

ENCORE ACQUISITION CO

Form 10-Q

August 08, 2008

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2008

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 001-16295

ENCORE ACQUISITION COMPANY

(Exact name of registrant as specified in its charter)

Delaware

75-2759650

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

777 Main Street, Suite 1400, Fort Worth, Texas

76102

(Address of principal executive offices)

(Zip Code)

(817) 877-9955

(Registrant's telephone number, including area code)

Not applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether 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 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 the definitions 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 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 Exchange Act).
Yes No

Number of shares of common stock, \$0.01 par value, outstanding as of August 1, 2008

53,323,951

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Statement Showing Computation of Ratios of Earnings (Loss) to Fixed Charges
Second Amendment to Amended and Restated Credit Agreement

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Certain information included in this Quarterly Report on Form 10-Q (the "Report") and other materials filed with the SEC, or in other written or oral statements made or to be made by us, other than statements of historical fact, are forward-looking statements as defined by the safe harbor provisions of the Private Securities Litigation Reform Act of

1995. These forward-looking statements give our current expectations or forecasts of future events. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. These statements may include words such as may, will, could, anticipate, estimate, expect, project, intend, plan, believe, potential, pursue, target, continue, and other words and terms of similar meaning. Readers are cautioned not to place undue reliance on such forward-looking statements, which speak only as of the date of this Report. Our actual results may differ significantly from the results discussed in the forward-looking statements. Such statements involve risks and uncertainties, including, but not limited to, the matters discussed in Item 1A. Risk Factors in our 2007 Annual Report on Form 10-K and in our other filings with the SEC. If one or more of these risks or uncertainties materialize (or the consequences of such a development changes), or should underlying assumptions prove incorrect, actual outcomes may vary materially from those forecasted or expected. We undertake no responsibility to update forward-looking statements for changes related to these or any other factors that may occur subsequent to this filing for any reason.

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**ENCORE ACQUISITION COMPANY
GLOSSARY**

The following are abbreviations and definitions of certain terms used in this Report. The definitions of proved developed reserves, proved reserves, and proved undeveloped reserves have been abbreviated from the applicable definitions contained in Rule 4-10(a)(2-4) of Regulation S-X.

Bbl. One stock tank barrel, or 42 U.S. gallons liquid volume, used in reference to oil or other liquid hydrocarbons.

Bbl/D. One Bbl per day.

BOE. One barrel of oil equivalent, calculated by converting natural gas to oil equivalent barrels at a ratio of six Mcf of natural gas to one Bbl of oil.

BOE/D. One BOE per day.

Completion. The installation of permanent equipment for the production of oil or natural gas.

Council of Petroleum Accountants Societies (COPAS). A professional organization of oil and gas accountants that maintains consistency in accounting procedures and interpretations, including the procedures that are part of most joint operating agreements. These procedures establish a drilling rate and an overhead rate to reimburse the operator of a well for overhead costs, such as accounting and engineering.

Delay Rentals. Fees paid to the lessor of an oil and natural gas lease during the primary term of the lease prior to the commencement of production from a well.

Development Well. A well drilled within the proved area of an oil or natural gas reservoir to the depth of a stratigraphic horizon known to be productive.

Dry Hole. A well found to be incapable of producing hydrocarbons in sufficient quantities such that proceeds from the sale of such production would exceed LOE and production taxes.

Dry Gas. Natural gas comprised of over 90 percent methane and suitable for use by customers of local gas distribution companies.

EAC. Encore Acquisition Company, a Delaware corporation, together with its subsidiaries.

ENP. Encore Energy Partners LP, a publicly traded Delaware limited partnership, together with its subsidiaries.

Exploratory Well. A well drilled to find and produce oil or natural gas in an unproved area, to find a new reservoir in a field previously producing oil or natural gas in another reservoir, or to extend a known reservoir.

Field. An area consisting of a single reservoir or multiple reservoirs, all grouped on or related to the same individual geological structural feature and/or stratigraphic condition.

Gross Acres or Gross Wells. The total acres or wells, as the case may be, in which an entity owns a working interest.

Lease Operations Expense (LOE). All direct and allocated indirect costs of producing oil and natural gas after completion of drilling. Such costs include labor, superintendence, supplies, repairs, maintenance, and

direct overhead charges.

LIBOR. London Interbank Offered Rate.

MBbl. One thousand Bbls.

MBOE. One thousand BOE.

Mcf. One thousand cubic feet, used in reference to natural gas.

Mcf/D. One Mcf per day.

MMcf. One million cubic feet, used in reference to natural gas.

Natural Gas Liquids (NGLs). The combination of ethane, propane, butane, and natural gasolines that when removed from natural gas become liquid under various levels of higher pressure and lower temperature.

Net Acres or Net Wells. Gross acres or wells, as the case may be, multiplied by the working interest percentage owned by an entity.

