BERRY PETROLEUM CO
Form 10-Q
August 09, 2005

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

For the quarterly period ended June 30, 2005
Commission file number 1-9735

BERRY PETROLEUM COMPANY
(Exact name of registrant as specified in its charter)

DELAWARE (State or other jurisdiction of incorporation or organization)	77-0079387 (I.R.S. Employer Identification No.)
5201 Truxtun Avenue, Suite 300, Bakersfield, California (Address of principal executive offices)	93309-0640 (Zip Code)

Registrant's telephone number, including area code (661) 616-3900

Former name, Former Address and Former Fiscal Year, if Changed Since Last Report:
NONE

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 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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES x NO o

The number of shares of each of the registrant’s classes of capital stock outstanding as of June 30, 2005, was 21,181,208 shares of Class A Common Stock ($.01 par value) and 898,892 shares of Class B Stock ($.01 par value). All of the Class B Stock is held by a shareholder who owns in excess of 5% of the outstanding stock of the registrant.

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Part I. Financial Information
Item 1. Financial Statements
Condensed Consolidated Balance Sheets
(In Thousands, Except Per Share Information)
(Unaudited)

	June 30, 2005	December 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 9,561	$ 16,690
Short-term investments available for sale	655	659
Accounts receivable	46,928	34,621
Deferred income taxes	12,678	3,558
Fair value of derivatives	4,447	3,243
Prepaid expenses and other	7,768	2,230
Total current assets	82,037	61,001
Oil and gas properties (successful efforts basis), buildings and equipment, net	487,220	338,706
Deposit on potential property acquisitions	3,322	10,221
Other assets	2,730	2,176
	$ 575,309	$ 412,104
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 35,043	$ 27,750
Revenue and royalties payable	20,151	23,945
Accrued liabilities	5,925	6,132
Income taxes payable	-	1,067
Fair value of derivatives	30,127	5,947
Total current liabilities	91,246	64,841
Long-term liabilities:		
Deferred income taxes	53,588	47,963
Long-term debt	125,000	28,000
Abandonment obligations	9,420	8,214
Fair value of derivatives	9,865	-
	197,873	84,177
Shareholders' equity:		
Preferred stock, $.01 par value; 2,000,000 shares authorized; 0 outstanding	-	-
Capital stock, $.01 par value;		
Class A Common Stock, 50,000,000 shares authorized; 21,181,208 shares issued and outstanding (21,060,420 in 2004)	211	210
Class B Stock, 1,500,000 shares authorized;898,892 shares issued and outstanding (liquidation preference of $899)	9	9
Capital in excess of par value	61,644	60,676
Accumulated other comprehensive loss	(21,327)	(987)

Retained earnings		245,653		203,178
Total shareholders' equity		286,190		263,086
	$	575,309	$	412,104

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

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BERRY PETROLEUM COMPANY
Part I. Financial Information
Item 1. Financial Statements
Condensed Consolidated Income Statements
Three Month Periods Ended June 30, 2005 and 2004
(In Thousands, Except Per Share Information)
(Unaudited)

	Three months ended June 30, 2005		Three months ended June 30, 2004	
Revenues:				
Sales of oil and gas	$	80,825	$	52,755
Sales of electricity		11,514		11,291
Interest and other income, net		350		90
		92,689		64,136
Expenses:				
Operating costs - oil and gas production		26,374		19,451
Operating costs - electricity generation		10,923		10,590
Exploration costs		225		-
Depreciation, depletion and amortization - oil and gas production		9,461		7,643
Depreciation, depletion and amortization - electricity generation		839		861
General and administrative		5,204		4,844
Dry hole, abandonment and impairment		601		-
Interest		1,740		534
		55,367		43,923
Income before income taxes		37,322		20,213
Provision for income taxes		12,062		4,935
Net income	$	25,260	$	15,278
Basic net income per share	$	1.14	$	.70
Diluted net income per share	$	1.13	$	.68
Cash dividends per share	$	.12	$	.11
Weighted average number of shares of capital stock outstanding used to calculate basic net income per share		22,067		21,873
Effect of dilutive securities:				
Stock options		327		488
Other		57		55
Weighted average number of shares of capital stock used to calculate diluted net income per share		22,451		22,416

