CALLON PETROLEUM CO
Form 10-K
March 13, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

ý ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2013
OR
¨ TRANSITION REPORT UNDER SECTION 13 OR 15(D) OF SECURITIES EXCHANGE ACT OF 1934
Commission File Number 001-14039

Callon Petroleum Company
(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	64-0844345 (IRS Employer Identification No.)
200 North Canal Street Natchez, Mississippi (Address of Principal Executive Offices)	39120 (Zip Code)

(Registrant's Telephone Number, Including Area Code): 601-442-1601
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 ý
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 ý
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 ý 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 ý 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 ý
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 ý

Aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2013 was approximately $129.6 million.

As of March 10, 2014, 40,465,227 shares of the Registrant’s common stock, par value $.01 per share, were outstanding.

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, 2013) relating to the Annual Meeting of Stockholders to be held on May 15, 2014, 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 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-Q 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 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,
- 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 Securities and Exchange Commission.

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, 2013 and all quarterly reports on Form 10-Q filed subsequently thereto.

Should one or more of the risks or uncertainties described above or elsewhere in this 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.

DEFINITIONS

All defined terms under Rule 4-10(a) of Regulation S-X shall have their statutorily prescribed meanings when used in this report. As used in this document:

- 3-D: three-dimensional.
- ARO: Asset Retirement Obligation.
- Bbl or Bbls: barrel or barrels of oil or natural gas liquids.
- Bcf: billion cubic feet.
- 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.
- BOE/d: BOE per day.
- BLM: Bureau of Land Management.
- BOEM: Bureau of Ocean Energy Management, Regulation and Enforcement; formerly the Minerals Management Service.
- 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.
- BSEE: Bureau of Safety and Environmental Enforcement.
- DOI: Department of Interior.
- EPA: Environmental Protection Agency.
- GHG: greenhouse gases.
- LIBOR: London Interbank Offered Rate.
- LOE: lease operating expense.
- MBbls: thousand barrels of oil.
- MBOE: thousand boe.
- MBOE/d: Mboe per day.
- Mcf: thousand cubic feet of natural gas.
- Mcfe: thousand cubic feet of natural gas equivalents.
- Mcf/d: Mcf per day.
- MMBbls: million barrels of oil.
- MMBOE: million BOE.
- MMBtu: million Btu.
- MMcf: million cubic feet of natural gas.
- MMcf/d: MMcf per day.
- MMS: Minerals Management Service.
- 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.
- GAAP: Generally Accepted Accounting Principles in the United States

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.

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. The Company was incorporated under the laws of the state of Delaware in 1994 and succeeded to the business of a publicly traded limited partnership, a joint venture with a consortium of European investors and an independent energy company partially owned by a member of current management. As used herein, the “Company,” “Callon,” “we,” “us,” and “our” refer to Callon Petroleum Company and its predecessors and subsidiaries unle the context requires otherwise.

In 2013, the Company completed its onshore strategic repositioning that began in 2009, shifting its operations from the offshore waters in the Gulf of Mexico to the onshore, Permian Basin in Texas. In the fourth quarter of 2013, the Company sold its interest in its only remaining deepwater property, the Medusa field, in addition to the sale of the Medusa spar facility and substantially all remaining offshore shelf properties. Previously, Callon sold its interest in its deepwater Habanero field in the fourth quarter of 2012. Collectively, these transactions completed the Company’s transition to an onshore operator with an asset base concentrated exclusively in the Midland Basin, a sub-basin contained in the broader Permian Basin.

Callon exited 2013 with average Permian production in the month of December of 3,611 BOE/d (approximately 84% oil), a 129% increase over our exit rate in 2012. We believe that the Company’s transition to a horizontal development program, which was expanded from two fields to four fields in late 2013, has improved Callon’s overall capital efficiency and has contributed to a net increase of 59% in the Company’s Permian proven reserve base.

The Company operates 100% of its Permian acreage, which provides additional flexibility to modify development plans to address potential changes in the operating and commodity price environments. As of December 31, 2013, we had estimated net proved reserves of 11.9 MMBbls and 17.8 Bcf, or 14.9 MMBOE, all of which were located in the Permian Basin, compared with approximately 67% located in the Permian Basin at December 31, 2012. Additionally, 80% of our proved reserves were crude oil and 50% were proved developed at year-end 2013, on a BOE basis.