Net Profits Interest (NPI). An interest that entitles the owner to a specified share of net profits from production of hydrocarbons.

NYMEX. New York Mercantile Exchange.

Oil. Crude oil, condensate, and NGLs.

Operator. The entity responsible for the exploration, exploitation, and production of an oil or natural gas well or lease.

Production Margin. Oil and natural gas revenues less LOE and production, ad valorem, and severance taxes.

Proved Developed Reserves. Proved reserves that can be expected to be recovered from existing wells with existing equipment and operating methods.

Proved Reserves. The estimated quantities of oil, natural gas, and NGLs that geological and engineering data demonstrate with reasonable certainty are recoverable in future years from known reservoirs under existing economic and operating conditions.

Proved Undeveloped Reserves. Proved reserves that are expected to be recovered from new wells drilled to known reservoirs

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ENCORE ACQUISITION COMPANY

on acreage yet to be drilled for which the existence and recoverability of such reserves can be estimated with reasonable certainty, or from existing wells where a relatively major expenditure is required to establish production, including unrealized production response from enhanced recovery techniques that have been proved effective by actual tests in the area and in the same reservoir.

Reservoir. A porous and permeable underground formation containing a natural accumulation of producible oil and/or natural gas that is confined by impermeable rock or water barriers and is individual and separate from other reservoirs.

SEC. The United States Securities and Exchange Commission.

Secondary Recovery. Enhanced recovery of oil or natural gas from a reservoir beyond the oil or natural gas that can be recovered by normal flowing and pumping operations. Secondary recovery techniques involve maintaining or enhancing reservoir pressure by injecting water, gas, or other substances into the formation. The purpose of secondary recovery is to maintain reservoir pressure and to displace hydrocarbons toward the wellbore. The most common secondary recovery techniques are gas injection and waterflooding.

Successful Well. A well capable of producing oil and/or natural gas in commercial quantities.

Tertiary Recovery. An enhanced recovery operation that normally occurs after waterflooding in which chemicals or natural gases are used as the injectant.

Undeveloped Acreage. Lease acreage on which wells have not been drilled or completed to a point that would permit the production of commercial quantities of oil or natural gas regardless of whether such acreage contains proved reserves.

Waterflood. A secondary recovery operation in which water is injected into the producing formation in order to maintain reservoir pressure and force oil toward and into the producing wells.

Working Interest. An interest in an oil or natural gas lease that gives the owner the right to drill for and produce oil and natural gas on the leased acreage and requires the owner to pay a share of the production and development costs.

Workover. Operations on a producing well to restore or increase production.

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CONSOLIDATED BALANCE SHEETS**

(in thousands, except share and per share amounts)

	June 30, 2008 (unaudited)	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,594	\$ 1,704
Accounts receivable, net of allowance for doubtful accounts of \$6,045	185,054	134,880
Inventory	26,582	16,257
Derivatives	3,301	9,722
Deferred taxes	84,242	20,420
Other	4,882	5,527
Total current assets	305,655	188,510
Properties and equipment, at cost – successful efforts method:		
Proved properties, including wells and related equipment	3,106,417	2,845,776
Unproved properties	85,757	63,352
Accumulated depletion, depreciation, and amortization	(586,900)	(489,004)
	2,605,274	2,420,124
Other property and equipment	22,357	21,750
Accumulated depreciation	(11,369)	(10,733)
	10,988	11,017
Goodwill	60,606	60,606
Derivatives	10,863	34,579
Long-term receivables	64,850	40,945
Other	29,040	28,780
Total assets	\$ 3,087,276	\$ 2,784,561
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 30,177	\$ 21,548
Accrued liabilities:		
Lease operations expense	18,216	15,057

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Development capital	61,025	48,359
Interest	12,078	12,795
Production, ad valorem, and severance taxes	42,712	24,694
Marketing	8,331	8,721
Derivatives	198,142	39,337
Oil and natural gas revenues payable	16,628	13,076
Other	27,512	21,143
 Total current liabilities	 414,821	 204,730
 Derivatives	 133,318	 47,091
Future abandonment cost, net of current portion	28,895	27,371
Deferred taxes	350,292	312,914
Long-term debt	1,141,519	1,120,236
Other	1,538	1,530
 Total liabilities	 2,070,383	 1,713,872
 Commitments and contingencies (see Note 16)		
 Minority interest in consolidated partnership	 101,034	 122,534
 Stockholders' equity:		
Preferred stock, \$.01 par value, 5,000,000 shares authorized, none issued and outstanding		
Common stock, \$.01 par value, 144,000,000 shares authorized, 52,357,211 and 53,303,464 issued and outstanding, respectively	525	534
Additional paid-in capital	537,779	538,620
Treasury stock, at cost, none and 17,690 shares, respectively		(590)
Retained earnings	377,138	411,377
Accumulated other comprehensive income (loss)	417	(1,786)
 Total stockholders' equity	 915,859	 948,155
 Total liabilities and stockholders' equity	 \$ 3,087,276	 \$ 2,784,561