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

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Condensed Consolidated Income Statements
Six Month Periods Ended June 30, 2005 and 2004
(In Thousands, Except Per Share Information)
(Unaudited)

	Six months ended June 30, 2005		2004	
Revenues:				
Sales of oil and gas	$	156,196	$	97,960
Sales of electricity		23,970		23,225
Interest and other income, net		518		293
		180,684		121,478
Expenses:				
Operating costs - oil and gas production		49,781		36,677
Operating costs - electricity generation		24,281		22,993
Exploration costs		786		-
Depreciation, depletion and amortization - oil and gas production		17,988		13,997
Depreciation, depletion and amortization - electricity generation		1,611		1,716
General and administrative		10,023		11,744
Dry hole, abandonment and impairment		2,622		-
Interest		2,902		1,064
		109,994		88,191
Income before income taxes		70,690		33,287
Provision for income taxes		22,925		7,644
Net income	$	47,765	$	25,643
Basic net income per share	$	2.17	$	1.17
Diluted net income per share	$	2.13	$	1.15
Cash dividends per share	$	.24	$	.22
Weighted average number of shares of capital stock outstanding used to calculate basic net income per share		22,024		21,845
Effect of dilutive securities:				
Stock options		383		439
Other		57		53
Weighted average number of shares of capital stock used to calculate diluted net income per share		22,464		22,337

Condensed Consolidated Statements of Comprehensive Income
Six Month Periods Ended June 30, 2005 and 2004
(In Thousands)
(Unaudited)

Net income	$	47,765	$	25,643
Unrealized gains (losses) on derivatives, (net of income taxes of $13,560				

and $1,032 in 2005 and 2004, respectively)		(20,340)		1,548
Comprehensive income	$	27,425	$	27,191

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

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Item 1. Financial Statements
Condensed Consolidated Statements of Cash Flows
Six Month Periods Ended June 30, 2005 and 2004
(In Thousands)
(Unaudited)

	Six months ended June 30, 2005	2004
Cash flows from operating activities:		
Net income	$ 47,765	$ 25,643
Depreciation, depletion and amortization	19,599	15,713
Deferred income taxes, net	10,064	6,142
Stock-based compensation expense	969	2,808
Other, net	194	528
Increase in current assets other than cash, cash equivalents and short-term investments	(17,840)	(6,877)
Increase (decrease) in current liabilities	5,440	(6,324)
Net cash provided by operating activities	66,191	37,633
Cash flows from investing activities:		
Capital expenditures, excluding property acquisitions	(48,159)	(31,838)
Property acquisitions	(116,062)	-
Net cash used in investing activities	(164,221)	(31,838)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	116,000	-
Payment of long-term debt	(19,000)	-
Debt issuance cost	(809)	-
Dividends paid	(5,290)	(4,646)
Net cash provided by (used in) financing activities	90,901	(4,646)
Net (decrease) increase in cash and cash equivalents	(7,129)	1,149
Cash and cash equivalents at beginning of year	16,690	10,658
Cash and cash equivalents at end of period	$ 9,561	$ 11,807
Supplemental non-cash activity:		
Increase (decrease) in fair value of derivatives:		
Current (net of income taxes of $9,191 and ($322) in 2005 and 2004, respectively)	$ 13,786	$ (484)
Non-current (net of income taxes of $4,369 and ($710) in 2005 and 2004, respectively)	6,554	(1,064)

Net increase (decrease) to accumulated other comprehensive loss	$	20,340	$	(1,548)

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

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BERRY PETROLEUM COMPANY
Part I. Financial Information
Item 1. Financial Statements
Notes to Condensed Consolidated Financial Statements
June 30, 2005
(Unaudited)

1. General. All adjustments which are, in the opinion of Management, necessary for a fair statement of Berry Petroleum Company's and subsidiary (collectively, the "Company") financial position at June 30, 2005 and December 31, 2004 and results of operations and cash flows for the six month periods ended June 30, 2005 and 2004 have been included. All such adjustments are of a normal recurring nature. The results of operations and cash flows are not necessarily indicative of the results for a full year.

