CALLON PETROLEUM CO
Form 10-K
March 05, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For The Fiscal Year Ended December 31, 2014

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF 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	(IRS Employer
Incorporation or Organization)	Identification No.)
200 North Canal Street	
Natchez, Mississippi	39120
(Address of Principal Executive Offices)	(Zip Code)

601-442-1601

(Registrant’s Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $.01 par value	New York Stock Exchange
10.0% Series A Cumulative Preferred Stock	New York Stock Exchange

Securities registered pursuant to section 12 (g) of the Act: None

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark whether the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrants knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definition of “large accelerated filer,” “accelerated filer,” and “smaller reporting company” in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if 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 Exchange Act).
Yes No

Aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2014 was approximately $456.3 million. The Registrant had 55,510,729 shares of common stock outstanding as of February 27, 2015.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement of Callon Petroleum Company (to be filed no later than 120 days after December 31, 2014) relating to the Annual Meeting of Stockholders to be held on May 14, 2015, which are incorporated into Part III of this Form 10-K.

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Special Note Regarding Forward Looking Statements

All statements, other than statements of historical fact, may be deemed to be forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements that address activities, outcomes and other matters that should or may occur in the future, including, without limitation, statements regarding the financial position, business strategy, production and reserve quantities, present value and growth and other plans and objectives for our future operations, are forward-looking statements. Although we believe the expectations expressed in such forward-looking statements are based on reasonable assumptions, such statements are not guarantees of future performance.

Forward-looking statements include the items identified in the preceding paragraph, information concerning possible or assumed future results of operations and other statements in this Form 10-K identified by words such as “anticipate,” “project,” “intend,” “estimate,” “expect,” “believe,” “predict,” “budget,” “projection,” “goal,” “plan,” “forecast,” “target” or si

You should not place undue reliance on forward-looking statements. They are subject to known and unknown risks, uncertainties and other factors that may affect our operations, markets, products, services and prices and cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. In addition to any assumptions and other factors referred to specifically in connection with forward-looking statements, risks, uncertainties and factors that could cause our actual results to differ materially from those indicated in any forward-looking statement include, but are not limited to:

- the timing and extent of changes in market conditions and prices for oil, natural gas and NGLs (including regional basis differentials),
- our ability to transport our production to the most favorable markets or at all,
- the timing and extent of our success in discovering, developing, producing and estimating reserves,
- our ability to fund our planned capital investments,
- the impact of government regulation, including regulation of endangered species, any increase in severance or similar taxes, legislation relating to hydraulic fracturing, the climate and over-the-counter derivatives,
- the costs and availability of oilfield personnel services and drilling supplies, raw materials, and equipment and services,
- our future property acquisition or divestiture activities,
- the effects of weather,
- increased competition,
- the financial impact of accounting regulations and critical accounting policies,
- the comparative cost of alternative fuels,
- conditions in capital markets, changes in interest rates and the ability of our lenders to provide us with funds as agreed,
- credit risk relating to the risk of loss as a result of non-performance by our counterparties, and

- any other factors listed in the reports we have filed and may file with the SEC.

We caution you that the forward-looking statements contained in this Form 10-K are subject to all of the risks and uncertainties, many of which are beyond our control, incident to the exploration for and development, production and sale of oil and natural gas. These risks include, but are not limited to, the risks described in Item 1A of this Annual Report on Form 10-K for the year ended December 31, 2014 (the "2014 Annual Report on Form 10-K"), and all quarterly reports on Form 10-Q filed subsequently thereto.

Should one or more of the risks or uncertainties described above or in our 2014 Annual Report on Form 10-K occur, or should underlying assumptions prove incorrect, our actual results and plans could differ materially from those expressed in any forward-looking statements. We specifically disclaim all responsibility to publicly update any information contained in a forward-looking statement or any forward-looking statement in its entirety and therefore disclaim any resulting liability for potentially related damages.

