

ULTRA PETROLEUM CORP

Form 10-Q

August 08, 2007

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

**Form 10-Q**

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended June 30, 2007**
- OR**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from        to**

**Commission file number 0-29370**

**ULTRA PETROLEUM CORP.**  
*(Exact name of registrant as specified in its charter)*

**Yukon Territory, Canada**  
*(State or other jurisdiction of  
incorporation or organization)*

**N/A**  
*(I.R.S. employer  
identification number)*

**363 North Sam Houston Parkway,  
Suite 1200, Houston, Texas**  
*(Address of principal executive offices)*

**77060**  
*(Zip code)*

**(281) 876-0120**  
*(Registrant's telephone number, including area code)*

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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES  NO

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

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

The number of common shares, without par value, of Ultra Petroleum Corp., outstanding as of July 31, 2007 was 152,219,226.

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Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1 FINANCIAL STATEMENTS****ULTRA PETROLEUM CORP.****CONSOLIDATED STATEMENTS OF INCOME**

	<b>For the Three Months</b>		<b>For the Six Months</b>	
	<b>Ended June 30,</b>		<b>Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>(Unaudited)</b>			
	<b>(Amounts in thousands of U.S. dollars, except per share data)</b>			
Revenues:				
Natural gas sales	\$ 116,420	\$ 96,044	\$ 263,705	\$ 213,837
Oil sales	40,402	33,849	69,310	67,306
Total operating revenues	156,822	129,893	333,015	281,143
Expenses:				
Production expenses and taxes	33,744	24,829	66,665	49,672
Depletion and depreciation	38,239	18,048	73,263	36,688
General and administrative	3,675	3,714	6,943	7,916
Total operating expenses	75,658	46,591	146,871	94,276
Operating income	81,164	83,302	186,144	186,867
Other income (expense):				
Interest expense	(4,221)	(139)	(6,921)	(311)
Interest income	309	770	636	1,344
Total other income (expense)	(3,912)	631	(6,285)	1,033
Income, before income tax provision	77,252	83,933	179,859	187,900
Income tax provision	28,183	33,258	64,199	69,751
Net income	49,069	50,675	115,660	118,149
Retained earnings, beginning of period	691,375	461,063	624,784	393,589
Retained earnings, end of period	\$ 740,444	\$ 511,738	\$ 740,444	\$ 511,738
Income per common share basic	\$ 0.32	\$ 0.33	\$ 0.76	\$ 0.76
Income per common share fully diluted	\$ 0.31	\$ 0.31	\$ 0.73	\$ 0.72
Weighted average common shares outstanding basic	152,022	155,223	151,975	155,222

Weighted average common shares outstanding	fully				
diluted		158,992	162,966	159,056	163,115

See accompanying notes to consolidated financial statements.

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**ULTRA PETROLEUM CORP.**  
**CONSOLIDATED BALANCE SHEETS**

	<b>June 30, 2007</b>	<b>December 31, 2006</b>
	<b>(Unaudited)</b>	
	<b>(Amounts in thousands of U.S. dollars)</b>	
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 17,481	\$ 14,707
Restricted cash	1,874	667
Accounts receivable	108,597	90,099
Deferred tax asset	8,512	8,266
Derivative assets	1,412	
Inventory	13,166	19,337
Prepaid drilling costs and other current assets	649	3,495
<b>Total current assets</b>	<b>151,691</b>	<b>136,571</b>
Oil and gas properties, net, using the full cost method of accounting		
Proved	1,332,960	1,048,308
Unproved	77,764	71,060
Capital assets	1,679	1,830
Other	2,407	
<b>Total assets</b>	<b>\$ 1,566,501</b>	<b>\$ 1,257,769</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities		
Accounts payable and accrued liabilities	\$ 122,639	\$ 76,291
Current taxes payable	6,133	6,842
Capital cost accrual	85,115	94,867
<b>Total current liabilities</b>	<b>213,887</b>	<b>178,000</b>
Long-term debt	300,000	165,000
Deferred income tax liability	300,400	259,191
Other long-term obligations	26,071	26,573
Shareholders' equity		
Share capital	478	5,415
Treasury stock	(16,744)	(1,194)
Retained earnings	740,444	624,784
Accumulated other comprehensive income	1,965	
<b>Total shareholders' equity</b>	<b>726,143</b>	<b>629,005</b>

Total liabilities and shareholders' equity	\$ 1,566,501	\$ 1,257,769
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See accompanying notes to consolidated financial statements.

**Table of Contents****ULTRA PETROLEUM CORP.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Six Months Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(Unaudited)</b>	
	<b>(Amounts in thousands of U.S. dollars)</b>	
Cash provided by (used in):		
Operating activities:		
Net income for the period	\$ 115,660	\$ 118,149
Adjustments to reconcile net income to net cash provided by operating activities:		
Depletion and depreciation	73,263	36,688
Deferred income taxes	51,945	52,128
Excess tax benefit from stock based compensation	(11,548)	(8,058)
Stock compensation	1,648	524
Other	43	
Net changes in non-cash working capital:		
Restricted cash	(1,207)	(1)
Accounts receivable	(18,498)	3,677
Inventory	106	794
Prepaid expenses and other current assets	3,018	15
Accounts payable and accrued liabilities	46,349	28,198
Deferred revenue		780
Other long-term obligations	(1,748)	1,092
Taxes payable	(1,205)	3,725
Net cash provided by operating activities	257,826	237,711
Investing activities:		
Oil and gas property expenditures	(361,507)	(185,940)
Change in capital cost accrual	(9,752)	8,777
Inventory	5,837	(2,435)
Purchase of capital assets	(219)	(394)
Net cash used in investing activities	(365,641)	(179,992)
Financing activities:		
Borrowings on long-term debt, gross	135,000	
Payments on long-term debt, gross		
Deferred financing costs	(1,082)	
Repurchased shares	(39,744)	(73,346)
Stock issued for compensation		1,741
Excess tax benefit from stock based compensation	11,548	8,058
Proceeds from exercise of options	4,867	6,682

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Net cash provided by (used in) financing activities	110,589	(56,865)
Increase in cash during the period	2,774	854
Cash and cash equivalents, beginning of period	14,707	44,395
Cash and cash equivalents, end of period	\$ 17,481	\$ 45,249

See accompanying notes to consolidated financial statements.

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**ULTRA PETROLEUM CORP.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)**

(All dollar amounts in this Quarterly Report on Form 10-Q are expressed in U.S. dollars (except per share data) unless otherwise noted)

**DESCRIPTION OF THE BUSINESS:**

Ultra Petroleum Corp. (the Company) is an independent oil and gas company engaged in the acquisition, exploration, development, and production of oil and gas properties. The Company is incorporated under the laws of the Yukon Territory, Canada. The Company's principal business activities are in the Green River Basin of Southwest Wyoming.

**1. SIGNIFICANT ACCOUNTING POLICIES:**

The accompanying financial statements, other than the balance sheet data as of December 31, 2006, are unaudited and were prepared from the Company's records. Balance sheet data as of December 31, 2006 was derived from the Company's audited financial statements, but does not include all disclosures required by U.S. generally accepted accounting principles. The Company's management believes that these financial statements include all adjustments necessary for a fair presentation of the Company's financial position and results of operations. All adjustments are of a normal and recurring nature unless specifically noted. The Company prepared these statements on a basis consistent with the Company's annual audited statements and Regulation S-X. Regulation S-X allows the Company to omit some of the footnote and policy disclosures required by generally accepted accounting principles and normally included in annual reports on Form 10-K. You should read these interim financial statements together with the financial statements, summary of significant accounting policies and notes to the Company's most recent annual report on Form 10-K.

(a) *Basis of presentation and principles of consolidation:* The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries UP Energy Corporation, Ultra Resources, Inc. and Sino-American Energy Corporation. The Company presents its financial statements in accordance with U.S. GAAP. All material inter-company transactions and balances have been eliminated upon consolidation.

(b) *Accounting principles:* The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States.

(c) *Cash and cash equivalents:* We consider all highly liquid investments with an original maturity of three months or less to be cash equivalents.

