

FOREST OIL CORP
Form 10-Q
August 09, 2005

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2005

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 1-13515

FOREST OIL CORPORATION

(Exact name of registrant as specified in its charter)

New York

(State or other jurisdiction of
incorporation or organization)

25-0484900

(I.R.S. Employer
Identification No.)

1600 Broadway Suite 2200 Denver, Colorado 80202

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(303) 812-1400**

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 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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of July 31, 2005 there were 62,012,491 shares of the registrant's common stock, par value \$.10 per share, outstanding.

FOREST OIL CORPORATION
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June 30, 2005

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PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

FOREST OIL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	June 30, 2005	December 31, 2004
	(In Thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 14,048	55,251
Accounts receivable	146,138	151,927
Deferred tax asset	66,457	38,321
Other current assets	30,019	37,969
Total current assets	256,662	283,468
Property and equipment, at cost:		
Oil and gas properties, full cost method of accounting:		
Proved, net of accumulated depletion of \$2,887,890 and \$2,701,402	2,728,035	2,495,894
Unproved	279,603	213,870
Net oil and gas properties	3,007,638	2,709,764
Other property and equipment, net of accumulated depreciation and amortization of \$30,913 and \$28,797	20,997	11,354
Net property and equipment	3,028,635	2,721,118
Goodwill	99,897	68,560
Other assets	43,531	49,359
	\$ 3,428,725	3,122,505
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	\$ 203,122	217,640
Derivative instruments	136,193	80,523
Asset retirement obligations	36,772	25,452
Total current liabilities	376,087	323,615
Long-term debt	917,958	888,819
Asset retirement obligations	180,217	184,724
Derivative instruments	41,259	20,890
Other liabilities	37,492	35,785
Deferred income taxes	317,928	196,525
Total liabilities	1,870,941	1,650,358
Shareholders' equity:		
Preferred stock, none issued		
Common stock, 63,864 and 61,595 shares issued and outstanding	6,386	6,159
Capital surplus	1,493,753	1,444,367
Retained earnings	157,066	66,007
Accumulated other comprehensive (loss) income	(48,518)	6,780
Treasury stock, at cost, 1,891 and 1,902 shares held	(50,903)	(51,166)
Total shareholders' equity	1,557,784	1,472,147
	\$ 3,428,725	3,122,505

See accompanying Notes to Condensed Consolidated Financial Statements.

FOREST OIL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
	(In Thousands Except Per Share Amounts)			
Revenue:				
Oil and gas sales:				
Natural gas	\$ 160,115	131,153	314,641	255,215
Oil, condensate and natural gas liquids	109,240	76,735	213,584	146,510
Total oil and gas sales	269,355	207,888	528,225	401,725
Processing and marketing income, net	1,700	590	3,121	1,006
Total revenue	271,055	208,478	531,346	402,731
Operating expenses:				
Lease operating expenses	45,783	43,868	93,643	92,057
Production and property taxes	10,547	7,095	20,444	14,543
Transportation costs	4,583	3,728	9,755	7,420
General and administrative	11,091	8,169	21,847	14,529
Depreciation and depletion	97,249	83,474	193,525	163,102
Accretion of asset retirement obligation	4,322	4,153	8,599	8,428
Impairment of oil and gas properties		1,690	2,924	1,690
Total operating expenses	173,575	152,177	350,737	301,769
Earnings from operations	97,480	56,301	180,609	100,962
Other income and expense:				
Interest expense	16,061	13,084	30,560	26,031
Unrealized (gain) loss on derivative instruments	(4,310)	(1,248)	2,270	(217)
Other expense (income), net	1,659	115	3,592	(1,340)
Total other income and expense	13,410	11,951	36,422	24,474
Earnings before income taxes and discontinued operations	84,070	44,350	144,187	76,488
Income tax expense:				
Current	617	157	2,174	868
Deferred	31,252	16,063	50,941	27,853
Total income tax expense	31,869	16,220	53,115	28,721
Earnings from continuing operations	52,201	28,130	91,072	47,767
Loss from discontinued operations, net of tax				(575)
Net earnings	\$ 52,201	28,130	91,072	47,192
Basic earnings per common share:				
Earnings from continuing operations	\$.85	.51	1.50	.88
Loss from discontinued operations, net of tax				(.01)
Net earnings per common share	\$.85	.51	1.50	.87
Diluted earnings per common share:				
Earnings from continuing operations	\$.83	.50	1.46	.86
Loss from discontinued operations, net of tax				(.01)
Net earnings per common share	\$.83	.50	1.46	.85

See accompanying Notes to Condensed Consolidated Financial Statements.

