

Hawg Hauling Disposal LLC

Form S-3ASR

November 27, 2006

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As filed with the Securities and Exchange Commission on November 27, 2006

Registration No. 333-

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM S-3

REGISTRATION STATEMENT

Under

THE SECURITIES ACT OF 1933

Chesapeake Energy Corporation*

(Name of Registrant as specified in its charter)

Oklahoma

73-1395733

(State or other jurisdiction

(I.R.S. Employer

of incorporation or organization)

Identification No.)

6100 North Western Avenue

Aubrey K. McClendon

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Oklahoma City, Oklahoma 73118

(405) 848-8000

(Address, including zip code,

and telephone number, including area code,

of Registrant's principal executive offices)

Chairman of the Board and

Chief Executive Officer

6100 North Western Avenue

Oklahoma City, Oklahoma 73118

(405) 848-8000

(Name, address, including zip code,

and telephone number, including

area code, of agent for service)

Copy to:

James M. Prince, Esq.

Vinson & Elkins L.L.P.

2300 First City Tower

1001 Fannin Street

Houston, Texas 77002-6760

(713) 758-3710

(713) 615-5962 (Fax)

Approximate date of commencement of proposed sale to the public: From time to time after this Registration Statement becomes effective.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. ☐

If any of the securities registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, 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, please 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 registration statement pursuant to General Instruction I.D. or a post-effective amendment thereto that shall become effective upon filing with the Commission pursuant to Rule 462(e) under the Securities Act, check the following box. ☒

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If this Form is a post-effective amendment to a registration statement filed pursuant to General Instruction I.D. filed to register additional securities or additional classes of securities pursuant to Rule 413(b) under the Securities Act, check the following box. "

CALCULATION OF REGISTRATION FEE

| Title of each class of securities to be registered | Amount to be registered | Proposed maximum aggregate offering price⁽¹⁾ | Amount of registration fee |
|---|--------------------------------|--|-----------------------------------|
| Senior Notes | \$512,000,000 | \$512,000,000 | \$54,784 |

(1) Estimated solely for purposes of calculating the registration fee, based on an exchange rate of \$1.28 per 1.00, as of November 22, 2006.

* Includes certain subsidiaries of Chesapeake Energy Corporation identified on the following pages.

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Chesapeake Eagle Canada Corp.

(Exact Name of Registrant As Specified In Its Charter)

New Brunswick, Canada
(State or Other Jurisdiction of
Incorporation or Organization)

None
(I.R.S. Employer
Identification Number)

Chesapeake Energy Louisiana Corporation

(Exact Name of Registrant As Specified In Its Charter)

Oklahoma
(State or Other Jurisdiction of
Incorporation or Organization)

73-1524569
(I.R.S. Employer
Identification Number)

Chesapeake Energy Marketing, Inc.

(Exact Name of Registrant As Specified In Its Charter)

Oklahoma
(State or Other Jurisdiction of
Incorporation or Organization)

73-1439175
(I.R.S. Employer
Identification Number)

Chesapeake Operating, Inc.

(Exact Name of Registrant As Specified In Its Charter)

Oklahoma
(State or Other Jurisdiction of
Incorporation or Organization)

73-1343196
(I.R.S. Employer
Identification Number)

Chesapeake South Texas Corp.

(Exact Name of Registrant As Specified In Its Charter)

Oklahoma
(State or Other Jurisdiction of
Incorporation or Organization)

41-2050649
(I.R.S. Employer
Identification Number)

Nomac Drilling Corporation

(Exact Name of Registrant As Specified In Its Charter)

Oklahoma
(State or Other Jurisdiction of
Incorporation or Organization)

73-1606317
(I.R.S. Employer
Identification Number)

Carmen Acquisition, L.L.C.

(Exact Name of Registrant As Specified In Its Charter)

Oklahoma
(State or Other Jurisdiction of
Incorporation or Organization)

73-1604860
(I.R.S. Employer
Identification Number)

Chesapeake Acquisition, L.L.C.

(Exact Name of Registrant As Specified In Its Charter)

Oklahoma
(State or Other Jurisdiction of
Incorporation or Organization)

73-1528271
(I.R.S. Employer
Identification Number)

Chesapeake Appalachia, L.L.C.

(Exact Name of Registrant As Specified In Its Charter)

Oklahoma
(State or Other Jurisdiction of
Incorporation or Organization)

20-3774650
(I.R.S. Employer
Identification Number)

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Chesapeake Land Company, L.L.C.

(Exact Name of Registrant As Specified In Its Charter)

Oklahoma
(State or Other Jurisdiction of
Incorporation or Organization)

20-2099392
(I.R.S. Employer
Identification Number)

Chesapeake ORC, L.L.C.

(Exact Name of Registrant As Specified In Its Charter)

Oklahoma
(State or Other Jurisdiction of
Incorporation or Organization)

71-0934234
(I.R.S. Employer
Identification Number)

Chesapeake Royalty, L.L.C.

(Exact Name of Registrant As Specified In Its Charter)

Oklahoma
(State or Other Jurisdiction of
Incorporation or Organization)

73-1549744
(I.R.S. Employer
Identification Number)

Gothic Production, L.L.C.

(Exact Name of Registrant As Specified In Its Charter)

Oklahoma
(State or Other Jurisdiction of
Incorporation or Organization)

73-1539475
(I.R.S. Employer
Identification Number)

Hodges Trucking Company, L.L.C.

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(Exact Name of Registrant As Specified In Its Charter)

Oklahoma
(State or Other Jurisdiction of
Incorporation or Organization)

73-1293811
(I.R.S. Employer
Identification Number)

Hawg Hauling & Disposal, LLC

(Exact Name of Registrant As Specified In Its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

06-1706211
(I.R.S. Employer
Identification Number)

Mayfield Processing, L.L.C.

(Exact Name of Registrant As Specified In Its Charter)

Oklahoma
(State or Other Jurisdiction of
Incorporation or Organization)

20-0174765
(I.R.S. Employer
Identification Number)

MC Mineral Company, L.L.C.

(Exact Name of Registrant As Specified In Its Charter)

Oklahoma
(State or Other Jurisdiction of
Incorporation or Organization)

61-1448831
(I.R.S. Employer
Identification Number)

W.W. Realty, L.L.C.

(Exact Name of Registrant As Specified In Its Charter)

Oklahoma
(State or Other Jurisdiction of
Incorporation or Organization)

73-1360666
(I.R.S. Employer
Identification Number)

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Chesapeake Exploration Limited Partnership

(Exact Name of Registrant As Specified In Its Charter)

Oklahoma
(State or Other Jurisdiction of
Incorporation or Organization)

73-1384282
(I.R.S. Employer
Identification Number)

Chesapeake Louisiana, L.P.

(Exact Name of Registrant As Specified In Its Charter)

Oklahoma
(State or Other Jurisdiction of
Incorporation or Organization)

73-1519126
(I.R.S. Employer
Identification Number)

Chesapeake Sigma, L.P.

(Exact Name of Registrant As Specified In Its Charter)

Oklahoma
(State or Other Jurisdiction of
Incorporation or Organization)

27-0029884
(I.R.S. Employer
Identification Number)

MidCon Compression, L.P.

(Exact Name of Registrant As Specified In Its Charter)

Oklahoma
(State or Other Jurisdiction of
Incorporation or Organization)

20-0299525
(I.R.S. Employer
Identification Number)

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

Subject to Completion, dated November 27, 2006

PRELIMINARY PROSPECTUS

400,000,000

% Senior Notes due 2017

The Company:

Chesapeake Energy Corporation is the third largest independent producer of natural gas in the United States and owns interests in approximately 33,700 producing oil and natural gas wells.

The Offering:

Use of Proceeds: We intend to use the net proceeds from this offering to repay outstanding indebtedness under our revolving bank credit facility, which may be reborrowed for general corporate purposes, including to finance potential future acquisitions.

Interest: The notes have a fixed annual rate of _____ % which will be paid every six months on January 15 and July 15, commencing July 15, 2007.

Maturity: January 15, 2017.

Guarantees: The notes will be guaranteed on a senior unsecured basis by each of our existing United States subsidiaries, other than certain de minimis subsidiaries, and one of our non-United States subsidiaries.

Ranking: The notes will be our senior unsecured obligations and will rank equally in right of payment with all of our existing and future senior debt and senior to any subordinated debt that we may incur. The notes will be effectively subordinated to our and our guarantor subsidiaries' existing and future secured debt, including debt under our revolving bank credit facility, to the extent of the value of the assets securing such debt. The notes will also be effectively subordinated to the debt of any non-guarantor subsidiaries.

Change of Control: Upon the occurrence of certain change of control events, each holder of notes may require us to repurchase all or a portion of its notes at a purchase price equal to 101% of the principal amount of the notes, plus accrued interest.

Tax Redemption: We may redeem the notes in whole but not in part at 100% of their principal amount plus accrued interest if at any time we became obligated to pay withholding taxes as a result of a change in law.

Make-Whole Redemption: We may redeem some or all of the notes at any time pursuant to certain make-whole provisions. If we enter into certain sale-leaseback transactions and do not reinvest the proceeds or repay certain senior debt, we must offer to repurchase the notes.

Pricing:

| <u>Per Note</u> | <u>Total</u> |
|-----------------|--------------|
|-----------------|--------------|

| | |
|--|---|
| Initial public offering price | % |
| Underwriting discount | % |
| Proceeds, before expenses, to Chesapeake | % |

This investment involves risks. See Risk Factors beginning on page 14.

The underwriters expect to deliver the notes to investors on or about _____, 2006, only in book-entry form through the facilities of Euroclear and Clearstream. We intend to apply to list the notes on the Irish Stock Exchange for trading on the Alternative Securities Market thereof.

Joint Book-Running Managers

Barclays Capital

Sole Global Coordinator

Credit Suisse

Deutsche Bank Securities

Goldman Sachs International

Senior Co-Managers

**ABN AMRO
Fortis Securities**

Banc of America Securities Limited

**BNP PARIBAS
The Royal Bank of Scotland
plc**

**Lehman Brothers
UBS Investment Bank**

Co-Managers

**Bayerische Hypo- und Vereinsbank AG
DZ Financial Markets LLC**

**BMO Capital Markets
Natexis Bleichroeder Inc.
TD Securities**

**Calyon Securities (USA)
RBC Capital Markets**

The date of this prospectus is _____, 2006.

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We have not authorized any dealer, salesperson or other person to give any information or represent anything to you other than the information contained in this prospectus. You must not rely on unauthorized information or representations. The information in this prospectus is current only as of the date on its cover, and may change after that date.

NOTICE TO INVESTORS

This prospectus does not constitute an offer or solicitation by anyone in any jurisdiction in which such offer or solicitation is not authorized or to any person to whom it is unlawful to make such offer or solicitation. No action has been, or will be, taken to permit a public offering in any jurisdiction where action would be required for that purpose other than the United States. Accordingly, the notes may not be offered or sold, directly or indirectly, and this prospectus may not be distributed, in any jurisdiction except in accordance with the legal requirements applicable in such jurisdiction. You must comply with all laws applicable in any jurisdiction in which you buy, offer or sell the notes or possess or distribute this prospectus, and you must obtain all applicable consents and approvals; neither we nor the underwriters shall have any responsibility for any of the foregoing legal requirements.

Neither we nor the underwriters nor any of our or their respective representatives is making any representation to you regarding the legality of an investment in the notes, and you should not construe anything in this prospectus as legal, business, tax or other advice. You should consult your own advisors as to the legal, tax, business, financial and related aspects of an investment in the notes. In making an investment decision regarding the notes, you must rely on your own examination of the issuer and the terms of the offering, including the merits and risks involved.

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By accepting delivery of this prospectus, you agree not to use any information herein for any purpose other than considering an investment in the notes.

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Subject to the following paragraph, we accept responsibility for the information contained in this prospectus. We have made all reasonable inquiries and confirm to the best of our knowledge, information and belief that the information contained in this prospectus with regard to our Subsidiaries and our affiliates and the notes is true and accurate in all material respects, that the opinions and intentions expressed in this prospectus are honestly held and that we are not aware of any other facts the omission of which would make this prospectus or any statement contained herein misleading in any material respect.

The information contained under the caption **Exchange Rate Information** includes extracts from information and data publicly released by official and other sources. While we accept responsibility for accurately summarizing the information concerning exchange rate information, we accept no further responsibility in respect of such information. The information set out in relation to sections of this prospectus describing clearing and settlement arrangements, including the section entitled **Description of Notes Book-Entry, Delivery and Form**, is subject to any change in or reinterpretation of the rules, regulations and procedures of Euroclear Bank S.A./N.V. (**Euroclear**) or Clearstream Banking, société anonyme (**Clearstream**) currently in effect. While we accept responsibility for accurately summarizing the information concerning Euroclear or Clearstream, we accept no further responsibility in respect of such information. In addition, this prospectus contains summaries believed to be accurate with respect to certain documents, but reference is made to the actual documents for complete information. All such summaries are qualified in their entirety by such reference. Copies of documents referred to herein will be made available to prospective investors upon request to us.

The underwriters, the trustee, the paying agents and any other agents acting with respect to the notes accept no responsibility for and make no representation or warranty, express or implied, as to the accuracy or completeness of the information set forth in this prospectus and nothing contained in this prospectus is, or should be relied upon as, a promise or representation by the underwriters, the trustee, the paying agents or any other agents acting with respect to the notes as to the past or the future.

By purchasing the notes, you will be deemed to have acknowledged that you have reviewed this prospectus and have had an opportunity to request, and have received, all additional information that you need from us. No person is authorized in connection with any offering made by this prospectus to give any information or to make any representation not contained in this prospectus and, if given or made, any other information or representation must not be relied upon as having been authorized by us or the underwriters.

The information contained in this prospectus is as of the date hereof. Neither the delivery of this prospectus at any time after the date of publication nor any subsequent commitment to purchase the notes shall, under any circumstances, create an implication that there has been no change in the information set forth in this prospectus or in our business since the date of this prospectus.

The notes will be issued in the form of one or more global notes, which will be deposited with, or on behalf of, a common depositary for the accounts of Euroclear and Clearstream. Beneficial interests in the global notes will be shown on, and transfers of beneficial interests in the global notes will be effected only through, records maintained by Euroclear and/or Clearstream and their participants, as applicable. See **Description of Notes Book-Entry, Delivery and Form**.

This prospectus sets out the procedures of Euroclear and Clearstream in order to facilitate the original issue and subsequent transfers of interests in the notes among participants of Euroclear and Clearstream. However, neither Euroclear nor Clearstream is under any obligation to perform or continue to perform such procedures and such procedures may be modified or discontinued by either of them at any time. We will not, nor will any of our agents, have responsibility for the performance of the respective obligations of Euroclear, Clearstream or their respective participants under the rules and procedures

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governing their operations, nor will we or our agents have any responsibility or liability for any aspect of the records relating to, or payments made on account of, book-entry interests held through the facilities of any clearing system or for maintaining, supervising or reviewing any records relating to these book-entry interests. Investors wishing to use these clearing systems are advised to confirm the continued applicability of their rules, regulations and procedures.

Neither the U.S. Securities and Exchange Commission (the SEC), any state securities commission nor any non-U.S. securities authority has approved or disapproved of these securities or determined that this prospectus is accurate or complete. Any representation to the contrary is a criminal offense.

We reserve the right to withdraw this offering of the notes at any time. We and the underwriters also reserve the right to reject any offer to purchase the notes in whole or in part for any reason or no reason and to allot to any prospective purchaser less than the full amount of the notes sought by it. The underwriters and certain of their respective related entities may acquire, for their own accounts, a portion of the notes.

We cannot guarantee that our application to list the notes on the Irish Stock Exchange for trading on the Alternative Securities Market thereof will be approved as of the settlement date for the notes or at any time then after, and settlement of the notes is not conditioned on obtaining this listing.

The underwriters may engage in transactions that stabilize, maintain or otherwise affect the price of the notes. Specifically, the underwriters may over-allot in connection with this offering and may bid for and purchase notes in the open market. For a description of these activities, see Underwriting.

NOTICE TO CERTAIN EUROPEAN INVESTORS

Austria. The notes may be offered and sold in Austria only in accordance with the provisions of the Banking Act, the Securities Supervision Act of Austria (*Bankwesengesetz and Wertpapieraufsichtsgesetz*) and any other applicable Austrian law. The notes have not been admitted to public offer in Austria under the provisions of the Capital Markets Act or the Investment Fund Act or the Exchange Act (*Kapitalmarktgesetz, Investmentfondsgesetz or Börsengesetz*). Consequently, in Austria, the notes may not be offered or sold directly or indirectly by way of a public offering in Austria and will only be available to a limited group of persons within the scope of their professional activities.

Belgium. The offering of the notes does not constitute an offer to the public in Belgium. It is only directed to persons who are qualified investors (within the meaning of Article 2.1(e)(i) to (iii) of the Prospectus Directive or, upon its implementation, of the relevant Belgian act implementing the Prospectus Directive).

Denmark. This prospectus has not been filed with or approved by any authority in the Kingdom of Denmark. The notes have not been offered or sold and may not be offered, sold or delivered directly or indirectly in the Kingdom of Denmark, except to qualified investors within the meaning of, or otherwise in compliance with an exemption set forth in, Executive Order No. 306 of 28 April 2005.

France. The notes have not been and will not be offered or sold to the public in France (*appel public à l'épargne*), and no offering or marketing materials relating to the notes must be made available or distributed in any way that would constitute, directly or indirectly, an offer to the public in the Republic of France.

The notes may only be offered or sold in the Republic of France to qualified investors (*investisseurs qualifiés*) and/or to a limited group of investors (*cercle restreint d'investisseurs*) as defined in and in accordance with articles L.411-1 and L.411-2 of the French *Code monétaire et financier* and Decree n°98-880 dated October 1, 1998.

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Prospective investors are informed that:

- (i) this prospectus has not been submitted for clearance to the French financial market authority (*Autorité des Marchés Financiers*);
- (ii) in compliance with Decree n°98-880 dated October 1, 1998, any investors subscribing for the notes should be acting for their own account; and
- (iii) the direct and indirect distribution or sale to the public of the notes acquired by them may only be made in compliance with articles L.411-1, L.411-2, L.412-1 and L.621-8 of the *French Code monétaire et financier*.

Germany. The offering of the notes is not a public offering in the Federal Republic of Germany. The notes may be offered and sold in the Federal Republic of Germany only in accordance with the provisions of the Securities Prospectus Act of the Federal Republic of Germany (*Wertpapierprospektgesetz, WpPG*) and any other applicable German law. Consequently, in Germany, the notes will only be available to and this prospectus and any other offering material in relation to the notes is directed only at persons who are qualified investors (*qualifizierte Anleger*) within the meaning of Section 2 No. 6 of the Securities Prospectus Act and the notes must not be publicly offered, and this prospectus and any other offering material in relation to the notes must not be passed on, to any person in Germany other than such qualified investor. Any resale of the notes in Germany may only be made in accordance with the Securities Prospectus Act and other applicable laws.

Ireland. The notes may be offered or sold in Ireland only in accordance with the European Communities (Stock Exchange) Regulations 1984, the European Communities (Transferable Securities and Stock Exchange) Regulations 1992, the Investment Intermediaries Act, 1995 (as amended) and the Companies Act 1963 to 2001 and all other applicable Irish laws and regulations.

Italy. The offering of the notes in Italy has not been registered with the Commissione Nazionale per le Società e la Borsa (CONSOB) pursuant to Italian securities legislation and, accordingly: (i) the notes cannot be offered, sold or delivered in the Republic of Italy (Italy) in a solicitation to the public at large (*sollecitazione all investimento*) within the meaning of Article 1, paragraph 1, letter (t) of Legislative Decree no. 58 of February 24, 1998 (the Financial Services Act), nor may any copy of this prospectus or any other document relating to the notes be distributed in Italy, (ii) the notes cannot be offered, sold and/or delivered, nor may any copy of this prospectus or any other document relating to the notes be distributed, either in the primary or in the secondary market, to individuals resident in Italy, and (iii) sales of the notes in Italy shall only be: (a) negotiated with Professional Investors (*operatori qualificati*), as defined under Article 31, paragraph 2, of CONSOB Regulation no. 11522 of July 1, 1998, as amended (CONSOB Regulation 11522), (b) effected in compliance with Article 129 of the Legislative Decree no. 385 of September 1, 1993 (the Italian Banking Act) and the implementing instructions of the Bank of Italy, (c) made by an investment firm, bank or financial intermediary permitted to conduct such activities in Italy in accordance with the Italian Banking Act, the Financial Services Act, CONSOB Regulation 11522 and all the other relevant provisions of Italian law and (d) effected in accordance with any other Italian securities, tax and exchange control and other applicable laws and regulations and any other applicable requirement or limitation which may be imposed by CONSOB or the Bank of Italy. Insofar as the requirements above are based on laws which are suspended at any time pursuant to the Prospectus Directive, such requirements shall be replaced by the applicable requirements under the Prospectus Directive or the relevant implementing laws.

Grand Duchy of Luxembourg. This offering should not be considered a public offering in the Grand Duchy of Luxembourg. This prospectus may not be reproduced or used for any purpose other than this offering, nor provided to any person other than the recipient thereof. The notes are offered to a limited

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number of sophisticated investors in all cases under circumstances designed to preclude a distribution, which would be other than a private placement. All public solicitations are banned and the sale may not be publicly advertised.

The Netherlands. Each of the underwriters represents and agrees that (a) it is a professional market party (PMP) within the meaning of Section 1(e) of the Exemption Regulation of June 26, 2002 in respect of the Act on the Supervision of the Credit System 1992 (*Vrijstellingsregeling Wtk 1992*), as amended from time to time (the Exemption Regulation), where applicable read in conjunction with the policy rules of the Dutch Central Bank (*de Nederlandsche Bank N.V.*) on key concepts of market access and enforcement of the Act on the Supervision of the Credit System 1992 (*Wet toezicht Kredietwezen 1992*) published on December 29, 2004 (*Beleidsregel 2005 kernbegrippen markttoetreding en handhaving Wtk 1992*) (the Policy Rules), and Section 2 of the Policy Rules, as amended, supplemented and restated from time to time and (b) it has offered or sold and will offer or sell, directly or indirectly, as part of the initial distribution or at any time thereafter, the notes exclusively (i) to PMPs as reasonably identified by the Issuer on the issue date or (ii) to persons which cannot reasonably be identified as PMPs by the Issuer on the issue date, provided that the notes have a denomination of 50,000 (or the equivalent in any other currency) and shall upon their issuance be included in a clearing institution that is established in an EU Member State, the United States, Japan, Australia, Canada or Switzerland; so that it can reasonably be expected that the underwriters will transfer the notes exclusively to other PMPs.

Generally, notes (including rights representing an interest in a global note) may not be offered, sold, transferred or delivered at any time by anyone, directly or indirectly, to individuals or legal entities who or which are established, domiciled or have their residence in The Netherlands (Dutch Residents) other than to PMPs acquiring the notes for their own account. Dutch Residents, by purchasing notes (or any interest therein), will be deemed to have represented and agreed for the benefit of the Issuer that they are a PMP and acquire the notes for their own account. Each holder of the notes , by purchasing notes (or any interest therein), will be deemed to have represented and agreed for the benefit of the Issuer that (i) such notes (or any interest therein) may not be offered, sold, pledged or otherwise transferred to Dutch Residents other than to a PMP acquiring for its own account or for the account of another PMP and (ii) they will provide notice of this transfer restriction to any subsequent transferee.

In addition, and without prejudice to the relevant restrictions set out above, the notes that are offered in The Netherlands may only be offered and such an offer may only be announced: (i) if the notes have a denomination of at least 50,000 or the equivalent in any other currency; (ii) if the notes, irrespective of their denomination, can be acquired only as a package for a consideration of at least 50,000 or the equivalent in any other currency; and/or (iii) to professional market parties within the meaning of Section 1a paragraph 3 of the Exemption Regulation to the Dutch Securities Supervision Act 1995 (*Vrijstellingsregeling Wet toezicht effectenverkeer 1995*); and otherwise (iv) in accordance with the Dutch Securities Supervision Act 1995 (*Wet toezicht effectenverkeer 1995*) and corresponding regulations, as amended from time to time.

Spain. The notes may not be offered or sold in Spain except in accordance with the requirements of the Spanish Securities Market Law (*Ley 24/1988, de 28 de julio, del Mercado de Valores*), as amended and restated, and Royal Decree 291/1992, on issues and public offerings for the sale of securities (*Real Decreto 291/1992, de 27 de marzo, sobre emisiones y ofertas públicas de venta de valores*), as amended and restated, and the decrees and regulations made thereunder. The notes may not be listed, sold, offered or distributed to persons in Spain except (i) in circumstances which do not constitute an offer of securities in Spain within the meaning of Spanish Securities Market Law and further relevant legislation or (ii) pursuant to Article 7 of Royal Decree 291/1992 and subject to compliance with the registration requirements set out therein. This prospectus has not been registered with the Spanish Securities Market Commission (*Comisión Nacional del Mercado de Valores*) and therefore it is not intended for the offering or sale of the notes in Spain.

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Sweden. This prospectus has not been and will not be registered with the Swedish Financial Supervisory Authority. Accordingly, this prospectus may not be made available, nor may the notes otherwise be marketed and offered for sale, in Sweden other than in circumstances that are deemed not to be an offer to the public under the Financial Instruments Trading Act (1991:980).

Switzerland. The offering of the notes is not a public offering in Switzerland. The notes have not been and will not be offered, directly or indirectly, to the public in Switzerland and this prospectus does not constitute a public offering prospectus as that term is understood pursuant to art. 1156 of the Swiss Federal Code of Obligations.

United Kingdom. This prospectus is for distribution only to persons who (i) have professional experience in matters relating to investments falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended, the Financial Promotion Order), (ii) are persons falling within Article 49(2)(a) to (d) (high net worth companies, unincorporated associations, etc) of the Financial Promotion Order or (iii) are persons to whom an invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000) in connection with the issue or sale of any notes may otherwise lawfully be communicated or caused to be communicated (all such persons together being referred to as relevant persons). This prospectus is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is available only to relevant persons and will be engaged in only with relevant persons. The notes are being offered solely to qualified investors as defined in the Prospectus Directive and accordingly the offer of notes is not subject to the obligation to publish a prospectus within the meaning of the Prospectus Directive.

NOTICE TO NEW HAMPSHIRE RESIDENTS

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENSE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES (RSA 421-B) WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE OF THE STATE OF NEW HAMPSHIRE THAT ANY DOCUMENT FILED UNDER RSA 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

Table of Contents**EXCHANGE RATE INFORMATION**

In this prospectus, (i) or euro refers to the single currency of the participating Member States in the Third Stage of the European Economic and Monetary Union of the Treaty Establishing The European Community, as amended from time to time, and (ii) \$ or dollars refers to the lawful currency of the United States.

The following chart shows for the period from January 1, 2001 through November 22, 2006, the period end, average, high and low noon buying rates in the City of New York for cable transfers of euro as certified for customs purposes by the Federal Reserve Bank of New York expressed as dollars per 1.00.

| Year <u> </u> | dollars per <u>1.00</u> | | | |
|---|--------------------------------|------------|---|-------------------|
| | High | Low | Period average⁽¹⁾ | Period end |
| 2001 | 0.9535 | 0.8370 | 0.8909 | 0.8901 |
| 2002 | 1.0485 | 0.8594 | 0.9495 | 1.0485 |
| 2003 | 1.2597 | 1.0361 | 1.1411 | 1.2597 |
| 2004 | 1.3625 | 1.1801 | 1.2478 | 1.3538 |
| 2005 | 1.3476 | 1.1667 | 1.2400 | 1.1842 |
| Month <u> </u> | | | | |
| January 2006 | 1.2287 | 1.1980 | 1.2126 | 1.2158 |
| February 2006 | 1.2100 | 1.1860 | 1.1940 | 1.1925 |
| March 2006 | 1.2197 | 1.1886 | 1.2028 | 1.2139 |
| April 2006 | 1.2624 | 1.2091 | 1.2273 | 1.2624 |
| May 2006 | 1.2888 | 1.2607 | 1.2767 | 1.2833 |
| June 2006 | 1.2953 | 1.2522 | 1.2661 | 1.2779 |
| July 2006 | 1.2822 | 1.2500 | 1.2681 | 1.2764 |
| August 2006 | 1.2914 | 1.2735 | 1.2810 | 1.2793 |
| September 2006 | 1.2833 | 1.2648 | 1.2722 | 1.2687 |
| October 2006 | 1.2773 | 1.2502 | 1.2617 | 1.2773 |
| November 2006 (through November 22, 2006) | 1.2928 | 1.2705 | 1.2804 | 1.2928 |

(1) Period average represents the average of the noon buying rates on the last business day of each month during the relevant period for yearly information and the average of the noon buying rates on each business day during the period for monthly information.

The above rates may differ from the actual rates used in the preparation of the consolidated financial statements and other financial information appearing in this prospectus or incorporated by reference herein. Our inclusion of these exchange rates is not meant to suggest that the dollar amounts actually represent such euro amounts or that such amounts could have been converted into euro at any particular rate, if at all.

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SUMMARY

This summary may not contain all the information that may be important to you. You should read this entire prospectus and the documents to which we have referred you before making an investment decision. You should carefully consider the information set forth under Risk Factors. In addition, certain statements include forward-looking information which involves risks and uncertainties. See Forward-Looking Statements.

Chesapeake

We are the third largest independent producer of natural gas in the United States, and we own interests in approximately 33,700 producing oil and natural gas wells that are currently producing approximately 1.69 billion cubic feet equivalent, or bcfe, per day, 92% of which is natural gas. Our strategy is focused on discovering, developing and acquiring onshore natural gas reserves in the U.S. east of the Rocky Mountains. Our most important operating area has historically been in various conventional plays in the Mid-Continent region, which includes Oklahoma, Arkansas, Kansas and the Texas Panhandle. At September 30, 2006, 47% of our proved oil and natural gas reserves were located in the Mid-Continent region. During the past four years, we have also built significant positions in various conventional and unconventional plays in the South Texas and Texas Gulf Coast regions, the Permian Basin of West Texas and eastern New Mexico, the Barnett Shale area of North Texas, the Ark-La-Tex area of East Texas and northern Louisiana, the Appalachian Basin in West Virginia, eastern Kentucky, eastern Ohio and southern New York, the Caney and Woodford Shales in southeastern Oklahoma, the Fayetteville Shale in Arkansas, the Barnett and Woodford Shales in West Texas and the Conasauga, Floyd and Chattanooga Shales of Alabama.

As of December 31, 2005, we had 7.5 trillion cubic feet equivalent, or tcf, of proved reserves, of which 92% were natural gas and all of which were onshore. During 2005, we produced an average of 1.3 bcfe per day, a 30% increase over the 1.0 bcfe per day produced in 2004. For 2005, we generated net income available to common shareholders of \$880 million, or \$2.51 per fully diluted common share, which was a 64% increase over the prior year. For the year ended December 31, 2005, we had total revenues of \$4.67 billion and an EBITDA of \$2.66 billion and, for the nine months ended September 30, 2006, we had total revenues of \$5.46 billion and an EBITDA of \$3.77 billion. Please see note 4 to Summary Consolidated Financial Data.

During the first three quarters of 2006, we led the nation in drilling activity with an average utilization of 89 operated rigs and 74 non-operated rigs. Through this drilling activity, we drilled 1,024 (845 net) operated wells and participated in another 1,154 (141 net) wells operated by other companies. Our success rate was 98% for operated and non-operated wells. We replaced our 426 bcfe of production with an internally estimated 1.339 tcf of new proved reserves for a reserve replacement rate of 314%. Reserve replacement through the drillbit was 825 bcfe, or 194% of production (including 541 bcfe of positive performance revisions and 387 bcfe of downward revisions resulting from oil and natural gas price declines between December 31, 2005 and September 30, 2006), and reserve replacement through acquisitions was 514 bcfe, or 120% of production. As a result, our proved reserves grew by 12% during the first three quarters of 2006, from 7.5 tcf to 8.4 tcf. Of the 8.4 tcf, 63% were proved developed reserves.

In the first three quarters of 2006, we produced an average of 1.6 bcfe per day, a 26% increase over the 1.2 bcfe per day produced in the first three quarters of 2005. During the first three quarters of 2006, we generated net income available to common shareholders of \$1.459 billion, or \$3.40 per fully diluted common share, which was a 158% increase over the first three quarters of 2005. Also, in the first three quarters of 2006 we added approximately 1,700 new employees to support our growth, which increased our total employee base to approximately 4,600 employees at September 30, 2006, and invested \$558

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million in leasehold (excluding leasehold acquired through acquisitions) and 3-D seismic data, all of which we consider the building blocks of future value creation.

From January 1, 1998 through September 30, 2006, we have been one of the most active consolidators of onshore U.S. natural gas assets, having purchased approximately 6.4 tcf of proved reserves, at a total cost of approximately \$13.4 billion (including \$4.3 billion for unproved leasehold, but excluding \$987 million of deferred taxes established in connection with certain corporate acquisitions). Excluding the amounts allocated to unproved leasehold and deferred taxes, our acquisition cost per proved thousand cubic feet equivalent, or mcfe, was \$1.42 over this time period. During 2006, we have remained active in the acquisitions market. Acquisition expenditures in 2006 totaled \$3.1 billion (including \$2.1 billion for unproved leasehold). Through these acquisitions, we will have acquired an internally estimated 514 bcfe of proved oil and natural gas reserves.

We intend to use the net proceeds from this offering to repay outstanding indebtedness under our revolving bank credit facility, which may be reborrowed for general corporate purposes, including to finance potential future acquisitions. Please see Use of Proceeds.

Our executive offices are located at 6100 North Western Avenue, Oklahoma City, Oklahoma 73118, and our telephone number is (405) 848-8000.

Business Strategy

Since our inception in 1989, Chesapeake's goal has been to create value for investors by building one of the largest onshore natural gas resource bases in the United States. For much of the past eight years, our strategy to accomplish this goal has been to build a dominant operating position in the Mid-Continent region, the third largest natural gas supply region in the U.S. In building our industry-leading position in the Mid-Continent, we have integrated an aggressive and technologically advanced drilling program with an active property consolidation program focused on small to medium-sized corporate and property acquisitions. In 2002, we began expanding our focus from the Mid-Continent region to other regions where we believed we could extend our successful strategy. To date, those areas have included the South Texas and Texas Gulf Coast regions, the Permian Basin of West Texas and eastern New Mexico, the Barnett Shale area of North Texas, the Ark-La-Tex area of East Texas and northern Louisiana, the Appalachian Basin in West Virginia, eastern Kentucky, eastern Ohio and southern New York, the Caney and Woodford Shales in southeastern Oklahoma, the Fayetteville Shale in Arkansas, the Barnett and Woodford Shales in West Texas and the Conasauga, Floyd and Chattanooga Shales of Alabama. We believe significant elements of our successful Mid-Continent strategy of acquisition, exploitation, extension and exploration have been or will be successfully transferred to these areas.

Key elements of this business strategy are further explained below:

Make High-Quality Acquisitions. Our acquisition program is focused on acquisitions of natural gas properties that offer high-quality, long-lived production and significant development and high potential deep drilling opportunities. From January 1, 1998 through September 30, 2006, we have purchased approximately 6.4 tcf of proved reserves, at a total cost of approximately \$13.4 billion (including \$4.3 billion for unproved leasehold, but excluding \$987 million of deferred taxes established in connection with certain corporate acquisitions). Excluding the amounts allocated to unproved leasehold and deferred taxes, our acquisition cost per proved mcfe was \$1.42 over this time period. The vast majority of these acquisitions either increased our ownership in existing wells or fields or added additional drilling locations in our focused operating areas. Because these operating areas contain many

smaller companies

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seeking liquidity opportunities and larger companies seeking to divest non-core assets, we expect to continue to find additional attractive acquisition opportunities in the future.

Grow through the Drillbit. One of Chesapeake's most distinctive characteristics is our ability to increase reserves and production through the drillbit. We are currently utilizing 122 operated drilling rigs and 99 non-operated drilling rigs to conduct the most active drilling program in the United States. We focus both on finding significant new natural gas reserves and developing existing proved reserves, principally at deeper depths than the industry average. For much of the past eight years, we have been actively investing in leasehold, 3-D seismic information and human capital to be able to take advantage of the favorable drilling economics that exist today. While we believe U.S. natural gas production has declined during the past five years, we are one of the few large-cap independent oil and gas companies that have been able to increase production, which we have successfully achieved for the past 16 consecutive years and 21 consecutive quarters. We believe key elements of the success and scale of our drilling programs have been our early recognition that natural gas prices were likely to move higher in the U.S. in the post-1999 period accompanied by our willingness to proactively hire new employees and to build the nation's largest onshore leasehold and 3-D seismic inventories, all of which are the building blocks of a successful large-scale drilling program.

Build Regional Scale. We believe one of the keys to success in the natural gas exploration industry is to build significant operating scale in a limited number of operating areas that share many similar geological and operational characteristics. Achieving such scale provides many benefits, the most important of which are higher per unit revenues, lower per unit operating costs, greater rates of drilling success, higher returns from more easily integrated acquisitions and higher returns on drilling investments. We first began pursuing this focused strategy in the Mid-Continent region in late 1997 and we are now the largest natural gas producer, the most active driller and the most active acquirer of leasehold and producing properties in the Mid-Continent. We believe this region, which trails only the Gulf Coast and Rocky Mountain basins in U.S. natural gas production, has many attractive characteristics. These characteristics include long-lived natural gas properties with predictable decline curves, multi-pay geological targets that decrease drilling risk and have resulted in a drilling success rate of 94% over the past 17 years, generally lower service costs than in more competitive or more remote basins and a favorable regulatory environment with virtually no federal land ownership. We believe our other operating areas possess many of these same favorable characteristics and our goal is to become or remain a top five natural gas producer in each of our operating areas.

Focus on Low Costs. By minimizing lease operating costs and general and administrative expense through focused activities and increased scale, we have been able to deliver attractive financial returns through all phases of the commodity price cycle. We believe our low cost structure is the result of management's effective cost-control programs, a high-quality asset base and extensive and competitive services, natural gas processing and transportation infrastructures that exist in our key operating areas. As of September 30, 2006, we operated approximately 19,800 wells, which accounted for approximately 83% of our daily production volume. This large percentage of operated properties provides us with a high degree of operating flexibility and cost control.

Improve our Balance Sheet. We have made significant progress in improving our balance sheet over the past seven years. From December 31, 1998 through September 30, 2006, we have increased our shareholders' equity by \$10.4 billion through a combination of earnings and common and preferred equity issuances. As of September 30, 2006, our debt as a percentage of total capitalization (total capitalization is the sum of debt and stockholders' equity) was 44%, compared to 137% as of December 31, 1998. On a pro forma basis for this offering, our debt to total capitalization ratio as of

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September 30, 2006, would also have been 44%. We plan to continue improving our balance sheet in the years ahead.

Based on our view that natural gas will be in a tight supply/demand relationship in the U.S. during at least the next few years because of the significant structural challenges to growing natural gas supply and the growing demand for this clean-burning, U.S.-produced fuel, we believe our focused natural gas acquisition, exploitation and exploration strategy should provide substantial value-creating growth opportunities in the years ahead. Our goal is to increase our overall production by 10% to 20% per year, with growth at an annual rate of 7% to 10% generated organically through the drillbit and the remaining growth generated through acquisitions. We have reached or exceeded this overall production goal in 11 of our 13 years as a public company.

Company Strengths

We believe the following six characteristics distinguish our past performance and differentiate our future growth potential from other independent natural gas producers:

High-Quality Asset Base. Our producing properties are characterized by long-lived reserves, established production profiles and an emphasis on onshore natural gas. Based upon current production and proved reserve estimates, our proved reserves-to-production ratio, or reserve life, is approximately 14 years. In addition, we believe we are the seventh largest producer of natural gas in the U.S. (third among independents) and the fourth largest owner of proved U.S. natural gas reserves (first among independents). In each of our operating areas, our properties are concentrated in locations that enable us to establish substantial economies of scale in drilling and production operations and facilitate the application of more effective reservoir management practices. We intend to continue building our asset base in each of our operating areas through a balance of acquisitions, exploitation and exploration.

Low-Cost Producer. Our high-quality asset base, the work ethic of our employees, our hands-on management style and our headquarters location in Oklahoma City have enabled us to achieve a low operating and administrative cost structure. During the first three quarters of 2006, our operating costs per unit of production were \$1.38 per mcfe, which consisted of general and administrative expenses of \$0.23 per mcfe (including non-cash stock-based compensation of \$0.05 per mcfe), production expenses of \$0.85 per mcfe and production taxes of \$0.30 per mcfe. We believe this is one of the lowest cost structures among publicly traded, large-cap independent oil and natural gas producers.

Successful Acquisition Program. Our experienced acquisition team focuses on enhancing and expanding our existing assets in each of our operating areas. These areas are characterized by long-lived natural gas reserves, low lifting costs, multiple geological targets, favorable basis differentials to benchmark commodity prices, well-developed oil and natural gas transportation infrastructures and considerable potential for further consolidation of assets. Since 1998, we have acquired approximately 6.4 tcf of proved reserves that replaced 281% of our total production. We believe we are well-positioned to continue making attractive acquisitions as a result of our extensive track record of identifying, completing and integrating multiple successful acquisitions, our large operating scale and our knowledge and experience in the regions in which we operate.

Large Inventory of Drilling Projects. During the 17 years since our inception, we have been among the five most active drillers of new wells in the United States. Presently we are the most active driller in the U.S. with 122 operated and 99 non-operated rigs drilling. Through this high level of activity over the years, we have developed an industry-leading expertise in drilling deep vertical and horizontal wells in

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search of large natural gas accumulations in challenging conventional and unconventional reservoirs. As a result of our successful acquisition program and active leasehold acquisition and seismic acquisition strategies, we have been able to accumulate a U.S. onshore leasehold position of approximately 10.5 million net acres, and have acquired rights to 14.7 million acres of onshore 3-D seismic data to provide informational advantages over our competitors and to help evaluate our large acreage inventory. On this very large acreage position, our technical teams believe approximately 25,000 exploratory and developmental drill sites exist, representing a backlog of more than ten years of future drilling opportunities at current drilling rates.

Hedging Program. We have used and intend to continue using hedging programs to reduce the risks inherent in acquiring and producing oil and natural gas reserves, commodities that are frequently characterized by significant price volatility. We believe this price volatility is likely to continue in the years ahead and that we can use this volatility to our benefit by taking advantage of prices when they reach levels that management believes are either unsustainable for the long-term or provide unusually high rates of return on our invested capital. As of September 30, 2006, we had natural gas hedges in place covering 57%, 57% and 51% of our anticipated natural gas production for the fourth quarter of 2006 and all of 2007 and 2008, respectively, at average NYMEX prices of \$9.10, \$9.61 and \$9.37 per mcf, respectively. In addition, we have 88%, 72% and 59% of our anticipated oil production hedged for the remainder of 2006 and all of 2007 and 2008, respectively, at average NYMEX prices of \$65.64, \$71.42 and \$71.45 per barrel of oil, respectively. During the first three quarters of 2006, we realized gains from our hedging program of approximately \$807 million.

Entrepreneurial Management. Our management team formed the company in 1989 with an initial capitalization of \$50,000 and fewer than ten employees. Since then, our management team has guided the company through various operational and industry challenges and extremes of oil and natural gas prices to create the third largest independent producer of natural gas in the U.S. with approximately 4,600 employees and an enterprise value of approximately \$24 billion (pro forma for this offering). Our chief executive officer and co-founder, Aubrey K. McClendon, has been in the oil and natural gas industry for 25 years and beneficially owns, as of November 22, 2006, approximately 25.4 million shares of our common stock.

Other Developments

In the past year, there has been significant focus on corporate governance and accounting practices in the grant of equity based awards to executives and employees of publicly traded companies, including the use of market hindsight to select award dates to favor award recipients. Like many other public companies, we have in recent months received occasional investor inquiries regarding our practices in granting employee and executive stock options in past years. On our own initiative and under the auspices of our audit committee, we undertook an internal review of our practices in this area, primarily for the purpose of confirming that the past accounting treatment of our equity compensation awards was appropriate. Recently, we received an investor inquiry questioning the timing of several option grants during the period from 1995 to 2003 in relation to the trading price of our common stock. We expanded our internal review to review these specific option grants and the results were reported to our audit committee. While these internal reviews revealed deficiencies in the documentation of our option grants in prior years, there was no evidence of any misconduct by our executives or directors in the timing or selection of our option grant dates, or that would cause us to conclude that our prior accounting for stock option grants was incorrect in any material respect.

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The Offering

The summary below describes the principal terms of the notes. Some of the terms and conditions described below are subject to important limitations and exceptions. The Description of Notes section of this prospectus contains a more detailed description of the terms and conditions of the notes.

| | |
|---------------|--|
| Issuer | Chesapeake Energy Corporation. |
| Notes Offered | 400,000,000 in aggregate principal amount of % Senior Notes due 2017. |
| Maturity Date | January 15, 2017. |
| Interest | Interest on the notes will accrue at an annual rate of %. Interest will be paid semi-annually in arrears on January 15 and July 15 of each year, commencing July 15, 2007. |
| Guarantees | The notes will be unconditionally guaranteed, jointly and severally, by (i) each of our existing United States subsidiaries, other than certain de minimis subsidiaries, and one of our non-United States subsidiaries and (ii) each of our future United States subsidiaries that guarantees any other indebtedness of us or a subsidiary guarantor in excess of \$5 million. The guarantee will be released if we dispose of the subsidiary guarantor or it ceases to guarantee certain other indebtedness of us or any other subsidiary guarantor. |
| Ranking | <p>The notes will be unsecured and will rank equally in right of payment to all of our existing and future senior indebtedness. The notes will rank senior in right of payment to all of our future subordinated indebtedness. Holders of our secured indebtedness have claims with respect to our assets constituting collateral for their indebtedness that are prior to your claim under the notes. In addition, the notes will be structurally subordinated to any indebtedness of a subsidiary that is not a subsidiary guarantor. Please read Description of Notes Ranking.</p> <p>As of September 30, 2006, we had approximately \$8.0 billion in principal amount of senior indebtedness outstanding, of which \$1.5 billion was secured indebtedness under our revolving bank credit facility. After giving effect to this offering and the application of net proceeds therefrom as described under Use of Proceeds, on a pro forma basis as of September 30, 2006, we would have had approximately \$8.0 billion in principal amount of senior indebtedness outstanding, \$972 million of which would have been secured indebtedness. As of November 22, 2006, we had outstanding borrowings of \$2.079 billion under our revolving bank credit facility.</p> |

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|---------------------------------|--|
| Make-Whole Redemption | We may redeem some or all of the notes at any time prior to maturity by the payment of a make-whole premium described in the Description of Notes Make-Whole Redemption section of this prospectus. |
| Change of Control | Upon the occurrence of certain change of control events, each holder of notes may require us to repurchase all or a portion of its notes at a purchase price equal to 101% of the principal amount of the notes, plus accrued interest. |
| Restrictive Covenants | <p>The indenture governing the notes will contain covenants that limit our ability and our subsidiaries' ability to:</p> <p style="padding-left: 40px;">incur certain secured indebtedness;</p> <p style="padding-left: 40px;">enter into sale-leaseback transactions; and</p> <p style="padding-left: 40px;">consolidate, merge or transfer assets.</p> <p>The covenants are subject to a number of exceptions and qualifications. See Description of Notes Certain Covenants.</p> |
| Additional Amounts | Any payments made by us with respect to the notes will be made without withholding or deduction for taxes imposed by any relevant taxing jurisdiction unless required by law. If we are required by law to withhold or deduct for taxes with respect to a payment to the holders of notes, we will pay additional amounts necessary so that the net amount received by the holders of notes after the withholding is not less than the amount that they would have received in the absence of the withholding. See Description of Notes Payment of Additional Amounts. |
| Redemption for Taxation Reasons | In the event that we become obligated to pay additional amounts (as described above) to holders of the notes as a result of changes affecting withholding taxes applicable to payments on the notes, we may redeem the notes in whole but not in part at any time at 100% of the principal amount of the notes plus accrued interest to the date of redemption. See Description of Notes Redemption Upon Changes in Withholding Taxes. |
| Use of Proceeds | We expect the net proceeds to us from this offering, after deducting discounts to the underwriters and estimated expenses of the offering payable by us, will be approximately 393.3 million (or approximately \$503.4 million based on a dollar/euro exchange rate of approximately \$1.28 to 1.00 as of November 22, 2006). We intend to use the net proceeds from this offering to repay outstanding indebtedness under our revolving bank credit facility, which may be reborrowed for general corporate purposes, including to finance potential future acquisitions. Please see Use of Proceeds. |
| Listing | We intend to apply to list the notes on the Irish Stock Exchange for trading on the Alternative Securities Market thereof. |

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| | |
|-------------------------------|---|
| Denomination | The notes will be issued in denominations of 50,000 and in any integral multiples of 1,000 in excess of 50,000. |
| Book-Entry, Delivery and Form | Initially, the notes will be represented by one or more permanent global certificates in definitive, fully registered form deposited with a custodian for, and registered in the name of, a nominee of a common depositary for the accounts of Euroclear and Clearstream. |

Risk Factors

An investment in the notes involves certain risks that a potential investor should carefully evaluate prior to making an investment in the notes. Please read Risk Factors beginning on page 14.

Table of Contents**Summary Consolidated Financial Data**

The following tables set forth summary consolidated financial data as of and for each of the three years ended December 31, 2005, 2004 and 2003 and nine months ended September 30, 2006 and 2005. This data was derived from our audited consolidated financial statements included in our annual report on Form 10-K for the year ended December 31, 2005 and from our unaudited condensed consolidated financial statements included in our quarterly report on Form 10-Q for the quarterly period ended September 30, 2006, each of which is incorporated by reference herein and included in Annex A and Annex B, respectively. The financial data below should be read together with, and is qualified in its entirety by reference to, our historical consolidated financial statements and the accompanying notes and the Management's Discussion and Analysis of Financial Condition and Results of Operations which are set forth in such annual report on Form 10-K and quarterly report on Form 10-Q.

| | Nine Months Ended | | | | |
|--|-------------------------|------------------|------------------|------------------|------------------|
| | Year Ended December 31, | | | September 30, | |
| | 2005 | 2004 | 2003 | 2006 | 2005 |
| (\$ in thousands, except per share data) | | | | | |
| Statement of Operations Data: | | | | | |
| Revenues: | | | | | |
| Oil and natural gas sales | \$ 3,272,585 | \$ 1,936,176 | \$ 1,296,822 | \$ 4,190,430 | \$ 2,032,271 |
| Oil and natural gas marketing sales | 1,392,705 | 773,092 | 420,610 | 1,170,091 | 882,040 |
| Service operations revenue | | | | 97,473 | |
| Total revenues | 4,665,290 | 2,709,268 | 1,717,432 | 5,457,994 | 2,914,311 |
| Operating costs: | | | | | |
| Production expenses | 316,956 | 204,821 | 137,583 | 364,134 | 222,660 |
| Production taxes | 207,898 | 103,931 | 77,893 | 129,858 | 136,313 |
| General and administrative expenses | 64,272 | 37,045 | 23,753 | 99,728 | 39,640 |
| Oil and natural gas marketing expenses | 1,358,003 | 755,314 | 410,288 | 1,131,521 | 860,789 |
| Service operations expense | | | | 48,925 | |
| Oil and natural gas depreciation, depletion and amortization | 894,035 | 582,137 | 369,465 | 976,839 | 621,484 |
| Depreciation and amortization of other assets | 50,966 | 29,185 | 16,793 | 74,051 | 34,791 |
| Employee retirement expense | | | | 54,753 | |
| Provision for legal settlements | | 4,500 | 6,402 | | |
| Total operating costs | 2,892,130 | 1,716,933 | 1,042,177 | 2,879,809 | 1,915,677 |
| Income from operations | 1,773,160 | 992,335 | 675,255 | 2,578,185 | 998,634 |
| Other income (expense): | | | | | |
| Interest and other income | 10,452 | 4,476 | 2,827 | 19,742 | 7,790 |
| Interest expense | (219,800) | (167,328) | (154,356) | (220,226) | (155,623) |
| Loss on repurchases or exchanges of Chesapeake senior notes | (70,419) | (24,557) | (20,759) | | (70,047) |
| Gain on sale of investment | | | | 117,396 | |
| Loss on investment in Seven Seas | | | (2,015) | | |
| Total other income (expense) | (279,767) | (187,409) | (174,303) | (83,088) | (217,880) |
| Income before income taxes and cumulative effect of accounting change | 1,493,393 | 804,926 | 500,952 | 2,495,097 | 780,754 |
| Income tax expense (benefit): | | | | | |
| Current | | | 5,000 | | |

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| | | | | | |
|--|------------|------------|------------|--------------|------------|
| Deferred | 545,091 | 289,771 | 185,360 | 963,136 | 284,977 |
| Total income tax expense (benefit) | 545,091 | 289,771 | 190,360 | 963,136 | 284,977 |
| Net income before cumulative effect of accounting change, net of tax | 948,302 | 515,155 | 310,592 | 1,531,961 | 495,777 |
| Cumulative effect of accounting change, net of income taxes of \$1,464,000 | | | 2,389 | | |
| Net Income | 948,302 | 515,155 | 312,981 | 1,531,961 | 495,777 |
| Preferred stock dividends | (41,813) | (39,506) | (22,469) | (62,793) | (25,526) |
| Loss on conversion/exchange of preferred stock | (26,874) | (36,678) | | (10,556) | (22,468) |
| Net income available to common shareholders | \$ 879,615 | \$ 438,971 | \$ 290,512 | \$ 1,458,612 | \$ 447,783 |

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| | Nine Months Ended | | | | |
|---|-------------------------|--------------|--------------|---------------------|---------------|
| | Year Ended December 31, | | | September 30, | |
| | 2005 | 2004 | 2003 | 2006 | 2005 |
| (\$ in thousands, except per share data) | | | | | |
| Earnings per common share basic: | | | | | |
| Income before cumulative effect of accounting change | \$ 2.73 | \$ 1.73 | \$ 1.36 | \$ 3.75 | \$ 1.42 |
| Cumulative effect of accounting change | | | 0.02 | | |
| | \$ 2.73 | \$ 1.73 | \$ 1.38 | \$ 3.75 | \$ 1.42 |
| Earnings per common share assuming dilution: | | | | | |
| Income before cumulative effect of accounting change | \$ 2.51 | \$ 1.53 | \$ 1.20 | \$ 3.40 | \$ 1.32 |
| Cumulative effect of accounting change | | | 0.01 | | |
| | \$ 2.51 | \$ 1.53 | \$ 1.21 | \$ 3.40 | \$ 1.32 |
| Cash dividends declared per common share | \$ 0.195 | \$ 0.170 | \$ 0.135 | \$ 0.170 | \$ 0.145 |
| Cash Flow Data: | | | | | |
| Cash provided by operating activities | \$ 2,406,888 | \$ 1,432,274 | \$ 938,907 | \$ 2,982,419 | \$ 1,577,345 |
| Cash used in investing activities | 6,921,378 | 3,381,204 | 2,077,217 | 6,668,005 | 3,655,044 |
| Cash provided by financing activities | 4,567,621 | 1,915,245 | 931,254 | 3,626,275 | 2,197,905 |
| Other Financial Data: | | | | | |
| Ratio of earnings to fixed charges ⁽¹⁾⁽²⁾ | 5.6x | 4.8x | 4.0x | 7.7x | 4.3x |
| Ratio of earnings to fixed charges and preference dividends ⁽¹⁾⁽²⁾ | 4.6x | 3.7x | 3.3x | 6.0x | 3.7x |
| Ratio of total debt to EBITDA | 2.1x | 1.9x | 2.0x | | |
| EBITDA ⁽³⁾ | \$ 2,658,194 | \$ 1,583,576 | \$ 1,041,566 | \$ 3,766,213 | \$ 1,592,652 |
| | As of December 31, | | | As of September 30, | |
| | 2005 | 2004 | 2003 | 2006 | 2005 |
| (\$ in thousands) | | | | | |
| Balance Sheet Data: | | | | | |
| Total assets | \$ 16,118,462 | \$ 8,244,509 | \$ 4,572,291 | \$ 23,394,921 | \$ 12,365,629 |
| Long-term debt, net | 5,489,742 | 3,075,109 | 2,057,713 | 7,861,108 | 4,250,160 |
| Stockholders' equity | 6,174,323 | 3,162,883 | 1,732,810 | 10,192,820 | 4,206,320 |

(1) For purposes of determining the ratios of earnings to fixed charges and earnings to fixed charges and preference dividends, earnings are defined as net income before income taxes, cumulative effect of accounting changes, pretax gain or loss of equity investees, amortization of capitalized interest and fixed charges, less capitalized interest. Fixed charges consist of interest (whether expensed or capitalized and excluding the effect of unrealized gains or losses on interest rate derivatives), and amortization of debt expenses and discount or premium relating to any indebtedness. Preference dividends consist of preferred stock dividends grossed up to reflect the pre-tax amount.

(2) The ratio of earnings to fixed charges for the years ended December 31, 2001 and 2002 was 4.4x and 1.5x, respectively. The ratio of earnings to fixed charges and preference dividends for the years ended December 31, 2001 and 2002 was 4.2x and 1.3x, respectively.

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- (3) EBITDA represents net income before income tax expense, interest expense, oil and natural gas depreciation, depletion and amortization and depreciation and amortization of other assets. EBITDA is presented as a supplemental financial measurement in the evaluation of our business. We believe that it provides additional information regarding our ability to meet our future debt service, capital expenditures and working capital requirements. This measure is widely used by investors and rating agencies in the valuation, comparison, rating and investment recommendations of companies. EBITDA is also a financial measurement that, with certain negotiated adjustments, is reported to our lenders pursuant to our revolving bank credit facility and is used in the financial covenants in our revolving bank credit facility and our senior note indentures. EBITDA is not a measure of financial performance under GAAP. Accordingly, it should not be considered as a substitute for net income, income from operations or cash flow provided by operating activities prepared in accordance with GAAP. EBITDA is reconciled to net income as follows:

| | Year Ended December 31, | | | Nine Months Ended September 30, | |
|--|-------------------------|--------------|--------------|---------------------------------|--------------|
| | 2005 | 2004 | 2003 | 2006 | 2005 |
| | (\$ in thousands) | | | | |
| Net income | \$ 948,302 | \$ 515,155 | \$ 312,981 | \$ 1,531,961 | \$ 495,777 |
| Income tax expense | 545,091 | 289,771 | 190,360 | 963,136 | 284,977 |
| Interest expense | 219,800 | 167,328 | 154,356 | 220,226 | 155,623 |
| Oil and natural gas depreciation, depletion and amortization | 894,035 | 582,137 | 369,465 | 976,839 | 621,484 |
| Depreciation and amortization of other assets | 50,966 | 29,185 | 16,793 | 74,051 | 34,791 |
| Cumulative effect of accounting change | | | (2,389) | | |
| EBITDA | \$ 2,658,194 | \$ 1,583,576 | \$ 1,041,566 | \$ 3,766,213 | \$ 1,592,652 |

Table of Contents**Summary Reserve Information**

The following table sets forth our estimated proved reserves and the present value of the proved reserves as of December 31, 2005 (based on our weighted average wellhead prices at December 31, 2005 of \$56.41 per barrel of oil and \$8.76 per mcf of natural gas). These prices were based on the cash spot prices for oil and natural gas at December 31, 2005.

| | Oil | Gas | Gas Equivalent | Percent of Proved Reserves | Present Value (\$ in thousands) |
|----------------------------------|----------------|------------------|-------------------|-------------------------------------|--|
| | (mbbl) | (mmcf) | (mmcfe) | | |
| Mid-Continent | 48,915 | 3,504,653 | 3,798,216 | 51% | \$ 11,308,766 |
| Appalachia | 1,094 | 1,289,919 | 1,296,482 | 17 | 3,462,744 |
| Ark-La-Tex and Barnett Shale | 6,379 | 1,030,962 | 1,069,236 | 14 | 3,551,565 |
| Permian | 39,126 | 457,811 | 692,570 | 9 | 2,040,175 |
| South Texas and Texas Gulf Coast | 3,308 | 602,551 | 622,399 | 8 | 2,459,379 |
| Other | 4,501 | 14,858 | 41,787 | 1 | 110,965 |
| Total | 103,323 | 6,900,754 | 7,520,690 | 100% | \$ 22,933,594₍₁₎ |

(1) The standardized measure of discounted future net cash flows at December 31, 2005 was \$16.0 billion.

As of December 31, 2005, the present value of our proved developed reserves as a percentage of total proved reserves was 71%, and the volume of our proved developed reserves as a percentage of total proved reserves was 65%. Natural gas reserves accounted for 92% of the volume of total proved reserves at December 31, 2005.

Future prices and costs may be materially higher or lower than the prices and costs as of the date of any estimate. A change in price of \$0.10 per mcf for natural gas and \$1.00 per barrel for oil would result in a change in our December 31, 2005 present value of estimated future net revenue of proved reserves of approximately \$315 million and \$50 million, respectively.

Table of Contents**Summary Production, Sales, Prices and Expenses Data**

The following table sets forth certain information regarding the production volumes, oil and natural gas sales, average sales prices received and expenses associated with sales of natural gas and oil for the periods indicated:

| | Year Ended December 31, | | | Nine Months Ended | |
|---|-------------------------|---------------------|---------------------|---------------------|---------------------|
| | | | | September 30, | |
| | 2005 | 2004 | 2003 | 2006 | 2005 |
| Net Production: | | | | | |
| Oil (mbbl) | 7,698 | 6,764 | 4,665 | 6,437 | 5,684 |
| Natural gas (mmcf) | 422,389 | 322,009 | 240,366 | 387,696 | 304,060 |
| Natural gas equivalent (mmcfe) | 468,577 | 362,593 | 268,356 | 426,318 | 338,164 |
| Oil and Natural Gas Sales (\$ in thousands): | | | | | |
| Oil sales | \$ 401,845 | \$ 260,915 | \$ 132,630 | \$ 404,595 | \$ 290,332 |
| Oil derivatives realized gains (losses) | (34,132) | (69,267) | (12,058) | (25,695) | (28,654) |
| Oil derivatives unrealized gains (losses) | 4,374 | 3,454 | (9,440) | 24,825 | (5,951) |
| Total oil sales | \$ 372,087 | \$ 195,102 | \$ 111,132 | \$ 403,725 | \$ 255,727 |
| Natural gas sales | \$ 3,231,286 | \$ 1,789,275 | \$ 1,171,050 | \$ 2,526,168 | \$ 2,005,670 |
| Natural gas derivatives realized gains (losses) | (367,551) | (85,634) | (5,331) | 832,769 | (97,955) |
| Natural gas derivatives unrealized gains (losses) | 36,763 | 37,433 | 19,971 | 427,768 | (131,171) |
| Total natural gas sales | \$ 2,900,498 | \$ 1,741,074 | \$ 1,185,690 | \$ 3,786,705 | \$ 1,776,544 |
| Total oil and natural gas sales | \$ 3,272,585 | \$ 1,936,176 | \$ 1,296,822 | \$ 4,190,430 | \$ 2,032,271 |
| Average Sales Price: (excluding gains (losses) on derivatives): | | | | | |
| Oil (\$ per bbl) | \$ 52.20 | \$ 38.57 | \$ 28.43 | \$ 62.85 | \$ 51.08 |
| Natural gas (\$ per mcf) | \$ 7.65 | \$ 5.56 | \$ 4.87 | \$ 6.52 | \$ 6.60 |
| Natural gas equivalent (\$ per mcfe) | \$ 7.75 | \$ 5.65 | \$ 4.86 | \$ 6.87 | \$ 6.79 |
| Average Sales Price: (excluding unrealized gains (losses) on derivatives): | | | | | |
| Oil (\$ per bbl) | \$ 47.77 | \$ 28.33 | \$ 25.85 | \$ 58.86 | \$ 46.04 |
| Natural gas (\$ per mcf) | \$ 6.78 | \$ 5.29 | \$ 4.85 | \$ 8.66 | \$ 6.27 |
| Natural gas equivalent (\$ per mcfe) | \$ 6.90 | \$ 5.23 | \$ 4.79 | \$ 8.77 | \$ 6.42 |
| Expenses (\$ per mcfe): | | | | | |
| Production expenses | \$ 0.68 | \$ 0.56 | \$ 0.51 | \$ 0.85 | \$ 0.66 |
| Production taxes | \$ 0.44 | \$ 0.29 | \$ 0.29 | \$ 0.30 | \$ 0.40 |
| General and administrative expenses | \$ 0.14 | \$ 0.10 | \$ 0.09 | \$ 0.23 | \$ 0.12 |
| Oil and natural gas depreciation, depletion and amortization | \$ 1.91 | \$ 1.61 | \$ 1.38 | \$ 2.29 | \$ 1.84 |
| Depreciation and amortization of other assets | \$ 0.11 | \$ 0.08 | \$ 0.06 | \$ 0.17 | \$ 0.10 |
| Interest expense ⁽¹⁾ | \$ 0.47 | \$ 0.45 | \$ 0.55 | \$ 0.52 | \$ 0.47 |

(1) Includes the effects of realized gains (losses) from interest rate derivatives, but does not include the effects of unrealized gains (losses) and is net of amounts capitalized.

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RISK FACTORS

In addition to the other information set forth elsewhere or incorporated by reference in this prospectus, the following factors relating to our company and the offering should be considered carefully before making an investment in the notes offered hereby.

Risks Relating to Our Business

Oil and gas prices are volatile. A decline in prices could adversely affect our financial position, financial results, cash flows, access to capital and ability to grow.

Our revenues, operating results, profitability and future rate of growth depend primarily upon the prices we receive for the oil and gas we sell. Prices also affect the amount of cash flow available for capital expenditures and our ability to borrow money or raise additional capital. The amount we can borrow from banks is subject to periodic redeterminations based on prices specified by our bank group at the time of redetermination. In addition, we may have ceiling test write-downs in the future if prices fall significantly.

Historically, the markets for oil and gas have been volatile and they are likely to continue to be volatile. Wide fluctuations in oil and gas prices may result from relatively minor changes in the supply of and demand for oil and natural gas, market uncertainty and other factors that are beyond our control, including:

worldwide and United States supplies of oil and gas;

weather conditions;

the level of consumer demand;

the price and availability of alternative fuels;

the proximity and capacity of natural gas pipelines and other transportation facilities;

the price and level of imports in the United States;

United States and non-United States governmental regulations and taxes;

the ability of the members of the Organization of Petroleum Exporting Countries to agree to and maintain oil price and production controls;

political instability or armed conflict in oil-producing regions; and

overall United States and global economic conditions.

These factors and the volatility of the energy markets make it extremely difficult to predict future oil and gas price movements with any certainty. Declines in oil and natural gas prices would not only reduce revenue, but could reduce the amount of oil and gas that we can produce economically and, as a result, could have a material adverse effect on our financial condition, results of operations and reserves. Further, oil and gas prices do not necessarily move in tandem. Because approximately 92% of our reserves at December 31, 2005 were natural gas reserves, we are more affected by movements in natural gas prices.

Our level of indebtedness and preferred stock may adversely affect operations and limit our growth, and we may have difficulty making debt service payments on our indebtedness as such payments become due.

As of September 30, 2006, we had long-term indebtedness of approximately \$7.9 billion, with \$1.5 billion of outstanding borrowings drawn under our revolving bank credit facility. Our long-term

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indebtedness represented 44% of our total book capitalization at September 30, 2006. As of November 22, 2006, we had approximately \$2.079 billion outstanding under our revolving bank credit facility. We expect to continue to be highly leveraged in the foreseeable future.

Our level of indebtedness and preferred stock affects our operations in several ways, including the following:

a portion of our cash flows from operating activities must be used to service our indebtedness and pay dividends on our preferred stock and is not available for other purposes;

we may be at a competitive disadvantage as compared to similar companies that have less debt;

the covenants contained in the agreements governing our outstanding indebtedness and future indebtedness may limit our ability to borrow additional funds, pay dividends and make certain investments and may also affect our flexibility in planning for, and reacting to, changes in the economy and in our industry;

additional financing in the future for working capital, capital expenditures, acquisitions, general corporate or other purposes may have higher costs and more restrictive covenants;

changes in the credit ratings of our debt may negatively affect the cost, terms, conditions and availability of future financing, and lower ratings will increase the interest rate and fees we pay on our revolving bank credit facility; and

we may be more vulnerable to general adverse economic and industry conditions.