(d) *Restricted cash:* Restricted cash represents cash received by the Company from production sold where the final division of ownership of the production is unknown or in dispute. Wyoming law requires that these funds be held in a federally insured bank in Wyoming.

(e) *Capital assets other than oil and gas properties:* Capital assets are recorded at cost and depreciated using the declining-balance method based on a seven-year useful life.

(f) *Oil and gas properties:* The Company uses the full cost method of accounting for exploration and development activities as defined by the Securities and Exchange Commission (SEC). Under this method of accounting, the costs of unsuccessful, as well as successful, exploration and development activities are capitalized as properties and equipment

on a country-by-country basis. This includes any internal costs that are directly related to exploration and development activities but does not include any costs related to production, general corporate overhead or similar activities. The carrying amount of oil and gas properties also includes estimated asset retirement costs recorded based on the fair value of the asset retirement obligation when incurred. Gain or loss on the sale or other disposition of oil and gas properties is not recognized, unless the gain or loss would significantly alter the relationship between capitalized costs and proved reserves of oil and natural gas attributable to a country.

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The sum of net capitalized costs and estimated future development costs of oil and gas properties are amortized using the unit-of-production method based on the proven reserves as determined by independent petroleum engineers. Oil and gas reserves and production are converted into equivalent units based on relative energy content. Operating fees received related to the properties in which the Company owns an interest are netted against expenses. Fees received in excess of costs incurred are recorded as a reduction to the full cost pool.

Certain costs of oil and gas properties are excluded from capitalized costs being amortized. These amounts represent investments in unproved properties and major development projects. The Company excludes these costs on a country-by-country basis until proved reserves are found or until it is determined that the costs are impaired. All costs excluded are reviewed quarterly to determine if impairment has occurred. The amount of any impairment is transferred to the capitalized costs being amortized (the depreciation, depletion and amortization ( DD&A ) pool) or a charge is made against earnings for those international operations where a reserve base has not yet been established. For international operations where a reserve base has not yet been established, an impairment requiring a charge to earnings may be indicated through evaluation of drilling results, relinquishing drilling rights or other information.

Under the full cost method of accounting, a ceiling test is performed each quarter. The full cost ceiling test is an impairment test prescribed by SEC Regulation S-X Rule 4-10. The ceiling test determines a limit, on a country-by-country basis, on the book value of oil and gas properties. The capitalized costs of proved oil and gas properties, net of accumulated DD&A and the related deferred income taxes, may not exceed the estimated future net cash flows from proved oil and gas reserves, generally using prices in effect at the end of the period held flat for the life of production excluding the estimated abandonment cost for properties with asset retirement obligations recorded on the balance sheet and including the effect of derivative contracts that qualify as cash flow hedges, discounted at 10%, net of related tax effects, plus the cost of unevaluated properties and major development.

(g) *Inventories:* Crude oil products and materials and supplies inventories are carried at the lower of current market value or cost. Inventory costs include expenditures and other charges directly and indirectly incurred in bringing the inventory to its existing condition and location and the Company uses the weighted average method to record its inventory. Selling expenses and general and administrative expenses are reported as period costs and excluded from inventory cost. Inventories of materials and supplies are valued at cost or less. Crude oil product inventory at June 30, 2007 includes depletion and lease operating expenses of \$0.1 million associated with the Company's crude oil production in China. Drilling and completion supplies inventory of \$13.1 million primarily includes the cost of pipe that will be utilized during the 2007 drilling program.

(h) *Forward natural gas sales transactions:* The Company primarily relies on fixed price physical delivery contracts to manage its commodity price exposure. The Company may, from time to time and to a lesser extent, use derivative instruments as one way to manage its exposure to commodity prices. (See Note 8).

(i) *Income taxes:* Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The Company's total income tax expense for the six-months ended June 30, 2007 totaled \$64.2 million.

(j) *Earnings per share:* Basic earnings per share is computed by dividing net earnings attributable to common stock by the weighted average number of common shares outstanding during each period. Diluted

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earnings per share is computed by adjusting the average number of common shares outstanding for the dilutive effect, if any, of common stock equivalents. The Company uses the treasury stock method to determine the dilutive effect.

The following table provides a reconciliation of the components of basic and diluted net income per common share:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>	<b>June 30,</b>	<b>June 30,</b>	<b>June 30,</b>
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Net income	\$ 49,069	\$ 50,675	\$ 115,660	\$ 118,149
Weighted average common shares outstanding during the period	152,022	155,223	151,975	155,222
Effect of dilutive instruments	6,970	7,743	7,081	7,893
Weighted average common shares outstanding during the period including the effects of dilutive Instruments	158,992	162,966	159,056	163,115
Basic earnings per share	\$ 0.32	\$ 0.33	\$ 0.76	\$ 0.76
Diluted earnings per share	\$ 0.31	\$ 0.31	\$ 0.73	\$ 0.72

(k) *Use of estimates:* Preparation of consolidated financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(l) *Accounting for share-based compensation:* On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment ( SFAS No. 123R ) which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors including employee stock options based on estimated fair values.

The Company adopted SFAS No. 123R using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, the first day of the Company's fiscal year 2006. Share-based compensation expense recognized under SFAS No. 123R for the six-months ended June 30, 2007 and 2006 was \$1.1 million and \$0.3 million, respectively, which consisted of stock-based compensation expense related to employee stock options. See Note 4 for additional information.

(m) *Revenue Recognition.* Within the Company's United States segment, natural gas revenues are recorded on the entitlement method. Under the entitlement method, revenue is recorded when title passes based on the Company's net interest. The Company records its entitled share of revenues based on estimated production volumes. Subsequently,

these estimated volumes are adjusted to reflect actual volumes that are supported by third party pipeline statements or cash receipts. Since there is a ready market for natural gas, the Company sells the majority of its products soon after production at various locations at which time title and risk of loss pass to the buyer. Gas imbalances occur when the Company sells more or less than its entitled ownership percentage of total gas production. Any amount received in excess of the Company's share is treated as a liability. If the Company receives less than its entitled share, the underproduction is recorded as a receivable. Oil revenues are recognized when production is sold to a purchaser at a fixed or determinable price, when delivery has occurred and title is transferred.

In China, revenues are recognized when production is sold to a purchaser at a fixed or determinable price, when delivery has occurred and title is transferred.

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(n) *Other Comprehensive Earnings (Loss)*: Other comprehensive earnings (loss) is a term used to define revenues, expenses, gains and losses that under generally accepted accounting principles impact Shareholders' Equity, excluding transactions with shareholders.

	<b>Three Months Ended June 30, 2007</b>		<b>Six Months Ended June 30, 2007</b>		<b>2006</b>
Net income	\$ 49,069	\$ 50,675	\$ 115,660	\$ 118,149	
Unrealized gain on derivative instruments, net of tax	1,965		1,965		
Comprehensive income	\$ 51,034	\$ 50,675	\$ 117,625	\$ 118,149	

(o) *Impact of recently issued accounting pronouncements*: In September 2006, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 157, Fair Value Measurements ( SFAS No. 157 ). This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements. Accordingly, this Statement does not require any new fair value measurements. The changes to current practice resulting from the application of this Statement relate to the definition of fair value, the methods used to measure fair value, and the expanded disclosures about fair value measurements. SFAS No. 157 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company does not anticipate that the implementation of SFAS No. 157 will have a material impact on consolidated results of operations, financial position or liquidity.

**2. OIL AND GAS PROPERTIES:**

		<b>June 30, 2007</b>	<b>December 31, 2006</b>
<b>Developed Properties:</b>			
Acquisition, equipment, exploration, drilling and environmental costs	Domestic	\$ 1,520,944	\$ 1,174,683
Acquisition, equipment, exploration, drilling and environmental costs	China	107,560	96,874
Less accumulated depletion, depreciation and amortization	Domestic	(258,267)	(196,683)
Less accumulated depletion, depreciation and amortization	China	(37,277)	(26,566)
		1,332,960	1,048,308
<b>Unproven Properties:</b>			
Acquisition and exploration costs	Domestic	35,427	28,998
Acquisition and exploration costs	China	42,337	42,062
		\$ 1,410,724	\$ 1,119,368

**3. LONG-TERM LIABILITIES:**

	<b>June 30, 2007</b>	<b>December 31, 2006</b>
Bank indebtedness	\$ 300,000	\$ 165,000
Other long-term obligations	26,071	26,573
	<b>\$ 326,071</b>	<b>\$ 191,573</b>

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*Bank indebtedness:* As of April 30, 2007, the Company (through its subsidiary) entered into a new revolving credit facility with a syndicate of banks led by JP Morgan Chase Bank, N.A. which matures in April 2012. This new agreement provides an initial loan commitment of \$500.0 million and may be increased to a maximum aggregate amount of \$750.0 million at the request of the Company. Each bank has the right, but not the obligation, to increase the amount of its commitment as requested by the Company. In the event the existing banks increase their commitment to an amount less than the requested commitment amount, then it would be necessary to add new financial institutions to the credit facility.

