

Edgar Filing: MERIDIAN RESOURCE CORP - Form 10-Q

MERIDIAN RESOURCE CORP  
Form 10-Q  
May 05, 2004

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549  
FORM 10-Q

(Mark One)

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

For the quarterly period ended: March 31, 2004

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 1-10671

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

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

1401 ENCLAVE PARKWAY, SUITE 300, HOUSTON, TEXAS 77077  
(Address of principal executive offices) (Zip Code)

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

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

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

Number of shares of common stock outstanding at April 20, 2004 68,132,518

THE MERIDIAN RESOURCE CORPORATION  
QUARTERLY REPORT ON FORM 10-Q

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## PART I - FINANCIAL INFORMATION

### ITEM 1. FINANCIAL STATEMENTS

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

	THREE MONTHS ENDED MARCH 31,	
	2004	2003
	-----	-----
REVENUES:		
Oil and natural gas	\$ 46,140	\$ 28,987
Interest and other	52	38
	-----	-----

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	46,192	29,025
	-----	-----
OPERATING COSTS AND EXPENSES:		
Oil and natural gas operating	3,008	2,484
Severance and ad valorem taxes	2,317	1,819
Depletion and depreciation	23,701	14,655
Accretion expense	119	128
General and administrative	3,204	2,810
	-----	-----
	32,349	21,896
	-----	-----
EARNINGS BEFORE INTEREST AND INCOME TAXES	13,843	7,129
	-----	-----
OTHER EXPENSES:		
Interest expense	2,169	2,476
Debt conversion expense	1,188	--
	-----	-----
	3,357	2,476
	-----	-----
EARNINGS BEFORE INCOME TAXES	10,486	4,653
	-----	-----
INCOME TAXES:		
Current	1,000	--
Deferred	2,900	--
	-----	-----
	3,900	--
	-----	-----
EARNINGS BEFORE CUMULATIVE		
EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	6,586	4,653
Cumulative effect of change in accounting principle	--	(1,309)
	-----	-----
NET EARNINGS	6,586	3,344
Dividends on preferred stock	1,299	1,623
	-----	-----
NET EARNINGS APPLICABLE TO COMMON STOCKHOLDERS	\$ 5,287	\$ 1,721
	=====	=====
NET EARNINGS PER SHARE BEFORE CUMULATIVE		
EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE:		
Basic	\$ 0.08	\$ 0.06
Diluted	\$ 0.08	\$ 0.06
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING ACCOUNTING PRINCIPLE PER SHARE:		
Basic and Diluted	\$ --	\$ (0.03)
	-----	-----
NET EARNINGS PER SHARE:		
Basic	\$ 0.08	\$ 0.03
	=====	=====
Diluted	\$ 0.08	\$ 0.03
	=====	=====
WEIGHTED AVERAGE NUMBER OF COMMON SHARES:		
Basic	63,010	50,090
	=====	=====
Diluted	68,341	50,090
	=====	=====

See notes to consolidated financial statements.

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

	MARCH 31, 2004	DECEMBER 31, 2003
	-----	-----
	(unaudited)	
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 15,996	\$ 12,821
Accounts receivable, less allowance for doubtful accounts of \$249 [2004] and \$251 [2003]	23,530	24,703
Due from affiliates	--	349
Prepaid expenses and other	1,497	1,586
Assets from price risk management activities	980	584
	-----	-----
Total current assets	42,003	40,043
	-----	-----
<b>PROPERTY AND EQUIPMENT:</b>		
Oil and natural gas properties, full cost method (including \$37,921 [2004] and \$30,542 [2003] not subject to depletion)	1,255,903	1,230,643
Land	478	478
Equipment and other	10,061	9,931
	-----	-----
	1,266,442	1,241,052
Less accumulated depletion and depreciation	860,025	836,368
	-----	-----
Total property and equipment, net	406,417	404,684
	-----	-----
<b>OTHER ASSETS</b>		
	3,213	4,022
	-----	-----
Total assets	\$ 451,633	\$ 448,749
	=====	=====

See notes to consolidated financial statements.

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

	MARCH 31, 2004	DECEMBER 2003
	-----	-----
	(unaudited)	
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		

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CURRENT LIABILITIES:		
Accounts payable	\$ 8,056	\$ 8,6
Revenues and royalties payable	12,064	13,0
Due to affiliates	597	
Notes payable	--	1
Accrued liabilities	10,755	12,0
Liabilities from price risk management activities	12,524	9,7
Abandonment costs	991	9
Current income taxes payable	1,200	4
Current portion long-term debt	10,000	10,0
	-----	-----
Total current liabilities	56,187	55,1
	-----	-----
LONG-TERM DEBT	117,000	122,3
	-----	-----
9 1/2% CONVERTIBLE SUBORDINATED NOTES	--	20,0
	-----	-----
OTHER:		
Liabilities from price risk management activities	2,001	2,3
Abandonment costs	3,291	3,1
Deferred income taxes	3,139	9
	-----	-----
	8,431	6,4
	-----	-----
REDEEMABLE PREFERRED STOCK:		
Preferred stock, \$1.00 par value (1,500,000 shares authorized, 538,727 [2004] and 604,460 [2003] shares of Series C Redeemable Convertible Preferred Stock issued at stated value)	53,873	60,4
	-----	-----
STOCKHOLDERS' EQUITY:		
Common stock, \$0.01 par value (200,000,000 shares authorized, 67,389,791 [2004] and 61,724,597 [2003] issued)	701	6
Additional paid-in capital	421,977	394,1
Accumulated deficit	(197,205)	(202,4
Accumulated other comprehensive loss	(8,989)	(7,7
Unamortized deferred compensation	(342)	(2
	-----	-----
Total stockholders' equity	216,142	184,3
	-----	-----
Total liabilities and stockholders' equity	\$ 451,633	\$ 448,7
	=====	=====

See notes to consolidated financial statements.

