CALLON PETROLEUM CO
Form 10-Q
August 06, 2007

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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, 2007 **Commission File Number 001-14039**

CALLON PETROLEUM COMPANY

(Exact name of registrant as specified in its charter)

Delaware	**64-0844345**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

200 North Canal Street
Natchez, Mississippi 39120
(Address of principal executive offices)(Zip code)
(601) 442-1601
(Registrant s telephone number, including area code)

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 þ No o

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

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

As of August 1, 2007, there were 20,808,254 shares of the Registrant s Common Stock, par value $0.01 per share, outstanding.

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Callon Petroleum Company
Consolidated Balance Sheets
(In thousands, except share data)

	June 30, 2007 (Unaudited)	December 31, 2006 (Note 1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 29,270	$ 1,896
Accounts receivable	24,486	32,166
Restricted investments	2,658	4,306
Fair market value of derivatives	4,325	13,311
Other current assets	6,902	5,973
Total current assets	67,641	57,652
Oil and gas properties, full-cost accounting method:		
Evaluated properties	1,268,691	1,096,907
Less accumulated depreciation, depletion and amortization	(645,348)	(604,682)
	623,343	492,225
Unevaluated properties excluded from amortization	68,050	54,802
Total oil and gas properties	691,393	547,027
Other property and equipment, net	2,104	1,996
Restricted investments	3,749	1,935
Investment in Medusa Spar LLC	12,610	12,580
Other assets, net	11,354	4,337
Total assets	$ 788,851	$ 625,527
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 44,721	$ 46,611
Asset retirement obligations	11,083	14,355
Current maturities of long-term debt		213
Total current liabilities	55,804	61,179
Long-term debt	390,907	225,521
Asset retirement obligations	23,527	26,824
Deferred tax liability	32,169	30,054

Other long-term liabilities	1,018	586
Total liabilities	503,425	344,164
Stockholders equity:		
Preferred Stock, $.01 par value, 2,500,000 shares authorized;		
Common Stock, $.01 par value, 30,000,000 shares authorized; 20,754,450 and 20,747,773 shares outstanding at June 30, 2007 and December 31, 2006, respectively	208	207
Capital in excess of par value	222,304	220,785
Other comprehensive income	2,811	8,652
Retained earnings	60,103	51,719
Total stockholders equity	285,426	281,363
Total liabilities and stockholders equity	$ 788,851	$ 625,527

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

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Callon Petroleum Company
Consolidated Statements of Operations
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	**2006**	**2007**	**2006**
Operating revenues:				
Oil sales	$ 16,178	$ 26,580	$ 32,146	$ 54,379
Gas sales	27,296	20,477	56,812	38,259
Total operating revenues	43,474	47,057	88,958	92,638
Operating expenses:				
Lease operating expenses	8,613	7,365	15,212	13,270
Depreciation, depletion and amortization	18,819	14,791	40,666	28,627
General and administrative	2,271	1,924	4,492	3,650
Accretion expense	943	1,331	2,055	2,750
Derivative expense		30		120
Total operating expenses	30,646	25,441	62,425	48,417
Income from operations	12,828	21,616	26,533	44,221
Other (income) expenses:				
Interest expense	9,172	4,128	13,757	8,276
Other (income)	(102)	(670)	(427)	(1,000)
Total other (income) expenses	9,070	3,458	13,330	7,276
Income before income taxes	3,758	18,158	13,203	36,945
Income tax expense	1,315	6,294	5,118	12,844
Income before Medusa Spar LLC	2,443	11,864	8,085	24,101
Income from Medusa Spar LLC net of tax	138	439	299	969
Net income	$ 2,581	$ 12,303	$ 8,384	$ 25,070
Net income per common share:				
Basic	$ 0.12	$ 0.61	$ 0.40	$ 1.26

Diluted	$ 0.12	$ 0.57	$ 0.39	$ 1.17
Shares used in computing net income:				
Basic	20,726	20,314	20,724	19,855
Diluted	21,302	21,448	21,248	21,388

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

Callon Petroleum Company
Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
Cash flows from operating activities:		
Net income	$ 8,384	$ 25,070
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation, depletion and amortization	41,095	28,996
Accretion expense	2,055	2,750
Amortization of deferred financing costs	1,314	1,106
Non-cash derivative expense		120
Equity in earnings of Medusa Spar LLC	(299)	(969)
Deferred income tax expense	5,118	12,844
Non-cash charge related to compensation plans	725	267
Excess tax benefits from share-based payment arrangements		(1,304)
Changes in current assets and liabilities:		
Accounts receivable	6,340	1,282
Other current assets	(929)	243
Current liabilities	6,980	5,579
Change in gas balancing receivable	(10)	(257)
Change in gas balancing payable	437	103
Change in other long-term liabilities	(5)	216
Change in other assets, net	(1,049)	(704)
Cash provided by operating activities	70,156	75,342
Cash flows from investing activities:		
Capital expenditures	(50,911)	(80,015)
Entrada acquisition	(150,000)	
Distribution from Medusa Spar LLC	430	370
Cash used by investing activities	(200,481)	(79,645)
Cash flows from financing activities:		
Change in accrued liabilities to be refinanced		(5,000)
Increases in debt	211,000	39,000
Payments on debt	(46,000)	(32,000)
Deferred financing costs	(6,429)	
Equity issued related to employee stock plans		(381)
Excess tax benefits from share-based payment arrangements		1,304
Capital leases	(872)	(139)
Cash provided by financing activities	157,699	2,784

