BERRY PETROLEUM CO
Form 10-Q
October 29, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2008
oTransition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from __to ___
Commission file number 1-9735

BERRY PETROLEUM COMPANY
(Exact name of registrant as specified in its charter)

DELAWARE	77-0079387
(State of incorporation or organization)	(I.R.S. Employer Identification Number)

1999 Broadway, Suite 3700
Denver, Colorado 80202
(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: (303) 999-4400

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.
Large accelerated filerx Accelerated filero Non-accelerated filero Smaller reporting companyo

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES o NO x

As of October 20, 2008, the registrant had 42,738,091 shares of Class A Common Stock ($.01 par value) outstanding. The registrant also had 1,797,784 shares of Class B Stock ($.01 par value) outstanding on October 20, 2008 all of which is held by an affiliate of the registrant.

BERRY PETROLEUM COMPANY
THIRD QUARTER 2008 FORM 10-Q
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BERRY PETROLEUM COMPANY
Unaudited Condensed Balance Sheets
(In Thousands, Except Share Information)

	September 30, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 59	$ 316
Short-term investments	65	58
Accounts receivable	145,701	117,038
Deferred income taxes	38,987	28,547
Fair value of derivatives	2,198	2,109
Assets held for sale	-	1,394
Prepaid expenses and other	19,432	11,557
Total current assets	206,442	161,019
Oil and gas properties (successful efforts basis), buildings and equipment, net	2,196,322	1,275,091
Other assets	17,307	15,996
	$ 2,420,071	$ 1,452,106
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 150,750	$ 90,354
Revenue and royalties payable	35,779	47,181
Accrued liabilities	37,284	21,653
Line of credit	19,300	14,300
Income taxes payable	380	2,591
Fair value of derivatives	110,427	95,290
Total current liabilities	353,920	271,369
Long-term liabilities:		
Deferred income taxes	206,848	128,824
Long-term debt	1,109,300	445,000
Abandonment obligation	40,414	36,426
Unearned revenue	-	398
Other long-term liabilities	6,226	1,657
Fair value of derivatives	106,459	108,458
	1,469,247	720,763
Shareholders' equity:		
Preferred stock, $.01 par value, 2,000,000 shares authorized; no shares outstanding	-	-
Capital stock, $.01 par value:		
Class A Common Stock, 100,000,000 shares authorized; 42,737,029 shares issued and outstanding (42,583,002 in 2007)	427	425
Class B Stock, 3,000,000 shares authorized; 1,797,784 shares issued and outstanding (liquidation preference of $899) (1,797,784 in 2007)	18	18
Capital in excess of par value	77,739	66,590
Accumulated other comprehensive loss	(130,361)	(120,704)
Retained earnings	649,081	513,645
Total shareholders' equity	596,904	459,974
	$ 2,420,071	$ 1,452,106

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

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BERRY PETROLEUM COMPANY
Unaudited Condensed Statements of Income
Three Month Periods Ended September 30, 2008 and 2007
(In Thousands, Except Per Share Data)

	Three months ended September 30,	
	2008	2007
REVENUES AND OTHER INCOME ITEMS		
Sales of oil and gas	$ 207,863	$ 118,733
Sales of electricity	18,317	12,241
Gas marketing	13,284	-
Gain on sale of assets	95	1,418
Interest and other income, net	1,202	1,108
	240,761	133,500
EXPENSES		
Operating costs - oil and gas production	56,038	33,995
Operating costs - electricity generation	13,706	9,760
Production taxes	9,673	4,344
Depreciation, depletion & amortization - oil and gas production	40,440	23,356
Depreciation, depletion & amortization - electricity generation	646	938
Gas marketing	12,034	-
General and administrative	14,524	9,333
Interest	8,755	4,326
Commodity derivatives	(594)	-
Dry hole, abandonment, impairment and exploration	1,571	5,175
	156,793	91,227
Income before income taxes	83,968	42,273
Provision for income taxes	30,620	15,418
Net income	$ 53,348	$ 26,855
Basic net income per share	$ 1.20	$ .61
Diluted net income per share	$ 1.17	$ .60
Dividends per share	$ .075	$ .075
Weighted average number of shares of capital stock outstanding used to calculate basic net income per share		
Effect of dilutive securities:	44,527	44,112
Equity based compensation	886	772
Director deferred compensation	128	118
Weighted average number of shares of capital stock used to calculate diluted net income per share	45,541	45,002

Unaudited Condensed Statements of Comprehensive Income
Three Month Periods Ended September 30, 2008 and 2007

	(In Thousands)	
Net income	$ 53,348	$ 26,855
Unrealized gains (losses) on derivatives, net of income taxes (benefits) of $144,881 and ($7,027), respectively	225,693	(10,541)
Reclassification of realized gains on derivatives included in net income, net of income taxes of $18,745 and $1,411, respectively	30,584	2,116
Comprehensive income	$ 309,625	$ 18,430

