

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 September 30, 2004

Commission File Number 001-14039

CALLON PETROLEUM COMPANY

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of  
incorporation or organization)

64-0844345

(I.R.S. Employer  
Identification No.)

200 North Canal Street  
Natchez, Mississippi 39120

(Address of principal executive offices)(Zip code)

(601) 442-1601

(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 required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

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

As of November 3, 2004, there were 17,595,784 shares of the Registrant's Common Stock, par value \$0.01 per share, outstanding.

CALLON PETROLEUM COMPANY

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**Callon Petroleum Company**  
**Consolidated Balance Sheets**  
(In thousands, except share data)

|  | September 30,<br>2004 | December 31,<br>2003 |
|--|-----------------------|----------------------|
|  | (Unaudited)           | (Note 1)             |
| <b>ASSETS</b>  |                       |                      |
| Current assets:  |                       |                      |
| Cash and cash equivalents  | \$ 6,821              | \$ 8,700             |
| Restricted cash  | —                     | 63,345               |
| Accounts receivable  | 7,842                 | 10,117               |
| Other current assets   | 3,686                 | 3,606                |
| Total current assets   | <u>18,349</u>         | <u>85,768</u>        |
| Oil and gas properties, full cost accounting method:   |                       |                      |
| Evaluated properties   | 832,428               | 802,912              |
| Less accumulated depreciation, depletion and amortization  | (483,458)             | (447,000)            |
|  | 348,970               | 355,912              |
| Unevaluated properties excluded from amortization  | 48,101                | 34,251               |
| Total oil and gas properties   | <u>397,071</u>        | <u>390,163</u>       |
| Other property and equipment, net  | 1,527                 | 1,547                |
| Deferred tax asset   | 4,018                 | —                    |
| Long-term gas balancing receivable   | 631                   | 1,101                |
| Restricted investments   | 7,715                 | 7,420                |
| Investment in Medusa Spar LLC  | 9,419                 | 8,471                |
| Other assets, net  | 2,275                 | 1,562                |
| Total assets   | <u>\$ 441,005</u>     | <u>\$ 496,032</u>    |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                       |                      |
| Current liabilities:   |                       |                      |
| Accounts payable and accrued liabilities   | \$ 12,080             | \$ 16,020            |
| Fair market value of derivatives   | 11,528                | —                    |
| Undistributed oil and gas revenues   | 993                   | 897                  |
| Accrued net profits interest payable   | 1,881                 | 1,886                |
| Suspended Medusa oil royalties (See Note 9)  | 3,856                 | —                    |
| Asset retirement obligations-current   | 8,945                 | 8,571                |
| Current maturities of long-term debt   | 833                   | 93,223               |
| Total current liabilities  | <u>40,116</u>         | <u>120,597</u>       |
| Long-term debt-excluding current maturities  | 187,080               | 214,885              |
| Accounts payable and accrued liabilities to be refinanced  | 2,800                 | —                    |
| Asset retirement obligations-long-term   | 28,177                | 25,120               |
| Other long-term liabilities  | 1,284                 | 2,169                |
| Total liabilities  | <u>259,457</u>        | <u>362,771</u>       |
| Stockholders' equity:  |                       |                      |
| Preferred Stock, \$.01 par value, 2,500,000 shares authorized; 596,671 and 600,861 shares of Convertible Exchangeable Preferred Stock, Series A, issued and outstanding with a liquidation preference of \$14,916,775 and \$15,021,525 at September 30, 2004 and December 31, 2003, respectively | 6                     | 6                    |
| Common Stock, \$.01 par value, 30,000,000 shares authorized; 17,587,844 and 13,935,311 shares outstanding at September 30, 2004 and at December 31, 2003, respectively   | 176                   | 139                  |
| Capital in excess of par value   | 219,409               | 169,036              |
| Unearned compensation restricted stock   | (5,688)               | (372)                |
| Accumulated other comprehensive loss   | (8,250)               | (20)                 |
| Retained earnings (deficit)  | (24,105)              | (35,528)             |
| Total stockholders' equity   | <u>181,548</u>        | <u>133,261</u>       |
| Total liabilities and stockholders' equity   | <u>\$ 441,005</u>     | <u>\$ 496,032</u>    |

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

**Callon Petroleum Company**  
**Consolidated Statements of Operations**  
**(Unaudited)**  
**(In thousands, except per share amounts)**

|  | Three Months Ended<br>September 30, |                   | Nine Months Ended<br>September 30, |                   |
|--|-------------------------------------|-------------------|------------------------------------|-------------------|
|  | 2004                                | 2003              | 2004                               | 2003              |
| Operating revenues:  |                                     |                   |                                    |                   |
| Oil and gas sales  | \$ 25,138                           | \$ 15,082         | \$ 94,663                          | \$ 54,759         |
| Total operating revenues   | <u>25,138</u>                       | <u>15,082</u>     | <u>94,663</u>                      | <u>54,759</u>     |
| Operating expenses:  |                                     |                   |                                    |                   |
| Lease operating expenses   | 5,771                               | 2,659             | 17,062                             | 8,003             |
| Depreciation, depletion and amortization   | 10,147                              | 6,416             | 36,458                             | 20,769            |
| General and administrative   | 1,509                               | 1,068             | 6,839                              | 3,704             |
| Accretion expense  | 825                                 | 772               | 2,555                              | 2,214             |
| Derivative expense (income)  | 1,519                               | (199)             | 1,608                              | 335               |
| Total operating expenses   | <u>19,771</u>                       | <u>10,716</u>     | <u>64,522</u>                      | <u>35,025</u>     |
| Income from operations   | <u>5,367</u>                        | <u>4,366</u>      | <u>30,141</u>                      | <u>19,734</u>     |
| Other (income) expenses:   |                                     |                   |                                    |                   |
| Interest expense   | 4,511                               | 7,554             | 15,838                             | 22,225            |
| Other (income) expense   | 65                                  | (70)              | (311)                              | (226)             |
| Loss on early extinguishment of debt   | 532                                 | —                 | 3,004                              | —                 |
| Total other (income) expenses  | <u>5,108</u>                        | <u>7,484</u>      | <u>18,531</u>                      | <u>21,999</u>     |
| Income (loss) before income taxes  | 259                                 | (3,118)           | 11,610                             | (2,265)           |
| Income tax expense (benefit)   | —                                   | (1,092)           | —                                  | (793)             |
| Income (loss) before Medusa Spar LLC and cumulative effect of change in accounting principle     | 259                                 | (2,026)           | 11,610                             | (1,472)           |
| Income from Medusa Spar LLC, net of tax  | 287                                 | —                 | 768                                | —                 |
| Income (loss) before cumulative effect of change in accounting principle                         | 546                                 | (2,026)           | 12,378                             | (1,472)           |
| Cumulative effect of change in accounting principle, net of tax                                  | —                                   | —                 | —                                  | 181               |
| Net income (loss)  | 546                                 | (2,026)           | 12,378                             | (1,291)           |
| Preferred stock dividends  | 317                                 | 320               | 955                                | 958               |
| Net income (loss) available to common shares   | <u>\$ 229</u>                       | <u>\$ (2,346)</u> | <u>\$ 11,423</u>                   | <u>\$ (2,249)</u> |
| Net income (loss) per common share:  |                                     |                   |                                    |                   |
| Basic  |                                     |                   |                                    |                   |
| Net income (loss) available to common before cumulative effect of change in accounting principle | \$ 0.01                             | \$ (0.17)         | \$ 0.75                            | \$ (0.18)         |
| Cumulative effect of change in accounting principle, net of tax                                  | —                                   | —                 | —                                  | 0.01              |
| Net income (loss) available to common  | <u>\$ 0.01</u>                      | <u>\$ (0.17)</u>  | <u>\$ 0.75</u>                     | <u>\$ (0.17)</u>  |
| Diluted  |                                     |                   |                                    |                   |
| Net income (loss) available to common before cumulative effect of change in accounting principle | \$ 0.01                             | \$ (0.17)         | \$ 0.74                            | \$ (0.18)         |
| Cumulative effect of change in accounting principle, net of tax                                  | —                                   | —                 | —                                  | 0.01              |
| Net income (loss) available to common  | <u>\$ 0.01</u>                      | <u>\$ (0.17)</u>  | <u>\$ 0.74</u>                     | <u>\$ (0.17)</u>  |
| Shares used in computing net income:   |                                     |                   |                                    |                   |
| Basic  | <u>17,552</u>                       | <u>13,679</u>     | <u>15,192</u>                      | <u>13,640</u>     |
| Diluted  | <u>18,815</u>                       | <u>13,679</u>     | <u>16,762</u>                      | <u>13,640</u>     |

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

**Callon Petroleum Company**  
**Consolidated Statements of Cash Flows**  
**(Unaudited)**  
**(In thousands)**

|   | Nine Months Ended     |                       |
|---|-----------------------|-----------------------|
|   | September 30,<br>2004 | September 30,<br>2003 |
| Cash flows from operating activities:   |                       |                       |
| Net income  | \$ 12,378             | \$ (1,291)            |
| Adjustments to reconcile net income to cash provided by operating activities: |                       |                       |
| Depreciation, depletion and amortization                                      | 36,993                | 21,560                |
| Accretion expense   | 2,555                 | 2,214                 |
| Amortization of deferred financing costs                                      | 1,451                 | 4,783                 |
| Non-cash loss on extinguishment of debt                                       | 2,910                 | —                     |
| Non-cash derivative expense   | 597                   | 374                   |
| Income from investment in Medusa Spar, LLC                                    | (768)                 | —                     |
| Deferred income tax expense (benefit)   | —                     | (793)                 |
| Cumulative effect of change in accounting principle                           | —                     | (181)                 |
| Non-cash charge related to compensation plans                                 | 815                   | 612                   |
| Changes in current assets and liabilities:                                    |                       |                       |
| Accounts receivable   | 1,911                 | 2,511                 |
| Other current assets  | (19)                  | (2,852)               |
| Current liabilities   | (2,297)               | 5,223                 |
| Change in gas balancing receivable  | 470                   | (259)                 |
| Change in gas balancing payable   | 197                   | (347)                 |
| Change in other long-term liabilities   | (16)                  | (11)                  |
| Change in other assets, net   | (2,508)               | (346)                 |
| Cash provided (used) by operating activities                                  | <u>54,669</u>         | <u>31,197</u>         |
| Cash flows from investing activities:   |                       |                       |
| Capital expenditures  | (43,284)              | (39,326)              |
| Distribution from Medusa Spar, LLC  | 233                   | —                     |
| Proceeds from sale of pipeline and other facilities                           | —                     | 1,500                 |
| Proceeds from sale of mineral interests                                       | —                     | 781                   |
| Cash provided (used) by investing activities                                  | <u>(43,051)</u>       | <u>(37,045)</u>       |
| Cash flows from financing activities:   |                       |                       |
| Change in accounts payable and accrued liabilities to be refinanced           | 2,800                 | (3,861)               |
| Increase in debt  | 82,000                | 11,000                |
| Payments on debt  | (202,915)             | (4,000)               |
| Restricted cash   | 63,345                | —                     |
| Debt issuance cost  | (984)                 | —                     |
| Issuance of common stock  | 44,050                | —                     |
| Equity issued related to employee stock plans                                 | 229                   | 128                   |
| Capital leases  | (1,067)               | (973)                 |
| Cash dividends on preferred stock   | (955)                 | (958)                 |
| Cash provided (used) by financing activities                                  | <u>(13,497)</u>       | <u>1,336</u>          |
| Net increase (decrease) in cash and cash equivalents                          | (1,879)               | (4,512)               |
| Cash and cash equivalents:  |                       |                       |
| Balance, beginning of period  | 8,700                 | 5,807                 |
| Balance, end of period  | <u>\$ 6,821</u>       | <u>\$ 1,295</u>       |

