

GASTAR EXPLORATION LTD  
Form S-1/A  
October 13, 2005  
Table of Contents

Index to Financial Statements

As filed with the Securities and Exchange Commission on October 13, 2005

Registration No. 333-127498

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

**Washington, D.C. 20549**

**AMENDMENT NO. 1**

**TO**

**FORM S-1**

**REGISTRATION STATEMENT**

*UNDER*

*THE SECURITIES ACT OF 1933*

**GASTAR EXPLORATION LTD.**

(Exact Name of Registrant as Specified in Its Charter)

**Alberta, Canada**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**1311**  
(Primary Standard Industrial  
Classification Code Number)  
**1331 Lamar Street**

**38-3324634**  
(I.R.S. Employer  
Identification Number)

**Suite 1080**

**Houston, Texas 77010**

**(713) 739-1800**

(Address, Including Zip Code, and Telephone Number, including Area Code, of Registrant's Principal Executive Offices)

**J. Russell Porter, Chief Executive Officer and President**

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Gastar Exploration Ltd.

1331 Lamar Street, Suite 1080

Houston, Texas 77010

(713) 739-1800

(Name, Address, Including Zip Code, and Telephone Number, Including Area Code, of Agent for Service)

*Copies to:*

T. Mark Kelly

Vinson & Elkins L.L.P.

1001 Fannin, Suite 2300

Houston, Texas 77002

(713) 758-2222

**Approximate date of commencement of proposed sale to the public:** As soon as practicable after this Registration Statement becomes effective.

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box.

**CALCULATION OF REGISTRATION FEE**

Title of Each Class of Securities to be Registered	Amount to be Registered (1)	Proposed Maximum Offering Price per Share (2)	Proposed Maximum Aggregate Offering Price (1) (2)	Amount of Registration Fee (3)
Common shares, without par value	23,961,831 shares	\$2.60	\$62,300,760	\$7,332.80

- (1) Includes (i) 2,992,261 common shares issuable upon exercise of warrants at various exercise prices; (ii) 6,849,315 common shares to be issued upon conversion of the registrant's outstanding convertible debentures; (iii) up to 5,029,858 additional common shares to be issued at various dates for no additional consideration pursuant to the terms of subscription receipts issued upon the original sale of the registrant's senior secured notes (number of shares determined based upon a recent trading price of CND\$3.11 per share); and (iv) 9,090,397 outstanding common shares.
- (2) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(c) under the Securities Act of 1933 based on the average of the high and low prices of the Registrant's common shares, as reported on The Toronto Stock Exchange on September 30, 2005, and translated into U.S. dollars at the exchange rate of \$1.00 = CND\$0.8613, which was the exchange rate in effect on September 30, 2005.
- (3) \$7,400.00 previously paid for this registration statement.

**The Registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment that specifically states that this registration statement shall thereafter become effective in**

accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Securities and Exchange Commission acting pursuant to said Section 8(a), may determine.

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Table of Contents

Index to Financial Statements

**The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.**

**Subject to Completion, dated October 13, 2005**

**PROSPECTUS**

**23,961,831 Shares**

**Gastar Exploration Ltd.**

**Common Shares**

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This prospectus relates to the offer and sale, from time to time, of up to 23,961,831 common shares of Gastar Exploration Ltd., an Alberta corporation, held by or issuable to the selling shareholders listed on page 75 of this prospectus. The common shares being offered by the selling shareholders are outstanding, issuable upon conversion of the convertible debentures, issuable pursuant to outstanding subscription receipts and upon exercise of warrants. See "Selling Shareholders". Gastar will not receive any proceeds from the sale of the shares by the selling shareholders. All the proceeds from the sale of shares will be for the respective account of each selling shareholder.

For a description of the plan of distribution of the shares, please see page 82 of this prospectus.

Our common shares are listed on the Toronto Stock Exchange under the symbol "YGA" (in the U.S., "YGA.TO") and may also trade in the United States over-the-counter market under the symbol "GSREF.PK". On September 30, 2005, the last reported sale prices for our common shares on The Toronto Stock Exchange and in the United States over-the-counter market were CDN\$4.08 and \$3.52, respectively.