Loans under the new credit facility are unsecured and bear interest, at our option, based on (A) a rate per annum equal to the higher of the prime rate or the weighted average fed funds rate on overnight transactions during the preceding business day plus 50 basis points, or (B) a base Eurodollar rate, substantially equal to the LIBOR rate, plus a margin based on a grid of our consolidated leverage ratio (0.875 basis points per annum as of June 30, 2007).

At June 30, 2007, we had \$300.0 million in outstanding borrowings under our new credit facility and \$200.0 million of available borrowing capacity under our new facility.

The new facility has restrictive covenants that include the maintenance of a ratio of consolidated funded debt to EBITDAX (earnings before interest, taxes, DD&A and exploration expense) not to exceed 3 1/2 times; and as long as our debt rating is below investment grade, the maintenance of an annual ratio of the net present value of our oil and gas properties to total funded debt of at least 1.75 to 1.00. At June 30, 2007, we were in compliance with all of our debt covenants.

Prior to April 30, 2007, the Company (through its subsidiary) participated in a revolving credit facility with a group of banks led by JP Morgan Chase Bank, N.A. The agreement specified a maximum loan amount of \$500.0 million, an aggregate borrowing base of \$1.1 billion and a commitment amount of \$250.0 million. This agreement was replaced by the new agreement dated April 30, 2007.

*Other long-term obligations:* These costs relate to the long-term portion of production taxes payable, a liability associated with imbalanced production, the long-term portion of costs associated with our compensation programs and our asset retirement obligations.

**4. SHARE BASED COMPENSATION*****Valuation and Expense Information under SFAS 123R***

The following table summarizes share-based compensation expense related to employee stock options under SFAS No. 123R for the six months ended June 30, 2007 and 2006, respectively, which was allocated as follows:

<b>Six Months Ended June 30, 2007</b>	<b>Six Months Ended June 30, 2006</b>
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Total cost of share-based payment plans	\$	2,342	\$	611
Amounts capitalized in fixed assets		1,194		287
Amounts recognized in income for amounts previously capitalized in inventory and fixed assets				
Amounts charged against income, before income tax benefit	\$	1,148	\$	324
Amount of related income tax benefit recognized in income	\$	403		114

The fair value of each share option award is estimated on the date of grant using a Black-Scholes pricing model based on assumptions noted in the following table. The Company's employee stock options have various restrictions including vesting provisions and restrictions on transfers and hedging, among others, and

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are often exercised prior to their contractual maturity. Expected volatilities used in the fair value estimate are based on historical volatility of the Company's stock. The Company uses historical data to estimate share option exercises, expected term and employee departure behavior used in the Black-Scholes pricing model. Groups of employees (executives and non-executives) that have similar historical behavior are considered separately for purposes of determining the expected term used to estimate fair value. The assumptions utilized result from differing pre- and post-vesting behaviors among executive and non-executive groups. The risk-free rate for periods within the contractual term of the share option is based on the U.S. Treasury yield curve in effect at the time of grant.

	Six Months Ended					
	June 30, 2007			June 30, 2006		
	Non-Executives		Executives	Non-Executives		Executives
Expected volatility	42.54	43.70%	44.4%	45.0	45.8%	43.5%
Expected dividends		0%	0%		0%	0%
Expected term (in years)	4.75	5.02	5.53	2.75	4.70	3.58
Risk free rate	4.52	5.07%	4.69%	4.84	5.03%	4.84%
Expected forfeiture rate		14.0%	14.0%		25.0%	25.0%

***Changes in Stock Options and Stock Options Outstanding***

The following table summarizes the changes in stock options for the six months ended June 30, 2007:

	Number of Options	Weighted Average Exercise Price (US\$)
Balance, December 31, 2006	9,082,756	\$ 0.26 to \$67.73
Granted	380,976	\$ 45.95 to \$62.23
Exercised	(704,108)	\$ 0.38 to \$55.58
Forfeited	(76,432)	\$ 47.19 to \$63.05
Expired		
Balance, June 30, 2007	8,683,192	\$ 0.26 to \$67.73

**PERFORMANCE SHARE PLANS:**

*Long-Term Equity-Based Incentives.* In 2005, we adopted the Long Term Incentive Plan ( LTIP ) in order to further align the interests of key employees with shareholders and give key employees the opportunity to share in the long-term performance of the Company by achieving specific corporate financial and operational goals. Participants

are recommended by the CEO and approved by the Compensation Committee. Selected officers, managers and other key employees are eligible to participate in the LTIP which has two components, an LTIP Stock Option Award and an LTIP Common Stock Award.

Under the LTIP, each year the Compensation Committee establishes a percentage of base salary for each participant which is multiplied by the participants base salary to derive an LTI Value. With respect to LTIP Stock Option Awards, options are awarded equal to one half of the LTI Value based on the fair value on the date of grant (using Black-Scholes methodology).

The LTI Value is the target amount that may be awarded to the participant as an LTIP Common Stock Award at the end of a three-year performance period. The Compensation Committee establishes performance measures at the beginning of each three-year overlapping performance period. Each participant is also assigned threshold and maximum award levels in the event that performance is below or above target levels. Awards are

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**ULTRA PETROLEUM CORP.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

expressed as dollar targets and become payable in common shares at the end of each performance period based on the Company's overall performance during such period. A new three-year period begins each January. Participants must be employed by the Company at the end of a performance period in order to receive an award.

For the first (January 2005 – December 2007), second (January 2006 – December 2008) and third (January 2007 – December 2009) performance periods, the Compensation Committee established the following performance measures: return on equity, reserve replacement ratio, and production growth.

Also in 2005, we established a Best in Class program for all employees. The Best in Class program recognizes and financially rewards the collective efforts of all of our employees in achieving sustained industry leading performance and the enhancement of shareholder value. Under the Best in Class program, on January 1, 2005 or the employment date if subsequent to January 1, 2005, all employees received a contingent award of stock units equal to \$50,000 worth of our common stock based on the average high and low share price on the date of grant. Employees joining the Company after January 1, 2005 will participate on a pro rata basis based on their length of employment during the performance period. The number of units that will vest and become payable is based on our performance relative to the industry during a three-year performance period beginning January 1, 2005, and ending December 31, 2007, and are set at threshold (50%), target (100%) and maximum (150%) levels. For each vested unit, the participant will receive one share of common stock. The performance measures are all sources finding and development cost and full cycle economics.

For the six months ended June 30, 2007, the Company recognized \$268,802, \$280,006 and \$274,130 in pre-tax compensation expense related to the 2005 LTIP, 2006 LTIP and 2007 LTIP, respectively. For the six months ended June 30, 2006, the Company recognized \$335,678 and \$344,547 in pre-tax compensation expense related to the 2005 LTIP and 2006 LTIP, respectively. The amounts recognized during the first six months of 2007 and 2006 assume that maximum performance objectives are attained. If the Company ultimately attains maximum performance objectives, the associated total compensation expense, estimated at June 30, 2007, for the three year performance periods would be approximately \$2.1 million, \$2.6 million and \$2.9 million (before taxes) related to the 2005 LTIP, 2006 LTIP and 2007 LTIP, respectively.

