

SOUTHWESTERN ENERGY CO
Form 10-Q
July 30, 2008

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

Form 10-Q

(Mark One)

Quarterly Report pursuant to Section 13 or 15(d) of the Securities

Exchange Act of 1934

For the quarterly period ended **June 30, 2008**

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 registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or
organization)

71-0205415

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

**2350 North Sam Houston Parkway East, Suite
125, Houston, Texas**

(Address of principal executive offices)

77032

(Zip Code)

(281) 618-4700

(Registrant's telephone number, including area code)

Not Applicable

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(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 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

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

Class	Outstanding as of July 25, 2008
Common Stock, Par Value \$0.01	343,184,434

CAUTIONARY STATEMENT ABOUT FORWARD-LOOKING STATEMENTS

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, except as may be required by law.

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

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:

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

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

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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 impact of federal, state and local government regulation, including any increase in severance taxes;

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

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our future property acquisition or divestiture activities;

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the effects of weather;

increased competition;

the financial impact of accounting regulations and critical accounting policies;

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 contained in this Form 10-Q 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, 2007 (the 2007 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 this Form 10-Q 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.

PART I

FINANCIAL INFORMATION

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SOUTHWESTERN ENERGY COMPANY AND SUBSIDIARIES
STATEMENTS OF OPERATIONS
(Unaudited)

For the three months ended		For the six months ended	
June 30,		June 30,	
2008	2007	2008	2007

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(in thousands, except share/per share amounts)

Operating Revenues:

Gas sales	\$	368,879	\$	184,059	\$	729,550	\$	395,703
Gas marketing		208,071		72,238		345,298		127,555
Oil sales		15,538		10,216		29,251		19,453
Gas gathering, transportation and other		11,882		3,569		24,377		12,023
		604,370		270,082		1,128,476		554,734

Operating Costs and Expenses:

Gas purchases – midstream services		202,889		69,488		335,341		122,705
Gas purchases – gas distribution		9,544		7,427		61,439		55,408
Operating expenses		30,030		20,485		54,026		40,522
General and administrative expenses		25,741		17,935		49,481		34,683
Depreciation, depletion and amortization		98,151		66,435		195,248		122,220
Taxes, other than income taxes		8,729		6,306		16,145		13,431
		375,084		188,076		711,680		388,969
Operating Income		229,286		82,006		416,796		165,765

Interest Expense:

Interest on long-term debt		15,659		7,384		32,745		11,509
Other interest charges		619		545		1,267		926
Interest capitalized		(7,281)		(2,923)		(13,486)		(5,971)
		8,997		5,006		20,526		6,464
Other Income (Loss)		169		(125)		176		(104)

Income Before Income Taxes and Minority Interest

		220,458		76,875		396,446		159,197
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Minority Interest in Partnership

		(215)		(111)		(350)		(194)
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Income Before Income Taxes

		220,243		76,764		396,096		159,003
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Provision for Income Taxes

Current		46,500				46,500		
Deferred		37,193		29,170		104,017		60,421

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		83,693		29,170		150,517		60,421
Net Income	\$	136,550	\$	47,594	\$	245,579	\$	98,582

Earnings Per Share:

Basic	\$	0.40	\$	0.14 ⁽¹⁾	\$	0.72	\$	0.29 ⁽¹⁾
Diluted	\$	0.39	\$	0.14 ⁽¹⁾	\$	0.71	\$	0.29 ⁽¹⁾

**Weighted Average
Common Shares
Outstanding:**

Basic		341,402,888		338,933,824 ⁽¹⁾		341,233,574		338,073,050 ⁽¹⁾
Diluted		346,551,198		345,001,082 ⁽¹⁾		346,287,843		344,537,804 ⁽¹⁾

(1) Restated to reflect the two-for-one stock split effect on March 25, 2008.

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

**SOUTHWESTERN ENERGY COMPANY AND SUBSIDIARIES
BALANCE SHEETS**

(Unaudited)

Assets

June 30,
2008

December 31,
2007

(in thousands)

Current Assets

Cash and cash equivalents	\$	177,091	\$	727
Accounts receivable		306,794		177,680
Inventories, at average cost		27,814		33,034

Hedging asset FAS 133	52,048	64,472
Deferred income tax benefit	173,807	
Current assets held for sale (see Note 4)	42,926	58,877
Other	25,513	28,551
Total current assets	805,993	363,341
Property, Plant and Equipment, at cost		
Gas and oil properties, using the full cost method, including \$415.9 million in 2008 and \$372.4 million in 2007 excluded from amortization	4,162,839	4,020,448
Gathering systems	236,432	158,604
Gas in underground storage	13,349	13,349
Other	97,752	85,983
	4,510,372	4,278,384
Less: Accumulated depreciation, depletion and amortization	1,392,380	1,200,754
	3,117,992	3,077,630
Assets Held For Sale (see Note 4)	142,971	143,234
Other Assets	70,504	38,511
Total Assets	\$ 4,137,460	\$ 3,622,716

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

LIABILITIES AND STOCKHOLDERS EQUITY

	June 30, 2008	December 31, 2007
	(in thousands)	
Current Liabilities		
Short-term debt	\$ 61,200	\$ 1,200
Accounts payable	427,702	313,070
Taxes payable	56,981	5,087
Interest payable	22,288	2,213
Advances from partners	43,188	32,005
Hedging liability FAS 133	519,313	8,598
Current deferred income taxes		20,909
Current liabilities associated with assets held for sale (see Note 4)	32,633	39,118
Other	6,144	8,695
Total current liabilities	1,169,449	430,895
Long-Term Debt	674,800	977,600
Other Liabilities		
Deferred income taxes	450,089	479,196
Long-term hedging liability	301,668	15,186
Pension liability	11,352	12,268
Liabilities associated with assets held for sale (see Note 4)	17,005	15,417
Other	39,377	35,084
	819,491	557,151
Commitments and Contingencies		
Minority Interest in Partnership	10,718	10,570
Stockholders Equity		
Common stock, \$0.01 par value; authorized 540,000,000 shares, issued 342,786,381 shares in 2008 and 341,581,672 in 2007 ⁽¹⁾	3,428	3,416
Additional paid-in capital ⁽¹⁾	798,750	752,369
Retained earnings	1,127,610	882,031
	(462,061)	13,348

Accumulated other comprehensive income (loss)			
Common stock in treasury, 224,594 shares in 2008 and 222,774 in 2007 ⁽¹⁾	(4,725)		(4,664)
	1,463,002		1,646,500
Total Liabilities and Stockholders Equity	\$ 4,137,460	\$	3,622,716

(1) 2007 restated to reflect the two-for-one stock split effected on March 25, 2008.

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

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

	For the six months ended June 30,	
	2008	2007
	(in thousands)	
Cash Flows From Operating Activities		
Net Income	\$ 245,579	\$ 98,582
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion and amortization	196,411	122,887
Deferred income taxes	104,017	60,421
Unrealized loss on derivatives	20,345	4,589
Stock-based compensation expense	5,839	2,648

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Gain on sale of property, plant and equipment	(392)	
Minority interest in partnership	148	59
Change in assets and liabilities:		
Accounts receivable	(112,355)	(21,786)
Inventories	1,790	811
Under/over-recovered purchased gas costs	(2,922)	4,101
Accounts payable	84,805	14,403
Taxes payable	51,131	(4,876)
Interest payable	19,953	358
Advances from partners and customer deposits	11,003	(1,161)
Deferred tax benefit stock options	(39,332)	(17,764)
Other assets and liabilities	2,232	(5,054)
Net cash provided by operating activities	588,252	258,218

Cash Flows From Investing Activities

Capital investments	(812,421)	(704,583)
Proceeds from sale of property, plant and equipment	590,513	2,712
Other items	(296)	158
Net cash used in investing activities	(222,204)	(701,713)

Cash Flows From Financing Activities

Debt retirement	(600)	(600)
Payments on revolving long-term debt	(1,843,600)	(355,200)
Borrowings under revolving long-term debt	1,001,400	715,300
Proceeds from issuance of long-term debt	600,000	
Debt issuance cost and revolving credit facility costs	(8,895)	(1,275)
Excess tax benefit for stock-based compensation	39,332	17,764
Change in bank drafts outstanding	19,643	21,056
Proceeds from exercise of common stock options	2,067	3,834
Net cash provided by (used in) financing activities	(190,653)	400,879
Increase (decrease) in cash and cash equivalents	175,395	(42,616)
Cash and cash equivalents at beginning of year ⁽¹⁾	1,832	42,927
Cash and cash equivalents at end of period ⁽¹⁾	\$ 177,227	\$ 311

(1) Cash and cash equivalents includes amounts classified as held for sale. See Note 4 for additional information.

