CALLON PETROLEUM CO

Form 10-Q August 08, 2013

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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended: June 30, 2013

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 001-14039

CALLON PETROLEUM COMPANY

(Exact name of registrant as specified in its charter)

Delaware 64-0844345 (State or other jurisdiction (I.R.S. Employer of 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)

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 "

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x

No "

Indicate by check mark whether the registrant is a larger accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "accelerated filer", "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer " Accelerated filer x

Non-accelerated filer " 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 x

As of August 5, 2013 there were outstanding 40,328,507 shares of the Registrant's common stock, par value \$0.01 per share.

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Part I. Financial Information Item I. Financial Statements Callon Petroleum Company Consolidated Balance Sheets		
(in thousands, except per share data)	June 30, 2013	December 31, 2012
ASSETS Current assets:	Unaudited	December 31, 2012
Cash and cash equivalents	\$13,406	\$1,139
Accounts receivable	15,828	15,608
Fair market value of derivatives	1,647	1,674
Other current assets	904	1,502
Total current assets	31,785	19,923
Oil and natural gas properties, full-cost accounting method:		
Evaluated properties	1,583,159	1,497,010
Less accumulated depreciation, depletion and amortization		(1,296,265)
Net oil and natural gas properties	265,198	200,745 68,776
Unevaluated properties excluded from amortization Total oil and natural gas properties	55,182 320,380	269,521
Total oil and natural gas properties	320,360	209,321
Other property and equipment, net	9,926	10,058
Restricted investments	3,800	3,798
Investment in Medusa Spar LLC	7,946	8,568
Deferred tax asset	63,892	64,383
Other assets, net	3,474	1,922
Total assets	\$441,203	\$378,173
LIADH WEEG AND GEOGRAPOLDEDGE FOLLOW		
LIABILITIES AND STOCKHOLDERS' EQUITY Current liabilities:		
Accounts payable and accrued liabilities	\$40,637	\$36,016
Asset retirement obligations	6,223	2,336
Fair market value of derivatives	106	125
Total current liabilities	46,966	38,477
13% Senior Notes:	•	•
Principal outstanding	96,961	96,961
Deferred credit, net of accumulated amortization of \$19,415 and \$17,800, respectively	12,092	13,707
Total 13% Senior Notes	109,053	110,668
Senior secured revolving credit facility	_	10,000
Asset retirement obligations	7,175	10,965
Other long-term liabilities	1,474	2,092
Total liabilities	164,668	172,202
Stockholders' equity:		
Preferred stock, series A cumulative, \$0.01 par value and \$50.00		
liquidation preference, 2,500 shares authorized: 1,579 and 0 shares	16	_
outstanding, respectively		

Common stock, \$0.01 par value, 60,000 shares authorized; 40,277 and	404	398	
39,801 shares outstanding, respectively	404	390	
Capital in excess of par value	399,380	328,116	
Retained deficit	(123,265) (122,543)
Total stockholders' equity	276,535	205,971	
Total liabilities and stockholders' equity	\$441,203	\$378,173	

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

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Callon Petroleum Company Consolidated Statements of Operations (Unaudited; in thousands, except per share data)

	Three Months	Ended June 30,	Six Months En	nded June 30,
	2013	2012	2013	2012
Operating revenues:				
Crude oil sales	\$19,061	\$22,073	\$38,601	\$47,822
Natural gas sales	3,699	3,287	6,700	6,833
Total operating revenues	22,760	25,360	45,301	54,655
Operating expenses:				
Lease operating expenses	5,384	5,246	11,142	13,484
Production taxes	687	575	1,226	1,122
Depreciation, depletion and amortization	10,654	11,844	21,696	24,033
General and administrative	4,545	4,374	8,284	9,405
Accretion expense	533	562	1,098	1,135
Total operating expenses	21,803	22,601	43,446	49,179
Income from operations	957	2,759	1,855	5,476
Other (income) expenses:				
Interest expense	1,537	2,384	3,052	4,961
Gain on early extinguishment of debt		(1,366)	_	(1,366)
Gain on derivative contracts	(1,981)	(3,505)	(1,563)	(3,575)
Other income, net	(44)	(157)	(89)	(461)
Total other (income) expenses, net	(488)	(2,644)	1,400	(441)
Income before income taxes	1,445	5,403	455	5,917
Income tax expense	663	1,610	494	1,754
Income (loss) before equity in earnings of Medusa Spar	782	2 702	(20	1 162
LLC	182	3,793	(39)	4,163
Equity in (loss) earnings of Medusa Spar LLC	(24)	6	(3)	124
Net income (loss)	758	3,799	(42)	4,287
Preferred stock dividends	(680)		(680)	_
Net income (loss) available to common shareholders	\$78	\$3,799	\$(722)	\$4,287
Net income (loss) per common share:				
Basic	\$0.00	\$0.10	\$(0.02)	\$0.11
Diluted	\$0.00	\$0.09	\$(0.02)	\$0.11
Shares used in computing net income (loss) per				
common share:				
Basic	40,089	39,399	39,941	39,375
Diluted	40,323	40,155	39,941	40,204