For the six months ended June 30, 2007, the Company recognized \$266,154 in pre-tax compensation expense related to the Best in Class Incentive Compensation Plan. For the six months ended June 30, 2006, the Company recognized \$544,168 in pre-tax compensation expense related to the Best in Class plan. The amount recognized to date assumes that maximum performance levels are achieved. If the Company ultimately attains the maximum performance level, the associated total compensation expense will be approximately \$3.5 million before income taxes, of which the Company has expensed \$2.7 million as of June 30, 2007.

Table of Contents**ULTRA PETROLEUM CORP.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****5. SEGMENT INFORMATION**

The Company has two reportable operating segments, one domestic and one foreign, which are in the business of natural gas and crude oil exploration and production. The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company evaluates performance based on profit or loss from oil and gas operations before price-risk management and other, general and administrative expenses and interest expense. The Company's reportable operating segments are managed separately based on their geographic locations. Financial information by operating segment is presented below:

	<b>Three Months Ended June 30,</b>					
	<b>Domestic</b>	<b>2007 China</b>	<b>Total</b>	<b>Domestic</b>	<b>2006 China</b>	<b>Total</b>
Oil and gas sales	\$ 130,872	\$ 25,950	\$ 156,822	\$ 104,822	\$ 25,071	\$ 129,893
Costs and Expenses:						
Depletion and depreciation	32,591	5,648	38,239	15,377	2,671	18,048
Lease operating expenses	5,574	2,982	8,556	2,398	1,926	4,324
Production taxes	14,694	3,514	18,208	12,049	4,093	16,142
Gathering	6,980		6,980	4,363		4,363
Income from operations	71,033	13,806	84,839	70,635	16,381	87,016
General and administrative			3,675			3,714
Other (income) expense			3,912			(631)
Income before income taxes			\$ 77,252			\$ 83,933
Capital expenditures	\$ 191,494	\$ 3,235	\$ 194,729	\$ 105,645	\$ 7,095	\$ 112,740
Net oil and gas properties at June 30, 2007 and December 31, 2006, respectively	\$ 1,298,104	\$ 112,620	\$ 1,410,724	\$ 1,006,998	\$ 112,370	\$ 1,119,368

**Table of Contents****ULTRA PETROLEUM CORP.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	<b>Six Months Ended June 30,</b>					
	<b>Domestic</b>	<b>2007 China</b>	<b>Total</b>	<b>Domestic</b>	<b>2006 China</b>	<b>Total</b>
Oil and gas sales	\$ 287,448	\$ 45,567	\$ 333,015	\$ 230,639	\$ 50,504	\$ 281,143
Costs and Expenses:						
Depletion and depreciation	62,220	11,043	73,263	30,633	6,055,438	36,688
Lease operating expenses	10,251	5,609	15,860	4,807	4,714	9,521
Production taxes	32,207	5,125	37,332	26,674	5,365	32,039
Gathering	13,473		13,473	8,112		8,112
Income from operations	169,297	23,790	193,087	160,413	34,370	194,783
General and administrative			6,943			7,916
Other (income) expense			6,285			(1,033)
Income before income taxes			\$ 179,859			\$ 187,900
Capital expenditures	\$ 350,547	\$ 10,960	\$ 361,507	\$ 172,185	\$ 13,755	\$ 185,940
Net oil and gas properties at June 30, 2007 and December 31, 2006, respectively	\$ 1,298,104	\$ 112,620	\$ 1,410,724	\$ 1,006,998	\$ 112,370	\$ 1,119,368

**6. SHARE REPURCHASE PROGRAM:**

On May 17, 2006, the Company announced that its Board of Directors authorized a share repurchase program for up to an aggregate \$1 billion of the Company's outstanding common stock which has been and will be funded by cash on hand and the Company's senior credit facility. Pursuant to this authorization, the Company has commenced a program to purchase up to \$500.0 million of the Company's outstanding shares through open market transactions or privately negotiated transactions. The stock repurchase will be funded with cash held in an Ultra Resources bank account or the Company's senior credit facility.

During the six months ended June 30, 2007, the Company repurchased 639,250 shares of its common stock in open market transactions for an aggregate \$35.2 million at a weighted average price of \$55.05 per share. Since the program's inception in May 2006, the Company has purchased a total of 4.6 million shares in open market transactions for an aggregate \$232.7 million at a weighted average price of \$50.50 per share.

In addition to the shares repurchased in open market transactions, the Company also acquired 64,321 shares delivered by employees for \$3.8 million to satisfy the exercise price of the employees' stock options and tax withholding obligations to satisfy tax withholding obligations in connection with the vesting of equity shares of common stock issued pursuant to the Company's employee incentive plans.

In total, during the six months ended June 30, 2007, the Company repurchased 703,571 shares of its common stock for an aggregate \$39.0 million dollars at a weighted average price of \$55.48 per share. Since the program's inception in May 2006, the Company has repurchased 4.7 million shares of its common stock for an aggregate \$237.3 million at a weighted average price of \$50.48 per share.

## **7. INCOME TAXES:**

In June 2006, the FASB issued FIN 48, *Accounting for Uncertainty in Income Taxes* — an interpretation of FASB Statement No. 109, *Accounting for Income Taxes*. This interpretation addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, the Company may recognize the tax benefit from an uncertain tax position only if

**Table of Contents****ULTRA PETROLEUM CORP.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. FIN 48 also provides guidance on derecognition, classification, interest and penalties on income taxes, accounting in interim periods and requires increased disclosures. The Company adopted the provisions of FIN 48 on January 1, 2007.

The Company did not have any unrecognized tax benefits and there was no effect on our financial condition or results of operations as a result of implementing FIN 48. The amount of unrecognized tax benefits did not materially change as of June 30, 2007.

It is expected that the amount of unrecognized tax benefits may change in the next twelve months; however Ultra does not expect the change to have a significant impact on the results of operations or the financial position of the Company.

The Company files a consolidated federal income tax return in the United States Federal jurisdiction and various combined, consolidated, unitary, and separate filings in several state and foreign jurisdictions. For all material jurisdictions, the Company is no longer subject to U.S. Federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 1997.

Estimated interest and penalties related to potential underpayment on any unrecognized tax benefits are classified as a component of tax expense in the Consolidated Statement of Operations. As of the date of adoption of FIN 48, Ultra did not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense recognized during the six months ended June 30, 2007.

The Company does not anticipate that total unrecognized tax benefits will significantly change due to the settlement of audits and the expiration of statute of limitations prior to June 30, 2008.

The following table summarizes the components of Income Tax Expense for the three and six months ended June 30, 2007 and 2006:

	For the Three Months Ended June 30,				For the Six Months Ended June 30,			
	2007		2006		2007		2006	
	\$	Rate	\$	Rate	\$	Rate	\$	Rate
<b>Current:</b>								
China	\$ 5,661	7.3%	\$ 7,290	8.7%	\$ 9,645	5.3%	\$ 13,825	7.4%
US AMT, other	15	0.0%		0.0%	1,541	0.9%		0.0%
Withholding taxes-stock distribution	1,068	1.4%	3,797	4.5%	1,068	0.6%	3,798	2.0%
Deferred tax expense	21,440	27.8%	22,171	26.4%	51,945	28.9%	52,128	27.7%

Total Income Tax Provision	\$ 28,183	36.5%	\$ 33,258	39.6%	\$ 64,199	35.7%	\$ 69,751	37.1%
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## 8. DERIVATIVE FINANCIAL INSTRUMENTS:

The Company's major market risk exposure is in the pricing applicable to its natural gas and oil production. Realized pricing is primarily driven by the prevailing price for the Company's Wyoming natural gas production. Historically, prices received for natural gas production have been volatile and unpredictable. Pricing volatility is expected to continue. Gas price realizations averaged \$5.13 per Mcf during the six months ended June 30, 2007.

