CALLON PETROLEUM CO
Form 11-K
June 19, 2015

Callon Petroleum

Company Employee

Savings and Protection Plan

Employer I.D. Number 94-0744280

Plan Number: 002

Audited Financial Statements

Years Ended December 31, 2014 and 2013

Table of Contents

	Page(s)
Report of Independent Registered Public Accounting Firm	1
Financial Statements	
Statements of Net Assets Available for Benefits	2
Statement of Changes in Net Assets Available for Benefits	3
Notes to Financial Statements	4
Supplementary Information	
Schedule of Assets (Held at End of Year)	11
Signature	13

Note: Supplemental schedules required by the Employee Retirement Income Security Act of 1974 not included herein are deemed not applicable to Callon Petroleum Company Employee Savings and Protection Plan.

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Participants and Plan Administrator

Callon Petroleum Company Employee Savings and Protection Plan

We have audited the accompanying statements of net assets available for benefits of Callon Petroleum Company Employee Savings and Protection Plan (the "Plan") as of December 31, 2014 and 2013, and the related statement of changes in net assets available for benefits for the year ended December 31, 2014. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits of the Plan as of December 31, 2014 and 2013, and the changes in net assets available for benefits for the year ended December 31, 2014, in conformity with accounting principles generally accepted in the United States of America.

The supplemental information in the accompanying schedule of assets (held at end of year) as of December 31, 2014 has been subjected to audit procedures performed in conjunction with the audit of the Plan's financial statements. The supplemental information is presented for the purpose of additional analysis and is not a required part of the financial statements but includes supplemental information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. The supplemental information is the responsibility of the Plan's management. Our audit procedures included determining whether the supplemental information reconciles to the financial statements or the underlying accounting and other records, as applicable, and performing procedures to test the completeness and accuracy of the information presented in the supplemental information. In forming our opinion on the supplemental information in the accompanying schedule, we evaluated whether the supplemental information, including its form and content, is presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. In our opinion, the supplemental information is fairly stated in all material respects in relation to the financial statements as a whole.

/s/ HORNE LLP

HORNE LLP

Ridgeland, Mississippi

June 19, 2015

Table of Contents

CALLON PETROLEUM COMPANY

EMPLOYEE SAVINGS AND PROTECTION PLAN

Statements of Net Assets Available for Benefits

December 31, 2014 and 2013

	2014	2013
ASSETS		
Investments		
Participant directed		
Pooled separate accounts	$ 11,824,645	$ 10,756,912
Guaranteed investment contract	13,124,880	13,747,299
Company stock unit fund	3,900,068	5,664,933
Total investments, at fair value	28,849,593	30,169,144
Receivables		
Notes receivable from participants	389,251	460,255
Employer contribution receivable	58,755	62,705
Total receivables	448,006	522,960
Net assets available for benefits, at fair value	29,297,599	30,692,104
Adjustment from fair value to contract value for fully benefit-responsive contract	(647,314)	(353,620)
Net assets available for benefits	$ 28,650,285	$ 30,338,484

See accompanying notes.

Table of Contents

CALLON PETROLEUM COMPANY

EMPLOYEE SAVINGS AND PROTECTION PLAN

Statement of Changes in Net Assets

Available for Benefits

Year Ended December 31, 2014

	2014
Additions to net assets attributed to	
Investment income	
Net appreciation in fair value of investments	$ 452,903
Dividends	524,739
Total investment income	977,642
Interest income on notes receivable from participants	18,479
Contributions	
Employer – cash	740,848
Employer – noncash	261,176
Employee – rollovers	292,753
Employee	907,562
Total contributions	2,202,339
Total additions	3,198,460
Deductions from net assets attributed to	
Benefits paid to participants	4,807,374
Deemed distributions	77,650
Administrative expense	1,635
Total deductions	4,886,659
Net decrease	(1,688,199)
Net assets available for Plan benefits	
Beginning of year	30,338,484
End of year	$ 28,650,285

See accompanying notes.

3

Table of Contents

CALLON PETROLEUM COMPANY

EMPLOYEE SAVINGS AND PROTECTION PLAN

Year Ended December 31, 2014

NOTES TO FINANCIAL STATEMENTS

Note 1. Description of the Plan

The following description of the Callon Petroleum Company Employee Savings and Protection Plan (the "Plan") provides only general information. Participants should refer to the Plan agreement for a more complete description of the Plan's provisions.

General

Employees of Callon Petroleum Company (the "Company") become eligible to participate in the Plan on the first eligibility date of their employment or attainment of age twenty-one while employed. Eligibility dates are the first day of each month. The Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 ("ERISA").

Contributions

Employee contributions/deferrals. Each participant may make voluntary before-tax or Roth contributions of 1% to 99% of his or her qualified yearly earnings as defined by the Plan, subject to Internal Revenue Code ("IRC") limitations for the current year. Employees at least 50 years of age are permitted to contribute additional amounts, or catch-up contributions, of his or her qualified yearly earnings up to a prescribed maximum in addition to the voluntary before-tax, Roth, and after-tax maximums.

