BLUE DOLPHIN ENERGY CO
Form 10QSB
May 14, 2004

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

FORM 10-QSB

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended: March 31, 2004

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

Commission File Number: 0-15905

BLUE DOLPHIN ENERGY COMPANY
(Exact name of small business issuer as specified in its charter)

Delaware	73-1268729
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
801 Travis, Suite 2100, Houston, Texas	77002
(Address of principal executive offices)	(Zip Code)

(713) 227-7660
(Issuer's telephone number, including area code)

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

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 the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date.

As of May 12, 2004, there were 6,712,438 shares of the registrants' common stock, par value $.01 per share, outstanding.

Transitional Small Business Disclosure Format (Check one): Yes [ ] No [X]

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEET -UNAUDITED

March 31, 2004

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

The condensed consolidated financial statements of Blue Dolphin Energy Company and subsidiaries (referred to herein, with its predecessors and subsidiaries, as "Blue Dolphin", "we", "us" and "our") included herein have been prepared by us, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and, in the opinion of management, reflect all adjustments necessary to present a fair statement of operations, financial position and cash flows. We follow the full-cost method of accounting for oil and gas properties, wherein costs incurred in the acquisition, exploration and development of oil and gas reserves are capitalized. We believe that the disclosures are adequate and the information presented is not misleading, although certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations.

Our accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-KSB/A-1 for the year ended December 31, 2003.

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEET -UNAUDITED

ASSETS

Current assets:	
Cash and cash equivalents	$ 1,727,101
Accounts receivable	606,939
Related party receivable	6,984
Prepaid expenses and other assets	152,729
TOTAL CURRENT ASSETS	2,493,753
Property and Equipment at cost:	
Oil and Gas properties, including $160,697 of unproved leasehold cost (full-cost method)	529,258
Pipelines	4,546,287
Onshore separation and handling facilities	1,664,128
Land	860,275
Other property and equipment	307,238
	7,907,186
Less: Accumulated depletion, depreciation and amortization	2,261,745
	5,645,441
Deferred federal income tax	244,444
Investment in New Avoca	581,897
Other assets	14,664
TOTAL ASSETS	$ 8,980,199

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:	
Trade accounts payable	$ 1,954,332
Accrued expenses and other liabilities	136,585
TOTAL CURRENT LIABILITIES	2,090,917
Note payable	750,000
Asset retirement obligations	1,574,865
Common Stock, ($.01 par value, 10,000,000 shares authorized, 6,712,438 shares issued and outstanding)	67,124
Additional Paid-in Capital	26,349,762
Accumulated Deficit	(21,852,469)
	4,564,417
TOTAL LIABILITES AND STOCKHOLDERS' EQUITY	$ 8,980,199

See accompanying notes to the condensed consolidated financial statements.

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS - UNAUDITED

	Three Months Ended March 31, 2004	20
Revenue from operations:		
Pipeline operations	$ 204,039	$ 24
Oil and gas sales	154,892	7
	358,931	32
Cost of operations:		
Pipeline operating expenses	243,251	19
Lease operating expenses	31,839	1
Depletion, depreciation and amortization	134,782	8
General and administrative	496,014	48
Accretion expense	23,356	2
	929,242	79
LOSS FROM OPERATIONS	(570,311)	(47
Other income (expense):		
Interest and other expense	(11,702)	(1
Interest and other income	85,709	13
Equity in loss of affiliate	(23,302)	
LOSS BEFORE INCOME TAXES	(519,606)	(35
Income taxes	--	
LOSS BEFORE CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE	(519,606)	(35
Cumulative effect of a change in accounting principle for asset retirement obligations	--	(4
Net loss	$ (519,606)	$ (39
Loss per common share before cumulative effect of a change in accounting principle - basic and diluted	$ (0.08)	$
Cumulative effect of a change in accounting principle - basic and diluted	$ --	$
Loss per common share - basic and diluted	$ (0.08)	$
Weighted average number of common shares outstanding - basic and diluted	6,663,990	6,61

See accompanying notes to the condensed consolidated financial statements.

