

FOREST OIL CORP
Form 10-Q
May 10, 2007

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2007

Or

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

For the transition period from _____ to _____
Commission File Number 1-13515

FOREST OIL CORPORATION

(Exact name of registrant as specified in its charter)

New York
(State or other jurisdiction of
incorporation or organization)

25-0484900
(I.R.S. Employer
Identification No.)

707 17th Street, Suite 3600 Denver, Colorado 80202
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(303) 812-1400**

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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

As of April 30, 2007 there were 63,053,239 shares of the registrant's common stock, par value \$.10 per share, outstanding.

FOREST OIL CORPORATION
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March 31, 2007

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PART I FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

FOREST OIL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)
(In Thousands, Except Share Data)

| | March 31, 2007 | December 31, 2006 |
|---|---------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 17,086 | 33,164 |
| Accounts receivable | 141,821 | 125,446 |
| Derivative instruments | 17,508 | 53,205 |
| Deferred tax asset | 365 | |
| Other current assets | 65,926 | 49,185 |
| | <u>242,706</u> | <u>261,000</u> |
| Property and equipment, at cost: | | |
| Oil and gas properties, full cost method of accounting: | | |
| Proved, net of accumulated depletion of \$2,331,625 and \$2,265,018 | 2,601,815 | 2,486,153 |
| Unproved | 244,228 | 261,259 |
| | <u>2,846,043</u> | <u>2,747,412</u> |
| Net oil and gas properties | 2,846,043 | 2,747,412 |
| Other property and equipment, net of accumulated depreciation and amortization of \$34,157 and \$32,504 | 48,445 | 42,514 |
| | <u>2,894,488</u> | <u>2,789,926</u> |
| Net property and equipment | 2,894,488 | 2,789,926 |
| Derivative instruments | 6,804 | 15,019 |
| Goodwill | 86,385 | 86,246 |
| Other assets | 38,902 | 36,881 |
| | <u>\$ 3,269,285</u> | <u>3,189,072</u> |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 216,856 | 224,933 |
| Accrued interest | 20,419 | 6,235 |
| Derivative instruments | 10,774 | 1,294 |
| Current portion of long-term debt | 2,500 | 2,500 |
| Asset retirement obligations | 3,055 | 2,694 |
| Deferred income taxes | | 14,907 |
| Other current liabilities | 10,877 | 11,378 |
| | <u>264,481</u> | <u>263,941</u> |
| Total current liabilities | 264,481 | 263,941 |
| Long-term debt | 1,245,810 | 1,204,709 |
| Asset retirement obligations | 62,758 | 61,408 |
| Derivative instruments | 5,256 | 811 |
| Deferred income taxes | 211,127 | 191,957 |
| Other liabilities | 34,116 | 32,240 |

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| | March 31, 2007 | December 31, 2006 |
|---|-----------------------------|-----------------------------|
| | <u> </u> | <u> </u> |
| Total liabilities | 1,823,548 | 1,755,066 |
| Shareholders' equity: | | |
| Preferred stock, none issued and outstanding | | |
| Common stock, 63,039,391 and 62,998,155 shares issued and outstanding | 6,304 | 6,300 |
| Capital surplus | 1,218,814 | 1,215,660 |
| Retained earnings | 143,647 | 137,796 |
| Accumulated other comprehensive income | 76,972 | 74,250 |
| | <u> </u> | <u> </u> |
| Total shareholders' equity | 1,445,737 | 1,434,006 |
| | <u> </u> | <u> </u> |
| | \$ 3,269,285 | 3,189,072 |
| | <u> </u> | <u> </u> |

See accompanying Notes to Condensed Consolidated Financial Statements.

FOREST OIL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

| | Three Months Ended March 31, | |
|---|---------------------------------|----------------|
| | 2007 | 2006 |
| (In Thousands, Except Per Share Amounts) | | |
| Revenue: | | |
| Oil and gas sales: | | |
| Natural gas | \$ 97,297 | 127,053 |
| Oil, condensate, and natural gas liquids | 85,259 | 92,043 |
| | <u>182,556</u> | <u>219,096</u> |
| Marketing, processing, and other | 53 | 2,350 |
| | <u>182,609</u> | <u>221,446</u> |
| Operating expenses: | | |
| Lease operating expenses | 36,040 | 45,331 |
| Production and property taxes | 7,910 | 10,728 |
| Transportation and processing costs | 4,194 | 4,729 |
| General and administrative (including stock-based compensation) | 12,971 | 17,136 |
| Depreciation and depletion | 60,459 | 77,668 |
| Accretion of asset retirement obligations | 1,275 | 3,352 |
| Spin-off and merger costs | | 5,416 |
| | <u>122,849</u> | <u>164,360</u> |
| Earnings from operations | 59,760 | 57,086 |
| Other income and expense: | | |
| Interest expense | 24,353 | 15,151 |
| Unrealized losses on derivative instruments, net | 57,838 | 24,114 |
| Realized (gains) losses on derivative instruments, net | (25,134) | 3,915 |
| Unrealized foreign currency exchange gain | (49) | |
| Gain on sale of assets | (7,176) | |
| Other (income) expense, net | (888) | 860 |
| | <u>48,944</u> | <u>44,040</u> |
| Earnings before income taxes and discontinued operations | 10,816 | 13,046 |
| Income tax expense: | | |
| Current | 878 | 1,002 |
| Deferred | 3,047 | 10,795 |
| | <u>3,925</u> | <u>11,797</u> |
| Earnings from continuing operations | 6,891 | 1,249 |
| Income from discontinued operations, net of tax | | 2,422 |
| | <u>6,891</u> | <u>3,671</u> |
| Net earnings | \$ 6,891 | 3,671 |

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| | Three Months Ended March 31, | |
|---|---------------------------------|-------|
| | _____ | _____ |
| Basic earnings per common share: | | |
| Earnings from continuing operations | \$.11 | .02 |
| Income from discontinued operations, net of tax | | .04 |
| | _____ | _____ |
| Basic earnings per common share | \$.11 | .06 |
| | _____ | _____ |
| Diluted earnings per common share: | | |
| Earnings from continuing operations | \$.11 | .02 |
| Income from discontinued operations, net of tax | | .04 |
| | _____ | _____ |
| Diluted earnings per common share | \$.11 | .06 |
| | _____ | _____ |

See accompanying Notes to Condensed Consolidated Financial Statements.

