

CALLON PETROLEUM CO  
Form 10-Q  
November 09, 2009

**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 September 30, 2009  
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  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 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 definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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

As of November 2, 2009, there were 21,833,094 shares of the Registrant's Common Stock, par value \$0.01 per share, outstanding.

**CALLON PETROLEUM COMPANY  
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**Callon Petroleum Company**  
**Consolidated Balance Sheets**  
(In thousands, except share data)

	<b>September 30, 2009 (Unaudited)</b>	<b>December 31, 2008 (Note 2)</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,062	\$ 17,126
Accounts receivable	17,796	44,290
Fair market value of derivatives	3,630	21,780
Other current assets	2,681	1,103
Total current assets	25,169	84,299
Oil and gas properties, full-cost accounting method:		
Evaluated properties	1,576,267	1,581,698
Less accumulated depreciation, depletion and amortization	(1,480,000)	(1,455,275)
	96,267	126,423
Unevaluated properties excluded from amortization	29,315	32,829
Total oil and gas properties	125,582	159,252
Other property and equipment, net	2,498	2,536
Restricted investments	4,057	4,759
Investment in Medusa Spar LLC	11,688	12,577
Other assets, net	2,174	2,667
Total assets	\$ 171,168	\$ 266,090
<b>LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 15,589	\$ 76,516
Asset retirement obligations	4,283	9,151
	19,872	85,667
Callon Entrada non-recourse credit facility (See Note 1)	84,450	
Total current liabilities	104,322	85,667
9.75% Senior Notes	196,412	194,420
Callon Entrada non-recourse credit facility (See Note 1)		78,435

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Total long-term debt	196,412	272,855
Asset retirement obligations	12,503	33,043
Callon Entrada non-recourse credit facility interest payable (See Note 1)		2,719
Other long-term liabilities	1,685	1,610
Total liabilities	314,922	395,894
Stockholders' equity (deficit):		
Preferred Stock, \$.01 par value, 2,500,000 shares authorized;		
Common Stock, \$.01 par value, 30,000,000 shares authorized; 21,805,311		
and 21,621,142 shares outstanding at September 30, 2009 and December 31,		
2008, respectively	218	216
Capital in excess of par value	231,540	227,803
Other comprehensive income (loss)	(4,056)	14,157
Retained (deficit) earnings	(371,456)	(371,980)
Total stockholders' equity (deficit)	(143,754)	(129,804)
Total liabilities and stockholders' equity (deficit)	\$ 171,168	\$ 266,090

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

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

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Operating revenues:				
Oil sales	\$ 16,451	\$ 20,366	\$ 51,374	\$ 74,016
Gas sales	4,869	12,417	19,786	51,756
<b>Total operating revenues</b>	<b>21,320</b>	<b>32,783</b>	<b>71,160</b>	<b>125,772</b>
Operating expenses:				
Lease operating expenses	4,962	3,701	13,657	13,749
Depreciation, depletion and amortization	6,861	11,513	24,726	41,760
General and administrative	3,000	1,451	10,210	7,046
Derivative expense		1,386		1,386
Accretion expense	698	1,092	2,531	3,076
<b>Total operating expenses</b>	<b>15,521</b>	<b>19,143</b>	<b>51,124</b>	<b>67,017</b>
<b>Income from operations</b>	<b>5,799</b>	<b>13,640</b>	<b>20,036</b>	<b>58,755</b>
Other (income) expenses:				
Interest expense	4,919	4,152	14,555	18,526
Callon Entrada non-recourse credit facility interest expense (See Note 1)	1,882	862	5,373	1,183
Other (income) expense	110	(89)	76	(940)
Loss on early extinguishment of debt				11,871
<b>Total other (income) expenses</b>	<b>6,911</b>	<b>4,925</b>	<b>20,004</b>	<b>30,640</b>
<b>Income (loss) before income taxes</b>	<b>(1,112)</b>	<b>8,715</b>	<b>32</b>	<b>28,115</b>
Income tax expense		2,919		9,731
<b>Income (loss) before equity in earnings of Medusa Spar LLC</b>	<b>(1,112)</b>	<b>5,796</b>	<b>32</b>	<b>18,384</b>
Equity in earnings of Medusa Spar LLC	157	60	492	257
<b>Net income (loss) available to common shares</b>	<b>\$ (955)</b>	<b>\$ 5,856</b>	<b>\$ 524</b>	<b>\$ 18,641</b>

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Net income (loss) per common share:				
Basic	\$ (0.04)	\$ 0.27	\$ 0.02	\$ 0.88
Diluted	\$ (0.04)	\$ 0.27	\$ 0.02	\$ 0.85
Shares used in computing net income (loss) per common share:				
Basic	21,705	21,460	21,631	21,078
Diluted	21,705	22,028	21,665	21,893