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED

	Three Mon Ended Marc 2004
OPERATING ACTIVITIES	
Net loss	$ (519,606)
Adjustments to reconcile net loss to net cash used in operating activities	
Depletion, depreciation and amortization	134,782
Change in accounting principle	--
Accretion of asset retirement obligations	23,356
Equity in loss of affiliate	23,302
Common stock issued for services	83,000
Changes in operating assets and liabilities:	
Accounts receivable	(124,838)
Prepaid expenses and other assets	4,925
Abandonment costs incurred	--
Trade accounts payable and accrued expenses	(578,445)
NET CASH USED IN OPERATING ACTIVITIES	(953,524)
INVESTING ACTIVITIES	
Purchases of property and equipment	(5,767)
Development costs - New Avoca	(16,500)
NET CASH USED IN INVESTING ACTIVITIES	(22,267)
FINANCING ACTIVITIES	--
DECREASE IN CASH AND CASH EQUIVALENTS	(975,791)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	2,702,892
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 1,727,101

See accompanying notes to the condensed consolidated financial statements.

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
UNAUDITED
MARCH 31, 2004

1. Liquidity and Going Concern

At March 31, 2004, our working capital was approximately $400,000. In order to satisfy our working capital and capital expenditure requirements for the twelve months ending March 31, 2005, we believe that we will need to raise approximately $1.5 million of capital. We will need to arrange external financing and/or sell assets to raise the necessary capital.

Historically, we have relied on the proceeds from the sale of assets and capital raised from the issuance of debt and equity securities to individual investors and related parties to sustain our operations. There can be no assurance that we will be able to obtain financing or sell assets on commercially acceptable terms to meet our capital requirements. Our inability to raise capital will have a material adverse effect on our financial condition, ability to meet our obligations and operating needs, and results of operations. Our financial statements contained herein have been prepared assuming that we will continue as a going concern, however our working capital deficiency raises substantial doubt about our ability to continue as a going concern. Our financial statements do not include any adjustments that might result from the outcome of this uncertainty.

2. Related Party Transactions

We own 12.8% of the common stock of Drillmar, Inc. Our Chairman, Ivar Siem, and one of our Directors, Harris A. Kaffie, are owners of 30.3%, and 30.6%, respectively, of Drillmar's common stock. Messrs. Siem and Kaffie are both Directors, and Mr. Siem is Chairman and President of Drillmar.

In 2002, we recorded a full impairment of our investment in Drillmar of approximately $340,000 and a full reserve for the accounts receivable amount owed to us from Drillmar of approximately $200,000 due to Drillmar's working capital deficiency and delays in securing capital funding. During the quarter ended March 31, 2004, we collected $30,000 from Drillmar and we expect to receive $15,000 per month until the accounts receivable is fully collected.

In January 2003, Drillmar stockholders approved a restructuring plan whereby Drillmar will issue up to $3.0 million of convertible notes that are convertible into common stock representing over 99% of Drillmar's outstanding shares. As a result, our ownership in Drillmar can be reduced to less than 1%. However, in November 2003, we converted our contingent obligation due from Drillmar for providing office space, accounting and administrative services from May 2002 through January 2003 totaling $162,000 (9 months at $18,000 per month) into a convertible note, which if converted along with all of Drillmar's outstanding convertible notes would represent 7.7% of Drillmar's common stock. Messrs. Siem, Kaffie and Trimble (one of our Directors) also hold Drillmar convertible notes, which if converted along with all of Drillmar's outstanding convertible notes would represent 22.2%, 27.5% and 2.1%, respectively, of Drillmar's common stock.

We entered into a new agreement with Drillmar effective as of February 1, 2003, whereby we provide office space to Drillmar which is currently $2,000 per month. We also provide professional, accounting and administrative services to Drillmar based on hourly rates based on our cost. The agreement can be terminated upon 30 days notice or by the mutual agreement of the parties.

Effective April 1, 2003, we entered into a sublease agreement expiring December 31, 2006 for certain of our office space with Tri-Union Development Corporation. Our receipts from this sublease will be approximately $78,500 annually. Mr. Trimble is the Chairman and Chief Executive Officer of Tri-Union.

3. Contingencies

We are involved in various claims and legal actions arising in the ordinary course of business. In our opinion, the ultimate disposition of these matters will not have a material effect on our financial position, results of operations or cash flows.