**Investing in our common shares involves risks. Please read Risk Factors beginning on page 7.**

This prospectus has not been filed in respect of, and will not qualify, any distribution of the common shares in any province or territory of Canada.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

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, 2005

**Table of Contents****Index to Financial Statements****TABLE OF CONTENTS**

<u>Prospectus Summary</u>	1
<u>The Offering</u>	5
<u>Summary Consolidated Financial Data</u>	6
<u>Risk Factors</u>	7
<u>Cautionary Statements Regarding Forward-Looking Statements</u>	18
<u>Use of Proceeds</u>	19
<u>Price Range of Common Shares</u>	19
<u>Dividend History</u>	20
<u>Selected Historical Financial and Operational Information</u>	21
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	22
<u>Business</u>	35
<u>Management</u>	60
<u>Security Ownership of Certain Beneficial Owners and Management</u>	66
<u>Description of Capital Stock</u>	68
<u>Description of Indebtedness</u>	73
<u>Selling Shareholders</u>	75
<u>Plan of Distribution</u>	82
<u>Certain Relationships and Related Party Transactions</u>	85
<u>Material Income Tax Consequences</u>	87
<u>Legal Matters</u>	91
<u>Experts</u>	91
<u>Where You Can Find More Information</u>	92
<u>Index to Financial Statements</u>	F-1
<u>Appendix A – Glossary of Natural Gas and Oil Terms</u>	A-1

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You should rely only on the information contained in this prospectus. We have not authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not making an offer to sell these securities in any jurisdiction where an offer or sale is not permitted. You should assume that the information appearing in this prospectus is accurate as of the date on the front cover of this prospectus only. Our business, financial condition, results of operations and prospects may have changed since that date.

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Unless otherwise specified or the context otherwise requires, all dollar amounts in this prospectus are expressed in U.S. dollars. Canadian dollars, when used, are expressed with the symbol "CDN\$". Unless otherwise specified, where dollars are shown on a converted basis, the conversion is based upon an exchange ratio of \$1.00 = CDN\$0.8613, the exchange rate in effect on September 30, 2005, except for dollars set forth in or derived from the financial statements, where the exchange rate is derived as of the date of the financial statements.

**Table of Contents**

**Index to Financial Statements**

**PROSPECTUS SUMMARY**

*This summary highlights information contained elsewhere in this prospectus. You should read the entire prospectus carefully, including the detailed information contained under the heading "Risk Factors", consolidated financial statements and the accompanying notes to those financial statements included elsewhere in this prospectus. Unless otherwise indicated or required by the context, (i) we, us, and our refer to Gastar Exploration Ltd. and its subsidiaries and predecessors, (ii) Geostar acquisition refers to our June 2005 acquisition from Geostar Corporation ( Geostar ) of additional reserves and working interests in the Powder River Basin and in East Texas, (iii) convertible debentures refers to our \$30.0 million principal amount of 9.75% convertible senior unsecured debentures, (iv) warrants refers to the warrants to purchase common shares issued to investors in connection with certain financing transactions or to our placement agents in connection with the offering of convertible debentures and certain other subordinated notes as partial compensation for their services, (v) senior secured notes refers to our \$63.0 million principal amount of senior secured notes issued in June 2005, (vi) all dollar amounts appearing in this prospectus are stated in U.S. dollars unless specifically noted in Canadian dollars ( CDN\$ ), and (vii) all financial data included in this prospectus has been prepared in accordance with generally accepted accounting principles in the United States. We have provided definitions for some of the natural gas and oil industry terms used in this prospectus in the "Glossary of Natural Gas and Oil Terms" on page A-1 of this prospectus.*

**Gastar Exploration Ltd.**

**Our Business**

We are an independent energy company engaged in the exploration, development and production of natural gas and oil in the United States and Australia. Our principal business activities include the identification, acquisition, and subsequent exploration and development of natural gas and oil properties. Our emphasis is on prospective deep structures identified through seismic and other analytical techniques as well as unconventional natural gas reserves, such as coal bed methane. Our current areas for natural gas or oil activities are:

Deep Bossier play in East Texas;

Powder River Basin in Wyoming and Montana;

Gunnedah Basin in New South Wales, Australia;

Gippsland Basin in Victoria, Australia;

Appalachian Basin in West Virginia;

San Joaquin Basin in California; and

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Cherokee Basin in Southeast Kansas.

We currently are pursuing conventional natural gas exploration in the Deep Bossier play in the Hilltop area in East Texas and the Appalachian Basin in West Virginia. As of June 30, 2005, we had leases on approximately 53,100 gross acres (34,000 net) in Texas and approximately 26,700 gross acres (13,300 net) in Appalachia. For the six months ended June 30, 2005, our daily net production from the Hilltop area averaged approximately 6.9 MMcfed, and from the Appalachian Basin, it averaged 0.1 MMcfed.

In our coal bed methane, or CBM, projects, we use advanced technologies to assist us in developing commercial natural gas production from known coal beds. Our primary CBM properties are in the United States in the Powder River Basin and in the Gunnedah and Gippsland Basins of Australia. As of June 30, 2005, our



**Table of Contents**

**Index to Financial Statements**

acreage position in the Powder River Basin was approximately 56,800 gross acres (21,900 net), and our Australian acreage totaled approximately 3.4 million gross acres (2.0 million net). For the six months ended June 30, 2005, our average net daily production from our CBM properties in the Powder River Basin was approximately 1.9 MMcfed. Exploration and long term production testing on our Australian CBM properties is currently underway. Thus, we currently have no natural gas sales from our Australian CBM properties.

**Our Strategy**

Management believes that:

Natural gas is an environmentally friendly fuel that will be increasingly valued in the United States and Australia;

CBM projects provide us with lower risk exposure to long-lived natural gas production and reserves;

We have made a significant natural gas discovery in the Deep Bossier play in the Hilltop area of East Texas that will require additional exploration and development;

We have the ability to assemble the technical and commercial resources needed to pursue these potential projects; and

Our successful development of one or more large potential natural gas projects will create substantial shareholder value.

Based on these beliefs, we have pursued a strategy that includes:

Accelerating exploration and development drilling on our Deep Bossier play in East Texas;

Combining lower risk CBM projects, such as the Powder River Basin and Australia, with higher risk conventional natural gas exploration;

Assembling a portfolio of high-potential natural gas exploration and development projects in East Texas and in the Appalachian Basin; and

Limiting capital commitments and reducing risk by maintaining financial flexibility through accessing various sources of capital and monetizing certain assets through joint venture arrangements with industry participants.

**Recent Developments**

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*Issuance of Senior Secured Notes and Common Shares.* On June 17, 2005, we completed the private placement of \$63.0 million in principal amount of senior secured notes and 1,217,269 common shares. The notes bear interest at three month LIBOR plus 6% and mature on June 18, 2010. LIBOR is an abbreviation for London Interbank Offered Rate, and is the interest rate offered by a specific group of London banks for U.S. dollar deposits of a stated maturity. We also issued to the purchasers of the notes, for no additional consideration, subscription receipts entitling the holders to receive additional common shares in CDN\$4.5 million increments on each of the six, twelve and eighteen-month anniversaries of the original note issuance date valued on a five-day weighted average trading price immediately prior to the date of issuance.

On September 19, 2005, we issued to the holders of our senior secured notes an additional \$10.0 million of senior secured notes on substantially the same terms as the original June 2005 private placement, including the issuance of 206,354 common shares to the note holders. The common shares issued in the transaction represented an aggregate value of CDN\$714,286 based upon the five day weighted average trading price of CDN\$3.4615 per share for the five trading days immediately prior to closing. In connection with the sale of the additional notes,

**Table of Contents**

**Index to Financial Statements**

We issued subscription receipts to the purchasers of the notes, for no additional consideration, entitling the holders to receive additional common shares in CDN\$714,286 increments on each of the six, twelve and eighteen-month anniversaries of the closing date, valued on a five day weighted average trading price immediately prior to the date of issuance.

We have the right, exercisable quarterly to June 16, 2007, to require the original purchaser of the senior secured note to purchase additional notes in an amount limited to an additional \$10.0 million in principal. If additional notes are issued, the purchasers will also be entitled to receive, for no additional consideration, additional common shares and subscription receipts on similar terms as those issued with the original notes in a pro rata amount based on the additional principal amount of the notes. To issue these additional notes, we must meet certain requirements, as set forth in the senior secured notes. For additional information on the requirement to issue additional notes, see Description of Indebtedness Senior Secured Notes .

*Geostar Acquisition.* Concurrently with the private placement of senior secured notes, we closed the acquisition of additional leasehold and working interest properties from Geostar in the Hilltop area of East Texas and in the Powder River Basin of Wyoming and Montana. We paid a total of \$68.5 million for the interests acquired from Geostar consisting of \$30.5 million in cash, 1,650,133 common shares valued at CDN\$4.50 per share and \$32.0 million in unsecured subordinated notes maturing on January 31, 2006. The acquisition increased our working interest position in the Hilltop area to an average of over 90% and gave us operational control of the properties. The acquisition of additional Powder River Basin interests provides us with a larger interest in properties currently being developed through an existing joint venture. The Board of Directors retained a qualified, independent investment banking firm to render an opinion regarding the fairness of the Geostar acquisition. The investment banking firm provided the Board of Directors with their opinion that the Geostar acquisition was fair for Gastar's shareholders from a financial perspective.

On August 11, 2005, we executed an agreement with Geostar whereby the Geostar \$32.0 million unsecured subordinated note was cancelled. In conjunction with the note cancellation, we agreed to issue Geostar 6,373,694 common shares, calculated by dividing \$17.0 million by an assumed value of CDN\$3.25 per share and a new unsecured subordinated note for \$15.0 million. The new Geostar note bears interest, payable monthly commencing February 15, 2006, at three-month LIBOR plus 4.5% and matures November 15, 2006. The note requires monthly principal payments of \$1.5 million commencing February 15, 2006 and continuing for nine months thereafter with a final principal payment of \$1.5 million due on November 15, 2006. We may elect to pay interest in kind through the issuance of additional notes with such notes maturing on January 15, 2007. We may also be required to issue additional common shares to Geostar in the future based on the results of East Texas drilling, as described in Certain Relationships and Related Party Transactions . For additional information on the Geostar acquisition and our activities in the East Texas Basin, see Business Natural Gas and Oil Operations .

*Letter of Intent with Chesapeake Energy Corporation.* On September 19, 2005, we announced that we had executed a Letter of Intent ( LOI ) with Chesapeake Energy Corporation ( Chesapeake ) outlining the terms under which Chesapeake proposes to (i) acquire for cash new common shares from us equal to 19.9% of our outstanding common shares, (ii) acquire a 33.33% working interest in our Deep Bossier play in the Hilltop prospect area of Leon and Robertson Counties of East Texas and (iii) form an area of mutual interest ( AMI ) to explore 13 counties in East Texas.

Under the terms of the LOI, Chesapeake will acquire, for cash, newly issued common shares equal to 19.9% of our outstanding shares at a price equal to the lesser of (i) CDN\$3.31 per share or (ii) the average of the closing price of our common shares for the three business days immediately preceding the date of closing (the Average Price ), with such Average Price not to be less than CDN\$3.15 per share. We currently have approximately 136.4 million common shares outstanding and expect to issue to Chesapeake approximately 27.2 million new shares.



