BERRY PETROLEUM CO
Form 10-Q
May 08, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
T Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2013
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 T 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 T 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.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES £ NO T
As of May 6, 2013 the registrant had 52,671,706 shares of Class A Common Stock ($0.01 par value) outstanding. The registrant also had 1,763,866 shares of Class B Stock ($0.01 par value) outstanding on May 6, 2013, all of which is held by a single holder.

Table of Contents

BERRY PETROLEUM COMPANY
INDEX TO FORM 10-Q
March 31, 2013

Table of Contents

BERRY PETROLEUM COMPANY
Condensed Balance Sheets
(Unaudited)
(In Thousands, Except Share Information)

	March 31, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$105	$312
Restricted short-term investments	125	125
Accounts receivable	131,632	122,159
Deferred income taxes	6,093	703
Derivative instruments	7,622	14,661
Prepaid expenses and other	22,205	19,065
Total current assets	167,782	157,025
Oil and natural gas properties (successful efforts basis), buildings and equipment, net	3,177,892	3,128,502
Derivative instruments	17,491	10,891
Other assets	27,468	28,984
	$3,390,633	$3,325,402
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$108,713	$175,893
Revenue and royalties payable	31,564	57,021
Accrued liabilities	47,183	51,151
Derivative instruments	5,057	1,111
Deferred income taxes	—	1,456
Total current liabilities	192,517	286,632
Long-term liabilities:		
Deferred income taxes	281,925	255,471
Senior secured revolving credit facility	653,600	562,900
10.25% Senior notes due 2014, net of unamortized discount of $1,950 and $2,340, respectively	203,307	202,917
6.75% Senior notes due 2020	300,000	300,000
6.375% Senior notes due 2022	600,000	600,000
Asset retirement obligations	90,237	82,316
Derivative instruments	—	1,239
Other long-term liabilities	22,241	19,136
	2,151,310	2,023,979
Shareholders' equity:		
Preferred stock, $0.01 par value, 2,000,000 shares authorized; no shares outstanding	—	—
Capital stock, $0.01 par value:		
Class A Common Stock, 100,000,000 shares authorized; 52,669,614 and 52,428,423 shares issued and outstanding, respectively	527	524
Class B Stock, 3,000,000 shares authorized; 1,763,866 shares issued and outstanding (liquidation preference of $0.50 per share)	18	18
Capital in excess of par value	368,688	364,710
Retained earnings	677,573	649,539
Total shareholders' equity	1,046,806	1,014,791

	$3,390,633	$3,325,402

The accompanying notes are an integral part of these Condensed Financial Statements.

Table of Contents

BERRY PETROLEUM COMPANY
Condensed Statements of Operations
(Unaudited)
(In Thousands, Except Per Share Data)

	Three Months Ended March 31,	
	2013	2012
REVENUES		
Oil and natural gas sales	$266,772	$233,653
Electricity sales	7,589	5,980
Natural gas marketing	2,027	1,859
Gain on sale of assets	23	1,763
Interest and other income, net	475	747
	276,886	244,002
EXPENSES		
Operating costs—oil and natural gas production	86,148	54,221
Operating costs—electricity generation	5,296	5,017
Production taxes	10,784	10,658
Depreciation, depletion & amortization—oil and natural gas production	68,084	47,956
Depreciation, depletion & amortization—electricity generation	394	466
Natural gas marketing	1,878	1,777
General and administrative	22,278	17,741
Interest	24,687	20,104
Dry hole, abandonment, impairment and exploration	962	3,067
Impairment of oil and natural gas properties	2,467	—
Realized and unrealized loss on derivatives, net	737	28,481
	223,715	189,488
Earnings before income taxes	53,171	54,514
Income tax provision	20,737	20,616
Net earnings	$32,434	$33,898
Basic net earnings per share	$0.59	$0.62
Diluted net earnings per share	$0.58	$0.61
Dividends per share	$0.08	$0.08

The accompanying notes are an integral part of these Condensed Financial Statements.

Table of Contents

BERRY PETROLEUM COMPANY
Condensed Statements of Comprehensive Earnings
(Unaudited)
(In Thousands)

	Three Months Ended March 31,	
	2013	2012
Net earnings	$32,434	$33,898
Other comprehensive earnings, net of income taxes:		
Amortization of accumulated other comprehensive loss related to de-designated hedges, net of income tax benefits of $0 and $777, respectively	—	1,267
Other comprehensive earnings	—	1,267
Comprehensive earnings	$32,434	$35,165

The accompanying notes are an integral part of these Condensed Financial Statements.