FOREST OIL CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

(Unaudited)

| | Common Stock | | Capital Surplus | Retained Earnings | Accumulated Other Comprehensive Income | Total Shareholders' Equity |
|---|--------------|----------|--------------------|----------------------|--|----------------------------------|
| | Shares | Amount | | | | |
| (In Thousands) | | | | | | |
| Balances at December 31, 2006 | 62,998 | \$ 6,300 | 1,215,660 | 137,796 | 74,250 | 1,434,006 |
| Exercise of stock options | 40 | 4 | 776 | | | 780 |
| Employee stock purchase plan | 8 | 1 | 217 | | | 218 |
| Restricted stock issued, net of cancellations | (7) | (1) | (278) | | | (279) |
| Amortization of stock-based compensation | | | 2,439 | | | 2,439 |
| Adoption of FIN 48 | | | | (1,040) | | (1,040) |
| Comprehensive earnings: | | | | | | |
| Net earnings | | | | 6,891 | | 6,891 |
| Increase in unfunded postretirement benefits, net of tax | | | | | (104) | (104) |
| Foreign currency translation | | | | | 2,826 | 2,826 |
| Total comprehensive earnings | | | | | | 9,613 |
| Balances at March 31, 2007 | 63,039 | \$ 6,304 | 1,218,814 | 143,647 | 76,972 | 1,445,737 |

See accompanying Notes to Condensed Consolidated Financial Statements.

FOREST OIL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

| | Three Months Ended March 31, | |
|--|------------------------------|------------------|
| | 2007 | 2006 |
| (In Thousands) | | |
| Operating activities: | | |
| Net earnings | \$ 6,891 | 3,671 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation and depletion | 60,459 | 77,668 |
| Accretion of asset retirement obligations | 1,275 | 3,352 |
| Stock-based compensation | 1,796 | 7,315 |
| Unrealized losses on derivative instruments, net | 57,838 | 24,114 |
| Amortization of deferred derivative losses | | 15,204 |
| Gain on sale of assets | (7,176) | |
| Deferred income tax expense | 3,047 | 12,022 |
| Other, net | (1,129) | 886 |
| Changes in operating assets and liabilities, net of effects of acquisition and divestitures: | | |
| Accounts receivable | (9,392) | (13,988) |
| Other current assets | (14,562) | (20,716) |
| Accounts payable | (41,148) | (6,499) |
| Accrued interest and other current liabilities | 16,939 | 11,506 |
| Net cash provided by operating activities | 74,838 | 114,535 |
| Investing activities: | | |
| Capital expenditures for property and equipment: | | |
| Exploration, development, and acquisition costs | (135,486) | (465,175) |
| Other fixed assets | (7,510) | (2,643) |
| Proceeds from sales of assets | 1,661 | 1,018 |
| Other, net | | 106 |
| Net cash used by investing activities | (141,335) | (466,694) |
| Financing activities: | | |
| Proceeds from bank borrowings | 182,027 | 674,818 |
| Repayments of bank borrowings | (139,759) | (325,415) |
| Repayments of term loans | (625) | |
| Proceeds from the exercise of options and from employee stock purchase plan | 997 | 2,250 |
| Other, net | 8,463 | (24) |
| Net cash provided by financing activities | 51,103 | 351,629 |
| Effect of exchange rate changes on cash | (684) | (391) |
| Net decrease in cash and cash equivalents | (16,078) | (921) |
| Cash and cash equivalents at beginning of period | 33,164 | 7,231 |
| Cash and cash equivalents at end of period | \$ 17,086 | 6,310 |
| Cash paid during the period for: | | |
| Interest | \$ 11,600 | 3,080 |
| Income taxes | 574 | 1,969 |

See accompanying Notes to Condensed Consolidated Financial Statements.

FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(1) BASIS OF PRESENTATION

The Condensed Consolidated Financial Statements included herein are unaudited and include the accounts of Forest Oil Corporation and its consolidated subsidiaries (collectively, "Forest" or the "Company"). In the opinion of management, all adjustments, consisting of normal recurring accruals, have been made which are necessary for a fair presentation of the financial position of Forest at March 31, 2007, the results of its operations for the three months ended March 31, 2007 and 2006, and its cash flows for the three months ended March 31, 2007 and 2006. Interim results are not necessarily indicative of expected annual results because of the impact of fluctuations in prices received for liquids (oil, condensate, and natural gas liquids) and natural gas and other factors.

In the course of preparing the Condensed Consolidated Financial Statements, management makes various assumptions, judgments, and estimates to determine the reported amount of assets, liabilities, revenue, and expenses, and in the disclosures of commitments and contingencies. Changes in these assumptions, judgments, and estimates will occur as a result of the passage of time and the occurrence of future events and, accordingly, actual results could differ from amounts initially established.

The more significant areas requiring the use of assumptions, judgments, and estimates relate to volumes of oil and gas reserves used in calculating depletion, the amount of future net revenues used in computing the ceiling test limitations, and the amount of future capital costs and abandonment obligations used in such calculations. Assumptions, judgments, and estimates are also required in determining impairments of undeveloped properties, valuing deferred tax assets, and estimating fair values of derivative instruments.

Certain amounts in the prior year financial statements have been reclassified to conform to the 2007 financial statement presentation.

For a more complete understanding of Forest's operations, financial position, and accounting policies, reference is made to the consolidated financial statements of Forest, and related notes thereto, filed with Forest's Annual Report on Form 10-K for the year ended December 31, 2006, previously filed with the Securities and Exchange Commission.

