

HESS CORP
Form 10-Q
November 07, 2007

Table of Contents

**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 quarter ended *September 30, 2007*

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 1-1204**

HESS CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

DELAWARE

(State or Other Jurisdiction of Incorporation or Organization)

13-4921002

(I.R.S. Employer Identification Number)

1185 AVENUE OF THE AMERICAS, NEW YORK, N.Y.

(Address of Principal Executive Offices)

10036

(Zip Code)

(Registrant's Telephone Number, Including Area Code is (212) 997-8500)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes

No

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

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

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

No

At September 30, 2007, there were 319,449,308 shares of Common Stock outstanding.

TABLE OF CONTENTS

PART I-FINANCIAL INFORMATION

Item 1. Financial Statements

Item 2. Management's Discussion and Analysis of Results of Operations and Financial Condition

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Item 4. Controls and Procedures

PART II OTHER INFORMATION

Item 1. Legal Proceedings

Item 6. Exhibits and Reports on Form 8-K

SIGNATURES

EX-31.1: CERTIFICATION

EX-31.2: CERTIFICATION

EX-32.1: CERTIFICATION

EX-32.2: CERTIFICATION

Table of Contents**PART I-FINANCIAL INFORMATION****Item 1. Financial Statements.**

HESS CORPORATION AND CONSOLIDATED SUBSIDIARIES
STATEMENT OF CONSOLIDATED INCOME (UNAUDITED)
(In millions, except per share data)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2007	2006	2007	2006
REVENUES AND NON-OPERATING INCOME				
Sales (excluding excise taxes) and other operating revenues	\$ 7,451	\$ 7,035	\$ 22,191	\$ 20,912
Non-operating income				
Equity in income of HOVENSA L.L.C.	19	67	156	172
Gain on asset sales			21	369
Other, net	34	25	56	59
Total revenues and non-operating income	7,504	7,127	22,424	21,512
COSTS AND EXPENSES				
Cost of products sold (excluding items shown separately below)	5,322	4,899	15,922	14,854
Production expenses	394	323	1,118	892
Marketing expenses	238	230	701	686
Exploration expenses, including dry holes and lease impairment	131	221	314	412
Other operating expenses	45	32	115	89
General and administrative expenses	133	115	406	354
Interest expense	59	49	185	150
Depreciation, depletion and amortization	365	323	1,046	871
Total costs and expenses	6,687	6,192	19,807	18,308
INCOME BEFORE INCOME TAXES	817	935	2,617	3,204
Provision for income taxes	422	639	1,295	1,643
NET INCOME	\$ 395	\$ 296	\$ 1,322	\$ 1,561
Less preferred stock dividends		12		36
NET INCOME APPLICABLE TO COMMON SHAREHOLDERS	\$ 395	\$ 284	\$ 1,322	\$ 1,525
NET INCOME PER SHARE				
BASIC	\$ 1.26	\$ 1.03	\$ 4.24	\$ 5.54
DILUTED	1.23	.94	4.15	4.95
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING (DILUTED)	319.9	316.0	318.6	315.5
COMMON STOCK DIVIDENDS PER SHARE	\$.10	\$.10	\$.30	\$.30

See accompanying notes to consolidated financial statements.

Table of Contents

PART I-FINANCIAL INFORMATION (CONT. D.)
HESS CORPORATION AND CONSOLIDATED SUBSIDIARIES
CONSOLIDATED BALANCE SHEET (UNAUDITED)

(In millions of dollars, thousands of shares)