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THE MERIDIAN RESOURCE CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(thousands of dollars)  
(unaudited)

THREE MONTHS ENDED  
MARCH 31,  
-----  
2004                      2003  
-----

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CASH FLOWS FROM OPERATING ACTIVITIES:

Net earnings	\$ 6,586	\$ 3,344
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Cumulative effect of change in accounting principle	--	1,309
Debt conversion expense	1,188	--
Depletion and depreciation	23,701	14,655
Amortization of other assets	485	426
Non-cash compensation	411	395
Accretion expense	119	128
Deferred income taxes	2,900	--
Changes in assets and liabilities:		
Accounts receivable	1,173	(6,975)
Due to/from affiliates	946	(75)
Prepaid expenses and other	89	150
Accounts payable	(636)	3,567
Revenues and royalties payable	(1,023)	181
Accrued liabilities and other	1,101	687
	-----	-----
Net cash provided by operating activities	37,040	17,792
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to property and equipment	(25,387)	(16,085)
Sale of property and equipment	15	135
	-----	-----
Net cash used in investing activities	(25,372)	(15,950)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of long-term debt	(5,320)	(1,250)
Net payments of notes payable	(194)	(749)
Issuance of stock/exercise of options	87	84
Payment of preferred dividends	(3,057)	--
Additions to deferred loan costs	(9)	--
	-----	-----
Net cash used in financing activities	(8,493)	(1,915)
	-----	-----
NET CHANGE IN CASH AND CASH EQUIVALENTS	3,175	(73)
Cash and cash equivalents at beginning of period	12,821	7,287
	-----	-----
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 15,996	\$ 7,214
	=====	=====

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Non-cash financing activities:		
Conversion of preferred stock	\$ (6,573)	\$ --
Conversion of convertible subordinated debt	(20,000)	--

See notes to consolidated financial statements.

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	Common Stock		Additional Paid-In Capital	Accumulated Earnings (Deficit)	Accumu Oth Compreh Lo
	Shares	Par Value			
Balance, December 31, 2002	50,089	\$ 557	\$ 378,215	\$ (209,738)	\$ (4
Issuance of rights to common stock	--	2	208	--	
Company's 401(k) plan contribution	73	--	(504)	--	
Compensation expense	--	--	--	--	
Accum. other comprehensive loss	--	--	--	--	(2
Preferred dividends	--	--	--	(1,623)	
Net earnings	--	--	--	3,344	
Balance, March 31, 2003	50,162	\$ 559	\$ 377,919	\$ (208,017)	\$ (7
Balance, December 31, 2003	61,725	\$ 644	\$ 394,177	\$ (202,492)	\$ (7
Issuance of rights to common stock	--	1	462	--	
Company's 401(k) plan contribution	14	--	82	--	
Exercise of stock options	1	--	5	--	
Compensation expense	--	--	--	--	
Accum. other comprehensive loss	--	--	--	--	(1
Issuance for conversion of pref stock	1,477	14	6,343	--	
Issuance for conversion of sub debt	4,173	42	20,908	--	
Preferred dividends	--	--	--	(1,299)	
Net earnings	--	--	--	6,586	
Balance, March 31, 2004	67,390	\$ 701	\$ 421,977	\$ (197,205)	\$ (8

	Treasury Stock		
	Shares	Cost	Total
Balance, December 31, 2002	3,779	\$ (30,347)	\$ 133,393
Issuance of rights to common stock	--	--	--
Company's 401(k) plan contribution	(73)	588	84
Compensation expense	--	--	395
Accum. other comprehensive loss	--	--	(2,079)
Preferred dividends	--	--	(1,623)
Net earnings	--	--	3,344
Balance, March 31, 2003	3,706	\$ (29,759)	\$ 133,514
Balance, December 31, 2003	--	\$ --	\$ 184,335
Issuance of rights to common stock	--	--	0
Company's 401(k) plan contribution	--	--	82
Exercise of stock options	--	--	5
Compensation expense	--	--	411
Accum. other comprehensive loss	--	--	(1,285)
Issuance for conversion of pref stock	--	--	6,357
Issuance for conversion of sub debt	--	--	20,950
Preferred dividends	--	--	(1,299)
Net earnings	--	--	6,586
Balance, March 31, 2004	--	\$ --	\$ 216,142

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See notes to consolidated financial statements.

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

	THREE MONTHS ENDED MARCH 31,	
	2004	2003
	-----	-----
Net earnings applicable to common stockholders	\$ 5,287	\$ 1,721
	-----	-----
Other comprehensive income (loss), net of tax, for unrealized losses from hedging activities:		
Unrealized holding losses arising during period	(3,634)	(6,697)
Reclassification adjustments on settlement of commodity hedge contracts	2,349	4,618
	-----	-----
	(1,285)	(2,079)
	-----	-----
Total comprehensive income (loss)	\$ 4,002	\$ (358)
	=====	=====

See notes to consolidated financial statements.

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

1. BASIS OF PRESENTATION

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

The financial statements included herein as of March 31, 2004, and for the three month periods ended March 31, 2004 and 2003, are unaudited, and in the opinion of management, the information furnished reflects all material adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of financial position and of the results for the interim periods presented. Certain minor reclassifications of prior period statements have been made to conform to current reporting practices. The results of operations for interim periods are not necessarily indicative of results to be expected for a full year.



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### 2. DEBT

CREDIT FACILITY. During August 2002, the Company replaced its Chase Manhattan Bank Credit Facility with a new three-year \$175 million underwritten senior secured credit agreement (the "Credit Agreement") with Societe Generale as administrative agent, lead arranger and book runner, and Fortis Capital Corporation, as co-lead arranger and documentation agent. Borrowings under the Credit Agreement mature on August 13, 2005. The borrowing base is currently set at \$130 million and has been redetermined to \$127.5 million effective on April 30, 2004. Credit Facility payments of \$5.3 million have been made during the first three months of 2004, bringing the outstanding balance to \$117 million as of March 31, 2004. The Company anticipates that it will continue to make additional debt repayments during the remainder of the year.