Employer non-matching and matching contributions. For the year ended December 31, 2014, the Company contributed, in relation to each participating employee's eligible compensation, a 2.5% non-matching contribution in cash and a 2.5% non-matching contribution in the form of the Company's stock unit fund. The Company also made a matching contribution at the rate of 0.625% in cash for every 1% that the participant deferred, limited to a maximum matching contribution by the Company of 5% in cash.

Rollover Contributions

At the discretion of the Plan administrator, a participant in the Plan who is currently employed may be permitted to deposit into the Plan distributions received from other plans and certain IRAs. Such a deposit is called a “rollover”. This rollover will be accounted for in a “rollover account,” and is 100% vested by the depositing participant. The participant may withdraw amounts in the “rollover account” only when an otherwise allowable distribution is permitted under the Plan.

Participant Accounts

Each participant’s account is credited with the participant’s salary deferral, the Company’s matching and non-matching contributions, and an allocation of the Plan earnings thereon. Allocations are based on participant compensation or account balances, as defined. The benefit to which a participant is entitled is the benefit that can be provided from the participant’s vested account balance.

Table of Contents

CALLON PETROLEUM COMPANY

EMPLOYEE SAVINGS AND PROTECTION PLAN

Year Ended December 31, 2014

Investment Options

Participants direct contributions, including employer cash matching and non-matching contributions, into any of the investment options offered by Voya Financial Partners, LLC, (“Voya”), formerly ING U.S., Inc., the Plan custodian. Participants may change their investment options at any time.

Vesting

Participants are immediately vested in all contributions to the Plan made on their behalf including their voluntary contributions plus actual earnings thereon and in the Company’s contributions and earnings thereon.

Notes Receivable from Participants

Notes receivable from participants (“loans”) are available to participants at a minimum amount of $1,000. Loans bear interest at a fixed interest rate of 4.25%, which is comprised of the U.S. Prime Interest Rate of 3.25% plus a 1% adjustment factor at December 31, 2014. Participants have up to five years to repay the loan unless it is for a principal residence, in which case the repayment period is up to 30 years. Participants may repay the loan by having an amount withheld from their compensation each pay period or, in the case of terminated employees, by submitting an amount to the Company monthly. Each loan is collateralized by the borrowing participant’s vested account balance; however, additional collateral may also be required at the discretion of the Plan administrator. During 2014, the Plan allowed participants to have up to four loans consisting of three regular loans and one residential loan. The maximum amount of any new loans, when added to the outstanding balance of existing loans from the Plan, is limited to the lesser of (a) $50,000 reduced by the excess, if any, of the participant’s highest outstanding balance of loans from the Plan during the one-year period ending on the day before the date of the new loan over the participant’s current outstanding balance of loans as of the date of the new loan or (b) one-half of the participant’s vested interest in qualifying investments within the Plan.

Payment of Benefits

Benefits in the form of distributions are paid from the vested portion of a participant's balance (1) upon termination, (2) normal retirement, (3) disability, (4) death of the participant or (5) under certain, limited circumstances, in-service withdrawals, as defined by the Plan. Hardship withdrawals are allowed for participants incurring an immediate and heavy financial need, as defined by the Plan. Hardship withdrawals are strictly regulated by the Internal Revenue Service ("IRS") and all requirements must be met before requesting a hardship withdrawal. Upon termination of service, a participant may elect to (a) receive a lump sum equal to the value of the participant's vested interest in his or her account (b) receive installments over a period not to exceed the participant's or beneficiary's assumed life expectancy or (c) receive a partial withdrawal.

Plan Termination

Although it has not expressed any intent to do so, the Company has the right under the Plan to discontinue its contributions at any time and to terminate the Plan subject to the provisions of ERISA.

Note 2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying financial statements of the Plan have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and changes therein and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

Table of Contents

CALLON PETROLEUM COMPANY

EMPLOYEE SAVINGS AND PROTECTION PLAN

Year Ended December 31, 2014

Investment Valuation and Income Recognition

All Plan investments as of December 31, 2014 and 2013 are held by Voya, the Plan custodian. Investments are reported at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. See Note 9 for discussion of fair value measurements.

Investment security transactions are accounted for on the date the securities are purchased or sold (trade date). Interest income is recorded as it is earned. Dividends are recorded on the ex-dividend date. Realized and unrealized gains and losses on the Plan’s investments bought and sold as well as held during the year are included in net appreciation in fair value of investments at year-end in the statement of changes in net assets available for benefits.

Notes Receivable from Participants

Loans are measured at their unpaid principal balance plus any accrued but unpaid interest. Interest income is recorded on the accrual basis. Related fees are recorded as administrative expenses and are expensed when they are incurred. No allowance for credit losses has been recorded as of December 31, 2014. If a participant ceases to make loan repayments and the Plan administrator deems the participant loan to be in default, the participant loan balance is reduced and a benefit payment is recorded.

