

CALLON PETROLEUM CO
Form 10-Q
August 08, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM
10-Q

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

For The Quarterly Period Ended June 30, 2016

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 001-14039

Callon Petroleum Company

(Exact Name of Registrant as Specified in Its Charter)

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Delaware
64-0844345
(State or Other
Jurisdiction of (IRS
Employer
Incorporation
or Identification
Organization) No.)

200 North
Canal Street

Natchez,
Mississippi

(Address of
Principal 39120
Executive
Offices) (Zip Code)

601-442-1601

(Registrant's Telephone Number, Including Area Code)

Not Applicable

(Former Name, Former Address and Former Fiscal Year, If Changed Since Last Report)

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

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

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

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Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if smaller reporting company) Smaller reporting company

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

The Registrant had 131,136,233 shares of common stock outstanding as of August 1, 2016.

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DEFINITIONS

All defined terms under Rule 4-10(a) of Regulation S-X shall have their prescribed meanings when used in this report. As used in this document:

- ARO: asset retirement obligation.
- Bbl or Bbls: barrel or barrels of oil or natural gas liquids.
- BOE: barrel of oil equivalent, determined by using the ratio of one Bbl of oil or NGLs to six Mcf of gas. The ratio of one barrel of oil or NGL to six Mcf of natural gas is commonly used in the industry and represents the approximate energy equivalence of oil or NGLs to natural gas, and does not represent the economic equivalency of oil and NGLs to natural gas. The sales price of a barrel of oil or NGLs is considerably higher than the sales price of six Mcf of natural gas.
- BBtu: billion Btu.
- BOE/d: BOE per day.
- Btu: a British thermal unit, which is a measure of the amount of energy required to raise the temperature of one pound of water one degree Fahrenheit.
- GAAP: Generally Accepted Accounting Principles in the United States.
- Henry Hub: A natural gas pipeline delivery point that serves as the benchmark natural gas price underlying NYMEX natural gas futures contracts.
- LIBOR: London Interbank Offered Rate.
- LOE: lease operating expense.
- MBbls: thousand barrels of oil.
- MBOE: thousand BOE.
- Mcf: thousand cubic feet of natural gas.
- MMBtu: million Btu.
- MMcf: million cubic feet of natural gas.
- NGL or NGLs: natural gas liquids, such as ethane, propane, butanes and natural gasoline that are extracted from natural gas production streams.
- NYMEX: New York Mercantile Exchange.
- Oil: includes crude oil and condensate.
- SEC: United States Securities and Exchange Commission.
- WTI: West Texas Intermediate grade crude oil, used as a pricing benchmark for sales contracts and NYMEX oil futures contracts.

With respect to information relating to our working interest in wells or acreage, “net” oil and gas wells or acreage is determined by multiplying gross wells or acreage by our working interest therein. Unless otherwise specified, all references to wells and acres are gross.

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Part I. Financial Information

Item I. Financial Statements

Callon Petroleum Company

Consolidated Balance Sheets

(in thousands, except par and per share values and share data)

	June 30, 2016	December 31, 2015
	Unaudited	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 207	\$ 1,224
Accounts receivable	44,460	39,624
Fair value of derivatives	5,537	19,943
Other current assets	1,766	1,461
Total current assets	51,970	62,252
Oil and natural gas properties, full cost accounting method:		
Evaluated properties	2,530,978	2,335,223
Less accumulated depreciation, depletion, amortization and impairment	(1,883,806)	(1,756,018)
Net oil and natural gas properties	647,172	579,205
Unevaluated properties	379,605	132,181
Total oil and natural gas properties	1,026,777	711,386
Other property and equipment, net	9,971	7,700
Restricted investments	3,323	3,309
Deferred financing costs	3,076	3,642
Fair value of derivatives	60	—
Other assets, net	413	305
Total assets	\$ 1,095,590	\$ 788,594
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 71,960	\$ 70,970
Accrued interest	6,258	5,989
Cash-settleable restricted stock unit awards	5,168	10,128
Asset retirement obligations	3,933	790
Fair value of derivatives	7,491	—
Total current liabilities	94,810	87,877
Senior secured revolving credit facility	40,000	40,000
Secured second lien term loan, net of unamortized deferred financing costs	289,559	288,565
Asset retirement obligations	2,164	4,317
Cash-settleable restricted stock unit awards	4,141	4,877
Fair value of derivatives	6,313	—
Other long-term liabilities	286	200