In addition to the scheduled quarterly borrowing base redeterminations, the lenders or borrower, under the Credit Agreement, have the right to redetermine the borrowing base at any time, once during each calendar year. Borrowings under the Credit Agreement are secured by pledges of outstanding capital stock of the Company's subsidiaries and a mortgage on the Company's oil and natural gas properties of at least 90% of its present value of proved properties. The Credit Agreement contains various restrictive covenants, including, among other items, maintenance of certain financial ratios and restrictions on cash dividends on Common Stock and under certain circumstances Preferred Stock, and an unqualified audit report on the Company's consolidated financial statements.

Under the Credit Agreement, the Company may secure either (i) (a) an alternative base rate loan that bears interest at a rate per annum equal to the greater of the administrative agent's prime rate; or (b) federal funds-based rate plus  $1/2$  of 1%, plus an additional 0.5% to 1.5% depending on the ratio of the aggregate outstanding loans and letters of credit to the borrowing base or; (ii) a Eurodollar base rate loan that bears interest, generally, at a rate per annum equal to the London interbank offered rate ("LIBOR") plus 1.5% to 2.5%, depending on the ratio of the aggregate outstanding loans and letters of credit to the borrowing base. At March 31, 2004, the three-month LIBOR interest rate was 1.11%. The Credit Agreement also provides for commitment fees ranging from 0.375% to 0.5% per annum.

SUBORDINATED CREDIT AGREEMENT. The Company extended and amended a short-term subordinated credit agreement with Fortis Capital Corporation for \$25 million on April 5, 2002, with a maturity date of

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December 31, 2004. The notes are unsecured and contain customary events of default, but do not contain any maintenance or other restrictive covenants. The interest rate is LIBOR plus 5.5% from January 1, 2003, through August 31, 2003, and LIBOR plus 6.5% from September 1, 2003, through December 31, 2004. At March 31, 2004, the three-month LIBOR interest rate was 1.11%. A note payment of \$5 million was made during April 2004, with the remaining \$5 million payable on December 31, 2004. The Company is compliance with the terms of this agreement.

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

### 3. 8.5% REDEEMABLE CONVERTIBLE PREFERRED STOCK

A private placement of \$66.85 million of 8.5% redeemable convertible preferred stock was completed during May 2002. The preferred stock is convertible into

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shares of the Company's Common Stock at a conversion price of \$4.45 per share. Dividends are payable semi-annually in cash or additional preferred stock. At the option of the Company, one-third of the preferred shares can be forced to convert to Common Stock if the closing price of the Company's Common Stock exceeds 150% of the conversion price for 30 out of 40 consecutive trading days on the New York Stock Exchange. Based on the above conversion criteria, the Company can elect to convert up to one-third of the then outstanding shares. The preferred stock is subject to redemption at the option of the Company after March 2005, and mandatory redemption on March 31, 2009. The holders of the preferred stock have been granted registration rights with respect to the shares of Common Stock issued upon conversion of the preferred stock. In the fourth quarter of 2003, \$12.2 million of preferred stock was converted into 2.7 million shares of Common Stock. In addition, \$6.6 million of preferred stock was converted into 1.5 million shares of Common Stock during the first quarter of 2004. Subsequent to March 31, 2004, \$5.3 million of additional preferred stock has been converted into 1.2 million shares of Common Stock.

#### 4. COMMITMENTS AND CONTINGENCIES

##### LITIGATION.

**RAMOS TITLE LITIGATION.** Three different groups have asserted adverse title claims to some or all of Section 80 within Meridian's "Thibodaux units" in the Ramos Field. Another entity has asserted adverse title claims to a portion of Section 36 within these same units. These claims turn primarily on the location of the parish boundary between Terrebonne and Assumption Parishes and/or the validity of various tax sales. Meridian's gas purchaser, Louisiana Intrastate Gas Company LLC ("LIG"), has deposited into the Terrebonne Parish court registry certain gas and plant-product proceeds attributable to 25 acres within these units since October 2000, and Meridian has been suspending all remaining proceeds attributable to these same 25 acres since December 2000. Meridian has reached an agreement with the various parties whereby the parties will grant a lease to the current interest owners for a lease bonus of \$4.5 million and a future royalty interest of 1.5%.

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

There are no other material legal proceedings to which Meridian or any of its subsidiaries is a party or to which any of its property is subject, other than ordinary and routine litigation incidental to the business of producing

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and exploring for crude oil and natural gas.

#### 5. STOCKHOLDERS' EQUITY

**COMMON STOCK.** In August 2003, the Company completed a private offering of 8,703,537 shares of common stock at a price of \$3.87 per share. The total proceeds of the offering, net of issuance costs, received by the Company were approximately \$33.0 million. The Company used the majority of these funds to retire \$31.8 million in long-term debt, with the remainder of the proceeds being used for exploration activities and other general corporate purposes. As previously noted, during the three months ended March 31, 2004, 1.5 million shares of Common Stock was issued for the conversion of the 8.5% Redeemable

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Convertible Preferred Stock and 4.2 million shares of Common Stock was issued for the early retirement of the 9 1/2% Convertible Subordinated Notes.

