

Edgar Filing: MERIDIAN RESOURCE CORP - Form 10-Q

MERIDIAN RESOURCE CORP
Form 10-Q
November 09, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: September 30, 2004

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: 1-10671

THE MERIDIAN RESOURCE CORPORATION
(Exact name of registrant as specified in its charter)

TEXAS 76-0319553
(State or other jurisdiction of (I.R.S. Employer Identification No.)
incorporation or organization)

1401 ENCLAVE PARKWAY, SUITE 300, HOUSTON, TEXAS 77077

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: 281-597-7000

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

Number of shares of common stock outstanding at November 1, 2004 79,214,894

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THE MERIDIAN RESOURCE CORPORATION
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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

THE MERIDIAN RESOURCE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(thousands, except per share information)
(unaudited)

THREE MONTHS ENDED SEPTEMBER 30,	

2004	2003
----	----

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REVENUES:		
Oil and natural gas	\$ 52,951	\$ 39,129
Interest and other	86	208
	-----	-----
	53,037	39,337
	-----	-----
OPERATING COSTS AND EXPENSES:		
Oil and natural gas operating	3,057	2,714
Severance and ad valorem taxes	2,176	2,025
Depletion and depreciation	28,387	22,497
Accretion expense	147	145
Write-down of securities held	195	----
General and administrative	4,028	2,880
	-----	-----
	37,990	30,261
	-----	-----
EARNINGS BEFORE INTEREST AND INCOME TAXES	15,047	9,076
	-----	-----
OTHER EXPENSES:		
Interest expense	1,624	2,811
Debt conversion expense	----	----
	-----	-----
	1,624	2,811
	-----	-----
EARNINGS BEFORE INCOME TAXES	13,423	6,265
	-----	-----
INCOME TAXES:		
Current	(600)	(490)
Deferred	5,500	2,100
	-----	-----
	4,900	1,610
	-----	-----
EARNINGS BEFORE CUMULATIVE		
EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	8,523	4,655
Cumulative effect of change in accounting principle	----	----
	-----	-----
NET EARNINGS	8,523	4,655
Dividends on preferred stock	737	1,690
	-----	-----
NET EARNINGS APPLICABLE		
TO COMMON STOCKHOLDERS	\$ 7,786	\$ 2,965
	=====	=====
NET EARNINGS PER SHARE BEFORE CUMULATIVE		
EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE:		
Basic	\$ 0.10	\$ 0.06
Diluted	\$ 0.09	\$ 0.05
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING		
ACCOUNTING PRINCIPLE PER SHARE:		
Basic and Diluted	\$ -----	\$ -----
	-----	-----
NET EARNINGS PER SHARE:		
Basic	\$ 0.10	\$ 0.06
	=====	=====
Diluted	\$ 0.09	\$ 0.05
	=====	=====
WEIGHTED AVERAGE NUMBER OF COMMON SHARES:		
Basic	76,678	53,532
	=====	=====
Diluted	83,359	62,014
	=====	=====

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See notes to consolidated financial statements.

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THE MERIDIAN RESOURCE CORPORATION AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS

(thousands of dollars)

	SEPTEMBER 30, 2004 ---- (unaudited)	DECEMBER 31, 2003 ----
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 28,448	\$ 12,821
Accounts receivable, less allowance for doubtful accounts of \$303 [2004] and \$251 [2003]	25,065	24,703
Due from affiliates	----	349
Prepaid expenses and other	3,114	1,586
Assets from price risk management activities	1,439	584
	-----	-----
Total current assets	58,066	40,043
	-----	-----
PROPERTY AND EQUIPMENT:		
Oil and natural gas properties, full cost method (including \$38,673 [2004] and \$30,542 [2003] not subject to depletion)	1,331,929	1,230,643
Land	478	478
Equipment and other	9,944	9,931
	-----	-----
	1,342,351	1,241,052
Less accumulated depletion and depreciation	913,490	836,368
	-----	-----
Total property and equipment, net	428,861	404,684
	-----	-----
OTHER ASSETS	1,158	4,022
	-----	-----
Total assets	\$ 488,085	\$ 448,749
	=====	=====

See notes to consolidated financial statements.

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THE MERIDIAN RESOURCE CORPORATION AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (continued) (thousands of dollars)

SEPTEMBER 30, DECEMBER 31,
2004 2004

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(unaudited)

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:

Accounts payable	\$ 10,596	\$ 8,
Revenues and royalties payable	9,152	13,
Due to affiliates	1,265	-
Notes payable	1,598	
Accrued liabilities	20,753	12,
Liabilities from price risk management activities	16,125	9,
Asset retirement obligations	648	
Current income taxes payable	285	
Current portion long-term debt	5,000	10,
	-----	-----
Total current liabilities	65,422	55,

LONG-TERM DEBT

74,000 122,

9 1/2% CONVERTIBLE SUBORDINATED NOTES

----- 20,

OTHER:

Liabilities from price risk management activities	-----	2,
Asset retirement obligations	5,069	3,
Deferred income taxes	12,755	
	-----	-----
	17,824	6,

REDEEMABLE PREFERRED STOCK:

Preferred stock, \$1.00 par value (1,500,000 shares authorized, 315,890 [2004] and 604,460 [2003] shares of Series C Redeemable Convertible Preferred Stock issued at stated value)	31,589	60,
---	--------	-----

STOCKHOLDERS' EQUITY:

Common stock, \$0.01 par value (200,000,000 shares authorized, 79,204,834 [2004] and 61,724,597 [2003] issued and outstanding)	821	
Additional paid-in capital	490,063	394,
Accumulated deficit	(181,674)	(202,
Accumulated other comprehensive loss	(9,546)	(7,
Unamortized deferred compensation	(414)	(
	-----	-----
Total stockholders' equity	299,250	184,
	-----	-----
Total liabilities and stockholders' equity	\$ 488,085	\$ 448,
	=====	=====

See notes to consolidated financial statements.

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	NINE MONTHS ENDED SEPTEMBER 30, -----	
	2004 ----	2003 ----
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net earnings	\$ 23,962	\$ 11,547
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Cumulative effect of change in accounting principle	----	1,309
Debt conversion expense	1,188	-----
Depletion and depreciation	77,440	52,339
Amortization of other assets	1,468	1,280
Non-cash compensation	1,267	1,063
Write-down of securities held	195	----
Accretion expense	414	401
Deferred income taxes	12,500	2,100
Changes in assets and liabilities:		
Accounts receivable	(362)	(145)
Due to/from affiliates	1,614	(1,338)
Prepaid expenses and other	(1,528)	(1,512)
Accounts payable	1,904	(6,286)
Revenues and royalties payable	(3,935)	3,099
Accrued liabilities and other	10,934	1,276
	-----	-----
Net cash provided by operating activities	127,061	65,133
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to property and equipment	(99,899)	(55,552)
Sale of property and equipment	(73)	2,628
	-----	-----
Net cash used in investing activities	(99,972)	(52,924)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of long-term debt	(53,320)	(35,430)
Net increases of notes payable	1,404	99
Issuance of stock/exercise of options	95,009	33,605
Repurchase of common stock	(49,291)	----
Payment of preferred dividends	(5,248)	----
Additions to deferred loan costs	(16)	(171)
	-----	-----
Net cash used in financing activities	(11,462)	(1,897)
	-----	-----
NET CHANGE IN CASH AND CASH EQUIVALENTS	15,627	10,312
Cash and cash equivalents at beginning of period	12,821	7,287
	-----	-----
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 28,448	\$ 17,599
	=====	=====
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Non-cash financing activities:		
Conversion of preferred stock	\$ (27,766)	\$ -----
Conversion of convertible subordinated debt	\$ (20,000)	\$ -----

See notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
 NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003
 (in thousands)
 (unaudited)

