BERRY PETROLEUM CO
Form 10-Q
April 28, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2010

o **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 1-9735

BERRY PETROLEUM COMPANY

(Exact name of registrant as specified in its charter)

DELAWARE	**77-0079387**
(State of incorporation or organization)	(I.R.S. Employer Identification Number)

1999 Broadway, Suite 3700

Denver, Colorado 80202

(Address of principal executive offices, including zip code)

Registrant s telephone number, including area code: **(303) 999-4400**

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 x NO o

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 o NO o

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.

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES o NO x

As of April 19, 2010, the registrant had 51,131,921 shares of Class A Common Stock ($.01 par value) outstanding. The registrant also had 1,797,784 shares of Class B Stock ($.01 par value) outstanding on April 19, 2010 all of which is held by an affiliate of the registrant.

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Unaudited Condensed Balance Sheets

(In Thousands, Except Share Information)

	March 31, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 57	$ 5,311
Short-term investments	65	66
Accounts receivable, net of allowance for doubtful accounts of $38,508	84,764	74,337
Deferred income taxes	10,274	5,623
Fair value of derivatives	6,164	11,527
Prepaid expenses and other	10,878	6,612
Total current assets	112,202	103,476
Oil and gas properties (successful efforts basis), buildings and equipment, net	2,269,848	2,106,385
Fair value of derivatives	2,369	735
Other assets	27,973	29,539
	$ 2,412,392	$ 2,240,135
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 76,641	$ 63,096
Revenue and royalties payable	16,909	25,878
Accrued liabilities	42,498	29,320
Fair value of derivatives	44,851	33,843
Total current liabilities	180,899	152,137
Long-term liabilities:		
Deferred income taxes	251,913	237,161
Senior secured revolving credit facility	270,000	372,000
8¼ % Senior subordinated notes due 2016	200,000	200,000
10¼% Senior notes due 2014, net of unamortized discount of $12,877 and $13,456, respectively	437,124	436,544
Asset retirement obligation	46,919	43,487
Other long-term liabilities	20,150	19,711
Fair value of derivatives	57,773	75,836
	1,283,879	1,384,739
Shareholders equity:		
Preferred stock, $.01 par value, 2,000,000 shares authorized; no shares outstanding		
Capital stock, $.01 par value:		
Class A Common Stock, 100,000,000 shares authorized; 51,126,421 shares issued and outstanding (42,952,499 in 2009)	511	430
Class B Stock, 3,000,000 shares authorized; 1,797,784 shares issued and outstanding (liquidation preference of $899)	18	18
Capital in excess of par value	316,313	89,068
Accumulated other comprehensive loss	(56,972)	(60,372)
Retained earnings	687,744	674,115
Total shareholders equity	947,614	703,259
	$ 2,412,392	$ 2,240,135

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

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BERRY PETROLEUM COMPANY

Unaudited Condensed Statements of Income

Three Months Ended March 31, 2010 and 2009

(In Thousands, Except Per Share Data)

	Three months ended March 31, 2010		Three months ended March 31, 2009	
REVENUES AND OTHER INCOME ITEMS				
Sales of oil and gas	$	147,807	$	127,869
Sales of electricity		9,933		10,270
Gas marketing		8,272		7,581
Realized and unrealized gain on derivatives, net		1,603		37,164
Interest and other income, net		164		283
		167,779		183,167
EXPENSES				
Operating costs - oil and gas production		47,036		37,384
Operating costs - electricity generation		9,670		8,783
Production taxes		5,204		5,652
Depreciation, depletion & amortization - oil and gas production		35,907		36,398
Depreciation, depletion & amortization - electricity generation		795		959
Gas marketing		7,786		7,284
General and administrative		13,835		13,294
Interest expense		17,447		10,050
Transaction costs on acquisitions, net of gain		727		
Dry hole, abandonment, impairment and exploration		1,369		122
		139,776		119,926
Income before income taxes		28,003		63,241
Provision for income taxes		10,334		21,462
Income from continuing operations		17,669		41,779
Loss from discontinued operations, net of taxes				(6,781)
Net income	$	17,669	$	34,998
Basic net income from continuing operations per share	$	0.34	$	0.92
Basic net loss from discontinued operations per share	$		$	(0.15)
Basic net income per share	$	0.34	$	0.77
Diluted net income from continuing operations per share	$	0.34	$	0.92
Diluted net loss from discontinued operations per share	$		$	(0.15)
Diluted net income per share	$	0.34	$	0.77
Dividends per share	$	0.075	$	0.075

