Linn Energy, LLC
Form 10-Q
June 30, 2006

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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 Quarterly Period Ended March 31, 2006

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: 000-51719

LINN ENERGY, LLC
(Exact name of registrant as specified in its charter)

Delaware	**65-1177591**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

650 Washington Road
8th Floor
Pittsburgh, PA 15228
(Address of principal executive offices)
(412) 440-1400
(Registrant s telephone number, including area code)

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

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. (Check one):

Large accelerated filer o Accelerated filer o Non-accelerated filer þ

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

As of June 1, 2006, there were 27,832,500 units outstanding.

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Item 1. Financial Statements.

LINN ENERGY, LLC
CONSOLIDATED BALANCE SHEETS

	March 31, 2006 (Unaudited)	December 31, 2005
	(in thousands)	
Assets		
Current assets:		
Cash and cash equivalents	$ 15,880	$ 11,041
Receivables:		
Natural gas and oil, net of allowance for doubtful accounts of $100,000 as of March 31, 2006 and December 31, 2005	9,387	17,103
Other	241	650
Fair value of interest rate swaps	273	202
Inventory	68	68
Current portion of natural gas derivatives	8,831	1,601
Prepaid expenses and other current assets	1,528	4,068
Total current assets	36,208	34,733
Natural gas and oil properties and related equipment	272,048	249,565
Less accumulated depreciation, depletion, and amortization	14,254	10,707
	257,794	238,858
Property and equipment, net	3,626	2,525
Other assets:		
Prepaid drilling costs	418	435
Long-term portion of natural gas derivatives	3,751	2,795
Operating bonds	197	198
	4,366	3,428
Total assets	$ 301,994	$ 279,544

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

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LINN ENERGY, LLC
CONSOLIDATED BALANCE SHEETS

	March 31, 2006	December 31, 2005
	(Unaudited) (in thousands)	
Liabilities and Unitholders Capital (Deficit)		
Current liabilities:		
Current portion of long-term notes payable	$ 442	$ 113
Subordinated term loan		59,501
Accounts payable and accrued expenses	4,257	5,572
Current portion of natural gas derivatives	4,869	12,094
Revenue distribution	1,520	6,082
Accrued interest payable	958	1,448
Gas purchases payable	761	1,208
Other current liabilities	40	40
Total current liabilities	12,847	86,058
Long-term liabilities:		
Long-term portion of notes payable	1,476	695
Credit facility	157,279	206,119
Long-term portion of interest rate swaps	327	663
Asset retirement obligation	5,555	5,443
Long-term portion of natural gas derivatives	18,955	27,139
Other long-term liabilities	368	258
Total long-term liabilities	183,960	240,317
Total liabilities	196,807	326,375
Unitholders capital (deficit):		
27,812,500 Units issued and outstanding at March 31, 2006	146,065	16,024
Accumulated loss	(40,878)	(62,855)
	105,187	(46,831)
Total liabilities and unitholders capital (deficit)	$ 301,994	$ 279,544

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

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LINN ENERGY, LLC
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three months ended March 31, 2006	2005
	(in thousands)	
Revenues:		
Natural gas and oil sales	$ 16,375	$ 6,146
Realized gain (loss) on natural gas derivatives	3,323	(8,575)
Unrealized gain (loss) on natural gas derivatives	20,923	(6,580)
Natural gas marketing income	1,218	814
Other income	289	74
	42,128	(8,121)
Expenses:		
Operating expenses	2,994	1,817
Natural gas marketing expense	983	790
General and administrative expenses	9,470	478
Depreciation, depletion and amortization	3,700	1,181
	17,147	4,266
	24,981	(12,387)
Other income and (expenses):		
Interest income	146	
Interest and financing expense	(2,639)	20
Write-off of deferred financing fees and other losses	(392)	(32)
	(2,885)	(12)
Income (loss) before income taxes	22,096	(12,399)
Income tax (provision)	(119)	
Net income (loss)	$ 21,977	$ (12,399)
Net income (loss) per unit basic	$ 0.84	$ (.60)
Net income (loss) per unit diluted	$ 0.84	$ (.60)
Weighted average units outstanding basic	26,272,564	20,518,065
Weighted average units outstanding diluted	26,272,564	20,518,065