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 ⁽¹⁾		Additional	Retained	Accumulated	Common		
	Shares	Amount	Paid-In	Earnings	Other	Treasury	Stock in	Total
	Issued		Capital ⁽¹⁾	(in thousands)	Income (Loss)			
Balance at December 31, 2007	341,578	\$ 3,416	\$ 752,369	\$ 882,031	\$ 13,348	\$ (4,664)	\$ (4,664)	\$ 16,500
Comprehensive income:								
Net income				245,579				245,579
Change in value of derivatives					(475,828)			(475,828)
Change in value of pension liability					419			419
Total comprehensive income (loss)								(229,830)
Tax benefit for stock-based compensation			39,332					39,332
Stock-based compensation FAS 123(R)			4,912					4,912
Exercise of stock options	1,148	11	2,056					2,067

Issuance of restricted stock	78	1	(1)				
Cancellation of restricted stock	(22)						
Issuance of stock awards	4		82				82
Treasury stock non-qualified plan						(61)	(61)
Balance at June 30, 2008	342,786	\$ 3,428	\$ 798,750	\$ 1,127,610	\$ (462,061)	\$ (4,126)	\$ 3,002

(1) 2007 restated to reflect the two-for-one stock split effected on March 25, 2008.

STATEMENT OF COMPREHENSIVE INCOME (LOSS)

	For the three months ended		For the six months ended	
	June 30, 2008	2007	June 30, 2008	2007
	(in thousands)			
Net Income	\$ 136,550	\$ 47,594	\$ 245,579	\$ 98,582
Change in value of derivatives				
Current period reclassification to earnings	47,358	(1,798)	35,646	(14,054)
Current period ineffectiveness	17,822	(114)	26,281	4,809
Current period change in derivative instruments	(348,873)	40,130	(537,755)	(10,701)
Total change in value of derivatives	(283,693)	38,218	(475,828)	(19,946)
Current period change in pension and other postretirement liability	210		419	

Comprehensive income (loss), end of period	\$	(146,933)	\$	85,812	\$	(229,830)	\$	78,636
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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

June 30, 2008

(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, 2007 (the "2007 Annual Report on Form 10-K").

In February 2008, the Board of Directors declared a two-for-one stock split with respect to the Company's common stock, which was effected in March 2008. All historical per share information in the financial statements and footnotes has been adjusted, as necessary, to reflect the two-for-one stock split.

Certain reclassifications have been made to the prior years' financial statements to conform to the 2008 presentation. The effects of the reclassifications were not material to the Company's consolidated financial statements.

(2)

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 June 30, 2008 and 2007, the Company's unamortized costs of natural gas and oil properties did not exceed this ceiling amount. At June 30, 2008, the ceiling value of the Company's reserves was calculated based upon quoted market prices of \$13.10 per Mcf for Henry Hub gas and \$136.50 per barrel for West Texas Intermediate oil, adjusted for market differentials. Cash flow hedges of gas production in place at June 30, 2008, decreased the calculated ceiling value by approximately \$475.4 million (net of tax). The Company had approximately 237.5 Bcf of future gas production hedged at June 30, 2008. Decreases in market prices from June 30, 2008 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.

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(3)

EARNINGS PER SHARE

The following table presents the computation of earnings per share for the three and six months ended June 30, 2008 and 2007, respectively. For the periods ended June 30, 2007, all shares and per share amounts (including exercise prices for assumed exercises of stock options) have been restated to reflect the two-for-one stock split effected on March 25, 2008:

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	For the three months ended		For the six months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Net Income (in thousands)	\$ 136,550	\$ 47,594	\$ 245,579	\$ 98,582
Number of Common Shares:				
Weighted average outstanding	341,402,888	338,933,824	341,233,574	338,073,050
Issued upon assumed exercise of outstanding stock options	4,662,932	5,578,220	4,628,168	6,035,314
Effect of issuance of nonvested restricted common shares	485,378	489,038	426,101	429,440
Weighted average and potential dilutive outstanding ⁽¹⁾	346,551,198	345,001,082	346,287,843	344,537,804
Net Income per Common Share:				
Basic	\$ 0.40	\$ 0.14	\$ 0.72	\$ 0.29
Diluted	\$ 0.39	\$ 0.14	\$ 0.71	\$ 0.29

(1) Options for 387,659 shares for the six months ended June 30, 2008 and 419,460 shares for the comparable period of 2007 (as adjusted for the stock split) were excluded from the calculations because they would have had an antidilutive effect. Additionally, 16,189 shares of restricted stock for the six months ended June 30, 2008 and 400 shares of restricted stock for the comparable period of 2007 (as adjusted for the stock split) were excluded from the calculations because they would have had an antidilutive effect.

(4)

ASSETS HELD FOR SALE

In November 2007, the Company entered into an agreement to sell all of the capital stock of Arkansas Western Gas Company (AWG) for \$224 million plus working capital. On July 1, 2008, the transaction was closed and the Company received approximately \$230 million, subject to post-closing adjustments. The Company expects to record a gain on the sale of approximately \$55 million in the third quarter of 2008. Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (FAS 144), requires that

long-lived assets or disposal groups to be sold should be classified as held for sale in the period in which certain criteria are met. Accordingly, the assets and liabilities of AWG have been presented as held for sale in the June 30, 2008 and December 31, 2007 balance sheets.

The following table presents the assets and liabilities of AWG as of June 30, 2008 and December 31, 2007:

	June 30, 2008	December 31, 2007
	(in thousands)	
Current Assets:		
Cash	\$ 136	\$ 1,105
Accounts receivable	13,067	29,826
Inventory	24,029	23,737
Hedging asset FAS 133		2,387
Deferred income tax benefit	4,504	
Other current assets	1,190	1,822
	\$ 42,926	\$ 58,877
Long-term assets, including property, plant and equipment, net of accumulated depreciation and amortization	\$ 142,971	\$ 143,234
Current Liabilities:		
Accounts payable	\$ 3,540	\$ 3,700
Interest payable	48	171
Taxes payable	6,784	7,547
Deferred gas purchases	13,367	16,289
Customer deposits	7,371	7,551
Hedging liability FAS 133		2,387
Other current liabilities	1,523	1,473
	\$ 32,633	\$ 39,118
Long-term Liabilities:		
Deferred income taxes	\$ 16,690	\$ 15,066
Other long-term liabilities	315	351
	\$ 17,005	\$ 15,417

(5)

DEBT

Debt balances as of June 30, 2008 and December 31, 2007 consisted of the following:

	June 30, 2008	December 31, 2007
	(in thousands)	
Short-term debt:		
7.625% Senior Notes due 2027, putable at the holders' option in 2009	\$ 60,000	\$
7.15% Senior Notes due 2018	1,200	1,200
Total short-term debt	61,200	1,200
Long-term debt:		
Variable rate unsecured revolving credit facility, expires February 2012		842,200
7.5% Senior Notes due 2018	600,000	
7.625% Senior Notes due 2027, putable at the holders' option in 2009		60,000
7.21% Senior Notes due 2017	40,000	40,000
7.15% Senior Notes due 2018	34,800	35,400
Total long-term debt	674,800	977,600
Total debt	\$ 736,000	\$ 978,800

On January 16, 2008, the Company issued \$600 million of 7.5% Senior Notes due 2018 in a private placement. The 7.5% Senior Notes are redeemable at the Company's election, in whole or in part, at any time at a redemption price equal to the greater of: (1) 100% of the principal amount of the notes to be redeemed then outstanding; and (2) the sum of the present values of the remaining scheduled payments of principal and interest on the notes to be redeemed (not including any portion of such payments of interest accrued to the date of redemption) discounted to the redemption date on a semiannual basis as determined in accordance with the indenture, plus 50 basis points, plus, in either of such cases, accrued and unpaid interest to the date of redemption on the notes to be redeemed. In addition, if the Company undergoes a change of control, as defined in the indenture, holders of the 7.5% Senior Notes will have the option to require the Company to purchase all or any portion of the notes at a purchase price equal to 101% of the principal amount of the notes to be purchased plus any accrued and unpaid interest to, but excluding, the change of control date. Payment obligations with respect to the 7.5% Senior Notes are currently guaranteed by the Company's

subsidiaries, SEECO, Inc. (SEECO), Southwestern Energy Production Company (SEPCO) and Southwestern Energy Services Company (SES), which guarantees may be unconditionally released in certain circumstances. As a result of the issuance of the guarantees of the 7.5% Senior Notes, and in order for all of the Company's senior notes to rank equally, on May 2, 2008, the Company and its subsidiaries, SEECO, SEPCO and SES, entered into supplemental indenture agreements with the trustees under the indentures relating to the Company's 7.625% Medium-Term Notes due 2027, 7.125% Fixed Rate Notes due October 10, 2017, 7.35% Fixed Rate Notes due October 2, 2017 and 7.15% Notes due 2018, pursuant to which SEECO, SEPCO and SES became guarantors of such notes to the same extent to which such subsidiaries have guaranteed the

Company's 7.5% Senior Notes. Please refer to Note 6, "Condensed Consolidating Financial Information" in this Form 10-Q for additional information. The indentures governing the Company's senior notes contain covenants that, among other things, restrict the ability of the Company and/or its subsidiaries to incur liens, to engage in sale and leaseback transactions and to merge, consolidate or sell assets.

