

LEGACY RESERVES LP
Form 10-Q
August 06, 2010

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

FORM 10-Q

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

For the quarterly period ended June 30, 2010

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 1-33249

Legacy Reserves LP
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

16-1751069
(I.R.S. Employer
Identification No.)

303 W. Wall, Suite 1400
Midland, Texas
(Address of principal executive offices)

79701
(Zip code)

(432) 689-5200
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was

Edgar Filing: LEGACY RESERVES LP - Form 10-Q

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

40,162,479 units representing limited partner interests in the registrant were outstanding as of August 5, 2010.

TABLE OF CONTENTS

Page		
	Glossary of Terms	3
	Part I - Financial Information	
Item 1.	Financial Statements.	
	Condensed Consolidated Balance Sheets as of June 30, 2010 and December 31, 2009 (Unaudited)	6
	Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2010 and 2009 (Unaudited)	8
	Condensed Consolidated Statement of Unitholders' Equity for the six months ended June 30, 2010 (Unaudited)	9
	Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2010 and 2009 (Unaudited)	10
	Notes to Condensed Consolidated Financial Statements (Unaudited)	11
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations.	21
Item 3.	Quantitative and Qualitative Disclosures About Market Risk.	32
Item 4.	Controls and Procedures.	32
	Part II - Other Information	
Item 1.	Legal Proceedings.	33
Item 1A.	Risk Factors.	33
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds.	33
Item 3.	Defaults Upon Senior Securities.	33
Item 4.	(Removed and Reserved).	33
Item 5.	Other Information.	33
Item 6.	Exhibits.	34
Signature		35

GLOSSARY OF TERMS

Bbl. One stock tank barrel or 42 U.S. gallons liquid volume.

Bcf. Billion cubic feet.

Boe. One barrel of oil equivalent, determined using a ratio of six Mcf of natural gas to one Bbl of crude oil, condensate or natural gas liquids.

Boe/d. Barrels of oil equivalent per day.

Btu. British thermal unit, which is the heat required to raise the temperature of a one-pound mass of water from 58.5 to 59.5 degrees Fahrenheit.

Developed acreage. The number of acres that are allocated or assignable to productive wells or wells capable of production.

Development project. A drilling or other project which may target proven reserves, but which generally has a lower risk than that associated with exploration projects.

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

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

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

Gross acres or gross wells. The total acres or wells, as the case may be, in which a working interest is owned.

Hydrocarbons. Oil, NGLs and natural gas are all collectively considered hydrocarbons.

MBbbls. One thousand barrels of crude oil or other liquid hydrocarbons.

MBoe. One thousand barrels of crude oil equivalent, using a ratio of six Mcf of natural gas to one Bbl of crude oil, condensate or natural gas liquids.

Mcf. One thousand cubic feet.

MGal. One thousand gallons of natural gas liquids or other liquid hydrocarbons.

MMBbbls. One million barrels of crude oil or other liquid hydrocarbons.

MMBoe. One million barrels of crude oil equivalent, using a ratio of six Mcf of natural gas to one Bbl of crude oil, condensate or natural gas liquids.

MMBtu. One million British thermal units.

MMcf. One million cubic feet.

MMGal. One million gallons of natural gas liquids or other liquid hydrocarbons.

Net acres or net wells. The sum of the fractional working interests owned in gross acres or gross wells, as the case may be.

NGLs or natural gas liquids. The combination of ethane, propane, butane and natural gasolines that when removed from natural gas become liquid under various levels of higher pressure and lower temperature.

NYMEX. New York Mercantile Exchange.

Page 3

Oil. Crude oil, condensate and natural gas liquids.

Productive well. A well that is found to be capable of producing hydrocarbons in sufficient quantities such that proceeds from the sale of such production exceed production expenses and taxes.

Proved developed reserves. Reserves that can be expected to be recovered through existing wells with existing equipment and operating methods. Additional oil and natural gas expected to be obtained through the application of fluid injection or other improved recovery techniques for supplementing the natural forces and mechanisms of primary recovery are included in “proved developed reserves” only after testing by a pilot project or after the operation of an installed program has confirmed through production response that increased recovery will be achieved.