	Common Stock		Additional Paid-In Capital	Accumulated Earnings (Deficit)	Accu O Compr
	Shares Value	Par			
Balance, December 31, 2002	50,089	\$ 557	\$ 378,215	\$ (209,738)	\$
Issuance of rights to common stock	-----	8	1,045	-----	
Company's 401(k) plan contribution	93	-----	(569)	-----	
Exercise of stock options	80	1	78	-----	
Compensation expense	-----	-----	-----	-----	
Issuance of shares from stock offering	8,704	50	3,698	-----	
Accum. other comprehensive loss	-----	-----	-----	-----	
Preferred dividends	-----	-----	-----	(4,937)	
Net earnings	-----	-----	-----	11,547	
Balance, September 30, 2003	58,966	\$ 616	\$ 382,467	\$ (203,128)	\$
Balance, December 31, 2003	61,725	\$ 644	\$ 394,177	\$ (202,492)	\$
Issuance of rights to common stock	-----	3	1,388	-----	
Company's 401(k) plan contribution	44	-----	275	-----	
Exercise of stock options	25	-----	120	-----	
Compensation expense	-----	-----	-----	-----	
Accum. other comprehensive loss	-----	-----	-----	-----	
Write-off Inland Resources stock	-----	-----	-----	-----	
Issuance of shares from stock offering	13,800	138	94,476	-----	
Issuance for conversion of pref stock	6,484	65	27,701	-----	
Issuance for conversion of sub debt	4,209	42	21,146	-----	
Repurchase of common stock	-----	-----	-----	-----	
Retirement of treasury stock	(7,082)	(71)	(49,220)	-----	
Preferred dividends	-----	-----	-----	(3,144)	
Net earnings	-----	-----	-----	23,962	
Balance, September 30, 2004	79,205	\$ 821	\$ 490,063	\$ (181,674)	\$

	Treasury Stock		Total
	Shares	Cost	
Balance, December 31, 2002	3,779	\$ (30,347)	\$ 133,393
Issuance of rights to common stock	-----	-----	-----
Company's 401(k) plan contribution	(93)	747	178
Exercise of stock options	(22)	177	256
Compensation expense	-----	-----	1,063
Issuance of shares from stock offering	(3,664)	29,423	33,171
Accum. other comprehensive loss	-----	-----	(806)
Preferred dividends	-----	-----	(4,937)
Net earnings	-----	-----	11,547
Balance, September 30, 2003	-----	\$ -----	\$ 173,865

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Balance, December 31, 2003	-----	\$	-----	\$ 184,335
Issuance of rights to common stock	-----		-----	-
Company's 401(k) plan contribution	-----		-----	275
Exercise of stock options	-----		-----	120
Compensation expense	-----		-----	1,267
Accum. other comprehensive loss	-----		-----	(2,027)
Write-off Inland Resources stock	-----		-----	185
Issuance of shares from stock offering	-----		-----	94,614
Issuance for conversion of pref stock	-----		-----	27,766
Issuance for conversion of sub debt	-----		-----	21,188
Repurchase of common stock	(7,082)		(49,291)	(49,291)
Retirement of treasury stock	7,082		49,291	-----
Preferred dividends	-----		-----	(3,144)
Net earnings	-----		-----	23,962
	-----		-----	-----
Balance, September 30, 2004	-----	\$	-----	\$ 299,250
	=====		=====	=====

See notes to consolidated financial statements.

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THE MERIDIAN RESOURCE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(thousands of dollars)
(unaudited)

	Three Months En	September 30
	-----	-----
	2004	2003
	----	----
Net earnings applicable to common stockholders	\$ 7,786	\$
Other comprehensive income (loss), net of tax, for unrealized losses from hedging activities:		
Unrealized holding losses arising during period	(4,218)	
Reclassification adjustments on settlement of contracts	3,161	
	-----	-----
	(1,057)	
Total comprehensive income	\$ 6,729	\$
	=====	=====

See notes to consolidated financial statements.

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THE MERIDIAN RESOURCE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. BASIS OF PRESENTATION

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The consolidated financial statements reflect the accounts of The Meridian Resource Corporation and its subsidiaries (the "Company") after elimination of all significant intercompany transactions and balances. The financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2003, as filed with the Securities and Exchange Commission.

The financial statements included herein as of September 30, 2004, and for the three and nine month periods ended September 30, 2004 and 2003, are unaudited, and in the opinion of management, the information furnished reflects all material adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of financial position and of the results for the interim periods presented. Certain minor reclassifications of prior period statements have been made to conform to current reporting practices. The results of operations for interim periods are not necessarily indicative of results to be expected for a full year.

2. DEBT

CREDIT FACILITY. During August 2002, the Company replaced its Chase Manhattan Bank Credit Facility with a new three-year \$175 million underwritten senior secured credit agreement (the "Credit Agreement") with Societe Generale as administrative agent, lead arranger and book runner, and Fortis Capital Corporation ("Fortis"), as co-lead arranger and documentation agent. The borrowing base is currently set at \$127.5 million effective on October 31, 2004. Credit facility payments of \$48.3 million have been made during the first nine months of 2004, bringing the outstanding balance to \$74 million as of September 30, 2004. Borrowings under the Credit Agreement mature on November 15, 2005, as extended by an amendment dated November 8, 2004. The amendment is subject to an extension fee of \$450,000 to be paid in the event the Credit Facility has not been paid or refinanced by January 3, 2005. During October 2004, the Company and Fortis entered into a term sheet whereby Fortis will serve as lead arranger and administrative agent on a new four year \$200 million senior secured credit facility. The new facility is expected to close before December 31, 2004, at which time the existing facility will be repaid in full.

In addition to the scheduled quarterly borrowing base redeterminations, the lenders or borrower, under the Credit Agreement, have the right to redetermine the borrowing base at any time, once during each calendar year. Borrowings under the Credit Agreement are secured by pledges of outstanding capital stock of the Company's subsidiaries and a mortgage on the Company's oil and natural gas properties of at least 90% of its present value of proved properties. On October 25, 2004, the Company notified Societe Generale that the present value of the mortgaged oil and gas properties total 86%. The Company has received a waiver of the 90% test in anticipation of the new Fortis senior secured credit facility requiring only a 75% mortgage test. The Credit Agreement contains other restrictive covenants, including, among other items, maintenance of certain financial ratios and restrictions on cash dividends on Common Stock and under certain circumstances Preferred Stock, and an unqualified audit report on the Company's consolidated financial statements, with all of which the Company is in compliance.

Under the Credit Agreement, the Company may secure either (i) (a) an alternative base rate loan that bears interest at a rate per annum equal to the greater of the administrative agent's prime rate; or (b) federal funds-based rate plus $1/2$ of 1%, plus an additional 0.5% to 1.5% depending on the ratio of the aggregate outstanding loans and letters of credit to the borrowing base or; (ii) a Eurodollar base rate loan that bears interest, generally, at a rate per annum equal to the London interbank offered rate ("LIBOR") plus 1.5% to 2.5%,

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depending on the ratio of the aggregate outstanding loans and letters of credit to the borrowing base. At September 30, 2004, the three-month LIBOR interest rate was 2.02%. The Credit Agreement also provides for commitment fees ranging from 0.375% to 0.5% per annum.

SUBORDINATED CREDIT AGREEMENT. The Company extended and amended a short-term subordinated credit agreement with Fortis Capital Corporation for \$25 million on April 5, 2002, with a maturity date of December 31, 2004. The notes are unsecured and contain customary events of default, but do not contain any maintenance or other restrictive covenants. The interest rate is LIBOR plus 5.5% from January 1, 2003, through August 31, 2003, and LIBOR plus 6.5% from September 1, 2003, through December 31, 2004. At September 30, 2004, the three-month LIBOR interest rate was 2.02%. A note payment of \$5 million was made during April 2004, with the remaining \$5 million payable on December 31, 2004. The Company is in compliance with the terms of this agreement.

9 -1/2% CONVERTIBLE SUBORDINATED NOTES. During March 2004, the notes were converted into 4.0 million shares of the Company's Common Stock at a conversion price of \$5.00 per share, and included an additional non-cash conversion expense of approximately \$1.2 million that was incurred and paid via the issuance of Common Stock priced at market.

3. 8.5% REDEEMABLE CONVERTIBLE PREFERRED STOCK

A private placement of \$66.85 million of 8.5% redeemable convertible preferred stock was completed during May 2002. The preferred stock is convertible into shares of the Company's Common Stock at a conversion price of \$4.45 per share. Dividends are payable semi-annually in cash or additional preferred stock. At the option of the Company, one-third of the preferred shares can be forced to convert to Common Stock if the closing price of the Company's Common Stock exceeds 150% of the conversion price for 30 out of 40 consecutive trading days on the New York Stock Exchange. The preferred stock is subject to redemption at the option of the Company after March 2005, and mandatory redemption on March 31, 2009. The holders of the preferred stock have been granted registration rights with respect to the shares of Common Stock issued upon conversion of the preferred stock.

In June 2004, the Company exercised its right, as described above, to convert one-third of its remaining issued and outstanding preferred stock into shares of Common Stock. The conversion was completed on a pro rata basis and included a cash payment for accrued and unpaid dividends through the June 8, 2004, conversion date, at which time dividends ceased to accrue on the converted shares.

4. COMMITMENTS AND CONTINGENCIES

LITIGATION.