(2) ACQUISITIONS AND DIVESTITURES

Acquisitions

Pending Acquisition of Houston Exploration

On January 7, 2007, Forest announced it had entered into a definitive agreement and plan of merger pursuant to which The Houston Exploration Company ("Houston Exploration") will merge with and into Forest in a stock and cash transaction totaling approximately \$1.5 billion plus the assumption of debt. Houston Exploration is an independent natural gas and oil producer engaged in the exploration, development, exploitation, and acquisition of natural gas and oil reserves in North America with operations in the following four producing areas in the United States: South Texas, East Texas, the Arkoma Basin of Arkansas, and the Uinta and DJ Basins in the Rocky Mountains. The boards of directors of Forest and Houston Exploration have each unanimously approved the transaction. The transaction is subject to customary conditions, including both Forest shareholder and Houston Exploration stockholder approvals. Forest management and its board of directors will continue in their current positions with Forest following the completion of the merger. The merger is expected to close

in early June 2007, as soon as practicable following Forest shareholder approval and Houston Exploration stockholder approval and satisfaction of the closing conditions.

Under the terms of the merger agreement, Houston Exploration stockholders are to receive total consideration equal to 0.84 shares of Forest common stock and \$26.25 in cash for each share of Houston Exploration common stock outstanding. This represents estimated merger consideration of 23.8 million shares of Forest common stock and cash of approximately \$740 million, or \$52.47 per share, to be received by the Houston Exploration stockholders (based on the closing price of Forest's common stock on January 5, 2007 and the number of shares of Houston Exploration common stock outstanding on April 30, 2007 and subject to increase in the event that any additional shares of Houston Exploration common stock are issued prior to the merger closing date in connection with the exercise of outstanding stock options pursuant to the terms of the merger agreement). The actual amount of total cash and stock consideration to be received by each Houston Exploration stockholder will be determined by elections, an equalization formula, and a proration procedure. It is anticipated that the transaction will be tax free to Houston Exploration and the stock portion of the consideration will be received tax free by its stockholders. The cash component of the acquisition is expected to be financed under an amended and restated revolving credit facility of up to \$1.4 billion for which JPMorgan Chase Bank, N.A. has provided us a commitment letter. In connection with the pending acquisition of Houston Exploration, Forest may elect to access the debt capital markets to finance a portion of the cash component of the merger consideration and the related transactions or to refinance borrowings under its bank credit facilities.

Cotton Valley Acquisition

On March 31, 2006, Forest completed the acquisition of oil and gas properties located primarily in the Cotton Valley trend in East Texas. Forest paid approximately \$255 million, as adjusted to reflect an economic effective date of February 1, 2006, for properties with an estimated 110 Bcfe of estimated proved reserves at the time the acquisition was announced in February 2006 and production that averaged 13 MMcfe per day in January 2006. Forest acquired approximately 26,000 net acres in the fields, of which approximately 14,000 net acres were undeveloped. Forest funded this acquisition utilizing its bank credit facilities.

Divestitures

Spin-off and Merger of Offshore Gulf of Mexico Operations

On March 2, 2006, Forest completed the spin-off of its offshore Gulf of Mexico operations by means of a special dividend, which consisted of a pro rata spin-off (the "Spin-off") of all outstanding shares of Forest Energy Resources, Inc. (hereinafter known as Mariner Energy Resources, Inc. or "MERI"), a total of 50,637,010 shares of common stock, to holders of record of Forest common stock as of the close of business on February 21, 2006. Immediately following the Spin-off, MERI was merged with a subsidiary of Mariner Energy, Inc. ("Mariner") (the "Merger"). Mariner's common stock commenced trading on the New York Stock Exchange on March 3, 2006.

The Spin-off was a tax-free transaction for federal income tax purposes. Prior to the Merger, as part of the Spin-off, MERI paid Forest approximately \$176.1 million. The \$176.1 million was drawn on

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a newly created bank credit facility established by MERI immediately prior to the Spin-off. This credit facility and associated liability were included in the Spin-off. Subsequent to the closing, Forest received additional net cash proceeds of \$21.7 million from MERI for a total of \$197.8 million. As of April 30, 2007, in accordance with the transaction agreements, Forest and MERI had submitted post-closing adjustments from which Forest paid MERI approximately \$5.8 million, which is subject to further adjustment.

The table below sets forth the assets and liabilities included in the Spin-off (in thousands):

| | |
|---|-------------|
| Working capital | \$ (12,383) |
| Proved oil and gas properties, net of accumulated depletion | 1,033,289 |
| Unproved oil and gas properties | 38,523 |
| Other assets | 7,919 |
| Derivative instruments | (17,087) |
| MERI credit facility | (176,102) |
| Asset retirement obligations | (150,182) |
| Deferred income taxes | (184,483) |
| Other liabilities | (225) |
| Accumulated other comprehensive income | 7,549 |
| | <hr/> |
| Net decrease to capital surplus and retained earnings | \$ 546,818 |
| | <hr/> |

The following table presents the revenues and direct operating expenses of the offshore Gulf of Mexico operations reported in the Condensed Consolidated Statements of Operations for the three months ended March 31, 2006. As the spin-off of the offshore Gulf of Mexico operations were concluded in 2006, the Company did not have operating activity from offshore Gulf of Mexico operations during the comparative period in 2007.

| | Period Ended March 31, 2006 |
|---|--|
| | (In Thousands) |
| Oil and gas revenues | \$ 46,289 |
| Oil and gas production expense: | |
| Lease operating expenses | 18,296 |
| Transportation and processing costs | 344 |
| Production and property taxes | 151 |
| | <hr/> |
| Oil and gas revenues in excess of direct operating expenses | \$ 27,498 |
| | <hr/> |

Sale of ProMark Discontinued Operations

On March 1, 2004, the Company sold the assets and business operations of Producers Marketing, Ltd. ("ProMark") to Cinergy Canada, Inc. ("Cinergy") for \$11.2 million CDN. As a result of the sale, ProMark's results of operations were reported as discontinued operations in the historical financial statements. Under the terms of the purchase and sale agreement, Forest may receive

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additional contingent consideration over a period of five years through February 2009. During the three months ended March 31, 2006, Forest recognized an additional \$3.6 million contingent payment (\$2.4 million net of tax), which has been reflected as income from discontinued operations in the Condensed Consolidated Statements of Operations. No contingent payments are expected in 2007.