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

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

	THREE MONTHS ENDED MARCH 31, 2004	2003
	-----	-----
Numerator:		
Net earnings applicable to common stockholders	\$ 5,287	\$ 1,721
Plus income impact of assumed conversions:		
Preferred stock dividends	N/A	N/A
Interest on convertible subordinated notes	N/A	N/A
	-----	-----
Net earnings applicable to common stockholders plus assumed conversions	\$ 5,287	\$ 1,721
	-----	-----
Denominator:		
Denominator for basic earnings per share - weighted-average shares outstanding	63,010	50,090
Effect of potentially dilutive common shares:		
Warrants	4,037	N/A
Employee and director stock options	1,294	N/A
Convertible subordinated notes	--	--
Redeemable preferred stock	N/A	N/A
	-----	-----
Denominator for diluted earnings per share - weighted-average shares outstanding and assumed conversions	68,341	50,090
	=====	=====
Basic earnings per share	\$ 0.08	\$ 0.03
	=====	=====
Diluted earnings per share	\$ 0.08	\$ 0.03
	=====	=====

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### 7. OIL AND NATURAL GAS HEDGING ACTIVITIES

The Company may address market risk by selecting instruments with value fluctuations which correlate strongly with the underlying commodity being hedged. The Company enters into swaps and other derivative contracts to hedge the price risks associated with a portion of anticipated future oil and gas production. These swaps allow the Company to predict with greater certainty the effective oil and natural gas prices to be received for our hedged production. While the use of hedging arrangements limits the downside risk of adverse price movements, it may also limit future gains from favorable movements. Under these agreements, payments are received or made based on the differential between a fixed and a variable product price. These agreements are settled in cash at or prior to expiration or are exchanged for physical delivery contracts. The Company does not obtain collateral to support the agreements, but monitors the

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financial viability of counter-parties and believes its credit risk is minimal on these transactions. In the event of nonperformance, the Company would be exposed to price risk. The Company has some risk of accounting loss since the price received for the product at the actual physical delivery point may differ from the prevailing price at the delivery point required for settlement of the hedging transaction.

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

The estimated March 31, 2004, fair value of the Company's oil and natural gas swaps was an unrealized loss of \$13.5 million (\$8.8 million net of tax) which is recognized in other comprehensive income. Based upon March 31, 2004, oil and natural gas commodity prices, approximately \$12.5 million of the loss deferred in other comprehensive income could potentially lower gross revenues over the next twelve months. The swap agreements expire at various dates through July 31, 2005.

Net settlements under these swap agreements reduced oil and natural gas revenues by \$3,614,000 and \$7,105,000 for the three months ended March 31, 2004 and 2003, respectively, as a result of hedging transactions.

The Notional Amount is equal to the total net volumetric hedge position of the Company during the periods presented. The positions effectively hedge approximately 10% of our proved developed natural gas production and 71% of our proved developed oil production during the respective terms of the swap agreements. The fair values of the hedges are based on the difference between the strike price and the New York Mercantile Exchange future prices for the applicable trading months.

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	Notional Amount -----	Weighted Average Stri Price (\$ per unit) -----
Natural Gas (mmbtu)		
April 2004 - June 2005	2,890,000	\$ 3.73
Oil (bbls)		
April 2004 - July 2005	776,000	\$ 23.45

8. STOCK-BASED COMPENSATION

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SFAS 123, "Accounting for Stock-Based Compensation," as amended by SFAS 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans. As provided for under SFAS 123, there has been no amount of compensation expense recognized for the Company's stock option plans. The Company accounts for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion 25, "Accounting for Stock Issued to Employees." Compensation expense is recorded for restricted stock awards over the requisite vesting periods based upon the market value on the date of the grant. No stock-based compensation expense was recorded in the three month periods ended March 31, 2004 and 2003.

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

	(In thousands, except per share data)	
	Three Months Ended March 31,	
	2004	2003
	-----	-----
Net earnings applicable to common stockholders as reported	\$ 5,287	\$ 1,721
Stock-based compensation (expense) benefit determined under fair value method for all awards, net of tax	(4)	16
	-----	-----
Net earnings applicable to common stockholders pro forma	\$ 5,283	\$ 1,737
	=====	=====
Basic earnings per share:		
As reported	\$ 0.08	\$ 0.03
Pro forma	\$ 0.08	\$ 0.03
Diluted earnings per share:		
As reported	\$ 0.08	\$ 0.03
Pro forma	\$ 0.08	\$ 0.03

### 9. ASSET RETIREMENT OBLIGATIONS

On January 1, 2003, the Company adopted SFAS 143, "Accounting for Asset Retirement Obligations." This statement requires entities to record the fair value of a liability for legal obligations associated with the retirement obligations of tangible long-lived assets in the period in which it is incurred. The fair value of asset retirement obligation liabilities has been calculated using an expected present value technique. Fair value, to

the extent possible, should include a market risk premium for unforeseeable circumstances. No market risk premium was included in the Company's asset retirement obligations fair value estimate since a reasonable estimate could not be made. When the liability is initially recorded, the entity increases the carrying amount of the related long-lived asset. Over time, accretion of the liability is recognized each period, and the capitalized cost is amortized over the useful life of the related asset. Upon settlement of the liability, an

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entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. This standard requires the Company to record a liability for the fair value of our dismantlement and abandonment costs, excluding salvage values.

Upon adoption, the Company recorded transition amounts for liabilities related to our wells, and the associated costs to be capitalized. A liability of \$4.5 million was recorded to long-term liabilities and a net asset of \$3.2 million was recorded to oil and natural gas properties on January 1, 2003. This resulted in a cumulative effect of an accounting change of (\$1.3) million. Accretion expenses subsequent to the adoption of this accounting statement decreased net earnings \$119 thousand and \$128 thousand in the first three months of 2004 and 2003, respectively.

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

	Three Months Ended March 31,	
	2004	2003
Net earnings applicable to common stockholders	\$ 5,287	\$ 1,721
Additional accretion expense	--	--
Cumulative effect of accounting change	--	1,309
	\$ 5,287	\$ 3,030
Pro forma net earnings		
Pro forma earnings per share:		
Basic	\$ 0.08	\$ 0.06
Diluted	\$ 0.08	\$ 0.06

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

Asset retirement obligation at December 31, 2002	\$ 4,523
Additional retirement obligations recorded in 2003	338
Reduction due to property sale in 2003	(1,010)
Other revisions during 2003	(416)
Accretion expense for 2003	667
	4,102
Asset retirement obligation at December 31, 2003	
Additional retirement obligations recorded in 2004	61
Accretion expense for 2004	119
	\$ 4,282

### 10. NEW ACCOUNTING PRONOUNCEMENTS

In June 2001, the FASB issued SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 addresses accounting and reporting for business combinations and is effective for all business

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combinations initiated after June 30, 2001. SFAS No. 142 addresses the accounting and reporting for goodwill subsequent to acquisition and other intangible assets. The new standard eliminates

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the requirement to amortize acquired goodwill; instead, such goodwill is required to be reviewed at least annually for impairment. The new standard also requires that, at a minimum, all intangible assets be aggregated and presented as a separate line item in the balance sheet. The adoption of SFAS No. 141 and SFAS No. 142 had no impact on the Company's financial position or results of operations.

