

CONTANGO OIL & GAS CO

Form 10-Q

November 10, 2008

**Table of Contents**

**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 September 30, 2008  
OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number 001-16317  
CONTANGO OIL & GAS COMPANY  
(Exact name of registrant as specified in its charter)**

**DELAWARE**  
(State or other jurisdiction of  
incorporation or organization)

**95-4079863**  
(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)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The total number of shares of common stock, par value \$0.04 per share, outstanding as of October 31, 2008 was 16,709,292.

**CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES  
QUARTERLY REPORT ON FORM 10-Q  
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2008  
TABLE OF CONTENTS**

	<b>Page</b>
<b>PART I FINANCIAL INFORMATION</b>	
Item 1. Consolidated Financial Statements	
<u>Consolidated Balance Sheets as of September 30, 2008 and June 30, 2008</u>	3
<u>Consolidated Statements of Operations for the three months ended September 30, 2008 and 2007</u>	5
<u>Consolidated Statements of Cash Flows for the three months ended September 30, 2008 and 2007</u>	6
<u>Consolidated Statement of Shareholders' Equity for the three months ended September 30, 2008 and 2007</u>	7
<u>Notes to the Consolidated Financial Statements</u>	8
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	14
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	37
<u>Item 4. Controls and Procedures</u>	37
<b><u>PART II OTHER INFORMATION</u></b>	
<u>Item 1A. Risk Factors</u>	38
<u>Item 5. Other Information</u>	38
<u>Item 6. Exhibits</u>	39
<u>Exhibit 23.1</u>	
<u>Exhibit 31.1</u>	
<u>Exhibit 32.1</u>	

*All references in this Form 10-Q to the Company, Contango, we, us or our are to Contango Oil & Gas Company and its wholly-owned Subsidiaries. Unless otherwise noted, all information in this Form 10-Q 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.*

**Table of Contents**

**CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
**ASSETS**

	<b>September 30, 2008 (Unaudited)</b>	<b>June 30, 2008</b>
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 121,847,841	\$ 59,884,574
Inventory tubulars	334,797	334,797
Accounts receivable:		
Trade receivables	13,361,527	72,343,761
Advances to affiliates	5,192,685	5,754,516
Joint interest billings receivable	4,754,109	18,019,847
Prepaid capital costs	1,264,278	1,264,278
Other	1,199,996	1,147,345
<b>Total current assets</b>	<b>147,955,233</b>	<b>158,749,118</b>
<b>PROPERTY AND EQUIPMENT:</b>		
Natural gas and oil properties, successful efforts method of accounting:		
Proved properties	463,161,396	442,630,193
Unproved properties	7,915,297	7,591,447
Furniture and equipment	281,125	278,737
Accumulated depreciation, depletion and amortization	(19,609,763)	(13,134,511)
<b>Total property and equipment, net</b>	<b>451,748,055</b>	<b>437,365,866</b>
<b>OTHER ASSETS:</b>		
Cash and other assets held by affiliates	4,018,679	3,299,002
Other	195,819	559,764
<b>Total other assets</b>	<b>4,214,498</b>	<b>3,858,766</b>
<b>TOTAL ASSETS</b>	<b>\$ 603,917,786</b>	<b>\$ 599,973,750</b>

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

**Table of Contents**

**CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
**LIABILITIES AND SHAREHOLDERS EQUITY**

	<b>September 30, 2008 (Unaudited)</b>	<b>June 30, 2008</b>
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 13,307,712	\$ 22,990,887
Royalties and working interests payable	47,475,908	66,606,414
Accrued liabilities	2,151,718	10,334,008
Joint interest advances	5,599,408	15,666,389
Accrued exploration and development	21,471,013	3,082,399
Advances from affiliates		2,965,022
Payable to purchaser	7,732,115	
Debt of affiliates	3,344,519	3,261,177
Income tax payable	17,117,668	3,463,176
Other current liabilities	2,487,376	466,232
<b>Total current liabilities</b>	<b>120,687,437</b>	<b>128,835,704</b>
<b>LONG-TERM DEBT</b>		<b>15,000,000</b>
<b>DEFERRED TAX LIABILITY</b>	<b>114,320,315</b>	<b>112,189,684</b>
<b>ASSET RETIREMENT OBLIGATION</b>	<b>1,991,609</b>	<b>1,949,881</b>
<b>SHAREHOLDERS EQUITY:</b>		
Common stock, \$0.04 par value, 50,000,000 shares authorized, 19,609,246 shares issued and 16,880,792 outstanding at September 30, 2008, 19,404,746 shares issued and 16,819,746 outstanding at June 30, 2008	784,369	776,189
Additional paid-in capital	74,928,760	73,030,926
Treasury stock at cost (2,728,454 shares at September 30, 2008; 2,585,000 shares at June 30, 2008)	(14,750,342)	(6,843,900)
Retained earnings	305,955,638	275,035,266
<b>Total shareholders equity</b>	<b>366,918,425</b>	<b>341,998,481</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>	<b>\$ 603,917,786</b>	<b>\$ 599,973,750</b>

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

**Table of Contents**

**CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(Unaudited)**

	<b>Three Months Ended</b>	
	<b>September 30,</b>	
	<b>2008</b>	<b>2007</b>
<b>REVENUES:</b>		
Natural gas, oil and liquids sales	\$ 72,720,807	\$ 9,095,743
Total revenues	72,720,807	9,095,743
<b>EXPENSES:</b>		
Operating expenses	4,538,362	723,846
Exploration expenses	8,092,139	101,636
Depreciation, depletion and amortization	6,897,414	600,240
Impairment of natural gas and oil properties	68,766	
General and administrative expenses	1,926,087	1,342,461
Total expenses	21,522,768	2,768,183
<b>NET INCOME FROM CONTINUING OPERATIONS BEFORE OTHER INCOME AND INCOME TAXES</b>	<b>51,198,039</b>	<b>6,327,560</b>
<b>OTHER INCOME (EXPENSE):</b>		
Interest expense (net of interest capitalized)	(296,157)	(829,860)
Interest income	424,152	364,314
Other income		2,191,164
<b>NET INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES</b>	<b>51,326,034</b>	<b>8,053,178</b>
Provision for income taxes	(20,405,662)	(2,813,761)
<b>NET INCOME FROM CONTINUING OPERATIONS</b>	<b>30,920,372</b>	<b>5,239,417</b>
<b>DISCONTINUED OPERATIONS (NOTE 8)</b>		
Discontinued operations, net of income taxes		932,053
<b>NET INCOME</b>	<b>30,920,372</b>	<b>6,171,470</b>
Preferred stock dividends		450,000
<b>NET INCOME ATTRIBUTABLE TO COMMON STOCK</b>	<b>\$ 30,920,372</b>	<b>\$ 5,721,470</b>
<b>NET INCOME PER SHARE:</b>		
Basic		
Continuing operations	\$ 1.83	\$ 0.30

Edgar Filing: CONTANGO OIL & GAS CO - Form 10-Q

Discontinued operations			0.06
Total	\$	1.83	\$ 0.36
Diluted			
Continuing operations	\$	1.80	\$ 0.29
Discontinued operations			0.06
Total	\$	1.80	\$ 0.35
 WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:			
Basic		16,857,198	15,991,762
Diluted		17,211,298	16,419,956

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

**Table of Contents**

**CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

	<b>Three Months Ended</b>	
	<b>September 30,</b>	
	<b>2008</b>	<b>2007</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income from continuing operations	\$ 30,920,372	\$ 5,239,417
Plus income from discontinued operations, net of income taxes		932,053
Net income	30,920,372	6,171,470
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion and amortization	6,897,414	2,869,527
Impairment of natural gas and oil properties	68,766	
Exploration expenditures	7,972,904	316,392
Deferred income taxes	19,492,311	3,119,467
Tax benefit from exercise/cancellation of stock options	(120,540)	(60,848)
Stock-based compensation	363,679	396,508
Changes in operating assets and liabilities:		
Decrease (increase) in accounts receivable and other	60,105,834	(4,251,545)
Increase in prepaid insurance	(170,107)	(399,346)
Increase in interest receivable		(250,000)
Increase (decrease) in accounts payable and advances from joint owners	(19,750,156)	24,825,056
Decrease in other accrued liabilities	(18,638,479)	(244,919)
Increase (decrease) in income taxes payable	(3,586,569)	2,727,732
Other		(25,940)
Net cash provided by operating activities	83,555,429	35,193,554
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Natural gas and oil exploration and development expenditures	(2,258,629)	(41,075,249)
Sale of short-term investments		2,200,576
Retirements (additions) to furniture and equipment	32,826	(9,102)
Investment in Contango Venture Capital Corporation		1,715,605
Net cash used in investing activities	(2,225,803)	(37,168,170)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Repayments under credit facility	(15,000,000)	
Borrowings by affiliates		4,697,050
Preferred stock dividends		(450,000)
Tax benefit from exercise of stock options	120,540	60,848
Purchase of common stock	(5,908,694)	
Proceeds from exercised options, warrants and others	1,421,795	393,650
Net cash provided by (used in) financing activities	(19,366,359)	4,701,548
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>61,963,267</b>	<b>2,726,932</b>



Edgar Filing: CONTANGO OIL & GAS CO - Form 10-Q

CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	59,884,574	6,177,618
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 121,847,841	\$ 8,904,550
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for taxes	\$ 4,500,000	\$
Cash paid for interest	\$ 212,816	\$ 1,065,694

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

Table of Contents

**CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY**  
**(Unaudited)**

	<b>Common Stock</b>		<b>Paid-in</b>	<b>Treasury</b>	<b>Retained</b>	<b>Total</b>
	<b>Shares</b>	<b>Amount</b>	<b>Capital</b>	<b>Stock</b>	<b>Earnings</b>	<b>Shareholders</b>
						<b>Equity</b>
<b>Balance at June 30, 2008</b>	16,819,746	\$ 776,189	\$ 73,030,926	\$ (6,843,900)	\$ 275,035,266	\$ 341,998,481
Exercise of stock options	204,500	8,180	1,413,615			\$ 1,421,795
Tax benefit of exercising stock options			120,540			\$ 120,540
Issuance of restricted common stock			78,375			\$ 78,375
Net income					30,920,372	\$ 30,920,372
Treasury shares at cost	(143,454)			(7,906,442)		\$ (7,906,442)
Expense of stock options			285,304			\$ 285,304
<b>Balance at September 30, 2008</b>	16,880,792	\$ 784,369	\$ 74,928,760	\$ (14,750,342)	\$ 305,955,638	\$ 366,918,425

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

**Table of Contents**

**CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

**1. Basis of Presentation**

The accompanying unaudited consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ( GAAP ) for interim financial information, pursuant to the rules and regulations of the Securities and Exchange Commission, including instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by GAAP for complete annual financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. All such adjustments are of a normal recurring nature. The financial statements should be read in conjunction with the audited financial statements and notes included in the Company s Form 10-K for the fiscal year ended June 30, 2008. The results of operations for the three months ended September 30, 2008 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2009.

**2. Summary of Significant Accounting Policies**

The application of GAAP involves certain assumptions, judgments, choices and estimates that affect reported amounts of assets, liabilities, revenues and expenses. Thus, the application of these principles can result in varying results from company to company. Contango s significant accounting policies are described below.

*Successful Efforts Method of Accounting.* The Company follows the successful efforts method of accounting for its natural gas and oil activities. Under the successful efforts method, lease acquisition costs and all development costs are capitalized. Unproved properties are reviewed quarterly to determine if there has been impairment of the carrying value, and any such impairment is charged to expense in the period. Exploratory drilling costs are capitalized until the results are determined. If proved reserves are not discovered, the exploratory drilling costs are expensed. Other exploratory costs, such as seismic costs and other geological and geophysical expenses, are expensed as incurred. The provision for depreciation, depletion and amortization is based on the capitalized costs as determined above.