Unaudited Condensed Statements of Comprehensive Income

Three Months Ended March 31, 2010 and 2009

(In Thousands)

Net income	$	17,669	$	34,998
Unrealized gains on derivatives, net of income taxes of $0 and $48,160, respectively				78,577
Reclassification of realized gains on derivatives included in net income, net of income tax benefits of $2,084 and $17,788, respectively		(3,400)		(29,022)
Comprehensive income	$	14,269	$	84,553

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

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BERRY PETROLEUM COMPANY

Unaudited Condensed Statements of Cash Flows

Three Months Ended March 31, 2010 and 2009

(In Thousands)

	Three months ended March 31, 2010	2009
Cash flows from operating activities:		
Net income	$ 17,669	$ 34,998
Depreciation, depletion and amortization	36,702	39,545
Amortization of debt issue costs and net discount	2,098	1,088
Gain on purchase of oil and natural gas properties	(1,358)	
Dry hole and impairment	1,207	9,643
Unrealized loss (gain) on derivatives	2,476	(22,842)
Stock-based compensation expense	3,031	2,988
Deferred income taxes	8,548	21,059
Other, net		(5,040)
Cash paid for abandonment	(22)	(112)
Change in book overdraft	(1,377)	(23,510)
Increase in current assets other than cash and cash equivalents	(14,179)	(12,933)
Increase (decrease) in current liabilities other than book overdraft, line of credit and fair value of derivatives	8,720	(36,755)
Net cash provided by operating activities	63,515	8,129
Cash flows from investing activities:		
Exploration and development of oil and gas properties	(47,958)	(50,181)
Property acquisitions	(132,515)	(1,173)
Capitalized interest	(5,967)	(5,312)
Deposits on asset sales		14,000
Deposits on potential property acquisitions	(500)	
Net cash used in investing activities	(186,940)	(42,666)
Cash flows from financing activities:		
Proceeds from issuances on line of credit	76,100	147,800
Payments on line of credit	(76,100)	(173,100)
Long-term borrowings under credit facility	125,000	159,600
Repayments of long-term borrowings under credit facility	(227,000)	(92,000)
Debt issue costs		(4,538)
Financing obligation	(83)	
Dividends paid	(4,040)	(3,416)
Proceeds from issuance of common stock, net	224,337	
Proceeds from stock option exercises	75	
Excess tax benefit and other	(118)	
Net cash provided by financing activities	118,171	34,346
Net decrease in cash and cash equivalents	(5,254)	(191)
Cash and cash equivalents at beginning of year	5,311	240
Cash and cash equivalents at end of period	$ 57	$ 49

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

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Berry Petroleum Company

Notes to Unaudited Financial Statements

1. Basis of Presentation

These unaudited Condensed Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial reporting. All adjustments which are, in the opinion of management, necessary for a fair statement of Berry Petroleum Company s (the Company) financial position at March 31, 2010 and December 31, 2009 and results of operations and accumulated other comprehensive loss (AOCL) for the three months ended March 31, 2010 and 2009, and its cash flows for the three months ended March 31, 2010 and 2009 have been included. In the opinion of management, all adjustments, which are of a normal recurring nature, have been made which are necessary for a fair presentation of the financial position. 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 unaudited Condensed Financial Statements have been prepared on a basis consistent with the accounting principles and policies reflected in the December 31, 2009 Financial Statements. For a more complete understanding of the Company s operations, financial position and accounting policies, the Unaudited Condensed Financial Statements and the notes thereto should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2009 previously filed with the SEC. The year-end Condensed Balance Sheet was derived from audited Financial Statements, but does not include all disclosures required by GAAP.