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires the fair value of a liability for an asset retirement obligation to be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. SFAS No. 143 was effective for the Company on January 1, 2003. See Note 3. for discussion of the impact on the Company's consolidated financial statements.

During December 2003, the FASB issued Interpretation No. 46R, "Consolidation of Variable Interest Entities" ("FIN 46"), which requires the consolidation of certain entities that are determined to be variable interest entities ("VIE's"). An entity is considered to be a VIE when either (i) the entity lacks sufficient equity to carry on its principal operations, (ii) the equity owners of the entity cannot make decisions about the entity's activities or (iii) the entity's equity neither absorbs losses or benefits from gains. Meridian owns no interests in variable interest entities, and therefore this new interpretation has not affected the Company's consolidated financial statements.

In May 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 149 is generally effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. The adoption of this statement did not have a material effect on the Company's financial statements.

In May 2003, the FASB issued SFAS No. 150 "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 establishes the standards on how companies classify and measure certain financial instruments with characteristics of both liabilities and equity. The statement requires that the Company classify as liabilities the fair value of all mandatorily redeemable financial instruments that had previously been recorded as equity or elsewhere in the consolidated financial statements. This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise effective for all existing financial instruments beginning in the third quarter of 2003. This statement did not have any significant impact on the Company's consolidated financial statements.

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

The following is a discussion of Meridian's financial operations for the three months ended March 31, 2004 and 2003. The Company's consolidated financial

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statements included in this report, as well as our Annual Report on Form 10-K for the year ended December 31, 2003 (and the notes attached thereto), should be read in conjunction with this discussion.

### GENERAL.

**BUSINESS ACTIVITIES.** During the first three months of 2004, Meridian's exploration activities have been focused primarily in the Company's Biloxi Marshlands and Weeks Island project areas. As a result of these and similar operations during the last twelve months, the average daily production for the first quarter of 2004 increased by 52% to 94.5 Mmcfe compared to an average daily rate of 62.7 Mmcfe for the first quarter of 2003. Current production is between 95 Mmcfe and 100 Mmcfe per day and does not include the most recently announced Biloxi Marshlands 22/SL17980 No. 1 well, which tested at a daily production rate of approximately 9.0 Mmcfe/d. In April 2004, the Biloxi Marshlands No. 19-1 well was placed on production at a gross rate of 9.1 Mmcf/d. The Biloxi Marshlands 22/SL17980 No. 1 well is expected to be placed on production during the second half of the year.

Total capital expenditures for this period approximated \$25.4 million. Since the beginning of the year, the Company has drilled four successful wells in the Biloxi Marshlands and Weeks Island project areas. In addition to the drilling activities, Meridian is extending its proprietary 3-D data base at Biloxi Marshlands with the shooting of 258 square miles of new data by the end of June 2004, the total of which ultimately will provide over 578 square miles covering approximately 400,000 acres in St. Bernard Parish, Louisiana. The 2004 exploration drilling and seismic acquisition activities were initiated in January 2004 with approximately 75% of the area having been shot and 25% of the data has already been delivered. It is anticipated that the Biloxi Marshlands project area will comprise a substantial portion of the Company's future drilling inventory over the next several years as it continues to work the entire 3-D data set ranging in depths from the shallow Deltaic sand formations to the deep cretaceous sand formations for new prospect opportunities.

The Ducros et al No. 32-1 well in the Biloxi Marshlands area was spudded on April 23, 2004, and will be drilled to a measured depth of approximately 12,500 feet. The well is currently at approximately 9,800 feet and is expected to take up to 30 days to drill and complete. The Company holds a 92% working interest in the well. In addition, Meridian anticipates that the second rig planned for the Biloxi Marshlands area will arrive May 2004 and will begin drilling the Biloxi Marshlands No. 27-1 well on the Eros Deep prospect which is located near the Ducros et al No. 32-1 and the Biloxi Marshlands 22/SL 17980 No. 1 wells.

The Company previously disclosed in its recent Annual Report on Form 10-K, that it intends to increase its capital budget to approximately \$95 million for 2004 or 25% over its 2003 spending, subject to adjustments depending on drilling results, oil and natural gas prices and other factors. It is expected that Meridian will drill 20-30 wells during 2004, primarily focused in its Biloxi Marshlands project area.

As a result, the Company's revenues for the first quarter increased in excess of 59% when compared to the same period last year, cash flows from operations increased in excess of 108% for the same period and net earnings increased over 207%.

**INDUSTRY CONDITIONS.** Revenues, profitability and future growth rates of Meridian are substantially dependent upon prevailing prices for oil and natural gas. Oil and natural gas prices have been extremely volatile in recent years and are affected by many factors outside of our control. Our average oil price (after adjustments for hedging activities) for the three months ended March 31, 2004, was \$25.10 per barrel compared to \$25.15 per barrel for the three months ended March 31, 2003, and \$25.04 per barrel for the three months ended



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December 31, 2003. Our average natural gas price (after adjustments for hedging activities) for the three months ended March 31, 2004, was \$5.70 per Mcf compared to \$5.82 per Mcf for the three months ended March 31, 2003, and \$4.66 per Mcf for the three months ended December 31, 2003. Fluctuations in prevailing prices for oil and natural gas have several important consequences to us, including affecting the level of cash flow received from our producing properties, the timing of exploration of certain prospects and our access to capital markets, which could impact our revenues, profitability and ability to maintain or increase our exploration and development program.