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

BERRY PETROLEUM COMPANY
Unaudited Condensed Statements of Income
Nine Month Periods Ended September 30, 2008 and 2007
(In Thousands, Except Per Share Data)

	Nine months ended September 30, 2008	2007
REVENUES AND OTHER INCOME ITEMS		
Sales of oil and gas	$ 557,689	$ 333,933
Sales of electricity	51,223	40,704
Gas marketing	28,046	-
Gain on sale of assets	510	51,816
Interest and other income, net	4,095	3,754
	641,563	430,207
EXPENSES		
Operating costs - oil and gas production	152,852	103,330
Operating costs - electricity generation	45,620	35,014
Production taxes	23,121	12,297
Depreciation, depletion & amortization - oil and gas production	96,588	65,478
Depreciation, depletion & amortization - electricity generation	1,991	2,661
Gas marketing	26,087	-
General and administrative	37,067	29,291
Interest	16,444	13,593
Commodity derivatives	172	-
Dry hole, abandonment, impairment and exploration	9,162	9,342
	409,104	271,006
Income before income taxes	232,459	159,201
Provision for income taxes	86,939	61,534
Net income	$ 145,520	$ 97,667
Basic net income per share	$ 3.27	$ 2.22
Diluted net income per share	$ 3.20	$ 2.18
Dividends per share	$ .225	$ .225
Weighted average number of shares of capital stock outstanding used to calculate basic net income per share	44,466	44,020
Effect of dilutive securities:		
Equity based compensation	914	701
Director deferred compensation	126	115
Weighted average number of shares of capital stock used to calculate diluted net income per share	45,506	44,836

Unaudited Condensed Statements of Comprehensive Income
Nine Month Periods Ended September 30, 2008 and 2007
(In Thousands)

Net income	$ 145,520	$ 97,667

Unrealized losses on derivatives, net of income tax benefits of $58,260 and $19,484, respectively	(95,055)	(29,226)
Reclassification of realized gains on derivatives included in net income, net of income taxes of $52,341 and $529, respectively	85,399	793
Comprehensive income	$ 135,864	$ 69,234

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

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BERRY PETROLEUM COMPANY
Unaudited Condensed Statements of Cash Flows
Nine Month Periods Ended September 30, 2008 and 2007
(In Thousands)

	Nine months ended September 30,	
	2008	2007
Cash flows from operating activities:		
Net income	$ 145,520	$ 97,667
Depreciation, depletion and amortization	98,579	68,139
Dry hole and impairment	6,858	8,725
Commodity derivatives	(180)	804
Stock-based compensation expense	6,653	5,437
Deferred income taxes	76,502	53,162
Unrealized loss on ineffective hedges	172	-
Gain on sale of oil and gas properties	(510)	(51,816)
Other, net	(1,500)	750
Change in book overdraft	3,935	(2,995)
Cash paid for abandonment	(3,957)	(660)
Increase in current assets other than cash and cash equivalents	(35,361)	(10,785)
Increase in current liabilities other than book overdraft, line of credit and fair value of derivatives	34,537	13,116
Net cash provided by operating activities	331,248	181,544
Cash flows from investing activities:		
Exploration and development of oil and gas properties	(302,266)	(206,240)
Property acquisitions	(667,030)	(56,167)
Additions to vehicles, drilling rigs and other fixed assets	(4,146)	(2,944)
Proceeds from sale of assets	2,038	68,432
Capitalized interest	(15,461)	(13,160)
Net cash used in investing activities	(986,865)	(210,079)
Cash flows from financing activities:		
Proceeds from issuances on line of credit	308,000	285,150
Payments on line of credit	(303,000)	(296,650)
Proceeds from issuance of long-term debt	1,481,300	179,300
Payments on long-term debt	(817,000)	(134,300)
Debt issuance cost	(8,353)	-
Dividends paid	(10,084)	(10,036)
Proceeds from stock option exercises	2,834	3,051
Excess tax benefit and other	1,663	1,795
Net cash provided by financing activities	655,360	28,310
Net decrease in cash and cash equivalents	(257)	(225)
Cash and cash equivalents at beginning of year	316	416
Cash and cash equivalents at end of period	$ 59	$ 191

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

Berry Petroleum Company
Notes to the Unaudited Condensed Financial Statements

1. General

All adjustments which are, in the opinion of management, necessary for a fair statement of Berry Petroleum Company's (the Company) financial position at September 30, 2008 and December 31, 2007 and results of operations and comprehensive (loss) income and cash flows for the three month and nine month periods ended September 30, 2008 and 2007 have been included. All such adjustments, except as described below, are of a normal recurring nature. The results of operations and cash flows are not necessarily indicative of the results for a full year.