The Company primarily relies on fixed price forward gas sales to manage its commodity price exposure. These fixed price forward gas sales are considered normal sales. The Company may, from time to time and to a lesser extent, use derivative instruments as one way to manage its exposure to commodity prices. The Company

**Table of Contents****ULTRA PETROLEUM CORP.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

has periodically entered into fixed price to index price swap agreements in order to hedge a portion of its production. The oil and natural gas reference prices of these commodity derivatives contracts are based upon crude oil and natural gas futures, which have a high degree of historical correlation with actual prices the Company receives. Under SFAS No. 133 all derivative instruments are recorded on the balance sheet at fair value. Changes in the derivative's fair value are recognized currently in earnings unless specific hedge accounting criteria are met. For qualifying cash flow hedges, the gain or loss on the derivative is deferred in accumulated other comprehensive income (loss) to the extent the hedge is effective. For qualifying fair value hedges, the gain or loss on the derivative is offset by related results of the hedged item in the income statement. Gains and losses on hedging instruments included in accumulated other comprehensive income (loss) are reclassified to oil and natural gas sales revenue in the period that the related production is delivered. Derivative contracts that do not qualify for hedge accounting treatment are recorded as derivative assets and liabilities at market value in the consolidated balance sheet, and the associated unrealized gains and losses are recorded as current expense or income in the consolidated statement of operations. The Company currently does not have any derivative contracts in place that do not qualify as a cash flow hedge.

At June 30, 2007, the Company had the following open commodity derivative contracts to manage price risk on a portion of its natural gas production whereby the Company receives the fixed price and pays the variable price (all prices NWPL Rockies basis).

Type	Remaining Contract Period		Volume- MMBTU/ Day	Average Price/ MMBTU	Unrealized Gain at 06/30/2007*
	Swap	Apr 2008	Oct 2008	10,000	\$ 7.10
Swap	Apr 2008	Oct 2008	10,000	\$ 7.12	\$ 1,009,952
Swap	Apr 2008	Oct 2008	10,000	\$ 7.16	\$ 1,090,443

\* Unrealized gains are not adjusted for income tax effect.

The Company also utilizes fixed price forward physical delivery contracts at southwest Wyoming delivery points to hedge its commodity price exposure. The Company had the following fixed price physical delivery contracts in place on behalf of its interest and those of other parties at June 30, 2007. (The Company's approximate average net interest in physical gas sales is 80%.)

Remaining Contract Period	Volume - MMBTU/Day	Average Price/MMBTU
April 2007 - October 2007	40,000	\$ 6.20
Calendar 2008	100,000	\$ 6.83
April 2008 - October 2008	30,000	\$ 7.13
Calendar 2009	10,000	\$ 7.51

Subsequent to June 30, 2007 and through August 3, 2007, the Company has entered into the following commodity derivative contracts to manage price risk on a portion of its natural gas production whereby the Company receives the fixed price and pays the variable price (all prices NWPL Rockies basis):

<b>Type</b>	<b>Remaining Contract Period</b>		<b>Volume MMBTU/Day</b>	<b>Average Price/MMBTU</b>
Swap	Aug 2007	Dec 2007	10,000	\$ 4.59

**9. LEGAL PROCEEDINGS:**

The Company is currently involved in various routine disputes and allegations incidental to its business operations. While it is not possible to determine the ultimate disposition of these matters, the Company believes that the resolution of all such pending or threatened litigation is not likely to have a material adverse effect on the Company's financial position or results of operations.

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

The following discussion of the financial condition and operating results of the Company should be read in conjunction with the consolidated financial statements and related notes of the Company. Except as otherwise indicated all amounts are expressed in U.S. dollars. We operate in one industry segment, natural gas and oil exploration and development with two geographical segments; the United States and China.

The Company currently generates the majority of its revenue, earnings and cash from the production and sales of natural gas and oil from its property in southwest Wyoming. The price of natural gas in the southwest Wyoming region is a critical factor to the Company's business. The price of gas in southwest Wyoming historically has been volatile. The average realizations for the period 2003-2007 have ranged from \$3.84 to \$8.64 per Mcf. This volatility could be detrimental to the Company's financial performance. The Company seeks to limit the impact of this volatility on its results by entering into fixed price forward physical delivery contracts and swap agreements for gas in southwest Wyoming. The average realization for the Company's gas during the quarter ended June 30, 2007 was \$4.38 per Mcf. The Company's average realized crude oil price for its Bohai Bay production was \$59.72 USD per barrel for the quarter ended June 30, 2007.

The Company has grown its natural gas and oil production significantly over the past three years and management believes it has the ability to continue growing production by drilling already identified locations on its leases in Wyoming. The Company delivered 57% production growth on an Mcfe basis during the quarter ended June 30, 2007 as compared to the same quarter in 2006.

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS No. 123R) which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including employee stock options, based on estimated fair values. The Company adopted SFAS No. 123R using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, the first day of the Company's fiscal year 2006. Share-based compensation expense recognized under SFAS No. 123R for the six months ended June 30, 2007 and 2006 was \$1.1 million and \$0.3 million, respectively, which consisted of stock-based compensation expense related to employee stock options. At June 30, 2007, there was \$10.8 million of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under stock incentive plans. That cost is expected to be recognized over a weighted average period of 2.49 years. See Note 4 for additional information.

SFAS No. 123R requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The Company utilized a Black-Scholes option pricing model to measure the fair value of stock options granted to employees. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's Consolidated Statement of Operations. The Company's determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by the Company's stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, the Company's expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors.

The Company uses the full cost method of accounting for oil and gas operations whereby all costs associated with the exploration for and development of oil and gas reserves are capitalized to the Company's cost centers. Such costs include land acquisition costs, geological and geophysical expenses, carrying charges on non-producing properties, costs of drilling both productive and non-productive wells and overhead charges directly related to acquisition,

exploration and development activities. Separate cost centers are maintained for the United States and China. Substantially all of the oil and gas activities are conducted jointly with others and, accordingly, the amounts reflect only the Company's proportionate interest in such activities. Inflation has not had a material impact on the Company's results of operations and is not expected to have a material impact on the Company's results of operations in the future.

**Table of Contents****RESULTS OF OPERATIONS*****QUARTER ENDED JUNE 30, 2007 VS. QUARTER ENDED JUNE 30, 2006***

During the first quarter of 2007, production increased 57% on an equivalent basis to 30.5 Bcfe from 19.5 Bcfe for the same quarter in 2006 attributable to the Company's successful drilling activities during 2006 and in the first half of 2007 along with continued production in China. Average realized prices for natural gas decreased 25% to \$4.38 per Mcf in the second quarter of 2007 as compared to \$5.85 for the second quarter of 2006. The increase in production offset by the decrease in realized average natural gas price contributed to a 21% increase in revenues to \$156.8 million as compared to \$129.9 million in 2006.

Domestically, lease operating expense ( LOE ) increased to \$5.6 million at June 30, 2007 compared to \$2.4 million at June 30, 2006 due to increased production volumes along with increased water disposal costs in Wyoming. On a unit of production basis, LOE costs increased to \$0.20 per Mcfe at June 30, 2007 compared to \$0.14 per Mcfe at June 30, 2006 due to increased water disposal costs in Wyoming. During the first quarter of 2007, production taxes were \$14.7 million compared to \$12.0 million during the second quarter of 2006, or \$0.53 per Mcfe, compared to \$0.70 per Mcfe. The decrease in per unit taxes is attributable to the lower realized gas price received during the quarter ended June 30, 2007 as compared to the same period in 2006. Production taxes are calculated based on a percentage of revenue from production. Gathering fees increased to \$7.0 million at June 30, 2007 compared to \$4.4 million at June 30, 2006 largely due to increased production volumes. On a per unit basis, gathering fees remained flat at \$0.25 per Mcfe for the three months ended June 30, 2007 as compared to the same period in 2006.

Domestically, depletion, depreciation and amortization ( DD&A ) expenses increased to \$32.6 million during the quarter ended June 30, 2007 from \$15.4 million for the same period in 2006, attributable to increased production volumes and a higher depletion rate, due to forecasted increased future development costs. On a unit basis, DD&A increased to \$1.17 per Mcfe at June 30, 2007 from \$0.89 at June 30, 2006.

In China, LOE increased to \$3.0 million for the quarter ended June 30, 2007 (\$1.14 per Mcfe or \$6.84 per BOE) compared to \$1.9 million (\$0.83 per Mcfe and \$4.98 per BOE) for quarter ended June 30, 2006. The increase in production costs is largely attributable to higher costs associated with new fields brought on production during 2006. Severance taxes in China decreased to \$3.5 million (\$1.35 per Mcfe or \$8.10 per BOE) for the three months ended June 30, 2007 from \$4.1 million (\$1.77 per mcfe or \$10.62 per BOE) for the three months ended June 30, 2006. The decrease is due primarily to lower assessments under the Petroleum Special Profits Tax levied by the Chinese government beginning in April 2006 as a result of lower realized oil prices during the second quarter of 2007 as compared to the same period in 2006.

