

POGO PRODUCING CO
Form 10-Q
July 30, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2007 or

Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission file number 1-7792

POGO PRODUCING COMPANY

(Exact Name of Registrant as Specified in Its Charter)

Delaware

(State or Other Jurisdiction of
Incorporation or Organization)

74-1659398

(I.R.S. Employer
Identification No.)

5 Greenway Plaza, Suite 2700

Houston, Texas

(Address of principal executive offices)

77046-0504

(Zip Code)

(713) 297-5000

(Registrant's Telephone Number, Including Area Code)

Not Applicable

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, par value \$1.00 per share:

58,653,682 shares as of July 25, 2007

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

POGO PRODUCING COMPANY AND SUBSIDIARIES

Consolidated Statements of Income (Unaudited)

	Three Months Ended June 30, 2007		Six Months Ended June 30, 2007	
	2006	2006	2007	2006
	(Expressed in millions, except per share amounts)			
Revenue and Other Income				
Oil and gas	\$ 220.0	\$ 237.0	\$ 430.9	\$ 480.0
Other	2.9	0.4	3.6	1.2
Total	222.9	237.4	434.5	481.2
Operating Costs and Expenses:				
Lease operating	49.7	47.2	96.6	86.4
General and administrative	27.7	21.5	56.9	41.4
Exploration	5.9	0.5	14.0	1.7
Dry hole and impairment	5.4	12.8	51.7	35.9
Depreciation, depletion and amortization	79.6	64.0	164.0	127.3
Production and other taxes	15.3	16.9	32.9	28.0
Net gain on sales of properties	(127.2)	(308.4)	(129.5)	(308.4)
Other	8.0	5.8	13.1	10.6
Total	64.4	(139.7)	299.7	22.9
Operating Income	158.5	377.1	134.8	458.3
Interest:				
Charges	(40.9)	(36.0)	(83.7)	(64.3)
Income		0.1	0.1	0.3
Capitalized	20.5	18.7	39.9	34.8
Commodity Derivative Expense	(1.5)	(7.1)	(4.6)	(3.8)
Income from Continuing Operations Before Taxes	136.6	352.8	86.5	425.3
Income Tax Expense	(39.7)	(16.2)	(24.2)	(42.8)
Income from Continuing Operations	96.9	336.6	62.3	382.5
Income (Loss) from Discontinued Operations, net of tax	(141.7)	25.3	(128.3)	46.9
Net Income (Loss)	\$ (44.8)	\$ 361.9	\$ (66.0)	\$ 429.4
Earnings (Loss) per Common Share:				
Basic				
Income from Continuing Operations	\$ 1.68	\$ 5.87	\$ 1.08	\$ 6.67
Income (Loss) from Discontinued Operations, net of tax	(2.46)	0.44	(2.22)	0.81
Net Income (Loss)	\$ (0.78)	\$ 6.31	\$ (1.14)	\$ 7.48
Diluted				
Income from Continuing Operations	\$ 1.65	\$ 5.81	\$ 1.06	\$ 6.60
Income (Loss) from Discontinued Operations, net of tax	(2.42)	0.44	(2.19)	0.81
Net Income (Loss)	\$ (0.77)	\$ 6.25	\$ (1.13)	\$ 7.41
Dividends per Common Share	\$ 0.075	\$ 0.075	\$ 0.15	\$ 0.15
Potential Common Shares Outstanding:				
Basic	57,817	57,385	57,776	57,366
Diluted	58,577	57,930	58,501	57,948

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See accompanying notes to consolidated financial statements.

2

Consolidated Balance Sheets (Unaudited)

	June 30, 2007	December 31, 2006
	(Expressed in millions)	
Assets		
Current Assets:		
Cash and cash equivalents	\$ 20.3	\$ 22.7
Accounts receivable	89.6	103.9
Other receivables	46.4	47.6
Federal income tax receivable		58.0
Inventories tubulars	16.0	18.5
Commodity derivative contracts		10.9
Assets from discontinued operations	103.1	96.5
Other	4.1	10.1
Total current assets	279.5	368.2
Property and Equipment:		
Oil and gas, on the basis of successful efforts accounting		
Proved properties	4,221.0	5,056.6
Unevaluated properties	323.4	301.8
Other, at cost	45.2	43.2
	4,589.6	5,401.6
Accumulated depreciation, depletion and amortization		
Oil and gas	(1,204.1)	(1,619.8)
Other	(32.8)	(30.5)
	(1,236.9)	(1,650.3)
Property and equipment, net	3,352.7	3,751.3
Other Assets:		
Commodity derivative contracts		5.0
Assets from discontinued operations	2,946.6	2,819.5
Other	26.0	27.1
	2,972.6	2,851.6
	\$ 6,604.8	\$ 6,971.1

See accompanying notes to consolidated financial statements.