Depreciation, depletion and amortization is on a field by field basis using the unit of production method, with lease acquisition costs amortized over total proved reserves and other costs amortized over proved developed reserves. When circumstances indicate that proved properties may be impaired, the Company compares expected undiscounted future net cash flows on a cost center basis to the unamortized capitalized cost of the asset. If the future undiscounted net cash flows, based on the Company s estimate of future natural gas and oil prices and operating costs and anticipated production from proved reserves, are lower than the unamortized capitalized cost, then the capitalized cost is reduced to fair market value. For the three months ended September 30, 2008, the Company recorded an impairment charge of \$68,766 due to the expiration of lease block High Island 113 at our partially-owned subsidiary, Republic Exploration LLC.

An integral and on-going part of our business strategy is to sell our proved reserves from time to time in order to generate additional capital to reinvest in our offshore exploration programs. In accordance with Statement of Financial Accounting Standards ( SFAS ) No. 144 ( SFAS 144 ), Accounting for the Impairment or Disposal of Long-Lived Assets, the Company classifies such property sales as discontinued operations.

*Cash Equivalents.* Cash equivalents are considered to be highly liquid investment grade debt investments having an original maturity of 90 days or less. As of September 30, 2008, the Company had approximately \$121.8 million in cash and cash equivalents. Of this amount, approximately \$30.2 million was invested in U.S. Treasury money market funds and the remaining \$91.6 million was invested in overnight U.S. Treasury funds.

*Principles of Consolidation.* The Company s consolidated financial statements include the accounts of Contango Oil & Gas Company and its subsidiaries and affiliates, after elimination of all intercompany balances and transactions. Wholly-owned subsidiaries are fully consolidated. The Company has two subsidiaries that are not wholly owned: 32.3% owned Republic Exploration LLC ( REX ) and 65.6% owned Contango Offshore Exploration LLC ( COE ). These subsidiaries are not controlled by the Company and are proportionately consolidated.

**Table of Contents**

**CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

For the fiscal year ended June 30, 2007, the Company owned 42.7% of REX and 76.0% of COE. Effective April 1, 2008, the Company sold a portion of its ownership interest in REX and COE to an existing owner for approximately \$0.8 million and \$0.9 million, respectively. As a result of the sale, the Company's equity ownership interest in REX and COE decreased to 32.3% and 65.6%, respectively.

Contango's 19.5% ownership of Mobilize Inc. ( Mobilize ) is accounted for using the cost method. Under the cost method, Contango records an investment in the stock of an investee at cost, and recognizes dividends received as income. Dividends received in excess of earnings subsequent to the date of investment are considered a return of investment and are recorded as reductions of cost of the investment.

*Recent Accounting Pronouncements.* In June 2008, the Financial Accounting Standards Board ( FASB ) issued Staff Position No. EITF 03-6-1 ( FSP EITF 03-6-1 ), *Determining Whether Instruments Granted in Share-Based Payments Transactions Are Participating Securities* . FSP EITF 03-6-1 addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share ( EPS ) under the two-class method described in SFAS No. 128, *Earnings per Share* . The provisions of FSP EITF 03-6-1 are effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. All prior-period EPS data presented shall be adjusted retrospectively (including interim financial statements, summaries of earnings, and selected financial data) to conform with the provisions of FSP EITF 03-6-1. Early application is not permitted. We do not expect FSP EITF 03-6-1 to have a material effect on our consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162 ( SFAS 162 ), *The Hierarchy of Generally Accepted Accounting Principles* . SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with GAAP (the GAAP hierarchy). SFAS 162 is effective 60 days following the Securities and Exchange Commission's approval of the Public Company Accounting Oversight Board amendments to AU section 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles* . We are currently evaluating the provisions of SFAS 162 and assessing the impact, if any, it may have on our financial position and results of operations.

Effective July 1, 2009, the FASB issued SFAS No. 157-2 ( SFAS 157-2 ), *Effective Date of FASB Statement No. 157* . This pronouncement defers the effective date of SFAS No. 157 ( SFAS 157 ), *Fair Value Measurements* to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years, for all nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). An entity that has issued interim or annual financial statements reflecting the application of the measurement and disclosure provisions of SFAS 157 prior to February 12, 2008, must continue to apply all provisions of SFAS 157. We are currently evaluating the provisions of SFAS 157-2 and assessing the impact, if any, it may have on our financial position and results of operations.

In December 2007, the FASB issued SFAS No. 141(R) ( SFAS 141(R) ), *Business Combinations* and SFAS No. 160 ( SFAS 160 ), *Noncontrolling Interests in Consolidated Financial Statements* . These statements require most identifiable assets, liabilities and noncontrolling interests to be recorded at full fair value and require noncontrolling interests to be reported as a component of equity. Both statements are effective for periods beginning on or after December 15, 2008, and earlier adoption is prohibited. SFAS 141(R) will be applied to business combinations occurring after the effective date and SFAS 160 will be applied prospectively to all noncontrolling interests, including any that arose before the effective date. We are currently evaluating the provisions of SFAS 141(R) and SFAS 160 and assessing the impact, if any, they may have on our financial position and results of operations.

**Table of Contents**

**CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

*Stock-Based Compensation.* Effective July 1, 2001, the Company adopted the fair value based method prescribed in SFAS No. 123, Accounting for Stock Based Compensation. Under the fair value based method, compensation cost is measured at the grant date based on the fair value of the award and is recognized over the award vesting period. The fair value of each award is estimated as of the date of grant using the Black-Scholes option-pricing model. Effective July 1, 2005, the Company adopted SFAS No. 123 (revised 2004) (SFAS 123(R)), Share-Based Payment. SFAS 123(R) requires the benefits of tax deductions in excess of the compensation cost recognized for the options (excess tax benefit) to be classified as financing cash flows. The fair value of each option is estimated as of the date of grant using the Black-Scholes option-pricing model. The following weighted-average assumptions were used for the 45,000 options granted during the quarter ended September 30, 2008: (i) risk-free interest rate of 3.01 percent; (ii) expected life of five years; (iii) expected volatility of 53 percent and (iv) expected dividend yield of zero percent. No options were granted for the three months ended September 30, 2007.

Under the Company's 1999 Stock Incentive Plan, as amended (the 1999 Plan), the Company's Board of Directors may also grant restricted stock awards to officers or other employees of the Company. Restricted stock awards made under the 1999 Plan are subject to such restrictions, terms and conditions, including forfeitures, if any, as may be determined by the Board. Restricted stock awards generally vest over a period of three years. Grants of service-based restricted stock awards are valued at our common stock price at the date of grant. The Company did not grant shares of restricted stock to any officer or director for the three months ended September 30, 2008. For the three months ended September 30, 2007, the Company granted 331 shares of restricted stock to a new member of the Board. During the three months ended September 30, 2008 and 2007, the Company recorded stock-based compensation charges of approximately \$363,679 and \$396,508, respectively, to general and administrative expense for restricted stock and option awards granted in previous fiscal years.

**3. Natural Gas and Oil Exploration and Production Risk**

The Company's future financial condition and results of operations will depend upon prices received for its natural gas and oil production and the cost of finding, acquiring, developing and producing reserves. Substantially all of its production is sold under various terms and arrangements at prevailing market prices. Prices for natural gas and oil are subject to fluctuations in response to changes in supply, market uncertainty and a variety of other factors beyond the Company's control.

Other factors that have a direct bearing on the Company's financial condition are uncertainties inherent in estimating natural gas and oil reserves and future hydrocarbon production and cash flows, particularly with respect to wells that have not been fully tested and with wells having limited production histories; the timing and costs of our future drilling; development and abandonment activities; access to additional capital; changes in the price of natural gas and oil; availability and cost of services and equipment; and the presence of competitors with greater financial resources and capacity. The preparation of our financial statements in conformity with GAAP requires us to make estimates and assumptions that affect our reported results of operations, the amount of reported assets, liabilities and contingencies, and proved natural gas and oil reserves. We use the successful efforts method of accounting for our natural gas and oil activities.

**4. Customer Concentration Credit Risk**

The customer base for the Company is concentrated in the natural gas and oil industry. Major purchasers of our natural gas and oil for the three months ended September 30, 2008 were ConocoPhillips Company and Shell Trading US Company. Our sales to these companies are not secured with letters of credit and in the event of non-payment, we could lose up to two months of revenues. The loss of either of these companies as purchasers would not have a material effect on our financial position or results of operation since there are numerous potential purchasers of our production.

Table of Contents

**CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**5. Net Income per Common Share**

A reconciliation of the components of basic and diluted net income per share of common stock is presented in the tables below.

	<b>Three Months Ended September 30, 2008</b>		
	<b>Income</b>	<b>Weighted Average Shares</b>	<b>Per Share</b>
Income from continuing operations, including preferred dividends	\$ 30,920,372	16,857,198	\$ 1.83
<b>Basic Earnings per Share:</b>			
Net income attributable to common stock	\$ 30,920,372	16,857,198	\$ 1.83
Effect of Potential Dilutive Securities:			
Stock options		352,030	
Restricted shares		2,070	
Income from continuing operations	\$ 30,920,372	17,211,298	\$ 1.80
<b>Diluted Earnings per Share:</b>			
Net income, attributable to common stock	\$ 30,920,372	17,211,298	\$ 1.80

	<b>Three Months Ended September 30, 2007</b>		
	<b>Income</b>	<b>Weighted Average Shares</b>	<b>Per Share</b>
Income from continuing operations, including preferred dividends	\$ 4,789,417	15,991,762	\$ 0.30
Discontinued operations, net of income taxes	\$ 932,053	15,991,762	\$ 0.06
<b>Basic Earnings per Share:</b>			
Net income attributable to common stock	\$ 5,721,470	15,991,762	\$ 0.36
Effect of Potential Dilutive Securities:			
Stock options		428,194	
Series E preferred stock	(a)	(a)	
Income from continuing operations	\$ 4,789,417	16,419,956	\$ 0.29
Discontinued operations, net of income taxes	\$ 932,053	16,419,956	\$ 0.06
<b>Diluted Earnings per Share:</b>			
Net income, attributable to common stock	\$ 5,721,470	16,419,956	\$ 0.35

(a) Anti-dilutive

**Table of Contents**

**CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**6. Long-Term Debt**

On August 26, 2008, the Company prepaid the \$15.0 million it had outstanding under its \$30.0 million Term Loan Agreement with a private investment company and terminated the Term Loan Agreement. For the three months ended September 30, 2008, the Company paid \$212,816 in interest and non-use fees. As of September 30, 2008, the Company had no credit facilities and no debt outstanding.

**7. Other Income**

Other income for the three months ended September 30, 2007 totaled approximately \$2.2 million. This amount relates to a payment from a stockholder related to a short swing profit liability. In September 2007, one of our stockholders determined that it had inadvertently engaged in trades which resulted in automatic short swing profit liability to the Company pursuant to Section 16(b) of the Securities Exchange Act of 1934. After becoming aware of the situation, the stockholder promptly made a payment of approximately \$2.2 million to the Company to settle the entire short swing profit liability owed as a consequence of these trades.

**8. Sale of Properties Discontinued Operations**

The Company did not have any discontinued operations during the three months ended September 30, 2008. During the fiscal year ended June 30, 2008, the Company sold its Arkansas Fayetteville Shale properties, an on-shore well in Texas and an on-shore well in Louisiana for approximately \$328.3 million, in the aggregate. In accordance with SFAS 144, we classified these property sales as discontinued operations in our financial statements for all periods presented.

The summarized financial results for discontinued operations for the three months ended September 30, 2007 are as follows:

**Operating Results:**

	<b>Three Months Ended September 30, 2007</b>
Revenues	\$ 5,032,271
Operating expenses	(950,799)
Depletion expenses	(2,269,287)
Exploration expenses	(309,753)
Loss on sale of discontinued operations	(68,505)
Gain before income taxes	1,433,927
Provision for income taxes	(501,874)
Gain from discontinued operations, net of income taxes	\$ 932,053



**Table of Contents**

**CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**9. Related Party Transactions**

In the ordinary course of business, the Company contracted with Mobilize to install automation equipment that will allow Contango Operators, Inc. ( COI ) to remotely monitor, control and record, in real time, daily production volumes from the Grand Isle 72 #1 well. For the three months ended September 30, 2008 and 2007, the Company paid approximately \$1,400 to Mobilize for such services.

