

FOREST OIL CORP
Form 10-Q
November 08, 2011
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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, 2011

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 1-13515

FOREST OIL CORPORATION	
(Exact name of registrant as specified in its charter)	
New York	25-0484900
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
707 17th Street, Suite 3600	80202
Denver, Colorado	
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (303) 812-1400

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>

(Do not check if a 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

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As of November 2, 2011 there were 114,354,204 shares of the registrant's common stock, par value \$.10 per share, outstanding.

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September 30, 2011

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PART I—FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

FOREST OIL CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In Thousands, Except Share Amounts)

	September 30, 2011	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$270,089	\$217,569
Accounts receivable	72,639	102,325
Derivative instruments	66,726	60,182
Inventory	13,422	22,640
Other current assets	31,346	28,825
Current assets of discontinued operations	—	50,142
Total current assets	454,222	481,683
Property and equipment, at cost:		
Oil and gas properties, full cost method of accounting:		
Proved, net of accumulated depletion of \$6,838,561 and \$6,688,012	1,768,305	1,370,864
Unproved	687,900	646,264
Net oil and gas properties	2,456,205	2,017,128
Other property and equipment, net of accumulated depreciation and amortization of \$47,300 and \$42,432	51,182	53,145
Net property and equipment	2,507,387	2,070,273
Deferred income taxes	236,558	284,021
Goodwill	239,420	239,420
Derivative instruments	20,772	8,244
Other assets	39,746	36,698
Long-term assets of discontinued operations	—	665,049
	\$3,498,105	\$3,785,388
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$224,259	\$209,998
Accrued interest	34,041	23,630
Derivative instruments	13,101	36,413
Deferred income taxes	16,941	6,911
Current portion of long-term debt	285,497	287,092
Asset retirement obligations	2,501	121
Other current liabilities	17,891	19,562
Current liabilities of discontinued operations	—	45,647
Total current liabilities	594,231	629,374
Long-term debt	1,586,591	1,582,280
Asset retirement obligations	75,760	73,011

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Derivative instruments	1,849	—
Other liabilities	64,983	73,463
Long-term liabilities of discontinued operations	—	74,473
Total liabilities	2,323,414	2,432,601
Shareholders' equity:		
Preferred stock, none issued and outstanding	—	—
Common stock, 114,400,776 and 113,594,788 shares issued and outstanding	11,440	11,359
Capital surplus	2,480,984	2,684,269
Accumulated deficit	(1,306,530) (1,424,905)
Accumulated other comprehensive income	(11,203) 82,064
Total shareholders' equity	1,174,691	1,352,787
	\$3,498,105	\$3,785,388

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In Thousands, Except Per Share Amounts)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2011	2010	2011	2010
Revenues:				
Oil, natural gas, and natural gas liquids sales	\$174,012	\$174,991	\$526,915	\$529,012
Interest and other	109	203	939	471
Total revenues	174,121	175,194	527,854	529,483
Costs, expenses, and other:				
Lease operating expenses	23,480	23,602	70,593	69,549
Production and property taxes	7,926	12,751	32,187	35,419
Transportation and processing costs	3,197	3,302	10,263	9,228
General and administrative	19,942	16,313	49,122	49,016
Depreciation, depletion, and amortization	54,323	48,862	155,227	133,979
Interest expense	37,225	37,237	113,081	112,494
Realized and unrealized gains on derivative instruments, net	(65,961)	(59,156)	(70,632)	(177,398)
Other, net	(177)	2,399	12,280	4,192
Total costs, expenses, and other	79,955	85,310	372,121	236,479
Earnings from continuing operations before income taxes	94,166	89,884	155,733	293,004
Income tax	34,556	34,313	76,940	109,238
Net earnings from continuing operations	59,610	55,571	78,793	183,766
Earnings from discontinued operations, net of tax	28,108	13,340	44,569	27,561
Net earnings	87,718	68,911	123,362	211,327
Less: net earnings attributable to noncontrolling interest	4,923	—	4,987	—
Net earnings attributable to Forest Oil Corporation	\$82,795	\$68,911	\$118,375	\$211,327
Basic earnings per common share attributable to Forest Oil Corporation common shareholders:				
Earnings from continuing operations	\$.52	\$.49	\$.69	\$1.63
Earnings from discontinued operations, net of tax	.20	.12	.35	.24
Basic earnings per common share attributable to Forest Oil Corporation common shareholders	\$.72	\$.61	\$1.04	\$1.87
Diluted earnings per common share attributable to Forest Oil Corporation common shareholders:				
Earnings from continuing operations	\$.52	\$.49	\$.69	\$1.62
Earnings from discontinued operations, net of tax	.20	.11	.34	.24
Diluted earnings per common share attributable to Forest Oil Corporation common shareholders	\$.72	\$.60	\$1.03	\$1.86

