CONTINENTAL RESOURCES INC
Form S-1/A
May 01, 2007

Table of Contents

Index to Financial Statements

As filed with the Securities and Exchange Commission on May 1, 2007

Registration No. 333-132257

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Amendment No. 7

to

FORM S-1

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

Continental Resources, Inc.

(Exact name of registrant as specified in charter)

Oklahoma	**1311**	**73-0767549**
(State or other jurisdiction of incorporation or organization)	**(Primary Standard Industrial Classification Code Number)**	**(I.R.S. Employer Identification Number)**

302 N. Independence

Enid, Oklahoma 73701

(580) 233-8955

(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

Mark E. Monroe

President and Chief Operating Officer

302 N. Independence

Enid, Oklahoma 73701

(580) 233-8955

(Address, including zip code, and telephone number, including area code, of agent for service)

With a copy to:

David P. Oelman	**Joseph A. Hall**
Vinson & Elkins L.L.P.	**Davis Polk & Wardwell**
1001 Fannin, Suite 2300	**450 Lexington Avenue**
Houston, Texas 77002-6760	**New York, New York 10017**
(713) 758-2222	**(212) 450-4000**

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

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

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

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

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

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

[Table of Contents](#)

[Index to Financial Statements](#)

The information in this prospectus is not complete and may be changed. These securities may not be sold until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities nor does it seek an offer to buy these securities in any state where the offer or sale is not permitted.

Subject to completion, dated May 1, 2007

PROSPECTUS

29,500,000 Shares

Continental Resources, Inc.

Common Stock

This is our initial public offering of common stock. We are offering 8,850,000 shares of our common stock. The selling shareholder identified in this prospectus is offering 20,650,000 shares of our common stock. We will not receive any proceeds from the sale of the shares by the selling shareholder. The estimated initial public offering price is between $16.00 and $18.00 per share.

Prior to this offering, there has been no public market for our common stock. Our common stock has been approved for listing on the New York Stock Exchange, subject to official notice of issuance, under the symbol CLR.

Investing in our common stock involves a high degree of risk. See Risk Factors beginning on page 11.

	Per share	Total

Initial public offering price	$	$
Underwriting discount	$	$
Proceeds to Continental Resources, Inc.(1)	$	$
Proceeds to selling shareholder(1)	$	$

(1) Expenses, other than underwriting discounts related to the shares sold by the selling shareholder, associated with the offering will be paid by us.

The selling shareholder has granted the underwriters an option for a period of 30 days to purchase up to 4,425,000 additional shares of common stock to cover overallotments, if any. If such option is exercised in full, the total underwriting discount will be $ and the total proceeds to the selling shareholder will be $.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

The underwriters expect to deliver the shares of common stock to investors on , 2007.

JPMorgan **Merrill Lynch & Co.**

Citi

UBS Investment Bank

Deutsche Bank Securities

Raymond James

, 2007

Table of Contents

Index to Financial Statements

Table of Contents

Index to Financial Statements

Table of Contents

Table of Contents

Index to Financial Statements

Cautionary Statement Regarding Forward-Looking Statements

This prospectus contains forward-looking statements that are subject to a number of risks and uncertainties, many of which are beyond our control. All statements, other than statements of historical fact included in this prospectus, regarding our strategy, future operations, financial position, estimated revenues and losses, projected costs, prospects, plans and objectives of management are forward-looking statements. When used in this prospectus, the words could, believe, anticipate, intend, estimate, expect, project and similar expressions are intended to id forward-looking statements, although not all forward-looking statements contain such identifying words.

Forward-looking statements may include statements about our:

- business strategy;
- reserves;
- technology;
- financial strategy;
- oil and natural gas realized prices;
- timing and amount of future production of oil and natural gas;
- the amount, nature and timing of capital expenditures;
- drilling of wells;
- competition and government regulations;
- marketing of oil and natural gas;
- exploitation or property acquisitions;
- costs of exploiting and developing our properties and conducting other operations;

general economic conditions;

uncertainty regarding our future operating results; and

plans, objectives, expectations and intentions contained in this prospectus that are not historical.

All forward-looking statements speak only as of the date of this prospectus. You should not place undue reliance on these forward-looking statements. Although we believe that our plans, intentions and expectations reflected in or suggested by the forward-looking statements we make in this prospectus are reasonable, we can give no assurance that these plans, intentions or expectations will be achieved. We disclose important factors that could cause our actual results to differ materially from our expectations under Risk Factors and Management s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this prospectus. These cautionary statements qualify all forward-looking statements attributable to us or persons acting on our behalf.

Table of Contents

Index to Financial Statements

Industry and Market Data

The market data and certain other statistical information used throughout this prospectus are based on independent industry publications, government publications or other published independent sources. Some data are also based on our good faith estimates. Although we believe these third-party sources are reliable, we have not independently verified the information and cannot guarantee its accuracy and completeness.

Table of Contents

Index to Financial Statements

Prospectus Summary

This summary highlights information contained elsewhere in this prospectus. You should read this entire prospectus carefully, including Risk Factors and our historical consolidated financial statements and the notes to those historical consolidated financial statements included elsewhere in this prospectus. Unless the context otherwise requires, references in this prospectus to Continental Resources, we, us, our, ours or company refer to Continental Resources, Inc. and its subsidiary.

We have provided definitions for the oil and natural gas terms used in this prospectus in the Glossary of Oil and Natural Gas Terms beginning on page A-1 of this prospectus. Unless otherwise indicated, the information contained in this prospectus assumes that the underwriters do not exercise their overallotment option to purchase additional shares.

Our Business

We are an independent oil and natural gas exploration and production company with operations in the Rocky Mountain, Mid-Continent and Gulf Coast regions of the United States. We focus our exploration activities in large new or developing plays that provide us the opportunity to acquire undeveloped acreage positions for future drilling operations. We have been successful in targeting large repeatable resource plays where horizontal drilling, advanced fracture stimulation and enhanced recovery technologies provide the means to economically develop and produce oil and natural gas reserves from unconventional formations. As a result of these efforts, we have grown substantially through the drillbit, adding 96.2 MMBoe of proved oil and natural gas reserves through extensions and discoveries from January 1, 2001 through December 31, 2006 compared to 5.1 MMBoe added through proved reserve purchases during that same period.

As of December 31, 2006, our estimated proved reserves were 118.3 MMBoe, with estimated proved developed reserves of 87.1 MMBoe, or 74% of our total estimated proved reserves. Crude oil comprised 83% of our total estimated proved reserves. At December 31, 2006, we had 1,772 scheduled drilling locations on the 1,775,000 gross (1,071,000 net) acres that we held. For the year ended December 31, 2006, we generated revenues of $483.7 million, and operating cash flows of $417.0 million. For the first quarter of 2007, daily production averaged approximately 28,000 Boe per day.

Table of Contents

Index to Financial Statements

The following table summarizes our total estimated proved reserves, PV-10 and net producing wells as of December 31, 2006, average daily production for the three months ended December 31, 2006 and the reserve-to-production ratio in our principal regions. Our reserve estimates as of December 31, 2006 are based primarily on a reserve report prepared by Ryder Scott Company, L.P., our independent reserve engineers. In preparing its report, Ryder Scott Company, L.P. evaluated properties representing approximately 83% of our PV-10. Our technical staff evaluated properties representing the remaining 17% of our PV-10.

	At December 31, 2006				Average daily production		
	Proved reserves (MBoe)	Percent of total	PV-10(1) (in millions)	Net producing wells	Fourth quarter 2006 (Boe per day)	Percent of total	Annualized reserve/ production index(2)
Rocky Mountain:							
Red River units	66,527	56%	$ 791	201	11,732	44%	15.5
Bakken field	25,623	22%	441	66	7,905	30%	8.9
Other	9,077	8%	104	233	1,717	7%	14.5
Mid-Continent	16,894	14%	244	672	4,280	16%	10.8
Gulf Coast	228		4	19	869	3%	0.7
Total	118,349	100%	$ 1,584	1,191	26,503	100%	12.2

(1) PV-10 is a non GAAP financial measure and generally differs from Standardized Measure, the most directly comparable GAAP financial measure, because it does not include the effects of income taxes on future net revenues. However, our PV-10 and our Standardized Measure are equivalent because we are a subchapter S-corporation. In connection with the closing of this offering, we will convert to a subchapter C-corporation. Our pro-forma Standardized Measure, assuming our conversion to a subchapter C-corporation, was $1.0 billion at December 31, 2006. Neither PV-10 nor Standardized Measure represents an estimate of the fair market value of our oil and gas properties. We and others in the industry use PV-10 as a measure to compare the relative size and value of proved reserves held by companies without regard to the specific tax characteristics of such entities.

(2) The Annualized Reserve/Production Index is the number of years proved reserves would last assuming current production continued at the same rate. This index is calculated by dividing annualized fourth quarter 2006 production into the proved reserve quantity at December 31, 2006.

The following table provides additional information regarding our key development areas:

	At December 31, 2006					2007 Budget	
	Developed acres		Undeveloped acres				
	Gross	Net	Gross	Net	Scheduled drilling locations(1)	Wells planned for drilling	Capital expenditures (in millions)
Rocky Mountain:							
Red River units	144,309	128,484			133	51	$ 151
Bakken field	81,761	60,176	581,846	342,321	804	58	145
Other	49,010	38,534	375,185	213,516	66	12	13
Mid-Continent	147,681	94,214	335,982	175,780	762	151	122

Gulf Coast	41,450	11,869	17,368	6,360	7	3	6
Total	464,211	333,277	1,310,381	737,977	1,772	275	$ 437

(1) Scheduled drilling locations represent total gross locations specifically identified and scheduled by management as an estimate of our future multi-year drilling activities on existing acreage. Of the total locations shown in the table, 249 are classified as PUDs. As of April 12, 2007, we have commenced drilling 116 locations shown in the table, including 67 PUD locations. Our actual drilling activities may change depending on oil and natural gas prices, the availability of capital, costs, drilling results, regulatory approvals and other factors. See Risk Factors Risks Relating to the Oil and Natural Gas Industry and Our Business.

Table of Contents

Index to Financial Statements

Our Business Strategy

Our goal is to increase shareholder value by finding and developing crude oil and natural gas reserves at costs that provide an attractive rate of return on our investment. The principal elements of our business strategy are:

Growth Through Drilling. Substantially all of our annual capital expenditures are invested in drilling projects and acreage and seismic acquisitions.

Internally Generate Prospects. Our technical staff has internally generated substantially all of the opportunities for the investment of our capital. Because we have been an early entrant in new or emerging plays, our costs to acquire undeveloped acreage have generally been less than those of later entrants into a developing play.

Focus on Unconventional Oil and Natural Gas Resource Plays. Our experience with horizontal drilling, advanced fracture stimulation and enhanced recovery technologies allows us to commercially develop unconventional oil and natural gas resource plays, such as the Red River B dolomite, Bakken Shale and Woodford Shale formations.

Acquire Significant Acreage Positions in New or Developing Plays. Our technical staff is focused on identifying and testing new unconventional oil and natural gas resource plays where significant reserves could be developed if commercial production rates can be achieved through advanced drilling, fracture stimulation and enhanced recovery techniques.

Our Business Strengths

We have a number of strengths that we believe will help us successfully execute our strategies:

Large Drilling and Acreage Inventory. Our large number of identified drilling locations in all of our areas of operations provide for a multi-year drilling inventory.

Horizontal Drilling and Enhanced Recovery Experience. In 1992, we drilled our initial horizontal well, and we have drilled over 350 horizontal wells since that time. We also have substantial experience with enhanced recovery methods and currently serve as the operator of 48 waterflood units and eight high-pressure air injection units.

Control Operations Over a Substantial Portion of our Assets and Investments. As of December 31, 2006, we operated properties comprising 95% of our PV-10. By controlling operations, we are able to more effectively manage the cost and timing of exploration and development of our properties.

Experienced Management Team. Our senior management team has extensive expertise in the oil and gas industry. Our seven senior officers have an average of 26 years of oil and gas industry experience.

Strong Financial Position. As of April 25, 2007, we had outstanding borrowings under our credit facility of approximately $252.5 million. We believe that our planned exploration and development activities will be funded substantially from our operating cash flows. After giving effect to this offering at an assumed public offering price of $17.00 per share and the application of the net proceeds we will receive in this offering, we expect to have borrowings of approximately $112.9 million outstanding under our credit facility.

Table of Contents

Index to Financial Statements

Recent Events

Cash Dividends. On January 10, 2007, we declared a cash dividend of approximately $18.8 million to our shareholders and, subject to forefeiture, to holders of unvested restricted stock. On January 31, 2007, we paid $18.7 million of the dividend declared, of which $16.9 million was paid to our principal shareholder. On March 6, 2007, we declared a cash dividend of approximately $33.3 million to our shareholders and, subject to forfeiture, to holders of unvested restricted stock. On April 12, 2007, we paid $33.1 million of the dividend declared, of which $30.0 million was paid to our principal shareholder. We are currently a subchapter S-corporation under the rules and regulations of the Internal Revenue Service. As a result, income taxes attributable to our federal and state income are payable by our shareholders. The dividends have been paid to shareholders to fund their taxes due and estimated tax payments. In connection with the completion of this offering, we will convert from a subchapter S-corporation to a subchapter C-corporation, and we do not anticipate paying any additional cash dividends on our common stock in the foreseeable future. The selling shareholder has received dividends of approximately $13.5 million, $1.8 million, $79.0 million and $46.9 million in 2004, 2005, 2006 and 2007, respectively. The total net proceeds to the selling shareholder in this offering will be approximately $330.0 million, or approximately $400.7 million if the underwriters exercise their overallotment option in full, in each case assuming an initial public offering price of $17.00 per share, which is the midpoint of the range set forth on the cover of this prospectus.

Risk Factors

Investing in our common stock involves risks that include the speculative nature of oil and natural gas exploration, competition, volatile oil and natural gas prices and other material factors. You should read carefully the section entitled Risk Factors beginning on page 11 for an explanation of these risks before investing in our common stock. In particular, the following considerations may offset our business strengths or have a negative effect on our business strategy as well as on activities on our properties, which could cause a decrease in the price of our common stock and result in a loss of all or a portion of your investment:

- A substantial or extended decline in oil and natural gas prices may adversely affect our business, financial condition or results of operations and our ability to meet our capital expenditure obligations and financial commitments.

- Drilling for and producing oil and natural gas are high risk activities with many uncertainties that could adversely affect our business, financial condition or results of operations.

- Reserve estimates depend on many assumptions that may turn out to be inaccurate. Any material inaccuracies in these reserve estimates or underlying assumptions will materially affect the quantities and present value of our reserves.

- Our use of enhanced recovery methods creates uncertainties that could adversely affect our results of operations and financial condition.

- Our development and exploitation projects require substantial capital expenditures. We may be unable to obtain needed capital or financing on satisfactory terms, which could lead to a decline in our oil and natural gas reserves.

- If oil and natural gas prices decrease, we may be required to take write-downs of the carrying values of our oil and natural gas properties.

4

Table of Contents

Index to Financial Statements

Unless we replace our oil and natural gas reserves, our reserves and production will decline, which would adversely affect our cash flows and results of operations.

The unavailability or high cost of additional drilling rigs, equipment, supplies, personnel and oilfield services could adversely affect our ability to execute our exploration and development plans within our budget and on a timely basis.

We may incur substantial losses and be subject to substantial liability claims as a result of our oil and natural gas operations; we may not be insured for, or our insurance may be inadequate to protect us against, these risks.

Prospects that we decide to drill may not yield oil or natural gas in commercially viable quantities.

Our identified drilling locations are scheduled out over several years, making them susceptible to uncertainties that could materially alter the occurrence or timing of their drilling.

Following this offering, our Chairman and Chief Executive Officer will own approximately 73.2% of our outstanding common stock, giving him influence and control in corporate transactions and other matters.

For a discussion of other considerations that could negatively affect us, including risks related to this offering and our common stock, see Risk Factors and Cautionary Statement Regarding Forward-Looking Statements.

Corporate History and Information

Continental Resources, Inc. is incorporated under the laws of the State of Oklahoma. We were originally formed in 1967 to explore, develop and produce oil and natural gas properties in Oklahoma. Through 1993, our activities and growth remained focused primarily in Oklahoma. In 1993, we expanded our activity into the Rocky Mountain and Gulf Coast regions. Through drilling success and strategic acquisitions, approximately 86% of our estimated proved reserves as of December 31, 2006 are located in the Rocky Mountain region.

We are currently a subchapter S-corporation under the rules and regulations of the Internal Revenue Service. However, upon the consummation of this offering, we will have more shareholders than the IRS rules and regulations governing S-corporations allow, and, therefore, we will convert automatically from a subchapter S-corporation to a subchapter C-corporation. In connection with this conversion, we will record a charge to earnings (estimated to be approximately $178.8 million as if the conversion occurred on December 31, 2006) to recognize deferred taxes.

In addition, concurrent with the closing of this offering, we will effect an 11 for 1 stock split of our shares in the form of a stock dividend.

Our principal executive offices are located at 302 N. Independence, Enid, Oklahoma 73701, and our telephone number at that address is (580) 233-8955.

5

Table of Contents

Index to Financial Statements

The Offering

Common Stock Offered:

By Continental Resources, Inc.: 8,850,000 shares

By the selling shareholder: 20,650,000 shares

Overallotment option granted by the selling shareholder: 4,425,000 shares

Common stock to be owned by the selling shareholder after the offering: 122,980,608 shares (or 118,555,608 shares if the underwriters overallotment option is exercised in full)

Common stock to be outstanding after the offering: 168,005,799 shares

Use of Proceeds:

We expect to receive approximately $139.6 million of net proceeds from the sale of the common stock offered by us, based upon the assumed initial public offering price of $17.00 per share (the midpoint of the price range set forth on the cover page of this prospectus), after deducting underwriting discounts and estimated offering expenses. Each $1.00 increase (decrease) in the public offering price would increase (decrease) our net proceeds by approximately $8.3 million. We intend to use all of the net proceeds we receive from this offering to repay a portion of borrowings outstanding under our credit facility. We will not receive any proceeds from the sale of the shares of common stock by the selling shareholder. See Use of Proceeds.