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

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## RESULTS OF OPERATIONS

### THREE MONTHS ENDED MARCH 31, 2004 COMPARED TO THREE MONTHS ENDED MARCH 31, 2003

OPERATING REVENUES. First quarter 2004 oil and natural gas revenues increased \$17.2 million (59%) as compared to first quarter 2003 revenues due to a 52% increase in production volumes primarily from the Company's previously announced drilling results in the Biloxi Marshlands project area and Weeks Island coupled with successful workover operations in the Company's Ramos and Weeks Island fields, offset by natural production declines and property sales. Further, revenues were enhanced by a 5% increase in average commodity prices on a natural gas equivalent basis. The drilling and workover success increased our average daily production from 63 Mmcfe during the first quarter of 2003 to 94 Mmcfe for the first quarter of 2004. Oil and natural gas production volume totaled 8,596 Mmcfe for the first quarter of 2004, compared to 5,646 Mmcfe for the comparable period of 2003. Current production is ranging between 95 Mmcfe and 100 Mmcfe per day and does not include the most recently announced Biloxi Marshlands 22/SL17980 No. 1 well, which tested at a daily production rate of approximately 9.0 Mmcfe/d. In April 2004, the Biloxi Marshlands No. 19-1 well was placed on production at a gross rate of 9.1 Mmcf/d. The Biloxi Marshlands 222/SL 1980 No. 1 well is expected to be placed on production during the second half of the year.

The following table summarizes the Company's operating revenues, production volumes and average sales prices for the three months ended March 31, 2004 and 2003:

	THREE MONTHS ENDED		
	MARCH 31,		
	2004	2003	INCREASE (DECREASE)
	-----	-----	-----
Production Volumes:			
Oil (Mbbbl)	311	397	(22)%

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Natural gas (MMcf)	6,729	3,263	106%
Mmcfe	8,596	5,646	52%
 Average Sales Prices:			
Oil (per Bbl)	\$ 25.10	\$ 25.15	0%
Natural gas (per Mcf)	\$ 5.70	\$ 5.82	(2)%
Mmcfe	\$ 5.37	\$ 5.13	5%
 Operating Revenues (000's):			
Oil	\$ 7,807	\$ 9,985	(22)%
Natural gas	38,333	19,002	102%
	-----	-----	
Total Operating Revenues	\$46,140	\$28,987	59%
	=====	=====	

OPERATING EXPENSES. Oil and natural gas operating expenses on an aggregate basis increased \$0.5 million (21%) to \$3.0 million during the first quarter of 2004, compared to \$2.5 million in 2003. However, on a unit basis, lease operating expenses decreased \$0.09 per Mcfe to \$0.35 per Mcfe for the first quarter of 2004 from \$0.44 per Mcfe for the first quarter of 2003. Oil and gas operating expenses include additional operating expenses associated with the Biloxi Marshlands project area, offset by savings resulting from sold properties, combined with other cost savings.

SEVERANCE AND AD VALOREM TAXES. Severance and ad valorem taxes increased \$0.5 million (27%) to \$2.3 million for the first quarter of 2004, compared to \$1.8 million during the same period in 2003 primarily because of an increase in natural gas production and a higher natural gas tax rate. Meridian's oil and natural gas production is primarily from Louisiana, and is therefore subject to Louisiana severance tax. The severance

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tax rates for Louisiana are 12.5% of gross oil revenues and \$0.171 per Mcf for natural gas, an increase from \$0.122 per Mcf for the first half of 2003. The Company's increase was primarily due to the increase in natural gas production and the increase in the natural gas tax rate. On an equivalent unit of production basis, severance and ad valorem taxes decreased to \$0.27 per Mcfe from \$0.32 per Mcfe for the comparable three-month period, reflecting a shift in the mix between oil and natural gas production.

DEPLETION AND DEPRECIATION. Depletion and depreciation expense increased \$9.0 million (62%) during the first quarter of 2004 to \$23.7 million, from \$14.7 million for the same period of 2003. This was primarily the result of the 52% increase in production volumes in 2004 over 2003 levels, and an increase in the depletion rate as compared to the 2003 period. On a unit basis, depletion and depreciation expense increased by \$0.16 per Mcfe, to \$2.76 per Mcfe for the three months ended March 31, 2004, compared to \$2.60 per Mcfe for the same period in 2003.

GENERAL AND ADMINISTRATIVE EXPENSE. General and administrative expense increased \$0.4 million to \$3.2 million compared to \$2.8 million for 2003. On an equivalent unit of production basis, general and administrative expenses decreased \$0.13 per Mcfe to \$0.37 per Mcfe for the first quarter of 2004 compared to \$0.50 per Mcfe for the comparable 2003 period.

INTEREST EXPENSE. Interest expense decreased \$0.3 million (12%), to \$2.2 million for the first quarter of 2004 in comparison to the first quarter of 2003. The decrease is primarily a result of reduction in long-term debt, partially offset by an increase in interest rate from the prior year. Subsequent to March 31,

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2004, the Company has made additional repayments on the outstanding borrowings totaling \$5 million. With the conversion of the \$20 million convertible subordinated notes into common stock and the April 2004 repayment of \$5.0 million subordinated credit, the Company should see interest expense decrease an additional \$0.5 million per quarter.

ADOPTION OF STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 143. On January 1, 2003, the Company adopted Statement of Financial Accounting Standards No. 143 ("SFAS No. 143"), "Accounting for Asset Retirement Obligations." As a result, the Company recorded a long-term liability of \$4.5 million representing the discounted present value of the estimated retirement obligations and an increase in capitalized oil and gas properties of \$3.2 million. The liability will be accreted to its future value in subsequent reporting periods and will be charged to earnings on the Company's Consolidated Statement of Operations as "Accretion Expense." As a result of adoption of SFAS No. 143, the Company has charged approximately \$0.1 million to earnings as accretion expense during the 2004 and 2003 periods. The cumulative effect of the change in accounting principle for prior years totaled \$1.3 million, or \$0.03 per share, and was charged to earnings in the first quarter of 2003.