Amounts attributable to Forest Oil Corporation common shareholders:

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Net earnings from continuing operations	\$59,610	\$55,571	\$78,793	\$183,766
Earnings from discontinued operations, net of tax	23,185	13,340	39,582	27,561
Net earnings	\$82,795	\$68,911	\$118,375	\$211,327

See accompanying Notes to Condensed Consolidated Financial Statements.

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FOREST OIL CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF EQUITY

(Unaudited)

(In Thousands)

	Common Stock		Capital	Accumulated	Accumulated	Forest Oil	Noncontrolling	Total
	Shares	Amount	Surplus	Deficit	Other	Corporation	Interest	Shareholders'
					Comprehensive	Shareholders'		Equity
					Income	Equity		
Balances at December 31, 2010	113,595	\$ 11,359	\$ 2,684,269	\$(1,424,905)	\$ 82,064	\$ 1,352,787	\$—	\$ 1,352,787
Issuance of Lone Pine Resources Inc. common stock	—	—	112,610	—	(18,007)	94,603	83,572	178,175
Spin-off of Lone Pine Resources Inc.	—	—	(333,568)	—	(54,125)	(387,693)	(82,242)	(469,935)
Exercise of stock options	30	3	548	—	—	551	—	551
Employee stock purchase plan	68	7	1,121	—	—	1,128	—	1,128
Restricted stock issued, net of cancellations	894	90	(90)	—	—	—	—	—
Amortization of stock-based compensation	—	—	30,980	—	—	30,980	—	30,980
Tax impact of employee stock option exercises	—	—	(9,285)	—	—	(9,285)	—	(9,285)
Other, net	(187)	(19)	(5,601)	—	—	(5,620)	—	(5,620)
Comprehensive earnings:								
Net earnings	—	—	—	118,375	—	118,375	4,987	123,362
Unfunded postretirement benefits, net of tax	—	—	—	—	311	311	—	311
Foreign currency translation	—	—	—	—	(21,446)	(21,446)	(6,317)	(27,763)

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Total comprehensive earnings						97,240	(1,330)	95,910
Balances at September 30, 2011	114,400	\$11,440	\$2,480,984	\$(1,306,530)	\$(11,203)	\$1,174,691	\$—	\$1,174,691

See accompanying Notes to Condensed Consolidated Financial Statements.

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FOREST OIL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In Thousands)