The accompanying unaudited condensed consolidated financial statements have been prepared on a basis consistent with the accounting principles and policies reflected in the December 31, 2004 financial statements. The December 31, 2004 Form 10-K and the March 31, 2005 Form 10-Q should be read in conjunction herewith. The year-end condensed balance sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. Refer to Note 8 for discussion on the new subsidiary, Canyon Drilling.

2. Fair Value of Derivatives. Refer to Note 10 for discussion on new hedges. Due to the increase in NYMEX future strip crude oil prices at June 30, 2005 from December 31, 2004 and the addition of new derivative instruments, the Company's fair value of derivatives liability increased to $40.0 million at June 30, 2005 from $5.9 million at December 31, 2004. The unrealized loss, net of income taxes, of $20.3 million, is recorded in accumulated other comprehensive loss on the Company's balance sheet at June 30, 2005. The deferred tax benefit of the unrealized loss is reflected as an addition to the deferred income tax asset on the Company's balance sheet.

3. Asset Retirement Obligations. The Company follows Statement of Financial Accounting Standard, (SFAS) No. 143, *Accounting for Asset Retirement Obligations,* for recording future site restoration and abandonment costs related to its oil and gas properties. Under SFAS No. 143, the following table summarizes the change in abandonment obligation for the six months ended June 30, 2005 and 2004, respectively, (in thousands):

	2005	2004
Beginning balance at January 1	$ 8,214	$ 7,311
Liabilities incurred	1,165	-
Liabilities settled	(384)	(235)
Accretion expense	425	349
Ending balance at June 30	$ 9,420	$ 7,425

4. Reclassification. Certain amounts in the condensed consolidated income statements for the three and six months ended June 30, 2004 have been reclassified to conform to the 2005 presentation. In the fourth quarter of 2004, the Company concluded that it was appropriate to revise its allocation of cogeneration costs to oil and gas operations. The revised allocation is based on the thermal efficiency (of fuel to electricity and steam) of the Company's cogeneration facilities. In addition, in 2005 the Company is reclassifying technical labor between general and administrative expenses and operating costs - oil and gas. Accordingly, the Company has revised prior classifications for the three and six months ended June 30, 2004 as follows (in thousands):

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	Three Months Ended 6/30/04	Six Months Ended 6/30/04
Operating costs - oil and gas		
As previously reported	$ 19,194	$ 37,214
As revised	19,451	36,677
Difference	$ (257)	$ 537
Operating costs - electricity generation		
As previously reported	$ 11,291	$ 23,225
As revised	10,590	22,993
Difference	$ 701	$ 232
G&A expenses		
As previously reported	$ 4,400	$ 10,974
As revised	4,844	11,744
Difference	$ (444)	$ (769)
DD&A - oil and gas		
As previously reported	$ 8,504	$ 15,713
As revised	7,643	13,997
Difference	$ 861	$ 1,716
DD&A - electricity generation		
As previously reported	$ -	$ -
As revised	861	1,716
Difference	$ (861)	$ (1,716)

5. Credit Facility. In June 2005, the Company completed a new unsecured five year bank credit agreement (the Agreement) with a banking syndicate. The Agreement is a revolving credit facility for up to $500 million with nine banks and replaces the previous $200 million facility which was due to mature in 2006. Initial borrowings were $125 million which represented an amount equal to the borrowings outstanding under the previous credit facility and the initial borrowing base was established as $350 million. This transaction is considered a modification of a debt instrument due to modification of terms in accordance with Emerging Issues Task Force, (EITF) 96-19, *Debtor's Accounting for Modification or Exchange of Debt Instruments*.

The credit available under the Agreement is $225 million at June 30, 2005 without any increase to the borrowing base. The maximum amount available is subject to an annual redetermination of the borrowing base in accordance with the lender's customary procedures and practices. Both the Company and the banks have bilateral rights to one additional redetermination each year. The Agreement matures on July 1, 2010. Interest on amounts borrowed is charged at LIBOR plus a margin of 1.00% to 1.75%, or the higher of the lead bank's prime rate or the federal funds rate plus 50 basis points plus a margin of 0% to .50%, with margins on the various rate options based on the ratio of credit outstanding to the borrowing base. The Company is required under the Agreement to pay a commitment fee of 25 to 38 basis points on the unused portion of the credit facility.

