POGO PRODUCING CO
Form 10-Q
April 28, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

ý Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2006 or

o 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 1-7792

POGO PRODUCING COMPANY

(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	**74-1659398** (I.R.S. Employer Identification No.)
5 Greenway Plaza, Suite 2700 **Houston, Texas** (Address of principal executive offices)	**77046-0504** (Zip Code)

(713) 297-5000

(Registrant s Telephone Number, Including Area Code)

Not Applicable

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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 ý No o

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

Large accelerated filer ý Accelerated filer o Non-accelerated filer o

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

Yes o No ý

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Common Stock, par value $1.00 per share:	57,962,947 shares as of April 24, 2006

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

POGO PRODUCING COMPANY AND SUBSIDIARIES

Consolidated Statements of Income (Unaudited)

	Three Months Ended March 31,			
	2006		2005	
	(Expressed in millions, except per share amounts)			
Revenues:				
Oil and gas	$	354.4	$	254.1
Other		19.1		1.7
Total		373.5		255.8
Operating Costs and Expenses:				
Lease operating		57.1		28.7
General and administrative		28.7		18.7
Exploration		2.7		11.2
Dry hole and impairment		25.6		47.4
Depreciation, depletion and amortization		110.1		70.5
Production and other taxes		13.5		11.2
Transportation and other		25.5		(5.6)
Total		263.2		182.1
Operating Income		110.3		73.7
Interest:				
Charges		(28.3)		(10.2)
Income		0.5		0.8
Capitalized		16.2		2.2
Commodity derivative income (expense)		3.3		
Foreign Currency Transaction Gain (Loss)		(0.2)		
Income From Continuing Operations Before Taxes		101.8		66.5
Income Tax Expense		(34.3)		(27.0)
Income From Continuing Operations		67.5		39.5
Income from Discontinued Operations, net of tax				19.7
Net Income	$	67.5	$	59.2
Earnings per Common Share:				
Basic				
Income from continuing operations	$	1.18	$	0.62
Income from discontinued operations, net of tax				0.31
Net income	$	1.18	$	0.93

Diluted				
Income from continuing operations	$	1.16	$	0.62
Income from discontinued operations, net of tax				0.31
Net income	$	1.16	$	0.93
Dividends per Common Share	$	0.0750	$	0.0625

See accompanying notes to consolidated financial statements.

POGO PRODUCING COMPANY AND SUBSIDIARIES

Consolidated Balance Sheets (Unaudited)

	March 31, 2006	December 31, 2005
	(Expressed in millions)	
Assets		
Current Assets:		
Cash and cash equivalents	$ 23.7	$ 57.7
Accounts receivable	166.1	198.8
Other receivables	26.8	19.9
Federal income tax receivable		21.7
Deferred tax asset	21.2	12.2
Inventories - product	14.5	13.2
Inventories - tubulars	21.6	19.1
Other	3.2	4.2
Total current assets	277.1	346.8
Property and Equipment:		
Oil and gas, on the basis of successful efforts accounting		
Proved properties	6,411.1	6,254.5
Unevaluated properties	887.9	872.2
Other, at cost	42.1	40.5
	7,341.1	7,167.2
Accumulated depreciation, depletion and amortization		
Oil and gas	(1,965.6)	(1,858.3)
Other	(26.4)	(24.5)
	(1,992.0)	(1,882.8)
Property and equipment, net	5,349.1	5,284.4
Other Assets:		
Other	43.0	44.5
	43.0	44.5
	$ 5,669.2	$ 5,675.7

See accompanying notes to consolidated financial statements.

	March 31, 2006	December 31, 2005
	(Expressed in millions, except share amounts)	
Liabilities and Shareholders Equity		
Current Liabilities:		
Accounts payable - operating activities	$ 149.1	$ 167.3
Accounts payable - investing activities	138.7	137.1
Income taxes payable	63.2	2.0
Accrued interest payable	27.5	20.2
Accrued payroll and related benefits	3.8	3.7
Price hedge contracts	25.7	52.3
Other	10.2	12.5
Total current liabilities	418.2	395.1
Long-Term Debt	1,577.5	1,643.4
Deferred Income Tax	1,291.5	1,316.9
Asset Retirement Obligation	150.3	149.4
Other Liabilities and Deferred Credits	60.9	72.3
Total liabilities	3,498.4	3,577.1
Commitments and Contingencies		
Shareholders Equity:		
Preferred stock, $1 par; 4,000,000 shares authorized		
Common stock, $1 par; 200,000,000 shares authorized, 65,328,306 and 65,275,106 shares issued, respectively	65.3	65.3
Additional capital	955.3	977.9
Retained earnings	1,527.3	1,464.2
Deferred compensation		(17.5)
Accumulated other comprehensive income (loss)	(15.8)	(30.0)
Treasury stock (7,365,359 shares, at cost)	(361.3)	(361.3)
Total shareholders equity	2,170.8	2,098.6
	$ 5,669.2	$ 5,675.7

See accompanying notes to consolidated financial statements.