All forward-looking statements attributable to us are expressly qualified in their entirety by this cautionary statement.

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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.
- Bbl or Bbls: barrel or barrels of oil or natural gas liquids.
- Bcf: Billion cubic feet of natural gas.
- 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.
- BLM: Bureau of Land Management.
- 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.
- DOI: Department of Interior.
- EPA: Environmental Protection Agency.
- FASB: Financial Accounting Standards Board.
- GAAP: Generally Accepted Accounting Principles in the United States.
- GHG: greenhouse gases.
- LIBOR: London Interbank Offered Rate.
- LOE: lease operating expense, including workover expense.
- MBbls: thousand barrels of oil.
- MBOE: thousand BOE.
- MBOE/d: Mboe per day.
- Mcf: thousand cubic feet of natural gas.
- MMBbls: million barrels of oil.
- MMBOE: million BOE.
- MMBtu: million Btu.
- MMcf: million cubic feet of natural gas.
- MMcf/d: MMcf per day.
- 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.
- PDPs: proved developed producing reserves.
- PDNPs: proved developed non-producing reserves.
- PUDs: proved undeveloped reserves.

- RSU: restricted stock units.
- SEC: United States Securities and Exchange Commission.

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.

Items 1 and 2 – Business and Properties

Overview

Callon Petroleum Company has been engaged in the exploration, development, acquisition and production of oil and natural gas properties since 1950.

In 2013, we completed our onshore strategic repositioning that began in 2009, shifting our operations from the offshore waters in the Gulf of Mexico to the onshore Permian Basin in West Texas. Our asset base is concentrated exclusively in the Midland Basin, a sub-basin located within the broader Permian Basin, characterized by high drilling success rates, high oil content, multiple vertical and horizontal productive intervals, and extensive production history. 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.

Our net daily production for calendar year 2014 was 5,648 BOE/d (approximately 82% oil), representing an approximately 155% increase over comparable net daily Permian production in 2013. The increase is primarily attributed to our increased focus on horizontal development initiated in 2012. We currently operate two horizontal drilling rigs focused on four prospective zones for development.

As of December 31, 2014, we had estimated net proved reserves of 25.7 MMBbls and 42.5 Bcf, or 32.8 MMBOE, all of which were located in the Midland Basin. Additionally, 78% of our proved reserves were crude oil and 55% were proved developed at year-end 2014 on a BOE basis.

Our Business Strategy

Our goal is to enhance stockholder value through the execution of the following strategy:

Drive production and maximize resource recovery and reserve growth through horizontal development of our resource base. We believe our horizontal development efforts provide improved returns relative to vertical development of our resource base. Our initial vertical development programs allowed us to amass a database related to the subsurface geology and rock characteristics over the last several years. This information, combined with our review of industry activity and best practices, provided the foundation for us to initiate the horizontal development of our resource base in 2012 and further increase horizontal activity in recent quarters. As of December 31, 2014, we had 49 gross producing horizontal wells, all of which we operate. During the fourth quarter of 2014, approximately 70% of our total Permian production was sourced from horizontal wells. We expect to grow the contribution of horizontal production volumes, both from our existing properties and from properties acquired in recent acquisitions, as we continue to execute a resource development program almost exclusively focused on horizontal development.

Expand our drilling portfolio through evaluation of existing acreage. Our horizontal development drilling efforts to date have been primarily focused on the Upper and Lower Wolfcamp B zones. We have focused on these development zones to reduce drilling risk as we continue to grow our asset base in the Permian Basin, though we have continued to expand our development focus on a measured basis. Most recently, we drilled three Lower Spraberry wells in the Southern and Central Midland Basin in the second half of 2014, complementing three Wolfcamp A wells placed on production in the Southern Midland Basin since the third quarter of 2013. We believe incremental opportunities exist to selectively target other prospective zones across various positions of our acreage, including the Clearfork, Jo Mill, Middle Spraberry, Wolfcamp C and Cline formations (in order of relative depth). In addition, we will continue to monitor the efficiency of our horizontal wells related to reservoir drainage over time, and will pursue downspacing initiatives within target zones if we believe overall returns would be enhanced.