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Total liabilities	437,273	425,836
Stockholders' equity:		
Preferred stock, series A cumulative, \$0.01 par value and \$50.00 liquidation preference, 2,500,000 shares authorized: 1,458,948 and 1,578,948 shares outstanding, respectively	15	16
Common stock, \$0.01 par value, 300,000,000 and 150,000,000 shares authorized, respectively; 131,090,644 and 80,087,148 shares outstanding, respectively	1,311	801
Capital in excess of par value	1,112,873	702,970
Accumulated deficit	(455,882)	(341,029)
Total stockholders' equity	658,317	362,758
Total liabilities and stockholders' equity	\$ 1,095,590	\$ 788,594

The accompanying notes are an integral part of these consolidated financial statements.

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Callon Petroleum Company

Consolidated Statements of Operations

(Unaudited; in thousands, except per share data)

	Three Months Ended		Six Months Ended June	
	June 30,	2015	30,	2015
	2016		2016	
Operating revenues:				
Oil sales	\$ 40,555	\$ 36,093	\$ 67,998	\$ 64,002
Natural gas sales	4,590	3,149	7,845	5,631
Total operating revenues	45,145	39,242	75,843	69,633
Operating expenses:				
Lease operating expenses	7,311	6,575	14,268	13,534
Production taxes	2,455	2,952	4,675	5,217
Depreciation, depletion and amortization	16,293	17,587	32,015	35,691
General and administrative	6,302	5,763	11,864	17,865
Accretion expense	395	134	575	343
Write-down of oil and natural gas properties	61,012	—	95,788	—
Rig termination fee	—	—	—	3,641
Acquisition expense	1,906	—	1,954	—
Total operating expenses	95,674	33,011	161,139	76,291
Income (loss) from operations	(50,529)	6,231	(85,296)	(6,658)
Other (income) expense:				
Interest expense, net of capitalized amounts	4,180	5,106	9,671	9,964
Loss on derivative contracts	15,484	8,249	16,416	5,820
Other income, net	(96)	(41)	(177)	(85)
Total other expense	19,568	13,314	25,910	15,699
Loss before income taxes	(70,097)	(7,083)	(111,206)	(22,357)
Income tax benefit	—	(2,116)	—	(7,193)
Net loss	(70,097)	(4,967)	(111,206)	(15,164)
Preferred stock dividends	(1,823)	(1,973)	(3,647)	(3,947)
Loss available to common stockholders	\$ (71,920)	\$ (6,940)	\$ (114,853)	\$ (19,111)
Loss per common share:				
Basic	\$ (0.61)	\$ (0.11)	\$ (1.14)	\$ (0.31)
Diluted	\$ (0.61)	\$ (0.11)	\$ (1.14)	\$ (0.31)
Shares used in computing loss per common share:				
Basic	118,209	66,038	100,895	61,759

Diluted	118,209	66,038	100,895	61,759
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The accompanying notes are an integral part of these consolidated financial statements.

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Callon Petroleum Company

Consolidated Statements of Cash Flows

(Unaudited; in thousands)

	Six Months Ended June 30,	
	2016	2015
Cash flows from operating activities:		
Net loss	\$ (111,206)	\$ (15,164)
Adjustments to reconcile net loss to cash provided by operating activities:		
Depreciation, depletion and amortization	32,827	36,557
Write-down of oil and natural gas properties	95,788	—
Accretion expense	575	343
Amortization of non-cash debt related items	1,561	1,561
Deferred income tax benefit	—	(7,193)
Net loss on derivatives, net of settlements	28,149	21,129
Non-cash expense related to equity share-based awards	(861)	(668)
Change in the fair value of liability share-based awards	2,674	4,695
Payments to settle asset retirement obligations	(319)	(1,905)
Changes in operating assets and liabilities:		
Accounts receivable	(4,836)	(6,946)
Other current assets	(305)	(85)
Current liabilities	4,113	5,549
Change in other long-term liabilities	86	100
Change in other assets, net	(450)	(528)
Payments to settle vested liability share-based awards related to early retirements	—	(3,538)
Payments to settle vested liability share-based awards	(10,300)	(3,925)
Net cash provided by operating activities	37,496	29,982
Cash flows from investing activities:		
Capital expenditures	(75,280)	(129,050)
Acquisitions	(284,024)	(1,797)
Proceeds from sales of mineral interests and equipment	23,631	326
Net cash used in investing activities	(335,673)	(130,521)
Cash flows from financing activities:		
Borrowings on senior secured revolving credit facility	143,000	103,000
Payments on senior secured revolving credit facility	(143,000)	(63,000)
Issuance of common stock, net	300,807	65,546
Payment of preferred stock dividends	(3,647)	(3,947)
Net cash provided by financing activities	297,160	101,599
Net change in cash and cash equivalents	(1,017)	1,060
Balance, beginning of period	1,224	968
Balance, end of period	\$ 207	\$ 2,028

The accompanying notes are an integral part of these consolidated financial statements.