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	June 30, 2007	December 31, 2006
	(Expressed in millions, except share amounts)	
Liabilities and Shareholders' Equity		
Current Liabilities:		
Accounts payable - operating activities	\$ 109.6	\$ 107.6
Accounts payable - investing activities	58.0	74.2
Income taxes payable	93.6	0.4
Accrued interest payable	24.8	26.0
Accrued payroll and related benefits	10.0	5.1
Commodity derivative contracts	5.6	
Deferred income tax	3.7	7.2
Liabilities from discontinued operations	169.1	162.7
Other	16.6	18.6
Total current liabilities	491.0	401.8
Long-Term Debt	1,837.8	2,319.7
Deferred Income Tax	737.8	804.3
Asset Retirement Obligation	60.5	114.9
Other Liabilities and Deferred Credits	48.1	44.3
Liabilities from Discontinued Operations	737.8	718.7
Total liabilities	3,913.0	4,403.7
Commitments and Contingencies		
Shareholders' Equity:		
Preferred stock, \$1 par; 4,000,000 shares authorized		
Common stock, \$1 par; 200,000,000 shares authorized, 66,015,641 and 65,794,206 shares issued, respectively	66.0	65.8
Additional capital	987.7	971.4
Retained earnings	1,818.1	1,892.9
Accumulated other comprehensive income (loss)	181.3	(1.4)
Treasury stock (7,365,359 shares, at cost)	(361.3)	(361.3)
Total shareholders' equity	2,691.8	2,567.4
	\$ 6,604.8	\$ 6,971.1

See accompanying notes to consolidated financial statements.

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Condensed Consolidated Statements of Cash Flows (Unaudited)

	Six Months Ended June 30, 2007		2006 (Expressed in millions)	
Cash Flows from Operating Activities:				
Cash received from customers	\$	446.3	\$	406.4
Operating, exploration, and general and administrative expenses paid		(205.4)	)	(113.2)
Interest paid		(43.3)	)	(58.8)
Income taxes paid				(54.9)
Income tax refund		52.0		2.6
Business interruption insurance proceeds		4.2		6.2
Other		6.4		0.9
Net cash provided by continuing operating activities		260.2		189.2
Net cash provided by discontinued operations		152.8		149.0
Net cash provided by operating activities		413.0		338.2
Cash Flows from Investing Activities:				
Capital expenditures		(370.6)	)	(213.8)
Purchase of corporations and property		(16.8)	)	(790.5)
Sale of properties		597.1		463.0
Insurance proceeds		18.6		10.3
Other				(1.0)
Net cash provided by (used in) continuing investing activities		228.3		(532.0)
Net cash used in discontinued operations		(163.5)	)	(182.3)
Net cash provided by (used in) investing activities		64.8		(714.3)
Cash Flows from Financing Activities:				
Borrowings under senior debt agreements		1,135.0		1,368.0
Payments under senior debt agreements		(1,617.0)	)	(1,450.0)
Proceeds from 2013 notes				450.0
Purchase of Company stock				(7.7)
Payments to discontinued operations		(8.8))	
Payments of cash dividends on common stock		(8.8)	)	(8.7)
Payment of debt issue costs				(11.2)
Proceeds from exercise of stock awards		8.5		4.1
Net cash provided by (used in) continuing financing activities		(491.1)	)	344.5
Net cash provided by discontinued operations		8.8		
Net cash provided by (used in) financing activities		(482.3)	)	344.5
Effect of exchange rate changes on cash		2.1		0.8
Net decrease in cash and cash equivalents		(2.4)	)	(30.8)
Cash and cash equivalents from continuing operations, beginning of the year		5.6		8.0
Cash and cash equivalents from discontinued operations, beginning of the year		17.1		49.7
Cash and cash equivalents at the end of the period	\$	20.3	\$	26.9
Reconciliation of net income to net cash provided by operating activities:				
Net income (loss)	\$	(66.0)	)	\$ 429.4
Adjustments to reconcile net income (loss) to net cash provided by operating activities				
Loss (Income) from discontinued operations, net of tax		128.3		(46.9)
Net gains from the sales of properties		(129.5)	)	(308.4)
Depreciation, depletion and amortization		164.0		127.3
Dry hole and impairment		51.7		35.9
Commodity derivative contracts		7.9		4.3
Other		(7.6)	)	(26.2)
Deferred income taxes		(75.0)	)	(102.3)
Change in operating assets and liabilities		186.4		76.1
Net cash provided by continuing operating activities		260.2		189.2
Net cash provided by discontinued operations		152.8		149.0
Net cash provided by operating activities	\$	413.0	\$	338.2