Other Disposition

In February 2007, Forest sold its overriding royalty interests in Australia for net proceeds of \$7.2 million which resulted in a gain on the sale of \$7.2 million (\$4.5 million net of tax). As of March 31, 2007, Forest had received an initial payment of \$.7 million and received the remaining proceeds in April and May 2007.

(3) EARNINGS PER SHARE AND COMPREHENSIVE EARNINGS (LOSS)

Earnings per Share

Basic earnings per share is computed by dividing net earnings attributable to common stock by the weighted average number of common shares outstanding during each period, excluding treasury shares.

Diluted earnings per share is computed by adjusting the average number of common shares outstanding for the dilutive effect, if any, of stock options, unvested restricted stock grants, and

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unvested phantom stock units. The following sets forth the calculation of basic and diluted earnings per share:

| | Three Months Ended March 31, | |
|---|---------------------------------|--------------|
| | 2007 | 2006 |
| (In Thousands, Except Per Share Amounts) | | |
| Earnings from continuing operations | \$ 6,891 | 1,249 |
| Income from discontinued operations, net of tax | | 2,422 |
| Net earnings | \$ 6,891 | 3,671 |
| Weighted average common shares outstanding during the period | 62,393 | 62,115 |
| Add dilutive effects of stock options, unvested restricted stock grants, and unvested phantom stock units | 1,341 | 1,055 |
| Weighted average common shares outstanding, including the effects of dilutive securities | 63,734 | 63,170 |
| Basic earnings per share: | | |
| From continuing operations | \$.11 | .02 |
| From discontinued operations | | .04 |
| Basic earnings per share | \$.11 | .06 |
| Diluted earnings per share: | | |
| From continuing operations | \$.11 | .02 |
| From discontinued operations | | .04 |
| Diluted earnings per share | \$.11 | .06 |

Comprehensive Earnings (Loss)

Comprehensive earnings (loss) is a term used to refer to net earnings plus other comprehensive income (loss). Other comprehensive income (loss) is comprised of revenues, expenses, gains, and losses that under generally accepted accounting principles are reported as separate components of shareholders' equity instead of net earnings. Items included in Forest's other comprehensive income (loss) for the three months ended March 31, 2007 and 2006 are foreign currency gains (losses) related to the translation of the assets and liabilities of Forest's Canadian operations, changes in the unfunded postretirement benefits, and unrealized gains (losses) related to the changes in the fair value of derivative instruments designated as cash flow hedges.

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The components of comprehensive earnings (loss) are as follows:

| | Three Months Ended March 31, | |
|---|---------------------------------|---------|
| | 2007 | 2006 |
| (In Thousands) | | |
| Net earnings | \$ 6,891 | 3,671 |
| Other comprehensive income (loss): | | |
| Foreign currency translation gains (losses) | 2,826 | (1,930) |
| Unfunded postretirement benefits, net of tax | (104) | 83 |
| Unrealized gain on derivative instruments, net of tax | | 77,074 |
| Total comprehensive earnings | \$ 9,613 | 78,898 |

(4) STOCK-BASED COMPENSATION

The table below sets forth total stock-based compensation recorded during the three months ended March 31, 2007 under the provisions of Statement of Financial Accounting Standards ("SFAS") No. 123 (Revised), *Share-Based Payment* ("SFAS 123(R)") the remaining unamortized amounts and the weighted average amortization period remaining as of March 31, 2007.

| | Stock Options | Restricted Stock | Phantom Stock Units | Total ⁽¹⁾ |
|---|---------------|---------------------|------------------------|----------------------|
| (In Thousands) | | | | |
| Three Months Ended March 31, 2007: | | | | |
| Total stock-based compensation costs | \$ 933 | 1,433 | 224 | 2,590 |
| Less: stock-based compensation costs capitalized | (309) | (420) | (138) | (867) |
| Stock-based compensation costs expensed | \$ 624 | 1,013 | 86 | 1,723 |
| Unamortized stock-based compensation costs as of March 31, 2007 | \$ 5,034 | 9,541 | 1,839 ⁽²⁾ | 16,414 |
| Weighted average amortization period remaining | 1.5 years | 1.6 years | 1.8 years | 1.6 years |

(1) The Company also maintains an employee stock purchase plan (which is not included in the table above) under which \$.1 million of compensation cost was recognized for the three months ended March 31, 2007 under the provisions of SFAS 123(R).

(2) Based on the closing price of the Company's common stock on March 31, 2007.

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Stock Options

The following table summarizes stock option activity in the Company's stock-based compensation plans for the quarter ended March 31, 2007.

| | Number of Shares | Weighted Average Exercise Price | Aggregate Intrinsic Value (In Thousands) ⁽¹⁾ | Number of Shares Exercisable |
|--------------------------------|---------------------|---------------------------------------|---|---------------------------------|
| Outstanding at January 1, 2007 | 3,328,279 | \$ 18.80 | \$ 46,279 | 2,338,751 |
| Granted at fair value | | | | |
| Exercised | (39,826) | 19.54 | 536 | |
| Cancelled | (3,043) | 20.60 | | |
| Outstanding at March 31, 2007 | 3,285,410 | 18.79 | 49,128 | 2,541,824 |

(1) The intrinsic value of a stock option is the amount by which the current market value of the underlying stock exceeds the exercise price of the option.