POGO PRODUCING COMPANY AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows (Unaudited)

	Three Months Ended March 31, 2006	2005
	(Expressed in millions)	
Cash Flows from Operating Activities:		
Cash received from customers	$ 371.0	$ 256.6
Operating, exploration, and general and administrative expenses paid	(105.5)	(68.2)
Interest paid	(20.4)	(5.3)
Income taxes paid	(3.2)	
Income tax refund	1.6	
Other	(3.1)	3.0
Cash provided by continuing operations	240.4	186.1
Cash provided by discontinued operations		73.2
Net cash provided by operating activities	240.4	259.3
Cash Flows from Investing Activities:		
Capital expenditures	(176.1)	(127.5)
Purchase of corporations and property	(23.4)	(20.9)
Sale of current investments		122.3
Purchase of current investments		(16.8)
Insurance proceeds	2.5	4.4
Other	(1.1)	0.2
Cash used in continuing operations	(198.1)	(38.3)
Cash used in discontinued operations		(13.2)
Net cash used in investing activities	(198.1)	(51.5)
Cash Flows from Financing Activities:		
Borrowings under senior debt agreements	183.0	669.0
Payments under senior debt agreements	(249.0)	(944.0)
Proceeds from 2015 Notes		297.3
Purchase of Company stock	(7.7)	(81.5)
Payments of cash dividends on common stock	(4.3)	(4.0)
Payments from discontinued operations		82.5
Payment of debt issue costs	(0.1)	(2.6)
Proceeds from exercise of stock options	1.6	2.8
Cash provided by (used in) continuing operations	(76.5)	19.5
Cash provided by (used in) discontinued operations		(82.5)
Net cash used in financing activities	(76.5)	(63.0)
Effect of exchange rate changes on cash	0.2	(0.2)
Net decrease in cash and cash equivalents	(34.0)	144.6
Cash and cash equivalents from continuing operations, beginning of the year	57.7	33.5
Cash and cash equivalents from discontinued operations, beginning of the year		53.0
Cash and cash equivalents at the end of the period	$ 23.7	$ 231.1
Reconciliation of net income to net cash provided by operating activities:		
Net income	$ 67.5	$ 59.2
Adjustments to reconcile net income to net cash provided by operating activities -		
Income from discontinued operations, net of tax		(19.7)
(Gains) losses from the sales of properties		(0.3)

Depreciation, depletion and amortization		110.1		70.5
Dry hole and impairment		25.6		47.4
Interest capitalized		(16.2)		(2.2)
Price hedge contracts		0.3		1.2
Other		1.2		(1.9)
Deferred income taxes		1.0		(6.9)
Change in operating assets and liabilities		50.9		38.8
Net cash provided by continuing operating activities		240.4		186.1
Net cash provided by discontinued operating activities				73.2
Net cash provided by operating activities	$	240.4	$	259.3

See accompanying notes to consolidated financial statements.

POGO PRODUCING COMPANY AND SUBSIDIARIES

Consolidated Statements of Shareholders Equity (Unaudited)