4. Change in Accounting Principle

In August 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 143 ("SFAS 143"), "Accounting for Asset Retirement Obligations", which addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The standard applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal use of the asset.

SFAS 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The fair value of the liability is added to the carrying amount of the associated asset and this additional carrying amount is depreciated over the life of the asset. If the obligation is settled for other than the carrying amount of the liability, we will recognize a gain or loss on settlement.

SFAS 143 amended Statement of Financial Accounting Standards No. 19, Financial Accounting and Reporting by Oil and Gas Producing Companies ("SFAS 19") to require that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. Under the provisions of SFAS 143, asset retirement obligations are capitalized as part of the carrying value of the long-lived asset. Under the provisions of SFAS 19, asset retirement obligations were recognized using a cost-accumulation approach. Prior to the adoption of SFAS 143, we recorded asset retirement obligations through the unit-of-production method for oil and gas properties, and the straight line method for pipelines and related facilities.

The adoption of SFAS 143 resulted in a January 1, 2003 cumulative effect adjustment to record (i) a $1.0 million increase in the carrying value of pipelines, (ii) a $ .4 million decrease in accumulated depreciation, depletion, and amortization of property, plant and equipment, and (iii) a $1.4 million increase in non-current abandonment liabilities. The net impact of items (i) through (iii) was to record an expense of $40 thousand, net of tax, as a cumulative effect adjustment of a change in accounting principle in the

Company's consolidated statement of operations upon adoption on January 1, 2003.

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
UNAUDITED - Continued
MARCH 31, 2004

5. Earnings Per Share

We apply the provisions of Statement of Financial Accounting Standards No. 128 ("SFAS 128"), "Earnings per Share". SFAS 128 requires the presentation of basic earnings per share ("EPS") which excludes dilution and is computed by dividing net income (loss) available to common stockholders by the weighted-average number of shares of common stock outstanding for the period. SFAS 128 requires dual presentation of basic EPS and diluted EPS on the face of the income statement and requires a reconciliation of the numerators and denominators of basic EPS and diluted EPS.

The employee stock options at March 31, 2004 and 2003 were not included in the computation of diluted earnings per share because the effect of their assumed exercise and conversion would have an antidilutive effect on the computation of diluted loss per share.

6. Business Segment Information

Our income producing operations are conducted in two principal business segments: oil and gas exploration and production, and pipeline operations. There were no intersegment revenues during the periods presented. Information concerning these segments for the quarters ended March 31, 2004 and 2003, and at March 31, 2004 are as follows:

	Revenues	Operating Income (Loss)(1)	Depletio Depreciatio Amortizat
Quarter ended March 31, 2004:			
Oil and gas exploration and production	$ 154,892	(63,877)	4
Pipeline operations	204,039	(317,915)	8
Other	--	(188,519)	
Consolidated	358,931	(570,311)	13
		50,705	
Loss before income taxes		(519,606)	
Quarter ended March 31, 2003:			
Oil and gas exploration and production	$ 74,306	(12,864)	
Pipeline operations	246,668	(301,772)	8
Other	--	(163,327)	
Consolidated	320,974	(477,963)	8
		121,908	

Loss before income taxes	(356,055)

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
UNAUDITED - Continued
MARCH 31, 2004

	March 31, 2004
Identifiable assets:	
Oil and gas exploration and production	$ 745,471
Pipeline operations	5,683,441
Other	2,551,287
Consolidated	$ 8,980,199

(1) Consolidated income (loss) from operations includes $185,326 and $158,256 in unallocated general and administrative expenses, and unallocated depletion, depreciation and amortization of $3,193 and $5,071 for the quarters ended March 31, 2004 and 2003, respectively.