### LIQUIDITY AND CAPITAL RESOURCES

WORKING CAPITAL. During the first quarter of 2004, Meridian's capital expenditures were internally financed with cash from operations. As of March 31, 2004, the Company had a cash balance of \$16.0 million and a working capital deficit of \$14.2 million. This deficit was made up primarily of \$10.0 million of current maturities of long-term debt, \$5 million of which was paid in April 2004, and an \$11.6 million net current liability associated with price risk management activities which will be offset by future revenues. Management's strategy is to grow the Company prudently, taking advantage of the strong asset base built over the years and to add reserves through the drill bit while maintaining a disciplined approach to costs. Where appropriate, the Company will allocate excess cash above capital expenditures to reduce leverage.

CASH FLOWS. Net cash provided by operating activities was \$37.0 million for the three months ended March 31, 2004, as compared to \$17.8 million for the same period in 2003. The increase of \$19.2 million was primarily due to the increase in operating revenues of \$17.2 million and resulting increase in non-cash depletion and depreciation charges in the first three months of 2004, over the first three months of 2003.

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Net cash used in investing activities was \$25.4 million during the three months ended March 31, 2004, versus \$16.0 million in the first three months of 2003. The increase in capital expenditures of \$9.4 million was primarily associated with the acquisition of the Company's new 258-square mile 3-D survey at the Biloxi Marshlands project area, coupled with drilling and related activities.

Cash flows used in financing activities during the first three months of 2004 were \$8.5 million, compared to cash used in financing activities of \$1.9 million during the first three months of 2003. This additional cash used in financing activities was primarily due to \$3.0 million paid in preferred stock dividends coupled with the increase in debt repayments of \$5.3 million. With the preferred stock conversion of approximately \$23 million, the Company will see an annual \$2.0 million reduction of dividend payments.

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

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Corporation, as co-lead arranger and documentation agent. Borrowings under the Credit Agreement mature on August 13, 2005. The borrowing base is currently set at \$130 million and has been redetermined to \$127.5 million effective on April 30, 2004. Credit Facility payments of \$5.3 million have been made during the first three months of 2004, bringing the outstanding balance to \$117 million as of March 31, 2004. The Company anticipates that it will continue to make additional debt repayments during the remainder of the year.

In addition to the scheduled quarterly borrowing base redeterminations, the lenders or borrower, under the Credit Agreement, have the right to redetermine the borrowing base at any time, once during each calendar year. Borrowings under the Credit Agreement are secured by pledges of outstanding capital stock of the Company's subsidiaries and a mortgage on the Company's oil and natural gas properties of at least 90% of its present value of proved properties. The Credit Agreement contains various restrictive covenants, including, among other items, maintenance of certain financial ratios and restrictions on cash dividends on Common Stock and under certain circumstances Preferred Stock, and an unqualified audit report on the Company's consolidated financial statements.

Under the Credit Agreement, the Company may secure either (i) (a) an alternative base rate loan that bears interest at a rate per annum equal to the greater of the administrative agent's prime rate; or (b) federal funds-based rate plus  $1/2$  of 1% , plus an additional 0.5% to 1.5% depending on the ratio of the aggregate outstanding loans and letters of credit to the borrowing base or; (ii) a Eurodollar base rate loan that bears interest, generally, at a rate per annum equal to the London interbank offered rate ("LIBOR") plus 1.5% to 2.5%, depending on the ratio of the aggregate outstanding loans and letters of credit to the borrowing base. At March 31, 2004, the three-month LIBOR interest rate was 1.11%. The Credit Agreement also provides for commitment fees ranging from 0.375% to 0.5% per annum.

**SUBORDINATED CREDIT AGREEMENT.** The Company extended and amended a short-term subordinated credit agreement with Fortis Capital Corporation for \$25 million on April 5, 2002, with a maturity date of December 31, 2004. The notes are unsecured and contain customary events of default, but do not contain any maintenance or other restrictive covenants. The interest rate is LIBOR plus 5.5% from January 1, 2003, through August 31, 2003, and LIBOR plus 6.5% from September 1, 2003, through December 31, 2004. At March 31, 2004, the three-month LIBOR interest rate was 1.11%. A note payment of \$5 million was made during April 2004, with the remaining \$5 million payable on December 31, 2004. The Company is in compliance with the terms of this agreement.

**9 1/2% CONVERTIBLE SUBORDINATED NOTES.** During March 2004, the Notes were converted into 4.0 million shares of the Company's Common Stock at a conversion price of \$5.00 per share, and included an additional non-

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cash conversion expense of approximately \$1.2 million that was incurred and paid via the issuance of Common Stock priced at market.

**8.5% REDEEMABLE CONVERTIBLE PREFERRED STOCK.** A private placement of \$66.85 million of 8.5% redeemable convertible preferred stock was completed during May 2002. The preferred stock is convertible into shares of the Company's Common Stock at a conversion price of \$4.45 per share. Dividends are payable semi-annually in cash or additional preferred stock. At the option of the Company, one-third of the preferred shares can be forced to convert to Common Stock if the closing price of the Company's Common Stock exceeds 150% of the conversion price for 30 out of 40 consecutive trading days on the New York Stock Exchange. Based on the above conversion criteria, the Company can elect to convert up to one-third of the then outstanding shares. The preferred stock is

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subject to redemption at the option of the Company after March 2005, and mandatory redemption on March 31, 2009. The holders of the preferred stock have been granted registration rights with respect to the shares of Common Stock issued upon conversion of the preferred stock. In the fourth quarter of 2003, \$12.2 million of preferred stock was converted into 2.7 million shares of Common Stock. In addition, \$6.6 million of preferred stock was converted into 1.5 million shares of Common Stock during the first quarter of 2004. Subsequent to March 31, 2004, \$5.3 million of additional preferred stock has been converted into 1.2 million shares of Common Stock.