Effective September 1, 2008, COI purchased an interest in an existing offshore lease from Juneau Exploration, L.P. ( JEX ) for \$600,000.

On September 8, 2008, the Company purchased 21,754 shares of common stock from a member of its board of directors for approximately \$1.3 million, or \$60.81 per share, which represented the closing price of the Company's common stock on that date.

**10. Subsequent Events**

On October 3, 2008, the Company and its wholly-owned subsidiary, Contango Resources Company, completed the arrangement of a \$50 million Hydrocarbon Borrowing Base secured revolving credit facility pursuant to a credit agreement with Guaranty Bank, as administrative agent and issuing lender (the Credit Agreement ). The credit facility is available to fund the Company's offshore Gulf of Mexico exploration and development activities, as well as the repurchase of shares of the Company's common stock, the payment of dividends, and working capital as needed.

Borrowings under the Credit Agreement bear interest at LIBOR plus 2.0% per annum. The outstanding principal amount and any accrued interest thereon is due October 3, 2010, and may be prepaid at any time in accordance with the Credit Agreement with no prepayment penalty. An arrangement fee of 0.5%, or \$250,000, was paid in connection with the facility and a commitment fee of 0.5% will be paid on the unused commitment amount.

In October 2008, COI spud West Delta 77 ( Devil's Elbow ), a REX prospect, which has been determined to be a dry hole. COI has a 100% WI and will pay 100% of the estimated drilling costs of \$6.4 million. These costs together with associated leasehold costs of approximately \$1.6 million are reflected as exploration expenses in the Company's Consolidated Statements of Operations for the three months ended September 30, 2008.

**Table of Contents**

**Available Information**

General information about us can be found on our Website at [www.contango.com](http://www.contango.com). Our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, as well as any amendments and exhibits to those reports, are available free of charge through our Website as soon as reasonably practicable after we file or furnish them to the Securities and Exchange Commission.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the financial statements and the accompanying notes and other information included elsewhere in this Form 10-Q and in our Form 10-K for the fiscal year ended June 30, 2008, previously filed with the Securities and Exchange Commission.

**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

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

**Table of Contents**

Interest rate volatility

Uncertainties in the estimation of proved reserves and in the projection of future rates of production and timing of development expenditures

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

The 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

The ability to construct and operate offshore infrastructure, including pipeline and production facilities

Drilling and operating costs, production rates and ultimate reserve recoveries in our Eugene Island 10 ( Dutch ) and State of Louisiana ( Mary Rose ) acreage.

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** in this Form 10-Q 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.

**Overview**

Contango is a Houston-based, independent natural gas and oil company. The Company's business is to explore, develop, produce and acquire natural gas and oil properties primarily offshore in the Gulf of Mexico. Contango Operators, Inc. ( COI ) and Contango Resources Company ( CRC ), our wholly-owned subsidiaries, act as operator on certain offshore prospects.

**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 Juneau Exploration, L.P., our alliance partner.* We depend totally upon our alliance partner, Juneau Exploration, L.P. ( JEX ), for prospect generation expertise. JEX is experienced and has a successful track record in exploration.

*Using our limited capital availability to increase our reward/risk potential on selective prospects.* We have concentrated our risk investment capital in our offshore Gulf of Mexico prospects. Exploration prospects are inherently risky as they require large amounts of capital with no guarantee of success. COI and CRC drill and operate 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.

**Table of Contents**

*Operating in the Gulf of Mexico.* COI and CRC were formed for the purpose of drilling and operating exploration wells in the Gulf of Mexico. While the Company 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.

*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 offshore exploration activities. Since its inception, the Company has sold approximately \$484 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. We plan to continue outsourcing our geological, geophysical, and reservoir engineering and land functions. We have seven employees.

*Structuring transactions to share risk.* JEX, our alliance partner, shares 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 23% of our common stock.

**Exploration 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 ) and Contango Offshore Exploration, LLC ( COE ) (see Offshore Gulf of Mexico Exploration Joint Ventures below). We do not have a written agreement with JEX which contractually obligates them to provide us with their services.

**Offshore Gulf of Mexico Exploration Joint Ventures**

Contango, through its wholly-owned subsidiaries, COI and CRC, and its partially-owned subsidiaries, REX and COE, conducts exploration activities in the Gulf of Mexico. As of October 31, 2008, Contango, through COI, CRC, REX and COE, had an interest in 66 offshore leases. See Offshore Properties below for additional information on our offshore properties.

As of September 30, 2008, Contango owned a 32.3% equity interest in REX and a 65.6% equity interest in COE, both of which were formed for the purpose of generating exploration opportunities in the Gulf of Mexico. These companies focus on identifying prospects, acquiring leases at federal and state lease sales and then selling the prospects to Contango, subject to timed drilling obligations plus retained reversionary interests in favor of REX and COE.

*Impact of Hurricanes Gustav and Ike*

In September 2008, Hurricanes Gustav and Ike moved through the Gulf of Mexico. Our offshore facilities sustained only minor damage from Hurricane Ike, and was limited to six of our seven Dutch and Mary Rose wells, affecting mainly SCADA control systems, helideck skirting, risers, and disrupted flowlines. The 8/8ths cost to repair the damage on all six wells is approximately \$1.6 million, which is covered by the Company's insurance after an 8/8ths deductible of \$500,000. However, the third-party processing and pipeline facilities on which we rely incurred significant damage from Hurricane Ike. This damage has slowed reinstatement of production from a portion of our Gulf of Mexico assets. We expect our Gulf of Mexico production to come back online upon the restarting of the pipeline and other non-operated facilities. These repairs are estimated to be completed in the November/December 2008 time frame.

**Table of Contents**

Our corporate office sustained major damage and we have temporarily relocated to an office approximately 200 yards away. We have not lost any paper files and all of our electronic files were backed up prior to the storm.

*Republic Exploration LLC*

In October 2008, COI spud West Delta 77 ( Devil s Elbow ), a REX prospect, which has been determined to be a dry hole. COI has a 100% WI and will pay 100% of the estimated drilling costs of \$6.4 million. These costs together with associated leasehold costs of approximately \$1.6 million are reflected as exploration expenses in the Company s Consolidated Statements of Operations for the three months ended September 30, 2008.

West Delta 36, a REX prospect, is operated by a third party. The Company depends on a third-party operator for the operation and maintenance of this production platform. The well is temporarily shut-in while its associated gathering systems and processing facilities remain down. The well did not sustain any significant damage from Hurricane Ike. REX has a 25.0% working interest ( WI ), and a 20.0% net revenue interest ( NRI ), in this well.

*Contango Offshore Exploration LLC*

Grand Isle 72 ( Liberty ), a COE prospect operated by COI, began producing in March 2007 and as of October 31, 2008 was producing at a rate of approximately 0.2 million cubic feet equivalent per day ( Mmcfed ). COE has a 50% WI and a 40% NRI in this well. As of September 30, 2008, 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. As of September 30, 2008, accrued and unpaid interest on the Note was \$795,797.

Grand Isle 70, another COE prospect, was drilled by COI 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 45.1% WI before completion of the well and a 52.6% WI after completion of the well, while COI has a 3.6% WI before and after completion of the well.

**Contango Operators, Inc**

COI, a wholly-owned subsidiary of the Company, was formed for the purpose of drilling exploration and development wells in the Gulf of Mexico. COI operates and acquires significant working interests in offshore exploration and development opportunities in the Gulf of Mexico, usually under a farm-out agreement, or similar agreement, with either REX or COE. COI may also operate and acquire significant working interests in offshore exploration and development opportunities under farm-in agreements with third parties.

COI has recently successfully production tested its Eloise #1 well on State of Louisiana leases at a depth below our Mary Rose discovery. The well tested at a rate of approximately 8.3 Mmcfed. The Company s net revenue interest in Eloise #1, inclusive of its ownership interest in REX, is approximately 27.0%. Contango s independent third party engineer estimates this well to have proved reserves net to Contango of approximately 3.5 billion cubic feet equivalent ( Bcfe ). The Company has invested approximately \$16.3 million to drill and complete this well and estimates it will invest an additional \$2.2 million in pipeline and facility costs to bring this well to production. Production from Eloise #1 is estimated to commence before year-end, at a rate of approximately 5 to 10 Mmcfed (1 to 3 Mmcfed net to Contango). The well will flow to the Company s EI-11H platform.

Effective September 1, 2008, COI purchased additional working interests in nine offshore lease blocks from existing owners for a total of \$2.1 million. See Offshore Properties below for a detailed description of the interests owned in our offshore properties.

**Table of Contents**

For the remaining nine months of fiscal year 2009, we expect to invest approximately \$44.0 million for COI to drill up to potentially three additional wildcat exploration wells as follows.

Well	8/8ths DHC	Contango	NRI
		DHC WI	(inclusive of REX and COE)
Ship Shoal 263	\$ 20 million	100.00%	72.78%
Eugene Island 56 West	\$ 12 million	100.00%	59.45%
Eugene Island 56 East (1)	\$ 12 million	100.00%	59.45%
	\$ 44 million		

(1) May not be drilled if Eugene Island 56 West is a dry hole

In exchange for acting as operator, COI receives a 10% ground floor working interest in each of these three prospects. For the remaining 90%, COI carries either REX or COE, as applicable, for a 10% working interest through the tanks until initial production is achieved. Following a casing point election, REX or COE, as generator of the prospect, has the option to acquire an additional 25% working interest from COI.

**Contango Resources Company**

CRC is a wholly-owned subsidiary of Contango formed for the sole purpose of drilling and operating exploration and development wells in our Dutch and Mary Rose leases in the Gulf of Mexico.

*Current Activities*

In September 2008, Contango terminated the data room process for companies potentially interested in acquiring the Company's Dutch and Mary Rose fields in the Gulf of Mexico.

As of October 31, 2008, our four Mary Rose wells were flowing at a combined 8/8ths production rate of approximately 174 Mmcfd (approximately 65 Mmcfd net to Contango). We expect our 3<sup>rd</sup> party pipeline company to have completed repairs and will be able to raise production rates to pre-hurricane levels of approximately 200 Mmcfd 8/8ths or approximately 75 Mmcfd net to Contango in the November/December 2008 time frame. The four Mary Rose wells flow into the Company's production platform at Eugene Island 11, and from there through our owned pipeline to transportation hub facilities at Eugene Island 63. Our EI-11H platform has been designed with a capacity of 500 million cubic feet per day ( Mmcfd ) and 6,000 barrels of oil per day ( bopd ) and our pipeline, which flows from Eugene Island 11 to Eugene Island 63, has been designed with a capacity of 330 Mmcfd and 6,000 bopd. The gas and condensate then flow from Eugene Island 63 to on-shore processing facilities near Patterson, Louisiana.

As of October 31, 2008, production at our three Dutch wells remained shut-in as the third-party downstream gas plant that processes our gas is undergoing repairs as a result of damage incurred from Hurricane Ike. All of our Dutch production has been shut-in since August 30, 2008, when we first evacuated personnel due to Hurricane Gustav. It is expected the repairs to the plant will be completed and we will be able to resume our Dutch production in the November/December 2008 time frame. Before Hurricanes Gustav and Ike, we were flowing approximately 110 Mmcfd (42 Mmcfd net to Contango) and anticipate returning to that level of production.

In September 2008, CRC spud its first rate acceleration well, the Dutch #4. CRC has a 47.05% WI and will pay drilling costs of approximately \$6.8 million. The well has been logged and we anticipate completion and testing of this well before the end of November 2008. CRC has budgeted to invest approximately \$4.8 million in completion costs and \$3.2 million in pipeline and facility costs. Production from Dutch #4 of about 35 Mmcfd is expected to begin in February 2009. CRC has a 38.12% NRI in this well and it will flow to the Company's EI-11H platform.