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

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ENCORE ACQUISITION COMPANY
CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)

	Three months ended		Six months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Revenues:				
Oil	\$ 286,924	\$ 135,596	\$ 507,458	\$ 218,219
Natural gas	67,889	45,131	116,201	78,109
Marketing	2,521	8,916	6,577	23,857
Total revenues	357,334	189,643	630,236	320,185
Expenses:				
Production:				
Lease operations	40,697	37,552	81,047	68,072
Production, ad valorem, and severance taxes	35,043	19,232	62,495	31,747
Depletion, depreciation, and amortization	51,026	52,318	100,569	87,346
Exploration	11,593	3,415	17,081	14,936
General and administrative	11,559	6,188	21,246	13,548
Marketing	3,725	8,507	7,507	23,518
Derivative fair value loss	256,390	6,766	321,528	52,380
Other operating	3,226	4,751	5,732	7,316
Total expenses	413,259	138,729	617,205	298,863
Operating income (loss)	(55,925)	50,914	13,031	21,322
Other income (expenses):				
Interest	(16,785)	(27,820)	(36,545)	(44,107)
Other	686	601	1,537	1,032
Total other expenses	(16,099)	(27,219)	(35,008)	(43,075)
Income (loss) before income taxes and minority interest	(72,024)	23,695	(21,977)	(21,753)
Income tax benefit (provision)	21,322	(8,524)	2,589	7,496
Minority interest in loss of consolidated partnership	14,982		14,888	
Net income (loss)	\$ (35,720)	\$ 15,171	\$ (4,500)	\$ (14,257)

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Net income (loss) per common share:

Basic	\$ (0.68)	\$ 0.29	\$ (0.09)	\$ (0.27)
Diluted	\$ (0.68)	\$ 0.28	\$ (0.09)	\$ (0.27)

Weighted average common shares outstanding:

Basic	52,344	53,143	52,571	53,111
Diluted	52,344	54,020	52,571	53,111

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

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ENCORE ACQUISITION COMPANY
CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

(in thousands)

(unaudited)

	Issued	Common	Additional	Shares		Retained	Accumulated	
	Shares			Treasury	Treasury		Other	Total
	of	Stock	Paid-in	of	Stock	Earnings	Comprehensive	Stockholders
	Common	Stock	Capital	Treasury	Stock	Earnings	Income	Equity
	Stock	Stock	Capital	Stock	Stock	Earnings	(Loss)	Equity
Balance at December 31, 2007	53,321	\$ 534	\$ 538,620	(18)	\$ (590)	\$ 411,377	\$ (1,786)	\$ 948,155
Exercise of stock options and vesting of restricted stock	256	3	1,325					1,328
Repurchase and retirement of common stock	(1,174)	(12)	(11,679)			(27,427)		(39,118)
Purchase of treasury stock				(28)	(954)			(954)
Cancellation of treasury stock	(46)		(465)	46	1,544	(1,079)		
Non-cash equity-based compensation			6,535					6,535
ENP distributions to holders of management incentive units						(1,233)		(1,233)
Adjustment to reflect gain on issuance of ENP common units			3,458					3,458
Other			(15)					(15)
Components of comprehensive loss:								
Net loss						(4,500)		(4,500)
Change in deferred hedge gain on interest rate swaps, net of tax of \$253							417	417
							1,786	1,786

Amortization of
deferred loss on
commodity
derivative
contracts, net of
tax of \$1,071

Total
comprehensive
loss

(2,297)

**Balance at
June 30, 2008**

52,357 \$ 525 \$ 537,779 \$ \$ 377,138 \$ 417 \$ 915,859

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

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ENCORE ACQUISITION COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Six months ended	
	June 30,	
	2008	2007
Cash flows from operating activities:		
Net loss	\$ (4,500)	\$ (14,257)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depletion, depreciation, and amortization	100,569	87,346
Non-cash exploration expense	15,545	13,870
Deferred taxes	(26,756)	(7,745)
Non-cash equity-based compensation expense	6,205	5,480
Non-cash derivative loss	300,370	65,038
Loss (gain) on disposition of assets	(79)	2,282
Minority interest in loss of consolidated partnership	(14,888)	
Other	6,619	2,589
Changes in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable	(47,301)	(42,735)
Current derivatives	(670)	(15,303)
Other current assets	(9,680)	(8,554)
Long-term derivatives	(1,196)	(19,828)
Other assets	(1,033)	(2,200)
Accounts payable	4,208	4,468
Other current liabilities	25,825	11,127
Other noncurrent liabilities	(923)	(253)
Net cash provided by operating activities	352,315	81,325