ENVIRONMENTAL LITIGATION. Various landowners have filed claims against the Company and numerous other oil companies in four similar lawsuits concerning the Weeks Island, Gibson, Bayou Pigeon and Napoleonville Fields. The lawsuits seek injunctive relief and other relief, including unspecified amounts in both actual and punitive damages for alleged breaches of mineral leases and alleged failure to restore the plaintiffs' lands from alleged contamination and otherwise from the defendants' oil and gas operations.

There are no other material legal proceedings which exceed our insurance limits to which the Company or

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any of its subsidiaries is a party or to which any of its property is subject, other than ordinary and routine litigation incidental to the business of producing and exploring for crude oil and natural gas.

5. STOCKHOLDERS' EQUITY

COMMON STOCK. In August 2003, the Company completed a private offering of 8,703,537 shares of Common Stock at a price of \$3.87 per share. The total proceeds of the offering, net of issuance costs, received by the Company were approximately \$33.0 million. The Company used the majority of these funds to retire \$31.8 million in long-term debt, with the remainder of the proceeds being used for exploration activities and other general corporate purposes. As previously noted, during the nine months ended September 30, 2004, approximately 6.5 million shares of Common Stock were issued upon the conversion of a portion of the 8.5% Redeemable Convertible Preferred Stock and approximately 4.2 million shares of Common Stock were issued for the early conversion and retirement of the 9 -1/2% Convertible Subordinated Notes.

In August 2004, the Company completed a public offering of 13,800,000 shares of Common Stock at a price of \$7.25 per share. The total proceeds of the offering, net of issuance costs, received by the Company were approximately \$94.6 million. The Company repurchased all of the 7,082,030 shares of its Common Stock that were beneficially owned by Shell Oil Company for \$49.3 million and a portion of the remaining proceeds of that equity offering were used to repay borrowings under the Company's senior secured credit agreement, which resulted in an increase in funds available to the Company to accelerate planned capital expenditures for drilling activities and related pipeline construction. The repurchased 7,082,030 shares of Common Stock that were held in Treasury Stock were retired as of September 30, 2004.

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6. EARNINGS PER SHARE (in thousands, except per share)

The following tables set forth the computation of basic and diluted net earnings per share:

	THREE MONTHS ENDED SEPTEMBER 30, 2004	2003
	----	----
Numerator:		
Net earnings applicable to common stockholders	\$ 7,786	\$ 2,965
Plus income impact of assumed conversions:		
Preferred stock dividends	N/A	N/A
Interest on convertible subordinated notes	-----	309
	-----	-----
Net earnings applicable to common stockholders plus assumed conversions	\$ 7,786	\$ 3,274
	-----	-----
Denominator:		
Denominator for basic earnings per share - weighted-average shares outstanding	76,678	53,532
Effect of potentially dilutive common shares:		
Warrants	4,838	3,726
Employee and director stock options	1,842	756
Convertible subordinated notes	-----	4,000
Redeemable preferred stock	N/A	N/A

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	-----	-----
Denominator for diluted earnings per share - weighted-average shares outstanding and assumed conversions	83,359	62,014
	=====	=====
Basic earnings per share	\$ 0.10	\$ 0.06
	=====	=====
Diluted earnings per share	\$ 0.09	\$ 0.05
	=====	=====
	NINE MONTHS ENDED	
	SEPTEMBER 30,	
	2004	2003
	----	----
Numerator:		
Net earnings applicable to common stockholders	\$20,818	\$ 6,610
Plus income impact of assumed conversions:		
Preferred stock dividends	N/A	N/A
Interest on convertible subordinated notes	270	N/A
	-----	-----
Net earnings applicable to common stockholders plus assumed conversions	\$21,088	\$ 6,610
	-----	-----
Denominator:		
Denominator for basic earnings per share - weighted-average shares outstanding	69,690	51,274
Effect of potentially dilutive common shares:		
Warrants	4,439	3,238
Employee and director stock options	1,584	252
Convertible subordinated notes	1,139	N/A
Redeemable preferred stock	N/A	N/A
	-----	-----
Denominator for diluted earnings per share - weighted-average shares outstanding and assumed conversions	76,852	54,764
	=====	=====
Basic earnings per share	\$ 0.30	\$ 0.13
	=====	=====
Diluted earnings per share	\$ 0.27	\$ 0.12
	=====	=====

7. OIL AND NATURAL GAS HEDGING ACTIVITIES

The Company may address market risk by selecting instruments with value fluctuations which correlate strongly with the underlying commodity being hedged. The Company enters into swaps and other derivative contracts to hedge the price risks associated with a portion of anticipated future oil and gas production. These swaps allow the Company to predict with greater certainty the effective oil and natural gas prices to be received for our hedged production. While the use of hedging arrangements limits the downside risk of adverse price movements, it may also limit future gains from favorable movements. Under these agreements, payments are received or made based on the differential between a fixed and a variable product price. These agreements are settled in cash at or prior to expiration or are exchanged for physical delivery contracts. The

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Company does not obtain collateral to support the agreements, but monitors the financial viability of counter-parties and believes its credit risk is minimal on these transactions. In the event of nonperformance, the Company would be exposed to price risk. The Company has some risk of accounting loss since the price received for the product at the actual physical delivery point may differ from the prevailing price at the delivery point required for settlement of the hedging transaction.

The Company's results of operations and operating cash flows are impacted by changes in market prices for oil and natural gas. To mitigate a portion of the exposure to adverse market changes, the Company has entered into various swap agreements. Although derivatives often fail to achieve 100% effectiveness for accounting purposes, these derivative instruments continue to be highly effective in achieving the risk management objectives for which they were intended. These swaps have been designated as cash flow hedges as provided by Statement of Financial Accounting Standards ("SFAS") 133 and any changes in fair value are recorded in other comprehensive income until earnings are affected by the variability in cash flows of the designated hedged item. Any changes in fair value resulting from the ineffectiveness of the hedge are reported in the consolidated statement of operations as a component of revenues.

The estimated September 30, 2004, fair value of the Company's oil and natural gas swaps was an unrealized loss of \$14.6 million (\$9.5 million net of tax) which is recognized in other comprehensive income. Based upon September 30, 2004, oil and natural gas commodity prices, approximately \$14.6 million of the loss deferred in other comprehensive income could potentially lower gross revenues over the next twelve months. The swap agreements expire at various dates through July 31, 2005.

Net settlements under these swap agreements reduced oil and natural gas revenues by \$4,863,000 and \$2,608,000 for the three months ended September 30, 2004 and 2003, respectively, and by \$12,724,000 and \$12,739,000 for the nine months ended September 30, 2004 and 2003, respectively, as a result of hedging transactions.

The "Notional Amount" is equal to the total net volumetric hedge position of the Company during the periods presented. The positions effectively hedge approximately 9% of our proved developed natural gas production and 49% of our proved developed oil production during the respective terms of the swap agreements. The fair values of the hedges are based on the difference between the strike price and the New York Mercantile Exchange future prices for the applicable trading months.

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The estimated fair value of our oil and natural gas hedges as of September 30, 2004, is provided below:

	Notional Amount -----	Weighted Average Strike Price (\$ per unit) -----	Fair Value (unrealized) at September 30, 2004 (in thousands) -----
Natural Gas (mmbtu)			
October 2004 - June 2005	1,570,000	\$ 3.74	\$ (4,989)
Oil (bbls)			
October 2004 - July 2005	413,000	\$ 23.26	\$ (9,697)

			\$ (14,686)

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8. STOCK-BASED COMPENSATION

SFAS 123, "Accounting for Stock-Based Compensation," as amended by SFAS 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans. As provided for under SFAS 123, there has been no amount of compensation expense recognized for the Company's stock option plans. The Company accounts for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion 25, "Accounting for Stock Issued to Employees." Compensation expense is recorded for restricted stock awards over the requisite vesting periods based upon the market value on the date of the grant. No stock-based compensation expense was recorded in the three and nine month periods ended September 30, 2004 and 2003.

The following is a reconciliation of reported earnings and earnings per share as if the Company used the fair value method of accounting for stock-based compensation. Fair value is calculated using the Black-Scholes option-pricing model.

