first quarter of 2005 and none were outstanding. Assuming no more grants, we estimate that, for each of the next six quarters, we will reflect stock-based compensation expense of approximately \$115,000 per quarter, or a total of \$690,000.

9. Related Party Transactions

For the period from July 31, 2006 (date of acquisition) through September 30, 2006, two entities owned by two members of Sunrise (other than Hallador) provided services to the Company in the aggregate gross amount of \$44,000.

10. Segment Information

The Company is engaged in two segments: the acquisition, exploration, development and production of oil, natural gas and natural gas liquids through Hallador Petroleum Company, and the acquisition, development and sale of coal.. Accordingly, the Company's Chief Executive Officer makes operating decisions, assesses financial performance and allocates resources on a segment basis.

The Company prepares business segment information in accordance with generally accepted accounting principles, except that certain items below income (loss) from continuing operations are not allocated to business segments, as management does not consider them in its evaluation of business unit performance.

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The table below presents information about identifiable assets for the reported segments as of September 30, 2006 and 2005:

| | Hallador | Sunrise | Total |
|----------------------|----------|----------|----------|
| September 30, 2006: | | | |
| Total segment assets | \$16,277 | \$42,068 | \$58,345 |
| September 30, 2005: | | | |
| Total segment assets | \$17,888 | - | \$17,888 |

The table below presents information about operating income (loss) for the reported segments for the nine and three months ended September 30, 2006 and 2005.

| | Hallador | Sunrise | Total |
|---|----------|----------|----------|
| Nine months ended September 30, 2006: | | | |
| Revenue | \$ 2,166 | \$ 12 | \$ 2,178 |
| Expenses | 1,591 | 466 | 2,057 |
| Income (loss) from continuing operations before taxes | \$ 575 | \$ (454) | 121 |
| Income taxes | | | 125 |
| Income from continuing operations | | | \$ 246 |
| Nine months ended September 30, 2005: | | | |
| Revenue | \$ 1,154 | - | \$ 1,154 |
| Expenses | 958 | - | 958 |
| Income from continuing operations before taxes | \$ 196 | - | 196 |
| Income taxes | | | (90) |
| Income from continuing operations | | | \$ 106 |
| Three months ended September 30, 2006: | | | |
| Revenue | \$ 471 | \$ 12 | \$ 483 |
| Expenses | 421 | 466 | 887 |
| Income (loss) from continuing operations before taxes | \$ 50 | \$ (454) | (404) |
| Income taxes | | | 320 |
| Loss from continuing operations | | | \$ (84) |
| Three months ended September 30, 2005: | | | |
| Revenue | \$ 405 | - | \$ 405 |
| Expenses | 390 | - | 390 |
| Income from continuing operations before taxes | \$ 15 | - | 15 |
| Income taxes | | | (6) |
| Income from continuing operations | | | \$ 9 |

ITEM 2. MD&A

THE FOLLOWING DISCUSSION UPDATES THE MD&A SECTION OF OUR 2005 FORM 10-KSB WHICH WAS FILED ON APRIL 14, 2006 AND SHOULD BE READ IN CONJUNCTION THERETO.

Sunrise Coal and Loan Guarantee

As discussed in the first quarter Form 10-QSB, Sunrise informed us of their intention to shut down the Howesville mine which they did. As a result all of our previous agreements with Sunrise were voided and on July 31, 2006 we entered into a joint venture with Sunrise. Sunrise contributed all of their assets for a 40% interest and we agreed to a \$20.5 million commitment, of which \$7.5 million was paid to Sunrise at closing, to develop the Carlisle mine for a 60% interest. We expect the full \$20.5 million to be expended by the first quarter of 2007. We are to receive approximately 88% of the free cash flow from the Carlisle mine until we recoup our \$20.5 million plus interest at 10%. Upon recoupment, the ownership reverts back to 60/40. During the third quarter we will begin consolidating the joint venture at 100%. Due to the Sunrise's losses, we pick up 100% of their losses for financial reporting purposes. In addition we remain a guarantor of Sunrise's \$30 million line of credit with two Indiana banks. As of September 30, 2006, \$23 million has been drawn down, \$2.5 million has been used on allocated letters of credit leaving an available balance of \$4.5 million.

The equipment, valued at about \$10.8 million, that was being used at the Howesville mine has been moved to the Carlisle mine. Sunrise is in final discussions with the utility who purchased coal from the Howesville mine regarding the termination of the Howesville coal contract. We do not expect the final terms of the negotiation to have a material adverse effect.

To date Sunrise has not had significant operations and is currently concentrating its efforts in the development of the Carlisle mine.

Carlisle Mine

The Carlisle mine, Sunrise's primary asset, is currently being developed in order to begin shipping coal sometime during the first half of 2007. Sunrise has a large portion of its current production capacity contracted with a public utility for several years. The coal is contracted at market prices that were in effect July 1, 2005. Sunrise is talking to other coal purchasers about additional contracts, and if coal prices continue to rise, we believe coal production could peak at about 3 million tons per year in five or six years. Recoverable reserves that are presently leased are about 35 million tons.

Sunrise has 87 employees and is running three, eight-hour shifts to develop the Carlisle mine. The number of employees during the mining phase will depend on the number of tons of coal being mined.

Mine development continues with the building of the "slope", which is the entrance to the mine for transporting equipment and employees into the mine and transporting coal out of the mine. The "slope" starts at the surface and heads down into the earth at a 8-3/4% grade and when completed should be about 2,400 feet long. The slope will meet the coal seam about 340 vertical feet below the surface.