Payment of Benefits

Benefits are recorded when paid.

Administrative Expenses

Certain expenses for maintaining the Plan are paid directly by the Company and are excluded from these financial statements. Fees related to the administration of notes receivable and payment of benefits are charged directly to the participant's account and are included in administrative expenses. The participants incurred expense of $1,635 for fees related to the administration of notes receivable from participants and payment of benefits.

Note 3. Investments

The following table presents the fair value of the Plan's investments that represent 5% or more of the Plan's net assets at December 31, 2014 or 2013.

	2014	2013
Guaranteed investment contract:		
Voya Fixed Account (a)	$ 13,124,880	$ 13,747,299
Pooled separate account:		
Fidelity Advisor New Insights Fund - Class A	2,139,003	1,884,873
Vanguard 500 Index Fund - Admiral Shares	1,474,837	—
Other:		
Company stock unit fund	3,900,068	5,664,933

(a) Formerly ING Fixed Account

The Plan's investments, including gains and losses on investments bought and sold, as well as held during the year, appreciated (depreciated) in value during the year ended December 31, 2014 as follows:

Pooled separate accounts	$ 694,677
Company stock unit fund	(241,774)
Net appreciation in fair value of investments	$ 452,903

Table of Contents

CALLON PETROLEUM COMPANY

EMPLOYEE SAVINGS AND PROTECTION PLAN

Year Ended December 31, 2014

Note 4. Company Stock Unit Fund

The value of the Company stock unit fund is a combination of the market value of shares of Callon Common Stock ("Company Securities") and short-term investments. As of December 31, 2014 and 2013, the Company stock unit fund was made up of 701,114 and 850,682 shares of Company securities and $78,775 and $115,701 in short-term investments, respectively.

Note 5. Tax Status of Plan

The trust, established under the Plan to hold the Plan's assets, is qualified pursuant to the appropriate section of the IRC, and accordingly, the trust's net investment income is exempt from income taxes. The Plan has obtained a favorable tax determination letter from the IRS dated March 31, 2008. Although the Plan has been amended since receiving the determination letter, the Plan's administrator believes that the Plan is currently designed and being operated in compliance with the applicable requirements of the IRC.

The Plan had no uncertain tax positions at December 31, 2014 or 2013. If interest and penalties are incurred related to uncertain tax positions, such amounts are recognized in income tax expense. Tax periods for all fiscal years after 2010 remain open to examination by the federal and state taxing jurisdictions to which the Plan is subject.

Note 6. Related Party Transactions

The investments in pooled separate accounts and the guaranteed investment contract are managed by Voya. Voya is the custodian of the Plan assets and therefore, transactions in these investments, as well as investments in employer securities and notes receivable from participants, qualify as exempt party-in-interest transactions. Fees paid by the Plan to Voya for certain administrative services totaled $1,635 for the year ended December 31, 2014.

Note 7. Risks and Uncertainties

The Plan invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect participants' account balances and the amounts reported in the statement of net assets available for benefits.

Note 8. Reconciliation of Financial Statements to Form 5500

The financial information included in the Plan's Form 5500 is reported on the cash basis of accounting. Therefore, reconciliations are included to reconcile the net assets available for benefits and the net decrease in net assets available for benefits per the financial statements to the Form 5500.

The following is a reconciliation of net assets available for benefits per the financial statements to the Form 5500:

	December 31, 2014	2013
Net assets available for benefits per the financial statements	$ 28,650,285	$ 30,338,484
Employer contribution receivable	(58,755)	(62,705)
Net assets available for benefits per the Form 5500	$ 28,591,530	$ 30,275,779

The following is a reconciliation of the net decrease in net assets available for benefits per the financial statement to the Form 5500:

	Year Ended December 31, 2014
Net decrease in net assets available for benefits per the financial statements	$ (1,688,199)
Less: Current year employer contribution receivable	(58,755)
Plus: Prior year employer contribution receivable	62,705
Net decrease in net assets available for benefits per the Form 5500	$ (1,684,249)

7

Table of Contents

CALLON PETROLEUM COMPANY

EMPLOYEE SAVINGS AND PROTECTION PLAN

Year Ended December 31, 2014

Note 9. Fair Value Measurements

The fair value hierarchy outlined in the relevant accounting guidance gives the highest priority to Level 1 inputs, which consist of unadjusted quoted prices for identical instruments in active markets. Level 2 inputs consist of quoted prices for similar instruments. Level 3 valuations are derived from inputs that are significant and unobservable, and these valuations have the lowest priority.

The following is a description of the valuation methodologies used for assets measured at fair value on a recurring basis. There have been no changes in the methodologies used at December 31, 2014 and 2013.

