CONTANGO OIL & GAS CO
Form 10-K
September 13, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended June 30, 2007

¨ **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 001-16317

CONTANGO OIL & GAS COMPANY

(Exact name of registrant as specified in its charter)

Delaware	**95-4079863**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

3700 Buffalo Speedway, Suite 960

Houston, Texas 77098

(Address of principal executive offices)

(713) 960-1901

(Registrant s telephone number, including area code)

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

Common Stock, Par Value $0.04 per share	American Stock Exchange

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 x   No ¨

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

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 ¨   Accelerated filer x   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

At December 31, 2006, the aggregate market value of the registrant s common stock held by non-affiliates (based upon the closing sale price of shares of such common stock as reported on the American Stock Exchange) was $280,884,573. As of August 31, 2007, there were 16,015,138 shares of the registrant s common stock outstanding.

Documents Incorporated by Reference

Items 10, 11, 12, 13 and 14 of Part III have been omitted from this report since registrant will file with the Securities and Exchange Commission, not later than 120 days after the close of its fiscal year, a definitive proxy statement, pursuant to Regulation 14A. The information required by Items 10, 11, 12, 13 and 14 of this report, which will appear in the definitive proxy statement, is incorporated by reference into this Form 10-K.

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED JUNE 30, 2007

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CAUTIONARY STATEMENT ABOUT FORWARD-LOOKING STATEMENTS

Some of the statements made in this report may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934, as amended. The words and phrases should be , will be , believe , expect , anticipate , estimate , forecast , goal and similar expressions identify forward-looking statements and express our expectations about future events. These include such matters as:

- Our financial position
- Business strategy, including outsourcing
- Meeting our forecasts and budgets
- Anticipated capital expenditures
- Drilling of wells
- Natural gas and oil production and reserves
- Timing and amount of future discoveries (if any) and production of natural gas and oil
- Operating costs and other expenses
- Cash flow and anticipated liquidity
- Prospect development
- Property acquisitions and sales
- Development, construction and financing of our liquefied natural gas (LNG) receiving terminal
- Investments in alternative energy

Although we believe the expectations reflected in such forward-looking statements are reasonable, we cannot assure you that such expectations will occur. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from actual future results expressed or implied by the forward-looking statements. These factors include among others:

- Low and/or declining prices for natural gas and oil
- Natural gas and oil price volatility
- Operational constraints, start-up delays and production shut-ins at both operated and non-operated production platforms, pipelines and gas processing facilities
- The risks associated with acting as the operator in drilling deep high pressure wells in the Gulf of Mexico
- The risks associated with exploration, including cost overruns and the drilling of non-economic wells or dry holes, especially in prospects in which the Company has made a large capital commitment relative to the size of the Company s capitalization structure
- The timing and successful drilling and completion of natural gas and oil wells
- Availability of capital and the ability to repay indebtedness when due
- Availability of rigs and other operating equipment
- Ability to raise capital to fund capital expenditures
- Timely and full receipt of sale proceeds from the sale of our production
- The ability to find, acquire, market, develop and produce new natural gas and oil properties
- Interest rate volatility
- Uncertainties in the estimation of proved reserves and in the projection of future rates of production and timing of development expenditures

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- Operating hazards attendant to the natural gas and oil business
- Downhole drilling and completion risks that are generally not recoverable from third parties or insurance
- Potential mechanical failure or under-performance of significant wells, production facilities, processing plants or pipeline mishaps
- Weather
- Availability and cost of material and equipment
- Delays in anticipated start-up dates
- Actions or inactions of third-party operators of our properties
- Actions or inactions of third-party operators of pipelines or processing facilities
- Ability to find and retain skilled personnel
- Strength and financial resources of competitors
- Federal and state regulatory developments and approvals
- Environmental risks
- Worldwide economic conditions
- Ability of LNG to become a competitive energy supply in the United States
- Ability to fund our LNG project, cost overruns and third party performance
- Successful commercialization of alternative energy technologies
- Drilling and operating costs, production rates and ultimate reserve recoveries in our Arkansas Fayetteville Shale play
- Drilling and operating costs, production rates and ultimate reserve recoveries in our Eugene Island 10 (Dutch) and State of Louisiana (Mary Rose) acreage.
- The ability of Republic Exploration, LLC (REX), our partially-owned subsidiary, to fund its working interest commitment in our Dutch and Mary Rose development.

