

Penn Virginia GP Holdings, L.P.

Form 10-Q

May 11, 2009

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2009

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: 1-33171

**PENN VIRGINIA GP HOLDINGS, L.P.**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of incorporation or organization)

**20-5116532**  
(I.R.S. Employer Identification No.)

**THREE RADNOR CORPORATE CENTER, SUITE 300**

**100 MATSONFORD ROAD**

**RADNOR, PA**  
(Address of principal executive offices)

**19087**  
(Zip Code)

**(610) 687-8900**

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 ( "Exchange Act" ) 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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).    Yes    ☐ No    ☐

Indicate by a 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.

Large accelerated filer    ☐    Accelerated filer    ☒    Non-accelerated filer    ☐    (Do not check if a smaller reporting company)    Smaller reporting company    ☐

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

As of May 7, 2009, 39,074,500 common limited partner units were outstanding.

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**PENN VIRGINIA GP HOLDINGS, L.P. AND SUBSIDIARIES**

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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1      *Financial Statements*****PENN VIRGINIA GP HOLDINGS, L.P. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME - unaudited**

(in thousands, except per unit data)

	<b>Three Months Ended March 31,</b>	
	<b>2009</b>	<b>2008</b>
<b>Revenues</b>		
Natural gas midstream	\$ 117,379	\$ 125,048
Coal royalties	30,630	23,962
Coal services	1,888	1,862
Other	6,862	5,942
 Total revenues	 156,759	 156,814
<b>Expenses</b>		
Cost of midstream gas purchased	100,620	99,697
Operating	8,890	6,793
Taxes other than income	1,223	1,072
General and administrative	8,133	7,134
Depreciation, depletion and amortization	16,503	11,500
 Total expenses	 135,369	 126,196
 <b>Operating income</b>	 21,390	 30,618
<b>Other income (expense)</b>		
Interest expense	(5,616)	(4,932)
Other	329	545
Derivatives	(7,161)	7,776
 <b>Net Income</b>	 8,942	 34,007
Less net income attributable to noncontrolling interests	(2,093)	(17,205)
 <b>Net income attributable to Penn Virginia GP Holdings, L.P.</b>	 \$ 6,849	 \$ 16,802
 Net income per unit attributable to Penn Virginia G.P. Holdings, L.P. common unitholders, basic and diluted	 \$ 0.18	 \$ 0.43
 Weighted average number of units outstanding, basic and diluted	 39,075	 39,075

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



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**PENN VIRGINIA GP HOLDINGS, L.P. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED BALANCE SHEETS - unaudited**

**(in thousands)**

	March 31, 2009	December 31, 2008
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 21,710	\$ 18,338
Accounts receivable, net of allowance for doubtful accounts	57,237	73,267
Derivative assets	21,692	30,431
Other current assets	4,658	4,263
Total current assets	105,297	126,299
Property, plant and equipment	1,109,382	1,093,526
Accumulated depreciation, depletion and amortization	(213,163)	(198,407)
Net property, plant and equipment	896,219	895,119
Equity investments	80,002	78,442
Intangible assets, net	90,817	92,672
Other long-term assets	43,620	35,142
Total assets	\$ 1,215,955	\$ 1,227,674
<b>Liabilities and Partners' Capital</b>		
Current liabilities		
Accounts payable	\$ 46,896	\$ 60,442
Accrued liabilities	7,127	11,039
Deferred income	3,762	4,842
Derivative liabilities	15,719	13,585
Total current liabilities	73,504	89,908
Deferred income	5,671	6,150
Other liabilities	17,708	18,078
Derivative liabilities	6,176	6,915
Long-term debt of PVR	595,100	568,100
<b>Partners' capital:</b>		
Penn Virginia GP Holdings, L.P. partners' capital	261,668	269,542
Noncontrolling interests of subsidiaries	256,128	268,981
Total partners' capital	517,796	538,523
Total liabilities and partners' capital	\$ 1,215,955	\$ 1,227,674

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

**Table of Contents****PENN VIRGINIA GP HOLDINGS, L.P. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - unaudited****(in thousands)**