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

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Callon Petroleum Company Consolidated Statements of Comprehensive Income (Loss) (Unaudited; in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,),
	2013	2012	2013	2012	
Net income (loss)	\$758	\$3,799	\$(42) \$4,287	
Other comprehensive (loss) income:					
Change in fair value of derivatives designated as		1,393		(77	`
hedges,		1,393		(77	,
net of tax (See Note 5)					
Comprehensive income (loss)	758	5,192	(42) 4,210	
Preferred stock dividends	(680) —	(680) —	
Comprehensive income (loss) available to common shareholders	\$78	\$5,192	\$(722) \$4,210	

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

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Callon Petroleum Company Consolidated Statements of Cash Flows (Unaudited; in thousands)

	Six Months Ended June 30,		
	2013	2012	
Cash flows from operating activities:			
Net income (loss)	\$(42) \$4,287	
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation, depletion and amortization	22,405	24,676	
Accretion expense	1,098	1,135	
Amortization of non-cash debt related items	228	225	
Amortization of deferred credit	(1,615) (1,538)
Non-cash gain on early extinguishment of debt		(1,366)
Equity in loss (earnings) of Medusa Spar LLC	3	(124)
Deferred income tax expense	494	1,754	
Unrealized loss (gain) on derivative contracts	(249) (3,897)
Non-cash expense related to equity share-based awards	734	722	
Change in the fair value of liability share-based awards	(852) 989	
Payments to settle asset retirement obligations	(615) (1,029)
Changes in current assets and liabilities:			
Accounts receivable	789	(2,036)
Other current assets	598	63	
Current liabilities	(324) 4,756	
Payments to settle vested liability share-based awards	(239) (199)
Change in natural gas balancing receivable	(118) (95)
Change in natural gas balancing payable	(62) (17)
Change in other long-term liabilities	(206) —	
Change in other assets, net	(1,790) (865)
Cash provided by operating activities	\$20,237	\$27,441	
Cash flows from investing activities:			
Capital expenditures	(58,385) (72,538)
Acquisition	(11,000) —	
Proceeds from sale of mineral interest and equipment	1,389	522	
Distribution from Medusa Spar LLC	616	1,120	
Cash used in investing activities	\$(67,380) \$(70,896)
Cook flows from financing activities.			
Cash flows from financing activities:	31,000	10.000	
Borrowings on senior secured revolving credit facility	,	10,000	
Payments on senior secured revolving credit facility	(41,000) —	`
Redemption of 13% senior notes	70,000	(10,225)
Issuance of preferred stock Payment of preferred stock dividends	70,090	_	
•	(680	(2	`
Taxes paid related to exercise of employee stock options Cash provided by (used in) financing activities	<u> </u>	(2 \$ <i>(</i> 227)
Cash provided by (used in) illiancing activities	\$59,410	\$(227)
Net change in cash and cash equivalents	12,267	(43,682)
Beginning of period cash and cash equivalents	1,139	43,795	,
	•	•	

End of period cash and cash equivalents

\$13,406

\$113

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

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Callon Petroleum Company

Notes to the Consolidated Financial Statements

(Unless otherwise indicated, amounts included in the footnotes to the financial statements are presented in thousands, except for share, well, acreage and per-derivative instrument data.)

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<u>4.</u> Borrowings <u>9.</u> Equity Transactions

<u>5.</u> Derivative Instruments and Hedging Activities

Note 1 - Description of Business and Basis of Presentation

Description of business

Callon Petroleum Company is an independent crude oil and natural gas company, which since 1950 has been focused on building reserves and production both onshore and offshore through efficient operations and low finding and development costs. In 2009, we began to shift our operational focus from exploration in the Gulf of Mexico to building an onshore asset portfolio in order to provide a multi-year, low-risk drilling program in both crude oil and natural gas basins. To date, a significant portion of this onshore transition has been funded by reinvesting the cash flows from our Gulf of Mexico properties. In the fourth quarter of 2012, we monetized our interest in the deepwater Habanero field in order to accelerate development of our onshore properties.

The Company's properties and operations are geographically concentrated onshore in Texas and Louisiana and the offshore waters of the Gulf of Mexico.

Basis of presentation

Unless otherwise indicated, all amounts included within the footnotes to the financial statements are presented in thousands, except for share, well, acreage and per-derivative instrument data.

The interim consolidated financial statements of the Company have been prepared in accordance with (1) accounting principles generally accepted in the United States ("US GAAP"), (2) the Securities and Exchange Commission's instructions to Quarterly Report on Form 10-Q and (3) Rule 10-01 of Regulation S-X, and include the accounts of the Company, and its subsidiary, Callon Petroleum Operating Company ("CPOC"). CPOC also has subsidiaries, namely Callon Offshore Production, Inc., and Mississippi Marketing, Inc.

These interim consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2012. The balance sheet at December 31, 2012 has been derived from the audited financial statements at that date.

Operating results for the periods presented are not necessarily indicative of the results that may be expected for the year ended December 31, 2013.