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

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LINN ENERGY, LLC
CONSOLIDATED STATEMENT OF UNITHOLDERS CAPITAL (DEFICIT)
For the Three Months Ended March 31, 2006
(Unaudited)

	Unitholders Capital	Accumulated Loss	Treasury Units (at Cost)	Total Unitholders Capital (Deficit)
		(in thousands)		
Balance as of December 31, 2005	$ 16,024	$ (62,855)		$ (46,831)
Sale of units, net of offering expense of $4,339	225,139		13,671	238,810
Redemption of member interests			(114,449)	(114,449)
Cancellation of member interests	(100,778)		100,778	
Unit-based compensation expense	5,680			5,680
Net income		21,977		21,977
Balance as of March 31, 2006	$ 146,065	$ (40,878)		$ 105,187

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

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LINN ENERGY, LLC
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three months ended March 31, 2006	Three months ended March 31, 2005
	(in thousands)	
Cash flow from operating activities:		
Net income (loss)	$ 21,977	$ (12,399)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation, depletion and amortization	3,700	1,181
Amortization of deferred financing fees	190	45
Write-off of deferred financing fees and other losses	392	32
Accretion of asset retirement obligation	58	25
Unrealized (gain) loss on natural gas and interest rate derivatives	(21,330)	5,624
Unit-based compensation	5,680	
Changes in assets and liabilities:		
Decrease in accounts receivable	8,126	906
(Increase) decrease in prepaid expenses and other assets	(992)	11
(Decrease) in accounts payable and accrued expenses	(4,344)	(1,162)
(Decrease) in natural gas derivatives	(2,673)	(522)
(Decrease) in revenue distribution	(4,562)	(215)
Increase in asset retirement obligation	4	11
(Decrease) in accrued interest payable	(489)	(298)
Increase in other liabilities	110	
(Decrease) increase in gas purchases payable	(447)	22
Net cash provided by (used in) operating activities	5,400	(6,739)
Cash flow from investing activities:		
Acquisition and development of natural gas and oil properties	(21,784)	(1,899)
Purchases of property and equipment	(747)	(29)
Obligations related to drilling activities	3,024	
Proceeds from sale of assets	14	24
Decrease (increase) in operating bonds		(31)
Net cash used in investing activities	(19,493)	(1,935)
Cash flow from financing activities:		
Proceeds from sale of units	243,149	
Redemption of members units	(114,449)	
Proceeds from notes payable		5,000
Principal payments on notes payable	(60,056)	(14)
Principal payment on credit facility	(62,000)	
Proceeds from credit facility	13,000	3,000

Deferred offering costs		(807)		(265)
Deferred financing fees		95		(15)
Net cash provided by financing activities		18,932		7,706
Net increase (decrease) in cash		4,839		(968)
Cash and cash equivalents:				
Beginning		11,041		2,188
Ending	$	15,880	$	1,220
Supplemental disclosure of cash flow information:				
Cash payments for interest	$	3,336	$	1,189
Supplemental disclosure of non cash investing and financing activities:				
Increase in natural gas and oil properties and related asset retirement obligation due to acquisitions and new drilling	$	49	$	5
Acquisition of vehicles and equipment through the issuance of notes payable		1,172		

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

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LINN ENERGY, LLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(1) Basis of Presentation

The consolidated financial statements at March 31, 2006 and for the three months ended March 31, 2006 and 2005 are unaudited, but in the opinion of management include all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the results for the interim periods. Certain information and note disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles in the United States have been condensed or omitted under the Securities and Exchange Commission s rules and regulations. The results reported in these unaudited condensed consolidated financial statements should not necessarily be taken as indicative of results that may be expected for the entire year.