	For the Three Months Ended March 31, 2006 Shareholders Equity		For the Three Months Ended March 31, 2005 Shareholders Equity	
	Shares	**Amount**	**Shares**	**Amount**
	(Expressed in millions, except share amounts)			
Common Stock:				
$ 1.00 par-200,000,000 shares authorized				
Balance at beginning of year	65,275,106	$ 65.3	64,580,639	$ 64.6
Stock option activity and other	53,200		96,801	0.1
Issued at end of period	65,328,306	65.3	64,677,440	64.7
Additional Capital:				
Balance at beginning of year		977.9		943.7
Stock options exercised-proceeds		1.6		2.7
Stock based compensation-federal tax benefit		0.7		0.7
Stock based compensation expense-stock options		0.3		0.3
Stock based compensation expense-restricted stock		2.5		0.1
Cumulative effect of change in accounting principle		(27.7)		
Balance at end of period		955.3		947.5
Retained Earnings:				
Balance at beginning of year		1,464.2		728.7
Net income		67.5		59.2
Dividends ($0.075 and $0.0625 per common share, respectively)		(4.4)		(4.0)
Balance at end of period		1,527.3		783.9
Accumulated Other Comprehensive Income (Loss):				
Balance at beginning of year		(30.0)		2.6
Cumulative foreign currency translation adjustment		(7.9)		
Change in fair value of price hedge contracts		21.9		(13.5)
Reclassification adjustment for losses included in net income		0.2		(1.2)
Balance at end of period		(15.8)		(12.1)
Deferred Compensation				
Balance at beginning of year		(17.5)		(9.9)
Activity during the period				0.7
Cumulative effect of change in accounting principle		17.5		
Balance at end of period				(9.2)
Treasury Stock:				
Balance at beginning of year	(7,365,359)	(361.3)	(55,239)	(1.7)
Activity during the period			(2,113,800)	(98.6)
Balance at end of period	(7,365,359)	(361.3)	(2,169,039)	(100.3)
Common Stock Outstanding, at the End of the Period	57,962,947		62,508,401	
Total Shareholders Equity		$ 2,170.8		$ 1,674.5

See accompanying notes to consolidated financial statements.

POGO PRODUCING COMPANY AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

(1) GENERAL INFORMATION -

The consolidated financial statements included herein have been prepared by Pogo Producing Company (the Company) without audit and include all adjustments (of a normal and recurring nature), which are, in the opinion of management, necessary for the fair presentation of interim results. The interim results are not necessarily indicative of results for the entire year. 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, 2005.

The Company s results for 2005 reflect its oil and gas exploration, development and production activities in the Kingdom of Thailand and in Hungary as discontinued operations. Except where noted and for pro forma earnings per share, the discussions in the following notes relate to the Company s continuing operations only.

(2) ACQUISITIONS

2006 - On February 21, 2006, the Company completed the corporate acquisition of a Canadian company for cash consideration totaling approximately $18.5 million. The Company recorded the estimated fair value of assets and liabilities that consisted primarily of $25.7 million of oil and gas properties and deferred tax liabilities of $7.8 million. No goodwill was recorded in connection with the transaction.

2005 - On September 27, 2005, the Company completed the acquisition of Northrock Resources Ltd. (Northrock) for approximately $1.7 billion in cash. As of September 27, 2005, Northrock owned approximately 292,000 net producing acres, plus approximately 950,000 net acres of undeveloped leasehold. Northrock s activities are concentrated in Saskatchewan and Alberta with key exploration plays in Canada s Northwest Territories, British Columbia and the Alberta Foothills. The Company acquired Northrock primarily to strengthen its position in North American exploration and development properties. The following is a calculation and final allocation of purchase price to the acquired assets and liabilities based on their relative fair values:

CALCULATION OF PURCHASE PRICE (IN MILLIONS)	
Cash paid, including transaction costs	1,737.5
Plus fair market value of liabilites assumed:	
Other liabilites	100.5

Asset retirement obligation	38.8
Deferred income taxes	757.3
Total purchase price for assets acquired	2,634.1
ALLOCATION OF PURCHASE PRICE (IN MILLIONS)	
Proved oil and gas properties	1,715.8
Unproved oil and gas properties	799.0
Other assets	119.3
Total	2,634.1

In addition to the Northrock acquisition, during 2005 the Company completed two corporate acquisitions in Canada for cash consideration totaling approximately $32.9 million and six other producing property acquisitions for cash consideration totaling approximately $51 million. The Company recorded the estimated fair value of assets and liabilities on the two corporate transactions that consisted primarily of $50 million of oil and gas properties and deferred tax liabilities of $15.8 million. No goodwill was recorded for these transactions.

Pro Forma Information

The following summary presents unaudited pro forma consolidated results of operations for the three months ended March 31, 2005 for the Company s continuing operations as if the acquisition of Northrock (which is the only acquisition occurring since January 1, 2005 considered material for pro forma purposes) had occurred as of January 1, 2005. The pro forma results are for illustrative purposes only and include adjustments in addition to the pre-acquisition historical results of Northrock, such as increased depreciation, depletion and amortization expense resulting from the allocation of fair value to oil and gas properties acquired, increased interest expense on acquisition debt and the related tax effects of these adjustments. The unaudited pro forma information (presented in millions of dollars, except per share amounts) is not necessarily indicative of the operating results that would have occurred had the acquisitions been consummated at that date, nor are they necessarily indicative of future operating results.