In the opinion of management, the accompanying unaudited consolidated financial statements reflect all adjustments, including normal recurring adjustments and all intercompany account and transaction eliminations, necessary to present fairly the Company's financial position, the results of its operations and its cash flows for the periods indicated. When necessary to ensure consistent presentation, certain prior year amounts may be reclassified. To the

extent the amounts reclassified are material, we have either footnoted them within the Company's disclosures or have noted the items within this footnote.

New accounting standard

In February 2013, the Financial Accounting Standards Board issued an Accounting Standards Update (ASU) that clarified the reclassification requirements from accumulated other comprehensive income to net income. This ASU requires disclosure of amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present either on the face of the financial statements or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income, but only if the amount is reclassified in its entirety to net income in the same

Footnotes to the Financial Statements

Unless otherwise indicated, amounts included in the footnotes to the financial statements are presented in thousands, except for share, well, acreage and per-derivative instrument data.

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reporting period. For amounts not reclassified in their entirety to net income, an entity is required to cross-reference to the related note on the face of the financial statements for additional information. Callon adopted this guidance effective January 1, 2013, which did not have a material impact on its financial statements.

Note 2 - Property Disclosures and Operating Leases

In April 2012, the Company took delivery of a drilling rig for a term of two years to support its horizontal drilling program in the Permian Basin, and on August 1, 2013, the Company contracted an additional drilling rig for a one year term. Lease cost recorded during the three and six months ended June 30, 2013 was \$2,280 and \$4,551, respectively. Lease payments will approximate \$12,601 in 2013 (with \$8,050 remaining at June 30, 2013) and \$6,941 in 2014. The agreements include early termination provisions that would reduce the minimum rentals under the agreement, assuming the lessor is unable to re-charter the rig and staffing personnel to another lessee, to \$5,055 in 2013 and \$4,530 in 2014.

On June 1, 2013, the Company acquired approximately 2,468 gross (2,186 net) acres in Reagan County, Texas, which is located in the southern portion of the Midland Basin and which is prospective for both horizontal and vertical drilling. The acquisition also included seven gross vertical wells and 1,051 barrels of oil equivalent proved reserves. The purchase price of \$11,000 was funded using a portion of the proceeds from the preferred stock offering (discussed in Note 9).

Note 3 - Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share:

	Three Months Ended June 30,		Six Months End	ed June 30,		
	2013	2012	2013	2012		
(a) Net income (loss) available to common shareholders	\$78	\$3,799	\$(722)	\$4,287		
(b) Weighted average shares outstanding	40,089	39,399	39,941	39,375		
Dilutive impact of stock options		7	_	14		
Dilutive impact of restricted stock	234	749	_	815		
(c) Weighted average shares outstanding for diluted net income (loss) per share	40,323	40,155	39,941	40,204		
Basic net income (loss) per share (a/b)	\$0.00	\$0.10	\$(0.02)	\$0.11		
Diluted net income (loss) per share (a/c)	\$0.00	\$0.09	\$(0.02)	\$0.11		
The following were excluded from the diluted EPS calculation because their effect would be anti-dilutive:						
Stock options	52	67	52	52		
Restricted stock	267	1,013	267	1,013		

Note 4 – Borrowings

The Company's borrowings consisted of the following at:

June 30, 2013 December 31, 2012

Principal components:

Credit Facility	\$ —	\$10,000
13% Senior Notes due 2016, principal	96,961	96,961
Total principal outstanding	96,961	106,961
Non-cash components:		
13% Senior Notes due 2016 unamortized deferred credit	12,092	13,707
Total carrying value of borrowings	\$109,053	\$120,668

Footnotes to the Financial Statements

Unless otherwise indicated, amounts included in the footnotes to the financial statements are presented in thousands, except for share, well, acreage and per-derivative instrument data.

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Senior Secured Revolving Credit Facility (the "Credit Facility")

As of June 30, 2013, the Company's \$200,000 Credit Facility had an associated borrowing base of \$75,000 and a maturity of March 15, 2016. Regions Bank serves as the administrative agent for the Credit Facility, which also includes Citibank, NA, IberiaBank, Whitney Bank and OneWest Bank, FSB as participating lenders. Amounts borrowed under the Credit Facility may not exceed a borrowing base, which is generally reviewed on a semi-annual basis and is then eligible for re-determination. The Credit Facility is secured by mortgages covering the Company's major producing fields.

On May 10, 2013, the Company entered into the second amendment to our Fourth Amended and Restated Credit Agreement that allows the Company to pay quarterly Senior Unsecured Debt and Preferred Equity dividends of \$5.5 million per quarter, so long as the Company is not in default under the Credit Facility. The amendment became effective with the receipt of the cash proceeds from the preferred equity offering discussed in Note 9.

As of June 30, 2013, no balance was outstanding on the Credit Facility as a portion of the proceeds from the preferred stock offering was used to repay the balance then outstanding. The Credit Facility has an interest rate calculated as the London Interbank Offered Rate ("LIBOR") plus a tiered rate ranging from 2.5% to 3.0%, which is determined by utilization of the facility. In addition, the Credit Facility carries a commitment fee of 0.5% per annum on the unused portion of the borrowing base, which is payable quarterly.