The accompanying unaudited condensed financial statements have been prepared on a basis consistent with the accounting principles and policies reflected in the December 31, 2007 financial statements. The December 31, 2007 Form 10-K/A should be read in conjunction herewith. The year-end condensed Balance Sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

Our cash management process provides for the daily funding of checks as they are presented to the bank. Included in accounts payable at September 30, 2008 and December 31, 2007 is $11.7 million and $7.8 million, respectively, representing outstanding checks in excess of the bank balance (book overdraft).

Certain reclassifications have been made to prior period financial statements to conform them to the current year presentation. Specifically, the change in book overdraft line in the Statements of Cash Flows is classified as an operating activity to reflect the use of these funds in operations, rather than their prior year classification as a financing activity.

In March 2008, we determined there was an error in computing royalties payable in prior years, accumulating to $10.5 million as of December 31, 2007. We concluded the error was not material to any individual prior interim or annual period (or to the projected earnings for 2008) and, therefore, the error was corrected during the first quarter of 2008, with the effect of increasing our sales of oil and gas by $10.5 million and reducing our royalties payable.

The price sensitive royalty that burdens our Formax property in the South Midway Sunset field has changed. We previously paid a royalty equal to 75% of the amount of the heavy oil posted above a price of $16.11. This price escalates at 2% annually. Effective January 1, 2008, the royalty rate is reduced from 75% to 53% as long as we maintain a minimum steam injection level, which we expect to meet, that reduces over time. Current net production from this property is approximately 2,300 Bbl/D.

2. Recent Accounting Developments

In September 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Positions (FSP) No. 133-1 and FIN 45-4 to amend FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, to require disclosures by sellers of credit derivatives, including credit derivatives embedded in a hybrid instrument. This FSP also amends FASB Interpretation No.45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, to require an additional disclosure about the current status of the payment/performance risk of a guarantee. Further, this FSP clarifies the FASB's intent about the effective date of FASB Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities. We do not expect the adoption of this FSP to have a material effect on our financial statements and related disclosures. This FSP is effective for financial statements issued for reporting periods (annual or interim) ending after November 15, 2008, with early

application encouraged.

In December 2007, the FASB issued Statement of Financial Accounting Standard (SFAS) No. 160, Noncontrolling Interests in Consolidated Financial Statements. SFAS 160 was issued to establish accounting and reporting standards for the noncontrolling interest in a subsidiary (formerly called minority interests) and for the deconsolidation of a subsidiary. We do not expect the adoption of SFAS 160 to have a material effect on our financial statements and related disclosures. The effective date of this Statement is for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008.

Berry Petroleum Company
Notes to the Unaudited Condensed Financial Statements

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations, which expands the information that a reporting entity provides in its financial reports about a business combination and its effects. This Statement establishes principles and requirements for how the acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non controlling interest in the acquiree, recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase, and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. This Statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. An entity may not apply the principle before that date. We may experience a financial statement impact depending on the nature and extent of any new business combinations entered into after the effective date of SFAS No. 141(R).

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133, which changes the disclosure requirements for derivative instruments and hedging activities. Expanded disclosures are required to provide information about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This Statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This Statement will require us to provide the additional disclosures described above.

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles, which identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States of America (the GAAP hierarchy). This Statement is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles, which has not yet occurred. We do not expect the adoption of SFAS 162 to have a material effect on our financial statements or related disclosures.

3. Fair Value Measurement

In September 2006, SFAS No. 157, Fair Value Measurements was issued by the FASB. This statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. We adopted this Statement as of January 1, 2008.

Determination of fair value
We have established and documented a process for determining fair values. Fair value is based upon quoted market prices, where available. We have various controls in place to ensure that valuations are appropriate. These controls include: identification of the inputs to the fair value methodology through review of counterparty statements and other supporting documentation, determination of the validity of the source of the inputs, corroboration of the original source of inputs through access to multiple quotes, if available, or other information and monitoring changes in valuation methods and assumptions. The methods described above may produce a fair value calculation that may not be indicative of future fair values. Furthermore, while we believe these valuation methods are appropriate and consistent with that used by other market participants, the use of different methodologies, or assumptions, to determine the fair value of certain financial instruments could result in a different estimate of fair value.

Valuation hierarchy

SFAS 157 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows.

- Level 1 - inputs to the valuation methodology that are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 - inputs to the valuation methodology that include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 - inputs to the valuation methodology that are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Berry Petroleum Company
Notes to the Unaudited Condensed Financial Statements

Our oil swaps, natural gas swaps and interest rate swaps are valued using the counterparties' mark-to-market statements which are validated by our internally developed models and are classified within Level 2 of the valuation hierarchy. The observable inputs include underlying commodity and interest rate levels and quoted prices of these instruments on actively traded markets. Derivatives that are valued based upon models with significant unobservable market inputs (primarily volatility), and that are normally traded less actively are classified within Level 3 of the valuation hierarchy. Level 3 derivatives include oil collars, natural gas collars and natural gas basis swaps.