**Table of Contents**

**Index to Financial Statements**

From this stock offering, we expect to raise approximately CDN\$84.0 to CDN\$89.0 million (or approximately \$72.0 to \$75.0 million) and plan to use the proceeds to accelerate our drilling activities, to reduce short term debt, and for general corporate purposes. Chesapeake may be granted registration rights for the shares issued pursuant to this transaction. Chesapeake may also have the right, with certain exceptions, to maintain its percentage ownership on a fully diluted basis by participating in future stock issuances. The proposed transaction is subject to satisfactory completion of due diligence by Chesapeake and the negotiation of all agreements.

*Common Share Placement.* On June 30, 2005, we completed a private placement of 6,617,736 common shares at CDN\$3.31 per share. The estimated net proceeds from this placement were \$16.4 million (CDN\$20.5 million), after deducting placement fees and expenses.

**Corporate Information**

We are a Canadian corporation that is subsisting under the *Business Corporations Act* (Alberta). Our principal office is located at 1331 Lamar Street, Suite 1080, Houston, Texas 77010, and our telephone number is (713) 739-1800. Our website address is <http://www.gastar.com>. Information on our website or about us on any other website is not incorporated by reference into this prospectus and does not constitute a part of this prospectus.

We were originally incorporated in 1987 under the name CopperQuest Inc. pursuant to the *Business Corporations Act* (Ontario). On May 16, 2000, we continued from the Province of Ontario into the Province of Alberta to subsist pursuant to the *Business Corporations Act* (Alberta), changed our name to Gastar Exploration Ltd. and, pursuant to a reverse takeover, acquired 1075191 Ontario Ltd. and its resource property in Wyoming. Our common shares were quoted on the Canadian Dealing Network Inc. and its successor, the Canadian Venture Exchange, from June 5, 2000 until January 24, 2002 when our common shares began trading on The Toronto Stock Exchange under the symbol YGA (in the U.S., YGA.TO ).

Table of Contents

Index to Financial Statements

**THE OFFERING**

Common shares to be offered by the selling  
shareholders shares 23,961,831

Use of proceeds We will not receive any of the proceeds from the sale of the shares by the selling shareholders.  
All the proceeds from the sale of shares will be for the respective accounts of the selling  
shareholders.

Exchange listing Our common shares are listed on the Toronto Stock Exchange under the symbol YGA (in the  
U.S., YGA.TO ) and may be traded in the United States over-the-counter market under the  
symbol GSREF.PK .

This prospectus relates to the offer and sale, from time to time, of the common shares by selling shareholders. Pursuant to various agreements entered into in connection with the offering of our securities, we are required to register for resale certain of our common shares that are either now outstanding or will be issued upon exercise of certain warrants or conversion of our convertible debentures or common shares that we have issued, or committed to issue pursuant to subscription receipts. We are also offering the opportunity to participate in the registration statement to other holders of some of our restricted securities. Shares covered in the registration will include 9,090,397 outstanding common shares currently held by some holders and additional common shares to be issued in the future in connection with the following:

The exercise of outstanding warrants to purchase 2,992,261 common shares;

The conversion of our convertible debentures, which are convertible into 6,849,315 common shares; and

The issuance of an estimated 5,029,858 common shares that we have committed to issue pursuant to subscription receipts on future dates for no additional consideration to purchasers of our senior secured notes.

For additional information about our warrants, see Description of Capital Stock . For additional information about our convertible debentures, our senior secured notes and the shares issuable in connection with our senior secured notes, see Description of Indebtedness .

**Table of Contents****Index to Financial Statements****SUMMARY CONSOLIDATED FINANCIAL DATA**

The following table presents summary historical financial data as of and for the periods indicated. The summary consolidated financial data as of and for the years ended December 31, 2004, 2003 and 2002 are derived from our audited consolidated financial statements. The summary consolidated financial data as of June 30, 2005 and for the six months ended June 30, 2005 and 2004 are derived from our unaudited consolidated financial statements.

Our unaudited consolidated financial statements include, in the opinion of management, all adjustments, consisting only of normal, recurring adjustments, that management considers necessary for a fair statement of the results of those periods. Our historical results are not necessarily indicative of results to be expected in any future period and the results for the six months ended June 30, 2005 should not be considered indicative of results expected for the full 2005 fiscal year.