Dividend Policy:

We do not anticipate paying any cash dividends on our common stock. See Dividend Policy.

New York Stock Exchange Symbol:

CLR

Other Information About This Prospectus:

Unless specifically stated otherwise, the information in this prospectus:

- is adjusted to reflect an 11 for 1 stock split of our shares of common stock to be effected in the form of a stock dividend concurrent with the consummation of this offering;
- assumes no exercise of the underwriters overallotment option to purchase additional shares; and
- assumes an initial public offering price of $17.00, which is the midpoint of the range set forth on the front cover of this prospectus.

Table of Contents

Index to Financial Statements

Summary Historical and Pro Forma Consolidated Financial Data

This section presents our summary historical and pro forma consolidated financial data. The summary historical consolidated financial data presented below is not intended to replace our historical consolidated financial statements.

The following historical consolidated financial data, as it relates to each of the fiscal years ended December 31, 2004 through 2006, has been derived from our audited historical consolidated financial statements for such periods. You should read the following summary historical consolidated financial data in connection with Capitalization, Management s Discussion and Analysis of Financial Condition and Results of Operations and our historical consolidated financial statements and related notes included elsewhere in this prospectus. The summary historical consolidated results are not necessarily indicative of results to be expected in future periods.

The summary pro forma financial data reflect the tax effects of our conversion, concurrent with the closing of this offering, from a subchapter S-corporation to a subchapter C-corporation and the earnings per share impact of our 11 for 1 stock split to be effected in the form of a stock dividend concurrent with the closing of this offering. The pro forma earnings per share adjustments for 2006 also give effect to the number of shares to be issued in this offering whose net proceeds would be sufficient to pay the $52.1 million of cash dividends declared in 2007.

	Year ended December 31,		
	2004	**2005**	**2006**
	(in thousands, except per share amounts)		
Statement of operations data:			
Revenues:			
Oil and natural gas sales	$ 181,435	$ 361,833	$ 468,602
Crude oil marketing and trading(1)	226,664		
Oil and natural gas service operations	10,811	13,931	15,050
Total revenues	418,910	375,764	483,652
Operating costs and expenses:			
Production expense	43,754	52,754	62,865
Production tax	12,297	16,031	22,331
Exploration expense	12,633	5,231	19,738
Crude oil marketing and trading(1)	227,210		
Oil and gas service operations	6,466	7,977	8,231
Depreciation, depletion, amortization and accretion	38,627	49,802	65,428
Property impairments	11,747	6,930	11,751
General and administrative(2)	12,400	31,266	23,016
(Gain) loss on sale of assets	150	(3,026)	(290)
Total operating costs and expenses	$ 365,284	$ 166,965	$ 213,070
Income from operations	$ 53,626	$ 208,799	$ 270,582
Other income (expense)			

Interest expense	(23,617)	(14,220)	(11,310)
Loss on redemption of bonds	(4,083)		
Other	890	867	1,742
Total other income (expense)	(26,810)	(13,353)	(9,568)

Table of Contents

Index to Financial Statements

	Year ended December 31,		
	2004	2005	2006
	(in thousands, except per share amounts)		
Income from continuing operations before income taxes	26,816	195,446	261,014
Provision (benefit) for income taxes(3)		1,139	(132)
Income from continuing operations	26,816	194,307	261,146
Discontinued operations(4)	1,680		
Loss on sale of discontinued operations(4)	(632)		
Net income	$ 27,864	$ 194,307	$ 261,146
Basic earnings per share:			
From continuing operations	$ 1.87	$ 13.52	$ 18.17
From discontinued operations(4)	0.11		
Loss on sale of discontinued operations(4)	(0.04)		
Net income per share	$ 1.94	$ 13.52	$ 18.17
Shares used in basic earnings per share	14,369	14,369	14,374
Diluted earnings per share:			
From continuing operations	$ 1.85	$ 13.42	$ 17.99
From discontinued operations(4)	0.12		
Loss on sale of discontinued operations(4)	(0.04)		
Net income per share	$ 1.93	$ 13.42	$ 17.99
Shares used in diluted earnings per share	14,476	14,482	14,515
Pro forma C-corporation and stock split data:			
Income from continuing operations before income taxes	$ 26,816	$ 195,446	$ 261,014
Pro forma provision for income taxes attributable to operations	10,190	74,269	99,185
Pro forma income from operations after tax	16,626	121,177	161,829
Discontinued operations, net of tax(4)	1,042		
Loss on sale of discontinued operations, net of tax(4)	(392)		
Pro forma net income	$ 17,276	$ 121,177	$ 161,829
Pro forma basic earnings per share	$ 0.11	$ 0.77	$ 1.00
Pro forma diluted earnings per share	0.11	0.76	0.99
Other financial data:			
Cash dividends per share	$ 1.04	$ 0.14	$ 6.06
EBITDAX (5)	116,498	285,344	372,115
Net cash provided by operations	93,854	265,265	417,041
Net cash used in investing	(72,992)	(133,716)	(324,523)
Net cash used in financing	(7,245)	(141,467)	(91,451)

Capital expenditures	94,307	144,800	326,579
Balance sheet data at December 31:			
Cash and cash equivalents	$ 15,894	$ 6,014	$ 7,018
Property and equipment, net	434,339	509,393	751,747
Total assets	504,951	600,234	858,929
Long-term debt, including current maturities	290,522	143,000	140,000
Shareholders equity	130,385	324,730	498,519

Table of Contents

Index to Financial Statements

(1) Crude oil marketing and trading captions consist of our marketing activities under which crude oil production was sold at the wellhead and transported to a local hub where we purchased the barrels back to exchange at Cushing, Oklahoma in order to minimize pricing differentials with the NYMEX oil futures contract. We adopted Emerging Issues Task Force (EITF) 04-13 on January 1, 2005, which allowed certain purchase and sales transactions with the same counterparty to be combined and accounted for as a single transaction under the guidance of Accounting Principles Board Opinion No. 29. In 2005, we netted $39.8 million of crude oil marketing and trading revenues and $39.7 million of crude oil marketing and trading expenses under oil and natural gas sales. Prior to the adoption of EITF 04-13, we presented crude oil marketing and trading revenues and expenses gross under the guidance provided by EITF 99-19, Reporting Revenues Gross as a Principal and/or Net as an Agent. Effective March 2005, we ceased marketing our crude oil production under these arrangements. Thereafter, we have sold our crude oil at the wellhead. Certain of these sales have been to our affiliates, as described under Certain Relationships and Related Party Transactions.

(2) We have included stock-based compensation of $2.0 million, $13.7 million and $2.9 million in general and administrative expenses for the years ended December 31, 2004, 2005 and 2006, respectively. Our stock based compensation plans require us to purchase vested shares of restricted stock and shares issued upon the exercise of stock options at the plan participant s request based on an internally calculated value of our stock. In addition, we have the right to purchase vested shares of restricted stock and shares issued upon the exercise of stock options at the same price from plan participants upon termination of the participant s employment with us for any reason for a period of two years after the termination date. Amounts noted herein represent the increase in our liability associated with our purchase obligation. The valuation is based on the book value of our shareholders equity adjusted for our PV-10 as of each calendar quarter. Our requirement and right, as applicable, to purchase vested shares will be eliminated once we begin reporting under Section 12 of the Securities Exchange Act of 1934, as amended (the Exchange Act). As a result of this change, our stock grants will then be considered equity grants and not liability grants. Accordingly, due to this modification of our plan, we will recognize a non-cash charge to earnings upon completion of this offering to adjust historical compensation expense to an amount that reflects the value based upon our initial public offering price. As of December 31, 2006, the non-cash charge to earnings would have been approximately $19.2 million, consisting of $3.7 million associated with restricted stock and $15.5 million associated with stock options, assuming an initial offering price of $17.00 per share. See Capitalization.

(3) Properties owned by us at May 31, 1997, the date we converted into a subchapter S-corporation from a subchapter C-corporation, may be subject to federal taxation if sold for an amount in excess of the then tax basis for the sold assets. During 2005, we incurred federal taxes due to the sale of assets acquired prior to May 31, 1997. The benefit recorded during 2006 reflects a change in estimate of the original provision recorded for federal taxes incurred.

(4) In July 2004, we sold all of the outstanding stock in Continental Gas, Inc., a wholly owned subsidiary, to our shareholders. The Continental Gas, Inc. assets included seven gas gathering systems and three gas-processing plants. These assets represented our entire gas gathering, marketing and processing segment. We have accounted for these operations as discontinued operations.

(5) EBITDAX represents earnings before interest expense, income taxes (when applicable), depreciation, depletion, amortization and accretion, property impairments, exploration expense and non-cash compensation expense. EBITDAX is not a measure of net income or cash flow as determined by generally accepted accounting principles (GAAP). EBITDAX should not be considered as an alternative to, or more meaningful than, net income or cash flow as determined in accordance with GAAP or as an indicator of a company s operating performance or liquidity. Certain items excluded from EBITDAX are significant components in understanding and assessing a company s financial performance, such as a company s cost of capital and tax structure, as well as the historic costs of depreciable assets, none of which are components of EBITDAX. Our computations of EBITDAX may not be comparable to other similarly titled measures of other companies. We believe that EBITDAX is a widely followed measure of operating performance and may also be used by investors to measure our ability to meet future debt service requirements, if any. Our credit facility requires that we maintain a total debt to EBITDAX ratio of no greater than 3.75 to 1 on a rolling four-quarter basis. Our credit facility defines EBITDAX consistently with the definition of EBITDAX utilized and presented by us. At December 31, 2005 and 2006, this ratio was approximately 0.5 to 1 and 0.4 to 1, respectively. The following table represents a reconciliation of our net income to EBITDAX:

	Year ended December 31,		
	2004	**2005**	**2006**
	(in thousands)		
Net income	$ 27,864	$ 194,307	$ 261,146
Interest expense	23,617	14,220	11,310
Provision (benefit) for income taxes		1,139	(132)
Depreciation, depletion, amortization and accretion	38,627	49,802	65,428
Property impairments	11,747	6,930	11,751
Exploration expense	12,633	5,231	19,738
Equity compensation	2,010	13,715	2,874

EBITDAX	$ 116,498	$ 285,344	$ 372,115

Table of Contents

Index to Financial Statements

Summary Reserve, Production and Operating Data

The following table presents summary data with respect to our estimated net proved oil and natural gas reserves as of the dates indicated. Our reserve estimates as of December 31, 2004, 2005 and 2006 are based primarily on reserve reports prepared by Ryder Scott Company, L.P., our independent reserve engineers. In preparing its reports, Ryder Scott Company, L.P. evaluated properties representing approximately 83% of our PV-10 as of the end of each period. Our technical staff evaluated our remaining properties. A copy of Ryder Scott Company, L.P. s summary report as of December 31, 2006 is included in this prospectus beginning on page B-1. All calculations of estimated net proved reserves have been made in accordance with the rules and regulations of the Securities and Exchange Commission, or the SEC. For additional information regarding our reserves, see Business and Properties Proved Reserves.

	As of December 31,		
	2004	**2005**	**2006**
Proved reserves:			
Oil (MBbls)	80,602	98,645	98,038
Natural gas (MMcf)	60,620	108,118	121,865
Oil equivalents (MBoe)	90,705	116,665	118,349
Proved developed reserves percentage	83%	69%	74%
PV-10 (in millions)(1)	$ 1,114	$ 2,204	$ 1,584
Estimated reserve life (in years)	17.6	16.2	13.1
Costs incurred (in thousands):			
Property acquisition costs	$ 12,456	$ 16,763	$ 36,534
Exploration costs	30,867	9,289	68,686
Development costs	53,036	117,837	221,286
Total	$ 96,359	$ 143,889	$ 326,506

(1) PV-10 is a non GAAP financial measure and generally differs from Standardized Measure, the most directly comparable GAAP financial measure, because it does not include the effects of income taxes on future net revenues. However, our PV-10 and our Standardized Measure are equivalent because we are a subchapter S-corporation. In connection with the closing of this offering, we will convert to a subchapter C-corporation. Our pro-forma Standardized Measure, assuming our conversion to a subchapter C-corporation, was $1.0 billion at December 31, 2006. Neither PV-10 nor Standardized Measure represents an estimate of the fair market value of our oil and gas properties. We and others in the industry use PV-10 as a measure to compare the relative size and value of proved reserves held by companies without regard to the specific tax characteristics of such entities.

The following table sets forth summary data with respect to our production results, average sales prices and production costs on a historical basis for the periods presented:

	Year ended December 31,		
	2004	**2005**	**2006**
Net production volumes:			
Oil (MBbls)(1)	3,688	5,708	7,480

Natural gas (MMcf)	8,794	9,006	9,225
Oil equivalents (MBoe)	5,154	7,209	9,018
Average prices(1):			
Oil, without hedges ($/Bbl)	$ 38.85	$ 52.45	$ 55.30
Oil, with hedges ($/Bbl)	37.12	52.45	55.30
Natural gas ($/Mcf)	5.06	6.93	6.08
Oil equivalents, without hedges ($/Boe)	36.45	50.19	52.09
Oil equivalents, with hedges ($/Boe)	35.20	50.19	52.09
Costs and expenses(1):			
Production expense ($/Boe)	$ 8.49	$ 7.32	$ 6.99
Production tax ($/Boe)	2.39	2.22	2.48
General and administrative ($/Boe)	2.41	4.34	2.56
DD&A expense ($/Boe)(2)	7.02	6.50	6.91

(1) Oil sales volumes are 21 MBbls less than oil production volumes for the year ended December 31, 2006. Average prices and per unit costs have been calculated using sales volumes.

(2) Rate is determined based on DD&A expense derived from oil and natural gas assets.

Table of Contents

Index to Financial Statements

Risk Factors

You should carefully consider each of the risks described below, together with all of the other information contained in this prospectus, before deciding to invest in shares of our common stock. If any of the following risks develop into actual events, our business, financial condition or results of operations could be materially adversely affected, the trading price of your shares could decline and you may lose all or part of your investment.

Risks Relating to the Oil and Natural Gas Industry and Our Business

A substantial or extended decline in oil and natural gas prices may adversely affect our business, financial condition or results of operations and our ability to meet our capital expenditure obligations and financial commitments.

The price we receive for our oil and natural gas production heavily influences our revenue, profitability, access to capital and future rate of growth. Oil and natural gas are commodities and, therefore, their prices are subject to wide fluctuations in response to relatively minor changes in supply and demand. Historically, the markets for oil and natural gas have been volatile. These markets will likely continue to be volatile in the future. The prices we receive for our production, and the levels of our production, depend on numerous factors beyond our control. These factors include the following:

- changes in global supply and demand for oil and natural gas;
- the actions of the Organization of Petroleum Exporting Countries, or OPEC;
- the price and quantity of imports of foreign oil and natural gas;
- political conditions in or affecting other oil-producing and natural gas-producing countries, including the current conflicts in the Middle East and conditions in South America and Russia;
- the level of global oil and natural gas exploration and production;
- the level of global oil and natural gas inventories;
- localized supply and demand fundamentals and transportation availability;
- weather conditions;

technological advances affecting energy consumption; and

the price and availability of alternative fuels.

Lower oil and natural gas prices will reduce our cash flows and borrowing ability. See Our development and exploitation projects require substantial capital expenditures. We may be unable to obtain needed capital or financing on satisfactory terms, which could lead to a decline in our oil and natural gas reserves. Lower oil and natural gas prices may also reduce the amount of oil and natural gas that we can produce economically. Substantial decreases in oil and natural gas prices would render uneconomic a significant portion of our exploitation projects. This may result in our having to make significant downward adjustments to our estimated proved reserves. As a result, a substantial or extended decline in oil or natural gas prices may materially and adversely affect our future business, financial condition, results of operations, liquidity or ability to finance planned capital expenditures.

In addition, because our producing properties are geographically concentrated in the Rocky Mountain region, we are vulnerable to fluctuations in pricing in that area. In particular, 81% of our production during the fourth quarter of 2006 was from the Rocky Mountain region. As a result of this concentration, we may be disproportionately exposed to the impact of regional supply and demand factors, transportation capacity

Table of Contents

Index to Financial Statements

constraints, curtailment of production or interruption of transportation of oil produced from the wells in these areas. Such factors can cause significant fluctuation in our realized oil and natural gas prices. For example, the company-wide difference between the average NYMEX oil price and our average realized oil price for the year ended December 31, 2005 was $5.24 per Bbl, whereas the company-wide difference between the NYMEX oil price and our realized oil price for the year ended December 31, 2006 was $11.04 per Bbl. The increase in the difference was caused by higher oil imports and production in the Rocky Mountain region, lower demand by local Rocky Mountain refineries due to downtime for maintenance and reduced seasonal demand for gasoline and downstream transportation capacity constraints. We are unable to predict when, or if, the difference will revert back to pre-2006 levels. If such significant price differentials continue, our future business, financial condition and results of operations may be materially adversely affected.

Drilling for and producing oil and natural gas are high risk activities with many uncertainties that could adversely affect our business, financial condition or results of operations.