The Company s cash management process provides for the daily funding of checks as they are presented to the bank. Included in accounts payable at March 31, 2010 and December 31, 2009 is $14.4 million and $15.7 million, respectively, representing outstanding checks in excess of the bank balance (book overdraft).

2. Fair Value Measurements

The authoritative guidance for fair value measurements establishes a three-tier fair value hierarchy, which prioritizes the inputs used to measure fair value. These tiers include: Level 1, defined as unadjusted quoted prices in active markets for identical assets or liabilities; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs for use when little or no market data exists, therefore requiring an entity to develop its own assumptions.

A financial instrument s categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The Company s assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the classification of assets and liabilities within the fair value hierarchy. The Company utilizes a mid-market pricing convention (the mid-point price between bid and ask prices) for valuation as a practical expedient for assigning fair value. Oil swaps, natural gas swaps and interest rate swaps are valued using models which are based on active market data and are classified within Level 2 of the fair value hierarchy. Derivatives that are valued based upon models with significant unobservable market inputs (primarily volatility), and that are normally traded less actively are classified within Level 3 of the valuation hierarchy. These models are industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors and current market and contractual prices for the underlying instruments, as well as other relevant economic measures. The fair value of all derivative instruments are estimated using a combined income and market valuation methodology based upon forward commodity price and volatility curves. The curves are obtained from independent pricing services, and the Company has made no adjustments to the obtained prices. The pricing services publish observable market information from multiple brokers and exchanges. No proprietary models are used by the pricing services for the inputs. All valuations were compared against counterparty valuations to verify the reasonableness of prices. The Company also considers counterparty credit risk and its own credit risk in its determination of all estimated fair values. The Company has consistently applied these valuation techniques in all periods presented and believes it has obtained the most accurate information available for the types of derivative contracts it holds. Level 3 derivatives include oil collars, natural gas collars and natural gas basis swaps. The Company recognizes transfers between levels at the end of the reporting period for which the transfer has occurred.

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Notes to Unaudited Financial Statements

The following tables set forth by level within the fair value hierarchy the Company s derivative assets and liabilities that were measured at fair value on a recurring basis as of March 31, 2010 and December 31, 2009.

Assets and liabilities measured at fair value on a recurring basis

March 31, 2010 (in millions)	Total carrying value on the Condensed Balance Sheet	Level 2	Level 3
Commodity derivatives liability	$ (83.7)	$ (49.2)	$ (34.5)
Interest rate derivatives liability	(10.4)	(10.4)	
Total derivative liabilities at fair value	$ (94.1)	$ (59.6)	$ (34.5)

December 31, 2009 (in millions)	Total carrying value on the Condensed Balance Sheet	Level 2	Level 3
Commodity derivatives liability	$ (88.5)	$ (62.5)	$ (26.0)
Interest rate derivatives liability	(8.9)	(8.9)	
Total derivative liabilities at fair value	$ (97.4)	$ (71.4)	$ (26.0)

Changes in Level 3 fair value measurements

The table below includes a rollforward of the Condensed Balance Sheet amounts (including the change in fair value) for financial instruments classified by the Company within Level 3 of the fair value hierarchy. When a determination is made to classify a financial instrument within Level 3 of the fair value hierarchy, the determination is based upon the significance of the unobservable factors to the overall fair value measurement. Level 3 financial instruments typically include, in addition to the unobservable or Level 3 components, observable components (that is, components that are actively quoted and can be validated to external sources).

(in millions)	Three months ended March 31, 2010	Three months ended March 31, 2009
Fair value (liability) asset, beginning of period	$ (26.0)	$ 172.5
Total realized and unrealized gains included in Realized and unrealized gain on derivatives	(1.4)	(22.9)
Purchases, sales and settlements, net	(7.1)	(15.5)
Transfers in and/or out of Level 3		3.4
Fair value (liability) asset, end of period	$ (34.5)	$ 137.5
	$ (8.4)	$ 22.8

Total unrealized (losses) gains included in income related to financial assets and liabilities still on the Condensed Balance Sheet at March 31, 2010 and 2009	

The $3.4 million of transfers out of Level 3 for the three months ended March 31, 2009 represent crude oil collars that were converted to crude oil swaps during the first quarter of 2009.