Assets and liabilities measured at fair value on a recurring basis

September 30, 2008 (in millions)	Total carrying value on the condensed Balance Sheet	Level 2	Level 3
Commodity derivatives	209.8	.9	208.9
Interest rate swaps	4.9	4.9	-
Total liabilities at fair value	214.7	5.8	208.9

Changes in Level 3 fair value measurements
The table below includes a rollforward of the Balance Sheet amounts (including the change in fair value) for financial instruments classified by us within Level 3 of the valuation hierarchy. When a determination is made to classify a financial instrument within Level 3 of the valuation hierarchy, the determination is based upon the significance of the unobservable factors to the overall fair value measurement. Level 3 financial instruments typically include, in addition to the unobservable or Level 3 components, observable components (that is, components that are actively quoted and can be validated to external sources).

(in millions)	Three months ended September 30, 2008	Nine months ended September 30, 2008
Fair value, beginning of period	$ 569.6	$ 194.3
Total realized and unrealized gains and (losses) included in sales of oil and gas	(370.5)	31.1
Purchases, sales and settlements, net	9.8	(16.5)
Transfers in and/or out of Level 3	-	-
Fair value, September 30, 2008	$ 208.9	$ 208.9
Total unrealized gains and (losses) included in income related to financial assets and liabilities still on the condensed balance sheet at September 30, 2008	$ -	$ -

In February of 2007, the FASB issued SFAS 159, which is effective for fiscal years beginning after November 15, 2007. SFAS 159 provides an option to elect fair value as an alternative measurement for selected financial assets and

financial liabilities not previously carried at fair value. We adopted this statement at January 1, 2008, but did not elect fair value as an alternative for any financial assets or liabilities.

4. Hedging

The related cash flow impact of all of our hedges is reflected in cash flows from operating activities. At September 30, 2008, our net fair value of derivatives liability was $214.7 million as compared to $201.6 million at December 31, 2007 which reflects increases in commodity prices in the period. Based on NYMEX strip pricing as of September 30, 2008, we expect to make hedge payments under the existing derivatives of $115.4 million during the next twelve months. At September 30, 2008, Accumulated Other Comprehensive Loss consisted of $130.4 million, net of tax, of unrealized losses from our crude oil and natural gas swaps and collars that qualified for hedge accounting treatment at September 30, 2008. Deferred net losses recorded in Accumulated Other Comprehensive Loss at September 30, 2008 and subsequent mark-to-market changes in the underlying hedging contracts are expected to be reclassified to earnings over the life of these contracts.

We entered into the following natural gas hedges during the three months ended March 31, 2008:

- Swaps on 15,400 MMBtu/D at $8.50 for the full year of 2009 and basis swaps on the same volumes for average prices of $1.17, $1.12, $.97, and $1.05 for each of the four quarters of 2009, respectively.

Berry Petroleum Company
Notes to the Unaudited Condensed Financial Statements

These swaps were not highly effective at inception, so we subsequently entered into basis swaps and established effectiveness at that time. In 2007, we entered into natural gas swap contracts that were not highly effective. We recognized an unrealized net gain of approximately $.6 million and an unrealized net loss of $.2 million on the income statement under the caption Commodity derivatives in the three and nine months ended September 30, 2008, respectively.

We entered into the following oil hedges during the three months ended September 30, 2008:

Crude Oil Sales (NYMEX WTI) Collars	Average Barrels Per Day	Floor/Ceiling Prices	Deferred Premium Per Barrel
Full year 2009	1,000	$ 100.00 / $163.60	$ 1.00
Full year 2009	1,000	$ 100.00 / $150.30	$ -
Full year 2009	1,000	$ 100.00 / $160.00	$ 2.00
Full year 2009	1,000	$ 100.00 / $150.00	$ 0.63
Full year 2009	1,000	$ 100.00 / $157.48	$ -
Full year 2010	1,000	$ 100.00 / $161.10	$ 1.00
Full year 2010	1,000	$ 100.00 / $150.30	$ -
Full year 2010	1,000	$ 100.00 / $160.00	$ 2.00
Full year 2010	1,000	$ 100.00 / $150.00	$ 1.55
Full year 2010	1,000	$ 100.00 / $158.50	$ -

These hedges have been designated as cash flow hedges in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities.

Our hedge contracts have been primarily executed with the counterparties that are party to our senior secured revolving credit facility. The credit rating of each of these counterparties is AA/Aa2 or better as of September 30, 2008.