FOREST OIL CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY
(Unaudited)

	Common Stock		Capital	Retained	Accumulated	Treasury	Total
	Shares	Amount	Surplus	Earnings	Other	Stock	Shareholders
	(In Thousands)						
Balances at January 1, 2005	61,595	\$ 6,159	1,444,367	66,007	6,780	(51,166)	1,472,147
Exercise of warrants to purchase shares of common stock	1,358	136	14,248				14,384
Stock options exercised	901	90	23,696				23,786
Tax benefit of stock options exercised			3,241				3,241
Employee stock purchase plan	10	1	282				283
Effect of issuance of treasury stock for stock options exercised			(28)	(13)		272	231
Restricted stock granted, net of forfeitures			9			(9)	
Amortization of deferred stock compensation, net of forfeitures and other			443				443
Tax benefit of acquired net operating losses			7,495				7,495
Comprehensive earnings:							
Net earnings				91,072			91,072
Unrealized loss on effective derivative instruments, net of tax					(48,259)		(48,259)
Increase in unfunded pension liability, net of tax					(149)		(149)
Foreign currency translation					(6,890)		(6,890)
Total comprehensive earnings							35,774
Balances at June 30, 2005	63,864	\$ 6,386	1,493,753	157,066	(48,518)	(50,903)	1,557,784

See accompanying Notes to Condensed Consolidated Financial Statements.

FOREST OIL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended	
	June 30,	2004
	2005	
	(In Thousands)	
Operating activities:		
Net earnings	\$ 91,072	47,192
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and depletion	193,525	163,102
Accretion of asset retirement obligations	8,599	8,428
Impairment of oil and gas properties	2,924	1,690
Unrealized loss (gain) on derivative instruments	2,270	(217)
Deferred income tax expense	50,941	28,574
Other, net	(222)	(2,359)
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	20,745	24,251
Other current assets	1,324	(5,046)
Accounts payable and accrued expenses	(45,755)	(22,420)
Net cash provided by operating activities	325,423	243,195
Investing activities:		
Acquisition of subsidiaries	(196,631)	(167,968)
Capital expenditures for property and equipment:		
Exploration, development and other acquisition costs	(201,577)	(163,603)
Other fixed assets	(4,853)	(1,229)
Proceeds from sales of assets	6,437	8,510
Sale of goodwill and contract value		8,493
Other, net	(5,047)	1,168
Net cash used by investing activities	(401,671)	(314,629)
Financing activities:		
Proceeds from bank borrowings	1,157,953	493,490
Repayments of bank borrowings	(1,126,000)	(470,000)
Repayments of bank debt assumed in acquisitions	(35,000)	(30,000)
Proceeds of common stock offering, net of offering costs		117,143
Proceeds from the exercise of options and warrants and employee stock purchases	38,453	4,541
Other, net	322	(2,566)
Net cash provided by financing activities	35,728	112,608
Effect of exchange rate changes on cash	(683)	(495)
Net (decrease) increase in cash and cash equivalents	(41,203)	40,679
Cash and cash equivalents at beginning of period	55,251	11,509
Cash and cash equivalents at end of period	\$ 14,048	52,188
Cash paid during the period for:		
Interest	\$ 32,283	26,703
Income taxes	5,141	2,993

See accompanying Notes to Condensed Consolidated Financial Statements.

FOREST OIL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(1) BASIS OF PRESENTATION

The Condensed Consolidated Financial Statements included herein are unaudited and include the accounts of Forest Oil Corporation and its consolidated subsidiaries (collectively, Forest or the Company). In the opinion of management, all adjustments, consisting of normal recurring accruals, have been made which are necessary for a fair presentation of the financial position of Forest at June 30, 2005, the results of its operations for the three and six months ended June 30, 2005 and 2004, and its cash flows for the six months ended June 30, 2005 and 2004. Quarterly results are not necessarily indicative of expected annual results because of the impact of fluctuations in prices received for liquids (oil, condensate, and natural gas liquids) and natural gas and other factors.