Callon Petroleum Company Notes to the Consolidated Financial Statements

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(All dollar amounts in thousands, except per share and per unit data)

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Note 1 - Description of Business and Basis of Presentation

Description of business

Callon Petroleum Company is an independent oil and natural gas company established in 1950. The Company was incorporated under the laws of the state of Delaware in 1994 and succeeded to the business of a publicly traded limited partnership, a joint venture with a consortium of European investors and an independent energy company partially owned by a member of current management. As used herein, the “Company,” “Callon,” “we,” “us,” and “our” refer to Callon Petroleum Company and its predecessors and subsidiaries unless the context requires otherwise.

Callon is focused on the acquisition, development, exploration and exploitation of unconventional onshore, oil and natural gas reserves in the Permian Basin in West Texas. The Company’s operations to date have been predominantly focused on horizontal drilling of several prospective intervals, including multiple levels of the Wolfcamp formation and, more recently, the Lower Spraberry shale in the Midland Basin. Callon has assembled a multi-year inventory of potential horizontal well locations and intends to add to this inventory through delineation drilling of emerging zones on our existing acreage and acquisition of additional locations through working interest acquisitions, acreage purchases, joint ventures and asset swaps.

Basis of presentation

Unless otherwise indicated, all dollar amounts included within the Footnotes to the Financial Statements are presented in thousands, except for per share and per unit data.

The interim consolidated financial statements of the Company have been prepared in accordance with (1) GAAP, (2) the SEC's instructions to Quarterly Report on Form 10-Q and (3) Rule 10-01 of Regulation S-X, and include the accounts of Callon Petroleum Company, and its subsidiary, Callon Petroleum Operating Company ("CPOC"). CPOC also has subsidiaries, namely Callon Offshore Production, Inc. and Mississippi Marketing, Inc.

These interim consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2015. The balance sheet at December 31, 2015 has been derived from the audited financial statements at that date. Operating results for the periods presented are not necessarily indicative of the results that may be expected for the year ended December 31, 2016.

In the opinion of management, the accompanying unaudited consolidated financial statements reflect all adjustments, including normal recurring adjustments and all intercompany account and transaction eliminations, necessary to present fairly the Company's financial position, the results of its operations and its cash flows for the periods indicated. Certain prior year amounts may have been reclassified to conform to current year presentation.

(All dollar amounts in thousands, except per share and per unit data)

Recently issued accounting policies

In March 2016, the Financial Accounting Standards Board issued accounting standards update No. 2016-09, Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (“ASU 2016-09”). The standard is intended to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows, and will allow companies to estimate the number of stock awards expected to vest. The guidance in ASU 2016-09 is effective for public entities for annual reporting periods beginning after December 15, 2016, including interim periods therein. Early adoption is permitted and is to be applied on retrospective basis. The Company is currently evaluating the method of adoption and impact this standard may have on its financial statements and related disclosures.

Recently adopted accounting policies

In November 2015, the FASB issued ASU No. 2015-17, Balance Sheet Classification of Deferred Taxes (“ASU 2015-17”), which eliminates the current requirement to present deferred tax liabilities and assets as current and noncurrent amounts on the balance sheet. Instead, entities will be required to classify all deferred tax assets and liabilities as noncurrent on the balance sheet. The guidance in ASU 2015-17 is effective for public entities for annual reporting periods beginning after December 15, 2016, and interim periods within those annual periods. Early application is permitted. As of June 30, 2016, the Company adopted this ASU, which does not have a material impact on its financial statements.

Note 2 – Oil and Natural Gas Properties

The Company uses the full cost method of accounting for its exploration and development activities. Under this method of accounting, the cost of both successful and unsuccessful exploration and development activities are capitalized as oil and gas properties. Such amounts include the cost of drilling and equipping productive wells, dry hole costs, lease acquisition costs, delay rentals, interest capitalized on unevaluated leases, other costs related to exploration and development activities, and site restoration, dismantlement and abandonment costs capitalized in accordance with asset retirement obligation accounting guidance. Costs capitalized also include any internal costs that are directly related to exploration and development activities, including salaries and benefits, but do not include any costs related to production, general corporate overhead or similar activities.