The financial information included herein should be read in conjunction with the financial statements and notes in our Annual Report on Form 10-K for the year ended December 31, 2005.

(2) Summary of Significant Accounting Policies

(a) Organization and Description of Business

Linn Energy, LLC (Linn or the Company) was reorganized as a limited liability company in April 2005 under the laws of the State of Delaware. The Company is an independent natural gas and oil company focused on the development and acquisition of properties in the Appalachian Basin, primarily in West Virginia, Pennsylvania, New York and Virginia. Linn s wholly owned subsidiaries include Linn Energy Holdings, LLC (Holdings), Linn Operating, Inc. (Operating), Penn West Pipeline, LLC (Penn West), and Mid Atlantic Well Service, Inc. (Mid Atlantic).

(b) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. The Company presents its financial statements in accordance with U.S. generally accepted accounting principles. All material inter-company transactions and balances have been eliminated upon consolidation.

(c) Cash Equivalents

For purposes of the statement of cash flows, the Company considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents.

(d) Natural Gas and Oil Properties

The Company accounts for natural gas and oil properties by the successful efforts method. Leasehold acquisition costs are capitalized. If proved reserves are found on an undeveloped property, leasehold costs are transferred to proved properties. Under this method of accounting, costs relating to the development of proved areas are capitalized when incurred.

Depreciation and depletion of producing natural gas and oil properties is recorded based on units of production. Unit rates are computed for unamortized drilling and development costs using proved developed reserves and for unamortized leasehold costs using all proved reserves. Statement of Financial Accounting Standards (SFAS) No. 19 requires that acquisition costs of proved properties be amortized on the basis of all proved reserves, developed and undeveloped, and that capitalized development costs (wells and related equipment and facilities) be amortized on the basis of proved developed reserves. The Company follows SFAS No. 143. Under SFAS 143, estimated asset retirement costs are recognized when the obligation is incurred, and are amortized over proved developed reserves using the units of production method. Asset retirement costs are estimated by the Company s engineers using existing regulatory requirements and anticipated future inflation rates.

Geological, geophysical and exploratory dry hole costs on natural gas and oil properties relating to unsuccessful exploratory wells are charged to expense as incurred.

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Upon sale or retirement of complete fields of depreciable or depleted property, the book value thereof, less proceeds or salvage value, is charged or credited to income. On sale or retirement of an individual well the proceeds are credited to accumulated depreciation and depletion.

Natural gas and oil properties are reviewed for impairment when facts and circumstances indicate that their carrying value may not be recoverable. The Company assesses impairment of capitalized costs of proved natural gas and oil properties by comparing net capitalized costs to estimated undiscounted future net cash flows using expected prices. If net capitalized costs exceed estimated undiscounted future net cash flows, the measurement of impairment is based on estimated fair value, which would consider estimated future discounted cash flows. No impairments were recorded during the first three months of 2006 or 2005.

Unproved properties that are individually insignificant are amortized. Unproved properties that are individually significant are assessed for impairment on a property-by-property basis. If considered impaired, costs are charged to expense when such impairment is deemed to have occurred.

(e) Natural Gas and Oil Reserve Quantities

The Company s estimate of proved reserves is based on the quantities of natural gas and oil that engineering and geological analyses demonstrate, with reasonable certainty, to be recoverable from established reservoirs in the future under current operating and economic parameters. Schlumberger Data and Consulting Services prepares a reserve and economic evaluation of all the Company s properties on a well-by-well basis annually.

Reserves and their relation to estimated future net cash flows impact the Company s depletion and impairment calculations. As a result, adjustments to depletion and impairment are made concurrently with changes to reserve estimates. The Company prepares its reserve estimates, and the projected cash flows derived from these reserve estimates, in accordance with SEC guidelines. The independent engineering firm described above adheres to the same guidelines when preparing their reserve reports. The accuracy of the Company s reserve estimates is a function of many factors including the following: the quality and quantity of available data, the interpretation of that data, the accuracy of various mandated economic assumptions, and the judgments of the individuals preparing the estimates.