In the course of preparing the Condensed Consolidated Financial Statements, management makes various assumptions, judgments, and estimates to determine the reported amount of assets, liabilities, revenue, and expenses, and in the disclosures of commitments and contingencies. Changes in these assumptions, judgments, and estimates will occur as a result of the passage of time and the occurrence of future events and, accordingly, actual results could differ from amounts initially established.

The more significant areas requiring the use of assumptions, judgments, and estimates relate to volumes of oil and gas reserves used in calculating depletion, the amount of future net revenues used in computing the ceiling test limitations, and the amount of future capital costs and abandonment obligations used in such calculations. Assumptions, judgments, and estimates are also required in determining impairments of undeveloped properties, valuing deferred tax assets, and estimating fair values of derivative instruments.

Certain amounts in the prior year financial statements have been reclassified to conform to the 2005 financial statement presentation.

For a more complete understanding of Forest's operations, financial position, and accounting policies, reference is made to the consolidated financial statements of Forest, and related notes thereto, filed with Forest's annual report on Form 10-K for the year ended December 31, 2004, previously filed with the Securities and Exchange Commission.

(2) ACQUISITIONS AND DIVESTITURES

Acquisitions

Buffalo Wallow Acquisition

On April 1, 2005, Forest purchased a private company whose primary assets are located in the Buffalo Wallow field in Texas and include approximately 33,000 gross acres located primarily in Hemphill and Wheeler Counties, Texas (the Buffalo Wallow Acquisition). The purchase price was allocated to assets and liabilities, adjusted for tax effects, based on the fair values at the date of acquisition. The acquisition was accounted for using the purchase method of accounting and has been included in the consolidated financial statements of Forest since the date of acquisition.

(2) ACQUISITIONS AND DIVESTITURES (Continued)

The net cash consideration paid for the private company was allocated as follows:

	(In Thousands)	
Current assets	\$	9,286
Oil and gas properties		305,005
Goodwill		38,081
Other assets		68
Current liabilities		(25,039)
Derivative liability current		(6,373)
Long-term debt		(35,000)
Asset retirement obligation		(705)
Deferred taxes		(88,692)
Net cash consideration	\$	196,631

Goodwill of \$38.1 million has been recognized to the extent that cost exceeded the fair value of net assets acquired. Goodwill is not expected to be deductible for tax purposes. The goodwill was assigned to Forest's Western business unit. The principal factors that contributed to the recognition of goodwill include the mix of complementary high-quality assets in one of our existing core areas, lower-risk exploitation opportunities, expected increased cash flow from operations available for investing activities, and opportunities for cost savings through administrative and operational synergies.

The allocation of the purchase price is preliminary because certain items such as the determination of the final tax basis and the fair value of certain assets and liabilities as of the acquisition date have not been finalized.

Acquisition of The Wiser Oil Company

In June 2004, Forest completed its acquisition of the common stock of The Wiser Oil Company (Wiser), which held oil and gas assets located in the geographic areas of Forest's Gulf Coast, Western, and Canada business units (the Wiser Acquisition).

The following unaudited pro forma consolidated statements of operations information assumes that the Wiser Acquisition occurred as of January 1, 2004. The pro forma results of operations is not necessarily indicative of the results of operations that would have actually been attained if the transaction had occurred as of January 1, 2004.

	Three Months Ended June 30, 2004 (In Thousands Except Per Share Amounts)	Six Months Ended June 30, 2004
Total revenue	\$ 243,311	465,961
Earnings from continuing operations	30,604	46,691
Net earnings	30,604	46,116
Basic earnings per share	.55	.85
Diluted earnings per share	.54	.83

(2) ACQUISITIONS AND DIVESTITURES (Continued)*Divestitures*

On March 1, 2004, the assets and business operations of Forest's Canadian marketing subsidiary, ProMark, were sold to Cinergy Canada, Inc. (Cinergy) for \$11.2 million CDN. Under the terms of the purchase and sale agreement, Cinergy will market natural gas (not already subject to prior contractual commitments) on behalf of Forest's Canadian exploration and production subsidiary, Canadian Forest Oil Ltd., for five years. Cinergy will also administer the netback pool formerly administered by ProMark. Forest could receive additional contingent payments over the next five years if Cinergy meets certain earnings goals with respect to the acquired business.

