CALLON PETROLEUM CO
Form 10-Q
May 03, 2017

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 March 31, 2017

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)

Delaware	64-0844345
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)
200 North Canal Street	
Natchez, Mississippi	
(Address of Principal Executive Offices)	39120 (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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act (check one):

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 201,061,366 shares of common stock outstanding as of April 28, 2017.

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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.
- ASU: accounting standards update.
- 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.
- FASB: Financial Accounting Standards Board.
- 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.
- MMBOE: million 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)

	March 31, 2017 Unaudited	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$ 35,273	$ 652,993
Accounts receivable	75,959	69,783
Fair value of derivatives	3,093	103
Other current assets	1,671	2,247
Total current assets	115,996	725,126
Oil and natural gas properties, full cost accounting method:		
Evaluated properties	3,009,059	2,754,353
Less accumulated depreciation, depletion, amortization and impairment	(1,972,091)	(1,947,673)
Net evaluated oil and natural gas properties	1,036,968	806,680
Unevaluated properties	1,154,850	668,721
Total oil and natural gas properties	2,191,818	1,475,401
Other property and equipment, net	18,067	14,114
Restricted investments	3,339	3,332
Deferred financing costs related to the senior secured revolving credit facility	2,744	3,092
Fair value of derivatives	2,939	—
Acquisition deposit	—	46,138
Other assets, net	676	384
Total assets	$ 2,335,579	$ 2,267,587
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 131,252	$ 95,577
Accrued interest	12,114	6,057
Cash-settleable restricted stock unit awards	4,025	8,919
Asset retirement obligations	1,588	2,729
Fair value of derivatives	6,430	18,268
Total current liabilities	155,409	131,550
Senior secured revolving credit facility	—	—
6.125% senior unsecured notes due 2024, net of unamortized deferred financing costs	390,536	390,219
Asset retirement obligations	4,652	3,932
Cash-settleable restricted stock unit awards	4,108	8,071
Deferred tax liability	556	90

Fair value of derivatives	—	28
Other long-term liabilities	285	295
Total liabilities	555,546	534,185
Commitments and contingencies		
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 1,458,948 shares outstanding, respectively	15	15
Common stock, $0.01 par value, 300,000,000 and 300,000,000 shares authorized; 201,054,884 and 201,041,320 shares outstanding, respectively	2,011	2,010
Capital in excess of par value	2,173,243	2,171,514
Accumulated deficit	(395,236)	(440,137)
Total stockholders’ equity	1,780,033	1,733,402
Total liabilities and stockholders’ equity	$ 2,335,579	$ 2,267,587

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 March 31, 2017	2016
Operating revenues:		
Oil sales	$ 72,008	$ 27,443
Natural gas sales	9,355	3,255
Total operating revenues	81,363	30,698
Operating expenses:		
Lease operating expenses	12,937	6,957
Production taxes	5,904	2,220
Depreciation, depletion and amortization	24,433	15,722
General and administrative	5,206	5,562
Accretion expense	184	180
Write-down of oil and natural gas properties	—	34,776
Acquisition expense	450	48
Total operating expenses	49,114	65,465
Income (loss) from operations	32,249	(34,767)
Other (income) expenses:		
Interest expense, net of capitalized amounts	665	5,491
(Gain) loss on derivative contracts	(15,303)	932
Other income	(708)	(81)
Total other (income) expense	(15,346)	6,342
Income (loss) before income taxes	47,595	(41,109)
Income tax expense	466	—
Net income (loss)	47,129	(41,109)
Preferred stock dividends	(1,824)	(1,824)
Income (loss) available to common stockholders	$ 45,305	$ (42,933)
Income (loss) per common share:		
Basic	$ 0.23	$ (0.51)
Diluted	$ 0.22	$ (0.51)
Shares used in computing income (loss) per common share:		
Basic	201,054	83,582
Diluted	201,740	83,582

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)