13% Senior Notes due 2016 ("Senior Notes") and Deferred Credit

The Senior Notes' 13% interest coupon is payable on the last day of each quarter. Certain of the Company's subsidiaries guarantee the Company's obligations under the unsecured Senior Notes. The subsidiary guarantors are 100% owned, all of the guarantees are full and unconditional and joint and several, the parent company has no independent assets or operations, and any subsidiaries of the parent company other than the subsidiary guarantors are minor. Upon issuing the Senior Notes in November 2009, the Company recorded as a deferred credit the \$31,507 difference between the adjusted carrying amount of the Senior Notes that were exchanged and the principal of the Senior Notes. This deferred credit is being amortized as a reduction of interest expense over the life of the Senior Notes at an 8.5% effective interest rate. The following table summarizes the Company's deferred credit balance:

			Amortization	Estimated
Cross Corring	Accumulated	Comming Value at	Recorded during	Amortization to be
Gross Carrying	Amortization at	Carrying Value at	Current Year as a	Recorded during the
			Reduction of	Remainder of the
Amount	6/30/2013	6/30/2013	Interest Expense	Current Year
\$31,507	\$19,415	\$12,092	\$1,615	\$1,684

Restrictive Covenants

The indentures governing our Senior Notes and the Company's Credit Facility contain various covenants including restrictions on additional indebtedness and payment of cash dividends. In addition, Callon's Credit Facility contains covenants for maintenance of certain financial ratios. The Company was in compliance with these covenants at June 30, 2013.

Note 5 - Derivative Instruments and Hedging Activities

Objectives and strategies for using derivative instruments

The Company is exposed to fluctuations in realized crude oil and natural gas prices for its production. Consequently, the Company believes it is prudent to manage the variability in cash flows on a portion of its crude oil and natural gas production. The Company primarily utilizes collars, put and call options and swap derivative financial instruments to manage fluctuations in cash flows resulting from changes in commodity prices. The Company does not use these instruments for speculative purposes.

Counterparty risk

The use of derivative transactions exposes the Company to the risk that a counterparty will be unable to meet its commitments. To manage this risk, the Company's established counterparties for commodity derivative instruments include a large, well-known financial institution and a large, well-known oil and gas company. While the Company monitors counterparty creditworthiness on an ongoing basis, it cannot predict sudden changes in counterparties' creditworthiness. In addition, even if such changes are not sudden, the Company may be limited in its ability to mitigate an increase in counterparty credit risk. Should one of these

Footnotes to the Financial Statements

Unless otherwise indicated, amounts included in the footnotes to the financial statements are presented in thousands, except for share, well, acreage and per-derivative instrument data.

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counterparties not perform, the Company may not realize the benefit of some of its derivative instruments under lower commodity prices. Counterparty credit risk is considered when determining a derivative instruments' fair value; See Note 6 for additional information.

The Company executes commodity derivative transactions under master agreements that have netting provisions that provide for offsetting payables against receivables. In general, if a party to a derivative transaction incurs an event of default, as defined in the applicable agreement, the other party will have the right to demand the posting of collateral, demand a cash payment transfer or terminate the arrangement.

Financial statement presentation and settlements

In the first quarter of 2013, the Company monetized the remaining portion (covering the period Feb13-Dec13) of its 2013 crude oil collar positions of 40 Bbls per month. The proceeds from this transaction, combined with the proceeds from the sale of the below listed put for 30 Bbls per month, were used to finance the uplift in the crude oil swap for the period Feb13-Dec13.

Listed in the table below are the outstanding crude oil and natural gas derivative contracts as of June 30, 2013:

Commodity	Instrument	Average Notional Volumes per Month	Quantity Type	Put/Call Price	Fixed-Price Swap	Period	Designation under ASC 815
Natural gas	Swap	91	MMbtu	n/a	\$3.52	Jul13 - Dec13	Not Designated
Natural gas	Put Option	91	MMbtu	\$3.00	n/a	Jul13 - Dec13	Not Designated
Crude oil	Swap	40	Bbls	n/a	\$101.30	Jul13 - Dec13	Not Designated
Natural gas	Call Option	38	MMbtu	\$4.75	n/a	Jan14 - Dec14	Not Designated
Crude oil	Swap	30	Bbls	n/a	\$93.35	Jan14 - Dec14	Not Designated
Crude oil	Put Option	30	Bbls	\$70.00	n/a	Jan14 - Dec14	Not Designated

Settlements of the Company's derivative instruments are based on the difference between the contract price or prices specified in the derivative instrument and a New York Mercantile Exchange ("NYMEX") price. The fair value of the Company's derivative instruments, depending on the type of instruments, was determined by the use of present value methods or standard option valuation models with assumptions about commodity prices based on those observed in underlying markets. See Note 6 for additional information regarding fair value.