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See accompanying notes to consolidated financial statements.

5

Consolidated Statement of Shareholders Equity (Unaudited)

For the Six Months Ended June 30, 2007
Shareholders Equity
Shares **Amount**
(Expressed in millions, except share amounts)

Common Stock:

\$1.00 par-200,000,000 shares authorized

Balance at beginning of year	65,794,206	\$ 65.8
Stock option activity	231,435	0.2
Restricted stock activity	(10,000)	
Issued at end of period	66,015,641	66.0

Additional Capital:

Balance at beginning of year	971.4
Stock options exercised proceeds	8.2
Stock based compensation excess federal tax benefit	1.2
Stock based compensation restricted stock	6.9
Balance at end of period	987.7

Retained Earnings:

Balance at beginning of year	1,892.9
Net loss	(66.0)
Dividends (\$0.15 per common share)	(8.8)
Balance at end of period	1,818.1

Accumulated Other**Comprehensive Income (Loss):**

Balance at beginning of year	(1.4)
Cumulative foreign currency translation adjustment, net of tax	190.0
Deferred post-retirement benefit costs, net of tax	1.4
Change in fair value of commodity derivative contracts, net of tax	(12.1)
Reclassification adjustment for losses on commodity derivative contracts included in net income, net of tax	3.4
Balance at end of period	181.3

Treasury Stock:

Balance at beginning of year	(7,365,359)	(361.3)
Activity during the period		
Balance at end of period	(7,365,359)	(361.3)

Common Stock Outstanding, at the End of the Period	58,650,282
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Total Shareholders Equity	\$ 2,691.8
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See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements (Unaudited)

(1) GENERAL INFORMATION

The consolidated financial statements included herein have been prepared by Pogo Producing Company (the "Company") without audit and include all adjustments (of a normal and recurring nature), which are, in the opinion of management, necessary for the fair presentation of interim results. The interim results are not necessarily indicative of results for the entire year. The financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

Certain prior year amounts have been reclassified related to the Company's discontinued operations. Such reclassifications had no effect on the Company's net income or shareholders' equity. The Company changed the classification of Net gains on sales of properties from Revenue and Other Income to reflect it as a component of Operating Costs and Expenses for both the current and prior periods. The Company changed the classification of interest capitalized in the Statement of Cash Flows from an operating cash outflow to an investing cash outflow in the fourth quarter of 2006. The Company elected not to change the classification of interest capitalized in the Statement of Cash Flows for periods prior to the fourth quarter of 2006 due to the immateriality of the amounts.

The Company's results for all periods presented reflect its oil and gas exploration, development, and production activities in Canada as discontinued operations. Except where noted and for pro forma earnings per share, the discussions in the following notes relate to the Company's continuing operations only.

On July 17, 2007 Plains Exploration & Production Company ("PXP") and the Company entered into a definitive agreement for PXP to acquire the Company in a stock and cash transaction valued at approximately \$3.6 billion, based on PXP's closing price on July 16, 2007. Under the terms of the agreement, Pogo stockholders, on an aggregate basis, will receive 0.68201 shares of PXP common stock and \$24.88 in cash for each share of the Company's common stock, which represents a total consideration of approximately \$60 per share of the Company's common stock based on PXP's closing price on July 13, 2007. Total consideration for all of the issued and outstanding shares of the Company's common stock (excluding treasury shares) is 40 million PXP shares and approximately \$1.5 billion in cash. The Company's stockholders have the right to elect to receive cash or stock, subject to proration. In addition, if the 10-day average trading price of PXP shares at the time of the merger varies from the closing price at July 13, 2007, certain adjustment provisions will apply. These adjustment provisions are intended to approximately equalize the then-market value of the PXP shares being issued and the amount of cash being paid to those stockholders who elect to receive all stock or all cash. The aggregate amount of cash being paid and the aggregate number of PXP shares being issued will not change, however. These adjustment provisions are set forth in the merger agreement and will be more fully described in the joint proxy statement/prospectus to be filed by the Company and PXP. The transaction is expected to qualify as a tax-free reorganization under Section 368(a).