In October 2007, the Company amended its unsecured revolving credit facility increasing the borrowing capacity to \$1.0 billion. The amendment also provides that 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. 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, SEECO, SEPCO, and SES and requires additional subsidiary guarantors if certain guaranty coverage levels are not satisfied. At June 30, 2008, the Company's capital structure consisted of 33% debt and 67% equity and it was in compliance with the covenants of its debt agreements.

(6)

CONDENSED CONSOLIDATING FINANCIAL INFORMATION

The Company is providing condensed consolidating financial information for SEECO, SEPCO and SES, its subsidiaries that are guarantors of the Company's registered public debt, and for its other subsidiaries that are not guarantors. These wholly owned subsidiary guarantors have jointly and severally, fully and unconditionally guaranteed the Company's 7.625% Senior Notes and 7.21% Senior Notes. The subsidiary guarantees (i) rank equally in right of payment with all of the existing and future senior debt of the subsidiary guarantors; (ii) rank senior to all of the existing and future subordinated debt of the subsidiary guarantors; (iii) are effectively subordinated to any future secured obligations of the subsidiary guarantors to the extent of the value of the assets securing such obligations; and (iv) are structurally subordinated to all debt and other obligations of the subsidiaries of the guarantors.

The Company has not presented separate financial and narrative information for each of the subsidiary guarantors because it believes that such financial and narrative information would not provide any additional information that would be material in evaluating the sufficiency of the guarantees. The following condensed consolidating financial information summarizes the results of operations, financial position and cash flows for the Company's guarantor and non-guarantor subsidiaries.

CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS
(Unaudited)

Three months ended June 30, 2008:	Parent	Guarantors	Non- Guarantors (in thousands)	Eliminations	Consolidated
Operating revenues	\$	\$ 577,034	\$ 64,105	\$ (36,769)	\$ 604,370
Operating costs and expenses:					
Gas purchases		212,903	20,464	(20,934)	212,433
Operating expenses		28,394	17,324	(15,688)	30,030
General and administrative expenses		19,416	6,472	(147)	25,741
Depreciation, depletion and amortization		93,762	4,389		98,151
Taxes, other than income taxes		7,206	1,523		8,729
Total operating costs and expenses		361,681	50,172	(36,769)	375,084
Operating income		215,353	13,933		229,286
Other income (loss)		328	(159)		169
Equity in earnings of subsidiaries	136,550			(136,550)	
Interest expense		4,273	4,724		8,997

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Income before income taxes and minority interest	136,550	211,408	9,050	(136,550)	220,458
Minority interest in partnership		(215)			(215)
Provision for income taxes		80,254	3,439		83,693
Net income	\$ 136,550	\$ 130,939	\$ 5,611	\$ (136,550)	\$ 136,550

Three months ended June 30, 2007:	Parent	Guarantors	Non-Guarantors (in thousands)	Eliminations	Consolidated
Operating revenues	\$	\$ 252,273	\$ 37,515	\$ (19,706)	\$ 270,082
Operating costs and expenses:					
Gas purchases		75,399	16,187	(14,671)	76,915
Operating expenses		13,753	11,624	(4,892)	20,485
General and administrative expenses		12,771	5,307	(143)	17,935
Depreciation, depletion and amortization		63,635	2,800		66,435
Taxes, other than income taxes		5,278	1,028		6,306
Total operating costs and expenses		170,836	36,946	(19,706)	188,076
Operating income		81,437	569		82,006
Other income (loss)		24	(149)		(125)
Equity in earnings of subsidiaries	47,594			(47,594)	
Interest expense		3,512	1,494		5,006
Income before income taxes and minority interest	47,594	77,949	(1,074)	(47,594)	76,875
Minority interest in partnership		(111)			(111)
Provision (benefit) for income taxes		29,579	(409)		29,170
Net income	\$ 47,594	\$ 48,259	\$ (665)	\$ (47,594)	\$ 47,594

CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS (Continued)
(Unaudited)

Six months ended June 30, 2008:	Parent	Guarantors	Non- Guarantors (in thousands)	Eliminations	Consolidated
Operating revenues	\$	\$ 1,027,645	\$ 170,825	\$ (69,994)	\$ 1,128,476
Operating costs and expenses:					
Gas purchases		359,776	79,120	(42,116)	396,780
Operating expenses		50,296	31,319	(27,589)	54,026
General and administrative expenses		37,115	12,655	(289)	49,481
Depreciation, depletion and amortization		186,769	8,479		195,248
Taxes, other than income taxes		13,140	3,005		16,145
Total operating costs and expenses		647,096	134,578	(69,994)	711,680
Operating income		380,549	36,247		416,796
Other income (loss)		441	(265)		176
Equity in earnings of subsidiaries	245,579			(245,579)	
Interest expense		12,865	7,661		20,526
Income before income taxes and minority interest	245,579	368,125	28,321	(245,579)	396,446
Minority interest in partnership		(350)			(350)

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Provision for income taxes		139,755	10,762		150,517
Net income	\$ 245,579	\$ 228,020	\$ 17,559	\$ (245,579)	\$ 245,579

Six months ended June 30, 2007:	Parent	Guarantors	Non- Guarantors (in thousands)	Eliminations	Consolidated
Operating revenues	\$	\$ 473,752	\$ 121,631	\$ (40,649)	\$ 554,734
Operating costs and expenses:					
Gas purchases		139,254	70,404	(31,545)	178,113
Operating expenses		26,159	23,179	(8,816)	40,522
General and administrative expenses		24,124	10,847	(288)	34,683
Depreciation, depletion and amortization		116,376	5,844		122,220
Taxes, other than income taxes		11,250	2,181		13,431
Total operating costs and expenses		317,163	112,455	(40,649)	388,969
Operating income		156,589	9,176		165,765
Other income (loss)		94	(198)		(104)
Equity in earnings of subsidiaries	98,582			(98,582)	
Interest expense		3,605	2,859		6,464
Income before income taxes and minority interest	98,582	153,078	6,119	(98,582)	159,197
Minority interest in partnership		(194)			(194)
Provision for income taxes		58,096	2,325		60,421
Net income	\$ 98,582	\$ 94,788	\$ 3,794	\$ (98,582)	\$ 98,582

CONDENSED CONSOLIDATING BALANCE SHEETS

(Unaudited)

June 30, 2008:	Parent	Guarantors	Non-Guarantors (in thousands)	Eliminations	Consolidated
ASSETS					
Cash and cash equivalents	\$ 213,929	\$ (37,368)	\$ 530	\$	\$ 177,091
Accounts receivable	357	302,731	3,706		306,794
Inventories, at average cost	38	27,141	635		27,814
Current assets held for sale (see Note 4)			42,926		42,926
Other	7,087	243,829	452		251,368
Total current assets	221,411	536,333	48,249		805,993
Intercompany receivables/note	1,170,559	(930,169)	(166,021)	(74,369)	
Investments		8,810	(8,809)	(1)	
Property, plant and equipment, at cost	50,865	4,198,844	260,663		4,510,372
Accumulated depreciation, depletion and amortization	(26,819)	(1,333,839)	(31,722)		(1,392,380)
Net property, plant and equipment	24,046	2,865,005	228,941		3,117,992
Investments in subsidiaries (equity method)	890,864			(890,864)	
Assets held for sale (see Note 4)			142,971		142,971
Other assets	15,760	34,891	19,853		70,504
Total assets	\$ 2,322,640	\$ 2,514,870	\$ 265,184	\$ (965,234)	\$ 4,137,460

LIABILITIES AND STOCKHOLDERS EQUITY

Accounts and notes payable	\$ 248,944	\$ 307,727	\$ 23,200	\$ (11,700)	\$ 568,171
Current liabilities associated with assets held for sale (see Note 4)			32,633		32,633
Other current liabilities	1,494	565,749	1,402		568,645
Total current liabilities	250,438	873,476	57,235	(11,700)	1,169,449
Long-term debt	674,800				674,800
Indebtedness to related parties noncurrent			62,670	(62,670)	
Liabilities associated with assets held for sale (see Note 4)			17,005		17,005
Other liabilities	29,444	317,462	5,491		352,397
Commitments and contingencies					
Deferred income taxes	(95,044)	538,846	6,287		450,089
Minority interest in partnership		10,718			10,718
Total liabilities	859,638	1,740,502	148,688	(74,370)	2,674,458
Stockholders equity	1,463,002	774,368	116,496	(890,864)	1,463,002
Total liabilities and stockholders equity	\$ 2,322,640	\$ 2,514,870	\$ 265,184	\$ (965,234)	\$ 4,137,460