	Three Months Ended March 31, 2017	2016
Cash flows from operating activities:		
Net income (loss)	$ 47,129	$ (41,109)
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation, depletion and amortization	24,932	16,129
Write-down of oil and natural gas properties	—	34,776
Accretion expense	184	180
Amortization of non-cash debt related items	665	781
Deferred income tax expense	466	—
Net (gain) loss on derivatives, net of settlements	(17,794)	8,648
Non-cash expense related to equity share-based awards	930	516
Change in the fair value of liability share-based awards	(291)	709
Payments to settle asset retirement obligations	(765)	(161)
Changes in current assets and liabilities:		
Accounts receivable	(4,066)	5,941
Other current assets	576	580
Current liabilities	9,903	(717)
Change in other long-term liabilities	—	11
Change in other assets, net	(523)	(233)
Payments to settle vested liability share-based awards	(8,662)	(9,807)
Net cash provided by operating activities	52,684	16,244
Cash flows from investing activities:		
Capital expenditures	(66,154)	(50,775)
Acquisitions	(648,485)	(10,183)
Acquisition deposit	46,138	—
Net cash used in investing activities	(668,501)	(60,958)
Cash flows from financing activities:		
Borrowings on senior secured revolving credit facility	—	45,000
Payments on senior secured revolving credit facility	—	(85,000)
Issuance of common stock	—	94,949
Payment of preferred stock dividends	(1,824)	(1,824)
Tax withholdings related to restricted stock units	(79)	(124)
Net cash provided by (used in) financing activities	(1,903)	53,001
Net change in cash and cash equivalents	(617,720)	8,287
Balance, beginning of period	652,993	1,224
Balance, end of period	$ 35,273	$ 9,511

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

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

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3. Earnings Per Share	8. Asset Retirement Obligations
4. Borrowings	9. Equity Transactions
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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 its 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, 2016. The balance sheet at December 31, 2016 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, 2017.

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.

Recently adopted accounting policies

In March 2016, the FASB issued ASU 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. As of March 31, 2017, the Company adopted this ASU, which did not have a material impact on its financial statements. The Company has elected to no longer estimate forfeitures.

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

Note 2 - 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.

2017 acquisitions

On February 13, 2017, the Company completed the acquisition of 29,175 gross (16,688 net) acres in the Delaware Basin, primarily located in Ward and Pecos Counties, Texas from American Resource Development, LLC, for total cash consideration of $632,947, excluding customary purchase price adjustments (the “Ameredev Transaction”). The Company funded the cash purchase price with the net proceeds of an equity offering (see Note 9 for additional information regarding the equity offering). The Company acquired an 82% average working interest in the properties acquired in the Ameredev Transaction. In December 2016, in connection with the execution of the purchase and sale agreement for the Ameredev Transaction, the Company paid a deposit in the amount of $46,138 to a third party escrow agent, which was recorded as Acquisition deposit on the balance sheet as of December 31, 2016. The following table summarizes the estimated acquisition date fair values of the acquisition:

Evaluated oil and natural gas properties	$ 134,315
Unevaluated oil and natural gas properties	498,800
Asset retirement obligations	(168)
Net assets acquired	$ 632,947

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.

2016 acquisitions

On October 20, 2016, the Company completed the acquisition of 6,904 gross (5,952 net) acres in the Midland Basin, primarily located in Howard County, Texas from Plymouth Petroleum, LLC and additional sellers that exercised their “tag-along” sales rights, for total cash consideration of $339,687, excluding customary purchase price adjustments (the “Plymouth Transaction”). The Company funded the cash purchase price with the net proceeds of an equity offering (see Note 9 for additional information regarding the equity offering). The Company acquired an 82% average working interest (62% average net revenue interest) in the properties acquired in the Plymouth Transaction.

On May 26, 2016, the Company completed the acquisition of 17,298 gross (14,089 net) acres in the Midland Basin, 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 (at an assumed offering price of $11.74 per share, which is the last reported sale price of our common stock on the New York Stock Exchange on that date) 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.