The following table reflects the fair values of the Company's derivative instruments for the periods presented (none of which were designated as hedging instruments under ASC 815):

	Balance Sheet	Presentation	Asset Fair	r Value	Liability Value	Fair	Net Deri Value	vat	tive Fair	
Commodity	Classification	Line Description	06/30/13	12/31/12	06/30/13	12/31/12	06/30/13	;	12/31/12	,
Natural gas	Current	Fair market value of derivatives	\$—	\$—	\$(106)	\$(125)	\$(106)	\$(125)

Natural gas	Non-current	Other long-term liabilities	_	_	(38) (116)	(38	(116)
Crude oil	Current	Fair market value of derivatives	1,647	1,674	_	_	1,647	1,674
Crude oil	Non-current	Other long-term assets	428	250	_	_	428	250
	Totals		\$2,075	\$1,924	\$(144) \$(241)	\$1,931	\$1,683

The Company's derivative contracts are subject to netting arrangements and, being representative of the way in which the contracts settle, are presented in the balance sheet at their fair values on a net basis based on the underlying commodity being hedged. The following presents the impact of this presentation to the Company's recognized assets and liabilities at June 30, 2013:

	Presented without				As Presented with	
	Effects of Netting		Effects of Netting		Effects of Netting	
Current assets: Fair value of hedging contracts	\$2,330		\$(683)	\$1,647	
Long-term assets: Fair value of hedging contracts	852		(424)	428	
Current liabilities: Fair value of hedging contracts	(789)	683		(106)
Long-term liabilities: Fair value of hedging contracts	(462)	424		(38)

Footnotes to the Financial Statements

Unless otherwise indicated, amounts included in the footnotes to the financial statements are presented in thousands, except for share, well, acreage and per-derivative instrument data.

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Derivatives not designated as hedging instruments

As discussed in the Company's Form 10-K for the year ended December 31, 2012, the Company elected not to designate as an accounting hedge under FASB ASC 815 any of its derivative contracts executed subsequent to December 31, 2011, nor does it expect to designate future derivative contracts. Any derivative contract not designated as an accounting hedge is carried at its fair value on the balance sheet with both realized and unrealized (mark-to-market) gains or losses on these derivatives recorded on the statement of operations as a component of the Company's other income and expenses. For the periods indicated, the Company recorded the following related to its derivative instruments that were not designated as accounting hedges:

_	Three Months	s Ended June 30,	Six Months Ended June 30,		
	2013	2012	2013	2012	
Natural gas derivatives					
Realized gain (loss), net	\$(156) \$—	\$(107	\$—	
Unrealized gain (loss), net	485	(331)	97	(331)	
Sub-total gain (loss), net	\$329	\$(331)	\$(10) \$(331)	
Crude oil derivatives					
Realized gain, net	\$849	\$ —	\$1,422	\$ —	
Unrealized gain, net	803	3,836	151	3,906	
Sub-total gain, net	\$1,652	\$3,836	\$1,573	\$3,906	
Total gain on derivative instruments, net	\$1,981	\$3,505	\$1,563	\$3,575	

Derivatives designated as hedging instruments

As previously discussed, the Company elected to discontinue hedge accounting at the start of 2012, though certain of the Company's crude oil derivative contracts designated as cash flow hedges were executed in prior periods and were in effect during 2012. Consequently, these designated contracts were recorded at fair market value with the effective portion of the changes in fair value recorded net of tax through other comprehensive income (loss) ("OCI") in stockholders' equity. The cash settlements on contracts for future production were recorded as an increase or decrease in crude oil revenues. Both changes in fair value and cash settlements of ineffective derivative contracts were recognized as derivative expense (income). All contracts previously designated as hedging instruments expired during 2012.

The tables below present the effect of the Company's derivative financial instruments on the consolidated statements of operations as an increase (decrease) to crude oil revenues for the effective portion and as an increase (decrease) to other (income) expense for the ineffective portion and amounts excluded from effectiveness testing:

	Three N	Months	Six Mo	onths
	Ended.	June 30,	Ended	June 30,
	2013	2012	2013	2012
Amount of gain reclassified from OCI into income (effective portion)	\$ —	\$512	\$ —	\$512
Amount of gain recognized in income (ineffective portion and amount excluded from effectiveness testing)	_	92		322

Subsequent Event: Derivative contracts executed subsequent to June 30, 2013 include the following: Commodity Instrument Period

		Average Notional Volumes per Month	Quantity Type	Put/Call Price	Fixed-Price Swap		Designation under ASC 815
Crude oil	Swap	18	Bbls	n/a	\$102.08	Sep13 - Dec13	Not Designated
Crude oil	Swap	9	Bbls	n/a	\$94.58	Jan14 - Dec14	Not Designated

Footnotes to the Financial Statements

Unless otherwise indicated, amounts included in the footnotes to the financial statements are presented in thousands, except for share, well, acreage and per-derivative instrument data.

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Note 6 - Fair Value Measurements

The fair value hierarchy outlined in the relevant accounting guidance gives the highest priority to Level 1 inputs, which consist of unadjusted quoted prices for identical instruments in active markets. Level 2 inputs consist of quoted prices for similar instruments. Level 3 valuations are derived from inputs that are significant and unobservable, and these valuations have the lowest priority.