Net increase (decrease) in cash and cash equivalents	27,374	(1,519)
Cash and cash equivalents:		
Balance, beginning of period	1,896	2,565
Balance, end of period	$ 29,270	$ 1,046

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

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CALLON PETROLEUM COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2007

1. General

The financial information presented as of any date other than December 31, 2006 has been prepared from the books and records of Callon Petroleum Company (the Company or Callon) without audit. Financial information as of December 31, 2006 has been derived from the audited financial statements of the Company, but does not include all disclosures required by U.S. generally accepted accounting principles. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary for the fair presentation of the financial information for the periods indicated, have been included. For further information regarding the Company s accounting policies, refer to the Consolidated Financial Statements and related notes for the year ended December 31, 2006 included in the Company s Annual Report on Form 10-K filed March 16, 2007. The results of operations for the three-month and six-month periods ended June 30, 2007 are not necessarily indicative of future financial results.

2. Net Income Per Share

Basic net income per common share was computed by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted net income per common share was determined on a weighted average basis using common shares issued and outstanding adjusted for the effect of common stock equivalents computed using the treasury stock method.

A reconciliation of the basic and diluted net income per share computation is as follows (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	**2006**	**2007**	**2006**
(a) Net income	$ 2,581	$ 12,303	$ 8,384	$ 25,070
(b) Weighted average shares outstanding	20,726	20,314	20,724	19,855
Dilutive impact of stock options	150	247	144	294
Dilutive impact of warrants	335	775	317	1,133
Dilutive impact of restricted stock	91	112	63	106
(c) Weighted average shares outstanding for diluted net income per share	21,302	21,448	21,248	21,388
Basic net income per share (a¸b)	$ 0.12	$ 0.61	$ 0.40	$ 1.26
Diluted net income per share (a¸c)	$ 0.12	$ 0.57	$ 0.39	$ 1.17
Stock options and warrants excluded due to the exercise price being greater than the stock price	77	15	73	15

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3. Derivatives

The Company periodically uses derivative financial instruments to manage oil and gas price risk on a limited amount of its future production and does not use these instruments for trading purposes. Settlements of derivative contracts are generally based on the difference between the contract price or prices specified in the derivative instrument and a NYMEX price or other cash or futures index price. Such derivative contracts are accounted for under Statement of Financial Accounting Standards No. 133. Accounting for Derivative Instruments and Hedging Activities, (SFAS No. 133), as amended.

The Company s derivative contracts that are accounted for as cash flow hedges under SFAS 133 are recorded at fair market value and the changes in fair value are recorded through other comprehensive income (loss), net of tax, in stockholders equity. The cash settlements on these contracts are recorded as an increase or decrease in oil and gas sales. The changes in fair value related to ineffective derivative contracts are recognized as derivative expense (income). The cash settlements on these contracts are also recorded within derivative expense (income).

Cash settlements on effective cash flow hedges during the three-month periods ended June 30, 2007 and 2006 resulted in an increase in oil and gas sales of $823,000 and $1.8 million, respectively. Cash settlements on effective cash flow hedges during the six-month periods ended June 30, 2007 and 2006 resulted in an increase in oil and gas sales of $3.6 million and $2.5 million, respectively.

Derivative expense of $30,000 and $120,000 for three-month and the six-month periods ended June 30, 2006, respectively, represents the amortization of derivative contract premiums.

Listed in the table below are the outstanding derivative contracts as of June 30, 2007:

Collars

Product	Volumes per Month	Quantity Type	Average Floor Price	Average Ceiling Price	Period
Oil	25,000	Bbls	$65.00	$83.30	07/07-12/07
Oil	25,000	Bbls	$65.00	$94.20	07/07-12/07
Natural Gas	600,000	MMBtu	$ 8.00	$12.70	07/07-12/07

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4. Long-Term Debt

Long-term debt consisted of the following at:

	June 30, 2007	December 31, 2006
	(In thousands)	
Senior Secured Credit Facility (matures July 31, 2010)	$	$ 35,000
9.75% Senior Notes (due 2010), net of discount	190,907	189,862
Senior Revolving Credit Facility (due 2014)	200,000	
Capital lease		872
Total debt	390,907	225,734
Less current portion:		
Capital lease		213
Long-term debt	$ 390,907	$ 225,521

On August 30 2006, the Company closed on a four-year amended and restated senior secured credit facility with Union Bank of California (UBOC), N.A. The borrowing base, which is reviewed and redetermined semi-annually, was $50 million at June 30, 2007. Borrowings under the credit facility are secured by mortgages covering the Company s major fields excluding Entrada. As of June 30, 2007, there were no borrowings under the facility.