**Table of Contents****Offshore Properties**

*Producing Properties.* The following table sets forth the interests owned by Contango through CRC and its related entities in the Gulf of Mexico which were producing natural gas or oil as of October 31, 2008:

<b>Area/Block</b>	<b>WI</b>	<b>NRI</b>	<b>Status</b>	<b>Notes</b>
<i>Contango Resources Company:</i>				
Eugene Island 10 #1 (Dutch #1)	47.05%	38.1%	Shut-in	
Eugene Island 10 #2 (Dutch #2)	47.05%	38.1%	Shut-in	
Eugene Island 10 #3 (Dutch #3)	47.05%	38.1%	Shut-in	
S-L 18640 #1 (Mary Rose #1)	53.21%	40.5%	Producing	
S-L 19266 #1 (Mary Rose #2)	53.21%	38.7%	Producing	
S-L 19266 #2 (Mary Rose #3)	53.21%	38.7%	Producing	
S-L 18860 #1 (Mary Rose #4)	34.58%	25.5%	Producing	
<i>Republic Exploration LLC</i>				
Eugene Island 113B	0.0%	3.3%	Shut-in	Farmed out
West Delta 36	25.0%	20.0%	Shut-in	Farmed out
<i>Contango Offshore Exploration LLC:</i>				
Grand Isle 72	50.0%	40.0%	Producing	
Ship Shoal 358, A-3 well	10.0%	7.7%	Shut-in	

**Table of Contents**

*Leases.* The following table sets forth the working interests owned by Contango and related entities in the Gulf of Mexico as of October 31, 2008:

<b>Area/Block</b>	<b>WI</b>	<b>Lease Date</b>	<b>Expiration Date</b>	<b>Status</b>	<b>Notes</b>
<i>Contango Resources Company:</i>					
S-L 19266 #3 (Eloise North #1)	36.90%	Feb 07	Feb 12	Completing	
S-L 19261	53.21%	Feb 07	Feb 12		
S-L 19396	53.21%	Jun 07	Jun 12		
Eugene Island 11	53.21%	Dec 07	(1)		
<i>Contango Operators, Inc.:</i>					
Grand Isle 63	25.00%	May-04	May-09		
Grand Isle 73	25.00%	May-04	May-09		
West Delta 43	35.00%	May-04	May-09	Dry Hole	
Ship Shoal 14	50.00%	May-06	May-11		
Ship Shoal 25	50.00%	May-06	May-11		
South Marsh Island 57	50.00%	May-06	May-11		
South Marsh Island 59	50.00%	May-06	May-11		
South Marsh Island 75	50.00%	May-06	May-11		
South Marsh Island 282	50.00%	May-06	May-11		
Ship Shoal 263	25.00%	Jan-06	Jan-11		
Grand Isle 70	3.65%	Jun-06	Jun-11		
West Delta 77	50.00%	Jun-06	Jun-11	Dry Hole	
Vermilion 194	50.00%	Jul-06	Jul-11		
<i>Republic Exploration LLC</i>					
South Timbalier 191	50.00%	May-04	May-09		
Vermilion 36	100.00%	May-04	May-09		
Vermilion 109	100.00%	May-04	May-09		
Vermilion 134	100.00%	May-04	May-09		
West Cameron 179	100.00%	May-04	May-09		
West Cameron 185	100.00%	May-04	May-09		
West Cameron 200	100.00%	May-04	May-09		
West Delta 18	100.00%	May-04	May-09		
West Delta 33	100.00%	May-04	May-09		
West Delta 34	100.00%	May-04	May-09		
West Delta 43	30.00%	May-04	May-09	Dry Hole	
Ship Shoal 220	50.00%	Jun-04	Jun-09		
South Timbalier 240	50.00%	Jun-04	Jun-09		
West Cameron 133	100.00%	Jun-04	Jun-09		
West Cameron 80	100.00%	Jun-04	Jun-09		
West Cameron 167	100.00%	Jun-04	Jun-09		
Eugene Island 76	0.00%	Jul-04	Jul-09	Depleted	Farmed out
Vermilion 130	100.00%	Jul-04	Jul-09		
West Cameron 107	100.00%	May-05	May-10		
Eugene Island 168	50.00%	Jun-05	Jun-10		
Vermilion 73	0.00%	Jul-05	Jul-10	Dry Hole	Farmed out
High Island A243	75.00%	Jan-06	Jan-11		



**Table of Contents**

<b>Area/Block</b>	<b>WI</b>	<b>Lease Date</b>	<b>Expiration Date</b>	<b>Status</b>	<b>Notes</b>
<i>Republic Exploration LLC</i>					
<i>(continued)</i>					
South Marsh Island 57	50.00%	May-06	May-11		
South Marsh Island 59	50.00%	May-06	May-11		
South Marsh Island 75	50.00%	May-06	May-11		
South Marsh Island 282	50.00%	May-06	May-11		
Ship Shoal 14	50.00%	May-06	May-11		
Ship Shoal 25	50.00%	May-06	May-11		
West Delta 77	50.00%	Jun-06	Jun-11	Dry Hole	
Vermilion 154	(2)	Jul-06	Jul-11	(3)	Farmed out
Vermilion 194	50.00%	Jul-06	Jul-11		
High Island A196	100.00%	Nov-06	Nov-11		
High Island A197	100.00%	Nov-06	Nov-11		
High Island A198	100.00%	Nov-06	Nov-11	Dry Hole	
High Island 263	100.00%	Jan-08	Jan-13		
High Island A38	100.00%	Jan-08	Jan-13		
Eugene Island 56	100.00%	Jul-08	Jul-13		
<i>Contango Offshore Exploration LLC:</i>					
East Breaks 283	100.00%	Dec-03	Dec-11		
East Breaks 369	0.00%	Dec-03	Dec-08	Dry Hole	Farmed out
East Breaks 370	0.00%	Dec-03	Dec-08	(3)	Farmed out
High Island A16	100.00%	Dec-03	Dec-08		
South Timbalier 191	50.00%	May-04	May-09		
Grand Isle 63	50.00%	May-04	May-09		
Grand Isle 73	50.00%	May-04	May-09		
Ship Shoal 220	50.00%	Jun-04	Jun-09		
South Timbalier 240	50.00%	Jun-04	Jun-09		
Viosca Knoll 118	50.00%	Jun-04	Jun-09		
Vermilion 154	(2)	Jul-04	Jul-09	(3)	Farmed out
Viosca Knoll 475	100.00%	May-05	May-10		
Eugene Island 168	50.00%	Jun-05	Jun-10		
East Breaks 366	100.00%	Nov-05	Nov-15		
East Breaks 410	100.00%	Nov-05	Nov-15		
East Breaks 167	75.00%	Dec-05	Dec-10		
High Island A311	75.00%	Dec-05	Dec-10		
East Breaks 166	75.00%	Jan-06	Jan-11		
High Island A342	75.00%	Jan-06	Jan-11		
Ship Shoal 263	75.00%	Jan-06	Jan-11		
Viosca Knoll 383	100.00%	Jan-06	Jan-11		
Grand Isle 70	45.10%	Jun-06	Jun-11		
Viosca Knoll 119	50.00%	Jun-06	Jun-11		

(1) Held by  
Right-of-Use-and-Easement

- (2) REX and COE will split a 25% back-in WI after payout
- (3) Not drilled. Lease is in the process of being assigned back to the Company

**Table of Contents****Application of Critical Accounting Policies and Management's Estimates**

The discussion and analysis of the Company's financial condition and results of operations is based upon the consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. The Company's significant accounting policies are described in Note 2 to the consolidated financial statements included in this Quarterly Report on Form 10-Q. We have identified below the policies that are of particular importance to the portrayal of our financial position and results of operations and which require the application of significant judgment by management. The Company analyzes its estimates, including those related to its natural gas and oil reserve estimates, on a periodic basis and bases its estimates on historical experience, independent third party reservoir engineers and various other assumptions that management believes to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. The Company believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of the Company's financial statements:

*Successful Efforts Method of Accounting.* Our application of the successful efforts method of accounting for our natural gas and oil business activities requires judgments as to whether particular wells are developmental or exploratory, since exploratory costs and the costs related to exploratory wells that are determined to not have proved reserves must be expensed whereas developmental costs are capitalized. The results from a drilling operation can take considerable time to analyze, and the determination that commercial reserves have been discovered requires both judgment and application of industry experience. Wells may be completed that are assumed to be productive and actually deliver natural gas and oil in quantities insufficient to be economic, which may result in the abandonment of the wells at a later date. On occasion, wells are drilled which have targeted geologic structures that are both developmental and exploratory in nature, and in such instances an allocation of costs is required to properly account for the results. Delineation seismic costs incurred to select development locations within a productive natural gas and oil field are typically treated as development costs and capitalized, but often these seismic programs extend beyond the proved reserve areas and therefore management must estimate the portion of seismic costs to expense as exploratory. The evaluation of natural gas and oil leasehold acquisition costs included in unproved properties requires management's judgment to estimate the fair value of exploratory costs related to drilling activity in a given area. Drilling activities in an area by other companies may also effectively condemn leasehold positions.

*Reserve Estimates.* The Company's estimates of natural gas and oil reserves are, by necessity, projections based on geologic and engineering data, and there are uncertainties inherent in the interpretation of such data as well as the projection of future rates of production and the timing of development expenditures. Reserve engineering is a subjective process of estimating underground accumulations of natural gas and oil that are difficult to measure. The accuracy of any reserve estimate is a function of the quality of available data, engineering and geological interpretation and judgment. Estimates of economically recoverable natural gas and oil reserves and future net cash flows necessarily depend upon a number of variable factors and assumptions, such as historical production from the area compared with production from other producing areas, the assumed effect of regulations by governmental agencies, and assumptions governing future natural gas and oil prices, future operating costs, severance taxes, development costs and workover costs, all of which may in fact vary considerably from actual results. The future drilling costs associated with reserves assigned to proved undeveloped locations may ultimately increase to the extent that these reserves are later determined to be uneconomic. For these reasons, estimates of the economically recoverable quantities of expected natural gas and oil attributable to any particular group of properties, classifications of such reserves based on risk of recovery, and estimates of the future net cash flows may vary substantially. Any significant variance in the assumptions could materially affect the estimated quantity and value of the reserves, which could affect the carrying value of the Company's natural gas and oil properties and/or the rate of depletion of such natural gas and oil properties. Actual production, revenues and expenditures with respect to the Company's reserves will likely vary from estimates, and such variances may be material. Holding all other factors constant, a reduction in the Company's proved reserve estimate at September 30, 2008 of 1% would not have a material effect on depreciation, depletion and amortization.





**Table of Contents**

*Impairment of Natural Gas and Oil Properties.* The Company reviews its proved natural gas and oil properties for impairment on an annual basis or whenever events and circumstances indicate a potential decline in the recoverability of their carrying value. The Company compares expected undiscounted future net cash flows on a cost center basis to the unamortized capitalized cost of the asset. If the future undiscounted net cash flows, based on the Company's estimate of future natural gas and oil prices and operating costs and anticipated production from proved reserves, are lower than the unamortized capitalized cost, then the capitalized cost is reduced to fair market value. The factors used to determine fair value include, but are not limited to, estimates of reserves, future commodity pricing, future production estimates, anticipated capital expenditures, and a discount rate commensurate with the risk associated with realizing the expected cash flows projected. Unproved properties are reviewed quarterly to determine if there has been impairment of the carrying value, with any such impairment charged to expense in the period. Given the complexities associated with natural gas and oil reserve estimates and the history of price volatility in the natural gas and oil markets, events may arise that will require the Company to record an impairment of its natural gas and oil properties and there can be no assurance that such impairments will not be required in the future nor that they will not be material.

*Stock-Based Compensation.* Effective July 1, 2006, we adopted SFAS No. 123 (revised 2004) ( SFAS 123(R) ), Share-Based Payment which requires companies to measure and recognize compensation expense for all stock-based payments at fair value. SFAS 123(R) requires that management make assumptions including stock price volatility and employee turnover that are utilized to measure compensation expense. The fair value of stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model. This model requires the input of highly subjective assumptions, which are set forth in Note 1 to our consolidated financial statements.

**Table of Contents****MD&A Summary Data**

The table below sets forth revenue, expense and production data for continuing operations for the three months ended September 30, 2008 and 2007.