The Company s proved reserve estimates are a function of many assumptions, all of which could deviate significantly from actual results. As such, reserve estimates may materially vary from the ultimate quantities of natural gas, natural gas liquids and oil eventually recovered.

(f) Income Taxes

The Company is a limited liability company treated as a partnership for federal and state income tax purposes with all income tax liabilities and/or benefits of the Company being passed through to the unitholders. As such, no recognition of federal or state income taxes for the company and its subsidiaries that are organized as limited liability companies have been provided for in the accompanying financial statements except as described below.

Certain subsidiaries are subchapter C-corporations subject to corporate income taxes, which are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred tax liabilities of approximately $193,000 and $74,000 have been included in other long-term liabilities as of March 31, 2006 and December 31, 2005, respectively. Deferred tax benefits of $900,000 related to net operating losses and other carry-forwards are reflected net of a valuation allowance of the same amount since, as of March 31, 2006, the subsidiaries generating that benefit are unlikely to generate adequate on-going taxable income to realize those benefits.

(g) Derivative Instruments and Hedging Activities

The Company periodically uses derivative financial instruments to achieve a more predictable cash flow from its natural gas production by reducing its exposure to price fluctuations. As of March 31, 2006, these transactions were in the form of swaps and puts. Additionally, the Company uses derivative financial instruments in the form of interest rate swaps to mitigate its interest rate exposure. The Company accounts for its derivatives at fair value as an asset or liability and the change in the fair value of derivatives is included in income.

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(h) Earnings per unit

Basic earnings per unit is computed by dividing net earnings attributable to unitholders by the weighted average number of units outstanding during each period. During 2006 for the period prior to the Offering, equivalent units were calculated by adjusting pre-Offering members membership interests by the exchange ratio to reflect the exchange of pre-Offering membership interests for post-Offering units and cash immediately prior to completion of the Offering (see Note 3). Diluted earnings per unit is computed by adjusting the average number of units outstanding for the dilutive effect, if any, of unit equivalents. The Company uses the treasury stock method to determine the dilutive effect. For the quarter ended March 31, 2006, unvested units granted but not issued to the CEO and all unit options outstanding were excluded in the computation of diluted EPS, because to do so would have been antidilutive for the period.

(i) Use of Estimates

Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities and revenues and expenses and the disclosure of contingent assets and liabilities to prepare these financial statements in conformity with U.S. generally accepted accounting principles. Actual results could differ from those estimates. The estimates that are particularly significant to the financial statements include estimates of natural gas and oil reserves, future cash flows from natural gas and oil properties, and depreciation, depletion and amortization, asset retirement obligations and the fair value of derivatives.

(j) Revenue Recognition

Sales of natural gas and oil are recognized when natural gas has been delivered to a custody transfer point, persuasive evidence of a sales arrangement exists, the rights and responsibility of ownership pass to the purchaser upon delivery, collection of revenue from the sale is reasonably assured, and the sales price is fixed or determinable. Natural gas is sold by the Company on a monthly basis. Virtually all of the Company s contracts pricing provisions are tied to a market index, with certain adjustments based on, among other factors, whether a well delivers to a gathering or transmission line, quality of natural gas, and prevailing supply and demand conditions, so that the price of the natural gas fluctuates to remain competitive with other available natural gas supplies. As a result, the Company s revenues from the sale of natural gas will suffer if market prices decline and benefit if they increase. The Company believes that the pricing provisions of its natural gas contracts are customary in the industry.

Gas imbalances occur when the Company sells more or less than its entitled ownership percentage of total gas production. Any amount received in excess of the Company s share is treated as a liability. If the Company receives less than its entitled share, the underproduction is recorded as a receivable. The Company did not have any significant gas imbalance positions at March 31, 2006 or December 31, 2005.