We may incur additional debt, including significant secured indebtedness, or issue additional series of preferred stock in order to make future acquisitions or to develop our properties. A higher level of indebtedness and/or additional preferred stock increases the risk that we may default on our obligations. Our ability to meet our debt obligations and to reduce our level of indebtedness depends on our future performance. General economic conditions, oil and gas prices and financial, business and other factors affect our operations and our future performance. Many of these factors are beyond our control. We may not be able to generate sufficient cash flow to pay the interest on our debt, and future working capital, borrowings or equity financing may not be available to pay or refinance such debt. Factors that will affect our ability to raise cash through an offering of our capital stock or a refinancing of our debt include financial market conditions, the value of our assets and our performance at the time we need capital.

In addition, our bank borrowing base is subject to periodic redetermination. A lowering of our borrowing base could require us to repay indebtedness in excess of the borrowing base, or we might need to further secure the lenders with additional collateral.

Competition in the oil and natural gas industry is intense, and many of our competitors have greater financial and other resources than we do.

We operate in the highly competitive areas of oil and natural gas acquisition, development, exploitation, exploration and production. We face intense competition from both major and other independent oil and natural gas companies in each of the following areas:

seeking to acquire desirable producing properties or new leases for future exploration; and

seeking to acquire the equipment and expertise necessary to develop and operate our properties.

Many of our competitors have financial and other resources substantially greater than ours, and some of them are fully integrated oil companies. These companies may be able to pay more for development prospects and productive oil and natural gas properties and may be able to define, evaluate, bid for and

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purchase a greater number of properties and prospects than our financial or human resources permit. Our ability to develop and exploit our oil and natural gas properties and to acquire additional properties in the future will depend upon our ability to successfully conduct operations, evaluate and select suitable properties and consummate transactions in this highly competitive environment.

Significant capital expenditures are required to replace our reserves.

Our exploration, development and acquisition activities require substantial capital expenditures. Historically, we have funded our capital expenditures through a combination of cash flows from operations, our revolving bank credit facility and debt and equity issuances. Future cash flows are subject to a number of variables, such as the level of production from existing wells, prices of oil and gas, and our success in developing and producing new reserves. If revenues were to decrease as a result of lower oil and gas prices or decreased production, and our access to capital were limited, we would have a reduced ability to replace our reserves. If our cash flow from operations is not sufficient to fund our capital expenditure budget, we may not be able to access additional bank debt, debt or equity or other methods of financing on an economic basis to meet these requirements.

If we are not able to replace reserves, we may not be able to sustain production.

Our future success depends largely upon our ability to find, develop or acquire additional oil and gas reserves that are economically recoverable. Unless we replace the reserves we produce through successful development, exploration or acquisition activities, our proved reserves and production will decline over time. In addition, approximately 35% of our total estimated proved reserves (by volume) at December 31, 2005 were undeveloped. By their nature, estimates of undeveloped reserves are less certain. Recovery of such reserves will require significant capital expenditures and successful drilling operations. Our reserve estimates reflect that our production rate on producing properties will decline approximately 24% from 2006 to 2007. Thus, our future oil and natural gas reserves and production and, therefore, our cash flow and income are highly dependent on our success in efficiently developing and exploiting our current reserves and economically finding or acquiring additional recoverable reserves.

The actual quantities and present value of our proved reserves may prove to be lower than we have estimated.

This prospectus and the documents incorporated by reference herein contain estimates of our proved reserves and the estimated future net revenues from our proved reserves. These estimates are based upon various assumptions, including assumptions required by the SEC relating to oil and gas prices, drilling and operating expenses, capital expenditures, taxes and availability of funds. The process of estimating oil and gas reserves is complex. The process involves significant decisions and assumptions in the evaluation of available geological, geophysical, engineering and economic data for each reservoir. Therefore, these estimates are inherently imprecise.

Actual future production, oil and gas prices, revenues, taxes, development expenditures, operating expenses and quantities of recoverable oil and gas reserves most likely will vary from these estimates. Such variations may be significant and could materially affect the estimated quantities and present value of our proved reserves. In addition, we may adjust estimates of proved reserves to reflect production history, results of exploration and development drilling, prevailing oil and gas prices and other factors, many of which are beyond our control. Our properties may also be susceptible to hydrocarbon drainage from production by operators on adjacent properties.

At December 31, 2005, approximately 35% of our estimated proved reserves (by volume) were undeveloped. Recovery of undeveloped reserves requires significant capital expenditures and successful drilling operations. These reserve estimates include the assumption that we will make significant capital

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expenditures to develop the reserves, including approximately \$1.8 billion in 2006. You should be aware that the estimated costs may not be accurate, development may not occur as scheduled and results may not be as estimated.

You should not assume that the present values referred to in this prospectus and the documents incorporated by reference herein represent the current market value of our estimated oil and gas reserves. In accordance with SEC requirements, the estimates of our present values are based on prices and costs as of the date of the estimates. The December 31, 2005 present value is based on weighted average oil and natural gas wellhead prices of \$56.41 per barrel of oil and \$8.76 per mcf of natural gas. Actual future prices and costs may be materially higher or lower than the prices and costs as of the date of an estimate.

Any changes in consumption by oil and natural gas purchasers or in governmental regulations or taxation will also affect actual future net cash flows.

The timing of both the production and the expenses from the development and production of oil and gas properties will affect both the timing of actual future net cash flows from our proved reserves and their present value. In addition, the 10% discount factor, which is required by the SEC to be used in calculating discounted future net cash flows for reporting purposes, is not necessarily the most accurate discount factor. The effective interest rate at various times and the risks associated with our business or the oil and natural gas industry in general will affect the accuracy of the 10% discount factor.

Acquisitions may prove to be worth less than we paid because of uncertainties in evaluating recoverable reserves and potential liabilities.

Our recent growth is due in large part to acquisitions of exploration and production companies, producing properties and undeveloped leasehold. We expect acquisitions will also contribute to our future growth. Successful acquisitions require an assessment of a number of factors, including estimates of recoverable reserves, exploration potential, future oil and gas prices, operating costs and potential environmental and other liabilities. Such assessments are inexact and their accuracy is inherently uncertain. In connection with our assessments, we perform a review of the acquired properties which we believe is generally consistent with industry practices. However, such a review will not reveal all existing or potential problems. In addition, our review may not permit us to become sufficiently familiar with the properties to fully assess their deficiencies and capabilities. We do not inspect every well. Even when we inspect a well, we do not always discover structural, subsurface and environmental problems that may exist or arise. We are generally not entitled to contractual indemnification for preclosing liabilities, including environmental liabilities. Normally, we acquire interests in properties on an as is basis with limited remedies for breaches of representations and warranties. As a result of these factors, we may not be able to acquire oil and gas properties that contain economically recoverable reserves or be able to complete such acquisitions on acceptable terms.

As new owners, we may not effectively consolidate and integrate acquired operations, particularly when we make significant acquisitions outside our historical operating areas.

Significant acquisitions present operational and administrative challenges that may prove more difficult than anticipated. The failure to consolidate functions and integrate procedures, personnel and operations in an effective and timely manner may adversely affect our business and results of operations, at least temporarily. Significant acquisitions can change the nature of our operations and business depending upon the character of the acquired properties, which may have substantially different operating and geological characteristics or be in different geographic locations than our existing properties. To the extent that we acquire properties

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substantially different from the properties in our primary operating areas or acquire properties that require different technical expertise, we may not be able to realize the economic benefits of these acquisitions as efficiently as in our prior acquisitions.

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Exploration and development drilling may not result in commercially productive reserves.

We do not always encounter commercially productive reservoirs through our drilling operations. The new wells we drill or participate in may not be productive and we may not recover all or any portion of our investment in wells we drill or participate in. The seismic data and other technologies we use do not allow us to know conclusively prior to drilling a well that oil or gas is present or may be produced economically. The cost of drilling, completing and operating a well is often uncertain, and cost factors can adversely affect the economics of a project. Our efforts will be unprofitable if we drill dry wells or wells that are productive but do not produce enough reserves to return a profit after drilling, operating and other costs. Further, our drilling operations may be curtailed, delayed or canceled as a result of a variety of factors, including:

increases in the cost of, or shortages or delays in the availability of, drilling rigs and equipment;

unexpected drilling conditions;

title problems;

pressure or irregularities in formations;

equipment failures or accidents;

adverse weather conditions; and

compliance with environmental and other governmental requirements.

Future price declines may result in a write-down of our asset carrying values.

We utilize the full cost method of accounting for costs related to our oil and gas properties. Under this method, all such costs (for both productive and nonproductive properties) are capitalized and amortized on an aggregate basis over the estimated lives of the properties using the unit-of-production method. However, these capitalized costs are subject to a ceiling test which limits such pooled costs to the aggregate of the present value of future net revenues attributable to proved oil and natural gas reserves discounted at 10% plus the lower of cost or market value of unproved properties. The full cost ceiling is evaluated at the end of each quarter using the prices for oil and gas at that date, adjusted for the impact of derivatives accounted for as cash flow hedges. A significant decline in oil and gas prices from current levels, or other factors, without other mitigating circumstances, could cause a future writedown of capitalized costs and a non-cash charge against future earnings.

At December 31, 2005, our net book value of oil and natural gas properties less deferred income taxes was below the calculated ceiling by approximately \$6.5 billion. From December 31, 2005 to September 30, 2006, spot natural gas prices decreased by approximately 59% from \$10.08 to \$4.18 per mcf. As a result, as of September 30, 2006, our ceiling test calculation indicated an impairment of our oil and natural gas properties of approximately \$415 million. However, natural gas prices subsequent to September 30, 2006 have improved sufficiently to eliminate this calculated impairment. As a result, we were not required to record

a write-down of our oil and natural gas properties under the full-cost method of accounting in the third quarter of 2006.

Our hedging activities may reduce the realized prices received for our oil and natural gas sales and require us to provide collateral for hedging liabilities.

In order to manage our exposure to price volatility in marketing our oil and gas, we enter into oil and gas price risk management arrangements for a portion of our expected production. Commodity price hedging may limit the prices we actually realize and therefore reduce oil and natural gas revenues in the future. The fair value of our oil and gas derivative instruments outstanding as of September 30, 2006 was an

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asset of approximately \$1.476 billion. In addition, our commodity price risk management transactions may expose us to the risk of financial loss in certain circumstances, including instances in which:

our production is less than expected;

there is a widening of price differentials between delivery points for our production and the delivery point assumed in the hedge arrangement; or

the counterparties to our contracts fail to perform under the contracts.

All but two of our commodity price risk management counterparties require us to provide assurances of performance in the event that the counterparties' mark-to-market exposure to us exceeds certain levels. Most of these arrangements allow us to minimize the potential liquidity impact of significant mark-to-market fluctuations by making collateral allocations from our revolving bank credit facility or directly pledging oil and gas properties, rather than posting cash or letters of credit with the counterparties. As of September 30, 2006, we had outstanding collateral allocations and pledges of oil and gas properties, with respect to commodity price risk management transactions but were not required to post any collateral with our counterparties through letters of credit issued under our revolving bank credit facility. As of November 22, 2006, we had outstanding transactions with thirteen counterparties, seven of which hold collateral allocations from our revolving bank credit facility or liens against certain oil and gas properties under our secured hedging facilities, and two of which do not require us to provide security for our risk management transactions. As of November 22, 2006, we were not required to post cash or letters of credit with the remaining four counterparties. Future collateral requirements are uncertain and will depend on the arrangements with our counterparties and highly volatile natural gas and oil prices.

Lower oil and gas prices could negatively impact our ability to borrow.

Our revolving bank credit facility limits our borrowings to the lesser of the borrowing base and the total commitments (currently both are \$2.5 billion). The borrowing base is determined periodically at the discretion of the banks and is based in part on oil and natural gas prices. Additionally, some of our indentures contain covenants limiting our ability to incur indebtedness in addition to that incurred under our revolving bank credit facility. These indentures limit our ability to incur additional indebtedness unless we meet one of two alternative tests. The first alternative is based on our adjusted consolidated net tangible assets (as defined in all of our indentures), which is determined using discounted future net revenues from proved oil and natural gas reserves as of the end of each year. The second alternative is based on the ratio of our adjusted consolidated EBITDA (as defined in the relevant indentures) to our adjusted consolidated interest expense over a trailing twelve-month period. As of the date of this prospectus, we are permitted to incur significant additional indebtedness under both of these debt incurrence tests. Lower oil and gas prices in the future could reduce our adjusted consolidated EBITDA, as well as our adjusted consolidated net tangible assets, and thus could reduce our ability to incur additional indebtedness.

Oil and natural gas drilling and producing operations can be hazardous and may expose us to environmental liabilities.

Oil and natural gas operations are subject to many risks, including well blowouts, cratering and explosions, pipe failure, fires, formations with abnormal pressures, uncontrollable flows of oil, natural gas, brine or well fluids, and other environmental hazards and risks. Our drilling operations involve risks from high pressures and from mechanical difficulties such as stuck pipes, collapsed casings and separated cables. If any of these risks occurs, we could sustain substantial losses as a result of:

injury or loss of life;

severe damage to or destruction of property, natural resources and equipment;

pollution or other environmental damage;

clean-up responsibilities;

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regulatory investigations and administrative, civil and criminal penalties; and

injunctions resulting in limitation or suspension of operations.

There is inherent risk of incurring significant environmental costs and liabilities in our exploration and production operations due to our generation, handling, and disposal of materials including wastes and petroleum hydrocarbons. We may incur joint and several, strict liability under applicable U.S. federal and state environmental laws in connection with releases of petroleum hydrocarbons and wastes on, under or from our leased or owned properties, some of which have been used for oil and natural gas exploration and production activities for a number of years, oftentimes by third parties not under our control. While we may maintain insurance against some, but not all, of the risks described above, our insurance may not be adequate to cover casualty losses or liabilities. Also, in the future we may not be able to obtain insurance at premium levels that justify its purchase.

In addition, in response to studies suggesting that emissions of certain gases may be contributing to warming of the Earth's atmosphere, many states are beginning to consider initiatives to track and record these gases, generally referred to as greenhouse gases, with several states having already adopted regulatory initiatives and one state, California, having adopted legislation aimed at reducing emissions of greenhouse gases. Methane, a primary component of natural gas, and carbon dioxide a byproduct of the burning of natural gas, are included among the types of gases targeted by greenhouse gas initiatives and laws. This movement is in its infancy but regulatory initiatives or legislation placing restrictions on emissions of methane or carbon dioxide that may be imposed in various states of the United States could adversely affect our operations and the demand for our products.

Risks Related to the Notes

Holders of the notes will be effectively subordinated to all of our and our subsidiaries' secured indebtedness.

Holders of our secured indebtedness, which is comprised primarily of the indebtedness under our revolving bank credit facility, have claims with respect to our assets constituting collateral for their indebtedness that are prior to your claims under the notes. In the event of a default on the notes or our bankruptcy, liquidation or reorganization, those assets would be available to satisfy obligations with respect to the indebtedness secured thereby before any payment could be made on the notes. Accordingly, the secured indebtedness would effectively be senior to the notes to the extent of the value of the collateral securing the indebtedness. While the indenture governing the notes places some limitations on our ability to create liens, there are significant exceptions to these limitations, including with respect to sale and leaseback transactions, that will allow us to secure indebtedness without equally and ratably securing the notes. To the extent the value of the collateral is not sufficient to satisfy the secured indebtedness, the holders of that indebtedness would be entitled to share with the holders of the notes and the holders of other claims against us with respect to our other assets. In addition, in certain circumstances a subsidiary may not be required to be, or may be delayed in becoming, a Subsidiary Guarantor. The notes will be structurally subordinated to any indebtedness of a subsidiary that is not a Subsidiary Guarantor.

A guarantee could be voided if the guarantor fraudulently transferred the guarantee at the time it incurred the indebtedness, which could result in the noteholders being able to rely on only us to satisfy claims.

Under U.S. bankruptcy law and comparable provisions of state fraudulent transfer laws, a guarantee can be voided, or claims under a guarantee may be subordinated to all other debts of that guarantor if, among other things, the guarantor, at the time it

incurred the indebtedness evidenced by its guarantee:

intended to hinder, delay or defraud any present or future creditor or received less than reasonably equivalent value or fair consideration for the incurrence of the guarantee;

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was insolvent or rendered insolvent by reason of such incurrence;

was engaged in a business or transaction for which the guarantor's remaining assets constituted unreasonably small capital;
or

intended to incur, or believed that it would incur, debts beyond its ability to pay those debts as they mature.

In addition, any payment by that guarantor under a guarantee could be voided and required to be returned to the guarantor or to a fund for the benefit of the creditors of the guarantor.

The measures of insolvency for purposes of fraudulent transfer laws vary depending upon the governing law. Generally, a guarantor would be considered insolvent if:

the sum of its debts, including contingent liabilities, was greater than the fair saleable value of all of its assets;

the present fair saleable value of its assets was less than the amount that would be required to pay its probable liability on its existing debts, including contingent liabilities, as they became absolute and mature; or

it could not pay its debts as they became due.

On the basis of historical financial information, recent operating history and other factors, we believe that the subsidiary guarantees are being incurred for proper purposes and in good faith and that each subsidiary guarantor, after giving effect to its guarantee of the notes, will not be insolvent, have unreasonably small capital for the business in which it is engaged or have incurred debts beyond its ability to pay those debts as they mature. We cannot be certain, however, that a court would agree with our conclusions in this regard.

You may find it difficult to sell your notes.

The notes will constitute a new issue of securities with no established public market. Although the underwriters have indicated that they intend to make a market in the notes, they are not obligated to do so and any of their market making activities may be terminated or limited at any time. In addition, although we have registered the offer and sale of the notes under the Securities Act of 1933 and intend to apply for a listing of the notes on the Irish Stock Exchange for trading on the Alternative Securities Market, there can be no assurance as to the liquidity of markets that may develop for the notes, the ability of noteholders to sell their notes or the prices at which notes could be sold. The notes may trade at prices that are lower than their initial purchase price depending on many factors, including prevailing interest rates and the markets for similar securities. The liquidity of trading markets for the notes may also be adversely affected by general declines or disruptions in the markets for debt securities. Those market declines or disruptions could adversely affect the liquidity of and market for the notes independent of our financial performance or prospects. An active market for the notes may not develop or, if developed, may not continue. In the absence of an active trading market, you may not be able to transfer the notes within the time or at the price you desire.

The notes lack some covenants typically found in other comparably rated public debt securities.

Although the notes are rated below investment grade by both Standard & Poor's and Moody's Investors Service, they lack the protection for holders of several financial and other restrictive covenants associated with several other series of our outstanding senior notes and typically associated with comparably rated public debt securities, including:

incurrence of additional indebtedness;

payment of dividends and other restricted payments;

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sale of assets and the use of proceeds therefrom;

transactions with affiliates; and

dividend and other payment restrictions affecting subsidiaries.

The principal amount of the notes and interest thereon contained in our financial statements may be adversely affected by fluctuations in the dollar/euro exchange rate.

Since our financial statements are presented in dollars, fluctuations in the dollar/euro exchange rate could adversely affect the principal amount of the notes and the amount of interest payments made on the notes reflected in our financial statements. Since the payments related to the notes will be made in euro, we will need to convert dollars into euro to make such payments, which could result in an increase or decrease in the dollar equivalent of interest payments on the notes depending on fluctuations in the exchange rate. In addition, because our financial results are reported in dollars, the outstanding principal amount of the notes will be reported in dollars based on the average exchange rate for the euro prevailing during the reporting period or the exchange rate at the end of that period. If such exchange rate declines, the amount of debt represented by the notes reflected in our financial statements in dollars will increase.

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USE OF PROCEEDS

We expect the net proceeds from this offering to be approximately 393.3 million (or approximately \$503.4 million based on a dollar/euro exchange rate of approximately \$1.28 to 1.00 as of November 22, 2006), after deducting underwriters' discounts and the estimated expenses of the offering payable by us. We intend to use the net proceeds from this offering to repay borrowings under our revolving bank credit facility and for general corporate purposes, including funding potential future acquisitions. Affiliates of certain of the underwriters in this offering are lenders under our existing revolving bank credit facility and may receive a portion of the proceeds from this offering. See Underwriting. As of September 30, 2006, the average interest rate on borrowings outstanding under our revolving bank credit facility was 6.53%.

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The following table shows our unaudited capitalization as of September 30, 2006:

on a historical basis; and

on a pro forma basis to reflect this offering.

This table should be read in conjunction with, and is qualified in its entirety by reference to, our historical financial statements and the accompanying notes included in our annual report on Form 10-K for the year ended December 31, 2005, and our quarterly report on Form 10-Q for the quarter ended September 30, 2006, which are incorporated by reference herein and included in Annex A and Annex B, respectively.

| | As of September 30, 2006 | |
|---|---------------------------------|------------------------|
| | Historical | Pro Forma |
| | (\$ in thousands) | |
| Cash and cash equivalents | \$ 716 | \$ 716 |
| Long-term debt: | | |
| Revolving bank credit facility ⁽¹⁾ | \$ 1,464,000 | \$ 960,570 |
| 7.500% Senior Notes due 2013 | 363,823 | 363,823 |
| 7.625% Senior Notes due 2013 | 500,000 | 500,000 |
| 7.000% Senior Notes due 2014 | 300,000 | 300,000 |
| 7.500% Senior Notes due 2014 | 300,000 | 300,000 |
| 7.750% Senior Notes due 2015 | 300,408 | 300,408 |
| 6.375% Senior Notes due 2015 | 600,000 | 600,000 |
| 6.625% Senior Notes due 2016 | 600,000 | 600,000 |
| 6.875% Senior Notes due 2016 | 670,437 | 670,437 |
| 6.500% Senior Notes due 2017 | 1,100,000 | 1,100,000 |
| % Senior Notes due 2017 offered hereby | | 512,000 ⁽²⁾ |
| 6.250% Senior Notes due 2018 | 600,000 | 600,000 |
| 6.875% Senior Notes due 2020 | 500,000 | 500,000 |
| 2.750% Contingent Convertible Senior Notes due 2035 | 690,000 | 690,000 |
| Interest rate derivatives | (23,621) | (23,621) |
| Discount, net of premium, on Senior Notes | (103,939) | (103,939) |
| Total long-term debt | \$ 7,861,108 | \$ 7,869,678 |
| Stockholders' equity: | | |
| Preferred stock, \$0.01 par value, 20,000,000 authorized: | | |
| 5.00% Cumulative Convertible Preferred Stock (Series 2003), 38,625 shares issued and outstanding, entitled in liquidation to \$3.9 million | 3,863 | 3,863 |
| 4.125% Cumulative Convertible Preferred Stock, 3,065 shares issued and outstanding, entitled in liquidation to \$3.1 million | 3,065 | 3,065 |
| 5.00% Cumulative Convertible Preferred Stock (Series 2005), 4,600,000 shares issued and outstanding, entitled in liquidation to \$460.0 million | 460,000 | 460,000 |
| 4.50% Cumulative Convertible Preferred Stock, 3,450,000 shares issued and outstanding, entitled in liquidation to \$345.0 million | 345,000 | 345,000 |
| | 575,000 | 575,000 |

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5.00% Cumulative Convertible Preferred Stock (Series 2005B), 5,750,000 shares issued and outstanding, entitled in liquidation to \$575.0 million

| | | |
|--|---------------|---------------|
| 6.25% Mandatory Convertible Preferred Stock, 2,300,000 shares issued and outstanding, entitled in liquidation to \$575.0 million | 575,000 | 575,000 |
| Common stock, \$0.01 par value, 750,000,000 shares authorized, 437,859,397 issued and outstanding | 4,379 | 4,379 |
| Paid-in capital | 4,899,634 | 4,899,634 |
| Retained earnings | 2,495,215 | 2,495,215 |
| Accumulated other comprehensive income (loss), net of tax of (\$518,564,000) | 862,241 | 862,241 |
| Less: treasury stock, at cost; 1,306,528 common shares | (30,577) | (30,577) |
| | <hr/> | <hr/> |
| Total stockholders' equity | \$ 10,192,820 | \$ 10,192,820 |
| | <hr/> | <hr/> |
| Total capitalization | \$ 18,053,928 | \$ 18,062,498 |
| | <hr/> | <hr/> |

(1) As of November 22, 2006, we had outstanding borrowings of \$2.079 billion under our revolving bank credit facility.

(2) Based on an assumed public offering price of par and the dollar/euro exchange rate as of November 22, 2006 of approximately \$1.28 per 1.00.

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DESCRIPTION OF NOTES

Chesapeake Energy Corporation will issue the notes offered hereby (the **Notes**) under an indenture to be dated as of _____, 2006 (the **Indenture**), among the Company, as issuer, the Subsidiary Guarantors, as guarantors, The Bank of New York Trust Company, N.A., as trustee (the **Trustee**), The Bank of New York, London Branch, as registrar, transfer agent and paying agent, and AIB/BNY Fund Management (Ireland) Limited, as Irish paying agent and transfer agent. The terms of the Notes include those stated in the Indenture and those made part of the Indenture by reference to the Trust Indenture Act of 1939 (the **Trust Indenture Act**).

The following description is only a summary of the material provisions of the Notes and the Indenture. These descriptions do not purport to be complete and are subject to, and are qualified in their entirety by reference to, the Notes and the Indenture. You may request copies of the Indenture at our address set forth under the heading **Where You Can Find More Information**.

Certain terms used in this description are defined under the subheading **Certain Definitions**. In this description, the words **Company**, **we** and **our** refer only to Chesapeake Energy Corporation and not to any of its Subsidiaries.

General

The Company will issue the Notes initially with a maximum aggregate principal amount of 400 million. The Company is permitted to issue additional Notes under the Indenture in an unlimited aggregate principal amount (**Add-On Notes**). Any Add-On Notes that are actually issued will be treated as issued and outstanding Notes (as the same class as the initial Notes) for all purposes of the Indenture and this **Description of Notes**, unless the context indicates otherwise. Each Note will mature on January 15, 2017 and will bear interest at the rate of interest per annum indicated on the cover page of this prospectus.

Interest on the Notes issued in this offering will accrue from the Issue Date at an annual rate of _____ %, payable semi-annually in arrears on January 15 and July 15 of each year, commencing July 15, 2007. We will make each interest payment to the Holders of record of the Notes at the close of business on January 1 or July 1 preceding such interest payment date. Interest will be computed on the basis of a 360-day year of twelve 30-day months. Principal, premium, if any, and interest will be payable at the offices of the Trustee and the paying agents, *provided* that, at the option of the Company, payment of interest on Notes not in global form may be made by check mailed to the address of the Person entitled thereto as it appears in the register of the Notes maintained by the registrar. Initially, The Bank of New York, London Branch will act as registrar, transfer agent and paying agent for the Notes in London, England, and AIB/BNY Fund Management (Ireland) Limited will act as paying agent and transfer agent in Dublin, Ireland.

The Notes are unsecured senior obligations of the Company. The Notes rank *pari passu* in right of payment with all existing and future Senior Indebtedness of the Company and rank senior in right of payment to all future Subordinated Indebtedness of the Company.

Guarantees

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On the Issue Date, all the existing United States Subsidiaries, other than certain de minimis Subsidiaries, and one non-United States Subsidiary of the Company will fully and unconditionally guarantee, on a joint and several basis, the Company's obligations to pay principal of, premium, if any, and interest on the Notes. The Indenture provides that each Person that becomes a United States Subsidiary after the Issue Date and guarantees any other Indebtedness of the Company or a Subsidiary Guarantor in excess of a De Minimis Guaranteed Amount will guarantee the payment of the Notes within 180 days after the later of (i) the date it becomes a United States Subsidiary and (ii) the date it guarantees such other Indebtedness, provided that no guarantee shall be required if the Subsidiary merges into the Company or an existing Subsidiary Guarantor and the surviving entity remains a Subsidiary Guarantor.

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The obligations of each Subsidiary Guarantor under its Guarantee will be limited as necessary to prevent that Guarantee from constituting a fraudulent conveyance or fraudulent transfer under federal, state or non-United States law. Each Subsidiary Guarantor that makes a payment or distribution under a Guarantee shall be entitled to a contribution from each other Subsidiary Guarantor in a pro rata amount based on the respective net assets of each Subsidiary Guarantor at the time of such payment determined in accordance with GAAP.

If a Guarantee were rendered voidable, it could be subordinated by a court to all other indebtedness (including guarantees and other contingent liabilities) of the applicable Subsidiary Guarantor, and, depending on the amount of such indebtedness, a Subsidiary Guarantor's liability on its Guarantee could be reduced to zero. Please read **Risk Factors** **Risks Related to the Notes**. A guarantee could be voided if the guarantor fraudulently transferred the guarantee at the time it incurred the indebtedness, which could result in the noteholders being able to rely on only us to satisfy claims.

Subject to the next succeeding paragraph, no Subsidiary Guarantor may consolidate or merge with or into (whether or not such Subsidiary Guarantor is the surviving Person) another Person unless:

- (1) the Person formed by or surviving any such consolidation or merger (if other than such Subsidiary Guarantor) assumes all the obligations of such Subsidiary Guarantor under the Indenture and the Notes pursuant to a supplemental indenture, in a form reasonably satisfactory to the Trustee, and
- (2) immediately after such transaction, no Default or Event of Default exists.

The preceding does not prohibit a merger between Subsidiary Guarantors or a merger between the Company and a Subsidiary Guarantor. In the event of a sale or other disposition of all or substantially all of the assets of any Subsidiary Guarantor, or a sale or other disposition of all the Capital Stock of such Subsidiary Guarantor, in any case whether by way of merger, consolidation or otherwise, then such Subsidiary Guarantor (in the event of a sale or other disposition by way of such a merger, consolidation or otherwise, of all of the Capital Stock of such Subsidiary Guarantor) or the Person acquiring the assets (in the event of a sale or other disposition of all or substantially all of the assets of such Subsidiary Guarantor) will be released and relieved of any obligations under its Guarantee. Further, a Subsidiary Guarantor will be released and relieved from any obligations under its Guarantee if it ceases to guarantee any other Indebtedness of the Company or any other Subsidiary Guarantor other than a De Minimis Guaranteed Amount.

Ranking

Senior Indebtedness versus Notes. The Indebtedness evidenced by the Notes and the Guarantees will be unsecured and will rank pari passu in right of payment to all Senior Indebtedness of the Company and the Subsidiary Guarantors, as the case may be.

As of September 30, 2006, the Company and the Subsidiary Guarantors had approximately \$8.0 billion in principal amount of Senior Indebtedness outstanding, \$1.5 billion of which was secured indebtedness under our revolving bank credit facility. Upon completion of this offering, and the ultimate application of the net proceeds therefrom as described under **Use of Proceeds**, we would have had, on a pro forma basis as of September 30, 2006, approximately \$8.0 billion in principal amount of Senior Indebtedness outstanding, \$972 million of which would have been secured. As of November 22, 2006, we had outstanding borrowings of \$2.079 billion under our revolving bank credit facility.

The Notes will be unsecured obligations of the Company. Secured debt and other secured obligations of the Company and the Subsidiary Guarantors (including obligations with respect to our revolving bank credit facility) will be effectively senior to the Notes to the extent of the value of the assets securing such debt or other obligations.

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Liabilities of Subsidiaries versus Notes. A substantial portion of the Company's operations is conducted through its Subsidiaries. Claims of creditors of any Subsidiaries that are not Subsidiary Guarantors, including trade creditors and creditors holding indebtedness or guarantees issued by such Subsidiaries, and claims of preferred stockholders of such Subsidiaries will have priority with respect to the assets and earnings of such Subsidiaries over the claims of the Company's creditors, including Holders of the Notes. Accordingly, the Notes will be effectively subordinated to creditors (including trade creditors) and preferred stockholders, if any, of Subsidiaries that are not Subsidiary Guarantors.

Although the Indenture limits the incurrence of certain secured Indebtedness by the Company's Subsidiaries, such limitations are subject to a number of significant qualifications and the Indenture does not limit the incurrence of unsecured Indebtedness.

Make-Whole Redemption

At any time prior to the Maturity Date, the Company may, at its option, redeem all or any portion of the Notes at the Make-Whole Price plus accrued and unpaid interest to the date of redemption.

Redemption Upon Changes in Withholding Taxes

If, as a result of:

- (a) any amendment to, or change in, the laws (or regulations or rulings promulgated thereunder) of any Relevant Taxing Jurisdiction (as defined below under "Payment of Additional Amounts"); or
- (b) any change in the official application or the official interpretation or administration of such laws, regulations or rulings (including a holding, judgment or order by a court of competent jurisdiction or a change in published practice) (each of the foregoing in clauses (a) and (b), a "Change in Tax Law"),

the Company, any Subsidiary Guarantor or any Successor (as defined below under "Certain Covenants - Limitations on Mergers and Consolidations") would be obligated to pay, on the next date for any payment, Additional Amounts, as described below under

"Payment of Additional Amounts," which the Company, such Subsidiary Guarantor or such Successor cannot avoid by the use of reasonable measures available to it (including making payment through a paying agent located in another jurisdiction), then the Company or the Successor, as the case may be, may redeem all, but not less than all, of the Notes at any time after such amendment or change, upon not less than 30 nor more than 60 days' notice, at a redemption price of 100% of their principal amount, plus accrued and unpaid interest, if any, to the redemption date. In the case of the United States or any other jurisdiction that is a Relevant Taxing Jurisdiction on the Issue Date, the applicable Change in Tax Law must become effective on or after the date of this prospectus. In the case of a jurisdiction that becomes a Relevant Taxing Jurisdiction after the Issue Date, the applicable Change in Tax Law must become effective after the date that such jurisdiction becomes a Relevant Taxing Jurisdiction.

Prior to the giving of any notice of redemption described in this paragraph, the Company or the Successor, as the case may be, will deliver to the Trustee:

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- (i) an officers certificate of the Company or the Successor, as the case may be, stating that the obligation to pay such Additional Amounts cannot be avoided by the Company, such Subsidiary Guarantor or such Successor taking reasonable measures available to it; and
- (ii) a written opinion of independent legal counsel of recognized standing addressed to the Company or the Successor, as the case may be, to the effect that the Company, such Subsidiary

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Guarantor or such Successor has or will become obligated to pay such Additional Amounts as a result of a Change in Tax Law described above.

Absent manifest error, the Trustee will accept such officers' certificate and opinion as sufficient evidence of the satisfaction of the conditions to a redemption upon a Change in Tax Law, including any changes in withholding taxes, in which event it will be conclusive and binding on the Holders of the Notes.

Notwithstanding the foregoing, no such notice will be given (a) earlier than 90 days prior to the earliest date on which the Company or the relevant Successor or Subsidiary Guarantor, as the case may be, would be obliged to pay such Additional Amounts if a payment were then due and (b) unless at the time such notice is given, such obligation to pay such Additional Amounts remains in effect.

Payment of Additional Amounts

All payments that the Company or any Successor makes under or with respect to the Notes, or that any Subsidiary Guarantor makes with respect to any Guarantee, will be made free and clear of, and without withholding or deduction for or on account of, any present or future tax, duty, levy, impost, assessment or other governmental charges (including, without limitation, penalties, interest and other similar liabilities related thereto) of whatever nature (collectively, "Taxes") imposed or levied by or on behalf of any jurisdiction in which the Company, or, if applicable, any Subsidiary Guarantor or any Successor, as the case may be, is incorporated, organized or otherwise resident for tax purposes or from or through which any of the foregoing makes any payment on the Notes or by any taxing authority therein or political subdivision thereof (each, as applicable, a "Relevant Taxing Jurisdiction"), unless the Company, such Subsidiary Guarantor or such Successor, as the case may be, is required to withhold or deduct Taxes by law or by the interpretation or administration of law. If the Company, a Subsidiary Guarantor or such Successor is required to withhold or deduct any amount for, or on account of, Taxes of a Relevant Taxing Jurisdiction from any payment made under or with respect to the Notes or any Guarantee, the Company, such Subsidiary Guarantor or such Successor, as the case may be, will pay such additional amounts ("Additional Amounts") as may be necessary to ensure that the net amount received by each Holder of the Notes after such withholding or deduction will be not less than the amount the Holder would have received if such Taxes had not been required to be withheld or deducted.

Notwithstanding the foregoing, neither the Company, any Subsidiary Guarantor nor any Successor will, however, be required to pay Additional Amounts to a Holder or beneficial owner of Notes in respect of or on account of:

- (a) any Taxes that are imposed or levied by a Relevant Taxing Jurisdiction by reason of the Holder's or beneficial owner's present or former connection with such Relevant Taxing Jurisdiction, including, without limitation, the Holder or beneficial owner being or having been a citizen, national, or resident, being or having been engaged in a trade or business, being, or having been, physically present in or having or having had a permanent establishment in a Relevant Taxing Jurisdiction (but not including, in each case, any connection arising from the mere receipt or holding of Notes or the receipt of payments thereunder or under a Guarantee or the exercise or enforcement of rights under any Notes or the Indenture or a Guarantee);
- (b) any Taxes that are imposed or levied by reason of the failure of the Holder or beneficial owner of Notes, following the written request of the Company, any Subsidiary Guarantor or any Successor (as the case may be) addressed to the Holder (and made at a time that would enable the Holder or beneficial owner acting reasonably to comply with that request) made in accordance with the notice procedures set forth in the Indenture, to comply with any certification, identification, information or other reporting requirements, whether required by statute, treaty, regulation or administrative practice of a Relevant Taxing Jurisdiction, as a precondition to exemption from, or reduction in the rate of withholding or deduction of, Taxes imposed by the

Relevant Taxing Jurisdiction (including,

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- without limitation, a certification that the Holder or beneficial owner is not resident in the Relevant Taxing Jurisdiction);
- (c) any estate, inheritance, gift, sales, transfer, personal property or similar Taxes;
 - (d) any Tax that is payable otherwise than by withholding or deduction from payments made under or with respect to the Notes;
 - (e) any Tax that is imposed or levied by reason of the presentation (where presentation is required in order to receive payment) of such Notes for payment on a date more than 30 days after the date on which such payment became due and payable or the date on which payment thereof is duly provided for, whichever is later, except to the extent that the beneficial owner or Holder thereof would have been entitled to Additional Amounts had the Notes been presented for payment on any date during such 30 day period;
 - (f) any withholding or deduction in respect of any Taxes where such withholding or deduction is imposed or levied on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of November 26-27, 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive;
 - (g) any Tax that is imposed or levied on or with respect to a payment made to a Holder or beneficial owner who would have been able to avoid such withholding or deduction by presenting the Notes to another paying agent in a Member State of the European Union; or
 - (h) any combination of items (a) through (g) above.

Furthermore, Additional Amounts will not be paid with respect to the Notes to a Holder who is a fiduciary, a partnership, a limited liability company or other than the sole beneficial owner of the payment under or with respect to the Notes, to the extent that payment would be required by the laws of a Relevant Taxing Jurisdiction to be included in the income, for tax purposes, of a beneficiary or settlor with respect to the fiduciary, a member of that partnership, an interest holder in that limited liability company or a beneficial owner who would not have been entitled to the Additional Amounts had it been the Holder of the Notes.

The Company, the relevant Subsidiary Guarantor or the relevant Successor, as the case may be, will (i) make such withholding or deduction as is required by applicable law and (ii) remit the full amount withheld or deducted to the relevant taxing authority in accordance with applicable law.

At least 30 calendar days prior to each date on which any payment under or with respect to the Notes is due and payable, if the Company, any Subsidiary Guarantor or a Successor will be obligated to pay Additional Amounts with respect to such payment, the Company, the relevant Subsidiary Guarantor or the relevant Successor (as the case may be) will deliver to the Trustee an officers certificate stating that such Additional Amounts will be payable and the amounts so payable and will set forth such other information necessary to enable the Trustee to pay such Additional Amounts to Holders on the payment date (unless such obligation to pay Additional Amounts arises after the 30th day prior to the date on which payment under or with respect to the Notes is due and payable, in which case such officers' certificate shall be delivered promptly thereafter). The Company, the relevant Subsidiary Guarantor or the relevant Successor, as the case may be, will promptly publish a notice in accordance with the notice provisions set forth in the Indenture stating that such Additional Amounts will be payable and describing the obligation to pay such amounts.

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Upon written request, the Company, the relevant Subsidiary Guarantor or the relevant Successor, as the case may be, will furnish to the Trustee or to a Holder of the Notes copies of tax receipts evidencing the payment of any Taxes by the Company, such Guarantor or such Successor in such form as provided in

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the normal course by the taxing authority imposing such Taxes and as is reasonably available to the Company, such Subsidiary Guarantor or such Successor. If, notwithstanding the efforts of the Company, such Subsidiary Guarantor or such Successor to obtain such receipts, the same are not obtainable, the Company, such Subsidiary Guarantor or such Successor will provide the Trustee or such Holder with other evidence reasonably satisfactory to the Trustee or the Holder.

In addition, the Company, any Subsidiary Guarantor and any Successor, as the case may be, will pay any present or future stamp, issue, registration, court, documentation, excise or property taxes or other similar taxes, charges and duties, including interest and penalties with respect thereto, imposed by or in any Relevant Taxing Jurisdiction in respect of the execution, issue, enforcement or delivery of the Notes or any other document or instrument referred to thereunder (other than on or in connection with a transfer of the Notes other than the initial resale by the underwriters).

Whenever the Indenture, the Notes or this Description of Notes refers to, in any context, the payment of principal, premium, if any, interest or any other amount payable under or with respect to any Note or with respect to any Guarantee, such reference includes the payment of Additional Amounts, if applicable.

Change of Control

The Indenture provides that, following the occurrence of any Change of Control, unless the Company has exercised its right to redeem all of the Notes, the Company must offer to purchase all outstanding Notes at a purchase price equal to 101% of the aggregate principal amount of the Notes, plus accrued and unpaid interest to the date of purchase.

Within 15 days after any Change of Control, the Company will mail or cause to be mailed to all Holders on the date of the Change of Control a Notice (the Change of Control Notice) of the occurrence of such Change of Control and of the Holders' rights arising as a result thereof. The Change of Control Notice shall state, among other things:

- (1) that the change of control offer is being made pursuant to this covenant;
- (2) the purchase price and the change of control payment date;
- (3) that any Note not tendered will continue to accrue interest;
- (4) that any Note accepted for payment pursuant to the change of control offer shall cease to accrue interest on the change of control payment date; and
- (5) the instructions, consistent with the covenant described hereunder, that a Holder must follow in order to have such Holder's Notes purchased.

The change of control offer will be deemed to have commenced upon mailing of a notice pursuant to the Indenture and will terminate 20 business days after its commencement, unless a longer offering period is required by law. Promptly after the

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termination of the change of control offer, the Company will purchase and mail or deliver payment for all Notes tendered in response to the change of control offer.

On the change of control payment date, the Company will, to the extent lawful, (a) accept for payment Notes or portions thereof tendered pursuant to the change of control offer, (b) deposit with a paying agent an amount equal to the change of control payment in respect of all Notes or portions thereof so tendered and (c) deliver to the Trustee the Notes so accepted together with an officers' certificate stating the Notes or portions thereof tendered to the Company. The paying agent will promptly mail or deliver to each Holder of Notes so accepted payment in an amount equal to the purchase price for such Notes, and the Trustee will promptly authenticate and mail or deliver to each Holder a new Note equal in principal amount to any unpurchased portion of the Notes surrendered, if any, provided that each such new Note will be in a principal amount of \$50,000 or in any integral multiple of \$1,000 in excess thereof.

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The Company will comply with Section 14 of the Exchange Act and the provisions of Regulation 14E and any other tender offer rules under the Exchange Act and any other U.S. federal and state securities laws, rules and regulations and other jurisdictions laws which may then be applicable to any change of control offer.

The Change of Control purchase feature of the Notes may in certain circumstances make more difficult or discourage a sale or takeover of the Company. The change of control purchase feature is a result of negotiations between the Company and the underwriters. The Company has no present intention to engage in a transaction involving a Change of Control, although it is possible that it could decide to do so in the future. Subject to the limitations discussed below, the Company could, in the future, enter into certain transactions, including acquisitions, refinancings or other recapitalizations, that would not constitute a Change of Control under the Indenture, but that could increase the amount of indebtedness outstanding at such time or otherwise affect the Company's capital structure or credit ratings. Restrictions on the Company's ability to incur additional Indebtedness are contained in the covenants described under **Certain Covenants Limitation on Liens** and **Limitation on Sale/Leaseback Transactions**. Under the Indenture, such restrictions can only be waived with the consent of the Holders of a majority in principal amount of the Notes then outstanding. Except for the limitations contained in such covenants, however, the Indenture does not contain any covenants or provisions that may afford Holders of the Notes protection in the event of a highly leveraged transaction.

Future indebtedness that the Company may incur may contain prohibitions on the occurrence of certain events that would constitute a Change of Control or require the repurchase of such indebtedness upon a Change of Control. Moreover, the exercise by the Holders of their right to require the Company to repurchase the Notes could cause a default under such indebtedness, even if the Change of Control itself does not, due to the financial effect of such repurchase on the Company. Finally, the Company's ability to pay cash to the Holders of Notes following the occurrence of a Change of Control may be limited by the Company's then existing financial resources. There can be no assurance that sufficient funds will be available when necessary to make any required repurchases.

The provisions under the Indenture relative to the Company's obligation to make an offer to repurchase the Notes as a result of a Change of Control may be waived or modified with the written consent of the Holders of a majority in principal amount of the Notes.

Certain Covenants

The following restrictive covenants will be applicable to the Company and its Subsidiaries.

Limitation on Liens. The Company will not, and will not permit any Subsidiary to, create, incur or assume any Indebtedness secured by any Liens (other than Permitted Liens) upon any of the properties of the Company or any Subsidiary, unless the Notes or a Guarantee is equally and ratably secured; *provided* that if such Indebtedness is expressly subordinated to the Notes or a Guarantee, the Lien securing such Indebtedness will be subordinated and junior to the Lien securing the Notes or such Guarantee.

Limitation on Sale/Leaseback Transactions. The Company will not, and will not permit any Subsidiary to, enter into any Sale/Leaseback Transaction with any Person (other than the Company or any other Subsidiary) unless:

- (1) the Company or such Subsidiary would be entitled to incur secured Indebtedness, in a principal amount equal to the Attributable Indebtedness with respect to such Sale/Leaseback Transaction in accordance with the covenant captioned **Limitation on Liens**; or

- (2) the Company or such Subsidiary receives proceeds from such Sale/Leaseback Transaction at least equal to the fair market value thereof (as determined in good faith by the Company's Board of

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Directors, whose determination in good faith, evidenced by a resolution of such Board, shall be conclusive) and such proceeds are applied in accordance with the following two paragraphs:

The Company may apply Net Available Proceeds from such Sale/Leaseback Transaction, within 365 days following the receipt of Net Available Proceeds from the Sale/Leaseback Transaction, to:

- (1) the repayment of Indebtedness of the Company or a Subsidiary under Credit Facilities or other Senior Indebtedness, including any mandatory redemption or repurchase or make-whole redemption of the Existing Notes or the Notes;
- (2) make an Investment in assets used in the Oil and Gas Business; or
- (3) develop by drilling the Company's oil and gas reserves.

If, upon completion of the 365-day period, any portion of the Net Available Proceeds shall not have been applied by the Company as described in clauses (1), (2) or (3) in the immediately preceding paragraph and such remaining Net Available Proceeds, together with any remaining net cash proceeds from any prior Sale/Leaseback Transaction (such aggregate constituting Excess Proceeds), exceed \$40 million, then the Company will be obligated to make an offer (the Net Proceeds Offer) to purchase the Notes and any other Senior Indebtedness in respect of which such an offer to purchase is also required to be made concurrently with the Net Proceeds Offer having an aggregate principal amount (or, with respect to the Notes, an equivalent amount in dollars based on the Federal Reserve Bank of New York noon buying rate of euro on the second business day preceding such offer) equal to the Excess Proceeds (such purchase to be made on a pro rata basis if the amount available for such repurchase is less than the principal amount of the Notes and other such Senior Indebtedness tendered in such Net Proceeds Offer) at a purchase price of 100% of the principal amount thereof plus accrued interest to the date of repurchase. Upon the completion of the Net Proceeds Offer, the amount of Excess Proceeds will be reset to zero.

Within 15 days after the Company becomes obligated to make a Net Proceeds Offer (a Net Proceeds Offer Triggering Event), the Company will mail or cause to be mailed to all Holders on the date of the Net Proceeds Offer Triggering Event a notice (the Offer Notice) of the occurrence of such Net Proceeds Offer Triggering Event and of the Holders' rights arising as a result thereof. The Offer Notice shall state, among other things:

- (1) that the offer is being made pursuant to this covenant;
- (2) that any Note not tendered will continue to accrue interest;
- (3) that any Note accepted for payment pursuant to the offer shall cease to accrue interest on the payment date; and
- (4) the instructions, consistent with this covenant, that a Holder must follow in order to have such Holder's Notes purchased.

The Net Proceeds Offer will be deemed to have commenced upon mailing of the Offer Notice and will terminate 20 business days after its commencement, unless a longer offering period is required by law. Promptly after the termination of the offer, the Company will purchase and mail or deliver payment for all Notes tendered in response to the offer.

On the payment date, the Company will, to the extent lawful, (a) accept for payment Notes or portions thereof tendered pursuant to the Net Proceeds Offer, (b) deposit with a paying agent an amount equal to the payment in respect of all Notes or portions thereof so tendered and (c) deliver to the Trustee the Notes so accepted together with an officers certificate stating the Notes or portions thereof tendered to the Company. The paying agent will promptly mail or deliver to each Holder of Notes so accepted

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payment in an amount equal to the purchase price for such Notes, and the Trustee will promptly authenticate and mail or deliver to each Holder a new Note equal in principal amount to any unpurchased portion of the Notes surrendered, if any, *provided* that each such new Note will be in a principal amount of 50,000 or in any integral multiple of 1,000 in excess thereof.

The Company will comply with Section 14 of the Exchange Act and the provisions of Regulation 14E and any other tender offer rules under the Exchange Act and any other U.S. federal and state securities laws, rules and regulations and any laws of other jurisdictions which may then be applicable to any Net Proceeds Offer.

During the period between any Sale/Leaseback Transaction and the application of the Net Available Proceeds therefrom in accordance with this covenant, all Net Available Proceeds shall be maintained in a segregated account and shall be invested in Permitted Financial Investments.

Limitations on Mergers and Consolidations. The Company will not consolidate or merge with or into any Person, or sell, convey, lease or otherwise dispose of all or substantially all of its assets to any Person, unless:

- (1) the Person formed by or surviving such consolidation or merger (if other than the Company), or to which such sale, lease, conveyance or other disposition shall be made (collectively, the Successor), is a corporation, limited liability company or limited partnership organized and existing under the laws of the United States or any state thereof or the District of Columbia, or Canada or any province thereof, and the Successor assumes by supplemental indenture all of the obligations of the Company under the Indenture and under the Notes; *provided*, that unless the Successor is a corporation, a corporate co-issuer of the Notes will be added to the Indenture by such supplemental indenture; and
- (2) immediately before and after giving effect to such transaction, no Default or Event of Default exists.

SEC Reports. Notwithstanding that the Company may not be required to remain subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act, the Company will file with the SEC and provide the Holders with annual reports and such information, documents and other reports specified in Sections 13 and 15(d) of the Exchange Act.

Certain Definitions

The following is a summary of certain defined terms used in the Indenture. Reference is made to the Indenture for the full definition of all such terms and for the definitions of capitalized terms used in this prospectus and not defined below.

Adjusted Consolidated Net Tangible Assets or *ACNTA* means, without duplication, as of the date of determination, (a) the sum of

- (1) discounted future net revenue from proved oil and gas reserves of the Company and its Subsidiaries calculated in accordance with SEC guidelines before any U.S. state or federal income taxes, as estimated by petroleum engineers (which may include the Company's internal engineers) in a reserve report prepared as of the end of the Company's most recently completed

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fiscal year, as increased by, as of the date of determination, the discounted future net revenue of (A) estimated proved oil and gas reserves of the Company and its Subsidiaries attributable to any acquisition consummated since the date of such year-end reserve report and (B) estimated proved oil and gas reserves of the Company and its Subsidiaries attributable to extensions, discoveries and other additions and upward revisions of estimates of proved oil and gas reserves due to exploration, development or exploitation, production or other activities conducted or otherwise occurring since the date of such year-end

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reserve report which, in the case of sub-clauses (A) and (B), would, in accordance with standard industry practice, result in such increases as calculated in accordance with SEC guidelines (utilizing the prices utilized in such year-end reserve report), and decreased by, as of the date of determination, the discounted future net revenue of (C) estimated proved oil and gas reserves of the Company and its Subsidiaries produced or disposed of since the date of such year-end reserve report and (D) reductions in the estimated oil and gas reserves of the Company and its Subsidiaries since the date of such year-end reserve report attributable to downward revisions of estimates of proved oil and gas reserves due to exploration, development or exploitation, production or other activities conducted or otherwise occurring since the date of such year-end reserve report which, in the case of sub-clauses (C) and (D) would, in accordance with standard industry practice, result in such decreases as calculated in accordance with SEC guidelines (utilizing the prices utilized in such year-end reserve report); *provided* that, in the case of each of the determinations made pursuant to clauses (A) through (D), such increases and decreases shall be as estimated by the Company's engineers,

- (2) the capitalized costs that are attributable to oil and gas properties of the Company and its Subsidiaries to which no proved oil and gas reserves are attributable, based on the Company's books and records as of a date no earlier than the date of the Company's latest annual or quarterly financial statements,
- (3) the Net Working Capital on a date no earlier than the date of the Company's latest annual or quarterly financial statements and
- (4) the greater of (A) the net book value on a date no earlier than the date of the Company's latest annual or quarterly financial statements and (B) the appraised value, as estimated by independent appraisers, of other tangible assets (including Investments in unconsolidated Subsidiaries) of the Company and its Subsidiaries, as of a date no earlier than the date of the Company's latest audited financial statements,

minus (b) the sum of

- (1) minority interests,
- (2) any gas balancing liabilities of the Company and its Subsidiaries reflected as a long-term liability in the Company's latest annual or quarterly financial statements,
- (3) the discounted future net revenue, calculated in accordance with SEC guidelines (utilizing the prices utilized in the Company's year-end reserve report), attributable to reserves which are required to be delivered to third parties to fully satisfy the obligations of the Company and its Subsidiaries with respect to Volumetric Production Payments on the schedules specified with respect thereto,
- (4) the discounted future net revenue, calculated in accordance with SEC guidelines, attributable to reserves subject to Dollar-Denominated Production Payments which, based on the estimates of production included in determining the discounted future net revenue specified in (a)(1) above (utilizing the same prices utilized in the Company's year-end reserve report), would be necessary to fully satisfy the payment obligations of the Company and its Subsidiaries with respect to Dollar-Denominated Production Payments on the schedules specified with respect thereto and
- (5) the discounted future net revenue, calculated in accordance with SEC guidelines (utilizing the same prices utilized in the Company's year-end reserve report), attributable to reserves subject to participation interests, overriding royalty interests or other interests of third parties, pursuant to participation, partnership, vendor financing or other agreements then in effect, or which otherwise are required to be delivered to third parties.

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If the Company changes its method of accounting from the full cost method to the successful efforts method or a similar method of accounting, ACNTA will continue to be calculated as if the Company were still using the full cost method of accounting.

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Affiliate of any specified Person means any other Person directly or indirectly controlling or controlled by or under direct or indirect common control with such specified Person. For the purposes of this definition, *control* when used with respect to any specified Person means the power to direct the management and policies of such Person directly or indirectly, whether through the ownership of voting stock, by contract or otherwise; and the terms *controlling* and *controlled* have meanings correlative to the foregoing.

Attributable Indebtedness means, with respect to any particular lease under which any Person is at the time liable and at any date as of which the amount thereof is to be determined, the present value of the total net amount of rent required to be paid by such Person under the lease during the primary term thereof, without giving effect to any renewals at the option of the lessee, discounted from the respective due dates thereof to such date at the rate of interest per annum implicit in the terms of the lease. As used in the preceding sentence, the *net amount of rent* under any lease for any such period shall mean the sum of rental and other payments required to be paid with respect to such period by the lessee thereunder excluding any amounts required to be paid by such lessee on account of maintenance and repairs, insurance, taxes, assessments, water rates or similar charges. In the case of any lease which is terminable by the lessee upon payment of a penalty, such net amount of rent shall also include the amount of such penalty, but no rent shall be considered as required to be paid under such lease subsequent to the first date upon which it may be so terminated.

Average Life means, as of the date of determination, with respect to any Indebtedness, the quotient obtained by dividing (a) the product of (x) the number of years from such date to the date of each successive scheduled principal payment of such Indebtedness multiplied by (y) the amount of such principal payment by (b) the sum of all such principal payments.

Capital Stock means, with respect to any Person, any and all shares, interests, participations or other equivalents (however designated) of corporate stock or partnership or limited liability company interests and any and all warrants, options and rights with respect thereto (whether or not currently exercisable), including each class of common stock and preferred stock of such Person.

Capitalized Lease Obligations of any Person means the obligations of such Person to pay rent or other amounts under a lease of property, real or personal, that is required to be capitalized for financial reporting purposes in accordance with GAAP, and the amount of such obligations shall be the capitalized amount thereof determined in accordance with GAAP.

Change of Control means the occurrence of any of the following:

- (1) the sale, lease or transfer, in one or a series of related transactions, of all or substantially all of the Company's assets to any Person or group (as such term is used in Section 13(d)(3) of the Exchange Act), other than to Permitted Holders;
- (2) the adoption of a plan relating to the liquidation or dissolution of the Company;
- (3) the acquisition, directly or indirectly, by any Person or group (as such term is used in Section 13(d)(3) of the Exchange Act), other than Permitted Holders, of beneficial ownership (as defined in Rule 13d-3 under the Exchange Act, except that such Person shall be deemed to have beneficial ownership of all shares that any such Person has the right to acquire, whether such right is exercisable immediately or only after passage of time) of more than 50% of the aggregate voting power of the Voting Stock of the Company; provided, however, that the Permitted Holders beneficially own (as defined in Rules 13d-3 and 13d-5 under the Exchange Act), directly or indirectly, in the aggregate a lesser percentage of the total voting power of the

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Voting Stock of the Company than such other Person and do not have the right or ability by voting power, contract or otherwise to elect or designate for election a majority of the Board of Directors of the Company (for

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the purposes of this definition, such other Person shall be deemed to beneficially own any Voting Stock of a specified corporation held by a parent corporation, if such other Person is the beneficial owner (as defined above), directly or indirectly, of more than 35% of the voting power of the Voting Stock of such parent corporation and the Permitted Holders beneficially own (as defined in this proviso), directly or indirectly, in the aggregate a lesser percentage of the voting power of the Voting Stock of such parent corporation and do not have the right or ability by voting power, contract or otherwise to elect or designate for election a majority of the Board of Directors of such parent corporation); or

- (4) during any period of two consecutive years, individuals who at the beginning of such period constituted the Board of Directors of the Company (together with any new directors whose election by such Board of Directors or whose nomination for election by the shareholders of the Company was approved by a vote of 66 ²/₃% of the directors of the Company then still in office who were either directors at the beginning of such period or whose election or nomination for election was previously so approved) cease for any reason to constitute a majority of the Board of Directors of the Company then in office.

Credit Facilities means, one or more debt facilities (including, without limitation, the Company's existing credit facility) or commercial paper facilities, in each case with banks, investment banks, insurance companies, mutual funds and/or other institutional lenders providing for revolving credit loans, term loans, receivables financing (including through the sale of receivables to such lenders or to special purpose entities formed to borrow from (or sell receivables to) such lenders against such receivables) or letters of credit, in each case, as amended, extended, restated, renewed, refunded, replaced or refinanced (in each case with Credit Facilities), supplemented or otherwise modified (in whole or in part and without limitation as to amount, terms, conditions, covenants and other provisions) from time to time.

Currency Hedge Obligations means, at any time as to the Company and its Subsidiaries, the obligations of any such Person at such time that were incurred in the ordinary course of business pursuant to any non-dollar currency exchange agreement, option or futures contract or other similar agreement or arrangement designed to protect against or manage such Person's or any of its Subsidiaries' exposure to fluctuations in non-dollar currency exchange rates.

Default means any event which is, or after notice of passage of time would be, an Event of Default.

De Minimis Guaranteed Amount means a principal amount of Indebtedness that does not exceed \$5 million.

Disqualified Stock means any Capital Stock of the Company or any Subsidiary of the Company which, by its terms (or by the terms of any security into which it is convertible or for which it is exchangeable), or upon the happening of any event or with the passage of time, matures or is mandatorily redeemable, pursuant to a sinking fund obligation or otherwise, or is redeemable at the option of the holder thereof, in whole or in part, on or prior to the Maturity Date or which is exchangeable or convertible into debt securities of the Company or any Subsidiary of the Company, except to the extent that such exchange or conversion rights cannot be exercised prior to the Maturity Date.

Dollar-Denominated Production Payments mean production payment obligations recorded as liabilities in accordance with GAAP, together with all undertakings and obligations in connection therewith.

European Government Obligations means (1) securities that are direct obligations of the Federal Republic of Germany for the payment of which its full faith and credit is pledged or (2) obligations of a person controlled or supervised by and acting as an

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agency or instrumentality of the Federal Republic of Germany, the payment of which is unconditionally guaranteed as a full faith and credit obligation by the Federal Republic of Germany, which, in either case under clauses (1) or (2) are not callable or redeemable at the option of the issuer thereof.

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Exchange Act means the Securities Exchange Act of 1934, as amended, and the rules and regulations of the SEC thereunder.

Existing Notes means the Company's outstanding (a) 7.5% Senior Notes due 2013, (b) 7.625% Senior Notes due 2013, (c) 7.5% Senior Notes due 2014, (d) 7% Senior Notes due 2014, (e) 7.75% Senior Notes due 2015, (f) 6.375% Senior Notes due 2015, (g) 6.875% Senior Notes due 2016, (h) 6.625% Senior Notes due 2016, (i) 6.5% Senior Notes due 2017, (j) 6.25% Senior Notes due 2018, (k) 6.875% Senior Notes due 2020 and (l) 2.75% Contingent Convertible Senior Notes due 2035.

GAAP means generally accepted accounting principles as in effect in the United States of America as of the Issue Date.

Guarantee means, individually and collectively, the guarantees given by the Subsidiary Guarantors pursuant to Article Ten of the Indenture.

Holder means a Person in whose name a Note is registered on the registrar's books, which will initially be the nominee for the common depository of Euroclear or Clearstream, as applicable.

Indebtedness means, without duplication, with respect to any Person,

(a) all obligations of such Person

(1) in respect of borrowed money (whether or not the recourse of the lender is to the whole of the assets of such Person or only to a portion thereof),

(2) evidenced by bonds, notes, debentures or similar instruments,

(3) representing the balance deferred and unpaid of the purchase price of any property or services (other than accounts payable or other obligations arising in the ordinary course of business),

(4) evidenced by bankers' acceptances or similar instruments issued or accepted by banks,

(5) for the payment of money relating to a Capitalized Lease Obligation, or

(6) evidenced by a letter of credit or a reimbursement obligation of such Person with respect to any letter of credit;

(b) all net obligations of such Person under Interest Rate Hedging Agreements, Oil and Gas Hedging Contracts, and Currency Hedge Obligations, except to the extent such net obligations are taken into account in the determination of future net revenues from

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proved oil and gas reserves for purposes of the calculation of Adjusted Consolidated Net Tangible Assets;

(c) all liabilities of others of the kind described in the preceding clauses (a) or (b) that such Person has guaranteed or that are otherwise its legal liability (including, with respect to any Production Payment, any warranties or guaranties of production or payment by such Person with respect to such Production Payment but excluding other contractual obligations of such Person with respect to such Production Payment);

(d) Indebtedness (as otherwise defined in this definition) of another Person secured by a Lien on any asset of such Person, whether or not such Indebtedness is assumed by such Person, the amount of such obligations being deemed to be the lesser of

(1) the full amount of such obligations so secured and

(2) the fair market value of such asset, as determined in good faith by the Board of Directors of such Person, which determination shall be evidenced by a resolution of such Board;

(e) with respect to such Person, the liquidation preference or any mandatory redemption payment obligations in respect of Disqualified Stock;

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(f) the aggregate preference in respect of amounts payable on the issued and outstanding shares of preferred stock of any of such Person's Subsidiaries in the event of any voluntary or involuntary liquidation, dissolution or winding up (excluding any such preference attributable to such shares of preferred stock that are owned by such Person or any of its Subsidiaries; *provided*, that if such Person is the Company, such exclusion shall be for such preference attributable to such shares of preferred stock that are owned by the Company or any of its Subsidiaries); and

(g) any and all deferrals, renewals, extensions, refinancings and refundings (whether direct or indirect) of, or amendments, modifications or supplements to, any liability of the kind described in any of the preceding clauses (a), (b), (c), (d), (e) or (f) or this clause (g), whether or not between or among the same parties.

Subject to clause (c) of the preceding sentence, neither Dollar-Denominated Production Payments nor Volumetric Production Payments shall be deemed to be Indebtedness.

Interest Rate Hedging Agreements means, with respect to the Company and its Subsidiaries, the obligations of such Persons under (a) interest rate swap agreements, interest rate cap agreements and interest rate collar agreements and (b) other agreements or arrangements designed to protect any such Person or any of its Subsidiaries against fluctuations in interest rates.

Investment of any Person means (a) all investments by such Person in any other Person in the form of loans, advances or capital contributions, (b) all guarantees of Indebtedness or other obligations of any other Person by such Person, (c) all purchases (or other acquisitions for consideration) by such Person of assets, Indebtedness, Capital Stock or other securities of any other Person and (d) all other items that would be classified as investments (including, without limitation, purchases of assets outside the ordinary course of business) or advances on a balance sheet of such Person prepared in accordance with GAAP.

Issue Date means the first date on which the Notes are originally issued, , 2006.

Lien means, with respect to any Person, any mortgage, pledge, lien, encumbrance, easement, restriction, covenant, right-of-way, charge or adverse claim affecting title or resulting in an encumbrance against real or personal property of such Person, or a security interest of any kind (including any conditional sale or other title retention agreement, any lease in the nature thereof, any option, right of first refusal or other similar agreement to sell, in each case securing obligations of such Person and any filing of or agreement to give any financing statement under the Uniform Commercial Code (or equivalent statute or statutes) of any jurisdiction).

Make-Whole Amount with respect to a Note means an amount equal to the excess, if any, of (a) the present value of the remaining interest, premium and principal payments due on such Note (excluding any portion of such payments of interest accrued as of the redemption date) as if such Note were redeemed on the Maturity Date, computed using a discount rate equal to the Bund Rate plus 50 basis points, over (b) the outstanding principal amount of such Note. *Bund Rate* with respect to a Note means the yield to maturity (calculated on a semi-annual bond equivalent basis) at the time of the computation of direct obligations of the Federal Republic of Germany (*Bunds* or *Bundesanleihe*) with a constant maturity (as compiled by and published in the most recent financial statistics that have become publicly available at least two business days prior to the date of the redemption notice or, if such financial statistics are no longer published, any publicly available source of similar market data) most nearly equal to the then remaining maturity of such Note assuming that such Note will be redeemed on the Maturity Date; *provided, however*, that if the Make-Whole Average Life of a Note is not equal to the constant maturity of a direct obligation of the Federal Republic of Germany

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for which a weekly average yield is given, the Bund Rate shall be obtained by linear interpolation (calculated to the nearest one-twelfth of a year) from the weekly average yields of direct obligations of the Federal Republic of Germany for which

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such yields are given, except that if the Make-Whole Average Life of such Note is less than one year, the weekly average yield on actually traded direct obligations of the Federal Republic of Germany adjusted to a constant maturity of one year shall be used.

Make-Whole Average Life means, with respect to a Note, the number of years (calculated to the nearest one-twelfth of a year) between the date of redemption of such Note and the Maturity Date.

Make-Whole Price means the sum of the outstanding principal amount of the Notes to be redeemed plus the Make-Whole Amount of such Notes.

Maturity Date means January 15, 2017.

Moody's means Moody's Investors Service, Inc. or any successor to the rating agency business thereof.

Net Available Proceeds means, with respect to any Sale/Leaseback Transaction of any Person, cash proceeds received (including any cash proceeds received by way of deferred payment of principal pursuant to a note or installment receivable or otherwise, but only as and when received, and excluding any other consideration until such time as such consideration is converted into cash) therefrom, in each case net of all legal, title and recording tax expenses, commissions and other fees and expenses incurred, and all U.S. federal, state or local taxes or taxes in other jurisdictions required to be accrued as a liability as a consequence of such Sale/Leaseback Transaction, and in each case net of all Indebtedness which is secured by such assets, in accordance with the terms of any Lien upon or with respect to such assets, or which must, by its terms or in order to obtain a necessary consent to such Sale/Leaseback Transaction or by applicable law, be repaid out of the proceeds from such Sale/Leaseback Transaction and which is actually so repaid.