You should not unduly rely on these forward-looking statements in this report, as they speak only as of the date of this report. Except as required by law, we undertake no obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances occurring after the date of this report or to reflect the occurrence of unanticipated events. See the information under the heading Risk Factors referred to on page 16 of this report for some of the important factors that could affect our financial performance or could cause actual results to differ materially from estimates contained in forward-looking statements.

All references in this Form 10-K to the Company , Contango , we , us or our are to Contango Oil & Gas Company and wholly-owned Subsidiaries. Unless otherwise noted, all information in this Form 10-K relating to natural gas and oil reserves and the estimated future net cash flows attributable to those reserves are based on estimates prepared by independent engineers and are net to our interest.

PART I

Item 1. *Business*

Overview

Contango is a Houston-based, independent natural gas and oil company. The Company s core business is to explore, develop, produce and acquire natural gas and oil properties primarily offshore in the Gulf of Mexico and in the Arkansas Fayetteville Shale. Contango Operators, Inc. (COI), our wholly-owned subsidiary, acts as operator on certain offshore prospects. The Company also owns a 10% interest in a limited partnership formed to develop an LNG receiving terminal in Freeport, Texas, and holds investments in companies focused on commercializing environmentally preferred energy technologies.

Our Strategy

Our exploration strategy is predicated upon two core beliefs: (1) that the only competitive advantage in the commodity-based natural gas and oil business is to be among the lowest cost producers and (2) that virtually all the exploration and production industry s value creation occurs through the drilling of successful exploratory wells. As a result, our business strategy includes the following elements:

Funding exploration prospects generated by our alliance partners. We depend totally upon our alliance partners for prospect generation expertise. Our alliance partners, Juneau Exploration, L.P. (JEX) and Alta Resources, LLC (Alta) are experienced and have successful track records in exploration.

Using our limited capital availability to increase our reward/risk potential on selective prospects. We have concentrated our risk investment capital in two prospect areas; our onshore Arkansas Fayetteville Shale play and our offshore Gulf of Mexico prospects. Exploration prospects are inherently risky as they require large amounts of capital with no guarantee of success. COI drills and operates our offshore prospects. Should we be successful in any of our offshore prospects, we will have the opportunity to spend significantly more capital to complete development and bring the discovery to producing status.

Operating in the Gulf of Mexico. COI was formed for the purpose of drilling and operating exploration wells in the Gulf of Mexico. Assuming the role of an operator represents a significant increase in the risk profile of the Company since the Company has limited operating experience. While COI has historically drilled turnkey wells, adverse weather conditions as well as difficulties encountered while drilling our offshore wells could cause our contracts to come off turnkey and thus lead to significantly higher drilling costs.

Arkansas Fayetteville Shale. We have made a major commitment to our Arkansas Fayetteville Shale program and this commitment is expected to continue to grow as we participate in the drilling of hundreds of gross exploration/development wells over the next five to ten years.

Sale of proved properties. From time-to-time as part of our business strategy, we have sold and in the future expect to continue to sell some or a substantial portion of our proved reserves and assets to capture current value, using the sales proceeds to further our exploration, LNG and alternative energy investment activities. Since its inception, the Company has sold over $87.0 million worth of natural gas and oil properties, and views periodic reserve sales as an opportunity to capture value, reduce reserve and price risk, and as a source of funds for potentially higher rate of return natural gas and oil exploration opportunities.