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

**CALLON PETROLEUM COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**September 30, 2004**

**1. General**

The financial information presented as of any date other than December 31, has been prepared from the books and records of Callon Petroleum Company (the "Company" or "Callon") without audit. Financial information as of December 31, 2003 has been derived from the audited financial statements of the Company, but does not include all disclosures required by US generally accepted accounting principles. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary for the fair presentation of the financial information for the periods indicated, have been included. For further information regarding the Company's accounting policies, refer to the Consolidated Financial Statements and related notes for the year ended December 31, 2003 included in the Company's Annual Report on Form 10-K filed March 15, 2004. The results of operations for the three-month and nine-month periods ended September 30, 2004 are not necessarily indicative of future financial results.

**Accounting Pronouncements**

In January 2003, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin (ARB) 51" ("FIN 46"). FIN 46 addresses consolidation by business enterprises of variable interest entities ("VIEs"). The primary objective of FIN 46 is to provide guidance on the identification of, and financial reporting for, entities over which control is achieved through means other than voting rights; such entities are known as VIEs. The Company adopted FIN 46, as revised, as of December 31, 2003, which had no impact on the financial statements.

In September 2004, the Securities and Exchange Commission issued Staff Accounting Bulletin ("SAB") No. 106 which expressed the Staff's views regarding the application of Statement of Financial Accounting Standards ("SFAS") No. 143 "Accounting for Asset Retirement Obligations" by oil and gas producing companies following full cost accounting method. SAB No. 106 specifies that subsequent to the adoption of SFAS No. 143 an oil and gas company following the full cost method of accounting should include assets recorded in connection with the recognition of an asset retirement obligation pursuant to SFAS No. 143 as part of the costs subject to the full cost ceiling limitation. The future cash outflows associated with settling the recorded asset retirement obligations should be excluded from the computation of the present value of estimated future net revenues used in applying the ceiling test. The Company will be required to adopt the provisions of SAB No. 106 in the first quarter of 2005.

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### Stock-Based Compensation

The Company has various stock plans (“the Plans”) under which employees of the Company and its subsidiaries and non-employee members of the Board of Directors of the Company have been or may be granted certain equity compensation. The Company has compensatory stock option plans in place whereby participants have been or may be granted rights to purchase shares of common stock of Callon. The Company accounts for stock-based compensation in accordance with APB Opinion No. 25.

The Company’s pro forma net income and net income per share of common stock for the three-month and nine-month periods ended September 30, 2004 and 2003, had compensation costs been recorded using the fair value method in accordance with SFAS No. 123 – “Accounting for Stock-Based Compensation,” as amended by SFAS No. 148 – “Accounting for Stock-Based Compensation-Transition and Disclosure – an amendment of SFAS No. 123,” are presented below pursuant to the disclosure requirement of SFAS No. 148 (in thousands except per share data):

|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |           |
|--|-------------------------------------|------------|------------------------------------|-----------|
|  | 2004                                | 2003       | 2004                               | 2003      |
| Net income (loss) available to common- as reported                                       | \$ 229                              | \$ (2,346) | \$11,423                           | \$(2,249) |
| Add: Stock-based compensation expense included in net income as reported, net of tax     | 156                                 | —          | 156                                | 17        |
| Deduct: Total stock-based compensation expense under fair value based method, net of tax | (226)                               | (60)       | (319)                              | (206)     |
| Net income (loss) available to common- pro forma   | \$ 159                              | \$ (2,406) | \$11,260                           | \$(2,438) |
| Net income (loss) per share available to common:   |                                     |            |                                    |           |
| Basic-as reported  | \$ 0.01                             | \$ (0.17)  | \$ 0.75                            | \$ (0.17) |
| Basic-pro forma  | \$ 0.01                             | \$ (0.18)  | \$ 0.74                            | \$ (0.18) |
| Diluted-as reported  | \$ 0.01                             | \$ (0.17)  | \$ 0.74                            | \$ (0.17) |
| Diluted-pro forma  | \$ 0.01                             | \$ (0.18)  | \$ 0.73                            | \$ (0.18) |

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### 2. Per Share Amounts

Basic net income or loss per common share was computed by dividing net income or loss by the weighted average number of shares of common stock outstanding during the period. Diluted net income or loss per common share was determined on a weighted average basis using common shares issued and outstanding adjusted for the effect of common stock equivalents computed using the treasury stock method and the effect of the convertible preferred stock (if dilutive). The conversion of the preferred stock was not included in the calculation for the three-month periods ended September 30, 2004 and 2003, respectively and the nine-month period ended September 30, 2003 due to the antidilutive effect on net income or loss per share.

A reconciliation of the basic and diluted earnings per share computation is as follows (in thousands, except per share amounts):

|   | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|------------|------------------------------------|------------|
|   | 2004                                | 2003       | 2004                               | 2003       |
| (a) Net income (loss) available to common shares  | \$ 229                              | \$ (2,346) | \$11,423                           | \$ (2,249) |
| Preferred dividends assuming conversion of preferred stock (if dilutive)  | —                                   | —          | 955                                | —          |
| (b) Income (loss) available to common shares assuming conversion of preferred stock (if dilutive)               | \$ 229                              | \$ (2,346) | \$12,378                           | \$ (2,249) |
| (c) Weighted average shares outstanding   | 17,552                              | 13,679     | 15,192                             | 13,640     |
| Dilutive impact of stock options  | 234                                 | —          | 220                                | —          |
| Dilutive impact of warrants   | 1,028                               | —          | 805                                | —          |
| Dilutive impact of restricted stock   | 1                                   | —          | 91                                 | —          |
| Convertible preferred stock (if dilutive)   | —                                   | —          | 454                                | —          |
| (d) Total diluted shares  | 18,815                              | 13,679     | 16,762                             | 13,640     |
| Basic income (loss) per share (a÷c)   | \$ 0.01                             | \$ (0.17)  | \$ 0.75                            | \$ (0.17)  |
| Diluted income (loss) per share (b÷d)   | \$ 0.01                             | \$ (0.17)  | \$ 0.74                            | \$ (0.17)  |
| Stock options and warrants excluded due to the exercise price being greater than the stock price (in thousands) | 65                                  | 499        | 536                                | 469        |

### 3. Derivatives

The Company periodically uses derivative financial instruments to manage oil and gas price risk. Settlements of gains and losses on commodity price contracts are generally based upon the difference between the contract price or prices specified in the derivative instrument and a NYMEX price or other cash or futures index price.

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In 2003 and 2004, the Company purchased and sold various derivatives including put options and call options and elected not to designate these derivative financial instruments as accounting hedges and accordingly, the changes in fair value of these contracts were recorded through earnings. The Company recognized a loss of approximately \$72,000 and a gain of \$13,000 for the three-month periods ended September 30, 2004 and 2003, respectively. Losses of approximately \$160,000 and \$467,000 were recognized for the nine months ended September 30, 2004 and 2003, respectively. The fair value of these derivatives at September 30, 2004 is recorded as a current asset of \$1,050.

During 2002, the Company entered into costless natural gas collar contracts in effect for February 2003 through October 2003. These contracts were accounted for as cash flow hedges under SFAS No. 133. The Company recognized a loss of \$319,000 and \$2,932,000 in oil and gas sales related to the settlements of such collars in the three-month and nine-month periods ended September 30, 2003, respectively.

During 2003, the Company entered into additional costless natural gas collar contracts in effect for May 2003 through October 2003. The company elected not to designate these derivative financial instruments as hedges and accordingly, the changes in fair value of these contracts were recorded through earnings. For the three-month and nine-month periods ended September 30, 2003, the Company recognized gains of approximately \$205,200 and \$131,600, respectively.

In the fourth quarter of 2003 and the first half of 2004, Callon entered into various derivative contracts, which are designated as effective cash flow hedges under SFAS No. 133. Accordingly, the changes in fair value of these contracts are recorded net of tax through other comprehensive income. The Company recognized losses of \$4.0 million and \$7.2 million in oil and gas sales related to the settlements of such derivative contracts for the three-month and nine-month periods ended September 30, 2004, respectively. In addition, a derivative expense of \$716,000 related to an ineffective portion of the September 2004 contract settlements was recorded for the third quarter of 2004. The fair value of the remaining contracts at September 30, 2004 is recorded in the balance sheet as a current liability of \$9.7 million.

As a result of a production shortfall due to downtime for Hurricane Ivan and damage repairs, it became probable that our actual 2004 production would be less than the projected amounts contemplated in our hedge effectiveness assessment. Therefore, a portion of our hedged volumes for the month of October became ineffective and the related unrealized loss of \$731,000 previously recorded in other comprehensive income was recognized in the third quarter.

During June and the third quarter of 2004, Callon entered into various derivative contracts for 2005 production, which are designated as effective cash flow hedges under SFAS No. 133. Accordingly the changes in fair value of these contracts are recorded net of tax through comprehensive income. The fair value of the gas contracts at September 30, 2004 is an asset of \$123,500. The fair value of the oil contracts at September 30, 2004 was a liability of \$2.5 million.