Table of Contents

BERRY PETROLEUM COMPANY
Condensed Statements of Cash Flows
(Unaudited)
(In Thousands)

	Three Months Ended March 31, 2013	2012
Cash flows from operating activities:		
Net earnings	$32,434	$33,898
Depreciation, depletion and amortization	68,478	48,422
Gain on sale of assets	(23)	(1,763)
Amortization of debt issuance costs and net discount	1,709	2,037
Impairment of oil and natural gas properties	2,467	—
Dry hole and impairment	449	28
Derivatives	3,146	42,837
Stock-based compensation expense	3,195	3,104
Deferred income taxes	19,648	16,567
Other, net	2,381	683
Allowance for bad debt	—	315
Change in book overdraft	(232)	(509)
Changes in operating assets and liabilities:		
Accounts receivable	(9,507)	(7,835)
Inventories, prepaid expenses, and other current assets	(3,057)	(2,686)
Accounts payable and revenue and royalties payable	(25,411)	(674)
Accrued interest and other accrued liabilities	(3,979)	20,982
Net cash provided by operating activities	91,698	155,406
Cash flows from investing activities:		
Development and exploration of oil and natural gas properties	(174,663)	(167,758)
Property acquisitions	(2,897)	(8,529)
Capitalized interest	(1,799)	(5,190)
Proceeds from sale of assets	480	15,700
Deposits on asset sales	—	(3,300)
Net cash used in investing activities	(178,879)	(169,077)
Cash flows from financing activities:		
Proceeds from issuance of 6.375% Senior notes due 2022	—	600,000
Long-term borrowings under credit facility	299,200	102,700
Repayments of long-term borrowings under credit facility	(208,500)	(634,200)
Financing obligation	(112)	(101)
Debt issuance costs	—	(10,569)
Dividends paid	(4,400)	(4,381)
Stock options and restricted stock issued	65	3,498
Excess income tax benefit	721	422
Net cash provided by financing activities	86,974	57,369
Net (decrease) increase in cash and cash equivalents	(207)	43,698
Cash and cash equivalents at beginning of period	312	298
Cash and cash equivalents at end of period	$105	$43,996
Noncash investing activities:		
Accrued capital expenditures	$32,379	$41,339
Asset retirement obligations	7,022	4,994

The accompanying notes are an integral part of these Condensed Financial Statements.

Table of Contents

BERRY PETROLEUM COMPANY
Condensed Statements of Shareholders' Equity
(Unaudited)
(In Thousands, Except Per Share Data)

	Class A	Class B	Capital in Excess of Par Value	Retained Earnings	Total Shareholders' Equity
Balances at December 31, 2012	$524	$18	$364,710	$649,539	$1,014,791
Stock options and restricted stock issued	3	—	62	—	65
Stock based compensation expense	—	—	3,195	—	3,195
Income tax effect of stock option exercises	—	—	721	—	721
Dividends ($0.08 per share)	—	—	—	(4,400)	(4,400)
Net earnings	—	—	—	32,434	32,434
Balances at March 31, 2013	$527	$18	$368,688	$677,573	$1,046,806

The accompanying notes are an integral part of these Condensed Financial Statements.

Table of Contents

BERRY PETROLEUM COMPANY
Notes to Condensed Financial Statements
(Unaudited)

1. Basis of Presentation

These Condensed Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial reporting. Pursuant to the rules and regulations of the Securities and Exchange Commission (SEC), the unaudited Condensed Financial Statements do not include all disclosures required by GAAP. For a more complete understanding of Berry Petroleum Company's (the Company) operations, financial position and accounting policies, the unaudited Condensed Financial Statements and notes thereto should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2012, previously filed with the SEC.

All adjustments, consisting of normal and recurring accruals, which are, in the opinion of management, necessary to fairly state the Company's Condensed Financial Statements have been included herein. Interim results are not necessarily indicative of expected annual results because of the impact of fluctuations in prices received for oil and natural gas, as well as other factors. In the course of preparing the Condensed Financial Statements, management makes various assumptions, judgments and estimates to determine the reported amounts of assets, liabilities, revenues and expenses, and to prepare disclosures of commitments and contingencies. 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 previously established.