5. Asset Retirement Obligations

Inherent in the fair value calculation of the asset retirement obligation (ARO) are numerous assumptions and judgments including the ultimate settlement amounts, inflation factors, credit adjusted discount rates, timing of settlement, and changes in the legal, regulatory, environmental and political environments. To the extent future revisions to these assumptions impact the fair value of the existing ARO liability, a corresponding adjustment is made to the oil and gas property balance.

Under SFAS 143, the following table summarizes the change in abandonment obligation for the nine months ended September 30, 2008 (in thousands):

Beginning balance at January 1	$	36,426
Liabilities incurred		3,490
Liabilities settled		(3,957)
Revisions in estimated liabilities		2,006
Accretion expense		2,449
Ending balance at September 30	$	40,414

6. Acquisitions and Dispositions

During the third quarter of 2008, Berry completed the acquisition of certain interests in natural gas producing properties on 4,500 net acres in Limestone and Harrison Counties of East Texas for $666 million cash including an initial purchase price of $622 million, and normal post closing adjustments of $44 million. See the pro forma discussion in Footnote 8 of these financial statements. As part of the acquisition we assumed commitments for drilling rig contracts and compressor rental agreements which approximate $30 million. Oil and gas properties increased $921 million or 72% from December 31, 2007 to September 30, 2008 primarily due to this acquisition. Proceeds from the first quarter 2008 sale of our Prairie Star assets were $1.8 million and are reflected in the Statements of Cash Flows. The gain from that sale is $.4 million and is reflected in the Statements of Income for the nine month period ended September 30, 2008.

Berry Petroleum Company
Notes to the Unaudited Condensed Financial Statements

7. Dry Hole, Abandonment and Impairment

In the first nine months of 2008, we recorded a total of $9.2 million in dry hole, abandonment, impairment and exploration expense. Charges of $2.7 million, $2.6 million and $1.6 million were recorded during the first, second and third quarters of 2008, respectively, for technical difficulties that were encountered on five wells in the Piceance basin before reaching total depth. These holes were abandoned in favor of drilling to the same bottom hole location by drilling new wells. In addition, $2.3 million of exploration expense was recorded for exploration activities which were primarily 3-D seismic activity in the DJ basin.

8. Pro Forma Results

On July 15, 2008, the Company acquired certain interests in natural gas producing properties on 4,500 net acres in Limestone and Harrison Counties in East Texas for $666 million cash (East Texas Acquisition) including an initial purchase price of $622 million, and normal post closing adjustments of $44 million.

The unaudited pro forma results presented below for the three and nine months ended September 30, 2008 and 2007 have been prepared to give effect to the East Texas Acquisition on the Company's results of operations under the purchase method of accounting as if it had been consummated on January 1, 2007. The unaudited pro forma results do not purport to represent the results of operations that actually would have occurred on such date or to project the Company's results of operations for any future date or period:

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Pro forma revenue	$ 253,112	$ 142,785	$ 694,269	$ 454,747
Pro forma income from operations	$ 91,082	$ 31,035	$ 239,235	$ 124,520
Pro forma net income	$ 57,427	$ 20,913	$ 150,423	$ 78,878
Pro forma basic earnings per share	$ 1.29	$ 0.47	$ 3.38	$ 1.79
Pro forma diluted earnings per share	$ 1.27	$ 0.46	$ 3.31	$ 1.76

The following is a preliminary calculation and allocation of purchase price to the East Texas Acquistion assets and liabilities based on their relative fair values:

Purchase price (in thousands):	As of September 30, 2008
Original purchase price	$ 622,356
Closing adjustments for property costs, and operating expenses in excess of revenues between the effective date and closing date	43,811
Total purchase price allocation	$ 666,167

Preliminary allocation of purchase price (in thousands):			
Oil and natural gas properties	$	651,803	(i)
Pipeline		17,288	
Total assets acquired		669,091	
Current liabilities		(1,569)	(ii)
Asset retirement obligation		(1,355)	
Net assets acquired	$	666,167	

(i) Determined by reserve analysis.

(ii) Accrual for royalties payable and transaction costs, which are primarily legal and accounting fees.

Berry Petroleum Company
Notes to the Unaudited Condensed Financial Statements

9. Income Taxes

The effective tax rate was 36.5% for the third quarter of 2008 compared to 36.8% for the second quarter of 2008 and 36.5% for the third quarter of 2007. Our estimated annual effective tax rate varies from the 35% federal statutory rate due to the effects of state income taxes and estimated permanent differences.

As of September 30, 2008, we had a gross liability for uncertain tax benefits of $11.9 million of which $9.6 million, if recognized, would affect the effective tax rate. There were no significant changes to the calculation since year end 2007. For the nine months ending September 30, 2008, we recognized a net tax benefit of approximately $0.9 million due to the closure of the 2004 federal tax year offset by additional FIN 48 accruals including interest.

Due to the uncertainty about the periods in which examinations will be completed and limited information related to current audits, we are not able to make reasonably reliable estimates of the periods in which cash settlements will occur with taxing authorities for the noncurrent liabilities.