Controlling general and administrative and geological and geophysical costs. Our goal is to be among the most efficient in the industry in revenue and profit per employee and among the lowest in general and administrative costs. With respect to our onshore prospects, we plan to continue outsourcing our geological, geophysical, and reservoir engineering and land functions, and partnering with cost efficient operators. We have six employees.

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Structuring transactions to share risk. Our alliance partners share in the upfront costs and the risk of our exploration prospects.

Structuring incentives to drive behavior. We believe that equity ownership aligns the interests of our partners, employees, and stockholders. Our directors and executive officers beneficially own or have voting control over approximately 24% of our common stock.

Exploration Alliances with JEX and Alta

Alliance with JEX. JEX is a private company formed for the purpose of assembling domestic natural gas and oil prospects. Under our agreement with JEX, JEX generates natural gas and oil prospects and evaluates exploration prospects generated by others. JEX focuses on the Gulf of Mexico, and generates offshore exploration prospects via our affiliated companies, Republic Exploration, LLC (REX), Contango Offshore Exploration, LLC (COE) and Magnolia Offshore Exploration LLC (MOE) (see Offshore Gulf of Mexico Exploration Joint Ventures below).

Alliance with Alta. Alta is a private company formed for the purpose of assembling domestic, onshore natural gas and oil prospects. Our arrangement with Alta generally provides for us to pay our share of seismic and lease costs, with Alta generally receiving a negotiated overriding royalty interest (ORRI) and a carried or back-in working interest.

Onshore Exploration and Properties

Alta Activities

Arkansas Fayetteville Shale

In March 2005, Contango, Alta and another private company entered into an agreement to acquire natural gas, oil, and mineral leases in the Arkansas Fayetteville Shale play area located in Pope, Van Buren, Conway, Faulkner, Cleburne, and White Counties, Arkansas. As of August 31, 2007, we and our partners have acquired or received commitments on approximately 45,300 net mineral acres at a cost of approximately $13.6 million. Contango has a 70% working interest prior to payout. At project payout, Alta will be assigned a 20% reversionary working interest, proportionately reduced to Contango, Alta and the other participant. Alta will receive an ORRI in each lease assignment contingent on the amount of lease burden assigned to the third party royalty owners. Our 70% share of the lease acquisition costs as of August 31, 2007, is approximately $9.5 million.

The Arkansas Oil & Gas Commission has now approved 16 separate 640-acre drilling units in Arkansas that we estimate will allow our partnership to drill and operate approximately 144 horizontal wells. The horizontal wells are estimated to cost between $3.5 to $2.5 million each. Thus far, our working interest and net revenue interest in these Alta operated wells has averaged approximately 46% and 36%, respectively. Alta intends to continue to seek approval from the Arkansas Oil & Gas Commission for additional 640-acre drilling units.

The first wells drilled by Tepee Petroleum as contract operator took considerably longer than expected to drill and incurred significant cost overruns. Of these wells, the Alta-Thines #1-30H is currently producing at 0.5 million cubic feet per day (Mmcf/d), the Alta-Ledbetter #1-33H is currently producing at 0.7 Mmcf/d, the Alta-Briggler #1-31H is shut in awaiting pipeline hookup, the Alta-Clark #1-26H is currently producing at 0.7 Mmcf/d and the Alta-Wooten #1-34H is currently producing at 1.0 Mmcf/d. The 8/8ths cost for drilling and completing these five wells is estimated at $20.4 million (approximately $10.6 million net to Contango). We have already invested the $10.6 million as of August 31, 2007 and do not expect to incur any significant additional costs for these five wells. Additionally, two wells, the Alta-Beck #1-32H and the Alta-Kaufman #1-12H have been plugged and abandoned due to mechanical problems at a cost of approximately $4.1 million, net to the Company. This charge was recorded in the fourth quarter of the fiscal year ended June 30, 2007.