Pooled separate accounts ("PSA"): PSAs are made up of a wide variety of underlying investments such as equities, preferred stock, bonds, real estate and mutual funds. The accumulated unit value ("AUV") of a PSA is based on the market value of its underlying investments but the PSA AUV is not a publicly quoted price in an active market. Therefore, the AUV is used as a practical expedient to estimate fair value (Level 2).

Guaranteed investment contract ("GIC"): The GIC is reported based upon observable inputs, including the Plan's assumptions as to what market participants would use in pricing such instruments (Level 2).

Company stock unit fund: The value of a unit of the Company stock unit fund reflects the combined value of Company common stock, which is valued at the closing price reported on the active market on which the individual securities are traded, and cash held by the fund on the same date. The cash buffer maintained in the Company stock unit fund, which is determined by Voya Retirement Insurance and Annuity Company ("VRIAC")(formerly ING Life Insurance and Annuity Company ("formerly ILIAC")), based on a specific formula, typically ranges between 1% and 3% of the total value of the stock fund, and has a target buffer of 2% (Level 2).

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Plan believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Table of Contents

CALLON PETROLEUM COMPANY

EMPLOYEE SAVINGS AND PROTECTION PLAN

Year Ended December 31, 2014

The following table sets forth by level, within the fair value hierarchy, the Plan’s assets at fair value as of December 31, 2014:

	Level 1	Level 2	Level 3
Guaranteed investment contract			
Fixed account	$ -	$ 13,124,880	$ -
Pooled separate accounts			
Money market	-	265,654	-
Bonds	-	591,769	-
Asset allocation	-	2,757,097	-
Balanced	-	818,103	-
Large-cap value	-	2,129,123	-
Large-cap growth	-	2,139,003	-
Small/Mid/Specialty	-	2,267,557	-
Global/International	-	856,339	-
Other			
Company stock unit fund	-	3,900,068	-
Total assets at fair value	$ -	$ 28,849,593	$ -

The following table sets forth by level, within the fair value hierarchy, the Plan’s assets at fair value as of December 31, 2013:

	Level 1	Level 2	Level 3
Guaranteed investment contract			
Fixed account	$ -	$ 13,747,299	$ -
Pooled separate accounts			
Money market	-	325,807	-
Bonds	-	431,843	-
Asset allocation	-	2,434,565	-
Balanced	-	674,261	-
Large-cap value	-	1,854,835	-
Large-cap growth	-	1,898,933	-
Small/Mid/Specialty	-	2,001,734	-
Global/International	-	1,134,934	-

Other			
Company stock unit fund	-	5,664,933	-
Total assets at fair value	$ -	$ 30,169,144	$ -

Note 10. Guaranteed Investment Contract ("GIC")

As of December 31, 2014, the Plan maintained one GIC related investment option, the Voya Fixed Account. The contract underlying this investment option is considered to be fully benefit-responsive in accordance with ASC Topic 962. As of December 31, 2014 and 2013, the fair value of the investment in the Voya Fixed Account was $13,124,880 and $13,747,299, respectively.

The average yield for the contract period of January 1, 2014 through December 18, 2014, December 19, 2014 through December 31, 2014, and for the year ended December 31, 2013, were 3.00%, 1.85% and 3.00%, respectively. The average yield for the interest credited to participants for the contract period of January 1, 2014 through December 18, 2014, December 19, 2014 through December 31, 2014 and for the year ended December 31, 2013 were 3.00%, 1.80%, and 3.00%, respectively. The guaranteed minimum crediting interest rate for the contract period of January 1, 2014 through December 18, 2014, December 19, 2014 through December 31, 2014, and for the year ended December 31, 2013 were 3.00%, 1.75% and 3.00%, respectively. VRIAC (formerly ILIAC) makes this guarantee, and although VRIAC (formerly ILIAC) may credit a higher interest rate, the credited rate will never fall below the lifetime guaranteed minimum of 1.00% under the current provisions of the GIC investment options for the year ended December 31, 2014.

VRIAC's (formerly ILIAC) determination of credited interest rates reflects a number of factors, including mortality and expense risks, interest rate guarantees, the investment income earned on invested assets and the amortization of any capital

Table of Contents

CALLON PETROLEUM COMPANY

EMPLOYEE SAVINGS AND PROTECTION PLAN

Year Ended December 31, 2014

gains and/or losses realized on the sale of invested assets. A market value adjustment may apply to amounts withdrawn at the request of the contract holder.

The underlying contract has no restrictions on the use of Plan assets and there are no valuation reserves recorded to adjust contract amounts.

Certain events limit the ability of the Plan to transact at contract value with the issuer. Such events include the following: (i) amendments to the Plan documents (including complete or partial Plan termination or merger with another plan) (ii) changes to Plan’s prohibition on competing investment options or deletion of equity wash provisions; or (iii) the failure of the trust to qualify for exemption from federal income taxes or any required prohibited transaction exemption under ERISA. The Plan Administrator does not believe that the occurrence of any such value event, which would limit the Plan’s ability to transact at contract value with participants, is probable.