Pro Forma for the three months ended March 31, 2005:

Revenues	$	350.3
Income from continuing operations		48.2
Earnings per share:		
Basic -	$	0.76
Diluted -	$	0.75

(3) DISCONTINUED OPERATIONS

Under SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the Company classifies assets to be disposed of as held for sale or, if appropriate, discontinued operations when appropriate approvals by the Company s management or Board of Directors have occurred and other criteria are met. During 2005, the Company completed the sale of the assets discussed below.

Thaipo Ltd. and B8/32 Partners Ltd.

On August 17, 2005, the Company completed the sale of its wholly owned subsidiary Thaipo Ltd. and its 46.34% interest in B8/32 Partners Ltd. (collectively referred to as the Thailand Entities) for a purchase price of $820 million. The Company recognized an after tax gain of approximately $403 million on the sale of the Thailand Entities.

Pogo Hungary Ltd.

On June 7, 2005, the Company completed the sale of its wholly owned subsidiary Pogo Hungary, Ltd. (Pogo Hungary) for a purchase price of $9 million. The Company recognized an after tax gain of approximately $5 million on the sale of Pogo Hungary.

The Thailand Entities and Pogo Hungary are classified as discontinued operations in the Company s financial statements for all periods presented. The summarized results of the discontinued operations were as follows (amounts expressed in millions):

Operating Results Data

		Three months ended March 31, 2005
Revenues	$	101.6
Costs and expenses		(55.0)
Other income		0.6
Income before income taxes		47.2
Income taxes		(27.5)
Income from discontinued operations, net of tax	$	19.7

(4) EARNINGS PER SHARE -

Earnings per common share (basic earnings per share) are based on the weighted average number of shares of common stock outstanding during the periods. Earnings per share and potential common shares (diluted earnings per share) consider the effect of dilutive securities as set out below. This disclosure reflects net income from both continuing and discontinued operations. Amounts are expressed in millions, except per share amounts.

	Three Months Ended March 31,	
	2006	**2005**
Income (numerator):		
Income from continuing operations	$ 67.5	$ 39.5
Income from discontinued operations, net of tax		19.7
Net Income - basic and diluted	$ 67.5	$ 59.2
Weighted average shares (denominator):		
Weighted average shares - basic	57.3	63.5
Shares assumed issued from the exercise of options to purchase common shares and unvested restricted stock, net of treasury shares assumed purchased from the proceeds, at the average market price for the period	0.6	0.6
Weighted average shares - diluted	57.9	64.1
Earnings per share:		
Basic:		
Income from continuing operations	$ 1.18	$ 0.62
Income from discontinued operations		0.31
Basic earnings per share	$ 1.18	$ 0.93
Diluted:		
Income from continuing operations	$ 1.16	$ 0.62
Income from discontinued operations		0.31
Diluted earnings per share	$ 1.16	$ 0.93
Antidilutive securities;		
Shares assumed not issued from options to purchase common shares as the exercise prices are above the average market price for the period or the effect of the assumed exercise would be antidilutive		0.03
Average price	$	$ 49.02

(5) LONG-TERM DEBT

Long-term debt at March 31, 2006 and December 31, 2005, consists of the following (dollars expressed in millions):

	March 31, 2006	December 31, 2005
Senior debt -		
Bank revolving credit agreement:		
LIBOR based loans, borrowings at March 31, 2006 and December 31, 2005 at interest rates of 5.824% and 5.837%, respectively	$ 540.0	$ 606.0
LIBOR Rate Advances, borrowings at March 31, 2006 and December 31, 2005 at interest rates of 6.003% and 5.618%, respectively	40.0	40.0
Total senior debt	580.0	646.0
Subordinated debt -		
8.25% Senior subordinated notes, due 2011	200.0	200.0
6.625% Senior subordinated notes, due 2015	300.0	300.0
6.875% Senior subordinated notes, due 2017	500.0	500.0
Total subordinated debt	1,000.0	1,000.0
Unamortized discount on 2015 Notes	(2.5)	(2.5)
Total debt	1,577.5	1,643.5
Amount due within one year		
Long-term debt	$ 1,577.5	$ 1,643.5

(6) INCOME TAXES

As of March 31, 2006 no deferred U.S. income tax liability has been recognized on the $50.7 million of undistributed earnings of certain foreign subsidiaries as they have been deemed permanently invested outside the U.S., and it is not practicable to estimate the deferred tax liability related to such undistributed earnings.