Albany Shale Gas Lease Play

In early May, we sold for about \$3.3 million all of our interest in our Albany Shale Gas Lease Play, located in Kentucky, to Approach Oil and Gas Inc. (Approach), a private company based in Fort Worth, Texas. Approach is controlled by the Yorktown group of companies. We recognized a gain of about \$360,000.

Under our agreement with Approach, sixty days after three exploratory gas wells are drilled, we have the option to purchase a 1/3 working interest in the project by paying 1/3 of the land costs expended by Approach. We are carried on the drilling of the three wells. Drilling is expected to begin December 2006. Our 1/3 of the land costs would be about \$1.2 million.

In mid-October, we sold one-half of our rights under this option for \$500,000 to an unaffiliated third party. If we jointly elect to exercise the option, the third party will owe us an additional \$500,000. We would then owe one-half of our share of the land costs which would be about \$600,000 (one-half of the \$1.2 million discussed above). Our net ownership in the project would then be 1/6th.

For accounting purposes we plan to defer the \$500,000 gain pending the decision to exercise the option which we should know in early 2007.

COALition Energy LLC (CELLC)

We continue to be in discussions with CELLC as to the resolution of our 29% interest. Our remaining investment in CELLC is not significant.

Liquidity and Capital Resources

Upon completion of our \$20.5 million commitment to Sunrise estimated to be completed during the first half of 2007, we expect to have about \$2 million in cash. We may be required to raise additional capital to fund future cash calls for mine development and expansion. There can be no assurances that we will be able to raise additional capital on terms which would be acceptable to us.

Results Of Continuing Operations

The tables below provides sales data and average prices for the period.

| | Year-to-date Comparison | | | | | |
|---------------|--------------------------------|-----------------------|-----------------|----------------------|-----------------------|-----------------|
| | 2006 Sales Volume | 2006 Average Price | 2006 Revenue | 2005 Sales Volume | 2005 Average Price | 2005 Revenue |
| Gas-mcf | | | | | | |
| San Juan | 49,230 | \$10.17 | \$500,600 | 47,172 | \$9.54 | \$450,000 |
| Other | 23,475 | 7.36 | 172,800 | 30,961 | 7.01 | 217,000 |
| Oil - barrels | | | | | | |
| Other | 987 | 65.50 | 64,650 | 1,380 | 52.90 | 73,000 |

| | Quarter-to-date Comparison | | | | | |
|---------------|-----------------------------------|-----------------------|-----------------|----------------------|-----------------------|-----------------|
| | 2006 Sales Volume | 2006 Average Price | 2006 Revenue | 2005 Sales Volume | 2005 Average Price | 2005 Revenue |
| Gas-mcf | | | | | | |
| San Juan | 15,702 | \$9.50 | \$149,000 | 15,402 | \$10.84 | \$167,000 |
| Other | 7,712 | 6.85 | 53,000 | 9,519 | 8.20 | 78,000 |
| Oil - barrels | | | | | | |
| Other | 402 | 66.93 | 26,900 | 468 | 59.94 | 28,000 |

Oil and gas sales and LOE remained about the same comparing 2006 to 2005.

Interest income increased due to higher rates and more cash available for investment. In the future interest income will decrease due to the Sunrise funding and a reduction of our cash balances.

For the nine months, G&A increased by about \$680,000 due primarily to stock option expense of \$345,000, employee bonuses of \$100,000, higher salaries of \$71,000, accounting fees of \$70,000, increased travel of \$17,000, higher franchise taxes in New Mexico of \$25,000, and late fees to Minerals Management Services for properties held 20 years ago of \$20,000. The increase in accounting fees relate primarily to the Sunrise transaction.

For the three months G&A increased by about \$196,000 due primarily to stock option expense of \$115,000, higher salaries of \$28,000, and higher legal and accounting fees of \$33,000.

Sunrise's G&A relates to the its coal operations which are in the start up phase.

Interest expense relates solely to the debt connected with the Sunrise acquisition.

For the nine months income taxes reflect a benefit of \$125,000 primarily as a result of reflecting the 2005 current tax provision in excess of taxes paid. For the three months, income taxes reflect a benefit of \$320,000 primarily as a result of reflecting the 2005 current tax provision in excess of taxes paid, and the tax benefit derived from losses generated by Sunrise Coal.

During the first quarter, we expensed \$137,000 of legal fees related to the merger with Sunrise which was terminated

Loss on the sale of discontinued operations relates to additional income taxes due on the sale of the South Cuyama field.

ITEM 3. CONTROLS AND PROCEDURES

We maintain a system of disclosure controls and procedures that are designed for the purposes of ensuring that information required to be disclosed in our SEC reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our CEO as appropriate to allow timely decisions regarding required disclosure.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our CEO of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon that evaluation, our CEO, who is also our CFO, concluded that our disclosure controls and procedures are effective for the purposes discussed above. There have been no changes in our internal controls that has materially affected, or is reasonably likely to materially affect our internal control over financial reporting.

PART II—OTHER INFORMATION

ITEM 6.

EXHIBITS

- | | |
|-----|-----------------------------|
| (a) | 31 -- SOX 302 Certification |
| | 32 -- SOX 906 Certification |

SIGNATURE

In accordance with the requirements of the Exchange Act, the Registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

HALLADOR PETROLEUM COMPANY

Dated: November 20, 2006

By:

/S/VICTOR P. STABIO
CEO and CFO

Signing on behalf of registrant and
as principal financial officer.