Alta Operating Company drilled the next four wells which were all successful. The first of these, the Alta-Huff #1-29H, was spud in March 2007 and is currently producing at 1.6 Mmcf/d. The second well, the Alta- Jones #1-29H, was spud in April 2007 and is currently producing at 3.5 Mmcf/d. The third and fourth wells, the

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Alta-Chwalinski #2-29H and Alta-Chwalinski #3-29, were spud in May 2007, simultaneously fraced, and are currently producing at a combined 3.6 million cubic feet equivalent per day (Mmcfe/d). These four wells are in and around the Gravel Hill Field area in Van Buren County, Arkansas. In addition, Alta arranged for an independent third party operator to drill two additional wells on Alta s behalf. The first of these, the Alta-Chwalinski #1-29H, was spud in March 2007 and is currently producing at 1.3 Mmcf/d. The second, the Alta-Koone #1-4H, was spud in March 2007 and is currently producing at 0.4 Mmcf/d. In June 2007, Alta spud the Deltic #1-8H and in August 2007, Alta spud the Alta-Deltic #2-8H which is currently drilling horizontally. We expect to simultaneously frac these two Deltic wells in September 2007. The 8/8ths cost for drilling and completing these eight wells is estimated to be $20.7 million (approximately $10.2 million net to Contango). Of this $10.2 million, we have already expended approximately $8.9 million as of August 31, 2007. Contango s net average working interest and net revenue interest in the 13 above Alta-operated wells, prior to project payout, are approximately 50% and 40%, respectively. As of August 31, 2007, these Alta-operated wells were producing at a combined rate of 5.2 Mmcf/d, net to Contango.

In addition, we have been integrated by a third party independent oil and gas exploration company into 129 wells as of July 31, 2007 (the Integrated Wells). Of these 129 Integrated Wells, 78 are producing. The 8/8ths production rate for 68 of these 78 producing wells was 58 Mmcf/d as of July 31, 2007 (approximately 3.0 Mmcf/d, net to Contango). Production data for the remaining ten producing wells was not available. The remaining 51 Integrated Wells are either currently being drilled or are expected to be drilled over the next several months. The 8/8ths cost for drilling and completing these 129 wells is estimated to be $307.0 million (approximately $17.0 million net to Contango). Of this $17.0 million, we have already invested approximately $12.1 million as of June 30, 2007. Contango s net average working interest and net revenue interest in these 129 wells are approximately 6% and 5%, respectively.

Texas, Alabama and Louisiana

Outside of Arkansas, we spudded two onshore wells with Alta in fiscal year 2007 and one in fiscal year 2008. The Alta-Ellis #1 in Texas, in which we have a 50% working interest, is currently producing at 0.4 Mmcf/d. We recorded an impairment charge of $0.2 million for this well in December 2006. The Temple Inland #1 in Louisiana, in which we have a 77% working interest, is currently producing at 1.0 Mmcf/d and 30 barrels of oil per day. The Alta-Coley in Alabama, in which we have a 67.5% working interest, was spud in July 2007 and was determined to be a dry hole at a cost of approximately $0.5 million. This charge was recorded in the fourth quarter of the fiscal year ended June 30, 2007.

We have also invested with Alta in the developing West Texas Barnett Shale play in Jeff Davis and Reeves Counties, Texas. Alta has leased approximately 5,800 net mineral acres (4,000 net mineral acres to Contango before a basket payout). A third party operator has drilled several wells near our acreage. Our plans are to monitor activity in this play.

Offshore Gulf of Mexico Exploration Joint Ventures

Contango directly and through affiliated companies conducts exploration activities in the Gulf of Mexico. As of June 30, 2007, Contango and its affiliates had interests in 70 offshore leases. See Offshore Properties below for additional information on our offshore properties.