For further discussion related to the Company s derivatives see Note 3 to the Condensed Financial Statements.

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Notes to Unaudited Financial Statements

Fair Market Value of Financial Instruments

The Company used various assumptions and methods in estimating the fair values of its financial instruments. The carrying amounts of cash and cash equivalents and accounts receivable approximated their fair value due to the short-term maturity of these instruments. The carrying amount of the Company s credit facilities approximated fair value, because the interest rates on the credit facilities are variable. The fair values of the 8.25% senior subordinated notes due 2016 and the 10.25% senior notes due 2014 were estimated based on quoted market prices. The fair values of the Company s derivative instruments and other investments are discussed above.

	As of March 31, 2010	
(in millions)	**Carrying Amount**	**Estimated Fair Value**
Senior secured revolving credit facility	$ 270	$ 270
8.25% Senior subordinated notes due 2016	200	202
10.25% Senior notes due 2014	437	495
	$ 907	$ 967

	As of December 31, 2009	
(in millions)	**Carrying Amount**	**Estimated Fair Value**
Senior secured revolving credit facility	$ 372	$ 372
8.25% Senior subordinated notes due 2016	200	196
10.25% Senior notes due 2014	437	487
	$ 1,009	$ 1,055

3. Derivative Instruments

The Company uses financial derivative instruments as part of its price risk management program to achieve a more predictable, economic cash flow from its oil and natural gas production by reducing its exposure to price fluctuations. The Company has entered into financial commodity swap and collar contracts to fix the floor and ceiling prices received for a portion of the Company s oil and natural gas production. The terms of the contracts depend on various factors, including management s view of future crude oil and natural gas prices, acquisition economics on purchased assets and future financial commitments. The Company periodically enters into interest rate derivative agreements in an attempt to normalize the mix of fixed and floating interest rates within its debt portfolio.

The Company s derivative contracts have been executed primarily with counterparties that are party to its senior secured revolving credit facility.

Neither the Company nor its counterparties are required to post collateral in connection with its derivative positions and netting agreements are in place with each of the Company s counterparties allowing the Company to offset its derivative asset and liability positions. The credit rating of each of these counterparties was AA-/Aa3, or better as of March 31, 2010. As of March 31, 2010, the Company s largest three counterparties accounted for 74% of the value of its total derivative positions.

As of March 31, 2010, the Company had the following commodity derivatives:

	2010	2011	2012
Oil Bbl/D:	15,930	11,020	5,000
Natural Gas MMBtu/D:	19,000	10,000	10,000

For further discussion related to the fair value of the Company s derivatives see Note 2 to the Condensed Financial Statements.

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Notes to Unaudited Financial Statements

The Company entered into the following crude oil collars during the three months ended March 31, 2010:

Term	Average Barrels Per Day	Floor/Ceiling Prices
Full year 2010	500	$75.00/$93.95
Full year 2010	500	$75.00/$94.45
Full year 2011	500	$75.00/$100.75
Full year 2011	500	$75.00/$101.15
Full year 2011	1,000	$75.00/$91.25
Full year 2012	500	$75.00/$105.00
Full year 2012	500	$75.00/$106.00
Full year 2012	1,000	$75.00/$95.00

Discontinuance of cash flow hedge accounting

Prior to January 1, 2010, the Company designated most of its commodity and interest rate derivative contracts as cash flow hedges, whose unrealized fair value gains and losses were recorded to AOCL. Effective January 1, 2010, however, the Company elected to de-designate all of its commodity and interest rate derivative contracts that had been previously designated as cash flow hedges as of December 31, 2009. As a result, subsequent to December 31, 2009, the Company recognizes all gains and losses from changes in commodity derivative fair values immediately in earnings rather than deferring any such amounts in AOCL.