	September 30, 2007	December 31, 2006
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 565	\$ 383
Accounts receivable	3,076	3,873
Inventories	1,341	1,005
Other current assets	287	587
Total current assets	5,269	5,848
INVESTMENTS IN AFFILIATES		
HOVENSA L.L.C.	1,011	1,055
Other	180	188
Total investments in affiliates	1,191	1,243
PROPERTY, PLANT AND EQUIPMENT		
Total at cost	25,122	21,980
Less reserves for depreciation, depletion, amortization and lease impairment	10,849	9,672
Property, plant and equipment net	14,273	12,308
GOODWILL	1,225	1,253
DEFERRED INCOME TAXES	1,634	1,430
OTHER ASSETS	344	360
TOTAL ASSETS	\$ 23,936	\$ 22,442
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 4,440	\$ 4,803
Accrued liabilities	1,458	1,477
Taxes payable	458	432
Current maturities of long-term debt	46	27
Total current liabilities	6,402	6,739
LONG-TERM DEBT	3,939	3,745
DEFERRED INCOME TAXES	2,310	2,116

ASSET RETIREMENT OBLIGATIONS	826	824
OTHER LIABILITIES	950	871
Total liabilities	14,427	14,295
STOCKHOLDERS EQUITY		
Preferred stock, \$1.00 par value, 20,000 shares authorized 3% cumulative convertible series Authorized 330 shares Issued 284 shares (\$14 million liquidation preference)		
Common stock, \$1.00 par value Authorized 600,000 shares Issued 319,449 shares at September 30, 2007; 315,018 shares at December 31, 2006	319	315
Capital in excess of par value	1,831	1,689
Retained earnings	8,933	7,707
Accumulated other comprehensive income (loss)	(1,574)	(1,564)
Total stockholders equity	9,509	8,147
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 23,936	\$ 22,442

See accompanying notes to consolidated financial statements.

Table of Contents

PART I-FINANCIAL INFORMATION (CONT. D.)
HESS CORPORATION AND CONSOLIDATED SUBSIDIARIES
STATEMENT OF CONSOLIDATED CASH FLOWS (UNAUDITED)
(In millions of dollars)

	Nine Months Ended	
	September 30,	
	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 1,322	\$ 1,561
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation, depletion and amortization	1,046	871
Exploratory dry hole costs	25	192
Lease impairment	50	79
Pre-tax gain on asset sales	(21)	(369)
Provision for deferred income taxes	66	286
Distributed earnings of HOVENSA L.L.C., net	44	128
Changes in other operating assets and liabilities	169	(36)
Net cash provided by operating activities	2,701	2,712
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(2,773)	(2,883)
Proceeds from asset sales	93	444
Payments received on notes receivable	46	61
Other	(52)	20
Net cash used in investing activities	(2,686)	(2,358)
CASH FLOWS FROM FINANCING ACTIVITIES		
Debt with maturities of greater than 90 days		
Borrowings	761	21
Repayments	(548)	(31)
Cash dividends paid	(127)	(148)
Employee stock options exercised	81	35
Net cash provided by (used in) financing activities	167	(123)
NET INCREASE IN CASH AND CASH EQUIVALENTS	182	231
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	383	315
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 565	\$ 546

See accompanying notes to consolidated financial statements.

Table of Contents

PART I-FINANCIAL INFORMATION (CONT. D.)
HESS CORPORATION AND CONSOLIDATED SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Basis of Presentation

The financial statements included in this report reflect all normal and recurring adjustments which, in the opinion of management, are necessary for a fair presentation of Hess Corporation's (the Corporation) consolidated financial position at September 30, 2007 and December 31, 2006, the consolidated results of operations for the three and nine month periods ended September 30, 2007 and 2006 and the consolidated cash flows for the nine month periods ended September 30, 2007 and 2006. The unaudited results of operations for the interim periods reported are not necessarily indicative of results to be expected for the full year.

Certain notes and other information have been condensed or omitted from these interim financial statements. These statements, therefore, should be read in conjunction with the consolidated financial statements and related notes included in the Corporation's Form 10-K for the year ended December 31, 2006.