As of June 30, 2007, Contango owned a 42.7% equity interest in REX, a 76.0% equity interest in COE, and a 50.0% equity interest in MOE, all of which were formed for the purpose of generating exploration opportunities in the Gulf of Mexico. See Exhibit 21.2 for an organizational chart of our subsidiaries. These companies have collectively licensed approximately 4,450 blocks of 3-D seismic data and have focused on identifying prospects, acquiring leases at federal and state lease sales and then selling the prospects to third parties, including Contango, subject to timed drilling obligations plus retained reversionary interests in favor of REX, COE and MOE.

Republic Exploration LLC. On August 22, 2007, REX was the apparent high bidder on two lease blocks at the Western Gulf of Mexico Lease Sale No. 204. REX bid approximately $1.75 million on High Island

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263, and approximately $1.1 million on High Island A38. An apparent high bid (AHB) gives the bidding party priority in award of offered tracts, notwithstanding the fact that the Minerals Management Service (MMS) may reject all bids for a given tract. The MMS review process can take up to 90 days on some bids. Upon completion of that process, final results for all AHB s will be known.

In June 2007, REX was awarded State Lease No. 19396 at the State of Louisiana Mineral Lease Sale for an aggregate purchase price of approximately $0.3 million. State Lease No. 19396, together with our other State of Louisiana prospects, are commonly referred to as the Mary Rose prospect.

Record title interests in the Vermilion 73 and South Marsh Island 247 leases have been assigned to a common third party. Vermillion 73 was drilled and determined to be a dry hole. REX negotiated with the farmee and lowered its ORRI from 5% to 1.5% on Vermillion 73 in exchange for $35,000 so that another well may be drilled in the same block. The second well at Vermilion 73 was drilled during the second quarter of 2007 and also determined to by dry. South Marsh Island 247 was drilled and determined to be a dry hole. The well was plugged and abandoned on September 3, 2007. REX had reserved a 5.0% ORRI before payout on South Marsh Island 247.

REX and COE have farmed out East Breaks 369/370 and Vermillion 154. East Breaks 369 was spud in March 2007 and determined to be a dry hole. The well has been plugged and abandoned. The farmee has until September 1, 2008 to decide if it will drill East Breaks 370. Vermillion 154 has been farmed out, and the operator expects to drill an exploratory well prior to July 2008.

In February 2007, REX was awarded State Lease 19261 and 19266 at the State of Louisiana Mineral Lease Sale for an aggregate purchase price of approximately $4.6 million ($1.8 million net to Contango).

In November 2006, REX acquired 75% of High Island A243 from a private company in exchange for REX paying all future delay rentals. In November 2006, COE acquired 75% of East Breaks 167, High Island A311, East Breaks 166 and High Island A342 from a private company in exchange for COE paying all future delay rentals.

In October 2006, REX was awarded the following three lease blocks from the Western Gulf of Mexico Lease Sale #200 for an aggregate purchase price of approximately $1.0 million: High Island A196, High Island A197 and High Island A198.

On September 2, 2005, Contango purchased an additional 9.4% ownership interest in REX for $5.625 million from JEX. As a result of this purchase, our equity ownership interest in REX increased from 33.3% to 42.7%. As of June 30, 2007, Contango had approximately $5.9 million invested in REX. The three other members of REX are JEX, its managing member, a privately held investment company, and a privately held seismic company. REX holds a non-exclusive license to approximately 2,637 blocks of 3-D seismic data in the shallow waters of the Gulf of Mexico. This data is used to identify, acquire and exploit natural gas and oil prospects. All leases owned by REX are subject to a 3.3% ORRI in favor of the JEX prospect generation team. See Offshore Properties below for more information on REX s offshore properties.

In April 2005, REX, along with COI, secured from a third party, the right to earn an assignment of operating rights in Eugene Island 10. In September 2005, REX, COI and other third parties entered into a participation agreement whereby COI was named the operator. See Contango Operators, Inc. below for additional information on Eugene Island 10.