At December 31, 2009, AOCL consisted of $97.4 million, ($60.4 million, net of tax) of unrealized losses, representing the change in the fair value of the Company s open commodity and interest rate derivative contracts designated as cash flow hedges as of that balance sheet date, less any ineffectiveness recognized. As a result of discontinuing hedge accounting on January 1, 2010, such fair values at December 31, 2009 are frozen in AOCL as of the de-designation date and reclassified into earnings as the original hedge transactions settle. During the three months ended March 31, 2010, $5.5 million ($3.4 million, net of tax) of derivative losses relating to de-designated commodity and interest rate hedges were reclassified from AOCL into earnings. As of March 31, 2010, AOCL consisted of $91.9 million ($57.0 million, net of tax) of unrealized losses on commodity and interest rate derivative contracts that had been previously designated as cash flow hedges. The Company expects to reclassify into earnings from AOCL after-tax net losses of $22.7 million related to de-designated commodity and interest rate derivative contracts during the next twelve months.

At March 31, 2010, the net fair value derivative liability was $94.1 million as compared to a net fair value liability of $97.4 million at December 31, 2009 which reflects changes in commodity prices and interest rates. Based on NYMEX strip pricing as of March 31, 2010, the Company expects to make payments under the existing derivatives of $35.3 million during the next twelve months.

The related cash flow impact of all of the Company s derivatives is reflected in cash flows from operating activities.

The Company presents its derivative assets and liabilities on its Condensed Balance Sheets on a net basis. The Company nets derivative assets and liabilities whenever it has a legally enforceable master netting agreement with a counterparty to a derivative contract. The Company uses these agreements to manage and reduce its potential counterparty credit risk.

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Notes to Unaudited Financial Statements

The following table disaggregates the Company s net derivative assets and liabilities into gross components on a contract-by-contract basis before giving effect to master netting arrangements. Finally, the Company identifies the line items on its Condensed Balance Sheets in which these fair value amounts are included. The gross asset and liability values in the table below are segregated between those derivatives designated in qualifying hedge accounting relationships and those not designated in hedge accounting relationships.

	As of March 31, 2010			
	Derivative Assets		**Derivative Liabilities**	
(in millions)	**Balance Sheet Classification**	**Fair Value**	**Balance Sheet Classification**	**Fair Value**
Total derivatives designated as hedging instruments				
Commodity Oil	Current assets	$ 4.5	Current liability	$ 44.9
Commodity Oil			Long term liabilities	57.6
Commodity Natural Gas	Current assets	5.2		
Commodity Natural Gas	Current liability	3.0		
Commodity Natural Gas	Long term assets	2.4		
Commodity Natural Gas	Long term liabilities	3.6		
Interest rate contracts			Current assets	3.5
Interest rate contracts			Current liability	3.0
Interest rate contracts			Long term liabilities	3.8
Total derivatives not designated as hedging instruments		18.7		112.8
Total Derivatives		$ 18.7		$ 112.8

	As of December 31, 2009			
	Derivative Assets		**Derivative Liabilities**	
(in millions)	**Balance Sheet Classification**	**Fair Value**	**Balance Sheet Classification**	**Fair Value**
Commodity Oil	Current assets	$ 14.2	Current liability	$ 30.8
Commodity Oil			Long term liabilities	74.1
Commodity Natural Gas	Current assets	1.3		
Commodity Natural Gas	Long term assets	0.4		
Commodity Natural Gas	Current liability	0.2		
Commodity Natural Gas	Long term liabilities	1.2		
Interest rate contracts	Long term assets	0.3	Current assets	3.5
Interest rate contracts			Current liabilities	2.7
Interest rate contracts			Long term liabilities	3.0
Total derivatives designated as hedging instruments under authoritative guidance		$ 17.6		$ 114.1
Commodity Natural Gas			Current assets	0.4
Commodity Natural Gas			Current liabilities	0.5
Total derivatives not designated as hedging instruments under authoritative guidance				0.9