Fair value of financial instruments

Cash, cash equivalents, short-term investments. The carrying amounts for these instruments approximate fair value due to the short-term nature or maturity of the instruments.

Debt. The Company's debt is recorded at the carrying amount on its Consolidated Balance Sheet. The fair value of Callon's fixed-rate debt, which is valued using Level 2 inputs, is based upon estimates provided by an independent investment banking firm. The carrying amount of floating-rate debt approximates fair value because the interest rates are variable and reflective of market rates.

The following table summarizes the respective carrying and fair values at:

	June 30, 2013		December 3	31, 2012
	Carrying	Carrying Fair Value		Fair Value
	Value	ran value	Value	ran value
Credit Facility	\$—	\$—	\$10,000	\$10,000
13% Senior Notes due 2016 (1)	109,053	101,615	110,668	100,112
Total	\$109,053	\$101,615	\$120,668	\$110,112

(1) Fair value is calculated only in relation to the \$96,961 principal outstanding of the Senior Notes at each of the dates indicated above, respectively. The remaining \$12,092 and \$13,707, respectively, which the Company has recorded as a deferred credit, is excluded from the fair value calculation, and will be recognized in earnings as a reduction of interest expense over the remaining amortization period. See Note 4 for additional information.

Assets and liabilities measured at fair value on a recurring basis

Certain assets and liabilities are reported at fair value on a recurring basis (unless otherwise noted below) in the Company's Consolidated Balance Sheet. The following methods and assumptions were used to estimate the fair values:

Commodity derivative instruments: Callon's derivative policy allows for commodity derivative instruments to consist of natural gas and crude oil collars, basis swaps, puts, calls and similar commodity instrument structures. The fair value of these derivatives is derived using a valuation model that utilizes market-corroborated inputs that are observable over the term of the derivative contract, and the values are corroborated by quotes obtained from counterparties to the agreements. The Company's fair value calculations, based on analysis of each contract, also incorporate an estimate of the counterparties' default risk for derivative assets and an estimate of the Company's default risk for derivative liabilities. The Company believes that the majority of the inputs used to calculate the commodity derivative instruments fall within Level 2 of the fair-value hierarchy based on the wide availability of quoted market prices for similar commodity derivative contracts. See Note 5 for additional information regarding the Company's derivative instruments.

Footnotes to the Financial Statements

Unless otherwise indicated, amounts included in the footnotes to the financial statements are presented in thousands, except for share, well, acreage and per-derivative instrument data.

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The following tables present the Company's assets and liabilities measured at fair value on a recurring basis for each hierarchy level:

As of June 30, 2013 Assets	Balance Sheet Presentation	Level 1	Level 2	Level 3	Total
Derivative financial instruments - current	Fair market value of derivatives	\$—	\$1,647	\$—	\$1,647
Derivative financial instruments - non-current	Other long-term assets	_	428	_	428
Sub-total assets		_	2,075	_	2,075
Liabilities					
Derivative financial instruments - current	Fair market value of derivatives	\$—	\$106	\$—	\$106
Derivative financial instruments - non-current	Other long-term liabilities		38	_	38
Sub-total liabilities	Other long-term liabilities	_	144	_	144
Total		\$ —	\$1,931	\$ —	\$1,931
As of 12/31/2012 Assets	Balance Sheet Presentation	Level 1	Level 2	Level 3	Total
As of 12/31/2012 Assets Derivative financial instruments - current	Balance Sheet Presentation Fair market value of derivatives	Level 1	Level 2 \$1,674	Level 3 \$—	Total \$1,674
Assets Derivative financial instruments - current Derivative financial instruments -	Fair market value of				
Assets Derivative financial instruments - current	Fair market value of derivatives		\$1,674		\$1,674
Assets Derivative financial instruments - current Derivative financial instruments - non-current	Fair market value of derivatives		\$1,674 250		\$1,674 250
Assets Derivative financial instruments - current Derivative financial instruments - non-current Sub-total assets Liabilities Derivative financial instruments - current	Fair market value of derivatives		\$1,674 250		\$1,674 250
Assets Derivative financial instruments - current Derivative financial instruments - non-current Sub-total assets Liabilities Derivative financial instruments - current Derivative financial instruments -	Fair market value of derivatives Other long-term assets Fair market value of	\$— — —	\$1,674 250 1,924	\$— — —	\$1,674 250 1,924
Assets Derivative financial instruments - current Derivative financial instruments - non-current Sub-total assets Liabilities Derivative financial instruments - current	Fair market value of derivatives Other long-term assets Fair market value of derivatives	\$— — —	\$1,674 250 1,924 \$125	\$— — —	\$1,674 250 1,924 \$125

Assets and liabilities measured at fair value on a nonrecurring basis

Certain assets and liabilities are reported at fair value on a nonrecurring basis in Callon's Consolidated Balance Sheet. The following methods and assumptions were used to estimate the fair values:

Asset retirement obligations incurred in current period. Callon estimates the fair value of AROs based on discounted cash flow projections using numerous estimates, assumptions and judgments regarding such factors as (1) the existence of a legal obligation for an ARO, (2) amounts and timing of settlements, (3) the credit-adjusted risk-free rate to be used and (4) inflation rates. AROs incurred during the six months ended June 30, 2013, including upward revisions of \$360, were Level 3 fair value measurements. See Note 8, Asset Retirement Obligations, which provides a

summary of changes in the ARO liability.