Restricted Stock and Phantom Stock Units

The following table summarizes the restricted stock and phantom stock unit activity for the quarter ended March 31, 2007.

| | Restricted Stock | | Phantom Stock Units | |
|-----------------------------|---------------------|--|---------------------|--|
| | Number of Shares | Weighted Average Grant Date Fair Value | Number of Shares | Weighted Average Grant Date Fair Value |
| Unvested at January 1, 2007 | 627,450 | \$ 43.15 | 77,950 | \$ 44.32 |
| Awarded | 2,500 | 32.01 | 3,500 | 30.88 |
| Vested | (20,200) | 25.25 | | |
| Forfeited | (800) | 46.07 | (100) | 46.07 |
| Unvested at March 31, 2007 | 608,950 | 43.70 | 81,350 | 43.74 |

The restricted stock and phantom stock units generally vest on the third anniversary of the date of the award, but may vest earlier upon a qualifying disability, death, retirement, or a change in control of the Company in accordance with the term of the underlying agreement. The phantom stock units can be settled in cash, shares of common stock, or a combination of both. The phantom stock units have been accounted for as a liability within the consolidated financial statements.

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(5) DEBT

Components of debt are as follows:

| | March 31, 2007 | | | | December 31, 2006 | | | |
|---|---------------------|--------------------------------|----------------------|------------------|-------------------|--------------------------------|----------------------|------------------|
| | Principal | Unamortized Premium (Discount) | Other ⁽²⁾ | Total | Principal | Unamortized Premium (Discount) | Other ⁽²⁾ | Total |
| (In Thousands) | | | | | | | | |
| U.S. Credit Facility | \$ 55,000 | | | 55,000 | 23,000 | | | 23,000 |
| Canadian Credit Facility | 95,271 | | | 95,271 | 84,094 | | | 84,094 |
| Term Loan Agreements ⁽¹⁾ | 374,375 | | | 374,375 | 375,000 | | | 375,000 |
| 8% Senior Notes due 2008 | 265,000 | (122) | 2,780 | 267,658 | 265,000 | (146) | 3,346 | 268,200 |
| 8% Senior Notes due 2011 | 285,000 | 6,135 | 3,945 | 295,080 | 285,000 | 6,458 | 4,152 | 295,610 |
| 7 ³ / ₄ % Senior Notes due 2014 | 150,000 | (1,691) | 12,617 | 160,926 | 150,000 | (1,751) | 13,056 | 161,305 |
| Total debt | 1,224,646 | 4,322 | 19,342 | 1,248,310 | 1,182,094 | 4,561 | 20,554 | 1,207,209 |
| Less: current portion of long-term debt | 2,500 | | | 2,500 | 2,500 | | | 2,500 |
| Long-term debt | \$ 1,222,146 | 4,322 | 19,342 | 1,245,810 | 1,179,594 | 4,561 | 20,554 | 1,204,709 |

(1) In December 2006, two of Forest's wholly-owned subsidiaries, Forest Alaska Operating LLC and Forest Alaska Holding LLC, entered into term loan financing arrangements in the aggregate principal amount of \$375 million. The financing is comprised of two term loan agreements, including a \$250 million first lien credit agreement and a \$125 million second lien credit agreement. The term loans mature in December 2010 and December 2011, respectively, and are non-recourse to Forest.

(2) Represents the unamortized portion of gains realized upon termination of interest rate swaps that were accounted for as fair value hedges. The gains are being amortized as a reduction of interest expense over the terms of the notes.

Term Loan Agreements

On December 8, 2006, Forest, through its wholly-owned subsidiaries Forest Alaska Operating LLC and Forest Alaska Holding LLC (together "Forest Alaska"), issued, on a non-recourse basis to Forest, term loan financing facilities in the aggregate principal amount of \$375 million. The issuance was comprised of two term loan facilities, including a \$250 million first lien credit agreement and a \$125 million second lien credit agreement (together the "Credit Agreements"). The loan proceeds were used to fund a \$350 million distribution to Forest, which Forest used to pay down its U.S. credit facility, and to provide Forest Alaska working capital for its operations and pay transaction fees and expenses. Interest on the loans are based on an adjusted LIBO rate ("LIBOR") (LIBOR plus 3.50% under the first lien credit agreement and LIBOR plus 6.50% under the second lien credit agreement) or on a rate based on the federal funds rate (federal funds rate plus 3.0% under the first lien credit agreement and federal funds rate plus 6.0% under the second lien credit agreement), at the election of Forest Alaska. The loans under the first lien agreement will become due on December 8, 2010 and the loans under the second lien agreement will become due on December 8, 2011. The Credit Agreements are secured by substantially all of Forest Alaska's assets.

Partial repayments on the loans outstanding under the first lien agreement are due at the end of each calendar quarter, while the loans under the second lien agreement are scheduled for repayment on the maturity date. In addition, Forest Alaska is obligated to make mandatory prepayments annually

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using its excess cash flow and the proceeds associated with certain equity issuances, asset sales, and incurrence of additional indebtedness. Under certain circumstances involving a change in control involving Forest Alaska, the Credit Agreements also require Forest Alaska to offer to repurchase outstanding loans and purchase loans put to it by the lenders and, depending on the date of any such repurchase, the repurchase price may include a premium. Upon an event of default, a majority of the lenders under each of the Credit Agreements may request the agent to declare the loans immediately payable. Under certain circumstances involving insolvency, the loans will automatically become immediately due and payable.

The Credit Agreements include terms and covenants that place limitations on certain types of activities that may be conducted by Forest Alaska. The terms include restrictions or requirements with respect to additional debt, liens, investments, hedging activities, acquisitions, dividends, mergers, sales of assets, transactions with affiliates, and capital expenditures. In addition, the Credit Agreements include financial covenants addressing limitations on present value to total debt and first lien debt, interest coverage and leverage ratios. In the event Forest Alaska should not meet the prescribed financial or non-financial covenants and enter into a default position, the creditor may take action to terminate the committed term loan facilities and declare amounts outstanding to be immediately due and payable in whole or in part including accrued interest.

The Credit Agreements contain a covenant requiring that, for rolling time periods equal to four consecutive fiscal quarters, Forest Alaska may not have a "Leverage Ratio" greater than a defined amount. The Leverage Ratio is the ratio of (i) the total debt outstanding under the Credit Agreements at the end of the applicable four quarters to (ii) Forest Alaska's net income plus interest expense, depreciation, depletion expense, amortization expense, incomes taxes, exploration expense, and other non-cash charges and expenses, subject to certain adjustments (defined in the Credit Agreements as "Consolidated EBITDAX"), for the applicable four quarters. In addition, the first lien credit agreement (but not the second lien credit agreement) contains a covenant requiring that, for the same rolling time periods, Forest Alaska may not have an "Interest Coverage Ratio" less than a defined amount. The Interest Coverage Ratio is the ratio of (i) Forest Alaska's Consolidated EBITDAX for the applicable four quarters to (ii) the total interest expense under the two credit agreements, subject to certain adjustments, for the same time period.