Our future financial condition and results of operations will depend on the success of our exploitation, exploration, development and production activities. Our oil and natural gas exploration and production activities are subject to numerous risks beyond our control, including the risk that drilling will not result in commercially viable oil or natural gas production. We expect to invest approximately 45% of our exploration and development capital during 2007 in two relatively new unconventional projects, the Bakken Shale in western North Dakota and the Woodford Shale in eastern Oklahoma. Due to limited production history from the relatively few number of wells drilled in these projects, we are unable to predict with certainty the quantity of future production from wells to be drilled in those projects. Our decisions to purchase, explore, develop or otherwise exploit prospects or properties will depend in part on the evaluation of data obtained through geophysical and geological analyses, production data and engineering studies, the results of which are often inconclusive or subject to varying interpretations. For a discussion of the uncertainty involved in these processes, see Reserve estimates depend on many assumptions that may turn out to be inaccurate. Any material inaccuracies in these reserve estimates or underlying assumptions will materially affect the quantities and present value of our reserves. Our cost of drilling, completing and operating wells is often uncertain before drilling commences. For example, our exploration expenses increased more significantly than we had expected in 2006 to $19.7 million, primarily due to increased dry hole expenses in each of the Rocky Mountain, Mid-Continent and Gulf Coast regions as a result of a higher level of drilling in 2006. In addition, impairment provisions for our developed oil and natural gas properties increased to $6.3 million for the year ended December 31, 2006 as a result of developmental well dry holes and properties where the associated field level reserves were not sufficient to recover capitalized drilling and completion costs. Overruns in budgeted expenditures are common risks that can make a particular project uneconomical.

Further, many factors may curtail, delay or cancel our scheduled drilling projects, including the following:

- delays imposed by or resulting from compliance with regulatory requirements;
- pressure or irregularities in geological formations;
- shortages of or delays in obtaining equipment and qualified personnel;
- equipment failures or accidents;
- adverse weather conditions, such as hurricanes and tropical storms;

reductions in oil and natural gas prices;

title problems; and

limitations in the market for oil and natural gas.

Table of Contents

Index to Financial Statements

Reserve estimates depend on many assumptions that may turn out to be inaccurate. Any material inaccuracies in these reserve estimates or underlying assumptions will materially affect the quantities and present value of our reserves.

We estimate that our proved reserves as of December 31, 2006 were 118.3 MMBoe with a PV-10 of approximately $1,584 million. The process of estimating oil and natural gas reserves is complex. It requires interpretations of available technical data and many assumptions, including assumptions relating to economic factors. Any significant inaccuracies in these interpretations or assumptions could materially affect our estimated quantities and present value of our reserves. See Business and Properties Proved Reserves for information about our estimated oil and natural gas reserves and the PV-10 and standardized measure of discounted future net cash flows as of December 31, 2006.

In order to prepare our estimates, we must project production rates and timing of development expenditures. We must also analyze available geological, geophysical, production and engineering data. The extent, quality and reliability of this data can vary. The process also requires economic assumptions about matters such as oil and natural gas prices, drilling and operating expenses, capital expenditures, taxes and availability of funds.

Actual future production, oil and natural gas prices, revenues, taxes, development expenditures, operating expenses and quantities of recoverable oil and natural gas reserves most likely will vary from our estimates. Any significant variance could materially affect the estimated quantities and present value of our reserves. In addition, we may adjust estimates of proved reserves to reflect production history, results of exploration and development, prevailing oil and natural gas prices and other factors, many of which are beyond our control.

For example, our initial well in the Bakken Field was completed in August 2003. As of December 31, 2006, we had 16.4 MMBoe of proved producing reserves assigned to 121 producing wells and 9.2 MMBoe of proved undeveloped reserves assigned to 48 undrilled locations. The Bakken Field contained 22% of our total proved reserves and 30% of our total proved undeveloped reserves as of December 31, 2006. Due to the limited production history of our wells in the Bakken Field, the estimates of future production associated with such properties may be subject to greater variance to actual production than would be the case with properties having a longer production history.

You should not assume that the present value of future net revenues from our proved reserves is the current market value of our estimated oil and natural gas reserves. In accordance with SEC requirements, we generally base the estimated discounted future net cash flows from our proved reserves on prices and costs on the date of the estimate. Actual future prices and costs may differ materially from those used in the present value estimate. If oil prices decline by $1.00 per Bbl, then our PV-10 as of December 31, 2006 would decrease from $1,584 million to $1,536 million. If natural gas prices decline by $0.10 per Mcf, then our PV-10 as of December 31, 2006 would decrease from $1,584 million to $1,582 million.

Our use of enhanced recovery methods creates uncertainties that could adversely affect our results of operations and financial condition.

One of our business strategies is to commercially develop unconventional oil and natural gas resource plays using enhanced recovery technologies. For example, we inject water and high-pressure air into formations on some of our properties to increase the production of oil and natural gas. The additional production and reserves attributable to the use of these enhanced recovery methods are inherently difficult to predict. If our enhanced recovery programs do not allow for the extraction of oil and natural gas in the manner or to the extent that we anticipate, our future results of operations and financial condition could be materially adversely affected.

Table of Contents

Index to Financial Statements

Our development and exploitation projects require substantial capital expenditures. We may be unable to obtain needed capital or financing on satisfactory terms, which could lead to a decline in our oil and natural gas reserves.

The oil and natural gas industry is capital intensive. We make and expect to continue to make substantial capital expenditures in our business for the development, exploitation, production and acquisition of oil and natural gas reserves. We invested approximately $326.6 million for capital and exploration expenditures in 2006. Our budgeted capital expenditures for 2007 are expected to increase approximately 34% over the $326.6 million invested during 2006. To date, these capital expenditures have been financed with cash generated by operations and through borrowings from banks and from our principal shareholder. The actual amount and timing of our future capital expenditures may differ materially from our estimates as a result of, among other things, actual drilling results, the availability of drilling rigs and other services and equipment, and regulatory, technological and competitive developments. We intend to finance our future capital expenditures primarily through cash flow from operations and through borrowings under our revolving credit facility; however, our financing needs may require us to alter or increase our capitalization substantially through the issuance of debt or equity securities. The issuance of additional debt will require that a portion of our cash flow from operations be used for the payment of interest and principal on our debt, thereby reducing our ability to use cash flow to fund working capital, capital expenditures and acquisitions. The issuance of additional equity securities could have a dilutive effect on the value of your common stock.

Our cash flow from operations and access to capital are subject to a number of variables, including:

- our proved reserves;
- the level of oil and natural gas we are able to produce from existing wells;
- the prices at which our oil and natural gas are sold; and
- our ability to acquire, locate and produce new reserves.

If our revenues or the borrowing base under our credit facility decrease as a result of lower oil or natural gas prices, operating difficulties, declines in reserves or for any other reason, we may have limited ability to obtain the capital necessary to sustain our operations at current levels. If additional capital is needed, we may not be able to obtain debt or equity financing. If cash generated by operations or cash available under our revolving credit facility is not sufficient to meet our capital requirements, the failure to obtain additional financing could result in a curtailment of our operations relating to development of our prospects, which in turn could lead to a decline in our oil and natural gas reserves, and could adversely affect our business, financial condition and results of operations.

If oil and natural gas prices decrease, we may be required to take write-downs of the carrying values of our oil and natural gas properties.

Accounting rules require that we review periodically the carrying value of our oil and natural gas properties for possible impairment. Based on specific market factors and circumstances at the time of prospective impairment reviews, and the continuing evaluation of development plans, production data, economics and other factors, we may be required to write down the carrying value of our oil and natural gas properties. A write-down constitutes a non-cash charge to earnings. We may incur impairment charges in the future, which could have a material adverse effect on our results of operations for the periods in which such charges are taken.

Unless we replace our oil and natural gas reserves, our reserves and production will decline, which would adversely affect our cash flows and results of operations.

Unless we conduct successful development, exploitation and exploration activities or acquire properties containing proved reserves, our proved reserves will decline as those reserves are produced. Producing oil and

Table of Contents

Index to Financial Statements

natural gas reservoirs generally are characterized by declining production rates that vary depending upon reservoir characteristics and other factors. Our future oil and natural gas reserves and production, and therefore our cash flow and results of operations, are highly dependent on our success in efficiently developing and exploiting our current reserves and economically finding or acquiring additional recoverable reserves. We may not be able to develop, exploit, find or acquire sufficient additional reserves to replace our current and future production. If we are unable to replace our current and future production, the value of our reserves will decrease, and our business, financial condition and results of operations would be adversely affected.

The unavailability or high cost of additional drilling rigs, equipment, supplies, personnel and oilfield services could adversely affect our ability to execute our exploration and development plans within our budget and on a timely basis.

Shortages or the high cost of drilling rigs, equipment, supplies, personnel or oilfield services could delay or cause us to incur significant expenditures that are not provided for in our capital budget, which could have a material adverse effect on our business, financial condition or results of operations.

We may incur substantial losses and be subject to substantial liability claims as a result of our oil and natural gas operations; we may not be insured for, or our insurance may be inadequate to protect us against, these risks.

We are not insured against all risks. Losses and liabilities arising from uninsured and underinsured events could materially and adversely affect our business, financial condition or results of operations. Our oil and natural gas exploration and production activities are subject to all of the operating risks associated with drilling for and producing oil and natural gas, including the possibility of:

- environmental hazards, such as uncontrollable flows of oil, natural gas, brine, well fluids, toxic gas or other pollution into the environment, including groundwater and shoreline contamination;
- abnormally pressured formations;
- mechanical difficulties, such as stuck oilfield drilling and service tools and casing collapse;
- fires, explosions and ruptures of pipelines in connection with our high-pressure air injection operations;
- personal injuries and death; and
- natural disasters.

Any of these risks could adversely affect our ability to conduct operations or result in substantial losses to our company as a result of:

injury or loss of life;

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

pollution and other environmental damage;

regulatory investigations and penalties;

suspension of our operations; and

repair and remediation costs.

Table of Contents

Index to Financial Statements

We may elect not to obtain insurance if we believe that the cost of available insurance is excessive relative to the risks presented. In addition, pollution and environmental risks generally are not fully insurable. The occurrence of an event that is not fully covered by insurance could have a material adverse effect on our business, financial condition and results of operations.

Prospects that we decide to drill may not yield oil or natural gas in commercially viable quantities.

Prospects that we decide to drill that do not yield oil or natural gas in commercially viable quantities will adversely affect our result of operations and financial condition. In this prospectus, we describe some of our current prospects and our plans to explore those prospects. Our prospects are in various stages of evaluation, ranging from a prospect which is ready to drill to a prospect that will require substantial additional seismic data processing and interpretation. There is no way to predict in advance of drilling and testing whether any particular prospect will yield oil or natural gas in sufficient quantities to recover drilling or completion costs or to be economically viable. The use of seismic data and other technologies and the study of producing fields in the same area will not enable us to know conclusively prior to drilling whether oil or natural gas will be present or, if present, whether oil or natural gas will be present in commercial quantities. We cannot assure you that the analogies we draw from available data from other wells, more fully explored prospects or producing fields will be applicable to our drilling prospects.

Our identified drilling locations are scheduled out over several years, making them susceptible to uncertainties that could materially alter the occurrence or timing of their drilling.

Our management has specifically identified and scheduled drilling locations as an estimation of our future multi-year drilling activities on our existing acreage. As of December 31, 2006, we had identified and scheduled 1,772 gross drilling locations. These scheduled drilling locations represent a significant part of our growth strategy. Our ability to drill and develop these locations depends on a number of uncertainties, including oil and natural gas prices, the availability of capital, costs, drilling results, regulatory approvals and other factors. The North Dakota Bakken Shale and Woodford Shale projects comprise 1,417 gross drilling locations. Due to limited production history on the relatively few number of wells drilled in these projects, we are unable to predict with certainty the quantity of future production from wells to be drilled in these projects. If future drilling results in these projects do not establish sufficient reserves to achieve an economic return, we may curtail drilling in these projects. Because of these uncertainties, we do not know if the numerous potential drilling locations we have identified will ever be drilled or if we will be able to produce oil or natural gas from these or any other potential drilling locations. In addition, unless production is established within the spacing units covering the undeveloped acres on which some of the locations are identified, the leases for such acreage will expire. As of December 31, 2006, we had 134,088, 174,169 and 178,399 net acres expiring in 2007, 2008 and 2009, respectively. As such, our actual drilling activities may materially differ from those presently identified, which could adversely affect our business.

Market conditions or operational impediments may hinder our access to oil and natural gas markets or delay our production.

Market conditions or the unavailability of satisfactory oil and natural gas transportation arrangements may hinder our access to oil and natural gas markets or delay our production. The availability of a ready market for our oil and natural gas production depends on a number of factors, including the demand for and supply of oil and natural gas and the proximity of reserves to pipelines and terminal facilities. Our ability to market our production depends in substantial part on the availability and capacity of gathering systems, pipelines and processing facilities owned and operated by third parties. Our failure to obtain such services on acceptable terms could materially harm our business. We may be required to shut in wells due to lack of a market or inadequacy or unavailability of crude oil or natural gas pipeline or gathering system capacity. If that were to occur, then we would be unable to realize revenue from those wells until production arrangements were made to deliver to market.

16

Table of Contents

Index to Financial Statements

We have been an early entrant into new or emerging plays; as a result, our drilling results in these areas are uncertain, and the value of our undeveloped acreage will decline if drilling results are unsuccessful.

While our costs to acquire undeveloped acreage in new or emerging plays have generally been less than those of later entrants into a developing play, our drilling results in these areas are more uncertain than drilling results in areas that are developed and producing. Since new or emerging plays have limited or no production history, we are unable to use past drilling results in those areas to help predict our future drilling results. As a result, our cost of drilling, completing and operating wells in these areas may be higher than initially expected, and the value of our undeveloped acreage will decline if drilling results are unsuccessful.

We are subject to complex federal, state, local, provincial and other laws and regulations that could adversely affect the cost, manner or feasibility of conducting our operations or expose us to significant liabilities.

Our oil and natural gas exploration, production and transportation operations are subject to complex and stringent laws and regulations. In order to conduct our operations in compliance with these laws and regulations, we must obtain and maintain numerous permits, approvals and certificates from various federal, state, local and provincial governmental authorities. We may incur substantial costs in order to maintain compliance with these existing laws and regulations. In addition, our costs of compliance may increase if existing laws and regulations are revised or reinterpreted, or if new laws and regulations become applicable to our operations. Such costs could have a material adverse effect on our business, financial condition and results of operations.

Our business is subject to federal, state, local and provincial laws and regulations as interpreted and enforced by governmental authorities possessing jurisdiction over various aspects of the exploration for, and the production and transportation of, oil and natural gas. Failure to comply with such laws and regulations, as interpreted and enforced, could have a material adverse effect on our business, financial condition and results of operations. See Business and Properties Environmental, Health and Safety Regulation and Business and Properties Regulation of the Oil and Natural Gas Industry for a description of the laws and regulations that affect us.

Strict, joint and several liability may be imposed under certain environmental laws, which could cause us to become liable for the conduct of others or for consequences of our own actions that were in compliance with all applicable laws at the time those actions were taken. In addition, claims for damages to persons or property, including natural resources, may result from our operations.

New laws, regulations or enforcement policies could be more stringent and impose unforeseen liabilities or significantly increase compliance costs. If we were not able to recover the resulting costs through insurance or increased revenues, our business, financial condition or results of operations could be adversely affected.

Competition in the oil and natural gas industry is intense, making it more difficult for us to acquire properties, market oil and natural gas and secure trained personnel.

Our ability to acquire additional prospects and to find and develop reserves in the future will depend on our ability to evaluate and select suitable properties and to consummate transactions in a highly competitive environment for acquiring properties, marketing oil and natural gas and securing trained personnel. Also, there is substantial competition for capital available for investment in the oil and natural gas industry. Many of our competitors possess and employ financial, technical and personnel resources substantially greater than ours. Those companies may be able to pay more for productive oil and natural gas properties and exploratory prospects and to evaluate, bid for and purchase a greater number of properties and prospects than our financial or personnel resources permit. The recent trend in the formation of publicly traded exploration and production master limited partnerships has increased the competition for producing property acquisitions. In addition, companies may be able to offer better compensation packages to attract and retain qualified personnel than we are able to offer. The cost to attract and retain qualified personnel has increased over the past three years due to competition and may

Table of Contents

Index to Financial Statements

increase substantially in the future. We may not be able to compete successfully in the future in acquiring prospective reserves, developing reserves, marketing hydrocarbons, attracting and retaining quality personnel and raising additional capital, which could have a material adverse effect on our business.

The loss of senior management or technical personnel could adversely affect operations.

We depend on the services of our senior management and technical personnel. The loss of the services of our senior management or technical personnel, including Harold G. Hamm, our Chairman and Chief Executive Officer, could have a material adverse effect on our operations. We do not maintain, nor do we plan to obtain, any insurance against the loss of any of these individuals.

Terrorist attacks aimed at our energy operations could adversely affect our business.

The continued threat of terrorism and the impact of military and other government action has led and may lead to further increased volatility in prices for oil and natural gas and could affect these commodity markets or financial markets used by us. In addition, the U.S. government has issued warnings that energy assets may be a future target of terrorist organizations. These developments have subjected our oil and natural gas operations to increased risks. Any future terrorist attack on our facilities, those of our customers and, in some cases, those of other energy companies, could have a material adverse effect on our business.

Seasonal weather conditions and lease stipulations adversely affect our ability to conduct drilling activities in some of the areas where we operate.

Oil and natural gas operations in the Rocky Mountains are adversely affected by seasonal weather conditions and lease stipulations designed to protect various wildlife. In certain areas, including parts of Montana, North Dakota, South Dakota, Utah and Wyoming, drilling and other oil and natural gas activities can only be conducted during the spring and summer months. This limits our ability to operate in those areas and can intensify competition during those months for drilling rigs, oilfield equipment, services, supplies and qualified personnel, which may lead to periodic shortages. These constraints and the resulting shortages or high costs could delay our operations and materially increase our operating and capital costs.