Net Working Capital means (a) all current assets of the Company and its Subsidiaries, minus (b) all current liabilities of the Company and its Subsidiaries, except current liabilities included in Indebtedness.

Oil and Gas Business means the business of the exploration for, and exploitation, development, production, processing (but not refining), marketing, storage and transportation of, hydrocarbons, and other related energy and natural resource businesses (including oil and gas services businesses related to the foregoing).

Oil and Gas Hedging Contracts means any oil and gas purchase or hedging agreement, and other agreement or arrangement, in each case, that is designed to provide protection against price fluctuations of oil, gas or other commodities.

Permitted Company Refinancing Indebtedness means Indebtedness of the Company, the net proceeds of which are used to renew, extend, refinance, refund or repurchase outstanding Indebtedness of the Company, *provided that*

- (1) if the Indebtedness (including the Notes) being renewed, extended, refinanced, refunded or repurchased is *pari passu* with or subordinated in right of payment to the Notes, then such Indebtedness is *pari passu* or subordinated in right of payment to, as

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the case may be, the Notes at least to the same extent as the Indebtedness being renewed, extended, refinanced, refunded or repurchased,

- (2) such Indebtedness is scheduled to mature no earlier than the Indebtedness being renewed, extended, refinanced, refunded or repurchased, and
- (3) such Indebtedness has an Average Life at the time such Indebtedness is incurred that is equal to or greater than the Average Life of the Indebtedness being renewed, extended, refinanced, refunded or repurchased;

provided, further, that such Indebtedness (to the extent that such Indebtedness constitutes Permitted Company Refinancing Indebtedness) is in an aggregate principal amount (or, if such Indebtedness is

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issued at a price less than the principal amount thereof, the aggregate amount of gross proceeds therefrom is) not in excess of the aggregate principal amount then outstanding of the Indebtedness being renewed, extended, refinanced, refunded or repurchased (or if the Indebtedness being renewed, extended, refinanced, refunded or repurchased was issued at a price less than the principal amount thereof, then not in excess of the amount of liability in respect thereof determined in accordance with GAAP).

Permitted Financial Investments means the following kinds of instruments if, in the case of instruments referred to in clauses (1)-(4) below, on the date of purchase or other acquisition of any such instrument by the Company or any Subsidiary, the remaining term to maturity is not more than one year:

- (1) readily marketable obligations issued or unconditionally guaranteed as to principal of and interest thereon by the United States of America or by any agency or authority controlled or supervised by and acting as an instrumentality of the United States of America;
- (2) repurchase obligations for instruments of the type described in clause (1) for which delivery of the instrument is made against payment;
- (3) obligations (including, but not limited to, demand or time deposits, bankers' acceptances and certificates of deposit) issued by a depository institution or trust company incorporated or doing business under the laws of the United States of America, any state thereof or the District of Columbia or a branch or subsidiary of any such depository institution or trust company operating outside the United States, *provided*, that such depository institution or trust company has, at the time of the Company's or such Subsidiary's investment therein or contractual commitment providing for such investment, capital surplus or undivided profits (as of the date of such institution's most recently published financial statements) in excess of \$500,000,000;
- (4) commercial paper issued by any corporation, if such commercial paper has, at the time of the Company's or any Subsidiary's investment therein or contractual commitment providing for such investment, credit ratings of A-1 (or higher) by S&P and P-1 (or higher) by Moody's; and
- (5) money market mutual or similar funds having assets in excess of \$500,000,000.

Permitted Holders means Aubrey K. McClendon and his Affiliates.

Permitted Liens means

- (1) Liens existing on the Issue Date;
- (2) Liens securing Indebtedness under Credit Facilities;
- (3) Liens now or hereafter securing any obligations under Interest Rate Hedging Agreements so long as the related Indebtedness
 - (a) constitutes the Existing Notes or the Notes (or any Permitted Company Refinancing Indebtedness in respect thereof) or
 - (b) is, or is permitted to be under the Indenture, secured by a Lien on the same property securing such interest rate hedging

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obligations;

- (4) Liens securing Permitted Company Refinancing Indebtedness or Permitted Subsidiary Refinancing Indebtedness; *provided*, that such Liens extend to or cover only the property or assets currently securing the Indebtedness being refinanced and that the Indebtedness being refinanced was not incurred under the Credit Facilities;
- (5) Liens for taxes, assessments and governmental charges not yet delinquent or being contested in good faith and for which adequate reserves have been established to the extent required by GAAP;
- (6) mechanics , worker s, materialmen s, operators or similar Liens arising in the ordinary course of business;
- (7) Liens in connection with worker s compensation, unemployment insurance or other social security, old age pension or public liability obligations;

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- (8) Liens, deposits or pledges to secure the performance of bids, tenders, contracts (other than contracts for the payment of money), leases, public or statutory obligations, surety, stay, appeal, indemnity, performance or other similar bonds, or other similar obligations arising in the ordinary course of business;
- (9) survey exceptions, encumbrances, easements or reservations of, or rights of others for, rights of way, zoning or other restrictions as to the use of real properties, and minor defects in title which, in the case of any of the foregoing, were not incurred or created to secure the payment of borrowed money or the deferred purchase price of property or services, and in the aggregate do not materially adversely affect the value of such properties or materially impair use for the purposes of which such properties are held by the Company or any Subsidiaries;
- (10) Liens on, or related to, properties to secure all or part of the costs incurred in the ordinary course of business of exploration, drilling, development or operation thereof;
- (11) Liens on pipeline or pipeline facilities which arise out of operation of law;
- (12) judgment and attachment Liens not giving rise to an Event of Default or Liens created by or existing from any litigation or legal proceeding that are currently being contested in good faith by appropriate proceedings and for which adequate reserves have been made;
- (13) (a) Liens upon any property of any Person existing at the time of acquisition thereof by the Company or a Subsidiary, (b) Liens upon any property of a Person existing at the time such Person is merged or consolidated with the Company or any Subsidiary or existing at the time of the sale or transfer of any such property of such Person to the Company or any Subsidiary, or (c) Liens upon any property of a Person existing at the time such Person becomes a Subsidiary; *provided*, that in each case such Lien has not been created in contemplation of such sale, merger, consolidation, transfer or acquisition, and *provided* that in each such case no such Lien shall extend to or cover any property of the Company or any Subsidiary other than the property being acquired and improvements thereon;
- (14) Liens on deposits to secure public or statutory obligations or in lieu of surety or appeal bonds entered into in the ordinary course of business;
- (15) Liens in favor of collecting or payor banks having a right of setoff, revocation, refund or chargeback with respect to money or instruments of the Company or any Subsidiary on deposit with or in possession of such bank;
- (16) purchase money security interests granted in connection with the acquisition of assets in the ordinary course of business and consistent with past practices, *provided*, that (A) such Liens attach only to the property so acquired with the purchase money indebtedness secured thereby and (B) such Liens secure only Indebtedness that is not in excess of 100% of the purchase price of such assets;
- (17) Liens reserved in oil and gas mineral leases for bonus or rental payments and for compliance with the terms of such leases;
- (18) Liens arising under partnership agreements, oil and gas leases, farm-out agreements, division orders, contracts for the sale, purchase, exchange, transportation or processing (but not refining) of oil, gas or other hydrocarbons, unitization and pooling declarations and agreements, development agreements, operating agreements, area of mutual interest agreements, and other similar agreements which are customary in the Oil and Gas Business;
- (19)

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Liens securing obligations of the Company or any of its Subsidiaries under Currency Hedge Obligations or Oil and Gas Hedging Contracts;

(20) Liens to secure Dollar-Denominated Production Payments and Volumetric Production Payments; and

(21) Liens securing other Indebtedness in an aggregate principal amount which, together with all other Indebtedness outstanding on the date of such incurrence and secured by Liens pursuant to this clause (21), does not exceed 15% of Adjusted Consolidated Tangible Net Assets.

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Permitted Subsidiary Refinancing Indebtedness means Indebtedness of any Subsidiary, the net proceeds of which are used to renew, extend, refinance, refund or repurchase outstanding Indebtedness of such Subsidiary, *provided* that

- (1) if the Indebtedness (including the Guarantees) being renewed, extended, refinanced, refunded or repurchased is *pari passu* with or subordinated in right of payment to the Guarantees, then such Indebtedness is *pari passu* with or subordinated in right of payment to, as the case may be, the Guarantees at least to the same extent as the Indebtedness being renewed, extended, refinanced, refunded or repurchased,
- (2) such Indebtedness is scheduled to mature no earlier than the Indebtedness being renewed, extended, refinanced, refunded or repurchased, and
- (3) such Indebtedness has an Average Life at the time such Indebtedness is incurred that is equal to or greater than the Average Life of the Indebtedness being renewed, extended, refinanced, refunded or repurchased;

provided, further, that such Indebtedness (to the extent that such Indebtedness constitutes Permitted Subsidiary Refinancing Indebtedness) is in an aggregate principal amount (or, if such Indebtedness is issued at a price less than the principal amount thereof, the aggregate amount of gross proceeds therefrom is) not in excess of the aggregate principal amount then outstanding of the Indebtedness being renewed, extended, refinanced, refunded or repurchased (or if the Indebtedness being renewed, extended, refinanced, refunded or repurchased was issued at a price less than the principal amount thereof, then not in excess of the amount of liability in respect thereof determined in accordance with GAAP).

Person means any individual, corporation, partnership, joint venture, trust, estate, unincorporated organization or government or any agency or political subdivision thereof.

Production Payments means, collectively, Dollar-Denominated Production Payments and Volumetric Production Payments.

S&P refers to Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc., or any successor to the rating agency business thereof.

Sale/Leaseback Transaction means with respect to the Company or any of its Subsidiaries, any arrangement with any Person providing for the leasing by the Company or any of its Subsidiaries of any principal property, acquired or placed into service more than 180 days prior to such arrangement, whereby such property has been or is to be sold or transferred by the Company or any of its Subsidiaries to such Person.

Senior Indebtedness means any Indebtedness of the Company or a Subsidiary Guarantor (whether outstanding on the Issue Date or thereafter incurred), unless such Indebtedness is contractually subordinate or junior in right of payment of principal, premium and interest to the Notes or the Guarantees, respectively.

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Subordinated Indebtedness of a Subsidiary Guarantor means any Indebtedness of such Subsidiary Guarantor, whether outstanding on the Issue Date or thereafter created, incurred or assumed, which is contractually subordinate or junior in right of payment of principal, premium and interest to the Guarantees.

Subordinated Indebtedness of the Company means any Indebtedness of the Company, whether outstanding on the Issue Date or thereafter incurred, which is contractually subordinate or junior in right of payment of principal, premium and interest to the Notes.

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Subsidiary means any subsidiary of the Company. A subsidiary of any Person means

- (1) a corporation a majority of whose Voting Stock is at the time, directly or indirectly, owned by such Person, by one or more subsidiaries of such Person or by such Person and one or more subsidiaries of such Person,
- (2) a partnership in which such Person or a subsidiary of such Person is, at the date of determination, a general or limited partner of such partnership, but only if such Person or its subsidiary is entitled to receive more than 50 percent of the assets of such partnership upon its dissolution, or
- (3) any other Person (other than a corporation or partnership) in which such Person, directly or indirectly, at the date of determination thereof, has (x) at least a majority ownership interest or (y) the power to elect or direct the election of a majority of the directors or other governing body of such Person.

Subsidiary Guarantor means (a) each of the United States Subsidiaries on the Issue Date, other than Subsidiaries that are not guarantors of other Indebtedness of the Company in excess of a De Minimis Guaranteed Amount, (b) Chesapeake Eagle Canada Corp., a Canadian Subsidiary, and (c) each of the other Subsidiaries that becomes a guarantor of the Notes in compliance with the terms of the Indenture.

Volumetric Production Payments mean production payment obligations recorded as deferred revenue in accordance with GAAP, together with all undertakings and obligations in connection therewith.

Voting Stock means, with respect to any Person, securities of any class or classes of Capital Stock in such Person *entitling* the holders thereof (whether at all times or only so long as no senior class of stock has voting power by reason of contingency) to vote in the election of members of the Board of Directors or other governing body of such Person.

Events of Default

The following will be Events of Default with respect to the Notes:

- (1) default by the Company or any Subsidiary Guarantor in the payment of principal of or premium, if any, on the Notes when due and payable at maturity, upon repurchase pursuant to the provisions described under *Change of Control* or pursuant to the covenant described under *Limitation on Sale/Leaseback Transactions*, upon acceleration or otherwise;
- (2) default by the Company or any Subsidiary Guarantor for 30 days in payment of any interest on the Notes;
- (3) default by the Company or any Subsidiary Guarantor in the deposit of any make-whole redemption payment;
- (4) default on any other Indebtedness of the Company, any Subsidiary Guarantor or any other Subsidiary if either

- (A) such default results in the acceleration of the maturity of any such Indebtedness having a principal amount of \$50.0 million or more individually or, taken together with the principal amount of any other such Indebtedness the maturity of which has been so accelerated, in the aggregate, or
- (B) such default results from the failure to pay when due principal of, premium, if any, or interest on, any such Indebtedness, after giving effect to any applicable grace period (a Payment Default), having a principal amount of \$50.0 million or more individually or, taken together with the principal amount of any other Indebtedness under which there has been a Payment Default, in the aggregate;

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provided that if any such default is cured or waived or any such acceleration is rescinded, or such Indebtedness is repaid, within a period of 30 days from the continuation of such default beyond any applicable grace period or the occurrence of such acceleration, as the case may be, such Event of Default and any consequent acceleration of the Notes shall be rescinded, so long as any such rescission does not conflict with any judgment or decree or applicable provision of law;

- (5) default in the performance, or breach of, the covenant set forth in the covenant captioned Limitations on Mergers and Consolidations, or in the performance, or breach of, any other covenant or agreement of the Company or any Subsidiary Guarantor in the Indenture and failure to remedy such default within a period of 45 days after written notice thereof from the Trustee or Holders of 25% of the principal amount of the outstanding Notes;
- (6) the entry by a court of one or more judgments or orders for the payment of money against the Company, any Subsidiary Guarantor or any other Subsidiary in an aggregate amount in excess of \$50.0 million (net of applicable insurance coverage by a third party insurer which is acknowledged in writing by such insurer) that has not been vacated, discharged, satisfied or stayed pending appeal within 60 days from the entry thereof;
- (7) the failure of a Guarantee by a Subsidiary Guarantor to be in full force and effect, or the denial or disaffirmance by such entity thereof; or
- (8) certain events involving bankruptcy, insolvency or reorganization of the Company or any Subsidiary of the Company.

The Indenture provides that the Trustee may withhold notice to the Holders of the Notes of any default (except in payment of principal of, or premium, if any, or interest on the Notes) if the Trustee considers it in the interest of the Holders of the Notes to do so.

If an Event of Default occurs and is continuing, the Trustee or the Holders of not less than 25% in principal amount of the Notes outstanding may declare the principal of and premium, if any, and accrued but unpaid interest on all the Notes to be due and payable. Upon such a declaration, such principal, premium, if any, and interest will be due and payable immediately. If an Event of Default relating to certain events of bankruptcy, insolvency or reorganization of the Company or any Subsidiary of the Company occurs and is continuing, the principal of, and premium, if any, and interest on all the Notes will become and be immediately due and payable without any declaration or other act on the part of the Trustee or any Holders of the Notes. The amount due and payable on the acceleration of any Note will be equal to 100% of the principal amount of the Note, plus accrued and unpaid interest to the date of payment. Under certain circumstances, the Holders of a majority in principal amount of the outstanding Notes may rescind any such acceleration with respect to the Notes and its consequences.

No Holder of a Note may pursue any remedy under the Indenture unless

- (1) the Trustee shall have received written notice of a continuing Event of Default,
- (2) the Trustee shall have received a request from Holders of at least 25% in principal amount of the Notes to pursue such remedy,
- (3) the Trustee shall have been offered indemnity reasonably satisfactory to it,

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- (4) the Trustee shall have failed to act for a period of 60 days after receipt of such notice, request and offer of indemnity and
- (5) no direction inconsistent with such written request has been given to the Trustee during such 60-day period by the Holders of a majority in principal amount of the Notes;

provided, however, such provision does not affect the right of a Holder of any Note to sue for enforcement of any overdue payment thereon.

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The Holders of a majority in principal amount of the Notes then outstanding will have the right to direct the time, method and place of conducting any proceeding for exercising any remedy available to the Trustee, subject to certain limitations specified in the Indenture. The Indenture requires the annual filing by the Company with the Trustee of a written statement as to compliance with the covenants contained in the Indenture.

Modification and Waiver

Supplements and amendments to the Indenture or the Notes may be made by the Company, the Subsidiary Guarantors and the Trustee with the consent of the Holders of a majority in principal amount of the Notes then outstanding; *provided* that no such modification or amendment may, without the consent of the Holder of each Note then outstanding affected thereby,

- (1) reduce the percentage of principal amount of Notes whose Holders must consent to an amendment or supplement;
- (2) reduce the rate or change the time for payment of interest, including default interest, on any Note;
- (3) reduce the principal amount of any Note or change the Maturity Date;
- (4) reduce the redemption price, including premium, if any, payable upon redemption of any Note or change the time at which any Note may or shall be redeemed;
- (5) reduce the purchase price payable upon the repurchase of any Note in connection with a Change of Control Offer or a Net Proceeds Offer, or change the time at which any Note may or shall be repurchased thereunder;
- (6) make any Note payable in money other than that stated in such Note;
- (7) impair the right to institute suit for the enforcement of any payment of principal of, or premium, if any, or interest on, any Note;
- (8) make any change in the percentage of principal amount of Notes necessary to waive compliance with certain provisions of the Indenture; or
- (9) waive a continuing Default or Event of Default in the payment of principal of, premium, if any, or interest on the Notes.

Supplements and amendments of the Indenture may be made by the Company, the Subsidiary Guarantors and the Trustee without the consent of any Holders of the Notes in certain limited circumstances, including

- (1) to cure any ambiguity, omission, defect or inconsistency,
- (2)

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to provide for the assumption of the obligations of the Company or any Subsidiary Guarantor under the Indenture upon the merger, consolidation or sale or other disposition of all or substantially all of the assets of the Company or such Subsidiary Guarantor,

- (3) to reflect the release of any Subsidiary Guarantor from its Guarantee of the Notes, or the addition of any Subsidiary of the Company as a Subsidiary Guarantor, in the manner provided in the Indenture,
- (4) to comply with any requirement of the SEC in order to effect or maintain the qualification of the Indenture under the Trust Indenture Act or
- (5) to make any change that would provide any additional benefit to the Holders or that does not adversely affect the rights of any Holder of the Notes in any material respect.

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The Holders of a majority in aggregate principal amount of the Notes then outstanding may waive any past default under the Indenture, except a default in the payment of principal, premium, if any, or interest.

Legal Defeasance and Covenant Defeasance

The Company may, at its option and at any time, elect to have its obligations discharged with respect to the outstanding Notes (Legal Defeasance). Such Legal Defeasance means that the Company will be deemed to have paid and discharged the entire Indebtedness represented by such Notes, except for

- (1) the rights of Holders of the Notes to receive payments solely from the trust fund described in the following paragraph in respect of the principal of, premium, if any, and interest on the Notes when such payments are due,
- (2) the Company's obligations with respect to the Notes concerning the issuance of temporary Notes, transfers and exchanges of the Notes, replacement of mutilated, destroyed, lost or wrongfully taken Notes, the maintenance of an office or agency where the Notes may be surrendered for transfer or exchange or presented for payment, and duties of paying agents,
- (3) the rights, powers, trusts, duties and immunities of the Trustee, and the Company's obligations in connection therewith and
- (4) the Legal Defeasance provisions of the Indenture.

In addition, the Company may, at its option and at any time, elect to have the obligations of the Company released with respect to certain covenants described under Certain Covenants (Covenant Defeasance), and thereafter any omission to comply with such obligations shall not constitute a Default or Event of Default. In the event Covenant Defeasance occurs, certain events (not including non-payment) described under Events of Default will no longer constitute an Event of Default. If we exercise our Legal Defeasance or Covenant Defeasance option, each Subsidiary Guarantor will be released from all its obligations under the Indenture and its Guarantee.

In order to exercise either Legal Defeasance or Covenant Defeasance under the Indenture,

- (1) the Company must irrevocably deposit with the Trustee, in trust, for the benefit of the Holders of the Notes, cash in euro, European Government Obligations, or a combination thereof, in such amounts as will be sufficient, in the opinion of a nationally recognized firm of independent public accountants, to pay the principal of, premium, if any, and interest on the outstanding amount of the Notes on the Maturity Date or on the applicable redemption date, as the case may be, of such principal or installment of principal, premium, if any, or interest;
- (2) in the case of Legal Defeasance, the Company must deliver to the Trustee an opinion of counsel confirming that
 - (a) the Company has received from or there has been published by, the Internal Revenue Service a ruling or

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- (b) since the date of the Indenture, there has been a change in the applicable U.S. Federal income tax law, in either case to the effect that, and based thereon such opinion of counsel shall confirm that, the Holders of the Notes will not recognize income, gain or loss for U.S. Federal income tax purposes as a result of such Legal Defeasance and will be subject to U.S. Federal income tax on the same amounts, in the same manner and at the same times as would have been the case if such Legal Defeasance had not occurred;
- (3) in the case of Covenant Defeasance, the Company shall have delivered to the Trustee an opinion of counsel to the effect that the Holders of the Notes will not recognize income, gain or loss for U.S.

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Federal income tax purposes as a result of such Covenant Defeasance and will be subject to U.S. Federal income tax on the same amounts, in the same manner and at the same times as would have been the case if such Covenant Defeasance had not occurred;

- (4) no Default or Event of Default shall have occurred and be continuing on the date of such deposit or insofar as Events of Default from bankruptcy or insolvency events are concerned, at any time in the period ending on the 91st day after the date of deposit;
- (5) such Legal Defeasance or Covenant Defeasance shall not result in a breach or violation of, or constitute a default under the Indenture or any other material agreement or instrument to which the Company is a party or by which the Company is bound;
- (6) the Company shall have delivered to the Trustee an officers' certificate stating that the deposit was not made by the Company with the intent of preferring the Holders of the Notes over other creditors of the Company or with the intent of defeating, hindering, delaying or defrauding creditors of the Company or others; and
- (7) the Company shall have delivered to the Trustee an officers' certificate and an opinion of counsel each stating that the Company has complied with all conditions precedent provided for relating to the Legal Defeasance or the Covenant Defeasance.

Governing Law

The Indenture provides that it and the Notes will be governed by, and construed in accordance with, the laws of the State of New York.

The Trustee

The Bank of New York Trust Company, N.A. is the Trustee under the Indenture. The Bank of New York Trust Company, N.A. also serves as trustee for our 7.5% Senior Notes due 2013, our 7.625% Senior Notes due 2013, our 7% Senior Notes due 2014, our 7.5% Senior Notes due 2014, our 7.75% Senior Notes due 2015, our 6.375% Senior Notes due 2015, our 6.875% Senior Notes due 2016, our 6.625% Senior Notes due 2016, our 6.5% Senior Notes due 2017, our 6.25% Senior Notes due 2018, our 6.875% Senior Notes due 2020 and our 2.75% Contingent Convertible Senior Notes due 2035. We may also maintain banking and other commercial relationships with the Trustee and its affiliates in the ordinary course of business, and the Trustee may own our debt securities. The Trustee's address is 2 North LaSalle Street, Suite 1020, Chicago, Illinois 60602. The Company has also appointed the Trustee as the initial registrar and paying agent in the U.S. under the Indenture.

The Trustee is permitted to become an owner or pledgee of the Notes and may otherwise deal with the Company or its Subsidiaries or Affiliates with the same rights it would have if it were not Trustee. If, however, the Trustee acquires any conflicting interest (as defined in the Trust Indenture Act) after an Event of Default has occurred and is continuing, it must eliminate such conflict or resign.

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In case an Event of Default shall occur (and be continuing), the Trustee will be required to use the degree of care and skill of a prudent person in the conduct of such person's own affairs. The Trustee will be under no obligation to exercise any of its powers under the Indenture at the request of any of the Holders of the Notes, unless such Holders have offered the Trustee indemnity reasonably satisfactory to it.

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Book-Entry, Delivery and Form

General

Notes sold will be represented by one or more global notes in registered form without interest coupons attached (collectively, the Global Notes). The Notes will be issued in denominations of 50,000 and in any integral multiple of 1,000 in excess thereof. The Global Notes will be deposited with, or on behalf of, a common depositary for the accounts of Euroclear and Clearstream and registered in the name of the nominee of the common depositary.

Ownership of interests in the Global Notes (the Book-Entry Interests) will be limited to persons that have accounts with Euroclear and/or Clearstream, or persons that hold interests through such participants or otherwise in accordance with applicable transfer restrictions set out in the indenture governing the Notes and any applicable securities laws of any state of the United States or any other jurisdiction. Euroclear and Clearstream will hold interests in the Global Notes on behalf of their participants through customers' securities accounts in their respective names on the books of their respective depositaries. Except under the limited circumstances described below, owners of beneficial interests in the Global Notes will not be entitled to receive physical delivery of certificated Notes.

Book-Entry Interests will be shown on, and transfers thereof will be done only through, records maintained in book-entry form by Euroclear and Clearstream and their respective participants. The laws of some jurisdictions, including certain states of the United States, may require that certain purchasers of securities take physical delivery of such securities in definitive form. The foregoing limitations may impair your ability to own, transfer or pledge Book-Entry Interests. In addition, while the Notes are in global form, holders of Book-Entry Interests will not be considered the owners or Holders of Notes for any purpose.

So long as the Notes are held in global form, Euroclear and/or Clearstream (or their respective nominees), as applicable, will be considered the sole Holders of Global Notes for all purposes under the indenture. In addition, participants in Euroclear and/or Clearstream must rely on the procedures of Euroclear and/or Clearstream, as the case may be, and indirect participants must rely on the procedures of Euroclear, Clearstream and the participants through which they own Book-Entry Interests, to transfer their interests or to exercise any rights of Holders under the Indenture.

Neither we nor the Trustee under the Indenture and neither the registrar nor the transfer agent will have any responsibility or be liable for any aspect of the records relating to the Book-Entry Interests.

Redemption of the Global Notes

In the event any Global Note (or any portion thereof) is redeemed, Euroclear and/or Clearstream (or their respective nominees), as applicable, will redeem an equal amount of the Book-Entry Interests in such Global Note from the amount received by it in respect of the redemption of such Global Note. The redemption price payable in connection with the redemption of such Book-Entry Interests will be equal to the amount received by Euroclear and Clearstream, as applicable, in connection with the redemption of such Global Note (or any portion thereof). We understand that, under existing practices of Euroclear and Clearstream, if fewer than all of the Notes are to be redeemed at any time, Euroclear and Clearstream will credit their respective participants' accounts on a

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proportionate basis (with adjustments to prevent fractions) or by lot or on such other basis as they deem fair and appropriate; provided, however, that no book-entry interest of 50,000 principal amount or less may be redeemed in part.

Payments on Global Notes

We will make payments of any amounts owing in respect of the Global Notes (including principal, premium and interest, if any) to the common depositary or its nominee, which will distribute such

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payments to participants in accordance with their procedures. We expect that standing customer instructions and customary practices will govern payments by participants to owners of Book-Entry Interests held through such participants.

Under the terms of the Indenture, we and the Trustee will treat the registered Holders of the Global Notes (e.g., Euroclear or Clearstream (or their respective nominees)) as the owners thereof for the purpose of receiving payments and for all other purposes. Consequently, neither we nor the Trustee nor any of our or its respective agents has or will have any responsibility or liability for:

any aspect of the records of Euroclear, Clearstream or any participant or indirect participant relating to payments made on account of a Book-Entry Interest or for maintaining, supervising or reviewing the records of Euroclear, Clearstream or any participant or indirect participant relating to or payments made on account of a Book-Entry Interest; or

Euroclear, Clearstream or any participant or indirect participant.

Payments by participants to owners of Book-Entry Interests held through participants are the responsibility of such participants.

Currency of Payment for the Global Notes

Except as may otherwise be agreed between Euroclear and/or Clearstream and any Holder, the principal of, premium, if any, and interest on, and all other amounts payable in respect of, the Global Notes will be paid to owners of Book-Entry Interests in such Notes (the Euroclear/Clearstream Holders) through Euroclear and/or Clearstream in euro.

Payments will be subject in all cases to any fiscal or other laws and regulations (including any regulations of the applicable clearing system) applicable thereto. Neither we nor the Trustee nor the underwriters nor any of our or their respective agents will be liable to any Holder of a Global Note or any other person for any commissions, costs, losses or expenses in relation to or resulting from any currency conversion or rounding effected in connection with any such payment.

Action by Owners of Book-Entry Interests

Euroclear and Clearstream have advised us that they will take any action permitted to be taken by a Holder of Notes (including the presentation of Notes for exchange as described below) only at the direction of one or more participants to whose account the Book-Entry Interests in the Global Notes are credited and only in respect of such portion of the aggregate principal amount of Notes as to which such participant or participants has or have given such direction. Euroclear and Clearstream will not exercise any discretion in the granting of consents, waivers or the taking of any other action in respect of the Global Notes. However, if there is an Event of Default, each of Euroclear and Clearstream reserves the right to exchange the relevant Global Notes for definitive registered Notes in certificated form (the Definitive Registered Notes), and to distribute Definitive Registered Notes to its participants.

Transfers

Transfers of beneficial interests in the Global Notes will be subject to the applicable rules and procedures of Euroclear and Clearstream and their respective direct or indirect participants, which rules and procedures may change from time to time.

Any Book-Entry Interest in one of the Global Notes that is transferred to a person who takes delivery in the form of a Book-Entry Interest in any other Global Note will, upon transfer, cease to be a Book-Entry Interest in the first-mentioned Global Note and become a Book-Entry Interest in such other Global Note, and accordingly will thereafter be subject to all transfer restrictions, if any, and other procedures applicable to Book-Entry Interests in such other Global Note for as long as it remains such a Book-Entry Interest.

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Definitive Registered Notes

Under the terms of the Indenture, owners of the Book-Entry Interests will receive Definitive Registered Notes:

if Euroclear or Clearstream notifies us that it is unwilling or unable to continue as depositary for the Global Note, and we fail to appoint a successor;

if Euroclear or Clearstream so requests following an event of default under the Indenture; or

if the owner of a Book-Entry Interest requests such exchange in writing delivered through either Euroclear or Clearstream, as applicable, following an event of default under the Indenture.

Euroclear has advised the issuer that upon request by an owner of a Book-Entry Interest, its current procedure is to request that the issuer issue or cause to be issued Definitive Registered Notes to all owners of Book-Entry Interests.

In such an event, the registrar will issue Definitive Registered Notes, registered in the name or names and issued in any approved denominations, requested by or on behalf of Euroclear and/or Clearstream, as applicable (in accordance with their respectively customary procedures and based upon directions received from participants reflecting the beneficial ownership of Book-Entry Interests).

In the case of the issuance of Definitive Registered Notes, the Holder of a Definitive Registered Note may transfer such Note by surrendering it to the transfer agent. In the event of a partial transfer or a partial redemption of a holding of Definitive Registered Notes represented by one Definitive Registered Note, a Definitive Registered Note will be issued to the transferee in respect of the part transferred, and a new Definitive Registered Note in respect of the balance of the holding not transferred or redeemed will be issued to the transferor or the Holder, as applicable; provided that Definitive Registered Notes will be issued in denominations of 50,000 and in any integral multiple of 1,000 in excess thereof. We will bear the cost of preparing, printing, packaging and delivering the Definitive Registered Notes. Holders of the Book-Entry Interests may incur fees normally payable in respect of the maintenance and operation of accounts in Euroclear and/or Clearstream.

If Definitive Registered Notes are issued and a Holder thereof claims that such Definitive Registered Notes have been lost, destroyed or wrongfully taken or if such Definitive Registered Notes are mutilated and are surrendered to the registrar or at the office of a transfer agent, we will issue and the Trustee will authenticate a replacement Definitive Registered Note if the Trustee's requirements are met. We or the Trustee may require a Holder requesting replacement of a Definitive Registered Note to furnish an indemnity bond sufficient in the judgment of both the Trustee and us to protect us, the Trustee, any transfer agent or any paying agent appointed pursuant to the indenture from any loss which any of them may suffer if a Definitive Registered Note is replaced. We may charge for its expenses in replacing a Definitive Registered Note.

In case any such mutilated, destroyed, lost or wrongfully taken Definitive Registered Note has become or is about to become due and payable, or is about to be redeemed or purchased by us pursuant to the provisions of the Indenture, we in our discretion may, instead of issuing a new Definitive Registered Note, pay, redeem or purchase such Definitive Registered Note, as the case may be.

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Definitive Registered Notes may be transferred and exchanged for Book-Entry Interests in a Global Note only in accordance with the Indenture.

Global Clearance and Settlement Under the Book-Entry System

Initial Settlement

Initial settlement for the Notes will be made in euro. Book-Entry Interests owned through depositary accounts will follow the settlement procedures applicable to conventional eurobonds in registered form. Book-Entry Interests held through Euroclear and Clearstream will be credited to the securities custody account of Euroclear and Clearstream Holders on the business day following the settlement date against payment for value on the settlement date.

Secondary Market Trading

The Book-Entry Interests will trade through participants of the relevant depositary, and will settle in same day funds. Since the purchase determines the place of delivery, it is important to establish at the time of trading any Book-Entry Interests where both the purchaser's and seller's accounts are located to ensure that settlement can be made on the desired value date.

Special Timing Considerations

You should be aware that investors will only be able to make and receive deliveries, payments and other communications involving Notes through Euroclear or Clearstream on days when those systems are open for business.

In addition, because of time-zone differences, there may be complications with completing transactions involving Clearstream and/or Euroclear on the same business day as in the United States. U.S. investors who wish to transfer their interests in the Notes, or to receive or make a payment or delivery of Notes, on a particular day, may find that the transactions will not be performed until the next business day in Luxembourg if Clearstream is used, or Brussels if Euroclear is used.

Clearing Information

We expect that the Notes will be accepted for clearance through the facilities of Euroclear and Clearstream. The international securities identification numbers and common codes for the Notes are set out under Listing and General Information Clearing Information.

Information Concerning Euroclear and Clearstream

The preceding description of the operations and procedures of Euroclear and Clearstream is provided solely as a matter of convenience. These operations and procedures are solely within the control of the relevant settlement systems and are subject to changes by them. We take no responsibility for these operations and procedures and urge investors to contact the systems or their participants directly to discuss these matters.

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We understand as follows with respect to Euroclear and Clearstream:

Euroclear and Clearstream hold securities for participating organizations. They also facilitate the clearance and settlement of securities transactions between their respective participants through electronic book-entry changes in the accounts of such participants. Euroclear and Clearstream provide various services to their participants, including the safekeeping, administration, clearance, settlement, lending and borrowing of internationally traded securities. Euroclear and Clearstream interface with domestic securities markets. Euroclear and Clearstream participants are financial institutions such as underwriters, securities brokers and dealers, banks, trust companies and certain other organizations. Indirect access to Euroclear or Clearstream is also available to others such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a Euroclear or Clearstream participant, either directly or indirectly.

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DESCRIPTION OF CERTAIN OTHER INDEBTEDNESS

The following is a summary of certain of our indebtedness that will be outstanding following the consummation of this offering. To the extent this summary contains descriptions of our revolving bank credit facility, our 7.5% Senior Notes due 2013, our 7.625% Senior Notes due 2013, our 7% Senior Notes due 2014, our 7.5% Senior Notes due 2014, our 7.75% Senior Notes due 2015, our 6.375% Senior Notes due 2015, our 6.875% Senior Notes due 2016, our 6.625% Senior Notes due 2016, our 6.5% Senior Notes due 2017, our 6.25% Senior Notes due 2018, our 6.875% Senior Notes due 2020 and our 2.75% Contingent Convertible Senior Notes due 2035, and the indentures governing them, the descriptions do not purport to be complete and are qualified in their entirety by reference to those and related documents, copies of which we will provide you upon request.

Our Revolving Bank Credit Facility

Our revolving bank credit facility limits our borrowings to the lesser of the borrowing base and the total commitments (currently both are \$2.5 billion) and matures in February 2011. As of November 22, 2006, we had outstanding borrowings of \$2.079 billion under this facility and had \$6.165 million of the facility securing various letters of credit. Borrowings under the facility are collateralized by some of our producing oil and gas properties and bear interest at either (i) the greater of the reference rate of Union Bank of California N.A. or the U.S. federal funds effective rate plus 0.50% or (ii) the London Interbank Offered Rate (LIBOR), at our option, plus a margin that varies based on our senior unsecured long-term debt ratings. The collateral value and borrowing base are determined periodically. The unused portion of the facility is subject to an annual commitment fee that also varies according to our senior unsecured long-term debt ratings. As of September 30, 2006, the annual commitment fee rate was 0.25%. Interest is payable quarterly or, if LIBOR applies, it may be payable at more frequent intervals. The credit agreement contains various covenants and restrictive provisions, including those restricting our ability to incur additional indebtedness, make investments or loans and create liens. The credit agreement requires us to maintain an indebtedness to EBITDA ratio (as defined in the credit agreement) not to exceed 3.5 to 1 and an indebtedness to total capitalization ratio (as defined in the credit agreement) not to exceed 0.65 to 1.

Our Senior Notes

At September 30, 2006, we had outstanding senior notes in an aggregate principal amount of \$5.8 billion, which, together with our \$690 million aggregate principal amount of 2.75% Contingent Convertible Senior Notes due 2035, represented the remainder of our long-term debt. At the date of this prospectus, we have issued and outstanding \$363.8 million in principal amount of 7.5% Senior Notes due 2013, \$500 million in principal amount of 7.625% Senior Notes due 2013, \$300.0 million in principal amount of 7% Senior Notes due 2014, \$300.0 million in principal amount of 7.5% Senior Notes due 2014, \$300.4 million in principal amount of 7.75% Senior Notes due 2015, \$600.0 million in principal amount of 6.375% Senior Notes due 2015, \$670.4 million in principal amount of 6.875% Senior Notes due 2016, \$600.0 million principal amount of 6.625% Senior Notes due 2016, \$1.1 billion principal amount of 6.5% Senior Notes due 2017, \$600.0 million principal amount of 6.25% Senior Notes due 2018 and \$500.0 million principal amount of 6.875% Senior Notes due 2020. There are no scheduled principal payments required on any of these senior notes until their final maturities.

Our outstanding senior notes are senior, unsecured obligations that rank pari passu in right of payment with all of our existing and future senior indebtedness, including the notes offered hereby, and rank senior in right of payment to all of our future subordinated indebtedness. Our outstanding senior notes are fully and unconditionally guaranteed, jointly and severally, by certain of our United States subsidiaries and one of our non-United States subsidiaries.

Our existing senior note indentures (other than the indentures governing the 7.625% Senior Notes due 2013, the 6.50% Senior Notes due 2017 and the 6.875% Senior Notes due 2020) restrict our and our

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restricted subsidiaries' ability to incur additional indebtedness. Please read "Risk Factors" "Risks Relating to Our Business" "Lower oil and natural gas prices could negatively impact our ability to borrow." As of September 30, 2006, we estimate that secured bank indebtedness of \$5.4 billion could have been incurred within those restrictions. These restrictions under such indentures will not apply to any future unrestricted subsidiaries. There are no unrestricted subsidiaries under our indentures as of the date of this prospectus.

Our existing senior note indentures (other than the indentures governing the 7.625% Senior Notes due 2013, the 6.50% Senior Notes due 2017 and the 6.875% Senior Notes due 2020) also limit our ability to make restricted payments, including the payment of cash dividends, unless certain tests are met.

We also have issued and outstanding \$690 million aggregate principal amount of 2.75% Contingent Convertible Senior Notes due 2035 (the "Convertible Senior Notes"). The Convertible Senior Notes are senior unsecured obligations and rank pari passu in right of payment to all of our existing and future senior indebtedness, including the notes offered hereby, and rank senior in right of payment to all of our future subordinated indebtedness. The Convertible Senior Notes are guaranteed by certain of our existing United States subsidiaries and one of our non-United States subsidiaries and by certain of our future United States subsidiaries on a senior unsecured basis. The indenture governing the Convertible Senior Notes does not have any financial or restricted payment covenants.

The Convertible Senior Notes will be convertible, at the holder's option, prior to the maturity date under certain circumstances, using a net share settlement process, into cash and, in some circumstances, our common stock. In general, upon conversion of a Convertible Senior Note, the holder of such note will receive cash equal to the principal amount of the note and common stock for the note's conversion value in excess of such principal amount.

In addition, we will pay contingent interest on the Convertible Senior Notes during any six-month interest period, beginning with the six-month period ending May 14, 2016, under certain conditions.

The Convertible Senior Notes mature on November 15, 2035. We may redeem the Convertible Senior Notes, in whole at any time, or in part from time to time, on or after November 15, 2015 at a redemption price, payable in cash, of 100% of the principal amount of such notes, plus accrued and unpaid interest.

Holders of the Convertible Senior Notes may require us to repurchase all or a portion of their notes on November 15, 2015, 2020, 2025 and 2030 at 100% of the principal amount of the notes, plus accrued and unpaid interest, payable in cash. Upon a fundamental change, as defined in the indenture governing the Convertible Senior Notes, holders may require us to repurchase all or a portion of their notes, payable in cash equal to 100% of the principal amount of the notes plus accrued and unpaid interest.

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MATERIAL UNITED STATES FEDERAL TAX CONSIDERATIONS

General

The following discussion summarizes the material U.S. Federal income and certain estate tax consequences of the purchase, ownership and disposition of the notes by an initial holder of the notes who purchases the notes for cash at the original offering price, who holds the notes as capital assets (generally property held for investment) and who does not have a special tax status. This discussion is based upon the Internal Revenue Code of 1986, as amended (the Code), Treasury Regulations, and judicial decisions and administrative interpretations thereunder, as of the date hereof, all of which are subject to change, possibly with retroactive effect, or are subject to different interpretations. We cannot assure you that the Internal Revenue Service (the IRS) will not challenge one or more of the tax consequences described herein, and we have not obtained, nor do we intend to obtain, a ruling from the IRS or an opinion of counsel with respect to the U.S. Federal tax consequences of purchasing, owning or disposing of the notes.

In this discussion, we do not purport to address all tax considerations that may be important to a particular holder in light of the holder's circumstances, or to certain categories of investors (such as financial institutions, insurance companies, tax-exempt organizations, dealers or traders in securities or currencies, persons who hold the notes through partnerships or other pass-through entities, regulated investment companies, real estate investment trusts, U.S. persons whose functional currency is not the U.S. dollar, persons liable for alternative minimum tax, U.S. expatriates or persons who hold the notes as part of a hedge, conversion transaction, straddle or other risk reduction transaction) that may be subject to special rules. This discussion also does not address the tax considerations arising under the laws of any foreign, state or local jurisdiction.

If a partnership (including an entity treated as a partnership for U.S. Federal income tax purposes) holds notes, the tax treatment of a partner generally will depend upon the status of the partner and upon the activities of the partnership. If you are a partner of a partnership holding notes, we suggest that you consult your tax advisor.

YOU SHOULD CONSULT YOUR OWN TAX ADVISORS AS TO THE PARTICULAR TAX CONSEQUENCES TO YOU OF THE ACQUISITION, OWNERSHIP AND DISPOSITION OF THE NOTES, INCLUDING THE EFFECT AND APPLICABILITY OF STATE, LOCAL OR FOREIGN TAX LAWS.

Consequences to U.S. Holders

You are a U.S. holder for purposes of this discussion if you are a beneficial owner of notes and you are:

an individual U.S. citizen or resident alien;

a corporation, or other entity taxable as a corporation for U.S. Federal income tax purposes, that was created or organized in or under the laws of the United States, any state thereof or the District of Columbia;

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an estate whose world-wide income is subject to U.S. Federal income taxation; or

a trust that either is subject to the supervision of a court within the United States and which has one or more United States persons with authority to control all substantial decisions or has a valid election in effect under applicable U.S. Treasury Regulations to be treated as a United States person.

Because the notes provide for the payment of additional amounts under certain circumstances (see Description of Notes Make-Whole Redemption), the notes may be subject to U.S. Treasury Regulations applicable to debt instruments that provide for one or more contingent payments. Under such Treasury Regulations, if the payment of additional amounts on the notes is, as of the issue date, neither a remote contingency nor an incidental contingency, the U.S. federal income tax consequences to a

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U.S. holder would be different from those discussed below. We intend to take the position that the payment of additional amounts is a remote or incidental contingency. Our determination that such payments are a remote or incidental contingency for these purposes is binding on a U.S. holder unless such U.S. holder discloses to the IRS that it is taking a contrary position. It is possible, however, that the IRS may take a contrary position from that described above, in which case the tax consequences to a holder could differ materially and adversely from those described below. The remainder of this discussion assumes that the notes are not contingent payment debt instruments under the U.S. Treasury Regulations. Prospective investors should consult with their own tax advisors as to the tax consequences that relate to the possibility of additional payments.

Purchase of Notes

The conversion of U.S. dollars into euro and the immediate use of that currency to purchase notes generally will not result in taxable gain or loss. However, if you use previously acquired euro to purchase notes, you will generally recognize ordinary currency exchange gain or loss at the time of purchase. Such currency exchange gain or loss will generally be the difference between the U.S. dollar value of those euro based on the spot rate on the date the notes are purchased and your tax basis in those euro, which will generally be the U.S. dollar value of the euro based on the spot exchange rate on the date the euro were acquired by you. For purposes of this discussion, *spot rate* generally means a currency exchange rate that reflects a market exchange rate available to the public for cash.

Interest

Interest payable on the notes will generally be included in the gross income of a U.S. holder as ordinary interest income at the time it is accrued or received, in accordance with such U.S. holder's method of accounting for U.S. federal income tax purposes.

If you are a cash method taxpayer (including most individual holders), you will be taxed on the U.S. dollar value of the euro you receive as interest when you receive them. The U.S. dollar value of the euro will be determined using the *spot rate* in effect at such time.

If you are an accrual method taxpayer, you will be taxed on the U.S. dollar value of the euro as the interest accrues on the notes. In determining the U.S. dollar value of the euro for this purpose, you may use the average euro exchange rate during the relevant interest accrual period (or, if that period spans two taxable years, during the portion of the interest accrual period in the relevant taxable year). The average rate for an accrual period (or partial period) is the simple average of the spot rates for each business day of such period, or other average exchange rate for the period reasonably derived and consistently applied by you. When interest is actually paid, you will generally also recognize currency exchange gain or loss, taxable as ordinary income or loss from sources within the United States, equal to the difference between (a) the value of the euro received as interest, as translated into U.S. dollars using the spot rate on the date of receipt, and (b) the U.S. dollar amount previously included in income with respect to such payment. If you do not wish to accrue interest income using the average exchange rate, certain alternative elections may be available.

Your tax basis in the euro you receive as interest will be the aggregate amount reported by you as income with respect to the receipt of the euro. If you subsequently sell those euro, additional tax consequences will apply as described in *Sale of euro*.

Disposition of the Notes

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On the sale, exchange, redemption, retirement, or other taxable disposition of your notes:

If you receive proceeds on the disposition of your notes in the form of U.S. dollars, you will be considered to have received the principal in the form of euro and to have sold those euro for U.S. dollars.

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You will have taxable gain or loss equal to the difference between the amount realized by you (less any amount attributable to accrued but unpaid interest to the extent not previously included in income) and your tax basis in the notes. The amount realized on the disposition of your notes will generally be the U.S. dollar value of the euro you receive (or are considered to receive) based on the spot exchange rate on the date of disposition. Your tax basis in the notes is the U.S. dollar value of the amount in euro paid for the notes, determined on the date of purchase.

Any such gain or loss (except to the extent attributable to foreign currency gain or loss) will be capital gain or loss, and will be long term capital gain or loss if you held the notes for more than one year. Long term capital gain recognized by certain U.S. holders (including individuals) is currently subject to taxation at reduced rates. The deductibility of capital losses may be subject to limitations.

You will realize foreign currency gain or loss to the extent the U.S. dollar value of the euro that you paid for the notes, based on the spot rate at the time you dispose of the notes, is greater or less than the U.S. dollar value of the euro that you paid for the notes, based on the spot rate at the time you acquired the notes. Any resulting foreign currency gain or loss will be U.S.-source ordinary income or loss. You will only recognize such foreign currency gain or loss to the extent you have gain or loss, respectively, on the overall sale, retirement, or other disposition of the notes.

If you sell notes between interest payment dates, a portion of the amount you receive reflects interest that has accrued on the notes but has not yet been paid by the sale date. That amount is treated as ordinary interest income and not as sale proceeds.

Your tax basis in the euro you receive on sale or retirement of the notes will be the value of euro reported by you as received on the sale or retirement of the notes. If you receive euro on retirement of the notes and subsequently sell those euro, or if you are considered to receive euro on retirement of the notes and those euro are considered to be sold for U.S. dollars on your behalf, or if you sell the notes for euro and subsequently sell those euro, additional tax consequences will apply as described in Sale of euro.

Sale of euro

If you receive euro from the sale, exchange, redemption, retirement, or other taxable disposition of a note, and you later sell those euro (or euro you received as interest on the notes) for U.S. dollars, you will have taxable gain or loss equal to the difference between the amount of U.S. dollars received and your tax basis in the euro. Any such gain or loss is foreign currency gain or loss taxable as ordinary income or loss.

Consequences to Non-U.S. Holders

You are a non-U.S. holder for purposes of this discussion if you are a beneficial owner of notes (other than an entity treated as a partnership for U.S. Federal income tax purposes) and you are not a U.S. holder.

U.S. Federal Withholding Tax

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The 30% U.S. Federal withholding tax generally will not apply to any payment of principal or interest on the notes under the portfolio interest exemption provided that interest on the notes is not effectively connected with your conduct of a trade or business in the United States, you provide the appropriate certification, as described below, and:

you do not actually or constructively own 10% or more of the total combined voting power of all classes of our voting stock within the meaning of the Code and applicable Treasury Regulations;

you are not a controlled non-U.S. corporation that is related to us (directly or indirectly) through stock ownership; and

you are not a bank whose receipt of interest on the notes is pursuant to a loan agreement entered into in the ordinary course of business.

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The exemption from withholding tax will not apply unless (a) you provide your name and address on an IRS Form W-8BEN (or successor form), and certify under penalties of perjury, that you are not a United States person, (b) a financial institution holding the notes on your behalf certifies, under penalties of perjury, that it has received an IRS Form W-8BEN (or successor form) from you and must provide us with a copy, or (c) you hold your notes directly through a qualified intermediary, and the qualified intermediary has sufficient information in its files indicating that you are not a U.S. holder. A qualified intermediary is a bank, broker or other intermediary that is acting out of a non-U.S. branch or office and has signed an agreement with the IRS providing that it will administer all or part of the U.S. Federal tax withholding rules under specified procedures.

If you cannot satisfy the requirements described above, payments of principal and interest made to you will be subject to the 30% U.S. Federal withholding tax, unless you provide us with a properly executed (1) IRS Form W-8BEN or successor form claiming an exemption from or a reduction of withholding under the benefit of a tax treaty or (2) IRS Form W-8ECI (or successor form) stating that interest paid on the notes is not subject to withholding tax because it is effectively connected with your conduct of a trade or business in the United States.

U.S. Federal Income Tax

Interest. If you are engaged in a trade or business in the United States and interest on the notes is effectively connected with the conduct of that trade or business (and, in the case of an applicable tax treaty, is attributable to a U.S. permanent establishment maintained by you), you will be subject to U.S. Federal income tax on the interest on a net income basis (although exempt from the 30% withholding tax) in the same manner as if you were a United States person as defined under the Code. In addition, if you are a non-U.S. corporation, you may be subject to a branch profits tax equal to 30% (or lower applicable treaty rate) of your earnings and profits for the taxable year, including earnings and profits from an investment in the notes, that are effectively connected with the conduct by you of a trade or business in the United States.

Sale, Exchange, Redemption or Other Disposition of the Notes. Any gain or income realized on the sale, exchange, redemption or other disposition of the notes generally will not be subject to U.S. Federal income tax unless:

that gain or income is effectively connected with the conduct of a trade or business in the United States by you (and, in the case of an applicable tax treaty, is attributable to a U.S. permanent establishment maintained by you),

you are an individual who is present in the United States for 183 days or more in the taxable year of that disposition, and certain other conditions are present, or

the gain represents accrued interest, in which case the rules for taxation of interest would apply.

If you are a holder subject to U.S. Federal income tax under the first bullet point, you will be taxed on a net income basis in the same manner as if you were a United States person as defined under the Code. In addition, if you are a non-U.S. corporation, you may be subject to a branch profits tax as explained above. Holders subject to U.S. Federal income tax under the second bullet point will be taxed on the net gain at a 30% rate.

U.S. Federal Estate Tax

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Your estate will not be subject to U.S. Federal estate tax on notes beneficially owned by you at the time of your death, provided that interest on the notes is exempt from U.S. Federal withholding tax under the portfolio interest exemption (without regard to the certification requirement) described in the first paragraph of Consequences to Non-U.S. Holders U.S. Federal Withholding Tax above.

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Backup Withholding and Information Reporting

U.S. Holders

Information reporting will apply to payments of principal and interest made by us on, or the proceeds of the sale or other disposition of, the notes with respect to certain noncorporate U.S. holders, and backup withholding, currently at a rate of 28%, may apply unless the recipient of such payment provides the appropriate intermediary with a taxpayer identification number, certified under penalties of perjury, as well as certain other information or otherwise establishes an exemption from backup withholding. Any amount withheld under the backup withholding rules is allowable as a credit against the U.S. holder's U.S. Federal income tax liability, provided the required information is timely provided to the IRS.

Non-U.S. Holders

Payments to you of interest on a note and amounts withheld from such payments, if any, generally will be reported to the IRS and you. Backup withholding will not apply to payments of principal and interest on the notes if you certify as to your non-U.S. holder status on an IRS Form W-8BEN (or successor form) under penalties of perjury or you otherwise qualify for an exemption (provided that neither we nor our agent know or have reason to know that you are a United States person or that the conditions of any other exemptions are not in fact satisfied).

The payment of the proceeds of the disposition of notes to or through the U.S. office of a U.S. or non-U.S. broker will be subject to information reporting and backup withholding unless you provide the certification described above or you otherwise qualify for an exemption. The proceeds of a disposition effected outside the United States by a non-U.S. holder to or through a non-U.S. office of a broker generally will not be subject to backup withholding or information reporting. However, if such broker is a United States person, a controlled non-U.S. corporation, a non-U.S. person 50% or more of whose gross income from all sources for certain periods is effectively connected with a trade or business in the United States, or a non-U.S. partnership that is engaged in the conduct of a trade or business in the United States or that has one or more partners that are United States persons who in the aggregate hold more than 50% of the income or capital interests in the partnership, information reporting requirements will apply unless such broker has documentary evidence in its files of the holder's non-U.S. status and has no actual knowledge or reason to know to the contrary or unless the holder otherwise qualifies for an exemption. Any amount withheld under the backup withholding rules is allowable as a credit against your U.S. Federal income tax liability, if any, provided the required information or appropriate claim for refund is provided to the IRS.

EU DIRECTIVE ON THE TAXATION OF SAVINGS INCOME

On June 3, 2003, the Council of the EU adopted the Directive on the taxation of savings income pursuant to which a Member State is generally required to provide the tax authorities of another Member State with details on payments of interest or other similar income paid by a person within its jurisdiction to or for an individual resident in the other Member State. Exceptionally (and for a transitional period only, which will end after agreement on exchange of information has been reached between the EU and certain non-EU States), Belgium, Luxembourg and Austria will, instead, be required to withhold tax from such payments unless bondholders either authorize the person making the payment to report the payment as described above or present a certificate

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from the relevant tax authority establishing exemption therefrom. The Directive applies since July 1, 2005.

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We, the subsidiary guarantors, and the underwriters for the offering named below have entered into an underwriting agreement with respect to the notes. Subject to certain conditions, each underwriter has severally agreed to purchase the principal amount of notes indicated in the following table.

| Underwriters | Principal Amount of Notes |
|---|--|
| Barclays Bank PLC | |
| Credit Suisse Securities (Europe) Limited | |
| Deutsche Bank Securities Inc. | |
| Goldman Sachs International | |
| ABN AMRO Incorporated | |
| Banc of America Securities Limited | |
| BNP Paribas Securities Corp. | |
| Fortis Securities LLC | |
| Lehman Brothers International (Europe) | |
| The Royal Bank of Scotland plc | |
| UBS Limited | |
| Bayerische Hypo- und Vereinsbank AG | |
| BMO Capital Markets Corp. | |
| Calyon Securities (USA) Inc. | |
| DZ Financial Markets LLC | |
| Natexis Bleichroeder Inc. | |
| Royal Bank of Canada Europe Limited | |
| The Toronto-Dominion Bank | |
| Total | 400,000,000 |

The underwriters are committed to take and pay for all of the notes being offered, if any are taken.

Notes sold by the underwriters to the public will initially be offered at the initial public offering price set forth on the cover of this prospectus.

The notes are a new issue of securities with no established trading market. We have been advised by the underwriters that the underwriters intend to make a market in the notes but are not obligated to do so and may discontinue market making at any time without notice. No assurance can be given as to the liquidity of the trading market for the notes.

In connection with the offering, the underwriters may purchase and sell notes in the open market. These transactions may include short sales, stabilizing transactions and purchases to cover positions created by short sales. Short sales involve the sale by the

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underwriters of a greater number of notes than they are required to purchase in the offering. Stabilizing transactions consist of certain bids or purchases made for the purpose of preventing or retarding a decline in the market price of the notes while the offering is in progress.

The underwriters also may impose a penalty bid. This occurs when a particular underwriter repays to the underwriters a portion of the underwriting discount received by it because the representatives have repurchased notes sold by or for the account of such underwriter in stabilizing or short covering transactions.

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These activities by the underwriters, as well as other purchases by the underwriters for their own accounts, may stabilize, maintain or otherwise affect the market price of the notes. As a result, the price of the notes may be higher than the price that otherwise might exist in the open market. If these activities are commenced, they may be discontinued by the underwriters at any time. These transactions may be effected in the over-the-counter market or otherwise.

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a Relevant Member State), each underwriter, with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the Relevant Implementation Date), has not made and will not make an offer of notes to the public in that Relevant Member State prior to the publication of a prospectus in relation to the notes which has been approved by the competent authority in that Relevant Member State or, where appropriate, approved in another Relevant Member State and notified to the competent authority in that Relevant Member State, all in accordance with the Prospectus Directive, except that it may, with effect from and including the Relevant Implementation Date, make an offer of notes to the public in that Relevant Member State at any time:

- (a) to legal entities which are authorised or regulated to operate in the financial markets or, if not so authorised or regulated, whose corporate purpose is solely to invest in securities;
- (b) to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than 43,000,000 and (3) an annual net turnover of more than 50,000,000, as shown in its last annual or consolidated accounts; or
- (c) in any other circumstances which do not require the publication by the Issuer of a prospectus pursuant to Article 3 of the Prospectus Directive.

For the purposes of this provision, the expression an offer of notes to the public in relation to any notes in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the notes to be offered so as to enable an investor to decide to purchase or subscribe the notes, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State and the expression Prospectus Directive means Directive 2003/71/EC and includes any relevant implementing measure in each Relevant Member State.

Each Underwriter has represented and agreed that:

- (a) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of section 21 of FSMA) to persons who have professional experience in matters relating to investments falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 or in circumstances in which section 21 of FSMA does not apply to the company; and
- (b) it has complied with, and will comply with, all applicable provisions of FSMA with respect to anything done by it in relation to the notes in, from or otherwise involving the United Kingdom.

The notes may not be offered or sold by means of any document other than (i) in circumstances which do not constitute an offer to the public within the meaning of the Companies Ordinance (Cap.32, Laws of Hong Kong), or (ii) to professional investors within the meaning of the Securities and Futures Ordinance (Cap.571, Laws of Hong Kong) and any rules made thereunder, or (iii) in other circumstances which do not result in the document being a prospectus within the meaning of the Companies Ordinance (Cap.32,

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Laws of Hong Kong), and no advertisement, invitation or document relating to the notes may be issued or may be in the possession of any person for the purpose of issue (in each case whether in Hong Kong or elsewhere), which is directed at, or the contents of which are likely to be accessed or read by,

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the public in Hong Kong (except if permitted to do so under the laws of Hong Kong) other than with respect to notes which are or are intended to be disposed of only to persons outside Hong Kong or only to professional investors within the meaning of the Securities and Futures Ordinance (Cap. 571, Laws of Hong Kong) and any rules made thereunder.

The notes have not been and will not be registered under the Securities and Exchange Law of Japan (the Securities and Exchange Law) and each underwriter has agreed that it will not offer or sell any notes, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan (which term as used herein means any person resident in Japan, including any corporation or other entity organized under the laws of Japan), or to others for re-offering or resale, directly or indirectly, in Japan or to a resident of Japan, except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the Securities and Exchange Law and any other applicable laws, regulations and ministerial guidelines of Japan.

This prospectus has not been registered as a prospectus with the Monetary Authority of Singapore. Accordingly, this prospectus and any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of the notes may not be circulated or distributed, nor may the notes be offered or sold, or be made the subject of an invitation for subscription or purchase, whether directly or indirectly, to persons in Singapore other than (i) to an institutional investor under Section 274 of the Securities and Futures Act, Chapter 289 of Singapore (the SFA), (ii) to a relevant person, or any person pursuant to Section 275(1A), and in accordance with the conditions, specified in Section 275 of the SFA or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA.

Where the notes are subscribed or purchased under Section 275 by a relevant person which is: (a) a corporation (which is not an accredited investor) the sole business of which is to hold investments and the entire share capital of which is owned by one or more individuals, each of whom is an accredited investor; or (b) a trust (where the trustee is not an accredited investor) whose sole purpose is to hold investments and each beneficiary is an accredited investor, shares, debentures and units of shares and debentures of that corporation or the beneficiaries' rights and interest in that trust shall not be transferable for 6 months after that corporation or that trust has acquired the notes under Section 275 except: (1) to an institutional investor under Section 274 of the SFA or to a relevant person, or any person pursuant to Section 275(1A), and in accordance with the conditions, specified in Section 275 of the SFA; (2) where no consideration is given for the transfer; or (3) by operation of law.

We do not intend to apply for the notes to be listed on any securities exchange other than the Irish Stock Exchange for trading on the Alternative Securities Market thereof or for the notes to be quoted on any quotation system. We cannot assure you that the notes will be approved for listing or such listing will be maintained. The underwriters have advised us that they currently intend to make a market in the notes. However, they are not obligated to do so and any market making may be discontinued by an underwriter at any time without notice. Accordingly, no assurance can be given as to the liquidity of, or the trading market for, the notes.

Buyers who purchase the notes from the underwriters may be required to pay stamp taxes and other charges in accordance with the laws and practice of the country of purchase in addition to the initial public offering price set forth on the cover of this prospectus.

We estimate that our share of the total expenses of the offering, excluding underwriting discounts and commissions, will be approximately \$250,000. The underwriters have also agreed to reimburse us for up to \$150,000 in expenses incurred by us in connection with this offering.

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We have agreed to indemnify the several underwriters against certain liabilities, including liabilities under the Securities Act of 1933.

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The underwriters have from time to time provided, and in the future may provide, certain investment banking and financial advisory services to us and our affiliates, for which they have received, and in the future would receive, customary fees. In addition, affiliates of each of the underwriters listed in the table are lenders under our existing revolving bank credit facility. Amounts outstanding under our existing revolving bank credit facility will be repaid in connection with this offering. An affiliate of Lehman Brothers Inc. is a participant in a drilling business with us. We have each contributed approximately \$25 million to this venture.

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ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we filed with the Securities and Exchange Commission utilizing a shelf registration process for an immediate, delayed or continuous offering process as set forth in Rule 415 under the Securities Act. You should read this prospectus together with additional information described under Where You Can Find More Information. You should rely only on the information contained or incorporated by reference in this prospectus. We have not authorized anyone to provide you with different information. You should not assume that the information contained in this prospectus is accurate as of any date other than the date on the front of this prospectus.

WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and special reports, proxy statements and other information with the SEC.

We incorporate by reference in this prospectus the following documents filed with the SEC pursuant to the Securities Exchange Act of 1934 (the Exchange Act):

our Annual Report on Form 10-K for the fiscal year ended December 31, 2005;

our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2006, June 30, 2006 and September 30, 2006; and

our current reports on Form 8-K filed on November 1, 2005, January 10, 2006, January 18, 2006, January 26, 2006, January 30, 2006 (two reports of the same date), February 1, 2006, February 3, 2006, February 8, 2006, February 10, 2006, February 15, 2006 (two reports of the same date), February 21, 2006, February 24, 2006, February 28, 2006, March 8, 2006, March 22, 2006, April 7, 2006, April 21, 2006, May 2, 2006, May 8, 2006, May 31, 2006, June 6, 2006, June 8, 2006 (two reports of the same date), June 15, 2006 (three reports of the same date), June 27, 2006 (one such report as amended on July 24, 2006), June 30, 2006 (two reports of the same date), July 10, 2006, July 28, 2006, August 3, 2006, August 9, 2006, September 27, 2006, October 2, 2006, October 6, 2006, October 16, 2006, October 23, 2006, October 27, 2006, November 13, 2006, November 17, 2006, November 20, 2006 and November 21, 2006 (excluding any information furnished pursuant to Item 2.02 or Item 7.01 of any such current report on Form 8-K).

We also incorporate by reference any future filings made by us with the SEC under Sections 13(a), 13(c), 14, or 15(d) of the Exchange Act (excluding any information furnished pursuant to Item 2.02 or Item 7.01 of any such current report on Form 8-K that is filed in the future and is not deemed filed under the Exchange Act), until the underwriters have sold all of the notes.

The information incorporated by reference is an important part of this prospectus, and information that we file later with the SEC will automatically update and supersede this information as well as the information included in this prospectus.

You may read and copy any document we file with the SEC at the SEC public reference room located at:

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100 F Street, N.E.

Room 1580

Washington, D.C. 20549

Please call the SEC at 1-800-SEC-0330 for further information on the public reference room and its copy charges. Our SEC filings are also available to the public on the SEC's web site at <http://www.sec.gov> and through the New York Stock Exchange, Inc., 20 Broad Street, New York, New York 10005, on which our shares of common stock are traded.

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During the course of the offering and prior to sale, we invite each offeree of the notes to ask us questions concerning the terms and conditions of the offering and to obtain any additional information necessary to verify the accuracy of the information in this prospectus which is material to the offering to the extent that we possess such information or can acquire it without unreasonable effort or expense. You may obtain a copy of any or all of the documents summarized in this prospectus or incorporated by reference in this prospectus, without charge, by request directed to us at the following address and telephone number:

Jennifer M. Grigsby

Corporate Secretary

Chesapeake Energy Corporation

6100 North Western Avenue

Oklahoma City, Oklahoma 73118

Telephone: (405) 879-9225

corpsec@chkenergy.com

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FORWARD-LOOKING STATEMENTS

This prospectus contains or incorporates by reference forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements give our current expectations or forecasts of future events. They include statements regarding oil and natural gas reserve estimates, planned capital expenditures, the drilling of oil and natural gas wells and future acquisitions, expectations of closing and the impact of the pending committed acquisitions as described in this prospectus, expected oil and natural gas production, cash flow and anticipated liquidity, business strategy and other plans and objectives for future operations and expected future expenses. Statements concerning the fair values of derivative contracts and their estimated contribution to our future results of operations are based upon market information as of a specific date. These market prices are subject to significant volatility.

Although we believe the expectations and forecasts reflected in these and other forward-looking statements are reasonable, we can give no assurance they will prove to have been correct. They can be affected by inaccurate assumptions or by known or unknown risks and uncertainties. Factors that could cause actual results to differ materially from expected results are described under Risk Factors and include:

the volatility of oil and natural gas prices;

our level of indebtedness;

the strength and financial resources of our competitors;

the availability of capital on an economic basis to fund reserve replacement costs;

uncertainties inherent in estimating quantities of oil and natural gas reserves, projecting future rates of production and the timing of development expenditures;

our ability to replace reserves and sustain production;

uncertainties in evaluating oil and natural gas reserves of acquired properties and associated potential liabilities;

the effect of oil and natural gas prices on our borrowing ability;

unsuccessful exploration and development drilling;

declines in the values of our oil and natural gas properties resulting in ceiling test write-downs;

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lower prices realized on oil and natural gas sales and collateral required to secure hedging liabilities resulting from our commodities price risk management activities;

adverse effects of governmental and environmental regulation;

losses possible from pending or future litigation;

drilling and operating risks; and

uncertainties and difficulties associated with the integration and operation of our recently acquired properties.

We caution you not to place undue reliance on these forward-looking statements, which speak only as of the date of this prospectus, and we undertake no obligation to update this information. We urge you to carefully review and consider the disclosures made in this prospectus and our reports filed with the SEC and incorporated by reference herein that attempt to advise interested parties of the risks and factors that may affect our business.

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LISTING AND GENERAL INFORMATION

Listing

We intend to apply to list the notes on the Irish Stock Exchange for trading on the Alternative Securities Market thereof in accordance with the rules of that exchange. In connection with such listing, we will appoint a listing agent.

Pursuant to the rules of the Irish Stock Exchange, we accept responsibility for the information contained in this prospectus. To the best of our knowledge and belief, the information contained in this prospectus is in accordance with the facts and does not omit anything likely to affect the import of such information. Information relating to each of the Guarantors was provided by the respective Guarantor.

For as long as the Notes are listed on the Irish Stock Exchange for trading on the Alternative Securities Market thereof and the rules of that exchange require, copies of the following documents may be inspected and obtained at the specific office of the Issuer and the Irish paying agent:

our certificate of incorporation and by-laws and the certificates of incorporation and by-laws (or comparable organizational documents) of the Guarantors;

our annual consolidated and interim financial statements; and

the Indenture for the Notes (which includes the form of the Notes).

As long as the Notes are listed on the Irish Stock Exchange and the rules of the Irish Stock Exchange shall so require, we will maintain a paying and transfer agent in Ireland. We reserve the right to vary such appointment and we will publish notice of such change of appointment in a newspaper having a general circulation in Ireland.

We have appointed AIB/BNY Fund Management (Ireland) Limited as paying agent and transfer agent in Ireland and The Bank of New York, London Branch as principal paying agent to make payments on, and transfers of, the Notes. We reserve the right to vary such appointments.

We prepare audited consolidated annual financial statements according to U.S. GAAP. These annual financial statements are published in our annual report on Form 10-K and filed with the SEC. We do not prepare non-consolidated financial statements or financial statements for individual Guarantors. Our historical consolidated financial statements include the financial information of the Guarantors that are our subsidiaries.

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So long as the Notes are listed on the Irish Stock Exchange for trading on the Alternative Securities Market thereof, the Notes will be freely transferable and negotiable in accordance with the rules of the Irish Stock Exchange.

Clearing Information

The Notes sold pursuant to the Securities Act have been accepted for clearance through the facilities of Euroclear and Clearstream. The Notes are represented by the Global Note with the ISIN of and the Common Code of .

Legal Information

We are a corporation incorporated under the laws of Oklahoma on December 23, 1996. Our registered office is 735 First National Bank, 120 North Robinson, Oklahoma City, Oklahoma 73102. We have not been involved in any litigation, administrative proceeding or arbitration relating to claims or amounts which are material in the context of the issue of the Notes, and, to our knowledge, no such litigation, administrative proceeding or arbitration is pending or threatened.

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Guarantor Information

As of the date of closing of the offering of the Notes hereby, the Guarantors are expected to include:

Chesapeake Eagle Canada Corp., which is a corporation incorporated under the laws of New Brunswick, Canada on June 7, 2002 with a registered office at Suite 600, 570 Queen Street, P.O. Box 610, Fredericton, New Brunswick E3B 5A6;

Chesapeake Energy Louisiana Corporation, which is a corporation incorporated under the laws of Oklahoma on June 27, 1997 with a registered office at 735 First National Bank, 120 North Robinson, Oklahoma City, Oklahoma 73102;

Chesapeake Energy Marketing, Inc., which is a corporation incorporated under the laws of Oklahoma on December 15, 1993 with a registered office at 735 First National Bank, 120 North Robinson, Oklahoma City, Oklahoma 73102;

Chesapeake Operating, Inc., which is a corporation incorporated under the laws of Oklahoma on May 18, 1989 with a registered office at 735 First National Bank, 120 North Robinson, Oklahoma City, Oklahoma 73102;

Chesapeake South Texas Corp., which is a corporation incorporated under the laws of Oklahoma on July 5, 2002 with a registered office at 735 First National Bank, 120 North Robinson, Oklahoma City, Oklahoma 73102;

Nomac Drilling Corporation, which is a corporation incorporated under the laws of Oklahoma on February 7, 2001 with a registered office at 735 First National Bank, 120 North Robinson, Oklahoma City, Oklahoma 73102;

Carmen Acquisition, L.L.C., which is a limited liability company formed under the laws of Oklahoma on January 29, 2001 with a registered office at 735 First National Bank, 120 North Robinson, Oklahoma City, Oklahoma 73102;

Chesapeake Acquisition, L.L.C., which is a limited liability company formed under the laws of Oklahoma on October 13, 1997 with a registered office at 735 First National Bank, 120 North Robinson, Oklahoma City, Oklahoma 73102;

Chesapeake Appalachia, L.L.C., which is a limited liability company formed under the laws of Oklahoma on October 10, 2005 with a registered office at 735 First National Bank, 120 North Robinson, Oklahoma City, Oklahoma 73102;

Chesapeake Land Company, L.L.C., which is a limited liability company formed under the laws of Oklahoma on December 29, 2004 with a registered office at 735 First National Bank, 120 North Robinson, Oklahoma City, Oklahoma 73102;

Chesapeake ORC, L.L.C., which is a limited liability company formed under the laws of Oklahoma on January 28, 2003 with a registered office at 735 First National Bank, 120 North Robinson, Oklahoma City, Oklahoma 73102;

Chesapeake Royalty, L.L.C., which is a limited liability company formed under the laws of Oklahoma on September 30, 1998 with a registered office at 735 First National Bank, 120 North Robinson, Oklahoma City, Oklahoma 73102;

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Gothic Production, L.L.C., which is a limited liability company formed under the laws of Oklahoma on March 26, 1998 with a registered office at 735 First National Bank, 120 North Robinson, Oklahoma City, Oklahoma 73102;

Hawg Hauling & Disposal, LLC, which is a limited liability company formed under the laws of Delaware on August 27, 2003 with a registered office at The Corporation Trust Company, 1209 Orange Street, Corporation Trust Center, Wilmington, Delaware 19801;

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Hodges Trucking Company, L.L.C., which is a limited liability company formed under the laws of Oklahoma on January 23, 1987 with a registered office at 735 First National Bank, 120 North Robinson, Oklahoma City, Oklahoma 73102;

Mayfield Processing, L.L.C., which is a limited liability company formed under the laws of Oklahoma on August 25, 2003 with a registered office at 735 First National Bank, 120 North Robinson, Oklahoma City, Oklahoma 73102;

MC Mineral Company, L.L.C., which is a limited liability company formed under the laws of Oklahoma on April 21, 2003 with a registered office at 735 First National Bank, 120 North Robinson, Oklahoma City, Oklahoma 73102;

W. W. Realty, L.L.C., which is a limited liability company formed under the laws of Oklahoma on April 3, 1990 with a registered office at 735 First National Bank, 120 North Robinson, Oklahoma City, Oklahoma 73102;

Chesapeake Exploration Limited Partnership, which is a limited partnership formed under the laws of Oklahoma on December 27, 1994 with a registered office at 735 First National Bank, 120 North Robinson, Oklahoma City, Oklahoma 73102;

Chesapeake Louisiana, L.P., which is a limited partnership formed under the laws of Oklahoma on May 20, 1997 with a registered office at 735 First National Bank, 120 North Robinson, Oklahoma City, Oklahoma 73102;

Chesapeake Sigma, L.P., which is a limited partnership formed under the laws of Oklahoma on July 28, 2002 with a registered office at 735 First National Bank, 120 North Robinson, Oklahoma City, Oklahoma 73102; and

MidCon Compression, L.P., which is a limited partnership formed under the laws of Oklahoma on September 15, 2003 with a registered office at 735 First National Bank, 120 North Robinson, Oklahoma City, Oklahoma 73102.

LEGAL MATTERS

The validity of the issuance of the notes and certain other legal matters will be passed upon for us by Vinson & Elkins L.L.P., Houston, Texas. The underwriters are being represented by Cravath, Swaine & Moore LLP, New York, New York. Vinson & Elkins L.L.P. and Cravath, Swaine & Moore LLP will rely upon Commercial Law Group, P.C., Oklahoma City, Oklahoma, as to all matters of Oklahoma law.

EXPERTS

The financial statements as of December 31, 2005 and 2004, and for each of the three years in the period ended December 31, 2005 and management's assessment of the effectiveness of internal control over financial reporting (which is included in Management's Report on Internal Control over Financial Reporting) as of December 31, 2005, included in this prospectus have been so included in reliance on the report of PricewaterhouseCoopers LLP, an independent registered public accounting firm, given on the authority of said firm as experts in auditing and accounting.

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The financial statements of Columbia Energy Resources, LLC as of December 31, 2004 and 2003 and for the year ended December 31, 2004 and the four months ended December 31, 2003, incorporated in this prospectus by reference from the current report on Form 8-K of Chesapeake Energy Corporation filed with the SEC on November 1, 2005, have been so incorporated in reliance on the report of Ernst & Young LLP,

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an independent registered public accounting firm, given on the authority of said firm as experts in auditing and accounting.

Estimates of the oil and gas reserves of Chesapeake Energy Corporation and related future net cash flows and the present values thereof, included in Chesapeake's annual report on Form 10-K for the year ended December 31, 2005, were based in part upon reserve reports prepared by Netherland, Sewell & Associates, Inc., Schlumberger Data and Consulting Services, Lee Keeling and Associates, Inc., Ryder Scott Company, L.P., LaRoche Petroleum Consultants, Ltd., H.J. Gruy and Associates, Inc. and Miller and Lents, Ltd., independent petroleum engineers. We have incorporated these estimates in reliance on the authority of each such firm as experts in such matters.

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Annex A

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Fiscal Year Ended December 31, 2005

.. Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission File No. 1-13726

Chesapeake Energy Corporation

(Exact Name of Registrant as Specified in Its Charter)

Oklahoma
(State or other jurisdiction of
incorporation or organization)

73-1395733
(I.R.S. Employer
Identification No.)

6100 North Western Avenue

Oklahoma City, Oklahoma
(Address of principal executive offices)

73118
(Zip Code)

(405) 848-8000

Registrant's telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class
Common Stock, par value \$.01
7.5% Senior Notes due 2013
7.0% Senior Notes due 2014
7.5% Senior Notes due 2014

Name of Each Exchange on Which Registered
New York Stock Exchange
New York Stock Exchange
New York Stock Exchange
New York Stock Exchange

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| | |
|---|-------------------------|
| 6.375% Senior Notes due 2015 | New York Stock Exchange |
| 7.75% Senior Notes due 2015 | New York Stock Exchange |
| 6.625% Senior Notes due 2016 | New York Stock Exchange |
| 6.875% Senior Notes due 2016 | New York Stock Exchange |
| 6.25% Senior Notes due 2018 | New York Stock Exchange |
| 6.0% Cumulative Convertible Preferred Stock | New York Stock Exchange |
| 5.0% Cumulative Convertible Preferred Stock (Series 2003) | New York Stock Exchange |
| 4.5% Cumulative Convertible Preferred Stock | New York Stock Exchange |

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES ☒ NO ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. YES ☐ NO ☒

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K ☐

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

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 ☒

The aggregate market value of our common stock held by non-affiliates on June 30, 2005 was \$6,327,096,262. At March 10, 2006, there were 373,622,333 shares of our \$0.01 par value common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the proxy statement for the 2006 Annual Meeting of Shareholders are incorporated by reference in Part III.

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CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

2005 ANNUAL REPORT ON FORM 10-K

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PART I

ITEM 1. *Business* General

We are the second largest independent producer of natural gas in the United States, owning interests in approximately 30,600 producing oil and gas wells that are currently producing approximately 1.5 bcfe per day, 92% of which is natural gas. Our strategy is focused on discovering, developing and acquiring onshore natural gas reserves primarily in the southwestern U.S. and secondarily in the Appalachian Basin of the eastern U.S. Our most important operating area has historically been the Mid-Continent region of the U.S., which includes Oklahoma, Arkansas, Kansas and the Texas Panhandle, and is where 51% of our proved oil and natural gas reserves are located. During the past four years, we have also built significant positions in the South Texas and Texas Gulf Coast regions, the Permian Basin of West Texas and eastern New Mexico, the Barnett Shale area of north-central Texas, the Ark-La-Tex area of East Texas and northern Louisiana and most recently, the emerging Fayetteville Shale play located in Arkansas. As a result of our recent acquisition of the holding company of Columbia Natural Resources, LLC and certain affiliated entities (CNR), we now have a significant presence in the Appalachian Basin, principally in West Virginia, eastern Kentucky, eastern Ohio and southern New York.

As of December 31, 2005, we had 7.5 tcf of proved reserves, of which 92% are natural gas and all of which are onshore. During 2005, we replaced our 469 bcfe of production with an internally estimated 3.088 tcf of new proved reserves, for a reserve replacement rate of 659%. Reserve replacement through the drillbit was 1.047 tcf, or 223% of production (including a positive 17 bcfe from performance revisions and a positive 24 bcfe from oil and natural gas price increases), and reserve replacement through acquisitions was 2.041 tcf, or 436% of production. Our proved reserves grew by 53% during 2005, from 4.9 tcf to 7.5 tcf.

During 2005, we led the nation in drilling activity with an average utilization of 73 operated rigs and 66 non-operated rigs. Through this drilling activity, we drilled 902 (686 net) operated wells and participated in another 1,066 (130 net) wells operated by other companies. We added approximately 1.047 tcf of proved oil and natural gas reserves through our drilling efforts. Our success rate was 98% for operated wells and 95% for non-operated wells. As of December 31, 2005, our proved developed reserves were 65% of our total proved reserves. In 2005, we added approximately 1,200 new employees and invested \$362 million in leasehold (exclusive of leases acquired through acquisitions) and 3-D seismic data, all of which we consider the building blocks of future value creation.

From January 1, 1998 through December 31, 2005, we have been one of the most active consolidators of onshore U.S. natural gas assets, having purchased approximately 5.9 tcf of proved reserves, at a total cost of approximately \$10.3 billion (including \$2.2 billion for unproved leasehold, but excluding \$809 million of deferred taxes established in connection with certain corporate acquisitions) for a per proved mcfe acquisition cost of \$1.37.

During 2005, we were especially active in the acquisitions market. Acquisition expenditures totaled \$4.9 billion through December 31, 2005 (including \$1.4 billion for unproved leasehold, but excluding \$252 million of deferred taxes established in connection with certain corporate acquisitions). Through these acquisitions, we have acquired an internally estimated 2.0 tcf of proved oil and natural gas reserves at a per proved mcfe acquisition cost of \$1.74.

On November 14, 2005, we acquired CNR and its significant natural gas reserves, acreage and mid-stream assets for approximately \$3.02 billion, of which \$2.2 billion was in cash and \$0.82 billion was in assumed liabilities related to CNR's prepaid sales agreement, hedging positions and other liabilities. The CNR assets consist of 125 mmcf per day of natural gas production, 1.3 tcf of proved reserves and approximately 3.2 million net acres of U.S. oil and gas leasehold, which we estimate have over 9,000 additional undrilled locations with reserve potential. CNR also owns extensive mid-stream natural gas assets, including over 6,500 miles of natural gas gathering lines.

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Our principal executive offices are located at 6100 North Western Avenue, Oklahoma City, Oklahoma 73118 and our main telephone number at that location is (405) 848-8000. We make available free of charge on our website at www.chkenergy.com our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. References to us, we and our in this report refer to Chesapeake Energy Corporation together with its subsidiaries.

Recent Developments

In the first quarter of 2006, we have continued to execute our acquisition and financing strategy through the following transactions, in which we:

acquired oil and natural gas assets from private companies located in the Barnett Shale, South Texas, Permian Basin, Mid-Continent and Ark-La-Tex regions for an aggregate purchase price of approximately \$640 million in cash and expect to close another acquisition for a cash purchase price of approximately \$60 million by March 31, 2006;

acquired a privately-held Oklahoma-based trucking company for \$48 million;

issued an additional \$500 million of our 6.5% Senior Notes due 2017 in a private placement and used the proceeds of approximately \$487 million to repay outstanding borrowings under our revolving bank credit facility incurred primarily to finance our recent acquisitions;

amended and restated our revolving bank credit facility, increasing the commitments to \$2.0 billion and extending the maturity date to February 2011;

sold our investment in Pioneer Drilling Company (AMEX:PDC) common stock for cash proceeds of \$159 million and a pre-tax gain of \$116 million; and

acquired 13 drilling rigs and related assets through our wholly-owned subsidiary, Nomac Drilling Corporation, from Martex Drilling Company, L.L.P., a privately-held drilling contractor with operations in East Texas and North Louisiana, for \$150 million.

Our President and Chief Operating Officer, Tom L. Ward, resigned as a director, officer and employee of the company effective February 10, 2006. Mr. Ward has agreed to act as a consultant to Chesapeake for a period of six months from the effective date of his resignation, pursuant to a resignation agreement, to assist in the transition of his responsibilities. During the term of his consulting agreement, Mr. Ward will receive no cash compensation but will be provided support staff for personal administrative and accounting services together with access to the company's fractional shares in aircraft in accordance with historical practices. The resignation agreement provides for the immediate vesting of all of Mr. Ward's unvested stock options and restricted stock on February 10, 2006. As a result of such vesting, options to purchase 724,615 shares of Chesapeake's common stock at an average exercise price of \$8.01 per share and 1,291,875 shares of restricted common stock became immediately vested. As a result, the company expects to incur a non-cash after-tax charge of approximately \$31.8 million in the first quarter 2006. Mr. Ward will have until May 10, 2006 to exercise the stock options granted to him by the company.

Business Strategy

Since our inception in 1989, our goal has been to create value for investors by building one of the largest onshore natural gas resource bases in the United States. For much of the past eight years, our strategy to accomplish this goal has been to build the dominant operating position in the Mid-Continent region, the third largest gas supply region in the U.S. In building our industry-leading position in the Mid-Continent, we have integrated an aggressive and technologically advanced drilling program with an active property consolidation program focused on small to medium-sized corporate and property acquisitions. In 2002, we began expanding our focus from the Mid-Continent to other regions where we believed we could extend our successful strategy. To date, those areas have included the South Texas and Texas Gulf Coast regions, the Permian Basin of West

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Texas and eastern New Mexico, the Barnett Shale area of north-central Texas, the Ark-La-Tex area of East Texas and northern Louisiana, and, through our recent CNR acquisition, the Appalachian Basin, principally in West Virginia, eastern Kentucky, eastern Ohio and southern New York. We believe significant elements of our successful Mid-Continent strategy of acquisition, exploitation, extension and exploration have been or will be successfully transferred to these areas.

Key elements of this business strategy are further explained below:

Make High-Quality Acquisitions. Our acquisition program is focused on acquisitions of natural gas properties that offer high-quality, long-lived production and significant development and higher potential deep drilling opportunities. From January 1, 1998 through December 31, 2005, we have acquired \$10.3 billion of oil and gas properties at an estimated average cost of \$1.37 per mcf of proved reserves. Included in this amount is \$2.2 billion for unproved leasehold, but excluded from this amount is \$809 million, or \$0.14 per mcf of proved reserves, of deferred taxes established in connection with certain corporate acquisitions. The vast majority of these acquisitions either increased our ownership in existing wells or fields or added additional drilling locations in our focused operating areas. Because these operating areas contain many smaller companies seeking liquidity opportunities and larger companies seeking to divest non-core assets, we expect to continue to find additional attractive acquisition opportunities in the future.

Grow through the Drillbit. One of our most distinctive characteristics is our ability to increase reserves and production through the drillbit. We are currently utilizing 78 operated drilling rigs and 82 non-operated drilling rigs to conduct the most active drilling program in the United States. We focus both on finding significant new natural gas reserves and developing existing proved reserves, principally at deeper depths than the industry average. For the past seven years, we have been aggressively investing in leasehold, 3-D seismic information and human capital to be able to take advantage of the favorable drilling economics that exist today. While we believe U.S. natural gas production has been generally declining during the past five years, we are one of the few large-cap companies that have been able to increase production, which we have successfully achieved for the past 16 consecutive years and 18 consecutive quarters. We believe key elements of the success and scale of our drilling programs have been our early recognition that gas prices were likely to move higher in the U.S. in the post-1999 period accompanied by our willingness to aggressively hire new employees and to build the nation's largest onshore leasehold and 3-D seismic inventories, all of which are the building blocks of value creation in a successful large-scale drilling program.

Build Regional Scale. We believe one of the keys to success in the natural gas exploration industry is to build significant operating scale in a limited number of operating areas that share many similar geological and operational characteristics. Achieving such scale provides many benefits, the most important of which are higher per unit revenues, lower per unit operating costs, greater rates of drilling success, higher returns from more easily integrated acquisitions and higher returns on drilling investments. We first began pursuing this focused strategy in the Mid-Continent in late 1997 and we are now the largest natural gas producer, the most active driller and the most active acquirer of leasehold and producing properties in the Mid-Continent. We believe this region, which trails only the Gulf Coast and Rocky Mountain basins in current U.S. gas production, has many attractive characteristics. These characteristics include long-lived natural gas properties with predictable decline curves; multi-pay geological targets that decrease drilling risk and have resulted in a drilling success rate of 93% over the past sixteen years; generally lower service costs than in more competitive or more remote basins; and a favorable regulatory environment with virtually no federal land ownership. We believe our other operating areas possess many of these same favorable characteristics and our goal is to become or remain a top five producer in each of our operating areas.

Focus on Low Costs. By minimizing lease operating costs and general and administrative expense through focused activities and increased scale, we have been able to deliver attractive financial returns through all phases of the commodity price cycle. We believe our low cost structure is the result of

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management's effective cost-control programs, a high-quality asset base and the extensive and competitive services, gas processing and transportation infrastructures that exist in our key operating areas. As of December 31, 2005, we operated approximately 18,200 wells, or approximately 80% of our daily production.

Improve our Balance Sheet. We have made significant progress in improving our balance sheet over the past seven years. From December 31, 1998 through December 31, 2005, we have increased our shareholders' equity by \$6.4 billion through a combination of earnings and common and preferred equity issuances. As of December 31, 2005, our debt as a percentage of total capitalization (total capitalization is the sum of debt and stockholders' equity) was 47%, compared to 49% as of December 31, 2004 and 137% as of December 31, 1998. We plan to continue improving our balance sheet in the years ahead.

Based on our view that natural gas will be in a tight supply/demand relationship in the U.S. during at least the next few years because of the significant structural challenges to growing gas supply and the growing demand for this clean-burning, domestically-produced fuel, we believe our focused natural gas acquisition, exploitation and exploration strategy should provide substantial value-creating growth opportunities in the years ahead. Our goal is to increase our overall production by 10% to 20% per year, with growth at an annual rate of 5% to 10% generated organically through the drillbit and the remaining growth generated through acquisitions. We have reached or exceeded this overall production goal in 11 of our 13 years as a public company.

Company Strengths

We believe the following six characteristics distinguish our past performance and differentiate our future growth potential from other independent natural gas producers:

High-Quality Asset Base. Our producing properties are characterized by long-lived reserves, established production profiles and an emphasis on onshore natural gas. Based upon current production and proved reserve estimates, our proved reserves-to-production ratio, or reserve life, is approximately 14 years. In addition, we believe we are the sixth largest producer of natural gas in the U.S. (second among independents) and among the largest owners of proved U.S. natural gas reserves. In each of our operating areas, our properties are concentrated in locations that enable us to establish substantial economies of scale in drilling and production operations and facilitate the application of more effective reservoir management practices. We intend to continue building our asset base in each of our operating areas through a balance of acquisitions, exploitation and exploration. As of December 31, 2005, we operated properties accounting for approximately 80% of our daily production volumes. This large percentage of operated properties provides us with a high degree of operating flexibility and cost control.

Low-Cost Producer. Our high-quality asset base, the work ethic of our employees, our hands-on management style and our headquarters location in Oklahoma City have enabled us to achieve a low operating and administrative cost structure. During 2005, our operating costs per unit of production were \$1.26 per mcfe, which consisted of general and administrative expenses of \$0.14 per mcfe (including non-cash stock-based compensation of \$0.03 per mcfe), production expenses of \$0.68 per mcfe and production taxes of \$0.44 per mcfe. We believe this is one of the lowest cost structures among publicly-traded, large-cap independent oil and natural gas producers.

Successful Acquisition Program. Our experienced acquisition team focuses on enhancing and expanding our existing assets in each of our operating areas. These areas are characterized by long-lived natural gas reserves, low lifting costs, multiple geological targets, favorable basis differentials to benchmark commodity prices, well-developed oil and gas transportation infrastructures and considerable potential for further consolidation of assets. Since 1998, we have completed \$10.3 billion in acquisitions at an estimated average cost of \$1.37 per mcfe of proved reserves. Included in this amount is \$2.2 billion for unproved leasehold, but excluded from this amount is \$809 million, or \$0.14

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per mcf of proved reserves, of deferred taxes established in connection with certain corporate acquisitions. We are well-positioned to continue making attractive acquisitions as a result of our extensive track record of identifying, completing and integrating multiple successful acquisitions, our large operating scale and our knowledge and experience in the regions in which we operate.

Large Inventory of Drilling Projects. During the 16 years since our inception, we have been among the five most active drillers of new wells in the United States. Presently, we are the most active driller in the U.S. (with 78 operated and 82 non-operated rigs drilling). Through this high level of activity over the years, we have developed an industry-leading expertise in drilling deep vertical and horizontal wells in search of large natural gas accumulations in challenging reservoir conditions. In addition, we believe that our large 11.6 million acre 3-D seismic inventory, much of which is proprietary to us, provides significant informational advantages over our competitors. As a result of our aggressive leasehold acquisition and seismic acquisition strategies, we have been able to accumulate a U.S. onshore leasehold position of approximately 8.5 million net acres and have acquired rights to 11.6 million acres of onshore 3-D seismic data to help evaluate our expansive acreage inventory. On this very large acreage position, our technical teams have identified approximately 28,000 exploratory and developmental drill sites, representing a backlog of more than ten years of future drilling opportunities at current drilling rates.

Hedging Program. We have used and intend to continue using hedging programs to reduce the risks inherent in acquiring and producing oil and natural gas reserves, commodities that are frequently characterized by significant price volatility. We believe this price volatility is likely to continue in the years ahead and that we can use this volatility to our benefit by taking advantage of prices when they reach levels that management believes are either unsustainable for the long-term or provide unusually high rates of return on our invested capital. Excluding hedges assumed in the acquisition of CNR, we currently have gas hedges in place covering 71% of our anticipated gas production for 2006, 36% of our anticipated gas production for 2007 and 22% of our anticipated gas production for 2008 at average NYMEX prices of \$9.43, \$9.85 and \$9.10 per mcf, respectively (excluding collars and options). In addition, we have 63% of our anticipated oil production hedged for 2006, 22% of our anticipated oil production hedged for 2007 and 14% of our anticipated oil production hedged for 2008 at average NYMEX prices of \$61.02, \$62.42 and \$65.48 per barrel of oil, respectively.

Entrepreneurial Management. Chesapeake was formed in 1989 with an initial capitalization of \$50,000 and fewer than ten employees. Since then, management has guided the company through various operational and industry challenges and extremes of oil and gas prices to create the second largest independent U.S. producer of natural gas with approximately 2,900 employees and an enterprise value of approximately \$20 billion. Our CEO and co-founder, Aubrey K. McClendon, has been in the oil and gas industry for 23 years and beneficially owns, as of March 10, 2006, approximately 22.4 million shares of our common stock.

Properties

Chesapeake focuses its natural gas exploration, development and acquisition efforts in one primary operating area and in four secondary operating areas: (i) the Mid-Continent (consisting of Oklahoma, Arkansas, southwestern Kansas and the Texas Panhandle), representing 51% of our proved reserves, (ii) the South Texas and Texas Gulf Coast region, representing 8% of our proved reserves, (iii) the Barnett Shale area of north-central Texas and the Ark-La-Tex area of central and East Texas and northern Louisiana, representing 14% of our proved reserves, (iv) the Permian Basin of western Texas and eastern New Mexico, representing 9% of our proved reserves, and (v) the Appalachian basin, principally in West Virginia, eastern Kentucky, eastern Ohio and southern New York, representing 17% of our proved reserves.

Chesapeake's strategy for 2006 is to continue developing our natural gas assets through exploratory and developmental drilling and by selectively acquiring strategic properties in the Mid-Continent and in our secondary areas. We project that our 2006 production will be between 576 bcfe and 586 bcfe. We have budgeted

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\$3.0 to \$3.2 billion for drilling, acreage acquisition, seismic and related capitalized internal costs, all of which is expected to be funded with operating cash flow based on our current assumptions. Our budget is frequently adjusted based on changes in oil and gas prices, drilling results, drilling costs and other factors. We expect to fund future acquisitions through a combination of operating cash flow, our revolving bank credit facility and, if needed, new debt and equity issuances.

Operating Areas

Mid-Continent. Chesapeake's Mid-Continent proved reserves of 3.798 tcf represented 51% of our total proved reserves as of December 31, 2005, and this area produced 298 bcfe, or 64%, of our 2005 production. During 2005, we invested approximately \$1.102 billion to drill 1,442 (498 net) wells in the Mid-Continent. We anticipate spending approximately 35% of our total budget for exploration and development activities in the Mid-Continent region during 2006.

South Texas and Texas Gulf Coast. Chesapeake's South Texas and Texas Gulf Coast proved reserves represented 622 bcfe, or 8%, of our total proved reserves as of December 31, 2005. During 2005, the South Texas and Texas Gulf Coast assets produced 64 bcfe, or 14%, of our total production. During 2005, we invested approximately \$239.1 million to drill 115 (80 net) wells in the South Texas and Texas Gulf Coast region. We anticipate spending approximately 10% of our total budget for exploration and development activities in the South Texas and Texas Gulf Coast region during 2006.

Ark-La-Tex and Barnett Shale. Chesapeake's Ark-La-Tex and Barnett Shale proved reserves represented 1.069 tcf, or 14%, of our total proved reserves as of December 31, 2005. During 2005, the Ark-La-Tex and Barnett Shale assets produced 58 bcfe, or 12%, of our total production. During 2005, we invested approximately \$326.9 million to drill 257 (171 net) wells in the Ark-La-Tex and Barnett Shale regions. For 2006, we anticipate spending approximately 33% of our total budget for exploration and development activities in the Ark-La-Tex and Barnett Shale regions.

Permian Basin. Chesapeake's Permian Basin proved reserves represented 693 bcfe, or 9%, of our total proved reserves as of December 31, 2005. During 2005, the Permian assets produced 40 bcfe, or 9%, of our total production. During 2005, we invested approximately \$265.9 million to drill 139 (56 net) wells in the Permian Basin. For 2006, we anticipate spending approximately 15% of our total budget for exploration and development activities in the Permian Basin.

Appalachian Basin. Chesapeake's Appalachian Basin proved reserves represented 1.296 tcf, or 17%, of our total proved reserves as of December 31, 2005. During 2005, the Appalachian assets produced 6 bcfe, or 1%, of our total production, which was not acquired until November 14, 2005. During 2005, we invested approximately \$8 million to drill 15 (11 net) wells in the Appalachian Basin. For 2006, we anticipate spending approximately 7% of our total budget for exploration and development activities in the Appalachian Basin.

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Drilling Activity

The following table sets forth the wells we drilled during the periods indicated. In the table, gross refers to the total wells in which we had a working interest and net refers to gross wells multiplied by our working interest.

| | 2005 | | | | 2004 | | | | 2003 | | | |
|----------------|-------|---------|-----|---------|-------|---------|-----|---------|-------|---------|-----|---------|
| | Gross | Percent | Net | Percent | Gross | Percent | Net | Percent | Gross | Percent | Net | Percent |
| Development: | | | | | | | | | | | | |
| Productive | 1,736 | 97% | 735 | 97% | 1,239 | 97% | 463 | 98% | 958 | 96% | 401 | 97% |
| Non-productive | 51 | 3 | 21 | 3 | 34 | 3 | 9 | 2 | 37 | 4 | 11 | 3 |
| Total | 1,787 | 100% | 756 | 100% | 1,273 | 100% | 472 | 100% | 995 | 100% | 412 | 100% |
| Exploratory: | | | | | | | | | | | | |
| Productive | 177 | 98% | 57 | 95% | 164 | 92% | 67 | 91% | 76 | 86% | 36 | 83% |
| Non-productive | 4 | 2 | 3 | 5 | 14 | 8 | 7 | 9 | 12 | 14 | 8 | 17 |
| Total | 181 | 100% | 60 | 100% | 178 | 100% | 74 | 100% | 88 | 100% | 44 | 100% |

The following table shows the wells we drilled by area:

| | 2005 | | 2004 | | 2003 | |
|----------------------------------|-------------|-----------|-------------|-----------|-------------|-----------|
| | Gross Wells | Net Wells | Gross Wells | Net Wells | Gross Wells | Net Wells |
| Mid-Continent | 1,442 | 498 | 1,195 | 417 | 984 | 403 |
| South Texas and Texas Gulf Coast | 115 | 80 | 67 | 38 | 55 | 25 |
| Ark-La-Tex and Barnett Shale | 257 | 171 | 82 | 36 | | |
| Permian | 139 | 56 | 107 | 55 | 44 | 28 |
| Appalachia | 15 | 11 | | | | |
| Total | 1,968 | 816 | 1,451 | 546 | 1083 | 456 |

At December 31, 2005, we had 154 (67 net) wells in process. As of December 31, 2005, we owned 18 drilling rigs dedicated to drilling wells operated by Chesapeake. An additional 26 drilling rigs are under construction or on order, and we purchased 13 drilling rigs in February 2006. Our drilling business is conducted through our wholly owned subsidiary, Nomac Drilling Corporation.

Well Data

At December 31, 2005, we had interests in approximately 30,600 (16,985 net) producing wells, including properties in which we held an overriding royalty interest, of which 3,100 (1,360 net) were classified as primarily oil producing wells and 27,500 (15,625 net) were classified as primarily gas producing wells. Chesapeake operated approximately 18,200 of its 30,600 producing wells. During 2005, we drilled 902 (686 net) wells and participated in another 1,066 (130 net) wells operated by other companies. We operate approximately 80% of our current daily production volumes.

Table of Contents**Production, Sales, Prices and Expenses**

The following table sets forth information regarding the production volumes, oil and gas sales, average sales prices received and expenses for the periods indicated:

| | 2005 | 2004 | 2003 |
|--|--------------|--------------|--------------|
| Net Production: | | | |
| Oil (mmbbl) | 7,698 | 6,764 | 4,665 |
| Gas (mmcf) | 422,389 | 322,009 | 240,366 |
| Gas equivalent (mmcfe) | 468,577 | 362,593 | 268,356 |
| Oil and Gas Sales (\$ in thousands): | | | |
| Oil sales | \$ 401,845 | \$ 260,915 | \$ 132,630 |
| Oil derivatives realized gains (losses) | (34,132) | (69,267) | (12,058) |
| Oil derivatives unrealized gains (losses) | 4,374 | 3,454 | (9,440) |
| Total oil sales | \$ 372,087 | \$ 195,102 | \$ 111,132 |
| Gas sales | \$ 3,231,286 | \$ 1,789,275 | \$ 1,171,050 |
| Gas derivatives realized gains (losses) | (367,551) | (85,634) | (5,331) |
| Gas derivatives unrealized gains (losses) | 36,763 | 37,433 | 19,971 |
| Total gas sales | \$ 2,900,498 | \$ 1,741,074 | \$ 1,185,690 |
| Total oil and gas sales | \$ 3,272,585 | \$ 1,936,176 | \$ 1,296,822 |
| Average Sales Price (excluding gains (losses) on derivatives): | | | |
| Oil (\$ per bbl) | \$ 52.20 | \$ 38.57 | \$ 28.43 |
| Gas (\$ per mcf) | \$ 7.65 | \$ 5.56 | \$ 4.87 |
| Gas equivalent (\$ per mcfe) | \$ 7.75 | \$ 5.65 | \$ 4.86 |
| Average Sales Price (excluding unrealized gains (losses) on derivatives): | | | |
| Oil (\$ per bbl) | \$ 47.77 | \$ 28.33 | \$ 25.85 |
| Gas (\$ per mcf) | \$ 6.78 | \$ 5.29 | \$ 4.85 |
| Gas equivalent (\$ per mcfe) | \$ 6.90 | \$ 5.23 | \$ 4.79 |
| Expenses (\$ per mcfe): | | | |
| Production expenses | \$ 0.68 | \$ 0.56 | \$ 0.51 |
| Production taxes | \$ 0.44 | \$ 0.29 | \$ 0.29 |
| General and administrative expenses | \$ 0.14 | \$ 0.10 | \$ 0.09 |
| Oil and gas depreciation, depletion and amortization | \$ 1.91 | \$ 1.61 | \$ 1.38 |
| Depreciation and amortization of other assets | \$ 0.11 | \$ 0.08 | \$ 0.06 |
| Interest expense (a) | \$ 0.47 | \$ 0.45 | \$ 0.55 |

- (a) Includes realized gains or (losses) from interest rate derivatives, but does not include unrealized gains or (losses) and is net of amounts capitalized.

Table of Contents**Oil and Gas Reserves**

The tables below set forth information as of December 31, 2005 with respect to our estimated proved reserves, the associated estimated future net revenue and present value (discounted at 10%) of estimated future net revenue before and after income tax (standardized measure) at such date. Neither the pre-tax present value of estimated future net revenue nor the after-tax standardized measure is intended to represent the current market value of the estimated oil and gas reserves we own.

| | December 31, 2005 | | Total (mmcfe) |
|---------------------|-------------------|------------------|------------------|
| | Oil (mbbl) | Gas (mmcf) | |
| Proved developed | 76,238 | 4,442,270 | 4,899,694 |
| Proved undeveloped | 27,085 | 2,458,484 | 2,620,996 |
| Total proved | 103,323 | 6,900,754 | 7,520,690 |

| | Proved Developed | Proved Undeveloped (\$ in thousands) | Total Proved |
|---|---------------------|--|-----------------|
| | | | |
| Estimated future net revenue (a) | \$ 32,435,228 | \$ 14,376,458 | \$ 46,811,686 |
| Present value of future net revenue (a) | \$ 16,271,138 | \$ 6,662,456 | \$ 22,933,594 |
| Standardized measure (a) (b) | | | \$ 15,967,911 |

| | Oil (mbbl) | Gas (mmcf) | Gas Equivalent (mmcfe) | Percent of Proved Reserves | Present Value (\$ in thousands) |
|----------------------------------|----------------|------------------|------------------------------|-------------------------------------|---------------------------------------|
| | | | | | |
| Mid-Continent | 48,915 | 3,504,653 | 3,798,216 | 51% | \$ 11,308,766 |
| South Texas and Texas Gulf Coast | 3,308 | 602,551 | 622,399 | 8 | 2,459,379 |
| Ark-La-Tex and Barnett Shale | 6,379 | 1,030,962 | 1,069,236 | 14 | 3,551,565 |
| Permian | 39,126 | 457,811 | 692,570 | 9 | 2,040,175 |
| Appalachia | 1,094 | 1,289,919 | 1,296,482 | 17 | 3,462,744 |
| Other | 4,501 | 14,858 | 41,787 | 1 | 110,965 |
| Total | 103,323 | 6,900,754 | 7,520,690 | 100% | \$ 22,933,594(a) |

- (a) Estimated future net revenue represents the estimated future gross revenue to be generated from the production of proved reserves, net of estimated production and future development costs, using prices and costs in effect at December 31, 2005. The prices used in the external and internal reports yield weighted average wellhead prices of \$56.41 per barrel of oil and \$8.76 per mcf of gas. These prices should not be interpreted as a prediction of future prices. The amounts shown do not give effect to non-property related expenses, such as corporate general and administrative expenses and debt service, or to depreciation, depletion and amortization. Estimated future net revenue and the present value thereof differ from future net cash flows and the standardized measure thereof only because the former do not include the effects of future income tax expenses (\$6.97 billion as of December 31, 2005).

Management uses future net revenue, which is calculated without deducting estimated future income tax expenses, and the present value thereof as one measure of the value of the company's current proved reserves and to compare relative values among peer companies without regard to income taxes. We also understand that securities analysts and rating agencies use this measure in similar ways. While future net revenue and present value are based on prices, costs and discount factors which are consistent from company to company, the standardized measure of discounted future net cash flows is dependent on the unique tax situation of each individual company.

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- (b) The standardized measure of discounted future net cash flows is calculated in accordance with SFAS 69. Additional information on the standardized measure is presented in note 11 of the notes to our consolidated financial statements included in Item 8 of this report.

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As of December 31, 2005, our reserve estimates included 2.621 tcf of reserves classified as proved undeveloped (PUD). Of this amount, approximately 56% (by volume) were initially classified as PUDs in 2005, 29% were initially classified as PUDs in 2004, 5% were initially classified as PUDs in 2003, and the remaining 10% were initially classified as PUDs prior to 2003. Of our proved developed reserves, 555 bcf are non-producing, which are primarily behind pipe zones in producing wells.

The future net revenue attributable to our estimated proved undeveloped reserves of \$14.4 billion at December 31, 2005, and the \$6.7 billion present value thereof, has been calculated assuming that we will expend approximately \$4.3 billion to develop these reserves. The amount and timing of these expenditures will depend on a number of factors, including actual drilling results, product prices and the availability of capital, but we have projected to incur \$1.8 billion in 2006, \$1.1 billion in 2007, \$0.7 billion in 2008 and \$0.7 billion in 2009 and beyond. We do not believe any of these proved undeveloped reserves are contingent upon installation of additional infrastructure and we are not subject to regulatory approval other than routine permits to drill, which we expect to obtain in the normal course of business.

Chesapeake employed third-party engineers to prepare independent reserve forecasts for approximately 78% of our proved reserves (by volume) at year-end 2005. These are not audits or reviews of internally prepared reserve reports. The estimates of the proved reserves evaluated by third-party engineers were within 99% of the company's own estimates and were used instead of our estimates for booking purposes. Netherland, Sewell & Associates, Inc. evaluated 25%, Data and Consulting Services, Division of Schlumberger Technology Corporation evaluated 16%, Lee Keeling and Associates, Inc. evaluated 15%, Ryder Scott Company L.P. evaluated 12%, LaRoche Petroleum Consultants, Ltd. evaluated 8%, and H. J. Gruy and Associates, Inc. evaluated 2% of our estimated proved reserves by volume at December 31, 2005. Of the 41,880 properties included in the 2005 reserve reports, the estimates prepared by the independent firms covered approximately 16,400 properties, or 39% of the total well count. Because, in management's opinion, it is cost prohibitive for third-party engineers to evaluate all of our wells, we have prepared reserve forecasts for approximately 22% of our proved reserves. All estimates were prepared based upon a review of production histories and other geologic, economic, ownership and engineering data we developed. The estimates are not based on any single significant assumption due to the diverse nature of the reserves and there is no significant concentration of proved reserves volume or value in any one well.

No estimates of proved reserves comparable to those included herein have been included in reports to any federal agency other than the Securities and Exchange Commission.

Chesapeake's ownership interest used in calculating proved reserves and the associated estimated future net revenue was determined after giving effect to the assumed maximum participation by other parties to our farmout and participation agreements. The prices used in calculating the estimated future net revenue attributable to proved reserves do not reflect market prices for oil and gas production sold subsequent to December 31, 2005. There can be no assurance that all of the estimated proved reserves will be produced and sold at the assumed prices.

There are numerous uncertainties inherent in estimating quantities of proved reserves and in projecting future rates of production and timing of development expenditures, including many factors beyond Chesapeake's control. The reserve data represent only estimates. Reserve engineering is a subjective process of estimating underground accumulations of oil and gas that cannot be measured in an exact way, and the accuracy of any reserve estimate is a function of the quality of available data and of engineering and geological interpretation and judgment. As a result, estimates made by different engineers often vary. In addition, results of drilling, testing and production subsequent to the date of an estimate may justify revision of such estimates, and such revisions may be material. Accordingly, reserve estimates are often different from the actual quantities of oil and gas that are ultimately recovered. Furthermore, the estimated future net revenue from proved reserves and the associated present value are based upon certain assumptions, including prices, future production levels and costs that may not prove correct. Future prices and costs may be materially higher or lower than the prices and costs as of the date of any estimate. A change in price of \$0.10 per mcf for natural gas and \$1.00 per barrel for oil would result

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in a change in the December 31, 2005 present value of estimated future net revenue of our proved reserves of approximately \$315 million and \$50 million, respectively. The estimated future net revenue used in this analysis does not include the effects of future income taxes or hedging. The foregoing uncertainties are particularly true as to proved undeveloped reserves, which are inherently less certain than proved developed reserves and which comprise a significant portion of our proved reserves.

The company's estimated proved reserves and the standardized measure of discounted future net cash flows of the proved reserves at December 31, 2005, 2004 and 2003, and the changes in quantities and standardized measure of such reserves for each of the three years then ended, are shown in Note 11 of the notes to the consolidated financial statements included in Item 8 of this report.

Development, Exploration, Acquisition and Divestiture Activities

The following table sets forth historical cost information regarding our development, exploration, acquisition and divestiture activities during the periods indicated:

| | 2005 | December 31, 2004 (\$ in thousands) | 2003 |
|---|--------------|---|--------------|
| Acquisition of properties: | | | |
| Proved properties | \$ 3,554,651 | \$ 1,541,920 | \$ 1,110,077 |
| Unproved properties | 1,375,675 | 570,495 | 198,394 |
| Deferred income taxes | 251,722 | 463,949 | (4,903) |
| Total | 5,182,048 | 2,576,364 | 1,303,568 |
| Development costs: | | | |
| Development drilling (a) | 1,566,730 | 863,268 | 474,355 |
| Leasehold acquisition costs | 290,946 | 110,530 | 84,984 |
| Asset retirement obligation and other (b) | 52,619 | 41,924 | 54,657 |
| Total | 1,910,295 | 1,015,722 | 613,996 |
| Exploration costs: | | | |
| Exploratory drilling | 253,341 | 128,635 | 103,424 |
| Geological and geophysical costs (c) | 70,901 | 55,618 | 42,736 |
| Total | 324,242 | 184,253 | 146,160 |
| Sales of oil and gas properties | (9,769) | (12,048) | (22,156) |
| Total | \$ 7,406,816 | \$ 3,764,291 | \$ 2,041,568 |

(a) Includes capitalized internal cost of \$94.1 million, \$45.4 million and \$30.9 million, respectively.

(b) The 2003 amount includes \$24.1 million of asset retirement costs recorded as a result of implementation of SFAS 143 effective January 1, 2003.

(c) Includes capitalized internal cost of \$8.1 million, \$6.3 million and \$4.6 million, respectively.

Our development costs included \$671 million, \$333 million and \$229 million in 2005, 2004 and 2003, respectively, related to properties carried as proved undeveloped locations in the prior year's reserve reports. Included in our reserve report as of December 31, 2005 are estimated future development costs of \$4.3 billion related to the development of proved undeveloped reserves (\$1.8 billion in 2006, \$1.1 billion in 2007, \$0.7 billion in 2008 and \$0.7 billion in 2009 and beyond). Chesapeake's developmental drilling schedules are subject to revision and reprioritization throughout the year, resulting from unknowable factors such as the relative success in an individual developmental drilling prospect leading to an additional drilling opportunity, rig availability, title issues or delays, and the effect that acquisitions may have on prioritizing development drilling plans.

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A summary of our development, exploration, acquisition and divestiture activities in 2005 by operating area is as follows:

| | Gross Wells Drilled | Net Wells Drilled | Exploration and Development | Leasehold | Acquisition of Unproved Properties (\$ in thousands) | Acquisition of Proved Properties (a) | Sales of Properties | Total |
|----------------------------------|---------------------------|-------------------------|-----------------------------------|-------------------|---|--|------------------------|---------------------|
| Mid-Continent South Texas and | 1,442 | 498 | \$ 1,102,099 | \$ 166,281 | \$ 178,169 | \$ 217,238 | \$ (214) | \$ 1,663,573 |
| Texas Gulf Coast | 115 | 80 | 239,107 | 87,418 | 224,947 | 215,166 | | 766,638 |
| Ark-La-Tex and Barnett Shale | 257 | 171 | 359,206 | 7,816 | 350,416 | 666,309 | | 1,383,747 |
| Permian | 139 | 56 | 233,597 | 29,452 | 114,874 | 339,838 | (9,555) | 708,206 |
| Appalachia | 15 | 11 | 7,673 | | 506,881 | 2,367,835 | | 2,882,389 |
| Other | | | 1,909 | (21) | 388 | (13) | | 2,263 |
| Total | 1,968 | 816 | \$ 1,943,591 | \$ 290,946 | \$ 1,375,675 | \$ 3,806,373 | \$ (9,769) | \$ 7,406,816 |

(a) Includes \$252 million of deferred tax adjustments.

Acreage

The following table sets forth as of December 31, 2005 the gross and net acres of both developed and undeveloped oil and gas leases which we hold. Gross acres are the total number of acres in which we own a working interest. Net acres refer to gross acres multiplied by our fractional working interest. Acreage numbers do not include our options to acquire additional leasehold which have not been exercised.

| | Developed | | Undeveloped | | Total | |
|----------------------------------|------------------|------------------|------------------|------------------|-------------------|------------------|
| | Gross | Net | Gross | Net | Gross | Net |
| Mid-Continent | 3,636,949 | 1,723,203 | 3,497,527 | 1,609,322 | 7,134,476 | 3,332,525 |
| South Texas and Texas Gulf Coast | 304,027 | 172,915 | 352,121 | 229,615 | 656,148 | 402,530 |
| Ark-La-Tex and Barnett Shale | 164,589 | 116,239 | 317,082 | 220,316 | 481,671 | 336,555 |
| Permian | 175,204 | 110,571 | 726,714 | 459,224 | 901,918 | 569,795 |
| Appalachia | 506,828 | 478,791 | 2,907,116 | 2,681,685 | 3,413,944 | 3,160,476 |
| Canada | | | 673,689 | 614,616 | 673,689 | 614,616 |
| Other | 43,424 | 18,607 | 95,240 | 76,084 | 138,664 | 94,691 |
| Total | 4,831,021 | 2,620,326 | 8,569,489 | 5,890,862 | 13,400,510 | 8,511,188 |

Marketing

Chesapeake's oil production is generally sold under market sensitive or spot price contracts. Our natural gas production is sold to purchasers under percentage-of-proceeds contracts, percentage-of-index contracts or spot price contracts. By the terms of the percentage-of-proceeds contracts, we receive a percentage of the resale price received by the purchaser for sales of residue gas and natural gas liquids recovered after transportation and processing of our gas. These purchasers sell the residue gas and natural gas liquids based primarily on spot market prices. The revenue we receive from the sale of natural gas liquids is included in oil sales. Under percentage-of-index contracts, the price per mmbtu we receive for our gas is tied to indexes published in *Inside FERC* or *Gas Daily*. Although exact percentages vary daily, as of February 2006, approximately 70% of our natural gas production was sold under short-term contracts at market-sensitive or spot prices.

During 2005, sales to Eagle Energy Partners I, L.P. (Eagle) of \$851 million accounted for 18% of our total revenues. Chesapeake owns approximately 33% of Eagle. Management believes that the loss of this customer would not have a material adverse effect on our results of

operations or our financial position. No other customer accounted for more than 10% of total revenues in 2005.

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Chesapeake Energy Marketing, Inc., which is our marketing subsidiary, provides marketing services, including commodity price structuring, contract administration and nomination services for Chesapeake and its partners. This subsidiary is a reportable segment under SFAS No. 131, *Disclosure about Segments of an Enterprise and Related Information*. See Note 8 of the notes to our consolidated financial statements in Item 8.

Drilling

In 2001, Chesapeake formed its 100% owned drilling rig subsidiary, Nomac Drilling Corporation (Nomac), with an investment of \$26 million to build and refurbish five drilling rigs. As of December 31, 2005, Nomac owned 18 drilling rigs dedicated to drilling wells operated by Chesapeake and had an additional 26 rigs under construction or on order. The 18 drilling rigs which are currently drilling company-operated wells have depth ratings between 7,500 and 23,000 feet and range in drilling horsepower from 650 to 2,000. These drilling rigs are currently operating in the Mid-Continent region of Oklahoma and Texas. In February 2006, Nomac acquired 13 drilling rigs from privately-held Martex Drilling Corporation for \$150 million. The acquisition of Martex will bring Nomac's rig fleet to 57 drilling rigs when all rigs on order are delivered. As the Martex drilling rigs currently under contract become available, they will be used for drilling company-operated wells.

Gas Gathering

Chesapeake owns and operates gathering systems in 13 states throughout the Mid-Continent and Appalachian regions. These systems are designed primarily to gather company production and are comprised of approximately 7,600 miles of gathering lines, treating facilities and processing facilities which provide service to approximately 8,775 wells.

Hedging Activities

We utilize hedging strategies to hedge the price of a portion of our future oil and natural gas production and to manage interest rate exposure. See Item 7A Quantitative and Qualitative Disclosures About Market Risk.

Regulation

General. All of our operations are conducted onshore in the United States. The U.S. oil and gas industry is subject to regulation at the federal, state and local level, and some of the laws, rules and regulations that govern our operations carry substantial penalties for noncompliance. This regulatory burden increases our cost of doing business and, consequently, affects our profitability.

Regulation of Oil and Gas Operations. Our exploration and production operations are subject to various types of regulation at the U.S. federal, state and local levels, although very few of our oil and gas leases are located on federal lands. Such regulation includes requirements for permits to drill and to conduct other operations and for provision of financial assurances (such as bonds) covering drilling and well operations. Other activities subject to regulation are:

the location of wells,

the method of drilling and completing wells,

the surface use and restoration of properties upon which wells are drilled,

the plugging and abandoning of wells,

the disposal of fluids used or other wastes obtained in connection with operations,

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the marketing, transportation and reporting of production, and

the valuation and payment of royalties.

Our operations are also subject to various conservation regulations. These include the regulation of the size of drilling and spacing units (regarding the density of wells which may be drilled in a particular area) and the

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unitization or pooling of oil and gas properties. In this regard, some states, such as Oklahoma and Arkansas, allow the forced pooling or integration of tracts to facilitate exploration, while other states, such as Texas and New Mexico, rely on voluntary pooling of lands and leases. In areas where pooling is voluntary, it may be more difficult to form units and, therefore, more difficult to fully develop a project if the operator owns less than 100% of the leasehold. In addition, state conservation laws establish maximum rates of production from oil and gas wells, generally prohibit the venting or flaring of gas and impose certain requirements regarding the ratability of production. The effect of these regulations is to limit the amount of oil and gas we can produce and to limit the number of wells or the locations at which we can drill.

Chesapeake operates a number of natural gas gathering systems. The U.S. Department of Transportation and certain state agencies regulate the safety and operating aspects of the transportation and storage activities of these facilities. All of the company's sales of oil, natural gas liquids and natural gas are currently deregulated, although governmental agencies may elect in the future to regulate certain sales.

We do not anticipate that compliance with existing laws and regulations governing exploration, production and gas gathering will have a significantly adverse effect upon our capital expenditures, earnings or competitive position.

Environmental Regulation. Various federal, state and local laws and regulations concerning the discharge of contaminants into the environment, the generation, storage, transportation and disposal of contaminants, and the protection of public health, natural resources, wildlife and the environment affect our exploration, development and production operations, including processing facilities. We must take into account the cost of complying with environmental regulations in planning, designing, drilling, operating and abandoning wells. In most instances, the regulatory requirements relate to the handling and disposal of drilling and production waste products, water and air pollution control procedures, and the remediation of petroleum-product contamination. In addition, our operations may require us to obtain permits for, among other things,

air emissions,

discharges into surface waters, and

the construction and operation of underground injection wells or surface pits to dispose of produced saltwater and other nonhazardous oilfield wastes.

Under state and federal laws, we could be required to remove or remediate previously disposed wastes, including wastes disposed of or released by us or prior owners or operators in accordance with current laws or otherwise, to suspend or cease operations in contaminated areas, or to perform remedial well plugging operations or cleanups to prevent future contamination. The Environmental Protection Agency and various state agencies have limited the disposal options for hazardous and nonhazardous wastes. The owner and operator of a site, and persons that treated, disposed of or arranged for the disposal of hazardous substances found at a site, may be liable, without regard to fault or the legality of the original conduct, for the release of a hazardous substance into the environment. The Environmental Protection Agency, state environmental agencies and, in some cases, third parties are authorized to take actions in response to threats to human health or the environment and to seek to recover from responsible classes of persons the costs of such action. Furthermore, certain wastes generated by our oil and natural gas operations that are currently exempt from treatment as hazardous wastes may in the future be designated as hazardous wastes and, therefore, be subject to considerably more rigorous and costly operating and disposal requirements.

Federal and state occupational safety and health laws require us to organize information about hazardous materials used, released or produced in our operations. Certain portions of this information must be provided to employees, state and local governmental authorities and local citizens. We are also subject to the requirements and reporting set forth in federal workplace standards.

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We have made and will continue to make expenditures to comply with environmental regulations and requirements. These are necessary business costs in the oil and gas industry. Although we are not fully insured against all environmental risks, we maintain insurance coverage which we believe is customary in the industry. Moreover, it is possible that other developments, such as stricter and more comprehensive environmental laws and regulations, as well as claims for damages to property or persons resulting from company operations, could result in substantial costs and liabilities, including civil and criminal penalties, to Chesapeake. We believe we are in compliance with existing environmental regulations, and that, absent the occurrence of an extraordinary event the effect of which cannot be predicted, any noncompliance will not have a material adverse effect on our operations or earnings.

Income Taxes

Chesapeake recorded income tax expense of \$545.1 million in 2005 compared to income tax expense of \$289.8 million in 2004 and \$191.8 million in 2003. Our effective income tax rate was 36.5% in 2005 compared to 36% in 2004 and 38% in 2003. The increase in 2005 reflected the impact state income taxes and permanent differences had on our overall effective rate. We expect our effective income tax rate will increase to 38% in 2006 to reflect our current assessment of expected increases in state income taxes and permanent differences.

At December 31, 2005, Chesapeake had federal income tax net operating loss (NOL) carryforwards of approximately \$564.5 million. We also had approximately \$169.6 million of alternative minimum tax (AMT) NOL carryforwards available as a deduction against future AMT income and approximately \$12.3 million of percentage depletion carryforwards. The NOL carryforwards expire from 2012 through 2025. The value of the remaining carryforwards depends on the ability of Chesapeake to generate taxable income. In addition, for AMT purposes, only 90% of AMT income in any given year may be offset by AMT NOLs.

The ability of Chesapeake to utilize NOL carryforwards to reduce future federal taxable income and federal income tax is subject to various limitations under the Internal Revenue Code of 1986, as amended. The utilization of such carryforwards may be limited upon the occurrence of certain ownership changes, including the issuance or exercise of rights to acquire stock, the purchase or sale of stock by 5% stockholders, as defined in the Treasury regulations, and the offering of stock by us during any three-year period resulting in an aggregate change of more than 50% in the beneficial ownership of Chesapeake.

In the event of an ownership change (as defined for income tax purposes), Section 382 of the Code imposes an annual limitation on the amount of a corporation's taxable income that can be offset by these carryforwards. The limitation is generally equal to the product of (i) the fair market value of the equity of the company multiplied by (ii) a percentage approximately equivalent to the yield on long-term tax exempt bonds during the month in which an ownership change occurs. In addition, the limitation is increased if there are recognized built-in gains during any post-change year, but only to the extent of any net unrealized built-in gains (as defined in the Code) inherent in the assets sold. Certain NOLs acquired through various acquisitions are also subject to limitations. The following table summarizes our net operating losses as of December 31, 2005 and any related limitations:

| | Net Operating Losses | | |
|------------------------|----------------------|------------------------------|------------|
| | | | Annual |
| | Total | Limited (\$ in thousands) | Limitation |
| Net operating loss | \$ 564,451 | \$ 49,284 | \$ 27,754 |
| AMT net operating loss | \$ 169,635 | \$ 11,220 | \$ 6,652 |

Although no assurances can be made, we do not believe that an ownership change has occurred as of December 31, 2005. Future equity transactions by Chesapeake or by 5% stockholders (including relatively small transactions and transactions beyond our control) could cause an ownership change and therefore a limitation on the annual utilization of NOLs. Following an ownership change, the amount of Chesapeake's NOLs available for use each year will depend upon future events that cannot currently be predicted and upon interpretation of complex

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rules under Treasury regulations. If less than the full amount of the annual limitation is utilized in any given year, the unused portion may be carried forward and may be used in addition to successive years' annual limitation.

We expect to utilize our NOL carryforwards and other tax deductions and credits to offset taxable income in the future. However, there is no assurance that the Internal Revenue Service will not challenge these carryforwards or their utilization.

Title to Properties

Our title to properties is subject to royalty, overriding royalty, carried, net profits, working and other similar interests and contractual arrangements customary in the oil and gas industry, to liens for current taxes not yet due and to other encumbrances. As is customary in the industry in the case of undeveloped properties, only cursory investigation of record title is made at the time of acquisition. Drilling title opinions are usually prepared before commencement of drilling operations. We believe we have satisfactory title to substantially all of our active properties in accordance with standards generally accepted in the oil and gas industry. Nevertheless, we are involved in title disputes from time to time which result in litigation.

Operating Hazards and Insurance

The oil and gas business involves a variety of operating risks, including the risk of fire, explosions, blow-outs, pipe failure, abnormally pressured formations and environmental hazards such as oil spills, gas leaks, ruptures or discharges of toxic gases. If any of these should occur, Chesapeake could suffer substantial losses due to injury or loss of life, severe damage to or destruction of property, natural resources and equipment, pollution or other environmental damage, clean-up responsibilities, regulatory investigation and penalties, and suspension of operations. Our horizontal and deep drilling activities involve greater risk of mechanical problems than vertical and shallow drilling operations.

Chesapeake maintains a \$50 million oil and gas lease operator policy that insures against certain sudden and accidental risks associated with drilling, completing and operating our wells. There is no assurance that this insurance will be adequate to cover all losses or exposure to liability. Chesapeake also carries a \$175 million comprehensive general liability umbrella policy and a \$100 million pollution liability policy. We provide workers' compensation insurance coverage to employees in all states in which we operate and we maintain a \$1 million employment practice liability policy. While we believe these policies are customary in the industry, they do not provide complete coverage against all operating risks.

Facilities

Chesapeake owns an office complex in Oklahoma City and also owns or leases various field offices in the following locations:

Illinois: Chicago;

Kansas: Garden City;

Kentucky: Gray, Elkhorn City, Hueysville, Inez and Prestonburg;

Louisiana: Cheneyville and Shreveport;

New Mexico: Eunice and Hobbs;

New York: Hammondsport;

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Oklahoma: Arkoma, Billings, El Reno, Kingfisher, Lindsay, Waynoka, Weatherford, Wilburton, Forgan and Sayre;

Tennessee: Egan;

Texas: Borger, Dumas, College Station, Midland, Cleburne, Goliad, Ozona, Tyler, Victoria and Zapata; and

West Virginia: Branchland, Buckhannon, Cedar Grove, Charleston, Clendenin, Kermit and Tad.

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Employees

Chesapeake had 2,885 employees as of December 31, 2005, which includes 429 employed by our drilling subsidiary, Nomac Drilling Corporation. As a result of the CNR acquisition, approximately 140 of our employees are covered by a collective bargaining agreement. We believe our employee relations are good.

Glossary of Oil and Gas Terms

The terms defined in this section are used throughout this Form 10-K.

Bcf. Billion cubic feet.

Bcfe. Billion cubic feet of gas equivalent.

Bbl. One stock tank barrel, or 42 U.S. gallons liquid volume, used herein in reference to crude oil or other liquid hydrocarbons.

Btu. British thermal unit, which is the heat required to raise the temperature of a one-pound mass of water from 58.5 to 59.5 degrees Fahrenheit.

Commercial Well; Commercially Productive Well. An oil and gas well which produces oil and gas in sufficient quantities such that proceeds from the sale of such production exceed production expenses and taxes.

Developed Acreage. The number of acres which are allocated or assignable to producing wells or wells capable of production.

Development Well. A well drilled within the proved area of an oil or gas reservoir to the depth of a stratigraphic horizon known to be productive.

Dry Hole; Dry Well. A well found to be incapable of producing either oil or gas in sufficient quantities to justify completion as an oil or gas well.

Exploratory Well. A well drilled to find and produce oil or gas in an unproved area, to find a new reservoir in a field previously found to be productive of oil or gas in another reservoir or to extend a known reservoir.

Farmout. An assignment of an interest in a drilling location and related acreage conditional upon the drilling of a well on that location.

Formation. A succession of sedimentary beds that were deposited under the same general geologic conditions.

Full Cost Pool. The full cost pool consists of all costs associated with property acquisition, exploration, and development activities for a company using the full cost method of accounting. Additionally, any internal costs that can be directly identified with acquisition, exploration and development activities are included. Any costs related to production, general corporate overhead or similar activities are not included.

Gross Acres or Gross Wells. The total acres or wells, as the case may be, in which a working interest is owned.

Horizontal Wells. Wells which are drilled at angles greater than 70 degrees from vertical.

Mbbl. One thousand barrels of crude oil or other liquid hydrocarbons.

Mbtu. One thousand btus.

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Mcf. One thousand cubic feet.

Mcfe. One thousand cubic feet of gas equivalent.

Mmbbl. One million barrels of crude oil or other liquid hydrocarbons.

Mmbtu. One million btus.

Mmcf. One million cubic feet.

Mmcfe. One million cubic feet of gas equivalent.

Net Acres or Net Wells. The sum of the fractional working interests owned in gross acres or gross wells.

NYMEX. New York Mercantile Exchange.

Present Value or PV-10. When used with respect to oil and gas reserves, present value or PV-10 means the estimated future gross revenue to be generated from the production of proved reserves, net of estimated production and future development costs, using prices and costs in effect at the determination date, without giving effect to non-property related expenses such as general and administrative expenses, debt service and future income tax expense or to depreciation, depletion and amortization, discounted using an annual discount rate of 10%.

Productive Well. A well that is producing oil or gas or that is capable of production.

Proved Developed Reserves. Reserves that can be expected to be recovered through existing wells with existing equipment and operating methods. Additional oil and gas expected to be obtained through the application of fluid injection or other improved recovery techniques for supplementing the natural forces and mechanisms of primary recovery should be included as proved developed reserves only after testing by a pilot project or after the operation of an installed program has confirmed through production responses that increased recovery will be achieved.

Reserve Replacement. Calculated by dividing the sum of reserve additions from all sources (revisions, extensions, discoveries and other additions and acquisitions) by the actual production for the corresponding period. The values for these reserve additions are derived directly from the proved reserves table on page 107. In calculating reserve replacement, we do not use unproved reserve quantities or proved reserve additions attributable to less than wholly-owned consolidated entities or investments accounted for using the equity method. Management uses the reserve replacement ratio as an indicator of the company's ability to replenish annual production volumes and grow its reserves, thereby providing some information on the sources of future production. It should be noted that the reserve replacement ratio is a statistical indicator that has limitations. As an annual measure, the ratio is limited because it typically varies widely based on the extent and timing of new discoveries and property acquisitions. Its predictive and comparative value is also limited for the same reasons. In addition, since the ratio does not imbed the cost or timing of future production of new reserves, it cannot be used as a measure of value creation.

Proved Reserves. The estimated quantities of crude oil, natural gas and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions, i.e., prices and costs as of the date the estimate is made. Reservoirs are considered proved if economic producibility is supported by either actual production or conclusive formation test. The area of a reservoir considered proved includes (a) that portion delineated by drilling and defined by gas-oil and/or oil-water contacts, if any, and (b) the immediately adjoining portions not yet drilled, but which can be reasonably judged as economically productive on the basis of available

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geological and engineering data. In the absence of information on fluid contacts, the lowest known structural occurrence of hydrocarbons controls the lower proved limit of the reservoir. Reserves which can be produced economically through application of improved recovery techniques (such as fluid injection) are included in the proved classification when successful testing by a pilot project, or the operation of an installed program in the reservoir, provides support for the engineering analysis on which the project or program was based.

Proved Undeveloped Location. A site on which a development well can be drilled consistent with spacing rules for purposes of recovering proved undeveloped reserves.