DD&A expense in China was \$5.6 million (\$2.17 per Mcfe or \$13.02 per BOE) for the quarter ended June 30, 2007 as compared to \$2.7 million (\$1.16 per Mcfe or \$6.96 per BOE) for the same period in 2006. This increase is largely attributable to increased costs being allocated from unevaluated properties to the full cost pool.

General and administrative expenses remained flat at \$3.7 million (\$0.12 per Mcfe) at June 30, 2007 compared to \$3.7 million (\$0.19 per Mcfe) for the same period in 2006. This decrease in per unit costs is attributable to higher production volumes during the quarter ended June 30, 2007 as compared to the same period in 2006.

Interest expense increased to \$4.2 million during the quarter ended June 30, 2007 from \$0.1 million during the same period in 2006. The increase is related to higher outstanding balances under the Company's credit facility during the quarter ended June 30, 2007 as compared to the same period in 2006. At June 30, 2007, the outstanding balance under the credit facility was \$300.0 million while the outstanding balance at June 30, 2006 was zero.

Net income before income taxes decreased to \$77.3 million for the quarter ended June 30, 2007 from \$83.9 million for the same period in 2006. The income tax provision decreased to \$28.2 million for the three months ended June 30, 2007 as compared to \$33.3 million for the three months ended June 30, 2006. For the

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quarter ended June 30, 2007, net income decreased slightly to \$49.1 million or \$0.31 per diluted share as compared with \$50.7 million or \$0.31 per diluted share for the same period in 2006.

***SIX MONTHS ENDED JUNE 30, 2007 VS. SIX MONTHS ENDED JUNE 30, 2006***

During the six-months ended June 30, 2007, production increased 49% on an equivalent basis to 59.0 Bcfe from 39.6 Bcfe for the same six-month period in 2006. The increase is primarily attributable to the additional wells drilled and completed during 2006 along with the increased drilling and completion during the first six-months of 2007. Average realized prices for natural gas decreased 21% to \$5.13 per Mcf for the six months ended June 30, 2007 as compared to \$6.49 for the same period in 2006. The increase in production offset by the decrease in realized average natural gas price contributed to an 18% increase in revenues to \$333.0 million as compared to \$281.1 million in 2006.

Domestically, LOE increased to \$10.3 million for the six months ended June 30, 2007 compared to \$4.8 million during the same period in 2006 due to increased production volumes as well as increased water disposal costs in Wyoming. On a unit of production basis, LOE costs increased to \$0.19 per Mcfe during the six months ended June 30, 2007 as compared to \$0.14 per Mcfe during the same period ended June 30, 2006 due to increased water disposal costs in Wyoming. During the six months ended June 30, 2007 production taxes were \$32.2 million compared to \$26.7 million during the same period in 2006, or \$0.60 per Mcfe during six months ended June 30, 2007 as compared to \$0.77 per Mcfe during the first half of 2006. Production taxes are calculated based on a percentage of revenue from production. Gathering fees increased to \$13.5 million during the first half of 2007 compared to \$8.1 million during the six months ended June 30, 2006 largely due to increased production volumes. On a per unit basis, gathering fees increased slightly to \$0.25 per Mcfe for the six months ended June 30, 2007 from \$0.24 per Mcfe for the same period in 2006.

Domestically, DD&A expenses increased to \$62.2 million during the first half of 2007 from \$30.6 million for the same period in 2006, attributable to increased production volumes and a higher depletion rate, due to forecasted increased future development costs. On a unit basis, DD&A increased to \$1.15 per Mcfe for the six months ended June 30, 2007 from \$0.89 per Mcfe for the same period in 2006.

In China, LOE was \$5.6 million during the six months ending June 30, 2007 (\$1.10 per Mcfe or \$6.60 per BOE) compared to \$4.7 million (\$0.92 per Mcfe or \$5.52 per BOE) during the same period in 2006. The increase is largely attributable to higher costs associated with new fields brought on production during 2006. Severance taxes in China decreased slightly to \$5.1 million (\$1.00 per Mcfe or \$6.00 per BOE) for the six months ended June 30, 2007 from \$5.4 million (\$1.05 per Mcfe or \$6.30 per BOE) for the same period in 2006. The decrease is due primarily to lower assessments under the Petroleum Special Profits Tax levied by the Chinese government beginning in April 2006 as a result of lower realized oil prices during the first half of 2007 as compared to the same period in 2006.

DD&A expense in China was \$11.0 million (\$2.16 per Mcfe or \$12.96 per BOE) for the first half of 2007 as compared to \$6.1 million (\$1.19 per Mcfe or \$7.14 per BOE) for the same period in 2006. This increase is largely attributable to higher DD&A rates as a result of costs being allocated from unevaluated properties to the full cost pool.

General and administrative expenses decreased by 12% to \$6.9 million during the first half of 2007 compared to \$7.9 million for the same period in 2006. On a per unit basis, general and administrative expenses decreased to \$0.12 per Mcfe during the six months ended June 30, 2007 compared with \$0.20 per Mcfe for the same six months ended June 30, 2006. This decrease was primarily attributable to a reduction in year over year compensation expense in combination with higher production volumes.

Interest expense increased to \$6.9 million during the six months ended June 30, 2007 from \$0.3 million during the same period in 2006. The increase is related to higher outstanding balances under the Company's credit facility during

the first half of 2007 as compared to the same period in 2006.

Net income before income taxes decreased slightly by 4% to \$179.9 million for the six months ended June 30, 2007 from \$187.9 million for the same period in 2006. The income tax provision decreased 8% to \$64.2 million for the six months ended June 30, 2007 as compared to \$69.8 million for the six months ended

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June 30, 2006, attributable to a decrease in pre-tax income. For the six months ended June 30, 2007, net income decreased slightly by 2% to \$115.7 million or \$0.73 per diluted share as compared with \$118.1 million or \$0.72 per diluted share for the same period in 2006. The increase in diluted earnings per share is attributable to the Company's share repurchase program, which was implemented beginning in May 2006 (See Note 6).

The discussion and analysis of the Company's financial condition and results of operations is based upon consolidated financial statements, which have been prepared in accordance with U.S. GAAP. In addition, application of generally accepted accounting principles requires the use of estimates, judgments and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements as well as the revenues and expenses reported during the period. Changes in these estimates, judgments and assumptions will occur as a result of future events, and, accordingly, actual results could differ from amounts estimated.

## **LIQUIDITY AND CAPITAL RESOURCES**

During the six month period ended June 30, 2007, the Company relied on cash provided by operations along with borrowings under the senior credit facility to finance its capital expenditures. The Company participated in the drilling of 90 wells in Wyoming and continued to participate in the exploration and development processes in the China blocks including the ongoing batch drilling program for the development wells. For the six-month period ended June 30, 2007, net capital expenditures were \$361.5 million. At June 30, 2007, the Company reported a cash position of \$17.5 million compared to \$45.2 million at June 30, 2006. Working capital at June 30, 2007 was a deficit of \$62.2 million compared to a deficit of \$0.6 million at June 30, 2006. As of June 30, 2007, the Company had \$300.0 million in bank indebtedness outstanding and \$200.0 million of available borrowing capacity under our facility. Other long-term obligations of \$26.1 million comprised of items payable in more than one year, primarily related to production taxes.

The Company's positive cash provided by operating activities, along with the availability under the senior credit facility, are projected to be sufficient to fund the Company's budgeted capital expenditures for 2007, which are currently projected to be \$740 million. Of the \$740 million budget, the Company plans to allocate approximately 93% to Wyoming, 4% to Pennsylvania and 3% to China.