Pursue selective acquisitions in the Permian Basin. During 2014, we continued to demonstrate our ability to acquire and trade acreage in the Midland Basin. Most significantly, we acquired 6,230 gross (3,862 net) acres located in Midland and Andrews Counties, which are in close proximity to our existing Carpe Diem and Pecan Acres fields, for approximately $210 million. Due to its close proximity to our existing fields, we believe this acquired acreage can be efficiently integrated into our ongoing horizontal development activity. The acquisition added 194 gross (121.6 net) potential horizontal drilling locations targeting the currently producing Wolcamp B, Lower Spraberry and Middle Spraberry zones, and additional potential horizontal drilling locations targeting four other prospective zones that are producing in offsetting fields. We also expanded our asset base in existing core development fields by acquiring 1,527 net acres for approximately $8.2 million through a “bolt-on” strategy whereby we identify and pursue smaller blocks of offsetting acreage that are potentially inefficient for the current owner to develop, but have value to Callon based on its location relative to our acreage. These smaller scale acquisitions generally provide acreage at costs significantly below the value assigned to larger blocks of acreage. While remaining mindful about our liquidity, we will continue to pursue leasehold acquisitions in the Permian Basin, and primarily in the Midland Basin, that have horizontal resource potential that can be further augmented by “bolt-on acreage” acquisitions and acreage trades over time.

Maintain financial liquidity and capacity to capitalize on growth opportunities. We believe that our asset base provides the opportunity to deploy a significant amount of capital for horizontal development in the coming years. We have focused on positioning ourselves to supplement our cash flow from operations with an improved cost of debt capital. In conjunction with our acquisition completed in the fourth quarter of 2014, we raised approximately $430 million in gross proceeds through a combination of common equity and long-term debt securities to support the acquisition and our ongoing development efforts in the Midland Basin.

Our Strengths

Established resource base and acreage position in the Permian Basin. Our production is exclusively from the Permian Basin in West Texas, an area that has supported production since the 1940s. The basin has well-established infrastructure from historical operations, and we believe the Basin also benefits from a relatively stable regulatory environment that has been established over time. We have assembled a position of approximately 18,065 net surface acres in the Southern and Central Midland Basin that are prospective for multiple oil-bearing intervals that have been produced by us and other industry participants. As of December 31, 2014, our estimated net proved reserves were comprised of approximately 78% oil and 22% natural gas, which includes NGLs in the production stream.

Multi-year drilling inventory. Our current acreage position in the Permian Basin provides visible growth potential from a horizontal drilling inventory of approximately 525 locations, or 20 years under our current two-rig horizontal drilling program, based solely on four currently producing zones, which include the Lower Spraberry, the Wolfcamp A and the Upper and Lower Wolfcamp B. This drilling inventory increases to over 1,000 drilling locations, with the addition of drilling locations from other prospective zones, which include the Clearfork, Middle Spraberry, Jo Mill, Wolfcamp C and the Cline (or Wolfcamp D). Our identified well locations across our Southern and Central Midland Basin acreage are based upon the results of horizontal wells drilled by us and other offsetting operators, and our analysis of core data and historical vertical well performance.

Experienced team operating in the Permian Basin. We have assembled a management team experienced in acquisitions, exploration, development and production in the Midland Basin. Reflective of this experience, we have realized improvements in our drilling and capital efficiency since launching our horizontal drilling program in 2012 and drilling more than 50 horizontal wells with lengths varying from approximately 5,000 feet to 10,000 feet. We continue to evaluate our completion techniques, and downspacing initiatives that we believe have the potential to improve resource recovery and contribute to enhanced returns on capital. In addition, we regularly evaluate our operating results against those of other operators in the area in an effort to benchmark our performance against the best performing operators and evaluate and adopt best practices.