10. Debt Obligations

Short-term lines of credit
In 2005, we completed an unsecured uncommitted money market line of credit (Line of Credit). Borrowings under the Line of Credit may be up to $30 million for a maximum of 30 days. The Line of Credit may be terminated at any time upon written notice by either us or the lender. In conjunction with the amendment to our senior secured credit facility, on July 15, 2008, the Line of Credit was secured with oil and gas properties. At September 30, 2008 the outstanding balance under this Line of Credit was $19.3 million. Interest on amounts borrowed is charged at LIBOR plus a margin of approximately 1%. The weighted average interest rate on outstanding borrowings on the Line of Credit at September 30, 2008 was 5.35%.

In July, 2008, we completed a $100 million senior unsecured credit facility that was to mature on December 31, 2008. There was no outstanding balance under this credit facility at September 30, 2008 and we terminated it without penalty in October, 2008 (see footnote 12 Subsequent Events in these financial statements).

Senior Secured Revolving Credit Facility
On July 15, 2008, we entered into a five year amended and restated credit agreement (the Agreement) with Wells Fargo Bank, N.A. as administrative agent and other lenders. The Agreement amends and restates the Company's previous credit agreement dated as of April 28, 2006, as amended. The Agreement is a revolving credit facility for up to $1.5 billion with a borrowing base of $1.0 billion. The outstanding Line of Credit reduces our borrowing capacity available under the Agreement. The borrowing base under the previous agreement was $650 million. Interest on amounts borrowed under this debt is charged at LIBOR plus a margin of 1.125% to 1.875% or the prime rate, with margins on the various rate options based on the ratio of credit outstanding to the borrowing base. Additionally, an annual commitment fee of .25% to .375% is charged on the unused portion of the credit facility. The deferred costs of approximately $8.2 million associated with the issuance of this credit facility and $.6 million associated with the issuance of the previous credit facility are being amortized over the 5 year life of the Agreement. $.1 million was charged to the income statement as a loss on debt extinguishment during the third quarter of 2008 related to parties who reduced their commitment or chose not to participate in the Agreement.

The total outstanding debt at September 30, 2008 under the Agreement and the Line of Credit was $910 million and $19 million, respectively, and $8 million in letters of credit have been issued under the facility, leaving $63 million in

borrowing capacity available under the Agreement and $100 million available under our $100 million senior unsecured credit facility. The maximum amount available is subject to annual redetermination of the borrowing base in accordance with the lender's customary procedures and practices. Both we and the banks have bilateral right to one additional redetermination each year. We further amended this credit facility in October 2008 (see Footnote 12 Subsequent Events in these financial statements).

Senior Subordinated 8.25% notes due 2016
In 2006, we issued in a public offering $200 million of 8.25% senior subordinated notes due 2016 (the Notes). Interest on the Notes is paid semiannually in May and November of each year. The deferred costs of approximately $5 million associated with the issuance of this debt are being amortized over the ten year life of the Notes.

Berry Petroleum Company
Notes to the Unaudited Condensed Financial Statements

Financial Covenants

The senior secured revolving credit facility contains restrictive covenants which, among other things, require us to maintain a debt to EBITDA ratio of not greater than 3.5 to 1.0 and a minimum current ratio, as defined, of 1.0. The $200 million Notes are subordinated to our credit facility indebtedness. Under the Notes, as long as the interest coverage ratio (as defined) is greater than 2.5
times, we may incur additional debt. We were in compliance with all of these covenants as of September 30, 2008.

Interest Rates and Interest Rate Hedges

Additionally, in 2006 we entered into five year interest rate swaps for a fixed rate of approximately 5.5% on $100 million of our outstanding borrowings under our credit facility for five years beginning on September 29, 2006. These interest rate swaps have been designated as cash flow hedges.

The weighted average interest rate on total outstanding borrowings at September 30, 2008 was 5.3%.

11. Contingencies and Commitments

We have no accrued environmental liabilities for our sites, including sites in which governmental agencies have designated us as a potentially responsible party, because it is not probable that a loss will be incurred and the minimum cost and/or amount of loss cannot be reasonably estimated. However, because of the uncertainties associated with environmental assessment and remediation activities, future expense to remediate the currently identified sites, and sites identified in the future, if any, could be incurred. Management believes, based upon current site assessments, that the ultimate resolution of any matters will not result in substantial costs incurred. We are involved in various other lawsuits, claims and inquiries, most of which are routine to the nature of our business. In the opinion of management, the resolution of these matters will not have a material effect on our financial position, or on the results of operations or liquidity.