Acquisition. In accordance with the acquisition method of accounting, the purchase price from the Company's acquisition during the period has been allocated to the assets acquired and liabilities assumed based on their estimated fair values on the acquisition date. In valuing the acquired assets and liabilities assumed, fair values were based on expected future cash flows based on estimated reserve quantities; costs to produce and develop reserves; and oil and gas forward prices. The fair value measurements were based on significant inputs not observable in the market and thus represent a level 3 measurement.

Note 7 - Income Taxes

The Company provides for income taxes at a statutory rate of 35% adjusted for permanent differences expected to be realized, which primarily relate to statutory depletion and non-deductible executive compensation expenses. The effective tax rate for the six months ended June 30, 2013 and 2012 was 109% and 30%, respectively. The 109% effective tax rate for the six months ended June 30, 2013 is primarily a result of the permanent differences previously noted, as well as certain discrete items occurring in the second quarter of 2013, including shortfalls associated with the Company's restricted stock awards vesting during the period. We have no liability for uncertain tax positions or any accrued interest or penalties as of June 30, 2013.

Footnotes to the Financial Statements

Unless otherwise indicated, amounts included in the footnotes to the financial statements are presented in thousands, except for share, well, acreage and per-derivative instrument data.

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Note 8 - Asset Retirement Obligations

The following table summarizes the Company's asset retirement obligations activity for the six months ended June 30, 2013:

Asset retirement obligations at January 1, 2013	\$13,301	
Accretion expense	1,098	
Liabilities incurred	572	
Liabilities settled	(397)
Revisions to estimate	(1,176)
Asset retirement obligations at end of period	13,398	
Less: Current asset retirement obligations	6,223	
Long-term asset retirement obligations at June 30, 2013	\$7,175	

Certain of the Company's operating agreements require that assets be restricted for future abandonment obligations. Amounts recorded on the Consolidated Balance Sheets as restricted investments were \$3,800 at June 30, 2013. These investments include primarily U.S. Government securities, and are held in abandonment trusts dedicated to pay future abandonment costs for several of the Company's crude oil and natural gas properties.

Note 9 - Equity Transactions

On May 30, 2013, the Company issued \$75,000 of 10.0% Series A Cumulative Preferred Stock (the "Preferred Stock") and received \$70,000 net proceeds after deducting the underwriting commissions and offering expenses. The sale consisted of 1.6 million shares of Preferred Stock, par value \$0.01 per share, public offering price of \$47.50 per share and liquidation preference of \$50.00 per share in an underwritten public offering. The Preferred Stock ranks senior to the Company's common stock with respect to the payment of dividends and distribution of assets upon liquidation or dissolution. The Preferred Stock has no stated maturity and is not subject to mandatory redemption or any sinking fund. The Preferred Stock will remain outstanding indefinitely unless repurchased by the Company or converted into Callon common stock in connection with certain changes in control as defined in the Preferred Stock prospectus.

Holders of the Preferred Stock are entitled to receive, when, as and if declared by our Board of Directors (the "Board"), out of funds legally available for the payment of dividends, cumulative cash dividends at a rate of 10.0% per annum of the \$50.00 liquidation preference per share (equivalent to \$5.00 per annum per share). Dividends are payable quarterly in arrears on the last day of each March, June, September and December when, as and if declared by our Board. The first dividend date for the Preferred Stock was June 30, 2013, and these dividends were paid on June 28, 2013 (as June 30 fell on a weekend) in the amount of \$0.43 per share or \$680 for the stub period beginning with the issuance on May 30, 2013 through the dividend date on June 30, 2013.

Beginning on May 30, 2018, the Company may, solely at its option, redeem the Preferred Stock in whole at any time, or in part from time to time, for cash at a redemption price of \$50.00 per share, plus accrued and unpaid dividends (whether or not declared) to the redemption date. The Company may redeem the Preferred Stock following certain changes of control as defined in the Preferred Stock prospectus, in whole or in part, within 120 days after the date on which the change of control has occurred, for cash at \$50.00 per share, plus accrued and unpaid dividends (whether or not declared) to the redemption date. If the Company elects not to exercise this option, the holders of the Preferred Stock have the option to convert each share of Preferred Stock into a predefined number of Company common shares, subject to certain adjustments. As defined in a provision of the Preferred Stock prospectus, the common shares reserved for issuance vary based on the number of authorized common shares. Based on the Company's 60 million currently authorized shares, 16.8 million shares are reserved for a potential conversion.