High degree of operational control. We operate nearly all of our Permian Basin acreage and have limited continuous drilling requirements across our acreage. For example, only 10% of our planned development drilling activity in 2015 is required to satisfy acreage commitments, with decreasing obligations in future years. This acreage status, combined with our control as an operator across the majority of our properties, provides us the opportunity to modify our operational plans to respond to changes in operational and commodity price environments. In addition, we have the ability to change our drilling schedule as needed to manage the assimilation of newly acquired acreage that may have drilling commitments.

Operating culture focused on safety and the environment. We have a Health, Safety and Environmental ("HSE") department dedicated to our operations in the Permian Basin. This group is responsible for developing and implementing work processes to mitigate safety and environmental risks associated with our work activities. With emphasis on planning, training and communication, and empowering both our employees and third party service providers with Stop Work Authority, we continue to improve operational performance. Callon has enhanced Management of Change, routine inspections and compliance action tracking methods with the implementation of a HSE management system software program. This department also coordinates closely with our operational team to ensure effective communication with appropriate regulatory bodies as well as landowners. We believe that our proactive efforts in this area have made a positive impact on our operations and culture.

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Exploration and Development Activities

Our 2014 total capital expenditures, including acquisitions, were $455.5 million, representing a 166% increase over 2013 capital expenditures. Of the $455.5 million, $217.7 million was allocated to drilling, development and leasehold acquisition activity in the Permian Basin. During 2014, we drilled 27 gross (24.4 net) horizontal and 7 gross (4.3 net) vertical wells, while completing 31 gross (27.3 net) horizontal and 5 gross (3.1 net) vertical wells. Capital expenditures for 2014 included the following expenditures (in millions):

Southern Midland Basin	$ 160.3
Central Midland Basin	56.9
Northern Midland Basin	0.5
Total operational expenditures	217.7
Capitalized general and administrative costs allocated directly to exploration and development projects	12.5
Capitalized interest	2.4
Total capitalized general and administrative and interest costs	14.9
Total operational expenditures inclusive of capitalized general and administrative and interest costs	232.6
Acquisitions	222.9
Total capital expenditures	$ 455.5

In late 2014, we expanded our horizontal pad development efforts to six fields. We expect our 2015 horizontal drilling program will be primarily focused on development of established Upper and Lower Wolfcamp zones in the Southern and Central Midland Basin. We also expect to drill five wells in the Southern and Central Midland Basin targeting the Lower Spraberry shale formation and one well targeting the Wolfcamp A shale formation.

Recent Developments

We are currently operating two horizontal drilling rigs, complemented by an additional vertical rig that is being used to drill the vertical section of horizontal wells. Based on current commodity market conditions, the Company has elected to release the vertical rig in mid-March and focus on a two-rig horizontal program for the balance of 2015.

Oil and Natural Gas Properties

As of December 31, 2014, our estimated net proved reserves totaled 32.8 MMBOE and included 25.7 MMBbls of oil and 42.5 Bcf, of natural gas with a pre-tax present value, discounted at 10%, of $629.7 million. Pre-tax present value is a non-GAAP financial measure, which we reconcile to the GAAP measure of standardized measure of $579.5 million in note (d) to the table below. Oil constituted approximately 78% of our total estimated equivalent net proved reserves and approximately 77% of our total estimated equivalent proved developed reserves.

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The following table sets forth certain information about our estimated net proved reserves prepared by our independent petroleum reserve engineers by major area and for all other properties combined at December 31, 2014:

	Estimated Net Proved Reserves			Pre-tax Discounted Present
	Oil (MBbls)	Natural Gas (MMcf)	Total (MBoe) (a)	Value ($000) (b)(c)(d)
Southern Midland Basin	16,973	26,102	21,323	$ 416,463
Central Midland Basin	8,736	16,337	11,459	219,286
Northern Midland Basin	24	109	42	803
Other	—	—	—	(6,872)
Total	25,733	42,548		