(7) ASSET RETIREMENT OBLIGATION

The Company s liability for expected future costs associated with site reclamation, facilities dismantlement, and plugging and abandonment of wells for the three-month period ended March 31, 2006 is as follows (in millions):

	2006
ARO as of January 1,	$ 156.3
Liabilities incurred during the three months ended March 31,	0.6
Liabilities settled during the three months ended March 31,	(1.7)
Accretion expense	2.6
Balance of ARO as of March 31,	157.8
Less: current portion of ARO	(7.5)

Long-term ARO as of March 31,	$	150.3

For the three months ended March 31, 2006 and 2005 the Company recognized depreciation expense related to its asset retirement cost of $2.2 million and $0.9 million, respectively.

(8) GEOGRAPHIC INFORMATION

The Company s reportable geographic information is identified below. The Company evaluates performance based on operating income (loss). Financial information by geographic region is presented below:

	2006	2005
	(Expressed in millions)	
Long-Lived Assets:		
As of March 31,		
United States	$ 2,634.6	$ 2,545.0
Canada	2,714.5	
Total	$ 5,349.1	$ 2,545.0
Capital Expenditures:		
(including interest capitalized)		
For the three months ended March 31,		
United States	$ 96.9	$ 124.7
Canada	116.9	
Total	$ 213.8	$ 124.7
Revenues:		
For the three months ended March 31,		
United States	$ 243.7	$ 255.8
Canada	129.8	
Total	$ 373.5	$ 255.8
Depreciation, depletion, and amortization expense:		
For the three months ended March 31,		
United States	$ 63.3	$ 70.5
Canada	46.8	
Total	$ 110.1	$ 70.5
Operating income (loss):		
For the three months ended March 31,		
United States	$ 82.1	$ 81.6
Canada	29.2	
Other	(1.0)	(7.9)
Total	$ 110.3	$ 73.7

(9) COMMODITY DERIVATIVES AND HEDGING ACTIVITIES -

As of March 31, 2006, the Company held various derivative instruments. During 2005, the Company entered into natural gas and crude oil option agreements referred to as collars . Collars are designed to establish floor and ceiling prices on anticipated future natural gas and crude oil production. The Company has designated these contracts as cash flow hedges designed to achieve a more predictable cash flow, as well as to reduce its exposure to price volatility. While the use of these derivative instruments limits the downside risk of adverse price movements, they may also limit future revenues from favorable price movements. The use of derivatives also involves the risk that the counterparties to such instruments will be unable to meet the financial terms of such contracts. Currently, the Company does not expect losses due to creditworthiness of its counterparties.

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During the three-month period ended March 31, 2006 the Company recognized $4.4 million of pre-tax losses related to settled contracts in its oil and gas revenues from its price hedge contracts. Price hedging activity had no effect on the Company s oil and gas revenues during the first quarter of 2005. The Company recognized pre-tax losses of $0.3 million and $1.3 million due to ineffectiveness on hedge contracts during the first quarter of 2006 and 2005, respectively. Unrealized losses on derivative instruments of $30.9 million, net of deferred taxes of $17.7 million, have been reflected as a component of other comprehensive income at March 31, 2006. Based on the fair market value of the hedge contracts as of March 31, 2006, the Company would reclassify additional pre-tax losses of approximately $24.8 million (approximately $15.7 million after taxes) from accumulated other comprehensive income (shareholders equity) to net income during the next twelve months.

The gas derivative contracts are generally settled based upon the average of the reported settlement prices on the NYMEX for the last three trading days of a particular contract month. The oil derivative transactions are generally settled based on the average of the reporting settlement prices for West Texas Intermediate on the NYMEX for each trading day of a particular calendar month. For any particular collar transaction, the counterparty is required to make a payment to the Company if the settlement price for any settlement period is below the floor price for such transaction, and the Company is required to make a payment to the counterparty if the settlement price for any settlement period is above the ceiling price of such transaction.

The estimated fair value of these transactions is based upon various factors that include closing exchange prices on the NYMEX, volatility and the time value of options. Further details related to the Company s hedging activities as of March 31, 2006 are as follows: