SOUTHWESTERN ENERGY CO
Form 10-Q
November 07, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended **September 30, 2007**

or

[ ] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from___________ to ___________

Commission file number **1-08246**

SOUTHWESTERN ENERGY COMPANY

(Exact name of the registrant as specified in its charter)

Delaware	**71-0205415**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2350 N. Sam Houston Pkwy. E., Suite 125, Houston, Texas	**77032**
(Address of principal executive offices)	(Zip Code)

(281) 618-4700
(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year; if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding twelve months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes: X No: ___

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

Large accelerated filer X Accelerated filer ___ Non-accelerated filer ___

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes: ___ No: X

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

Class	Outstanding at November 5, 2007
Common Stock, Par Value $0.01	170,435,408

FORWARD-LOOKING INFORMATION

All statements, other than historical fact or present financial information, may be deemed to be forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements that address activities, outcomes and other matters that should or may occur in the future, including, without limitation, statements regarding the financial position, business strategy, production and reserve growth and other plans and objectives for our future operations, are forward-looking statements. Although we believe the expectations expressed in such forward-looking statements are based on reasonable assumptions, such statements are not guarantees of future performance. We have no obligation and make no undertaking to publicly update or revise any forward-looking statements.

Forward-looking statements include the items identified in the preceding paragraph, information concerning possible or assumed future results of operations and other statements in this Form 10-Q identified by words such as "anticipate," "project," "intend," "estimate," "expect," "believe," "predict," "budget," "projection," "goal," "plan," "forecast," "target" or similar expressions.

You should not place undue reliance on forward-looking statements. They are subject to known and unknown risks, uncertainties and other factors that may affect our operations, markets, products, services and prices and cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. In addition to any assumptions and other factors referred to specifically in connection with forward-looking statements, risks, uncertainties and factors that could cause our actual results to differ materially from those indicated in any forward-looking statement include, but are not limited to:

*

the timing and extent of changes in market conditions and prices for natural gas and oil (including regional basis differentials);

*

the timing and extent of our success in discovering, developing, producing and estimating reserves;

*

the economic viability of, and our success in drilling, our large acreage position in the Fayetteville Shale play, overall as well as relative to other productive shale gas plays;

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our ability to fund our planned capital investments;

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our ability to determine the most effective and economic fracture stimulation for the Fayetteville Shale formation;

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the costs and availability of oil field personnel services and drilling supplies, raw materials, and equipment and services, including pressure pumping equipment and crews in the Arkoma basin;

*

our future property acquisition or divestiture activities;

*

the effects of weather;

*

increased competition;

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the impact of federal, state and local government regulation;

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the financial impact of accounting regulations and critical accounting policies;

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the comparative cost of alternative fuels;

*

conditions in capital markets and changes in interest rates, and;

*

any other factors listed in the reports we have filed and may file with the Securities and Exchange Commission (SEC).

We caution you that these forward-looking statements are subject to all of the risks and uncertainties, many of which are beyond our control, incident to the exploration for and development, production and sale of natural gas and oil. These risks include, but are not limited to, commodity price volatility, third-party interruption of sales to market, inflation, lack of availability of goods and services, environmental risks, drilling and other operating risks, regulatory changes, the uncertainty inherent in estimating proved natural gas and oil reserves and in projecting future rates of production and timing of development expenditures and the other risks described in our Annual Report on Form 10-K for the year ended December 31, 2006 (the 2006 Annual Report on Form 10-K), and all quarterly reports on Form 10-Q filed subsequently thereto, including this Form 10-Q (Form 10-Qs).

Should one or more of the risks or uncertainties described above or elsewhere in our 2006 Annual Report on Form 10-K or the Form 10-Qs occur, or should underlying assumptions prove incorrect, our actual results and plans could differ materially from those expressed in any forward-looking statements. We specifically disclaim all responsibility to publicly update any information contained in a forward-looking statement or any forward-looking statement in its entirety and therefore disclaim any resulting liability for potentially related damages.

All forward-looking statements attributable to us are expressly qualified in their entirety by this cautionary statement.

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SOUTHWESTERN ENERGY COMPANY AND SUBSIDIARIES
BALANCE SHEETS
(Unaudited)

ASSETS

	September 30, 2007	December 31, 2006
	(in thousands)	
Current Assets		
Cash and cash equivalents	$ 615	$ 42,927
Accounts receivable	136,053	131,370
Inventories, at average cost	75,244	62,488
Hedging asset - FAS 133	69,147	64,082
Other	30,094	22,969
Total current assets	311,153	323,836
Property, Plant and Equipment, at cost		
Gas and oil properties, using the full cost method, including $288.8 million in 2007 and $166.8 million in 2006 excluded from amortization	3,692,926	2,651,427
Gas distribution systems	233,005	226,067
Gathering systems	127,714	51,836
Gas in underground storage	32,254	32,254
Other	86,939	77,702
	4,172,838	3,039,286
Less: Accumulated depreciation, depletion and amortization	1,225,527	1,022,786

		2,947,311		2,016,500
Other Assets		34,665		38,733
Total Assets	$	3,293,129	$	2,379,069

The accompanying notes are an integral part of these consolidated financial statements.

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SOUTHWESTERN ENERGY COMPANY AND SUBSIDIARIES
BALANCE SHEETS
(Unaudited)

LIABILITIES AND STOCKHOLDERS' EQUITY

		September 30, 2007		December 31, 2006
		(in thousands)		
Current Liabilities				
Current portion of long-term debt	$	1,200	$	1,200
Accounts payable		333,676		266,023
Taxes payable		12,291		16,088
Advances from partners and customer deposits		37,443		31,941
Hedging liability - FAS 133		8,145		23,864
Over-recovered purchased gas costs		15,214		10,580
Current deferred income taxes		7,004		19,162
Other		14,537		10,002
Total current liabilities		429,510		378,860
Long-Term Debt		730,300		136,600
Other Liabilities				
Deferred income taxes		459,525		370,522
Long-term hedging liability		7,915		4,902
Pension liability		9,938		11,697
Other		34,515		30,811
		511,893		417,932

Commitments and Contingencies				
Minority Interest in Partnership		10,912		11,034
Stockholders' Equity				
Common stock, $0.01 par value; authorized 540,000,000 shares, issued 170,307,333 shares in 2007 and 168,953,893 in 2006		1,703		1,690
Additional paid-in capital		768,312		740,609
Retained earnings		810,399		660,857
Accumulated other comprehensive income		34,752		31,487
Common stock in treasury, at cost, 111,162 shares in 2007		(4,652)		-
		1,610,514		1,434,643
Total Liabilities and Stockholders' Equity	$	3,293,129	$	2,379,069

The accompanying notes are an integral part of these consolidated financial statements.

SOUTHWESTERN ENERGY COMPANY AND SUBSIDIARIES
STATEMENTS OF CASH FLOWS
(Unaudited)

	For the nine months ended September 30,			
		2007		2006
	(in thousands)			
Cash Flows From Operating Activities				
Net income	$	149,542	$	128,876
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation, depletion and amortization		204,662		101,425
Deferred income taxes		91,654		78,988
Unrealized (gain) loss on derivatives		(2,669)		3,542
Stock-based compensation expense		3,839		4,034

Minority interest in partnership	(122)	(230)
Gain on sale of investment in partnership and other property	-	(10,863)
Equity in income of NOARK partnership	-	(925)
Change in assets and liabilities:		
Accounts receivable	(4,683)	47,468
Inventories	(12,756)	(11,654)
Under/over-recovered purchased gas costs	4,634	(148)
Accounts payable	21,513	(17,506)
Advances from partners and customer deposits	5,501	16,500
Deferred tax benefit - stock options	(17,858)	(7,447)
Other assets and liabilities	(8,239)	(924)
Net cash provided by operating activities	435,018	331,136
Cash Flows From Investing Activities		
Capital investments	(1,139,946)	(603,410)
Proceeds from sale of investment in partnership and other property	5,777	79,655
Other items	383	880
Net cash used in investing activities	(1,133,786)	(522,875)
Cash Flows From Financing Activities		
Debt retirement	(600)	(600)
Payments on revolving long-term debt	(628,050)	-
Borrowings under revolving long-term debt	1,222,350	-
Revolving credit facility amendment costs	(1,275)	-
Excess tax benefit for stock-based compensation	17,858	7,447
Change in bank drafts outstanding	42,013	11,768
Proceeds from exercise of common stock options	4,160	2,540
Net cash provided by financing activities	656,456	21,155
Decrease in cash and cash equivalents	(42,312)	(170,584)
Cash and cash equivalents at beginning of year	42,927	223,705
Cash and cash equivalents at end of period	$ 615	$ 53,121

The accompanying notes are an integral part of these consolidated financial statements.

SOUTHWESTERN ENERGY COMPANY AND SUBSIDIARIES
STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS)
(Unaudited)

	Common Stock Shares Issued	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Common Stock in Treasury	Accumulated Other Comprehensive Income (Loss)	Total
				(in thousands)			
Balance at December 31, 2006	168,954	$ 1,690	$ 740,609	$ 660,857	$ -	$ 31,487	$ 1,434,643
Comprehensive income:							
Net income	-	-	-	149,542	-	-	149,542
Change in value of derivatives	-	-	-	-	-	2,830	2,830
Change in value of pension liability	-	-	-	-	-	435	435
Total comprehensive income	-	-	-	-	-	-	152,807
Tax benefit for stock-based compensation	-	-	17,858	-	-	-	17,858
Stock-based compensation - FAS 123(R)	-	-	5,698	-	-	-	5,698
Exercise of stock options	1,339	13	4,147	-	-	-	4,160
Issuance of restricted stock	36	-	-	-	-	-	-
Cancellation of restricted stock	(22)	-	-	-	-	-	-
Treasury stock	-	-	-	-	(4,652)	-	(4,652)
Balance at September 30, 2007	170,307	$ 1,703	$ 768,312	$ 810,399	$ (4,652)	$ 34,752	$ 1,610,514

STATEMENT OF COMPREHENSIVE INCOME (LOSS)

	For the three months ended September 30,		For the nine months ended September 30,	
	2007	2006	2007	2006
	(in thousands)		(in thousands)	

Net income	$	50,960	$	33,477	$	149,542	$	128,876
Change in value of derivatives								
Current period reclassification to earnings		(16,136)		474		(30,075)		359
Current period ineffectiveness		(870)		(6,396)		3,939		(10,863)
Current period change in derivative instruments		39,782		44,973		28,966		133,667
Total change in value of derivatives		22,776		39,051		2,830		123,163
Current period change in pension liability		435		-		435		-
Comprehensive income, end of period	$	74,171	$	72,528	$	152,807	$	252,039

The accompanying notes are an integral part of these consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Southwestern Energy Company and Subsidiaries

September 30, 2007

(1)

BASIS OF PRESENTATION

The financial statements included herein are unaudited; however, such information reflects all adjustments (consisting solely of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the results for the interim periods. The Company's significant accounting policies, which have been reviewed and approved by the audit committee of the Company s Board of Directors, are summarized in Note 1 of the Notes to Consolidated Financial Statements included in Item 8 of the Company's Annual Report on Form 10-K for the year ended December 31, 2006 (the "2006 Annual Report on Form 10-K").

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GAS AND OIL PROPERTIES

The Company utilizes the full cost method of accounting for costs related to the exploration, development, and acquisition of natural gas and oil reserves. Under this method, all such costs (productive and nonproductive) including salaries, benefits and other internal costs directly attributable to these activities are capitalized and amortized on an aggregate basis over the estimated lives of the properties using the units-of-production method. These capitalized costs are subject to a ceiling test that limits such pooled costs to the aggregate of the present value of future net revenues attributable to proved natural gas and oil reserves discounted at 10 percent (standardized measure) plus the lower of cost or market value of unproved properties. Any costs in excess of the ceiling are written off as a non-cash expense. The expense may not be reversed in future periods, even though higher natural gas and oil prices may subsequently increase the ceiling. Full cost companies must use the prices in effect at the end of each accounting quarter, including the impact of derivatives qualifying as hedges, to calculate the ceiling value of their reserves. However, commodity price increases subsequent to the end of a reporting period but prior to the release of periodic reports may be utilized to calculate the ceiling value of reserves. At September 30, 2007, the ceiling value of the Company s reserves was calculated based upon quoted market prices of $6.38 per Mcf for Henry Hub gas and $78.25 per barrel for West Texas Intermediate oil, adjusted for market differentials. At September 30, 2007, the Company's unamortized costs of natural gas and oil properties did not exceed this ceiling amount. Cash flow hedges of gas production in place at September 30, 2007 increased the calculated ceiling value by approximately $225.0 million (net of tax). Without the effects of cash flow hedges, the Company s unamortized costs of natural gas and oil properties would have exceeded the ceiling amount. The Company had approximately 174.0 Bcf of future gas production hedged at September 30, 2007. Decreases in market prices from September 30, 2007 levels, as well as changes in production rates, levels of reserves, the evaluation of costs excluded from amortization, future development costs, and service costs could result in future ceiling test impairments.

(3)

EARNINGS PER SHARE

The following table presents the computation of earnings per share for the three and nine months ended September 30, 2007 and 2006, respectively:

	For the three months ended September 30,		For the nine months ended September 30,	
	2007	2006	2007	2006

Net Income (in thousands)	$ 50,960	$ 33,477	$ 149,542	$ 128,876
Number of Common Shares:				
Weighted average outstanding	169,795,520	167,514,249	169,292,304	167,114,831
Issued upon assumed exercise of outstanding stock options	2,506,547	3,565,013	2,847,287	3,498,226
Effect of issuance of nonvested restricted common shares	242,045	498,842	223,828	527,456
Weighted average and potential dilutive outstanding (1)	172,544,112	171,578,104	172,363,419	171,140,513
Net Income per Common Share:				
Basic	$ 0.30	$ 0.20	$ 0.88	$ 0.77
Diluted	$ 0.30	$ 0.20	$ 0.87	$ 0.75

(1) Options for 226,473 shares for the nine months ended September 30, 2007 and 220,730 shares for the comparable period of 2006 were excluded from the calculations because they would have had an antidilutive effect. Additionally, 400 shares of restricted stock for the nine months ended September 30, 2007 and 5,535 shares of restricted stock for the comparable period of 2006 were excluded from the calculations because they would have had an antidilutive effect.

(4)

DEBT

Debt balances as of September 30, 2007 and December 31, 2006 consisted of the following:

	September 30, 2007	December 31, 2006
	(in thousands)	
Short-term:		
7.15% Senior Notes due 2018 (current portion)	$ 1,200	$ 1,200
Long-term:		
Variable rate (6.10% at September 30, 2007) unsecured revolving credit facility	594,300	-

7.625% Senior Notes due 2027, putable at the holders' option		
in 2009	60,000	60,000
7.21% Senior Notes due 2017	40,000	40,000
7.15% Senior Notes due 2018	36,000	36,600
Total long-term debt	730,300	136,600
Total debt	$ 731,500	$ 137,800

On October 12, 2007, the Company amended its unsecured revolving credit facility to, among other things, increase the current borrowing capacity to $1.0 billion. Pursuant to the amendment, the amount available under the revolving credit facility may be increased to $1.25 billion at any time upon the Company s agreement with its existing or additional lenders. There was $594.3 million outstanding under the revolving credit facility at September 30, 2007, compared to no amount outstanding at December 31, 2006. The interest rate on the amended credit facility is calculated based upon the Company s debt rating and is currently 87.5 basis points over the current London Interbank Offered Rate (LIBOR). The revolving credit facility is currently guaranteed by the Company s subsidiaries, Southwestern Energy Production Company, SEECO, Inc. and Southwestern Energy Services Company and requires additional subsidiary guarantors if certain guaranty coverage levels are not satisfied. The revolving credit facility also contains covenants which impose certain restrictions on the Company. Under the credit agreement, the Company may not issue total debt in excess of 60% of its total capital, must maintain a certain level of stockholders' equity, and must maintain a ratio of earnings before interest, taxes, depreciation and amortization (EBITDA) to interest expense of 3.5 or above. There are also restrictions on the ability of the Company s subsidiaries to incur debt. At September 30, 2007, the Company s capital structure consisted of 31% debt and 69% equity and it was in compliance with the covenants of its debt agreements.

(5)

DERIVATIVES AND RISK MANAGEMENT

Management enters into various types of derivative instruments for a portion of the Company s projected gas and oil sales to reduce its exposure to market price volatility for natural gas and oil. At September 30, 2007, our gas derivative instruments consisted of price swaps, costless collars and basis swaps. Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" (FAS 133), as amended by FAS 137, FAS 138 and FAS 149, requires that all derivatives be recognized in the balance sheet as either an asset or liability measured at its fair value. Accounting for qualifying hedges allows a derivative's gains and losses to be recorded as a component of other comprehensive income. Hedges that are not elected for hedge accounting treatment or that do not meet the requirement of FAS 133 cannot be recorded as a component of other comprehensive income. The Company s hedging practices are summarized in Note 8 of the Notes to Consolidated Financial Statements of the 2006 Annual Report on Form 10-K.

At September 30, 2007, the Company's net asset recorded on the balance sheet related to its hedging activities was $74.9 million. Additionally, at September 30, 2007, the Company had recorded a gain to other comprehensive income of $44.2 million related to its hedging activities. The amount recorded in other comprehensive income will be relieved over time and taken to the income statement as the physical transactions being hedged occur. Assuming the market prices of gas futures as of September 30, 2007 remain unchanged, the Company would expect to transfer an aggregate after-tax gain of approximately $36.1 million from accumulated other comprehensive income to earnings during the next 12 months. The change in accumulated other comprehensive income related to derivatives was a gain of $36.2 million ($22.8 million after tax) compared to a gain of $62.0 million ($39.1 million after tax) for the three months ended September 30, 2007 and 2006, respectively, and a gain of $4.5 million ($2.8 million after tax) compared to a gain of $195.5 million ($123.2 million after tax) for the nine months ended September 30, 2007 and 2006, respectively. Additional volatility in earnings and other comprehensive income may occur in the future as a result of the application of FAS 133.

(6)

SEGMENT INFORMATION

The Company s three reportable business segments, Exploration and Production (E&P), Midstream Services and Natural Gas Distribution, have been identified based on the differences in products or services provided. Revenues for the E&P segment are derived from the production and sale of natural gas and crude oil. The Midstream Services segment generates revenue through the marketing of both Company and third-party produced gas volumes and through gathering fees associated with the transportation of natural gas to market. Gathering revenues are expected to increase in the future as the level of production from our Fayetteville Shale properties continues to increase. Revenues for the Natural Gas Distribution segment arise from the transportation and sale of natural gas at retail.

Summarized financial information for the Company's reportable segments is shown in the following table. The accounting policies of the segments are the same as those described in Note 1 of the Notes to Consolidated Financial Statements included in Item 8 of the 2006 Annual Report on Form 10-K. Management evaluates the performance of its segments based on operating income, defined as operating revenues less operating costs and expenses. Income before income taxes is the sum of operating income, interest expense, other income (expense) and minority interest in partnership. The "Other" column includes items not related to the Company's reportable segments including real estate, corporate items and, with respect to the nine months ended September 30, 2006, the Company s former investment in the Ozark Gas Transmission system.

	Exploration And	Midstream Services	Natural Gas	Other	Total

	Production		Distribution (in thousands)		
Three months ended September 30, 2007:					
Revenues from external customers	$ 195,569	$ 84,819	$ 17,234	$ -	$ 297,622
Intersegment revenues	8,561	154,208	20	112	162,901
Operating income (loss)	88,856	4,078	(3,541)	60	89,453
Interest and other income (loss) (1)	299	-	(216)	-	83
Depreciation, depletion and amortization expense	78,279	1,505	1,610	32	81,426
Interest expense (1)	5,483	608	1,173	-	7,264
Provision (benefit) for income taxes (1)	31,766	1,318	(1,873)	22	31,233
Assets	2,838,405	203,649	179,988	71,087 (2)	3,293,129 (2)
Capital investments (3)	381,099	31,115	2,498	1,888	416,600
Three months ended September 30, 2006:					
Revenues from external customers	$ 116,289	$ 33,830	$ 18,275	$ -	$ 168,394
Intersegment revenues	8,483	91,497	20	111	100,111
Operating income (loss)	56,326	1,259	(4,530)	63	53,118
Interest and other income (loss) (1)	1,330	-	(117)	4	1,217
Depreciation, depletion and amortization expense	38,792	174	1,470	23	40,459
Interest expense (1)	190	-	30	-	220
Provision (benefit) for income taxes (1)	21,763	474	(1,776)	57	20,518
Assets	1,818,899	73,937	185,918	101,789 (2)	2,180,543 (2)
Capital investments (3)	233,688	14,727	2,777	7,253	258,445

	Exploration And Production	Midstream Services	Natural Gas Distribution (in thousands)	Other	Total
Nine months ended September 30, 2007:					
Revenues from external customers	$ 515,458	$ 215,217	$ 121,681	$ -	$ 852,356
Intersegment revenues	31,731	436,066	172	336	468,305
Operating income	244,518	6,399	4,134	167	255,218
Interest and other income (loss) (1)	392	-	(420)	7	(21)

Depreciation, depletion and amortization expense	195,392	3,291	4,859	104	203,646
Interest expense (1)	9,122	989	3,617	-	13,728
Provision for income taxes (1)	89,496	2,055	37	66	91,654
Assets	2,838,405	203,649	179,988	71,087 (2)	3,293,129 (2)
Capital investments (3)	1,051,422	76,395	8,441	4,436	1,140,694
Nine months ended September 30, 2006:					
Revenues from external customers	$ 330,969	$ 99,166	$ 118,960	$ -	$ 549,095
Intersegment revenues	29,276	238,295	180	336	268,087
Operating income	186,606	3,128	1,285	197	191,216
Interest and other income (loss) (1)	6,184	-	(312)	11,802	17,674
Depreciation, depletion and amortization expense	95,225	580	4,636	71	100,512
Interest expense (1)	394	-	107	-	501
Provision for income taxes (1)	72,882	1,184	331	4,591	78,988
Assets	1,818,899	73,937	185,918	101,789 (2)	2,180,543 (2)
Capital investments (3)	577,905	30,639	9,108	14,470	632,122

(1)

Interest income, interest expense and the provision (benefit) for income taxes by segment are allocations as they are incurred at the corporate level.

(2)

Other assets include corporate assets not allocated to segments, assets for non-reportable segments and the Company's investment in cash equivalents.

(3)

Capital investments include a reduction of $20.2 million and $2.5 million for the three- and nine-month periods ended September 30, 2007, respectively, and an increase of $11.5 million and $26.8 million for the three- and nine-month periods ended September 30, 2006, respectively, relating to the change in accrued expenditures between periods.

Included in intersegment revenues of the Midstream Services segment are $133.7 million and $77.7 million for the third quarters of 2007 and 2006, respectively, and $382.8 million and $200.3 million for the nine months ended September 30, 2007 and 2006, respectively, for marketing of the Company's E&P sales. Intersegment sales by the E&P segment and Midstream Services segment to the Natural Gas Distribution segment are priced in accordance with the terms of existing contracts and current market conditions. Parent company assets include furniture and fixtures and prepaid costs. Parent company general and administrative costs, depreciation expense and taxes other than income are allocated to segments. All of the Company's operations are located within the United States.

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INTEREST AND INCOME TAXES PAID

The following table provides interest and income taxes paid during each period presented:

	For the nine months ended September 30,	
	2007	2006
	(in thousands)	
Interest payments	$ 19,141	$ 5,825
Income tax payments	$ -	$ 6

(8)

CONTINGENCIES AND COMMITMENTS

Operating Commitments

The Company has various operating commitments in the normal course of its operations. The Company has not made any new material operating commitments or modified its disclosed material commitments other than as disclosed in the 2006 Annual Report on Form 10-K and the Form 10-Q for the period ended June 30, 2007.

Environmental

The Company is subject to laws and regulations relating to the protection of the environment. The Company's policy is to accrue environmental and cleanup related costs of a non-capital nature when it is both probable that a liability has been incurred and when the amount can be reasonably estimated. Management believes any future remediation or other compliance related costs will not have a material adverse effect on the financial position or results of operations of the Company.

Litigation

The Company is subject to litigation and claims that arise in the ordinary course of business. The Company accrues for such items when a liability is both probable and the amount can be reasonably estimated. In the opinion of management, the results of litigation and claims currently pending will not have a material adverse effect on the financial position or results of operations of the Company.

(9)

STOCK-BASED COMPENSATION

The Company has incentive plans that provide for the issuance of equity awards, including stock options and restricted stock. These plans are discussed more fully in Note 9 of the Notes to Consolidated Financial Statements included in Item 8 of the 2006 Annual Report on Form 10-K. The Company has issued options and restricted stock under these plans. All options are issued at fair market value at the date of grant and expire seven years from the date of grant for awards under the 2004 Plan and ten years from the date of grant for awards under all other plans. Generally, stock options granted to employees and directors vest ratably over three to four years from the grant date. There were no stock options granted during the first nine months of 2007. The Company issues shares of restricted stock to employees and directors which generally vest over four years. The Company

recognizes stock-based compensation expense on a straight-line basis over the requisite service period of the individual grants with the exception of awards granted to participants who have reached retirement age and have met the minimum service requirements in order to become fully vested prior to the requisite service period.

For the third quarter and first nine months of 2007, the Company recorded compensation cost of $0.6 and $1.9 million, respectively, in general and administrative expense related to stock options. Additional amounts of $0.2 million and $0.5 million for the same respective periods were directly related to the acquisition, exploration and development activities for the Company s gas and oil properties and were capitalized into the full cost pool. The Company also recorded a deferred tax benefit of $0.7 million related to stock options for the nine months ended September 30, 2007. A total of $3.9 million of unrecognized compensation costs related to stock options not yet vested is expected to be recognized over future periods. For the third quarter and first nine months of 2006, the Company recorded compensation cost of $1.4 and $2.5 million, respectively, in general and administrative expense related to stock options. Additional amounts of $0.1 million and $0.4 million for the same respective periods were directly related to the acquisition, exploration and development activities for the Company s gas and oil properties and were capitalized into the full cost pool.

For the third quarter and first nine months of 2007, the Company recorded compensation cost of $0.6 and $1.9 million, respectively, in general and administrative expense related to prior restricted stock grants. Additional amounts of $0.5 million and $1.4 million for the same respective periods were directly related to the acquisition, exploration and development activities for the Company s gas and oil properties and were capitalized into the full cost pool. As of September 30, 2007, there was $9.6 million of total unrecognized compensation cost related to nonvested shares of restricted stock. For the third quarter and first nine months of 2006, the Company recorded compensation cost of $0.6 and $1.5 million, respectively, in general and administrative expense related to restricted stock. Additional amounts of $0.3 million and $0.9 million for the same respective periods were directly related to the acquisition, exploration and development activities for the Company s gas and oil properties and were capitalized into the full cost pool.

The following tables summarize stock option activity for the first three quarters of 2007 and provide information for options outstanding at September 30, 2007:

	Number of Options	Weighted Average Exercise Price
Outstanding at December 31, 2006	5,792,240	$ 6.19
Granted	-	-
Exercised	(1,338,931)	3.11
Forfeited or expired	(12,000)	20.91
Outstanding at September 30, 2007	4,441,309	$ 7.09
Exercisable at September 30, 2007	3,893,005	$ 3.96

During the first nine months of 2007 and 2006 there were no options granted. The total intrinsic value of options exercised during the first nine months of 2007 and 2006 was $52.1 million and $25.6 million, respectively. Associated with the exercise of stock options, the Company received a tax benefit of $17.9 million and $7.4 million in the first nine months of 2007 and 2006, respectively. The tax benefit is recorded as an increase in additional paid-in capital.

	Options Outstanding				Options Exercisable		
Range of Exercise Prices	Options Outstanding at September 30, 2007	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value (in thousands)	Options Exercisable at September 30, 2007	Weighted Average Exercise Price	Aggregate Intrinsic Value (in thousands)

$1.50 - $1.86	1,683,243	$ 1.75	2.8		1,683,243	$ 1.75	
$1.87 - $2.85	461,307	2.52	3.8		461,307	2.52	
$2.86 - $5.00	751,806	2.91	4.9		751,806	2.91	
$5.01 - $12.00	733,514	5.49	6.2		693,514	5.45	
$12.01 - $42.00	811,439	26.06	5.0		303,135	17.63	
	4,441,309	$ 7.09	4.2	$ 154,401	3,893,005	$ 3.96	$ 147,501

The following table summarizes restricted stock activity for the first nine months of 2007:

	Number of Shares	Weighted Average Grant Date Fair Value
Unvested shares at December 31, 2006	478,732	$ 25.30
Granted	35,550	39.07
Vested	(16,633)	17.79
Forfeited	(21,842)	29.99
Unvested shares at September 30, 2007	475,807	$ 26.37

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PENSION PLAN AND OTHER POSTRETIREMENT BENEFITS

The Company applies Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." Substantially all employees are covered by the Company's defined benefit pension and postretirement benefit plans. Net periodic pension and other postretirement benefit costs include the following components for the three- and nine-month periods ended September 30, 2007 and 2006:

	Pension Benefits			
	For the three months ended September 30,		For the nine months ended September 30,	
	2007	2006	2007	2006
	(in thousands)			

Service cost	$ 995	$ 753	$ 2,987	$ 2,258
Interest cost	1,061	971	3,182	2,911
Expected return on plan assets	(1,140)	(1,145)	(3,419)	(3,433)
Amortization of prior service cost	119	109	356	327
Amortization of net loss	115			