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, 2013 and December 31, 2012 was $14.7 million and $14.9 million, respectively, representing outstanding checks in excess of the bank balance (book overdraft).

Recent Accounting Standards

There are no material new accounting pronouncements that have been issued but not yet adopted by the Company as of March 31, 2013.

2. Acquisitions and Divestitures

2012 Acquisitions

On September 12, 2012, the Company completed the acquisition of approximately 14,000 net acres contiguous to the Company's Brundage Canyon asset in the Uinta for an aggregate purchase price of $39.6 million, including usual and customary post-closing adjustments. Disclosures of purchase price allocation and also of pro forma revenues and net earnings for this acquisition are not material and have not been presented.

On April 13, 2012, the Company completed the acquisition of approximately 2,000 net acres and one well in the Wolfberry trend in the Permian for an aggregate purchase price of $14.9 million including usual and customary post-closing adjustments. Disclosures of purchase price allocation and also of pro forma revenues and net earnings for this acquisition are not material and have not been presented.

2012 Divestiture

On December 21, 2011, the Company entered into an agreement to sell its assets related to proved developed properties in Elko, Eureka and Nye Counties, Nevada, which closed on January 31, 2012, for total cash consideration of $15.6 million. The Company recorded a $1.6 million gain in conjunction with the sale. The gain was recorded in the Condensed Statements of Operations under the caption gain on sale of assets.

Table of Contents
BERRY PETROLEUM COMPANY
Notes to Condensed Financial Statements (Continued)
(Unaudited)

3. Debt

Senior Secured Revolving Credit Facility

As of March 31, 2013, the Company's credit facility, which matures on May 13, 2016, had a borrowing base of $1.4 billion, subject to lender commitments. At March 31, 2013, lender commitments under the facility were $1.2 billion. Borrowings under the credit facility bear interest at either (i) LIBOR plus a margin between 1.50% and 2.50% or (ii) the prime rate plus a margin between 0.50% and 1.50%, in each case, based on the amount utilized. The annual commitment fee on the unused portion of the credit facility ranges between 0.35% and 0.50% based on the amount utilized.

As of March 31, 2013, there were $653.6 million in outstanding borrowings under the credit facility and $23.2 million in outstanding letters of credit, leaving $523.2 million in borrowing capacity available under the credit facility. The maximum amount available under the credit facility is subject to semi-annual redeterminations of the borrowing base in April and October of each year, based on the value of the Company's proved oil and natural gas reserves, in accordance with the lenders' customary procedures and practices. The Company and the lenders each have the right to one additional redetermination each year. The semi-annual redetermination in April 2013 did not result in any changes to the borrowing base, lender commitments, or other terms of the credit facility.

4. Income Taxes

The effective income tax rate for the three months ended March 31, 2013 and 2012 was 39.0% and 37.8%, respectively. The Company's provision for income taxes differed from the U.S. statutory rate of 35% primarily due to state income taxes, domestic production activities deduction, percentage depletion, nondeductible employee compensation and other permanent differences.

As of March 31, 2013, the Company had a gross liability for uncertain income tax benefits of $22.6 million, $17.5 million of which, if recognized, would impact the effective income tax rate. There have been no significant changes to the calculation of uncertain income tax benefits during 2013. Consistent with the Company's policy, interest and penalties on income taxes have been recorded as a component of the income tax provision. The Company estimates that it is reasonably possible that the balance of unrecognized income tax benefits as of March 31, 2013 could decrease by a maximum of $6.7 million in the next 12 months due to the expiration of statutes of limitation and audit settlements.

5. Earnings Per Share

Basic net earnings per share is calculated by dividing net earnings available to common shareholders by the weighted average shares outstanding-basic during each period. Diluted earnings per share is calculated by dividing earnings available to common shareholders by the weighted average shares outstanding-dilutive, which includes the effect of potentially dilutive securities. Potentially dilutive securities consist of unvested restricted stock awards and outstanding stock options. No potential shares of common stock are included in the computation of any diluted per share amount when a net loss exists.