7. Stock Based Compensation

We account for stock-based compensation granted under our long-term incentive plans using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations. Stock-based compensation expenses associated with option grants were not recognized in our net loss in the three months ended March 31, 2004 and 2003, as all options granted had exercise prices equal to the market value of the underlying common stock on the dates of grant. The following table illustrates the effect on net loss and loss per share if we had applied the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" to stock-based employee compensation:

	Three months ended March 31, 2004	Three months ended March 31, 2003
	(in thousands, except per share amounts)	
Net loss, as reported	$ (520)	$ (397)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	--	--

Pro forma net loss	$ (520)	$ (397)
Net loss per share:		
Basic and diluted - as reported	$ (.08)	$ (.06)
Basic and diluted - pro forma	$ (.08)	$ (.06)

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

Forward Looking Statements. Certain of the statements included in this quarterly report on Form 10-QSB, including those regarding future financial performance or results or that are not historical facts, are "forward-looking" statements as that term is defined in Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended. The words "expect", "plan", "believe", "anticipate", "project", "estimate", and similar expressions are intended to identify forward-looking statements. We caution readers that any such statements are not guarantees of future performance or events and such statements involve risks and uncertainties that may cause actual results and outcomes to differ materially from those indicated in the forward-looking statements. Some of the important factors, risks and uncertainties that could cause actual results to vary from the forward-looking statements include:

- availability and cost of capital;
- the level of utilization of our pipelines;
- the risks associated with exploration;
- the level of production from oil and gas properties;
- gas and oil price volatility;
- uncertainties in the estimation of proved reserves and in the projection of future rates of production and timing of development expenditures;
- actions or inactions of third party operators for properties where we have an interest;
- regulatory developments; and
- general economic conditions.

Additional factors that could cause actual results to differ materially from those indicated in the forward-looking statements are discussed under the caption "Risk Factors" in our Form 10-KSB/A-1 for the fiscal year ended December 31, 2003. Readers are cautioned not to place undue reliance on these forward-looking statements which speak only as of the date hereof. We undertake no duty to update these forward-looking statements. Readers are urged to carefully review and consider the various disclosures made by us which attempt to advise interested parties of the additional factors which may affect our business, including the disclosures made under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this report.

EXECUTIVE SUMMARY

We are engaged in two lines of business; pipeline operations and oil and gas exploration and production. We are a holding company and conduct our operations through our subsidiaries. We provide pipeline transportation services to producer/shippers, and sell oil and gas from our producing properties. Our assets primarily are located offshore and onshore in the Texas Gulf coast area. We also own an interest in and manage the New Avoca gas storage project located in Avoca, New York.

Our future cash flows are subject to a number of variables, primarily, utilization of our pipeline systems. Approximately 57% of our revenues for the year ended December 31, 2003 were from sales of oil and gas production from the

High Island Block A-7 field. Oil and gas production from the High Island Block A-7 field has declined significantly and production is expected to cease during the third or fourth quarter of 2004. We expect a significant portion of our revenues in 2004 will be derived from utilization of our pipeline systems. As a result of our expected decline in revenues from oil and gas sales and our remaining payments associated with the abandonment/reefing of the Buccaneer Field of approximately $1.3 million during the remainder of 2004, we expect that we will need to raise approximately $1.5 million of capital. Our inability to raise capital may have a material adverse effect on our financial condition, ability to meet our obligations and operating needs, and results of operations.

In addition to satisfying our liquidity and capital needs, our focus in 2004 is to increase utilization of existing assets, strategic acquisitions and cost management. Our long-term goal is to create greater value for our stockholders.

LIQUIDITY AND CAPITAL RESOURCES

Historically, we have relied on the proceeds from the sale of assets and capital raised from the issuance of debt and equity securities to individual investors and related parties to sustain our operations. In order to satisfy our working capital and capital expenditure requirements for the twelve months ending March 31, 2005, we believe that we will need to raise approximately $1.5 million of capital. We incurred a net loss of approximately $.5 million in the first quarter 2004 and currently continue to operate at a net loss. Combined with our ongoing cash requirements, substantial doubt exists about our ability to continue as a going concern. Accordingly, as a result of our ongoing liquidity problems, our auditors, Mann Frankfort Stein & Lipp CPAs, L.L.P. added an explanatory paragraph in their opinion on our consolidated financial statements as of and for the year ended December 31, 2003, indicating that substantial doubt exists about our ability to continue as a going concern. Our long-term viability as a going concern is dependent upon the following factors:

o our ability to raise capital to meet current commitments and fund the continuation of our business operations; and

o our ability to ultimately achieve profitability and positive cash flows from operations in amounts that will sustain our operations.