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Listed in the table below are the outstanding derivative contracts as of September 30, 2004:

### Swaps

| Product | Volumes per Month | Quantity Type | Average Price | Period      |
|---------|-------------------|---------------|---------------|-------------|
| Oil     | 30,000            | Bbls          | \$31.29       | 10/04-01/05 |
| Oil     | 15,000            | Bbls          | \$30.00       | 10/04-03/05 |
| Oil     | 15,000            | Bbls          | \$30.00       | 10/04-12/04 |

### Puts

| Product     | Volumes per Month | Quantity Type | Average Price | Period      |
|-------------|-------------------|---------------|---------------|-------------|
| Oil         | 50,000            | Bbls          | \$35.00       | 02/05-06/05 |
| Oil         | 7,000             | Bbls          | \$35.00       | 01/05-12/05 |
| Natural Gas | 270,000           | MMBtu         | \$ 5.00       | 04/05-10/05 |
| Natural Gas | 120,000           | MMBtu         | \$ 5.00       | 01/05-10/05 |
| Natural Gas | 100,000           | MMBtu         | \$ 5.00       | 04/05-12/05 |

### Collars

| Product     | Volumes per Month | Quantity Type | Average Floor Price | Average Ceiling Price | Period      |
|-------------|-------------------|---------------|---------------------|-----------------------|-------------|
| Oil         | 45,000            | Bbls          | \$29.33             | \$32.17               | 10/04-01/05 |
| Oil         | 15,000            | Bbls          | \$30.00             | \$32.50               | 10/04-10/04 |
| Oil         | 15,000            | Bbls          | \$32.50             | \$40.00               | 01/05-12/05 |
| Oil         | 15,208            | Bbls          | \$40.00             | \$50.00               | 01/05-12/05 |
| Oil         | 15,000            | Bbls          | \$32.50             | \$40.00               | 02/05-12/05 |
| Oil         | 15,000            | Bbls          | \$35.00             | \$43.50               | 03/05-12/05 |
| Natural Gas | 500,000           | MMBtu         | \$ 5.00             | \$ 6.08               | 10/04-11/04 |
| Natural Gas | 100,000           | MMBtu         | \$ 5.00             | \$ 5.60               | 10/04-11/04 |
| Natural Gas | 300,000           | MMBtu         | \$ 5.00             | \$ 6.91               | 12/04-03/05 |
| Natural Gas | 190,000           | MMBtu         | \$ 5.00             | \$12.80               | 01/05-03/05 |
| Natural Gas | 100,000           | MMBtu         | \$ 5.00             | \$ 7.75               | 04/05-10/05 |

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### 4. Long-Term Debt

Long-term debt consisted of the following at:

|  | September 30,<br>2004 | December 31,<br>2003 |
|--|-----------------------|----------------------|
|  | (In thousands)        |                      |
| Senior Secured Credit Facility (matures July 31, 2007) | \$ —                  | \$ —                 |
| Senior Secured Credit Facility (expired June 2004)     | —                     | 30,000               |
| Senior Subordinated Notes (due 2004):                  |                       |                      |
| 10.125% notes, net of discount                         | —                     | 21,772               |
| 10.25% notes   | —                     | 40,000               |
| 12% Senior Loans (due 2005) net of discount            | —                     | 9,490                |
| 11% Senior Subordinated Notes (due 2005)               | —                     | 33,000               |
| 9.75% Senior Notes (due 2010) net of discount          | 185,817               | 170,684              |
| Capital lease  | 2,096                 | 3,162                |
| Total debt   | 187,913               | 308,108              |
| Less current portion:                                  |                       |                      |
| Senior Secured Credit Facility                         | —                     | 30,000               |
| 10.125% Senior Subordinated Notes                      | —                     | 21,772               |
| 10.25% Senior Subordinated Notes                       | —                     | 40,000               |
| Capital lease  | 833                   | 1,451                |
| Total current portion                                  | 833                   | 93,223               |
| Long-term debt   | \$ 187,080            | \$ 214,885           |

In June 2004, Callon closed on a three-year \$175 million senior secured credit facility underwritten by Union Bank of California, N.A. The credit facility includes an initial borrowing base of \$60 million, which may be adjusted on a quarterly basis throughout 2004 and semi-annually thereafter. At closing, \$21 million was advanced under the new facility for repayment of the existing debt under the expiring credit facility with Wachovia Bank, National Association. As of September 30, 2004, there were no borrowings outstanding under the facility; however, as of September 30, 2004, the Company had an aggregate of \$2.8 million in outstanding letters of credit issued under the credit facility. These letters of credit secure obligations under the outstanding hedging contracts described in Note 3. The outstanding letters of credit reduce the amount available for borrowings under the credit facility. As a result, \$57.2 million was available for future borrowings under the Company's credit facility as of September 30, 2004.

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On January 8, 2004 the Company retired the 10.125% and 10.25% Senior Subordinated Notes with restricted cash that was placed in trust on December 8, 2003. In March 2004, the Company borrowed an additional \$15 million pursuant to the 9.75% senior unsecured credit facility negotiated in December 2003. The net proceeds of approximately \$14 million were used to redeem the remaining 12% senior loans due March 31, 2005, plus a 1% call premium of \$100,000. As a result of these transactions, the Company recognized a loss on early extinguishment of debt of \$2,472,000 in the first quarter of 2004.

In March 2004, the \$200 million in aggregate principal amount of loans outstanding under the 9.75% senior unsecured credit facility were exchanged for 9.75% Senior Notes due 2010, Series A, "Series A notes", issued pursuant to a senior indenture between the Company and American Stock Transfer & Trust Company dated March 15, 2004. On August 12, 2004, the Company completed its offer to exchange its 9.75% Senior Notes due 2010, Series B, that have been registered under the Securities Act of 1933, for all outstanding Series A notes. See Note 5 of Callon's Consolidated Financial Statements for the year ended December 31, 2003 included in the Company's Annual Report on Form 10-K filed March 15, 2004 for a more detailed description of the Company's long-term debt securities.

On June 23, 2004, the Company sent a required 30-day notice of redemption to holders of the Company's 11% Senior Subordinated Notes due December 15, 2005. The redemption was funded by a portion of the proceeds from the Company's recent secondary common stock offering, which closed June 22, 2004. See Note 5. The funds were sent to the trustee, American Stock Transfer & Trust, and the trustee paid the holders of the notes on July 23, 2004. As a result of this transaction, the Company recognized a loss on early extinguishment of debt of \$532,000 in the third quarter of 2004.

### **5. Equity Securities**

On June 22, 2004, Callon closed the public offering of three million shares of common stock priced at \$13.25 per share, raising net proceeds of approximately \$38.2 million, after expenses. In addition, the Company granted the underwriter, Johnson Rice & Company L.L.C., an over-allotment option to purchase an additional 450,000 shares. On June 30, 2004, the underwriter exercised the over-allotment option for an additional 450,000 shares priced at \$13.25 per share, raising the net proceeds of the offering by approximately \$5.7 million, after expenses. The proceeds from the transactions were used to redeem the \$33 million of the 11% Senior Subordinated Notes due December 15, 2005 and general corporate purposes.

## 6. Income Taxes

The Company follows the asset and liability method of accounting for deferred income taxes prescribed by SFAS No. 109 "Accounting for Income Taxes". The statement provides for the recognition of a deferred tax asset for deductible temporary timing differences, capital and operating loss carryforwards, statutory depletion carryforward and tax credit carryforwards, net of a "valuation allowance". The valuation allowance is provided for that portion of the asset for which it is deemed more likely than not that it will not be realized.

SFAS No. 109 provides for the weighing of positive and negative evidence in determining whether it is more likely than not that a deferred tax asset is recoverable. The Company had incurred losses in 2002 and 2003 and had losses on an aggregate basis for the three-year period ended December 31, 2003. However, in December 2003, the Company refinanced nearly all its highest cost debt, incurring an early extinguishment loss of \$5.6 million, but achieving significant interest savings in the future. In addition, the first two of the Company's deepwater projects began production in November 2003, resulting in a significant increase in 2004 production as compared to 2003. Nevertheless, relevant accounting guidance suggests that a recent history of cumulative losses constitutes significant negative evidence, and that future expectations about income are overshadowed by such recent losses. As a result, the Company established a valuation allowance of \$11.5 million as of December 31, 2003. The Company revised the valuation allowance in the nine-month period ended September 30, 2004 as a result of current year ordinary income, the impact of which is included in the Company's effective tax rate and resulted in no net income tax expense (benefit) for the period.

## 7. Comprehensive Income

A summary of the Company's comprehensive income (loss) is detailed below (in thousands):

|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2004                                | 2003       | 2004                               | 2003       |
| Net income (loss)                            | \$ 546                              | \$ (2,026) | \$12,378                           | \$ (1,291) |
| Other comprehensive income (loss):           |                                     |            |                                    |            |
| Change in unrealized derivatives' fair value | (4,291)                             | 554        | (8,230)                            | 469        |
| Total comprehensive income (loss)            | \$ (3,745)                          | \$ (1,472) | \$ 4,148                           | \$ (822)   |

## 8. Asset Retirement Obligations

In June 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations, effective for fiscal years beginning after June 15, 2002. As more fully discussed in Note 2 to the Consolidated Financial Statements for the year ended December 31, 2003, included in Callon's Annual Report on Form 10-K filed March 15, 2004, SFAS No. 143 essentially requires entities to record the fair value of a liability for legal obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. Callon adopted the statement on January 1, 2003 resulting in a gain of \$181,000, net of tax, which was recorded as a cumulative effect of change in accounting principle.

Approximately \$30.3 million was recorded as the present value of asset retirement obligations on January 1, 2003 with the adoption of SFAS No. 143 related to the Company's oil and gas properties. Changes to the present value of the asset retirement obligations due to the passage of time are recorded as accretion expense in the Consolidated Statements of Operations.

Assets, primarily U.S. Government securities, of approximately \$7.7 million at September 30, 2004, are recorded as restricted investments. These assets are held in abandonment trusts dedicated to pay future abandonment costs of oil and gas properties in which the Company has sold a net profits interest. If there is any excess of trust assets over abandonment costs, the excess will be distributed to the net profits interest owners.