	<b>Three Months Ended September 30,</b>		
	<b>2008</b>	<b>2007</b>	<b>Change</b>
		(\$000)	
<b>Revenues:</b>			
Natural gas, oil and NGL sales	\$ 72,721	\$ 9,096	699%
Total revenues	\$ 72,721	\$ 9,096	699%
<b>Production:</b>			
Natural gas (million cubic feet)	4,859	1,269	283%
Oil and condensate (thousand barrels)	117	37	216%
Natural gas liquids (thousand gallons)	704	379	86%
Total (million cubic feet equivalent)	5,662	1,545	266%
Natural gas (million cubic feet per day)	52.8	13.8	283%
Oil and condensate (thousand barrels per day)	1.3	0.4	225%
Natural gas liquids (thousand gallons per day)	7.7	4.1	86%
Total (million cubic feet equivalent per day)	61.7	16.8	267%
<b>Average Sales Price:</b>			
Natural gas (per thousand cubic feet)	\$ 11.60	\$ 5.60	107%
Oil and condensate (per barrel)	\$ 126.16	\$ 54.37	132%
Natural gas liquids (per gallon)	\$ 2.18	\$ 1.15	90%
Operating expenses	\$ 4,538	\$ 724	527%
Exploration expenses	\$ 8,092	\$ 102	7833%
Depreciation, depletion and amortization	\$ 6,897	\$ 600	1050%
Impairment of natural gas and oil properties	\$ 69	\$	100%
General and administrative expenses	\$ 1,926	\$ 1,342	44%
Interest expense, net of interest capitalized	\$ 296	\$ 830	-64%
Interest income	\$ 424	\$ 364	16%
Other income	\$	\$ 2,191	-100%

**Three Months Ended September 30, 2008 Compared to Three Months Ended September 30, 2007**

*Natural Gas, Oil and Natural Gas Liquids ( NGL ) Sales.* We reported revenues of approximately \$72.7 million for the three months ended September 30, 2008, compared to revenues of approximately \$9.1 million for the three months ended September 30, 2007. This increase is attributable to increased natural gas and oil sales from our Dutch #3 discovery which began producing in November 2007, our Mary Rose #1 and #3 discoveries which began producing in April 2008, our Mary Rose #2 discovery which began producing in June 2008 and our Mary Rose #4 discovery which began producing in July 2008. The large increase is also attributable to the additional interest we purchased in our Dutch and Mary Rose discoveries, effective January 1, 2008.



**Table of Contents**

For the three months ended September 30, 2008, the price of natural gas was \$11.60 per thousand cubic feet ( Mcf ) while the price for oil and condensate was \$126.16 per barrel and the price for NGLs was \$2.18 per gallon. For the three months ended September 30, 2007, the price of natural gas was \$5.60 per Mcf while the price for oil and condensate was \$54.37 per barrel and the price for NGLs was \$1.15 per gallon.

*Natural Gas, Oil and NGL Production and Average Sales Prices.* Our net natural gas production for the three months ended September 30, 2008 was approximately 52.8 Mmcfd, up from approximately 13.8 Mmcfd for the three months ended September 30, 2007. Net oil and condensate production for the comparable periods also increased from approximately 400 barrels per day to approximately 1,300 barrels per day, while our NGL production increased from approximately 4,100 gallons per day to approximately 7,700 gallons per day. This increase in natural gas, oil and NGL production is principally attributable to our Dutch #3 discovery which began producing in November 2007, our Mary Rose #1 and #3 discoveries which began producing in April 2008, our Mary Rose #2 discovery which began producing in June 2008 and our Mary Rose #4 discovery which began producing in July 2008. The large increase is also attributable to the additional interest we purchased in our Dutch and Mary Rose discoveries, effective January 1, 2008.

*Operating Expenses.* Lease operating expenses ( LOE ) for the three months ended September 30, 2008 were approximately \$4.5 million which related mainly to continuing operations from our three Dutch wells and four Mary Rose wells. Included in LOE is \$2.4 million of Louisiana state severance taxes. Lease operating expenses for the three months ended September 30, 2007 were approximately \$0.7 million which related to only two Dutch wells.

*Exploration Expense.* We reported approximately \$8.1 million of exploration expenses for the three months ended September 30, 2008. Of this amount, approximately \$8.0 million related to the dry hole the Company drilled at West Delta 77 while the remaining \$0.1 million related to various geological and geophysical activities, seismic data, and delay rentals. We reported \$101,636 of exploration expenses for the three months ended September 30, 2007, attributable to various geological and geophysical activities, seismic data, and delay rentals.

*Depreciation, Depletion and Amortization.* Depreciation, depletion and amortization for the three months ended September 30, 2008 was approximately \$6.9 million. For the three months ended September 30, 2007, we recorded approximately \$0.6 million of depreciation, depletion and amortization. The increase in depreciation, depletion and amortization was primarily attributable to added production from newly added reserves from our Dutch #3 and Mary Rose #1, #2, #3 and #4 discoveries, as well as from the additional interest we purchased in our Dutch and Mary Rose discoveries, effective January 1, 2008.

*Impairment of Natural Gas and Oil Properties.* For the three months ended September 30, 2008, the Company recorded an impairment charge of \$68,766 related to the expiration of lease block High Island 113. No impairment of natural gas and oil properties was incurred during the three months ended September 30, 2007.

*General and Administrative Expenses.* General and administrative expenses for the three months ended September 30, 2008 and the three months ended September 30, 2007 were approximately \$1.9 million and \$1.3 million, respectively. Major components of general and administrative expenses for the three months ended September 30, 2008 included approximately \$0.5 million in salaries and benefits, \$0.2 million in accounting and tax services, \$0.5 million in legal, engineering and other professional fees, \$0.1 million in office administration expenses, \$0.2 million in insurance costs, and \$0.4 million related to the cost of expensing stock options and stock grant compensation.

Major components of general and administrative expenses for the three months ended September 30, 2007 included approximately \$0.5 million in salaries and benefits, approximately \$0.1 million in legal, accounting, engineering and other professional fees, \$0.1 million in office administration expenses, \$0.1 million in insurance costs, and \$0.5 million related to the cost of expensing stock options and stock grant compensation.

**Table of Contents**

*Interest Expense.* We reported interest expense of \$296,157 for the three months ended September 30, 2008, compared to interest expense of approximately \$829,860 for the three months ended September 30, 2007. The lower level of interest expense is attributable to the Company retiring all of its long term debt in the in the first quarter of fiscal year 2009.

*Interest Income.* We reported interest income of \$424,152 for the three months ended September 30, 2008. This compares to \$364,314 of interest income reported for the three months ended September 30, 2007. The increase is due to additional interest income from loans made to affiliates.

*Other Income.* Other income for the three months ended September 30, 2007 totaled approximately \$2.2 million. This amount relates to a payment from a stockholder related to a short swing profit liability. In September 2007, one of our stockholders determined that it had inadvertently engaged in trades which resulted in automatic short swing profit liability to the Company pursuant to Section 16(b) of the Securities Exchange Act of 1934. After becoming aware of the situation, the stockholder promptly made a payment of approximately \$2.2 million to the Company to settle the entire short swing profit liability owed as a consequence of these trades.

**Production, Prices, Operating Expenses, and Other**

	<b>Three Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>
	(Dollar amounts in 000 s, except per Mcfe amounts)	
<b>Production Data:</b>		
Natural gas (million cubic feet)	4,859	1,269
Oil and condensate (thousand barrels)	117	37
Natural gas liquids (thousand gallons)	704	379
 Total (million cubic feet equivalent)	 5,662	 1,545
 Natural gas (million cubic feet per day)	 52.8	 13.8
Oil and condensate (thousand barrels per day)	1.3	0.4
Natural gas liquids (thousand gallons per day)	7.7	4.1
 Total (million cubic feet equivalent per day)	 61.7	 16.8
<b>Average Sales Price:</b>		
Natural gas (per thousand cubic feet)	\$ 11.60	\$ 5.60
Oil and condensate (per barrel)	\$ 126.16	\$ 54.37
Natural gas liquids (per gallon)	\$ 2.18	\$ 1.15
<b>Selected data per Mcfe:</b>		
Lease operating expenses (including severance taxes)	\$ 0.80	\$ 0.47
General and administrative expenses	\$ 0.34	\$ 0.87
Depreciation, depletion and amortization of natural gas and oil properties	\$ 1.13	\$ 0.30

**Capital Resources and Liquidity**

*Cash From Operating Activities.* Cash flows from operating activities provided approximately \$83.6 million in cash for the three months ended September 30, 2008 compared to \$35.2 million for the same period in 2007. This increase in cash provided by operating activities is attributable to increased natural gas and oil sales from our Dutch #3 and Mary Rose #1, #2, #3 and #4 discoveries, as well as from the additional interest we purchased in our Dutch and Mary Rose discoveries, effective January 1, 2008.



**Table of Contents**

*Cash From Investing Activities.* Cash flows used in investing activities for the three months ended September 30, 2008 were approximately \$2.2 million, compared to \$37.2 million used in investing activities for the three months ended September 30, 2007. This difference in capital expenditures is primarily attributable to investing approximately \$28.5 million in natural gas and oil properties during the three months ended September 30, 2008, partially offset by receiving \$12.8 million in outstanding capital related receivables and accruing \$14.5 million in capital related payables during the period. Additionally, the Company did not have any sale of short-term investments or investments in affiliates for the three months ended September 30, 2008.

*Cash From Financing Activities.* Our financing activities used approximately \$19.4 million in cash flow for the three months ended September 30, 2008 compared to providing \$4.7 million for the same period in 2007. This difference of approximately \$24.1 million is primarily attributable to prepaying \$15.0 million of long term debt and purchasing approximately \$5.9 million of equity, while not having any borrowings by affiliates or preferred stock dividend payments during the three months ended September 30, 2008.

*Capital Budget.* For the remaining nine months of fiscal year 2009, our capital expenditure budget calls for us to invest approximately \$59.3 million as we bring Eloise #1 to production, drill our Dutch #4 rate acceleration well and drill three wildcat exploration wells in the Gulf of Mexico.

Of the \$59.3 million in offshore capital expenditures budgeted for the next nine months, we have budgeted to invest approximately \$2.2 million in pipeline and facility costs to bring Eloise #1 to production, \$24.9 million to drill and complete Ship Shoal 263 ( Nautilus ), \$16.1 million to drill and complete Eugene Island 56 #1( High Country West ) and \$16.1 million to drill and complete Eugene Island 56 #2( High Country East ).

The above capital expenditure descriptions are for the Company and its wholly-owned subsidiaries only, and do not include the capital expenditure descriptions for our partially-owned REX and COE subsidiaries. Contango or our partially owned subsidiary, REX, may need to raise additional debt and/or equity capital to supplement our internally generated cash flow to fund our offshore exploration and development program. There can be no assurance that we or REX will be able to raise such additional capital.

The Company views periodic reserve sales as an opportunity to capture value, reduce reserve and price risk, in addition to being a source of funds for potentially higher rate of return natural gas and oil exploration investments. We believe these periodic natural gas and oil property sales are an efficient strategy to meet our cash and liquidity needs by providing us with immediate cash, which would otherwise take years to realize through the production lives of the fields sold. We have in the past and expect in the future to continue to rely heavily on the sales of assets to generate cash to fund our exploration investments and operations.

These sales bring forward future revenues and cash flows, but our longer term liquidity could be impaired to the extent our exploration efforts are not successful in generating new discoveries, production, revenues and cash flows. Additionally, our longer term liquidity could be impaired due to the decrease in our inventory of producing properties that could be sold in future periods. Further, as a result of these property sales the Company's ability to collateralize bank borrowings is reduced which increases our dependence on more expensive mezzanine debt and potential equity sales. The availability of such funds will depend upon prevailing market conditions and other factors over which we have no control, as well as our financial condition and results of operations.

**Table of Contents****Natural Gas and Oil Reserves**

The following table presents our estimated net proved, developed producing natural gas and oil reserves and the pre-tax net present value of our reserves at September 30, 2008. The offshore reserves were based on a reserve report generated by William M. Cobb & Associates, Inc. The pre-tax net present value is not intended to represent the current market value of the estimated natural gas and oil reserves we own.