Proved developed non-producing or PDNP’s. Proved oil and natural gas reserves that are developed behind pipe, shut-in or that can be recovered through improved recovery only after the necessary equipment has been installed, or when the costs to do so are relatively minor. Shut-in reserves are expected to be recovered from (1) completion intervals which are open at the time of the estimate but which have not started producing, (2) wells that were shut-in for market conditions or pipeline connections, or (3) wells not capable of production for mechanical reasons. Behind-pipe reserves are expected to be recovered from zones in existing wells that will require additional completion work or future recompletion prior to the start of production.

Proved reserves. Proved oil and gas reserves are those quantities of oil and gas, which, by analysis of geoscience and engineering data, can be estimated with reasonable certainty to be economically producible—from a given date forward, from known reservoirs, and under existing economic conditions, operating methods, and government regulations—prior to the time at which contracts providing the right to operate expire, unless evidence indicates that renewal is reasonably certain, regardless of whether deterministic or probabilistic methods are used for the estimation.

Proved undeveloped drilling location. A site on which a development well can be drilled consistent with spacing rules for purposes of recovering proved undeveloped reserves.

Proved undeveloped reserves or PUDs. Proved oil and natural gas reserves that are expected to be recovered from new wells on undrilled acreage or from existing wells where a relatively major expenditure is required for recompletion. Reserves on undrilled acreage are limited to those drilling units offsetting productive units that are reasonably certain of production when drilled. Proved reserves for other undrilled units are claimed only where it can be demonstrated with certainty that there is continuity of production from the existing productive formation. Estimates for proved undeveloped reserves are not attributed to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless such techniques have been proven effective by actual tests in the area and in the same reservoir.

Re-completion. The completion for production of an existing wellbore in another formation from that which the well has been previously completed.

Reserve acquisition cost. The total consideration paid for an oil and natural gas property or set of properties, which includes the cash purchase price and any value ascribed to units issued to a seller adjusted for any post-closing items.

R/P ratio (reserve life). The reserves as of the end of a period divided by the production volumes for the same period.

Reserve replacement. The replacement of oil and natural gas produced with reserve additions from acquisitions, reserve additions and reserve revisions.

Reserve replacement cost. An amount per Boe equal to the sum of costs incurred relating to oil and natural gas property acquisition, exploitation, development and exploration activities (as reflected in our year-end financial statements for the relevant year) divided by the sum of all additions and revisions to estimated proved reserves, including reserve purchases. The calculation of reserve additions for each year is based upon the reserve report of our independent engineers. Management uses reserve replacement cost to compare our company to others in terms of our historical ability to increase our reserve base in an economic manner. However, past performance does not necessarily reflect future reserve replacement cost performance. For example, increases in oil and natural gas prices in recent years have increased the economic life of reserves, adding additional reserves with no required capital expenditures. On the other hand, increases in oil and natural gas prices have increased the cost of reserve purchases and reserves added through development projects. The reserve replacement cost may not be indicative of the economic value added of the reserves due to differing lease operating expenses per barrel and differing timing of production.

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

Standardized measure. The present value of estimated future net revenues to be generated from the production of proved reserves, determined in accordance with assumptions required by the Financial Accounting Standards Board and the Securities and Exchange Commission (using prices as of the period end date and costs over the prior period for periods prior to 2009 and the average annual prices based on the un-weighted arithmetic average of the first-day-of-the-month price for each month of periods beginning on or after January 1, 2009) without giving effect to non-property related expenses such as general and administrative expenses, debt service and future income tax expenses or to depreciation, depletion and amortization and discounted using an annual discount rate of 10%. Because we are a limited partnership that allocates our taxable income to our unitholders, no provisions for federal or state income taxes have been provided for in the calculation of standardized measure. Standardized measure does not give effect to derivative transactions.