In April 2007, based on a preliminary assessment of Forest Alaska's results of operations through March 31, 2007, Forest Alaska believed that it would likely fail to meet the Leverage Ratio and Interest Coverage Ratio requirements for the four-quarter period that ended on March 31, 2007. Unless waived by the lenders of more than 50 percent of the outstanding debt under the Forest Alaska Credit Agreements, a failure to meet the Leverage Ratio and the Interest Coverage ratio constitutes an event of default, entitling the lenders to declare the Credit Agreements terminated and demand immediate payment by Forest Alaska of all outstanding borrowings at par (approximately \$374 million as of March 31, 2007), accrued interest, and unpaid accrued fees. On April 26, 2007, Forest Alaska entered into amendments to the first lien credit agreement and second lien credit agreement, which amended certain definitions in the Credit Agreements and added a new provision to Article VII of the first lien credit agreement. Forest Alaska believes that the amendments to the Credit Agreements will prevent any default with respect to the four quarters ended March 31, 2007.

(6) PROPERTY AND EQUIPMENT

Forest uses the full cost method of accounting for oil and gas properties. Separate cost centers are maintained for each country in which Forest has operations. During the periods presented, Forest's primary oil and gas operations were conducted in the United States and Canada. All costs incurred in the acquisition, exploration, and development of properties (including costs of surrendered and abandoned leaseholds, delay lease rentals, dry holes, and overhead related to exploration and development activities) and the fair value of estimated future costs of site restoration, dismantlement, and abandonment activities are capitalized. Forest capitalized \$8.2 million and \$11.1 million of general and administrative costs (including stock-based compensation) during the three months ended March 31, 2007 and 2006, respectively. Interest costs related to significant unproved properties that are under development are also capitalized to oil and gas properties. During the three months ended March 31, 2007 and 2006, the Company capitalized approximately \$.8 million and \$.7 million, respectively, of interest expense attributed to unproved properties.

Investments in unproved properties, including related capitalized interest costs, are not depleted pending determination of the existence of proved reserves. Unproved properties are assessed periodically to ascertain whether impairment has occurred. Unproved properties whose costs are individually significant are assessed individually by considering the primary lease terms of the properties, the holding period of the properties, and geographic and geologic data obtained relating to the properties. Where it is not practicable to assess individually the amount of impairment of properties for which costs are not individually significant, such properties are grouped for purposes of assessing impairment. The amount of impairment assessed is added to the costs to be amortized, or is reported as a period expense, as appropriate.

Pursuant to full cost accounting rules, the Company must perform a ceiling test each quarter on its proved oil and gas assets. The ceiling test provides that capitalized costs less related accumulated depletion and deferred income taxes for each cost center may not exceed the sum of (1) the present value of future net revenue from estimated production of proved oil and gas reserves using current prices, including the effects of derivative instruments but excluding the future cash outflows associated with settling asset retirement obligations that have been accrued on the balance sheet, at a discount factor of 10%; plus (2) the cost of properties not being amortized, if any; plus (3) the lower of cost or estimated fair value of unproved properties included in the costs being amortized, if any; less (4) income tax effects related to differences in the book and tax basis of oil and gas properties. Should the net capitalized costs for a cost center exceed the sum of the components noted above, an impairment charge would be recognized to the extent of the excess capitalized costs. There were no ceiling test impairments of oil and gas properties in 2007 or 2006, although the Company's Canadian full cost pool, in particular, could be adversely impacted by moderate declines in commodity prices.

Gain or loss is not recognized on the sale of oil and gas properties unless the sale significantly alters the relationship between capitalized costs and estimated proved oil and gas reserves attributable to a cost center.

Depletion of proved oil and gas properties is computed on the units-of-production method, whereby capitalized costs, as adjusted for future development costs and asset retirement obligations, are amortized over the total estimated proved reserves. Furniture and fixtures, computer hardware and software, and other equipment are depreciated on the straight-line or declining balance method, based upon estimated useful lives of the assets ranging from three to 15 years.

(7) ASSET RETIREMENT OBLIGATIONS

Forest records estimated future asset retirement obligations pursuant to the provisions of Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations* ("SFAS 143"). SFAS No. 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred with a corresponding increase in the carrying amount of the related long-lived asset. Subsequent to initial measurement, the asset retirement liability is required to be accreted each period to its present value. Capitalized costs are depleted as a component of the full cost pool using the units-of-production method. Forest's asset retirement obligations consist of costs related to the plugging of wells, the removal of facilities and equipment, and site restoration on oil and gas properties.

The following table summarizes the activity for Forest's asset retirement obligations for the three months ended March 31, 2007 and 2006:

| | Three Months Ended March 31, | |
|---|-------------------------------------|---------------|
| | 2007 | 2006 |
| | (In Thousands) | |
| Asset retirement obligations at beginning of period | \$ 64,102 | 211,554 |
| Accretion expense | 1,275 | 3,352 |
| Liabilities incurred | 693 | 202 |
| Liabilities assumed | | 1,009 |
| Liabilities included in the Spin-off | | (150,182) |
| Liabilities settled | (563) | (4,379) |
| Revisions of estimated liabilities | 175 | (484) |
| Impact of foreign currency exchange rate | 131 | (73) |
| | <u>65,813</u> | <u>60,999</u> |
| Asset retirement obligations at end of period | 65,813 | 60,999 |
| Less: current asset retirement obligations | 3,055 | 1,497 |
| | <u>62,758</u> | <u>59,502</u> |
| Long-term asset retirement obligations | \$ 62,758 | 59,502 |