	(In thousands, except per share d Three Months Ended September 3	
	2004	2003
	-----	-----
Net earnings applicable to common stockholders as reported	\$ 7,786	\$ 2,786
Stock-based compensation (expense) benefit determined under fair value method for all awards, net of tax	(66)	(66)
Net earnings applicable to common stockholders pro forma	\$ 7,720	\$ 2,720
	=====	=====
Basic earnings per share:		
As reported	\$ 0.10	\$ 0.10
Pro forma	\$ 0.10	\$ 0.10
Diluted earnings per share:		
As reported	\$ 0.09	\$ 0.09
Pro forma	\$ 0.09	\$ 0.09

	(In thousands, except per share d Three Months Ended September 3	
	2004	2003
	-----	-----
Net earnings applicable to common stockholders as reported	\$ 20,818	\$ 6,818
Stock-based compensation (expense) benefit determined under fair value method for all awards, net of tax	(74)	(74)

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Net earnings applicable to common stockholders pro forma	\$ 20,744	\$ 6,
Basic earnings per share:		
As reported	\$ 0.30	\$ 0
Pro forma	\$ 0.30	\$ 0
Diluted earnings per share:		
As reported	\$ 0.27	\$ 0
Pro forma	\$ 0.27	\$ 0

9. ASSET RETIREMENT OBLIGATIONS

On January 1, 2003, the Company adopted SFAS 143, "Accounting for Asset Retirement Obligations." This statement requires entities to record the fair value of a liability for legal obligations associated with the retirement obligations of tangible long-lived assets in the period in which it is incurred. The fair value of asset retirement obligation liabilities has been calculated using an expected present value technique. Fair value, to the extent possible, should include a market risk premium for unforeseeable circumstances. No market risk premium was included in the Company's asset retirement obligations fair value estimate since a reasonable estimate could not be made. When the liability is initially recorded, the entity increases the carrying amount of the related long-lived asset. Over time, accretion of the liability is recognized each period, and the capitalized cost is amortized over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. This standard requires the Company to record a liability for the fair value of our dismantlement and abandonment costs, excluding salvage values.

Upon adoption, the Company recorded transition amounts for liabilities related to our wells, and the associated costs to be capitalized. A liability of \$4.5 million was recorded to long-term liabilities and a net asset of \$3.2 million was recorded to oil and natural gas properties on January 1, 2003. This resulted in a cumulative effect of an accounting change of (\$1.3) million. Accretion expenses subsequent to the adoption of this accounting statement decreased net earnings \$414,000 and \$401,000 in the first nine months of 2004 and 2003, respectively.

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The pro forma effect of the application of SFAS 143 as if the statement had been adopted on January 1, 2002, is presented below (thousands of dollars except per share information):

	Three Months Ended Sept 30,		Nine Months Ended Sept 30,	
	2004	2003	2004	2003
Net earnings applicable to common stockholders	\$ 7,786	\$ 2,965	\$ 20,818	\$ 6,611
Additional accretion expense	-----	-----		-----
Cumulative effect of accounting change	-----	-----		1,300
Pro forma net earnings	\$ 7,786	\$ 2,965	\$ 20,818	\$ 7,911
Basic	\$ 0.10	\$ 0.06	\$ 0.30	\$ 0.10
Diluted	\$ 0.09	\$ 0.05	\$ 0.27	\$ 0.10

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The following table describes the change in the Company's asset retirement obligations for the period ended September 30, 2004, and the pro forma amounts for the year ended December 31, 2002 (thousands of dollars):

Asset retirement obligation at December 31, 2002	\$ 4,52
Additional retirement obligations recorded in 2003	33
Reduction due to property sale in 2003	(1,01)
Other revisions during 2003	(41)
Accretion expense for 2003	66

Asset retirement obligation at December 31, 2003	4,10

Additional retirement obligations recorded in 2004	79
Other revisions during 2004	41
Accretion expense for 2004	41

Asset retirement obligation at September 30, 2004	\$ 5,71
	=====

10. NEW ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS 141, "Business Combinations" and SFAS 142, "Goodwill and Other Intangible Assets." SFAS 141 addresses accounting and reporting for business combinations and is effective for all business combinations initiated after June 30, 2001. SFAS 142 addresses the accounting and reporting for goodwill subsequent to acquisition and other intangible assets. The new standard eliminates the requirement to amortize acquired goodwill; instead, such goodwill is required to be reviewed at least annually for impairment. The new standard also requires that, at a minimum, all intangible assets be aggregated and presented as a separate line item in the balance sheet. The adoption of SFAS 141 and SFAS 142 had no impact on the Company's financial position or results of operations. In April 2004, the FASB issued FASB Staff Position FAS 142-1 and EITF Issue No. 04-2, "Whether Mineral Rights Are Tangible or Intangible Assets," which amends SFAS 142 to exclude mineral use rights from the intangible category. The Company will continue to monitor this issue and continue to classify oil and natural gas leaseholds as oil and natural gas properties until further guidance is provided.

In June 2001, the FASB issued SFAS 143, "Accounting for Asset Retirement Obligations." SFAS 143 requires the fair value of a liability for an asset retirement obligation to be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. SFAS 143 was effective for the Company on January 1, 2003. See Note 9 for discussion of the impact on the Company's consolidated financial statements.

During December 2003, the FASB issued Interpretation No. 46R, "Consolidation of Variable Interest Entities" ("FIN 46"), which requires the consolidation of certain entities that are determined to be variable

interest entities ("VIE's"). An entity is considered to be a VIE when either (i) the entity lacks sufficient equity to carry on its principal operations, (ii) the equity owners of the entity cannot make decisions about the entity's activities or (iii) the entity's equity neither absorbs losses or benefits from

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gains. Meridian owns no interests in variable interest entities, and therefore this new interpretation has not affected the Company's consolidated financial statements.

In May 2003, the FASB issued SFAS 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS 149 is generally effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. The adoption of this statement did not have a material effect on the Company's financial statements.

In May 2003, the FASB issued SFAS 150 "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS 150 establishes the standards on how companies classify and measure certain financial instruments with characteristics of both liabilities and equity. The statement requires that the Company classify as liabilities the fair value of all mandatorily redeemable financial instruments that had previously been recorded as equity or elsewhere in the consolidated financial statements. This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise effective for all existing financial instruments beginning in the third quarter of 2003. This statement did not have any significant impact on the Company's consolidated financial statements.

ACCOUNTING PRONOUNCEMENTS. In March 2004, the FASB issued an exposure draft entitled "Share-Based Payment, an Amendment of FASB Statement No. 123 and 95." This proposed statement addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The proposed statement would eliminate the ability to account for share-based compensation transactions using APB Opinion No. 25, "Accounting for Stock Issued to Employees," and generally would require instead that such transactions be accounted for using a fair-value-based method. As proposed, this statement would be effective for the Company on January 1, 2005. The impact on the results of operations would be similar to the pro forma disclosures made above.

II. SUBSEQUENT EVENT

On October 29, 2004, the Company entered into a series of hedge contracts on a portion of its expected gas production for 2004 and 2005. The hedge contracts were completed in the form of costless collars. The costless collars provide the Company with a lower limit "floor" price and an upper limit "ceiling" price on the hedged volumes. The floor price represents the lowest price the Company will receive for the hedged volumes while the ceiling price represents the highest price the Company will receive for the hedged volumes. The hedges are settled monthly based on the closing NYMEX price of natural gas for each respective month. These transactions will be accounted for as cash flow hedges as provided by SFAS 133. The following table summarizes the contracted volumes and price for the costless collars:

PRODUCTION MONTH	CONTRACTED VOLUME (MMBtu)	FLOOR PRICE (\$ / MMBtu)	CEILING PRICE (\$ / MMBtu)
-----	-----	-----	-----
Dec.'04 - Mar.'05	3,940,000	\$ 7.00	\$ 13.00
Apr.'05 - Oct.'05	2,600,000	\$ 6.50	\$ 7.90

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion of The Meridian Resource Corporation and its subsidiaries ("Meridian" or the "Company") financial operations for the three and nine months ended September 30, 2004 and 2003. The Company's consolidated financial statements included in this report, as well as our Annual Report on Form 10-K for the year ended December 31, 2003 (and the notes attached thereto), should be read in conjunction with this discussion.

GENERAL.

BUSINESS ACTIVITIES. The Company continues to pursue its business plan, focusing on growth primarily through its exploration and exploitation/development drilling program, as well as the acquisition of reserves with an upside component of future drilling activities. During the first nine months of 2004, Meridian's capital expenditures have totaled approximately \$100 million and have been focused primarily in the Company's Biloxi Marshlands and Weeks Island project areas. As a result of the Company's exploration activities, the average daily production for the first nine months of 2004 increased by 37% to 99.5 Mmcfe compared to an average daily rate of 72.9 Mmcfe for the first nine months of 2003. As a result of the increased production and an increase in oil and natural gas prices, the Company's revenues for the first nine months increased in excess of 52% when compared to the corresponding period of 2003. In addition, net cash provided by operating activities increased in excess of 94% for the same period and net earnings increased over 84%.