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(Unaudited)

December 31, 2007:	Parent	Guarantors	Non-Guarantors (in thousands)	Eliminations	Consolidated
ASSETS					
Cash	\$ 10,040	\$ (9,607)	\$ 294	\$	\$ 727
Accounts receivable	346	173,772	3,562		177,680
Inventories, at average cost		33,034			33,034
Current assets held for sale (see Note 4)			58,877		58,877
Other	8,270	83,572	1,181		93,023
Total current assets	18,656	280,771	63,914		363,341
Intercompany receivables/note	1,555,926	(1,313,826)	(148,949)	(93,151)	
Investments		8,444	(8,443)	(1)	
Property, plant and equipment, at cost	47,623	4,016,483	214,278		4,278,384
Accumulated depreciation, depletion and amortization	(23,772)	(1,149,713)	(27,269)		(1,200,754)
Net property, plant and equipment	23,851	2,866,770	187,009		3,077,630
Investments in subsidiaries (equity method)	1,120,985			(1,120,985)	
Assets held for sale (see Note 4)			143,234		143,234
Other assets	7,518	14,277	16,716		38,511
Total assets	\$ 2,726,936	\$ 1,856,436	\$ 253,481	\$ (1,214,137)	\$ 3,622,716

LIABILITIES AND STOCKHOLDERS EQUITY

Accounts and notes payable	\$ 105,259	\$ 220,923	\$ 9,503	\$ (14,115)	\$ 321,570
Current liabilities associated with assets held for sale (see Note 4)			39,118		39,118
Other current liabilities	1,368	67,530	1,309		70,207

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Total current liabilities	106,627	288,453	49,930	(14,115)	430,895
Long-term debt	977,600				977,600
Indebtedness to related parties noncurrent			79,037	(79,037)	
Liabilities associated with assets held for sale (see Note 4)			15,417		15,417
Other liabilities	26,091	30,845	5,602		62,538
Commitments and contingencies					
Deferred income taxes	(29,882)	508,041	1,037		479,196
Minority interest in partnership		10,570			10,570
Total liabilities	1,080,436	837,909	151,023	(93,152)	1,976,216
Stockholders equity	1,646,500	1,018,527	102,458	(1,120,985)	1,646,500
Total liabilities and stockholders equity	\$ 2,726,936	\$ 1,856,436	\$ 253,481	\$ (1,214,137)	\$ 3,622,716

CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS

(Unaudited)

Six months ended June 30, 2008:	Parent	Guarantors	Non-Guarantors (in thousands)	Eliminations	Consolidated
Net cash provided by operating activities	\$ (4)	\$ 549,753	\$ 38,503	\$	\$ 588,252
Investing activities:					

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Capital investments	(3,286)	(729,252)	(79,883)		(812,421)
Proceeds from sale of property, plant and equipment		542,092	48,421		590,513
Other items	3,047	3,999	(7,342)		(296)
Net cash used in investing activities	(239)	(183,161)	(38,804)		(222,204)
Financing activities:					
Intercompany activities	394,775	(394,918)	143		
Payments on revolving long-term debt	(1,843,600)				(1,843,600)
Borrowings under revolving long-term debt	1,001,400				1,001,400
Proceeds from issuance of long-term debt	600,000				600,000
Excess tax benefit for stock-based compensation	39,332				39,332
Other items	12,225	565	(575)		12,215
Net cash used in financing activities	204,132	(394,353)	(432)		(190,653)
Increase (decrease) in cash and cash equivalents	203,889	(27,761)	(733)		175,395
Cash and cash equivalents at beginning of year ⁽¹⁾	10,040	(9,607)	1,399		1,832
Cash and cash equivalents at end of period ⁽¹⁾	\$ 213,929	\$ (37,368)	\$ 666	\$	\$ 177,227
Six months ended June 30, 2007:					
	Parent	Guarantors	Non-Guarantors	Eliminations	Consolidated (in thousands)
Net cash provided by operating activities	\$ 2,421	\$ 231,631	\$ 24,166	\$	\$ 258,218
Investing activities:					
Capital investments	(4,562)	(641,477)	(58,544)		(704,583)
Proceeds from sale of property, plant and equipment		2,712			2,712

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Other items	2,119	(2,069)	108	158
Net cash used in investing activities	(2,443)	(640,834)	(58,436)	(701,713)
Financing activities:				
Intercompany activities	(434,271)	399,626	34,645	
Payments on revolving long-term debt	(355,200)			(355,200)
Borrowings under revolving long-term debt	715,300			715,300
Proceeds from issuance of long-term debt				
Excess tax benefit for stock-based compensation	17,764			17,764
Other items	23,015	426	(426)	23,015
Net cash provided by financing activities	(33,392)	400,052	34,219	400,879
Increase (decrease) in cash and cash equivalents	(33,414)	(9,151)	(51)	(42,616)
Cash and cash equivalents at beginning of year ⁽¹⁾	46,951	(4,424)	400	42,927
Cash and cash equivalents at end of period ⁽¹⁾	\$ 13,537	\$ (13,575)	\$ 349	\$ 311

(1) Cash and cash equivalents includes amounts classified as held for sale. See Note 4 for additional information.

(7)

DERIVATIVES AND RISK MANAGEMENT

The Company enters into various types of derivative instruments for a portion of its projected gas and oil sales to reduce its exposure to market price volatility for natural gas and oil. At June 30, 2008, 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, FAS 149 and FAS 157 (see Note 8 below regarding the adoption of FAS 157 in the first quarter of 2008), 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 requirements of FAS 133 cannot be recorded as a component of other comprehensive income. The Company's hedging practices are summarized in Note 9 of the Notes to Consolidated Financial Statements in the 2007 Annual Report on Form 10-K.

At June 30, 2008, the Company's net liability recorded on the balance sheet related to its hedging activities was \$740.1 million. Additionally, at June 30, 2008, the Company recorded a loss to other comprehensive income of \$451.2 million related to its hedging activities which resulted in a current deferred income tax benefit of \$177.6 million. 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 June 30, 2008 remain unchanged, the Company would expect to transfer an aggregate after-tax loss of approximately \$289.7 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 loss of \$457.6 million (\$283.7 million after tax) compared to a gain of \$61.6 million (\$38.2 million after tax) for the three months ended June 30, 2008 and 2007, respectively, and a loss of \$767.5 million (\$475.8 million after tax) compared to a loss of \$32.2 million (\$19.9 million after tax) for the six months ended June 30, 2008 and 2007, respectively. The Company recorded decreases of \$12.7 million and \$20.3 million in gas sales revenues during the second quarter and first half of 2008, respectively, related to the ineffectiveness of cash flow hedges and changes in unrealized gains or losses for derivatives that were not accounted for as cash flow hedges, compared to decreases of \$2.1 million and \$4.6 million for the same periods in 2007, respectively. Additional volatility in earnings and other comprehensive income may occur in the future as a result of the application of FAS 133.

(8)

FAIR VALUE MEASUREMENTS

Effective January 1, 2008, the Company partially adopted Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (FAS 157), which defines fair value, provides a framework for measuring fair value under generally accepted accounting principles (GAAP) and expands required disclosures about fair value measurements. The Company also adopted Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (FAS 159), on January 1, 2008, which allows an entity the irrevocable option to elect fair value for the initial and subsequent measurement for certain financial assets and liabilities on a contract-by-contract basis. The Company does not plan to elect to use the fair value option under FAS 159 for any of its financial instruments that are not currently measured at fair value.

FAS 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. As presented in the tables below, this hierarchy consists of three broad levels. Level 1 valuations consist of unadjusted quoted prices in active markets for identical assets and liabilities and has the highest priority. Level 2 fair value valuations rely on quoted market information for the calculation of fair market value. Level 3 valuations are internal estimates and have the lowest priority. Per FAS 157, the Company has classified its derivatives into these levels depending upon the data relied on to determine the fair values. The Company's natural gas swaps are estimated using internal discounted cash flow calculations using the NYMEX futures index and are designated as Level 2. The fair values of collars and natural gas basis swaps are estimated using internal discounted cash flow calculations based upon forward commodity price curves or quotes obtained from counterparties to the agreements and are designated as Level 3. Assets and liabilities measured at fair value on a recurring basis are summarized below:

June 30, 2008
(in thousands)

	Fair Value Measurements Using:			
	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Assets/Liabilities at Fair Value
Derivative assets	\$	\$ 1,061	\$ 58,550	\$ 59,611
Derivative liabilities		(535,980)	(263,752)	(799,732)
Total	\$	\$ (534,919)	\$ (205,202)	\$ (740,121)

The tables below present reconciliations for assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the second quarter and first half of 2008. The fair values of Level 3 derivative instruments are estimated using proprietary valuation models that utilize both market observable and unobservable parameters. Level 3 instruments presented in the tables consist of net derivatives valued using pricing models incorporating assumptions that, in management's judgment, reflect the assumptions a marketplace participant would have used at June 30, 2008.

Total Gains and Losses for the three months ended June 30, 2008 (Level 3 Only)

	Net Derivatives (in thousands)
Balance at April 1, 2008	\$ (53,513)
Total gains or losses (realized/unrealized):	
Included in earnings ⁽¹⁾	4,651
Included in other comprehensive income (loss)	(156,208)
Purchases, issuances, and settlements	(132)
Transfers in to/out of Level 3	
Balance at June 30, 2008	\$ (205,202)
Change in unrealized gains (losses) included in earnings relating to derivatives still held as of June 30, 2008	\$ 4,519

Total Gains and Losses for the six months ended June 30, 2008 (Level 3 Only)

	Net Derivatives (in thousands)
Balance at January 1, 2008	\$ 32,767
Total gains or losses (realized/unrealized):	
Included in earnings ⁽¹⁾	13,984
Included in other comprehensive income (loss)	(240,586)
Purchases, issuances, and settlements	(11,367)
Transfers in to/out of Level 3	
Balance at June 30, 2008	\$ (205,202)
Change in unrealized gains (losses) included in earnings relating to derivatives still held as of June 30, 2008	\$ 2,617

(1) Reported in gas sales revenue in the consolidated statements of operations.

(9)

SEGMENT INFORMATION

The Company's three reportable business segments for the reportable periods presented, 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 by AWG. Effective as of the July 1, 2008 closing of the sale of AWG, the Company no longer has any natural gas distribution operations.

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 2007 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 (loss) and minority interest in partnership. The "Other" column includes items not related to the Company's reportable segments including real estate and corporate items.

	Exploration And Production	Midstream Services	Natural Gas Distribution (in thousands)	Other	Total
<u>Three months ended June 30, 2008:</u>					
Revenues from external customers	\$ 353,258	\$ 217,639	\$ 33,473	\$	\$ 604,370
Intersegment revenues	24,467	422,119	46	112	446,744
Operating income (loss)	215,086	15,002	(857)	55	229,286
Interest and other income (loss) ⁽¹⁾	327		(163)	5	169

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Depreciation, depletion and amortization expense	94,031	2,370	1,713	37	98,151
Interest expense ⁽¹⁾	4,807	3,081	1,109		8,997
Provision (benefit) for income taxes ⁽¹⁾	79,949	4,530	(809)	23	83,693
Assets	3,206,932	475,507	185,897	269,124	(2) 4,137,460
Capital investments ⁽³⁾	362,821	47,878	2,583	2,260	415,542

Three months ended June

30, 2007:

Revenues from external customers	\$ 168,434	\$ 74,079	\$ 27,569	\$	\$ 270,082
Intersegment revenues	13,364	159,588	36	112	173,100
Operating income (loss)	81,352	2,310	(1,706)	50	82,006
Interest and other income (loss) ⁽¹⁾	21		(153)	7	(125)
Depreciation, depletion and amortization expense	64,039	744	1,615	37	66,435
Interest expense ⁽¹⁾	3,546	381	1,079		5,006
Provision (benefit) for income taxes ⁽¹⁾	29,533	733	(1,117)	21	29,170
Assets	2,501,659	187,779	175,296	64,260	(2) 2,928,994
Capital investments ⁽³⁾	369,125	23,660	3,339	717	396,841

Six months ended June

30, 2008:

Revenues from external customers	\$ 650,357	\$ 363,162	\$ 114,957	\$	\$ 1,128,476
Intersegment revenues	39,385	681,921	2,753	224	724,283
Operating income	380,796	25,163	10,733	104	416,796
Interest and other income (loss) ⁽¹⁾	441		(270)	5	176
Depreciation, depletion and amortization expense	187,337	4,407	3,431	73	195,248
Interest expense ⁽¹⁾	13,577	4,632	2,317		20,526
Provision for income taxes ⁽¹⁾	139,578	7,802	3,095	42	150,517
Assets	3,206,932	475,507	185,897	269,124	(2) 4,137,460
Capital investments ⁽³⁾	739,335	79,323	3,574	3,168	825,400

Six months ended June

30, 2007:

Revenues from external customers	\$ 319,889	\$ 130,398	\$ 104,447	\$	\$ 554,734
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Intersegment revenues	23,170	281,858	152	224	305,404
Operating income	155,662	2,321	7,675	107	165,765
Interest and other income (loss) ⁽¹⁾	93		(204)	7	(104)
Depreciation, depletion and amortization expense	117,113	1,786	3,249	72	122,220
Interest expense ⁽¹⁾	3,639	381	2,444		6,464
Provision for income taxes ⁽¹⁾	57,730	737	1,910	44	60,421
Assets	2,501,659	187,779	175,296	64,260	⁽²⁾ 2,928,994
Capital investments ⁽³⁾	670,323	45,280	5,943	2,548	724,094

(1)

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

22

(2)

Other assets include the Company's investment in cash equivalents for 2008, and for 2008 and 2007 corporate assets not allocated to segments and assets for non-reportable segments.

(3)

Capital investments include a reduction of \$6.8 million and an increase of \$10.0 million for the three- and six-month periods ended June 30, 2008, respectively, and increases of \$64.0 million and \$17.7 million for the three- and six-month periods ended June 30, 2007, respectively, relating to the change in accrued expenditures between periods.

Included in intersegment revenues of the Midstream Services segment are \$389.0 million and \$142.1 million for the second quarters of 2008 and 2007, respectively, and \$628.1 million and \$249.1 million for the six months ended June 30, 2008 and 2007, 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 terms of existing contracts and current market conditions. Parent company assets include furniture and fixtures and prepaid debt and other 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.

(10)

INTEREST AND INCOME TAXES PAID

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

	For the six months ended June 30,	
	2008	2007
	(in thousands)	
Interest payments	\$ 12,669	\$ 11,080
Income tax payments	\$	\$

As a result of the gains on the proceeds received from the sales of Fayetteville Shale acreage, the utility and certain oil and gas properties, the Company expects to be subject to future alternative minimum tax payments in 2008.

(11)

CONTINGENCIES AND COMMITMENTS

Operating Commitments

The Company has various operating commitments in the normal course of its operations. In the first quarter of 2008, the Company exercised the first of its three options to increase the volumes to be transported on each of the two pipeline laterals and related facilities being constructed by Texas Gas Transmission, LLC for which the Company is the anchor shipper, and subsequent to the second quarter, the Company exercised its remaining options. Once effective, which can occur no earlier than April 1, 2010, the exercised options will result in aggregate commitments of 800,000 MMBtu per day on the Fayetteville Lateral and 640,000 MMBtu per day on the Greenville Lateral. Other than the increase in pipeline volume commitments, the Company has not made any new material operating commitments or modified its disclosed material commitments from those disclosed in the 2007 Annual Report on Form 10-K.

Environmental Risk

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 effect on the financial position or reported results of operations of the Company.

Litigation

The Company is subject to litigation and claims that have arisen 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 such litigation and claims currently pending will not have a material effect on the results of operations or the financial position of the Company.

(12)

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 10 of the Notes to Consolidated Financial Statements included in Item 8 of the 2007 Annual Report on Form 10-K.

For the second quarter and first six months of 2008, the Company recorded compensation cost of \$0.7 million and \$1.5 million, respectively, in general and administrative expense related to stock options. Additional amounts of \$0.3 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 \$0.2 million related to stock options for the six months ended June 30, 2008, compared to a deferred tax benefit of \$0.5 million for the comparable period in 2007. A total of \$5.9 million of unrecognized compensation costs related to stock options not yet vested is expected to be recognized over future periods. For the second quarter and first six months of 2007, the Company recorded compensation cost of \$0.5

million and \$1.3 million, respectively, in general and administrative expense related to stock options. Additional amounts of \$0.1 million and \$0.3 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 second quarter and first six months of 2008, the Company recorded compensation cost of \$0.8 and \$1.7 million, respectively, in general and administrative expense related to restricted stock grants. Additional amounts of \$0.6 million and \$1.3 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 June 30, 2008, there was \$13.8 million of total unrecognized compensation cost related to nonvested shares of restricted stock. For the second quarter and first six months of 2007, the Company recorded compensation cost of \$0.6 and \$1.3 million, respectively, in general and administrative expense related to restricted stock grants. Additional amounts of \$0.4 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 half of 2008 and provide information for options outstanding at June 30, 2008. The number of options and exercise prices have been restated, as necessary, to reflect the two-for-one stock split effected on March 25, 2008:

	Number of Options	Weighted Average Exercise Price
Outstanding at December 31, 2007	8,552,874	\$ 4.81
Granted	31,500	36.68
Exercised	(1,147,825)	1.80
Forfeited or expired	(3,200)	27.18
Outstanding at June 30, 2008	7,433,349	\$ 5.41
Exercisable at June 30, 2008	6,565,306	\$ 2.99

During the first six months of 2008, there were 31,500 options granted, compared to no options granted during the first six months of 2007. The total intrinsic value of options exercised during the first six months of 2008 and 2007

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was \$43.6 million and \$48.6 million, respectively. Associated with the exercise of stock options, the Company recorded a tax benefit of \$39.3 million in the first six months of 2008, compared to \$17.8 million in the first six months of 2007. The tax benefits were recorded as increases in additional paid-in capital.

Range of Exercise Prices	Options Outstanding at June 30, 2008	Options Outstanding			Options Exercisable		
		Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value (in thousands)	Options Exercisable at June 30, 2008	Weighted Average Exercise Price	Aggregate Intrinsic Value (in thousands)
\$0.75 - \$1.00	2,336,776	\$ 0.91	2.3		2,336,776	\$ 0.91	
\$1.01 - \$2.50	1,957,166	1.38	4.0		1,957,166	1.38	
\$2.51 - \$6.00	1,218,910	2.76	5.5		1,218,910	2.76	
\$6.01 - \$17.75	1,029,183	10.38	3.8		894,831	9.29	
\$17.76 - \$44.34	891,314	23.91	5.9		157,623	20.09	
	7,433,349	\$ 5.41	3.9	\$ 313,723	6,565,306	\$ 2.99	\$ 292,918

The following table summarizes restricted stock activity for the first half of 2008. The number of shares and the grant date fair values have been restated, as necessary, to reflect the two-for-one stock split effected on March 25, 2008:

	Number of Shares	Weighted Average Grant Date Fair Value
Unvested shares at December 31, 2007	791,030	\$ 19.89
Granted	78,070	41.35
Vested	(28,176)	15.28
Forfeited	(21,528)	21.70
Unvested shares at June 30, 2008	819,396	\$ 22.05

(13)

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 six-month periods ended June 30, 2008 and 2007:

	Pension Benefits			
	For the three months ended		For the six months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
	(in thousands)			
Service cost	\$ 1,408	\$ 996	\$ 2,816	\$ 1,992
Interest cost	1,208	1,061	2,418	2,121
Expected return on plan assets	(1,254)	(1,139)	(2,509)	(2,279)
Amortization of prior service cost	122	118	244	237
Amortization of net loss	175	115	349	230
Net periodic benefit cost	\$ 1,659	\$ 1,151	\$ 3,318	\$ 2,301

	Postretirement Benefits			
	For the three months ended		For the six months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
	(in thousands)			
Service cost	\$ 165	\$ 105	\$ 330	\$ 209
Interest cost	78	54	155	108

Expected return on plan assets	(24)	(20)	(48)	(40)
Amortization of transition obligation	22	21	44	43
Amortization of prior service cost	3		6	
Amortization of net loss	17	5	34	10
Net periodic benefit cost	\$ 261	\$ 165	\$ 521	\$ 330

The Company currently expects to contribute \$8.1 million to the pension plans and \$0.4 million to the postretirement benefit plans in 2008. As of June 30, 2008, \$3.6 million has been contributed to the pension plans and \$0.2 million has been contributed to the postretirement benefit plans.

The Company also maintains a non-qualified defined contribution supplemental retirement savings plan for certain key employees whereby participants may elect to defer and contribute a portion of their compensation, as permitted by the plan. The Company maintains supplemental retirement savings plan assets that are accounted for in accordance with EITF Issue No. 97-14, Accounting for Deferred Compensation Arrangements Where Accounts are Held in a Rabbi Trust and Invested (EITF 97-14), and the underlying assets are held in a Rabbi Trust. Shares of the Company's common stock purchased under a non-qualified deferred compensation arrangement are

held in a Rabbi Trust and are presented as treasury stock. As of June 30, 2008, 224,594 shares were accounted for as treasury stock, compared to 222,774 shares at December 31, 2007.

(14)

ASSET RETIREMENT OBLIGATIONS

Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations," (FAS 143) requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made, and that the associated asset retirement costs be capitalized as part of the carrying amount of the long-lived asset. The Company owns natural gas and oil properties which require expenditures to plug and abandon the wells when reserves in the wells are depleted. These expenditures under FAS 143 are recorded in the period the liability is incurred (at the time the wells are drilled or acquired). The following table summarizes the Company's activity related to asset retirement obligations (in thousands) for the six-month period ended June 30, 2008 and for the year ended December 31, 2007:

Asset retirement obligation at January 1	\$ 12,114	\$ 10,545
Accretion of discount	259	481
Obligations incurred	1,361	2,236
Obligations settled/removed	(1,986)	(499)
Revisions of estimates		(649)
Asset retirement obligation at June 30, 2008 and December 31, 2007	\$ 11,748	\$ 12,114
Current liability	602	720
Long-term liability	11,146	11,394
Asset retirement obligation at June 30, 2008 and December 31, 2007	\$ 11,748	\$ 12,114

(15)**INVENTORY**

Inventory recorded in current assets includes \$15.0 million at June 30, 2008, and \$25.0 million at December 31, 2007, for gas in underground storage owned by the Company's E&P segment, and \$12.8 million at June 30, 2008, and \$8.1 million at December 31, 2007, for tubulars and other equipment used in the Company's E&P segment. Additionally, the Natural Gas Distribution segment had current gas in underground storage of \$21.8 million at June 30, 2008, and \$21.6 million at December 31, 2007, that was classified in the balance sheets as Current Assets Held for Sale.

Other assets includes \$19.9 million at June 30, 2008, and \$16.7 million at December 31, 2007, for non-current inventory held by the Midstream Services segment consisting primarily of tubulars that will be used to construct gathering systems for the Fayetteville Shale play.

(16)**DIVESTITURES AND SUBSEQUENT EVENTS**

In the second quarter of 2008, the Company sold certain oil and gas leases, wells and gathering equipment in its Fayetteville Shale play for \$518.3 million. The sale included approximately 6% of the Company's net acres in the play as of December 31, 2007. Additionally, the Company has sold, or has agreements to sell, various oil and gas properties in the Gulf Coast and the Permian Basin for approximately \$250 million in the aggregate. Approximately \$179 million of these proceeds will be

received in the third quarter of 2008. Proceeds from the sales of oil and gas properties are credited to the full cost pool when received.

On July 1, 2008, the Company announced that it had closed the previously announced sale of its utility, Arkansas Western Gas Company, to SourceGas, LLC for approximately \$230 million, subject to post-closing adjustments. As a result of the sale of the utility, the Company is no longer engaged in any natural gas distribution operations. The Company expects to record a gain on the sale of the utility of approximately \$55 million in the third quarter of 2008.

These announced sales represent all of the Company's planned 2008 divestitures and, once all have closed, are expected to result in gross proceeds of approximately \$1.0 billion. A portion of the proceeds from these sales has been used to pay down borrowings under the Company's credit facility and the remainder will be used to help fund its 2008 capital investment program.

(17)

NEW ACCOUNTING PRONOUNCEMENTS

In February 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position FAS 157-2, Effective Date of FASB Statement No. 157 (FSP FAS 157-2). FSP FAS 157-2 delays the effective date of FAS 157 to fiscal years beginning after November 15, 2008 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). FSP FAS 157-2 is effective for the Company's fiscal year beginning January 1, 2009. The adoption of FSP FAS 157-2 is not expected to have a material impact on the Company's results of operations and financial condition.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (FAS 161). FAS 161 requires enhanced disclosures for derivative instruments and hedging activities that include explanations of how and why an entity uses derivatives, how instruments and the related hedged items are accounted for under FAS 133 and related interpretations, and how derivative instruments and related hedged items affect the entity's financial position, results of operations and cash flows. FAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company is currently reviewing the standard to assess what impact of the adoption of FAS 161 will have on the Company's results of operations and financial condition.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following updates information as to Southwestern Energy Company's financial condition provided in our 2007 Annual Report on Form 10-K and analyzes the changes in the results of operations between the three- and six-month periods ended June 30, 2008 and 2007. For definitions of commonly used gas and oil terms used in this Form 10-Q, please refer to the "Glossary of Certain Industry Terms" provided in our 2007 Annual Report on Form 10-K.

The following discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in our forward-looking statements for many reasons, including the risks described in the Cautionary Statement About Forward-Looking Statements in the forepart of this Form 10-Q, in Item 1A, Risk Factors in Part I and elsewhere in our 2007 Annual Report on Form 10-K, and Item 1A, Risk Factors in Part II in this Form 10-Q. You should read the following discussion with our consolidated financial statements and the related notes included in this Form 10-Q.

OVERVIEW

Southwestern Energy Company is an independent energy company primarily focused on the exploration and production of natural gas within the United States. Our operations primarily are located in Arkansas, Oklahoma and Texas. We are also focused on creating and capturing additional value at and beyond the wellhead through our established natural gas gathering and marketing businesses, which we refer to collectively as our Midstream Services.

We have historically operated principally in three segments: Exploration and Production (E&P), Midstream Services and Natural Gas Distribution. On July 1, 2008, we closed the sale of our utility subsidiary, Arkansas Western Gas Company (AWG) and, as a result, we no longer have any natural gas distribution operations. The assets and liabilities of AWG have been reclassified as held for sale in our June 30, 2008 and December 31, 2007 balance sheets, however, the results of operations for AWG are appropriately consolidated in the statements of operations and are not presented as discontinued operations. We refer you to Note 4 to the consolidated financial statements included in this Form 10-Q for additional information.

We derive the vast majority of our operating income and cash flow from the natural gas production of our E&P business and expect this to continue in the future. We expect that growth in our operating income and revenues will primarily depend on natural gas prices and our ability to increase our natural gas production. In recent years, there has been significant price volatility in natural gas and crude oil prices due to a variety of factors we cannot control or predict. These factors, which include weather conditions, political and economic events, and competition from other energy sources, impact supply and demand for natural gas, which determines the pricing. In addition, the price we realize for our gas production is affected by our hedging activities as well as locational differences in market prices. Our ability to increase our natural gas production is dependent upon our ability to economically find and produce natural gas, our ability to control costs and our ability to market natural gas on economically attractive terms to our customers.

Three Months Ended June 30, 2008, Compared with Three Months Ended June 30, 2007

In the second quarter of 2008, our gas and oil production increased to 45.1 Bcfe, up 74% from the second quarter of 2007. The 19.2 Bcfe increase in 2008 production was due to an 18.9 Bcf increase in net production from our Fayetteville Shale play as a result of our ongoing development program, with the remainder of the increase coming from our East Texas and Arkoma operations. The average price realized for our gas production, including the effects of hedges, increased approximately 18% to \$8.17 per Mcf for the three months ended June 30, 2008, as compared to the same period last year.

We reported net income of \$136.6 million in the second quarter of 2008, or \$0.39 per share on a fully diluted basis, up 187% from the prior year. Operating income for our E&P segment was \$215.1 million for the second quarter of 2008, up \$133.7 million, or 164%, from the comparable period of 2007, primarily due to an increase in revenues of \$195.9 million from higher gas production volumes and increased product prices, partially offset by an increase in operating costs and expenses of \$62.2 million. Operating income for our Midstream Services segment was \$15.0 million for the second quarter of 2008, up significantly from \$2.3 million in the second quarter of 2007, due to an increase of \$19.4 million in gathering revenues and an increase of \$1.6 million in the margin generated from our natural gas marketing activities, which were only partially offset by an \$8.3 million increase in operating costs and expenses, exclusive of gas purchased costs. The seasonal operating loss for our Natural Gas Distribution segment decreased 50% to \$0.9 million for the three months ended June 30, 2008, as the result of a rate increase implemented in August 2007.

We had capital investments of \$415.5 million for the second quarter of 2008, of which \$362.8 million was invested in our E&P segment, compared to \$396.8 million in the second quarter of 2007, of which \$369.1 million was invested in our E&P segment.

Six Months Ended June 30, 2008, Compared with Six Months Ended June 30, 2007

For the six months ended June 30, 2008, our gas and oil production increased to 84.1 Bcfe, up 73% compared to the same period in 2007. The 35.4 Bcfe increase in 2008 production was due to a 34.3 Bcf increase in net production from our Fayetteville Shale play with the remainder of the increase coming from our East Texas and Arkoma operations. The average price realized for our gas production, including the effects of hedges, increased approximately 17% to \$7.95 per Mcf for the six months ended June 30, 2008, as compared to the same period last year.

We reported net income of \$245.6 million for the first six months of 2008, or \$0.71 per share on a fully diluted basis, up 149% from the prior year. Operating income for our E&P segment was \$380.8 million for the six months ended June 30, 2008, up \$225.1 million, or 145%, from the comparable period of 2007, due to an increase in revenues of \$346.7 million from higher gas production volumes and increased product prices, partially offset by an increase in operating costs and expenses of \$121.5 million. Operating income for our Midstream Services segment was \$25.2 million for the first six months of 2008, up significantly from \$2.3 million for the same period of 2007, due to an increase of \$34.1 million in gathering revenues and an increase of \$2.2 million in the margin generated from our natural gas marketing activities, which were only partially offset by a \$13.5 million increase in operating costs and expenses, exclusive of gas purchased costs. Operating income for our Natural Gas Distribution segment increased 40% to \$10.7 million for the six months ended June 30, 2008, as the result of a rate increase implemented in August 2007.

Our capital investments increased approximately 14% to \$825.4 million for the six months ended June 30, 2008, of which \$739.3 million was invested in our E&P segment, compared to \$724.1 million in the first six months of 2007, of which \$670.3 million was invested in our E&P segment.

RESULTS OF OPERATIONS

Exploration and Production

	For the three months ended June 30,		For the six months ended June 30,	
	2008	2007	2008	2007
Revenues (in thousands)	\$ 377,725	\$ 181,798	\$ 689,742	\$ 343,059
Operating income (in thousands)	\$ 215,086	\$ 81,352	\$ 380,796	\$ 155,662
Gas production (MMcf)	44,312	24,848	82,517	46,734
Oil production (MBbls)	127	166	269	333
Total production (MMcfe)	45,075	25,841	84,132	48,732
Average gas price per Mcf, including hedges	\$ 8.17	\$ 6.90	\$ 7.95	\$ 6.81
Average gas price per Mcf, excluding hedges	\$ 10.00	\$ 6.83	\$ 8.82	\$ 6.53
Average oil price per Bbl	\$ 122.26	\$ 61.72	\$ 108.69	\$ 58.42

Average unit costs per Mcfe:

Lease operating expenses	\$ 0.95	\$ 0.73	\$ 0.87	\$ 0.73
General & administrative expenses	\$ 0.41	\$ 0.48	\$ 0.42	\$ 0.47
Taxes, other than income taxes	\$ 0.16	\$ 0.21	\$ 0.16	\$ 0.23
Full cost pool amortization	\$ 2.01	\$ 2.41	\$ 2.15	\$ 2.33

Revenues, Operating Income and Production

Revenues. Revenues for our E&P segment were up \$195.9 million, or 108%, for the three months ended June 30, 2008, compared to the same period in 2007. Approximately \$132.0 million, or 67%, of the increase was attributable to an increase in production volumes and \$63.7 million, or 33%, was attributable to higher gas and oil prices realized.

E&P revenues were up \$346.7 million, or 101%, for the first half of 2008, compared to the first half of 2007, of which approximately \$240.1 million, or 69%, of the increase, was attributable to an increase in production volumes and \$107.6 million, or 31%, was attributable to higher gas and oil prices realized. We expect our production volumes to continue to increase due to the development of our Fayetteville Shale play in Arkansas. Gas and oil prices are difficult to predict and subject to wide price fluctuations. As of July 25, 2008, we had hedged 60.5 Bcf of our remaining 2008 gas production, 135.0 Bcf of 2009 gas production and 50.0 Bcf of 2010 gas production to limit our exposure to price fluctuations. Revenues for the first six months of 2008 and 2007 also included pre-tax gains of \$4.0 million and \$5.1 million, respectively, related to the sale of gas in storage inventory. We refer you to Note 7 to the consolidated financial statements included in this Form 10-Q and to *Commodity Prices* below for additional information.

Operating Income. Operating income from our E&P segment was up 164% to \$215.1 million for the second quarter of 2008 from \$81.4 million for the same period in 2007, as the increase in revenues was partially offset by a 62% increase in operating costs and expenses. For the six months ended June 30, 2008, operating income increased 145% to \$380.8 million from \$155.7 million for the same period in 2007, as the increase in revenues was partially offset by a 65% increase in operating costs and expenses.