Proved Undeveloped Reserves. Reserves that are expected to be recovered from new wells on undrilled acreage or from existing wells where a relatively major expenditure is required for recompletion. Reserves on undrilled acreage are limited to those drilling units offsetting productive units that are reasonably certain of production when drilled. Proved reserves for other undrilled units can be claimed only where it can be demonstrated with certainty that there is continuity of production from the existing productive formation. Proved undeveloped reserves may not include estimates attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless such techniques have been proved effective by actual tests in the area and in the same reservoir.

Royalty Interest. An interest in an oil and gas property entitling the owner to a share of oil or gas production free of costs of production.

Standardized Measure of Discounted Future Net Cash Flows. The discounted future net cash flows relating to proved reserves based on year-end prices, costs and statutory tax rates (adjusted for permanent differences) and a 10-percent annual discount rate.

Tcf. One trillion cubic feet.

Tcfe. One trillion cubic feet of gas equivalent.

Undeveloped Acreage. Lease acreage on which wells have not been drilled or completed to a point that would permit the production of commercial quantities of oil and gas regardless of whether such acreage contains proved reserves.

Working Interest. The operating interest which gives the owner the right to drill, produce and conduct operating activities on the property and a share of production.

ITEM 1A. Risk Factors

Our business has many risks. Any of the following factors could materially adversely affect our business, financial condition, operating results or liquidity and the trading price of our common stock, preferred stock or senior notes could decline. This information should be considered carefully, together with other information in this report and other reports and materials we file with the Securities and Exchange Commission.

Oil and gas prices are volatile. A decline in prices could adversely affect our financial position, financial results, cash flows, access to capital and ability to grow.

Our revenues, operating results, profitability and future rate of growth depend primarily upon the prices we receive for the oil and gas we sell. Prices also affect the amount of cash flow available for capital expenditures and our ability to borrow money or raise additional capital. The amount we can borrow from banks is subject to periodic redeterminations based on prices specified by our bank group at the time of redetermination. In addition, we may have ceiling test write-downs in the future if prices fall significantly.

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Historically, the markets for oil and gas have been volatile and they are likely to continue to be volatile. Wide fluctuations in oil and gas prices may result from relatively minor changes in the supply of and demand for oil and natural gas, market uncertainty and other factors that are beyond our control, including:

worldwide and domestic supplies of oil and gas;

weather conditions;

the level of consumer demand;

the price and availability of alternative fuels;

the proximity and capacity of natural gas pipelines and other transportation facilities;

the price and level of foreign imports;

domestic and foreign governmental regulations and taxes;

the ability of the members of the Organization of Petroleum Exporting Countries to agree to and maintain oil price and production controls;

political instability or armed conflict in oil-producing regions; and

overall domestic and global economic conditions.

These factors and the volatility of the energy markets make it extremely difficult to predict future oil and gas price movements with any certainty. Declines in oil and gas prices would not only reduce revenue, but could reduce the amount of oil and gas that we can produce economically and, as a result, could have a material adverse effect on our financial condition, results of operations and reserves. Further, oil and gas prices do not necessarily move in tandem. Because approximately 92% of our reserves at December 31, 2005 are natural gas reserves, we are more affected by movements in natural gas prices.

Our level of indebtedness may limit our financial flexibility.

As of December 31, 2005, we had long-term indebtedness of approximately \$5.5 billion, with \$72.0 million drawn under our revolving bank credit facility. Our long-term indebtedness represented 47% of our total book capitalization at December 31, 2005. As of March 10, 2006, we had approximately \$402 million outstanding under our revolving bank credit facility.

Our level of indebtedness and preferred stock affects our operations in several ways, including the following:

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a portion of our cash flows from operating activities must be used to service our indebtedness and pay dividends on our preferred stock and is not available for other purposes;

we may be at a competitive disadvantage as compared to peer companies that have less debt;

the covenants contained in the agreements governing our outstanding indebtedness and future indebtedness may limit our ability to borrow additional funds, pay dividends and make certain investments and may also affect our flexibility in planning for, and reacting to, changes in the economy and in our industry;

additional financing in the future for working capital, capital expenditures, acquisitions, general corporate or other purposes may have higher costs and more restrictive covenants;

changes in the credit ratings of our debt may negatively affect the cost, terms, conditions and availability of future financing, and lower ratings will increase the interest rate and fees we pay on our revolving bank credit facility; and

we may be more vulnerable to general adverse economic and industry conditions.

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We may incur additional debt, including significant secured indebtedness, or issue additional series of preferred stock in order to make future acquisitions or to develop our properties. A higher level of indebtedness and/or additional preferred stock increases the risk that we may default on our obligations. Our ability to meet our debt obligations and to reduce our level of indebtedness depends on our future performance. General economic conditions, oil and gas prices and financial, business and other factors affect our operations and our future performance. Many of these factors are beyond our control. We may not be able to generate sufficient cash flow to pay the interest on our debt, and future working capital, borrowings or equity financing may not be available to pay or refinance such debt. Factors that will affect our ability to raise cash through an offering of our capital stock or a refinancing of our debt include financial market conditions, the value of our assets and our performance at the time we need capital.

In addition, our bank borrowing base is subject to periodic redetermination. A lowering of our borrowing base could require us to repay indebtedness in excess of the borrowing base, or we might need to further secure the lenders with additional collateral.

Competition in the oil and natural gas industry is intense, and many of our competitors have greater financial and other resources than we do.

We operate in the highly competitive areas of oil and natural gas acquisition, development, exploitation, exploration and production. We face intense competition from both major and other independent oil and natural gas companies in each of the following areas:

seeking to acquire desirable producing properties or new leases for future exploration, and

seeking to acquire the equipment and expertise necessary to develop and operate our properties.

Many of our competitors have financial and other resources substantially greater than ours, and some of them are fully integrated oil companies. These companies may be able to pay more for development prospects and productive oil and natural gas properties and may be able to define, evaluate, bid for and purchase a greater number of properties and prospects than our financial or human resources permit. Our ability to develop and exploit our oil and natural gas properties and to acquire additional properties in the future will depend upon our ability to successfully conduct operations, evaluate and select suitable properties and consummate transactions in this highly competitive environment.

Significant capital expenditures are required to replace our reserves.

Our exploration, development and acquisition activities require substantial capital expenditures. Historically, we have funded our capital expenditures through a combination of cash flows from operations, our revolving bank credit facility and debt and equity issuances. Future cash flows are subject to a number of variables, such as the level of production from existing wells, prices of oil and gas, and our success in developing, acquiring and producing new reserves. If revenue were to decrease as a result of lower oil and gas prices or decreased production, and our access to capital were limited, we would have a reduced ability to replace our reserves. If our cash flow from operations is not sufficient to fund our capital expenditure budget, we may not be able to access additional bank debt, debt or equity or other methods of financing on an economic basis to meet these requirements.

If we are not able to replace reserves, we may not be able to sustain production.

Our future success depends largely upon our ability to find, develop or acquire additional oil and gas reserves that are economically recoverable. Unless we replace the reserves we produce through successful development, exploration or acquisition activities, our proved reserves and production will decline over time. In addition, approximately 35% of our total estimated proved reserves (by volume) at December 31, 2005 were undeveloped. By their nature, estimates of undeveloped reserves are less certain. Recovery of such reserves will

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require significant capital expenditures and successful drilling operations. Our reserve estimates reflect that our production rate on producing properties will decline approximately 24% from 2006 to 2007. Thus, our future oil and natural gas reserves and production and, therefore, our cash flow and income are highly dependent on our success in efficiently developing and exploiting our current reserves and economically finding or acquiring additional recoverable reserves.

The actual quantities and present value of our proved reserves may prove to be lower than we have estimated.

This report contains estimates of our proved reserves and the estimated future net revenues from our proved reserves. These estimates are based upon various assumptions, including assumptions required by the SEC relating to oil and gas prices, drilling and operating expenses, capital expenditures, taxes and availability of funds. The process of estimating oil and gas reserves is complex. The process involves significant decisions and assumptions in the evaluation of available geological, geophysical, engineering and economic data for each reservoir. Therefore, these estimates are inherently imprecise.

Actual future production, oil and gas prices, revenues, taxes, development expenditures, operating expenses and quantities of recoverable oil and gas reserves most likely will vary from these estimates. Such variations may be significant and could materially affect the estimated quantities and present value of our proved reserves. In addition, we may adjust estimates of proved reserves to reflect production history, results of exploration and development drilling, prevailing oil and gas prices and other factors, many of which are beyond our control. Our properties may also be susceptible to hydrocarbon drainage from production by operators on adjacent properties.

At December 31, 2005, approximately 35% of our estimated proved reserves (by volume) were undeveloped. Recovery of undeveloped reserves requires significant capital expenditures and successful drilling operations. These reserve estimates include the assumption that we will make significant capital expenditures to develop the reserves, including \$1.8 billion in 2006. You should be aware that the estimated costs may not be accurate, development may not occur as scheduled and results may not be as estimated.

You should not assume that the present values referred to in this report represent the current market value of our estimated oil and natural gas reserves. In accordance with SEC requirements, the estimates of our present values are based on prices and costs as of the date of the estimates. The December 31, 2005 present value is based on weighted average oil and natural gas wellhead prices of \$56.41 per barrel of oil and \$8.76 per mcf of natural gas. Actual future prices and costs may be materially higher or lower than the prices and costs as of the date of an estimate.

Any changes in consumption by oil and natural gas purchasers or in governmental regulations or taxation will also affect actual future net cash flows.

The timing of both the production and the expenses from the development and production of oil and natural gas properties will affect both the timing of actual future net cash flows from our proved reserves and their present value. In addition, the 10% discount factor, which is required by the SEC to be used in calculating discounted future net cash flows for reporting purposes, is not necessarily the most accurate discount factor. The effective interest rate at various times and the risks associated with our business or the oil and gas industry in general will affect the accuracy of the 10% discount factor.

Acquisitions may prove to be worth less than we paid because of uncertainties in evaluating recoverable reserves and potential liabilities.

Our recent growth is due in part to acquisitions of exploration and production companies, producing properties and undeveloped leasehold. We expect acquisitions will also contribute to our future growth. Successful acquisitions require an assessment of a number of factors, including estimates of recoverable reserves,

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exploration potential, future oil and gas prices, operating costs and potential environmental and other liabilities. Such assessments are inexact and their accuracy is inherently uncertain. In connection with our assessments, we perform a review of the acquired properties which we believe is generally consistent with industry practices. However, such a review will not reveal all existing or potential problems. In addition, our review may not permit us to become sufficiently familiar with the properties to fully assess their deficiencies and capabilities. We do not inspect every well. Even when we inspect a well, we do not always discover structural, subsurface and environmental problems that may exist or arise. We are generally not entitled to contractual indemnification for pre-closing liabilities, including environmental liabilities. Normally, we acquire interests in properties on an as is basis with limited remedies for breaches of representations and warranties. As a result of these factors, we may not be able to acquire oil and gas properties that contain economically recoverable reserves or be able to complete such acquisitions on acceptable terms.

We were not entitled to contractual indemnification for the majority of pre-closing liabilities, including environmental liabilities, in our recent acquisition of CNR. We acquired CNR on an as is basis with very limited remedies for breaches of representations and warranties. We might incur significant liabilities relating to CNR in the future which we have not yet identified or cannot quantify at this time.

As new owners, we may not effectively consolidate and integrate acquired operations, particularly when we make significant acquisitions outside our historical operating areas.

Significant acquisitions present operational and administrative challenges that may prove more difficult than anticipated. The failure to consolidate functions and integrate procedures, personnel and operations in an effective and timely manner may adversely affect our business and results of operations, at least temporarily. Significant acquisitions can change the nature of our operations and business depending upon the character of the acquired properties, which may have substantially different operating and geological characteristics or be in different geographic locations than our existing properties. To the extent that we acquire properties substantially different from the properties in our primary operating areas or acquire properties that require different technical expertise, we may not be able to realize the economic benefits of these acquisitions as efficiently as in our prior acquisitions. As a result of our recent acquisition of CNR, we now have a significant presence in the Appalachian Basin, principally in West Virginia, eastern Kentucky, eastern Ohio and southern New York. We have not previously developed or explored for oil and natural gas in this part of the U.S.

Exploration and development drilling may not result in commercially productive reserves.

We do not always encounter commercially productive reservoirs through our drilling operations. The new wells we drill or participate in may not be productive and we may not recover all or any portion of our investment in wells we drill or participate in. The seismic data and other technologies we use do not allow us to know conclusively prior to drilling a well that oil or gas is present or may be produced economically. The cost of drilling, completing and operating a well is often uncertain, and cost factors can adversely affect the economics of a project. Our efforts will be unprofitable if we drill dry wells or wells that are productive but do not produce enough reserves to return a profit after drilling, operating and other costs. Further, our drilling operations may be curtailed, delayed or canceled as a result of a variety of factors, including:

increases in the cost of, or shortages or delays in the availability of, drilling rigs and equipment;

unexpected drilling conditions;

title problems;

pressure or irregularities in formations;

equipment failures or accidents;

adverse weather conditions; and

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compliance with environmental and other governmental requirements.

Future price declines may result in a write-down of our asset carrying values.

We utilize the full cost method of accounting for costs related to our oil and gas properties. Under this method, all such costs (for both productive and nonproductive properties) are capitalized and amortized on an aggregate basis over the estimated lives of the properties using the unit-of-production method. However, these capitalized costs are subject to a ceiling test which limits such pooled costs to the aggregate of the present value of future net revenues attributable to proved oil and gas reserves discounted at 10% plus the lower of cost or market value of unproved properties. The full cost ceiling is evaluated at the end of each quarter using the prices for oil and gas at that date, adjusted for the impact of derivatives accounted for as cash flow hedges. A significant decline in oil and gas prices from current levels, or other factors, without other mitigating circumstances, could cause a future write-down of capitalized costs and a non-cash charge against future earnings.

Our hedging activities may reduce the realized prices received for our oil and gas sales and require us to provide collateral for hedging liabilities.

In order to manage our exposure to price volatility in marketing our oil and gas, we enter into oil and gas price risk management arrangements for a portion of our expected production. Commodity price hedging may limit the prices we actually realize and therefore reduce oil and gas revenues in the future. The fair value of our oil and gas derivative instruments outstanding as of December 31, 2005 was a liability of approximately \$945.8 million. In addition, our commodity price risk management transactions may expose us to the risk of financial loss in certain circumstances, including instances in which:

our production is less than expected;

there is a widening of price differentials between delivery points for our production and the delivery point assumed in the hedge arrangement; or

the counterparties to our contracts fail to perform under the contracts.

Some of our commodity price and interest rate risk management arrangements require us to deliver cash collateral or other assurances of performance to the counterparties in the event that our payment obligations exceed certain levels. As of December 31, 2005, we were required to post a total of \$50 million of collateral with our counterparties through letters of credit issued under our bank credit facility with respect to commodity price and financial risk management transactions. As of March 10, 2006, we were required to post \$50 million of collateral with our counterparties through letters of credit. Future collateral requirements are uncertain and will depend on arrangements with our counterparties and highly volatile natural gas and oil prices.

Lower oil and gas prices could negatively impact our ability to borrow.

Our amended and restated revolving bank credit facility limits our borrowings to the lesser of the borrowing base (currently \$2.5 billion) and the commitment (currently \$2.0 billion). The borrowing base is determined periodically at the discretion of the banks and is based in part on oil and gas prices. Additionally, some of our indentures contain covenants limiting our ability to incur indebtedness in addition to that incurred under our bank credit facility. These indentures limit our ability to incur additional indebtedness unless we meet one of two alternative tests. The first alternative is based on our adjusted consolidated net tangible assets (as defined in all of our indentures), which is determined using discounted future net revenues from proved oil and gas reserves as of the end of each year. The second alternative is based on the ratio of our adjusted consolidated EBITDA (as defined in the relevant indentures) to our adjusted consolidated interest expense over a trailing twelve-month period. As of the date of this report, we are permitted to incur significant additional indebtedness under both of these debt incurrence tests. Lower oil and gas prices in the future could reduce our adjusted consolidated EBITDA, as well as our adjusted consolidated net tangible assets, and thus could reduce our ability to incur additional indebtedness.

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Oil and gas drilling and producing operations can be hazardous and may expose us to environmental liabilities.

Oil and gas operations are subject to many risks, including well blowouts, cratering and explosions, pipe failure, fires, formations with abnormal pressures, uncontrollable flows of oil, natural gas, brine or well fluids, and other environmental hazards and risks. Our drilling operations involve risks from high pressures and from mechanical difficulties such as stuck pipes, collapsed casings and separated cables. If any of these risks occur, we could sustain substantial losses as a result of:

injury or loss of life;

severe damage to or destruction of property, natural resources and equipment;

pollution or other environmental damage;

clean-up responsibilities;

regulatory investigations and penalties; and

suspension of operations.

Our liability for environmental hazards includes those created either by the previous owners of properties that we purchase or lease or by acquired companies prior to the date we acquire them. We maintain insurance against some, but not all, of the risks described above. Our insurance may not be adequate to cover casualty losses or liabilities. Also, in the future we may not be able to obtain insurance at premium levels that justify its purchase.

ITEM 1B. *Unresolved Staff Comments*

None.

ITEM 2. *Properties*

Information regarding our properties is included in Item 1 and in Note 11 of the notes to our consolidated financial statements included in Item 8 of this report.

ITEM 3. *Legal Proceedings*

We are currently involved in various disputes incidental to our business operations. We believe that the final resolution of currently pending or threatened litigation is not likely to have a material adverse effect on our financial position or results of operations or cash flows.

ITEM 4. *Submission of Matters to a Vote of Security Holders*

Not applicable.

Table of Contents**PART II****ITEM 5. *Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities*****Price Range of Common Stock**

Our common stock trades on the New York Stock Exchange under the symbol **CHK**. The following table sets forth, for the periods indicated, the high and low sales prices per share of our common stock as reported by the New York Stock Exchange:

| | Common Stock | |
|--------------------------------------|---------------------|------------|
| | High | Low |
| Year ended December 31, 2005: | | |
| First Quarter | \$ 23.65 | \$ 15.06 |
| Second Quarter | 24.00 | 17.74 |
| Third Quarter | 38.98 | 22.90 |
| Fourth Quarter | 40.20 | 26.59 |
| Year ended December 31, 2004: | | |
| First Quarter | \$ 13.98 | \$ 11.70 |
| Second Quarter | 15.05 | 12.68 |
| Third Quarter | 16.24 | 13.69 |
| Fourth Quarter | 18.31 | 15.17 |

At March 10, 2006, there were 1,473 holders of record of our common stock and approximately 322,000 beneficial owners.

Dividends

The following table sets forth the amount of dividends per share declared on Chesapeake common stock during 2005 and 2004:

| | 2005 | 2004 |
|----------------|-------------|-------------|
| First Quarter | \$ 0.045 | \$ 0.035 |
| Second Quarter | 0.050 | 0.045 |
| Third Quarter | 0.050 | 0.045 |
| Fourth Quarter | 0.050 | 0.045 |

While we expect to continue to pay dividends on our common stock, the payment of future cash dividends will depend upon, among other things, our financial condition, funds from operations, the level of our capital and development expenditures, our future business prospects, contractual restrictions and any other factors considered relevant by the board of directors.

Several of the indentures governing our outstanding senior notes contain restrictions on our ability to declare and pay cash dividends. Under these indentures, we may not pay any cash dividends on our common or preferred stock if an event of default has occurred, if we have not met one of the two debt incurrence tests described in the indentures, or if immediately after giving effect to the dividend payment, we have paid total dividends and made other restricted payments in excess of the permitted amounts. As of December 31, 2005, our coverage ratio for purposes of the debt incurrence test under the relevant indentures was 5.45 to 1, compared to 2.25 to 1 required in our indentures. Our adjusted consolidated net tangible assets under the relevant indentures exceeded 200% of our total indebtedness, as required in our indentures, by more than \$5.2 billion.

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The following table presents information about repurchases of our common stock during the three months ended December 31, 2005:

| | | | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs (b) |
|--|--|--|---|--|
| Period | Total Number of Shares Purchased (a) | Average Price Paid Per Share (a) | | |
| October 1, 2005 through October 31, 2005 | 28,227 | \$ 32.461 | | |
| November 1, 2005 through November 30, 2005 | 26,596 | \$ 29.890 | | |
| December 1, 2005 through December 31, 2005 | 22,952 | \$ 31.965 | | |
| Total | 77,775 | \$ 31.435 | | |

- (a) Includes 75,224 shares purchased in the open market for the matching contributions we make to our 401(k) plans and the surrender to the company of 2,551 shares of common stock to pay withholding taxes in connection with the vesting of employee restricted stock.
- (b) We make matching contributions to our 401(k) plans and 401(k) make-up plan using Chesapeake common stock which is held in treasury or is purchased by the respective plan trustees in the open market. The plans contain no limitation on the number of shares that may be purchased for purposes of company contributions. There are no other repurchase plans or programs currently authorized by the board of directors.

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The following table sets forth selected consolidated financial data of Chesapeake for the years ended December 31, 2005, 2004, 2003, 2002 and 2001. The data are derived from our audited consolidated financial statements revised to reflect the reclassification of certain items. In addition to changes in the annual average prices for oil and gas and increased production from drilling activity, significant acquisitions in recent years also impacted comparability between years. See Notes 11 and 13 of the notes to our consolidated financial statements. The table should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements, including the notes, appearing in Items 7 and 8 of this report.

| | 2005 | Years Ended December 31, | | | | 2001 |
|--|--|--------------------------|--------------|------------|------------|------|
| | | 2004 | 2003 | 2002 | | |
| | (\$ in thousands, except per share data) | | | | | |
| Statement of Operations Data: | | | | | | |
| Revenues: | | | | | | |
| Oil and gas sales | \$ 3,272,585 | \$ 1,936,176 | \$ 1,296,822 | \$ 568,187 | \$ 820,318 | |
| Oil and gas marketing sales | 1,392,705 | 773,092 | 420,610 | 170,315 | 148,733 | |
| Total revenues | 4,665,290 | 2,709,268 | 1,717,432 | 738,502 | 969,051 | |
| Operating costs: | | | | | | |
| Production expenses | 316,956 | 204,821 | 137,583 | 98,191 | 75,374 | |
| Production taxes | 207,898 | 103,931 | 77,893 | 30,101 | 33,010 | |
| General and administrative expenses | 64,272 | 37,045 | 23,753 | 17,618 | 14,449 | |
| Oil and gas marketing expenses | 1,358,003 | 755,314 | 410,288 | 165,736 | 144,373 | |
| Oil and gas depreciation, depletion and amortization | 894,035 | 582,137 | 369,465 | 221,189 | 172,902 | |
| Depreciation and amortization of other assets | 50,966 | 29,185 | 16,793 | 14,009 | 8,663 | |
| Provision for legal settlements | | 4,500 | 6,402 | | | |
| Total operating costs | 2,892,130 | 1,716,933 | 1,042,177 | 546,844 | 448,771 | |
| Income from operations | 1,773,160 | 992,335 | 675,255 | 191,658 | 520,280 | |
| Other income (expense): | | | | | | |
| Interest and other income | 10,452 | 4,476 | 2,827 | 7,340 | 2,877 | |
| Interest expense | (219,800) | (167,328) | (154,356) | (112,031) | (98,321) | |
| Loss on repurchases or exchanges of Chesapeake debt | (70,419) | (24,557) | (20,759) | (2,626) | (76,667) | |
| Loss on investment in Seven Seas Petroleum, Inc. | | | (2,015) | (17,201) | | |
| Impairments of investments in securities | | | | | (10,079) | |
| Gain on sale of Canadian subsidiary | | | | | 27,000 | |
| Gothic standby credit facility costs | | | | | (3,392) | |
| Total other income (expense) | (279,767) | (187,409) | (174,303) | (124,518) | (158,582) | |
| Income before income taxes and cumulative effect of accounting change | 1,493,393 | 804,926 | 500,952 | 67,140 | 361,698 | |
| Income tax expense (benefit): | | | | | | |
| Current | | | 5,000 | (1,822) | 3,565 | |
| Deferred | 545,091 | 289,771 | 185,360 | 28,676 | 140,727 | |
| Total income tax expense | 545,091 | 289,771 | 190,360 | 26,854 | 144,292 | |
| Net income before cumulative effect of accounting change, net of tax | 948,302 | 515,155 | 310,592 | 40,286 | 217,406 | |
| Cumulative effect of accounting change, net of income taxes of \$1,464,000 | | | 2,389 | | | |
| Net Income | 948,302 | 515,155 | 312,981 | 40,286 | 217,406 | |
| Preferred stock dividends | (41,813) | (39,506) | (22,469) | (10,117) | (2,050) | |
| Loss on conversion/exchange of preferred stock | (26,874) | (36,678) | | | | |

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| | | | | | | | | | | |
|--|----|---------|----|---------|----|---------|----|--------|----|---------|
| Net income available to common shareholders | \$ | 879,615 | \$ | 438,971 | \$ | 290,512 | \$ | 30,169 | \$ | 215,356 |
| Earnings per common share basic: | | | | | | | | | | |
| Income before cumulative effect of accounting change | \$ | 2.73 | \$ | 1.73 | \$ | 1.36 | \$ | 0.18 | \$ | 1.33 |
| Cumulative effect of accounting change | | | | | | 0.02 | | | | |
| | \$ | 2.73 | \$ | 1.73 | \$ | 1.38 | \$ | 0.18 | \$ | 1.33 |
| Earnings per common share assuming dilution: | | | | | | | | | | |
| Income before cumulative effect of accounting change | \$ | 2.51 | \$ | 1.53 | \$ | 1.20 | \$ | 0.17 | \$ | 1.25 |
| Cumulative effect of accounting change | | | | | | 0.01 | | | | |
| | \$ | 2.51 | \$ | 1.53 | \$ | 1.21 | \$ | 0.17 | \$ | 1.25 |
| Cash dividends declared per common share | \$ | 0.195 | \$ | 0.170 | \$ | 0.135 | \$ | 0.060 | \$ | |

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| | 2005 | Years Ended December 31, | | | |
|---|---------------|--|--------------|--------------|--------------|
| | | 2004 | 2003 | 2002 | 2001 |
| | | (\$ in thousands, except per share data) | | | |
| Cash Flow Data: | | | | | |
| Cash provided by operating activities | \$ 2,406,888 | \$ 1,432,274 | \$ 938,907 | \$ 428,797 | \$ 478,098 |
| Cash used in investing activities | 7,017,494 | 3,381,204 | 2,077,217 | 779,745 | 670,105 |
| Cash provided by financing activities | 4,663,737 | 1,915,245 | 931,254 | 480,991 | 310,146 |
| Effect of exchange rate changes on cash | | | | | (545) |
| Balance Sheet Data (at end of period): | | | | | |
| Total assets | \$ 16,118,462 | \$ 8,244,509 | \$ 4,572,291 | \$ 2,875,608 | \$ 2,286,768 |
| Long-term debt, net of current maturities | 5,489,742 | 3,075,109 | 2,057,713 | 1,651,198 | 1,329,453 |
| Stockholders' equity | 6,174,323 | 3,162,883 | 1,732,810 | 907,875 | 767,407 |

ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**Financial Data**

The following table sets forth certain information regarding the production volumes, oil and gas sales, average sales prices received and expenses for the periods indicated:

| | 2005 | December 31, 2004 | 2003 |
|--|--------------|-------------------|--------------|
| Net Production: | | | |
| Oil (mmbbl) | 7,698 | 6,764 | 4,665 |
| Gas (mmcf) | 422,389 | 322,009 | 240,366 |
| Gas equivalent (mmcf) | 468,577 | 362,593 | 268,356 |
| Oil and Gas Sales (\$ in thousands): | | | |
| Oil sales | \$ 401,845 | \$ 260,915 | \$ 132,630 |
| Oil derivatives realized gains (losses) | (34,132) | (69,267) | (12,058) |
| Oil derivatives unrealized gains (losses) | 4,374 | 3,454 | (9,440) |
| Total oil sales | 372,087 | 195,102 | 111,132 |
| Gas sales | 3,231,286 | 1,789,275 | 1,171,050 |
| Gas derivatives realized gains (losses) | (367,551) | (85,634) | (5,331) |
| Gas derivatives unrealized gains (losses) | 36,763 | 37,433 | 19,971 |
| Total gas sales | 2,900,498 | 1,741,074 | 1,185,690 |
| Total oil and gas sales | \$ 3,272,585 | \$ 1,936,176 | \$ 1,296,822 |
| Average Sales Price (excluding gains (losses) on derivatives): | | | |
| Oil (\$ per bbl) | \$ 52.20 | \$ 38.57 | \$ 28.43 |
| Gas (\$ per mcf) | \$ 7.65 | \$ 5.56 | \$ 4.87 |
| Gas equivalent (\$ per mcf) | \$ 7.75 | \$ 5.65 | \$ 4.86 |
| Average Sales Price (excluding unrealized gains (losses) on derivatives): | | | |
| Oil (\$ per bbl) | \$ 47.77 | \$ 28.33 | \$ 25.85 |
| Gas (\$ per mcf) | \$ 6.78 | \$ 5.29 | \$ 4.85 |
| Gas equivalent (\$ per mcf) | \$ 6.90 | \$ 5.23 | \$ 4.79 |
| Expenses (\$ per mcf): | | | |
| Production expenses | \$ 0.68 | \$ 0.56 | \$ 0.51 |
| Production taxes (a) | \$ 0.44 | \$ 0.29 | \$ 0.29 |
| General and administrative expenses | \$ 0.14 | \$ 0.10 | \$ 0.09 |
| Oil and gas depreciation, depletion and amortization | \$ 1.91 | \$ 1.61 | \$ 1.38 |
| Depreciation and amortization of other assets | \$ 0.11 | \$ 0.08 | \$ 0.06 |
| Interest expense (b) | \$ 0.47 | \$ 0.45 | \$ 0.55 |
| Interest Expense (\$ in thousands): | | | |

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| | | | | |
|--|---------------------------|------------|------------|------------|
| Interest expense | | \$ 226,330 | \$ 162,781 | \$ 151,676 |
| Interest rate derivatives | realized (gains) losses | (4,945) | (791) | (3,859) |
| Interest rate derivatives | unrealized (gains) losses | (1,585) | 5,338 | 6,539 |
| Total interest expense | | \$ 219,800 | \$ 167,328 | \$ 154,356 |
| Net Wells Drilled | | 816 | 546 | 456 |
| Net Producing Wells as of the End of Period | | 16,985 | 8,058 | 5,873 |

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- (a) Production taxes in 2004 include a benefit of \$6.8 million, or \$0.02 per mcfe, from 2003 severance tax credits.
- (b) Includes realized gains or (losses) from interest rate derivatives, but does not include unrealized gains or (losses) and is net of amounts capitalized.

We manage our business as three separate segments, an exploration and production segment, a marketing segment and a service operations segment which is comprised of our wholly owned drilling subsidiary. We refer you to Note 8 of the notes to our consolidated financial statements appearing in Item 8 of this report, which summarizes by segment our net income and capital expenditures for 2005, 2004 and 2003 and our assets as of December 31, 2005, 2004 and 2003.

Executive Summary

Chesapeake is the second largest independent producer of natural gas in the United States and we own interests in approximately 30,600 producing oil and gas wells. Our strategy is focused on discovering, developing and acquiring onshore natural gas reserves primarily in the southwestern U.S. and secondarily in the Appalachian Basin in the eastern U.S. Our most important operating area has historically been the Mid-Continent region, which includes Oklahoma, Arkansas, Kansas and the Texas Panhandle. At December 31, 2005, 51% of our proved reserves were located in the Mid-Continent. During the past four years, we have also built significant positions in the South Texas and Texas Gulf Coast regions, the Permian Basin of West Texas and eastern New Mexico, the Barnett Shale area of north-central Texas, the Ark-La-Tex area of East Texas and northern Louisiana and the emerging Fayetteville Shale play in Arkansas. As a result of our recent acquisition of Columbia Energy Resources, LLC and its subsidiaries, including Columbia Natural Resources, LLC (CNR) as described below, we now have a significant presence in the Appalachian Basin, principally in West Virginia, eastern Kentucky, eastern Ohio and southern New York.

Chesapeake attributes its strong organic growth rates during 2005 and in the past five years to management's early recognition that oil and gas prices were undergoing structural change and its subsequent decision to invest aggressively in the building blocks of value creation in the E&P industry—people, land and seismic. During the past five years, Chesapeake has invested more than \$3.0 billion in new leasehold and 3-D seismic acquisitions and now owns what it believes to be the largest inventories of onshore leasehold (8.5 million net acres) and 3-D seismic (11.6 million acres) in the U.S. On this leasehold, the company has identified more than a 10-year drilling inventory of approximately 28,000 drilling locations.

In addition, Chesapeake has significantly strengthened its technical capabilities during the past five years by increasing its land, geoscience and engineering staff by 400% to over 600 employees. Today, the company has more than 3,300 employees, of which approximately 70% work in the company's E&P operations and 30% work in the company's oilfield service operations.

Oil and natural gas production for 2005 was 468.6 bcfe, an increase of 106.0 bcfe, or 29% over the 362.6 bcfe produced in 2004. We have increased our production for 16 consecutive years and 18 consecutive quarters. During these 18 quarters, Chesapeake's U.S. production has increased 262% for an average compound quarterly growth rate of 7% and an average compound annual growth rate of 33%.

In addition to increased oil and natural gas production, the prices we received were higher in 2005 than in 2004. On a natural gas equivalent basis, weighted average prices (excluding the effect of unrealized gains or losses on derivatives) were \$6.90 per mcfe in 2005 compared to \$5.23 per mcfe in 2004. The increase in prices resulted in an increase in revenue of \$782.2 million, and increased production resulted in an increase in revenue of \$554.0 million, for a total increase in revenue of \$1.336 billion (excluding the effect of unrealized gains or losses on derivatives). In each of the operating areas where Chesapeake sells its oil and natural gas, established marketing and transportation infrastructures exist thereby contributing to relatively high wellhead price realizations for our production.

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During 2005, Chesapeake drilled 902 (686 net) operated wells and participated in another 1,066 (130 net) wells operated by other companies. The company's drilling success rate was 98% for company-operated wells and 95% for non-operated wells. During 2005, Chesapeake invested \$1.511 billion in operated wells (using an average of 73 operated rigs), \$309 million in non-operated wells (using an average of approximately 66 non-operated rigs) and \$362 million in acquiring new 3-D seismic data and new leasehold (excluding leasehold acquired through acquisitions). Our acquisition expenditures totaled \$4.9 billion during 2005 (including amounts paid for unproved leasehold and excluding \$252 million of deferred taxes in connection with certain corporate acquisitions). We expect to continue replacing reserves through the drillbit and acquisitions, although the timing and magnitude of future additions are uncertain.

Chesapeake began 2005 with estimated proved reserves of 4.902 tcf and ended the year with 7.521 tcf, an increase of 2.619 tcf, or 53%. During 2005, we replaced 468.6 bcf of production with an estimated 3.088 tcf of new proved reserves, for a reserve replacement rate of 659%. This compares to reserve replacement of 578% and 459% for 2004 and 2003, respectively. Reserve replacement through the drillbit was 1.047 tcf, or 223% of production (including a positive 17 bcf from performance revisions and a positive 24 bcf from oil and natural gas price increases), or 34% of the total increase. Reserve replacement through acquisitions was 2.041 tcf, or 436% of production, or 66% of the total increase. Our annual decline rate on producing properties is projected to be 24% from 2006 to 2007, 16% from 2007 to 2008, 13% from 2008 to 2009, 11% from 2009 to 2010 and 10% from 2010 to 2011. Our percentage of proved undeveloped reserve additions to total proved reserve additions was approximately 36% in 2005, 56% in 2004 and 35% in 2003. Based on our current drilling schedule and budget, we expect that virtually all of the proved undeveloped reserves added in 2005 will begin producing within the next five years. Generally, proved developed reserves are producing at the time they are added or will begin producing within a year.

On November 14, 2005, we acquired CNR and its significant natural gas reserves, acreage and mid-stream assets for approximately \$3.02 billion, of which \$2.2 billion was in cash and \$0.82 billion was in assumed liabilities related to CNR's working capital deficit and its prepaid sales agreement and hedging positions. The CNR assets consist of 125 mmcf per day of natural gas production, 1.3 tcf of proved reserves and approximately 3.2 million net acres of U.S. oil and gas leasehold, which we estimate have over 9,000 additional undrilled locations with reserve potential. CNR also owns extensive mid-stream natural gas assets, including over 6,500 miles of natural gas gathering lines.

In anticipation of today's tight drilling rig market, Chesapeake began making a series of investments in drilling rigs in 2001. In that year, Chesapeake formed its 100% owned drilling rig subsidiary, Nomac Drilling Corporation, with an investment of \$26 million to build and refurbish five drilling rigs. Chesapeake has invested a total of \$123 million in Nomac's 19 operating rigs, invested another \$26 million in 25 rigs that Nomac is currently building, and budgeted an additional \$191 million for completion of these rigs.

In addition to Nomac, Chesapeake has also made four other major drilling rig investments. The first of these was its ownership of approximately 17% of the common stock of Pioneer Drilling Company (Pioneer), which we began acquiring in 2003. The company recently sold its Pioneer stock, realizing proceeds of \$159 million and a pre-tax gain of \$116 million that it will recognize in the 2006 first quarter. Chesapeake re-invested the Pioneer proceeds to acquire 13 rigs from privately held Martex Drilling Company, L.L.P. for \$150 million.

Chesapeake has invested \$43 million in two private drilling rig contractors, DHS Drilling Company and Mountain Drilling Company, in which Chesapeake owns 45% and 49%, respectively. DHS owns ten drilling rigs and has three more rigs on order. Mountain owns one drilling rig and has ordered another nine rigs for delivery in 2006 and 2007. Chesapeake's drilling rig investments have served as a partial hedge to rising service costs and have also provided competitive advantages in making acquisitions and in developing its own leasehold on a more timely basis.

As of December 31, 2005, the company's debt as a percentage of total capitalization (total capitalization is the sum of debt and stockholders equity) was 47% compared to 49% as of December 31, 2004. During 2005, we

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received net proceeds of \$5.252 billion through issuances of \$1.380 billion of preferred equity, \$1.025 billion of common equity, and \$2.990 billion principal amount of senior notes. We issued 18.7 million shares of common stock in exchange for outstanding shares of our 4.125% and 5.0% (Series 2003) preferred stock and upon conversions of our 6.0% preferred stock. Additionally, we purchased and retired \$564.4 million principal amount of outstanding senior notes during 2005. As a result of our debt transactions during 2005, we have extended the average maturity of our long-term debt to over 10 years and have lowered our average interest rate to approximately 6.3%.

We intend to continue to focus on improving the strength of our balance sheet. We believe our business strategy and operational performance will lead to an investment grade credit rating for our unsecured debt in the future.

Our President and Chief Operating Officer, Tom L. Ward, resigned as a director, officer and employee of the company effective February 10, 2006. The Resignation Agreement provides for the immediate vesting of all of Mr. Ward's unvested stock options and restricted stock on February 10, 2006. As a result of such vesting, options to purchase 724,615 shares of Chesapeake's common stock at an average exercise price of \$8.01 per share and 1,291,875 shares of restricted common stock became immediately vested. As a result, the company expects to incur a non-cash after-tax charge of approximately \$31.8 million in the first quarter 2006.

Liquidity and Capital Resources

Sources of Liquidity and Uses of Funds

Our primary source of liquidity to meet operating expenses and fund capital expenditures (other than for certain acquisitions) is cash flow from operations. Based on our current production, price and expense assumptions, we expect cash flow from operations will exceed our drilling capital expenditures in 2006. Our budget for drilling, land and seismic activities during 2006 is currently between \$3.0 billion and \$3.2 billion. We believe this level of exploration and development will be sufficient to increase our reserves in 2006 and achieve our goal of a 10% to 20% increase in production over 2005 production (inclusive of acquisitions completed or scheduled to close in 2006 through the filing date of this report but without regard to any additional acquisitions that may be completed in 2006). However, higher drilling and field operating costs, drilling results that alter planned development schedules, acquisitions or other factors could cause us to revise our drilling program, which is largely discretionary. Any cash flow from operations not needed to fund our drilling program will be available for acquisitions, dividends, debt repayment or other general corporate purposes in 2006.

Cash provided by operating activities was \$2.407 billion in 2005, compared to \$1.432 billion in 2004 and \$938.9 million in 2003. The \$975 million increase from 2004 to 2005 and the \$493.1 million increase from 2003 to 2004 were primarily due to higher realized prices and higher volumes of oil and gas production. We expect that 2006 production volumes will be higher than in 2005 and that cash provided by operating activities in 2006 will exceed 2005 levels. While a precipitous decline in gas prices in 2006 would affect the amount of cash flow that would be generated from operations, we have 63% of our expected oil production in 2006 hedged at an average NYMEX price of \$61.02 per barrel of oil and 71% (excluding the hedges assumed in the CNR acquisition and certain collars and options) of our expected natural gas production in 2006 hedged at an average NYMEX price of \$9.43 per mcf. This level of hedging provides certainty of the cash flow we will receive for a substantial portion of our 2006 production. Depending on changes in oil and gas futures markets and management's view of underlying oil and natural gas supply and demand trends, however, we may increase or decrease our current hedging positions.

Based on fluctuations in natural gas and oil prices, our hedging counterparties may require us to deliver cash collateral or other assurances of performance from time to time. At December 31, 2005 and March 10, 2006, we had \$50 million of letters of credit securing our performance of hedging contracts. To mitigate the liquidity impact of those collateral requirements, we have negotiated caps on the amount of collateral that we might be required to post with seven of our counterparties. All of our existing commodity hedges that are not under our

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secured hedge facilities (described below under *Contractual Obligations*) are with these counterparties and the maximum amount of collateral that we would be required to post with them is no more than \$230 million in the aggregate.

A significant source of liquidity is our \$2.0 billion syndicated revolving bank credit facility which matures in February 2011. At March 10, 2006, there was \$1.5 billion of borrowing capacity available under the revolving bank credit facility. We use the facility to fund daily operating activities and acquisitions as needed. We borrowed \$5.682 billion and repaid \$5.669 billion in 2005, we borrowed \$2.160 billion and repaid \$2.101 billion in 2004 and we borrowed and repaid \$738 million in 2003 under our bank credit facility. We incurred \$4.7 million, \$2.2 million and \$2.5 million of financing costs related to our revolving bank credit facility in 2005, 2004 and 2003, respectively, as a result of amendments to the credit facility agreement. Also during 2005, we repaid the remaining credit facility balance of \$96.1 million assumed in the CNR acquisition.

We believe that our available cash, cash provided by operating activities and funds available under our revolving bank credit facility will be sufficient to fund our operating, interest and general and administrative expenses, our capital expenditure budget, our short-term contractual obligations and dividend payments at current levels for the foreseeable future.

The public and institutional markets have been our principal source of long-term financing for acquisitions. We have sold debt and equity in both public and private offerings in the past, and we expect that these sources of capital will continue to be available to us in the future for acquisitions. Nevertheless, we caution that ready access to capital on reasonable terms and the availability of desirable acquisition targets at attractive prices are subject to many uncertainties, as explained under *Risk Factors* in Item 1A.

The following table reflects the proceeds from sales of securities we issued in 2005, 2004 and 2003 (\$ in millions):

| | 2005 | | 2004 | | 2003 | |
|---|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| | Total | Net | Total | Net | Total | Net |
| | Proceeds | Proceeds | Proceeds | Proceeds | Proceeds | Proceeds |
| Unsecured senior notes guaranteed by subsidiaries | \$ 2,300.0 | \$ 2,251.3 | \$ 1,200.0 | \$ 1,166.0 | \$ 500.0 | \$ 485.4 |
| Contingent convertible unsecured senior notes | 690.0 | 673.3 | | | | |
| Convertible preferred stock | 1,380.0 | 1,341.5 | 313.3 | 304.9 | 402.5 | 390.4 |
| Common stock | 1,024.6 | 985.8 | 650.0 | 624.2 | 186.3 | 177.4 |
| Total | \$ 5,394.6 | \$ 5,251.9 | \$ 2,163.3 | \$ 2,095.1 | \$ 1,088.8 | \$ 1,053.2 |

We qualify as a well-known seasoned issuer (WKSI), as defined in Rule 405 of the Securities Act of 1933, and therefore we may utilize automatic shelf registration to register future debt and equity issuances with the Securities and Exchange Commission. A prospectus supplement will be prepared at the time of an offering and will contain a description of the security issued, the plan of distribution and other information.

We paid dividends on our common stock of \$60.5 million, \$38.9 million and \$27.3 million in 2005, 2004 and 2003, respectively, and we paid dividends on our preferred stock of \$31.5 million, \$40.9 million and \$20.9 million in 2005, 2004 and 2003, respectively. We received \$21.6 million, \$12.0 million and \$9.3 million from the exercise of employee and director stock options and warrants in 2005, 2004 and 2003, respectively. We paid \$4.0 million and \$2.1 million to purchase treasury stock in 2005 and 2003 to fund our matching contributions to our 401(k) make-up plan. There were no treasury stock purchases made in 2004.

In 2005, we paid \$11.6 million to settle derivative liabilities assumed from CNR.

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Outstanding payments from certain disbursement accounts in excess of funded cash balances where no legal right of set-off exists increased by \$61.2 million, \$88.3 million and \$28.3 million in 2005, 2004 and 2003, respectively. All disbursements are funded on the day they are presented to our bank using available cash on hand or draws on our revolving bank credit facility.

Historically, we have used significant funds to redeem or purchase and retire outstanding senior notes issued by Chesapeake. The following table shows our redemption, purchases and exchanges of senior notes for 2005, 2004 and 2003 (\$ in millions):

| | Senior Notes Activity | | | | Cash Paid |
|---|-----------------------|---------|-----------|------------|-----------|
| For the Year Ended December 31, 2005: | Retired | Premium | Other (a) | Issued | |
| 8.375% Senior Notes due 2008 | \$ 19.0 | \$ 1.2 | \$ | \$ | \$ 20.2 |
| 8.125% Senior Notes due 2011 | 245.4 | 17.3 | 0.7 | | 263.4 |
| 9.0% Senior Notes due 2012 | 300.0 | 41.4 | 0.8 | | 342.2 |
| | \$ 564.4 | \$ 59.9 | \$ 1.5 | \$ | \$ 625.8 |
| For the Year Ended December 31, 2004: | | | | | |
| 8.375% Senior Notes due 2008 | \$ 190.8 | \$ 16.1 | \$ 0.5 | \$ | \$ 207.4 |
| 7.875% Senior Notes due 2004 | 42.1 | | | | 42.1 |
| 8.5% Senior Notes due 2012 | 4.3 | 0.2 | | | 4.5 |
| 8.125% Senior Notes due 2011 (b) | 482.8 | | 62.1 | (534.2) | 10.7 |
| | \$ 720.0 | \$ 16.3 | \$ 62.6 | \$ (534.2) | \$ 264.7 |
| For the Year Ended December 31, 2003: | | | | | |
| 8.5% Senior Notes due 2012 | \$ 106.4 | \$ 6.7 | \$ | \$ | \$ 113.1 |
| 8.5% Senior Notes due 2012 (c) | 32.0 | | 1.5 | (33.5) | |
| 8.375% Senior Notes due 2008 (d) | 27.9 | | 1.6 | (29.5) | |
| 8.375 Senior Notes due 2008 and 8.125% Senior Notes due 2011 (e) | 22.9 | | 0.8 | (23.7) | |
| 8.375% Senior Notes due 2008 and 8.125% Senior Notes due 2011 (f) | 61.2 | | 2.6 | (63.8) | |
| | \$ 250.4 | \$ 6.7 | \$ 6.5 | \$ (150.5) | \$ 113.1 |

- (a) Includes adjustments to accrued interest and discount associated with notes retired and new notes issued, cash in lieu of fractional notes, transaction costs and fair value hedging adjustments.
- (b) We issued \$63.7 million of our 7.75% Senior Notes and \$470.5 million of our 6.875% Senior Notes.
- (c) We issued \$33.5 million of our 7.75% Senior Notes.
- (d) We issued \$29.5 million of our 7.75% Senior Notes.
- (e) We issued \$23.7 million of our 7.75% Senior Notes for \$6.0 million 8.375% Senior Notes and \$16.8 million 8.125% Senior Notes.
- (f) We issued \$63.8 million of our 7.5% Senior Notes for \$6.3 million 8.375% Senior Notes and \$54.9 million 8.125% Senior Notes.

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Cash used in investing activities increased to \$6.921 billion in 2005, compared to \$3.381 billion in 2004 and \$2.077 billion in 2003. The following table shows our capital expenditures during these years (\$ in millions):

| | 2005 | 2004 | 2003 |
|---|-------------------|-------------------|-------------------|
| Acquisitions of oil and gas companies, proved and unproved properties, net of cash acquired | \$ 3,925.5 | \$ 1,914.7 | \$ 1,261.3 |
| Exploration and development of oil and gas properties | 2,371.9 | 1,276.3 | 727.2 |
| Additions to buildings and other fixed assets | 417.5 | 126.7 | 71.5 |
| Additions to investments | 135.0 | 37.0 | 30.8 |
| Additions to drilling equipment | 66.8 | 23.1 | 1.2 |
| Deposits for acquisitions | 35.0 | 16.3 | 13.3 |
| Total | \$ 6,951.7 | \$ 3,394.1 | \$ 2,105.3 |

Through divestitures of oil and gas properties, we received \$9.8 million in 2005, \$12.0 million in 2004 and \$22.2 million, in 2003. Sales of other assets and investments in securities of other companies provided \$20.4 million, \$0.9 million and \$5.8 million of cash in 2005, 2004 and 2003, respectively.

Our accounts receivable are primarily from purchasers of oil and natural gas (\$615.4 million at December 31, 2005) and exploration and production companies which own interests in properties we operate (\$84.8 million at December 31, 2005). This industry concentration has the potential to impact our overall exposure to credit risk, either positively or negatively, in that our customers may be similarly affected by changes in economic, industry or other conditions. We generally require letters of credit for receivables from customers which are judged to have sub-standard credit, unless the credit risk can otherwise be mitigated.

Our liquidity is not dependent on the use of off-balance sheet financing arrangements, such as the securitization of receivables or obtaining access to assets through special purpose entities. We have not relied on off-balance sheet financing arrangements in the past and we do not intend to rely on such arrangements in the future as a source of liquidity. We are not a commercial paper issuer.

Investing and Financing Transactions

The following table describes investing transactions that we completed in 2005 (\$ in millions):

| Acquisition | Location | Amount |
|--|------------------------------|-----------------|
| Columbia Natural Resources, LLC | Appalachian Basin | \$ 2,200(a) |
| BRG Petroleum Corporation | Mid-Continent and Ark-La-Tex | 325(b) |
| Hallwood Energy, III L.P. | Barnett Shale | 250(c) |
| Laredo Energy II, L.L.C. | South Texas | 228 |
| Houston-based oil and gas company | Texas Gulf Coast/South Texas | 202 |
| Pecos Production Company | Permian | 198 |
| Laredo II Partners | Texas Gulf Coast/South Texas | 139 |
| Corpus Christi-based oil and gas company | Ark-La-Tex | 95 |
| Dallas-based oil and gas company | Ark-La-Tex | 85 |
| Midland-based oil and gas company | Permian | 38 |
| Other | Various | 372(d) |
| | | \$ 4,132 |

- (a) Includes \$175 million related to gathering systems which was allocated to other property and equipment.
(b) We paid \$16.3 million of the purchase amount in 2004.
(c) Includes \$15 million related to gathering systems which was allocated to other property and equipment.

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- (d) In 2005, we paid the remaining \$57 million of the purchase price related to an acquisition transaction with Hallwood Energy Corporation in the fourth quarter of 2004.

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During 2004 and continuing in 2005, we have taken several steps to improve our capital structure. These transactions enabled us to extend our average maturity of long-term debt to over ten years with an average interest rate of approximately 6.3%. Maintaining a debt-to-total-capitalization ratio below 50% and reducing debt per mcfe of proved reserves remain key goals of our business strategy.

We completed the following significant financing transactions in 2005:

First Quarter 2005

Amended our revolving bank credit facility to increase the committed borrowing base to \$1.25 billion and extended the maturity of the facility to January 2010.

Completed a private purchase of \$11.0 million of our 8.375% Senior Notes due 2008 for \$12.0 million (including a premium of \$0.8 million).

Second Quarter 2005

Completed private offerings of \$600 million principal amount of 6.625% Senior Notes due 2016 and 4,600,000 shares of 5.0% cumulative convertible preferred stock having a liquidation preference of \$100 per share. Net proceeds of approximately \$1.032 billion from these transactions were used to finance acquisitions totaling \$459 million that closed in the second quarter of 2005 and to repay debt incurred under our revolving bank credit facility to temporarily finance the BRG and the Laredo acquisitions completed in the first quarter.

Completed a private placement of \$600 million of 6.25% Senior Notes due 2018. Net proceeds of approximately \$596.4 million were used to fund our purchases in June 2005 of \$237.8 million of our 8.125% Senior Notes due 2011 for \$255.3 million (including a premium of \$16.8 million and transaction costs of \$0.7 million) and \$298.9 million of our 9.0% Senior Notes due 2012 for \$341.0 million (including a premium of \$41.3 million and transaction costs of \$0.8 million) pursuant to tender offers for the 8.125% and 9.0% Senior Notes.

Completed a private exchange of 45,000 shares of our outstanding 4.125% cumulative convertible preferred stock for 2,911,250 shares of common stock. No cash was received or paid in connection with this transaction.

Third Quarter 2005

Completed cash tender offers for our 8.125% Senior Notes due 2011 and 9.0% Senior Notes due 2012. Approximately \$0.3 million was used to purchase \$0.1 million of 8.125% Senior Notes due 2011 and \$0.2 million of 9.0% Senior Notes due 2012. Together with the amounts acquired in June 2005, we acquired a total of \$237.9 million principal amount of 8.125% Senior Notes due 2011 and \$299.1 million principal amount of 9.0% Senior Notes due 2012, representing 96.9% and 99.7%, respectively, of the amounts outstanding, in the tender offers, which expired on July 6, 2005. We redeemed the remaining \$7.5 million of 8.125% and \$0.9 million of 9.0% Senior Notes for \$9.1 million (including a premium of \$0.6 million) on August 17, 2005 based on the make-whole redemption provisions in the indentures.

Completed a number of transactions whereby we exchanged 133,675 shares of our 4.125% cumulative convertible preferred stock for 8,529,758 shares of our common stock. No cash was received or paid in connection with these transactions.

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Completed a number of transactions whereby we exchanged 697,724 shares of our 5.0% (Series 2003) cumulative convertible preferred stock for 4,354,439 shares of our common stock. No cash was received or paid in connection with these transactions.

Completed a private placement of \$600 million of 6.5% Senior Notes due 2017. Net proceeds of approximately \$584.6 million were used to repay amounts outstanding under our revolving bank credit facility which resulted from acquisitions completed in the third quarter.

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Completed public offerings of 3,450,000 shares of 4.5% cumulative convertible preferred stock having a liquidation preference of \$100 per share and 9,200,000 shares of common stock at \$32.72 per share. Net proceeds from both offerings of approximately \$624.6 million were used to repay amounts outstanding under our revolving bank credit facility which resulted from acquisitions completed in the third quarter.

Fourth Quarter 2005

Completed private offerings of \$500 million of 6.875% Senior Notes due 2020, \$690 million of 2.75% Contingent Convertible Senior Notes due 2035 and 5,750,000 shares of 5.00% cumulative convertible preferred stock having a liquidation preference of \$100 per share. Net proceeds of approximately \$1.718 billion along with cash on hand and borrowings under our credit facility were used to fund the CNR acquisition.

Completed a public offering of 23 million shares of common stock at \$31.46 per share. Net proceeds of approximately \$696.4 million were used to repay outstanding borrowings under our revolving bank credit facility which were incurred to temporarily finance the CNR acquisition.

Completed a number of transactions whereby we exchanged 45,515 shares of our 4.125% cumulative convertible preferred stock for 2,880,873 shares of our common stock. No cash was received or paid in connection with these transactions.

Completed an exchange of 1,330 shares of 5.0% (Series 2003) cumulative convertible preferred stock for 8,281 shares of common stock. No cash was received or paid in connection with these transactions.

Contractual Obligations

We currently have a \$2.0 billion syndicated revolving bank credit facility which matures in February 2011. The credit facility was increased from \$1.25 billion to \$2.0 billion in February 2006. As of December 31, 2005, we had \$72.0 million of outstanding borrowings under this facility and had utilized \$53.0 million of the facility for various letters of credit. Borrowings under the facility are collateralized by certain producing oil and natural gas properties and bear interest at either (i) the greater of the reference rate of Union Bank of California, N.A., or the federal funds effective rate plus 0.50% or (ii) London Interbank Offered Rate (LIBOR), at our option, plus a margin that varies from 0.875% to 1.50% according to our senior unsecured long-term debt ratings. The collateral value and borrowing base are redetermined periodically. The unused portion of the facility is subject to an annual commitment fee that also varies from 0.125% to 0.30% according to our senior unsecured long-term debt ratings. Currently the annual commitment fee is 0.25%. Interest is payable quarterly or, if LIBOR applies, it may be payable at more frequent intervals.

The credit facility agreement contains various covenants and restrictive provisions which limit our ability to incur additional indebtedness, purchase or redeem our capital stock, make investments or loans, and create liens. The credit facility agreement requires us to maintain an indebtedness to total capitalization ratio (as defined) not to exceed 0.65 to 1 and an indebtedness to EBITDA ratio (as defined) not to exceed 3.5 to 1. At December 31, 2005, our indebtedness to total capitalization ratio was 0.48 to 1 and our indebtedness to EBITDA ratio was 2.34 to 1. If we should fail to perform our obligations under these and other covenants, the revolving credit commitment could be terminated and any outstanding borrowings under the facility could be declared immediately due and payable. Such acceleration, if involving a principal amount of \$10 million (\$50 million in the case of our senior notes issued after 2004), would constitute an event of default under our senior note indentures which could in turn result in the acceleration of a significant portion of our senior note indebtedness. The credit facility agreement also has cross default provisions that apply to other indebtedness we may have with an outstanding principal amount in excess of \$75 million.

Some of our commodity price and financial risk management arrangements require us to deliver cash collateral or other assurances of performance to the counterparties in the event that our payment obligations exceed certain levels. As of December 31, 2005, we were required to post \$50 million of collateral in the form of

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letters of credit with respect to such derivative transactions. These collateral requirements were \$50 million as of March 10, 2005. Future collateral requirements are uncertain and will depend on arrangements with our counterparties and fluctuations in natural gas and oil prices and interest rates. We currently have arrangements with five of our counterparties, with which we have outstanding transactions, that limit the amount of collateral that we would be required to post with them to no more than \$230 million in the aggregate.

We have two secured hedging facilities, each of which permits us to enter into cash-settled natural gas and oil commodity transactions, valued by the counterparty, for up to \$500 million. The scheduled maturity date for these facilities is May 2010. Outstanding transactions under each facility are collateralized by certain of our oil and natural gas properties that do not secure any of our other obligations. One of the hedging facilities is subject to an annual fee of 0.30% of the maximum total capacity and each of them has a 1.0% exposure fee, which is assessed quarterly on the average of the daily negative fair market value amounts, if any, during the quarter. As of December 31, 2005, the fair market value of the natural gas and oil hedging transactions was a liability of \$92.9 million under one of the facilities and a liability of \$10.9 million under the other facility. As of March 10, 2006, the fair market value of the same transactions was an asset of approximately \$100 million and \$400 million, respectively. The hedging facilities contain the standard representations and default provisions that are typical of such agreements. The agreements also contain various restrictive provisions which govern the aggregate gas and oil production volumes that we are permitted to hedge under all of our agreements at any one time.

Two of our subsidiaries, Chesapeake Exploration Limited Partnership and Chesapeake Appalachia, L.L.C., are the borrowers under our revolving bank credit facility and Chesapeake Exploration Limited Partnership is the named party to our hedging facilities. The facilities are guaranteed by Chesapeake and all its other wholly-owned domestic subsidiaries. Our revolving bank credit facility and secured hedge facilities do not contain material adverse change or adequate assurance covenants. Although the applicable interest rates and commitment fees in our bank credit facility fluctuate slightly based on our long-term senior unsecured credit ratings, the bank facility and the secured hedge facilities do not contain provisions which would trigger an acceleration of amounts due under the facilities or a requirement to post additional collateral in the event of a downgrade of our credit ratings.

In addition to outstanding revolving bank credit facility borrowings discussed above, as of December 31, 2005, senior notes represented approximately \$5.4 billion of our long-term debt and consisted of the following (\$ in thousands):

| | |
|--|--------------|
| 7.5% Senior Notes due 2013 | \$ 363,823 |
| 7.0% Senior Notes due 2014 | 300,000 |
| 7.5% Senior Notes due 2014 | 300,000 |
| 7.75% Senior Notes due 2015 | 300,408 |
| 6.375% Senior Notes due 2015 | 600,000 |
| 6.625% Senior Notes due 2016 | 600,000 |
| 6.875% Senior Notes due 2016 | 670,437 |
| 6.5% Senior Notes due 2017 | 600,000 |
| 6.25% Senior Notes due 2018 | 600,000 |
| 6.875% Senior Notes due 2020 | 500,000 |
| 2.75% Contingent Convertible Senior Notes due 2035 | 690,000 |
| Discount on senior notes | (95,577) |
| Discount for interest rate derivatives | (11,349) |
| | \$ 5,417,742 |

No scheduled principal payments are required on any of the senior notes until 2013, when \$363.8 million is due. The holders of the 2.75% Contingent Convertible Senior Notes due 2035 may require us to repurchase all or a portion of these notes on November 15, 2015, 2020, 2025 and 2030 at 100% of the principal amount of the notes.

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As of December 31, 2005 and currently, debt ratings for the senior notes are Ba2 by Moody's Investor Service (stable outlook), BB by Standard & Poor's Ratings Services (stable outlook) and BB by Fitch Ratings (stable outlook).

Our senior notes are unsecured senior obligations of Chesapeake and rank equally with all of our other unsecured indebtedness. All of our wholly-owned domestic subsidiaries guarantee the notes. The indentures (other than the indentures issued after June 2005) contain covenants limiting our ability and our restricted subsidiaries' ability to incur additional indebtedness; pay dividends on our capital stock or redeem, repurchase or retire our capital stock or subordinated indebtedness; make investments and other restricted payments; incur liens; engage in transactions with affiliates; sell assets; and consolidate, merge or transfer assets. The debt incurrence covenants do not presently restrict our ability to borrow under or expand our secured credit facility. As of December 31, 2005, we estimate that secured commercial bank indebtedness of approximately \$3.6 billion could have been incurred under the most restrictive indenture covenant.

The table below summarizes our contractual obligations as of December 31, 2005 (\$ in thousands)

| Contractual Obligations | Total | Payments Due By Period | | | |
|---|---------------------|------------------------|-------------------|------------------|----------------------|
| | | Less than 1 Year | 1-3 Years | 3-5 Years | More than 5 years |
| Long-term debt obligations | \$ 5,596,668 | \$ | \$ | \$ | \$ 5,596,668 |
| Capital lease obligations | 8,979 | 3,370 | 4,219 | 1,390 | |
| Operating lease obligations | 13,759 | 4,124 | 6,310 | 2,623 | 702 |
| Purchase obligations (a) | 662,551 | 387,290 | 167,375 | 12,419 | 95,467 |
| Standby letters of credit | 57,609 | 57,609 | | | |
| Other long-term obligations | | | | | |
| Total contractual cash obligations | \$ 6,339,566 | \$ 452,393 | \$ 177,904 | \$ 16,432 | \$ 5,692,837 |

(a) See Note 4 of the notes to our consolidated financial statements for discussion regarding transportation and drilling contract commitments.

Hedging Activities*Oil and Gas Hedging Activities*

Our results of operations and operating cash flows are impacted by changes in market prices for oil and gas. To mitigate a portion of the exposure to adverse market changes, we have entered into various derivative instruments. Executive management is involved in all risk management activities and the Board of Directors reviews the company's hedging program at every Board meeting. We believe we have sufficient internal controls to prevent unauthorized hedging. As of December 31, 2005, our oil and gas derivative instruments were comprised of swaps, cap-swaps, basis protection swaps, call options and collars. Item 7A Quantitative and Qualitative Disclosures About Market Risk contains a description of each of these instruments. Although derivatives often fail to achieve 100% effectiveness for accounting purposes, we believe our derivative instruments continue to be highly effective in achieving the risk management objectives for which they were intended.

Hedging allows us to predict with greater certainty the effective prices we will receive for our hedged oil and gas production. We closely monitor the fair value of our hedging contracts and may elect to settle a contract prior to its scheduled maturity date in order to lock in a gain or loss. Commodity markets are volatile, and Chesapeake's hedging activity is dynamic.

Mark-to-market positions under oil and gas hedging contracts fluctuate with commodity prices. As described above under *Contractual Obligations*, we may be required to deliver cash collateral or other assurances of performance if our payment obligations to our hedging counterparties exceed levels stated in our contracts.

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Realized gains and losses from our oil and gas derivatives resulted in a net decrease in oil and gas sales of \$401.7 million, or \$0.86, per mcf in 2005, a net decrease of \$154.9 million, or \$0.43, per mcf in 2004 and a net decrease of \$17.4 million, or \$0.06, per mcf in 2003. Oil and gas sales also include changes in the fair value of oil and gas derivatives that do not qualify as cash flow hedges under SFAS 133, as well as gains (losses) on ineffectiveness of instruments designated as cash flow hedges. Unrealized gains (losses) included in oil and gas sales in 2005, 2004 and 2003 were \$41.1 million, \$40.9 million and \$10.5 million, respectively. Included in these unrealized gains (losses) are gains (losses) on ineffectiveness of cash flow hedges of (\$76.3) million in 2005, (\$8.2) million in 2004 and (\$9.2) million in 2003.

Changes in the fair value of oil and gas derivative instruments designated as cash flow hedges, to the extent effective in offsetting cash flows attributable to the hedged commodities, and locked-in gains and losses of derivative contracts are recorded in accumulated other comprehensive income until being transferred to earnings in the month of related production. These unrealized losses, net of related tax effects, totaled \$270.7 million, \$4.4 million and \$20.3 million as of December 31, 2005, 2004, and 2003, respectively. Based upon the market prices at December 31, 2005, we expect to transfer to earnings approximately \$153.8 million of the loss included in the balance of accumulated other comprehensive income during the next 12 months when the transactions actually occur. A detailed explanation of accounting for oil and gas derivatives under SFAS 133 appears under Application of Critical Accounting Policies Hedging elsewhere in this Item 7.

The fair values of our oil and gas derivative instruments are recorded on our consolidated balance sheet as assets or liabilities. The estimated fair values of our oil and gas derivative instruments (including derivatives acquired from CNR) as of December 31, 2005 and 2004 are provided below:

| | December 31, | |
|----------------------------------|-------------------|-----------|
| | 2005 | 2004 |
| | (\$ in thousands) | |
| Derivative assets (liabilities): | | |
| Fixed-price gas swaps | \$ (1,047,094) | \$ 57,073 |
| Gas basis protection swaps | 307,308 | 122,287 |
| Fixed-price gas cap-swaps | (161,056) | (48,761) |
| Fixed-price gas counter-swaps | 37,785 | 4,654 |
| Gas call options (a) | (21,461) | (5,793) |
| Fixed-price gas collars | (9,374) | (5,573) |
| Fixed-price gas locked swaps | (34,229) | (77,299) |
| Floating-price gas swaps | 2,607 | |
| Fixed-price oil swaps | (16,936) | |
| Fixed-price oil cap-swaps | (3,364) | (8,238) |
| Estimated fair value | \$ (945,814) | \$ 38,350 |

- (a) After adjusting for the remaining \$23.0 million and \$3.2 million premium paid to Chesapeake by the counterparty, the cumulative unrealized loss related to these call options as of December 31, 2005 and 2004 was \$1.6 million and \$2.6 million, respectively.