This sale is expected to close during the fourth quarter of 2007, subject to customary closing conditions and regulatory approvals, including from the U.S. Securities and Exchange Commission, Federal Trade Commission and Department of Justice, and will be contingent upon approval by PXP stockholders of the issuance of shares of PXP stock to be used as merger consideration and adoption of the merger agreement by the Company's stockholders.

(2) DISCONTINUED OPERATIONS

Under SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ("SFAS No. 144"), the Company classifies assets to be disposed of as held for sale, or, if appropriate, discontinued operations, when the criteria defined in SFAS No. 144 have been met, including a commitment by the Company's management or Board of Directors to sell the assets. On May 28, 2007, the Company entered into an agreement to sell all of the outstanding stock of its wholly-owned subsidiary, Northrock Resources Ltd. ("Northrock") for \$2.0 billion in cash. The Company expects to complete the sale during the third quarter of 2007 and currently plans to use the proceeds to pay off senior debt and invest the remainder while evaluating debt repayment strategies.

The financial results and financial position for Northrock have been classified as discontinued operations in the Company's financial statements for all periods presented. SFAS No. 144 requires that long-lived assets classified as discontinued operations be measured at the lower of their carrying amount or fair value less cost to sell. The Company has recognized a loss on its investment in Northrock of approximately \$184.5 million, which includes \$23 million of U.S. income tax expense related to previously unremitted foreign earnings, as part of income (loss) from discontinued operations for both the three and six month periods ended June 30, 2007.

The summarized financial results and financial position of the discontinued operations for the periods presented are as follows:

Operating Results Data

	Three months ended		Six months ended	
	June 30,		June 30,	
	2007	2006	2007	2006
Revenues	\$ 141.7	\$ 128.8	\$ 279.2	\$ 258.6
Costs and expenses	(105.0)	(97.5)	(237.3)	(198.1)
Other income	7.4	1.6	8.5	1.7
Income (loss) before income taxes	44.1	32.9	50.4	62.2
Income tax benefit (expense)	(1.3)	(7.6)	5.8	(15.3)
Income before loss from discontinued operations, net of tax	42.8	25.3	56.2	46.9
Loss on Northrock investment, including tax expense of \$23 million	(184.5)		(184.5)	
Income(loss) from discontinued operations, net of tax	\$ (141.7)	\$ 25.3	\$ (128.3)	\$ 46.9

Financial Position Data

	June 30,	December 31,
	2007	2006
<u>Assets of Discontinued Operations</u>		
Accounts receivable	\$ 75.0	\$ 69.7
Inventories	25.6	24.8
Other current assets	2.5	2.0
Total current assets	103.1	96.5
Property, plant, and equipment, net	2,931.3	2,805.8
Other long-term assets	15.3	13.7
Total assets	\$ 3,049.7	\$ 2,916.0
<u>Liabilities of Discontinued Operations</u>		
Accounts payable	\$ 121.4	\$ 158.5
Income taxes payable	43.6	0.4
Other current liabilities	4.1	3.8
Total current liabilities	169.1	162.7
Deferred income tax	686.5	673.7
Asset retirement obligation	48.0	41.4
Other deferred credits	3.3	3.6
Total liabilities	\$ 906.9	\$ 881.4

(3) OTHER DIVESTITURES

During the three and six months ended June 30, 2007, the Company completed the sale of properties in the onshore Texas and Louisiana areas and the Texas Panhandle for approximately \$181.1 million and \$190.2 million, respectively. In addition, on June 8, 2007 the Company completed the sale of certain of its federal and state Gulf of Mexico oil and gas leasehold interests and related pipelines and equipment. This transaction, along with the exercise of preferential purchase rights, was for approximately \$419.5 million before purchase price adjustments. The proceeds from these sales transactions were used to reduce outstanding debt. The transactions resulted in gains on the sale of properties of \$127.2 million and \$129.5 million for the three and six months ended June 30, 2007, respectively, which consisted primarily of a gain of \$224.9 million on the Gulf of Mexico sale and losses of \$7.8 million on the South Texas, Texas Gulf Coast and

Louisiana Gulf Coast sale and \$89.4 million on the Texas Panhandle sale. Additionally, the Company recognized impairments for \$0.2 million and \$34.4 million during the three and six months ended June 30, 2007 on the above properties prior to the completion of the sales.