	Nine Months Ended September 30,	
	2011	2010
Operating activities:		
Net earnings	\$ 123,362	\$ 211,327
Less: earnings from discontinued operations, net of tax	44,569	27,561
Net earnings from continuing operations	78,793	183,766
Adjustments to reconcile net earnings from continuing operations to net cash provided by operating activities of continuing operations:		
Depreciation, depletion, and amortization	155,227	133,979
Deferred income tax	46,724	121,327
Unrealized gains on derivative instruments, net	(40,538)	(102,839)
Stock-based compensation expense	17,809	13,565
Accretion of asset retirement obligations	4,496	4,667
Other, net	6,123	804
Changes in operating assets and liabilities:		
Accounts receivable	29,686	23,734
Other current assets	8,218	10,476
Accounts payable and accrued liabilities	(5,096)	(61,914)
Accrued interest and other current liabilities	3,977	5,134
Net cash provided by operating activities of continuing operations	305,419	332,699
Investing activities:		
Capital expenditures for property and equipment:		
Exploration, development, acquisition, and leasehold costs	(656,894)	(439,687)
Other fixed assets	(4,375)	(3,722)
Proceeds from sales of assets	120,956	128,588
Net cash used by investing activities of continuing operations	(540,313)	(314,821)
Financing activities:		
Redemption of 7¾% senior notes	—	(151,938)
Proceeds from the exercise of options and from employee stock purchase plan	1,679	5,445
Payment of debt issue costs	(8,198)	—
Change in bank overdrafts	(20,660)	13,712
Other, net	(5,788)	(6,001)
Net cash used by financing activities of continuing operations	(32,967)	(138,782)
Cash flows of discontinued operations:		
Operating cash flows	101,292	65,608
Investing cash flows	(255,470)	(160,097)
Financing cash flows	478,324	107
Net cash provided (used) by discontinued operations	324,146	(94,382)
Effect of exchange rate changes on cash	(3,476)	(336)
Net increase (decrease) in cash and cash equivalents	52,809	(215,622)

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Net (increase) decrease in cash and cash equivalents of discontinued operations	(289) 25
Net increase (decrease) in cash and cash equivalents of continuing operations	52,520	(215,597)
Cash and cash equivalents of continuing operations at beginning of period	217,569	458,275
Cash and cash equivalents of continuing operations at end of period	\$270,089	\$242,678
Cash paid during the period for:		
Continuing operations:		
Interest	\$101,907	\$103,774
Income taxes	2,602	67,641
Discontinued operations:		
Interest	\$4,594	\$338
Income taxes	—	—
See accompanying Notes to Condensed Consolidated Financial Statements.		

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(1) ORGANIZATION AND BASIS OF PRESENTATION

Organization

Forest Oil Corporation is an independent oil and gas company engaged in the acquisition, exploration, development, and production of oil, natural gas, and natural gas liquids (“NGLs”) primarily in the United States. Forest was incorporated in New York in 1924, as the successor to a company formed in 1916, and has been a publicly held company since 1969. Forest holds assets in several exploration and producing areas in the United States and has exploratory and development interests in two other countries. In December 2010, Forest announced its intention to separate its Canadian operations through an initial public offering of up to 19.9% of the common stock of its subsidiary, Lone Pine Resources Inc. (“Lone Pine”), followed by a distribution, or spin-off, of the remaining shares of Lone Pine held by Forest to its shareholders. On June 1, 2011, Lone Pine completed an initial public offering of 15 million shares of common stock. On September 30, 2011, Forest completed the spin-off of the 70 million shares of Lone Pine held by Forest in the form of a pro rata common stock dividend to all Forest shareholders. See Note 10 for more information regarding the initial public offering and spin-off of Lone Pine. Unless the context indicates otherwise, the terms “Forest,” the “Company,” “we,” “our,” and “us,” as used in this Quarterly Report on Form 10-Q, refer to Forest Oil Corporation and its subsidiaries.

Basis of Presentation

The Condensed Consolidated Financial Statements included herein are unaudited and include the accounts of Forest and its consolidated subsidiaries. The results of operations of Lone Pine are reported as discontinued operations due to the spin-off, with prior periods being recast for comparative purposes. In the opinion of management, all adjustments, consisting of normal recurring accruals, have been made that are necessary for a fair presentation of the financial position of Forest at September 30, 2011, and the results of its operations, its cash flows, and changes in its shareholders’ equity for the periods presented. Interim results are not necessarily indicative of expected annual results because of the impact of fluctuations in the price of oil, natural gas, and natural gas liquids and the impact the prices have on our revenues and fair values of our derivative instruments.

In the course of preparing the Condensed Consolidated Financial Statements, management makes various assumptions, judgments, and estimates to determine the reported amounts of assets, liabilities, revenues, and expenses, and in the disclosures of commitments and contingencies. Changes in these assumptions, judgments, and estimates will occur as a result of the passage of time, and the occurrence of future events and, accordingly, actual results could differ from amounts previously established.