Effective January 1, 2007, the Corporation adopted Financial Accounting Standards Board (FASB) Staff Position (FSP) AUG AIR-1, *Accounting for Planned Major Maintenance Activities*. This FSP eliminates the previously acceptable accrue-in-advance method of accounting for planned major maintenance. As a result, the Corporation retrospectively changed its method of accounting to recognize expenses associated with refinery turnarounds when such costs are incurred. The impact of adopting this FSP decreased previously reported third quarter 2006 net income by \$1 million with no impact to diluted earnings per share and increased previously reported net income for the nine months ended September 30, 2006 by \$4 million (\$.02 per diluted share). The impact on the fourth quarter of 2006 was not material. In addition, previously reported net income for the year ended December 31, 2005 decreased by \$16 million and retained earnings as of January 1, 2005 increased by \$48 million. Prior period financial information in the financial statements and notes reflect this retrospective accounting change.

Effective January 1, 2007, the Corporation adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 prescribes the financial statement recognition and measurement criteria for a tax position taken or expected to be taken in a tax return. FIN 48 also requires additional disclosures related to uncertain income tax positions. See note 9, *Income Taxes*, for further information.

2. Acquisition

In February 2007, the Corporation completed the acquisition of a 28% interest in the Genghis Khan oil and gas development located in the deepwater Gulf of Mexico on Green Canyon Blocks 652 and 608 for \$371 million, of which \$342 million was allocated to proved and unproved properties and the remainder to wells and equipment. The Genghis Khan development is part of the same geologic structure as the Shenzi development. This transaction was accounted for as an acquisition of assets.

Table of Contents

PART I-FINANCIAL INFORMATION (CONT. D.)
HESS CORPORATION AND CONSOLIDATED SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. Inventories

Inventories consist of the following (in millions):

	September 30, 2007	December 31, 2006
Crude oil and other charge stocks	\$ 346	\$ 202
Refined products and natural gas	1,484	1,185
Less: LIFO adjustment	(847)	(676)
	983	711
Merchandise, materials and supplies	358	294
Total inventories	\$ 1,341	\$ 1,005

4. Refining Joint Venture

The Corporation accounts for its investment in HOVENSA L.L.C. (HOVENSA) using the equity method.

Summarized financial information for HOVENSA follows (in millions):

	September 30, 2007	December 31, 2006*
Summarized balance sheet		
Cash and short-term investments	\$ 355	\$ 290
Other current assets	991	943
Net fixed assets	2,161	2,123
Other assets	42	32
Current liabilities	(1,149)	(1,013)
Long-term debt	(356)	(252)
Deferred liabilities and credits	(75)	(70)
Members' equity	\$ 1,969	\$ 2,053

	Three months ended September 30, 2007		Nine months ended September 30, 2006*	
	2007	2006*	2007	2006*
Summarized income statement				
Total sales	\$ 3,539	\$ 3,319	\$ 9,181	\$ 9,041
Cost and expenses	(3,500)	(3,184)	(8,866)	(8,692)
Net income	\$ 39	\$ 135	\$ 315	\$ 349

Hess Corporation's share, before income taxes	\$ 19	\$ 67	\$ 156	\$ 172
---	-------	-------	--------	--------

(*) Reflects the impact of the retrospective adoption of a new accounting pronouncement related to expensing the costs of refinery turnarounds.

During the first nine months of 2007 and 2006, the Corporation received cash distributions from HOVENSA of \$200 million and \$300 million, respectively.

Table of Contents**PART I-FINANCIAL INFORMATION (CONT. D.)****HESS CORPORATION AND CONSOLIDATED SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****5. Capitalized Exploratory Well Costs**

The following table discloses the net changes in capitalized exploratory well costs pending determination of proved reserves for the nine months ended September 30, 2007 (in millions):

Beginning balance at January 1	\$ 399
Additions to capitalized exploratory well costs pending the determination of proved reserves	195
Reclassifications to wells, facilities, and equipment based on the determination of proved reserves	(20)
Ending balance at September 30	\$ 574

The preceding table excludes costs related to exploratory dry holes of \$25 million, which were incurred and subsequently expensed in 2007. Capitalized exploratory well costs greater than one year old after completion of drilling were \$130 million as of September 30, 2007 and \$71 million as of December 31, 2006.