8

(4) ACQUISITIONS

2006 - On May 2, 2006, the Company completed the acquisition of Latigo Petroleum, Inc. (Latigo), a privately held corporation for approximately \$764.9 million in cash, including transaction costs. The purchase price was funded using cash on hand and debt financing. At the date of purchase, Latigo owned approximately 100,100 net producing acres, plus approximately 304,600 net acres of undeveloped leasehold. Latigo's operations are concentrated in west Texas and the Texas Panhandle with key exploration plays in the Texas Panhandle. The Company acquired Latigo primarily to strengthen its position in domestic exploration and development properties. The following is a calculation and final allocation of purchase price to the acquired assets and liabilities based on their relative fair values:

CALCULATION OF PURCHASE PRICE (IN MILLIONS)	
Cash paid, including transaction costs	\$ 764.9
Plus fair market value of liabilities assumed:	
Deferred income taxes	205.9
Other liabilities	55.1
Total purchase price for assets acquired	\$ 1,025.9
ALLOCATION OF PURCHASE PRICE (IN MILLIONS)	
Proved oil and gas properties	\$ 846.9
Unproved oil and gas properties	157.0
Other assets	22.0
Total	\$ 1,025.9

Pro Forma Information

The following summary presents unaudited pro forma consolidated results of operations for the three and six months ended June 30, 2006 as if the acquisition of Latigo had occurred as of January 1, 2006. The pro forma results are for illustrative purposes only and include adjustments in addition to the pre-acquisition historical results of Latigo, such as increased depreciation, depletion and amortization expense resulting from the allocation of fair value to oil and gas properties acquired, increased interest expense on acquisition debt and the related tax effects of these adjustments. The unaudited pro forma information (presented in millions of dollars, except per share amounts) is not necessarily indicative of the operating results that would have occurred had the acquisition been consummated at that date, nor is it necessarily indicative of future operating results.

Pro Forma:	Three Months Ended June 30, 2006	Six Months Ended June 30, 2006
Revenues	\$ 247.5	\$ 522.7
Net income	333.3	378.2
Earnings per share:		
Basic	\$ 5.81	\$ 6.59
Diluted	\$ 5.75	\$ 6.53

(5) EARNINGS PER SHARE

Earnings per common share (basic earnings per share) are based on the weighted average number of shares of common stock outstanding during the periods. Earnings per share and potential common shares (diluted earnings per share) consider the effect of dilutive securities as set out below. Amounts are expressed in millions, except per share amounts.

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Income (numerator):				
Income from continuing operations	\$ 96.9	\$ 336.6	\$ 62.3	\$ 382.5
Income (loss) from discontinued operations, net of tax	(141.7)	25.3	(128.3)	46.9
Net Income (loss) basic and diluted	\$ (44.8)	\$ 361.9	\$ (66.0)	\$ 429.4
Weighted average shares (denominator):				
Weighted average shares - basic	57.8	57.4	57.8	57.4
Dilution effect of stock options and unvested restricted stock outstanding at end of period	0.8	0.5	0.7	0.6
Weighted average shares diluted	58.6	57.9	58.5	58.0
Earnings per share:				
Basic:				
Income from continuing operations	\$ 1.68	\$ 5.87	\$ 1.08	\$ 6.67
Income (loss) from discontinued operations	(2.46)	0.44	(2.22)	0.81
Basic earnings (loss) per share	\$ (0.78)	\$ 6.31	\$ (1.14)	\$ 7.48
Diluted:				
Income from continuing operations	\$ 1.65	\$ 5.81	\$ 1.06	\$ 6.60
Income (loss) from discontinued operations	(2.42)	0.44	(2.19)	0.81
Diluted earnings (loss) per share	\$ (0.77)	\$ 6.25	\$ (1.13)	\$ 7.41

There were no adjustments for anti-dilutive shares for the three and six months ended June 30, 2007. For the three months ended June 30, 2006, the Company excluded from the diluted earnings per share calculation common stock equivalents totaling 0.2 million shares because their effect on earnings per share was anti-dilutive. There were no adjustments for anti-dilutive shares for the six months ended June 30, 2006.

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(6) LONG-TERM DEBT

Long-term debt at June 30, 2007 and December 31, 2006, consists of the following (dollars expressed in millions):

	June 30, 2007	December 31, 2006
Senior debt		
Bank revolving credit agreement:		
LIBOR based loans, borrowings at June 30, 2007 and December 31, 2006 at interest rates of 6.5712% and 6.8524%, respectively	\$ 290.0	\$ 797.0
LIBOR Rate Advances, borrowings at June 30, 2007 and December 31, 2006 at interest rates of 6.695% and 6.6833%, respectively	100.0	75.0
Total senior debt	390.0	872.0
Senior subordinated debt		
8.25% Senior subordinated notes, due 2011	200.0	200.0
7.875% Senior subordinated notes, due 2013	450.0	450.0
6.625% Senior subordinated notes, due 2015	300.0	300.0
6.875% Senior subordinated notes, due 2017	500.0	500.0
Total senior subordinated debt	1,450.0	1,450.0
Unamortized discount on 2015 Notes	(2.2)	(2.3)
Total debt	1,837.8	2,319.7
Amount due within one year		
Long-term debt	\$ 1,837.8	\$ 2,319.7

(7) INCOME TAXES

The components of income (loss) from continuing operations before income taxes for the three and six month periods ended June 30, 2007 and 2006 are as follows (expressed in millions):

	Three months ended		Six months ended	
	June 30, 2007	2006	June 30, 2007	2006
United States	\$ 140.3	\$ 348.5	\$ 92.1	\$ 422.0
Foreign	(3.7)	4.3	(5.6)	3.3
Income (loss) before income taxes	\$ 136.6	\$ 352.8	\$ 86.5	\$ 425.3

The components of income tax expense (benefit) for the three and six month periods ended June 30, 2007 and 2006 are as follows (expressed in millions):

	Three months ended		Six months ended	
	June 30, 2007	2006	June 30, 2007	2006
Current				
United States	\$ 98.4	\$ 118.1	\$ 98.4	\$ 145.0
Foreign			0.8	
Deferred				
United States	(48.3)	10.4	(64.6)	10.0
Foreign (a)	(10.4)	(112.3)	(10.4)	(112.2)
Income tax (benefit) expense	\$ 39.7	\$ 16.2	\$ 24.2	\$ 42.8

(a) The foreign income tax benefit in 2006 and 2007 is a result of reductions in the Canadian federal and provincial tax rates. Generally accepted accounting principles (GAAP) require that the entire tax effect of a change in

enacted tax rates be allocated to continuing operations.

11

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Total income tax expense (benefit) for the three and six month periods ended June 30, 2007 and 2006, differs from the amounts computed by applying the statutory federal income tax rate to income before taxes as follows (expressed as percent of pretax income):

	Three months ended		Six months ended					
	June 30, 2007	2006	June 30, 2007	2006				
Federal statutory income tax rate	35.0	%	35.0	%	35.0	%	35.0	%
Increases (decreases) resulting from:								
Canadian rate change	(7.6	)	(31.8	)	(12.1	)	(26.4)
State income taxes, net of federal benefits	0.6		1.6		1.1		1.6	
Other	1.1		(0.2	)	4.0		(0.2)
	29.1	%	4.6	%	28.0	%	10.0	%

As pre-tax book income changes in future quarters, the Company's effective tax rate may increase or decrease. The Company expects to complete the sale of Northrock during the third quarter of 2007. The pending sale resulted in the recognition for financial reporting purposes of U.S. income tax on previously unremitted foreign earnings of approximately \$23.0 million. This U.S. tax has been included in the loss on Northrock investment in discontinued operations.

On January 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes. The Company has determined that no uncertain tax positions exist where the Company would be required to make additional tax payments. As a result, the Company has not recorded any additional liabilities for any unrecognized tax benefits as of June 30, 2007.

The Company and its subsidiaries file income tax returns in the U.S. federal and various state and foreign jurisdictions. The Company is no longer subject to U.S. federal, state, or local tax examinations by tax authorities for years prior to 2003. The Company's Canadian subsidiary is no longer subject to examinations by Canadian taxing authorities for years prior to 2002.

The Company's accounting policy is to recognize penalties and interest related to unrecognized tax benefits as income tax expense. The Company does not have an accrued liability for the payment of penalties and interest at June 30, 2007.

(8) ASSET RETIREMENT OBLIGATION

The Company's liability for expected future costs associated with site reclamation, facilities dismantlement, and plugging and abandonment of wells for the six month period ended June 30, 2007 is as follows (in millions):

	2007
ARO as of January 1,	\$ 121.7
Liabilities incurred during the six months ended June 30,	2.1
Liabilities settled during the six months ended June 30,	(64.9)
Accretion expense	4.2
Balance of ARO as of June 30,	63.1
Less: current portion of ARO	(2.6)
Long-term ARO as of June 30,	\$ 60.5

For the three months ended June 30, 2007 and 2006, the Company recognized depreciation expense related to its asset retirement cost (ARC) of \$1.6 million and \$1.4 million, respectively. For the six months ended June 30, 2007 and 2006, the Company recognized depreciation expense related to its ARC of \$3.7 million and \$3.8 million, respectively.

(9) SEVERANCE AND RETENTION INCENTIVE PROGRAM

The Company established a Change of Control Severance and Retention Program (the Plan), effective as of January 1, 2007, to provide severance benefits and a retention incentive to employees who are designated by the Plan Administrator as eligible for benefits under the Plan in the event of a Change of Control. Employees who are selected to participate in the Plan will receive retention benefits on the earlier of (i) involuntary termination of employment by the Company, other than for cause, (ii) a change of control, or (iii) December 31, 2007. For the three months and six months ended June 30, 2007, the Company recorded general and administrative expense related to retention benefits of \$2.6 million and \$5.5 million, respectively.

(10) COMMODITY DERIVATIVES AND HEDGING ACTIVITIES

As of June 30, 2007, the Company held various derivative instruments. During 2005 and 2006, the Company entered into natural gas and crude oil option agreements referred to as collars. Collars are designed to establish floor and ceiling prices on anticipated future natural gas and crude oil production. The Company designated these contracts as cash flow hedges designed to achieve a more predictable cash flow, as well as to reduce exposure to price volatility. While the use of these derivative instruments limits the downside risk of adverse price movements, they may also limit future revenues from favorable price movements. The use of derivatives also involves the risk that the counterparties to such instruments will be unable to meet the financial terms of such contracts. Currently, the Company does not expect losses due to creditworthiness of its counterparties.

During the three and six month periods ended June 30, 2007, the Company recognized pre-tax gains of \$0.6 million and \$2.5 million, respectively, in its oil and gas revenues related to settled price hedge contracts. During the three and six month periods ended June 30, 2006, the Company recognized a pre-tax gain of \$0.1 million and a pre-tax loss of \$4.3 million, respectively, in its oil and gas revenues related to settled price hedge contracts. The Company recognized pre-tax losses of \$0.1 million and \$3.3 million in Other expense due to ineffectiveness on unsettled hedge contracts during the three and six month periods ended June 30, 2007, respectively. The Company recognized pre-tax losses of \$1.3 million and \$1.6 million in Other expense due to ineffectiveness on unsettled hedge contracts during the three and six month periods ended June 30, 2006, respectively. Unrealized pre-tax losses on derivative instruments of \$3.2 million (\$2.0 million after taxes) have been reflected as a component of other comprehensive income at June 30, 2007. Based on the fair market value of the hedge contracts as of June 30, 2007, the Company would reclassify additional pre-tax losses of approximately \$3.2 million (approximately \$2.1 million after taxes) from accumulated other comprehensive income (shareholders' equity) to net income during the next twelve months.

The gas derivative contracts are generally settled based upon the average of the reported settlement prices on the NYMEX for the last three trading days of a particular contract month. The oil derivative transactions are generally settled based on the average of the reported settlement prices for West Texas Intermediate on the NYMEX for each trading day of a particular calendar month. For any particular collar transaction, the counterparty is required to make a payment to the Company if the settlement price for any settlement period is below the floor price for such transaction, and the Company is required to make a payment to the counterparty if the settlement price for any settlement period is above the ceiling price of such transaction.

The estimated fair value of these contracts is based upon various factors that include closing exchange prices on the NYMEX, volatility and the time value of options. Further details related to the Company's hedging activities as of June 30, 2007 are as follows:

NYMEX