As of April 30, 2007, the Company (through its subsidiary) entered into a new revolving credit facility with a syndicate of banks led by JP Morgan Chase Bank, N.A. which matures in April 2012. This new agreement provides an initial loan commitment of \$500.0 million and may be increased to a maximum aggregate amount of \$750.0 million at the request of the Company. Each bank has the right, but not the obligation, to increase the amount of its commitment as requested by the Company. In the event the existing banks increase their commitment to an amount less than the requested commitment amount, then it would be necessary to add new financial institutions to the credit facility.

Loans under the new credit facility are unsecured and bear interest, at our option, based on (A) a rate per annum equal to the higher of the prime rate or the weighted average fed funds rate on overnight transactions during the preceding business day plus 50 basis points, or (B) a base Eurodollar rate, substantially equal to the LIBOR rate, plus a margin based on a grid of our consolidated leverage ratio (0.875 basis points per annum as of June 30, 2007).

At June 30, 2007, we had \$300.0 million in outstanding borrowings under our new credit facility and \$200.0 million of available borrowing capacity under our new facility.

The new facility has restrictive covenants that include the maintenance of a ratio of consolidated funded debt to EBITDAX (earnings before interest, taxes, DD&A and exploration expense) not to exceed 3 1/2 times; and as long as our debt rating is below investment grade, the maintenance of an annual ratio of the net present value of our oil and gas properties to total funded debt of at least 1.75 to 1.00. At June 30, 2007, we were in compliance with all of our

debt covenants.

Prior to April 30, 2007, the Company (through its subsidiary) participated in a revolving credit facility with a group of banks led by JP Morgan Chase Bank, N.A. The agreement specified a maximum loan amount

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of \$500.0 million, an aggregate borrowing base of \$1.1 billion and a commitment amount of \$250.0 million. This agreement was replaced by the new agreement dated April 30, 2007.

During the six months ended June 30, 2007, net cash provided by operating activities was \$257.8 million, an 8% increase over the \$237.7 million for the same period in 2006. The increase in net cash provided by operating activities was largely attributable to the increase in production during the first half of 2007, partially offset by decreased realized prices during the six months ended June 30, 2007 as compared to the same period in 2006.

During the six months ended June 30, 2007, net cash used in investing activities was \$365.6 million as compared to \$180.0 million for the same period in 2006. The increase in net cash used in investing activities is largely due to increased capital expenditures associated with the Company's drilling activities in 2007.

During the six months ended June 30, 2007, net cash provided by financing activities was \$110.6 million as compared to net cash used in financing activities of \$56.9 million for the same period in 2006. The change in net financing activities is primarily attributable to borrowings under the Company's senior credit facility during 2007 offset by increased share repurchases under the Company's share repurchase program during the six months ended June 30, 2006 (See Note 6).

## **OFF BALANCE SHEET ARRANGEMENTS**

The Company did not have any off-balance sheet arrangements as of June 30, 2007.

## **CAUTIONARY STATEMENT PURSUANT TO SAFE HARBOR PROVISION OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995**

This report contains or incorporates by reference forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934 and the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical facts included in this document, including without limitation, statements in Management's Discussion and Analysis of Financial Condition and Results of Operations regarding our financial position, estimated quantities and net present values of reserves, business strategy, plans and objectives of the Company's management for future operations, covenant compliance and those statements preceded by, followed by or that otherwise include the words believe, expects, anticipates, intends, estimates, projects, target, goal, plans, objective, should, or similar expressions or variations on such expressions are forward-looking statements. The Company can give no assurances that the assumptions upon which such forward-looking statements are based will prove to be correct nor can the Company assure adequate funding will be available to execute the Company's planned future capital program.

Other risks and uncertainties include, but are not limited to, fluctuations in the price the Company receives for oil and gas production, reductions in the quantity of oil and gas sold due to increased industry-wide demand and/or curtailments in production from specific properties due to mechanical, marketing or other problems, operating and capital expenditures that are either significantly higher or lower than anticipated because the actual cost of identified projects varied from original estimates and/or from the number of exploration and development opportunities being greater or fewer than currently anticipated and increased financing costs due to a significant increase in interest rates. See the Company's annual report on Form 10-K for the year ended December 31, 2006 for additional risks related to the Company's business.

## **ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company's major market risk exposure is in the pricing applicable to its natural gas and oil production. Realized pricing is primarily driven by the prevailing price for the Company's Wyoming natural gas production. Historically, prices received for natural gas production have been volatile and unpredictable. Pricing volatility is expected to continue. Gas price realizations averaged \$5.13 per Mcf during the six months ended June 30, 2007.

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The Company primarily relies on fixed price forward gas sales to manage its commodity price exposure. These fixed price forward gas sales are considered normal sales. The Company may, from time to time and to a lesser extent, use derivative instruments as one way to manage its exposure to commodity prices. The Company has periodically entered into fixed price to index price swap agreements in order to hedge a portion of its production. The oil and natural gas reference prices of these commodity derivatives contracts are based upon crude oil and natural gas futures, which have a high degree of historical correlation with actual prices the Company receives. Under SFAS No. 133 all derivative instruments are recorded on the balance sheet at fair value. Changes in the derivative's fair value are recognized currently in earnings unless specific hedge accounting criteria are met. For qualifying cash flow hedges, the gain or loss on the derivative is deferred in accumulated other comprehensive income (loss) to the extent the hedge is effective. For qualifying fair value hedges, the gain or loss on the derivative is offset by related results of the hedged item in the income statement. Gains and losses on hedging instruments included in accumulated other comprehensive income (loss) are reclassified to oil and natural gas sales revenue in the period that the related production is delivered. Derivative contracts that do not qualify for hedge accounting treatment are recorded as derivative assets and liabilities at market value in the consolidated balance sheet, and the associated unrealized gains and losses are recorded as current expense or income in the consolidated statement of operations. The Company currently does not have any derivative contracts in place that do not qualify as a cash flow hedge.

At June 30, 2007, the Company had the following open commodity derivative contracts to manage price risk on a portion of its natural gas production whereby the Company receives the fixed price and pays the variable price (all prices NWPL Rockies basis).

Type	Remaining Contract		Volume-	Average	Unrealized
	Period		MMBTU/ Day	Price/ MMBTU	Gain at 06/30/2007*
Swap	Apr 2008	Oct 2008	10,000	\$ 7.10	\$ 926,771
Swap	Apr 2008	Oct 2008	10,000	\$ 7.12	\$ 1,009,952
Swap	Apr 2008	Oct 2008	10,000	\$ 7.16	\$ 1,090,443

\* Unrealized gains are not adjusted for income tax effect.

The Company also utilizes fixed price forward physical delivery contracts at southwest Wyoming delivery points to hedge its commodity price exposure. The Company had the following fixed price physical delivery contracts in place on behalf of its interest and those of other parties at June 30, 2007. (The Company's approximate average net interest in physical gas sales is 80%.)

Remaining Contract Period	Volume- MMBTU/Day	Average Price/MMBTU
April 2007 - October 2007 Calendar 2008	40,000	\$ 6.20
April 2008 - October 2008 Calendar 2009	100,000	\$ 6.83
April 2008 - October 2008 Calendar 2009	30,000	\$ 7.13
April 2008 - October 2008 Calendar 2009	10,000	\$ 7.51

Subsequent to June 30, 2007 and through August 3, 2007, the Company has entered into the following commodity derivative contracts to manage price risk on a portion of its natural gas production whereby the Company receives the fixed price and pays the variable price (all prices NWPL Rockies basis):

<b>Type</b>	<b>Remaining Contract Period</b>		<b>Volume MMBTU/Day</b>	<b>Average Price/MMBTU</b>
Swap	Aug 2007	Dec 2007	10,000	\$ 4.59

**ITEM 4. CONTROLS AND PROCEDURES**

**(a) Evaluation of Disclosure Controls and Procedures**

We have performed an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure

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controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act). Our disclosure controls and procedures are the controls and other procedures that we have designed to ensure that we record, process, accumulate and communicate information to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures and submissions within the time periods specified in the SEC's rules and forms. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those determined to be effective can provide only a reasonable assurance with respect to financial statement preparation and presentation. Based on the evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective as of June 30, 2007. There were no changes in our internal control over financial reporting during the six months ended June 30, 2007 that have materially affected or are reasonably likely to affect, our internal control over financial reporting.