Contango Offshore Exploration LLC. Grand Isle 72 (Liberty), a COE prospect, began producing in March 2007 and as of August 31, 2007 was producing at a rate of approximately 1.5 Mmcfe/d. COE has invested approximately $5.0 million ($3.8 million net to the Company) in drilling, completion, pipeline and production facility costs as of August 31, 2007. COE s net revenue interest in this well is 40%. As of June 30, 2007, COE had borrowed $4.3 million from the Company under a promissory note (the Note) to fund a portion of its share of development costs at Grand Isle 72. The Note bears interest at a per annum rate of 10% and is payable upon demand.

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Grand Isle 70, a COE prospect, was spud in July 2006 and proved to be a discovery. The well has been temporarily abandoned while alternative development scenarios are being evaluated. COE has a 52.6% working interest and a 42.1% net revenue interest in this well.

On September 2, 2005, Contango purchased an additional 9.4% ownership interest in COE for $1.875 million from JEX. As a result of this purchase, our equity ownership interest in COE increased from 66.6% to 76.0%. As of June 30, 2007, Contango had approximately $19.4 million invested in COE, which COE has used to acquire and reprocess 1,815 blocks of 3-D seismic data and to acquire leases in the Gulf of Mexico. The two other members of COE are JEX, its managing member, and a privately held investment company. All leases are subject to a 3.3% ORRI in favor of the JEX prospect generation team. See Offshore Properties below for additional information on COE s offshore properties.

Magnolia Offshore Exploration LLC. As of June 30, 2007, Contango had approximately $1.0 million invested in MOE. JEX is the only other member of MOE and acts as the managing member, deciding which prospects MOE may acquire, develop, and exploit. MOE s license rights to 3-D seismic data have been assigned to COE. All leases are subject to a 3.3% ORRI in favor of the JEX prospect generation team. See Offshore Properties below for additional information on MOE s offshore properties.

The MMS has implemented a rule on royalty relief for shallow water, deep shelf natural gas production from certain Gulf of Mexico leases. Deep shelf gas refers to natural gas produced from depths greater than 15,000 feet in waters of 200 meters or less. Royalty relief is available on the first 15 billion cubic feet (Bcf) of natural gas production if produced from an interval between 15,000 to less than 18,000 feet. Royalty relief is available on the first 25 Bcf of natural gas production if produced from an interval between 18,000 to less than 20,000 feet. Royalty relief is available on the first 35 Bcf of natural gas production if produced from well depths at or greater than 20,000 feet. This royalty relief is expected to have a positive impact on the economics of deep gas wells drilled on the shelf of the Gulf of Mexico.

Non-Operated Offshore Wells. The Company has non-operating working interests in three offshore blocks: Ship Shoal 358, Eugene Island 113-B and West Delta 36. Contango s net revenue interest in these three wells is 5.8%, 3.1% and 3.67%, respectively. The Company depends on third-party operators for the operation and maintenance of these production platforms. As of August 31, 2007, Ship Shoal 358 and Eugene Island 113-B were not producing. Ship Shoal 358 is to be re-completed later this year and Eugene Island 113-B is to have compression installed. West Delta 36 was producing at a rate of approximately 11.5 Mmcfe/d. REX has a 3.67% ORRI before payout in West Delta 36, and at its option, may elect either a 5.0% ORRI or 25% working interest (WI) after payout. The Company had a non-operating working interest in Eugene Island 76, but this well depleted in November 2006.

Contango Operators, Inc.

COI is a wholly-owned subsidiary of Contango formed for the purpose of drilling exploration and development wells in the Gulf of Mexico. As part of our strategy, COI will operate and acquire significant working interests in offshore exploration and development opportunities in the Gulf of Mexico, usually under a farm-out agreement with either REX or COE. COI expects to take working interests in these prospects under the same arms-length terms offered to industry third party participants. COI also operates and acquires significant working interests in offshore exploration and development opportunities under farm-in agreements with third parties.