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

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

	<b>Nine Months Ended</b>	
	<b>September</b>	<b>September</b>
	<b>30,</b>	<b>30,</b>
	<b>2009</b>	<b>2008</b>
Cash flows from operating activities:		
Net income	\$ 524	\$ 18,641
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation, depletion and amortization	25,359	42,333
Accretion expense	2,531	3,076
Amortization of deferred financing costs	2,251	2,308
Callon Entrada non-recourse credit facility interest expense	3,296	
Non-cash loss on early extinguishment of debt		5,598
Equity in earnings of Medusa Spar LLC	(492)	(257)
Non-cash derivative expense		690
Deferred income tax expense		9,731
Non-cash charge related to compensation plans	1,947	1,026
Excess tax benefits from share-based payment arrangements		(1,985)
Changes in current assets and liabilities:		
Accounts receivable	8,355	13,094
Other current assets	(841)	3,094
Current liabilities	(25,709)	26,039
Change in gas balancing receivable	454	806
Change in gas balancing payable	(201)	356
Change in other long-term liabilities	54	1,174
Change in other assets, net	(531)	(949)
Cash provided by operating activities	16,997	124,775
Cash flows from investing activities:		
Capital expenditures	(34,442)	(123,626)
Proceeds from sale of mineral interests		167,493
Distribution from Medusa Spar LLC	1,381	389
Cash (used in) provided by investing activities	(33,061)	44,256
Cash flows from financing activities:		
Proceeds from senior secured credit facility	9,337	94,435
Payments on senior secured credit facility	(9,337)	(216,000)
Equity issued related to stock incentive plans		(1,152)
Excess tax benefits from share-based payment arrangements		1,985
Cash used in financing activities		(120,732)

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Net change in cash and cash equivalents	(16,064)	48,299
Cash and cash equivalents:		
Balance, beginning of period	17,126	53,250
Balance, end of period	\$ 1,062	\$ 101,549

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

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**CALLON PETROLEUM COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**September 30, 2009**

**1. Callon Entrada Non-Recourse Credit Facility**

A wholly-owned subsidiary of Callon Petroleum Company (the Company or Callon), Callon Entrada Company (Callon Entrada), entered into a non-recourse credit agreement with CIECO Energy (Entrada) LLC, (CIECO Entrada) pursuant to which Callon Entrada was entitled to borrow up to \$150 million, plus interest expense incurred of up to \$12 million, to finance the development of the Entrada project prior to the abandonment of the project in November 2008. Based on the terms of the non-recourse credit agreement, the debt was to be repaid solely from assets, primarily production, from the Entrada field. As a result of abandoning the project prior to completion and the lease expiring on June 1, 2009, Callon Entrada's only source of payment is from the sale of equipment purchased but not used for the Entrada project. The agreement bears interest at six-month LIBOR (as in effect on the first day of each interest period) plus 375 basis points and is subject to customary representations, warranties, covenants and events of default. The interest rate increased by 400 basis points as of April 2, 2009 due to a notice of default received from CIECO Entrada which is discussed below. As of September 30, 2009, \$78.4 million of principal and \$6.0 million of interest were outstanding under this facility.

On April 2, 2009, Callon Entrada received a notice from CIECO Entrada advising Callon Entrada that certain alleged events of default occurred under the non-recourse credit agreement relating to failure to pay interest when due and the breach of various other covenants related to the decision to abandon the Entrada project. The notice of default received from CIECO Entrada invoked CIECO Entrada's rights under the Callon Entrada non-recourse credit agreement to accelerate payment of the principal and interest due. The acceleration of payment caused the principal and interest balances under the Callon Entrada non-recourse credit agreement to be reclassified effective as of the date of notice to current liabilities from long-term liabilities under U.S. generally accepted accounting principles (GAAP). The agreement has not been legally extinguished and as such under GAAP, the agreement remains as a liability of Callon Entrada. The Company is currently required to continue to consolidate the financial statements and results of operations of Callon Entrada. Callon Entrada's non-recourse liability is reflected in a separate line item in Callon's consolidated financial statements. All assets of Callon Entrada, and its stock, are pledged to CIECO Entrada. Based on the advice of counsel, the Company believes that Callon and its subsidiaries (other than Callon Entrada) did not guarantee and are not otherwise obligated to repay the principal, accrued interest or any other amount which may become due under the Callon Entrada credit facility. However, Callon has entered into a customary indemnification agreement pursuant to which it agrees to indemnify the lenders under the Callon Entrada credit facility against Callon Entrada's misappropriation of funds, non-performance of certain covenants, excluding the events of default discussed above, and similar matters. In addition, Callon also guaranteed the obligations of Callon Entrada to fund its proportionate share of any operating costs related to the Entrada project that Callon Entrada may, from time to time, expressly approve under the Entrada joint operating agreement for which none remain nor are there any planned. Callon also has guaranteed Callon Entrada's payment of all amounts to plug and abandon wells and related facilities and for a breach of law, rule or

regulation (including environmental laws) and for any losses of CIECO Entrada attributable to gross negligence of Callon Entrada. The well for which Callon Entrada was responsible for was plugged and abandoned in the fourth of quarter of 2008 and the Minerals Management Service ( MMS ) has confirmed to Callon that all abandonment obligations have been satisfied.