Natural gas marketing is recorded on the gross accounting method because Penn West, the Company s marketing subsidiary, takes title to the natural gas it purchases from the various producers and bears the risks and enjoys the benefits of that ownership. Natural gas marketing revenues totaled $1,218,000 and $814,000 and natural gas marketing expenses were $983,000 and $790,000 for the three months ended March 31, 2006 and 2005, respectively.

The Company currently uses the Net-Back method of accounting for transportation arrangements of its natural gas sales. The Company sells natural gas at the wellhead and collects a price and recognizes revenues based on the wellhead sales price since transportation costs downstream of the wellhead are incurred by its customers and reflected in the wellhead price.

The Company is paid a monthly operating fee for each well it operates for outside owners. The fee covers monthly operating and accounting costs, insurance and other recurring costs. As the operating fee is a reimbursement for costs incurred on behalf of third parties, the fee has been netted against general and administrative expense. For the three months ended March 31, 2006 and 2005 the operating fees netted against general and administrative expense were $284,000 and $287,000, respectively.

(k) Unit-Based Compensation

The Company accounts for unit-based compensation pursuant to SFAS No. 123(R) *Share-Based Payment.* SFAS No. 123(R), which requires an entity to recognize at the grant date the fair value of unit options and other equity-based compensation issued to employees in the income statement. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company s consolidated income statement. Compensation expense attributable to granted awards are recognized using the straight-line method.

The Company utilizes a Black-Scholes option pricing model to measure the fair value of unit options granted to employees. The Company s determination of fair value of unit-based payment awards on the date of grant using the model is affected by the Company s unit price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, the Company s expected unit price volatility over the term of the awards, and actual and projected employee unit option exercise behaviors. In addition, forfeitures are required to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Although the fair value of employee unit

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options is determined in accordance with SFAS No. 123R and SAB 107 using a Black-Scholes option-pricing model, that value may not be indicative of the fair value observed in a willing buyer/willing seller market transaction. The Company is responsible for determining the assumptions used in estimating the fair value of its unit-based payment awards. The Company recorded $5,680,000 of unit-based compensation expense for the three months ended March 31, 2006. As of March 31, 2005 and December 31, 2005, there were no outstanding unit-based awards.

(l) Recently Issued Accounting Standards

As of January 1, 2006, the Company adopted SFAS No. 154 Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and SFAS No. 3 (SFAS No. 154). SFAS No. 154 requires retrospective application of voluntary changes in accounting principles, unless it is impracticable. The implementation of this standard did not have a material impact on the consolidated financial statements.

(3) Initial Public Offering

During the three months ended March 31, 2006, the Company completed its initial public offering (IPO) of 12,450,000 units representing limited liability interests in the Company at $21.00 per unit, for net proceeds, after underwriting discounts and other offering costs, of $243.1 million, of which $122.0 million was used to reduce indebtedness under the Company s revolving credit facility and repay, in full, the subordinated term loan, approximately $114.4 million was used to redeem a portion of the membership interests in the Company and units held by certain affiliated and non-affiliated holders, approximately $4.3 million was used to pay offering expenses and approximately $2.0 million was used to pay bonuses to certain executive officers of the Company.

Subsequent to March 31, 2006, the Company s Board of Directors declared distributions of $0.32 per unit with respect to the first quarter of 2006 pro-rated for the period from the closing of the offering on January 19, 2006 to March 31, 2006. As a result, the Company paid aggregate distributions of approximately $8.9 million on May 15, 2006.

(4) Natural Gas and Oil Properties:

	March 31, 2006	December 31, 2005
Unproved Properties	$ 6,181,000	$ 4,562,000
Proved Developed Properties:		
Acquisition, equipment and drilling	260,267,000	239,423,000
Pipelines	5,600,000	5,580,000
	272,048,000	249,565,000
Less accumulated depreciation, depletion and amortization	(14,254,000)	(10,707,000)
	$ 257,794,000	$ 238,858,000

(5) Debt

Credit Facility

On April 7, 2006, the Company replaced its prior credit agreement and entered into a new $400.0 million Amended and Restated Credit Agreement (the Credit Agreement