VRIAC (formerly ILIAC), the GIC issuer, has the option to payout the current value of the contract only after completion of five contract years.

Note 11. Subsequent Events

The Plan has evaluated, for consideration of recognition or disclosure, subsequent events that have occurred through the date of issuance of its financial statements, and has determined that no significant events occurred after December 31, 2014 but prior to the issuance of these financial statements that would have a material impact on its financial statements.

Table of Contents

CALLON PETROLEUM COMPANY
EMPLOYEE SAVINGS AND PROTECTION PLAN
Employer Identification Number 94-0744280
Plan Number: 002
Schedule H, line 4(i)
Schedule of Assets (Held at End of Year)
December 31, 2014

(a)	(b) Identity of Issue, Borrower, Lessor or Similar Party	(c) Description of Investment, Including Maturity Date, Rate of Interest, Collateral, Par or Maturity Value	(d) Cost	(e) Current Value
	Guaranteed investment contract			
*	Voya	Fixed Account** 12,477,565.630 units		$ 13,124,880
	Pooled separate accounts			
*	Voya	Money Market Portfolio - Class I 265,653.620 units		265,654
	BlackRock	High Yield Bond Portfolio 22,346.196 units		176,088
*	VY	PIMCO Real Return Fund - Institutional Class 4,882.638 units		53,318
	American Funds	EuroPacific Growth Fund Class R-6 8,098.918 units		381,378
	Fidelity Advisor	New Insights Fund - Class A 80,202.597 units		2,139,003
	Eaton Vance	Atlanta Capital SMID-Cap Fund - Class I 28,335.502 units		714,055
*	Voya	Small-Cap Opportunities Portfolio - Class I 21,366.629 units		597,197
	Columbia	Mid-Cap Value Fund - Class A Shares 49,669.008 units		845,367
	Vanguard	Mid-Cap Index Fund - Admiral Shares 725.225 units		110,938

	Vanguard	500 Index Fund - Admiral Shares 7,766.798 units	1,474,837
*	VY	T. Rowe Price Equity Income Portfolio - Service Class 39,677.752 units	654,286
	Invesco	Equity & Income Fund A 67,955.513 units	704,019
	T. Rowe Price	Retirement Balanced Fund 7,687.578 units	114,084
	T. Rowe Price	Retirement 2005 Fund 5,266.742 units	68,467
	T. Rowe Price	Retirement 2015 Fund 48,620.313 units	703,536
	T. Rowe Price	Retirement 2020 Fund 5,018.473 units	103,933

Table of Contents

	T. Rowe Price	Retirement 2025 Fund 33,906.038 units			532,664						
	T. Rowe Price	Retirement 2030 Fund 2,075.697 units			47,783						
	T. Rowe Price	Retirement 2035 Fund 47,612.422 units			793,223						
	T. Rowe Price	Retirement 2040 Fund 388.958 units			9,304						
	T. Rowe Price	Retirement 2045 Fund 22,545.903 units			360,734						
	T. Rowe Price	Retirement 2050 Fund 428.835 units			5,750						
	T. Rowe Price	Retirement 2055 Fund 9,895.034 units			131,703						
	Pioneer	Pioneer Bond Fund - Class K Shares 37,013.613 units	**4.7**		362,363	0.6	*	**32.6**		22.3	46.2
Total revenues	**$**	**61.4**	$	44.0		39.5	**$ 189.5**	$	145.1	30.6	
Operating Profit:											
Leasing and management	**$**	**23.4**	$	12.8			**$ 60.5**	$	33.9		
Sales of cars from the lease fleet		**1.1**		0.1			**5.8**		5.6		

Total operating profit	**$ 24.5**	$ 12.9	**$ 66.3**	$ 39.5
Operating profit margin	**39.9%**	29.3%	**35.0%**	27.2%
Fleet utilization	**99.7%**	99.4%	**99.7%**	99.4%

* not meaningful

Total revenues increased for the three and nine month periods ended September 30, 2006 compared to the same periods last year due to increased rental revenues related to additions to the lease fleet, higher average rental rates, and sales of cars from the lease fleet. Operating profit for leasing and management operations increased for the three and nine month periods ended September 30, 2006 primarily attributable to an increase in the size of the fleet, higher average lease rates, improved efficiencies in maintenance expenses, and a change in depreciation expense due to the extension of the estimated useful lives of railcars in the fourth quarter of 2005.