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

Working interest. The operating interest that gives the owner the right to drill, produce and conduct operating activities on the property and a share of production.

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

Part I – FINANCIAL INFORMATION

Item 1. Financial Statements.

LEGACY RESERVES LP
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	ASSETS	June 30, 2010	December 31, 2009
		(In thousands)	
Current assets:			
Cash and cash equivalents		\$ 4,913	\$ 4,217
Accounts receivable, net:			
Oil and natural gas		20,288	18,070
Joint interest owners		5,708	4,547
Other		395	364
Fair value of derivatives (Notes 6 and 7)		23,783	20,090
Prepaid expenses and other current assets		2,234	2,323
Total current assets		57,321	49,611
Oil and natural gas properties, at cost:			
Proved oil and natural gas properties, at cost, using the successful efforts method of accounting:		1,014,042	847,120
Unproved properties		7,275	214
Accumulated depletion, depreciation and amortization		(307,095)	(271,909)
		714,222	575,425
Other property and equipment, net of accumulated depreciation and amortization of \$1,867 and \$1,448, respectively			
		2,727	1,512
Deposits on pending acquisitions		-	6,500
Operating rights, net of amortization of \$2,254 and \$1,979, respectively		4,763	5,038
Fair value of derivatives (Notes 6 and 7)		24,277	11,026
Other assets, net of amortization of \$3,759 and \$2,785, respectively		4,071	4,334
Investment in equity method investee		95	47
Total assets		\$ 807,476	\$ 653,493

See accompanying notes to condensed consolidated financial statements.

LEGACY RESERVES LP
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

LIABILITIES AND UNITHOLDERS' EQUITY

	June 30, 2010	December 31, 2009
(In thousands)		
Current liabilities:		
Accounts payable	\$ 1,356	\$ 1,580
Accrued oil and natural gas liabilities	23,281	13,890
Fair value of derivatives (Notes 6 and 7)	6,215	18,762
Asset retirement obligation (Note 8)	14,603	13,506
Other (Note 10)	6,285	6,488
Total current liabilities	51,740	54,226
Long-term debt (Note 2)	280,000	237,000
Asset retirement obligation (Note 8)	78,332	71,411
Fair value of derivatives (Notes 6 and 7)	7,915	12,149
Other long-term liabilities	1,079	47
Total liabilities	419,066	374,833
Commitments and contingencies (Note 5)		
Unitholders' equity:		
Limited partners' equity - 40,078,776 and 34,880,474 units issued and outstanding at June 30, 2010 and December 31 2009, respectively	388,336	278,627
General partner's equity (approximately 0.1%)	74	33
Total unitholders' equity	388,410	278,660
Total liabilities and unitholders' equity	\$ 807,476	\$ 653,493

See accompanying notes to condensed consolidated financial statements.

LEGACY RESERVES LP
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
(In thousands, except per unit data)				
Revenues:				
Oil sales	\$ 41,631	\$ 24,604	\$ 79,378	\$ 41,069
Natural gas liquids sales (NGL)	3,432	2,478	7,182	4,547
Natural gas sales	6,569	4,773	14,738	9,298
Total revenues	51,632	31,855	101,298	54,914
Expenses:				
Oil and natural gas production	17,792	11,468	32,862	23,471
Production and other taxes	2,954	1,887	5,873	3,240
General and administrative	4,047	3,900	8,808	7,268
Depletion, depreciation, amortization and accretion	16,067	13,549	29,181	30,170
Impairment of long-lived assets	471	452	8,387	1,608
(Gain) loss on disposal of assets	(155)	31	(142)	239
Total expenses	41,176	31,287	84,969	65,996
Operating income (loss)	10,456	568	16,329	(11,082)
Other income (expense):				
Interest income	3	5	7	6
Interest expense (Notes 2, 6 and 7)	(9,004)	1,761	(16,338)	(2,498)
Equity in income (loss) of partnership	25	-	48	(3)
Realized and unrealized net gains (losses) on commodity derivatives (Notes 6 and 7)	38,298	(59,172)	50,158	(39,666)
Other	121	6	88	10
Income (loss) before income taxes	39,899	(56,832)	50,292	(53,233)
Income taxes	(453)	(160)	(626)	(270)
Net income (loss)	\$ 39,446	\$ (56,992)	\$ 49,666	\$ (53,503)
Income (loss) per unit - basic and diluted (Note 9)	\$ 0.98	\$ (1.83)	\$ 1.25	\$ (1.72)
Weighted average number of units used in computing net income (loss) per unit -				
basic	40,072	31,069	39,646	31,061
diluted	40,078	31,069	39,646	31,061