The following table summarizes the activity for the Company's asset retirement obligation for the nine-month period ended September 30, 2004:

|  | <b>Nine Months Ended<br/>September 30, 2004</b> |
|--|---|
| Asset retirement obligation at beginning of period | \$ 33,691                                       |
| Accretion expense                                  | 2,555   |
| Net profits interest accretion                     | 328   |
| Liabilities incurred                               | 2,565   |
| Liabilities settled                                | (1,913)   |
| Revisions to estimate                              | (104)   |
| Asset retirement obligation at end of period       | 37,122  |
| Less: current asset retirement obligation          | (8,945)   |
| Long-term asset retirement obligation              | \$ 28,177                                       |

## **9. Suspended Medusa Oil Royalties**

The Company may be required to retroactively pay royalties to the Minerals Management Service (“MMS”) on the Medusa deepwater property, which is eligible for royalty suspensions pursuant to the Deep Water Royalty Relief Act. However, the federal offshore leases covering this property contain “price threshold” provisions for oil and gas prices. Under these “price threshold” provisions, if the average monthly New York Mercantile Exchange (NYMEX) sales price for oil or gas during a fiscal year exceeds the price threshold for oil or gas, respectively, then royalties on the associated production must be paid to the MMS at the rate stipulated in the lease. The price thresholds are adjusted annually by the implicit price deflator for the GDP. The determination of whether or not royalties are due as a result of the average NYMEX price exceeding the price threshold is made during the first quarter of the succeeding year. Any royalty payments due must be made shortly after this determination is made. If a royalty payment is due for all production during a year as a result of exceeding the price threshold, the lessee is required to make monthly royalty payments during the succeeding fiscal year for the succeeding year’s production. If at the end of any year the average NYMEX price is below the price threshold, the lessee can apply for a refund for any associated royalties paid during that year and the lessee will not be required to pay royalties monthly during the succeeding year for the succeeding year’s production.

The thresholds and the average NYMEX prices are calculated by the MMS. The average NYMEX price for 2003 was \$31.08 per barrel of oil and \$5.49 per MMBtu of natural gas. For the year ended December 31, 2003 the thresholds were \$32.81 per barrel of oil and \$4.10 per MMBtu of natural gas. As a result, the Company paid royalties related to 2003 gas production for Medusa, which commenced production in late November 2003 and is making monthly royalty payments for 2004 gas production. The actual royalty payments due for 2004, if any, cannot be determined until after the end of 2004. However, based on information from the MMS, the estimated threshold for 2004 oil price is \$33.91 and the average year to date NYMEX oil price through October 2004 was \$39.06. Therefore, oil royalties of \$3.9 million for the nine-month period ended September 30, 2004 are being suspended and classified as a current liability in the Company’s consolidated balance sheet.

## **10. Consolidating Condensed Financial Information**

Certain of the Company’s subsidiaries have fully and unconditionally guaranteed the payment of all obligations under the Company’s \$200 million 9.75% Senior Notes due 2010 and the \$175 million senior secured credit facility. The following tables present the consolidating condensed financial information of Callon Petroleum Company, as the parent company and guarantor subsidiaries of Callon Petroleum Company balance sheets as of September 30, 2004 and December 31, 2003, statements of income for the three-month and nine-month periods ended September 30, 2004 and September 30, 2003 and statements of cash flows for the nine-month periods ended September 30, 2004 and September 30, 2003.

**Callon Petroleum Company**  
**Consolidating Condensed Guarantor Subsidiaries and Parent Company**  
**Financial Information As of September 30, 2004 and December 31, 2003**  
**And For The Three-Month And The Nine-Month Periods Ended**  
**September 30, 2004 and September 30, 2003**  
**Unaudited**  
**(In thousands)**

|  | Callon Petroleum<br>Company<br>(Parent<br>Obligor) | Guarantor<br>Subsidiaries | Consolidating<br>and<br>Eliminating<br>Entries | Callon Petroleum<br>Company<br>Consolidated |
|--|--|---------------------------|--|---|
| <b>As of September 30, 2004</b>            |  |                           |  |   |
| <b>Balance Sheet</b>                       |  |                           |  |   |
| Current assets                             | \$ 521   | \$ 17,828                 | \$ —   | \$ 18,349                                   |
| Intercompany receivables                   | 300,392  | —                         | (300,392)                                      | —   |
| Investment in subsidiaries                 | 72,414   | 1,224                     | (73,638)                                       | —   |
| Oil and gas properties                     | 1,945  | 395,126                   | —  | 397,071                                     |
| Other assets                               | 1,215  | 24,370                    | —  | 25,585                                      |
| Total assets                               | <u>\$ 376,487</u>                                  | <u>\$ 438,548</u>         | <u>\$ (374,030)</u>                            | <u>\$ 441,005</u>                           |
| Current liabilities                        | \$ 637   | \$ 39,479                 | —  | 40,116                                      |
| Intercompany payables                      | —  | 300,392                   | (300,392)                                      | —   |
| Long-term debt, less current maturities    | 185,817  | 1,263                     | —  | 187,080                                     |
| Other accrued liabilities                  | 235  | 32,026                    | —  | 32,261                                      |
| Stockholders' equity                       | 189,798  | 65,388                    | (73,638)                                       | 181,548                                     |
| Total liabilities and stockholders' equity | <u>\$ 376,487</u>                                  | <u>\$ 438,548</u>         | <u>\$ (374,030)</u>                            | <u>\$ 441,005</u>                           |

|  | Callon Petroleum<br>Company<br>(Parent<br>Obligor) | Guarantor<br>Subsidiaries | Consolidating<br>and<br>Eliminating<br>Entries | Callon Petroleum<br>Company<br>Consolidated |
|--|--|---------------------------|--|---|
| <b>As of December 31, 2003</b>             |  |                           |  |   |
| <b>Balance Sheet</b>                       |  |                           |  |   |
| Current assets                             | \$ 64,300  | \$ 21,468                 | \$ —   | \$ 85,768                                   |
| Intercompany receivables                   | 326,251  | —                         | (326,251)                                      | —   |
| Investment in subsidiaries                 | 45,390   | 1,997                     | (47,387)                                       | —   |
| Oil and gas properties                     | 3,129  | 387,034                   | —  | 390,163                                     |
| Other assets                               | 1,557  | 18,544                    | —  | 20,101                                      |
| Total assets                               | <u>\$ 440,627</u>                                  | <u>\$ 429,043</u>         | <u>\$ (373,638)</u>                            | <u>\$ 496,032</u>                           |
| Current liabilities                        | \$ 93,846  | \$ 26,751                 | —  | 120,597                                     |
| Intercompany payables                      | —  | 326,251                   | (326,251)                                      | —   |
| Long-term debt, less current maturities    | 213,173  | 1,712                     | —  | 214,885                                     |
| Other accrued liabilities                  | 327  | 26,962                    | —  | 27,289                                      |
| Stockholders' equity                       | 133,281  | 47,367                    | (47,387)                                       | 133,261                                     |
| Total liabilities and stockholders' equity | <u>\$ 440,627</u>                                  | <u>\$ 429,043</u>         | <u>\$ (373,638)</u>                            | <u>\$ 496,032</u>                           |

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|  | Callon Petroleum<br>Company<br>(Parent<br>Obligor) | Guarantor<br>Subsidiaries | Consolidating<br>and<br>Eliminating<br>Entries | Callon Petroleum<br>Company<br>Consolidated |
|--|--|---------------------------|--|---|
| <b>For The Three Months Ended September 30, 2004</b> |  |                           |  |   |
| <b>Statement of Income</b>                           |  |                           |  |   |
| Operating revenues:                                  |  |                           |  |   |
| Oil and gas sales                                    | \$ 1,214   | \$ 23,924                 | \$ —   | \$ 25,138                                   |
| Total operating revenues                             | <u>1,214</u>                                       | <u>23,924</u>             | <u>—</u>                                       | <u>25,138</u>                               |
| Operating expenses:                                  |  |                           |  |   |
| Lease operating expenses                             | 99   | 5,672                     | —  | 5,771                                       |
| Depreciation, depletion and amortization             | 473  | 9,674                     | —  | 10,147                                      |
| General and administrative                           | 409  | 1,100                     | —  | 1,509                                       |
| Accretion expense                                    | 6  | 819                       | —  | 825   |
| Derivative expense                                   | —  | 1,519                     | —  | 1,519                                       |
| Total operating expenses                             | <u>987</u>   | <u>18,784</u>             | <u>—</u>                                       | <u>19,771</u>                               |
| Income from operations                               | <u>227</u>   | <u>5,140</u>              | <u>—</u>                                       | <u>5,367</u>                                |
| Other (income) expenses:                             |  |                           |  |   |
| Interest expense                                     | 113  | 4,398                     | —  | 4,511                                       |
| Other income   | (75)   | 140                       | —  | 65  |
| Loss on early extinguishment of debt                 | 13   | 519                       | —  | 532   |
| Equity in earnings of subsidiaries                   | (370)  | —                         | 370  | —   |
| Total other (income) expenses                        | <u>(319)</u>                                       | <u>5,057</u>              | <u>370</u>                                     | <u>5,108</u>                                |
| Income (loss) before income taxes                    | 546  | 83                        | (370)  | 259   |
| Income tax expense (benefit)                         | —  | —                         | —  | —   |
| Income (loss) before Medusa Spar LLC                 | 546  | 83                        | (370)  | 259   |
| Income from Medusa Spar LLC, net of tax              | —  | 287                       | —  | 287   |
| Net Income (loss)                                    | 546  | 370                       | (370)  | 546   |
| Preferred stock dividends                            | 317  | —                         | —  | 317   |
| Net income   | <u>\$ 229</u>                                      | <u>\$ 370</u>             | <u>\$ (370)</u>                                | <u>\$ 229</u>                               |