Current Activities. During July 2007, the Company began producing from its Dutch #2 well, successfully completed and production tested its Dutch # 3 well, and spudded its Mary Rose #1 well, located on State of Louisiana Lease No. 18640.

As of August 25, 2007, our Dutch #1 and #2 wells were flowing at a combined 8/8ths production rate of approximately 63.2 Mmcfe/d. COI has invested approximately $11.4 million to drill and complete Dutch #1 and #2, including pipeline and production facility costs. During June 2007, one of the farmors of the Eugene Island 10 block backed in for a 12.5% working interest. Therefore, COI now has a 16.04% WI and REX has a

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56.88% WI in each of the Dutch wells. For sales of natural gas, the net revenue interests to COI and REX are approximately 14.7% and 52.1%, respectively, with MMS deep gas royalty relief on the first 15 Bcf of gas produced from the entire field. Once the royalty relief has expired for natural gas, and for all sales of oil and condensate, COI and REX have a net revenue interest of 12.07% and 42.79%, respectively. The lease was farmed in on a produce-to-earn basis. The lease has now been assigned, and REX has earned the lease.

The Company s Dutch #3 well was production tested in July 2007 at a rate of approximately 34 Mmcfe/d. As of August 31, 2007, the Company had invested approximately $3.7 million to drill and complete this well, including pipeline and production facility costs. We estimate an additional $5.6 million will be required to build production and pipeline facilities to commence production. The well will flow into the same platform currently being used by Dutch #1 and #2 and we expect the well will be on-stream by the end of September 2007. COI has a 16.04% WI and REX has a 56.88% WI in Dutch #3. For sales of natural gas, the net revenue interests to COI and REX are approximately 14.7% and 52.1%, respectively, with MMS deep gas royalty relief on the first 15 Bcf of gas produced from the entire field. Once the royalty relief has expired for natural gas, and for all sales of oil and condensate, COI and REX have a net revenue interest of 12.07% and 42.79%, respectively. Once the second farmor backs in after project payout, COI and REX s working interests will be reduced to 13.75% and 48.75%, respectively.

We are currently drilling our Mary Rose #1 prospect, located off the coast of Louisiana, which is operated by COI. Our capital expenditure budget calls for us to invest approximately $2.5 million in estimated dry hole costs in the drilling of Mary Rose #1. In the event we have exploration success, our capital budget will be significantly increased as we will incur additional costs to complete the well and pay for production and pipeline facilities. In the event of tropical storms or hurricanes in the Gulf of Mexico while Mary Rose #1 is drilling, our estimated dry hole costs could be significantly greater. As a result of Hurricane Dean, we had to discontinue drilling and went off turn-key operations and lost ten days of drilling time at an estimated 8/8ths cost of $1.4 million. COI has a 15.72% working interest and an 11.27% net revenue interest in this well. The prospect is being drilled under a turn-key drilling contract.

The Company s independent third party engineer estimates the Dutch (Eugene Island 10) and Mary Rose (offshore State of Louisiana) discoveries to have total proved reserves of 226 billion cubic feet equivalent (Bcfe) (65 Bcfe net to Contango). A production platform and pipeline, at an estimated 8/8ths cost of $56.0 million, with a capacity of 300 Mmcfe/d is being built by the Company to process and transport anticipated production from the Mary Rose #1 well and from an expected additional three to five wells. The Company expects it will take between seven to nine wells to fully develop its Dutch and Mary Rose discoveries. The platform and pipeline are expected to be delivered by the end of the year and scheduled to be placed into service in May 2008. If successful, the Mary Rose #1 and follow-on developmental wells are anticipated to begin production in May 2008.