Unaudited pro forma financial statements

The following unaudited summary pro forma financial information for the periods presented is for illustrative purposes only and does not purport to represent what the Company’s results of operations would have been if the Ameredev Transaction, Plymouth Transaction and Big Star Transaction had occurred as presented, or to project the Company’s results of operations for any future periods:

	Three Months Ended March 31,	
	2017 (a)	2016 (a)
Revenues	$ 84,416	$ 42,615
Income (loss) from operations	34,907	(35,451)
Income (loss) available to common stockholders	47,963	(38,908)
Net income (loss) per common share:		
Basic	$ 0.24	$ (0.31)
Diluted	$ 0.24	$ (0.31)

(a) The pro forma financial information was prepared assuming the Ameredev Transaction occurred as of January 1, 2016 and the Plymouth Transaction and 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 revenue, lease operating expenses, production taxes, depreciation, depletion and amortization expense, accretion expense, interest expense and capitalized interest.

The properties associated with the Ameredev Transaction, Plymouth Transaction and 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.

Subsequent event

In April 2017, the Company entered into an agreement to acquire 7,031 gross (2,488 net) acres in the Delaware Basin, located near the acreage acquired in the Ameredev Transaction discussed above, for total cash consideration of $52,500, excluding customary purchase price adjustments. The Company plans to fund the cash purchase price with its available cash and borrowings on our senior secured revolving credit facility.

Note 3 - Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share:

(share amounts in thousands)	Three Months Ended March 31,			
		2017		2016
Net income (loss)	$	47,129	$	(41,109)
Preferred stock dividends		(1,824)		(1,824)

Income (loss) available to common stockholders	$	45,305	$	(42,933)
Weighted average shares outstanding		201,054		83,582
Dilutive impact of restricted stock		686		—
Weighted average shares outstanding for diluted income (loss) per share		201,740		83,582
Basic income (loss) per share	$	0.23	$	(0.51)
Diluted income (loss) per share	$	0.22	$	(0.51)
Stock options (a)		15		15
Restricted stock (a)		—		25

(a) Shares excluded from the diluted earnings per share calculation because their effect would be anti-dilutive.

Note 4 - Borrowings

The Company's borrowings consisted of the following at:

	March 31, 2017	December 31, 2016
Principal components:		
Senior secured revolving credit facility	$ —	$ —
6.125% senior unsecured notes due 2024	400,000	400,000
Total principal outstanding	400,000	400,000
6.125% senior unsecured notes due 2024, unamortized deferred financing costs	(9,464)	(9,781)
Total carrying value of borrowings	$ 390,536	$ 390,219

Senior secured revolving credit facility (the "Credit Facility")

On March 11, 2014, the Company entered into the Fifth Amended and Restated Credit Agreement to the Credit Facility with a maturity date of March 11, 2019. JPMorgan Chase Bank, N.A. is Administrative Agent, and participants include several institutional lenders. The total notional amount available under the Credit Facility is $500,000. Amounts borrowed under the Credit Facility may not exceed the borrowing base, which is generally reviewed on a semi-annual basis. The Credit Facility is secured by first preferred mortgages covering the Company's major producing properties. Effective November 21, 2016, the Company achieved an indication to increase the Credit Facility's borrowing base to $500,000, but elected to maintain the borrowing base at $385,000. As of March 31, 2017, the Company continued to maintain the Credit Facility's borrowing base at $385,000.

As of March 31, 2017, there was no balance outstanding on the Credit Facility. For the quarter ended March 31, 2017, the Credit Facility had a weighted-average interest rate of 2.83%, calculated as the LIBOR plus a tiered rate ranging from 2.00% to 3.00%, which is determined based on utilization of the facility. In addition, the Credit Facility carries a commitment fee of 0.5% per annum, payable quarterly, on the unused portion of the borrowing base.

6.125% senior notes due 2024 (“6.125% Senior Notes”)

On October 3, 2016, the Company issued $400,000 aggregate principal amount of 6.125% Senior Notes with a maturity date of October 1, 2024 and interest payable semi-annually beginning on April 1, 2017. The net proceeds of the offering, after deducting initial purchasers’ discounts and estimated offering expenses, were approximately $391,270. The 6.125% Senior Notes are guaranteed on a senior unsecured basis by the Company’s wholly-owned subsidiary, Callon Petroleum Operating Company, and may be guaranteed by certain future subsidiaries. The subsidiary guarantor is 100% owned, all of the guarantees are full and unconditional and joint and several, the parent company has no independent assets or operations and any subsidiaries of the parent company other than the subsidiary guarantor are minor.