The more significant areas requiring the use of assumptions, judgments, and estimates relate to volumes of oil and gas reserves used in calculating depletion, the amount of future net revenues used in computing the ceiling test limitations, and the amount of future capital costs and abandonment obligations used in such calculations, determining impairments of investments in unproved properties, valuing deferred tax assets and goodwill, and estimating fair values of financial instruments, including derivative instruments.

Certain amounts in the prior year financial statements have been reclassified to conform to the 2011 financial statement presentation.

For a more complete understanding of Forest's operations, financial position, and accounting policies, reference is made to the consolidated financial statements of Forest, and related notes thereto, filed with Forest's Annual Report on Form 10-K for the year ended December 31, 2010, previously filed with the Securities and Exchange Commission ("SEC").

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(2) EARNINGS PER SHARE AND COMPREHENSIVE EARNINGS

Earnings per Share

Basic earnings per share is computed using the two-class method by dividing net earnings attributable to common stock by the weighted average number of common shares outstanding during each period. The two-class method of computing earnings per share is required for those entities that have participating securities or multiple classes of common stock. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. Holders of restricted stock issued under Forest's stock incentive plans have the right to receive non-forfeitable cash and certain non-cash dividends, participating on an equal basis with common stock. Holders of phantom stock units issued to directors under Forest's stock incentive plans also have the right to receive non-forfeitable cash and certain non-cash dividends, participating on an equal basis with common stock, while phantom stock units issued to employees do not participate in dividends. Stock options issued under Forest's stock incentive plans do not participate in dividends. Performance units issued under Forest's stock incentive plans do not participate in dividends in their current form. Holders of performance units participate in dividends paid during the performance units' vesting period only after the performance units vest with common shares being earned by the holders of the performance units. Performance units may vest with no common shares being earned, depending on Forest's shareholder return over the performance units' vesting period in relation to the shareholder returns of specified peers. See Note 3 for more information on Forest's stock-based incentive awards. In summary, restricted stock issued to employees and directors and phantom stock units issued to directors are participating securities, and earnings are allocated to both common stock and these participating securities under the two-class method. However, these participating securities do not have a contractual obligation to share in Forest's losses. Therefore, in periods of net loss, none of the loss is allocated to these participating securities.

Under the treasury stock method, diluted earnings per share is computed by dividing (a) net earnings, adjusted for the effects of certain contracts that provide the issuer or holder with a choice between settlement methods, by (b) the weighted average number of common shares outstanding, adjusted for the dilutive effect, if any, of potential common shares (e.g., stock options, unvested restricted stock grants, unvested phantom stock units that may be settled in shares, and unvested performance units). No potential common shares are included in the computation of any diluted per share amount when a net loss exists. Unvested restricted stock grants were not included in the calculation of diluted earnings per share for the three and nine months ended September 30, 2011 and 2010 as their inclusion would have an antidilutive effect. Unvested performance units were not included in the calculation of diluted earnings per share for the three and nine months ended September 30, 2011 as no shares would be issuable under the performance unit agreements had the end of the contingency period occurred during these periods.

The following reconciles net earnings as reported in the Condensed Consolidated Statements of Operations to net earnings used for calculating basic and diluted earnings per share for the periods presented.

	Three Months Ended September 30, 2011			Nine Months Ended September 30, 2011		
	Continuing Operations	Discontinued Operations	Total	Continuing Operations	Discontinued Operations	Total
Net earnings	\$59,610	\$ 28,108	\$87,718	\$78,793	\$ 44,569	\$123,362
Net earnings attributable to noncontrolling interest	—	(4,923)	(4,923)	—	(4,987)	(4,987)
Net earnings attributable to participating securities	(1,341)	(522)	(1,863)	(1,606)	(807)	(2,413)
	\$58,269	\$ 22,663	\$80,932	\$77,187	\$ 38,775	\$115,962