In December 2006, COI sold its 25% working interest in Grand Isle 72 to an independent oil and gas company for $7.0 million. The sold property had reserves of approximately 1.9 billion cubic feet equivalent (Bcfe), net to COI. The Company recognized a loss of approximately $2.4 million for the fiscal year ended June 30, 2007 as a result of this sale. The Company continues to have an interest in Grand Isle 72 via its investment in COE. COE has a 50% working interest and a 40% net revenue interest in this well.

During July 2006, in the offshore Gulf of Mexico, we drilled two dry holes at West Delta 43 and High Island A-279.

Offshore Properties

Producing Properties. The following table sets forth the interests owned by Contango and related entities in the Gulf of Mexico which are producing natural gas or oil as of August 31, 2007:

Area/Block	WI	NRI	Status
Contango Operators, Inc:			
Eugene Island 113B	0%	1.7%	Awaiting installation of compression
Eugene Island 10 #1	16.0%	14.7%	Producing
Eugene Island 10 #2	16.0%	14.7%	Producing
Contango Offshore Exploration LLC:			
Ship Shoal 358, A-3 well	10.0%	7.7%	Awaiting Re-completion
Grand Isle 72	50.0%	40.0%	Producing
Republic Exploration LLC:			
Eugene Island 113B	0%	3.3%	Awaiting installation of compression
West Delta 36	(1)	(1)	Producing
Eugene Island 10 #1	56.9%	52.1%	Producing
Eugene Island 10 #2	56.9%	52.1%	Producing

(1) REX has a 3.67% ORRI before payout and, at its option, may elect either a 5.0% ORRI or 25% WI after payout.

Farmed-Out Properties. The following table sets forth the working interests and net revenue interests owned by Contango and related entities in the Gulf of Mexico which have been farmed out as of August 31, 2007:

Area/Block	WI	NRI	Status
Republic Exploration LLC:			
Vermilion 154	(2)	(2)	Drilling expected by summer 2008
Vermillion 73	(3)	(3)	Determined to be a dry hole
South Marsh Island 247	(4)	(4)	Determined to be a dry hole
Contango Offshore Exploration LLC:			
East Breaks 369	-	-	Determined to be a dry hole
East Breaks 370	(5)	(5)	No drilling date has been determined yet
Vermilion 154	(2)	(2)	Drilling expected by summer 2008

(2) REX and COE will split a 25% back-in WI after payout.
(3) Record title interest in lease has been assigned to a third party.
(4) Record title interest in lease has been assigned to a third party. REX has reserved a 5% of 8/8ths ORRI before payout.
(5) Farmee has until September 1, 2008 to decide if East Breaks 370 will be drilled. COE will receive a 3.67% ORRI before project payout and a 6.67% ORRI after project payout.

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Leases. The following table sets forth the working interests owned by Contango and related entities in the Gulf of Mexico as of August 31, 2007:

Area/Block	WI	Lease Date
Contango Operators, Inc.:		
West Cameron 174	10.0%	Jul-03
Grand Isle 63	25.0%	May-04
Grand Isle 73	25.0%	May-04
West Delta 43	35.0%	May-04
S-L 18640 (LA)	15.7%	Jul-05
S-L 18860 (LA)	15.7%	Jan-06
Ship Shoal 14	37.5%	May-06
Ship Shoal 25	37.5%	May-06
South Marsh Island 57	37.5%	May-06
South Marsh Island 59	37.5%	May-06
South Marsh Island 75	37.5%	May-06
South Marsh Island 282	37.5%	May-06
Grand Isle 70	3.65%	Jun-06
West Delta 77	25.0%	Jun-06
Vermilion 194	37.5%	Jul-06
Eugene Island 10	16.0%	Nov-06
S-L 19261 (LA)	15.7%	Feb-07
S-L 19266 (LA)	15.7%	Feb-07
S-L 19396 (LA)	15.7%	Jun-07

Area/Block	WI	Lease Date
Republic Exploration LLC:		
West Cameron 174	90.0%	Jul-03
High Island 113	100.0%	Oct-03
South Timbalier 191	50.0%	May-04