The number of reserved common shares increases to a maximum of 42.2 million at such time as the Company's authorized common shares increase. Except as required by law, holders of the Preferred Stock will have no voting rights unless dividends fall into arrears for six or more quarterly periods (whether or not consecutive). In that event and until such dividends in arrears are paid in full, the holders will be entitled to elect two directors to the Board, which will increase in size by that same number of directors.

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Special Note Regarding Forward Looking Statements

All statements, other than historical fact or present financial information, 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. We have no obligation and make no undertaking to publicly update or revise any forward-looking statements, except as may be required by law.

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 commodities (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 respond to low natural gas prices,

our ability to fund our planned capital investments,

the impact of government regulation, including 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, including the possible sale of our Medusa property,

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,

eredit 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 Securities and Exchange Commission ("SEC").

We caution you that the forward-looking statements contained in this Form 10-Q 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 crude oil and natural gas. These risks include, but are not limited to, the risks described in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2012 (the "2012 Annual Report on Form 10-K"), and all quarterly reports on Form 10-Q filed subsequently thereto ("Form 10-Qs").

Should one or more of the risks or uncertainties described above or elsewhere in our 2012 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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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

General

The following management's discussion and analysis describes the principal factors affecting the Company's results of operations, liquidity, capital resources and contractual cash obligations. This discussion should be read in conjunction with the accompanying unaudited consolidated financial statements and our 2012 Annual Report on Form 10-K, which include additional information about our business practices, significant accounting policies, risk factors, and the transactions that underlie our financial results. Our website address is www.callon.com. All of our filings with the SEC are available free of charge through our website as soon as reasonably practicable after we file them with, or furnish them to, the SEC. Information on our website does not form part of this report on Form 10-O.

We have been engaged in the exploration, development, acquisition and production of crude oil and natural gas properties since 1950. In 2009, we began to shift our operational focus from exploration in the Gulf of Mexico to building an onshore asset portfolio in order to provide a multi-year, low-risk drilling program in both crude oil and natural gas basins. To date, a significant portion of this onshore transition has been funded by reinvesting the cash flows from our Gulf of Mexico properties. In the fourth quarter of 2012, we monetized our interest in the deepwater Habanero field in order to accelerate development of our onshore properties. In furtherance of this strategy, in April 2013, we announced our intention to evaluate alternatives with respect to a potential sale of our interests in the Medusa field, our remaining deepwater asset.

Recent key accomplishments and development progress:

In May, we successfully completed a \$75 million Preferred Stock offering, which provided us with \$70 million of net proceeds to accelerate the development of our Permian acreage and to retire the balance on our Credit Facility, leaving \$75 million of available borrowing capacity on the Credit Facility.

In June, we expanded our acreage position in the Permian Basin with the acquisition of 2,468 gross (2,186 net) acres in the southern portion of the Midland Basin for approximately \$11 million. The properties acquired were producing approximately 145 net Boe per day at the time of acquisition.

During August, we increased our capital budget by 36% to \$170 million with approximately 90% of our budgeted operating expenditures (including drilling, completion, and infrastructure) allocated to our Midland Basin operations in an effort to accelerate the development of our fields in the southern and central portions of the Basin. As a result of this budget increase, we expect to increase the total number of Permian wells planned to be drilled in 2013 to 31 gross wells, including 22 horizontal wells (completion of 17 gross wells) and nine vertical wells (completion of eight gross wells).

On August 1, 2013, we accepted delivery of an additional horizontal drilling rig under a one-year contract to support our expanded drilling program.

To date in 2013, we continue to execute our horizontal drilling program (gross production data provided):

Two recent Wolfcamp B shale wells in the East Bloxom field produced at a peak (24-hour) rate of 1,258 Boe per day and an average peak 30-day rate of 634 Boe per day. Since commencing program development of this field in 2012, we have drilled seven wells with an average lateral length of 7,000 feet and completed four wells with demonstrated average peak initial (24-hour) rates of 1,031 Boe per day.

At our Taylor Draw field, we placed one well targeting the lower Wolfcamp B shale on production. The well produced at a 24-hour rate of 860 Boe per day. We also completed three additional wells in the upper Wolfcamp

B zone that are in the process of flowing back. The average lateral length for these four drill wells and an additional well completed in the first quarter of 2013 is 4,700 feet.

Also during 2013, we continue to execute our vertical Wolfberry drilling program with positive initial results. In our Pecan Acres field, our first well to simultaneous complete multiple zones down to the Woodford shale produced at a gross peak initial (24-hour) production rate of 543 Boe per day.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Overview and Outlook

Production and highlights of our operations include:

	Net Prod Three M	Of Change			
	2013	2012	Change	% Chan	ige
Onshore - Permian Basin:					
Southern Portion	122	85	37	44	%
Central Portion	48	57	(9) (16)%
Total Permian	170	142	28	20	%
Offshore - Deepwater Properties					
Medusa	73	90	(17) (19)%
Habanero	_	40	(40) (100)%
Total Deepwater	73	130	(57) (44)%
Other:					
Haynesville Shale	7	17	(10) (59)%
Gulf of Mexico shelf	79	85	(6) (7)%
Total Other	86	102	(16) (16)%
Total	329	374	(45)	