Production. Gas and oil production during the second quarter of 2008 was up approximately 74% to 45.1 Bcfe, due to an 18.9 Bcf increase in net production from our Fayetteville Shale play, as a result of our ongoing development program, and a 0.3 Bcfe increase in our other operating areas. Gas and oil production was up approximately 73% to 84.1 Bcfe for the first six months of 2008, as compared to prior periods, due to a 34.3 Bcf increase in net production from our Fayetteville Shale play and a 1.1 Bcfe increase in our other operating areas. Our total gas production was up

approximately 78% to 44.3 Bcf for the second quarter of 2008, which represented approximately 98% of our total equivalent production, and up approximately 77% to 82.5 Bcf for the first six months of 2008. Net production from the Fayetteville Shale was 29.6 Bcf in the second quarter of 2008, compared to 10.7 Bcf in the second quarter of 2007. For the first six months of 2008, net production from the Fayetteville Shale was 53.2 Bcf, compared to 18.9 Bcf for the first six months of 2007. In the second quarter of 2008, we completed the sale of 55,631 net acres, or approximately 6% of our December 31, 2007 total net acres in the Fayetteville Shale play, for \$518.3 million. Production from the acreage sold was approximately 10.5 MMcf per day at the time of the sale. Additionally, we have sold, or have agreements to sell, our Gulf Coast and Permian Basin properties. Production from these properties was approximately 1.3 Bcfe in the second quarter of 2008.

Commodity Prices

We periodically enter into various hedging and other financial arrangements with respect to a portion of our projected natural gas and crude oil production in order to ensure certain desired levels of cash flow and to minimize the impact of price fluctuations, including fluctuations in locational market differentials (we refer you to Item 3 and Notes 7 and 8 to the consolidated financial statements included in this Form 10-Q for additional discussion). The average price realized for our gas production, including the effects of hedges, increased approximately 18% to \$8.17 per Mcf for the three months ended June 30, 2008, and increased 17% to \$7.95 per Mcf for the six months ended June 30, 2008, as compared to the same periods last year. The change in the average price realized reflects changes in average spot market prices and the effects of our price hedging activities. Our hedging activities decreased the average gas price \$1.83 per Mcf during the second quarter of 2008, compared to an increase of \$0.07 per Mcf during the second quarter of 2007. Our hedging activities decreased our average gas price \$0.87 per Mcf for the first six months of 2008, compared to an increase of \$0.28 per Mcf during the same period of 2007. We had protected approximately 76% of our production in the second quarter of 2008, and expect to protect approximately 73% of our anticipated gas production for the remainder of the year from the impact of widening basis differentials through our hedging activities and sales arrangements. Disregarding the impact of hedges, the average price received for our gas production during the first six months of 2008 was approximately \$0.66 lower than average NYMEX spot prices, which represented the average locational basis differential.

As of July 25, 2008, we have NYMEX commodity price hedges in place for 60.5 Bcf of our remaining 2008 gas production. For our 2009 and 2010 future gas production, we have hedges in place on 135.0 Bcf and 50.0 Bcf, respectively. Additionally, we have basis swaps on 50.4 Bcf for the remainder of 2008, 26.0 Bcf for 2009 and on 7.6 Bcf for 2010, in order to reduce the effects of changes in market differentials on prices we receive.

Operating Costs and Expenses

Lease operating expenses per Mcfe for our E&P segment increased 30% to \$0.95 for the second quarter of 2008, and increased 19% to \$0.87 for the first six months of 2008, both as compared to \$0.73 for the same periods in 2007. The increases were driven by the higher per unit operating costs associated with our Fayetteville Shale operations, including the impact that higher natural gas prices had on the cost of compressor fuel. Our Fayetteville Shale production is growing rapidly and is expected to continue to provide upward pressure on our per unit operating costs. We expect our per unit operating cost for this segment to range between \$0.92 and \$0.97 per Mcfe for 2008.

General and administrative expenses per Mcfe decreased 15% to \$0.41 for the second quarter of 2008 and decreased 11% to \$0.42 for the first six months of 2008, both as compared to the prior periods of 2007, reflecting the effects of our increased production volumes. In total, general and administrative expenses for our E&P segment were \$18.4 million in the second quarter of 2008, compared to \$12.3 million in the second quarter of 2007, and were \$34.9 million for the first six months of 2008, compared to \$23.1 million for the first six months of 2007. The increases in general and administrative expenses were primarily due to increases in incentive compensation, and payroll and benefit-costs associated with the expansion of our E&P operations due to the Fayetteville Shale play which accounted for \$5.1 million, or 84%, of the second quarter increase and \$9.7 million, or 82%, of the six-month increase. Of the remaining increases, increased expenses associated with leased aircraft accounted for 12% of the increase in the second quarter of 2008 and 11% for the first six months of 2008. We expect our cost per unit for general and administrative expenses in 2008 to range between \$0.42 and \$0.47 per Mcfe.

Our full cost pool amortization rate averaged \$2.01 per Mcfe for the second quarter of 2008, as compared to \$2.41 per Mcfe for the same period in 2007. For the first six months of 2008, our full cost pool amortization rate averaged \$2.15 per Mcfe, compared to \$2.33 per Mcfe for the same period in 2007. The declines in the average amortization rates were the result of sales of oil and gas properties in the second quarter of 2008. The proceeds from the sales of approximately \$581.1 million were credited to the full cost pool. The amortization rate is impacted by timing and amount of reserve additions and the costs associated with those additions, revisions of previous reserve estimates due to both price and well performance, write-downs that result from full cost ceiling tests, proceeds from the sale of properties that reduce the full cost pool and the levels of costs subject to amortization. Additional proceeds of approximately \$179 million will be received in the third quarter of 2008 and will also have the effect of reducing the average full cost pool amortization rate. We cannot predict our future full cost pool amortization rate with accuracy due to the variability of each of the factors discussed above, as well as other factors, including but not limited to the uncertainty of the amount of future reserves attributed to our Fayetteville Shale play. Unevaluated costs excluded from amortization were \$415.9 million at June 30, 2008, compared to \$221.8 million at June 30, 2007, and \$372.4 million at December 31, 2007. The increase in unevaluated costs since June 30, 2007, resulted from an \$82.2 million increase in our undeveloped leasehold acreage and seismic costs (with \$53.6 million of the increase related to our Fayetteville Shale play) and a \$97.2 million increase in our drilling activity.

Taxes other than income taxes per Mcfe decreased to \$0.16 for the second quarter of 2008, compared to \$0.21 for the same period in 2007 and decreased to \$0.16 for the six months ended June 30, 2008, compared to \$0.23 for the first six months of 2007. Taxes other than income taxes per Mcfe vary from period to period due to changes in severance and ad valorem taxes that result from the mix of our production volumes and fluctuations in commodity prices. Additionally, we accrued \$0.5 million, or \$0.01 per Mcfe, and \$2.3 million, or \$0.03 per Mcfe, in the second quarter and first six months of 2008, respectively, for severance tax refunds related to our East Texas production, compared to accruals for \$1.3 million, or \$0.05 per Mcfe, and \$1.4 million, or \$0.03 per Mcfe, in the second quarter and first six months of 2007, respectively. In April 2008, the State of Arkansas enacted legislation that will increase the severance tax on natural gas produced within the state to a base rate of 5%, subject to certain periods of reduced rates for high-cost gas wells, new discovery gas wells and gas wells that produce below a specified level, effective January 1, 2009. Once effective, the new tax rates will increase the severance taxes we pay with respect to all of our production within the State of Arkansas, including our Fayetteville Shale operations, and negatively impact our results of operations.

The timing and amount of production and reserve additions attributed to our Fayetteville Shale play could have a material impact on our per unit costs; if production or reserves additions are lower than projected, our per unit costs could increase.

We utilize 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 June 30, 2008, our unamortized costs of natural gas and oil properties did not exceed this ceiling amount. At June 30, 2008, the ceiling value of our reserves was calculated based upon quoted market prices of \$13.10 per Mcf for Henry Hub gas and \$136.50 per barrel for West Texas Intermediate oil, adjusted for market differentials. Cash flow hedges of gas production in place at June 30, 2008 decreased the calculated ceiling value by approximately \$475.4 million (net of tax). We had approximately 237.5 Bcf of future gas production hedged at June 30, 2008. Decreases in market prices from June 30, 2008 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.

Midstream Services

	For the three months ended June 30,		For the six months ended June 30,	
	2008	2007	2008	2007
	(\$ in thousands, except volumes)			
Revenues marketing	\$ 612,884	\$ 226,187	\$ 998,605	\$ 399,838
Revenues gathering	\$ 26,874	\$ 7,480	\$ 46,478	\$ 12,418
Gas purchases marketing	\$ 609,366	\$ 224,221		