	<b>Three Months Ended March 31,</b>	
	<b>2009</b>	<b>2008</b>
<b>Cash flows from operating activities</b>		
Net income	\$ 8,942	\$ 34,007
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion and amortization	16,503	11,500
Derivative contracts:		
Total derivative losses (gains)	7,615	(6,668)
Cash received (paid) to settle derivatives	2,836	(9,522)
Non-cash interest expense	491	164
Equity earnings, net of distributions received	(1,559)	(360)
Other	(207)	(218)
Changes in operating assets and liabilities	(962)	(924)
Net cash provided by operating activities	33,659	27,979
<b>Cash flows from investing activities</b>		
Acquisitions	(1,256)	(20)
Additions to property, plant and equipment	(17,050)	(17,650)
Other	265	341
Net cash used in investing activities	(18,041)	(17,329)
<b>Cash flows from financing activities</b>		
Distributions to partners	(29,988)	(24,172)
Proceeds from borrowings	27,000	25,000
Repayments of borrowings		(23,000)
Payment of debt issuance costs	(9,258)	
Net cash used in financing activities	(12,246)	(22,172)
Net increase (decrease) in cash and cash equivalents	3,372	(11,522)
Cash and cash equivalents beginning of period	18,338	30,503
Cash and cash equivalents end of period	\$ 21,710	\$ 18,981
<b>Supplemental disclosure:</b>		
Cash paid for interest	\$ 6,156	\$ 6,123

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



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**PENN VIRGINIA GP HOLDINGS, L.P. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Unaudited**

**March 31, 2009**

**1. Organization**

Penn Virginia GP Holdings, L.P. (the Partnership, we, us or our ) is a publicly traded Delaware limited partnership formed in June 2006 that owns three types of equity interests in Penn Virginia Resource Partners, L.P. ( PVR ), a publicly traded Delaware limited partnership. As of March 31, 2009, the equity interests are (1) a 2% general partner interest in PVR, which we hold through our 100% ownership interest in Penn Virginia Resource GP, LLC, PVR's general partner, (2) all of the incentive distribution rights ( IDRs ) in PVR, which we hold through our 100% ownership interest in PVR's general partner and (3) an approximately 37% limited partner interest in PVR. With the IDRs, we receive an increasing percentage of PVR's quarterly distributions of available cash from operating surplus after certain levels of cash distributions have been achieved. Our only cash generating assets consist of our equity interests in PVR. Due to our control of the general partner of PVR, the financial results of PVR are included in our condensed consolidated financial statements. However, PVR functions with a capital structure that is independent of ours, consisting of its own debt instruments and publicly traded common units.

Our general partner is an indirect wholly owned subsidiary of Penn Virginia Corporation ( Penn Virginia ). As of March 31, 2009, Penn Virginia and its subsidiaries owned an approximately 77% limited partner interest in us.

PVR currently conducts operations in two business segments: (i) coal and natural resource management and (ii) natural gas midstream.

The PVR coal and natural resource management segment primarily involves the management and leasing of coal properties and the subsequent collection of royalties. PVR's coal reserves are primarily located in Kentucky, Virginia, West Virginia, Illinois and New Mexico. PVR also earns revenues from other land management activities, such as selling standing timber, leasing fee-based coal-related infrastructure facilities to certain lessees and end-user industrial plants, collecting oil and gas royalties and from coal transportation, or wheelage, fees.

The PVR natural gas midstream segment is engaged in providing natural gas processing, gathering and other related services. PVR owns and operates natural gas midstream assets located in Oklahoma and Texas. PVR's natural gas midstream business derives revenues primarily from gas processing contracts with natural gas producers and from fees charged for gathering natural gas volumes and providing other related services. In addition, PVR owns a 25% member interest in Thunder Creek Gas Services, LLC ( Thunder Creek ), a joint venture that gathers and transports coalbed methane in Wyoming's Powder River Basin. PVR also owns a natural gas marketing business, which aggregates third-party volumes and sells those volumes into intrastate pipeline systems and at market hubs accessed by various interstate pipelines.

We, through our ownership of the general partner of PVR, manage the operations and activities of PVR. Most of PVR's personnel are employees of Penn Virginia or its affiliates. PVR's general partner is liable for all of PVR's debts, to the extent not paid from PVR's assets, except for indebtedness or other obligations that are made specifically non-recourse to us.