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|   | Callon Petroleum<br>Company<br>(Parent<br>Obligor) | Guarantor<br>Subsidiaries | Consolidating<br>and<br>Eliminating<br>Entries | Callon Petroleum<br>Company<br>Consolidated |
|---|--|---------------------------|--|---|
| <b>For The Nine Months Ended September 30, 2004</b> |  |                           |  |   |
| <b>Statement of Income</b>                          |  |                           |  |   |
| Operating revenues:                                 |  |                           |  |   |
| Oil and gas sales                                   | \$ 3,325   | \$ 91,338                 | \$ —   | \$ 94,663                                   |
| Total operating revenues                            | <u>3,325</u>                                       | <u>91,338</u>             | <u>—</u>                                       | <u>94,663</u>                               |
| Operating expenses:                                 |  |                           |  |   |
| Lease operating expenses                            | 352  | 16,710                    | —  | 17,062                                      |
| Depreciation, depletion and amortization            | 1,288  | 35,170                    | —  | 36,458                                      |
| General and administrative                          | 1,039  | 5,800                     | —  | 6,839                                       |
| Accretion expense                                   | 11   | 2,544                     | —  | 2,555                                       |
| Derivative expense                                  | —  | 1,608                     | —  | 1,608                                       |
| Total operating expenses                            | <u>2,690</u>                                       | <u>61,832</u>             | <u>—</u>                                       | <u>64,522</u>                               |
| Income from operations                              | <u>635</u>   | <u>29,506</u>             | <u>—</u>                                       | <u>30,141</u>                               |
| Other (income) expenses:                            |  |                           |  |   |
| Interest expense                                    | 396  | 15,442                    | —  | 15,838                                      |
| Other income  | (191)  | (120)                     | —  | (311)                                       |
| Loss on early extinguishment of debt                | 75   | 2,929                     | —  | 3,004                                       |
| Equity in earnings of subsidiaries                  | (12,023)   | —                         | 12,023   | —   |
| Total other (income) expenses                       | <u>(11,743)</u>                                    | <u>18,251</u>             | <u>12,023</u>                                  | <u>18,531</u>                               |
| Income (loss) before income taxes                   | 12,378   | 11,255                    | (12,023)                                       | 11,610                                      |
| Income tax expense (benefit)                        | —  | —                         | —  | —   |
| Income (loss) before Medusa Spar LLC                | 12,378   | 11,255                    | (12,023)                                       | 11,610                                      |
| Income from Medusa Spar LLC, net of tax             | —  | 768                       | —  | 768   |
| Net Income (loss)                                   | 12,378   | 12,023                    | (12,023)                                       | 12,378                                      |
| Preferred stock dividends                           | 955  | —                         | —  | 955   |
| Net income  | <u>\$ 11,423</u>                                   | <u>\$ 12,023</u>          | <u>\$ (12,023)</u>                             | <u>\$ 11,423</u>                            |

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|  | Callon Petroleum<br>Company<br>(Parent<br>Obligor) | Guarantor<br>Subsidiaries | Consolidating<br>and<br>Eliminating<br>Entries | Callon Petroleum<br>Company<br>Consolidated |
|--|--|---------------------------|--|---|
| <b>For The Three Months Ended September 30, 2003</b>                     |  |                           |  |   |
| <b>Statement of Income</b>   |  |                           |  |   |
| Operating revenues:  |  |                           |  |   |
| Oil and gas sales  | \$ 1,004   | \$ 14,078                 | \$ —   | \$ 15,082                                   |
| Total operating revenues   | 1,004  | 14,078                    | —  | 15,082                                      |
| Operating expenses:  |  |                           |  |   |
| Lease operating expenses   | 108  | 2,551                     | —  | 2,659                                       |
| Depreciation, depletion and amortization                                 | 442  | 5,974                     | —  | 6,416                                       |
| General and administrative   | 265  | 803                       | —  | 1,068                                       |
| Accretion expense  | 21   | 751                       | —  | 772   |
| Derivative expense   | —  | (199)                     | —  | (199)                                       |
| Total operating expenses   | 836  | 9,880                     | —  | 10,716                                      |
| Income from operations   | 168  | 4,198                     | —  | 4,366                                       |
| Other (income) expenses:   |  |                           |  |   |
| Interest expense   | 173  | 7,381                     | —  | 7,554                                       |
| Other income   | (35)   | (35)                      | —  | (70)  |
| Loss on early extinguishment of debt                                     | —  | —                         | —  | —   |
| Equity in earnings of subsidiaries                                       | 2,046  | —                         | (2,046)  | —   |
| Total other (income) expenses  | 2,184  | 7,346                     | (2,046)  | 7,484                                       |
| Income (loss) before income taxes  | (2,016)  | (3,148)                   | 2,046  | (3,118)                                     |
| Income tax expense (benefit)   | 10   | (1,102)                   | —  | (1,092)                                     |
| Income (loss) before cumulative effect of change in accounting principle | (2,026)  | (2,046)                   | 2,046  | (2,026)                                     |
| Cumulative effect of change in accounting principle, net of tax          | —  | —                         | —  | —   |
| Net Income (loss)  | (2,026)  | (2,046)                   | 2,046  | (2,026)                                     |
| Preferred stock dividends  | 320  | —                         | —  | 320   |
| Net income   | \$ (2,346)   | \$ (2,046)                | \$ 2,046                                       | \$ (2,346)                                  |

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|  | Callon Petroleum<br>Company<br>(Parent<br>Obligor) | Guarantor<br>Subsidiaries | Consolidating<br>and<br>Eliminating<br>Entries | Callon Petroleum<br>Company<br>Consolidated |
|--|--|---------------------------|--|---|
| <b>For The Nine Months Ended September 30, 2003</b>                      |  |                           |  |   |
| <b>Statement of Income</b>   |  |                           |  |   |
| Operating revenues:  |  |                           |  |   |
| Oil and gas sales  | \$ 3,285   | \$ 51,474                 | \$ —   | \$ 54,759                                   |
| Total operating revenues   | 3,285  | 51,474                    | —  | 54,759                                      |
| Operating expenses:  |  |                           |  |   |
| Lease operating expenses   | 364  | 7,639                     | —  | 8,003                                       |
| Depreciation, depletion and amortization                                 | 1,264  | 19,505                    | —  | 20,769                                      |
| General and administrative   | 1,040  | 2,664                     | —  | 3,704                                       |
| Accretion expense  | 44   | 2,170                     | —  | 2,214                                       |
| Derivative expense   | —  | 335                       | —  | 335   |
| Total operating expenses   | 2,712  | 32,313                    | —  | 35,025                                      |
| Income from operations   | 573  | 19,161                    | —  | 19,734                                      |
| Other (income) expenses:   |  |                           |  |   |
| Interest expense   | 511  | 21,714                    | —  | 22,225                                      |
| Other income   | (127)  | (99)                      | —  | (226)                                       |
| Loss on early extinguishment of debt                                     | —  | —                         | —  | —   |
| Equity in earnings of subsidiaries                                       | 1,449  | —                         | (1,449)  | —   |
| Total other (income) expenses  | 1,833  | 21,615                    | (1,449)  | 21,999                                      |
| Income (loss) before income taxes  | (1,260)  | (2,454)                   | 1,449  | (2,265)                                     |
| Income tax expense (benefit)   | 66   | (859)                     | —  | (793)                                       |
| Income (loss) before cumulative effect of change in accounting principle | (1,326)  | (1,595)                   | 1,449  | (1,472)                                     |
| Cumulative effect of change in accounting principle, net of tax          | 35   | 146                       | —  | 181   |
| Net Income (loss)  | (1,291)  | (1,449)                   | 1,449  | (1,291)                                     |
| Preferred stock dividends  | 958  | —                         | —  | 958   |
| Net income   | \$ (2,249)   | \$ (1,449)                | \$ 1,449                                       | \$ (2,249)                                  |

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|  | Callon Petroleum<br>Company<br>(Parent<br>Obligor) | Guarantor<br>Subsidiaries | Consolidating<br>and<br>Eliminating<br>Entries | Callon Petroleum<br>Company<br>Consolidated |
|--|--|---------------------------|--|---|
| <b>For The Nine Months Ended September 30, 2004</b>  |  |                           |  |   |
| <b>Statement of Cash Flow</b>                        |  |                           |  |   |
| Net cash provided (used in) operating activities     | \$ 14,954  | \$ 39,715                 | \$ —   | \$ 54,669                                   |
| Net cash provided by (used in) investing activities  | (207)  | (42,844)                  | —  | (43,051)                                    |
| Net cash provided by (used in) financing activities  | (15,230)   | 1,733                     | —  | (13,497)                                    |
| Net increase (decrease) in cash and cash equivalents | (483)  | (1,396)                   | —  | (1,879)                                     |
| Cash and cash equivalents at beginning of the period | 489  | 8,211                     | —  | 8,700                                       |
| Cash and cash equivalents at end of the period       | <u>\$ 6</u>  | <u>\$ 6,815</u>           | <u>\$ —</u>                                    | <u>\$ 6,821</u>                             |

|  | Callon Petroleum<br>Company<br>(Parent<br>Obligor) | Guarantor<br>Subsidiaries | Consolidating<br>and<br>Eliminating<br>Entries | Callon Petroleum<br>Company<br>Consolidated |
|--|--|---------------------------|--|---|
| <b>For The Nine Months Ended September 30, 2003</b>  |  |                           |  |   |
| <b>Statement of Cash Flow</b>                        |  |                           |  |   |
| Net cash provided (used in) operating activities     | \$ (6,065)   | \$ 37,262                 | \$ —   | \$ 31,197                                   |
| Net cash provided by (used in) investing activities  | (167)  | (36,878)                  | —  | (37,045)                                    |
| Net cash provided by (used in) financing activities  | 6,170  | (4,834)                   | —  | 1,336                                       |
| Net increase (decrease) in cash and cash equivalents | (62)   | (4,450)                   | —  | (4,512)                                     |
| Cash and cash equivalents at beginning of the period | 191  | 5,616                     | —  | 5,807                                       |
| Cash and cash equivalents at end of the period       | <u>\$ 129</u>                                      | <u>\$ 1,166</u>           | <u>\$ —</u>                                    | <u>\$ 1,295</u>                             |

## **Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **Forward-Looking Statements**

This report includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements other than statements of historical facts included in this report, including statements regarding the Company's financial position, adequacy of resources, estimated reserve quantities, business strategies, plans, objectives and expectations for future operations and covenant compliance, are forward-looking statements. The Company can give no assurances that the assumptions upon which such forward-looking statements are based will prove to have been correct. Important factors that could cause actual results to differ materially from the Company's expectations ("Cautionary Statements") are disclosed, in the section entitled "Risk Factors" included in the Company's Annual Report on Form 10-K for the Company's most recent fiscal year, elsewhere in this report and from time to time in other filings made by the Company with the Securities and Exchange Commission. All subsequent written and oral forward-looking statements attributable to the Company or persons acting on its behalf are expressly qualified by the Cautionary Statements.

### **General**

The Company's revenues, profitability, future growth and the carrying value of its oil and gas properties are substantially dependent on prevailing prices of oil and gas, its ability to find, develop and acquire additional oil and gas reserves that are economically recoverable and its ability to develop existing proved undeveloped reserves. The Company's ability to maintain or increase its borrowing capacity and to obtain additional capital on attractive terms is also influenced by oil and gas prices. Prices for oil and gas are subject to large fluctuations in response to relatively minor changes in the supply of and demand for oil and gas, market uncertainty and a variety of additional factors beyond the control of the Company. These factors include weather conditions in the United States, the condition of the United States economy, the actions of the Organization of Petroleum Exporting Countries, governmental regulations, political stability in the Middle East and elsewhere, the foreign supply of oil and gas, the price of foreign imports and the availability of alternate fuel sources. Any substantial and extended decline in the price of oil or gas would have an adverse effect on the Company's carrying value of its proved reserves, borrowing capacity, revenues, profitability and cash flows from operations. The Company uses derivative financial instruments for price protection purposes on a limited amount of its future production but does not use derivative financial instruments for trading purposes. As of September 30, 2004, the Company had over 65% of its remaining 2004 production and over 50% of its 2005 production hedged.