See accompanying notes to condensed consolidated financial statements.

LEGACY RESERVES LP
CONDENSED CONSOLIDATED STATEMENTS OF UNITHOLDERS' EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2010
(UNAUDITED)

	Number of Limited Partner Units	Limited Partner (In thousands)	General Partner	Total Unitholders' Equity
Balance, December 31, 2009	34,880	\$278,627	\$33	\$ 278,660
Units issued to Legacy Board of Directors for services	11	226	-	226
Compensation expense on restricted unit awards issued to employees	-	179	-	179
Vesting of restricted units	3	-	-	-
Net proceeds from equity offering	4,888	95,436	-	95,436
Units issued in exchange for oil and natural gas properties	297	5,959	-	5,959
Net distributions to unitholders, \$0.52 per unit	-	(41,734)	18	(41,716)
Net income	-	49,643	23	49,666
Balance, June 30, 2010	40,079	\$388,336	\$74	\$ 388,410

See accompanying notes to condensed consolidated financial statements.

LEGACY RESERVES LP
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Six Months Ended June 30,	
	2010	2009
	(In thousands)	
Cash flows from operating activities:		
Net income (loss)	\$49,666	\$(53,503)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depletion, depreciation, amortization and accretion	29,181	30,170
Amortization of debt issuance costs	974	710
Impairment of long-lived assets	8,387	1,608
(Gain) loss on derivatives	(42,697)	34,255
Equity in (income) loss of partnership	(48)	3
Unit-based compensation	1,977	313
(Gain) loss on disposal of assets	(142)	239
Changes in assets and liabilities:		
Increase in accounts receivable, oil and natural gas	(2,218)	(2,322)
(Increase) decrease in accounts receivable, joint interest owners	(1,161)	2,860
(Increase) decrease in accounts receivable, other	(31)	3
Decrease in other current assets	297	660
Decrease in accounts payable	(224)	(3,791)
Increase (decrease) in accrued oil and natural gas liabilities	9,391	(5,113)
Increase (decrease) in other liabilities	499	(5,222)
Total adjustments	4,185	54,373
Net cash provided by operating activities	53,851	870
Cash flows from investing activities:		
Investment in oil and natural gas properties	(160,882)	(7,661)
Decrease in deposit on pending acquisition	6,500	-
Proceeds from sale of assets	-	51
Investment in other equipment	(1,633)	(130)
Goodwill	(494)	-
Net cash settlements on commodity derivatives	8,971	35,634
Investment in equity method investee	-	(4)
Net cash provided by (used in) investing activities	(147,538)	27,890
Cash flows from financing activities:		
Proceeds from long-term debt	195,000	24,000
Payments of long-term debt	(152,000)	(11,000)
Payments of debt issuance costs	(426)	(4,543)
Proceeds from issuance of units, net	95,436	-
Distributions to unitholders	(41,716)	(32,317)
Net payments of LTIP unit awards	(1,911)	-
Net cash provided by (used in) financing activities	94,383	(23,860)
Net increase in cash and cash equivalents	696	4,900
Cash and cash equivalents, beginning of period	4,217	2,500
Cash and cash equivalents, end of period	\$4,913	\$7,400

Non-Cash Investing and Financing Activities:

Asset retirement obligation costs and liabilities	\$363	\$-
Asset retirement obligations associated with property acquisitions	\$6,779	\$-
Units issued in exchange for oil and		