The pre-tax net present value of future cash flows attributable to our proved reserves as of September 30, 2008 was determined by the September 30, 2008 prices of \$7.18 per million British thermal units ( Mmbtu ) for natural gas at Henry Hub and \$100.64 per barrel of oil at West Texas Intermediate Posting, in each case before adjustments.

	<b>Proved Reserves as of September 30, 2008</b>
Natural Gas (MMcf)	288,954
Oil, Condensate and Natural Gas Liquids (MBbls)	12,821
Total proved reserves (Mmcfe)	365,880
Pre-tax net present value, SEC guidelines (\$000)	\$ 1,779,057

The process of estimating natural gas and oil reserves is complex. It requires various assumptions, including natural gas and oil prices, drilling and operating expenses, capital expenditures, taxes and availability of funds. Our third party engineers must project production rates and timing of development expenditures, as well as analyze available geological, geophysical, production and engineering data. The extent, quality and reliability of this data can vary. Therefore, estimates of natural gas and oil reserves are inherently imprecise. Actual future production, natural gas and oil prices, revenues, taxes, development expenditures, operating expenses and quantities of recoverable natural gas and oil reserves most likely will vary from estimates. Any significant variance could materially affect the estimated quantities and net present value of reserves. In addition, our third party engineers may adjust estimates of proved reserves to reflect production history, results of exploration and development, prevailing natural gas and oil prices and other factors, many of which are beyond our control. Because most of our reserve estimates are not based on a lengthy production history and are calculated using volumetric analysis, these estimates are less reliable than estimates based on a lengthy production history.

It should not be assumed that the pre-tax net present value is the current market value of our estimated natural gas and oil reserves. In accordance with requirements of the Securities and Exchange Commission, we base the estimated discounted future net cash flows from proved reserves on prices and costs available on the date of the estimate. Actual future prices and costs may differ materially from those used in the present value estimate.

**Share Repurchase Program**

In September 2008, the Company's board of directors approved the implementation of a \$100 million share repurchase program, effective immediately. Any shares purchased would be purchased in the open market from time to time by the Company or through privately negotiated transactions. The repurchases will be made subject to market conditions and certain volume, pricing and timing restrictions to minimize the impact of the repurchases upon the market.

Repurchased shares of common stock will become authorized but unissued shares, and may be issued in the future for general corporate and other purposes.

As of November 7, 2008, we have purchased 322,954 shares of our common stock for approximately \$15.6 million, or approximately 1.8% of our previously 17.7 million fully diluted shares, at an average price of \$48.17 per share. Each share of our common stock represents approximately 21 Mcfe's, using our September 30, 2008 reserve report of 365.8 Bcfe and fully diluted shares at November 7, 2008 of approximately 17.4 million. We thus purchased approximately 7.1 Bcfe of reserves at a cost of approximately \$2.29 per Mcfe.

**Credit Facility**

On October 3, 2008, the Company and its wholly-owned subsidiary, Contango Resources Company, completed the arrangement of a \$50 million Hydrocarbon Borrowing Base secured revolving credit facility pursuant to a credit agreement with Guaranty Bank, as administrative agent and issuing lender (the Credit Agreement). The credit facility



is available to fund the Company's offshore Gulf of Mexico exploration and development activities, as well as the repurchase of shares of the Company's common stock, the payment of dividends, and working capital as needed. Borrowings under the Credit Agreement bear interest at LIBOR plus 2.0% per annum. The outstanding principal amount and any accrued interest thereon is due October 3, 2010, and may be prepaid at any time in accordance with the Credit Agreement with no prepayment penalty. An arrangement fee of 0.5%, or \$250,000, was paid in connection with the facility and a commitment fee of 0.5% will be paid on the unused commitment amount.

## **Table of Contents**

### **Risk Factors**

*In addition to the other information set forth elsewhere in this Form 10-Q and in our annual report on Form 10-K, you should carefully consider the following factors when evaluating the Company. An investment in the Company is subject to risks inherent in our business. The trading price of the shares of the Company is affected by the performance of our business relative to, among other things, competition, market conditions and general economic and industry conditions. The value of an investment in the Company may decrease, resulting in a loss. The risk factors listed below are not all inclusive.*

***We have no ability to control the prices that we receive for natural gas and oil. Natural gas and oil prices fluctuate widely, and a substantial or extended decline in natural gas and oil prices would adversely affect our revenues, profitability and growth and could have a material adverse effect on the business, the results of operations and financial condition of the Company.***

Our revenues, profitability and future growth depend significantly on natural gas and crude oil prices. Prices received affect the amount of future cash flow available for capital expenditures and repayment of indebtedness and our ability to raise additional capital. We do not expect to hedge our production to protect against price decreases. Lower prices may also affect the amount of natural gas and oil that we can economically produce. Factors that can cause price fluctuations include:

The domestic and foreign supply of natural gas and oil.

Overall economic conditions.

The level of consumer product demand.

Adverse weather conditions and natural disasters.

The price and availability of competitive fuels such as heating oil and coal.

Political conditions in the Middle East and other natural gas and oil producing regions.

The level of LNG imports.

Domestic and foreign governmental regulations.

Potential price controls and special taxes.

Access to pipelines and gas processing plants.

A substantial or extended decline in natural gas and oil prices could have a material adverse effect on our access to capital and the quantities of natural gas and oil that may be economically produced by us. A significant decrease in price levels for an extended period would negatively affect us.

***We depend on the services of our chairman, chief executive officer and chief financial officer, and implementation of our business plan could be seriously harmed if we lost his services.***

We depend heavily on the services of Kenneth R. Peak, our chairman, chief executive officer, and chief financial officer. We do not have an employment agreement with Mr. Peak, and the proceeds from a \$10.0 million key person life insurance policy on Mr. Peak may not be adequate to cover our losses in the event of Mr. Peak's death.

***We are highly dependent on the technical services provided by JEX and could be seriously harmed if JEX terminated its services with us or became otherwise unavailable.***

Because we have only seven employees, none of whom are geoscientists or petroleum engineers, we are dependent upon JEX for the success of our natural gas and oil exploration projects and expect to remain so for the foreseeable future. We do not have a written agreement with JEX which contractually obligates them to provide us with their services in the future. Highly qualified explorationists and engineers are difficult to attract and retain. As a result, the

loss of the services of JEX could have a material adverse effect on us and could prevent us from pursuing our business plan. Additionally, the loss by JEX of certain explorationists could have a material adverse effect on our operations as well.

**Table of Contents**

***Our ability to successfully execute our business plan is dependent on our ability to obtain adequate financing.***

Our business plan, which includes participation in 3-D seismic shoots, lease acquisitions, the drilling of exploration prospects and producing property acquisitions, has required and is expected to continue to require substantial capital expenditures. We may require additional financing to fund our planned growth. Our ability to raise additional capital will depend on the results of our operations and the status of various capital and industry markets at the time we seek such capital. Accordingly, additional financing may not be available to us on acceptable terms, if at all. In the event additional capital resources are unavailable, we may be required to curtail our exploration and development activities or be forced to sell some of our assets in an untimely fashion or on less than favorable terms.

It is difficult to quantify the amount of financing we may need to fund our planned growth. The amount of funding we may need in the future depends on various factors such as:

Our financial condition.

The prevailing market price of natural gas and oil.

The type of projects in which we are engaging.

The lead time required to bring any discoveries to production.

***We frequently obtain capital through the sale of our producing properties.***

The Company, since its inception in September 1999, has raised approximately \$484.0 million from various property sales. These sales bring forward future revenues and cash flows, but our longer term liquidity could be impaired to the extent our exploration efforts are not successful in generating new discoveries, production, revenues and cash flows. Additionally, our longer term liquidity could be impaired due to the decrease in our inventory of producing properties that could be sold in future periods. Further, as a result of these property sales the Company's ability to collateralize bank borrowings is reduced which increases our dependence on more expensive mezzanine debt and potential equity sales. The availability of such funds will depend upon prevailing market conditions and other factors over which we have no control, as well as our financial condition and results of operations.

***We assume additional risk as Operator in drilling high pressure wells in the Gulf of Mexico.***

COI and CRC are wholly-owned subsidiaries of the Company, formed for the purpose of drilling and operating exploration wells in the Gulf of Mexico. COI is currently the operator of Eloise #1 and Grand Isle 72, and CRC is currently the operator for our Dutch and Mary Rose discoveries.

Drilling activities are subject to numerous risks, including the significant risk that no commercially productive hydrocarbon reserves will be encountered. The cost of drilling, completing and operating wells and of installing production facilities and pipelines is often uncertain. Drilling costs could be significantly higher if we encounter difficulty in drilling offshore exploration wells. The Company's drilling operations may be curtailed, delayed, canceled or negatively impacted as a result of numerous factors, including title problems, weather conditions, compliance with governmental requirements and shortages or delays in the delivery or availability of material, equipment and fabrication yards. In periods of increased drilling activity resulting from high commodity prices, demand exceeds availability for drilling rigs, drilling vessels, supply boats and personnel experienced in the oil and gas industry in general, and the offshore oil and gas industry in particular. This may lead to difficulty and delays in consistently obtaining certain services and equipment from vendors, obtaining drilling rigs and other equipment at favorable rates and scheduling equipment fabrication at factories and fabrication yards. This, in turn, may lead to projects being delayed or experiencing increased costs. The cost of drilling, completing, and operating wells is often uncertain, and new wells may not be productive or we may not recover all or any of our investment. The risk of significant cost overruns, curtailments, delays, inability to reach our target reservoir and other factors detrimental to drilling and completion operations may be higher due to our inexperience as an operator.

**Table of Contents**

Additionally, we use turnkey contracts that may cost more than drilling contracts at daily rates. Under certain conditions, the turnkey contract can be terminated by the turnkey drilling contractor, which could lead to materially higher risks and costs for the Company.

***We rely on third-party operators to operate and maintain some of our production pipelines and processing facilities and, as a result, we have limited control over the operations of such facilities. The interests of an operator may even differ from our interests.***

We depend upon the services of third-party operators to operate production platforms, pipelines, gas processing facilities and the infrastructure required to produce and market our natural gas, condensate and oil. We have limited influence over the conduct of operations by third-party operators. As a result, we have little control over how frequently and how long our production is shut-in when production problems, weather and other production shut-ins occur. Poor performance on the part of, or errors or accidents attributable to, the operator of a project in which we participate may have an adverse effect on our results of operations and financial condition. Also, the interest of an operator may differ from our interests.

***Repeated production shut-ins can possibly damage our well bores.***

Well bores are required to be shut-in from time to time due to a combination of weather, mechanical problems and shut-ins necessary to upgrade and increase the production handling capacity at related downstream platform, gas processing and pipeline infrastructure. In addition to negatively impacting our near term revenues and cash flow, repeated production shut-ins may damage our well bores if repeated excessively or not executed properly. The loss of a well bore due to damage could require us to drill additional wells to recover our reserves.

***Concentrating our capital investment in the Gulf of Mexico increases our exposure to risk.***

Our capital investments are focused in offshore Gulf of Mexico prospects. However, our exploration prospects in the Gulf of Mexico may not lead to significant revenues. Furthermore, we may not be able to drill productive wells at profitable finding and development costs.

***Natural gas and oil reserves are depleting assets and the failure to replace our reserves would adversely affect our production and cash flows.***

Our future natural gas and oil production depends on our success in finding or acquiring new reserves. If we fail to replace reserves, our level of production and cash flows would be adversely impacted. Production from natural gas and oil properties decline as reserves are depleted, with the rate of decline depending on reservoir characteristics. Our total proved reserves will decline as reserves are produced unless we conduct other successful exploration and development activities or acquire properties containing proved reserves, or both. Further, the majority of our reserves are proved developed producing. Accordingly, we do not have significant opportunities to increase our production from our existing proved reserves. Our ability to make the necessary capital investment to maintain or expand our asset base of natural gas and oil reserves would be impaired to the extent cash flow from operations is reduced and external sources of capital become limited or unavailable. We may not be successful in exploring for, developing or acquiring additional reserves. If we are not successful, our future production and revenues will be adversely affected.

**Table of Contents**

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

The process of estimating natural gas and oil reserves is complex. It requires interpretations of available technical data and various assumptions, including assumptions relating to economic factors. Any significant inaccuracies in these interpretations or assumptions could materially affect the estimated quantities and present value of reserves shown in this report.

In order to prepare these estimates, our independent third-party petroleum engineers must project production rates and timing of development expenditures as well as analyze available geological, geophysical, production and engineering data, and the extent, quality and reliability of this data can vary. The process also requires economic assumptions relating to matters such as natural gas and oil prices, drilling and operating expenses, capital expenditures, taxes and availability of funds. Therefore, estimates of natural gas and oil reserves are inherently imprecise.

Actual future production, natural gas and oil prices, revenues, taxes, development expenditures, operating expenses and quantities of recoverable natural gas and oil reserves most likely will vary from our estimates. Any significant variance could materially affect the estimated quantities and pre-tax net present value of reserves shown in this report. In addition, estimates of our proved reserves may be adjusted to reflect production history, results of exploration and development, prevailing natural gas and oil prices and other factors, many of which are beyond our control and may prove to be incorrect over time. As a result, our estimates may require substantial upward or downward revisions if subsequent drilling, testing and production reveal different results. Furthermore, some of the producing wells included in our reserve report have produced for a relatively short period of time. Because some of our reserve estimates are not based on a lengthy production history and are calculated using volumetric analysis, these estimates are less reliable than estimates based on a more lengthy production history. Any downward adjustment could indicate lower future production and thus adversely affect our financial condition, future prospects and market value.

You should not assume that the pre-tax net present value of our proved reserves prepared in accordance with Securities and Exchange Commission guidelines referred to in this report is the current market value of our estimated natural gas and oil reserves. We base the pre-tax net present value of future net cash flows from our proved reserves on prices and costs on the date of the estimate. Actual future prices, costs, taxes and the volume of produced reserves will likely differ materially from those used in the pre-tax net present value estimate.

***The Company's revenue activities are significantly concentrated in one field.***

The proved reserves assigned to our Dutch and Mary Rose discoveries have seven producing well bores concentrated in one reservoir. As of October 31, 2008, this reservoir had only twenty-one months of production history, and was producing via two pipelines and two production platforms. Reserve assessments based on only seven well bores in one reservoir with relatively limited production history are subject to greater risk of downward revision than multiple well bores from several mature producing reservoirs.

***We rely on the accuracy of the estimates in the reservoir engineering reports provided to us by our outside engineers.***

We have no in house reservoir engineering capability, and therefore rely on the accuracy of the periodic reservoir reports provided to us by our independent third-party reservoir engineers. If those reports prove to be inaccurate, our financial reports could have material misstatements. Further, we use the reports of our independent reservoir engineers in our financial planning. If the reports of the outside reservoir engineers prove to be inaccurate, we may make misjudgments in our financial planning.

**Table of Contents**

***Exploration is a high risk activity, and our participation in drilling activities may not be successful.***

Our future success largely depends on the success of our exploration drilling program. Participation in exploration drilling activities involves numerous risks, including the significant risk that no commercially productive natural gas or oil reservoirs will be discovered. The cost of drilling, completing and operating wells is uncertain, and drilling operations may be curtailed, delayed or canceled as a result of a variety of factors, including:

Unexpected drilling conditions.

Blowouts, fires or explosions with resultant injury, death or environmental damage.

Pressure or irregularities in formations.

Equipment failures or accidents.

Tropical storms, hurricanes and other adverse weather conditions.

Compliance with governmental requirements and laws, present and future.

Shortages or delays in the availability of drilling rigs and the delivery of equipment.

Our turnkey drilling contracts reverting to a day rate contract which would significantly increase the cost and risk to the Company.

Problems at third-party operated platforms, pipelines and gas processing facilities over which we have no control.

Even when properly used and interpreted, 3-D seismic data and visualization techniques are only tools used to assist geoscientists in identifying subsurface structures and hydrocarbon indicators. They do not allow the interpreter to know conclusively if hydrocarbons are present or economically producible. Poor results from our drilling activities would materially and adversely affect our future cash flows and results of operations.

In addition, as a successful exploration company, we choose to account for unsuccessful exploration efforts (the drilling of dry holes) and seismic costs as a current expense of operations, which immediately impacts our earnings. Significant exploration charges in any period would materially adversely affect our earnings for that period and cause our earnings to be volatile from period to period.

***The natural gas and oil business involves many operating risks that can cause substantial losses.***

The natural gas and oil business involves a variety of operating risks, including:

Blowouts, fires and explosions.

Surface cratering.

Uncontrollable flows of underground natural gas, oil or formation water.

Natural disasters.

Pipe and cement failures.

Casing collapses.

Stuck drilling and service tools.

Abnormal pressure formations.

Environmental hazards such as natural gas leaks, oil spills, pipeline ruptures or discharges of toxic gases.

Capacity constraints, equipment malfunctions and other problems at third-party operated platforms, pipelines and gas processing plants over which we have no control.

Repeated shut-ins of our well bores could significantly damage our well bores.

If any of the above events occur, we could incur substantial losses as a result of:

Injury or loss of life.

Reservoir damage.

Severe damage to and destruction of property or equipment.

Pollution and other environmental damage.

Clean-up responsibilities.

Regulatory investigations and penalties.

Suspension of our operations or repairs necessary to resume operations.



**Table of Contents**

Offshore operations are subject to a variety of operating risks peculiar to the marine environment, such as capsizing and collisions. In addition, offshore operations, and in some instances, operations along the Gulf Coast, are subject to damage or loss from hurricanes or other adverse weather conditions. These conditions can cause substantial damage to facilities and interrupt production. As a result, we could incur substantial liabilities that could reduce the funds available for exploration, development or leasehold acquisitions, or result in loss of properties.

If we were to experience any of these problems, it could affect well bores, platforms, gathering systems and processing facilities, any one of which could adversely affect our ability to conduct operations. In accordance with customary industry practices, we maintain insurance against some, but not all, of these risks. Losses could occur for uninsurable or uninsured risks or in amounts in excess of existing insurance coverage. We may not be able to maintain adequate insurance in the future at rates we consider reasonable, and particular types of coverage may not be available. An event that is not fully covered by insurance could have a material adverse effect on our financial position and results of operations.

***Not hedging our production may result in losses.***

Due to the significant volatility in natural gas prices and the potential risk of significant hedging losses if our production should be shut-in during a period when NYMEX natural gas prices increase, our policy is to hedge only through the purchase of puts. By not hedging our production, we may be more adversely affected by declines in natural gas and oil prices than our competitors who engage in hedging arrangements.

***Our ability to market our natural gas and oil may be impaired by capacity constraints and equipment malfunctions on the platforms, gathering systems, pipelines and gas plants that transport and process our natural gas and oil.***

All of our natural gas and oil is transported through gathering systems, pipelines, processing plants, and offshore platforms. Transportation capacity on gathering system pipelines and platforms is occasionally limited and at times unavailable due to repairs or improvements being made to these facilities or due to capacity being utilized by other natural gas or oil shippers that may have priority transportation agreements. If the gathering systems, processing plants, platforms or our transportation capacity is materially restricted or is unavailable in the future, our ability to market our natural gas or oil could be impaired and cash flow from the affected properties could be reduced, which could have a material adverse effect on our financial condition and results of operations. Further, repeated shut-ins of our wells could result in damage to our well bores that would impair our ability to produce from these wells and could result in additional wells being required to produce our reserves.

***We may not have title to our leased interests and if any lease is later rendered invalid, we may not be able to proceed with our exploration and development of the lease site.***

Our practice in acquiring exploration leases or undivided interests in natural gas and oil leases is to not incur the expense of retaining title lawyers to examine the title to the mineral interest prior to executing the lease. Instead, we rely upon the judgment of JEX and others to perform the field work in examining records in the appropriate governmental, county or parish clerk's office before leasing a specific mineral interest. This practice is widely followed in the industry. Prior to the drilling of an exploration well the operator of the well will typically obtain a preliminary title review of the drillsite lease and/or spacing unit within which the proposed well is to be drilled to identify any obvious deficiencies in title to the well and, if there are deficiencies, to identify measures necessary to cure those defects to the extent reasonably possible. However, such deficiencies may not have been cured by the operator of such wells. It does happen, from time to time, that the examination made by title lawyers reveals that the lease or leases are invalid, having been purchased in error from a person who is not the rightful owner of the mineral interest desired. In these circumstances, we may not be able to proceed with our exploration and development of the lease site or may incur costs to remedy a defect. It may also happen, from time to time, that the operator may elect to proceed with a well despite defects to the title identified in the preliminary title opinion.

**Table of Contents**

***Competition in the natural gas and oil industry is intense, and we are smaller and have a more limited operating history than many of our competitors.***

We compete with a broad range of natural gas and oil companies in our exploration and property acquisition activities. We also compete for the equipment and labor required to operate and to develop these properties. Most of our competitors have substantially greater financial resources than we do. These competitors may be able to pay more for exploratory prospects and productive natural gas and oil properties. Further, they may be able to evaluate, bid for and purchase a greater number of properties and prospects than we can. Our ability to explore for natural gas and oil and to acquire additional properties in the future depends on our ability to evaluate and select suitable properties and to consummate transactions in this highly competitive environment. In addition, most of our competitors have been operating for a much longer time than we have and have substantially larger staffs. We may not be able to compete effectively with these companies or in such a highly competitive environment.

***We are subject to complex laws and regulations, including environmental regulations that can adversely affect the cost, manner or feasibility of doing business.***

Our operations are subject to numerous laws and regulations governing the operation and maintenance of our facilities and the discharge of materials into the environment. Failure to comply with such rules and regulations could result in substantial penalties and have an adverse effect on us. These laws and regulations may:

Require that we obtain permits before commencing drilling.

Restrict the substances that can be released into the environment in connection with drilling and production activities.

Limit or prohibit drilling activities on protected areas, such as wetlands or wilderness areas.

Require remedial measures to mitigate pollution from former operations, such as plugging abandoned wells.

Under these laws and regulations, we could be liable for personal injury and clean-up costs and other environmental and property damages, as well as administrative, civil and criminal penalties. We maintain only limited insurance coverage for sudden and accidental environmental damages. Accordingly, we may be subject to liability, or we may be required to cease production from properties in the event of environmental damages. These laws and regulations have been changed frequently in the past. In general, these changes have imposed more stringent requirements that increase operating costs or require capital expenditures in order to remain in compliance. It is also possible that unanticipated factual developments could cause us to make environmental expenditures that are significantly different from those we currently expect. Existing laws and regulations could be changed and any such changes could have an adverse effect on our business and results of operations.

***We cannot control the activities on properties we do not operate.***

Other companies may from time to time drill, complete and operate properties in which we have an interest. As a result, we have a limited ability to exercise influence over operations for these properties or their associated costs. Our dependence on the operator and other working interest owners for these projects and our limited ability to influence operations and associated costs could materially adversely affect the realization of our targeted returns on capital in drilling or acquisition activities. The success and timing of our drilling and development activities on properties operated by others therefore depend upon a number of factors that are outside of our control, including:

Timing and amount of capital expenditures.

The operator's expertise and financial resources.

Approval of other participants in drilling wells.

Selection of technology.



**Table of Contents**

***We are highly dependent on our management team, JEX, exploration partners and third-party consultants and any failure to retain the services of such parties could adversely affect our ability to effectively manage our overall operations or successfully execute current or future business strategies.***

The successful implementation of our business strategy and handling of other issues integral to the fulfillment of our business strategy is highly dependent on our management team, as well as certain key geoscientists, geologists, engineers and other professionals engaged by us. We are highly dependent on the services provided by JEX and we do not have any written agreements contractually obligating them to provide us with their services in the future. The loss of key members of our management team, JEX or other highly qualified technical professionals could adversely affect our ability to effectively manage our overall operations or successfully execute current or future business strategies which may have a material adverse effect on our business, financial condition and operating results.

***Acquisition prospects are difficult to assess and may pose additional risks to our operations.***

We expect to evaluate and, where appropriate, pursue acquisition opportunities on terms our management considers favorable. The successful acquisition of natural gas and oil properties requires an assessment of:

Recoverable reserves.

Exploration potential.

Future natural gas and oil prices.