The following discussion is intended to assist in an understanding of the Company's historical financial positions and results of operations. The Company's historical financial statements and notes thereto included elsewhere in this quarterly report contain detailed information that should be referred to in conjunction with the following discussion.

## **Liquidity and Capital Resources**

Our primary sources of capital are cash flows from operations, borrowings from financial institutions and the sale of debt and equity securities. On September 30, 2004, we had net cash and cash equivalents of \$6.8 million and \$57.2 million of availability under our senior secured credit facility. Cash provided from operating activities during the nine-month period ended September 30, 2004 totaled \$54.7 million. Cash provided by operating activities for 2004 has increased significantly compared to 2003 due to the Medusa and Habanero deepwater projects commencing production in late November 2003 as well as increased prices. Net capital expenditures from the cash flow statement for the nine-month period ended September 30, 2004 totaled \$43.3 million. Dividends paid on preferred stock were \$955,000.

On June 15, 2004, we closed on a three-year \$175 million senior secured credit facility underwritten by Union Bank of California, N.A. The credit facility includes an initial borrowing base of \$60 million, which may be adjusted on a quarterly basis throughout 2004 and semi-annually thereafter. At closing, \$21 million was advanced under the new facility for repayment of the existing debt under the expiring credit facility with Wachovia Bank, National Association. As of September 30, 2004 there were no borrowings outstanding under the facility, however, we had an aggregate of \$2.8 million in outstanding letters of credit issued under the credit facility. These letters of credit secure obligations under the outstanding hedging contracts described in Note 3 to the Consolidated Financial Statements. The outstanding letters of credit reduce the amount available for borrowings under the credit facility. As a result, \$57.2 million was available for future borrowings under the credit facility as of September 30, 2004.

On June 22, 2004, we closed the public offering of three million shares of common stock priced at \$13.25 per share raising net proceeds of approximately \$38.2 million, after expenses. In addition, we granted the underwriter, Johnson Rice & Company L.L.C., an over-allotment option to purchase an additional 450,000 shares. On June 30, 2004, the underwriter exercised the over-allotment option for an additional 450,000 shares priced at \$13.25 per share, raising the net proceeds of the offering by approximately \$5.7 million, after expenses. The proceeds from the transactions were used to redeem \$33 million of the 11% Senior Subordinated Notes due December 15, 2005 and general corporate purposes.

On June 23, 2004, we sent a required 30-day redemption notice to holders of our 11% Senior Subordinated Notes due December 15, 2005. The redemption was funded by a portion of the proceeds from our recent public common stock offering, which closed June 22, 2004. The funds were sent to the trustee, American Stock Transfer & Trust, and the trustee paid the holders of the notes on July 23, 2004.

During March 2004, we borrowed an additional \$15 million under our 9.75% senior unsecured credit facility bringing the total outstanding under the facility to \$200 million. The net proceeds of approximately \$14 million were primarily used to retire the remaining \$10 million of 12% senior loans due March 31, 2005 plus a 1% call premium of \$100,000.

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Transactions completed during the nine months ended September 30, 2004 resulted in a \$3.0 million charge for the early extinguishment of debt.

In March 2004, the \$200 million in aggregate principal amount of loans outstanding under the 9.75% senior unsecured credit facility were exchanged for 9.75% Senior Notes due 2010, Series A, "Series A notes", issued pursuant to a senior indenture between us and American Stock Transfer & Trust Company dated March 15, 2004. On August 12, 2004, we completed an offer to exchange our 9.75% Senior Notes due 2010, Series B, that have been registered under the Securities Act of 1933, for all outstanding Series A notes. See Note 5 of our Consolidated Financial Statements for the year ended December 31, 2003 included in our Annual Report on Form 10-K filed March 15, 2004 for a more detailed description of our long-term debt securities.

The senior secured credit facility and the indentures for our senior unsecured debt contain various covenants, including restrictions on additional indebtedness and payment of cash dividends as well as maintenance of certain financial ratios. We were in compliance with respect to these covenants at September 30, 2004. See Note 5 of the Consolidated Financial Statements for the year ended December 31, 2003 included in our Annual Report on Form 10-K filed March 15, 2004 for a more detailed description of the securities discussed above.

Our capital expenditure plans for 2004, including capitalized interest and general and administrative expenses, will require \$65 million of funding. We anticipate that cash flow generated during 2004 and current availability under our senior secured credit facility, if necessary, will provide the \$65 million of capital necessary to fund these planned capital expenditures as well as the Company's asset retirement obligations. See the Capital Expenditures section below for a more detailed discussion of our capital expenditures for 2004.

The following table describes our outstanding contractual obligations (in thousands) as of September 30, 2004:

| <b>Contractual Obligations</b>          | <b>Total</b>     | <b>Less Than One Year</b> | <b>One-Three Years</b> | <b>Four-Five Years</b> | <b>After-Five Years</b> |
|---|------------------|---------------------------|------------------------|------------------------|-------------------------|
| Senior Secured Credit Facility          | \$ —             | \$ —                      | \$ —                   | \$ —                   | \$ —                    |
| 9.75% Senior Notes                      | 200,000          | —                         | —                      | —                      | 200,000                 |
| Capital Lease (future minimum payments) | 3,002            | 1,111                     | 883                    | 485                    | 523                     |
| Throughput Commitments:                 |                  |                           |                        |                        |                         |
| Medusa Spar                             | 19,228           | 5,548                     | 7,268                  | 5,388                  | 1,024                   |
| Medusa Oil Pipeline                     | 927              | 258                       | 348                    | 145                    | 176                     |
|   | <u>\$223,157</u> | <u>\$ 6,917</u>           | <u>\$ 8,499</u>        | <u>\$ 6,018</u>        | <u>\$201,723</u>        |

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### **Capital Expenditures**

Capital expenditures from the cash flow statement for exploration and development costs related to oil and gas properties totaled approximately \$43.3 million in the nine months ended September 30, 2004. We incurred approximately \$15.0 million in the Gulf of Mexico Deepwater Area primarily for continued development of our Habanero and Medusa discoveries and drilling of a satellite well in the Medusa area. Interest of approximately \$3.3 million and general and administrative costs allocable directly to exploration and development projects of approximately \$5.6 million were capitalized for the first nine months of 2004. Our Gulf of Mexico Shelf Area expenditures account for the remainder of the total capital expended, which includes the drilling and completion cost for a shallow miocene well and a shelf well and the drilling of three shelf wells, one of which is being evaluated.

Capital expenditures for the remainder of 2004 are forecast to be approximately \$22 million and include:

- the workovers of wells at Habanero and Medusa;
- the acquisition of seismic and leases;
- the drilling of one deepwater development well;
- discretionary capital projects for the exploratory drilling of conventional and deep shelf prospects developed through our 3-D seismic partnership using AVO technology; and
- capitalized interest and general and administrative costs.

### **Hurricane Ivan**

On September 13, 2004, several of our fields were shut-in due to Hurricane Ivan. Two of our major fields, Medusa which is located in Mississippi Canyon Blocks 538 and 582 and Mobile Bay Blocks 952, 953 and 955, incurred damage as a result of the hurricane.

The Medusa Spar production facility incurred minor damage, but a platform work-over rig owned by a third party incurred significant damage and had to be removed from the Medusa Spar production facility. After debris clean up and repairs, partial production was restored on October 13, 2004 and pre-hurricane production levels were achieved October 22, 2004.

Mobile Bay Blocks 952, 953 and 955 incurred minor damage and wells were brought on-line as repairs were completed. Partial production was restored on September 24, 2004 and the field reached pre-hurricane production levels by October 17, 2004.

Production from Medusa and Mobile Bay Blocks 952, 953 and 955 represented approximately 60% of our production for the eight months ended August 31, 2004.

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### **Off-Balance Sheet Arrangements**

In December 2003, we announced the formation of a limited liability company, Medusa Spar LLC, which now owns a 75% undivided ownership interest in the deepwater spar production facilities on our Medusa Field in the Gulf of Mexico. We contributed a 15% undivided ownership interest in the production facility to Medusa Spar LLC in return for approximately \$25 million in cash and a 10% ownership interest in the LLC. The LLC will earn a tariff based upon production volume throughput from the Medusa area. We are obligated to process our share of production from the Medusa field and any future discoveries in the area through the Spar production facilities. This arrangement allows us to defer the cost of the Spar production facility over the life of the Medusa field. Our cash proceeds were used to reduce the balance outstanding under our senior secured credit facility. The LLC used the cash proceeds from \$83.7 million of non-recourse financing and a cash contribution by one of the LLC owners to acquire its 75% interest in the Spar. The balance of Medusa Spar LLC is owned by Oceaneering International, Inc. (NYSE:OII) and Murphy Oil Corporation (NYSE:MUR). We are accounting for our 10% ownership interest in the LLC under the equity method.

### **Income Taxes**

As discussed in Notes 6 of the Consolidated Financial Statements, we established a valuation allowance of \$11.5 million as of December 31, 2003. We revised the valuation allowance in the nine-month period ended September 30, 2004 as a result of current year ordinary income, the impact of which is included in our effective tax rate and resulted in no net income tax expense (benefit) for the period.