The following table summarizes certain of our contractual obligations and other commercial commitments at March 31, 2004 (amounts in thousands):

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - Continued

Contractual Obligations	Total	Payments Due by Period: 1 year or less	1-3 years	3-5 years	After 5 years
Accounts Payable - Tetra	$ 1,336	1,336	--	--	--
Long-Term Debt	849	--	849	--	--
Operating Leases, net of sublease	330	124	206	--	--
Total Contractual Obligations	$ 2,515	1,460	1,055	--	--

Other Commercial Commitments	Total	Amount of Commitment Expiration Per Period: 1 year or less	1-3 years	3-5 years	After 5 years
Abandonment - Costs	$ 1,575	--	199	--	1,376
Total Commercial Obligations	$ 1,575	--	199	--	1,376

The following table summarizes our financial position for the periods indicated (amounts in thousands):

	March 31, 2004 Amount	%	December 31, 2003 Amount	%
Working Capital	$ 403	6	$ 680	9
Property and equipment, net	5,645	82	5,775	79

Other noncurrent assets	841	12	848	12
Total	$ 6,889	100	$ 7,303	100
Long-term Liabilities	$ 2,325	34	$ 2,302	32
Stockholders' equity	4,564	66	5,001	68
Total	$ 6,889	100	$ 7,303	100

The change in our financial position from December 31, 2003 to March 31, 2004, was primarily due to our net loss for the three months ended March 31, 2004 of approximately $.5 million.

The net cash provided by or used in operating, investing and financing activities is summarized below:

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - Continued

	Three Months Ended March 31 (amounts in thousands)	
	2004	2003
Net cash used in:		
Operating activities	$ (954)	$ (192)
Investing activities	(22)	(31)
Financing activities	--	--
Net decrease in cash	$ (976)	$ (223)

The net cash used in operating activities during the three months ended March 31, 2004, reflects the payment of Buccaneer Field abandonment costs and other payables, and the net loss from operations. In August 2003, we completed the abandonment/reefing of the Buccaneer Field. As of March 31, 2004, remaining costs of $1.3 million are due to our contractor, Tetra Technologies, with whom we arranged payment terms. The remaining payments include six monthly installments of $133,600 and a final payment of $534,400 due in October 2004.

During 2002, we sold substantially all of our interests in our proved oil and gas properties for approximately $5.0 million. From October 2002 to late April 2003, we had no interest in any producing oil and gas properties. In late April 2003, we began to receive revenue from our 8.9% reversionary working interest in the High Island Area Block A-7 field, in the Gulf of Mexico. Oil and gas production from this field now comes from one well that currently produces at a gross rate of 1.9 MMcf/day.

During the three months ended March 31, 2004, we incurred no capital expenditures for the development of our proved reserves. Projected capital expenditures totaling $27,000 and $199,000 are expected to be incurred in the years ending December 31, 2004 and 2005, respectively. Capital expenditures in 2005 represent the abandonment costs of our High Island Area Block A-7 and Block 34 properties.

We have significant available capacity in our Blue Dolphin Pipeline system in a market area that we believe is experiencing an increased level of interest by oil and gas operators. Natural gas throughput on our Blue Dolphin Pipeline system is currently 8 MMBtu per day, representing 6% of system capacity. Future utilization of our pipeline and related facilities will depend upon the success of drilling programs around our pipeline systems, and attraction and retention of producer/shippers to the systems. As a result of increased leasing and oil and gas prospect development activity around the Blue Dolphin Pipeline system and anticipated drilling activity, we expect that utilization of the Blue Dolphin Pipeline system will increase in late 2004 or 2005.

We are planning to expand our Freeport, Texas operations to include terminalling and shipment by barge of oil and condensate received by truck and/or pipeline (in addition to the Blue Dolphin pipeline). With excess capacity, including ample available acreage to handle liquids, we believe a liquids storage and transportation service can add to the base Blue Dolphin Pipeline production gathering business.

We currently are continuing our efforts to sell our interest in the New Avoca gas storage project. To enhance this effort, we are marketing prospective capacity to potential users of the project. We currently expect that costs net to our interest during the year ending December 31, 2004 will be approximately $80,000.