During 2004, the Company has drilled fifteen new wells in its Biloxi Marshlands ("BML") project area. Of the fifteen wells drilled ten have resulted in successful wells, representing a 67% success rate. Since the Company began its initial operations in the BML project area during late 2002, the Company has drilled twenty-one wells in the field of which 15 have been successfully completed and placed on production representing a 71% success rate. The most recent discovery in the BML project area was the BML No. 31-1 well which was drilled to a total depth of approximately 12,400 feet and logged 21 feet of net gas pay between 11,981 and 12,002 feet. The well was recently tested into the sales line at 3.3 Mmcfe of gas per day through a 16/64 inch choke. Flowing tubing pressure was measured at 2,995 psi and shut-in tubing pressure was measured at 3,503 psi. Current gross production from the field is totaling approximately 78.8 Mmcfe per day (48.8 Mmcfe, net).

OPERATIONS. Currently, the Company has three drilling rigs working in the BML project area. On the Hornets Nest prospect, the Company is drilling the BML No. 28-1 well. The well will be drilled to test the TexW and BigHum sand intervals and will be drilled to a total depth of approximately 11,000 feet. The well is currently drilling at approximately 10,100 feet and is expected to take approximately 15 days to reach its total depth. If successful the BML No. 28-1 well will setup five additional locations in the Hornets Nest prospect during the remainder of 2004 and early 2005. The Company moved a third drilling rig to the BML project area and expects to drill an average of 2-3 wells per month for the remainder of 2004 and 2005.

In addition to its drilling activities in the BML project area, during early 2004 the Company extended its proprietary 3-D seismic data base with the shooting of 264 square miles of new data, the total of which will ultimately provide approximately 540 square miles covering approximately 400,000 acres in St. Bernard Parish, Louisiana. The data is in the early stages of being

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processed and merged into the Company's existing data set. It is anticipated that the Biloxi Marshlands project area will comprise a substantial portion of the Company's future drilling inventory over the next several years as it continues to work the entire 3-D data set ranging in depths from the shallow Deltaic sand formations to the deep Cretaceous sand formations for new prospect opportunities.

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In the Weeks Island field, the Company has drilled four wells during 2004. The Smith Goodrich Cocke #10 well on the Camille prospect was recently drilled to a total depth of approximately 10,482 feet. Electric logs indicated apparent oil pay in the "I" sand between 10,218 and 10,238 feet. Upon completion of drilling operations on the Smith Goodrich Cocke #10 well, the Company mobilized the drilling rig to the BML project area to begin drilling the BML No. 28-1 well. The Company expects to have a completion rig available for the Smith Goodrich Cocke #10 well within the next three weeks.

During July 2004, drilling operations began on the Hosemann #1 well on the Enterprise prospect in the Riceville area. The well was drilled to a total depth of approximately 18,500 feet and encountered a buried fault, kicking the well to an up-thrown position. The operator of the well is currently sidetracking the well to attempt to get the well bore on the down-thrown side of the fault. The Company elected not to participate in the sidetrack and will be subject to industry standard non-consent penalties if the well proves to be successful. Also in the Riceville area, the Company is preparing to spud its F. Boudreaux No. 1 well on the Zwan prospect. The well will be drilled to a total depth of approximately 13,600 feet to test the Zwan sand interval. The Company will be operator of the well and will have a 59.5% working interest.

Also during July 2004, the Company began drilling the CL&F A-2 well on the North Turtle Bayou prospect. The well is an updip location to a well that encountered mechanical problems. The well is currently drilling at 15,220 feet and will be drilled to a total depth of 15,500 feet. The Company holds a 96.5% working interest in the well.

In the Turtle Bayou field, the Company recently drilled the CL&F No. 68 well to test an amplitude at 6,300 feet, true vertical depth. The well was drilled, logged and is currently awaiting completion. Finally, during the fourth quarter the Company plans to drill two additional wells in the Turtle Bayou/Ramos area.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES. The Company's discussion and analysis of its financial condition and results of operation are based upon consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted and adopted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. See the Company's Annual Report on Form 10-K for the year ended December 31, 2003, for further discussion.

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RESULTS OF OPERATIONS

THREE MONTHS ENDED SEPTEMBER 30, 2004 COMPARED TO THREE MONTHS ENDED SEPTEMBER 30, 2003

OPERATING REVENUES. Third quarter 2004 oil and natural gas revenues increased \$13.8 million (35%) as compared to third quarter 2003 revenues due to a 16% increase in production volumes primarily from the Company's previously announced

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drilling results in the Biloxi Marshlands ("BML") project area and Weeks Island coupled with successful workover operations in the Company's Ramos and Weeks Island fields, offset by natural production declines and storm-related shut-ins due to hurricane Ivan. Further, revenues were enhanced by a 16% increase in average commodity prices on a natural gas equivalent basis. The drilling and workover success increased our average daily production from 90 Mmcfe during the third quarter of 2003 to 105 Mmcfe for the third quarter of 2004. Oil and natural gas production volume totaled 9,671 Mmcfe for the third quarter of 2004, compared to 8,302 Mmcfe for the comparable period of 2003. Current production is ranging between 95 Mmcfe and 100 Mmcfe per day.

The following table summarizes the Company's operating revenues, production volumes and average sales prices for the three months ended September 30, 2004 and 2003:

	THREE MONTHS ENDED		
	SEPTEMBER 30,		
	2004	2003	INCREASE (DECREASE)
	----	----	-----
Production Volumes:			
Oil (Mbbbl)	320	338	(5%)
Natural gas (MMcf)	7,753	6,275	24%
Mmcfe	9,671	8,302	16%
Average Sales Prices:			
Oil (per Bbl)	\$ 30.26	\$ 24.46	24%
Natural gas (per Mcf)	\$ 5.58	\$ 4.92	13%
Mmcfe	\$ 5.48	\$ 4.71	16%
Operating Revenues (000's):			
Oil	\$ 9,683	\$ 8,268	17%
Natural gas	43,268	30,861	40%
	-----	-----	
Total Operating Revenues	\$52,951	\$39,129	35%
	=====	=====	

OPERATING EXPENSES. Oil and natural gas operating expenses on an aggregate basis increased \$0.4 million (13%) to \$3.1 million during the third quarter of 2004, compared to \$2.7 million in 2003. However, on a unit basis, lease operating expenses decreased \$0.01 per Mcfe to \$0.32 per Mcfe for the third quarter of 2004 from \$0.33 per Mcfe for the third quarter of 2003. Oil and gas operating expenses include additional operating expenses associated with the Biloxi Marshlands project area, offset by savings resulting from sold properties, combined with other cost savings.

SEVERANCE AND AD VALOREM TAXES. Severance and ad valorem taxes increased \$0.2 million (7%) to \$2.2 million for the third quarter of 2004, compared to \$2.0 million during the same period in 2003 primarily because of an increase in natural gas production and a higher natural gas tax rate. Meridian's oil and natural gas production is primarily from Louisiana, and is therefore subject to Louisiana severance tax. The severance tax rates for Louisiana are 12.5% of gross oil revenues and \$0.208 per Mcf for natural gas for the third quarter of 2004, an increase from \$0.171 per Mcf for the third quarter of 2003. The Company's increase was primarily due to the increase in natural gas production and the increase in the natural gas tax rate, partially offset by a tax refund from Louisiana for prior periods. On an equivalent unit of production basis,

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severance and ad valorem taxes decreased to \$0.22 per Mcfe from \$0.24 per Mcfe for the comparable three-month period.

DEPLETION AND DEPRECIATION. Depletion and depreciation expense increased \$5.9 million (26%) during the third quarter of 2004 to \$28.4 million, from \$22.5 million for the same period of 2003. This was primarily the result of the 16% increase in production volumes in 2004 over 2003 levels, and an increase in the depletion rate as compared to the 2003 period. On a unit basis, depletion and depreciation expense increased by \$0.23 per Mcfe, to \$2.94 per Mcfe for the three months ended September 30, 2004, compared to \$2.71 per Mcfe for the same period in 2003.

GENERAL AND ADMINISTRATIVE EXPENSE. General and administrative expense increased \$1.1 million to \$4.0 million compared to \$2.9 million for 2003 primarily due to an increase in professional fees and higher volume activity. On an equivalent unit of production basis, general and administrative expenses increased \$0.07 per Mcfe to \$0.42 per Mcfe for the third quarter of 2004 compared to \$0.35 per Mcfe for the comparable 2003 period.