The weighted average interest rate on outstanding borrowings at June 2005 was 4.6%. The Agreement contains restrictive covenants which, among other things, require the Company to maintain a certain debt to EBITDA ratio and a minimum current ratio, as defined. The Company was in compliance with all such covenants as of June 30, 2005.

6. Dry hole, abandonment and impairment. At December 31, 2004, the Company was in the process of drilling one exploratory well on its Midway-Sunset property in California and one exploratory well on its Coyote Flats, Utah prospect. These two wells were determined non-commercial in February 2005. Costs of $.5 million which were incurred as of December 31, 2004 were charged to expense in 2004. The remaining costs totaling approximately $2 million were charged to expense during 2005. Also, based on a market assessment, the Company determined that the carrying value of its Illinois properties was impaired and a charge of $.5 million was recorded in the second quarter of 2005. These costs are reflected on the Company's income statement under dry hole, abandonment and impairment.

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7. Pro Forma Results. On January 27, 2005, the Company acquired certain interests (J-W Acquisition) in the Niobrara field in northeastern Colorado for approximately $105 million. The properties consist of approximately 127,000 gross (69,500 net) acres. The acquisition also includes approximately 200 miles of a pipeline gathering system and gas compression facilities for delivery into interstate gas lines. The Company borrowed $105 million under its credit facility to fund this acquisition.

The unaudited pro forma results presented below for the six months ended June 30, 2005 and 2004 have been prepared to give effect to the J-W Acquisition on the Company's results of operations under the purchase method of accounting as if it had been consummated on January 1, 2004. The unaudited pro forma results do not purport to represent the results of operations that actually would have occurred on such date or to project the Company's results of operations for any future date or period:

	Six Months Ended June 30,	
	2005	2004
Pro forma:	(in thousands, except per share data)	
Revenue	$ 182,047	$ 130,890
Income from operations	84,282	50,285
Net income	48,069	26,811
Basic earnings per share	2.18	1.23
Diluted earnings per share	2.14	1.20

8. Canyon Drilling. Canyon Drilling ("Canyon") is a Colorado LLC formed by the Company in the second quarter of 2005. The Company purchased a drilling rig at auction and refurbished it for a total of approximately $2.8 million as of June 30, 2005. The Company has 100% membership interest of Canyon and contributed the drilling rig to Canyon. Canyon is consolidated, accounted for and disclosed in accordance with SFAS No. 94, *Consolidation of All Majority-Owned Subsidiaries*. Canyon's drilling rig is leased to a drilling company under a contract and is accounted for as a direct financing lease as defined by SFAS No. 13, *Accounting for Leases*, therefore, Canyon's balance sheet assets of $2.8 million are lease receivables.

Future minimum lease payments to be received as of June 30, 2005 are as follows:

2005	$ 702,625
2006	702,625
Total	$ 1,405,250

9. Recent Accounting Pronouncements. In May 2005, SFAS No. 154, *Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3* was issued. SFAS No. 154 requires retrospective application to prior period financial statements for changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 also requires that retrospective application of a change in accounting principle be limited to the direct effects of the change. Indirect effects of a change in accounting principle should be recognized in the period of the accounting change. SFAS No. 154 will become effective for the Company's fiscal year beginning January 1, 2006. The impact of SFAS No. 154 will depend on the nature and extent of any voluntary accounting changes and correction of errors after the effective date, but Management does not currently expect SFAS No. 154 to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

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In December 2004, SFAS No. 123 (revised 2004) or SFAS No. 123(R), *Share-Based Payment* was issued. This statement requires the cost resulting from all share-based payment transactions be recognized in the financial statements at their fair value on the grant date. SFAS No. 123(R) is effective as of the beginning of the first annual reporting period that begins after June 15, 2005. As a result, the Company expects to adopt this statement on January 1, 2006. The adoption of this statement is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In December 2004, the Financial Accounting Standards Board (FASB) issued Staff Position (FSP) FAS 109-1, *Application of FASB Statement No. 109, Accounting for Income Taxes, for the Tax Deduction Provided to U.S. Based Manufacturers by the American Jobs Creation Act of 2004*. FSP 109-1 became effective for the Company's fiscal year beginning January 1, 2005. This position clarifies how to apply SFAS No. 109 to the new law's tax deduction for income attributable to "domestic production activities." The implementation of this position did not have a material impact on the Company's financial position, net income or cash flows.