In February 2002, we acquired an additional 1/3 interest in the Blue Dolphin Pipeline System and the inactive Omega Pipeline from MCNIC Pipeline and Processing Group, Inc. ("MCNIC"). Pursuant to the terms of the purchase and sales agreement, Blue Dolphin Pipeline Company issued MCNIC a $750,000 promissory note due December 31, 2006, with required monthly payments to be made out of 90% of the net revenues of the interest acquired. As of March 31, 2004, the amount owed MCNIC is $750,000 plus accrued interest of approximately $99,000.

RESULTS OF OPERATIONS

For the three months ended March 31, 2004 ("2004"), we reported a net loss of $519,606, compared to a net loss of $396,510 for the three months ended March 31, 2003 ("2003").

2004 compared to 2003

Revenue from pipeline operations. Revenues from pipeline operations decreased by $42,629 or 17% in 2004 to $204,039. The decrease was due primarily to a decrease in transportation volumes on the Blue Dolphin Pipeline system of 30% resulting in a decrease in revenues of approximately $65,000, offset in part by a 42% increase in revenues of approximately $23,000 from the GA 350 Pipeline.

Revenue from oil and gas sales. Our revenues from oil and gas sales increased by $80,586 in 2004, from those of 2003. 2004 revenues include oil and gas sales from our interest in the High Island Block A-7 field, which interest was received in April 2003 and our interest in the High Island Block 34 field, which interest was received effective August 2003. 2003 revenues represent adjustments for periods prior to the sale of oil and gas properties in 2002.

Pipeline operating expenses. Pipeline operating expenses in 2004 increased by $49,857 from $193,394 in 2003. The increase was due to higher legal costs of approximately $27,000, and repairs and maintenance of approximately $13,000. The legal costs are associated with an action filed against us, the outcome of which we do not believe will have a material impact. However, if this litigation continues for a prolonged period of time, we would incur significant legal expenses, which could have a material effect on our financial condition.

Depletion, depreciation and amortization expense. Depletion, depreciation and amortization expense increased by $45,734 from 2003. In 2004 we recorded depletion and depreciation associated with our interest in the High Island Area Block A-7 and Block 34 fields, which interests we received in April and August 2003, respectively.

Interest and other income. Interest and other income decreased $48,891 in 2004. Other income in 2004 includes consulting services provided by us associated with the evaluation of oil and gas properties of approximately $50,000, and collection of accounts receivable that were previously written off of $30,000. Other income in 2003 includes consulting services provided by us associated with the evaluation of oil and gas properties of approximately $72,000, and the refund of prepaid costs associated with the oil and gas properties sold effective October 2002 that were in excess of actual costs incurred of approximately $40,000.

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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - Continued

Equity in loss of affiliate. In 2004, we recorded a loss from our equity interest in New Avoca of $23,302.

Cumulative effect of a change in accounting principal. In 2003, as a result of our adoption of SFAS No. 143, we recorded a cumulative effect adjustment at January 1, 2003 of a change in accounting principle for asset retirement obligations of $40,455 (see note 4 to the Condensed Consolidated Financial Statements).

ITEM 3. CONTROLS AND PROCEDURES

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 management, including our Chief Executive Officer and Principal Accounting Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13(a) - 14(c) and 15(d) - 14(c) under the Securities Exchange Act of 1934, as amended). Based upon the evaluation, the Chief Executive Officer and Principal Accounting Officer concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934, are recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. There were no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

PART II. OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORT ON FORM 8-K

A) Exhibits

31.1 Ivar Siem Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.

31.2 G. Brian Lloyd Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Ivar Siem Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

32.2 G. Brian Lloyd Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

B) Reports on Form 8-K

On March 26, 2004, we filed a current report on Form 8-K dated March 26, 2004 reporting our fourth quarter 2003 earnings. The Item in such current report was Item 5 (Other Events).

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

By: BLUE DOLPHIN ENERGY COMPANY

Date: May 14, 2004

/s/ Ivar Siem

Ivar Siem

Chairman and Chief Executive Officer

/s/ G. Brian Lloyd

G. Brian Lloyd
Vice President, Treasurer
(Principal Accounting and Financial Officer)