The two-class method of computing net earnings per share is required for those entities that have participating securities. The two-class method is an earnings allocation formula that determines net earnings per share for participating securities according to dividends declared (or accumulated) and participation rights in undistributed earnings. Unvested restricted shares issued under the Company's equity incentive plans prior to January 1, 2010 have the right to receive non-forfeitable dividends, participating on an equal basis with common shares, and thus are classified as participating securities. Participating securities do not have a contractual obligation to share in the Company's losses. Therefore, in periods of net loss, no portion of the loss is allocated to participating securities. Unvested restricted shares issued subsequent to January 1, 2010 under the Company's equity incentive plans do not participate in dividends. Stock options issued under the Company's equity incentive plans do not participate in dividends.

Table of Contents
BERRY PETROLEUM COMPANY
Notes to Condensed Financial Statements (Continued)
(Unaudited)
5. Earnings Per Share (Continued)

The following table shows the computation of basic and diluted net earnings per share for the three months ended March 31, 2013 and 2012:

	Three Months Ended March 31,	
(in thousands, except per share data)	2013	2012
Net earnings	$32,434	$33,898
Less: net earnings allocable to participating securities	81	171
Net earnings available for common shareholders	$32,353	$33,727
Basic net earnings per share	$0.59	$0.62
Diluted net earnings per share	$0.58	$0.61
Basic weighted average shares outstanding	55,186	54,759
Add: Dilutive effects of stock options and RSUs	379	504
Dilutive weighted average shares outstanding	55,565	55,263

Not included in the diluted earnings per share calculation were 0.8 million and 0.3 million stock options and RSUs, for the three months ended March 31, 2013 and March 31, 2012, respectively, because their effect would have been anti-dilutive.

6. Asset Retirement Obligations

The following table summarizes the activity for the Company's asset retirement obligations (AROs) for the three months ended March 31, 2013 and 2012:

	Three Months Ended March 31,	
(in thousands)	2013	2012
Beginning balance at January 1	$86,746	$64,019
Liabilities incurred	2,711	2,993
Liabilities settled	(805)	(467)
Disposition of assets	—	(705)
Accretion expense	1,704	1,223
Revisions in estimated cash flows	4,311	2,001
Ending balance at March 31	$94,667	$69,064

ARO reflects the estimated present value of the amount of dismantlement, removal, site reclamation and similar activities associated with the Company's oil and natural gas properties. Inherent in the fair value calculation of ARO are numerous assumptions and judgments including the ultimate settlement amounts, inflation factors, credit adjusted discount rates, timing of settlement and changes in the legal, regulatory, environmental and political environments. To the extent future revisions to these assumptions impact the fair value of the existing ARO liability, a corresponding adjustment is made to the oil and natural gas property balance.

10

7. Equity Incentive Compensation Plans

Stock-based compensation is measured at the grant date based on the fair value of the awards. The fair value is recognized on a straight-line basis over the requisite service period (generally the vesting period).

Total compensation cost recognized in the Condensed Statements of Operations for the grants under the Company's equity incentive compensation plans was $3.0 million and $3.0 million during the three months ended March 31, 2013 and 2012, respectively.

Stock Options

The following table summarizes stock option activity for the three months ended March 31, 2013:

	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value (in thousands)(1)	Weighted Average Remaining Contractual Term (Years)
Outstanding at January 1, 2013	1,387,592	$33.71	$4,681	
Granted	—	—		
Exercised	(3,000)	21.58	76	
Canceled/expired	—	—		
Outstanding at March 31, 2013	1,384,592	$33.74	$17,939	3.84
Vested and expected to vest at March 31, 2013	1,384,293	$33.73	$17,939	3.84
Exercisable at March 31, 2013	1,278,372	$32.29	$17,939	3.45

(1) The intrinsic value of a stock option is the amount by which the market value of the underlying stock at the end of the related period exceeds the exercise price of the option.

As of March 31, 2013, there were $2.3 million of total unrecognized compensation costs related to outstanding stock options. These costs are expected to be recognized over 3.0 years.

Restricted Stock Units

The following table summarizes restricted stock unit (RSU) activity for the three months ended March 31, 2013:

	RSUs	Weighted Average Grant Date Fair Value	Vest Date Fair Value (in thousands)
Outstanding at January 1, 2013	981,877	$26.72	
Granted	264,033	45.27	
Issued	(175,269)	24.68	$6,817
Canceled/expired	(1,445)	49.29	
Outstanding at March 31, 2013(1)(2)	1,069,196	$32.16	

(1) The balance outstanding includes 58,036 RSUs granted to non-employee directors that are 100% vested at date of grant, but are subject to deferral elections delaying the date on which the corresponding shares are issued.