You should read the following summary consolidated financial data in conjunction with our audited and unaudited consolidated financial statements and the accompanying notes included elsewhere in this prospectus and the sections of this prospectus entitled, *Selected Historical Financial and Operational Information* and *Management's Discussion and Analysis of Financial Condition and Results of Operations*.

	As of and for the		As of and for the		
	Six Months Ended		Years Ended		
	June 30,		December 31,		
	2005	2004	2004	2003	2002
(Unaudited)					
(in thousands, except per share amounts)					
<b>Consolidated Statement of Loss Data:</b>					
Revenues	\$ 9,674	\$ 873	\$ 6,059	\$ 1,461	\$ 783
Operating loss before interest expense	\$ (9,395)	\$ (852)	\$ (9,587)	\$ (2,368)	\$ (2,657)
Net loss	\$ (16,299)	\$ (1,420)	\$ (12,776)	\$ (4,947)	\$ (4,599)
Basic and diluted loss per share	\$ (0.14)	\$ (0.01)	\$ (0.12)	\$ (0.05)	\$ (0.05)
Shares used in the calculation of basic and diluted loss per share	115,547	109,733	111,374	104,958	98,618
<b>Consolidated Balance Sheet Data:</b>					
Net natural gas and oil properties	\$ 147,467		\$ 56,556	\$ 35,791	\$ 34,457
Total assets	\$ 173,888		\$ 84,442	\$ 38,757	\$ 36,034
Long term liabilities	\$ 120,215		\$ 60,668	\$ 10,554	\$ 12,291
Total shareholders' equity	\$ 33,957		\$ 21,976	\$ 23,669	\$ 22,430
<b>Production Data:</b>					
Production:					
Natural gas (MMcf)	1,606	185	1,108	385	393
Oil (MBbl)	1.2	0.4	1.8	1.0	3.1
Oil Natural gas equivalents (Mmcf)	1,614	188	1,119	391	412
Natural gas (MMcfd)	8.9	1.0	3.0	1.1	1.1
Oil (MBod)	0.0	0.0	0.0	0.0	0.0

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Oil Natural gas equivalents (Mmcfed)	8.9	1.0	3.1	1.1	1.1
Average Sales Prices:					
Natural gas (\$ per Mcf)	\$ 5.99	\$ 4.65	\$ 5.40	\$ 3.72	\$ 1.33
Oil (\$ per Bbl)	\$ 47.09	\$ 32.84	\$ 40.08	\$ 27.89	\$ 20.15



**Table of Contents**

**Index to Financial Statements**

**RISK FACTORS**

*In addition to the other information set forth elsewhere in this prospectus, you should carefully consider the following material risk factors associated with our business and the offering of shares of our common stock when evaluating Gastar. An investment in Gastar will be subject to risks inherent in our business. The trading price of the common shares of Gastar will be affected by the performance of our business relative to, among other things, competition, market conditions and general economic and industry conditions. The value of an investment in Gastar may decrease, resulting in a loss.*

**Risks Related to our Business**

*Natural gas and oil prices are volatile and a decline in natural gas and oil prices can significantly affect our financial condition.*

The success of our business greatly depends on market prices of natural gas and oil. The higher market prices are, the more likely it is that we will be financially successful. On the other hand, declines in natural gas or oil prices may materially adversely affect our financial condition, profitability and liquidity. Lower prices also may reduce the amount of natural gas or oil that we can produce economically.

Natural gas and oil are commodities whose prices are set by broad market forces. Historically, the natural gas and oil markets have been volatile. We do not see any reason why natural gas or oil prices will not continue to be volatile in the future. Prices for natural gas and oil are subject to wide fluctuations in response to relatively minor changes in the supply of and demand for natural gas or oil, market uncertainty and a variety of additional factors that are beyond our control. These factors include:

The domestic and foreign supply of natural gas and oil;

Overall economic conditions;

Weather conditions;

Political conditions in the Middle East and other oil producing regions;

Domestic and foreign governmental regulations;

The level of consumer product demand; and

The price and availability of alternative fuels.