On April 18, 2007, Callon closed the Entrada acquisition contemporaneous with a seven-year $200 million senior revolving credit facility arranged by Merrill Lynch Capital Corporation, which is secured by a lien on the Entrada properties. Borrowings outstanding under the facility bear interest at a rate of LIBOR plus 7%. The Company borrowed the full commitment amount under the facility at closing to cover the required $150 million payment to BP Exploration and Production Company (BP) and expenses and fees related to the transaction and the balance was used to pay down the Company s UBOC senior secured credit facility. Callon s UBOC senior secured credit facility was amended to allow for this transaction. The amendment included a provision which reduced the borrowing base under the UBOC facility to $50 million until the next borrowing base redetermination date. See Note 7 for more discussion on the Entrada acquisition.

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5. Comprehensive Income

A summary of the Company s comprehensive income is detailed below (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Net income	$ 2,581	$ 12,303	$ 8,384	$ 25,070
Other comprehensive income (loss):				
Change in fair value of derivatives	80	1,019	(5,841)	2,294
Total comprehensive income	$ 2,661	$ 13,322	$ 2,543	$ 27,364

6. Asset Retirement Obligations

The following table summarizes the activity for the Company s asset retirement obligations:

	Six Months Ended June 30, 2007
Asset retirement obligation at beginning of period	$ 41,179
Accretion expense	2,055
Liabilities incurred	315
Liabilities settled	(8,621)
Revisions to estimate	(318)
Asset retirement obligation at end of period	34,610
Less: current asset retirement obligation	(11,083)
Long-term asset retirement obligation	$ 23,527

Assets, primarily U.S. Government securities, of approximately $6.4 million at June 30, 2007, are recorded as restricted investments. These assets are held in abandonment trusts dedicated to pay future abandonment costs for several of the Company s oil and gas properties.

7. Entrada Acquisition

On April 18, 2007, the Company completed an acquisition of BP s 80% working interest in the Entrada Field for a purchase price of $190 million. The purchase price included $150 million payable at closing and an additional $40 million payable after the achievement of certain production milestones. The purchased interests included five federal offshore blocks at Garden Banks Blocks 738, 782, 785, 826 and 827, subject to certain depth limitations. As a result of the acquisition, Callon owns a 100% working interest in the Entrada Field and is operator. The acquisition added 150 billion cubic feet of natural gas equivalent (Bcfe) to Callon s proved undeveloped reserves.

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The acquisition was recorded at fair value based on the initial purchase price of $150 million. The Company may record the additional $40 million as additional purchase price in the future when the production milestones are achieved, in accordance with the terms of the agreement.

To finance the initial $150 million payment of the purchase price, Callon closed on a seven-year $200 million senior revolving credit facility arranged by Merrill Lynch Capital Corporation contemporaneous with the closing of the acquisition, which is secured by a lien on the Entrada properties. The Company borrowed the full commitment amount under the facility at closing to cover the required $150 million payment to BP and expenses and fees related to the transaction and the balance was used to pay down our UBOC senior secured credit facility.

8. Accounting for Uncertainty in Income Taxes

Callon adopted Financial Accounting Standards Board (FASB) Interpretation No. 48 Accounting for Uncertainty in Income Taxes (FIN 48), effective January 1, 2007. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company had no significant unrecognized tax benefits at the date of adoption or at June 30, 2007. Accordingly, the Company does not have any interest or penalties related to uncertain tax positions. However, if interest or penalties were to be incurred related to uncertain tax positions, such amounts would be recognized in income tax expense. Tax periods for all years after 1978 remain open to examination by the federal and state taxing jurisdictions to which the Company is subject.

9. Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standard No. 157, (SFAS 157), Fair Value Measurements. SFAS 157 defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company is currently reviewing the provisions of SFAS 157 and has not yet determined the impact of adoption.

In February 2007, the FASB issued Statement of Financial Accounting Standard No. 159 The Fair Value Option for Financial Assets and Liabilities Including an amendment of FASB No. 115 (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. This statement is effective for fiscal years beginning after November 15, 2007, with early adoption allowed. The Company has not yet determined the impact, if any, the adoption of this standard may have on its financial condition or results of operations.