INTEREST EXPENSE. Interest expense decreased \$1.2 million (42%), to \$1.6 million for the third quarter of 2004 in comparison to the third quarter of 2003. The decrease is primarily a result of reduction in long-term debt. With the conversion of the \$20 million convertible subordinated notes into common stock and the 2004 repayments of \$53.3 million of debt, the Company will realize additional future savings in interest.

NINE MONTHS ENDED SEPTEMBER 30, 2004 COMPARED TO NINE MONTHS ENDED SEPTEMBER 30, 2003

OPERATING REVENUES. Oil and natural gas revenues during the nine months ended September 30 2004, increased \$51.4 million (53%) as compared to 2003 revenues due to a 37% increase in production volumes primarily from the Company's previously announced drilling results in the Biloxi Marshlands ("BML") project area and Weeks Island coupled with successful workover operations in the Company's Ramos and Weeks Island fields, offset by natural production declines and property sales. Further, revenues were enhanced by an 11% increase in average commodity prices on a natural gas equivalent basis. The drilling and workover success increased our average daily production from 72.9 Mmcfe during the first nine months of 2003 to 99.5 Mmcfe for the first nine months of 2004. Oil and natural gas production volume totaled 27,269 Mmcfe for the first nine months of 2004, compared to 19,899 Mmcfe for the comparable period of 2003.

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The following table summarizes the Company's operating revenues, production volumes and average sales prices for the nine months ended September 30, 2004 and 2003:

	NINE MONTHS ENDED SEPTEMBER 30,		INCREASE (DECREASE)
	2004	2003	-----
Production Volumes:			
Oil (Mbbbl)	977	1,082	(10%)
Natural gas (MMcf)	21,409	13,407	60%
Mmcfe	27,269	19,899	37%

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Average Sales Prices:

Oil (per Bbl)	\$ 27.61	\$ 24.95	11%
Natural gas (per Mcf)	\$ 5.71	\$ 5.28	8%
Mmcfe	\$ 5.47	\$ 4.91	11%

Operating Revenues (000's):

Oil	\$ 26,957	\$ 26,995	-%
Natural gas	122,199	70,724	73%
	-----	-----	
Total Operating Revenues	\$149,156	\$ 97,719	53%
	=====	=====	

OPERATING EXPENSES. Oil and natural gas operating expenses on an aggregate basis increased \$0.8 million (10%) to \$8.8 million during the first nine months of 2004, compared to \$8.0 million in 2003. However, on a unit basis, lease operating expenses decreased \$0.08 per Mcfe to \$0.32 per Mcfe for the first nine months of 2004 from \$0.40 per Mcfe for the first nine months of 2003. Oil and gas operating expenses include additional operating expenses associated with the Biloxi Marshlands project area, offset by savings resulting from sold properties, combined with other cost savings.

SEVERANCE AND AD VALOREM TAXES. Severance and ad valorem taxes increased \$1.6 million (30%) to \$7.0 million for the first nine months of 2004, compared to \$5.4 million during the same period in 2003 primarily because of an increase in natural gas production and a higher natural gas tax rate, partially offset by a tax refund from Louisiana for prior periods. Meridian's oil and natural gas production is primarily from Louisiana, and is therefore subject to Louisiana severance tax. The severance tax rates for Louisiana are 12.5% of gross oil revenues and \$0.208 per Mcf (effective July 1, 2004) for natural gas. For the first six months of 2004, and the last six months of 2003, the rate was \$0.171 per Mcf for natural gas, an increase from \$0.122 per Mcf for the first half of 2003. On an equivalent unit of production basis, severance and ad valorem taxes decreased to \$0.26 per Mcfe from \$0.27 per Mcfe for the comparable nine-month period, reflecting a shift in the mix between oil and natural gas production.

DEPLETION AND DEPRECIATION. Depletion and depreciation expense increased \$25.1 million (48%) during the first nine months of 2004 to \$77.4 million, from \$52.3 million for the same period of 2003. This was primarily the result of the 37% increase in production volumes in 2004 over 2003 levels, and an increase in the depletion rate as compared to the 2003 period. On a unit basis, depletion and depreciation expense increased by \$0.21 per Mcfe, to \$2.84 per Mcfe for the nine months ended September 30, 2004, compared to \$2.63 per Mcfe for the same period in 2003.

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GENERAL AND ADMINISTRATIVE EXPENSE. General and administrative expense increased \$2.0 million to \$10.7 million compared to \$8.7 million for 2003 due to an increase in professional fees and higher volume activity. On an equivalent unit of production basis, general and administrative expenses decreased \$0.05 per Mcfe to \$0.39 per Mcfe for the first nine months of 2004 compared to \$0.44 per Mcfe for the comparable 2003 period.

INTEREST EXPENSE. Interest expense decreased \$3.2 million (36%), to \$5.6 million for the first nine months of 2004 in comparison to the same period for 2003. The decrease is primarily a result of reduction in long-term debt. With the conversion of the \$20 million convertible subordinated notes into common stock and the 2004 repayments of \$53.3 million of debt, the Company will realize additional future savings in interest.

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ADOPTION OF STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 143. On January 1, 2003, the Company adopted Statement of Financial Accounting Standards No. 143 ("SFAS 143"), "Accounting for Asset Retirement Obligations." As a result, the Company recorded a long-term liability of \$4.5 million representing the discounted present value of the estimated retirement obligations and an increase in capitalized oil and gas properties of \$3.2 million. The liability will be accreted to its future value in subsequent reporting periods and will be charged to earnings on the Company's Consolidated Statement of Operations as "Accretion Expense." As a result of adoption of SFAS 143, the Company has charged approximately \$0.4 million to earnings as accretion expense during the 2004 and 2003 periods. The cumulative effect of the change in accounting principle for prior years totaled \$1.3 million, or \$0.03 per share, and was charged to earnings in the first quarter of 2003.

LIQUIDITY AND CAPITAL RESOURCES

WORKING CAPITAL. During the first nine months of 2004, Meridian's capital expenditures were internally financed with cash from operations. As of September 30, 2004, the Company had a cash balance of \$28.4 million and a working capital deficit of \$7.4 million. This deficit was made up primarily of \$5.0 million of current maturities of long-term debt, and a \$16.1 million net current liability associated with price risk management activities which will be offset by future revenues. As of September 30, 2004, the Company had unutilized borrowing capacity of \$53.5 million from our credit facility.

CASH FLOWS. Net cash provided by operating activities was \$127.1 million for the nine months ended September 30, 2004, as compared to \$65.1 million for the same period in 2003. The increase of \$62.0 million was primarily due to the increase in revenues from oil and natural gas of \$51.2 million in the first nine months of 2004, over the first nine months of 2003.

Net cash used in investing activities was \$100.0 million during the nine months ended September 30, 2004, versus \$52.9 million in the first nine months of 2003. The increase in capital expenditures of \$44.3 million was primarily associated with the acquisition of the Company's new 264-square mile 3-D survey at the Biloxi Marshlands project area, coupled with expenditures for drilling and related activities.

Cash flows used in financing activities during the first nine months of 2004 were \$11.5 million, compared to cash used in financing activities of \$1.9 million during the first nine months of 2003. This additional cash used in financing activities was primarily due to cash payments of \$5.2 million in preferred stock dividends coupled with the debt repayments of \$53.3 million. With the preferred stock conversion of approximately \$29 million during the first nine months of 2004, the Company will see an annualized \$2.0 million reduction of dividend payments.

CREDIT FACILITY. During August 2002, the Company replaced its Chase Manhattan Bank Credit Facility with a new three-year \$175 million underwritten senior secured credit agreement (the "Credit Agreement") with Societe Generale as administrative agent, lead arranger and book runner, and Fortis Capital Corporation, as

co-lead arranger and documentation agent. Borrowings under the Credit Agreement mature on November 15, 2005, as extended by an amendment dated November 8, 2004. The amendment is subject to an extension fee of \$450,000 to be paid in the event the Credit Facility has not been paid or refinanced by January 3, 2005. During October 2004, the Company and Fortis entered into a term sheet whereby Fortis

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will serve as lead arranger and administrative agent on a new four year \$200 million senior secured credit facility. The new facility is expected to close before December 31, 2004, at which time the existing facility will be repaid in full.

The borrowing base is currently set at \$127.5 million effective on October 31, 2004. Credit Facility payments of \$48.3 million have been made during the first nine months of 2004, bringing the outstanding balance to \$74 million as of September 30, 2004. The Company made additional debt repayments of \$40 million in August 2004, which brought our unutilized borrowing capacity to \$53.5 million.