We have a crude oil sales contract with an independent refiner for substantially all of our California production for deliveries beginning February 1, 2006 and ending January 31, 2010. After the initial term of the contract, we have a one-year renewal at our option. The per barrel price, calculated on a monthly basis and blended across the various producing locations, is the higher of 1) the WTI NYMEX crude oil price less a fixed differential approximating $8.10, or 2) heavy oil field postings plus a premium of approximately $1.35. The agreement effectively eliminates our exposure to the risk of a widening WTI to California heavy crude price differential over the four year contract term and allows us to effectively hedge our production based on WTI pricing.

In February 2007, we entered into a multi-staged crude oil sales contract with a refiner for our Uinta basin light crude oil. Under the agreement, the refiner began purchasing 3,200 Bbl/D in July 2007. The refiner has increased its total purchase volume capacity to 5,000 Bbl/D as provided in our contract. The differential under the contract, which includes transportation and gravity adjustments, is linked to WTI and would range from $15 to $20 per barrel at WTI prices between $60 and $80 per barrel. Gross oil production averaged approximately 4,150 BOE/D in the quarter ended September 30, 2008.

We have two long-term firm transportation contracts for our Colorado natural gas production that total 35,000 MMBtu/D on the Rockies Express (REX) pipeline for gas production in the Piceance basin. We pay a demand charge for this capacity and our own production did not completely fill that capacity. To maximize the utilization of our firm transportation, we bought our partners' share of the gas produced in the Piceance basin at the market rate for that area and used our excess transportation to move this gas to the sales point. The pre-tax net of our gas marketing revenue

and our gas marketing expense in the Statements of Income is $2.0 million for the nine month period ended September 30, 2008.

In addition, Berry has signed a binding precedent agreement with El Paso Corporation for an average of 35,000 MMBtu/d of firm transportation on the proposed Ruby Pipeline from Opal, WY to Malin, OR. While it is not certain that this new line will be constructed, the expectation is that the project will proceed and be in service by 2011. As part of this agreement and in order to access the Ruby pipeline, we also secured firm transportation from the Piceance basin to Opal.

Berry Petroleum Company
Notes to the Unaudited Condensed Financial Statements

12. Subsequent Events

On October 17, 2008, we amended our $1.5 billion credit facility with the Company's syndicate of seventeen banks which increased our borrowing base from $1.0 billion to $1.25 billion with current commitments of $1.08 billion and a new maturity date of July 15, 2012. The amendment includes an accordion feature which allows the Company to increase borrowing commitments to $1.25 billion without further bank approval, and modifies the annual commitment fee and interest rate margins. Interest on amounts borrowed under the facility is charged at LIBOR or the prime rate plus a margin. The LIBOR and prime rate margins range between 1.375% and 2.125% based on the ratio of credit outstanding to the borrowing base. Additionally, an annual commitment fee of .30% to .50% is charged on the unused portion of the credit facility. We also terminated our $100 million senior unsecured credit facility without penalty that was to mature at December 31, 2008.

Berry Petroleum Company
Management's Discussion and Analysis of Financial Condition and Results of Operations

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

General. The following discussion provides information on the results of operations for the three and nine month periods ended September 30, 2008 and 2007 and our financial condition, liquidity and capital resources as of September 30, 2008. The financial statements and the notes thereto contain detailed information that should be referred to in conjunction with this discussion.

The profitability of our operations in any particular accounting period will be directly related to the realized prices of oil, gas and electricity sold, the type and volume of oil and gas produced and electricity generated and the results of development, exploitation, acquisition, exploration and hedging activities. The realized prices for natural gas and electricity will fluctuate from one period to another due to regional market conditions and other factors, while oil prices will be predominantly influenced by global supply and demand. The aggregate amount of oil and gas produced may fluctuate based on the success of development and exploitation of oil and gas reserves pursuant to current reservoir management. The cost of natural gas used in our steaming operations and electrical generation, production rates, labor, equipment costs, maintenance expenses, and production taxes are expected to be the principal influences on operating costs. Accordingly, our results of operations may fluctuate from period to period based on the foregoing principal factors, among others.

Overview. We seek to increase shareholder value through consistent growth in our production and reserves, both through the drill bit and acquisitions. We strive to operate our properties in an efficient manner to maximize the cash flow and earnings of our assets. The strategies to accomplish these goals include:

- Investing our capital in a disciplined manner and maintaining a strong financial position
- Developing our existing resource base
- Acquiring additional assets with significant growth potential
- Accumulating significant acreage positions near our producing operations
- Utilizing joint ventures with respected partners to enter new basins

Notable Third Quarter Items.