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Additional information concerning changes in the fair value of our oil and gas derivative instruments is as follows:

| | 2005 | December 31, 2004 (\$ in thousands) | 2003 |
|---|--------------|---|-------------|
| Fair value of contracts outstanding, as of January 1 | \$ 38,350 | \$ (44,988) | \$ (14,533) |
| Change in fair value of contracts during the period | (771,076) | (69,927) | (31,078) |
| Contracts realized or otherwise settled during the period | 401,684 | 154,901 | 17,389 |
| Fair value of new contracts when entered into during the period | (614,772) | (5,369) | (16,766) |
| Fair value of contracts when closed during the period | | 3,733 | |
| Fair value of contracts outstanding, as of December 31 | \$ (945,814) | \$ 38,350 | \$ (44,988) |

Interest Rate Derivatives

We use interest rate derivatives to mitigate our exposure to the volatility in interest rates. For interest rate derivative instruments designated as fair value hedges (in accordance with SFAS 133), changes in fair value of interest rate derivatives are recorded on the consolidated balance sheets as assets (liabilities) and the debt's carrying value amount is adjusted by the change in the fair value of the debt subsequent to the initiation of the derivative. Any resulting differences are recorded currently as ineffectiveness in the consolidated statements of operations as an adjustment to interest expense. Changes in the fair value of derivative instruments not qualifying as fair value hedges are recorded currently as adjustments to interest expense.

As of December 31, 2005, the following interest rate swaps were used to convert a portion of our long-term fixed-rate debt to floating-rate debt were outstanding:

| Term | Notional Amount | Fixed Rate | Floating Rate | Fair Value Gain (Loss) (\$ in thousands) |
|------------------------------|--------------------|---------------|---------------------------------------|--|
| September 2004 - August 2012 | \$ 75,000,000 | 9.000% | 6 month LIBOR plus 452 basis points | \$ (2,734) |
| July 2005 - January 2015 | \$ 150,000,000 | 7.750% | 6 month LIBOR plus 289 basis points | \$ (5,133) |
| July 2005 - June 2014 | \$ 150,000,000 | 7.500% | 6 month LIBOR plus 282 basis points | \$ (5,327) |
| September 2005 - August 2014 | \$ 250,000,000 | 7.000% | 6 month LIBOR plus 205.5 basis points | \$ (5,004) |
| October 2005 - June 20 | 1,365.1 | | | |

| | | |
|-------------------|------|------|
| MINORITY INTEREST | 33.1 | 29.6 |
|-------------------|------|------|

STOCKHOLDERS' EQUITY

| | | | |
|---------------------|-----|---------|---------|
| Capital | 14a | 946.0 | 946.0 |
| Capital reserve | 14c | 0.6 | 0.3 |
| Revaluation reserve | 14d | 13.0 | 15.0 |
| Profit reserves | 14e | 983.2 | 837.5 |
| Treasury shares | 14b | (9.3) | (8.7) |
| | | 1,933.5 | 1,790.1 |
| TOTAL | | 3,902.1 | 3,673.1 |

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

Table of Contents**ULTRAPAR PARTICIPAÇÕES S.A. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME**

FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004

(In millions of Brazilian reais - R\$, except for earnings per share)

| | Note | 2006 | 2005 | 2004 |
|--|------|-----------|-----------|-----------|
| GROSS SALES AND SERVICES | 3o | 5,229.9 | 5,158.0 | 5,250.6 |
| Deductions | | (435.8) | (464.2) | (466.4) |
| NET SALES AND SERVICES | | 4,794.1 | 4,693.8 | 4,784.2 |
| Cost of sales and services | 3p | (3,859.9) | (3,783.4) | (3,669.9) |
| GROSS PROFIT | | 934.2 | 910.4 | 1,114.3 |
| OPERATING (EXPENSES) INCOME | | | | |
| Selling | | (203.3) | (187.6) | (193.7) |
| General and administrative | | (279.1) | (237.8) | (237.5) |
| Depreciation and amortization | | (122.7) | (126.3) | (124.7) |
| Other operating income, net | | 1.3 | (0.4) | 5.5 |
| | | (603.8) | (552.1) | (550.4) |
| OPERATING INCOME BEFORE FINANCIAL ITEMS | | 330.4 | 358.3 | 563.9 |
| Financial income (expenses), net | 15 | 30.6 | (27.3) | (45.0) |
| Nonoperating expenses, net | 16 | (18.5) | (1.8) | (16.0) |
| | | 12.1 | (29.1) | (61.0) |
| INCOME BEFORE INCOME AND SOCIAL CONTRIBUTION TAXES, EQUITY IN GAIN OF AFFILIATED COMPANIES AND MINORITY INTEREST | | 342.5 | 329.2 | 502.9 |
| INCOME AND SOCIAL CONTRIBUTION TAXES | | | | |
| Current | 21b | (111.8) | (113.1) | (175.0) |
| Deferred | 21b | 5.4 | 20.5 | (1.5) |
| Benefit of tax holidays | 21b | 50.3 | 63.8 | 93.5 |
| | | (56.1) | (28.8) | (83.0) |
| INCOME BEFORE EQUITY IN GAIN OF AFFILIATED COMPANIES AND MINORITY INTEREST | | 286.4 | 300.4 | 419.9 |
| Equity in gain of affiliated companies | 9 | 1.0 | 1.6 | |
| Minority interest | | (5.3) | (2.8) | (5.4) |
| NET INCOME | | 282.1 | 299.2 | 414.5 |
| EARNINGS PER SHARE (BASED ON ANNUAL WEIGHTED AVERAGE OF SHARES OUTSTANDING) R\$ AFTER REVERSE STOCK SPLIT SEE NOTE 14 | | 3.55 | 3.73 | 5.95 |

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

Table of Contents**ULTRAPAR PARTICIPAÇÕES S.A.**

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004

(In millions of Brazilian reais - R\$)

| | | Capital | Revaluation reserve | Profit reserves | Retained | | |
|---|------|---------|-------------------------|-----------------|------------|----------|---------------------|
| | Note | Capital | of subsidiary and | Retention | Unrealized | earnings | Treasury |
| | | reserve | of affiliated companies | of profits | profits | | shares |
| | | | | Legal | | | Total |
| BALANCES AT DECEMBER 31, 2003 | | 664.0 | 17.8 | 40.8 | 551.0 | 85.6 | (2.5) 1,356.7 |
| Acquisition of treasury shares, net of sales | | 0.1 | | | | | (6.5) (6.4) |
| Realization of revaluation reserve | | | (1.4) | | | 1.4 | |
| Income and social contribution taxes on realization of revaluation reserve of subsidiaries | | | | | | (0.1) | (0.1) |
| Realization of profit reserve | | | | | (85.6) | 85.6 | |
| Net income | | | | | | 414.5 | 414.5 |
| Appropriation of net income: | | | | | | | |
| Legal reserve | | | | 20.8 | | (20.8) | |
| Reserve for unrealized profits | | | | | 118.3 | (118.3) | |
| Retention of profit reserves | | | | | 198.1 | (198.1) | |
| Interim dividends (R\$1.33 per thousand common and preferred shares) | | | | | | (92.4) | (92.4) |
| Proposed dividends payable (R\$1.03 per thousand common and preferred shares) | | | | | | (71.8) | (71.8) |
| BALANCES AT DECEMBER 31, 2004 | | 664.0 | 0.1 | 16.4 | 61.6 | 749.1 | 118.3 (9.0) 1,600.5 |
| Capital increase: | | | | | | | |
| Public offering | | 47.1 | | | | | 47.1 |
| Reserves | | 234.9 | | | (234.9) | | |
| Sale of treasury shares | | 0.2 | | 0.1 | | | 0.3 0.6 |
| Realization of revaluation reserve | | | (1.4) | | | 1.4 | |
| Income and social contribution taxes on realization of revaluation reserve of subsidiaries | | | | | | (0.2) | (0.2) |
| Realization of profit reserve | | | | | (89.2) | 89.2 | |
| Net income | | | | | | 299.2 | 299.2 |
| Appropriation of net income: | | | | | | | |
| Legal reserve | | | | 15.0 | | (15.0) | |
| Interim dividends (R\$0.70 per common and preferred share after reverse stock split, see Note 14) | | | | | | (57.1) | (57.1) |
| Proposed dividends payable (R\$1.23 per common and preferred share) | | | | | | (100.0) | (100.0) |
| Reserve for unrealized profits | | | | | 74.2 | (74.2) | |
| Retention of profit reserves | | | | | 143.3 | (143.3) | |
| BALANCES AT DECEMBER 31, 2005 | | 946.0 | 0.3 | 15.0 | 76.7 | 657.5 | 103.3 (8.7) 1,790.1 |
| Acquisition of treasury shares | 14b | | | | | | (1.1) (11) |

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| | | | | | | | | |
|---|-----|-------|-------|-------|--------|---------|------|---------------------|
| Sale of treasury shares | 14b | 0.3 | | | | | 0.5 | 0.8 |
| Realization of revaluation reserve | 14d | | (2.0) | | | 2.0 | | |
| Income and social contribution taxes on realization of revaluation reserve of subsidiaries | 14d | | | | | (0.5) | | (0.5) |
| Retention of realization of profit reserve net of income and social contribution taxes | 14e | | | 1.6 | | (1.6) | | |
| Net income | | | | | | 282.1 | | 282.1 |
| Reversal of allowance for factory maintenance shutdown by the subsidiary, net of income taxes | | | | | | 6.3 | | 6.3 |
| Appropriation of net income | | | | | | | | |
| Legal reserve | 14e | | 14.3 | | | (14.3) | | |
| Interim dividends (R\$0.89 per thousand common and preferred share) | 14f | | | | | (72.0) | | (72.0) |
| Proposed dividends payable (R\$0.89 per thousand common and preferred share) | 14f | | | | (68.2) | (4.0) | | (72.2) |
| Reserve for unrealized profits | 14e | | | | 61.0 | (61.0) | | |
| Retention of profit reserves | 14e | | | 137.0 | | (137.0) | | |
| BALANCES AT DECEMBER 31, 2006 | | 946.0 | 0.6 | 13.0 | 91.0 | 796.1 | 96.1 | (0.0) (9.3) 1,933.5 |

The accompanying notes are an integral part of these financial statements

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Ultrapar Participações S.A. and Subsidiaries

ULTRAPAR PARTICIPAÇÕES S.A. AND SUBSIDIARIES**CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION**

FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004

(In millions of Brazilian reais R\$)

| | 2006 | 2005 | 2004 |
|---|--------|---------|-------|
| SOURCES OF FUNDS | | | |
| Operations: | | | |
| Net income | 282.1 | 299.2 | 414.5 |
| Items not affecting working capital: | | | |
| Equity in losses of affiliated companies | (1.0) | (1.6) | |
| Depreciation and amortization | 185.8 | 187.7 | 172.7 |
| PIS and COFINS credit on depreciation | 2.1 | 1.4 | 3.0 |
| Long-term interest and monetary variations | (95.2) | (44.0) | 22.6 |
| Deferred income and social contribution taxes | 3.3 | (32.3) | 28.1 |
| Minority interest | 5.3 | 2.8 | 5.4 |
| Net book value of permanent assets written off | 34.2 | 16.6 | 24.1 |
| Other long-term taxes | 0.3 | 5.1 | 8.0 |
| Reversal of provision for probable losses on permanent assets | 3.2 | | (1.3) |
| Reversal of allowance for factory maintenance shutdown by the subsidiary, net of income taxes | 6.3 | | |
| Other | 0.9 | 0.7 | 0.5 |
| | 427.3 | 435.6 | 677.6 |
| Stockholders: | | | |
| Capital increase due to secondary public offering | | 47.1 | |
| | | 47.1 | |
| Third parties: | | | |
| Increase in long-term liabilities | | | |
| Long-term financing and debentures | 143.7 | 1,164.9 | 293.1 |
| | 143.7 | 1,164.9 | 293.1 |
| Total sources | 571.0 | 1,647.6 | 970.7 |
| USES OF FUNDS | | | |
| Permanent assets: | | | |
| Investments | 0.1 | | |
| Property, plant and equipment | 253.0 | 169.2 | 227.2 |
| Intangible | 11.7 | 10.2 | |
| Deferred charges | 74.9 | 51.3 | 48.3 |

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| | | | |
|--|---------|---------|---------|
| | 339.7 | 230.7 | 275.5 |
| Dividends and interest on capital | 146.1 | 158.7 | 165.2 |
| Transfer from long-term to current liabilities | 103.6 | 134.2 | 354.6 |
| Decrease in long-term liabilities | 24.6 | 3.9 | |
| Increase in long-term assets | 27.7 | 331.4 | 86.4 |
| Acquisition of treasury shares | 1.1 | | 6.8 |
| Acquisition of shares from minority stockholders | 0.1 | | 8.5 |
| Taxes on realization of revaluation reserve | 0.5 | 0.2 | 0.1 |
| | 157.6 | 469.7 | 456.4 |
| Total uses | 643.4 | 859.1 | 897.1 |
| INCREASE (DECREASE) IN WORKING CAPITAL | (72.4) | 788.5 | 73.6 |
| REPRESENTED BY | | | |
| Current assets: | | | |
| At end of year | 1,859.4 | 1,936.3 | 1,344.9 |
| At beginning of year | 1,936.3 | 1,344.9 | 1,218.7 |
| | (76.9) | 591.4 | 126.2 |
| Current liabilities: | | | |
| At end of year | 483.8 | 488.3 | 685.4 |
| At beginning of year | 488.3 | 685.4 | 632.8 |
| | (4.5) | (197.1) | 52.6 |
| INCREASE (DECREASE) IN WORKING CAPITAL | (72.4) | 788.5 | 73.6 |

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

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Ultrapar Participações S.A. and Subsidiaries

ULTRAPAR PARTICIPAÇÕES S.A. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004

(Amounts in millions of Brazilian reais - R\$, unless otherwise stated)

1. OPERATIONS

Ultrapar Participações S.A. (the Company or Ultrapar) is a holding company with headquarters in the city of São Paulo, organized under the laws of the Federative Republic of Brazil, which, through its operating subsidiaries, is engaged in the distribution of Liquefied Petroleum Gas (LPG) (Ultragaz), the production and sale of chemicals (Oxiten), and logistic services of chemicals and fuels (Ultracargo).

2. PRESENTATION OF THE FINANCIAL STATEMENTS AND SIGNIFICANT ACCOUNTING POLICIES

These financial statements were prepared in accordance with accounting practices adopted in Brazil. They have been translated into English from the original financial statements issued in Portuguese. In addition, certain terminology changes have been made and the notes to the financial statements have been adjusted to conform more closely to reporting practices prevailing in the United States of America.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting practices adopted in Brazil to record transactions and prepare the financial statements comply with those prescribed by Brazilian corporate law and specific standards established by the Brazilian Securities Commission (CVM), which differ in certain respects from accounting principles generally accepted in the United States of America (U.S. GAAP). See Note 24 for further discussions of these differences and a reconciliation of stockholders' equity and net income under both sets of principles.

The following is a summary of significant accounting policies followed in the preparation of the financial statements:

a) Consolidation principles

The consolidated financial statements include the accounts of the Company and all of the subsidiaries in which the Company directly or indirectly controls more than 50% of the voting share capital, as listed below. Intercompany investments, asset and liability balances, income and expenses, as well as the effects arising from significant intercompany transactions, have been eliminated. Minority interest in subsidiaries is presented separately in the financial statements.

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Ultrapar Participações S.A. and Subsidiaries

| | Ownership - % | | | |
|---|---------------|----------|--------|----------|
| | 2006 | | 2005 | |
| | Direct | Indirect | Direct | Indirect |
| Ultragaz Participações Ltda. | 100 | | 100 | |
| SPGás Distribuidora de Gás Ltda. | | 99 | | 99 |
| Companhia Ultragaz S.A. | | 99 | | 99 |
| Bahiana Distribuidora de Gás Ltda. | | 100 | | 100 |
| Utingás Armazenadora S.A. | | 56 | | 56 |
| LPG International Inc. | | 100 | | 100 |
| Ultracargo - Operações Logísticas e Participações Ltda. | 100 | | 100 | |
| Melamina Ultra S.A. Indústria Química | | 99 | | 99 |
| Transultra - Armazenamento e Transporte Especializado Ltda. | | 100 | | 100 |
| Terminal Químico de Aratu S.A. - Tequimar | | 99 | | 99 |
| Oxiten S.A. - Indústria e Comércio | 100 | | 100 | |
| Oxiten Nordeste S.A. - Indústria e Comércio | | 99 | | 99 |
| Oxiten Argentina Sociedad de Responsabilidad Ltda. | | 99 | | |
| Oleoquímica Indústria e Comércio de Produtos Químicos Ltda. | | 100 | | 100 |
| Barrington S.L. | | 100 | | 100 |
| Canamex Químicos S.A. de C.V. | | 100 | | 100 |
| Canamex Servicios Corporativos S.A. de C.V. | | 100 | | 100 |
| Canamex Servicios Industriales S.A. de C.V. | | 100 | | 100 |
| Oxiten International Corp. | | 100 | | 100 |
| Oxiten Overseas Corp. | | 100 | | 100 |
| Imaven Imóveis e Agropecuária Ltda. | 100 | | 100 | |

On December 29, 2004, the Company, through its subsidiary Ultragaz Participações Ltda., acquired an additional 7.31% of Companhia Ultragaz S.A. total share capital. This acquisition amounted to R\$10.0, with goodwill of R\$1.8, based on its expected future profitability, being amortized over five years, starting January 2005.

On April 29, 2005, Ultragaz Participações Ltda. conducted a capital increase in its subsidiary Companhia Ultragaz S.A. increasing its ownership interest from 93.94% to 98.53%.

On August 3, 2006, the subsidiaries Oxiten S.A. - Indústria e Comércio and Oxiten Nordeste S.A. Indústria e Comércio formed the subsidiary Oxiten Argentina Sociedad de Responsabilidad Ltda., which operates as a commercial representation office, and as of December 31, 2006 had four employees.

b) Cash and cash equivalents

Cash and cash equivalents comprise highly-liquid temporary cash investments (with maturities of three months or less when acquired and readily convertible to cash).

c) Short-term investments

Short-term investments are stated at cost plus accrued income earned (on a pro rata temporis basis), which approximates market value.

d) Trade accounts receivable

Trade accounts receivable are stated at estimated net realizable values. The allowance for doubtful accounts is based on estimated losses and is considered by management to be sufficient to cover probable losses on accounts receivable.

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Ultrapar Participações S.A. and Subsidiaries

e) Inventories

Inventories are stated at the lower of average cost of acquisition or production, market or net realizable value.

f) Long-term investments

Long-term investments are stated at cost plus accrued income earned (on a pro rata temporis basis), which approximates market value.

g) Investments in affiliated companies

Investments in operating companies not controlled by the Company, but over which it has significant influence, are accounted for using the equity method (see Note 9).

h) Other investments

Other investments are recorded at cost less provision for losses, if expected to be other than temporary.

i) Property, plant and equipment

Property, plant and equipment are stated at historical cost of acquisition, process or construction, monetarily restated through December 31, 1995, including financial charges incurred on constructions in progress and revaluation adjustments based on appraisal reports issued by independent appraisers, in accordance with item 68, letter b), of CVM Resolution No. 183/95, as well as costs related to the maintenance of significant assets during scheduled factory maintenance operations, less accumulated depreciation. Revaluation increases are credited to the revaluation reserve component of stockholders' equity and subsequently transferred to retained earnings as the related assets are depreciated or disposed of.

Depreciation is calculated on a straight-line basis at the annual rates described in Note 10, and is based on the estimated useful lives of the corresponding assets.

j) Intangible assets

Stated at acquisition cost, less an allowance for losses, should the losses not be considered temporary, as shown in Note 11.

k) Deferred charges

Deferred charges consist mainly of costs incurred in the installation of Company equipment at customers' facilities amortized over the terms of the LPG supply contracts with these customers, project expenses and goodwill arising from acquisition of subsidiaries, as stated in Note 12.

l) Income and social contribution taxes on income

Income and social contribution taxes (the latter of which is a federally mandated tax based on income) are accrued on taxable income at the applicable rates.

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The accrual for income tax includes the effects of tax holidays, where applicable. Deferred income and social contribution taxes on temporary differences are recognized in accordance with CVM Resolution No. 273/98, as mentioned in Note 21.

m) Compensated absences

The liability for future compensation for employee vacations is fully accrued as earned.

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Ultrapar Participações S.A. and Subsidiaries

n) Assets and liabilities denominated in foreign currency or subject to indexation

Assets and liabilities denominated in foreign currencies are translated into Brazilian reais at the exchange rate reported by the Brazilian Central Bank (BACEN) at each balance sheet date. Transaction gains and losses are recognized in income.

Assets and liabilities denominated in reais and contractually or legally subject to indexation are restated to the balance sheet date by applying the corresponding index, with related gains and losses recognized in income.

o) Revenues and expenses

Revenues from sales are recognized when products are delivered to the customer or services are performed, and the transfer of risks, rights and obligations associated with the ownership of products takes place. Expenses are recognized on the accrual basis. Advertising expenses, which are expensed as incurred, amounted to R\$3.4, R\$3.8 and R\$6.3 for the years ended December 31, 2006, 2005 and 2004, respectively. Shipping and handling costs, classified as selling expenses and expensed as incurred, amounted to R\$66.6, R\$69.0 and R\$63.4 for the years ended December 31, 2006, 2005 and 2004, respectively.

p) Cost of sales and services

Cost of sales and services provided includes raw materials (mainly LPG and chemicals) and production, distribution, storage and filling costs.

q) Earnings per share

Earnings per share are calculated based on the annual weighted average of shares outstanding during each of the years presented, giving retroactive effect to stock splits. Stock dividends are not included in such retroactive earnings per share calculation. See Note 14.

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Ultrapar Participações S.A. and Subsidiaries

r) Use of estimates

The preparation of financial statements in accordance with accounting practices adopted in Brazil requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the balance sheet dates and the reported amounts of revenues, costs and expenses for the years presented. Although these estimates are based on management's best available knowledge of current and expected future events, actual results could differ from those estimates.

s) Basis for translation of the financial statements of foreign subsidiaries

The financial statements of foreign subsidiaries are translated into Brazilian reais at the current exchange rate in effect at the balance sheet date. The criteria for preparation of the financial statements have been adapted to conform to accounting practices adopted in Brazil.

t) Reclassification

Due to the adoption of CVM Resolution No. 489/05, the balances of escrow deposits as of December 31, 2005, for which the Company and its subsidiaries had recognized allowances, were offset against these under the heading "Other taxes" in non-current liabilities.

4. CASH AND CASH EQUIVALENTS

Cash equivalents consist of investments, contracted with banks of good standing, mostly represented by certificates of deposit and funds linked to the Brazilian interbank certificates of deposit (CDI) rate, and are stated at cost plus accrued income on a pro rata temporis basis. In addition as at December 31, 2005, funds in the amount of R\$410.1, raised through notes issued by the subsidiary LPG International Inc. were invested in certificates of deposit denominated in U.S. dollars issued by foreign banks of good standing.

| | 2006 | 2005 |
|---|-------|---------|
| Cash | 32.0 | 32.7 |
| Certificates of deposit and funds in Brazil | 303.6 | 571.8 |
| Foreign investments | 49.5 | 509.7 |
| Total | 385.1 | 1,114.2 |

5. SHORT AND LONG-TERM INVESTMENTS

Short-term investments relate to the amount invested by the indirect subsidiary Oxitenio Overseas Corp. in debt securities of U.S. corporations. As of December 31, 2006, funds in the amount of R\$553.1, raised through notes issued by the subsidiary of LPG International Inc. were invested in certificates of deposit (Dual Currency Deposits) denominated in U.S. dollars issued by foreign banks of good standing. Dual Currency Deposits are investments of the subsidiary Oxitenio Overseas Corp., whose yield can be in US dollars or Brazilian reais, depending on the US dollar rate as of the maturity date. If the US dollar rate is lower than the strike rate on the maturity date, the yield of this operation will be in US dollars plus interest of 7.5% per year; otherwise, it will be in Brazilian reais plus average interest of 26% per year. The subsidiary records the investment at the lower of the two alternative yields, which in 2006 was represented by the US dollar. In 2006 the exchange rate always remained below the strike rate.

Long-term investments are mainly represented by a debt security of an European corporation denominated in U.S. dollars, bearing interest of six-month LIBOR plus interest of 3.25% per annum and maturing on September 27, 2009 and by notes issued by the Austrian Government.

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In April 2006, subsidiary Oxiteno Overseas Corp., owner of notes in the amount of US\$60 million issued by Companhia Ultraz S.A. in the international market in 1997 (Original Notes), sold these Original Notes to a foreign financial institution. Concurrently, subsidiary Oxiteno Overseas Corp. acquired from this financial institution a credit linked note backed by the Original Notes. This transaction provides a financial gain for the Company corresponding to the difference between the interest rate paid for the credit linked note and the Original Notes, as mentioned in Note 13.b).

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Ultrapar Participações S.A. and Subsidiaries

| | 2006 | 2005 |
|-----------------------|---------|-------|
| Short term investment | 737.3 | 184.8 |
| Long term investment | 548.0 | 372.7 |
| | 1,285.3 | 557.5 |

6. TRADE ACCOUNTS RECEIVABLE, NET

| | 2006 | 2005 |
|--|--------|--------|
| Domestic customers | 375.5 | 367.5 |
| Foreign customers | 76.4 | 60.9 |
| (-) Advances on foreign exchange contracts | (50.9) | (39.0) |
| (-) Allowance for doubtful accounts | (21.8) | (26.9) |
| | 379.2 | 362.5 |
| Current portion | 360.0 | 343.3 |
| Noncurrent portion | 19.2 | 19.2 |

The changes in the allowance for doubtful accounts are shown below:

| | |
|---|--------|
| Balance as of December 31, 2004 | 26.2 |
| Additions recorded in selling expenses | 15.2 |
| Deductions write-off of trade accounts receivable | (14.5) |
| Balance as of December 31, 2005 | 26.9 |
| Additions recorded in selling expenses | 10.8 |
| Deductions write-off of trade accounts receivable | (15.9) |
| Balance as of December 31, 2006 | 21.8 |

Allowance for doubtful accounts in the amount of R\$12.0 and R\$17.2 are recorded in current trade accounts receivable as of December 31, 2006 and 2005, and R\$9.8 and R\$9.7 are recorded in long-term trade accounts receivable as of December 31, 2006 and 2005, respectively.

7. INVENTORIES

| | 2006 | | | 2005 | | |
|-------------------|------|----------------------|------|-------|----------------------|-------|
| | Cost | Provision for losses | Net | Cost | Provision for losses | Net |
| Finished products | 98.7 | (1.5) | 97.2 | 103.3 | (1.8) | 101.5 |
| Work in process | 0.6 | | 0.6 | 1.1 | | 1.1 |

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| | | | | | | |
|-----------------------------------|-------|-------|-------|-------|-------|-------|
| Raw materials | 65.6 | (0.1) | 65.5 | 43.3 | (0.1) | 43.2 |
| Liquefied Petroleum Gas (LPG) | 23.4 | | 23.4 | 23.1 | | 23.1 |
| Supplies and cylinders for resale | 20.9 | (0.5) | 20.4 | 18.2 | (0.9) | 17.3 |
| Advances to suppliers mainly LPG | 10.1 | | 10.1 | 5.5 | | 5.5 |
| Total | 219.3 | (2.1) | 217.2 | 194.5 | (2.8) | 191.7 |

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Ultrapar Participações S.A. and Subsidiaries

The changes in the provision for losses on inventories are shown below:

| | |
|---------------------------------|-------|
| Balance as of December 31, 2004 | 2.9 |
| Additions | 1.9 |
| Reversals | (2.0) |
| Balance as of December 31, 2005 | 2.8 |
| Additions | 0.3 |
| Reversals | (1.0) |
| Balance as of December 31, 2006 | 2.1 |

8. RECOVERABLE TAXES

Represented, substantially, by credit balances of ICMS (State Value Added Tax - VAT), PIS and COFINS (taxes on revenue), and income and social contribution taxes.

| | 2006 | 2005 |
|---|--------|--------|
| Income and social contribution taxes | 75.3 | 68.0 |
| ICMS | 101.0 | 70.9 |
| Provision for losses - ICMS (*) | (31.4) | (36.0) |
| PIS and COFINS | 28.4 | 3.0 |
| VAT of subsidiary Canamex Químicos S.A. de C.V. | 8.5 | 3.5 |
| Other | 1.3 | 0.3 |
| Total | 183.1 | 109.7 |
| Current portion | 117.8 | 62.9 |
| Noncurrent portion | 65.3 | 46.8 |

(*) The provision refers to balances that the Company's subsidiaries estimate not being able to recover in the future.

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Ultrapar Participações S.A. and Subsidiaries

The changes in the provision for losses on ICMS are shown below:

| | |
|---------------------------------|-------|
| Balance as of December 31, 2004 | 33.7 |
| Additions | 9.5 |
| Deductions write-off | (7.2) |
| Balance as of December 31, 2005 | 36.0 |
| Additions | 4.5 |
| Deductions write-off | (9.1) |
| Balance as of December 31, 2006 | 31.4 |

The increase in the balance of recoverable taxes is mainly due to the increase in ICMS credits of the Camaçari (Bahia State) plant of the subsidiary Oxiteno Nordeste S.A. - Indústria e Comércio and the credit of PIS and COFINS recorded by this same subsidiary. The increase in this plant's ICMS balance occurred mainly in the second half of 2006, due to measures by Bahia State, which made it difficult to utilize credits for import payment or to transfer them to third parties. The total balance of credits from the Camaçari plant corresponds to R\$50.2 as of December 31, 2006 (R\$22.0 in 2005) of which R\$22.8 have already been reviewed by the tax authorities and are awaiting release by the state finance department of Bahia for commercialization. In addition to these credits, the subsidiary's management is working on a series of measures for realization of the plant's ICMS balance. The allowance for loss of the plant's credits was recognized on the basis of the maximum discount expected on their commercialization. The PIS and COFINS credits arose from the favorable outcome of a lawsuit and can be utilized to offset other federal taxes, as mentioned in Note 19.a).

9. INVESTMENTS IN AFFILIATED COMPANIES

A summary of financial information for the Company's equity investments is as follows:

| | December 31, 2006 | |
|---------------------------------|---------------------------------|--|
| | Oxicap Indústria de Gases Ltda. | Química da Bahia Indústria e Comércio S.A. |
| Number of shares or quotas held | 156 | 1,493,120 |
| Net equity R\$ | 7.2 | 6.9 |
| Net income for the year R\$ | 1.0 | 1.4 |
| Ownership interest % | 25.00 | 50.00 |

| | 2006 | | |
|-------------------------------------|---------------------------------|--|-------|
| | Oxicap Indústria de Gases Ltda. | Química da Bahia Indústria e Comércio S.A. | Total |
| Changes in investments: | | | |
| Balance at beginning of year | 1.4 | 2.8 | 4.2 |
| Equity pick-up | 0.3 | 0.7 | 1.0 |
| Advance for future capital increase | 0.1 | | 0.1 |

| | | | |
|------------------------|-----|-----|-----|
| Balance at end of year | 1.8 | 3.5 | 5.3 |
|------------------------|-----|-----|-----|

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Ultrapar Participações S.A. and Subsidiaries

| | December 31, 2005 | |
|---------------------------------|---------------------------------|--|
| | Oxicap Indústria de Gases Ltda. | Química da Bahia Indústria e Comércio S.A. |
| Number of shares or quotas held | 156 | 1,493,120 |
| Net equity R\$ | 5.7 | 5.5 |
| Net income for the year R\$ | 0.4 | (0.4) |
| Ownership interest % | 25.00 | 50.00 |

| | Oxicap Indústria de Gases Ltda. | 2005 Química da Bahia Indústria e Comércio S.A. | Total |
|------------------------------|---------------------------------|--|-------|
| Changes in investments: | | | |
| Balance at beginning of year | 1.3 | 4.6 | 5.9 |
| Equity pick-up | 0.1 | 1.5 | 1.6 |
| Stock redemption received | | (3.3) | (3.3) |
| Balance at end of year | 1.4 | 2.8 | 4.2 |

| | December 31, 2004 | |
|---------------------------------|---------------------------------|--|
| | Oxicap Indústria de Gases Ltda. | Química da Bahia Indústria e Comércio S.A. |
| Number of shares or quotas held | 156 | 3,174,501 |
| Net equity R\$ | 5.3 | 10.1 |
| Net income for the year R\$ | 0.7 | |
| Ownership interest % | 25.00 | 45.56 |

| | Oxicap Indústria de Gases Ltda. | 2004 Química da Bahia Indústria e Comércio S.A. | Other | Total |
|------------------------------|---------------------------------|--|-------|-------|
| Changes in investments: | | | | |
| Balance at beginning of year | 0.9 | 4.6 | 0.2 | 5.7 |
| Capital increase | 0.2 | | | 0.2 |
| Equity pick-up | 0.2 | | | 0.2 |
| Write-off | | | (0.2) | (0.2) |
| Balance at end of year | 1.3 | 4.6 | | 5.9 |

The investment of subsidiary Oxiten S.A. Indústria e Comércio in the affiliated company Oxicap Indústria de Gases Ltda. is carried under the equity method based on the affiliate's financial statements as of November 30, 2006. The investment of subsidiary Oxiten S.A. Indústria e Comércio is carried under the equity method based on the affiliate's financial statements as of November 30, 2006.

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Nordeste S.A. Indústria e Comércio in the affiliated company Química da Bahia Indústria e Comércio S.A. is carried under the equity method based on the affiliate's financial statements as of December 31, 2006.

The financial statements of Oxicap Indústria de Gases Ltda. and Química da Bahia Indústria e Comércio S.A. were audited by other independent auditors.

10. PROPERTY, PLANT AND EQUIPMENT, NET

| | | | 2006 | 2005 |
|--------------------------|-------------------------------|-----------------------------|--------------------------|------------|
| | Annual depreciation rates - % | Cost, including revaluation | Accumulated depreciation | Net amount |
| Land | | 46.7 | | 48.1 |
| Buildings | 4 to 5 | 345.8 | (141.6) | 218.2 |
| Leasehold improvements | 4 | 91.5 | (23.0) | 61.5 |
| Machinery and equipment | 5 to 10 | 926.2 | (468.0) | 450.4 |
| Gas tanks and cylinders | 10 | 275.5 | (161.0) | 127.3 |
| Vehicles | 20 to 25 | 156.8 | (121.2) | 48.1 |
| Furniture and fixtures | 10 | 25.4 | (10.4) | 13.7 |
| Construction in progress | | 107.0 | | 28.8 |
| Advances to suppliers | | 49.2 | | 1.7 |
| Imports in transit | | 0.5 | | 0.8 |
| IT equipment | 20 to 30 | 46.8 | (34.4) | 15.0 |
| Total | | 2,071.4 | (959.6) | 1,013.6 |

Property, plant and equipment include net capitalized interest cost of R\$4.3 and R\$4.9 as of December 31, 2006 and 2005, respectively.

The subsidiaries recorded, in previous years, revaluation of property, plant and equipment items. The revaluation balances are shown below:

| | 2006 | 2005 |
|-------------------------|--------------------------|----------------|
| | Accumulated depreciation | Net book value |
| | Revaluation | value |
| Land | 15.5 | 15.6 |
| Buildings | 44.6 | 11.9 |
| Machinery and equipment | 31.7 | 1.4 |
| Gas tanks and cylinders | 48.9 | |
| Vehicles | 0.8 | |
| | 141.5 | 28.9 |

The depreciation of these revaluations in the amount of R\$1.9 (R\$2.0 in 2005) was recorded in the statements of income. The amount of deferred taxes on revaluation totals R\$7.5 (R\$8.5 in 2005), of which R\$0.9 (R\$1.2 in 2005) is recorded as non-current liabilities, as shown in Note 21.a), and R\$6.6 (R\$7.3 in 2005) is accrued in the same period in which certain subsidiaries realize the revaluation reserve, since these revaluations occurred prior to the issuance of CVM Resolution No. 183/95.

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Ultrapar Participações S.A. and Subsidiaries

Construction in progress refers substantially to construction of the fatty alcohols plant of subsidiary Oleoquímica Indústria e Comércio de Produtos Químicos Ltda. in the amount of R\$40.8, and the new alkoxylation plant of subsidiary Oxiteno S.A. Indústria e Comércio in the amount of R\$27.5, as well as expansions and renovations of subsidiaries' plants.

Advances to suppliers refers basically to purchases of equipment for the fatty alcohols plant of subsidiary Oleoquímica Indústria e Comércio de Produtos Químicos Ltda.

11. INTANGIBLE ASSETS, NET

| | Annual amortization rates - % | Cost | 2006 Accumulated amortization | Net book value | 2005 Net book value |
|----------------------------|-------------------------------------|-------|-------------------------------------|----------------------|------------------------------|
| Software | 20 | 64.2 | (39.6) | 24.6 | 25.9 |
| Commercial property rights | 2 to 6 | 16.3 | (1.7) | 14.6 | 14.7 |
| Goodwill | 20 | 15.4 | (9.3) | 6.1 | 7.1 |
| Technology | 20 | 20.4 | (5.2) | 15.2 | 10.7 |
| Other | 10 | 1.4 | (0.9) | 0.5 | 0.7 |
| | | 117.7 | (56.7) | 61.0 | 59.1 |

Aggregate amortization expense for the above intangible assets amounted to R\$12.9, R\$12.2 and R\$10.0 for the years ended December 31, 2006, 2005 and 2004, respectively.

The estimated aggregate amortization expense for the next five years is as follows:

| | |
|--------------|-------------|
| 2007 | 15.3 |
| 2008 | 12.7 |
| 2009 | 8.1 |
| 2010 | 6.8 |
| 2011 | 4.5 |
| Thereafter | 13.6 |
| Total | 61.0 |

Commercial property rights, refer mainly to those described below:

On July 11, 2002, the indirect subsidiary Terminal Químico de Aratu S.A. Tequimar signed a contract with CODEBA Companhia Docas do Estado da Bahia for use of the site on which it operates its Aratu Terminal for 20 years, renewable for another 20 years. The amount of R\$12.0 paid by Tequimar is being amortized from August, 2002 to July 2042.

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Further, subsidiary Terminal Químico de Aratu S.A. Tequimar has a 20-year lease of an area adjacent to the Santos harbor which allows it to build, operate and exploit the terminal, intended for the distribution of liquid bulk renewable for another 20 years. The price paid by Tequimar was R\$4.3 and is being amortized from August 2005 until December 2022.

12. DEFERRED CHARGES, NET

| | Annual amortization rates - % | Cost | 2006 Accumulated amortization | Net book value | 2005 Net book value |
|---|-------------------------------------|-------|-------------------------------------|----------------------|------------------------------|
| Expenses with studies and projects | 10 to 20 | 50.9 | (11.2) | 39.7 | 21.0 |
| Pre-operating expenses | 10 to 33 | 7.2 | (2.6) | 4.6 | 4.8 |
| Installation of Ultrasystem equipment at customers facilities | 33 | 154.1 | (93.1) | 61.0 | 60.3 |
| Goodwill | 10 to 50 | 7.7 | (1.7) | 6.0 | 10.9 |
| Other | 20 | 2.2 | (1.2) | 1.0 | 1.3 |
| | | 222.1 | (109.8) | 112.3 | 98.3 |

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Expenses with studies and projects include, mainly, the LPG distribution structure review project and expenses for the Rio de Janeiro Petrochemical Complex (COMPERJ) project. These projects were responsible for the increase in the deferred charges balance from 2005 to 2006.

13. LOANS, FINANCING AND DEBENTURES**a) Composition**

| | Annual interest | | | | |
|--|-----------------|---------|--------------------|--------------------|--------------------|
| Description | 2006 | 2005 | Index/ Currency | rate 2006 - % | Maturity |
| Foreign currency: | | | | | |
| Syndicated loan (b) | 128.5 | 140.6 | US\$ | 5.05 | 2008 |
| Notes in the foreign market (c) | 535.6 | 586.5 | US\$ | 7.25 | 2015 |
| Notes in the foreign market (b) | 128.7 | | US\$ | 9.00 | 2020 |
| Working capital loan | 1.4 | 0.4 | MX\$ + TIIE (i) | 1.0 | 2007 |
| Foreign financing | 26.1 | 28.5 | US\$ + LIBOR | 2.0 | 2009 |
| Financing for inventories and property additions | | | | | |
| | 14.4 | 11.0 | MX\$ + TIIE (i) | From 1.0 to 2.0 | From 2007 to 2011 |
| Advances on foreign exchange contracts | 1.3 | 9.8 | US\$ | From 5.20 to 5.65 | Maximum of 56 days |
| National Bank for Economic and Social Development (BNDES) | 12.9 | 22.3 | UMBNDDES (ii) | From 8.30 to 10.05 | From 2007 to 2011 |
| National Bank for Economic and Social Development (BNDES) | 10.1 | 0.3 | US\$ | From 7.35 to 10.50 | From 2009 to 2013 |
| Export prepayments | 11.1 | 44.9 | US\$ | From 6.20 to 6.41 | 2008 |
| | | | | | |
| Subtotal | 870.1 | 844.3 | | | |
| Unrealized losses on swap transactions | 52.3 | 48.1 | | | |
| | | | | | |
| Subtotal | 922.4 | 892.4 | | | |
| | | | | | |
| Local currency: | | | | | |
| National Bank for Economic and Social Development (BNDES) | 199.9 | 173.0 | TJLP (iii) | From 1.5 to 4.85 | From 2007 to 2012 |
| National Bank for Economic and Social Development (BNDES) | 7.0 | 11.2 | IGP-M (iv) | 6.5 | 2008 |
| Government Agency for Machinery and Equipment Financing (FINAME) | 40.7 | 47.7 | TJLP (iii) | From 2.5 to 4.85 | From 2007 to 2011 |
| Research and projects financing (FINEP) | 46.9 | 38.1 | TJLP (iii) | From (2.0) to 5.0 | From 2009 to 2013 |
| Debentures (d) | 312.8 | 317.9 | CDI (v) | 102.5 of CDI | 2008 |
| Banco do Nordeste do Brasil | 19.8 | | | From 11.9 to 14.0 | 2018 |
| Other | 0.2 | 0.2 | | | |
| | | | | | |
| Subtotal | 627.3 | 588.1 | | | |
| | | | | | |
| Total financing and debentures | 1,549.7 | 1,480.5 | | | |

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| | | | |
|---------------------|---------|---------|--|
| Current liabilities | (167.9) | (201.9) | |
|---------------------|---------|---------|--|

| | | | |
|-----------------------|---------|---------|--|
| Long-term liabilities | 1,381.8 | 1,278.6 | |
|-----------------------|---------|---------|--|

-
- (i) MX\$ = Mexican pesos, TIE = Mexican break-even interbank interest rate.
 - (ii) UMBNDES = BNDES monetary unit. This is a basket of currencies representing the composition of BNDES debt in foreign currency, 93% of which is linked to the U.S. dollar.
 - (iii) TJLP = long-term interest rate.
 - (iv) IGP-M = general market price index, is a measure of Brazilian inflation calculated by the Getúlio Vargas Foundation.
 - (v) CDI = Interbank deposit rate

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Annual maturities of long-term financing

| | 2006 | 2005 |
|--------------|----------------|----------------|
| 2007 | | 94.0 |
| 2008 | 529.3 | 515.5 |
| 2009 | 101.5 | 75.0 |
| 2010 | 37.4 | 9.0 |
| 2011 | 21.7 | |
| Thereafter | 691.9 | 585.1 |
| Total | 1,381.8 | 1,278.6 |

b) Notes in the foreign market and syndicated loan

In June 1997, the subsidiary Companhia Ultragaz S.A. issued US\$60 million in notes, (Original Notes) maturing in 2005. In June 2005, maturity was extended to June 2020 with put/call options in June 2008.

In June 2005, the subsidiary Oxitenno Overseas Corp. acquired the full amount of Original Notes issued by Companhia Ultragaz S.A., with funds from a syndicated loan in the amount of US\$60 million with maturity in June 2008 and interest rate of 5.05% per year. The syndicated loan was guaranteed by the Company and the subsidiary Oxitenno S.A. Indústria e Comércio.

In April 2006, the subsidiary Oxitenno Overseas Corp. sold the Original Notes to a financial institution. Concurrently, the subsidiary acquired from this financial institution a credit linked note backed by the Original Notes, as mentioned in Note 5, thus obtaining an additional return on this investment. The transaction matures in 2020, and the subsidiary as well as the financial institution may redeem it early, although the subsidiary has only an annual option of redemption (purchase) in or after June 2008. In the event of insolvency of the financial institution, Companhia Ultragaz S.A. would be required to settle the Original Notes, although Oxitenno Overseas Corp. would continue to be creditor of the credit linked note. Thus, the Company is no longer eliminating the Original Notes in its consolidated financial statements.

c) Notes in the foreign market

In December 2005, the subsidiary LPG International Inc. issued notes in the amount of US\$250 million, maturing in December 2015, with annual interest rate of 7.25% paid semiannually, with the first payment scheduled for June 2006. The issue price was 98.75% of the notes' face value, which represented a total yield for investors of 7.429% per annum upon issuance. The notes were guaranteed by the Company and by Oxitenno S.A.- Indústria e Comércio.

As a result of the issuance of notes and the syndicated loan, the Company and its subsidiaries mentioned previously are subject to covenants that limit, among other things:

Transactions with shareholders that hold amounts of 5% or more of any class of Capital Stock of the Company, except upon fair and reasonable terms no less favorable to the Company than could be obtained in a comparable arm's-length transaction with a third party.

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Obligation of having Board of Directors resolution for transactions with related parties higher than US\$15 million (excepting transactions by the Company with subsidiaries and between subsidiaries).

Restriction of disposal of the totality or near totality of the assets of Company and subsidiaries.

Restriction of encumbrances on assets in excess of US\$150 million or 15% of the value of consolidated tangible assets.

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Maintenance of financial ratio, between consolidated net debt and consolidated EBITDA (Earning Before Interest, Taxes, Depreciation and Amortization), less than or equal to 3.5.

Maintenance of financial ratio, between consolidated EBITDA and consolidated net financial expenses higher than or equal to 1.5.

The restrictions imposed on the Company and its subsidiaries are usual in transactions of this nature and have not limited their ability to conduct their business to date.

d) Debentures

On March 1, 2005, the Company issued single series of 30,000 nonconvertible debentures, whose main features are:

| | |
|------------------------|--|
| Nominal unit value: | R\$10.000 (ten thousands reais). |
| Final maturity: | March 1, 2008. |
| Nominal value payment: | Lump sum at final maturity. |
| Yield: | 102.5% of CDI. |
| Yield payment: | Semiannually, beginning March 1, 2005. |
| Repricing: | None. |

The debentures are subject to commitments that restrict, among other things, certain operations of merger or spin-off, as well as the disposal of operating assets that would result in a reduction of more than 25% of consolidated net sales, and include the obligation to maintain a consolidated net debt to consolidated EBITDA ratio less than or equal to 3.5. None of these commitments have restricted the ability of Company and its subsidiaries to conduct business.

e) Collateral

A portion of the financing is collateralized by liens on property, plant and equipment, shares of investee and guarantees provided by the Company and its subsidiaries and by minority stockholders, as shown below:

| | 2006 | 2005 |
|---|------|------|
| Amount of financing secured by: | | |
| Property, plant and equipment | 42.7 | 53.8 |
| Shares of investee minority and stockholders guarantees | 7.0 | 11.2 |
| Total | 49.7 | 65.0 |

Other loans are collateralized by guarantees issued by Company and by the future flow of exports. The Company is responsible for sureties and guarantees offered on behalf of its subsidiaries, amounting to R\$1,073.1 (R\$1,017.9 in 2005).

Certain subsidiaries have issued guarantees to financial institutions related to amounts owed to those institutions by certain of their customers (vendor financing). There are no recourse provisions or collaterals that would enable the Company or its subsidiaries to recover any amounts paid to the financial institutions under these agreements. In the event such payments are made, the subsidiaries may recover such amounts paid

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directly from their customers. Maximum future payments related to these guarantees amount to R\$34.9 (R\$33.2 in 2005), with terms of up to 210 days. As of December 31, 2006, the Company and its subsidiaries have not incurred any loss nor recorded any liability related these guarantees.

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Ultrapar Participações S.A. and Subsidiaries

14. STOCKHOLDERS' EQUITY

a) Capital

The Company is a listed corporation with shares traded on the São Paulo and New York Stock Exchanges. Subscribed and paid-up capital is represented by 81,325,409 shares without par value, comprised of 49,429,897 common shares and 31,895,512 preferred shares.

As of December 31, 2006, 12,534,161 preferred shares were outstanding abroad, in the form of American Depositary Receipts (ADRs).

The Extraordinary Stockholders' Meeting held on July 20, 2005 approved reverse stock split, attributing 1 (one) share in substitution for every 1,000 (thousand) existing shares. Likewise, each American Depositary Share (ADS), previously representative of a lot of 1,000 (thousand) preferred shares, became representative of 1 (one) preferred share.

Preferred shares are not convertible into common shares, do not entail voting rights, and have priority in capital redemption, without premium, in the event of liquidation of the Company.

At the beginning of 2000, the Company granted, through a stockholders agreement, tag-along rights, which assure to minority stockholders identical conditions to those negotiated by the controlling shareholders in case of disposal of shareholding control of the Company. The tag-along rights guarantee 100% of the offer price for all types of shares issued by the Company. On May 18, 2004, the Company included the tag-along rights in its bylaws.

The Company is authorized to increase its capital, regardless of amendment to the bylaws, through a resolution of the Board of Directors, until it reaches R\$1,500,000, by means of issuance of common or preferred shares, without keeping the existing ratio, observing the limit of 2/3 of preferred shares, to the total of the shares issued.

b) Treasury shares

The Company acquired its own shares at market prices, without capital reduction, for holding in treasury and subsequent disposal or cancellation, in accordance with the provisions of Brazilian Securities Commission (CVM) Instructions No. 10 of February 14, 1980 and No. 268 of November 13, 1997.

As of December 31, 2006, the Company and its subsidiaries held 408,647 preferred shares (161,697 preferred shares, net of shares provided to certain executives of these subsidiaries as described in Note 22) and 6,617 common shares in treasury, which had been acquired at the average cost of R\$25.27 (whole Brazilian reais) and R\$19.30 (whole Brazilian reais) per share, respectively. The average acquisition cost, was adjusted to reflect the stock dividends and reverse stock split.

The market price of preferred shares issued by the Company as of December 31, 2006 on the BOVESPA (São Paulo Stock Exchange) was R\$48.99.

c) Capital reserve

The capital reserve in the amount of R\$0.6 reflects the goodwill of the sale of shares at market price to be held in treasury in the Company's subsidiaries, at the average price of R\$36.00 (whole Brazilian reais) per share. These shares were provided to certain executives of these subsidiaries as described in Note 22.

d) Revaluation reserve

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This reserve reflects the revaluation write-up of assets of subsidiaries and is realized based upon depreciation, write-off or disposal of revalued assets, including the related tax effects.

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In some cases, taxes on the revaluation reserve of certain subsidiaries are recognized only upon the realization of this reserve since the revaluations occurred prior to the publication of CVM Resolution No.183/95, as mentioned in Note 10.

e) Profit reserves

Legal reserve

Under Brazilian corporate law, the Company is required to appropriate 5% of annual earnings to a legal reserve, until the balance reaches 20% of capital stock. This reserve may be used to increase capital or absorb losses, but may not be distributed as dividends.

Reserve for retention of profits

This reserve is supported by the investment program, in conformity with article 196 of Brazilian corporate law, and includes both a portion of net income and the realization of the revaluation reserve.

Unrealized profit reserve

This reserve is established in conformity with article 197 of Brazilian corporate law, based on the equity pick-up in subsidiaries and affiliated companies. The realization of this reserve usually occurs on receipt of dividends, sale and write-off of investments.

f) Dividends and appropriation of net income (Company)

According to the Company's bylaws, stockholders are entitled to a minimum annual dividend of 50% of adjusted net income, calculated under the terms of accounting practices adopted in Brazil.

Proposed dividends as stated in the Company's financial statements, subject to approval at the Annual Stockholders Meeting, are as follows:

| | 2006 |
|---|-------------|
| Net income | 288.4 |
| Legal reserve | (14.4) |
| Retention of profits reserve | (137.0) |
| Realizable profits reserve | (61.0) |
| Dividends balance | 76.0 |
| Realization of realized profits reserve | 68.2 |
| Interim dividends (R\$0.887398 (whole Brazilian reais) per common and preferred share) | (72.0) |
| Proposed dividends (R\$0.889633 (whole Brazilian reais) per common and preferred share) | (72.2) |

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g) Reconciliation of net income Company and consolidated

The reconciliation of net income, Company and consolidated, shows the effect of the reversal of the allowance for scheduled factory maintenance of some subsidiaries, net of income and social contribution taxes, recorded in retained earnings, in accordance with CVM Resolution No. 489/05 and Technical Interpretation No. 01/06 by IBRACON, as follows:

| | 2006 | 2005 |
|--|-------|-------|
| Net income Company | 288.4 | 299.2 |
| Reversal of allowance for factory maintenance by the subsidiary Oxiteno S.A. Indústria e Comércio | (0.8) | |
| Reversal of allowance for factory maintenance by the subsidiary Oxiteno Nordeste S.A. Indústria e Comércio | (5.5) | |
| Net income consolidated | 282.1 | 299.2 |

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15. FINANCIAL INCOME (EXPENSES), NET

| | 2006 | 2005 | 2004 |
|--|---------|---------|---------|
| Financial income: | | | |
| Interest on cash and cash equivalents, short and long-term investments | 163.2 | 128.8 | 72.1 |
| Interest on trade accounts receivables | 5.3 | 5.1 | 4.9 |
| Monetary and exchange variation income | (14.4) | (17.8) | (10.4) |
| Other income | 1.8 | 2.6 | 2.3 |
| | 155.9 | 118.7 | 68.9 |
| Financial expense: | | | |
| Interest on financing | (85.5) | (42.9) | (45.2) |
| Interest on debentures | (44.8) | (41.4) | |
| Bank charges | (14.7) | (17.1) | (12.2) |
| Monetary and exchange variation expenses | 17.7 | 32.3 | 25.7 |
| Financial results from currency swap transactions | (19.0) | (48.8) | (52.6) |
| CPMF/IOF/other financial expenses (*) | 29.0 | (25.6) | (26.3) |
| Other expenses | (8.0) | (2.5) | (3.3) |
| | (125.3) | (146.0) | (113.9) |
| Financial income (expenses), net | 30.6 | (27.3) | (45.0) |

(*) In 2006, includes R\$23.5 referring to the reversal of the provision for PIS and COFINS contingencies and R\$26.2 related to the recovery of PIS and COFINS mentioned in Note 19 a), as they were originally recorded as financial expenses.

16. NONOPERATING INCOME (EXPENSES), NET

Composed mainly of R\$13.7 (R\$0.4 in 2005 and R\$2.0 in 2004) in write-off of deferred assets related to studies and projects, and R\$4.8 (R\$1.4 in 2005 and R\$14.0 in 2004) of result on the sale of property, plant and equipment, mainly gas cylinders and vehicles and allowance for losses of investments.

17. SEGMENT INFORMATION

The Company has three reportable segments: gas, chemical and logistics. The gas segment distributes LPG to residential, commercial and industrial consumers mainly in the South, Southeast and Northeast regions of Brazil. The chemical segment primarily produces ethylene oxide and byproducts, which are raw materials for the textiles, foods, cosmetics, detergents, agricultural chemicals, paints and varnishes industries, among other. Operations in the logistics segment include storage and transportation, mainly in the Southeast and Northeast regions of Brazil. Reportable segments are strategic business units that provide different products and services. Intersegment sales are transacted at prices that are freely negotiated and approximate those that could be obtained with third parties.

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Ultrapar Participações S.A. and Subsidiaries

The principal financial information about each of the Company's reportable segments is as follows:

| | 2006 | | | | 2005 | 2004 |
|---|----------|---------|------------|-------|--------------|--------------|
| | Ultragaz | Oxitenó | Ultracargo | Other | Consolidated | Consolidated |
| Net sales, net of intercompany transactions | 3,066.0 | 1,549.5 | 178.6 | | 4,794.1 | 4,784.2 |
| Operating income before financial items and equity in subsidiary and affiliated companies | 167.3 | 146.3 | 11.4 | 5.4 | 330.4 | 563.9 |
| Total assets, net of related parties | 961.4 | 2,307.8 | 310.1 | 322.8 | 3,902.1 | 2,667.2 |

Disclosures of segments in accordance with U.S. GAAP are made in Note 24.V.j).

18. RISKS AND FINANCIAL INSTRUMENTS

The main risk factors to which the Company and its subsidiaries are exposed reflect strategic-operating and economic-financial aspects. Strategic-operating risks (such as behavior of demand, competition, technological innovation and significant structural changes in industry, among others) are addressed by the Company's management model. Economic-financial risks mainly reflect customer default and macroeconomic variables, such as exchange and interest rates, as well as the characteristics of the financial instruments used by the Company. These risks are managed through control policies, specific strategies and the determination of limits, as follows:

Customer default These risks are managed by specific policies for accepting customers and analyzing credit and are mitigated by diversification of sales. As of December 31, 2006, Oxitenó S.A. Indústria e Comércio and its subsidiaries maintained R\$1.6 (2005 R\$0.8) and the subsidiaries of Ultragaz Participações Ltda, maintained R\$20.0 (2005 R\$25.2) as an allowance for doubtful accounts.

Interest rates The Company and its subsidiaries adopt conservative policies to obtain and invest funds and to minimize the cost of capital. The temporary cash investments of the Company and its subsidiaries are comprised substantially of transactions linked to the CDI, as described in Note 4. A portion of the financial assets is intended for foreign currency hedges, as mentioned below. Borrowings are mainly originated from the BNDES, debentures and foreign currency financing are disclosed in Note 13.

Exchange rate The Company's subsidiaries use foreign currency swap instruments (mainly US\$ and CDI) available in the financial market to cover assets and liabilities in foreign currency, so as to reduce the exchange rate variation effects on their results. Such swap instruments have amounts, periods and indexes equivalent to the assets and liabilities in foreign currency to which they are linked. The following summary shows assets and liabilities in foreign currency, translated into Brazilian reais at December 31, 2006 and 2005 at the corresponding year end exchange rates:

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| | 2006 | 2005 |
|--|--------------|--------------|
| Assets: | | |
| Investments abroad and swap instruments | 94.4 | 126.2 |
| Foreign cash and cash equivalents abroad | 50.4 | 512.5 |
| Short and long-term investments in foreign currency | 726.9 | 213.2 |
| Receivables from foreign customers, net of advances on foreign exchange contracts and allowance for losses | 25.4 | 22.0 |
| Total | 897.1 | 873.9 |
| Liabilities: | | |
| Foreign currency financing | 870.1 | 844.3 |
| Import transactions payables | 30.9 | 16.0 |
| Total | 901.0 | 860.3 |
| Net asset (liability) position | (3.9) | 13.6 |

The exchange rate variation related to cash and cash equivalents, short and long-term investments in foreign currencies was recorded as financial expense in the consolidated statement of income for the year ended December 31, 2006, in the amount of R\$15.3 (financial expense in 2005 of R\$9.4 and financial expense in 2004 of R\$11.0).

Market value of financial instruments

Market value of financial instruments as of December 31, 2006 and 2005 are as follow:

| | 2006 | | 2005 | |
|---|------------|--------------|------------|--------------|
| | Book value | Market value | Book value | Market value |
| Financial assets: | | | | |
| Cash and cash equivalents | 385.1 | 385.1 | 1,114.2 | 1,114.2 |
| Short-term investments | 737.3 | 734.6 | 184.8 | 184.8 |
| Long-term investments | 548.0 | 564.4 | 372.7 | 372.7 |
| | 1,670.4 | 1,684.1 | 1,671.7 | 1,671.7 |
| Financial liabilities: | | | | |
| Current and long-term financing and swaps | 1,236.9 | 1,265.3 | 1,162.6 | 1,164.4 |
| Current and long-term debentures | 312.8 | 312.7 | 317.9 | 318.5 |
| | 1,549.7 | 1,578.0 | 1,480.5 | 1,482.9 |
| Investment: | | | | |
| Investments in affiliated companies | 25.5 | 29.0 | 28.1 | 33.1 |

The market value of financial instruments was obtained through the commonly used marking to market methodology, which consists of carrying the balances of the instruments until the maturity at the respective contracted rates, discounting them to present value at market rates as of

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December 31, 2006 and 2005. The market value of investments in affiliated companies is based on the share price trading on the BOVESPA São Paulo Stock Exchange.

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19. CONTINGENCIES AND COMMITMENTS

a) Labor, civil and tax lawsuits

The Petrochemical Industry Labor Union, of which the employees of Oxiteno Nordeste S.A. Indústria e Comércio are members, filed a lawsuit against the subsidiary in 1990, demanding compliance with the adjustments established in collective labor agreement, in lieu of the salary policies effectively followed. At the same time, the employers' association proposed a collective bargaining for the interpretation and clarification of the fourth clause of the agreement. Based on the opinion of its legal counsel, who analyzed the last decision of the Federal Supreme Court (STF) on the collective bargaining, as well as the status of the individual lawsuit of the subsidiary, management believes that an accrual for a potential loss is not necessary as of December 31, 2006.

The subsidiaries Companhia Ultragaz S.A. and SPGás Distribuidora de Gás Ltda. are parties to an administrative proceeding at the SDE (Economic Law Department), linked to CADE (Administrative Council for Economic Defense), under the allegation of anticompetitive practice in certain municipalities of the State of Minas Gerais in 2001. In September 2005, the SDE issued a technical notice recommending to CADE a ruling against the companies involved in this proceeding. In their defense, the subsidiaries' arguments, among others, are that: (i) under the terms of the notice issued by the Company's chief executive officer on July 4, 2000, the subsidiaries' employees were forbidden to discuss with third parties matters related to prices; and (ii) no consistent proof was attached to the proceeding's records. In view of the arguments presented, the fact that the technical notice has no binding effect on CADE's decision, and their legal counsel's opinion, the subsidiaries did not record a provision for this issue. Should CADE's decision be unfavorable, the subsidiaries could still discuss the issue at the judicial level.

The subsidiary Companhia Ultragaz S.A. is a defendant in lawsuits relating to damages caused by an explosion in 1996 in a shopping mall in the city of Osasco, State of São Paulo. Such lawsuits involve: (i) individual suits filed by victims of the explosion claiming damages from Ultragaz for the loss of economic benefit and for pain and suffering, (ii) reimbursement of expenses from management of the shopping mall and its insurance company, and (iii) a class action lawsuit seeking indemnification for material damages and pain and suffering for all the victims injured and deceased. The subsidiary believes that it has presented evidence that defective gas pipes in the shopping mall caused the accident and that Ultragaz's on-site LPG storage facilities did not contribute to the explosion. Of the 58 lawsuits judged thus far, a favorable judgment was obtained for 57, and of these 16 have already been dismissed; only 1 had an unfavorable decision, which is still subject to appeal, and whose amount, should the decision be upheld, is seventeen thousands reais. Two lawsuits have not yet been judged. The subsidiary has insurance coverage for these lawsuits, and the uninsured contingent amount is R\$23.6. The Company has not recorded any provision for this amount, since it believes the probability of loss is remote.

The Company and its subsidiaries obtained injunctions to pay PIS and COFINS (taxes on revenues) without the changes introduced by Law No. 9718/98 in its original version. The ongoing questioning refers to the levy of these taxes on sources of income other than revenues. The unpaid amounts were recorded in the financial statements of the Company and its subsidiaries, totaling R\$14.5 as of December 31, 2006 (R\$37.0 in 2005). Recently the STF has decided the matter favorable to the taxpayer. Although it is a precedent, the effect of this decision does not automatically apply to all the companies, since they have to await judgment of their own lawsuit. In 2006 final decisions were rendered on the lawsuits of subsidiaries Companhia Ultragaz S.A., Transultra Armazenagem e Transporte Especializado Ltda., Oxiteno S.A Indústria e Comércio and Ultraquímica Florestal Ltda. (company merged into Ultracargo Operações Logísticas e Participações Ltda.), and the subsidiaries reversed the existing provisions in the amount of R\$15.9, R\$1.3, R\$5.7 and R\$0.6, respectively, net of attorney's fees, as financial income in the statement of income for the year. Likewise, a final decision was rendered on the lawsuit related to subsidiary Oxiteno Nordeste S.A. Indústria e Comércio. As this subsidiary had not obtained an injunction, it paid undue PIS and COFINS in prior periods. The amount of R\$26.2, related to the favorable outcome in this lawsuit, net of attorney's fees, was recorded as financial income and is being used for offset of federal taxes. The Company has other subsidiaries whose lawsuits have not yet been judged in the amount of R\$14.1, net of attorney's fees.

The Company's subsidiary Oxiteno S.A. Indústria e Comércio and its subsidiary Oxiteno Nordeste S.A. Indústria e Comércio accrued R\$15.6 (R\$14.5 in 2005) for ICMS tax assessments being judged at lower-level and appeal-level administrative courts. The subsidiaries are currently awaiting decisions on the appeals.

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The Company's subsidiary Utingás Armazenadora S.A. has challenged in court ISS (Service Tax) tax assessments issued by the municipal government of Santo André. Legal counsel of the subsidiary classifies the risk as low, since a significant portion of the lower-court decisions was favorable to the subsidiary. The thesis defended by the subsidiary is supported by the opinion of a renowned tax specialist. The unprovisioned updated amount of the contingency as of December 31, 2006 is R\$33.4 (R\$30.0 as of December 31, 2005).

On October 07, 2005, the subsidiaries of Ultragaz Participações Ltda. filed for and obtained an injunction to support the offset of PIS and COFINS credits against other federal taxes administered by the Federal Revenue Service (SRF), notably corporate income tax and social contribution taxes. According to the injunction obtained, the subsidiaries have been making escrow deposits for these debits and recognizing the corresponding liability for this purpose.

On December 29, 2006 the subsidiaries Oxiteno S.A Indústria e Comércio, Oxiteno Nordeste S.A Indústria e Comércio, Companhia Ultragaz S.A. and Transultra Armazenamento e Transporte Especializado Ltda filed for an injunction seeking the deduction of ICMS from PIS and COFINS tax basis.

The Company and its subsidiaries filed a request for injunction seeking not to be subject to the legislation that restricted the offset of corporate income tax (IRPJ) and social contribution (CSLL) tax loss carryforwards computed through December 31, 1994 to 30% of income for the year, as well as petitioning the full and immediate utilization of supplementary monetary adjustment based on the Consumer Price Index (IPC)/National Treasury Bonds (BTN) for 1990 (Law No. 8.200/91). There are good precedents for these discussions when it is proven that there was only a postponement of payment of IRPJ and CSLL to the following years, as is the case of the Company's subsidiaries, and legal counsel understands that the chances of success of the challenge in the judicial sphere is possible. The contingency is estimated at R\$21.4.

The Company and its subsidiaries have other ongoing administrative and judicial proceedings. Legal counsel classified the risks on these proceedings as possible and/or remote and, therefore, no reserves for potential losses on these proceedings have been recorded.

Accruals and escrow deposits are summarized below:

| Accrual | Balance in 2005 | Additions | Write-off | Monetary update | Balance in 2006 |
|--|--------------------|------------|---------------|--------------------|--------------------|
| Income and social contribution taxes | 9.3 | 25.0 | (0.3) | 2.0 | 36.0 |
| PIS and COFINS on other revenues | 37.0 | | (24.5) | 1.9 | 14.4 |
| ICMS | 14.4 | 0.3 | | 1.1 | 15.8 |
| INSS | | 2.2 | | | 2.2 |
| PIS on rendering service | | 0.3 | | | 0.3 |
| (-) Escrow deposits | (6.1) | (24.4) | | (1.7) | (32.2) |
| Total of other taxes and contribution | 54.6 | 3.4 | (24.8) | 3.3 | 36.5 |

b) Take or pay commitments

The Company's subsidiary Terminal Químico de Aratu S.A. Tequimar has contracts with CODEBA and Complexo Industrial Portuário Governador Eraldo Gueiros, in connection with their port facilities in Aratu and Suape, respectively. Such contracts establish minimum cargo movement of 1,000,000 tons per year for Aratu, effective through 2022, and

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250,000 tons per year for Suape, effective through 2027. If annual movement is less than the established minimum, the subsidiary is required to pay the difference between the actual movement and the minimum contractual movement using the port rates in effect at the date of payment. As of December 31, 2006, such rates were R\$3.67 and R\$3.44 per ton for Aratu and Suape, respectively. The subsidiary has met the minimum cargo movement limits since inception of the contracts. At December 31, 2006, future minimum lease payments under these operating leases are: R\$4.5 in 2007, R\$4.5 in 2008, R\$4.5 in 2009, R\$4.5 in 2010, R\$4.5 in 2011 and thereafter R\$52.1. A substantial part of these leases are paid directly to the port authorities by Tequimar's customers. The part of such lease expenses paid by Tequimar amounted to R\$2.2 in 2006, R\$2.0 in 2005 and R\$1.6 in 2004.