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Net earnings attributable to common stock for basic earnings per share						
Adjustment for liability classified stock-based compensation awards	—	(603) (603) —	(707) (707
Net earnings for diluted earnings per share	\$58,269	\$ 22,060	\$80,329	\$77,187	\$ 38,068	\$115,255

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	Three Months Ended September 30, 2010			Nine Months Ended September 30, 2010		
	Continuing Operations (In Thousands)	Discontinued Operations	Total	Continuing Operations	Discontinued Operations	Total
Net earnings	\$55,571	\$ 13,340	\$68,911	\$ 183,766	\$ 27,561	\$211,327
Net earnings attributable to participating securities	(1,151)	(276)	(1,427)	(3,579)	(537)	(4,116)
Net earnings attributable to common stock for basic earnings per share	\$54,420	\$ 13,064	\$67,484	\$ 180,187	\$ 27,024	\$207,211
Adjustment for liability classified stock-based compensation awards	—	74	74	—	250	250
Net earnings for diluted earnings per share	\$54,420	\$ 13,138	\$67,558	\$ 180,187	\$ 27,274	\$207,461

The following reconciles basic weighted average common shares outstanding to diluted weighted average common shares outstanding for the periods presented.

	Three Months Ended September 30, 2011		Nine Months Ended September 30, 2011	
	2011	2010	2011	2010
Weighted average common shares outstanding during the period for basic earnings per share	111,810	110,992	111,598	110,691
Dilutive effects of potential common shares	352	786	521	699
Weighted average common shares outstanding during the period, including the effects of dilutive potential common shares, for diluted earnings per share	112,162	111,778	112,119	111,390

Comprehensive Earnings

Comprehensive earnings is a term used to refer to net earnings plus other comprehensive income. Other comprehensive income is comprised of revenues, expenses, gains, and losses that under generally accepted accounting principles are reported as separate components of shareholders' equity instead of net earnings. Items included in Forest's other comprehensive income for the three and nine months ended September 30, 2011 and 2010 are net foreign currency gains and losses related to the translation of the assets and liabilities of Lone Pine's Canadian operations prior to the spin-off of Lone Pine on September 30, 2011, and changes in unfunded postretirement benefits.

The components of comprehensive earnings are as follows:

	Three Months Ended September 30, 2011		Nine Months Ended September 30, 2011	
	2011	2010	2011	2010
Consolidated net earnings	\$87,718	\$68,911	\$123,362	\$211,327
Other comprehensive income:				
Foreign currency translation (losses) gains	(38,234)	8,978	(27,763)	5,132
Unfunded postretirement benefits, net of tax	93	290	311	975
Total comprehensive earnings	\$49,577	\$78,179	\$95,910	\$217,434
	(1,824)	—	(1,330)	—

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Less: total comprehensive earnings attributable to
noncontrolling interest

Total comprehensive earnings attributable to Forest Oil Corporation	\$51,401	\$78,179	\$97,240	\$217,434
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(3) STOCK-BASED COMPENSATION

Equity Incentive Plans

Forest maintains the 2001 and 2007 Stock Incentive Plans (the “Plans”) under which qualified and non-qualified stock options, restricted stock, performance units, and phantom stock units may be granted to employees, consultants, and non-employee directors of Forest and its subsidiaries.

Compensation Costs

The table below sets forth total stock-based compensation of continuing operations recorded during the three and nine months ended September 30, 2011 and 2010, and the remaining unamortized amounts and weighted average amortization period as of September 30, 2011.

	Stock Options ⁽¹⁾ (In Thousands)	Restricted Stock ⁽²⁾	Performance Units	Phantom Stock Units	Total ⁽³⁾⁽⁴⁾
Three months ended September 30, 2011:					
Total stock-based compensation costs	\$1,095	\$15,434	\$ 775	\$(1,456)	\$15,848
Less: stock-based compensation costs capitalized	(437)	(6,994)	(253)	529	(7,155)
Stock-based compensation costs expensed	\$658	\$8,440	\$ 522	\$(927)	\$8,693
Nine months ended September 30, 2011:					