6. Long-Term Debt and Capitalized Interest

At September 30, 2007, the Corporation classified an aggregate of \$457 million of borrowings under short-term credit facilities as long-term debt, based on the available capacity under the \$3 billion syndicated revolving credit facility, substantially all of which is committed through May 2012.

Capitalized interest on development projects amounted to the following (in millions):

	Three months ended September 30		Nine months ended September 30	
	2007	2006	2007	2006
Capitalized interest	\$ 18	\$ 25	\$ 49	\$ 75

7. Foreign Currency

Pre-tax foreign currency gains (losses) amounted to the following (in millions):

	Three months ended September 30		Nine months ended September 30	
	2007	2006	2007	2006
Foreign currency gains (losses)	\$ 20	\$ (2)	\$ 14	\$ 11

Table of Contents

PART I-FINANCIAL INFORMATION (CONT. D.)
HESS CORPORATION AND CONSOLIDATED SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

8. Retirement Plans

Components of net periodic pension cost consisted of the following (in millions):

	Three months		Nine months	
	ended September 30		ended September 30	
	2007	2006	2007	2006
Service cost	\$ 11	\$ 9	\$ 29	\$ 26
Interest cost	18	17	52	49
Expected return on plan assets	(18)	(18)	(52)	(49)
Amortization of prior service cost				1
Amortization of net loss	6	8	16	20
Pension expense	\$ 17	\$ 16	\$ 45	\$ 47

In 2007, the Corporation expects to contribute approximately \$75 million to its funded pension plans and \$15 million to the trust established for its unfunded pension plan. Through September 30, 2007, the Corporation contributed \$58 million to its pension plans.

9. Income Taxes

The provision for income taxes consisted of the following (in millions):

	Three months		Nine months	
	ended September 30		ended September 30	
	2007	2006	2007	2006
Current	\$ 362	\$ 546	\$ 1,229	\$ 1,357
Deferred	60	48	71	241
Adjustment of deferred tax liability for foreign income tax rate change		45	(5)	45
Total	\$ 422	\$ 639	\$ 1,295	\$ 1,643

The Corporation adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, effective January 1, 2007. The impact of adoption was not material to the Corporation's financial position, results of operations or cash flows. A deferred tax asset of \$28 million related to an acquired net operating loss carryforward was recorded in conjunction with adopting FIN 48 and goodwill was reduced.

At January 1, 2007, the Corporation had \$142 million of unrecognized income tax benefits, of which \$76 million, if recognized, would affect the Corporation's effective income tax rate. The Corporation has elected to classify interest and penalties associated with uncertain tax positions as income tax expense.

The Corporation and its subsidiaries file income tax returns in the United States and various foreign jurisdictions. The Corporation is no longer subject to examinations by income tax authorities in most jurisdictions for years prior to 2002.

Edgar Filing: HESS CORP - Form 10-Q

In July 2006, the United Kingdom increased by 10% the supplementary tax on petroleum operations with an effective date of January 1, 2006. As a result, in the third quarter of 2006 the Corporation recorded a charge of \$105 million consisting of an incremental income tax of \$60 million on operating earnings for the first half of 2006 and \$45 million to adjust the United Kingdom deferred tax liability.

7

Table of Contents

PART I-FINANCIAL INFORMATION (CONT. D.)
HESS CORPORATION AND CONSOLIDATED SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

10. Weighted Average Common Shares

The weighted average number of common shares used in the basic and diluted earnings per share computations are as follows (in thousands):

	Three months ended September 30		Nine months ended September 30	
	2007	2006	2007	2006
Common shares basic	313,617	275,680	311,986	275,320
Effect of dilutive securities				
Restricted common stock	2,802	2,889	3,078	2,701
Stock options	2,856	3,237	2,889	3,187
Convertible preferred stock	590	34,243	601	34,243
Common shares diluted	319,865	316,049	318,554	315,451

11. Share-based Compensation

Share-based compensation expense was as follows (in millions):

	Three months ended September 30		Nine months ended September 30	
	2007	2006	2007	2006
Before income taxes	\$ 21	\$ 18	\$ 65	\$ 49