10. Hedging. In June 2005, the Company entered into derivative instruments (zero-cost collars) for approximately 10,000 Bbl/D for the period January 1, 2006 through December 31, 2009. Based on WTI pricing, the floor is $47.50 and the ceiling is $70 per barrel. The use of hedging transactions also involves the risk that the counterparties will be unable to meet the financial terms of such transactions. With respect to the Company's hedging activities, the Company utilizes multiple counterparties on its hedges and monitors each counterparty's credit rating. After the June hedge transaction, a significant credit risk concentration existed in one broker. In July 2005, the Company reduced the concentration as the hedges were transferred to multiple counterparties. The Company does not require collateral on these hedging transactions.

11. Taxes. The Company experienced an effective tax rate of 32% for the second quarter of 2005 compared to 33% for the first quarter of 2005 and 24% for the second quarter of 2004. The Company benefits from enhanced oil recovery (EOR) credits on development activities on its heavy oil properties. However, with higher crude oil prices and the increasing investment in its light crude oil and natural gas properties, the Company's effective income tax rate is trending higher compared to prior years.

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BERRY PETROLEUM COMPANY
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Item 2. Management's Discussion and Analysis of
Financial Condition and Results of Operations

Overview

The following discussion provides information on the results of operations for each of the three and six month periods ended June 30, 2005 and 2004 and the financial condition, liquidity and capital resources as of June 30, 2005. The financial statements and the notes thereto contain detailed information that should be referred to in conjunction with this discussion.

The profitability of the Company's operations in any particular accounting period will be directly related to the average realized prices of oil, gas and electricity sold, the type and volume of oil and gas produced and electricity generated and the results of development, exploitation, acquisition and exploration activities. The average realized prices for natural gas and electricity will fluctuate from one period to another due to regional market conditions and other factors, while oil prices will be predominantly influenced by world supply and demand. The aggregate amount of oil and gas produced may fluctuate based on the success of development and exploitation of oil and gas reserves pursuant to current reservoir management. The cost of natural gas used in the Company's steaming operations and electrical generation, production rates, labor, equipment costs, maintenance expenses, and production taxes are expected to be the principal influences on operating costs. Accordingly, the results of operations of the Company may fluctuate from period to period based on the foregoing principal factors, among others.

Results of Operations

The Company earned net income of $25.3 million, or $1.13 per share (diluted), on revenues of $92.7 million in the second quarter of 2005, up 12% from net income of $22.5 million, or $1.00 per share (diluted), on revenues of $88.0 million in the first quarter of 2005, and up 65% from net income of $15.3 million, or $.68 per share (diluted), on revenues of $64.1 million in the second quarter of 2004.

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The following table presents certain operating data for the periods ending:

	Three Months Ended						Six Months Ended	
	Jun 30 2005	%	Mar 31 2005	%	Jun 30 2004	%	Jun 30 2005	Jun 30 2004
Oil and Gas								
Oil Production (Bbl/D)	18,986	84	19,156	87	19,182	94	19,070	18,880
Natural Gas Production (Mcf/D)	22,090	16	17,347	13	6,796	6	19,732	6,409
Total (BOE/D)	22,668	100	22,047	100	20,315	100	22,359	19,949
Per BOE:								
Average sales price before hedging	$ 43.41		$ 40.89		$ 30.83		$ 42.21	$ 29.46
Average sales price after hedging	39.09		37.81		28.55		38.50	27.00
Oil, per Bbl:								
Average WTI price	$ 53.22		$ 49.85&#16					