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

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

**CAPITAL EXPENDITURES.** Total capital expenditures for this period approximated \$25.4 million. Although the Company plans to commence additional drilling during the remainder of 2004, such operations will depend primarily on achieving anticipated cash flows, permitting of wells and the availability of suitable drilling rigs. Meridian recently completed the final field work on its 187-square mile 3-D seismic survey at its Biloxi Marshlands acreage and preliminary indications are that a number of additional drilling locations are present in the area encompassing the new survey which will form the basis for its future drilling activities during 2004 and 2005.

Based on internal projections, using its internal risk analysis of production based on an expected capital expenditures program for 2004 of \$95 million, the Company believes that it can further improve its balance sheet while, at the same time, continuing its scheduled capital expenditure program, drilling 15 to 20 low-risk wells and acquiring additional 3-D seismic data over its Biloxi Marshlands project and other exploration areas targeted for exploration growth.

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

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stock.

### FORWARD-LOOKING INFORMATION

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

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

**CHANGES IN THE PRICE OF OIL AND NATURAL GAS.** The prices we receive for our oil and natural gas production and the level of such production are subject to wide fluctuations and depend on numerous factors that we do not control, including seasonality, worldwide economic conditions, the condition of the United States economy (particularly the manufacturing sector), foreign imports, political conditions in other oil-producing countries, the actions of the Organization of Petroleum Exporting Countries and domestic government regulation, legislation and policies. Material declines in the prices received for oil and natural gas could make the actual results differ from those reflected in our forward-looking statements.

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

**DRILLING RISKS.** Our decision to purchase, explore, develop or otherwise exploit a prospect or property will depend in part on the evaluation of data obtained through geophysical and geological analysis, production data

and engineering studies, which are inherently imprecise. Therefore, we cannot assure you that all of our drilling activities will be successful or that we will not drill uneconomical wells. The occurrence of unexpected drilling results could cause the actual results to differ from those reflected in our forward-looking statements.

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

BORROWING BASE FOR THE CREDIT FACILITY. The Credit Agreement with Societe Generale and Fortis Capital Corporation is presently scheduled for borrowing base redetermination dates on a quarterly basis with the next such redetermination scheduled for July 31, 2004. The borrowing base is redetermined on numerous factors including current reserve estimates, reserves that have recently been added, current commodity prices, current production rates and estimated future net cash flows. These factors have associated risks with each of them. Significant reductions or increases in the borrowing base will be determined by these factors, which, to a significant extent, are not under the Company's control.

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### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

#### INTEREST RATES

We are subject to interest rate risk on our long-term fixed interest rate debt and variable interest rate borrowings. Our long-term borrowings primarily consist of borrowings under the Credit Facility and principal due December 31, 2004 under our Subordinated Credit Agreement. Since interest charged borrowings under the Credit Facility floats with prevailing interest rates (except for the applicable interest period for Eurodollar loans), the carrying value of borrowings under the Credit Facility should approximate the fair market value of such debt. Changes in interest rates, however, will change the cost of borrowing. Assuming \$117.0 million remains borrowed under the Credit Facility and \$5 million remains borrowed under the Subordinated Credit Agreement, we estimate our annual interest expense will change by \$1.17 million for each 100 basis point change in the applicable interest rates utilized under the Credit Facility and \$5 million from the Subordinated Credit Agreement. Changes in interest rates would, assuming all other things being equal, cause the fair market value of debt with a fixed interest rate, such as the Notes, to increase

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or decrease, and thus increase or decrease the amount required to refinance the debt. The fair value of the Notes is dependent on prevailing interest rates.

### HEDGING CONTRACTS

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

In 2002, we entered into certain swap agreements as summarized in the table below. The Notional Amount is equal to the total net volumetric hedge position of the Company during the periods presented. The positions effectively hedge approximately 10% of our proved developed natural gas production and 71% of our proved developed oil production during the respective terms of the swap agreements. The fair values of the hedges are based on the difference between the strike price and the New York Mercantile Exchange future prices for the applicable trading months.

	Notional Amount	Weighted Average Stri Price (\$ per unit)
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Natural Gas (mmbtu)		
April 2004 - June 2005	2,890,000	\$ 3.73
Oil (bbls)		
April 2004 - July 2005	776,000	\$23.45

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### ITEM 4. CONTROLS AND PROCEDURES

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



PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

RAMOS TITLE LITIGATION. Three different groups have asserted adverse title claims to some or all of Section 80 within Meridian's "Thibodaux units" in the Ramos Field. Another entity has asserted adverse title claims to a portion of Section 36 within these same units. These claims turn primarily on the location of the parish boundary between Terrebonne and Assumption Parishes and/or the validity of various tax sales. Meridian's gas purchaser, Louisiana Intrastate Gas Company LLC ("LIG"), has deposited into the Terrebonne Parish court registry certain gas and plant-product proceeds attributable to 25 acres within these units since October 2000, and Meridian has been suspending all remaining proceeds attributable to these same 25 acres since December 2000. Meridian has reached an agreement with the various parties whereby the parties will grant a lease to the current interest owners for a lease bonus of \$4.5 million and a future royalty interest of 1.5%.

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

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

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

(a) Exhibits

- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) under the Securities Exchange Act of 1934, as amended.
- 31.2 Certification of President pursuant to Rule 13a-14(a) or Rule 15d-14(a) under the Securities Exchange Act of 1934, as amended.
- 31.3 Certification of Chief Accounting Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) under the Securities Exchange Act of 1934, as amended.
- 32.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) under the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350.
- 32.2 Certification of President pursuant to Rule 13a-14(b) or Rule 15d-14(b) under the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350.
- 32.3 Certification of Chief Accounting Officer pursuant Rule 13a-14(b) or Rule 15d-14(b) under the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350.

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(b) Reports on Form 8-K.

None.

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### SIGNATURES

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

THE MERIDIAN RESOURCE CORPORATION AND SUBSIDIARIES  
(Registrant)

Date: May 5, 2004

By: /s/ LLOYD V. DELANO

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Lloyd V. DeLano  
Senior Vice President  
Chief Accounting Officer

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### INDEX TO EXHIBITS

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