Our credit facility contains certain covenants that may inhibit our ability to make certain investments, incur additional indebtedness and engage in certain other transactions, which could adversely affect our ability to meet our future goals.

Our credit facility includes certain covenants that, among other things, restrict:

- our investments, loans and advances and the paying of dividends and other restricted payments;

our incurrence of additional indebtedness;

the granting of liens, other than liens created pursuant to the credit facility and certain permitted liens;

mergers, consolidations and sales of all or substantial part of our business or properties;

the hedging, forward sale or swap of our production of crude oil or natural gas or other commodities;

the sale of assets; and

our capital expenditures.

Our credit facility requires us to maintain certain financial ratios, such as leverage ratios. All of these restrictive covenants may restrict our ability to expand or pursue our business strategies. Our ability to comply with these and other provisions of our credit facility may be impacted by changes in economic or business conditions, results of operations or events beyond our control. The breach of any of these covenants could result in a default under our credit facility, in which case, depending on the actions taken by the lenders thereunder or

Table of Contents

Index to Financial Statements

their successors or assignees, such lenders could elect to declare all amounts borrowed under our credit facility, together with accrued interest, to be due and payable. If we were unable to repay such borrowings or interest, our lenders could proceed against their collateral. If the indebtedness under our credit facility were to be accelerated, our assets may not be sufficient to repay in full such indebtedness.

Increases in interest rates could adversely affect our business.

We are exposed to changes in interest rates as a result of borrowings outstanding under our credit facility. After giving effect to this offering and the application of the net proceeds received by us to repay borrowings outstanding under our credit facility, we expect to have total indebtedness outstanding under our credit facility of approximately $112.9 million. The impact of a 1% increase in interest rates on this amount of debt would result in increased interest expense of approximately $1.1 million and a corresponding decrease in our net income.

The inability of our significant customers to meet their obligations to us may adversely affect our financial results.

We are subject to credit risk due to concentration of our crude oil and natural gas receivables with several significant customers. The two largest purchasers of our oil and natural gas during the twelve months ended December 31, 2006 accounted for 19% and 14% of our total oil and natural gas sales revenues. We do not require our customers to post collateral. The inability of our significant customers to meet their obligations to us may adversely affect our financial results.

Risks Relating to the Offering and Our Common Stock

The initial public offering price of our common stock may not be indicative of the market price of our common stock after this offering. In addition, our stock price may be volatile.

Prior to this offering, there has been no public market for our common stock. An active market for our common stock may not develop or may not be sustained after this offering. The initial public offering price of our common stock was determined by negotiations between us, our selling shareholder and representatives of the underwriters, based on numerous factors which we discuss in the Underwriting section of this prospectus. This price may not be indicative of the market price for our common stock after this initial public offering. The market price of our common stock could be subject to significant fluctuations after this offering, and may decline below the initial public offering price. You may not be able to resell your shares at or above the initial public offering price. The following factors could affect our stock price:

- our operating and financial performance and prospects;
- quarterly variations in the rate of growth of our operational and financial indicators, such as net income per share, production, net income and revenues;

- changes in revenue or earnings estimates or publication of reports by equity research analysts;
- speculation in the press or investment community;
- sales of our common stock by us, Harold G. Hamm or other shareholders, or the perception that such sales may occur;
- general market conditions, including fluctuations in commodity prices; and
- domestic and international economic, legal and regulatory factors unrelated to our performance.

The stock markets in general have experienced extreme volatility that has often been unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the trading price of our common stock.

Table of Contents

Index to Financial Statements

Following this offering, our Chairman and Chief Executive Officer will own approximately 73.2% of our outstanding common stock, giving him influence and control in corporate transactions and other matters, including a sale of our company.

As of the closing of this offering, Harold G. Hamm, our Chairman and Chief Executive Officer, will beneficially own 122,980,608 shares of our outstanding common stock (assuming no exercise of the underwriters overallotment option), representing approximately 73.2% of our outstanding common stock. As a result, Mr. Hamm will continue to be our controlling shareholder and will continue to be able to control the election of our directors, determine our corporate and management policies and determine, without the consent of our other shareholders, the outcome of certain corporate transactions or other matters submitted to our shareholders for approval, including potential mergers or acquisitions, asset sales and other significant corporate transactions. As controlling shareholder, Mr. Hamm could cause, delay or prevent a change of control of our company. The interests of Mr. Hamm may not coincide with the interests of other holders of our common stock.

Several affiliated companies controlled by Mr. Hamm provide oilfield, gathering and processing, marketing and other services to us. We expect these transactions will continue in the future and may result in conflicts of interest between Mr. Hamm s affiliated companies and us. We can provide no assurance that any such conflicts will be resolved in our favor.

Purchasers of common stock in this offering will experience immediate and substantial dilution of $14.17 per share.

Based on an assumed initial public offering price of $17.00 per share, purchasers of our common stock in this offering will experience an immediate and substantial dilution of $14.17 per share in the net tangible book value per share of common stock from the initial public offering price, and our pro forma net tangible book value as of December 31, 2006 was $2.83 per share. See Dilution for a complete description of the calculation of net tangible book value.

The requirements of being a public company, including compliance with the reporting requirements of the Exchange Act and the requirements of the Sarbanes-Oxley Act, may strain our resources, increase our costs and distract management; and we may be unable to comply with these requirements in a timely or cost-effective manner.

As a public company with listed equity securities, we will need to comply with new laws, regulations and requirements, certain corporate governance provisions of the Sarbanes-Oxley Act of 2002, related regulations of the SEC and the requirements of the New York Stock Exchange (NYSE) with which we are not required to comply as a private company. Complying with these statutes, regulations and requirements will occupy a significant amount of time of our board of directors and management and will increase our costs and expenses. We will need to:

- institute a more comprehensive compliance function;

- design, establish, evaluate and maintain a system of internal controls over financial reporting in compliance with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 and the related rules and regulations of the SEC and the Public Company Accounting Oversight Board;

comply with rules promulgated by the NYSE;

prepare and distribute periodic public reports in compliance with our obligations under the federal securities laws;

establish new internal policies, such as those relating to disclosure controls and procedures and insider trading;

involve and retain to a greater degree outside counsel and accountants in the above activities; and

establish an investor relations function.

Table of Contents

Index to Financial Statements

In addition, we also expect that being a public company subject to these rules and regulations will require us to accept less director and officer liability insurance coverage than we desire or to incur substantial costs to obtain coverage. These factors could also make it more difficult for us to attract and retain qualified members of our board of directors, particularly to serve on our audit committee, and qualified executive officers. As a result, compliance with the requirements of the Sarbanes-Oxley Act could have a material adverse effect on our business.

Failure by us to achieve and maintain effective internal control over financial reporting in accordance with the rules of the SEC could harm our business and operating results and/or result in a loss of investor confidence in our financial reports, which could have a material adverse effect on our business and stock price.

We are in the process of evaluating our internal controls systems to allow management to report on, and our independent auditors to audit, our internal controls over financial reporting. We are also in the process of performing the system and process evaluation and testing (and any necessary remediation) required to comply with the management certification and auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act of 2002. We will be required to comply with Section 404 for the year ending December 31, 2008. However, we cannot be certain as to the timing of completion of our evaluation, testing and remediation actions or the impact of the same on our operations. Furthermore, upon completion of this process, we may identify control deficiencies of varying degrees of severity under applicable SEC and Public Company Accounting Oversight Board rules and regulations that remain unremediated. As a public company, we will be required to report, among other things, control deficiencies that constitute a material weakness or changes in internal controls that, or that are reasonably likely to, materially affect internal controls over financial reporting. A material weakness is a significant deficiency or combination of significant deficiencies that results in more than a remote likelihood that a material misstatement of the annual or interim consolidated financial statements will not be prevented or detected. If we fail to implement the requirements of Section 404 in a timely manner, we might be subject to sanctions or investigation by regulatory authorities such as the SEC. In addition, failure to comply with Section 404 or the report by us of a material weakness may cause investors to lose confidence in our consolidated financial statements, and our stock price may be adversely affected as a result. If we fail to remedy any material weakness, our consolidated financial statements may be inaccurate, we may face restricted access to the capital markets and our stock price may be adversely affected.

We will be required to recognize a charge to our earnings related to additional compensation expense associated with our equity compensation plans as a result of this offering.

Our equity compensation plans currently require us to, at a plan participant s request, purchase such participant s vested shares of our restricted stock based on an internally calculated per-share value of our stock. In addition, we currently have the right to purchase vested shares of restricted stock and shares issued upon stock option exercises at the same value from plan participants upon termination of the participant s employment with us for any reason for a period of two years after the termination date. The internal valuation is based on the book value of our shareholders equity adjusted for our PV-10 as of each calendar quarter. Our requirement and right, as applicable, to purchase vested shares of restricted stock and shares issued upon stock option exercises will be eliminated once we begin reporting under Section 12 of the Exchange Act upon completion of this offering. We consider this to be a modification to the plan (as defined in SFAS 123(R)) and will recognize a charge to earnings upon completion of this offering in order to account for the difference between the value at which we historically have recognized compensation expense and a value based on the initial public offering price. As of December 31, 2006, the charge to earnings would have been $19.2 million, consisting of $3.7 million associated with restricted stock and $15.5 million associated with stock options, assuming an initial offering price of $17.00 per share (the midpoint of the price range set forth on the cover page of this prospectus). The actual charge to earnings upon completion of the offering will be affected by changes in the fair value and unvested equity awards after

Table of Contents

Index to Financial Statements

December 31, 2006 and the actual initial public offering price. Each $1.00 increase (decrease) in the assumed public offering price per share would increase (decrease) the charge to earnings as of December 31, 2006 by approximately $1.8 million.

We have no plans to pay dividends on our common stock, and therefore, you may not receive funds without selling your shares.

On January 10, 2007, we declared a cash dividend of approximately $18.8 million to our shareholders and, subject to forfeiture, to holders of unvested restricted stock. On January 31, 2007, we paid $18.7 million of the dividend declared, of which $16.9 million was paid to our principal shareholder. On March 6, 2007, we declared a cash dividend of approximately $33.3 million to our shareholders and, subject to forfeiture, to holders of unvested restricted stock. On April 12, 2007, we paid $33.1 million of the dividend declared, of which $30.0 million was paid to our principal shareholder. We do not anticipate paying any additional cash dividends on our common stock in the foreseeable future. We currently intend to retain future earnings, if any, to finance the expansion of our business. Our future dividend policy is within the discretion of our board of directors and will depend upon various factors, including our business, financial condition, results of operations, capital requirements and investment opportunities.

We are a controlled company within the meaning of NYSE rules and, as a result, we will qualify for, and may rely on, exemptions from certain corporate governance requirements.

Because Harold G. Hamm will beneficially own in excess of 50% of our outstanding shares of common stock after the completion of this offering, he will be able to control the composition of our board of directors and direct our management and policies. We also will be deemed to be a controlled company under the rules of the NYSE. Under these rules, we are not required to comply with certain corporate governance requirements of the NYSE, including:

- the requirement that a majority of our board of directors consist of independent directors;
- the requirement that we have a nominating/corporate governance committee that is composed entirely of independent directors with a written charter addressing the committee s purpose and responsibilities; and
- the requirement that we have a compensation committee that is composed entirely of independent directors with a written charter addressing the committee s purpose and responsibilities.

Following this offering, we may utilize some or all of these exemptions. Accordingly, you may not have the same protections afforded to shareholders of companies that are subject to all of the corporate governance requirements of the NYSE. Mr. Hamm s significant ownership interest could adversely affect investors perceptions of our corporate governance.

Provisions in our organizational documents and under Oklahoma law could delay or prevent a change in control of our company, which could adversely affect the price of our common stock.

We are an Oklahoma corporation. The existence of some provisions in our organizational documents, which we will amend and restate prior to the closing of this offering, and under Oklahoma law could delay or prevent a change in control of our company, which could adversely affect the price of our common stock. The provisions in our amended and restated certificate of incorporation and bylaws that could delay or prevent an unsolicited change in control of our company include a staggered board of directors, board authority to issue preferred stock and advance notice provisions for director nominations or business to be considered at a shareholder meeting. See Description of Capital Stock Anti-Takeover Effects of Provisions of Our Certificate of Incorporation and Bylaws and of Oklahoma Law.

Table of Contents

Index to Financial Statements

Use of Proceeds

We estimate that we will receive net proceeds of $139.6 million from the sale of the 8,850,000 shares of common stock in this offering based upon the assumed initial public offering price of $17.00 per share (the midpoint of the price range set forth on the cover page of this prospectus), after deducting underwriting discounts and estimated offering expenses. Each $1.00 increase (decrease) in the public offering price would increase (decrease) proceeds by approximately $8.3 million. We expect to use the net proceeds of this offering to repay a portion of the borrowings outstanding under our credit facility incurred in connection with recent capital expenditures and cash dividends to our current shareholders. As of April 25, 2007, total borrowings under our credit facility were $252.5 million. Our credit facility has a maturity date in April 2011 and currently bears interest at a rate of 6.45%.

We will not receive any proceeds from the sale of the shares of common stock by the selling shareholder. We estimate that the selling shareholder will receive net proceeds of approximately $330.0 million from the sale of the 20,650,000 shares of our common stock in this offering based upon the assumed initial public offering price of $17.00 per share, after deducting underwriting discounts. We will pay all expenses relating to this offering, other than underwriting discounts related to the shares sold by the selling shareholder. If the underwriters overallotment option to purchase additional shares is exercised in full, we estimate that the selling shareholder s net proceeds will be approximately $400.7 million.

Dividend Policy

On January 10, 2007, we declared a cash dividend of approximately $18.8 million to our shareholders and, subject to forfeiture, to holders of unvested restricted stock. On January 31, 2007, we paid $18.7 million of the dividend declared, of which $16.9 million was paid to our principal shareholder. On March 6, 2007, we declared a cash dividend of approximately $33.3 million to our shareholders and, subject to forfeiture, to holders of unvested restricted stock. On April 12, 2007, we paid $33.1 million of the dividend declared, of which $30.0 million was paid to our principal shareholder. We are currently a subchapter S-corporation under the rules and regulations of the Internal Revenue Service. As a result, income taxes attributable to our federal and state income are payable by our shareholders. The dividends have been paid to shareholders to fund their taxes due and estimated tax payments. In connection with the completion of this offering, we will convert from a subchapter S-corporation to a subchapter C-corporation, and we do not anticipate paying any additional cash dividends on our common stock in the foreseeable future. The selling shareholder has received dividends of approximately $13.5 million, $1.8 million, $79.0 million and $46.9 million in 2004, 2005, 2006 and 2007, respectively. We currently intend to retain future earnings, if any, to finance the expansion of our business. Our future dividend policy is within the discretion of our board of directors and will depend upon various factors, including our results of operations, financial condition, capital requirements and investment opportunities.

Table of Contents

Index to Financial Statements

Capitalization

The following table shows our capitalization as of December 31, 2006:

- on a historical basis; and

- on a pro forma basis to reflect our conversion, concurrent with the closing of this offering, from a subchapter S-corporation to a subchapter C-corporation; reclassification of equity compensation accruals; the effect of an 11 for 1 stock split to be effected as a stock dividend prior to the consummation of this offering, the charge to compensation expense to recognize the difference between the initial public offering price of our stock and the value at which compensation expense has been previously recorded and other transactions for which pro forma presentation is necessary in conjunction with this offering and to reflect this offering at an assumed public offering price of $17.00 per share and the application of the net proceeds therefrom as described under Use of Proceeds.

We derived this table from, and it should be read in conjunction with and is qualified in its entirety by reference to, the historical consolidated financial statements and the accompanying notes included elsewhere in this prospectus. You should read this information in conjunction with these consolidated financial statements and Management s Discussion and Analysis of Financial Condition and Results of Operations.

	As of December 31, 2006	
	Historical	**Pro forma**
	(in thousands)	
Cash and cash equivalents(1)	$ 7,018	$ 7,941
Long-term debt, including current maturities(1)	140,000	
Shareholders equity:		
Common stock, $.01 par value; 20,000,000 shares historical, 500,000,000 shares pro forma authorized, 14,464,204 shares historical, 167,956,244 pro forma issued and outstanding(2)	144	1,680
Additional paid-in capital(3)	27,087	408,292
Retained earnings(3)	471,313	65,140
Accumulated other comprehensive loss, net of taxes	(25)	(25)
Total shareholders equity	498,519	475,087
Total capitalization	$ 638,519	$ 475,087

(1) Pro forma adjustment to reflect use of proceeds in connection with this offering to reduce debt with the remainder increasing cash.

(2) Pro forma adjustment to reflect the reclassification of $1.4 million from additional paid-in capital to common stock in order to adjust for the 11 for 1 stock split to be effected as a stock dividend in connection with the consummation of the offering and par value for newly issued shares.

(3) Pro forma adjustments as described in the table below.

Table of Contents

Index to Financial Statements

The following table reconciles historical additional paid-in capital and retained earnings to the pro forma amounts:

	Additional Paid-In Capital	Retained Earnings
	(in thousands)	
Historical	$ 27,087	$ 471,313
Underwriting discount	(9,027)	
Reclassification of liability for equity compensation(1)	14,444	
Compensation expense(2)	19,249	(19,249)
Proceeds of offering	150,362	
Offering costs(3)	(150)	(350)
Deferred taxes on C-corporation conversion(4)		(178,800)
Reclassification of additional paid-in-capital(5)	(1,447)	
Reclassification of undistributed earnings	207,774	(207,774)
Pro forma	$ 408,292	$ 65,140

(1) Pro forma adjustment to reflect the reclassification of the liability for equity compensation to additional paid-in capital.