Operating costs.

Potential environmental and other liabilities and other factors.

Permitting and other environmental authorizations required for our operations.

In connection with such an assessment, we would expect to perform a review of the subject properties that we believe to be generally consistent with industry practices. Nonetheless, the resulting conclusions are necessarily inexact and their accuracy inherently uncertain and such an assessment may not reveal all existing or potential problems, nor will it necessarily permit a buyer to become sufficiently familiar with the properties to fully assess their merits and deficiencies. Inspections may not always be performed on every platform or well, and structural and environmental problems are not necessarily observable even when an inspection is undertaken.

Future acquisitions could pose additional risks to our operations and financial results, including:

Problems integrating the purchased operations, personnel or technologies.

Unanticipated costs.

Diversion of resources and management attention from our exploration business.

Entry into regions or markets in which we have limited or no prior experience.

Potential loss of key employees, particularly those of the acquired organization.

***Anti-takeover provisions of our certificate of incorporation, bylaws and Delaware law could adversely effect a potential acquisition by third-parties that may ultimately be in the financial interests of our stockholders.***

Our certificate of incorporation, bylaws and the Delaware General Corporation Law contain provisions that may discourage unsolicited takeover proposals. These provisions could have the effect of inhibiting fluctuations in the market price of our common stock that could result from actual or rumored takeover attempts, preventing changes in our management or limiting the price that investors may be willing to pay for shares of common stock. These provisions, among other things, authorize the board of directors to:

Designate the terms of and issue new series of preferred stock.

Limit the personal liability of directors.

Limit the persons who may call special meetings of stockholders.

Prohibit stockholder action by written consent.

Establish advance notice requirements for nominations for election of the board of directors and for proposing matters to be acted on by stockholders at stockholder meetings.

Require us to indemnify directors and officers to the fullest extent permitted by applicable law.

Impose restrictions on business combinations with some interested parties.

**Table of Contents**

***Our common stock is thinly traded.***

Contango has approximately 16.7 million shares of common stock outstanding, held by approximately 91 holders of record. Directors and officers own or have voting control over approximately 3.4 million shares. Since our common stock is thinly traded, the purchase or sale of relatively small common stock positions may result in disproportionately large increases or decreases in the price of our common stock.

**Item 3. *Quantitative and Qualitative Disclosures About Market Risk***

***Interest Rate and Credit Rating Risks.*** As of September 30, 2008, we had approximately \$121.8 million in cash and cash equivalents, of which approximately \$30.2 million was invested in highly liquid AAA-rated tax exempt money market funds. We consider all highly liquid debt instruments having an original maturity of 90 days or less to be cash equivalents.

Investments in fixed-rate, interest-earning instruments carry a degree of interest rate and credit rating risk. Fixed-rate securities may have their fair market value adversely impacted because of changes in interest rates and credit ratings. Additionally, the value of our investments may be impaired temporarily or permanently. Due in part to these factors, our investment income may decline and we may suffer losses in principal. Currently, we do not use any derivative or other financial instruments or derivative commodity instruments to hedge any market risks, including changes in interest rates or credit ratings, and we do not plan to employ these instruments in the future. Because of the nature of the issuers of the securities that we invest in, we do not believe that we have any cash flow exposure arising from changes in credit ratings. Based on a sensitivity analysis performed on the financial instruments held as of September 30, 2008, an immediate 10% change in interest rates is not expected to have a material effect on our near-term financial condition or results of operations.

***Commodity Risk.*** Our major commodity price risk exposure is to the prices received for our natural gas and oil production. Realized commodity prices received for our production are the spot prices applicable to natural gas and crude oil. Prices received for natural gas and oil are volatile and unpredictable and are beyond our control. For the three months ended September 30, 2008, a 10% fluctuation in the prices received for natural gas and oil production would impact our revenues by approximately \$7.3 million. It could also lead to impairment of our natural gas and oil properties.

**Item 4. *Controls and Procedures***

Kenneth R. Peak, our Chairman, Chief Executive Officer and Chief Financial Officer, together with our Controller and Treasurer, carried out an evaluation of the effectiveness of the Company's disclosure controls and procedures as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act), as of September 30, 2008. Based upon that evaluation, the Company's management concluded that, as of September 30, 2008, the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and to ensure that the information required to be disclosed by us in reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chairman, Chief Executive Officer, Chief Financial Officer, Controller and Treasurer, as appropriate, to allow timely decisions regarding required disclosure. There were no changes in the Company's internal control over financial reporting that occurred during the fiscal quarter ended September 30, 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Table of Contents**

**PART II OTHER INFORMATION**

**Item 1A. Risk Factors**

The description of the risk factors associated with the Company set forth under the heading "Risk Factors" in Item 2 of Part I, "Management's Discussion and Analysis of Financial Condition and Results of Operations," of this Form 10-Q are incorporated into this Item 1A by reference and supersede the description of risk factors set forth under the heading "Risk Factors" in Item 1 of Part I of our annual report on Form 10-K.

**Item 5. Other Information**

On September 30, 2008, the Company adopted a Stockholder Rights Plan (the "Plan") that is designed to ensure that all stockholders of Contango receive fair value for their shares of common stock in the event of any proposed takeover of Contango and to guard against the use of partial tender offers or other coercive tactics to gain control of Contango without offering fair value to all of Contango's stockholders. The Plan is not intended, nor will it operate, to prevent an acquisition of Contango on terms that are favorable and fair to all stockholders.

Under the terms of the Plan, each right (a "Right") will entitle the holder to buy 1/100 of a share of Series F Junior Preferred Stock of Contango (the "Preferred Stock") at an exercise price of \$200 per share. The Rights will be exercisable and will trade separately from the shares of common stock only if a person or group acquires beneficial ownership of 20% or more of Contango's common stock or commences a tender or exchange offer that would result in such a person or group owning 20% or more of the Common Stock (the "Triggering Event").

Under the terms of the Plan, Rights have been distributed as a dividend at the rate of one Right for each share of common stock held as of the close of business on October 1, 2008. Stockholders will not actually receive certificates for the Rights at this time, but the Rights will become part of each outstanding share of common stock. An additional Right will be issued along with each share of common stock that is issued or sold by Contango after October 1, 2008. The Rights may only be exercised during a three-year period and are scheduled to expire on September 30, 2011.

Upon a Triggering Event, Contango stockholders will receive certificates for the Rights.

If any person actually acquires 20% or more of shares of common stock other than through a tender or exchange offer for all shares of common stock that provides a fair price and other acceptable terms for such shares, as determined by the board of directors of Contango or if a 20%-or-more stockholder engages in certain self-dealing transactions or engages in a merger or other business combination in which Contango survives and its shares of common stock remain outstanding, the other Contango stockholders will be able to exercise the Rights and buy shares of common stock of Contango having approximately twice the value of the exercise price of the Rights. Additionally, if Contango is involved in certain other mergers where its shares are exchanged or certain major sales of its assets occur, Contango stockholders will be able to purchase a certain number of the other party's common stock in an amount equal to approximately twice the value of the exercise price of the Rights.

Contango will be entitled to redeem the Rights at \$0.01 per Right at any time until the earlier of (i) the tenth day following public announcement that a person has acquired a 20% ownership position in shares of common stock of Contango or (ii) the final expiration date of the Rights. Contango in its discretion may extend the period during which it may redeem the Rights.

**Table of Contents****Item 6. Exhibits****(a) Exhibits:**

The following is a list of exhibits filed as part of this Form 10-Q. Where so indicated by a footnote, exhibits, which were previously filed, are incorporated herein by reference.

<b>Exhibit Number</b>	<b>Description</b>
3.1	Certificate of Incorporation of Contango Oil & Gas Company. (1)
3.2	Bylaws of Contango Oil & Gas Company. (1)
3.3	Agreement of Plan of Merger of Contango Oil & Gas Company, a Delaware corporation, and Contango Oil & Gas Company, a Nevada corporation. (1)
3.4	Amendment to the Certificate of Incorporation of Contango Oil & Gas Company. (2)
4.1	Facsimile of common stock certificate of Contango Oil & Gas Company. (3)
4.2	Certificate of Designation of Series F Junior Preferred Stock of Contango Oil & Gas Company dated September 30, 2008. (4)
4.3	Rights Agreement, dated as of September 30, 2008, between Contango Oil & Gas Company and Computershare Trust Company, N.A., as Rights Agent. (4)
10.1	\$50,000,000 Credit Agreement dated as of October 3, 2008 between Contango Oil & Gas Company and Contango Resources Company, as Borrowers, Guaranty Bank, as administrative agent and as issuing lender, and the lenders party thereto from time to time. (5)
23.1	Consent of William M. Cobb & Associates, Inc.
31.1	Certification required by Rules 13a-14 and 15d-14 under the Securities Exchange Act of 1934.
32.1	Certification pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Filed herewith.

1. Filed as an exhibit to the Company's report on Form 8-K, dated December 1, 2000, as filed with the



Securities and  
Exchange  
Commission on  
December 15,  
2000.

2. Filed as an exhibit to the Company's report on Form 10-QSB for the quarter ended December 31, 2002, dated November 14, 2002, as filed with the Securities and Exchange Commission.
3. Filed as an exhibit to the Company's Form 10-SB Registration Statement, as filed with the Securities and Exchange Commission on October 16, 1998.
4. Filed as an exhibit to the Company's report on Form 8-K, dated September 30, 2008, as filed with the Securities and Exchange Commission on October 1, 2008.
5. Filed as an exhibit to the Company's

report on Form  
8-K, dated  
October 3,  
2008, as filed  
with the  
Securities and  
Exchange  
Commission on  
October 8,  
2008.

**Table of Contents**

**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, thereto duly authorized.

**CONTANGO OIL & GAS COMPANY**

Date: November 10, 2008

By: /s/ KENNETH R. PEAK  
Kenneth R. Peak  
Chairman, Chief Executive Officer and  
Chief Financial Officer  
(Principal Executive and Financial  
Officer)

Date: November 10, 2008

By: /s/ LESIA BAUTINA  
Lesia Bautina  
Senior Vice President and Controller  
(Principal Accounting Officer)

**Table of Contents**

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description</b>
3.1	Certificate of Incorporation of Contango Oil & Gas Company. (1)
3.2	Bylaws of Contango Oil & Gas Company. (1)
3.3	Agreement of Plan of Merger of Contango Oil & Gas Company, a Delaware corporation, and Contango Oil & Gas Company, a Nevada corporation. (1)
3.4	Amendment to the Certificate of Incorporation of Contango Oil & Gas Company. (2)
4.1	Facsimile of common stock certificate of Contango Oil & Gas Company. (3)
4.2	Certificate of Designation of Series F Junior Preferred Stock of Contango Oil & Gas Company dated September 30, 2008. (4)
4.3	Rights Agreement, dated as of September 30, 2008, between Contango Oil & Gas Company and Computershare Trust Company, N.A., as Rights Agent. (4)
10.1	\$50,000,000 Credit Agreement dated as of October 3, 2008 between Contango Oil & Gas Company and Contango Resources Company, as Borrowers, Guaranty Bank, as administrative agent and as issuing lender, and the lenders party thereto from time to time. (5)
23.1	Consent of William M. Cobb & Associates, Inc.
31.1	Certification required by Rules 13a-14 and 15d-14 under the Securities Exchange Act of 1934.
32.1	Certification pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Filed herewith.

1. Filed as an exhibit to the Company's report on Form 8-K, dated December 1, 2000, as filed with the Securities and Exchange Commission on

December 15,  
2000.

2. Filed as an exhibit to the Company's report on Form 10-QSB for the quarter ended December 31, 2002, dated November 14, 2002, as filed with the Securities and Exchange Commission.
3. Filed as an exhibit to the Company's Form 10-SB Registration Statement, as filed with the Securities and Exchange Commission on October 16, 1998.
4. Filed as an exhibit to the Company's report on Form 8-K, dated September 30, 2008, as filed with the Securities and Exchange Commission on October 1, 2008.
5. Filed as an exhibit to the Company's report on Form 8-K, dated October 3,

2008, as filed  
with the  
Securities and  
Exchange  
Commission on  
October 8,  
2008.