To fund the continued expansion of its lease fleet to meet market demand, the Leasing Group generally uses its non-recourse warehouse facility or excess cash to provide initial financing for a portion of the manufacturing costs of the cars. Subsequently, the Leasing Group generally obtains long-term financing for the cars in the lease fleet through long-term recourse debt such as equipment trust certificates, long-term non-recourse operating leases pursuant to sales/leaseback transactions, non-recourse asset-backed securities, or recourse convertible subordinated notes. In May 2006, Trinity Rail Leasing V, L.P., a limited partnership (TRL-V) and a limited purpose, indirect wholly-owned subsidiary of the Company owned through the Company s wholly-owned subsidiary, TILC, issued $355 million in aggregate principal amount of Secured Railcar Equipment Notes, Series 2006-1A (the Secured Railcar Equipment Notes). The Secured Railcar Equipment Notes were issued pursuant to a Master Indenture, dated May 24, 2006, between TRL-V and Wilmington Trust Company, as indenture trustee. These Secured Railcar Equipment Notes bear interest at a fixed rate of 5.9% per annum, payable monthly, have a final maturity of May 14, 2036, and are limited recourse obligations of TRL-V only, secured by a portfolio of railcars and operating leases thereon, certain cash reserves, and other assets acquired and owned by TRL-V.

We use a non-GAAP measure to compare performance between periods. This non-GAAP measure is EBITDAR, which is Operating Profit of the Leasing Group plus depreciation and rental or lease expense. We use this measure to eliminate the costs resulting from financings. EBITDAR should not be considered as an alternative to operating profit or other GAAP financial measurements as an indicator of our operating performance. EBITDAR is shown below:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2006	**2005**	**2006**	**2005**
	(in millions)		**(in millions)**	
Operating profit leasing and management	**$ 23.4**	$ 12.8	**$ 60.5**	$ 33.9
Add: Depreciation and amortization	**8.6**	6.9	**22.6**	18.5
Rental expense	**11.0**	12.3	**33.7**	36.8
EBITDAR	**$ 43.0**	$ 32.0	**$ 116.8**	$ 89.2
EBITDAR margin	**75.8%**	73.7%	**74.4%**	72.6%

30

Table of Contents

The increase in EBITDAR for the three and nine month periods ended September 30, 2006 was due to higher average lease rates and an increase in the size of the fleet.

All Other

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2006	2005	Percent	2006	2005	Percent
	(in millions)		Change	(in millions)		Change
Revenues	**$15.0**	$11.9	26.1%	**$39.5**	$31.8	24.2%
Operating loss	**$ (3.9)**	$ (1.0)		**$ (7.3)**	$ (4.3)	

The increase in revenues for the three and nine month periods ended September 30, 2006 over the same periods last year was primarily attributable to an increase in intersegment sales by our transportation company. The operating loss for the three and nine month periods ended September 30, 2006 was due to legal and environmental costs associated with non-operating facilities and the expense related to the market valuation of ineffective commodity hedges.

Liquidity and Capital Resources

2006 Financing Activity

At September 30, 2006, there were no borrowings under our $350 million revolving credit facility. In June 2006, we removed securitization requirements related to this credit facility, modified debt covenant requirements, and extended the maturity of this facility to April 2011.

In June 2006, we completed the sale of $450 million of Convertible Subordinated Notes due 2036 (Convertible Subordinated Notes). These Convertible Subordinated Notes bear an interest rate of 3 7/8% per annum on the principal amount payable semi-annually in arrears on June 1 and December 1 of each year, beginning on December 1, 2006. In addition, commencing with the six-month period beginning June 1, 2018, and for each six-month period thereafter, the Company will pay contingent interest to the holders of the Convertible Subordinated Notes under certain circumstances. These Convertible Subordinated Notes mature on June 1, 2036, unless earlier redeemed, repurchased, or converted. The conversion of the Convertible Subordinated Notes into cash and shares of the Company s common stock is limited to specific circumstances described in the indenture. A conversion would currently be based on a conversion rate of 19.1472 shares of common stock per $1,000 principal amount, which is equivalent to a conversion price of approximately $52.23 per share, on a post-split basis. The Company used a portion of the proceeds from this sale to retire $98.5 million of Senior Notes and $0.7 million of Equipment Trust certificates.

In May 2006, TRL-V, a limited partnership and a limited purpose, indirect wholly-owned subsidiary of the Company owned through the Company s wholly-owned subsidiary TILC issued $355 million in aggregate principal amount of Secured Railcar Equipment Notes, Series 2006-1A. The Secured Railcar Equipment Notes were issued pursuant to a Master Indenture, dated May 24, 2006, between TRL-V and Wilmington Trust Company, as indenture trustee. These Secured Railcar Equipment Notes bear interest at a fixed rate of 5.9% per annum, payable monthly, and have a final maturity of May 14, 2036. These Secured Railcar Equipment Notes are limited recourse obligations of TRL-V only, secured by a portfolio of railcars and operating leases thereon, certain cash reserves, and other assets acquired and owned by TRL-V.

TILC s current warehouse facility was established to finance railcars owned by TILC. With the issuance of the Secured Railcar Equipment Notes, described above, the facility was reduced from $500 million to $375 million in June 2006. At September 30, 2006, there was $80.3 million outstanding on this facility.