As a result of the sale, ProMark's results of operations have been reported as discontinued operations in the accompanying financial statements. The components of loss from discontinued operations for the six months ended June 30, 2004 are as follows:

	Six Months Ended June 30, 2004 (In Thousands)
Marketing revenue, net	\$ 597
General and administrative expense	(280)
Interest expense	(2)
Other expense	(166)
Current income tax expense	(2)
Deferred income tax expense	(722)
Loss from discontinued operations, net of tax	\$ (575)

(3) EARNINGS PER SHARE AND COMPREHENSIVE EARNINGS (LOSS)*Earnings per Share*

Basic earnings per share is computed by dividing net earnings from continuing operations attributable to common stock by the weighted average number of common shares outstanding during each period, excluding treasury shares.

Diluted earnings per share is computed by adjusting the average number of common shares outstanding for the dilutive effect, if any, of convertible preferred stock, stock options, unvested restricted stock grants, and warrants. The following sets forth the calculation of basic and diluted earnings per share:

	Three Months		Six Months	
	Ended June 30,		Ended June 30,	
	2005	2004	2005	2004
	(In Thousands Except Per Share Amounts)			
Earnings from continuing operations	\$ 52,201	28,130	91,072	47,767
Weighted average common shares outstanding during the period	61,419	55,437	60,817	54,560
Add dilutive effects of stock options and unvested restricted stock grants	990	281	984	301
Add dilutive effects of warrants	318	719	632	733
Weighted average common shares outstanding including the effects of dilutive securities	62,727	56,437	62,433	55,594
Basic earnings per share from continuing operations	\$.85	.51	1.50	.88
Diluted earnings per share from continuing operations	\$.83	.50	1.46	.86

(3) EARNINGS PER SHARE AND COMPREHENSIVE EARNINGS (LOSS) (Continued)

For the three months ended June 30, 2005 and 2004, options to purchase 30,500 and 1,545,450 shares of common stock, respectively, were not included in the computation of diluted earnings per share, because the exercise prices of these options were greater than the average market price of the common stock during the period. For the six months ended June 30, 2005 and 2004, options to purchase 27,500 and 1,539,950 shares of common stock, respectively, were not included in the computation of diluted earnings per share, because the exercise prices of these options were greater than the average market price of the common stock during the period.

As of June 30, 2005, Forest has no outstanding Subscription Warrants. Forest had Subscription Warrants which entitled the holder to purchase 0.8 shares of Common Stock for \$10.00, or an equivalent per share of \$12.50 per share, and which were originally scheduled to expire on March 20, 2010 or earlier upon notice of expiration (the Subscription Warrants). On April 8, 2005, Forest gave notice that it was accelerating the expiration of the Subscription Warrants to May 9, 2005.

Comprehensive Earnings (Loss):

Comprehensive earnings (loss) is a term used to refer to net earnings (loss) plus other comprehensive income (loss). Other comprehensive income (loss) is comprised of revenues, expenses, gains, and losses that under generally accepted accounting principles are reported as separate components of shareholders' equity instead of net earnings (loss). Items included in Forest's other comprehensive income (loss) for the three and six months ended June 30, 2005 and 2004 are foreign currency gains (losses) related to the translation of the assets and liabilities of Forest's Canadian operations, changes in the unfunded pension liability, unrealized gains (losses) related to the change in fair value of derivative instruments designated as cash flow hedges, and unrealized gains (losses) related to the change in fair value of securities held for sale.

The components of comprehensive earnings (loss) are as follows:

	Three Months				Six Months			
	Ended June 30,				Ended June 30,			
	2005		2004		2005		2004	
	(In Thousands)							
Net earnings	\$	52,201		28,130		91,072		47,192
Other comprehensive income (loss):								
Foreign currency translation losses		(4,011))	(4,327))	(6,890))	(7,369)
Unfunded pension liability, net of tax						(149))	6
Unrealized gain (loss) on derivative instruments, net of tax								