We do not receive any management fee or other compensation for the management of PVR. We and our affiliates are reimbursed for expenses incurred on PVR's behalf. These expenses include the costs of employee, officer and director compensation and benefits properly allocable to PVR and all other expenses necessary or appropriate to conduct the business of, and allocable to, PVR. PVR's partnership agreement provides that PVR's general partner will determine the expenses that are allocable to PVR in any reasonable manner determined by PVR in its sole discretion.

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### **2. Summary of Significant Accounting Policies**

Our accounting policies are consistent with those described in our Annual Report on Form 10-K for the year ended December 31, 2008. Please refer to such Form 10-K for a further discussion of those policies.

#### *Basis of Presentation*

Unless otherwise indicated, for the purposes of our condensed consolidated financial statements, the Partnership, we, us or our refers to Penn Virginia GP Holdings, L.P. and subsidiaries. References to the parent company are intended to mean Penn Virginia GP Holdings, L.P. individually as the parent company and not on a consolidated basis.

Our condensed consolidated financial statements include the accounts of the Partnership and all of our wholly owned subsidiaries. Intercompany balances and transactions have been eliminated in consolidation. PVR owns a 25% member interest in Thunder Creek, a joint venture that gathers and transports coalbed methane in Wyoming's Powder River Basin, and a 50% member interest in a coal handling joint venture. Earnings from PVR's 25% member interest in Thunder Creek are recorded in the other revenues line on the condensed consolidated statements of income and earnings from PVR's 50% member interest in a coal handling venture are recorded in the coal services line on the condensed consolidated statements of income. PVR's investments in these equity affiliates are recorded on the equity investments line on the condensed consolidated balance sheets. Our condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. These statements involve the use of estimates and judgments where appropriate. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation of our condensed consolidated financial statements have been included. These financial statements should be read in conjunction with our condensed consolidated financial statements and footnotes included in our Annual Report on Form 10-K for the year ended December 31, 2008. Operating results for the three months ended March 31, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. Certain reclassifications have been made to conform to the current period's presentation.

#### *New Accounting Standards*

In April 2009, the Financial Accounting Standards Board (FASB) issued FSP FAS 107-1 and APB 28-1, *Interim Disclosures About Fair Value of Financial Instruments* (FSP FAS 107-1 and APB 28-1). This FSP requires disclosures about the fair value of financial instruments whenever we issue financial statements. The disclosures outlined in FSP FAS 107-1 and APB 28-1 are required for interim and annual periods ending after June 15, 2009. Early adoption is permitted for periods ending after March 15, 2009, and we have elected to adopt this FSP for the three months ended March 31, 2009. This FSP does not require disclosures for earlier periods presented for comparative purposes at initial adoption. See Note 3, Fair Value Measurements for the disclosure required under FSP FAS 107-1 and APB 28-1.

In April 2009, the FASB issued FSP FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies* (FSP FAS 141(R)-1). This FSP requires us to recognize assets acquired or liabilities assumed in a business combination that arise from a contingency if the acquisition-date fair value of that asset or liability can be determined during the measurement period. If the acquisition-date fair value of an asset acquired or a liability assumed in a business combination that arises from a contingency cannot be determined during the measurement period, an asset or liability shall be recognized at the acquisition at the amount that would be recognized in accordance with Statement of Financial Accounting Standards (SFAS) No. 5, *Accounting for Contingencies* and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss* an interpretation of FASB Statement No. 5. Certain disclosures are also required under this standard. FSP FAS 141(R)-1 is effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after December 15, 2008. We have had no material acquisitions since our adoption of this FSP. For each acquisition that includes assets acquired or liabilities assumed arising from contingencies, we will determine the fair value of the assets or liabilities and will make the appropriate disclosures.

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We adopted SFAS No. 157, *Fair Value Measurements*, effective January 1, 2008, for financial assets and liabilities measured on a recurring basis. FASB Staff Position FAS 157-2, *Effective Date of FASB Statement No. 157* ( FSP FAS 157-2 ), delayed the application of SFAS No. 157 for nonfinancial assets and liabilities to fiscal years and interim periods beginning after November 15, 2008. Prior to the adoption of FSP FAS 157-2, we only applied fair value measurements to our financial assets and liabilities. Effective January 1, 2009, SFAS No. 157 now applies to both financial and nonfinancial assets and liabilities that are measured and reported on a fair value basis.

