HESS CORP
Form 10-Q
November 06, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 10-Q

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

For the quarter ended *September 30, 2008*

or

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

For the transition period from __________ to __________

Commission File Number 1-1204

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 preceeding 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 þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o (Do not check if a smaller reporting company) Smaller Reporting Company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

At September 30, 2008, there were 326,068,288 shares of Common Stock outstanding.

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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 September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
REVENUES AND NON-OPERATING INCOME				
Sales (excluding excise taxes) and other operating revenues	$ 11,398	$ 7,451	$ 33,782	$ 22,191
Equity in income of HOVENSA L.L.C	52	19	23	156
Gain on asset sales				21
Other, net	(62)	34	38	56
Total revenues and non-operating income	11,388	7,504	33,843	22,424
COSTS AND EXPENSES				
Cost of products sold (excluding items shown separately below)	8,165	5,322	24,237	15,922
Production expenses	503	394	1,421	1,118
Marketing expenses	266	238	766	701
Exploration expenses, including dry holes and lease impairment	157	131	467	314
Other operating expenses	62	45	154	115
General and administrative expenses	170	133	478	406
Interest expense	68	59	200	185
Depreciation, depletion and amortization	497	365	1,431	1,046
Total costs and expenses	9,888	6,687	29,154	19,807
INCOME BEFORE INCOME TAXES	1,500	817	4,689	2,617
Provision for income taxes	725	422	2,255	1,295
NET INCOME	$ 775	$ 395	$ 2,434	$ 1,322
NET INCOME PER SHARE				
BASIC	$ 2.40	$ 1.26	$ 7.60	$ 4.24
DILUTED	2.37	1.23	7.47	4.15
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING (DILUTED)	327.4	319.9	325.7	318.6
COMMON STOCK DIVIDENDS PER SHARE	$ .10	$ .10	$ .30	$ .30

See accompanying notes to consolidated financial statements.

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PART I FINANCIAL INFORMATION (CONT D.)
HESS CORPORATION AND CONSOLIDATED SUBSIDIARIES
CONSOLIDATED BALANCE SHEET (UNAUDITED)
(In millions of dollars, thousands of shares)

	September 30, 2008	December 31, 2007
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 1,380	$ 607
Accounts receivable	4,652	4,708
Inventories	1,817	1,250
Other current assets	317	361
Total current assets	8,166	6,926
INVESTMENTS IN AFFILIATES		
HOVENSA L.L.C	907	933
Other	201	184
Total investments in affiliates	1,108	1,117
PROPERTY, PLANT AND EQUIPMENT		
Total at cost	28,153	24,831
Less reserves for depreciation, depletion, amortization and lease impairment	11,497	10,197
Property, plant and equipment net	16,656	14,634
GOODWILL	1,225	1,225
DEFERRED INCOME TAXES	2,109	1,873
OTHER ASSETS	314	356
TOTAL ASSETS	$ 29,578	$ 26,131
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 6,108	$ 5,741
Accrued liabilities	1,716	1,638
Taxes payable	897	583
Current maturities of long-term debt	39	62
Total current liabilities	8,760	8,024
LONG-TERM DEBT	3,893	3,918
DEFERRED INCOME TAXES	2,503	2,362

ASSET RETIREMENT OBLIGATIONS	1,344	1,016
OTHER LIABILITIES	847	1,037
Total liabilities	17,347	16,357
STOCKHOLDERS EQUITY		
Preferred stock, par value $1.00, 20,000 shares authorized		
3% cumulative convertible series		
Authorized 330 shares		
Issued 0 shares at September 30, 2008; 284 shares at December 31, 2007		
Common stock, par value $1.00		
Authorized 600,000 shares		
Issued 326,068 shares at September 30, 2008; 320,600 shares at December 31, 2007	326	321
Capital in excess of par value	2,074	1,882
Retained earnings	11,749	9,412
Accumulated other comprehensive income (loss)	(1,918)	(1,841)
Total stockholders equity	12,231	9,774
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 29,578	$ 26,131

See accompanying notes to consolidated financial statements.

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

	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 2,434	$ 1,322
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation, depletion and amortization	1,431	1,046
Exploratory dry hole costs and lease impairment	171	75
Pre-tax gain on asset sales		(21)
Provision for deferred income taxes	18	66
Distributed earnings of HOVENSA L.L.C., net	27	44
Changes in other operating assets and liabilities	(9)	169
Net cash provided by operating activities	4,072	2,701
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(3,282)	(2,773)
Proceeds from asset sales		93
Other, net	50	(6)
Net cash used in investing activities	(3,232)	(2,686)
CASH FLOWS FROM FINANCING ACTIVITIES		
Debt with maturities of greater than 90 days		
Borrowings	312	761
Repayments	(360)	(548)
Cash dividends paid	(130)	(127)
Employee stock options exercised	111	81
Net cash (used in) provided by financing activities	(67)	167
NET INCREASE IN CASH AND CASH EQUIVALENTS	773	182
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	607	383
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 1,380	$ 565

See accompanying notes to consolidated financial statements.