In anticipation of a future debt issuance, we entered into interest rate swap transactions during 2005 and 2006. These instruments, with a notional amount of $200 million, fixed the interest rate on a portion of a future debt issuance associated with a railcar leasing transaction in 2006 and settled at maturity in the first quarter of 2006. The weighted average fixed interest rate under these instruments was 4.87%. These interest rate swaps are being accounted for as cash flow hedges with changes in the fair value of the instruments of $4.5 million of income recorded in other comprehensive income. The future debt issuance closed in the second quarter of 2006 (see details of the Secured Railcar Equipment Notes above). As of September 30, 2006, the balance remaining in accumulated other comprehensive income was $4.3 million. The effect of the amortization on the consolidated statement of operations for the three and nine month periods ended September 30, 2006 was not material.

As of September 30, 2006, we had $65.0 million of interest rate swaps outstanding to fix the LIBOR component of outstanding debt. No portion of these swaps was treated as ineffective during the three or nine month periods ended September 30, 2006. The amount recorded in the consolidated balance sheet for these instruments was a net asset of $0.6

31

million as of September 30, 2006 with a $0.6 million balance of income in accumulated other comprehensive income. The effect on the consolidated statement of operations for the three and nine month periods ended September 30, 2006 was income of $0.2 million and $0.8 million, respectively.

Cash Flows

Operating Activities. Net cash provided by the operating activities of continuing operations for the nine months ended September 30, 2006 was $48.3 million compared to $16.1 million of net cash provided by the operating activities of continuing operations for the same period in 2005. This was primarily due to an increase in net income for the nine month period, an increase in deferred taxes, a decrease in receivables, and an increase in accounts payable, partially offset by an increase in inventories and other assets. The increase in inventories and accounts payable are related to increased production volumes. The increase in other assets is primarily the result of an increase in restricted cash related to the Leasing Group as well as an increase in deferred loan fees. Net cash provided by the operating activities of discontinued operations decreased to $15.0 million for the nine months ended September 30, 2006 from $43.7 million for the same period in 2005.

Investing Activities. Net cash required by investing activities of continuing operations for the nine months ended September 30, 2006 was $434.6 million compared to $248.0 million for the same period last year. Capital expenditures for the nine months ended September 30, 2006 were $483.4 million, of which $390.3 million were for additions to the lease fleet. This compares to $277.8 million of capital expenditures for the same period last year, of which $233.0 million were for additions to the lease fleet. Proceeds from the sale of property, plant, and equipment were $51.1 million for the nine months ended September 30, 2006 composed primarily of railcar sales from the lease fleet and the sale of non-operating assets, compared to $29.8 million for the same period in 2005 composed primarily of railcar sales from the lease fleet and the sale of non-operating assets. For the nine months ended September 30, 2006, $2.3 million of cash was required for an acquisition by our Construction Products Group. Cash provided by investing activities of discontinued operations of $82.9 million was primarily due to the sales of our weld fittings business and our European railcar business.

Financing Activities. Net cash provided by financing activities during the nine months ended September 30, 2006 was $520.5 million compared to $133.1 million for the same period in 2005. We intend to use our cash to fund the operations of the Company, including expansion of manufacturing plants and expansion of our leasing fleet.

Contractual Obligation and Commercial Commitments

As of September 30, 2006, other commercial commitments related to letters of credit decreased to $118.6 million from $118.9 million as of December 31, 2005. Refer to Note 7 in the consolidated financial statements for changes to our outstanding debt and maturities. Other commercial commitments that relate to operating leases under sale/leaseback transactions were basically unchanged as of September 30, 2006.

Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (SFAS No. 109) . This interpretation clarifies the accounting for uncertainty in income taxes recognized in an entity s financial statements in accordance with SFAS No. 109, Accounting for Income Taxes . It prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax positions taken or expected to be taken on a tax return. This interpretation is effective for fiscal years beginning after December 31, 2006. We will be required to adopt this interpretation in the first quarter of 2007. We are currently evaluating the requirements of FIN 48 and have not yet determined the impact on the consolidated financial statements.

In September 2006, the FASB issued Statement SFAS No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of SFAS 157 are effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of the provisions of SFAS 157.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans (SFAS 158). SFAS 158 requires employers to fully recognize the obligations associated with single-employer defined benefit pension, retiree healthcare, and other postretirement plans in their financial

statements. The provisions of SFAS 158 are effective for fiscal years ending after December 15, 2006. We are currently evaluating the impact of the provisions of SFAS 158.

In September 2006, the FASB issued FASB Staff Position AUG AIR-1, Accounting for Planned Major Maintenance Activities (FSP AUG AIR-1) that addresses the planned major maintenance of assets and prohibits the use of the accrue-in-advance method of accounting for these activities in annual and interim reporting periods. FSP AUG AIR-1 continues to

allow the direct expense, built-in overhaul, and deferral methods and requires disclosure of the accounting method for planned major maintenance activities as well as information related to the change from the accrue-in advance method to another method. FSP AUG AIR-1 is effective for the first fiscal year beginning after December 15, 2006 and should be applied retrospectively. We do not expect the adoption of FSP AUG AIR-1 to have a material impact on our financial statements.