Our financial instruments consist of cash and cash equivalents, receivables, accounts payable, derivative instruments and PVR's long-term debt. At March 31, 2009, the carrying values of all of these financial instruments approximated fair value.

SFAS No. 157 defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS No. 157 requires fair value measurements to be classified and disclosed in one of the following three categories:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities. Level 1 inputs generally provide the most reliable evidence of fair value.

Level 2: Quoted prices in markets that are not active or inputs, which are observable, either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

The following table summarizes the valuation of certain assets and liabilities by the above SFAS No. 157 categories as of March 31, 2009 (in thousands):

Description	Fair Value Measurements at March 31, 2009, Using Quoted Prices in Active Markets for			
	Fair Value Measurements at March 31, 2009	Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Interest rate swap liability - current	(6,925)		(6,925)	
Interest rate swap liability - noncurrent	(6,176)		(6,176)	
Commodity derivative assets - current	21,692		21,692	
Commodity derivative liability - current	(8,794)		(8,794)	
<b>Total</b>	<b>\$ (203)</b>	<b>\$</b>	<b>\$ (203)</b>	<b>\$</b>

See Note 4 Derivative Instruments, for the effects of derivative instruments on our condensed consolidated financial statements.

We use the following methods and assumptions to estimate the fair values of the assets and liabilities outlined in the above table:

Interest rate swaps: PVR has entered into interest rate swaps (the PVR Interest Rate Swaps) to establish fixed rates on a portion of the outstanding borrowings under PVR's revolving credit facility (the PVR Revolver). PVR uses an income approach using valuation techniques that connect future cash flows to a single discounted value. PVR estimates the fair value of the swaps based on published interest rate yield curves as of the date of the estimate, and uses discount rates adjusted for the credit risk of the counterparties if the

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derivative is in an asset position and PVR's own credit risk for derivatives in a liability position. This is a Level 2 input. See Note 4 Derivative Instruments.

Commodity derivative instruments: The PVR natural gas midstream segment's commodity derivatives utilize three-way collar derivative contracts. PVR also utilizes a combination of collar derivative contracts and commodity swaps to hedge against the variability in the frac spread. PVR determines the fair values of its commodity derivative agreements based on discounted cash flows based on quoted

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forward prices for the respective commodities, and uses discount rates adjusted for the credit risk of the counterparties if the derivative is in an asset position and PVR's own credit risk for derivatives in a liability position. This is a Level 2 input. PVR uses the income approach, using valuation techniques that convert future cash flows to a single discounted value. See Note 4 – Derivative Instruments.

### **4. Derivative Instruments**

#### *PVR Natural Gas Midstream Segment Commodity Derivatives*

PVR utilizes three-way collar derivative contracts to hedge against the variability in cash flows associated with anticipated natural gas midstream revenues and cost of midstream gas purchased. PVR also utilizes a combination of collar derivative contracts and swap contracts to hedge against the variability in its frac spread. PVR's frac spread is the spread between the purchase price for the natural gas PVR purchases from producers and the sale price for natural gas liquids (NGLs) that PVR sells after processing. PVR hedges against the variability in its frac spread by entering into costless collar and swap derivative contracts to sell NGLs forward at a predetermined commodity price and to purchase an equivalent volume of natural gas forward on an MMBtu basis. While the use of derivative instruments limits the risk of adverse price movements, such use may also limit future revenues or cost savings from favorable price movements.

A three-way collar contract consists of a collar contract plus a put option contract sold by PVR with a price below the floor price of the collar. The counterparty to a collar contract is required to make a payment to PVR if the settlement price for any settlement period is below the floor price for such contract. PVR is required to make a payment to the counterparty if the settlement price for any settlement period is above the ceiling price for such contract. Neither party is required to make a payment to the other party if the settlement price for any settlement period is equal to or greater than the floor price and equal to or less than the ceiling price for such contract. The additional put option sold by PVR requires it to make a payment to the counterparty if the settlement price for any settlement period is below the put option price. By combining the collar contract with the additional put option, PVR is entitled to a net payment equal to the difference between the floor price of the collar contract and the additional put option price if the settlement price is equal to or less than the additional put option price. If the settlement price is greater than the additional put option price, the result is the same as it would have been with a collar contract only. If market prices are below the additional put option, PVR would be entitled to receive the market price plus the difference between the additional put option and the floor. See the PVR natural gas midstr