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### Results of Operations

The following table sets forth certain unaudited operating information with respect to the Company's oil and gas operations for the periods indicated:

|   | Three Months Ended<br>September 30, |                  | Nine Months Ended<br>September 30, |                 |
|---|-------------------------------------|------------------|------------------------------------|-----------------|
|   | 2004                                | 2003             | 2004                               | 2003            |
| Net production :                                    |                                     |                  |                                    |                 |
| Oil (MBbls)   | 376                                 | 49               | 1,354                              | 140             |
| Gas (MMcf)  | 2,405                               | 2,772            | 8,924                              | 9,365           |
| Total production (MMcfe)                            | 4,659                               | 3,068            | 17,050                             | 10,206          |
| Average daily production (MMcfe)                    | 50.6                                | 33.3             | 62.2                               | 37.4            |
| Average sales price: (a)                            |                                     |                  |                                    |                 |
| Oil (Bbls)  | \$ 27.83                            | \$ 26.76         | \$ 29.63                           | \$ 28.15        |
| Gas (Mcf)   | 6.11                                | 4.97             | 6.11                               | 5.43            |
| Total (Mcfe)  | 5.40                                | 4.92             | 5.55                               | 5.37            |
| Oil and gas revenues: (a)                           |                                     |                  |                                    |                 |
| Oil revenue   | \$ 10,457                           | \$ 1,319         | \$40,120                           | \$ 3,945        |
| Gas revenue   | 14,681                              | 13,763           | 54,543                             | 50,814          |
| Total   | <u>\$ 25,138</u>                    | <u>\$ 15,082</u> | <u>\$94,663</u>                    | <u>\$54,759</u> |
| Oil and gas production costs:                       |                                     |                  |                                    |                 |
| Lease operating expense                             | \$ 5,771                            | \$ 2,659         | \$17,062                           | \$ 8,003        |
| Additional per Mcfe data:                           |                                     |                  |                                    |                 |
| Sales price   | \$ 5.40                             | \$ 4.92          | \$ 5.55                            | \$ 5.37         |
| Lease operating expense                             | 1.24                                | 0.87             | 1.00                               | 0.78            |
| Operating margin                                    | <u>\$ 4.16</u>                      | <u>\$ 4.05</u>   | <u>\$ 4.55</u>                     | <u>\$ 4.59</u>  |
| Depletion, depreciation and amortization            | \$ 2.18                             | \$ 2.09          | \$ 2.14                            | \$ 2.03         |
| General and administrative (net of management fees) | \$ 0.32                             | \$ 0.35          | \$ 0.40                            | \$ 0.36         |

(a) Includes the impact of settlements of hedging contracts.

**Comparison of Results of Operations for the Three Months Ended September 30, 2004 and the Three Months Ended September 30, 2003.**

Oil and Gas Production and Revenues

Total oil and gas revenues increased 67% to \$25.1 million in the third quarter of 2004 from \$15.1 million in the third quarter of 2003. The increase was primarily due to our deepwater discoveries, Medusa and Habanero, which began producing late in the fourth quarter of 2003. Total production for the third quarter of 2004 increased by 52% versus the third quarter of 2003.

Gas production during the third quarter of 2004 totaled 2.4 Bcf and generated \$14.7 million in revenues compared to 2.8 Bcf and \$13.8 million in revenues during the same period in 2003. The average gas price after hedging impact for the third quarter of 2004 was \$6.11 per Mcf compared to \$4.97 per Mcf for the same period last year. The decrease in production is primarily due to the downtime for Hurricane Ivan and the normal and expected decline in production from our Mobile area properties and older properties. The decrease was partially offset by production from Medusa and Habanero.

Oil production during the third quarter of 2004 totaled 376,000 barrels and generated \$10.5 million in revenues compared to 49,000 barrels and \$1.3 million in revenues for the same period in 2003. The average oil price received after hedging impact in the third quarter of 2004 was \$27.83 per barrel compared to \$26.76 per barrel in 2003. The increase in production for the third quarter of 2004 compared to the third quarter of 2003 was due to the commencement of production from Medusa and Habanero.

Lease Operating Expenses

Lease operating expenses for the three-month period ending September 30, 2004 increased to \$5.8 million compared to \$2.7 million for the same period in 2003. The 117% increase was due to lease operating expenses related to our deepwater discoveries, Medusa and Habanero, which began producing late in the fourth quarter of 2003.

Depreciation, Depletion and Amortization

Depreciation, depletion and amortization for the three months ending September 30, 2004 and 2003 was \$10.1 million and \$6.4 million, respectively. The 58% increase was primarily due to higher production volumes for the third quarter of 2004 compared to the same period last year.

Accretion Expense

Accretion expense for the three-month periods ended September 30, 2004 and 2003 of \$825,000 and \$772,000, respectively, represents accretion for Callon's asset retirement obligations. The increase was due to the addition of new plugging and abandonment obligations. See Note 8 to the Consolidated Financial Statements.

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### General and Administrative

General and administrative expenses, net of amounts capitalized, were \$1.5 million and \$1.1 million for the three-month periods ended September 30, 2004 and 2003, respectively. The 41% increase was a result of reduced capitalized overhead and higher audit and directors' fees.

### Interest Expense

Interest expense decreased by 40% to \$4.5 million during the three months ended September 30, 2004 from \$7.6 million during the three months ended September 30, 2003. This is a result of lower debt levels and lower interest rates due to the restructuring of debt in December 2003 and during the six-month period ended June 30, 2004 and an equity offering completed in the second quarter of 2004. In addition, amortization of deferred financing costs and bond discounts decreased due to the write-off of unamortized deferred financing costs and bond discounts associated with the early extinguishment of debt.

### Income Taxes

Income tax expense was zero for the three-month period ended September 30, 2004 compared to an income tax benefit of \$1.1 million for the same period last year. We established a valuation allowance of \$11.5 million as of December 31, 2003. We revised the valuation allowance in the third quarter of 2004 as a result of current quarter ordinary income, the impact of which is included in our effective tax rate and resulted in no net income tax expense (benefit) for the period. See Note 6 to the Consolidated Financial Statements for a detailed discussion of the valuation allowance.

## **Comparison of Results of Operations for the Nine Months Ended September 30, 2004 and the Nine Months Ended September 30, 2003.**

### Oil and Gas Production and Revenues

Total oil and gas revenues for the nine-month period ended September 30, 2004 increased 73% to \$94.7 million from \$54.8 million during the same period in 2003. The increase was primarily due to our deepwater discoveries, Medusa and Habanero, which began producing late in the fourth quarter of 2003. Total production for the nine-month period ended September 30, 2004 increased by 67% versus the same period in 2003.

Gas production for the nine-month period ended September 30, 2004 totaled 8.9 Bcf and generated \$54.5 million in revenues compared to 9.4 Bcf and \$50.8 million in revenues during the same period in 2003. The average gas price after hedging impact for the nine-month period ended September 30, 2004 was \$6.11 per Mcf compared to \$5.43 per Mcf for the same period last year. The decrease in production is primarily due to the normal and expected decline in production from our Mobile area properties and older properties and downtime for Hurricane Ivan in the third quarter of 2004. The decrease was partially offset by production from Medusa and Habanero.

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Oil production for the nine-month period ended September 30, 2004 totaled 1,354,000 barrels and generated \$40.1 million in revenues compared to 140,000 barrels and \$3.9 million in revenues for the same period in 2003. The average oil price received after hedging impact for the nine-month period ended September 30, 2004 was \$29.63 per barrel compared to \$28.15 per barrel in 2003. The increase in production for the nine-month period ended September 30, 2004 compared to the same period of 2003 was due to the commencement of production from Medusa and Habanero.

### Lease Operating Expenses

Lease operating expenses for the nine-month period ended September 30, 2004 increased to \$17.1 million compared to \$8.0 million for the same period in 2003. The 113% increase was due to lease operating expenses related to our deepwater discoveries, Medusa and Habanero, which began producing late in the fourth quarter of 2003.

### Depreciation, Depletion and Amortization

Depreciation, depletion and amortization for the nine-months ending September 30, 2004 and 2003 was \$36.5 million and \$20.8 million, respectively. The 75% increase was primarily due to higher production volumes for the nine-month period ended September 30, 2004 compared to the same period last year.

### Accretion Expense

Accretion expense for the nine-month periods ended September 30, 2004 and 2003 of \$2.6 million and \$2.2 million, respectively, represents accretion for Callon's asset retirement obligations. The increase was due to the addition of new plugging and abandonment obligations. See Note 8 to the Consolidated Financial Statements.

### General and Administrative

General and administrative expenses, net of amounts capitalized, were \$6.8 million and \$3.7 million for the nine-month periods ended September 30, 2004 and 2003, respectively. There was a charge in general and administrative expenses of \$2.6 million in the first quarter of 2004 for the early retirement of two executive officers of the Company. Also reduced capitalized overhead and higher audit and directors' fees contributed to the increase in general and administrative expenses.

### Interest Expense

Interest expense decreased by 29% to \$15.8 million during the nine months ended September 30, 2004 from \$22.2 million during the nine months ended September 30, 2003. This is a result of lower debt levels and lower interest rates due to the restructuring of debt in December 2003 and during the six-month period ended June 30, 2004 and an equity offering completed in the second quarter of 2004. In addition, amortization of deferred financing costs and bond discounts decreased due to the write-off of unamortized deferred financing costs and bond discounts associated with the early extinguishment of debt.

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### Income Taxes

Income tax expense was zero for the nine-month period ended September 30, 2004 compared to an income tax benefit of \$793,000 for the same period last year. We established a valuation allowance of \$11.5 million as of December 31, 2003. We revised the valuation allowance in the nine-month period ended September 30, 2004 as a result of current year ordinary income, the impact of which is included in our effective tax rate and resulted in no net income tax expense (benefit) for the period. See Note 6 to the Consolidated Financial Statements for a detail discussion of the valuation allowance.

### **Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company's revenues are derived from the sale of its crude oil and natural gas production. The prices for oil and gas remain extremely volatile and sometimes experience large fluctuations as a result of relatively small changes in supply, weather conditions, economic conditions and government actions. From time to time, the Company enters into derivative financial instruments (forward sales or swaps) to hedge oil and gas price risks for the production volumes to which the hedge relates. The hedges reduce the Company's exposure on the hedged volumes to decreases in commodity prices and limit the benefit the Company might otherwise have received from any increases in commodity prices on the hedged volumes. The Company from time to time has acquired puts which reduce the Company's exposure to decreases in commodity prices while allowing realization of the full benefit from any increases in commodity prices.

The Company also enters into price "collars" to reduce the risk of changes in oil and gas prices. Under these arrangements, no payments are due by either party so long as the market price is above the floor price set in the collar and below the ceiling. If the price falls below the floor, the counter-party to the collar pays the difference to the Company and if the price is above the ceiling, the counter-party receives the difference from the Company.

Callon has purchased "puts" as another form of hedging to reduce risk of changes in oil and gas prices. If the price falls below the puts, the counter-party pays the difference to the Company.

The Company enters into these various agreements from time to time to reduce the effects of volatile oil and gas prices and does not enter into hedge transactions for speculative purposes. However, certain of the Company's positions may not be designated as hedges for accounting purposes.

See Note 3 to the Consolidated Financial Statements for a description of the Company's hedged position at September 30, 2004. There have been no significant changes in market risks faced by the Company since the end of 2003.