Our Business Strategy

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

Drive production and reserve growth through horizontal development of our resource base. Our initial drilling efforts in the Permian Basin targeted the development of multiple zones with vertical wells as part of the “Wolfberry” play. As part of this drilling program, we amassed 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 Callon to initiate the horizontal development of our resource base in 2012. Importantly, we believe horizontal development of our resource base will provide the opportunity to improve returns relative to vertical drilling by accessing a larger base of reserves in target zone with a lateral wellbore. During the fourth quarter of 2013, approximately 44% of our total Permian production was sourced from horizontal wells. We expect the contribution of horizontal production volumes from our existing properties to increase with the recent expansion of our horizontal development efforts to four fields as part of our current two-rig drilling program.

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 shales, establishing production from both zones in the Southern Midland Basin. We have been focused on these development zones to reduce drilling risk as we continue to grow our asset base in the Permian Basin. We believe additional opportunities exist to selectively target various other prospective zones including the Jo-Mill, Lower Spraberry, Wolfcamp A, Wolfcamp C and Cline formations, and plan to selectively drill potential identified locations to complement our core development efforts in the Wolfcamp B. Moreover, we will monitor the efficiency of our horizontal wells related to reservoir drainage over time and pursue downspacing initiatives within target zones if overall returns can be enhanced. We recently transitioned to closer spacing of our horizontal laterals in the Southern Midland Basin in both the Upper and Lower Wolfcamp B shales.

Outside of our core development areas in the Southern and Central Midland Basin, we maintain an exploration position in the Northern Midland Basin. Our current activity in the Northern Midland Basin is limited to vertical drilling in order to assess resource potential and economic returns. If our exploration concept is proven to economically produce hydrocarbons on a repeatable basis from vertical wells, we will then determine whether the testing of horizontal development concepts is warranted.

Pursue selective acquisitions in the Permian Basin. We have demonstrated our ability to acquire and trade acreage in the Midland Basin. Specifically, we added our Taylor Draw field in 2012 and Garrison Draw Field in 2013 for a total of $23 million, including acquired production and proved reserves. These two fields are now part of our core horizontal development plan. We have built on these acquisitions with recent acquisitions of acreage near our existing East Bloxom (see Recent Developments below), as well as completing an acreage trade at Garrison Draw which added contiguous acreage for effective long lateral horizontal development. 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.

Capitalize on opportunities to further reduce cost of capital. Following the disposition of our offshore properties, we have the opportunity to recapitalize the Company with a lower cost of capital commensurate with an improved credit risk profile as a purely onshore operator. As part of an ongoing effort to reduce our cost of capital, we have redeemed nearly $90 million of our 13% Senior Notes due 2016 (the “Senior Notes”) since 2011 and recently called for the redemption of the remaining $49 million of principal to occur in April 2014, replacing these Senior Notes with lower cost financing. Additionally, we believe the demonstrated growth in our proved developed reserve base provides the foundation for a meaningful expansion of our borrowing base capacity under our revolving credit agreement. We recently increased the notional amount and reduced the interest expense related to our revolving credit agreement, evidencing another step in reducing our overall cost of capital (see Recent Developments below).

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 13,600 net 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, 2013, our estimated net proved reserves were comprised of approximately 80% oil and 20% natural gas, which includes NGLs in the production stream. This oil exposure provides us the opportunity to benefit from currently more favorable prices as compared to natural gas.

Multi-year drilling inventory. Our current acreage position in the Permian Basin provides visible growth potential from a horizontal drilling inventory of almost 20 years based on our current two-rig horizontal drilling program. As of December 31, 2013, 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, we have identified an inventory of approximately 540 potential horizontal well locations in multiple horizons across our Southern and Central Midland Basin acreage. Of these potential locations, approximately 225 are identified in the Upper Wolfcamp B, Lower Wolfcamp B and Wolfcamp A zones which have been drilled on our acreage and are currently producing.