**PART II OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

The Company is currently involved in various routine disputes and allegations incidental to its business operations. While it is not possible to determine the ultimate disposition of these matters, the Company believes that the resolution of all such pending or threatened litigation is not likely to have a material adverse effect on the Company's financial position, or results of operations.

**ITEM 1A. RISK FACTORS**

There have been no material changes with respect to the risk factors disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

**ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS**

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares That May Yet be Purchased Under the Plans or Programs
Jan 1 - Jan 31, 2007				\$ 802 million
Feb 1 - Feb 28, 2007	18,179	\$ 51.87	18,179	\$ 801 million
Mar 1 - Mar 31, 2007	149,900	\$ 52.66	149,900	\$ 793 million
Apr 1 - Apr 30, 2007	217,350	\$ 55.01	217,350	\$ 781 million
May 1 - May 31, 2007	46,142	\$ 62.88	18,179	\$ 778 million
Jun 1 - Jun 30, 2007	272,000	\$ 56.41	272,000	\$ 763 million

TOTAL	703,571	\$	55.48	703,571	\$	763 million
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On May 17, 2006, the Company announced that its Board of Directors authorized a share repurchase program for up to an aggregate \$1 billion of the Company's outstanding common stock which has been and will be funded by cash on hand and the Company's senior credit facility. Pursuant to this authorization, the Company has commenced an initial program to purchase up to \$500.0 million of shares of its common stock through open market transactions or privately negotiated transactions. During the six months ended June 30, 2007, the Company has repurchased 639,250 shares of its common stock in open market transactions for an aggregate \$35.2 million at a weighted average price of \$55.05 per share. Since the program's inception in May 2006, the Company has purchased a total of 4.6 million shares in open market transactions for an aggregate \$232.7 million at a weighted average price of \$50.50 per share.

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In addition to the shares repurchased in open market transactions, the Company also acquired 64,321 shares delivered by employees for \$3.8 million to satisfy the exercise price of the employees' stock options and tax withholding obligations to satisfy tax withholding obligations in connection with the vesting of equity shares of common stock issued pursuant to the Company's employee incentive plans.

In total, during the six months ended June 30, 2007, the Company repurchased 703,571 shares of its common stock for an aggregate \$39.0 million dollars at a weighted average price of \$55.48 per share. Since the program's inception in May 2006, the Company has repurchased 4.7 million shares of its common stock for an aggregate \$237.3 million at a weighted average price of \$50.48 per share.

**ITEM 3. DEFAULTS IN SENIOR SECURITIES**

None.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF THE SECURITY HOLDERS**

The Company held its annual meeting on June 14, 2007. At the annual meeting the entire board of directors of the Company was elected. The votes cast for each of the directors proposed by the Company's definitive proxy statement on Schedule 14A was as follows:

Michael D. Watford	127,487,357 voted in favor, zero voted against and 268,954 votes withheld.
W. Charles Helton	126,196,192 voted in favor, zero voted against and 1,561,067 votes withheld.
Stephen J. McDaniel	126,714,729 voted in favor, zero voted against and 1,042,530 votes withheld.
James C. Roe	127,025,213 voted in favor, zero voted against and 732,046 votes withheld.
Robert E. Rigney	125,317,592 voted in favor, zero voted against and 2,438,719 votes withheld.

The shareholders of the Company approved the appointment of Ernst & Young, LLP as the Company's independent auditors for 2007. There were 127,622,914 votes in favor of approval of the appointment of Ernst & Young, LLP as the Company's auditors, zero votes against and 134,346 votes withheld.

The shareholders of the Company voted against the shareholder proposal with 48,940,007 votes against, 21,093,126 votes in favor of the proposal, 25,963,710 votes withheld and 31,762,417 Broker Non-votes.

A total of 127,759,260 shares were voted by 220 shareholders, representing 84% of the Company's outstanding shares.

**ITEM 5. OTHER INFORMATION**

The Company and Michael D. Watford entered into an employment agreement, effective as of February 1, 2007 similar to the previous employment agreement between the Company and Mr. Watford. The agreement has an initial term of three years, and will be automatically extended for successive one-year periods unless earlier terminated or upon the election of the Company's board of directors not to renew the agreement. Under the agreement, Mr. Watford agrees to serve as chairman, CEO and president of the Company for a salary of \$600,000 per year. The salary is to be reviewed annually by the Company's compensation committee, which may recommend increases to the board of directors based on Mr. Watford's performance and then-current market conditions for comparable positions. Mr. Watford is entitled to participate in long-term incentive plans adopted by the Company, to reimbursement of reasonable business expenses, to participate in and receive all rights and benefits under any life insurance, disability, medical and dental, health and accident plans, and to participate in programs adopted for senior employees of the Company, including rights and benefits under the Company's insurance program. The agreement provides that the

Company will provide Mr. Watford with an automobile and will pay actual operating costs of the automobile.

The Company is entitled to terminate the Agreement at any time for cause, in which case Mr. Watford will be entitled to no severance or other termination benefit. Cause includes the willful failure or refusal of Mr. Watford to render services to the Company in accordance with the employment agreement, the

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commission by Mr. Watford of an act of fraud or embezzlement against the Company or any other act which is materially and demonstrably injurious to the Company, or if Mr. Watford has been convicted of a felony.

Mr. Watford is entitled to a one-time severance payment equal to 100% of his salary for the 12 months immediately preceding the termination plus an amount equal to Mr. Watford's most recent annual bonus if:

Mr. Watford and the Company cannot agree to the terms of an extension of the agreement, or if the Company elects not to renew the agreement at the end of the initial term or any extended term,

The agreement is terminated by the Company other than for just cause (except in connection with a change of control), or

Mr. Watford terminates the Agreement because his responsibilities or duties with the Company materially change, the Company fails to provide to Mr. Watford the compensation he is entitled to under the agreement, Mr. Watford is required to relocate outside of Houston, Texas, or there is a material breach by the Company of any provision of the agreement (provided such termination is within two years of any such event).

Mr. Watford is entitled to a one-time severance payment equal to two and a half times the sum of 100% of his salary for the 12 months immediately preceding the termination plus an amount equal to his most recent bonus upon the termination by either Mr. Watford or the Company of this agreement following a change of control. Change of control is defined in the employment agreement. In addition, all stock options shall immediately vest in full, all outstanding Best in Class stock awards shall become 150% vested and awards under the Company's long term incentive plan shall vest and be payable at the maximum award level.

The agreement also provides that Mr. Watford is entitled to tax gross up payments in certain cases.

**ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K**

(a) Exhibits

- 3.1 Articles of Incorporation of Ultra Petroleum Corp. (incorporated by reference to Exhibit 3.1 of the Company's Quarterly Report on Form 10Q for the period ended June 30, 2001.)
- 3.2 By-Laws of Ultra Petroleum Corp.-(incorporated by reference to Exhibit 3.2 of the Company's Quarterly Report on Form 10Q for the period ended June 30, 2001.)
- 3.3 Articles of Amendment to Articles of Incorporation of Ultra Petroleum Corp. (incorporated by reference to Exhibit 3.3 of the Company's Report on Form 10-K/A for the period ended December 31, 2005)
- 4.1 Specimen Common Share Certificate (incorporated by reference to Exhibit 4.1 of the Company's Quarterly Report on Form 10Q for the period ended June 30, 2001.)
- 10.1 Credit Agreement dated as of April 30, 2007 among Ultra Resources, Inc., JPMorgan Chase Bank, N.A. as Administrative Agent, J.P. Morgan Securities Inc. as Sole Bookrunner and Sole Lead Arranger, and the Lenders party thereto (incorporated by reference to Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q for the period ended March 31, 2007).
- 10.2\* Employment Agreement between the Company and Michael D. Watford dated August 6, 2007.
- 31.1\* Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2\* Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1\* Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2\* Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* filed herewith

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ULTRA PETROLEUM CORP.

Name: Michael D. Watford  
By: /s/ Michael D. Watford  
Title: Chairman, President and Chief Executive Officer

Date: August 8, 2007

Name: Marshall D. Smith  
By: /s/ Marshall D. Smith  
Title: Chief Financial Officer

Date: August 8, 2007

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