The Company may redeem the 6.125% Senior Notes in accordance with the following terms; (1) prior to October 1, 2019, a redemption of up to 35% of the principal in an amount not greater than the net proceeds from certain equity offerings, and within 180 days of the closing date of such equity offerings, at a redemption price of 106.125% of principal, plus accrued and unpaid interest, if any, to the date of the redemption, if at least 65% of the principal will remain outstanding after such redemption; (2) prior to October 1, 2019, a redemption of all or part of the principal at a price of 100% of principal of the amount redeemed, plus an applicable make-whole premium and accrued and unpaid interest, if any, to the date of the redemption; (3) a redemption, in whole or in part, at a redemption price, plus accrued and unpaid interest, if any, to the date of the redemption, (i) of 104.594% of principal if the redemption occurs on or after October 1, 2019, but before October 1, 2020, and (ii) of 103.063% of principal if the redemption occurs on or after October 1, 2020, but before October 1, 2021, and (iii) of 101.531% of principal if the redemption occurs on or after October 1, 2021, but before October 1, 2022, and (iv) of 100% of principal if the redemption occurs on or after October 1, 2022.

Following a change of control, each holder of the 6.125% Senior Notes may require the Company to repurchase all or a portion of the 6.125% Senior Notes at a price of 101% of principal of the amount repurchased, plus accrued and unpaid interest, if any, to the date of repurchase.

Restrictive covenants

The Company’s Credit Facility and the indenture governing our 6.125% Senior Notes contain various covenants including restrictions on additional indebtedness, payment of cash dividends and maintenance of certain financial ratios. The Company was in compliance with these covenants at March 31, 2017.

Note 5 - Derivative Instruments and Hedging Activities

Objectives and strategies for using derivative instruments

The Company is exposed to fluctuations in oil and natural gas prices received for its production. Consequently, the Company believes it is prudent to manage the variability in cash flows on a portion of its oil and natural gas production. The Company utilizes a mix of collars, swaps, put and call options and similar derivative financial instruments to manage fluctuations in cash flows resulting from changes in commodity prices. The Company does not use these instruments for speculative or trading purposes.

Counterparty risk and offsetting

The use of derivative instruments exposes the Company to the risk that a counterparty will be unable to meet its commitments. While the Company monitors counterparty creditworthiness on an ongoing basis, it cannot predict sudden changes in counterparties’ creditworthiness. In addition, even if such changes are not sudden, the Company may be limited in its ability to mitigate an increase in counterparty credit risk. Should one of these counterparties not perform, the Company may not realize the benefit of some of its derivative instruments under lower commodity prices while continuing to be obligated under higher commodity price contracts subject to any right of offset under the agreements. Counterparty credit risk is considered when determining the fair value of a derivative instrument; see Note 6 for additional information regarding fair value.

The Company executes commodity derivative contracts under master agreements with netting provisions that provide for offsetting assets against liabilities. In general, if a party to a derivative transaction incurs an event of default, as defined in the applicable agreement, the other party will have the right to demand the posting of collateral, demand a cash payment transfer or terminate the arrangement.

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

Financial statement presentation and settlements

Settlements of the Company's derivative instruments are based on the difference between the contract price or prices specified in the derivative instrument and a benchmark price, such as the NYMEX price. To determine the fair value of the Company's derivative instruments, the Company utilizes present value methods that include assumptions about commodity prices based on those observed in underlying markets. See Note 6 for additional information regarding fair value.

Derivatives not designated as hedging instruments

The Company records its derivative contracts at fair value in the consolidated balance sheets and records changes in fair value as a gain or loss on derivative contracts in the consolidated statements of operations. Cash settlements are also recorded as gain or loss on derivative contracts in the consolidated statements of operations.

The following table reflects the fair value of the Company's derivative instruments for the periods presented:

	Balance Sheet Presentation		Asset Fair Value		Liability Fair Value		Net Derivative Fair Value	
Commodity	Classification	Line Description	03/31/2017	12/31/2016	03/31/2017	12/31/2016	03/31/2017	12/31/2016
Natural gas	Current	Fair value of derivatives	$ —	$ —				