(8) EMPLOYEE BENEFITS

The following table sets forth the components of the net periodic cost of Forest's defined benefit pension plans and postretirement benefits in the United States for the three months ended March 31, 2007 and 2006:

| | Pension Benefits | | Postretirement Benefits | |
|----------------------------------|------------------------------|-------|-------------------------|---------|
| | Three Months Ended March 31, | | | |
| | 2007 | 2006 | 2007 | 2006 |
| | (In Thousands) | | | |
| Service cost | \$ | | 103 | 169 |
| Interest cost | | 553 | 548 | 118 |
| Curtailement gain ⁽¹⁾ | | | 94 | (1,851) |
| Expected return on plan assets | | (641) | (608) | |
| Recognized actuarial loss | | 195 | (22) | |
| Total net periodic expense | \$ | 107 | 175 | (1,564) |

- (1) Forest recognized a \$1.9 million curtailment gain in connection with the Spin-off on March 2, 2006. This gain was recorded as a reduction in general and administrative expense for the three months ended March 31, 2006.

(9) DERIVATIVE INSTRUMENTS

Forest periodically enters into derivative instruments such as swap, basis swap, and collar agreements in order to provide a measure of stability to Forest's cash flows in an environment of volatile oil and gas prices and to manage the exposure to commodity price risk. Forest's commodity derivative instruments generally serve as effective economic hedges of commodity price exposure; however, various circumstances can cause commodity hedges to not qualify for cash flow hedge accounting either at the inception of the hedge or during the term of the hedge. When the criteria for cash flow hedge accounting are not met or when cash flow hedging is not elected, realized gains and losses (i.e., cash settlements) are recorded in other income and expense in the Condensed Consolidated Statements of Operations. Similarly, changes in the fair value of the derivative instruments are recorded as unrealized gains or losses in the Condensed Consolidated Statements of Operations. In contrast, cash settlements for derivative instruments that qualify for hedge accounting are recorded as additions to or reductions of oil and gas revenues while changes in fair value of cash flow hedges are recognized, to the extent the hedge is effective, in other comprehensive income until the hedged item is recognized in earnings.

As a result of production deferrals experienced in the Gulf of Mexico related to hurricanes Katrina and Rita, Forest was required to discontinue cash flow hedge accounting on some of its natural gas and oil hedges during the third and fourth quarters of 2005. Additionally, as a result of the Spin-off on March 2, 2006, additional commodity swaps and collars formerly designated as cash flow hedges of offshore Gulf of Mexico production also no longer qualified for cash flow hedge accounting. Because a significant portion of the Company's derivatives no longer qualified for cash flow hedge accounting and to increase clarity in its financial statements, the Company elected to discontinue cash flow hedge accounting prospectively for all of its remaining commodity derivatives beginning in March 2006. This

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change in reporting has not impacted the Company's reported cash flows, although the results of operations have been affected by mark-to-market gains and losses, which fluctuate with volatile oil and gas prices. Subsequent to March 2006, the Company has recognized all mark-to-market gains and losses in earnings, rather than deferring such amounts in accumulated other comprehensive income included in shareholders' equity.

The table below summarizes the realized and unrealized losses (gains) Forest incurred related to its oil and gas derivative instruments for the periods indicated.

| | Three Months Ended March 31, | |
|--|---|---|
| | 2007 | 2006 |
| | (In Thousands) | |
| Realized losses on derivatives designated as cash flow hedges ⁽¹⁾ | \$ | 36,680 |
| Realized (gains) losses on derivatives not designated as cash flow hedges ⁽²⁾ | | (25,134) 3,915 |
| Ineffectiveness recognized on derivatives designated as cash flow hedges ⁽²⁾ | | (5,573) |
| Unrealized losses on derivatives not designated as cash flow hedges ⁽²⁾ | | 57,888 29,687 |
| | | Total realized and unrealized losses recorded |
| | \$ | 32,754 64,709 |

(1) Included in oil and gas sales in the Condensed Consolidated Statements of Operations.

(2) Included in other income and expense in the Condensed Consolidated Statements of Operations.

The tables below set forth Forest's outstanding commodity swaps and collars as of March 31, 2007:

| | Swaps | | | |
|---------------------|-------------------------------|--|----------------------------|--|
| | Natural Gas (NYMEX HH) | | Oil (NYMEX WTI) | |
| | Bbtu per Day | Weighted Average Hedged Price per MMBtu | Barrels per Day | Weighted Average Hedged Price per Bbl |
| Second Quarter 2007 | 60 | \$ 7.88 | 7,000 | \$ 70.03 |
| Third Quarter 2007 | 60 | 7.88 | 7,000 | 70.03 |
| Fourth Quarter 2007 | 60 | 7.88 | 7,000 | 70.03 |
| Calendar 2008 | | | 6,500 | 69.72 |
| Calendar 2009 | | | 4,500 | 69.01 |
| Calendar 2010 | | | 1,500 | 72.95 |

| Costless Collars | | | | |
|------------------------|----|---|-----------------|---|
| Natural Gas (NYMEX HH) | | | Oil (NYMEX WTI) | |
| Bbtu per Day | | Weighted Average Hedged Floor and Ceiling Price per MMBtu | Barrels per Day | Weighted Average Hedged Floor and Ceiling Price per Bbl |
| Second Quarter 2007 | 35 | \$ 8.76/11.70 | 4,000 | \$ 65.81/87.18 |
| Third Quarter 2007 | 35 | 8.76/11.70 | 4,000 | 65.81/87.18 |
| Fourth Quarter 2007 | 35 | 8.76/11.70 | 4,000 | 65.81/87.18 |
| Calendar 2008 | 10 | 7.75/9.57 | | |

Three-Way Costless Collars

| Natural Gas (NYMEX HH) | | |
|------------------------|----|---|
| Bbtu per Day | | Weighted Average Hedged Lower Floor, Upper Floor, and Ceiling Price per MMBtu |
| Calendar 2008 | 20 | \$ 6.00/8.00/10.00 |

The Company also uses basis swaps in connection with natural gas swaps in order to fix the price differential between the NYMEX price and the index price at which the natural gas production is sold. At March 31, 2007, there were three basis swaps in place covering 35.0 Bbtu per day for the remainder of 2007.