Rising demand for natural gas to fuel power generation and to meet increasingly stringent environmental requirements has led some observers to believe that long term demand for natural gas is increasing.

*Our success depends on natural gas prices in the specific areas where we operate, and these prices may be lower than prices at major markets.*

Even though overall natural gas prices at major markets, such as Henry Hub in Louisiana, may be high, regional natural gas prices may move somewhat independent of broad industry price trends. Because some of our operations are located outside major markets, we are directly impacted by regional natural gas prices regardless of Henry Hub or other major market pricing. For example, surplus natural gas supplies relative to available transportation in the Powder River Basin in 2002 caused local natural gas prices to be much less than national natural gas prices, and we, therefore, were unable to take advantage of those higher national natural gas prices. Low natural gas prices in any or all of the areas where we operate would negatively impact our financial condition and results of operations.

**Table of Contents**

**Index to Financial Statements**

*Natural gas and oil reserves are depleting assets and the failure to replace our reserves would adversely affect our production and cash flows.*

Our future natural gas and oil production depends on our success in finding or acquiring new reserves. If we fail to replace reserves, our level of production and cash flows would be adversely impacted. Production from natural gas and oil properties decline as reserves are depleted, with the rate of decline depending on reservoir characteristics. Our total proved reserves will decline as reserves are produced unless we conduct other successful exploration and development activities or acquire properties containing proved reserves, or both. Our ability to make the necessary capital investment to maintain or expand our asset base of natural gas and oil reserves would be impaired to the extent cash flow from operations is reduced and external sources of capital become limited or unavailable. We may not be successful in exploring for, developing or acquiring additional reserves. If we are not successful, our future production and revenues will be adversely affected.

*Exploration is a high risk activity, and our participation in drilling activities may not be successful.*

Our future success will largely depend on the success of our exploration drilling program. Participation in exploration drilling activities involves numerous risks, including the risk that no commercially productive natural gas or oil reservoirs will be discovered. The cost of drilling, completing and operating wells is often uncertain, and drilling operations may be curtailed, delayed or canceled as a result of a variety of factors, including:

Unexpected drilling conditions;

Blowouts, fires or explosions with resultant injury, death or environmental damage;

Pressure or irregularities in formations;

Equipment failures or accidents;

Adverse weather conditions;

Compliance with governmental requirements and laws, present and future; and

Shortages or delays in the availability of drilling rigs and the delivery of equipment.

We use available seismic data to assist in the location of potential drilling sites. Even when properly used and interpreted, 2-D and 3-D seismic data and other visualization techniques are only tools used to assist geoscientists in identifying subsurface structures and hydrocarbon indicators. They do not allow the interpreter to know conclusively if hydrocarbons are present or economically producible. Poor results from our drilling activities would materially and adversely affect our future cash flows and results of operations. In addition, using seismic data and other advanced technologies involves substantial upfront costs and is more expensive than traditional drilling strategies, and we could incur losses as a result of these expenditures.

*Our level of indebtedness reduces our financial and operational flexibility, and our level of indebtedness may increase.*

As of June 30, 2005, the principal amount of our total indebtedness was \$111.0 million. Our level of indebtedness affects our operations in several ways, including the following:

A significant portion of our cash flow must be used to service our indebtedness;

A high level of debt increases our vulnerability to general adverse economic and industry conditions;

The covenants contained in the agreements governing our outstanding indebtedness limit our ability to borrow additional funds, dispose of assets, pay dividends, sell common shares below certain prices and make certain investments;

Our debt covenants may also affect our flexibility in planning for, and reacting to, changes in the economy or in our industry;

**Table of Contents**

**Index to Financial Statements**

A high level of debt may impair our ability to obtain additional financing in the future for working capital, capital expenditures, acquisitions or general corporate purposes;

Our senior secured notes currently restrict our ability to issue additional notes senior to the senior secured notes; and

A default under our senior loan cove