Prior to abandonment of the Entrada project, CIECO Entrada failed to fund two loan requests totaling \$40 million under the Callon Entrada non-recourse credit agreement. These loan requests were to cover Callon Entrada's share of the cost incurred to develop the Entrada field up to the suspension of the project. Such amounts were subsequently funded by the Company to Callon Entrada and were included as part of the Company's full-cost pool impairment adjustment recorded in the fourth quarter of 2008. The Company continues to discuss with CIECO Entrada its failure to fund the \$40 million in loan requests.

CIECO Entrada also failed to fund its working interest share of a settlement payment in the amount of \$7.3 million to terminate a drilling contract for the Entrada Project. No assurances can be made regarding the outcome of discussions related to the Company's ability to recover its funds related to the Entrada Project. The Company does not believe that we have waived any of our rights under the agreements with CIECO Entrada or its parent, CIECO Energy (U.S.) LLC ( CIECO ).

As of September 30, 2009, the wind down of the Entrada project was complete and substantially all of the costs had been paid. The lease expired June 1, 2009 and reverted to the MMS. In addition, the sale of equipment purchased for the Entrada project, but not used, is in progress. As of September 2009, Callon Entrada has collected \$2.1 million in sales proceeds from the sale of equipment, net to its interest, which was applied to unpaid interest expense as required under the Callon Entrada non-recourse credit facility. The Company believes that the amount of future operating costs of Callon Entrada, for which the Company would be responsible for, is not significant.

Below are consolidating condensed financial statements of Callon presented to demonstrate that Callon Entrada does not have sufficient assets available to pay down the balance owed under the Callon Entrada non-recourse credit facility as a result of the abandonment of the Entrada project and reversion of the lease to the MMS.

**Callon Petroleum Company Consolidating Condensed Financial Information  
as of and for the Nine Months ended September 30, 2009**

	Callon Entrada	Callon and Other Subsidiaries	Callon Consolidated
<b>Balance Sheet (in thousands)</b>			
Total current assets	\$ 1,394	\$ 23,775	\$ 25,169
Total oil and gas properties		125,582	125,582
Other property and equipment		2,498	2,498
Other assets		17,919	17,919
 Total assets	 \$ 1,394	 \$ 169,774	 \$ 171,168
 Other current liabilities	 \$ 3,137	 \$ 16,735	 \$ 19,872
Callon Entrada non-recourse credit facility	84,450		84,450
 Total current liabilities	 87,587	 16,735	 104,322
Total long-term debt		196,412	196,412
Total other long-term liabilities		14,188	14,188
Total stockholders' equity (deficit)	(86,193)	(57,561)	(143,754)
 Total liabilities and stockholders' equity (deficit)	 \$ 1,394	 \$ 169,774	 \$ 171,168

	Callon Entrada	Callon and Other Subsidiaries	Callon Consolidated
<b>Statement of Operations (in thousands)</b>			
Total operating revenues	\$	\$ 71,160	\$ 71,160
Total operating expenses	56	51,068	51,124
 Income from operations	 (56)	 20,092	 20,036
Interest expense	5,373	14,555	19,928
Other (income) expenses	(6)	82	76
 Income (loss) before income taxes	 (5,423)	 5,455	 32
Income tax expense			
 Income (loss) before equity in earnings of Medusa Spar LLC	 (5,423)	 5,455	 32
Equity in earnings of Medusa Spar LLC		492	492

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Net (loss) income	\$ (5,423)	\$	5,947	\$	524
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	Callon Entrada	Callon and Other Subsidiaries	Callon Consolidated
<b>Statement of Cash Flows (in thousands)</b>			
Net cash (used in) provided by operating activities	\$ (7,256)	\$ 24,253	\$ 16,997
Net cash provided by (used in) investing activities	2,075	(35,136)	(33,061)
Net cash provided by financing activities			
Net decrease in cash and cash equivalents	(5,181)	(10,883)	(16,064)
Cash and cash equivalents at beginning of the period	5,218	11,908	17,126
Cash and cash equivalents at end of the Period	\$ 37	\$ 1,025	\$ 1,062

## 2. General

The financial information presented as of any date other than December 31, 2008 has been prepared from the books and records of the Company without audit. Financial information as of December 31, 2008 has been derived from the audited financial statements of the Company, but does not include all disclosures required by GAAP. 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, 2008 included in the Company's Annual Report on Form 10-K filed March 19, 2009. The results of operations for the three-month and nine-month periods ended September 30, 2009 are not necessarily indicative of future financial results.

## 3. Net Income Per Share

Basic net income per 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 stock options and restricted stock considered 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):