(2) Pro forma adjustment, consisting of $3.7 million associated with restricted stock and $15.5 million associated with stock options, to show the estimated charge to earnings related to compensation expense that we will recognize upon completion of the offering equal to the difference between the assumed initial public offering price of $17.00 per share (the midpoint of the range set forth on the cover page of this prospectus) and the value at which compensation expense has previously been recorded and the related reclassification of the liability to additional paid-in capital. See footnote (2) under Selected Historical and Pro Forma Financial Information

(3) Pro forma adjustment for offering costs not already recognized in historical results. Offering costs consist principally of legal, accounting and printing costs associated with our initial public offering and are estimated to total approximately $1.9 million. Approximately $1.4 million of the costs have already been incurred and reflected in the historical shareholders equity. These costs have been expensed to date because we were not planning to sell stock in the offering. We now intend to sell shares representing approximately 30% of the total offering and will not expense that percentage of offering costs incurred in the future. The balance of offering costs incurred in the future will be expensed.

(4) Pro forma adjustment to charge earnings to recognize deferred taxes upon our conversion from a non-taxable subchapter S-corporation to a taxable subchapter C-corporation.

(5) Pro forma adjustment to reflect the reclassification of $1.4 million from additional paid-in capital to common stock in order to adjust for the 11 for 1 stock split to be effected as a stock dividend in connection with the consummation of this offering.

Table of Contents

Index to Financial Statements

Dilution

Dilution is the amount by which the offering price paid by purchasers of common stock sold in this offering will exceed the net tangible book value per share of common stock after the offering. As of December 31, 2006, on a pro forma basis, after giving effect to adjustments to convert from a subchapter S-corporation to a subchapter C-corporation, reclassification of compensation accruals and the charge to compensation expense to recognize the difference between the assumed initial public offering price of our common stock of $17.00 per share and the value at which compensation expense has been previously recorded, our net tangible book value would have been $334.2 million, or $2.10 per share. After giving effect to the sale of common stock offered by us pursuant to this prospectus (at the assumed initial public offering price of $17.00 per share) and the receipt of the estimated net proceeds, after deducting underwriting discounts and estimated offering expenses, our net tangible book value at December 31, 2006 would have been $2.83 per share. This represents an immediate and substantial increase in the net tangible book value of $0.73 per share to existing shareholders and an immediate dilution of $14.17 per share to new investors purchasing common stock in this offering, resulting from the difference between the offering price and the net tangible book value after this offering. The following table illustrates the per share dilution to new investors who purchase common stock in the offering:

Assumed offering price per share:		$ 17.00
Pro forma net tangible book value per share at December 31, 2006	$ 2.10	
Increase per share attributable to new investors	0.73	
Pro forma net tangible book value per share after this offering		2.83
Dilution per share to new investors		$ 14.17

The following table sets forth, on a pro forma as adjusted basis as of December 31, 2006, the number of shares of common stock purchased from us, the book value of the total consideration paid to us and the book value of the average consideration per share paid to us by our existing shareholders and by the new investors in this offering at an assumed offering price of $17.00 per share (the midpoint of the range set forth on the cover page of this prospectus) after deducting underwriting discounts and estimated offering expenses.

	Shares Issued		Book Value of Total Consideration		Book Value of Average Consideration Per Share
	Number	%	Amount (000s)	%	
New investors	8,850,000	5%	$ 140,923	30%	$ 15.92
Existing shareholders	159,106,244	95%	$ 334,164	70%	$ 2.10
Total	167,956,244	100%	$ 475,087	100%	$ 2.83

Table of Contents

Index to Financial Statements

Selected Historical and Pro Forma

Consolidated Financial Information

This section presents our selected historical and pro forma consolidated financial data. The selected historical consolidated financial data presented below is not intended to replace our historical consolidated financial statements.

The following historical consolidated financial data, as it relates to each of the fiscal years ended December 31, 2002 through 2006, has been derived from our audited historical consolidated financial statements for such periods. You should read the following selected historical consolidated financial data in connection with Capitalization, Management s Discussion and Analysis of Financial Condition and Results of Operations and our historical consolidated financial statements and related notes included elsewhere in this prospectus. The selected historical consolidated results are not necessarily indicative of results to be expected in future periods.

The selected pro forma financial data reflect the tax effects of our conversion, concurrent with the closing of this offering, from a subchapter S-corporation to a subchapter C-corporation and the earnings per share impact of our 11 for 1 stock split to be effected in the form of a stock dividend concurrent with the closing of this offering. The pro forma earnings per share adjustments for 2006 also give effect to the number of shares to be issued in this offering whose net proceeds would be sufficient to pay the $52.1 million of cash dividends declared in 2007.

	Year ended December 31,				
	2002	2003	2004	2005	2006
	(in thousands, except per share amounts)				
Statement of operations data:					
Revenues:					
Oil and natural gas sales	$ 108,752	$ 138,948	$ 181,435	$ 361,833	$ 468,602
Crude oil marketing and trading(1)	152,092	169,547	226,664		
Oil and natural gas service operations	5,739	9,114	10,811	13,931	15,050
Total revenues	266,583	317,609	418,910	375,764	483,652
Operating costs and expenses:					
Production expense	32,299	40,821	43,754	52,754	62,865
Production tax	7,729	10,251	12,297	16,031	22,331
Exploration expense	10,229	17,221	12,633	5,231	19,738
Crude oil marketing and trading(1)	152,718	166,731	227,210		
Oil and gas service operations	3,485	5,641	6,466	7,977	8,231
Depreciation, depletion, amortization and accretion	29,010	40,256	38,627	49,802	65,428
Property impairments	25,686	8,975	11,747	6,930	11,751
General and administrative(2)	8,668	9,604	12,400	31,266	23,016
(Gain) loss on sale of assets	(223)	(589)	150	(3,026)	(290)
Total operating costs and expenses	$ 269,601	$ 298,911	$ 365,284	$ 166,965	$ 213,070
Income (loss) from operations	$ (3,018)	$ 18,698	$ 53,626	$ 208,799	$ 270,582

Other income (expense)					
Interest expense	(18,216)	(19,761)	(23,617)	(14,220)	(11,310)
Loss on redemption of bonds			(4,083)		
Other	912	295	890	867	1,742
Total other income (expense)	(17,304)	(19,466)	(26,810)	(13,353)	(9,568)

27

Table of Contents

Index to Financial Statements

	Year ended December 31,				
	2002	2003	2004	2005	2006
	(in thousands, except per share amounts)				
Income (loss) from continuing operations before income taxes	(20,322)	(768)	26,816	195,446	261,014
Provision (benefit) for income taxes(3)				1,139	(132)
Income (loss) from continuing operations	(20,322)	(768)	26,816	194,307	261,146
Discontinued operations(4)	290	946	1,680		
Loss on sale of discontinued operations(4)			(632)		
Income (loss) before cumulative effect of change in accounting principle	(20,032)	178	27,864	194,307	261,146
Cumulative effect of change in accounting principle(5)		2,162			
Net income (loss)	$ (20,032)	$ 2,340	$ 27,864	$ 194,307	$ 261,146
Basic earnings (loss) per share:					
From continuing operations	$ (1.41)	$ (0.05)	$ 1.87	$ 13.52	$ 18.17
From discontinued operations(4)	0.02	0.06	0.11		
Loss on sale of discontinued operations(4)			(0.04)		
Before cumulative effect of change in accounting principle	(1.39)	0.01	1.94	13.52	18.17
Cumulative effect of change in accounting principle		0.15			
Net income (loss) per share	$ (1.39)	$ 0.16	$ 1.94	$ 13.52	$ 18.17
Shares used in basic earnings (loss) per share	14,369	14,369	14,369	14,369	14,374
Diluted earnings (loss) per share:					
From continuing operations	$ (1.41)	$ (0.05)	$ 1.85	$ 13.42	$ 17.99
From discontinued operations(4)	0.02	0.06	0.12		
Loss on sale of discontinued operations(4)			(0.04)		
Before cumulative effect of change in accounting principle	(1.39)	0.01	1.93	13.42	17.99
Cumulative effect of change in accounting principle		0.15			
Net income (loss) per share	$ (1.39)	$ 0.16	$ 1.93	$ 13.42	$ 17.99
Shares used in diluted earnings (loss) per share	14,369	14,369	14,476	14,482	14,515

Table of Contents

Index to Financial Statements

	Year ended December 31,				
	2002	2003	2004	2005	2006
	(in thousands, except per share amounts)				
Pro forma C-corporation and stock split data:					
Income (loss) from continuing operations before income taxes	$ (20,322)	$ (768)	$ 26,816	$ 195,446	$ 261,014
Pro forma provision (benefit) for income taxes attributable to continuing operations	(7,722)	(292)	10,190	74,269	99,185
Pro forma income (loss) from continuing operations	(12,600)	(476)	16,626	121,177	161,829
Discontinued operations, net of tax(4)	180	587	1,042		
Loss on sale of discontinued operations, net of tax(4)			(392)		
Cumulative effect of change in accounting principle, net of tax		1,340			
Pro forma net income (loss)	$ (12,420)	$ 1,451	$ 17,276	$ 121,177	$ 161,829
Pro forma basic earnings (loss) per share	$ (0.08)	$ 0.01	$ 0.11	$ 0.77	$ 1.00
Pro forma diluted earnings (loss) per share	(0.08)	0.01	0.11	0.76	0.99
Other financial data:					
Cash dividends per share:	$	$	$ 1.04	$ 0.14	$ 6.06
EBITDAX (6)	63,288	88,750	116,498	285,344	372,115
Net cash provided by operations	46,997	65,246	93,854	265,265	417,041
Net cash used in investing	(113,295)	(108,791)	(72,992)	(133,716)	(324,523)
Net cash provided by (used in) financing	61,593	43,302	(7,245)	(141,467)	(91,451)
Capital expenditures	113,447	114,145	94,307	144,800	326,579
Balance sheet data at December 31:					
Cash and cash equivalents	$ 2,520	$ 2,277	$ 15,894	$ 6,014	$ 7,018
Property and equipment, net	367,903	439,432	434,339	509,393	751,747
Total assets	406,677	484,988	504,951	600,234	858,929
Long-term debt, including current maturities	247,105	290,920	290,522	143,000	140,000
Shareholders equity	115,081	116,932	130,385	324,730	498,519

(1) Crude oil marketing and trading captions consist of our marketing activities under which crude oil production was sold at the wellhead and transported to a local hub where we purchased the barrels back to exchange at Cushing, Oklahoma in order to minimize pricing differentials with the NYMEX oil futures contract. We adopted Emerging Issues Task Force (EITF) 04-13 on January 1, 2005, which allowed certain purchase and sales transactions with the same counterparty to be combined and accounted for as a single transaction under the guidance of Accounting Principles Board Opinion No. 29. In 2005, we netted $39.8 million of crude oil marketing and trading revenues and $39.7 million of crude oil marketing and trading expenses under oil and natural gas sales. Prior to the adoption of EITF 04-13, we presented crude oil marketing and trading revenues and expenses gross under the guidance provided by EITF 99-19, Reporting Revenues Gross as a Principal and/or Net as an Agent. Effective March 2005, we ceased marketing our crude oil production under these arrangements. Thereafter, we have sold our crude oil at the wellhead. Certain of these sales have been to our affiliates, as described under Certain Relationships and Related Party Transactions.

(2) We have included stock-based compensation of $0.2 million, $0.2 million, $2.0 million, $13.7 million and $2.9 million in general and administrative expenses for the years ended December 31, 2002, 2003, 2004, 2005 and 2006, respectively. Our stock based compensation plans require us to purchase vested shares of restricted stock and shares issued upon the exercise of stock options at the plan participant s request based on an internally calculated value of our stock. In addition, we have the right to purchase vested shares of restricted stock and shares issued upon the exercise of stock options at the same price from plan participants upon termination of the participant s employment with us for any reason for a period of two years after the termination date. Amounts noted herein represent the increase in our liability associated with our purchase obligation. The valuation is based on the book value of our shareholders equity adjusted for our PV-10 as of each calendar quarter. Our requirement and right, as applicable, to purchase vested shares will be eliminated once we begin reporting under Section 12 of the Securities Exchange Act of 1934, as amended (the Exchange Act). As a result of this change, our stock grants will then be considered equity grants and not liability grants. Accordingly, due to this modification of our plan, we will recognize a non-cash charge to earnings upon completion of this offering to adjust historical compensation expense, to an amount that reflects the value based upon our initial public offering price. As of

December 31, 2006, the non-cash charge to earnings would have been approximately $19.2 million, consisting of $3.7 million associated with restricted stock and $15.5 million associated with stock options, assuming an initial offering price of $17.00 per share. See Capitalization.

(3) Properties owned by us at May 31, 1997, the date we converted into a subchapter S-corporation from a subchapter C-corporation, may be subject to federal taxation if sold for an amount in excess of the then tax basis for the sold assets. During 2005, we incurred federal taxes due to the sale of assets acquired prior to May 31, 1997. The benefit recorded during 2006 reflects a change in estimate of the original provision recorded for federal taxes incurred.

Table of Contents

Index to Financial Statements

(4) In July 2004, we sold all of the outstanding stock in Continental Gas, Inc., a wholly owned subsidiary, to our shareholders. The Continental Gas, Inc. assets included seven gas gathering systems and three gas-processing plants. These assets represented our entire gas gathering, marketing and processing segment. We have accounted for these operations as discontinued operations.

(5) We adopted Statement of Financial Accounting Standards No. 143, Accounting for Asset Retirement Obligations and recorded the cumulative effect of the change in accounting principle on January 1, 2003.

(6) EBITDAX represents earnings before interest expense, income taxes (when applicable), depreciation, depletion, amortization and accretion, property impairments, exploration expense and non-cash compensation expense. EBITDAX is not a measure of net income or cash flow as determined by generally accepted accounting principles (GAAP). EBITDAX should not be considered as an alternative to, or more meaningful than, net income or cash flow as determined in accordance with GAAP or as an indicator of a company s operating performance or liquidity. Certain items excluded from EBITDAX are significant components in understanding and assessing a company s financial performance, such as a company s cost of capital and tax structure, as well as the historic costs of depreciable assets, none of which are components of EBITDAX. Our computations of EBITDAX may not be comparable to other similarly titled measures of other companies. We believe that EBITDAX is a widely followed measure of operating performance and may also be used by investors to measure our ability to meet future debt service requirements, if any. Our credit facility requires that we maintain a total debt to EBITDAX ratio of no greater than 3.75 to 1 on a rolling four-quarter basis. Our credit facility defines EBITDAX consistently with the definition of EBITDAX utilized and presented by us. At December 31, 2005 and 2006, this ratio was approximately 0.5 to 1 and 0.4 to 1, respectively. The following table represents a reconciliation of our net income (loss) to EBITDAX:

	Year ended December 31,				
	2002	**2003**	**2004**	**2005**	**2006**
	(in thousands)				
Net income (loss)	$ (20,032)	$ 2,340	$ 27,864	$ 194,307	$ 261,146
Interest expense	18,216	19,761	23,617	14,220	11,310
Provision (benefit) for income taxes				1,139	(132)
Depreciation, depletion, amortization and accretion	29,010	40,256	38,627	49,802	65,428
Property impairments	25,686	8,975	11,747	6,930	11,751
Exploration expense	10,229	17,221	12,633	5,231	19,738
Equity compensation	179	197	2,010	13,715	2,874
EBITDAX	$ 63,288	$ 88,750	$ 116,498	$ 285,344	$ 372,115

30

Table of Contents

Index to Financial Statements

Management s Discussion and Analysis of

Financial Condition and Results of Operations

The following discussion should be read in conjunction with our historical consolidated financial statements and notes, as well as the selected historical consolidated financial data included elsewhere in this prospectus.

Overview

We are engaged in oil and natural gas exploration and exploitation activities in the Rocky Mountain, Mid-Continent and Gulf Coast regions of the United States. Crude oil comprised 83% of our 118.3 MMBoe of estimated proved reserves as of December 31, 2006 and 83% of our 9,018 MBoe of production for the year then ended. We seek to operate wells in which we own an interest, and we operated wells that accounted for 95% of our PV-10 and 82% of our 1,589 gross wells as of December 31, 2006. By controlling operations, we are able to more effectively manage the cost and timing of exploration and development of our properties, including the drilling and fracture stimulation methods used.

Our business strategy has focused on reserve and production growth through exploration and development. For the three-year period ended December 31, 2006, we added 50,421 MBoe of proved reserves through extensions and discoveries, compared to 780 MBoe added through purchases. During this period, our production increased from 5,154 MBoe in 2004 to 9,018 MBoe in 2006. An aspect of our business strategy has been to acquire large undeveloped acreage positions in new or developing resource plays. As of December 31, 2006, we held approximately 1,310,000 gross (738,000 net) undeveloped acres, including 342,000 net acres in the Bakken field in Montana and North Dakota and 162,000 net acres in the New Albany Shale, Lewis Shale, Marfa Basin and Woodford Shale projects. As an early entrant in new or emerging plays, our costs to acquire undeveloped acreage have generally been less than those of later entrants into a developing play. As an example of the cost advantage of entering a play early, our per acre costs for our lease acquisitions in the North Dakota Bakken field during 2003 and 2004 were approximately 80% lower than the per acre costs paid by third parties and by us in the federal and state lease auctions for acreage near our holdings in that area during 2005. However, as an early entrant, we are exposed to the risk that the value of our undeveloped acreage is diminished by unsuccessful drilling results.

How We Evaluate Our Operations

We use a variety of financial and operational measures to assess our performance. Among these measures are the following:

(1) Volumes of oil and natural gas produced;

(2) Oil and natural gas prices realized;

(3) Volumetric operating and administrative costs; and

(4) EBITDAX.