### **Item 4. CONTROLS AND PROCEDURES**

Evaluation of Disclosure Controls and Procedures. Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")) are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission.

There were no changes in the Company's internal control over financial reporting that occurred during the Company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**CALLON PETROLEUM COMPANY**

**PART II. OTHER INFORMATION**

**Item 6. EXHIBITS AND REPORTS ON FORM 8-K**

Exhibits

2. Plan of acquisition, reorganization, arrangement, liquidation or succession\*
3. Articles of Incorporation and By-Laws
  - 3.1 Certificate of Incorporation of the Company, as amended (incorporated by reference from Exhibit 3.1 of the Company's Annual Report on Form 10-K for the year ended December 31, 2003 filed March 15, 2004, File No. 001-14039)
  - 3.2 Bylaws of the Company (incorporated by reference from Exhibit 3.2 of the Company's Registration Statement on Form S-4, filed August 4, 1994, Reg. No. 33-82408)
4. Instruments defining the rights of security holders, including indentures
  - 4.1 Specimen Common Stock Certificate (incorporated by reference from Exhibit 4.1 of the Company's Registration Statement on Form S-4, filed August 4, 1994, Reg. No. 33-82408)
  - 4.2 Specimen Preferred Stock Certificate (incorporated by reference from Exhibit 4.2 of the Company's Registration Statement on Form S-1, filed November 13, 1995, Reg. No. 33-96700)
  - 4.3 Designation for Convertible, Exchangeable Preferred Stock, Series A (incorporated by reference from Exhibit 4.3 of the Company's Registration Statement on Form S-1, filed November 13, 1995, Reg. No. 33-96700)
  - 4.4 Indenture for Convertible Debentures (incorporated by reference from Exhibit 4.4 of the Company's Registration Statement on Form S-1, filed November 13, 1995, Reg. No. 33-96700)

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- 4.5 Certificate of Correction on Designation of Series A Preferred Stock (incorporated by reference from Exhibit 4.4 of the Company's Registration Statement on Form S-1, filed November 22, 1996, Reg. No. 333-15501)
  - 4.6 Rights Agreement between Callon Petroleum Company and American Stock Transfer & Trust Company, Rights Agent, dated March 30, 2000 (incorporated by reference from Exhibit 99.1 of the Company's Registration Statement on Form 8-A, filed April 6, 2000, File No. 001-14039)
  - 4.7 Warrant dated as of June 29, 2001 entitling Duke Capital Partners, LLC to purchase common stock from the Company. (incorporated by reference to Exhibit 4.11 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2001, File No. 001-14039)
  - 4.8 Form of Warrant entitling certain holders of the Company's 10.125% Senior Subordinated Notes due 2002 to purchase common stock from the Company (incorporated by reference to Exhibit 4.13 of the Company's Form 10-Q for the period ended June 30, 2002, File No. 001-14039)
  - 4.9 Form of Warrants dated December 8, 2003 and December 29, 2003 entitling lenders under the Company's \$185 million amended and restated Senior Unsecured Credit Agreement dated December 23, 2003 to purchase common stock from the Company (incorporated by reference to Exhibit 4.14 of the Company's Annual Report on Form 10-K for the year ended December 31, 2003, File No. 001-14039)
  - 4.10 Indenture for the Company's 9.75% Senior Notes due 2010, dated March 15, 2004 between Callon Petroleum Company and American Stock Transfer & Trust Company (incorporated by reference to Exhibit 4.16 of the Company's Quarterly Report on Form 10-Q for the period ended March 31, 2004, File No. 001-14039)
10. Material contracts
- 10.1 Credit Agreement dated as of June 14, 2004 between the Company and Union Bank of California, N.A., as Administrative Agent (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K dated June 14, 2004, File No. 001-14039)

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- 11. Statement re computation of per share earnings\*
  - 15. Letter re unaudited interim financial information\*
  - 18. Letter re change in accounting principles\*
  - 19. Report furnished to security holders\*
  - 22. Published report regarding matters submitted to vote of security holders\*
  - 23. Consents of experts and counsel\*
  - 24. Power of attorney\*
  - 31. Certifications
    - 31.1 Certification of Chief Executive Officer pursuant to Rule 13(a)-14(a)
    - 31.2 Certification of Chief Financial Officer pursuant to Rule 13(a)-14(a)
  - 32. Section 1350 Certifications
    - 32.1 Certification of Chief Executive Officer pursuant to Rule 13(a)-14(b)
    - 32.2 Certification of Chief Financial Officer pursuant to Rule 13(a)-14(b)
  - 99. Additional exhibits\*
- \* Inapplicable to this filing

**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.

**CALLON PETROLEUM COMPANY**

Date: November 8, 2004

By: /s/ John S. Weatherly  
John S. Weatherly, Senior Vice President  
and Chief Financial Officer (on behalf of  
the registrant and as the principal financial  
officer)

**Exhibit Index**

| <b>Exhibit Number</b> | <b>Title of Document</b>   |
|-----------------------|--|
| 2.                    | Plan of acquisition, reorganization, arrangement, liquidation or succession*   |
| 3.                    | Articles of Incorporation and By-Laws  |
| 3.1                   | Certificate of Incorporation of the Company, as amended (incorporated by reference from Exhibit 3.1 of the Company's Annual Report on Form 10-K for the year ended December 31, 2003 filed March 15, 2004, File No. 001-14039) |
| 3.2                   | Bylaws of the Company (incorporated by reference from Exhibit 3.2 of the Company's Registration Statement on Form S-4, filed August 4, 1994, Reg. No. 33-82408)  |
| 4.                    | Instruments defining the rights of security holders, including indentures  |
| 4.1                   | Specimen Common Stock Certificate (incorporated by reference from Exhibit 4.1 of the Company's Registration Statement on Form S-4, filed August 4, 1994, Reg. No. 33-82408)  |
| 4.2                   | Specimen Preferred Stock Certificate (incorporated by reference from Exhibit 4.2 of the Company's Registration Statement on Form S-1, filed November 13, 1995, Reg. No. 33-96700)  |
| 4.3                   | Designation for Convertible, Exchangeable Preferred Stock, Series A (incorporated by reference from Exhibit 4.3 of the Company's Registration Statement on Form S-1, filed November 13, 1995, Reg. No. 33-96700)               |
| 4.4                   | Indenture for Convertible Debentures (incorporated by reference from Exhibit 4.4 of the Company's Registration Statement on Form S-1, filed November 13, 1995, Reg. No. 33-96700)  |
| 4.5                   | Certificate of Correction on Designation of Series A Preferred Stock (incorporated by reference from Exhibit 4.4 of the Company's Registration Statement on Form S-1, filed November 22, 1996, Reg. No. 333-15501)             |

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- 4.6 Rights Agreement between Callon Petroleum Company and American Stock Transfer & Trust Company, Rights Agent, dated March 30, 2000 (incorporated by reference from Exhibit 99.1 of the Company's Registration Statement on Form 8-A, filed April 6, 2000, File No. 001-14039)
  - 4.7 Warrant dated as of June 29, 2001 entitling Duke Capital Partners, LLC to purchase common stock from the Company. (incorporated by reference to Exhibit 4.11 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2001, File No. 001-14039)
  - 4.8 Form of Warrant entitling certain holders of the Company's 10.125% Senior Subordinated Notes due 2002 to purchase common stock from the Company (incorporated by reference to Exhibit 4.13 of the Company's Form 10-Q for the period ended June 30, 2002, File No. 001-14039)
  - 4.9 Form of Warrants dated December 8, 2003 and December 29, 2003 entitling lenders under the Company's \$185 million amended and restated Senior Unsecured Credit Agreement dated December 23, 2003 to purchase common stock from the Company (incorporated by reference to Exhibit 4.14 of the Company's Annual Report on Form 10-K for the year ended December 31, 2003, File No. 001-14039)
  - 4.10 Indenture for the Company's 9.75% Senior Notes due 2010, dated March 15, 2004 between Callon Petroleum Company and American Stock Transfer & Trust Company (incorporated by reference to Exhibit 4.16 of the Company's Quarterly Report on Form 10-Q for the period ended March 31, 2004, File No. 001-14039)
10. Material contracts
- 10.1 Credit Agreement dated as of June 14, 2004 between the Company and Union Bank of California, N.A., as Administrative Agent (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K dated June 14, 2004, File No. 001-14039)

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- 11. Statement re computation of per share earnings\*
  - 15. Letter re unaudited interim financial information\*
  - 18. Letter re change in accounting principles\*
  - 19. Report furnished to security holders\*
  - 22. Published report regarding matters submitted to vote of security holders\*
  - 23. Consents of experts and counsel\*
  - 24. Power of attorney\*
  - 31. Certifications
    - 31.1 Certification of Chief Executive Officer pursuant to Rule 13(a)-14(a)
    - 31.2 Certification of Chief Financial Officer pursuant to Rule 13(a)-14(a)
  - 32. Section 1350 Certifications
    - 32.1 Certification of Chief Executive Officer pursuant to Rule 13(a)-14(b)
    - 32.2 Certification of Chief Financial Officer pursuant to Rule 13(a)-14(b)
  - 99. Additional exhibits\*
- \* Inapplicable to this filing

## CERTIFICATIONS

I, Fred L. Callon, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Callon Petroleum Company;
  2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
  3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
  4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
    - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
    - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
    - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
  5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
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(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: November 8, 2004

By: /s/ Fred L. Callon

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Fred L. Callon, President and Chief Executive Officer

(Principal Executive Officer)

**CERTIFICATIONS**

I, John S. Weatherly, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Callon Petroleum Company;
  2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
  3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
  4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
    - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
    - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
    - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
  5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
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(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2004

By: /s/ John S. Weatherly  
John S. Weatherly, Senior Vice President  
and Chief Financial Officer  
(Principal Financial Officer)

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**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350**

In connection with the Quarterly Report of Callon Petroleum Company (the "**Company**") on Form 10-Q for the quarterly period ended September 30, 2004, as filed with the Securities and Exchange Commission on the date hereof (the "**Report**"), I, Fred L. Callon, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 8, 2004

/s/ Fred L. Callon

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Fred L. Callon, Chief Executive Officer

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350**

In connection with the Quarterly Report of Callon Petroleum Company (the "*Company*") on Form 10-Q for the quarterly period ended September 30, 2004, as filed with the Securities and Exchange Commission on the date hereof (the "*Report*"), I, John S. Weatherly, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 8, 2004

/s/ John S. Weatherly

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John S. Weatherly, Chief Financial Officer