The Company's subsidiary Oxitenor Nordeste S.A. Indústria e Comércio has a supply contract with Braskem S.A., that establishes a minimum annual consumption level of ethylene per year. The minimum purchase commitment and the actual demand for the years ended December 31, 2006 and 2005, expressed in tons of ethylene, are summarized below. Should the minimum purchase commitment not be met, the subsidiary would be liable for a fine of 40% of the current ethylene price for the quantity not purchased.

| | Minimum purchase commitment | Actual demand (real) | |
|---------|-----------------------------------|----------------------|-----------|
| | | 2006 | 2005 |
| | | Unaudited | Unaudited |
| In tons | 137,900 | 181,496 | 192,190 |

At December 31, 2006, future minimum purchase commitments under this contract, based on the price prevailing at that date, are: R\$224.4 in 2007, R\$236.9 in 2008, R\$249.4 in 2009, R\$261.8 in 2010, R\$274.3 in 2011 and thereafter R\$2,905.1. Total purchases made under this contract were R\$621.5 in 2006, R\$624.9 in 2005 and R\$576.9 in 2004.

On August 16, 2006 the subsidiary signed a memorandum of understanding, altering the ethylene supply contract with Braskem S.A. described above. The memorandum of understanding regulates new conditions of ethylene supply through 2021, and in 2007 and 2008 the subsidiary will have an additional volume of ethylene, with the minimum quantity in tons increasing to 180 thousand and 190 thousand, respectively. The new condition provided for in the memorandum of understanding are reflected in future minimum purchase commitments mentioned above.

c) Insurance coverage for subsidiaries

The Company has insurance policies to cover various risks, including loss and damage from fire, lightning, explosion of any nature, windstorm, plane crash and electrical damage, among others, protecting the plants and other branches of all subsidiaries, with coverage amounting to US\$396 million.

For the plants of Oxitenor S.A. Indústria e Comércio, Oxitenor Nordeste S.A. Indústria e Comércio and Canamex Químicos S.A. de C.V., there is also a loss of income insurance against losses from potential accidents related to their assets, with coverage amounting to US\$233 million.

A civil liability insurance program covers the Company and its subsidiaries, with global coverage of US\$200 million, for losses and damages from accidents caused by third parties, related to the commercial and industrial operations and/or distribution and sale of products and services.

Group life insurance, personal accident insurance, health insurance, and domestic and international transportation insurance are also contracted.

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20. RELATED COMPANIES

The balances and transactions with related parties are as follows:

| | 2006 | | | |
|---|--------|----------------------|------------------------------|---------|
| | Assets | Loans Liabilities | Trade accounts Receivable | Payable |
| Química da Bahia Indústria e Comércio S.A. | | 3.6 | | |
| Serma Associação dos Usuários de Equipamentos de Processamentos de Dados e Serviços | | | | |
| Correlatos | 7.3 | | | |
| Petroquímica União S.A. | | | | 1.8 |
| Oxicap Indústria de Gases Ltda. | | | | 1.0 |
| Liquigás Distribuidora S.A. | | | 0.2 | |
| Petróleo Brasileiro S.A. Petrobras | | | | 1.2 |
| Braskem S.A. | | | | 9.8 |
| SHV Gás Brasil Ltda. | | | 0.1 | |
| Other | 0.1 | 1.1 | 0.1 | |
| Total at December 31, 2006 | 7.4 | 4.7 | 0.4 | 13.8 |
| Total at December 31, 2005 | 3.7 | 5.0 | 2.3 | 26.8 |

| | 2006 | | |
|--|--------------|-----------|----------|
| | Transactions | Financial | |
| | Sales | Purchases | expenses |
| Petroquímica União S.A. | | 141.3 | |
| Oxicap Indústria de Gases Ltda. | | 9.7 | |
| Liquigás Distribuidora S.A. | 3.4 | | |
| Química da Bahia Indústria e Comércio S.A. | | | (0.3) |
| Petróleo Brasileiro S.A. Petrobras | | 2,024.0 | |
| Copagaz Distribuidora de Gás Ltda. | 1.2 | | |
| Braskem S.A. | 50.4 | 621.5 | |
| SHV Gás Brasil Ltda. | 1.2 | | |
| Other | 0.9 | | |
| Total 2006 | 57.1 | 2,796.5 | (0.3) |
| Total 2005 | 82.7 | 2,777.6 | (0.6) |
| Total 2004 | 98.3 | 2,805.9 | (0.5) |

The loan balance with Química da Bahia Indústria e Comércio S.A. is adjusted based on the Brazilian long-term interest rate (TJLP). Other loans are not subject to financial charges. Purchase and sale transactions refer, substantially, to purchases of raw materials, other materials and storage and transportation services, carried out at market prices and conditions.

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21. INCOME AND SOCIAL CONTRIBUTION TAXES

a) Deferred income and social contribution taxes

The Company and its subsidiaries recognize tax assets and liabilities, which do not expire, arising from tax loss carryforwards, temporary add-backs, revaluation of property, plant and equipment and other procedures. Tax credits are based on the continuing profitability from operations. Deferred income and social contribution taxes are presented in the following principal categories:

| | 2006 | 2005 |
|--|-------------|-------------|
| Assets: | | |
| Deferred income and social contribution taxes on: | | |
| Provision for losses in assets | 20.4 | 22.8 |
| Provision for contingencies | 13.3 | 17.1 |
| Other provisions | 25.8 | 18.8 |
| Income and social contribution on tax loss carryforwards | 26.0 | 24.3 |
| Total | 85.5 | 83.0 |
| Current portion | 27.3 | 22.0 |
| Noncurrent portion | 58.2 | 61.0 |
| Liabilities: | | |
| Deferred income and social contribution taxes on: | | |
| Revaluation of property, plant and equipment | 0.9 | 1.2 |
| Income earned abroad | 25.3 | 23.1 |
| Total | 26.2 | 24.3 |
| Current portion | 0.2 | 0.2 |
| Noncurrent portion | 26.0 | 24.1 |

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The estimated recovery of deferred income and social contribution tax assets is shown below:

| | |
|--------------|------|
| Through 2007 | 27.3 |
| 2008 | 27.3 |
| 2009 | 16.9 |
| 2010 | 14.0 |
| | 85.5 |

b) Reconciliation of income and social contribution taxes to statutory tax rates

| | 2006 | 2005 | 2004 |
|--|---------|---------|---------|
| Income before taxes, equity in subsidiaries and affiliated companies and minority interest | 342.5 | 329.2 | 502.9 |
| Official tax rates % | 34.0 | 34.0 | 34.0 |
| Income and social contribution taxes at official rates | (116.4) | (111.9) | (171.0) |
| Adjustments to the effective tax rate: | | | |
| Operating provisions and nondeductible expenses/nontaxable income | 7.7 | 17.8 | (5.2) |
| Adjustments to estimated income | 1.8 | 1.1 | (0.3) |
| Employees Meal Program (PAT) | 0.4 | 0.5 | 0.6 |
| Other adjustments | 0.1 | (0.1) | (0.6) |
| Income and social contribution taxes before tax benefits | (106.4) | (92.6) | (176.5) |
| Benefits of tax holidays ADENE | 50.3 | 63.8 | 93.5 |
| Income and social contribution taxes per statement of income | (56.1) | (28.8) | (83.0) |
| Current | (111.8) | (113.1) | (175.0) |
| Deferred | 5.4 | 20.5 | (1.5) |
| Benefits of tax holidays ADENE | 50.3 | 63.8 | 93.5 |

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c) Tax loss carryforwards

Tax loss carryforwards may be used to offset up to 30% of future taxable income and do not expire.

d) Tax exemption

The following indirect subsidiaries have partial or total exemption from income tax in connection with a government program for the development of the Northeast Region of Brazil:

| Subsidiary | Unit | Incentive | Expiration date |
|--|----------------|-----------|-----------------|
| | | - % | |
| Oxiteno Nordeste S.A. Indústria e Comércio (*) | Camaçari plant | 100 | 2006 |
| Bahiana Distribuidora de Gás Ltda. | Mataripe plant | 75 | 2013 |
| | Suape plant | 100 | 2007 |
| | Ilhéus plant | 25 | 2008 |
| | Aracaju plant | 25 | 2008 |
| | Caucaia plant | 75 | 2012 |
| Terminal Químico de Aratu S.A. Tequimar | Aratu Terminal | 75 | 2012 |
| | Suape Terminal | 75 | 2015 |

(*) In December 2006, this plant's exemption expired and a request was filed with ADENE (Northeast Development Agency), the agency in charge of managing this incentive program, seeking a 75% income tax reduction until 2016. The subsidiary expects to have a response to this request by May 2007, having been successful in previous similar requests. Should this 75% reduction not be approved, the subsidiary will file a new request with ADENE, for 25% income tax reduction until 2008 and 12.5% from 2009 to 2013, to which it is entitled for being located in a development region and exercising an economic activity that is considered as priority for the area.

22. STOCK COMPENSATION PLAN

The Extraordinary Stockholders' Meeting held on November 26, 2003 approved a compensation plan for management of the Company and its subsidiaries, which provides for: (i) the initial grant of usufruct of shares issued by the Company and held in treasury by the subsidiaries in which the beneficiaries are employed, and (ii) the transfer of the beneficial ownership of the shares after ten years of the initial concession provided that the professional relationship between the beneficiary and the Company and its subsidiaries is not interrupted. The total value granted to executives until December 31, 2006, including taxes, was R\$12.3 (R\$8.9 in 2005). Such value is being amortized over a period of ten years and the amortization related to the year ended December 31, 2006, in the amount of R\$0.9 (R\$0.8 in 2005 and R\$0.6 in 2004), was recorded as an operating expense for the period.

23. EMPLOYEE BENEFITS AND PRIVATE PENSION PLAN

The Company and its subsidiaries offer benefits to their employees, such as life insurance, health care and a pension plan. In addition, certain subsidiaries offer loans for the acquisition of vehicles and personal computers to some of their employees. These benefits are recorded on the accrual basis and terminate at the end of the employment relationship.

In August 2001, the Company and its subsidiaries began to offer their employees a defined contribution pension plan, managed by Ultraprev Associação de Previdência Complementar. Under the terms of the plan, the basic contribution of each participating employee is defined annually by the participant between 0% and 11%, of his/her salary. The sponsoring companies provide a matching contribution to the basic contribution. As participants retire, they may opt to receive monthly: (i) a percentage varying between 0.5% and 1.0% of the fund accumulated in his/her name at Ultraprev, or (ii) a fixed-monthly amount that will extinguish the fund accumulated in his/her name in a period between 5 and 25 years. As such, neither the Company nor its subsidiaries assume responsibility for guaranteeing amounts or periods of receipt.

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for the participants that retire. In 2006, the Company and its subsidiaries contributed R\$3.3 (R\$3.0 2005 and R\$4.0 2004) to Ultraprev, which was charged to income for

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the year. The total number of employee participants as of December 31, 2006 was 5,632, with no participants retired to date. Additionally, Ultraprev has 1 active participant and 31 former employees receiving benefits according to the policies of a previous plan.

24. SUMMARY AND RECONCILIATION OF THE DIFFERENCES BETWEEN ACCOUNTING PRACTICES ADOPTED IN BRAZIL AND ACCOUNTING PRINCIPLES GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA (U.S. GAAP)

I Description of GAAP differences

The consolidated financial statements of the Company are prepared in accordance with accounting practices adopted in Brazil, which comply with those prescribed by Brazilian corporate law and specific standards established by the Brazilian Securities Commission (CVM). Note 3 to the consolidated financial statements summarizes the accounting policies adopted by the Company. Accounting policies, which differ significantly from U.S. GAAP, are summarized below.

a) Inflation accounting

The Company, as described in Note 3.i), accounts for the effects of inflation in its consolidated financial statements through December 31, 1995. Under U.S. GAAP, Brazil was considered to be a highly inflationary economy until July 1, 1997, and the effect of inflation was recognized until December 31, 1997.

In determining amounts under U.S. GAAP, the effects of inflation for the years ended December 31, 1996 and 1997 were determined using the Índice Geral de Preços -Disponibilidade Interna IGP-DI index, which is widely-accepted and respected index published monthly by the Fundação Getúlio Vargas.

Through December 31, 1995, the Company used indexes established by the government to restate balances and transactions for purposes of its corporate law financial statements. Such indexes do not necessarily represent changes in general price levels, as would be required under U.S. GAAP.

Because the Company's management believes that the Índice Geral de Preços -Disponibilidade Interna IGP-DI is an appropriate and consistent measure of the general price inflation in Brazil and because of its availability, for U.S. GAAP purposes the Company adopted the IGP-DI for restatement of its financial statements through December 31, 1995, replacing the government mandated index. This procedure is consistent with the recommendation by the Brazilian Task Force (organized under the AICPA International Practices Task Force to review the issue of the appropriate index to be used for preparing price-level adjusted financial statements of Brazilian companies filing with the SEC) of using the IGP-M or IGP-DI for such purposes. Thus, all nonmonetary assets and liabilities were restated using the IGP-DI since the inception of the Company, through December 31, 1997.

b) Reversal of fixed asset revaluations and related deferred tax liabilities

For U.S. GAAP reconciliation purposes, the revaluation of fixed assets and the related deferred income tax effects recorded in the financial statements prepared in accordance with accounting practices adopted in Brazil have been eliminated in order to present fixed assets at historical cost less accumulated depreciation. Accordingly, the depreciation on such revaluation charged to income has also been eliminated for U.S. GAAP reconciliation purposes.

c) Deferred charges

Accounting practices adopted in Brazil permit the deferral of research and development costs and of pre-operating expenses incurred in the construction or expansion of a new facility until the facility begins commercial operations. Deferred charges are amortized over a period of five to ten years.

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For U.S. GAAP reconciliation purposes, such amounts do not meet the conditions established for deferral and, accordingly, have been charged to income and the related amortization under accounting practices adopted in Brazil has been reversed.

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d) Investments in affiliated companies

As from 1996, Brazilian corporate law allows certain less than 20% owned affiliated companies in which an investor owns more than 10% of voting stock to be accounted for under the equity method. In addition, certain more than 20% and less than 50% owned affiliated companies deemed not significant in relation to their parent company are accounted at cost.

For U.S. GAAP reconciliation purposes, less than 20% owned affiliated companies have been accounted for on the basis of cost and more than 20% and less than 50% owned affiliated companies have been accounted for on the equity method for all years presented.

e) Capitalization of interest in relation to construction in progress

Under accounting practices adopted in Brazil, prior to January 1, 1996 the Company was not required to capitalize the interest cost of borrowed funds as part of the cost of the related asset. Under U.S. GAAP, capitalization of borrowed funds during construction of major facilities is recognized as part of the cost of the related assets.

Under U.S. GAAP, interest on construction-period financing denominated in foreign currencies is capitalized using contractual interest rates, exclusive of foreign exchange or monetary correction gains or losses. Interest on construction-period financing denominated in Brazilian reais is capitalized.

f) Acquisitions and business combinations

Under accounting practices adopted in Brazil, assets and liabilities of acquired entities are reflected at book values. Goodwill is represented by the excess of purchase price paid over the book value of net assets and is amortized on a straight-line basis over the periods estimated to be benefited.

Under U.S. GAAP, business combinations are accounted for by the purchase method utilizing fair values. Goodwill is not amortized and should be tested for impairment. An impairment test of goodwill is performed annually or more frequently if events or changes in circumstances indicate that the goodwill might be impaired. Such impairment test is performed utilizing a two-step method. The first step compares the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying amount of a reporting unit exceeds its fair value, the second step is performed to measure the amount of impairment loss, if any. The second step compares the implied fair value of reporting unit goodwill with the carrying amount of that goodwill. If the implied fair value of reporting unit goodwill is lower than the carrying amount of such goodwill, an impairment loss is recognized.

Under Brazilian corporate law, purchases by subsidiaries of their own stock from minority stockholders are initially recorded at cost. Upon cancellation of these shares, the difference between cost and the related book value of the subsidiary's stockholders' equity is recorded by the parent company and in the consolidated financial statements as a capital gain or loss. Direct purchases by the parent company of the subsidiaries' stock from minority stockholders are recorded at cost, with the difference between cost and the related book value of the subsidiaries' stockholders' equity recorded as positive or negative goodwill by the parent company and in the consolidated financial statements.

Under U.S. GAAP, purchases of treasury stock by subsidiaries from minority stockholders and direct purchases by the parent company of the subsidiaries' stock from minority stockholders are recorded as step acquisitions under the purchase method, with assignment of the purchase price to the underlying assets and liabilities based on their fair values and recording of goodwill to the extent that the purchase price exceeds the proportionate amount of the net fair value of the assets and liabilities. No gain or loss is recognized upon either purchase or cancellation of the shares.

Acquisition of subsidiary shares from minority stockholders 2004

As mentioned in Note 3, on December 29, 2004 the Company acquired, through its subsidiary Ultragas Participações Ltda., an additional 7.31% of Companhia Ultragas S.A. total share capital. This acquisition amounted to R\$10.0. Under accounting practices adopted in Brazil, the goodwill of R\$1.8 generated in this acquisition was based on its expected future profitability and will be amortized over five years beginning

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January 2005. As a result of this acquisition, the Company increased its indirect interest in Companhia Ultraz S.A. to 94%.

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Under U.S. GAAP, the Company has accounted for this transaction as an acquisition of minority interest. The purchase price of this acquisition was R\$3.7 million, net of tax, higher than the historical book value recorded under U.S. GAAP. This difference was allocated as an increase of property, plant and equipment, in the amount of R\$3.2 million (net of deferred income taxes) and as an increase of inventories, in the amount of R\$0.5 million (net of deferred income taxes), based on the estimated fair value of the net assets of Companhia Ultragaz S.A.

g) Earnings per share

Under accounting practices adopted in Brazil, it is permitted to determine earnings per share based upon the weighted average number of shares outstanding during each year that earnings are reported. Subsequent changes in the Company's share capital, such as stock dividends, are not retroactively reflected in the disclosure of number of shares outstanding and in the calculation of earnings per share under accounting practices adopted in Brazil, except for the reverse stock split.

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Under U.S. GAAP, earnings per share are determined based upon the weighted average number of shares outstanding during the period, giving retroactive effect to stock dividends and stock splits. Nonvested shares granted to certain executives of the Company as disclosed in Note 24.I.k) are not included in the computation of basic earnings per share even though the shares are legally issued, since such shares are considered contingently returnable because if the executives do not render the requisite service, the shares are returned to the Company. These nonvested shares are included in diluted earnings per share applying the treasury stock method. The calculation of earnings per share under U.S. GAAP is shown in Note 24.V.a).

The Extraordinary Stockholders Meeting held on July 20, 2005 approved a reverse stock split of the Company's shares, attributing 1 (one) share in substitution for every 1,000 (thousand) existing shares. Likewise, each American Depositary Share ADS, previously representative of a lot of 1,000 (thousand) preferred shares, became representative of 1 (one) preferred share.

h) Available-for-sale securities

Equity securities

Under accounting practices adopted in Brazil, available-for-sale equity securities are generally carried at cost, less provision charged to the statement of income if a loss in value is considered to be other than temporary.

For U.S. GAAP reconciliation purposes, the available-for-sale equity security has been recorded at estimated fair value, and the resulting accumulated adjustment, in the amount of R\$4.1 (positive) and R\$5.1 (positive) as of December 31, 2006 and 2005, respectively, net of deferred tax effect, when applicable, has been recognized as a separate component of stockholders' equity until realization. The estimated fair values of the equity security carried by the Company are R\$22.2 and R\$23.7 as of December 31, 2006 and 2005, respectively. During the years presented, no equity security classified under U.S. GAAP as available-for-sale was disposed of.

Debt securities

Under accounting practices adopted in Brazil, available-for-sale debt securities are generally carried at cost, plus interest income earned less provisions, when applicable, charged to the statement of income to reduce its carrying value to market value.

For U.S. GAAP reconciliation purposes, available-for-sale debt securities have been recorded at estimated fair value, and the resulting accumulated adjustment, in the amount of R\$9.0 positive in 2006 (zero in 2005), has been recognized as a separate component of stockholders' equity, net of deferred tax effects and minority interest, when applicable, until realization.

As of December 31, 2006 and 2005, the fair values of available-for-sale debt securities amounted to R\$871.8 and R\$177.8, respectively, and the gross unrealized gains amount to R\$13.7 in 2006 (zero in 2005).

As of December 31, 2006, the amount of R\$704.3 of available-for-sale debt securities mature within one year, R\$128.3 mature between one and two years, and R\$25.7 mature between two and three years.

For the year ended December 31, 2006, the Company sold debt securities for R\$315.2 (R\$12.6 in 2005 and R\$18.7 in 2004), generating a gross realized loss of R\$6.1 (R\$3.0 in 2005 and R\$2.2 in 2004), recorded in the statement of income. The cost of such securities was based on specific identification.

As of December 31, 2006, the amount of R\$33.0 of held to maturity debt securities mature within one year, R\$386.8 mature between one and two years, and R\$7.2 mature in 2018. Under accounting practices adopted in Brazil and for U.S. GAAP, held to maturity debt securities are treated similarly.

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i) Accounting for derivative financial instruments

In the Company's financial statements prepared in accordance with accounting practices adopted in Brazil derivative financial instruments are recorded at net settlement price as determined on each balance sheet date.

Under U.S. GAAP, effective January 1, 2001, all derivative financial instruments must be reported at fair value on each balance sheet date and classified as a derivative asset or liability. Also under U.S. GAAP, the requirements for a derivative instrument to qualify for hedge accounting and deferral of gains and losses are more restrictive than under Brazilian corporate law.

The following table provides a detail of our derivative financial instruments outstanding at the end of each year for which income statement is being presented.

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| 2006 | | | | | | | |
|------------------|------------------|--------------|----------------------------------|-----------------------------------|------------------------|-----------------------|------------------------|
| Notional amount | | | | | | | |
| | | | Receiving side | Paying side | | Fair value - | |
| Description | Receive currency | Pay currency | Interest rate | Interest rate | Book value Gain (loss) | U.S. GAAP Gain (loss) | Adjustment Gain (loss) |
| Swap | US\$56.0 | R\$135.5 | 5.1% fixed | 101.7% to 102.0% of CDI -variable | (42.8) | (45.1) | (2.3) |
| Zero Cost Collar | US\$13.0 | MXN 143.6 | Below MXN 11.1140 | | | (0.4) | (0.4) |
| Swap | US\$7.7 | R\$16.7 | 41.0 to 61.0% of CDI - variable | | | (0.2) | (0.3) (0.1) |
| Swap | R\$28.3 | US\$13.2 | 51.5 to 58.6% of CDI - variable | | | 0.3 | 0.5 0.2 |
| Swap | R\$12.8 | US\$6.0 | 51.1 to 61.0% of CDI - variable | | | 0.1 | 0.2 0.1 |
| Swap | R\$44.9 | US\$20.9 | 96.4 to 105.0% of CDI - variable | | | 0.5 | 1.0 0.5 |
| Swap | R\$17.9 | US\$8.4 | 98.3 to 101.0% of CDI - variable | | | 0.1 | 0.4 0.3 |
| Swap | US\$4.3 | R\$12.6 | 6.2% fixed | | | (9.9) | (9.8) 0.1 |
| Total | | | | | (52.3) | (53.5) | (1.2) |

| 2005 | | | | | | | |
|-----------------|----------|----------|----------------------------------|----------------------------------|-------------|--------------|-------------|
| Notional amount | | | | | | | |
| | | | Receiving side | Paying side | | Fair value - | |
| | Receive | Pay | | | Book value | U.S. GAAP | Adjustment |
| Description | currency | currency | Interest rate | Interest rate | Gain (loss) | Gain (loss) | Gain (loss) |
| Swap | US\$58.9 | R\$142.4 | 5.1% fixed | 101.7% to 102% of CDI - variable | (15.2) | (16.7) | (1.5) |
| Swap | US\$10.8 | MXN122.0 | | 5.8% fixed | (3.3) | (5.2) | (1.9) |
| Swap | US\$1.4 | R\$3.3 | | 36.9% to 101.3% of CDI -variable | 0.1 | | (0.1) |
| Swap | R\$9.0 | US\$4.0 | 74.4% to 79.0% of CDI - variable | | (0.2) | (0.2) | |
| Swap | R\$84.3 | US\$37.7 | 99.6% to 104.5% of CDI -variable | 4% fixed | (2.0) | (1.5) | 0.5 |
| Swap | US\$16.7 | R\$49.3 | 4.2% to 6.9% fixed | 84.7% to 94.2% of CDI - variable | (27.5) | (27.1) | 0.4 |
| Total | | | | | (48.1) | (50.7) | (2.6) |

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| 2004 | | | | | | | |
|-------------|-----------------|----------|--------------------------|-------------------------------|-------------|--------------|-------------|
| Description | Notional amount | | Receiving side | Paying side | Book value | Fair value - | Adjustment |
| | Receive | Pay | | | | U.S. GAAP | |
| | currency | currency | Interest rate | Interest rate | Gain (loss) | Gain (loss) | Gain (loss) |
| Swap | US\$50.3 | R\$136.0 | 7.2% to 8.0% fixed | 100% of CDI -variable | (54.7) | (50.8) | 3.9 |
| Swap | US\$10.8 | MXN122.0 | | 5.8% fixed | (1.9) | (2.0) | (0.1) |
| Forward | R\$57.2 (**) | US\$19.5 | | US\$2.78 to US\$2.95 (*) | 5.0 | 5.0 | |
| Swap | R\$5.4 | US\$2.0 | 101.5% of CDI - variable | 2.5% fixed | 0.1 | 0.1 | |
| Swap | US\$43.9 | R\$130.4 | 4.2% to 6.9% fixed | 87% to 100% of CDI - variable | (37.1) | (31.9) | 5.2 |
| Total | | | | | (88.6) | (79.6) | 9.0 |

(*) Conversion exchange rate at maturity.

(**) Amount to be received at maturity.

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Ultrapar Participações S.A. and Subsidiaries

j) Expenses for public offering of shares

Under accounting practices adopted in Brazil, costs associated with the offering of shares to the public, in the amount of R\$2.4, are recorded as financial expenses in 2005.

Under U.S. GAAP, these costs directly reduce the proceeds of the offering recorded in capital.

k) Accounting for stock compensation plan

As mentioned in Note 22, the Company has approved a stock compensation plan on November 26, 2003.

The table below summarizes the information related to the shares granted to the Company's executives:

| Grant date | Restricted shares granted (*) | Fair value of shares (whole Brazilian reais) | Total compensation costs, including tax | Accumulated recognized compensation costs | Unrecognized compensation costs |
|-------------------|-------------------------------|--|---|---|---------------------------------|
| November 9, 2006 | 51,800 | 46.50 | 3.3 | | 3.3 |
| December 14, 2005 | 28,400 | 32.83 | 1.3 | (0.1) | 1.2 |
| October 4, 2004 | 47,150 | 40.78 | 2.7 | (0.6) | 2.1 |
| December 17, 2003 | 119,600 | 30.32 | 5.0 | (1.6) | 3.4 |
| | 246,950 | | 12.3 | (2.3) | 10.0 |

Those shares were granted at no cost to the Company's executives. The grant-date fair values were determined based on the market value of these shares on the BOVESPA. These executives have the right to receive dividends on these shares provided that the professional relationship between them and the Company and its subsidiaries is not interrupted. These shares will cliff vest after ten years of the initial award. As of December 31, 2006, none of these shares granted to the executives were forfeited. As of December 31, 2006, the total compensation cost related to nonvested awards not yet recognized amounts to R\$10.0, and 8.4 years is the weighted-average period over which this compensation cost is expected to be recognized.

(*) Retroactively adjusted for the stock dividend and reverse stock split as mentioned in Note 24.I.g).

Under accounting practices adopted in Brazil, the Company records compensation costs from its stock compensation plan similarly to the requirements of SFAS 123 (R) Share-Based Payment, using the fair value of the award. Compensation cost is charged to earnings on a straight-line basis. The fair value of the award equals its intrinsic value at the grant date.

No adjustments are included in the U.S. GAAP reconciliation related to the Company's stock compensation plan since the Company applies SFAS 123 (R) Share-Based Payment to account for the plan for U.S. GAAP purposes.

For U.S. GAAP purposes, dividends declared under these unvested restricted shares are accounted for initially as a charge to retained earnings. If the restricted shares do not vest, all previously declared dividends associated with the restricted shares are reversed from retained earnings and charged to compensation expense. As of December 31, 2006, accumulated dividends declared under all unvested restricted shares outstanding amounted to R\$0.9 (R\$0.5 in 2005).

l) Fair value of guarantees under FIN 45

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Under accounting practices adopted in Brazil, the Company is not required to record any liability related to guarantees given to third parties unless contingent obligations to make future payments under the guarantees are probable.

Under accounting practices adopted in Brazil, as of December 31, 2006, the Company has not recorded any liability related to these guarantees, as disclosed in Note 13.

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Under U.S. GAAP, the Company recognizes, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing guarantees in accordance with FIN 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. In the event that, at inception of the guarantee, the Company is required to recognize a liability under SFAS 5, *Accounting for Contingencies*, the liability initially recognized would be the greater of: (a) the amount of fair value of the value of the obligation undertaken in issuing guarantee, or (b) the contingent liability amount required to be recognized at inception of the guarantee by applying SFAS 5.

Under U.S. GAAP, as of December 31, 2006 and 2005 the Company recorded a liability in the amount of R\$0.8 and R\$0.8, respectively, related to these guarantees based on their fair value. The respective offsetting entry of this liability was recorded as an expense. The net effect of this matter in the income statement as per U.S. GAAP is R\$0.0, R\$0.3 (expenses) and R\$0.6 (expenses), per the year ended on December 31, 2006, 2005 and 2004, respectively, at the time those guarantees were issued. The Company reduces the liability (by a credit to earnings) as it is released from risk under the guarantees.

m) Translation adjustments Canamex

Under accounting practices adopted in Brazil, assets and liabilities of foreign subsidiaries are translated into Brazilian reais at the exchange rate in effect at the end of the reporting period, and revenues, expenses, gains and losses are translated into Brazilian reais at the exchange rates prevailing in the end of each month. The net translation gain or loss is reported, net of tax, in the statement of income as *Other operating income (loss)*.

Under U.S. GAAP, the functional currency of Canamex Químicos S.A. de C.V. (Canamex) is the Mexican Peso. As a consequence, the financial statements of Canamex are translated into Brazilian reais in accordance with the criteria set forth in *Statement of Financial Accounting Standards No. 52* (SFAS 52). Under these criteria, assets and liabilities are translated into Brazilian reais at the exchange rate in effect at the end of the reporting period, and revenues, expenses, gains and losses are translated into Brazilian reais at the average rates prevailing during the respective months. The net translation gain or loss resulting from this translation process is excluded from income and is presented as cumulative translation adjustments (CTA) in *Other comprehensive income (loss)* as a separate component of stockholders' equity.

As a result of this difference, the net translation gain or loss, net of tax, reported in the statement of income under accounting practices adopted in Brazil in the amount of R\$1.2 (loss) for the year ended December 31, 2006 (2005 R\$3.0 gain) was reclassified to *Accumulated other comprehensive income (loss)* in stockholders' equity under U.S. GAAP. Such difference has no total stockholders' equity effect.

n) Classification of export notes

Certain subsidiaries of the Company have discounted certain export notes under recourse financing arrangements with financial institutions operating in Brazil. If the original debtors fail to pay their obligations when due, these subsidiaries would be required to repay the financed amounts. Under accounting practices adopted in Brazil, such transactions are classified as a reduction of accounts receivable as mentioned in Note 6. Under U.S. GAAP, these transactions are recorded gross as accounts receivable and bank loans. As a consequence, current assets and liabilities under U.S. GAAP would be increased by R\$50.9 and R\$39.0 at December 31, 2006 and 2005, respectively. This U.S. GAAP difference has no net income or equity effect.

o) Operating income

Under accounting practices adopted in Brazil, nonoperating income (expenses) includes certain items that would be classified within operating income for U.S. GAAP purposes. These items amounted to R\$14.8 (loss), R\$1.6 (loss) and R\$15.1 (loss) for the years ended December 31, 2006, 2005 and 2004, respectively, and are composed as follows:

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| | 2006 | 2005 | 2004 |
|--|--------|-------|--------|
| Total nonoperating expenses, net reported under accounting practices adopted in Brazil | (18.5) | (1.8) | (16.0) |
| Operating items under U.S. GAAP: | | | |
| Loss on disposals of fixed assets | 1.1 | 1.6 | 15.1 |
| Expenses related to studies and projects | 13.7 | | |
| Nonoperating expenses, net under U.S. GAAP (loss on disposal of investments) | (3.7) | (0.2) | (0.9) |

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p) Escrow deposits

Under accounting practices adopted in Brazil, the balances of escrow deposits are offset against these under the heading Other taxes and contributions contingent liabilities in non-current liabilities. Under U.S. GAAP, these balances are recorded gross as escrow deposits and other taxes and contributions contingent liabilities. As a consequence, non-current assets and liabilities under U.S. GAAP would be increased by R\$32.2 and R\$6.1 at December 31, 2006 and 2005, respectively. This U.S. GAAP difference has no net income or equity effect.

q) Accounting for planned major maintenance activities change in accounting principle

Under accounting practices adopted in Brazil, the Company used the accrue-in-advance method of accounting for planned major maintenance activities until January 1, 2006. In accordance with the provisions contained in CVM Resolution No. 489, dated of October 3, 2005 and the Accounting Pronouncement and Standard-NPC 22 about Provisions, Liabilities and Contingencies, issued by the Brazilian Institute of Independent Auditors IBRACON, the accrue-in-advance method of accounting for planned major maintenance was prohibited to be used as from January 1, 2006. As a result, as from January 1, 2006, the Company changed its accounting principle in regards to planned major maintenance activities and selected to use the deferral method by which the Company capitalizes the amounts expended on the planned major maintenance activities and amortizes them through the period to the next planned major maintenance. The effect of such change in accounting principle is recorded as a prior year adjustment to retained earnings as of January 1, 2006 not restating prior periods.

Under U.S. GAAP, the Company also used the accrue-in-advance method of accounting for planned major maintenance activities until January 1, 2006. In order to be consistent with Company's view and accounting practices adopted in Brazil, the Company early adopted the FSP AUG AIR Accounting for Planned Maintenance Activities as of January 1, 2006. As a result, as from January 1, 2006, the Company changed its accounting principle in regards to planned major maintenance activities and selected to use the deferral method consistently with accounting principles adopted in Brazil. The Company applied the FSP guidance and SFAS No. 154 Accounting Changes and Error Corrections to record retrospectively the effect of the change in accounting principle for all periods presented. All effects related to this matter concerns the chemical segment. The table below summarizes this change in accounting principles:

| Description | Amount previously reported under U.S. GAAP | Gross effect of change in accounting principle | Income tax on change in accounting principle | Net effect of change in accounting principle | Amount reported under U.S. GAAP in these financial statements |
|--|---|--|--|---|---|
| Shareholders' equity | | | | | |
| As of December 31, 2005 | 1,723.9 | 9.6 | (3.3) | 6.3 | 1,730.2 |
| Net income | | | | | |
| Year ended December 31, 2005 | 292.1 | (4.9) | 1.7 | (3.2) | 288.9 |
| Year ended December 31, 2004 | 414.3 | (1.6) | 0.6 | (1.0) | 413.3 |
| Other comprehensive income | | | | | |
| Year ended December 31, 2005 | 290.0 | (4.9) | 1.7 | (3.2) | 286.8 |
| Year ended December 31, 2004 | 421.6 | (1.6) | 0.6 | (1.0) | 420.6 |
| Earnings per share - basic and diluted | | | | | |
| Year ended December 31, 2005 | 3.61 | (0.06) | 0.02 | (0.04) | 3.57 |
| Year ended December 31, 2004 | 5.18 | (0.02) | 0.01 | (0.01) | 5.17 |

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The cumulative effect of the change to new accounting principle prior to January 1, 2004 in the carrying amounts of assets and liabilities as of January 1, 2004 amounts to R\$10.5. See item IV Statement of changes in stockholders' equity in accordance with U.S. GAAP.

r) Financial statement note disclosures

Under accounting practices adopted in Brazil, a certain set of information is required to be disclosed in the notes to the financial statements. The additional disclosures required by U.S. GAAP, which are relevant to the accompanying financial statements, are included herein.

s) New pronouncements

In December 2006, the FASB issued FASB Staff Position (FSP) No. EITF 00-19-2, *Accounting for Registration Payment Arrangements*, which includes most registration rights agreements in security issuances and certain contingent interest features in debt instruments. The FSP specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement, whether issued as a separate agreement or included as a provision of a financial instrument or other agreement, should be separately recognized and measured in accordance with SFAS No. 5, *Accounting for Contingencies*. The FSP is effective immediately for registration payment arrangements and the financial instruments subject to those arrangements that are entered into or modified subsequent to December 21, 2006. The Company will apply this statement as the need arises.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, which requires employers to recognize the over funded or under funded status of defined benefit postretirement plans as an asset or a liability and to recognize the changes in the funded status through comprehensive income. This statement also requires that defined benefit plan assets and obligations be measured as of the fiscal year-end. The Company will apply this statement as circumstances arise.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expand disclosures about fair value measurements. This statement applies under other accounting pronouncements that require or permit fair value measurements. The Company will apply this statement as of November 15, 2007 as the need arises.

In July 2006, the FASB issued FIN 48, *Accounting for Uncertainty in Income Taxes*, which prescribes a comprehensive model for how a company should recognize, measure, update and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return (including a decision whether to file or not file a return in a particular jurisdiction). Under the Interpretation, the financial statements will reflect expected future tax consequences of such positions presuming the taxing authorities' full knowledge of the position and all relevant facts, but without considering time values. The Company will apply this Interpretation for its 2007 financials and does not expect any material impact resulting from this application.

In March 2006, the FASB issued SFAS No. 156 *Accounting for Servicing of Financial Assets*. SFAS No. 156 amends SFAS No. 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, that

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establishes, among other things, the accounting for all separately recognized servicing assets and servicing liabilities. SFAS No. 156 amends Statement 140 to require that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. SFAS No. 156 permits, but does not require, the subsequent measurement of separately recognized servicing assets and servicing liabilities at fair value. An entity that uses derivative instruments to mitigate the risks inherent in servicing assets and servicing liabilities is required to account for those derivative instruments at fair value. The Company will begin applying this interpretation as circumstances arise.

In February 2006, the FASB issued SFAS No. 155 *Accounting for Certain Hybrid Financial Instruments*. SFAS No. 155 amends FASB Statements No. 133 *Accounting for Derivative Instruments and Hedging Activities* and No. 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. SFAS No. 155 resolves issues addressed in Statement 133 Implementation Issue No. D1 *Application of Statement 133 to Beneficial Interests in Securitized Financial Assets*, and in general terms:

- (a) Permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation;
- (b) Clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133;
- (c) Establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation
- (d) Clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives;
- (e) Amends Statement 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument.

This Statement is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company will begin applying this statement as circumstances arise.

II Reconciliation of the differences between U.S. GAAP and accounting practices adopted in Brazil in net income

| | Note 24.I. | 2006 | 2005 | 2004 |
|---|------------|-------|-------|-------|
| Net income as reported under accounting practices adopted in Brazil | | 282.1 | 299.2 | 414.5 |
| Reversal of revaluation adjustments: | b) | | | |
| Depreciation of property, plant and equipment | | 3.3 | 2.8 | 2.9 |
| Deferred tax effects | | (0.3) | (0.4) | (0.4) |
| Minority interests | | (0.1) | (0.1) | (0.3) |
| | | 2.9 | 2.3 | 2.2 |
| Inflation accounting: | a) | | | |
| Property, plant and equipment incremental depreciation | | (3.6) | (3.4) | (3.4) |
| Other nonmonetary assets | | | (0.2) | (0.6) |

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| | | | | | |
|---|----------------|----|--------|--------|--------|
| | | | (3.6) | (3.6) | (4.0) |
| Deferred tax effects | | | 1.2 | 1.3 | 1.3 |
| Minority interests | | | | (0.1) | 0.1 |
| | | | (2.4) | (2.4) | (2.6) |
| Different criteria for: | | | | | |
| Cancellation of subsidiaries | treasury stock | f) | 0.8 | 0.9 | 0.9 |
| Deferred charges expensed: | | c) | | | |
| Cost | | | (61.7) | (49.5) | (42.9) |
| Amortization | | | 44.1 | 41.8 | 40.1 |
| Depreciation of interest costs capitalized during construction | | e) | (0.5) | (0.5) | (0.8) |
| Reversal of goodwill amortization | | f) | 5.3 | 8.8 | 8.5 |
| Fair value adjustments relating to accounting for derivative instruments and hedging activities | | i) | 1.4 | (11.6) | (12.3) |

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| | Note 24.I. | 2006 | 2005 | 2004 |
|---|-------------------|-------------|-------------|-------------|
| Translation adjustments - Canamex | m) | 1.8 | (4.5) | 2.6 |
| Other individually insignificant adjustments | d), h), l) | 1.3 | 0.5 | 1.8 |
| | | (7.5) | (14.1) | (2.1) |
| Deferred tax effects | | 2.1 | 1.9 | (0.6) |
| Minority interests | | | (0.1) | (0.4) |
| | | (5.4) | (12.3) | (3.1) |
| Fair value adjustments relating to business combinations | f) | (1.6) | (1.5) | (1.6) |
| Deferred tax effects | | 0.6 | 0.5 | 0.5 |
| | | (1.0) | (1.0) | (1.1) |
| Fair value adjustments relating to acquisition of minority interest in Oxitenio S.A. Indústria e Comércio | f) | 4.5 | 4.7 | 4.6 |
| Deferred tax effects | | (1.0) | (1.0) | (0.9) |
| | | 3.5 | 3.7 | 3.7 |
| Fair value adjustments relating to the acquisition of SPGás Distribuidora de Gás Ltda. | f) | 1.5 | 1.5 | 1.5 |
| Deferred tax effects | | (0.5) | (0.5) | (0.5) |
| Minority interests | | | | (0.1) |
| | | 1.0 | 1.0 | 0.9 |
| Fair value adjustments relating to the acquisition of Canamex Químicos S.A. de C.V. | f) | 0.1 | 0.2 | (0.3) |
| Deferred tax effects | | | (0.1) | 0.1 |
| | | 0.1 | 0.1 | (0.2) |
| Fair value adjustments relating to acquisition of minority interest in Companhia Ultragaz S.A | f) | (0.5) | (1.3) | |
| Deferred tax effects | | 0.2 | 0.4 | |
| | | (0.3) | (0.9) | |
| Expenses for public offering of shares | j) | | 2.4 | |
| Changes in accounting principles effects | q) | | (4.9) | (1.6) |
| Deferred tax effects | | | 1.7 | 0.6 |
| | | | (3.2) | (1.0) |
| Net income under U.S. GAAP | | 280.5 | 288.9 | 413.3 |

g)

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Basic and diluted earnings per share under U.S. GAAP (in accordance with SFAS 128) R\$:

| | | | |
|--|------|------|------|
| Basic and diluted earnings per common share (*) | 3.46 | 3.57 | 5.17 |
| Basic and diluted earnings per preferred share (*) | 3.46 | 3.57 | 5.17 |

(*) The calculation of basic and diluted earnings per share is summarized in Note 24.V.a), which is retroactively adjusted to the stock dividend and reverse stock split mentioned in Note 24.I.g).

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III Reconciliation of the differences between U.S. GAAP and accounting practices adopted in Brazil in stockholders' equity

| | Note 24.I. | 2006 | 2005 |
|--|------------|---------|---------|
| Stockholders' equity as reported under accounting practices adopted in Brazil | | 1,933.5 | 1,790.1 |
| Reversal of revaluation adjustments: | b) | | |
| Property, plant and equipment | | (27.3) | (30.6) |
| Deferred tax effects | | 0.9 | 1.2 |
| Minority interests | | 0.5 | 0.6 |
| | | (25.9) | (28.8) |
| Inflation accounting: | a) | | |
| Property, plant and equipment | | 21.7 | 25.3 |
| Other nonmonetary assets | | 2.8 | 2.8 |
| | | 24.5 | 28.1 |
| Deferred tax effects | | (8.3) | (9.5) |
| Minority interests | | (0.2) | (0.2) |
| | | 16.0 | 18.4 |
| Different criteria for: | | | |
| Cancellation of subsidiaries' treasury stock | f) | (2.1) | (2.9) |
| Deferred charges: | c) | | |
| Cost | | (205.0) | (288.0) |
| Accumulated amortization | | 108.1 | 208.7 |
| Capitalization of interest costs during construction: | e) | | |
| Cost | | 12.8 | 12.8 |
| Accumulated amortization | | (12.5) | (12.0) |
| Reversal of goodwill amortization of SPGás acquisition under BR GAAP | f) | 16.3 | 11.4 |
| Reversal of net goodwill generated in the acquisition of Companhia Ultragaz S.A. shares from minority stockholders under BR GAAP | f) | (1.1) | (1.5) |
| Fair value adjustments relating to accounting for derivative instruments | i) | (1.2) | (2.6) |
| Other individually insignificant adjustments | d), h), l) | 0.2 | (1.4) |
| | | (84.5) | (75.5) |
| Deferred tax effects | | 27.6 | 24.8 |
| Minority interests | | 0.6 | 0.6 |
| | | (56.3) | (50.1) |
| Fair value adjustments relating to business combinations: | f) | 1.5 | 3.1 |
| Deferred tax effect | | (0.5) | (1.1) |
| | | 1.0 | 2.0 |
| | f) | (22.6) | (27.1) |

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| | | |
|--|---------|---------|
| Fair value adjustments relating to acquisition of minority interest in Oxiteno S.A. Indústria e Comércio | | |
| Deferred tax effects | 4.6 | 5.6 |
| | (18.0) | (21.5) |
| Adjustments relating to the acquisition of SPGás Distribuidora de Gás Ltda.: f) | | |
| Fair value adjustments | (5.5) | (7.0) |
| Deferred tax effects | 1.9 | 2.4 |
| Goodwill difference between U.S. GAAP and accounting practices adopted in Brazil | 14.4 | 14.4 |
| Minority interest | (0.2) | (0.2) |
| | 10.6 | 9.6 |
| Adjustments relating to the acquisition of Canamex Químicos S.A. de C.V.: f) | | |
| Fair value adjustments | (1.8) | (1.9) |
| Deferred tax effects | 0.6 | 0.6 |
| Goodwill difference between U.S. GAAP and accounting practices adopted in Brazil | 0.7 | 0.7 |
| | (0.5) | (0.6) |
| Fair value adjustments relating to acquisition of minority interest in Companhia Ultragaz S.A. f) | | |
| Deferred tax effects | (1.3) | (1.5) |
| | 2.5 | 2.8 |
| Available-for-sale equity securities (temporary unrealized gain) h) | | |
| Deferred tax effects | (0.5) | (1.0) |
| | 1.0 | 2.0 |
| Available-for-sale debt securities (temporary unrealized gain) h) | | |
| Deferred tax effects | (4.7) | |
| | 9.0 | |
| Changes in accounting principles effects q) | | |
| Deferred tax effects | | (3.3) |
| | | 6.3 |
| Stockholders' equity under U.S. GAAP | 1,872.9 | 1,730.2 |

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IV Statement of changes in stockholders' equity in accordance with U.S. GAAP

| | 2006 | 2005 | 2004 |
|---|---------|---------|---------|
| Stockholders' equity under U.S. GAAP as of beginning of the year as previously reported | 1,730.2 | 1,555.3 | 1,294.8 |
| Cumulative effect of changes in accounting principles prior to the earliest period presented, net of tax Note 24.I.q) | | | 10.5 |
| Stockholders' equity under U.S. GAAP as of beginning of the year | 1,730.2 | 1,555.3 | 1,305.3 |
| Additional paid-in capital | 0.7 | 0.5 | 0.4 |
| Net income (adjusted for changes in accounting principles effects) | 280.5 | 288.9 | 413.3 |
| Dividends and interest on own capital | (144.2) | (157.1) | (164.2) |
| Acquisition of treasury shares | (1.1) | | (6.8) |
| Unrealized gains (losses) on available-for-sale equity securities, net of tax Note 24.I.h) | (1.0) | (5.9) | 9.5 |
| Unrealized gains (losses) on available-for-sale debt securities, net of tax Note 24.I.h) | 9.0 | 0.8 | (0.4) |
| Translation adjustment Canamex net of tax Note 24.I.m) | (1.2) | 3.0 | (1.8) |
| Capital Increase due to issuance of preferred shares | | 47.1 | |
| Expenses of public offering of shares Note 24.I.j) | | (2.4) | |
| Stockholders' equity under U.S. GAAP as of the end of the year | 1,872.9 | 1,730.2 | 1,555.3 |
| Comprehensive income (under SFAS 130): | | | |
| Net income (adjusted for changes in accounting principles effects) | 280.5 | 288.9 | 413.3 |
| Unrealized gains (losses) on available-for-sale equity securities, net of tax Note 24.I.h) | (1.0) | (5.9) | 9.5 |
| Unrealized gains (losses) on available-for-sale debt securities, net of tax Note 24.I.h) | 9.0 | 0.8 | (0.4) |
| Translation adjustment Canamex net of tax Note 24.I.m) | (1.2) | 3.0 | (1.8) |
| Total comprehensive income | 287.3 | 286.8 | 420.6 |
| Accumulated other comprehensive income as of the end of the year | 13.1 | 6.3 | 8.4 |
| Thereof: | | | |
| Available for sale equity securities, net of tax Note 24.I.h) | 4.1 | 5.1 | 11.0 |
| Available for sale debt securities, net of tax Note 24.I.h) | 9.0 | | (0.8) |
| Cumulative Translation adjustment Canamex, net of tax Note 24.I.m) | | 1.2 | (1.8) |
| | 13.1 | 6.3 | 8.4 |

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V Additional disclosures required by U.S. GAAP

a) Earnings per share

The following table provides a reconciliation of the numerators and denominators used in computing earnings per share as required by SFAS 128. The calculation of earnings per share as summarized below is retroactively adjusted for the stock dividend and reverse stock split as mentioned in Note 24.I.g). As discussed in Notes 22 and 24.I.k), the Company has a share compensation plan. For all periods presented, the impact of this share compensation plan on diluted earnings per share was minimis and, consequently, the Company has not presented a separate calculation of the diluted earnings per share amount.

| | |
|---|--------------|
| | 2006 |
| Distributed income | 144.2 |
| Undistributed income | 136.3 |
| Net income under U.S. GAAP | 280.5 |
| Weighted average shares outstanding (in thousands) | 81,129.7 |
| Basic and diluted earnings per share whole R\$ | 3.46 |
| | 2005 |
| Distributed income | 157.1 |
| Undistributed income | 131.8 |
| Net income under U.S. GAAP | 288.9 |
| Weighted average shares outstanding (in thousands) | 80,815.0 |
| Basic and diluted earnings per share whole R\$ | 3.57 |
| | 2004 |
| Distributed income | 164.2 |
| Undistributed income | 249.1 |
| Net income under U.S. GAAP | 413.3 |
| Weighted average shares outstanding (in thousands) | 79,975.8 |
| Basic and diluted earnings per share whole R\$ | 5.17 |

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Ultrapar Participações S.A. and Subsidiaries

b) Concentrations of credit risk

Financial instruments which potentially subject the Company to credit risk are cash and cash equivalents, financial investments and trade receivables. Based on the factors described below, the Company considers the risk of counterparty default to be minimal.

The Company manages its credit risk with respect to cash equivalents and financial investments by investing only in liquid instruments with highly-rated financial institutions. In addition, investments are diversified in several institutions, and credit limits are established for each individual institution.

Credit risk from accounts receivable is managed following specific criteria for each of the segments in which the Company operates, as follows:

Chemical segment (Oxiteno)

Oxiteno's customers of commodity chemicals are principally chemical companies, surface coating producers and polyester resin producers, while customers of specialty chemicals comprise a variety of industrial and commercial enterprises. No single customer or group accounts for more than 10% of total revenue. Management believes that by distributing its products to a variety of markets it is able to protect itself, to a certain extent, from the effects of negative trends in any particular market. Oxiteno acts as a member of a Credit Committee of the Brazilian chemical manufacturers which meets monthly to review the financial position of clients showing past-due accounts.

Historically, the Company has not experienced significant losses on trade receivables.

Gas segment (Ultragaz)

Ultragaz sells its products to the residential, commercial and industrial markets.

Sales to the residential market are carried out directly by Ultragaz using cash terms, from which no significant credit risk exists, or through outside distributors. Credit risk in sales to outside distributors is reduced due to the large customer base, the ongoing control procedures that monitor the creditworthiness of distributors, and by short payment terms (24 days on average) that permit continuous monitoring of distributors compliance.

Sales to the commercial and industrial markets are usually made to customers that have signed a credit agreement with the Company and have provided guarantees or collateral. Periodic monitoring of these accounts is performed by specific staff with the support of financial information systems.

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No single customer or group accounts for more than 10% of total revenue.

Historically, the Company has not experienced significant losses on trade receivables.

Logistic segment (Ultracargo)

The main customers of Ultracargo are chemical companies. The average-term payment is 34 days.

Historically, the Company has not experienced significant losses on trade receivables.

Company is dependent on few major suppliers

The Company is dependent on third-party manufacturers for all of its supply of ethylene and LPG. In 2006, 2005 and 2004, products purchased from the Company's three largest suppliers accounted for approximately 72%, 73% and 76% of cost of sales and services, respectively. The Company is dependent on the ability of its suppliers to provide products on a timely basis and on favorable pricing terms. The loss of certain principal suppliers or a significant reduction in product availability from principal suppliers could have a material adverse effect on the Company. The Company believes that its relationship with its suppliers is satisfactory.

c) Impairment of long-lived assets

The Company reviews the carrying value of property, plant, and equipment for impairment whenever events and circumstances indicate that the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of assets. The factors considered by management in performing this assessment include current operating results, trends, and prospects, as well as the effects of obsolescence, demand, competition, and other economic factors.

No impairment has been recorded in the consolidated financial statements as of December 31, 2006.

d) Impairment of goodwill

Under U.S. GAAP financial statements, goodwill consists of the excess of the cost paid for the acquisitions of SPGás and Canamex over the net of the fair value assigned to assets acquired and liabilities assumed of these companies.

The Company has recorded the following amounts of goodwill under the U.S. GAAP financial statements:

| Description | 2006 | 2005 |
|--|------|------|
| Gas segment (Ultrazag): | | |
| Goodwill on the acquisition of SPGás | 39.9 | 39.9 |
| Chemical segment (Oxiteno): | | |
| Goodwill on the acquisition of Canamex | 2.6 | 2.6 |

As mentioned in Note 24.I.(f), goodwill is not amortized and is tested for impairment annually.

e) Fair value of financial instruments

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The fair values of accounts receivables and trade suppliers approximate their book values. The fair value of financial assets and financial liabilities, including cash and cash equivalents, short and long-term investments, financing, debentures and swap instruments are disclosed in Note 18.

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Ultrapar Participações S.A. and Subsidiaries

f) Environmental issues

The Company and its subsidiaries are subject to federal, state and local laws and regulations relating to the environment. These laws generally provide for control of air and effluent emissions and require responsible parties to undertake remediation of hazardous waste disposal sites. Civil penalties may be imposed for noncompliance. The Company provides for remediation costs and penalties when a loss is probable and the amount is reasonably determinable. It is not presently possible to estimate the amount of all remediation costs that might be incurred or penalties that may be imposed; however, management does not presently expect that such costs and penalties will have a material effect on the Company's consolidated financial position or results of operations. Recurring costs associated with managing hazardous substances and pollution in on-going operations, mainly composed of costs for treatment of effluents and for incinerations, amounted to R\$4.4, R\$3.6 and R\$2.7 for the years ended December 31, 2006, 2005 and 2004, respectively. Capital expenditures to limit or monitor hazardous substances and pollutants amounted to R\$5.0, R\$8.3 and R\$4.2 for the years ended December 31, 2006, 2005 and 2004, respectively.

The Company's subsidiary Ultracargo Operações Logísticas e Participações Ltda. has controlled environmental liabilities in two of its terminals, situated in Santos and Paulínia, which are in monitoring and remediation phase, respectively.

We have no historical mandated expenditures to remediate previously contaminated sites, and other infrequent or non-recurring clean-up expenditures that can be anticipated but which are not required in the present circumstances.

g) Statement of cash flows

Accounting practices adopted in Brazil do not require the presentation of a statement of cash flows as required by U.S. GAAP. Changes in working capital are presented in the statement of changes in financial position. U.S. GAAP requires the presentation of a statement of cash flows describing the Company's cash flows from operating, financing and investing activities. Statements of cash flows derived from the information based on accounting practices adopted in Brazil are as follows:

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Ultrapar Participações S.A. and Subsidiaries

ULTRAPAR PARTICIPAÇÕES S.A. AND SUBSIDIARIES**CONSOLIDATED STATEMENTS OF CASH FLOWS**

FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004

(In millions of Brazilian reais R\$)

| | 2006 | 2005 | 2004 |
|---|---------|---------|---------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Net income | 282.1 | 299.2 | 414.5 |
| Adjustments to reconcile net income to cash provided by operating activities: | | | |
| Interest income on investments | | | (0.4) |
| Depreciation and amortization | 185.8 | 187.7 | 172.7 |
| PIS and COFINS credit on depreciation | 2.1 | 1.4 | 3.0 |
| Loss on disposals of permanent assets | 13.5 | 1.3 | 17.3 |
| Foreign exchange and indexation (gains) losses | (32.6) | (55.4) | 2.2 |
| Allowance (reversal of provision) for losses on permanent assets | 3.2 | | (1.3) |
| Equity in losses of affiliated companies | (1.0) | (1.6) | |
| Deferred income and social contribution taxes | (5.4) | (27.4) | 1.5 |
| Other long-term taxes | | | 8.0 |
| Minority interest | 5.3 | 2.8 | 5.4 |
| Other | 0.5 | 0.6 | 2.9 |
| Decrease (increase) in operating assets: | | | |
| Trade accounts receivable | (16.7) | 18.7 | (47.0) |
| Recoverable taxes | (73.4) | 10.1 | 15.4 |
| Inventories | (25.4) | 18.6 | (68.3) |
| Prepaid expenses | 0.1 | (3.3) | (2.7) |
| Other | 1.8 | (25.6) | (3.3) |
| Increase (decrease) in operating liabilities: | | | |
| Suppliers | 21.6 | (11.1) | 11.8 |
| Accrued interest | (5.0) | 20.1 | 0.2 |
| Salaries and related charges | 15.1 | (28.1) | 19.4 |
| Taxes | 13.5 | (0.5) | (0.9) |
| Income and social contribution taxes | 0.3 | (2.3) | (3.6) |
| Other | (1.1) | 4.8 | (7.2) |
| Net cash provided by operating activities | 384.3 | 410.0 | 539.6 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Additions to short-term investments | (880.4) | (175.6) | (2.6) |
| Proceeds from sales of short-term investments | 315.2 | 12.6 | 18.7 |
| Additions to long-term investments | (7.2) | (294.6) | (41.7) |
| Additions to investments | (0.1) | | (0.2) |
| Additions to escrow deposits | (24.0) | | |
| Additions to property, plant and equipment | (253.0) | (169.2) | (227.2) |
| Additions to intangible assets | (11.7) | (10.2) | |
| Additions to deferred charges | (74.9) | (51.3) | (46.5) |
| Acquisition of minority interests | (0.1) | | (10.3) |

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| | | | |
|--|---------|---------|---------|
| Proceeds from sales of property, plant and equipment | 20.7 | 12.0 | 6.0 |
| Other | | | 0.7 |
| Net cash used in investing activities | (915.5) | (676.3) | (303.1) |

(Continue)

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Ultrapar Participações S.A. and Subsidiaries

ULTRAPAR PARTICIPAÇÕES S.A. AND SUBSIDIARIES**CONSOLIDATED STATEMENTS OF CASH FLOWS**

FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004

(In millions of Brazilian reais R\$)

(Continuation)

| | 2006 | 2005 | 2004 |
|--|---------|---------|---------|
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| Short-term debt, net | (173.1) | (113.0) | (75.0) |
| Loans, Financing and Debentures: | | | |
| Issuances | 143.7 | 1,161.4 | 293.1 |
| Repayments | (0.1) | (202.6) | (255.4) |
| Loans from affiliated companies: | | | |
| Issuances | 4.0 | 9.0 | 64.5 |
| Repayments | (8.3) | (10.4) | (65.8) |
| Dividends paid | (148.6) | (129.5) | (132.3) |
| Capital increase | (0.1) | 47.1 | |
| Other | (1.1) | | (5.9) |
| Net cash provided by (used in) financing activities | (183.6) | 762.0 | (176.8) |
| Effect of exchange rate changes on cash and cash equivalents | (14.3) | (6.0) | (4.0) |
| Net increase (decrease) in cash and cash equivalents | (729.1) | 489.7 | 55.7 |
| Cash and cash equivalents at the beginning of the year | 1,114.2 | 624.5 | 568.8 |
| Cash and cash equivalents at the end of the year | 385.1 | 1,114.2 | 624.5 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION | | | |
| Cash paid during the year for: | | | |
| Interest, net of amounts capitalized | 92.5 | 57.3 | 25.3 |
| Income taxes | 30.9 | 26.4 | 49.6 |
| Noncash investing and financing activities: | | | |
| Off set of loans obtained from affiliated company with stock redemption received | | 3.3 | |

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Ultrapar Participações S.A. and Subsidiaries

h) Segment information

Financial information about each of the Company's reportable segments based on records in accordance with accounting practices adopted in Brazil is as follows:

| | 2006 | 2005 | 2004 |
|--|---------|---------|---------|
| Net revenue from sales to unassociated companies: | | | |
| Gas | 3,066.0 | 2,901.7 | 2,967.7 |
| Chemical (1) | 1,549.5 | 1,609.9 | 1,662.9 |
| Logistics | 178.6 | 182.2 | 153.6 |
| | 4,794.1 | 4,693.8 | 4,784.2 |
| Intersegment: | | | |
| Gas | 1.0 | 0.7 | 0.4 |
| Chemical | 0.1 | 0.2 | (0.2) |
| Logistics | 47.5 | 52.0 | 43.7 |
| Other | 6.3 | 6.4 | 6.4 |
| Elimination | 54.9 | 59.3 | 50.3 |
| Net revenues: | | | |
| Gas | 3,067.0 | 2,902.4 | 2,968.1 |
| Chemical | 1,549.6 | 1,610.1 | 1,662.7 |
| Logistics | 226.1 | 234.2 | 197.3 |
| Other | 6.3 | 6.4 | 6.4 |
| Elimination | (54.9) | (59.3) | (50.3) |
| | 4,794.1 | 4,693.8 | 4,784.2 |
| Operating profit before financial items: | | | |
| Gas | 167.3 | 77.8 | 152.7 |
| Chemical | 146.3 | 257.9 | 382.9 |
| Logistics | 11.4 | 17.2 | 23.0 |
| Other | 5.4 | 5.4 | 5.3 |
| | 330.4 | 358.3 | 563.9 |
| Financial income (expenses), net | 30.6 | (27.3) | (45.0) |
| Nonoperating expenses, net | (18.5) | (1.8) | (16.0) |
| Income before income and social contribution taxes, equity in gain of affiliated companies and minority interest | 342.5 | 329.2 | 502.9 |
| Equity in gain of affiliated companies | 1.0 | 1.6 | |

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| | | | |
|--|-------|-------|-------|
| Income before taxes and minority interests | 343.5 | 330.8 | 502.9 |
|--|-------|-------|-------|

-
- (1) Net revenue from sales to unassociated companies of the chemical segment includes the amounts of R\$441.8, R\$559.2 and R\$638.3 for the years ended December 31, 2006, 2005 and 2004, respectively, related to Glycols. Glycols is the only one of our chemical products families that represents more than 10% of total sales. An important portion of our products could be classified as a commodity and a specialty chemical, depending on the use of such products by our customers. As a consequence we consider that an exact split of sales between commodity and specialty chemicals would be impractical.