Volumes of Oil and Natural Gas Produced

For our operated properties in the Red River units and the Bakken field, we receive daily production estimates that enable us to monitor our production on a current basis. We believe the timeliness of this information and the control we exert as an operator enables us to respond promptly to production difficulties. Over the past three years our equivalent production volumes have increased 75% or 3,864 MBoe due primarily to

Table of Contents

Index to Financial Statements

a 103% increase in oil production. The following table presents our production volumes for each of the three years ended December 31, 2006:

	Year Ended December 31,			Three-year period	
				Volume increase	Percent increase
	2004	2005	2006	(decrease)	(decrease)
MBbls	3,688	5,708	7,480	3,792	103%
MMcf	8,794	9,006	9,225	431	5%
MBoe	5,154	7,209	9,018	3,864	75%

The increase in our production has been the result of a favorable response to additional field development and enhanced recovery efforts in our Red River units coupled with exploration and development within our other producing areas, primarily the Montana Bakken field.

Oil and Natural Gas Prices Realized

We market our oil and natural gas production to a variety of purchasers based on regional pricing. A significant portion of our oil and natural gas production has been marketed to affiliates as discussed under Certain Relationships and Related Party Transactions.

The following table presents the NYMEX oil and natural gas prices, our realized oil and natural gas prices, exclusive of the effects of hedging, and the differences for each of the three years ended December 31, 2006. The NYMEX oil price was determined each month as the calendar month average of the prompt NYMEX crude oil futures contract price and, the NYMEX natural gas price, as the average of the last three trading days of the prompt NYMEX natural gas futures contract price. The NYMEX natural gas futures contract price is quoted on an MMBtu basis. For purposes of comparison, in the table below, the NYMEX natural gas price was converted to an Mcf basis at a one-to-one conversion:

	Year ended December 31,		
	2004	2005	2006
NYMEX oil price ($/Bbl)	$ 41.95	$ 57.69	$ 66.34
Realized oil price before hedging ($/Bbl)	38.85	52.45	55.30
Difference	$ 3.10	$ 5.24	$ 11.04
NYMEX natural gas price ($/Mcf)	$ 6.10	$ 8.54	$ 7.24

Realized natural gas price ($/Mcf)	5.06	6.93	6.08
Difference	$ 1.04	$ 1.61	$ 1.16

The differences are subject to variability due to quality and location pricing fluctuations caused by localized supply and demand fundamentals and transportation availability. The increase in the difference between the NYMEX oil price and our realized oil price during 2006 was attributable to higher oil imports and production in the Rocky Mountain region, lower demand by local Rocky Mountain refineries due to downtime for maintenance and reduced seasonal demand for gasoline and downstream transportation capacity constraints. We are unable to predict when, or if, the difference will revert back to pre-2006 levels.

Our revenues and net income are sensitive to oil and natural gas prices. A $1.00 per Bbl change in realized oil prices would change our reported 2006 revenues and net income by approximately $7.5 million and $7.1 million, respectively. Similarly, a $0.10 per Mcf change in realized natural gas prices would change our reported 2006 revenues and net income by approximately $923,000 and $879,000, respectively.

Table of Contents

Index to Financial Statements

For the year ended December 31, 2004, we realized oil hedging losses of $6.4 million. As a result of our limited bank borrowings and strong operational cash flows, we did not enter into any hedges for our 2005 and 2006 production, and we do not currently have plans to hedge any of our 2007 production.

Volumetric Operating and Administrative Costs

Two other measures that we monitor and analyze are production expense per Boe sold and general and administrative expense per Boe sold. We believe these are important measures because they are indicators of operating cost efficiency.

The following table presents our production expense and general and administrative expense, inclusive of stock-based compensation, per Boe sold for each of the three years ended December 31, 2006:

	Year ended December 31,		
	2004	**2005**	**2006**
Production expense ($/Boe)	$ 8.49	$ 7.32	$ 6.99
General and administrative expense ($/Boe)	2.41	4.34	2.56

Our per unit production expense was higher during 2004 due to the start of our enhanced recovery project in the Red River units which initially lowered volumes and increased production expense. Our per unit production expense declined in 2005 and 2006 as we are experiencing higher production volumes due to continued drilling and higher production in conjunction with the completion of the enhanced recovery program. Generally as production increases, we will see increased production expense due to additional well costs, such as lifting and workover costs, and additional personnel costs although these costs may be lower on a volumetric basis due to higher production. The increase in our per unit general and administrative expense in 2005 was primarily due to higher compensation expense. The largest component of the increase was equity compensation, which contributed $2.0 million, $13.7 million and $2.9 million during the years ended December 31, 2004, 2005 and 2006, respectively. The annual increases in equity compensation through 2005 were attributable to additional equity grants and a higher per share valuation resulting from annual increases in our PV-10. The decline in equity compensation during 2006 was attributable to a lower per share valuation resulting from a decline in our PV-10 valuation due to lower oil and natural gas commodity prices as of December 31, 2006 compared to December 31, 2005. We compete with other companies for personnel, particularly in the operational and technical (engineering and geologic) aspects of our business. To remain competitive, we compare the compensation we pay our employees to that of our competitors through surveys, employee feedback and other means. We have experienced higher compensation expense due to competitive pressures, normal merit increases and incentive compensation. Our incentive compensation for 2004 was $413,000 compared to $4.0 million in 2005 and $2.9 million in 2006.

EBITDAX

We calculate and define EBITDAX as net income before interest expense, income taxes (when applicable), depreciation, depletion, amortization and accretion, property impairments, exploration expense and non-cash compensation expense. EBITDAX is used as a financial measure by our management team and by other users of our consolidated financial statements such as our commercial bank lenders, investors, research analysts and others to assess:

- Our operating performance and return on capital in comparison to other independent exploration and production companies, without regard to financial or capital structure;

- The financial performance of our assets and valuation of the entity without regard to financing methods, capital structure or historical cost basis; and

- Our ability to generate cash sufficient to pay interest costs and support our indebtedness.

Table of Contents

Index to Financial Statements

The following table presents our EBITDAX for each of the three years ended December 31, 2006 (in thousands):

	Year ended December 31,		
	2004	**2005**	**2006**
EBITDAX	$ 116,498	$ 285,344	$ 372,115

EBITDAX is a financial measure that is reported to our lenders each calendar quarter. Our credit facility requires that our total debt to EBITDAX ratio be no greater than 3.75 to 1 on a rolling four quarter basis. This ratio was 0.4 to 1 at December 31, 2006. Our credit facility defines EBITDAX consistently with the definition of EBITDAX utilized and presented by us. EBITDAX is not and should not be considered as an alternative to net income, operating income, cash flows from operating activities or any other measure of financial performance presented in accordance with GAAP. For a reconciliation of our consolidated net income to EBITDAX, see footnote (5) to Summary Historical and Pro Forma Consolidated Financial Data.

Recent Events

Cash Dividends. On January 10, 2007, we declared a cash dividend of approximately $18.8 million, to our shareholders and, subject to forfeiture, to holders of unvested restricted stock. On January 31, 2007, we paid $18.7 million of the dividend declared, of which $16.9 million was paid to our principal shareholder. On March 6, 2007, we declared a cash dividend of approximately $33.3 million to our shareholders of record and, subject to forfeiture, to holders of unvested restricted stock. On April 12, 2007, we paid $33.1 million of the dividend declared, of which $30.0 million was paid to our principal shareholder. We are currently a subchapter S-corporation under the rules and regulations of the Internal Revenue Service. As a result, income taxes attributable to our federal and state income are payable by our shareholders. The dividends have been paid to shareholders to fund their taxes due and estimated tax payments and not in connection with our contemplated initial public offering or conversion to a subchapter C-corporation. Upon the consummation of this offering, we will have more shareholders than the IRS rules and regulations governing S-corporations allow and, therefore, we will convert automatically from a subchapter S-corporation to a subchapter C-corporation. In connection with this conversion, we will record a charge to earnings (estimated to be approximately $178.8 million if the conversion had occurred on December 31, 2006) to recognize deferred taxes. We do not anticipate paying any additional cash dividends on our common stock in the foreseeable future.

Table of Contents

Index to Financial Statements

Results of Operations

The following tables present selected financial and operating information for each of the three years ended December 31, 2006:

	Year ended December 31,		
	2004	**2005**	**2006**
	(in thousands, except price data)		
Oil and natural gas sales	$ 181,435	$ 361,833	$ 468,602
Total revenues(1)	418,910	375,764	483,652
Operating costs and expenses(1)	365,284	166,965	213,070
Other expense	(26,810)	(13,353)	(9,568)
Income from continuing operations before income taxes	26,816	195,446	261,014
Provision for income taxes		1,139	(132)
Income from continuing operations	26,816	194,307	261,146
Discontinued operations	1,680		
Loss on sale of discontinued operations	(632)		
Net income	$ 27,864	$ 194,307	$ 261,146
Sales volumes:			
Oil (MBbl)(2)	3,688	5,708	7,459
Natural gas (MMcf)	8,794	9,006	9,225
Oil equivalents (MBoe)	5,154	7,209	8,997
Average prices(2):			
Oil, without hedges ($/Bbl)	$ 38.85	$ 52.45	$ 55.30
Oil, with hedges ($/Bbl)	37.12	52.45	55.30
Natural gas ($/Mcf)	5.06	6.93	6.08
Oil equivalents, without hedges ($/Boe)	36.45	50.19	52.09
Oil equivalents, with hedges ($/Boe)	35.20	50.19	52.09

(1) Revenues for 2004 include $226,664,000 for crude oil marketing and trading, and operating expenses include $227,210,000 for crude oil marketing and trading.

(2) Oil sales volumes are 21 MBbls less than oil production volumes for the year ended 2006. Average prices have been calculated using sales volumes.

Year Ended December 31, 2006 Compared to the Year Ended December 31, 2005

Revenues.

Oil and natural gas sales. Oil and natural gas sales for the year ended December 31, 2006 were $468.6 million, a 30% increase over sales of $361.8 million for the comparable period of 2005. Increased sales resulted from additional sales volumes, which increased 25%, and an increase of $1.90 in our realized price per Boe from $50.19 to $52.09. During 2006, we experienced an increase in the differential between NYMEX prices and our realized crude oil prices. The differential per barrel for the twelve months ended December 31, 2006 was $11.04 as compared to $5.24 for the comparable period of 2005. We realized a crude oil differential in December 2006 of $13.32 per Bbl compared to a high of $14.25 per Bbl in March 2006. Among the factors contributing to the higher differentials were higher Canadian oil imports, increases in production in the Rocky Mountain region, refinery downtime in the Rocky Mountain region, downstream transportation capacity constraints, and reduced seasonal demand for gasoline. We are unable to predict when, or if, the differential will revert back to pre-2006 levels.

Table of Contents

Index to Financial Statements

The following tables reflect our production by product and region for the periods presented.

	Year ended December 31,				
	2005		2006		Percent increase
	Volume	Percent	Volume	Percent	
Oil (MBbl)(1)	5,708	79%	7,480	83%	31%
Natural Gas (MMcf)	9,006	21%	9,225	17%	2%
Total (MBoe)	7,209	100%	9,018	100%	25%

	Year ended December 31,				
	2005		2006		Percent increase (decrease)
	MBoe	Percent	MBoe	Percent	
Rocky Mountain	5,410	75%	7,159	79%	32%
Mid-Continent	1,361	19%	1,497	17%	10%
Gulf Coast	438	6%	362	4%	(17)%
Total MBoe	7,209	100%	9,018	100%	25%

(1) Oil sales volumes are 21 MBbls less than oil production volumes for the year ended December 31, 2006.

Oil production volumes increased 31% during the year ended December 31, 2006 in comparison to the year ended December 31, 2005. Production increases in the Bakken field contributed incremental volumes in excess of 2005 levels of 815 MBbls, and the Red River units contributed 865 MBbls of incremental production. Initial production commenced in the Bakken field in August 2003 and has increased thereafter, as we have continued exploration and development activities within the field. Favorable results from the enhanced recovery program and additional field development have been the primary contributors to production growth in the Red River units.

Oil and Natural Gas Service Operations. Our oil and natural gas service operations consist primarily of sales of high-pressure air and the treatment and sale of lower quality crude oil, or reclaimed oil. We initiated the sale of high-pressure air from our Red River units to a third party in 2004 and recorded revenues of $3.1 million during 2006 and $3.0 million during 2005. Higher prices for reclaimed oil sold from our central treating unit in 2006 increased oil and natural gas service operations revenues by $0.8 million to $9.4 million at year end 2006. Associated oil and natural gas service operations expenses increased $0.2 million to $8.2 million during the year ended December 31, 2006 from $8.0 million during 2005 due mainly to an increase in the costs of purchasing and treating oil for resale.

Operating Costs and Expenses

Production Expense and Tax. Production expense increased $10.1 million or 19% during the year ended December 31, 2006 to $62.9 million from $52.8 million during the year ended December 31, 2005. The increase in 2006 was due to increases of $3.8 million in workovers, $1.4 million in energy and chemical costs, $1.5 million in repairs, $1.1 million in overhead, $0.6 million in outside operated well costs, $0.5 million in saltwater disposal expenses, $0.4 million in contract labor costs, and as a result of new wells drilled.

Production taxes increased $6.3 million during the year ended December 31, 2006 to $22.3 million from $16.0 million during 2005. The majority of the production tax increase was $5.9 million in the Rocky Mountain region. Production tax as a percentage of oil and natural gas sales was 4.4% for the year ended December 31, 2005 compared to 4.8% for the year ended December 31, 2006. Production taxes are based on the wellhead values of production and vary by state. Additionally, some states offer exemptions or reduced production tax rates for wells that produce less than a certain quantity of oil or gas and to encourage certain activities, such as horizontal drilling and enhanced recovery projects. In Montana, new horizontal wells qualify for a tax incentive and are taxed at 0.76% during the first 18 months of production. After the 18 month incentive period expires, the

Table of Contents

Index to Financial Statements

tax rate increases to 9.26%. In 2006, 33 new producing wells were added in Montana at a tax rate of 0.76% and 21 wells reached the end of their exemption period and their tax rate was increased to 9.26%. Also in the Rocky Mountain region, 8 wells were added in North Dakota at a rate of 11.5%. As production tax incentives we currently receive for horizontal wells in Montana continue to reach the end of the 18 month incentive period, our overall rate is expected to increase.

On a unit of sales basis, production expense and production taxes were as follows:

	Year ended December 31,		Percent increase (decrease)
	2005	2006	
Production expense ($/Boe)	$ 7.32	$ 6.99	(5)%
Production tax ($/Boe)	2.22	2.48	12%
Production expense and tax ($/Boe)	$ 9.54	$ 9.47	(1)%

Exploration Expense. Exploration expenses consist primarily of dry hole costs and exploratory geological and geophysical costs that are expensed as incurred. Exploration expenses increased $14.5 million in 2006 to $19.7 million due primarily to an increase in dry hole expense of $11.9 million and an increase in seismic expenses of $2.0 million. The Rocky Mountain region contributed 54% of the dry hole costs, 24% was in the Mid-Continent region and the remaining 22% was in the Gulf Coast region. The increase in dry hole expense was due to a higher level of drilling during 2006. Exploration capital expenditures were $68.7 million in 2006 compared to $9.3 million in 2005.

Depreciation, Depletion, Amortization and Accretion (DD&A.) DD&A on oil and gas properties increased $15.3 million in 2006 due to increased production and additional properties being added through our drilling program. The DD&A rate on oil and gas properties for 2005 was $6.50 per Boe compared to $6.91 per Boe for 2006. Accretion expense increased $0.1 million to $1.7 million during 2006 from $1.6 million during 2005.

Property Impairments. Property impairments increased during 2006 by $4.9 million to $11.8 million compared to $6.9 million for 2005. Non-producing properties consist of undeveloped leasehold costs and costs associated with the purchase of certain proved undeveloped reserves. Individually significant non-producing properties are periodically assessed for impairment of value and a loss is recognized at the time of impairment by providing an impairment allowance. Other non-producing properties are amortized on a composite method based on our estimated experience of successful drilling and the average holding period. Impairment of non-producing properties increased $1.0 million during 2006 to $5.4 million compared to $4.4 million for 2005.

Impairment provisions for developed oil and gas properties were approximately $2.5 million for the year ended December 31, 2005 and $6.3 million for the year ended December 31, 2006. The increase in 2006 impairment expense resulted primarily from developmental well dry holes and properties where the associated field level reserves were not sufficient to recover capitalized drilling and completion costs.

General and Administrative Expense. General and administrative expense decreased primarily due to a $10.8 million decrease in equity compensation expense net of a charge of $1.5 million associated with our President s non-equity compensation plan as described under Management Summary Compensation Table, associated with restricted stock grants and stock options under our long-term incentive plans. The decrease in equity compensation was attributable to lower per share value for our equity as a result of a decline in our PV-10 value due to lower oil and gas prices in the last half of 2006. On a volumetric basis, general and administrative expense was $2.56 per Boe for 2006 compared to $4.34 per Boe for 2005. We have granted stock options and restricted stock to our employees. The terms of the grants require that, while we are a private company, we are required to purchase vested options and restricted stock at each employee s request at a per share amount derived from our shareholders equity value adjusted quarterly for our PV-10. The obligation to purchase the options is eliminated in the event we become a reporting company under Section 12 of the Exchange Act.

Table of Contents

Index to Financial Statements

Gain on Sale of Assets. During 2005, we realized a gain of $6.1 million on the sale of oil and gas wells and a loss of $3.1 million on the termination of compressor capital leases. Gains in 2006 amounted to approximately $0.3 million on miscellaneous asset sales.