In addition to the scheduled quarterly borrowing base redeterminations, the lenders or borrower, under the Credit Agreement, have the right to redetermine the borrowing base at any time, once during each calendar year. Borrowings under the Credit Agreement are secured by pledges of outstanding capital stock of the Company's subsidiaries and a mortgage on the Company's oil and natural gas properties of at least 90% of its present value of proved properties. On October 25, 2004, the Company notified Societe Generale that the present value of the mortgaged oil and gas properties total 86%. The Company has received a waiver of the 90% test in anticipation of the new Fortis senior secured credit facility requiring only a 75% mortgage test. The Credit Agreement contains various restrictive covenants, including, among other items, maintenance of certain financial ratios and restrictions on cash dividends on Common Stock and under certain circumstances Preferred Stock, and an unqualified audit report on the Company's consolidated financial statements.

Under the Credit Agreement, the Company may secure either (i) (a) an alternative base rate loan that bears interest at a rate per annum equal to the greater of the administrative agent's prime rate; or (b) federal funds-based rate plus 0.5%, plus an additional 0.5% to 1.5% depending on the ratio of the aggregate outstanding loans and letters of credit to the borrowing base or; (ii) a Eurodollar base rate loan that bears interest, generally, at a rate per annum equal to the London interbank offered rate ("LIBOR") plus 1.5% to 2.5%, depending on the ratio of the aggregate outstanding loans and letters of credit to the borrowing base. At September 30, 2004, the three-month LIBOR interest rate was 2.02%. The Credit Agreement also provides for commitment fees ranging from 0.375% to 0.5% per annum.

SUBORDINATED CREDIT AGREEMENT. The Company extended and amended a short-term subordinated credit agreement with Fortis Capital Corporation for \$25 million on April 5, 2002, with a maturity date of December 31, 2004. The notes are unsecured and contain customary events of default, but do not contain any maintenance or other restrictive covenants. The interest rate is LIBOR plus 5.5% from January 1, 2003, through August 31, 2003, and LIBOR plus 6.5% from September 1, 2003, through December 31, 2004. At September 30, 2004, the three-month LIBOR interest rate was 2.02%. A note payment of \$5 million was made during April 2004, with the remaining \$5 million payable on December 31, 2004. The Company is in compliance with the terms of this agreement.

8.5% REDEEMABLE CONVERTIBLE PREFERRED STOCK A private placement of \$66.85 million of 8.5% redeemable convertible preferred stock was completed during May 2002. The preferred stock is convertible into shares of the Company's Common Stock at a conversion price of \$4.45 per share. Dividends are payable semi-annually in cash or additional preferred stock. At the option of the Company, one-third of the preferred shares can be forced to convert to Common Stock if the closing price of the Company's Common Stock exceeds 150% of the conversion price for 30 out of 40 consecutive trading days on the New York Stock Exchange. The preferred stock is subject to redemption at the option of the Company after March 2005, and mandatory redemption on March 31, 2009. The holders of the preferred stock have been granted registration rights with respect to the shares of Common Stock issued upon conversion of the preferred

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stock.

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In June 2004, we exercised our right, as described above, to convert one-third of our remaining issued and outstanding preferred stock into shares of our Common Stock. The conversion was completed on a pro rata basis and included a cash payment for accrued and unpaid dividends through the June 8, 2004, conversion date, at which time dividends ceased to accrue on the converted shares. Based on this conversion and other voluntary conversions, our outstanding Series C preferred stock has been reduced from a high stated value of approximately \$72.7 million as of June 30, 2003 to approximately \$31.6 million as of September 30, 2004, representing a future cash savings in dividends of approximately \$3.4 million on an annualized basis.

COMMON STOCK. In August 2003, the Company completed a private offering of 8,703,537 shares of Common Stock at a price of \$3.87 per share. The total proceeds of the offering, net of issuance costs, received by the Company were approximately \$33.0 million. The Company used the majority of these funds to retire \$31.8 million in long-term debt, with the remainder of the proceeds being used for exploration activities and other general corporate purposes. As previously noted, during the nine months ended September 30, 2004, approximately 6.5 million shares of Common Stock were issued upon the conversion of a portion of the 8.5% Redeemable Convertible Preferred Stock and approximately 4.2 million shares of Common Stock were issued for the early retirement of the 9 -1/2% Convertible Subordinated Notes.

In August 2004, the Company completed a public offering of 13,800,000 shares of Common Stock at a price of \$7.25 per share. The total proceeds of the offering, net of issuance costs, received by the Company were approximately \$94.6 million. The Company repurchased all of the 7,082,030 shares of its Common Stock that were beneficially owned by Shell Oil Company for \$49.3 million and a portion of the remaining proceeds of that equity offering were used to repay borrowings under the Company's senior secured credit agreement, which resulted increased funds available to the Company to accelerate planned capital expenditures for drilling activities and related pipeline construction. The repurchased 7,082,030 shares of Common Stock that were held in Treasury Stock were retired as of September 30, 2004.

OIL AND NATURAL GAS HEDGING ACTIVITIES. The Company may address market risk by selecting instruments whose value fluctuations correlate strongly with the underlying commodity being hedged. The Company enters into swaps and other derivative contracts to hedge the price risks associated with a portion of anticipated future oil and gas production. These swaps allow the Company to predict with greater certainty the effective oil and natural gas prices to be received for our hedged production. While the use of hedging arrangements limits the downside risk of adverse price movements, it may also limit future gains from favorable movements. Under these agreements, payments are received or made based on the differential between a fixed and a variable product price. These agreements are settled in cash at or prior to expiration or exchanged for physical delivery contracts. The Company does not obtain collateral to support the agreements, but monitors the financial viability of counter-parties and believes its credit risk is minimal on these transactions. In the event of nonperformance, the Company would be exposed to price risk. The Company has some risk of accounting loss since the price received for the product at the actual physical delivery point may differ from the prevailing price at the delivery point required for settlement of the hedging transaction.

These swaps have been designated as cash flow hedges as provided by SFAS No. 133 and any changes in fair value of the cash flow hedge resulting from ineffectiveness of the hedge is reported in the consolidated statement of

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operations as revenues.

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CAPITAL EXPENDITURES. Total capital expenditures for this period approximated \$99.9 million. Although the Company plans to commence additional drilling during the remainder of 2004, such operations will depend primarily on achieving anticipated cash flows, permitting of wells and the availability of suitable drilling rigs. Meridian recently completed the final field work on its 264-square mile 3-D seismic survey at its Biloxi Marshlands acreage and preliminary indications are that a number of additional drilling locations are present in the area encompassing the new survey which will form the basis for its future drilling activities during 2004 and 2005.

Based on internal projections, using its internal risk analysis of production based on an expected capital expenditures program for 2004 of \$135 million, the Company believes that it can further improve its balance sheet while, at the same time, continuing its scheduled capital expenditure program, drilling 15 to 20 low-risk wells and acquiring additional 3-D seismic data over its Biloxi Marshlands project and other exploration areas targeted for exploration growth.

DIVIDENDS. It is our policy to retain existing cash for reinvestment in our business, and therefore, we do not anticipate that dividends will be paid with respect to the Common Stock in the foreseeable future. During May 2002, the Company completed the private placement of \$67 million of 8.5% redeemable convertible preferred stock and dividends are payable semi-annually. A semi-annual cash dividend of \$3.1 million was paid in January 2004. On June 29, 2004, a cash dividend of \$0.8 million was paid for accrued dividends on converted shares. In July 2004, a semi-annual cash dividend of \$1.4 million was paid. Under the terms of the Credit Agreement, dividend payments required during 2003 on the preferred stock were paid-in-kind through our issuance of additional preferred stock.

FORWARD-LOOKING INFORMATION

From time to time, we may make certain statements that contain "forward-looking" information as defined in the Private Securities Litigation Reform Act of 1995 and that involve risk and uncertainty. These forward-looking statements may include, but are not limited to exploration and seismic acquisition plans, anticipated results from current and future exploration prospects, future capital expenditure plans and plans to sell properties, anticipated results from third party disputes and litigation, expectations regarding future financing and compliance with our credit facility, the anticipated results of wells based on logging data and production tests, future sales of production, earnings, margins, production levels and costs, market trends in the oil and natural gas industry and the exploration and development sector thereof, environmental and other expenditures and various business trends. Forward-looking statements may be made by management orally or in writing including, but not limited to, the Management's Discussion and Analysis of Financial Condition and Results of Operations section and other sections of our filings with the Securities and Exchange Commission under the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended.