Forward-Looking Statements. This quarterly report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Any statements contained herein that are not historical facts are forward-looking statements and involve risks and uncertainties. These forward-looking statements include expectations, beliefs, plans, objectives, future financial performance, estimates, projections, goals, and forecasts. Potential factors, which could cause our actual results of operations to differ materially from those in the forward-looking statements, include among others:

market conditions and demand for our products;

the cyclical nature of both the railcar and barge industries;

variations in weather in areas where construction products are sold and used;

disruption of manufacturing capacity due to weather related events;

the timing of introduction of new products;

the timing of customer orders;

price changes;

changes in mix of products sold;

the extent of utilization of manufacturing capacity;

availability and costs of component parts, supplies, and raw materials;

competition and other competitive factors;

changing technologies;

steel prices;

surcharges added to fixed pricing agreements for raw materials;

interest rates and capital costs;

long-term funding of our leasing warehouse facility;

taxes;

the stability of the governments and political and business conditions in certain foreign countries, particularly Mexico;

changes in import and export quotas and regulations;

business conditions in emerging economies;

results of litigation; and

legal, regulatory, and environmental issues.

Any forward-looking statement speaks only as of the date on which such statement is made. Trinity undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made.

Table of Contents

Item 3. ***Quantitative and Qualitative Disclosures About Market Risk***

There has been no material change in our market risks since December 31, 2005. Refer to Note 4 in the consolidated financial statements for a discussion of the impact of hedging activity for the nine months ended September 30, 2006. Refer to Note 7 in the consolidated financial statements for a discussion of debt related activity for the nine months ended September 30, 2006.

Item 4. ***Controls and Procedures***

Disclosure Controls and Procedures

The Company maintains controls and procedures designed to ensure that it is able to collect the information it is required to disclose in the reports it files with the SEC, and to process, summarize, and disclose this information within the time periods specified in the rules of the SEC. The Company s Chief Executive and Chief Financial Officers are responsible for establishing and maintaining these procedures and, as required by the rules of the SEC, evaluate their effectiveness. Based on their evaluation of the Company s disclosure controls and procedures which took place as of the end of the period covered by this report, the Chief Executive and Chief Financial Officers believe that these procedures are effective to ensure that the Company is able to collect, process, and disclose the information it is required to disclose in the reports it files with the SEC within the required time periods.

Internal Controls

The Company maintains a system of internal controls designed to provide reasonable assurance that: transactions are executed in accordance with management s general or specific authorization; transactions are recorded as necessary (1) to permit preparation of financial statements in conformity with generally accepted accounting principles, and (2) to maintain accountability for assets; access to assets is permitted only in accordance with management s general or specific authorization; and the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

During the period covered by this report, there have been no changes in the Company s internal control over financial reporting that have materially affected or are reasonably likely to materially affect the Company s internal control over financial reporting.

Table of Contents

PART II

Item 1. *Legal Proceedings*

The information provided in Note 14 in the consolidated financial statements on page 21 is hereby incorporated into this Part II, Item 1 by reference.

Item 1A. *Risk Factors*

There have been no material changes from the risk factors previously disclosed in Item 1A of our 2005 annual report on Form 10-K.

Item 2. *Unregistered Sales of Equity Securities and Use of Proceeds*

This table provides information with respect to purchases by the Company of shares of its Common Stock during the quarter ended September 30, 2006:

Period	Number of Shares Purchased (1)	Average Price Paid per Share (1)
July 1, 2006 through July 31, 2006		
August 1, 2006 through August 31, 2006	38,094	$ 33.62
September 1, 2006 through September 30, 2006	1,226	32.59
Total	39,320	$ 33.59

(1) This column includes the deemed surrender to the Company of 39,320 shares of Common Stock to pay the exercise price and satisfy tax withholding requirements in connection with the exercise of employee stock options during the three months ended September 30, 2006.

Item 3. *Defaults Upon Senior Securities*

None.

Item 5. *Other Information*

None.

Item 6. *Exhibits*

Exhibit Number	Description

10.26	Board Compensation Summary Sheet (filed herewith).*
31.1	Rule 13a-15(e) and 15d-15(e) Certification of Chief Executive Officer (filed herewith).
31.2	Rule 13a-15(e) and 15d-15(e) Certification of Chief Financial Officer (filed herewith).
32.1	Certification pursuant to 18 U.S.C., Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).
32.2	Certification pursuant to 18 U.S.C., Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).

* Management contracts and compensatory plan arrangements.

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

TRINITY INDUSTRIES, INC. Registrant	By /s/ WILLIAM A. MCWHIRTER II William A. McWhirter II Senior Vice President and Chief Financial Officer November 2, 2006

36

Table of Contents

INDEX TO EXHIBITS

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