- Achieved target production averaging 35,150 BOE/D, up 31% from the third quarter of 2007 and up 21% from the second quarter of 2008
- Closed on our East Texas acquisition on July 15, 2008, adding approximately 335 Bcfe of proved reserves
- Increased Diatomite net production to an average of 2,100 BOE/D, up 24% from the second quarter of 2008
- Increased Piceance net average production to 22.7 MMcf/D in the third quarter of 2008, up 37% from the second quarter of 2008
- Production at Poso Creek averaged 3,300 Bbl/D, up 3% from the second quarter of 2008
- Increased both oil and natural gas production during the quarter with oil production up 9% and natural gas production up 89% from the third quarter of 2007
- Amended our credit facility increasing the borrowing base from $600 million to $1 billion
- David D. Wolf joined the Company as Executive Vice President and Chief Financial Officer

Notable Items and Expectations for the Fourth Quarter of 2008.

- Increased the borrowing base on our senior secured credit facility from $1.0 billion to $1.25 billion with an increase in our commitments to $1.08 billion on October 17, 2008
- Reducing drilling activity from 12 rigs to 4 rigs by year-end 2008 with 1 rig in California, 1 rig in the Piceance basin and 2 rigs in East Texas
- Targeting a production average of 37,000 to 38,000 BOE/D in the fourth quarter
- Planning to takeover operations in East Texas from the seller on November 1, 2008

- Anticipating a 2009 Capital budget of approximately $200 million focusing on development of the diatomite and other high return oil projects in California and high impact recompletions in East Texas
- Expect proved reserves at year-end to range between 235-245 MMBOE, up over 40% from 169 MMBOE at year-end 2007, with organic growth of 27 MMBOE

Overview of the Third Quarter of 2008. We had net income of $53.3 million, or $1.17 per diluted share and net cash from operations was $137.4 million in the third quarter of 2008. We drilled 118 gross wells and capital expenditures, excluding property acquisitions, totaled $134.8 million. We achieved average production of 35,150 BOE/D in the third quarter of 2008, up 21% from an average of 29,000 BOE/D in the second quarter of 2008.

Berry Petroleum Company
Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations. The following companywide results are in millions (except per share data) for the three months ended:

	September 30, 2008 (3Q08)	September 30, 2007 (3Q07)	3Q07 to 3Q08 Change	June 30, 2008 (2Q08)	2Q08 to 3Q08 Change
Sales of oil	$ 145	$ 100	45%	$ 146	(1%)
Sales of gas	63	19	232%	39	62%
Total sales of oil and gas	$ 208	$ 119	75%	$ 185	12%
Sales of electricity	18	12	50%	17	6%
Gain on sale of assets	-	2	-%	-	-%
Other revenues	15	1	1,400%	13	15%
Total revenues and other income	$ 241	$ 134	80%	$ 215	12%
Net income	$ 53	$ 27	96%	$ 49	8%
Earnings per share (diluted)	$ 1.17	$ .60	95%	$ 1.08	8%

Our revenues may vary significantly from period to period as a result of changes in commodity prices and/or production volumes. Crude oil sales in the three months ended September 30, 2008 were flat with the three months ended June 30, 2008 resulting from price decreases of 1% and sales volume increases of 1%. While crude oil production was 3% higher during the quarter, our sales were up 1% due to a build up in our inventory which we expect to draw during the fourth quarter of 2008. Gas sales in the three months ended September 30, 2008 were 62% higher than the three months ended June 30, 2008 resulting from production increases of 69%, in part due to the East Texas acquisition, and a price decrease of 6%.

In the first quarter of 2008, we determined there was an error in computing royalties payable in prior years, accumulating to $10.5 million as of December 31, 2007. We concluded the error was not material to any individual prior interim or annual period (or to the projected earnings for 2008) and, therefore, the error was corrected during the first quarter of 2008, with the effect of increasing our sales of oil and gas by $10.5 million and reducing our royalties payable.

Operating data. The following table is for the three months ended:

	September 30, 2008	%	September 30, 2007	%	June 30, 2008	%
Heavy Oil Production (Bbl/D)	17,264	49	15,806	59	16,888	58
Light Oil Production (Bbl/D)	3,898	11	3,675	14	3,723	13
Total Oil Production (Bbl/D)	21,162	60	19,481	73	20,611	71
Natural Gas Production (Mcf/D)	83,928	40	44,346	27	50,339	29
Total (BOE/D)	35,150	100	26,873	100	29,000	100
Oil and gas, per BOE:						
Average sales price before hedging	$ 80.22		$ 49.35		$ 91.89	
Average sales price after hedging	64.98		47.93		69.77	

Oil, per Bbl:			
Average WTI price	$ 118.22	$ 75.15	$ 123.80
Price sensitive royalties	(5.30)	(5.50)	(5.92)
Quality differential and other	(10.80)	(9.56)	(11.52)
Crude oil hedges	(26.12)	(4.37)	(29.37)
Average oil sales price after hedging	$ 76.00	$ 55.72	$ 76.99
Natural gas price:			
Average Henry Hub price per MMBtu	$ 10.24	$ 6.24	$ 10.93
Conversion to Mcf	.52		