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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, 2008 and December 31, 2007, and the consolidated results of operations for the three and nine month periods ended September 30, 2008 and 2007 and the consolidated cash flows for the nine month periods ended September 30, 2008 and 2007. The unaudited results of operations for the interim periods reported are not necessarily indicative of results to be expected for the full year.

The financial statements were prepared in accordance with the requirements of the Securities and Exchange Commission (SEC) for interim reporting. As permitted under those rules, certain notes or other financial information that are normally required by U.S. generally accepted accounting principles (GAAP) 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, 2007.

Effective January 1, 2008, the Corporation adopted Financial Accounting Standards Board (FASB) Statement No. 157, *Fair Value Measurements* (FAS 157) for financial assets and liabilities that are required to be measured at fair value. FAS 157 established a framework for measuring fair value and requires disclosure of a fair value hierarchy (see Note 8, Fair Value Measurements). The impact of adopting FAS 157 was not material to the Corporation s results of operations. Upon adoption, the Corporation recorded a reduction in the net deferred hedge losses reflected in accumulated other comprehensive income, which increased stockholders equity by approximately $190 million, after income taxes.

In December 2007, the FASB issued FAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements-an amendment of ARB No. 51* (FAS 160). FAS 160 changes the accounting for and reporting of noncontrolling interests in a subsidiary. The Corporation is currently evaluating the impact of adoption on its financial statements and, as required, will adopt the provisions of FAS 160 effective January 1, 2009.

2. Inventories

Inventories consist of the following (in millions):

	September 30, 2008	December 31, 2007
Crude oil and other charge stocks	$ 519	$ 338
Refined products and natural gas	2,193	1,577
Less: LIFO adjustment	(1,336)	(1,029)
	1,376	886
Merchandise, materials and supplies	441	364
Total inventories	$ 1,817	$ 1,250

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3. 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, 2008	December 31, 2007
Summarized balance sheet		
Cash and short-term investments	$ 305	$ 279
Other current assets	1,240	1,183
Net fixed assets	2,149	2,181
Other assets	61	62
Current liabilities	(1,546)	(1,459)
Long-term debt	(356)	(356)
Deferred liabilities and credits	(85)	(75)
Members equity	$ 1,768	$ 1,815

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Summarized income statement				
Total sales	$ 5,404	$ 3,539	$ 15,143	$ 9,181
Cost and expenses	(5,299)	(3,500)	(15,092)	(8,866)
Net income	$ 105	$ 39	$ 51	$ 315
Hess Corporation s share, before income taxes	$ 52	$ 19	$ 23	$ 156

During the first nine months of 2008 and 2007, the Corporation received cash distributions from HOVENSA of $50 million and $200 million, respectively.

4. 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, 2008 (in millions):

Balance at beginning of period	$ 608
Additions to capitalized exploratory well costs pending the determination of proved reserves	455
Reclassifications to wells, facilities, and equipment based on the determination of proved reserves	(65)
Capitalized exploratory well costs charged to expense	(7)
Balance at end of period	$ 991

The preceding table excludes costs related to exploratory dry holes of $83 million which were incurred and subsequently expensed in 2008. Approximately 60% of the capitalized well costs are related to two projects in the deepwater Gulf of Mexico where further appraisal drilling is planned or development plans are being prepared.

Capitalized exploratory well costs greater than one year old after completion of drilling were $380 million as of September 30, 2008 and $304 million as of December 31, 2007.

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5. Long-Term Debt and Capitalized Interest

At September 30, 2008, the Corporation classified an aggregate of $515 million of borrowings under short-term credit facilities as long-term debt, based on the available capacity under its $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,	
	2008	2007	2008	2007
Capitalized interest	$ 2	$ 18	$ 4	$ 49

6. Foreign Currency

Foreign currency gains (losses) amounted to the following (in millions):

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Pre-tax foreign currency gains (losses)	$ (76)	$ 20	$ (32)	$ 14
After-tax foreign currency gains (losses)	(10)	1	2	(10)

The pre-tax amount of foreign currency gains (losses) is included in Other, net within Revenues and non-operating income.