Under full cost accounting rules, the Company reviews the carrying value of its proved oil and natural gas properties each quarter. Under these rules, capitalized costs of oil and natural gas properties, net of accumulated depreciation, depletion and amortization and deferred income taxes, may not exceed the present value of estimated future net cash flows from proved oil and natural gas reserves, discounted at 10%, plus the lower of cost or fair value of unevaluated properties, net of related tax effects (the full cost ceiling). These rules require pricing based on the preceding 12-months' average oil and natural gas prices based on closing prices on the first day of each month and require a write-down if the net capitalized costs of proved oil and natural gas properties exceeds the full cost ceiling. At June 30, 2016, the prices used in determining the estimated future net cash flows from proved reserves were \$40.62 per barrel of oil and \$2.46 per Mcf of natural gas. For the three and six months ended June 30, 2016, the Company recognized write-downs of oil and natural gas properties of \$61,012 and \$95,788, respectively, as a result of the ceiling test limitation.

Note 3 - Acquisitions

Acquisitions were accounted for under the acquisition method of accounting, which involves determining the fair value of the assets acquired and liabilities assumed under the income approach.

2016 acquisitions

On May 26, 2016, the Company completed the acquisition of 17,298 gross (14,089 net) acres primarily located in Howard County, Texas from BSM Energy LP, Crux Energy LP and Zaniah Energy LP, for total cash consideration of \$220,000 and 9,333,333 shares of common stock for a total purchase price of \$329,573, excluding customary purchase price adjustments (the "Big Star Transaction"). The Company acquired an 81% average working interest (61% average net revenue interest) in the properties acquired in the Big Star Transaction.

(All dollar amounts in thousands, except per share and per unit data)

The preliminary purchase price allocation is subject to change based on numerous factors, including the final adjusted purchase price and the final estimated fair value of the assets acquired and liabilities assumed. Any such adjustments to the preliminary estimates of fair value could be material. The following table summarizes the estimated acquisition date fair values of the net assets to be acquired in the acquisition (in thousands):

Oil and natural gas properties	\$ 96,194
Unevaluated oil and natural gas properties	233,387
Asset retirement obligations	(8)
Net assets acquired	\$ 329,573

The following unaudited summary pro forma financial information for the three and six months ended June 30, 2016 has been presented for illustrative purposes only and does not purport to represent what the Company's results of operations would have been if the Big Star Transaction had occurred as presented, or to project the Company's results of operations for any future periods. The pro forma financial information was prepared assuming the Big Star Transaction occurred as of January 1, 2015. The pro forma adjustments are based on available information and certain assumptions that management believes are reasonable, including those pertaining to revenue, lease operating expenses, production taxes, depreciation, depletion and amortization expense, accretion expense, interest expense and capitalized interest.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenues	\$ 48,937	\$ 45,047	\$ 85,010	\$ 78,060
Income from operations	(50,004)	6,179	(85,405)	(7,695)
Income available to common stockholders	(68,452)	(3,011)	(108,202)	(12,176)
Net income per common share:				
Basic	\$ (0.58)	\$ (0.03)	\$ (1.07)	\$ (0.13)
Diluted	\$ (0.58)	\$ (0.03)	\$ (1.07)	\$ (0.13)

From the date of the acquisition through the period ended June 30, 2016, the properties associated with the Big Star Transaction have been comingled with our existing properties and it is impractical to provide the stand-alone operational results related to these properties.

On May 16, 2016, the Company completed the following transactions (collectively, the “AMI Transaction”) for an aggregate cash purchase price of \$33,012, excluding customary purchase price adjustments. Key elements of the AMI Transaction include:

- Formation of an area of mutual interest with TRP Energy, LLC (“TRP”) in western Reagan County, Texas, through the joint acquisition from a private party of 4,745 net acres (with a 55% share to Callon) north of the Garrison Draw field; and
- Callon’s simultaneous sale of a 27.5% interest in the Garrison Draw field to TRP.

The following table summarizes the acquisition date fair values of the net assets acquired, including customary purchase price adjustments:

Oil and natural gas properties	\$ 15,951
Unevaluated oil and natural gas properties	17,069
Asset retirement obligations	(8)
Net assets acquired	\$ 33,012

Callon Petroleum Company Notes to the Consolidated Financial Statements

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(All dollar amounts in thousands, except per share and per unit data)