Interest Expense. Interest expense decreased 20% for 2006 due to a lower average outstanding debt balance on our credit facility of $156.6 million compared to $184.0 million for 2005 even though the weighted average interest rate on our credit facility was 6.36% for the year ended December 31, 2006 compared to 5.10% for the year ended December 31, 2005. Additionally, in 2005, we had an outstanding balance due to our principal shareholder for $48.0 million which was paid in full during December 2005. We paid $2.9 million in interest on this note during 2005 at a rate of 6%.

Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

Revenues

Oil and Natural Gas Sales. Oil and natural gas sales increased $180.4 million or 99% to $361.8 million in 2005. The increase was attributable to higher production volumes and higher oil and natural gas prices. During 2004, our average wellhead oil price was $38.85 per Bbl and our wellhead natural gas price was $5.06 per Mcf, compared to $52.45 per Bbl for oil and $6.93 per Mcf for natural gas during 2005. The increases in our wellhead prices were due to general industry price escalations in our producing regions. Our oil sales in 2004 were reduced by a $6.4 million loss in our hedging activities. We did not hedge our production during 2005. The following tables reflect our production by product and region for the periods presented:

	Year ended December 31,				
	2004		**2005**		
	Volume	**Percent**	**Volume**	**Percent**	**Percent increase**
Oil (MBbl)	3,688	72%	5,708	79%	55%
Natural Gas (MMcf)	8,794	28%	9,006	21%	2%
Total (MBoe)	5,154	100%	7,209	100%	40%

	Year ended December 31,				
	2004		**2005**		
	MBoe	**Percent**	**MBoe**	**Percent**	**Percent increase (decrease)**
Rocky Mountain	3,279	64%	5,410	75%	65%
Mid-Continent	1,461	28%	1,361	19%	(7)%
Gulf Coast	414	8%	438	6%	6%

Total MBoe	5,154	100%	7,209	100%	40%

Production increases in our Bakken field and Red River units in the Rocky Mountain region of 1,226 MBoe and 1,051 MBoe, respectively, accounted for the growth in production for 2005. We commenced drilling our initial well in the Bakken field in May 2003 and completed it as a producing well in August 2003. Our well count in the Bakken field rose from 25 gross (14.5 net) wells at December 31, 2004 to 60 gross (34.2 net) wells at December 31, 2005. Favorable response to the enhanced recovery program was the primary factor in the production growth in the Red River units.

Crude Oil Marketing and Trading. During 2004 and the first three months of 2005, we purchased barrels back from certain of our wellhead purchasers downstream of the initial sales point to exchange at the Cushing, Oklahoma hub in order to minimize pricing differentials with the NYMEX oil futures contract. In 2005, revenues of $39.8 million and expenses of $39.7 million pertaining to these marketing activities were netted as provided by Emerging Issues Task Force (EITF) 04-13, which we adopted as of January 1, 2005. We presented these purchase and sale activities gross in the 2004 income statement as crude oil marketing and trading revenues of

Table of Contents

Index to Financial Statements

$226.7 million and crude oil marketing and trading expenses of $227.2 million under the guidance provided by EITF 99-19, Reporting Revenues Gross as a Principal and/or Net as an Agent. We ceased marketing our production in this manner in March 2005 and now generally market our production at the wellhead.

Oil and Natural Gas Service Operations. Our oil and natural gas service operations consist primarily of sales of high-pressure air and the treatment and sale of lower quality crude oil (reclaimed oil). We initiated the sale of high-pressure air from our Red River units to a third party in 2004, and recorded revenues of $2.0 million and $3.0 million during 2004 and 2005, respectively. Higher prices for reclaimed oil sold from our central treating unit in 2005 increased oil and natural gas service operations revenues by $2.2 million to $8.8 million. Associated oil and natural gas service operations expenses increased $2.0 million from 2004 compared to 2005 due principally to an increase in the costs of purchasing and treating oil for resale.

Operating Costs and Expenses

Production Expense and Tax. Our production expense increased $9.0 million or 21%. This increase was primarily due to production expense associated with the 80 gross (45.4 net) productive wells drilled during 2005, industry inflation and higher energy costs in the Red River units. On a unit of production basis, production expense fell from $8.49 per Boe in 2004 to $7.32 per Boe in 2005.

Energy costs in the Red River units increased $3.0 million to $9.9 million in 2005. The increased energy costs were mainly due to higher electrical costs, resulting from higher production volumes, to run compressors for the high-pressure air injection and other enhanced recovery operations in the field. Workovers in this field also increased from $0.2 million in 2004 to $1.8 million in 2005.

Production tax increased $3.7 million or 30% in 2005 compared to the 99% increase in oil and gas sales. As a percentage of oil and natural gas revenues, production tax was 4.4% in 2005 compared to 6.8% in 2004. In the state of Montana, a horizontal well qualifies for a 0.76% production tax rate on oil and natural gas sales for the first 18 months of production. Thereafter, the production tax rate is 9.26%. All of the wells we drilled in the Montana Bakken field qualified for the reduced production tax rate.

Our oil and natural gas revenues from the Montana Bakken field increased to approximately $93.3 million in 2005 from $19.1 million in the prior year. The addition of approximately $74.2 million in oil and gas revenues at a 0.76% production tax rate was the principal reason production tax increased 30% compared to the 99% increase in oil and gas sales.

On a unit of sales basis, production expense and production tax were as follows:

	Year ended December 31,		
	2004	**2005**	**Percent decrease**

Production expense ($/Boe)	$ 8.49	$ 7.32	(14)%
Production tax ($/Boe)	2.39	2.22	(7)%
Production expense and tax ($/Boe)	$ 10.88	$ 9.54	(12)%

Exploration Expense. Exploration expense decreased from 2004 to 2005 as a result of a reduction primarily in our dry hole expense from $9.5 million in 2004 to $1.4 million in 2005. The higher dry hole expense during 2004 was primarily attributable to dry holes in the Gulf Coast region with a higher per well cost.

Depreciation, Depletion, Amortization and Accretion (DD&A). The DD&A rate per Boe decreased from $7.02 per Boe in 2004 to $6.50 per Boe in 2005. The reduction in the DD&A rate per Boe was mainly due to the addition of 32,427 MBoe of proved reserves during 2005. The amount of DD&A attributable to oil and gas properties increased by $10.6 million in 2005 due to increased production volumes. Accretion expense associated with our asset retirement obligations was $1.0 million and $1.6 million in 2004 and 2005, respectively.

Table of Contents

Index to Financial Statements

Property Impairments. We evaluate our properties on a field-by-field basis, as may be necessary, when facts and circumstances such as downward reserve revisions or lower oil and natural gas prices indicate that their carrying amounts may not be recoverable. We recorded a $6.2 million impairment in 2004 compared to a $2.5 million impairment in 2005 on producing properties. The decrease from 2004 to 2005 was due to higher impairment charges on Gulf Coast region properties during 2004. We also evaluate our undeveloped leasehold cost and adjust the acreage valuation quarterly based on our assessment of the potential for the acreage to be developed and the market value of the acreage. Undeveloped leasehold cost is expensed over the life of the lease or transferred to the associated producing properties. Individually significant non-producing properties are periodically assessed for impairment of value and a loss is recognized if necessary. During 2004 we impaired $5.5 million of undeveloped leasehold cost compared to $4.4 million during 2005.

General and Administrative Expense. The majority of the increase in general and administrative expense for 2005 was the result of higher wages and bonuses paid to our employees. The number of employees increased from 275 at year-end 2004 to 286 at year-end 2005, which, combined with salary adjustments and cash bonus increases, increased payroll and other employee-related expenses by $5.3 million during 2005. On a volumetric basis, our general and administrative expense, including equity compensation of $2.0 million and $13.7 million, respectively, was $2.41 per Boe and $4.34 per Boe for the years ended December 31, 2004 and 2005, respectively.

Equity compensation expense increased from $2.0 million in 2004 to $13.7 million in 2005 primarily due to additional equity grants and a higher per share valuation resulting from the increase in our PV-10.

Interest Expense. Interest expense declined from $23.6 million in 2004 to $14.2 million in 2005. The decline in interest expense was attributable to a lower average bank indebtedness during 2005. At December 31, 2004, we had $230.0 million outstanding on our bank credit facility with an effective interest rate of 4.36% compared to $143.0 million outstanding at December 31, 2005, with an effective interest rate of 6.08%. We incurred $6.8 million and $9.3 million in interest on our credit facility in 2004 and 2005, respectively. On November 22, 2004, we signed a note with our principal shareholder for $50.0 million due March 31, 2008. The annual rate of interest was 6.00% and interest payments were due on the last day of each calendar quarter beginning December 31, 2004. We paid $308,000 and $2.9 million in interest in 2004 and 2005, respectively on this note to our principal shareholder. In December 2005, we paid the note in full to our principal shareholder. During November 2004, we utilized available borrowing capacity under our credit facility to redeem $119.5 million of our outstanding Senior Subordinated 10.25% Notes and paid a premium of $4.1 million due on the early redemption of the Notes. Total interest expense on the Senior Subordinated Notes during 2004 was $11.4 million.

Provision for Income Taxes. We recognized income tax expense of $1.1 million during the three months ended March 31, 2005 in connection with the sale of assets acquired prior to our conversion to a subchapter S-corporation from a subchapter C-corporation on May 31, 1997. These assets had Built in gains, as defined by Section 1374 of the Internal Revenue Code, which resulted in a taxable event for us.

Discontinued Operations. In July 2004, we completed the sale of all of the outstanding stock in Continental Gas Inc. (CGI) to our shareholders for $22.6 million in cash. The sales price was representative of the fair value of the net assets based on an appraisal by an independent third party who also provided us with an opinion of the fairness from a financial point of view, of the sale of CGI to the shareholders. The CGI assets included seven natural gas gathering systems and three natural gas-processing plants. These assets represented our entire natural gas gathering, marketing and processing segment and have been classified as discontinued operations for all periods presented.

Table of Contents

Index to Financial Statements

Liquidity and Capital Resources

Our primary sources of liquidity have been cash flows generated from operating activities and financing provided by our bank credit facility and principal shareholder. In November 2004, we signed a note with our principal shareholder for $50 million due March 31, 2008. In January 2005, our principal shareholder contributed $2.0 million of the previously loaned amount to us. We paid the $48.0 million outstanding balance due on the note in December 2005. We believe that funds from operating cash flows and the bank credit facility should be sufficient to meet our cash requirements inclusive of, but not limited to, normal operating needs, debt service obligations, planned capital expenditures, and commitments and contingencies for the next 12 months. We intend to fund our longer term cash requirements beyond 12 months through operating cash flows, commercial bank borrowings and access to equity and debt capital markets. Although our longer term needs may be impacted by factors discussed in the section entitled Risk Factors, such as declines in oil and natural gas prices, drilling results, ability to obtain needed capital on satisfactory terms, and other risks which could negatively impact production and our results of operations, we currently anticipate that we will be able to generate or obtain funds sufficient to meet our long-term cash requirements. During 2006, we declared cash dividends totaling $87.6 million to existing shareholders and, subject to forfeiture, to holders of unvested restricted stock. Of this amount, $298,000 was charged to compensation expense related to the restricted stock liability. During 2006, we paid cash dividends of $87.4 million. The unpaid balance of $218,000 relates to dividends associated with unvested restricted stock and will be paid as the restricted stock vests. On January 10, 2007, we declared a cash dividend of approximately $18.8 million to our shareholders for tax purposes and, subject to forfeiture, to holders of unvested restricted stock. On January 31, 2007, we paid $18.7 million of the dividend declared. On March 6, 2007, we declared a cash dividend of approximately $33.3 million payable in April 2007 to our shareholders of record as of March 15, 2007, for tax purposes and, subject to forfeiture, to holders of unvested restricted stock. In connection with the completion of this offering, we will convert from a subchapter S-corporation to a subchapter C-corporation, and we do not anticipate paying any additional cash dividends on our common stock in the foreseeable future. At December 31, 2005 and 2006, we had cash and cash equivalents of $6.0 million and $7.0 million, respectively, and available borrowing capacity on our credit facility of $107.0 million and $160.0 million, respectively.

Cash Flow from Operating Activities

Our net cash provided by operating activities was $93.9 million, $265.3 million and $417.0 million for the years ended December 31, 2004, 2005 and 2006, respectively. The increases in operating cash flows in 2005 and 2006 were principally due to increased production and higher oil and natural gas prices. Additionally, hedging losses were $6.4 million in 2004. There were no hedges in place during 2005 and 2006.

Cash Flow from Investing Activities

During the years ended December 31, 2004, 2005 and 2006 we invested $94.3 million, $144.8 million and $326.6 million, respectively, in our capital program, inclusive of dry hole and seismic costs. The increases in our capital program in 2005 and 2006 were due to the implementation of enhanced recovery and increased density drilling in our Red River units and additional exploration and development drilling.

Cash Flow from Financing Activities

Net cash used in financing activities was $7.2 million for 2004, $141.5 million for 2005 and $91.5 million for 2006. In 2004, cash used in financing activities was primarily attributable to the repurchase of our Senior Subordinated Notes. In 2005, cash used in financing activities was primarily attributable to the repayment of long-term debt. During 2006, cash used in financing activities was primarily attributable to the payment of cash

Table of Contents

Index to Financial Statements

dividends. Our long-term debt, including the current portion and capital leases, was $290.5 million, $143.0 million and $140.0 million at December 31, 2004, 2005 and 2006, respectively.

Credit Facility

We had $143.0 million and $140.0 million outstanding under our bank credit facility at December 31, 2005 and 2006, respectively. During 2006, capital expenditures of $326.6 million and dividends of $87.4 million were funded principally by $417.0 million in cash provided by operating activities, which benefited from an increase of $77.4 million in our trade accounts payable for the year ended December 31, 2006. As of April 25, 2007, the amount outstanding under our credit facility has increased by $112.5 million to $252.5 million. The increase is largely due to borrowings to fund cash dividends of approximately $52.0 million paid in 2007 and borrowings for the reduction in our accounts payable trade balance which had increased by $50.4 million in the fourth quarter due to the increase in our fourth quarter capital expenditures. Our fourth quarter 2006 capital expenditures were approximately $105.3 million. After giving effect to this offering at an assumed public offering price of $17.00 per share and the application of the net proceeds we will receive in this offering, we expect to have borrowings of approximately $112.9 million outstanding under our credit facility.

The credit facility matures on April 12, 2011, and borrowings under our credit facility bear interest, payable quarterly, at (a) a rate per annum equal to the London Interbank Offered Rate for one, two, three or six months as offered by the lead bank plus an applicable margin ranging from 100 to 175 basis points, depending on the percentage of our borrowing base utilized or (b) the lead bank s reference rate. The credit facility has a note amount of $750.0 million, a borrowing base of $600.0 million, subject to semi-annual redetermination, and a commitment level of $300.0 million. Our next semi-annual redetermination is during October 2007. The terms of the credit facility allow us to determine the commitment level at any level up to the borrowing base.

The credit facility contains restrictive covenants that may limit our ability to, among other things, incur additional indebtedness, sell assets, make loans to others, make investments, enter into mergers, change material contracts, incur liens and engage in certain other transactions without the prior consent of the lenders. The facility also requires us to maintain certain ratios as defined and further described in our credit facility: a Current Ratio of not less than 1.0 to 1.0 (adjusted for available borrowing capacity), a Total Funded Debt to EBITDAX, as defined, of no greater than 3.75 to 1.0. As of December 31, 2006, we were in compliance with all covenants.

Capital Expenditures and Commitments

We evaluate opportunities to purchase or sell oil and natural gas properties in the marketplace and could participate as a buyer or seller of properties at various times. We seek acquisitions that utilize our technical expertise or offer opportunities to expand our existing core areas.

We invested approximately $326.6 million for capital and exploration expenditures in 2006 as follows (in millions):

	Amount

Exploration and development drilling	$ 248.6
Purchase of properties	6.6
Dry holes	13.3
Capital facilities, workovers and recompletions	21.1
Land costs	26.1
Seismic	3.9
Vehicles, computers and other equipment	7.0
	$ 326.6

Table of Contents

Index to Financial Statements

Expenditures for exploration and development of oil and natural gas properties are the primary use of our capital resources. We anticipate investing approximately $437.0 million for capital and exploration expenditures in 2007 as follows (in millions):

	Amount
Exploration and development drilling	$ 363
Capital facilities, workovers and recompletions	31
Land costs	32
Seismic	7
Vehicles, computers & other equipment	4
	$ 437

Our budgeted capital expenditures are expected to increase approximately 34% over the $326.6 million invested during 2006. We plan to invest approximately $209 million in development drilling. In the Red River units, we plan to invest approximately $151 million to drill infill wells and extend horizontal laterals on existing wells to increase production and sweep efficiency of the enhanced recovery projects. Most of the remaining development drilling budget is expected to be invested in the drilling of development wells in the Montana Bakken field. We have budgeted approximately $173 million for exploratory drilling with approximately $71 million and $82 million allocated to drilling exploratory wells in the North Dakota Bakken field and the Woodford Shale project, respectively.

Although we cannot provide any assurance, assuming successful implementation of our strategy, including the future development of our proved reserves and realization of our cash flows as anticipated, we believe that our remaining cash balance, cash flows from operations and borrowings available under our credit facility will be sufficient to satisfy our 2007 capital budget. The actual amount and timing of our capital expenditures may differ materially from our estimates as a result of, among other things, actual drilling results, the availability of drilling rigs and other services and equipment, and regulatory, technological and competitive developments.