7. Retirement Plans

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

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Service cost	$ 9	$ 11	$ 29	$ 29
Interest cost	15	18	55	52
Expected return on plan assets	(15)	(18)	(55)	(52)
Amortization of net loss	6	6	12	16
Pension expense	$ 15	$ 17	$ 41	$ 45

In 2008, the Corporation expects to contribute approximately $65 million to its funded pension plans and $15 million to the trust established for its unfunded pension plan. Through September 30, 2008, the Corporation contributed $76 million to its pension plans.

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8. Fair Value Measurements

The Corporation adopted the provisions of FAS 157 effective January 1, 2008 (see Note 1, Basis of Presentation). FAS 157 establishes a hierarchy for the inputs used to measure fair value based on the source of the input, which generally range from quoted prices for identical instruments in a principal trading market (Level 1) to estimates determined using related market data (Level 3). Multiple inputs may be used to measure fair value, however, the level of fair value for each financial asset or liability presented below is based on the lowest significant input level within this fair value hierarchy. The following table provides the fair value hierarchy of the Corporation s financial assets and (liabilities) as of September 30, 2008 (in millions):

	Level 1	Level 2	Level 3	Collateral and counterparty netting	Total
Supplemental pension plan investments	$ 73	$	$ 15	$	$ 88
Derivative contracts					
Assets	306	1,178	316	(811)	989
Liabilities	(268)	(3,812)	(284)	674	(3,690)

Details on the methods and assumptions used to determine the fair values of the financial assets and liabilities are as follows:

Fair value measurements based on Level 1 inputs:

Measurements that are most observable are based on quoted prices of identical instruments obtained from the principal markets in which they are traded. Closing prices are both readily available and representative of fair value. Market transactions occur with sufficient frequency and volume to assure liquidity. The fair value of certain of the Corporation s exchange traded futures and options are considered Level 1. In addition, fair values for the majority of the pension investments are considered Level 1, since they are determined using quotations from national securities exchanges.

Fair value measurements based on Level 2 inputs:

Measurements derived indirectly from observable inputs or from quoted prices from markets that are less liquid are considered Level 2. Measurements based on Level 2 inputs include over-the-counter derivative instruments that are priced on an exchange traded curve, but have contractual terms that are not identical to exchange traded contracts. The Corporation utilizes fair value measurements based on Level 2 inputs for certain forwards, swaps and options. The liability related to the Corporation s crude oil hedging program is classified as Level 2.

Fair value measurements based on Level 3 inputs:

Measurements that are least observable are estimated from related market data or determined from sources with little or no market activity for comparable contracts. For example, in its energy marketing business, the Corporation sells natural gas and electricity to customers and economically hedges the price exposure by purchasing forward contracts. The fair value of these sales and purchases may be based on specific prices at less liquid delivered locations, which are classified as Level 3. There may be offsets to these positions that are priced based on more liquid markets, which are, therefore, classified as Level 1 or Level 2.

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The following table provides changes in financial assets and liabilities that are measured at fair value based on Level 3 inputs (in millions):

	Three months ended September 30, 2008	Nine months ended September 30, 2008
Balance at beginning of period	$ 559	$ (4)
Unrealized gains (losses)		
Included in earnings (*)	259	224
Included in other comprehensive income	(708)	(93)
Purchases, sales or other settlements during the period	(18)	(21)
Net transfers in to (out of) Level 3	(45)	(59)
Balance at end of period	$ 47	$ 47

(*) Reflected in Sales and other operating revenue.

9. 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,	
	2008	2007	2008	2007
Common shares basic	322,365	313,617	320,159	311,986
Effect of dilutive securities				
Stock options	2,985	2,856	3,228	2,889
Restricted common stock	1,670	2,802	1,866	3,078
Convertible preferred stock	366	590	467	601
Common shares diluted	327,386	319,865	325,720	318,554

During the third quarter of 2008, the Corporation s remaining 284,139 outstanding shares of 3% cumulative convertible preferred shares were converted into common stock at a conversion rate of 1.8783 shares of common stock for each preferred share. The Corporation issued 533,697 shares of common stock for the conversion of these preferred shares and fractional shares were settled by cash payments.

10. Comprehensive Income

Comprehensive income (loss) was as follows (in millions):

	Three months	Nine months

	ended September 30,		ended September 30,	
	2008	2007	2008	2007
Net income	$ 775	$ 395	$ 2,434	$ 1,322
Deferred gains (losses) on cash flow hedges, after tax				
Effect of hedge losses recognized in income	83	98	270	209
Net change in fair value of cash flow hedges	326	(91)	(327)	(267)
Change in minimum postretirement plan liabilities, after tax	3	4	8	12
Change in foreign currency translation adjustment and other	(61)	30	(28)	36
Comprehensive income	$ 1,126	$ 436	$ 2,357	$ 1,312