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Actual results and trends in the future may differ materially depending on a variety of factors including, but not limited to the following:

CHANGES IN THE PRICE OF OIL AND NATURAL GAS. The prices we receive for our oil and natural gas production and the level of such production are subject to wide

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fluctuations and depend on numerous factors that we do not control, including seasonality, worldwide economic conditions, the condition of the United States economy (particularly the manufacturing sector), foreign imports, political conditions in other oil-producing countries, the actions of the Organization of Petroleum Exporting Countries and domestic government regulation, legislation and policies. Material declines in the prices received for oil and natural gas could make the actual results differ from those reflected in our forward-looking statements.

OPERATING RISKS. The occurrence of a significant event against which we are not fully insured could have a material adverse effect on our financial position and results of operations. Our operations are subject to all of the risks normally incident to the exploration for and the production of oil and natural gas, including uncontrollable flows of oil, natural gas, brine or well fluids into the environment (including groundwater and shoreline contamination), blowouts, cratering, mechanical difficulties, fires, explosions, unusual or unexpected formation pressures, pollution and environmental hazards, each of which could result in damage to or destruction of oil and natural gas wells, production facilities or other property, or injury to persons. In addition, we are subject to other operating and production risks such as title problems, weather conditions, compliance with government permitting requirements, shortages of or delays in obtaining equipment, reductions in product prices, limitations in the market for products, litigation and disputes in the ordinary course of business. Although we maintain insurance coverage considered to be customary in the industry, we are not fully insured against certain of these risks either because such insurance is not available or because of high premium costs. We cannot predict if or when any such risks could affect our operations. The occurrence of a significant event for which we are not adequately insured could cause our actual results to differ from those reflected in our forward-looking statements.

DRILLING RISKS. Our decision to purchase, explore, develop or otherwise exploit a prospect or property will depend in part on the evaluation of data obtained through geophysical and geological analysis, production data and engineering studies, which are inherently imprecise. Therefore, we cannot assure you that all of our drilling activities will be successful or that we will not drill uneconomical wells. The occurrence of unexpected drilling results could cause the actual results to differ from those reflected in our forward-looking statements.

UNCERTAINTIES IN ESTIMATING RESERVES AND FUTURE NET CASH FLOWS. Reserve engineering is a subjective process of estimating the recovery from underground accumulations of oil and natural gas we cannot measure in an exact manner, and the accuracy of any reserve estimate is a function of the quality of those accumulations of data and of engineering and geological interpretation and judgment. Reserve estimates are inherently imprecise and may be expected to change as additional information becomes available. There are numerous uncertainties inherent in estimating quantities and values of proved reserves and in projecting future rates of production and timing of development expenditures, including many factors beyond our control. The quantities of oil and natural gas that we ultimately recover, production and operating costs, the amount and timing of future development expenditures and future oil and natural gas sales prices may differ from those assumed in these estimates. Significant downward revisions to our existing reserve estimates could cause the actual results to differ from those reflected in our forward-looking statements.

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BORROWING BASE FOR THE CREDIT FACILITY. The Credit Agreement with Societe Generale and Fortis Capital Corporation is presently scheduled for borrowing base redetermination dates on a quarterly basis with the next such redetermination scheduled for January 31, 2005. The borrowing base is

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redetermined on numerous factors including current reserve estimates, reserves that have recently been added, current commodity prices, current production rates and estimated future net cash flows. These factors have associated risks with each of them. Significant reductions or increases in the borrowing base will be determined by these factors, which, to a significant extent, are not under the Company's control.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is currently exposed to market risk from hedging contracts changes and changes in interest rates. A discussion of the market risk exposure in financial instruments follows.

INTEREST RATES

We are subject to interest rate risk on our long-term fixed interest rate debt and variable interest rate borrowings. Our long-term borrowings primarily consist of borrowings under the Credit Facility and principal due December 31, 2004 under our Subordinated Credit Agreement. Since interest charged borrowings under the Credit Facility floats with prevailing interest rates (except for the applicable interest period for Eurodollar loans), the carrying value of borrowings under the Credit Facility should approximate the fair market value of such debt. Changes in interest rates, however, will change the cost of borrowing. Assuming \$74.0 million remains borrowed under the Credit Facility and \$5 million remains borrowed under the Subordinated Credit Agreement, we estimate our annual interest expense will change by \$0.74 million for each 100 basis point change in the applicable interest rates utilized under the Credit Facility and \$5 million from the Subordinated Credit Agreement. Changes in interest rates would, assuming all other things being equal, cause the fair market value of debt with a fixed interest rate, such as the Notes, to increase or decrease, and thus increase or decrease the amount required to refinance the debt. The fair value of the Notes is dependent on prevailing interest rates.

HEDGING CONTRACTS

Meridian may address market risk by selecting instruments whose value fluctuations correlate strongly with the underlying commodity being hedged. From time to time, we may enter into swaps and other derivative contracts to hedge the price risks associated with a portion of anticipated future oil and natural gas production. While the use of hedging arrangements limits the downside risk of adverse price movements, it may also limit future gains from favorable movements. Under these agreements, payments are received or made based on the differential between a fixed and a variable product price. These agreements are settled in cash at or prior to expiration or exchanged for physical delivery contracts. Meridian does not obtain collateral to support the agreements, but monitors the financial viability of counter-parties and believes its credit risk is minimal on these transactions. In the event of nonperformance, the Company would be exposed to price risk. Meridian has some risk of accounting loss since the price received for the product at the actual physical delivery point may differ from the prevailing price at the delivery point required for settlement of the hedging transaction.

In 2002, we entered into certain swap agreements as summarized in the table below. The Notional Amount is equal to the total net volumetric hedge position of the Company during the periods presented. The positions effectively hedge approximately 9% of our proved developed natural gas production and 49% of our proved developed oil production during the respective terms of the swap agreements. The fair values of the hedges are based on the difference between the strike price and the New York Mercantile Exchange future prices for the

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applicable trading months.

	Notional Amount -----	Weighted Average Strike Price (\$ per unit) -----	Fair Value (unrealized) at September 30, 2004 (in thousands) -----
Natural Gas (mmbtu)			
October 2004 - June 2005	1,570,000	\$ 3.74	\$ (4,989)
Oil (bbls)			
October 2004 - July 2005	413,000	\$ 23.26	\$ (9,697)
			----- \$ (14,686) -----

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ITEM 4. CONTROLS AND PROCEDURES

We conducted an evaluation under the supervision and with the participation of Meridian's management, including our Chief Executive Officer and Chief Accounting Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the third quarter of 2004. Based upon that evaluation, our Chief Executive Officer and Chief Accounting Officer concluded that the design and operation of our disclosure controls and procedures are effective. There have been no significant changes in our internal controls or in other factors during the third quarter of 2004 that could significantly affect these controls.

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

ENVIRONMENTAL LITIGATION. Various landowners have filed claims against Meridian (along with numerous other oil companies) in four similar lawsuits concerning the Weeks Island, Gibson, Bayou Pigeon and Napoleonville Fields. The lawsuits seek injunctive relief and other relief, including unspecified amounts in both actual and punitive damages for alleged breaches of mineral leases and alleged failure to restore the plaintiffs' lands from alleged contamination and otherwise from the defendants' oil and gas operations.

There are no other material legal proceedings which exceed our insurance limits to which Meridian or any of its subsidiaries is a party or to which any of its property is subject, other than ordinary and routine litigation incidental to the business of producing and exploring for crude oil and natural gas.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

In August 2004, the Company repurchased all of the 7,082,030 shares of its common stock that were beneficially owned by Shell Oil Company for \$49.3 million. See Note 5 to the Notes to Consolidated Financial Statements and "Management's Discussion and Analysis of Financial Condition and Results of Operations - General - Common Stock."

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ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits

- 10.1 Stock Purchase Agreement, dated July 21, 2004, between The Meridian Resource Corporation and SWEPI, LP, a Delaware limited partnership (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K dated August 4, 2004).
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) under the Securities Exchange Act of 1934, as amended.
- 31.2 Certification of President pursuant to Rule 13a-14(a) or Rule 15d-14(a) under the Securities Exchange Act of 1934, as amended.
- 31.3 Certification of Chief Accounting Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) under the Securities Exchange Act of 1934, as amended.
- 32.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) under the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350.
- 32.2 Certification of President pursuant to Rule 13a-14(b) or Rule 15d-14(b) under the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350.
- 32.3 Certification of Chief Accounting Officer pursuant Rule 13a-14(b) or Rule 15d-14(b) under the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

THE MERIDIAN RESOURCE CORPORATION AND SUBSIDIARIES

(Registrant)

Date: November 9, 2004

By: /s/ Lloyd V. DeLano

Lloyd V. DeLano
Senior Vice President
Chief Accounting Officer

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