Shareholder Distribution

In 2004, we made a distribution of $14.9 million to our shareholders and in 2005 we made a $2.0 million distribution to our shareholders. During 2006, we declared cash dividends totaling $87.6 million to existing shareholders and, subject to forfeiture, to holders of unvested restricted stock. Of this amount, $298,000 was charged to compensation expense related to the restricted stock liability. During 2006, we paid cash dividends of $87.4 million. The unpaid balance of $218,000 relates to dividends associated with unvested restricted stock and will be paid as the restricted stock vests. On January 10, 2007, we declared a cash dividend of approximately $18.8 million to our shareholders and, subject to forfeiture, to holders of unvested restricted stock. On January 31, 2007, we paid $18.7 million of the dividend declared, of which $16.9 million was paid to our principal shareholder. On March 6, 2007, we declared a cash dividend of approximately $33.3 million to our shareholders of record and, subject to forfeiture, to holders of unvested restricted stock. On April 12, 2007, we paid $33.1 million of the dividend declared, of which $30.0 was paid to our principal shareholder. In connection with the completion of this offering, we will convert from a subchapter S-corporation to a subchapter C-corporation, and we do not anticipate paying any additional cash dividends on our common stock in the foreseeable future. See Overview Recent Events.

Expenses to be Recognized Following Completion of the Offering

We expect to recognize a charge to earnings (estimated to be approximately $178.8 million if the conversion had occurred on December 31, 2006) to record deferred taxes as a result of our conversion to a C-corporation upon completion of this offering. This charge represents taxes provided on the difference between the book and tax basis of our assets. In addition, we expect to recognize a non-cash charge to earnings (estimated to be approximately $19.2 million, consisting of $3.7 million associated with restricted stock and $15.5 million

Table of Contents

Index to Financial Statements

associated with stock options, as of December 31, 2006) for compensation expense associated with a modification (as defined in SFAS 123(R)) of our equity compensation plans upon completion of this offering, assuming an offering price at the midpoint of the range set forth on the cover page of the prospectus.

The terms of our restricted stock grants and stock option grants under our equity compensation plans stipulate that while we are a private company, we are required to purchase the vested shares of restricted stock and stock acquired upon stock option exercises at the request of participants in our equity compensation plans based upon the purchase price as determined by a formula specified in each award agreement. Additionally, we have the right to purchase vested shares of restricted stock and shares issued upon stock option exercises from plan participants at the same price upon termination of the participant s employment with us for any reason for a period of two years after the termination date.

The right and requirement to purchase vested shares of our restricted stock and shares issued upon the exercise of stock options will lapse when we become a reporting company under Section 12 of the Exchange Act resulting in a modification (as defined in SFAS 123(R)) to our plan. Upon becoming a reporting company under Section 12 of the Exchange Act, we will record the charge to earnings described above to adjust to a value based on the price received in this offering.

Hedging

We account for derivative instruments in accordance with SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities. The specific accounting treatment for changes in the market value of the derivative instruments used in hedging activities is determined based on the designation of the derivative instruments as a cash flow or fair value hedge and effectiveness of the derivative instruments.

In 2004, we utilized fixed-price contracts and zero-cost collars to reduce exposure to unfavorable changes in oil and natural gas prices that are subject to significant and often volatile fluctuation. Under the fixed price physical delivery contracts we received the fixed price stated in the contract. Under the zero-cost collars, if the market price of crude oil was less than the ceiling strike price and greater than the floor strike price, we received market price. If the market price of crude oil exceeded the ceiling strike price or fell below the floor strike price, we received the applicable collar strike price. We recognized hedging losses of $6.4 million during 2004.

We did not hedge any of our oil or natural gas production during 2005 and 2006 and have not entered into any such hedges from January 1, 2007 through the date of this filing. We do not currently have plans to hedge any of our 2007 production.

Obligations and Commitments

We have the following contractual obligations and commitments as of December 31, 2006:

Payments due by period

	Total	Less than 1 year	1 - 3 years	3 - 5 years	More than 5 years
			(in thousands)		
Bank credit facility(1)	$ 140,000	$	$	$ 140,000	$
Operating lease obligations(2)	11,067	5,296	5,754	17	
Asset retirement obligations(3)	41,273	2,528	7,377	1,232	30,136
Total contractual cash obligations	$ 192,340	$ 7,824	$ 13,131	$ 141,249	$ 30,136

(1) Payments on the bank credit facility listed in the table exclude interest.

(2) Operating leases consist of compressors utilized in field operations, vehicles and office equipment.

(3) Amounts represent expected asset retirements by period.

Table of Contents

Index to Financial Statements

Critical Accounting Policies and Practices

Our historical consolidated financial statements and notes to our historical consolidated financial statements contain information that is pertinent to our management s discussion and analysis of financial condition and results of operations. Preparation of financial statements in conformity with accounting principles generally accepted in the United States requires that our management make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities. However, the accounting principles used by us generally do not change our reported cash flows or liquidity. Interpretation of the existing rules must be done and judgments made on how the specifics of a given rule apply to us.

In management s opinion, the more significant reporting areas impacted by management s judgments and estimates are revenue recognition, the choice of accounting method for oil and natural gas activities, oil and natural gas reserve estimation, asset retirement obligations and impairment of assets. Management s judgments and estimates in these areas are based on information available from both internal and external sources, including engineers, geologists and historical experience in similar matters. Actual results could differ from the estimates, as additional information becomes known.

Revenue Recognition

We derive substantially all of our revenues from the sale of oil and natural gas. Oil and gas revenues are recorded in the month the product is delivered to the purchaser and title transfers. We generally receive payment from one to three months after the sale has occurred. Each month we estimate the volumes sold and the price at which they were sold to record revenue. Variances between estimated revenue and actual amounts are recorded in the month payment is received.

Successful Efforts Method of Accounting

We utilize the successful efforts method of accounting for our oil and natural gas exploration and development activities. Exploration expenses, including geological and geophysical costs, rentals and exploratory dry holes, are charged against income as incurred. Costs of successful wells and related production equipment and developmental dry holes are capitalized and amortized on an individual property, field or unit basis using the unit-of-production method as oil and natural gas is produced. This accounting method may yield significantly different results than the full cost method of accounting.

Depreciation, depletion and amortization, or DD&A, of capitalized drilling and development costs of oil and natural gas properties are generally computed using the unit of production method on an individual property, field or unit basis based on total estimated proved developed oil and natural gas reserves. Amortization of producing leasehold is based on the unit-of-production method using total estimated proved reserves. In arriving at rates under the unit-of-production method, the quantities of recoverable oil and natural gas are established based on estimates made by our geologists and engineers and independent engineers. Service properties, equipment and other assets are depreciated using the straight-line method over estimated useful lives of 5 to 40 years. Upon sale or retirement of depreciable or depletable property, the cost and related accumulated DD&A are eliminated from the accounts and the resulting gain or loss is recognized.

Non-producing properties consist of undeveloped leasehold costs and costs associated with the purchase of certain proved undeveloped reserves. Undeveloped leasehold cost is expensed over the life of the lease or transferred to the associated producing properties. Individually significant non-producing properties are periodically assessed for impairment of value.

Table of Contents

Index to Financial Statements

Oil and Natural Gas Reserves and Standardized Measure of Future Cash Flows

Our independent engineers and technical staff prepare the estimates of our oil and natural gas reserves and associated future net cash flows. Current accounting guidance allows only proved oil and natural gas reserves to be included in our financial statement disclosures. The SEC has defined proved reserves as the estimated quantities of crude oil and natural gas which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. Even though our independent engineers and technical staff are knowledgeable and follow authoritative guidelines for estimating reserves, they must make a number of subjective assumptions based on professional judgments in developing the reserve estimates. Reserve estimates are updated at least annually and consider recent production levels and other technical information about each field. Periodic revisions to the estimated reserves and future cash flows may be necessary as a result of a number of factors, including reservoir performance, new drilling, oil and natural gas prices, cost changes, technological advances, new geological or geophysical data, or other economic factors. We cannot predict the amounts or timing of future reserve revisions. If such revisions are significant, they could significantly alter future DD&A and result in impairment of assets that may be material.

Asset Retirement Obligations

In June 2001, the FASB issued SFAS No. 143, which applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and the normal operation of a long-lived asset. The primary impact of this standard on us relates to oil and natural gas wells on which we have a legal obligation to plug and abandon. SFAS No. 143 requires us to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred and a corresponding increase in the carrying amount of the related long-lived asset. The determination of the fair value of the liability requires us to make numerous judgments and estimates, including judgments and estimates related to the future salvage value of well equipment, future costs to plug and abandon wells, future inflation rates and estimated lives of the related assets.

Impairment of Assets

All of our long-lived assets are monitored for potential impairment when circumstances indicate that the carrying value of an asset may be greater than its future net cash flows, including cash flows from risk adjusted proved reserves. The evaluations involve a significant amount of judgment since the results are based on estimated future events, such as future sales prices for oil and natural gas, future costs to produce these products, estimates of future oil and natural gas reserves to be recovered and the timing thereof, the economic and regulatory climates and other factors. The need to test a field for impairment may result from significant declines in sales prices or downward revisions to oil and natural gas reserves. Any assets held for sale are reviewed for impairment when we approve the plan to sell. Estimates of anticipated sales prices are highly judgmental and subject to material revision in future periods. Because of the uncertainty inherent in these factors, we cannot predict when or if future impairment charges will be recorded.

Off-Balance Sheet Arrangements

Currently, we do not have any off-balance sheet arrangements.

Recent Accounting Pronouncements

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123(R), Share-Based Payment , which is a revision of SFAS No. 123, Accounting for Stock-Based Compensation.

Table of Contents

Index to Financial Statements

SFAS No. 123(R) supersedes APB 25 and amends SFAS No. 95, Statement of Cash Flows. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, be recognized in the consolidated financial statements based on their estimated fair values. Pro forma disclosures are no longer an alternative.

We adopted SFAS 123(R) effective January 1, 2006. So long as we are not a reporting company under Section 12 of the Exchange Act, we have an obligation to purchase shares acquired through the exercise of stock options and vested restricted shares at a formula price set forth in the award agreements. As a result of this offering, we will no longer have this purchase obligation, and the liability will be reclassified to additional paid-in capital.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). The interpretation clarifies the accounting for uncertainty in income taxes recognized in a company s financial statements in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*. The interpretation is effective for fiscal years beginning after December 15, 2006. The adoption of FIN 48 is not expected to have a material impact on our consolidated financial position or results of operations.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Current Year Misstatements*. SAB No. 108 requires analysis of misstatements using both an income statement (rollover) approach and a balance sheet (iron curtain) approach in assessing materiality and provides for a one-time cumulative effect transition adjustment. We have applied the guidance of SAB No. 108 as of December 31, 2006. The application of this SAB had no effect on the consolidated financial statements.

In September 2006, the FASB finalized SFAS No. 157, *Fair Value Measurements* which will become effective in 2008. This Statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements; however, it does not require any new fair value measurements. The provisions of SFAS No. 157 will be applied prospectively to fair value measurements and disclosures in our Consolidated Financial Statements beginning in the first quarter of 2008. The adoption of SFAS No. 157 is not expected to have a material impact on our consolidated financial position or results of operations.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 . This Statement provides entities with an option to choose to measure eligible items at fair value at specified election dates. If elected, an entity must report unrealized gains and losses on the item in earnings at each subsequent reporting date. The fair value option: may be applied instrument by instrument, with a few exceptions, such as investments otherwise accounted for by the equity method; is irrevocable (unless a new election date occurs); and is applied only to entire instruments and not to portions of instruments. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. Management does not believe that the implementation of SFAS No. 159 will have a material impact on our financial statements.

Inflation

Historically, general inflationary trends have not had a material effect on our operating results. However, we have experienced inflationary pressure on technical staff compensation and the cost of oilfield services and equipment due to the increase in drilling activity and competitive pressures resulting from higher oil and natural gas prices in recent years.

Table of Contents

Index to Financial Statements

Quantitative and Qualitative Disclosures About Market Risk

We are exposed to a variety of market risks including credit risk, commodity price risk and interest rate risk. We address these risks through a program of risk management which may include the use of derivative instruments.

Credit Risk. We monitor our risk of loss due to non-performance by counterparties of their contractual obligations. Our principal exposure to credit risk is through the sale of our oil and natural gas production, which we market to energy marketing companies, refineries and affiliates, as described under Certain relationships and related party transactions. We monitor our exposure to these counterparties primarily by reviewing credit ratings, financial statements and payment history. We extend credit terms based on our evaluation of each counterparty s credit worthiness. Although we have not generally required our counterparties to provide collateral to support trade receivables owed to us, we routinely require prepayment of working interest holders proportionate share of drilling costs. For such prepayments, a liability is recorded and subsequently reduced as the associated work is performed. In this manner, we reduce credit risk.

Commodity Price Risk. We are exposed to market risk as the prices of crude oil and natural gas are subject to fluctuations resulting from changes in supply and demand. To partially reduce price risk caused by these market fluctuations, we have hedged in the past, and may hedge in the future, through the utilization of derivatives, including zero-cost collars and fixed price contracts, a portion of our production. We had no hedging contracts in place during 2005 and 2006 and do not currently plan to hedge any of our 2007 production. See the commodity price sensitivity analysis included in Management s Discussion and Analysis of Financial Condition Oil and Natural Gas Prices Realized .

Interest Rate Risk. Our exposure to changes in interest rates relates primarily to long-term debt obligations. We manage our interest rate exposure by limiting our variable-rate debt to a certain percentage of total capitalization and by monitoring the effects of market changes in interest rates. We may utilize interest rate derivatives to alter interest rate exposure in an attempt to reduce interest rate expense related to existing debt issues. Interest rate derivatives are used solely to modify interest rate exposure and not to modify the overall leverage of the debt portfolio. We are exposed to changes in interest rates as a result of our credit facility. We had total indebtedness of $252.5 million outstanding under our credit facility at April 25, 2007. The impact of a 1% increase in interest rates on this amount of debt would result in increased interest expense of approximately $2.5 million and a corresponding decrease in net income. The fair value of long-term debt is estimated based on quoted market prices and management s estimate of current rates available for similar issues. The following table itemizes our long-term debt maturities and the weighted-average interest rates by maturity date:

	2006	2007	2008	2009	2010	2011	Total
				(in thousands)			
Variable rate debt:							
Credit facility:							
Principal amount	$	$	$	$	$	$ 252,500	$ 252,500
Weighted-average interest rate						6.45%	6.45%

48

Table of Contents

Index to Financial Statements

Business and Properties

Our Business

We are an independent oil and natural gas exploration and production company with operations in the Rocky Mountain, Mid-Continent and Gulf Coast regions of the United States. We focus our exploration activities in large new or developing plays that provide us the opportunity to acquire undeveloped acreage positions for future drilling operations. We have been successful in targeting large repeatable resource plays where horizontal drilling, advanced fracture stimulation and enhanced recovery technologies provide the means to economically develop and produce oil and natural gas reserves from unconventional formations. As a result of these efforts, we have grown substantially through the drillbit, adding 96.2 MMBoe of proved oil and natural gas reserves through extensions and discoveries from January 1, 2001 through December 31, 2006 compared to 5.1 MMBoe added through proved reserve purchases during that same period.

As of December 31, 2006, our estimated proved reserves were 118.3 MMBoe, with estimated proved developed reserves of 87.1 MMBoe, or 74% of our total estimated proved reserves. Crude oil comprised 83% of our total estimated proved reserves. At December 31, 2006, we had 1,772 scheduled drilling locations on the 1,775,000 gross (1,071,000 net) acres that we held. For the year ended December 31, 2006, we generated revenues of $483.7 million, and operating cash flows of $417.0 million. For the first quarter of 2007, daily production averaged approximately 28,000 Boe per day.

The following table summarizes our total estimated proved reserves, PV-10 and net producing wells as of December 31, 2006, average daily production for the three months ended December 31, 2006 and the reserve-to-production ratio in our principal regions. Our reserve estimates as of December 31, 2006 are based primarily on a reserve report prepared by Ryder Scott Company, L.P., our independent reserve engineers. In preparing its report, Ryder Scott Company, L.P. evaluated properties representing approximately 83% of our PV-10. Our technical staff evaluated properties representing the remaining 17% of our PV-10.

	At December 31, 2006				Average daily production		
	Proved reserves (MBoe)	Percent of total	PV-10(1) (in millions)	Net producing wells	fourth quarter 2006 (Boe per day)	Percent of total	Annualized reserve/ production index(2)
Rocky Mountain:							
Red River units	66,527	56%	$ 791	201	11,732	44%	15.5
Bakken field	25,623	22%	441	66	7,905	30%	8.9
Other	9,077	8%	104	233	1,717	7%	14.5
Mid-Continent	16,894	14%	244	672	4,280	16%	10.8
Gulf Coast	228		4	19	869	3%	0.7
Total	118,349	100%	$ 1,584	1,191	26,503	100%	12.2

(1) PV-10 is a non GAAP financial measure and generally differs from Standardized Measure, the most directly comparable GAAP financial measure, because it does not include the effects of income taxes on future net revenues. However, our PV-10 and our Standardized Measure are equivalent because we are a subchapter S-corporation. In connection with the closing of this offering, we will convert to a subchapter C-corporation. Our pro-forma Standardized Measure, assuming our conversion to a subchapter C-corporation, was $1.0 billion at December 31, 2006. Neither PV-10 nor Standardized Measure represents an estimate of the fair market value of our oil and gas properties. We and others in the industry use PV-10 as a measure to compare the relative size and value of proved reserves held by companies without regard to the specific tax characteristics of such entities.

(2) The Annualized Reserve/Production Index is the number of years proved reserves would last assuming current production continued at the same rate. This index is calculated by dividing annualized fourth quarter 2006 production into the proved reserve quantity at December 31, 2006.

Table of Contents

Index to Financial Statements

The following table provides additional information regarding our key development areas:

	At December 31, 2006				2007 Budget	
	Developed acres		Undeveloped acres	Scheduled drilling locations(1)	Wells planned for drilling	Capital expenditures
	Gross	Net				(in millions)