(2) The balance outstanding includes 510,967 RSUs granted to executive officers and other officers that have vested in accordance with the RSU agreement but are subject to deferral elections delaying the date on which the corresponding shares are issued.

Table of Contents
BERRY PETROLEUM COMPANY
Notes to Condensed Financial Statements (Continued)
(Unaudited)
7. Equity Incentive Compensation Plans (Continued)

As of March 31, 2013, there were $20.3 million of total unrecognized compensation costs related to RSUs granted. These costs are expected to be recognized over 4.0 years.

Performance Share Program

The following table summarizes performance share award activity for the three months ended March 31, 2013:

	Performance Share Awards(1)	Weighted Average Grant Date Fair Value	Vest Date Fair Value (in thousands)
Outstanding at January 1, 2013	222,587	$45.79	
Granted	—	—	
Issued	(64,922)	32.75	$2,990
Canceled/expired	(34,742)	28.32	
Outstanding at March 31, 2013	122,923	$57.61	

(1) Reflects the maximum number of performance shares that can be issued.

As of March 31, 2013, there were $1.8 million of total unrecognized compensation costs related to performance shares granted. These costs are expected to be recognized over 1.8 years.

8. 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 production by reducing its exposure to price fluctuations. The Company has historically 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. During the second quarter of 2012, the Company began entering into derivative contracts to fix the floor and ceiling prices paid for a portion of its natural gas consumption. The terms of the Company's derivative contracts depend on various factors, including management's view of future crude oil and natural gas prices, acquisition economics on purchased assets, future financial commitments, and other considerations. The Company periodically enters into interest rate derivative agreements to protect against changes in interest rates on its floating rate debt. The Company recognizes all gains and losses from changes in commodity derivative fair values immediately in earnings. For further discussion related to the fair value of the Company's derivatives, see Note 9 to the Condensed Financial Statements.

As of March 31, 2013, the Company had commodity derivatives associated with the following volumes:

	2013	2014	2015
Oil sales, Bbl/D	19,800	21,000	3,000
Natural gas purchases, MMBtu/D	10,000	—	—

The Company entered into the following derivative instruments during the three months ended March 31, 2013:

Crude Oil Sales Three-Way Collars

Term	Index	Average Barrels Per Day	Sold Put / Purchased Put / Sold Call
Full year 2013 and 2014	ICE Brent	1,000	$80.00 / $100.00 / $114.05
Full year 2014	NYMEX WTI	1,000	$70.00 / $90.00 / $102.00

12

Table of Contents

BERRY PETROLEUM COMPANY
Notes to Condensed Financial Statements (Continued)
(Unaudited)
8. Derivative Instruments (Continued)

Crude Oil Sales (NYMEX WTI) Swaps

Term	Average Barrels Per Day	Weighted Average Price
Full year 2014	11,500	$90.14

Crude Oil Sales (NYMEX WTI to ICE Brent) Basis Swaps

Term	Average Barrels Per Day	Weighted Average Price
Full year 2014	10,000	$11.60
Full year 2015	8,000	$11.60

Crude Oil Sales (NYMEX WTI to Midland) Basis Swaps

Term	Average Barrels Per Day	Weighted Average Price
April 2013 - December 2013	4,000	$1.48

In March 2012, the Company terminated certain of its natural gas derivative instruments, which were associated with a total of 15,000 MMBtu/D for the remainder of 2012. The termination resulted in a net loss of $1.9 million, including cash settlements and non-cash fair value losses, and was recorded in the Condensed Statements of Operations under the caption realized and unrealized loss on derivatives, net.

The Company routinely enters into derivative contracts with a variety of counterparties, typically resulting in individual derivative instruments with both fair value asset and liability positions. The Company nets the fair values of derivative instruments executed with the same counterparty pursuant to ISDA master agreements, which mitigate the credit risk of the Company's derivative instruments by providing for net settlement over the term of the contract and in the event of default or termination of the contract. The tables below summarize the fair value of derivative assets and liabilities and the effect of netting on the Condensed Balance Sheets:
(in millions)