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Ultrapar Participações S.A. and Subsidiaries

| | 2006 | 2005 | 2004 |
|--|---------|---------|---------|
| Additions to property, plant and equipment and intangible assets according to: | | | |
| Accounting practices adopted in Brazil: | | | |
| Gas | 62.3 | 46.8 | 51.8 |
| Chemical | 160.2 | 90.1 | 85.4 |
| Logistics | 41.0 | 42.0 | 89.2 |
| Other | 1.2 | 0.5 | 0.8 |
| | 264.7 | 179.4 | 227.2 |
| U.S. GAAP: | | | |
| Gas | 62.3 | 46.8 | 51.8 |
| Chemical | 160.2 | 90.1 | 85.4 |
| Logistics | 41.0 | 42.0 | 89.2 |
| Other | 1.2 | 0.5 | 0.8 |
| | 264.7 | 179.4 | 227.2 |
| Depreciation and amortization charges according to: | | | |
| Accounting practices adopted in Brazil: | | | |
| Gas | 113.0 | 117.3 | 116.2 |
| Chemical | 45.3 | 42.3 | 38.1 |
| Logistics | 26.6 | 27.1 | 17.6 |
| Other | 0.9 | 1.0 | 0.8 |
| | 185.8 | 187.7 | 172.7 |
| U.S. GAAP: | | | |
| Gas | 66.6 | 68.2 | 69.5 |
| Chemical | 47.4 | 39.7 | 36.7 |
| Logistics | 29.7 | 29.4 | 20.3 |
| Other | 0.2 | 0.1 | 0.1 |
| | 143.9 | 137.4 | 126.6 |
| Identifiable assets accounting practices adopted in Brazil: | | | |
| Gas | 961.4 | 938.5 | 1,008.2 |
| Chemical | 2,307.8 | 2,020.6 | 1,296.8 |
| Logistics | 310.1 | 317.7 | 331.6 |
| Ultrapar and Imaven Imóveis e Agropecuária Ltda. | 322.8 | 396.3 | 30.6 |
| | 3,902.1 | 3,673.1 | 2,667.2 |
| Identifiable assets U.S. GAAP: | | | |
| Gas | 916.3 | 897.8 | 969.2 |
| Chemical | 2,299.3 | 2,004.2 | 1,290.0 |
| Logistics | 311.2 | 318.7 | 330.7 |

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| | | | |
|--|---------|---------|---------|
| Ultrapar and Imaven Imóveis e Agropecuária Ltda. | 316.7 | 389.3 | 6.0 |
| | 3,843.5 | 3,610.0 | 2,595.9 |

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Ultrapar Participações S.A. and Subsidiaries

Additional information about business segments can be found in Note 17.

| | 2006 | 2005 |
|---|------|------|
| Investments in equity investees - accounting practices adopted in Brazil: | | |
| Chemical | 5.3 | 4.2 |

See Note 9 for details of investment in equity investees.

i) Financial information for subsidiary guarantors and non-guarantor subsidiaries
 Ultrapar Participações S.A. (Company) and Oxiteno S.A. (a wholly-owned subsidiary of Ultrapar Participações) are guarantors of LPG International Inc.'s obligations in connection with the issuance of registered notes. The guarantees are full and unconditional and are joint and several. We are presenting, pursuant to Rule 3 - 10 of Regulation S-X, condensed consolidating financial information, according to accounting practices adopted in Brazil, of the guarantors and other Ultrapar subsidiaries, as follow:

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Ultrapar Participações S.A. and Subsidiaries

Consolidated Balance Sheets as of December 31, 2006

| | LPG Issuer | Ultrapar - Parent Company Guarantor | Oxiteno - Wholly Owned Guarantor Subsidiary | Total Guarantors | Non - Guarantor Subsidiaries | Eliminations | Consolidated |
|--|---------------|---|--|------------------|---------------------------------|------------------|----------------|
| ASSETS | | | | | | | |
| CURRENT ASSETS | | | | | | | |
| Cash and cash equivalents | 0.8 | 234.6 | 3.1 | 237.7 | 146.6 | | 385.1 |
| Short-term investments | | 44.8 | | 44.8 | 692.5 | | 737.3 |
| Trade accounts receivable, net | | | 76.5 | 76.5 | 343.5 | (60.0) | 360.0 |
| Inventories | | | 69.4 | 69.4 | 148.2 | (0.4) | 217.2 |
| Recoverable taxes | | 8.0 | 7.4 | 15.4 | 102.4 | | 117.8 |
| Deferred income and social contribution taxes | | 0.1 | 2.1 | 2.2 | 25.1 | | 27.3 |
| Dividends receivable | | 53.8 | 146.1 | 199.9 | | (199.9) | |
| Other | | 0.3 | 1.7 | 2.0 | 5.1 | (1.0) | 6.1 |
| Prepaid expenses | 1.1 | 0.6 | 0.8 | 1.4 | 7.0 | (0.9) | 8.6 |
| TOTAL CURRENT ASSETS | 1.9 | 342.2 | 307.1 | 649.3 | 1,470.4 | (262.2) | 1,859.4 |
| NONCURRENT ASSETS | | | | | | | |
| Long-term investments | | | | | 548.0 | | 548.0 |
| Trade accounts receivable | | | 0.5 | 0.5 | 18.7 | | 19.2 |
| Related companies | 535.3 | 3.5 | | 3.5 | 500.5 | (1,031.9) | 7.4 |
| Deferred income and social contribution taxes | | 3.1 | 10.2 | 13.3 | 44.9 | | 58.2 |
| Recoverable taxes | | 18.7 | 34.7 | 53.4 | 11.9 | | 65.3 |
| Escrow deposits | | 0.2 | 0.6 | 0.8 | 13.5 | | 14.3 |
| Other | | | | | 1.2 | | 1.2 |
| Prepaid expenses | 8.2 | 0.2 | 2.2 | 2.4 | 8.9 | (6.3) | 13.2 |
| TOTAL LONG - TERM ASSETS | 543.5 | 25.7 | 48.2 | 73.9 | 1,147.6 | (1,038.2) | 726.8 |
| PERMANENT ASSETS | | | | | | | |
| Investments: | | | | | | | |
| Subsidiary and affiliated companies | | 2,025.5 | 1,157.4 | 3,182.9 | 3.5 | (3,181.1) | 5.3 |
| Other | | | 19.1 | 19.1 | 6.4 | | 25.5 |
| Property, plant and equipment, net | | | 223.4 | 223.4 | 889.1 | (0.7) | 1,111.8 |
| Intangible assets, net | | | 12.1 | 12.1 | 48.9 | | 61.0 |
| Deferred charges, net | | | 11.5 | 11.5 | 100.8 | | 112.3 |
| TOTAL PERMANENT ASSETS | | 2,025.5 | 1,423.5 | 3,449.0 | 1,048.7 | (3,181.8) | 1,315.9 |
| | 545.4 | 2,393.4 | 1,778.8 | 4,172.2 | 3,666.7 | (4,482.2) | 3,902.1 |

**TOTAL ASSETS UNDER
ACCOUNTING
PRACTICES ADOPTED
IN BRAZIL**

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Ultrapar Participações S.A. and Subsidiaries

Consolidated Balance Sheets as of December 31, 2006

| RECONCILIATION TO U.S.GAAP | LPG Issuer | Ultrapar - Parent Company Guarantor | Oxiteno - Wholly Owned Guarantor Subsidiary | Total Guarantors | Non - Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---------------|---|--|------------------|---------------------------------|--------------|--------------|
| Reversal of revaluation adjustments | | | (1.7) | (1.7) | (25.6) | | (27.3) |
| Inflation accounting | | | 7.0 | 7.0 | 17.5 | | 24.5 |
| Different criteria for: | | | | | | | |
| Deferred charges | | | (11.0) | (11.0) | (85.9) | | (96.9) |
| Capitalization of interest costs during construction | | | | | 0.3 | | 0.3 |
| Reversal of goodwill amortization of SPGás acquisition under BR GAAP | | | | | 16.3 | | 16.3 |
| Reversal of goodwill amortization of Companhia Ultragas S.A. shares from minority stockholders | | | | | (1.1) | | (1.1) |
| Other individually insignificant adjustments | | | | | 1.0 | | 1.0 |
| Fair value adjustments relating to business combinations | | (1.1) | 2.6 | 1.5 | | | 1.5 |
| Fair value adjustments relating to acquisition of minority interest in Oxiteno S.A. - Indústria e Comércio | | (22.6) | | (22.6) | | | (22.6) |
| Fair value adjustments relating to the acquisition of SPGás Distribuidora de Gás Ltda. | | | | | 8.9 | | 8.9 |
| Fair value adjustments relating to the acquisition of Canamex Químicos S.A. de C.V. | | | | | (1.1) | | (1.1) |
| Fair value adjustments relating to acquisition of minority interest in Companhia Ultragas S.A | | | | | 3.8 | | 3.8 |
| Available-for-sale equity securities (temporary unrealized gain) | | | 1.5 | 1.5 | | | 1.5 |
| Available-for-sale debt securities (temporary unrealized gain) | | | | | 13.7 | | 13.7 |
| Deferred tax effects | | 5.0 | 0.4 | 5.4 | 13.5 | | 18.9 |
| Equity on U.S.GAAP adjustment | | (38.5) | 0.7 | (37.8) | | 37.8 | |

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| | | | | | | | |
|--|--------------|----------------|----------------|----------------|----------------|------------------|----------------|
| TOTAL ASSETS UNDER U.S.GAAP | 545.4 | 2,336.2 | 1,778.3 | 4,114.5 | 3,628.0 | (4,444.4) | 3,843.5 |
|--|--------------|----------------|----------------|----------------|----------------|------------------|----------------|

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Ultrapar Participações S.A. and Subsidiaries

Consolidated Balance Sheets as of December 31, 2006

| LIABILITIES | LPG Issuer | Ultrapar - Parent Company Guarantor | Oxiteno - Wholly Owned Guarantor Subsidiary | Total Guarantors | Non - Guarantor Subsidiaries | Eliminations | Consolidated |
|---|-----------------------|--|--|-------------------------|---|---------------------|---------------------|
| CURRENT LIABILITIES | | | | | | | |
| Loans and financing | 1.1 | | 27.6 | 27.6 | 126.4 | | 155.1 |
| Debentures | | 12.8 | | 12.8 | | | 12.8 |
| Suppliers | | 0.4 | 56.6 | 57.0 | 112.7 | (57.2) | 112.5 |
| Payroll and related charges | | | 18.9 | 18.9 | 62.3 | | 81.2 |
| Taxes payable | | | 0.6 | 0.6 | 16.3 | | 16.9 |
| Dividends payable | | 96.7 | 43.3 | 140.0 | 161.3 | (199.9) | 101.4 |
| Income and social contribution taxes | | | | | 1.0 | | 1.0 |
| Deferred income and social contribution taxes | | | 0.1 | 0.1 | 0.1 | | 0.2 |
| Other | | | 0.5 | 0.5 | 3.0 | (0.8) | 2.7 |
| TOTAL CURRENT LIABILITIES | 1.1 | 109.9 | 147.6 | 257.5 | 483.1 | (257.9) | 483.8 |
| NON-CURRENT LIABILITIES | | | | | | | |
| Loans and financing | 534.5 | | 51.8 | 51.8 | 495.5 | | 1,081.8 |
| Debentures | | 300.0 | | 300.0 | | | 300.0 |
| Related companies | | 33.5 | 146.1 | 179.6 | 857.0 | (1,031.9) | 4.7 |
| Deferred income and social contribution taxes | | | 24.7 | 24.7 | 1.3 | | 26.0 |
| Other taxes and contributions - contingent liabilities | | 9.4 | 8.9 | 18.3 | 18.2 | | 36.5 |
| Other | | | 0.6 | 0.6 | 2.1 | | 2.7 |
| TOTAL LONG-TERM LIABILITIES | 534.5 | 342.9 | 232.1 | 575.0 | 1,374.1 | (1,031.9) | 1,451.7 |
| MINORITY INTEREST | | | | | 51.4 | (18.3) | 33.1 |
| TOTAL LIABILITIES UNDER ACCOUNTING PRACTICES ADOPTED IN BRAZIL | 535.6 | 452.8 | 379.7 | 832.5 | 1,908.6 | (1,308.1) | 1,968.6 |
| STOCKHOLDERS EQUITY | | | | | | | |
| Capital | | 946.0 | 644.4 | 1,590.4 | 890.2 | (1,534.6) | 946.0 |
| Capital reserve | | 3.0 | | 3.0 | 95.6 | (98.0) | 0.6 |
| Revaluation reserve | | 13.0 | 1.7 | 14.7 | 20.2 | (21.9) | 13.0 |
| Profit reserves | 9.8 | 983.2 | 753.0 | 1,736.2 | 450.6 | (1,213.4) | 983.2 |
| Treasury shares | | (4.6) | | (4.6) | 0.0 | (4.7) | (9.3) |

| | | | | | | | |
|---|------------|----------------|----------------|----------------|----------------|------------------|----------------|
| Retained earnings | | | | | 301.5 | (301.5) | |
| TOTAL STOCKHOLDERS EQUITY UNDER ACCOUNTING PRACTICES ADOPTED IN BRAZIL | 9.8 | 1,940.6 | 1,399.1 | 3,339.7 | 1,758.1 | (3,174.1) | 1,933.5 |

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Ultrapar Participações S.A. and Subsidiaries

Consolidated Balance Sheets as of December 31, 2006

| STOCKHOLDERS EQUITY RECONCILIATION TO U.S.GAAP | LPG Issuer | Ultrapar - Parent Company Guarantor | Oxiten - Wholly Owned Guarantor Subsidiary | Total Guarantors | Non - Guarantor Subsidiaries | Eliminations | Consolidated |
|---|-----------------------|--|---|-------------------------|---|---------------------|---------------------|
| Reversal of revaluation adjustments | | | (1.7) | (1.7) | (25.6) | | (27.3) |
| Inflation accounting | | | 7.0 | 7.0 | 17.5 | | 24.5 |
| Different criteria for: | | | | | | | |
| Cancellation of subsidiaries treasury stock | | | | | (2.1) | | (2.1) |
| Deferred charges | | | (11.0) | (11.0) | (85.9) | | (96.9) |
| Capitalization of interest costs during construction | | | | | 0.3 | | 0.3 |
| Reversal of goodwill amortization of SPGás acquisition under BR GAAP | | | | | 16.3 | | 16.3 |
| Reversal of goodwill amortization of Companhia Ultragas S.A. shares from minority stockholders | | | | | (1.1) | | (1.1) |
| Fair value adjustments relating to accounting for derivative instruments and hedging activities | | | 0.8 | 0.8 | (2.0) | | (1.2) |
| Other individually insignificant adjustments | | | (0.2) | (0.2) | 0.4 | | 0.2 |
| Fair value adjustments relating to business combinations | | (1.1) | 2.6 | 1.5 | | | 1.5 |
| Fair value adjustments relating to acquisition of minority interest in Oxiten S.A. - Indústria e Comércio | | (22.6) | | (22.6) | | | (22.6) |
| Fair value adjustments relating to the acquisition of SPGás Distribuidora de Gás Ltda. | | | | | 8.9 | | 8.9 |
| Fair value adjustments relating to the acquisition of Canamex Químicos S.A. de C.V. | | | | | (1.1) | | (1.1) |
| Fair value adjustments relating to acquisition of minority interest in Companhia Ultragas S.A | | | | | 3.8 | | 3.8 |
| Available-for-sale equity securities (temporary unrealized gain) | | | 1.5 | 1.5 | | | 1.5 |

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| | | | | | | | |
|--|------------|----------------|----------------|----------------|----------------|------------------|----------------|
| Available-for-sale debt securities (temporary unrealized gain) | | | | | 13.7 | | 13.7 |
| Deferred tax effects | 5.0 | 0.4 | 5.4 | | 14.9 | | 20.3 |
| Minority Interest | | | | | 0.7 | | 0.7 |
| Equity on U.S.GAAP adjustment | (38.5) | 0.7 | (37.8) | | | 37.8 | |
| TOTAL STOCKHOLDERS EQUITY UNDER U.S.GAAP | 9.8 | 1,883.4 | 1,399.2 | 3,282.6 | 1,716.7 | (3,136.3) | 1,872.9 |

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Ultrapar Participações S.A. and Subsidiaries

Consolidated Statements of Income for the year ended December 31, 2006

| | LPG Issuer | Ultrapar - Parent Company Guarantor | Oxiteno - Wholly Owned Guarantor Subsidiary | Total Guarantors | Non - Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---------------|---|--|---------------------|---------------------------------|----------------|----------------|
| GROSS SALES AND SERVICES | | | 716.4 | 716.4 | 4,828.7 | (315.2) | 5,229.9 |
| Deductions | | | (166.2) | (166.2) | (328.2) | 58.6 | (435.8) |
| NET SALES AND SERVICES | | | 550.2 | 550.2 | 4,500.5 | (256.6) | 4,794.1 |
| Cost of sales and services | | | (479.8) | (479.8) | (3,627.5) | 247.4 | (3,859.9) |
| GROSS PROFIT | | | 70.4 | 70.4 | 873.0 | (9.2) | 934.2 |
| OPERATING (EXPENSES) INCOME | (0.2) | (0.2) | (116.8) | (117.0) | (496.3) | 9.7 | (603.8) |
| Selling | | | (23.1) | (23.1) | (180.2) | | (203.3) |
| General and administrative | (0.2) | (0.2) | (87.9) | (88.1) | (200.6) | 9.8 | (279.1) |
| Depreciation and amortization | | | (7.0) | (7.0) | (115.7) | | (122.7) |
| Other operating income, net | | | 1.2 | 1.2 | 0.2 | (0.1) | 1.3 |
| OPERATING INCOME (LOSS) BEFORE FINANCIAL ITEMS | (0.2) | (0.2) | (46.4) | (46.6) | 376.7 | 0.5 | 330.4 |
| Financial income (expenses), net | 0.2 | 2.6 | 7.9 | 10.5 | 17.4 | 2.5 | 30.6 |
| Nonoperating income (expenses), net | (1.6) | (0.1) | (3.2) | (3.3) | (13.6) | | (18.5) |
| INCOME (LOSS) BEFORE INCOME AND SOCIAL CONTRIBUTION TAXES, EQUITY IN GAIN (LOSSES) OF AFFILIATED COMPANIES AND MINORITY INTEREST | (1.6) | 2.3 | (41.7) | (39.4) | 380.5 | 3.0 | 342.5 |
| INCOME AND SOCIAL CONTRIBUTION TAXES | | (5.7) | 0.8 | (4.9) | (91.6) | 40.4 | (56.1) |
| Current | | (6.0) | (0.1) | (6.1) | (105.7) | | (111.8) |
| Deferred | | 0.3 | 0.9 | 1.2 | 4.2 | | 5.4 |

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| | | | | | | | |
|--|-------|-------|--------|--------|-------|---------|-------|
| Benefit of tax holidays | | | | | 9.9 | 40.4 | 50.3 |
| INCOME (LOSS) | | | | | | | |
| BEFORE EQUITY IN | | | | | | | |
| GAIN (LOSSES) OF | | | | | | | |
| AFFILIATED | | | | | | | |
| COMPANIES AND | | | | | | | |
| MINORITY INTEREST | | | | | | | |
| | (1.6) | (3.4) | (40.9) | (44.3) | 288.9 | 43.4 | 286.4 |
| Equity in losses of affiliated companies | | 291.8 | 222.8 | 514.6 | 0.6 | (514.2) | 1.0 |
| Minority interest | | | | | (7.8) | 2.5 | (5.3) |
| NET INCOME (LOSS) | | | | | | | |
| UNDER ACCOUNTING | | | | | | | |
| PRACTICES ADOPTED | | | | | | | |
| IN BRAZIL | | | | | | | |
| | (1.6) | 288.4 | 181.9 | 470.3 | 281.7 | (468.3) | 282.1 |

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Ultrapar Participações S.A. and Subsidiaries

Consolidated Statements of Income for the year ended December 31, 2006

| RECONCILIATION TO U.S.GAAP | LPG Issuer | Ultrapar - Parent Company Guarantor | Oxitenno - Wholly Owned Guarantor Subsidiary | Total Guarantors | Non - Guarantor Subsidiaries | Eliminations | Consolidated |
|--|-----------------------|--|---|-----------------------------|---|---------------------|---------------------|
| Reversal of revaluation adjustments | | | 0.9 | 0.9 | 2.4 | | 3.3 |
| Inflation accounting | | | (0.5) | (0.5) | (3.1) | | (3.6) |
| Different criteria for: Cancellation of subsidiaries treasury stock | | | | | 0.8 | | 0.8 |
| Deferred charges | | | (6.2) | (6.2) | (11.4) | | (17.6) |
| Depreciation of interest costs capitalized during construction | | | | | (0.5) | | (0.5) |
| Reversal of goodwill amortization | | | | | 5.3 | | 5.3 |
| Fair value adjustments relating to accounting for derivative instruments and heading activities | | | 0.4 | 0.4 | 1.0 | | 1.4 |
| Translation adjustments - Canamex | | | | | 1.8 | | 1.8 |
| Other individually insignificant adjustments | | 0.2 | (0.3) | (0.1) | 1.4 | | 1.3 |
| Fair value adjustments relating to business combinations | | 1.0 | (2.6) | (1.6) | | | (1.6) |
| Fair value adjustments relating to acquisition of minority interest in Oxitenno S.A. - Indústria e Comércio | | 4.5 | | 4.5 | | | 4.5 |
| Fair value adjustments relating to the acquisition of SPGás Distribuidora de Gás Ltda. | | | | | 1.5 | | 1.5 |
| Fair value adjustments relating to the acquisition of Canamex Químicos S.A. de C.V. | | | | | 0.1 | | 0.1 |
| Fair value adjustments relating to acquisition of minority interest in Companhia Ultragaz S.A | | | | | (0.5) | | (0.5) |
| Deferred tax effects | | (1.2) | 3.3 | 2.1 | 0.2 | | 2.3 |
| Minority Interest | | | | | (0.1) | | (0.1) |
| Equity on U.S.GAAP adjustment | | (11.9) | (2.7) | (14.7) | | 14.7 | |
| NET INCOME (LOSS) UNDER U.S.GAAP | (1.6) | 281.0 | 174.2 | 455.1 | 280.6 | (453.6) | 280.5 |

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Ultrapar Participações S.A. and Subsidiaries

Consolidated Statements of Cash Flows for the year ended December 31, 2006

| | LPG Issuer | Ultrapar - Parent Company Guarantor | Oxiteno - Wolly Owned Guarantor Subsidiary | Total Guarantors | Non - Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---------------|---|--|---------------------|---------------------------------|----------------|--------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | | | | | |
| Net income | (1.6) | 288.4 | 181.9 | 470.3 | 281.7 | (468.3) | 282.1 |
| Adjustments to reconcile net income to cash provided by operating activities: | | | | | | | |
| Depreciation and amortization | | | 19.2 | 19.2 | 166.8 | (0.2) | 185.8 |
| PIS and COFINS credit on depreciation | | | 0.3 | 0.3 | 1.8 | | 2.1 |
| Loss on disposals of permanent assets | | 391.0 | 2.9 | 393.9 | 10.6 | (391.0) | 13.5 |
| Foreign exchange and indexation (gains) losses | 39.2 | 44.8 | 1.9 | 46.7 | (112.6) | (5.9) | (32.6) |
| Allowance (reversal of provision) for losses on permanent assets | | | 0.2 | 0.2 | 3.0 | | 3.2 |
| Equity in income (losses) of affiliated companies | | (291.8) | (222.8) | (514.6) | (0.6) | 514.2 | (1.0) |
| Benefit of tax holidays | | | | | 40.4 | (40.4) | |
| Deferred income and social contribution taxes | | (0.2) | (0.9) | (1.1) | (4.3) | | (5.4) |
| Minority interest | | | | | 7.8 | (2.5) | 5.3 |
| Other | | 2.4 | | 2.4 | (0.4) | (1.5) | 0.5 |
| Decrease (increase) in operating assets: | | | | | | | |
| Trade accounts receivable | | | (12.1) | (12.1) | (25.3) | 20.7 | (16.7) |
| Recoverable taxes | | (6.0) | (14.3) | (20.3) | (53.1) | | (73.4) |
| Inventories | | | (11.5) | (11.5) | (13.2) | (0.7) | (25.4) |
| Prepaid expenses | | 0.6 | (0.4) | 0.2 | (1.8) | 1.7 | 0.1 |
| Dividends received | | 87.7 | 84.4 | 172.1 | (0.1) | (172.0) | |
| Other | | (0.3) | (0.7) | (1.0) | 2.4 | 0.4 | 1.8 |
| Increase (decrease) in operating liabilities: | | | | | | | |
| Suppliers | | 0.1 | 20.3 | 20.4 | 21.9 | (20.7) | 21.6 |
| Accrued interest | | | | | (5.0) | | (5.0) |
| Salaries and related charges | | | 1.0 | 1.0 | 14.1 | | 15.1 |
| Taxes | | | 0.3 | 0.3 | 13.2 | | 13.5 |
| Income and social contribution taxes | | 0.7 | (5.0) | (4.3) | 4.6 | | 0.3 |
| Other | 0.7 | | (0.1) | (0.1) | (1.5) | (0.2) | (1.1) |
| | 38.3 | 517.4 | 44.6 | 562.0 | 350.4 | (566.4) | 384.3 |

Net cash (used in)
provided by operating
activities

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Ultrapar Participações S.A. and Subsidiaries

Consolidated Statements of Cash Flows for the year ended December 31, 2006

| | LPG Issuer | Ultrapar - Parent Company Guarantor | Oxiteno -Wolly Owned Guarantor Subsidiary | Total Guarantors | Non - Guarantor Subsidiaries | Eliminations | Consolidated |
|--|-----------------------|--|--|-----------------------------|---|---------------------|---------------------|
| CASH FLOWS FROM INVESTING ACTIVITIES | | | | | | | |
| Additions to short-term investments | | (57.6) | | (57.6) | (822.8) | | (880.4) |
| Proceeds from sales of short-term investments | | 12.8 | | 12.8 | 302.4 | | 315.2 |
| Additions to long-term investments | | | | | (7.2) | | (7.2) |
| Additions to escrow deposits | | 0.2 | (0.1) | 0.1 | (24.1) | | (24.0) |
| Additions to investments | | (39.3) | (26.2) | (65.5) | (0.4) | 65.8 | (0.1) |
| Additions to property, plant and equipment | | | (62.6) | (62.6) | (190.4) | | (253.0) |
| Additions to intangible assets | | | (4.8) | (4.8) | (6.9) | | (11.7) |
| Additions to deferred charges | | | (9.9) | (9.9) | (65.0) | | (74.9) |
| Acquisition of minority interests | | | | | (0.1) | | (0.1) |
| Proceeds from sales of property, plant and equipment | | | 0.4 | 0.4 | 20.3 | | 20.7 |
| Net cash (used in) provided by investing activities | | (83.9) | (103.2) | (187.1) | (794.2) | 65.8 | (915.5) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | | | | | |
| Short-term debt, net | (40.0) | (49.9) | (31.0) | (80.9) | (52.2) | | (173.1) |
| Long term financings and debentures: | | | | | | | |
| Issuances | | | 24.7 | 24.7 | 119.0 | | 143.7 |
| Repayments | | | | | (0.1) | | (0.1) |
| Loans from affiliated companies: | | | | | | | |
| Issuances | | 90.6 | 163.6 | 254.2 | 638.0 | (888.2) | 4.0 |
| Repayments | | (450.5) | (65.2) | (515.7) | (380.8) | 888.2 | (8.3) |
| Dividends paid | | (147.7) | (64.5) | (212.2) | (108.4) | 172.0 | (148.6) |
| Capital increase | | | 29.4 | 29.4 | (354.6) | 325.1 | (0.1) |
| Other | | (1.1) | | (1.1) | | | (1.1) |
| Net cash provided by (used in) financing | (40.0) | (558.6) | 57.0 | (501.6) | (139.1) | 497.1 | (183.6) |

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activities

| | | | | | | | |
|--|------------|--------------|------------|--------------|--------------|--------------|--------------|
| Effect of exchange rate changes on cash and cash equivalents | | | | | (14.3) | | (14.3) |
| Net increase (decrease) in cash and cash equivalents | (1.7) | (125.1) | (1.6) | (126.7) | (597.2) | (3.5) | (729.1) |
| Cash and cash equivalents at the beginning of the year | 2.5 | 359.7 | 4.7 | 364.4 | 747.8 | (0.5) | 1,114.2 |
| Cash and cash equivalents at the end of the year | 0.8 | 234.6 | 3.1 | 237.7 | 150.6 | (4.0) | 385.1 |

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Ultrapar Participações S.A. and Subsidiaries

Consolidated Balance Sheets as of December 31, 2005

| | LPG Issuer | Ultrapar - Parent Company Guarantor | Oxitenó - Wholly Owned Guarantor Subsidiary | Total Guarantors | Non - Guarantor Subsidiaries | Eliminations | Consolidated |
|--|---------------|---|---|---------------------|---------------------------------|------------------|----------------|
| ASSETS | | | | | | | |
| CURRENT ASSETS | | | | | | | |
| Cash and cash equivalents | 2.5 | 359.7 | 4.7 | 364.4 | 747.8 | (0.5) | 1,114.2 |
| Short-term investments | | | | | 184.8 | | 184.8 |
| Trade accounts receivable, net | | | 64.3 | 64.3 | 318.3 | (39.3) | 343.3 |
| Inventories | | | 57.8 | 57.8 | 134.9 | (1.0) | 191.7 |
| Recoverable taxes | | 9.0 | 3.1 | 12.1 | 50.3 | 0.5 | 62.9 |
| Deferred income and social contribution taxes | | 0.1 | 3.8 | 3.9 | 18.1 | | 22.0 |
| Dividends receivable | | 73.3 | 48.1 | 121.4 | (1.8) | (119.6) | |
| Other | | 0.4 | 0.7 | 1.1 | 10.0 | (2.5) | 8.6 |
| Prepaid expenses | 1.0 | 0.5 | 1.1 | 1.6 | 6.9 | (0.7) | 8.8 |
| TOTAL CURRENT ASSETS | 3.5 | 443.0 | 183.6 | 626.6 | 1,469.3 | (163.1) | 1,936.3 |
| NONCURRENT ASSETS | | | | | | | |
| Long-term investments | | | | | 513.1 | (140.4) | 372.7 |
| Related companies | 586.5 | 14.4 | | 14.4 | 780.6 | (1,377.8) | 3.7 |
| Deferred income and social contribution taxes | | 2.8 | 8.2 | 11.0 | 50.0 | | 61.0 |
| Escrow deposits | | | 0.7 | 0.7 | 15.7 | | 16.4 |
| Recoverable taxes | | 11.7 | 24.7 | 36.4 | 10.4 | | 46.8 |
| Trade accounts receivable | | | | | 19.2 | | 19.2 |
| Other | 8.9 | 0.8 | 2.1 | 2.9 | 6.7 | (4.8) | 13.7 |
| TOTAL LONG TERM ASSETS | 595.4 | 29.7 | 35.7 | 65.4 | 1,395.7 | (1,523.0) | 533.5 |
| PERMANENT ASSETS | | | | | | | |
| Investments: | | | | | | | |
| Subsidiary and affiliated companies | | 2,153.9 | 1,090.8 | 3,244.7 | 2.7 | (3,243.2) | 4.2 |
| Other | | 0.2 | 19.1 | 19.3 | 8.8 | | 28.1 |
| Property, plant and equipment, net | | | 176.5 | 176.5 | 838.0 | (0.9) | 1,013.6 |
| Intangible assets, net | | | 9.2 | 9.2 | 49.9 | | 59.1 |
| Deferred charges, net | | | 7.1 | 7.1 | 91.2 | | 98.3 |
| TOTAL PERMANENT ASSETS | | 2,154.1 | 1,302.7 | 3,456.8 | 990.6 | (3,244.1) | 1,203.3 |
| TOTAL ASSETS UNDER ACCOUNTING PRACTICES ADOPTED IN BRAZIL | | | | | | | |
| | 598.9 | 2,626.8 | 1,522.0 | 4,148.8 | 3,855.6 | (4,930.2) | 3,673.1 |

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Ultrapar Participações S.A. and Subsidiaries

Consolidated Balance Sheets as of December 31, 2005

| | LPG Issuer | Ultrapar - Parent Company Guarantor | Oxiten - Wholly Owned Guarantor Subsidiary | Total Guarantors | Non - Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---------------|---|--|------------------|---------------------------------|------------------|----------------|
| RECONCILIATION TO U.S.GAAP | | | | | | | |
| Reversal of revaluation adjustments | | | (2.6) | (2.6) | (28.0) | | (30.6) |
| Inflation accounting | | | 7.6 | 7.6 | 20.5 | | 28.1 |
| Different criteria for: | | | | | | | |
| Deferred charges | | | (4.9) | (4.9) | (74.4) | | (79.3) |
| Capitalization of interest costs during construction | | | | | 0.8 | | 0.8 |
| Reversal of goodwill amortization of SPGás acquisition under BR GAAP | | | | | 11.4 | | 11.4 |
| Reversal of goodwill amortization of Companhia Ultragaz S.A. shares from minority stockholders | | | | | (1.5) | | (1.5) |
| Other individually insignificant adjustments | | (0.1) | | (0.1) | (1.3) | | (1.4) |
| Fair value adjustments relating to business combinations | | (2.1) | 5.2 | 3.1 | | | 3.1 |
| Fair value adjustments relating to acquisition of minority interest in Oxiten S.A. Indústria e Comércio | | (27.1) | | (27.1) | | | (27.1) |
| Fair value adjustments relating to the acquisition of SPGás Distribuidora de Gás Ltda. | | | | | 7.4 | | 7.4 |
| Fair value adjustments relating to the acquisition of Canamex Químicos S.A. de C.V. | | | | | (1.2) | | (1.2) |
| Fair value adjustments relating to acquisition of minority interest in Companhia Ultragaz S.A | | | | | 4.3 | | 4.3 |
| Available-for-sale equity securities (temporary unrealized gain) | | | 3.0 | 3.0 | | | 3.0 |
| Deferred tax effects | | 6.3 | (3.0) | 3.3 | 16.6 | | 19.9 |
| Equity on U.S.GAAP adjustment | | (21.7) | (1.1) | (22.8) | | 22.8 | |
| TOTAL ASSETS UNDER U.S.GAAP | 598.9 | 2,582.1 | 1,526.2 | 4,108.2 | 3,810.2 | (4,907.4) | 3,610.0 |

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Ultrapar Participações S.A. and Subsidiaries

Consolidated Balance Sheets as of December 31, 2005

| LIABILITIES | LPG Issuer | Ultrapar - Parent Company Guarantor | Oxiten - Wholly Owned Guarantor Subsidiary | Total Guarantors | Non - Guarantor Subsidiaries | Eliminations | Consolidated |
|---|-----------------------|--|---|-------------------------|---|---------------------|---------------------|
| CURRENT LIABILITIES | | | | | | | |
| Loans and financing | 1.3 | | 32.1 | 32.1 | 151.1 | (0.5) | 184.0 |
| Debentures | | 17.9 | | 17.9 | | | 17.9 |
| Suppliers | | 0.3 | 36.2 | 36.5 | 90.8 | (36.4) | 90.9 |
| Payroll and related charges | | | 17.8 | 17.8 | 48.3 | | 66.1 |
| Taxes | | | 0.4 | 0.4 | 10.9 | | 11.3 |
| Dividends payable | | 100.1 | 64.6 | 164.7 | 60.7 | (121.5) | 103.9 |
| Income and social contribution taxes | | | | | 0.6 | | 0.6 |
| Deferred income and social contribution taxes | | | 0.2 | 0.2 | | | 0.2 |
| Other | | | 2.0 | 2.0 | 12.0 | (0.6) | 13.4 |
| TOTAL CURRENT LIABILITIES | 1.3 | 118.3 | 153.3 | 271.6 | 374.4 | (159.0) | 488.3 |
| NON-CURRENT LIABILITIES | | | | | | | |
| Loans and financing | 585.2 | | 53.1 | 53.1 | 480.7 | (140.4) | 978.6 |
| Debentures | | 300.0 | | 300.0 | | | 300.0 |
| Related companies | | 404.2 | 47.7 | 451.9 | 930.9 | (1,377.8) | 5.0 |
| Deferred income and social contribution taxes | | | 23.6 | 23.6 | 0.5 | | 24.1 |
| Other taxes and contributions contingent liabilities | | 8.7 | 13.9 | 22.6 | 32.1 | | 54.7 |
| Other | | | 0.3 | 0.3 | 2.4 | | 2.7 |
| TOTAL LONG TERM LIABILITIES | 585.2 | 712.9 | 138.6 | 851.5 | 1,446.6 | (1,518.2) | 1,365.1 |
| MINORITY INTEREST | | | | | 47.5 | (17.9) | 29.6 |
| TOTAL LIABILITIES UNDER ACCOUNTING PRACTICES ADOPTED IN BRAZIL | | | | | | | |
| | 586.5 | 831.2 | 291.9 | 1,123.1 | 1,868.5 | (1,695.1) | 1,883.0 |
| STOCKHOLDERS EQUITY | | | | | | | |
| Capital | | 946.0 | 510.8 | 1,456.8 | 974.3 | (1,485.1) | 946.0 |
| Capital reserve | | 2.0 | | 2.0 | 137.2 | (138.9) | 0.3 |
| Revaluation reserve | | 15.0 | 2.1 | 17.1 | 22.3 | (24.4) | 15.0 |
| Profit reserves | 12.4 | 837.5 | 717.2 | 1,554.7 | 623.3 | (1,352.9) | 837.5 |

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| | | | | |
|-------------------|-------|-------|-------|---------|
| Treasury shares | (4.9) | (4.9) | (3.8) | (8.7) |
| Retained earnings | | | 233.8 | (233.8) |

| | | | | | | | |
|---|-------------|----------------|----------------|----------------|----------------|------------------|----------------|
| TOTAL STOCKHOLDERS EQUITY UNDER ACCOUNTING PRACTICES ADOPTED IN BRAZIL | 12.4 | 1,795.6 | 1,230.1 | 3,025.7 | 1,987.1 | (3,235.1) | 1,790.1 |
|---|-------------|----------------|----------------|----------------|----------------|------------------|----------------|

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Ultrapar Participações S.A. and Subsidiaries

Consolidated Balance Sheets as of December 31, 2005

| STOCKHOLDERS | EQUITY RECONCILIATION TO U.S.GAAP | LPG Issuer | Ultrapar - Parent Company Guarantor | Oxiten - Wholly Owned Guarantor Subsidiary | Total Guarantors | Non - Guarantor Subsidiaries | Eliminations | Consolidated |
|------------------------------|--|---------------|---|--|------------------|---------------------------------|------------------|----------------|
| | Adjustment of revaluation adjustments | | | (2.6) | (2.6) | (28.0) | | |
| | Adjustment on accounting | | | 7.6 | 7.6 | 20.5 | | |
| | Adjustment criteria for: | | | | | | | |
| | Adjustment of subsidiaries treasury stock | | | | | (2.9) | | |
| | Adjustment of charges | | | (4.9) | (4.9) | (74.4) | | |
| | Adjustment of interest costs during construction | | | | | 0.8 | | |
| | Adjustment of goodwill amortization of SPGás acquisition under U.S.GAAP | | | | | 11.4 | | |
| | Adjustment of goodwill amortization of Companhia Ultragas S.A. from minority stockholders | | | | | (1.5) | | |
| | Adjustment of adjustments relating to accounting for derivative instruments and hedging activities | | | 0.5 | 0.5 | (3.1) | | |
| | Adjustment of individually insignificant adjustments | | (0.1) | | (0.1) | (1.3) | | |
| | Adjustment of adjustments relating to business combinations | | (2.1) | 5.2 | 3.1 | | | |
| | Adjustment of adjustments relating to acquisition of minority interest in Oxiten S.A. Indústria e Comércio | | (27.1) | | (27.1) | | | |
| | Adjustment of adjustments relating to the acquisition of SPGás S.A. Siderúrgica de Gás Ltda. | | | | | 7.4 | | |
| | Adjustment of adjustments relating to the acquisition of Canamex S.A. de C.V. | | | | | (1.2) | | |
| | Adjustment of adjustments relating to acquisition of minority interest in Companhia Ultragas S.A. | | | | | 4.3 | | |
| | Adjustment of available-for-sale equity securities (temporary unrealized gain) | | | 3.0 | 3.0 | | | |
| | Adjustment of differences in accounting principles effects | | | 1.2 | 1.2 | 8.4 | | |
| | Adjustment of increase for incorporation | | (21.5) | | (21.5) | 21.5 | | |
| | Adjustment of deferred tax effects | | 6.3 | (3.0) | 3.3 | 14.9 | | |
| | Adjustment of Minority Interest | | | | | 0.8 | | |
| | Adjustment on U.S.GAAP adjustment | | (21.7) | (1.1) | (22.8) | | 22.8 | |
| ULTRAPAR STOCKHOLDERS | EQUITY UNDER U.S.GAAP | 12.4 | 1,729.4 | 1,236.0 | 2,965.4 | 1,964.7 | (3,212.3) | 1,693.2 |

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Ultrapar Participações S.A. and Subsidiaries

Consolidated Statements of Income for the year ended December 31, 2005

| | LPG Issuer | Ultrapar - Parent Company Guarantor | Oxitenó -Wholly Owned Guarantor Subsidiary | Total Guarantors | Non - Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---------------|---|--|---------------------|---------------------------------|----------------|----------------|
| GROSS SALES AND SERVICES | | | 721.0 | 721.0 | 4,817.2 | (380.2) | 5,158.0 |
| Deductions | | | (168.0) | (168.0) | (350.4) | 54.2 | (464.2) |
| NET SALES AND SERVICES | | | 553.0 | 553.0 | 4,466.8 | (326.0) | 4,693.8 |
| Cost of sales and services | | | (458.6) | (458.6) | (3,641.6) | 316.8 | (3,783.4) |
| GROSS PROFIT | | | 94.4 | 94.4 | 825.2 | (9.2) | 910.4 |
| OPERATING (EXPENSES) INCOME | (0.2) | 0.1 | (115.0) | (114.9) | (446.3) | 9.3 | (552.1) |
| Selling | | | (23.4) | (23.4) | (164.2) | | (187.6) |
| General and administrative | (0.2) | (1.1) | (87.0) | (88.1) | (159.0) | 9.5 | (237.8) |
| Depreciation and amortization | | | (6.7) | (6.7) | (119.6) | | (126.3) |
| Other operating income, net | | 1.2 | 2.1 | 3.3 | (3.5) | (0.2) | (0.4) |
| OPERATING INCOME (LOSS) BEFORE FINANCIAL ITEMS | (0.2) | 0.1 | (20.6) | (20.5) | 378.9 | 0.1 | 358.3 |
| Financial income (expenses), net | 3.2 | 2.3 | (1.9) | 0.4 | (4.9) | (26.0) | (27.3) |
| Nonoperating income (expenses), net | | | 0.4 | 0.4 | (1.3) | (0.9) | (1.8) |
| INCOME (LOSS) BEFORE INCOME AND SOCIAL CONTRIBUTION TAXES, EQUITY IN GAIN (LOSSES) OF AFFILIATED COMPANIES AND MINORITY INTEREST | 3.0 | 2.4 | (22.1) | (19.7) | 372.7 | (26.8) | 329.2 |
| INCOME AND SOCIAL CONTRIBUTION TAXES | | (1.7) | 10.6 | 8.9 | (93.7) | 56.0 | (28.8) |
| Current | | (1.9) | | (1.9) | (111.2) | | (113.1) |
| Deferred | | 0.2 | 10.6 | 10.8 | 9.7 | | 20.5 |

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| | | | | | | | |
|---|------------|--------------|---------------|---------------|--------------|----------------|--------------|
| Benefit of tax holidays | | | | | 7.8 | 56.0 | 63.8 |
| INCOME (LOSS) BEFORE EQUITY IN GAIN (LOSSES) OF AFFILIATED COMPANIES AND MINORITY INTEREST | | | | | | | |
| MINORITY INTEREST | 3.0 | 0.7 | (11.5) | (10.8) | 279.0 | 29.2 | 300.4 |
| Equity in affiliated companies | | 298.5 | 283.1 | 581.6 | 1.5 | (581.5) | 1.6 |
| Minority interest | | | | | (6.3) | 3.5 | (2.8) |
| NET INCOME UNDER ACCOUNTING PRACTICES ADOPTED IN BRAZIL | | | | | | | |
| | 3.0 | 299.2 | 271.6 | 570.8 | 274.2 | (548.8) | 299.2 |

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Ultrapar Participações S.A. and Subsidiaries

Consolidated Statements of Income for the year ended December 31, 2005

| RECONCILIATION TO U.S.GAAP | LPG Issuer | Ultrapar - Parent Company Guarantor | Oxiten - Wholly Owned Guarantor Subsidiary | Total Guarantors | Non - Guarantor Subsidiaries | Eliminations | Consolidated |
|--|-----------------------|--|---|-----------------------------|---|---------------------|---------------------|
| Reversal of revaluation adjustments | | | 1.0 | 1.0 | 1.8 | | 2.8 |
| Inflation accounting | | | (0.7) | (0.7) | (2.9) | | (3.6) |
| Different criteria for: Cancellation of subsidiaries treasury stock | | | | | 0.9 | | 0.9 |
| Deferred charges | | | (3.0) | (3.0) | (4.7) | | (7.7) |
| Depreciation of interest costs capitalized during construction | | | (0.1) | (0.1) | (0.4) | | (0.5) |
| Reversal of goodwill amortization | | | | | 8.8 | | 8.8 |
| Fair value adjustments relating to accounting for derivative instruments and heading activities | | | | | (11.6) | | (11.6) |
| Translation adjustments Canamex | | | | | (4.5) | | (4.5) |
| Other individually insignificant adjustments | | 0.4 | (0.6) | (0.2) | 0.7 | | 0.5 |
| Fair value adjustments relating to business combinations | | 1.0 | (2.6) | (1.6) | 0.1 | | (1.5) |
| Fair value adjustments relating to acquisition of minority interest in Oxiten S.A. Indústria e Comércio | | 4.6 | | 4.6 | 0.1 | | 4.7 |
| Fair value adjustments relating to the acquisition of SPGás Distribuidora de Gás Ltda. | | | | | 1.5 | | 1.5 |
| Fair value adjustments relating to the acquisition of Canamex Químicos S.A. de C.V. | | | | | 0.2 | | 0.2 |
| Fair value adjustments relating to acquisition of minority interest in Companhia Ultragaz S.A | | | | | (1.3) | | (1.3) |
| Expenses of public offering of shares | | 2.4 | | 2.4 | | | 2.4 |
| Changes in accounting principles | | | 0.1 | 0.1 | (5.0) | | (4.9) |
| Deferred tax effects | | (1.3) | 2.1 | 0.8 | 3.0 | | 3.8 |
| Minority Interest | | | | | (0.3) | | (0.3) |
| Equity on U.S.GAAP adjustment | | (14.2) | (8.4) | (22.6) | | 22.6 | |
| NET INCOME UNDER U.S.GAAP | 3.0 | 292.1 | 259.4 | 551.5 | 260.6 | (526.2) | 288.9 |

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Ultrapar Participações S.A. and Subsidiaries

Consolidated Statements of Cash Flows for the year ended December 31, 2005

| | LPG Issuer | Ultrapar - Parent Company Guarantor | Oxiteno -Wholly Owned Guarantor Subsidiary | Total Guarantors | Non - Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---------------|---|---|---------------------|---------------------------------|--------------|--------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | | | | | |
| Net income | 3.0 | 299.2 | 271.6 | 570.8 | 274.2 | (548.8) | 299.2 |
| Adjustments to reconcile net income to cash provided by operating activities: | | | | | | | |
| Depreciation and amortization | | | 18.1 | 18.1 | 169.6 | | 187.7 |
| PIS and COFINS credit on depreciation | | | 0.2 | 0.2 | 1.2 | | 1.4 |
| Loss (gain) on disposals of permanent assets | | | (0.2) | (0.2) | 0.6 | 0.9 | 1.3 |
| Foreign exchange and indexation (gains) losses | (23.8) | | 1.9 | 1.9 | (61.8) | 28.3 | (55.4) |
| Allowance (reversal of provision) for losses on permanent assets | | | (0.4) | (0.4) | 0.4 | | |
| Equity in income (losses) of affiliated companies | | (298.5) | (283.1) | (581.6) | (1.5) | 581.5 | (1.6) |
| Benefit of tax holidays | | | | | 56.0 | (56.0) | |
| Deferred income and social contribution taxes | | (0.2) | (6.9) | (7.1) | (20.3) | | (27.4) |
| Other long-term taxes | | | (0.8) | (0.8) | 0.8 | | |
| Minority interest | | | | | 6.3 | (3.5) | 2.8 |
| Other | | | | | (0.1) | 0.7 | 0.6 |
| Decrease (increase) in operating assets: | | | | | | | |
| Trade accounts receivable | | | (3.0) | (3.0) | (6.0) | 27.7 | 18.7 |
| Recoverable taxes | | (9.3) | (8.0) | (17.3) | 27.1 | 0.3 | 10.1 |
| Inventories | | | 10.3 | 10.3 | 7.9 | 0.4 | 18.6 |
| Prepaid expenses | (9.5) | (0.5) | 0.2 | (0.3) | 6.5 | | (3.3) |
| Dividends received | | 104.1 | 4.2 | 108.3 | 32.3 | (140.6) | |
| Other | | (1.4) | (0.9) | (2.3) | (50.1) | 26.8 | (25.6) |
| Increase (decrease) in operating liabilities: | | | | | | | |
| Suppliers | | 0.1 | 12.6 | 12.7 | 4.9 | (28.7) | (11.1) |
| Accrued interest | 1.2 | 17.9 | 0.1 | 18.0 | 1.3 | (0.4) | 20.1 |
| Salaries and related charges | | (0.4) | (14.3) | (14.7) | (13.4) | | (28.1) |
| Taxes | | | (0.4) | (0.4) | (0.1) | | (0.5) |
| Income and social contribution taxes | | | 0.2 | 0.2 | (2.5) | | (2.3) |
| Other | | 0.8 | 0.0 | 0.8 | (1.4) | 5.4 | 4.8 |

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| | | | | | | | |
|---|--------|-------|-----|-------|-------|---------|-------|
| Net cash provided by (used in) operating activities | (29.1) | 111.8 | 1.4 | 113.2 | 432.0 | (106.0) | 410.0 |
|---|--------|-------|-----|-------|-------|---------|-------|

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Ultrapar Participações S.A. and Subsidiaries

Consolidated Statements of Cash Flows for the year ended December 31, 2005

| | LPG Issuer | Ultrapar - Parent Company Guarantor | Oxiteno -Wholly Owned Guarantor Subsidiary | Total Guarantors | Non - Guarantor Subsidiaries | Eliminations | Consolidated |
|--|----------------|---|---|---------------------|---------------------------------|---------------|----------------|
| CASH FLOWS FROM INVESTING ACTIVITIES | | | | | | | |
| Additions to short-term investments | | | | | (175.6) | | (175.6) |
| Proceeds from sales of short-term investments | | | | | 12.6 | | 12.6 |
| Additions to long-term investments | | | | | (438.1) | 143.5 | (294.6) |
| Additions to investments | | | (8.9) | (8.9) | | 8.9 | |
| Additions to property, plant and equipment | | | (40.9) | (40.9) | (139.4) | 0.9 | (179.4) |
| Additions to deferred charges | | | (5.7) | (5.7) | (45.6) | | (51.3) |
| Proceeds from sales of property, plant and equipment | | 0.2 | 0.9 | 1.1 | 11.8 | (0.9) | 12.0 |
| Net cash (used in) provided by investing activities | | 0.2 | (54.6) | (54.4) | (774.3) | 152.4 | (676.3) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | | | | | |
| Short-term debt, net | | | (9.4) | (9.4) | (103.6) | | (113.0) |
| Long term financings and debentures: | | | | | | | |
| Issuances | 587.4 | 300.0 | 21.3 | 321.3 | 397.8 | (145.1) | 1,161.4 |
| Repayments | (142.2) | | (13.8) | (13.8) | (53.7) | 7.1 | (202.6) |
| Loans from affiliated companies: | | | | | | | |
| Issuances | 11.6 | 26.2 | 61.7 | 87.9 | 966.9 | (1,057.4) | 9.0 |
| Repayments | (585.2) | | (14.0) | (14.0) | (468.6) | 1,057.4 | (10.4) |
| Dividends paid | | (128.8) | (8.7) | (137.5) | (100.3) | 108.3 | (129.5) |
| Capital increase | | 47.1 | | 47.1 | 9.2 | (9.2) | 47.1 |
| Other | | 0.9 | | 0.9 | (1.0) | | |
| Net cash provided by (used in) financing activities | (128.4) | 245.4 | 37.1 | 282.5 | 646.7 | (38.9) | 762.0 |
| Effect of exchange rate changes on cash and cash equivalents | | | | | (6.0) | | (6.0) |

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| | | | | | | | |
|--|---------|-------|--------|-------|-------|-------|---------|
| Net increase (decrease) in cash and cash equivalents | (157.5) | 357.4 | (16.1) | 341.3 | 298.3 | 7.5 | 489.7 |
| Cash and cash equivalents at the beginning of the year | 160.0 | 2.3 | 20.8 | 23.1 | 449.4 | (8.0) | 624.5 |
| Cash and cash equivalents at the end of the year | 2.5 | 359.7 | 4.7 | 364.4 | 747.7 | (0.5) | 1,114.2 |

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Ultrapar Participações S.A. and Subsidiaries

Consolidated Statements of Income for the year ended December 31, 2004

| | LPG Issuer | Ultrapar - Parent Company Guarantor | Oxiteno - Wholly Owned Guarantor Subsidiary | Total Guarantors | Non - Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---------------|---|--|---------------------|---------------------------------|----------------|----------------|
| GROSS SALES AND SERVICES | | | 754.8 | 754.8 | 4,795.7 | (299.9) | 5,250.6 |
| Deductions | | | (176.7) | (176.7) | (347.1) | 57.4 | (466.4) |
| NET SALES AND SERVICES | | | 578.1 | 578.1 | 4,448.6 | (242.5) | 4,784.2 |
| Cost of sales and services | | | (451.4) | (451.4) | (3,454.0) | 235.5 | (3,669.9) |
| GROSS PROFIT | | | 126.7 | 126.7 | 994.6 | (7.0) | 1,114.3 |
| OPERATING (EXPENSES) INCOME | (0.2) | (0.1) | (122.4) | (122.5) | (434.0) | 6.3 | (550.4) |
| Selling | | | (24.1) | (24.1) | (169.6) | | (193.7) |
| General and administrative | (0.2) | (0.9) | (92.6) | (93.5) | (154.6) | 10.8 | (237.5) |
| Depreciation and amortization | | | (6.2) | (6.2) | (118.5) | | (124.7) |
| Other operating income, net | | 0.8 | 0.5 | 1.3 | 8.7 | (4.5) | 5.5 |
| OPERATING INCOME (LOSS) BEFORE FINANCIAL ITEMS | (0.2) | (0.1) | 4.3 | 4.2 | 560.6 | (0.7) | 563.9 |
| Financial income (expenses), net | 7.7 | 1.8 | (12.8) | (11.0) | (34.1) | (7.6) | (45.0) |
| Nonoperating income (expenses), net | | | (1.8) | (1.8) | (14.2) | | (16.0) |
| INCOME (LOSS) BEFORE INCOME AND SOCIAL CONTRIBUTION TAXES, EQUITY IN GAIN (LOSSES) OF AFFILIATED COMPANIES AND MINORITY INTEREST | 7.5 | 1.7 | (10.3) | (8.6) | 512.3 | (8.3) | 502.9 |
| INCOME AND SOCIAL CONTRIBUTION TAXES | | (5.2) | 0.3 | (4.9) | (160.8) | 82.7 | (83.0) |
| Current | | (5.3) | | (5.3) | (169.7) | | (175.0) |
| Deferred | | 0.1 | 0.3 | 0.4 | (1.9) | | (1.5) |

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| | | | | | | | |
|---|------------|--------------|---------------|---------------|--------------|----------------|--------------|
| Benefit of tax holidays | | | | | 10.8 | 82.7 | 93.5 |
| INCOME (LOSS) BEFORE EQUITY IN GAIN (LOSSES) OF AFFILIATED COMPANIES AND MINORITY INTEREST | | | | | | | |
| MINORITY INTEREST | 7.5 | (3.5) | (10.0) | (13.5) | 351.5 | 74.4 | 419.9 |
| Equity in affiliated companies | | 418.0 | 335.6 | 753.6 | | (753.6) | |
| Minority interest | | | | | (9.0) | 3.6 | (5.4) |
| NET INCOME UNDER ACCOUNTING PRACTICES ADOPTED IN BRAZIL | | | | | | | |
| | 7.5 | 414.5 | 325.6 | 740.1 | 342.5 | (675.6) | 414.5 |

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Ultrapar Participações S.A. and Subsidiaries

Consolidated Statements of Income for the year ended December 31, 2004

| | LPG Issuer | Ultrapar - Parent Company Guarantor | Oxiteno - Wholly Owned Guarantor Subsidiary | Total Guarantors | Non - Guarantor Subsidiaries | Eliminations | Consolidated |
|--|---------------|---|--|---------------------|---------------------------------|----------------|--------------|
| RECONCILIATION TO U.S.GAAP | | | | | | | |
| Reversal of revaluation adjustments | | | 1,0 | 1,0 | 1,9 | | 2,9 |
| Inflation accounting | | 0,1 | (0,4) | (0,3) | (3,7) | | (4,0) |
| Different criteria for: | | | | | | | |
| Cancellation of subsidiaries treasury stock | | | | | 0,9 | | 0,9 |
| Deferred charges expensed | | | 0,3 | 0,3 | (3,1) | | (2,8) |
| Depreciation of interest costs capitalized during construction | | | (0,2) | (0,2) | (0,6) | | (0,8) |
| Reversal of goodwill amortization | | | | | 8,5 | | 8,5 |
| Fair value adjustments relating to accounting for derivative instruments and heading activities | | | (0,5) | (0,5) | (11,8) | | (12,3) |
| Translation adjustments Canamex | | | | | 2,6 | | 2,6 |
| Other individually insignificant adjustments | | 0,6 | (0,8) | (0,2) | 2,0 | | 1,8 |
| Fair value adjustments relating to business combinations | | 1,0 | (2,6) | (1,6) | | | (1,6) |
| Fair value adjustments relating to acquisition of minority interest in Oxiteno S.A. Indústria e Comércio | | 4,7 | | 4,7 | (0,1) | | 4,6 |
| Fair value adjustments relating to the acquisition of SPGás Distribuidora de Gás Ltda. | | | | | 1,5 | | 1,5 |
| Fair value adjustments relating to the acquisition of Canamex Químicos S.A. de C.V. | | | | | (0,3) | | (0,3) |
| Changes in accounting principles | | | (0,8) | (0,8) | (0,8) | | (1,6) |
| Deferred tax effects | | (1,5) | 1,4 | (0,1) | 0,2 | | 0,1 |
| Minority Interest | | | | | (0,7) | | (0,7) |
| Equity on U.S.GAAP adjustment | | (5,1) | (2,9) | (8,1) | | 8,1 | |
| NET INCOME UNDER USGAAP | 7,5 | 414,3 | 320,1 | 734,3 | 339,0 | (667,5) | 413,3 |

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Ultrapar Participações S.A. and Subsidiaries

Consolidated Statements of Cash Flows for the year ended December 31, 2004

| | LPG Issuer | Ultrapar - Parent Company Guarantor | Oxiteno - Wholly Owned Guarantor Subsidiary | Total Guarantors | Non - Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---------------|---|--|---------------------|---------------------------------|--------------|--------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | | | | | |
| Net income | 7.5 | 414.5 | 325.6 | 740.1 | 342.5 | (675.6) | 414.5 |
| Adjustments to reconcile net income to cash provided by operating activities: | | | | | | | |
| Interest income on investments | | | | | (0.4) | | (0.4) |
| Depreciation and amortization | | | 16.3 | 16.3 | 156.4 | | 172.7 |
| PIS and COFINS credit on depreciation | | | 0.8 | 0.8 | 2.2 | | 3.0 |
| Loss on disposals of permanent assets | | | 1.7 | 1.7 | 15.6 | | 17.3 |
| Foreign exchange and indexation (gains) losses | (13.4) | 0.7 | 3.2 | 3.9 | 3.5 | 8.2 | 2.2 |
| Allowance (reversal of provision) for losses on permanent assets | | | | | (1.3) | | (1.3) |
| Equity in income (losses) of affiliated companies | | (418.1) | (335.6) | (753.7) | 0.9 | 752.8 | |
| Benefit of tax holidays | | | | | 82.7 | (82.7) | |
| Deferred income and social contribution taxes | | (0.1) | (0.3) | (0.4) | 1.9 | | 1.5 |
| Other long-term taxes | | | 7.5 | 7.5 | 0.5 | | 8.0 |
| Minority interest | | | | | 9.0 | (3.6) | 5.4 |
| Other | | (0.1) | | (0.1) | 3.0 | | 2.9 |
| Decrease (increase) in operating assets: | | | | | | | |
| Trade accounts receivable | | | (20.6) | (20.6) | (34.7) | 8.3 | (47.0) |
| Recoverable taxes | | 1.9 | (3.0) | (1.1) | 17.2 | (0.7) | 15.4 |
| Inventories | | | (20.1) | (20.1) | (48.0) | (0.2) | (68.3) |
| Prepaid expenses | (0.4) | | (0.5) | (0.5) | (2.4) | 0.6 | (2.7) |
| Dividends received | | 118.5 | 174.1 | 292.6 | (4.0) | (288.6) | |
| Other | | 3.6 | | 3.6 | (6.7) | (0.2) | (3.3) |
| Increase (decrease) in operating liabilities: | | | | | | | |
| Suppliers | | 0.1 | 5.6 | 5.7 | 11.3 | (5.2) | 11.8 |

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| | | | | | | | |
|---|-------|-------|-------|-------|-------|---------|-------|
| Accrued interest | (0.1) | | (0.2) | (0.2) | 0.5 | | 0.2 |
| Salaries and related charges | | | 9.5 | 9.5 | 9.9 | | 19.4 |
| Taxes | | | (1.4) | (1.4) | 0.5 | | (0.9) |
| Income and social contribution taxes | | | | | (3.6) | | (3.6) |
| Other | | | 0.3 | 0.3 | (4.3) | (3.2) | (7.2) |
| Net cash provided by (used in) operating activities | (6.4) | 121.0 | 162.9 | 283.9 | 552.2 | (290.1) | 539.6 |

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Ultrapar Participações S.A. and Subsidiaries

Consolidated Statements of Cash Flows for the year ended December 31, 2004

| | LPG Issuer | Ultrapar - Parent Company Guarantor | Oxiteno - Wholly Owned Guarantor Subsidiary | Total Guarantors | Non - Guarantor Subsidiaries | Eliminations | Consolidated |
|--|---------------|---|---|---------------------|---------------------------------|--------------|----------------|
| CASH FLOWS FROM INVESTING ACTIVITIES | | | | | | | |
| Additions to short-term investments | | | | | (2.6) | | (2.6) |
| Proceeds from sales of short-term investments | | | | | 18.7 | | 18.7 |
| Additions, to long-term investments | 173.3 | | (5.6) | (5.6) | (209.4) | | (41.7) |
| Additions to investments | | | (0.2) | (0.2) | (0.2) | 0.2 | (0.2) |
| Additions to property, plant and equipment | | | (41.6) | (41.6) | (185.6) | | (227.2) |
| Additions to deferred charges | | | (0.8) | (0.8) | (45.7) | | (46.5) |
| Acquisition of minority interests | | | | | (10.3) | | (10.3) |
| Proceeds from sales of property, plant and equipment | | 0.2 | 0.8 | 1.0 | 5.0 | | 6.0 |
| Other | | | 0.3 | 0.3 | (1.4) | 1.8 | 0.7 |
| Net cash (used in) provided by investing activities | 173.3 | 0.2 | (47.1) | (46.9) | (431.5) | 2.0 | (303.1) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | | | | | |
| Short-term debt, net | | | (21.5) | (21.5) | (53.5) | | (75.0) |
| Long term financings and debentures: | | | | | | | |
| Issuances | | | 29.0 | 29.0 | 264.1 | | 293.1 |
| Repayments | | | (10.0) | (10.0) | (237.4) | (8.0) | (255.4) |
| Loans from affiliated companies: | | | | | | | |
| Issuances | | (6.4) | 3.7 | (2.7) | 152.9 | (85.7) | 64.5 |
| Repayments | (10.6) | | (3.7) | (3.7) | (137.2) | 85.7 | (65.8) |
| Dividends paid | | (131.3) | (111.7) | (243.0) | (180.4) | 291.1 | (132.3) |
| Other | | (4.8) | 0.2 | (4.6) | 1.7 | (3.0) | (5.9) |
| Net cash provided by (used in) financing activities | (10.6) | (142.5) | (114.0) | (256.5) | (189.8) | 280.1 | (176.8) |
| Effect of exchange rate changes on cash and cash equivalents | | | | | (4.0) | | (4.0) |

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| | | | | | | | |
|--|--------------|------------|-------------|-------------|--------------|--------------|--------------|
| Net increase (decrease) in cash and cash equivalents | 156.3 | (21.3) | 1.8 | (19.5) | (73.1) | (8.0) | 55.7 |
| Cash and cash equivalents at the beginning of the year | 3.7 | 23.6 | 19.0 | 42.6 | 522.5 | | 568.8 |
| Cash and cash equivalents at the end of the year | 160.0 | 2.3 | 20.8 | 23.1 | 449.4 | (8.0) | 624.5 |

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Ultrapar Participações S.A. and Subsidiaries

j) Geographical area information

All long-lived assets are located in Brazil, except for long-lived assets located in Mexico, in the amount of R\$26.5, as of December 31, 2006 (R\$25.9 in 2005).

The Company generates revenues from operations in Brazil and, as from December 2003, from Mexico, as well as from exports of products to clients located in foreign countries as shown below:

| | 2006 | 2005 | 2004 |
|----------------------------------|---------|---------|---------|
| Gross sales: | | | |
| Brazil | 4,789.3 | 4,683.7 | 4,713.5 |
| Latin America, other than Brazil | 240.4 | 244.3 | 283.5 |
| Far East | 71.8 | 110.8 | 166.6 |
| Europe | 70.9 | 67.0 | 36.3 |
| North America | 36.6 | 28.8 | 24.6 |
| Other | 20.9 | 23.4 | 26.1 |
| Total | 5,229.9 | 5,158.0 | 5,250.6 |

k) Research and development expenses

Total research and development expenses amounted to R\$18.4, R\$17.4 and R\$15.4 for the years ended December 31, 2006, 2005 and 2004, respectively.

l) Employee severance fund and termination payments

The Company is required to contribute 8% of each employee's gross pay to an account maintained in the employee's name in the Government Severance Indemnity Fund (FGTS). No other contributions to the FGTS are required. Additionally, effective September 2001, the Company is required to pay an additional tax equal to 0.5% of gross pay. Contributions are expensed as incurred.

Under Brazilian law, the Company is also required to pay termination benefits to employees who have been dismissed. The amount of the benefit is calculated as 40% of the accumulated contributions made by the Company to the FGTS during the employee's period of service. Additionally, effective September 2001, the Company is required to pay a social tax of 10% of these accumulated contributions.

The Company does not accrue for these termination costs before a decision to terminate has been made, since the benefits are neither probable nor reasonably estimable. Actual termination costs paid on dismissal totaled R\$6.3, R\$5.3 and R\$4.1 for the years ended December 31, 2006, 2005 and 2004, respectively.

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Ultrapar Participações S.A. and Subsidiaries

m) Changes in number of shares

The following table presents changes in number of shares issued, held in treasury and outstanding for each of the three year periods ended December 31, 2006:

| | Common | Shares issued Preferred | Total | Common | Treasury shares Preferred | Total | Common | Outstanding shares Preferred | Total |
|--|----------------|----------------------------|----------------|----------------|------------------------------|----------------|----------------|---------------------------------|----------------|
| | (in thousands) | (in thousands) | (in thousands) | (in thousands) | (in thousands) | (in thousands) | (in thousands) | (in thousands) | (in thousands) |
| Shares at December 31, 2004 | 51,264,622 | 18,426,647 | 69,691,269 | 6,616 | 182,700 | 189,316 | 51,258,006 | 18,243,947 | 69,501,953 |
| Issuance of shares | | 11,634,140 | 11,634,140 | | 28,397 | 28,397 | | 11,605,743 | 11,605,743 |
| Conversion common shares into preferred shares | (1,834,725) | 1,834,725 | | | | | (1,834,725) | 1,834,725 | |
| Subtotal before reverse stock split | 49,429,897 | 31,895,512 | 81,325,409 | 6,616 | 211,097 | 217,713 | 49,423,281 | 31,684,415 | 81,107,696 |
| Reverse stock split (on July 20, Note 14.a.) | 49,430 | 31,895 | 81,325 | 6 | 211 | 217 | 49,424 | 31,684 | 81,108 |
| Shares granted to executives | | | | | (28) | (28) | | 28 | 28 |
| Shares at December 31, 2005 | 49,430 | 31,895 | 81,325 | 6 | 183 | 189 | 49,424 | 31,712 | 81,136 |
| Acquisition of treasury shares | | | | | 30 | 30 | | (30) | (30) |
| Shares granted to executives | | | | | (51) | (51) | | 51 | 51 |
| Shares at December 31, 2006 | 49,430 | 31,895 | 81,325 | 6 | 162 | 168 | 49,424 | 31,733 | 81,157 |

n) Aggregate transaction gains and losses

Total aggregate transaction gains and losses included in financial income or expense amounted to R\$18.6 (gain), R\$14.7 (gain) and R\$17.2 (gain) for the years ended December 31, 2006, 2005 and 2004, respectively.

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25. SUBSEQUENT EVENT ACQUISITION OF THE IPIRANGA GROUP

On April 18, 2007, Ultrapar (for itself), and acting as a commission agent of Braskem S.A. and Petróleo Brasileiro S.A. Petrobras, acquired for R\$2,113.1 from the controlling stockholders of Grupo Ipiranga 66.2% of common shares and 13.9% of preferred shares issued by Refinaria de Petróleo Ipiranga S.A. (RPI), 69.2% of common shares and 13.5% of preferred shares issued by Distribuidora de Produtos de Petróleo Ipiranga S.A. (DPPI), and 3.8% of common shares and 0.4% of preferred shares issued by Companhia Brasileira de Petróleo Ipiranga (CBPI). Of the total amount paid, Braskem and Petrobras paid R\$1,394.7 to Ultrapar under the terms of the commission established between the parties. Ultrapar will begin to consolidate this acquired business as from April 2007.

Under the terms of the agreement entered into among Ultrapar, Braskem and Petrobras, Ultrapar holds the control of the fuel distribution and lubricant businesses located in the South and Southeastern regions (South Distribution Business), Petrobras holds the control of fuel distribution and lubricant business located in the North, Northeast and Center-West regions (North Distribution Business), and Braskem holds control of the petrochemical assets, represented by Ipiranga Química S.A., Ipiranga Petroquímica S.A. (IPQ) and the ownership stake in Copesul Companhia Petroquímica do Sul (Petrochemical Business). The oil refining operations held by RPI are equally shared among Petrobras, Ultrapar and Braskem.

In the same agreement, the parties established that Ultrapar is responsible for executing a corporate restructuring of the acquired companies, with the objective of separating the assets attributed to each one of the acquirors, whose stages are:

- a) Tag Along Share Offering for the purchase of common shares issued by RPI, DPPI, CBPI and IPQ.
- b) Merger of shares issued by RPI, DPPI and CBPI into Ultrapar.
- c) Segregation of the assets through: (i) capital reduction of RPI and CBPI, in order to directly transfer the Petrochemical Business to Ultrapar, and subsequent transfer to Braskem and Petrobras, and (ii) split of CBPI to transfer the North Distribution Assets to a Petrobras subsidiary.

For this acquisition, Ultrapar issued, on April 11, 2007, debentures in the amount of R\$889.0, of which the first series was received on April 18, 2007, in the total amount of R\$675.0 with maturity on April 11, 2008 and semiannual interest payment of 102.5% of CDI, and the second series in the amount of R\$214.0 remains to be issued.

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On April 17, 2007 the CADE (Administrative Council for Economic Defense) issued a writ of prevention aiming to keep the reversibility of the asset acquisition by Braskem and Petrobras, as described in the press release of April 18, 2007. The determination with regard to the Petrochemical Business effectively were reviewed on April 25, 2007, in a decision homologated by CADE's Plenary assembly, with celebration, for Braskem, of a protection agreement for the operation reversibility (APRO). CADE recognized maintenance of the minority participation maintenance by Petrobras in Copesul after the acquisition. With regard to the fuel distribution, Petrobras and Ultrapar were requested to present to CADE an alternative model of corporate governance, which preserves the competition in the sector. Such measures do not affect the Offers conclusion.

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