At March 31, 2007, the fair values of Forest's commodity derivative contracts is presented on the Condensed Consolidated Balance Sheet as liabilities of \$16.0 million (of which \$10.8 million was classified as current) and assets of \$24.3 million (of which \$17.5 million was classified as current). Forest is exposed to risks associated with swap and collar agreements arising from movements in the prices of oil and natural gas and from the unlikely event of non-performance by the counterparties to the swap and collar agreements.

In April 2007, the Company entered into an additional collar agreement. The table below sets forth the weighted average terms of the agreement.

| Costless Collar | | |
|------------------------|----|---|
| Natural Gas (NYMEX HH) | | |
| Bbtu per Day | | Weighted Average Hedged Floor and Ceiling Price per MMBtu |
| Calendar 2008 | 10 | \$ 8.00/10.50 |

Interest Rate Swaps

The Company may enter into interest rate swap agreements in an attempt to normalize the mix of fixed and floating interest rates within its debt portfolio. Unrealized gains, losses, or any settlements are recorded in other income and expense in the Consolidated Statement of Operations.

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In fulfillment of requirements under Forest Alaska's Credit Agreements, Forest Alaska entered into two floating to fixed interest rate swaps. In March 2007, Forest Alaska entered into a \$75 million floating to fixed interest rate swap for three years at a one month LIBOR fixed rate of 4.80%. At March 31, 2007, the fair value of Forest's interest rate derivative contract was an asset of \$.1 million. In April 2007, Forest Alaska entered into a \$112.5 million floating to fixed interest rate swap for three years at a one month LIBOR fixed rate of 4.96%. For the three months ended March 31, 2007, the Company recorded an unrealized gain related to the interest rate swap of \$.1 million.

(10) GEOGRAPHICAL SEGMENTS

Segment information has been prepared in accordance with Statement of Financial Accounting Standards No. 131, *Disclosures About Segments of an Enterprise and Related Information*. At March 31, 2007, Forest conducts operations in one industry segment, that being the oil and gas exploration and production industry, and had three reportable geographical business segments: United States, Canada, and International. Forest's remaining activities are not significant and therefore are not reported as a separate segment, but are included as a reconciling item in the information below. The segments were determined based upon the geographical location of operations in each business segment. The segment data presented below was prepared on the same basis as the Condensed Consolidated Financial Statements. Effective in the third quarter of 2006, Forest decreased the number of reportable segments from five to three to correspond to the same number of cost centers under the full cost accounting rules. Segment information previously reported has been modified to conform to the current presentation.

| | Oil and Gas Operations | | | |
|---|--|---------------|----------------------|----------------------|
| | Three Months Ended March 31, 2007 | | | |
| | United States | Canada | International | Total Company |
| | (In Thousands) | | | |
| Revenue | \$ 137,424 | 45,132 | | 182,556 |
| Expenses: | | | | |
| Lease operating expenses | 28,635 | 7,405 | | 36,040 |
| Production and property taxes | 7,220 | 690 | | 7,910 |
| Transportation and processing costs | 1,713 | 2,481 | | 4,194 |
| Depletion | 41,232 | 18,431 | | 59,663 |
| Accretion of asset retirement obligations | 1,002 | 261 | 12 | 1,275 |
| Earnings (loss) from operations | \$ 57,622 | 15,864 | (12) | 73,474 |
| Capital expenditures | \$ 98,538 | 56,262 | 629 | 155,429 |
| Goodwill | \$ 71,377 | 15,008 | | 86,385 |

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A reconciliation of segment earnings (loss) from operations to consolidated earnings before income taxes and discontinued operations is as follows:

| | Three Months Ended March 31, 2007 |
|---|--|
| | (In Thousands) |
| Earnings from operations for reportable segments | \$ 73,474 |
| Marketing, processing, and other | 53 |
| General and administrative expense (including stock-based compensation) | (12,971) |
| Administrative asset depreciation | (796) |
| Interest expense | (24,353) |
| Unrealized losses on derivative instruments, net | (57,838) |
| Realized gains on derivative instruments, net | 25,134 |
| Unrealized foreign currency exchange gain | 49 |
| Gain on sale of assets | 7,176 |
| Other income, net | 888 |
| Earnings before income taxes and discontinued operations | \$ 10,816 |

| | Oil and Gas Operations | | | |
|---|--|---------------|----------------------|----------------------|
| | Three Months Ended March 31, 2006 | | | |
| | United States | Canada | International | Total Company |
| | (In Thousands) | | | |
| Revenue | \$ 174,590 | 44,506 | | 219,096 |
| Expenses: | | | | |
| Lease operating expenses | 39,019 | 6,312 | | 45,331 |
| Production and property taxes | 10,016 | 712 | | 10,728 |
| Transportation and processing costs | 2,856 | 1,873 | | 4,729 |
| Depletion | 57,917 | 18,939 | | 76,856 |
| Accretion of asset retirement obligations | 3,092 | 249 | 11 | 3,352 |
| Earnings (loss) from operations | \$ 61,690 | 16,421 | (11) | 78,100 |
| Capital expenditures | \$ 423,833 | 49,687 | 874 | 474,394 |
| Goodwill | \$ 71,377 | 15,607 | | 86,984 |

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A reconciliation of segment earnings (loss) from operations to consolidated earnings before income taxes and discontinued operations is as follows:

| | Three Months Ended March 31, 2006 |
|---|--|
| (In Thousands) | |
| Earnings from operations for reportable segments | \$ 78,100 |
| Marketing, processing, and other | 2,350 |
| General and administrative expense (including stock-based compensation) | (17,136) |
| Administrative asset depreciation | (812) |
| Spin-off and merger costs | (5,416) |
| Interest expense | (15,151) |
| Unrealized losses on derivative instruments, net | (24,114) |
| Realized losses on derivative instruments, net | (3,915) |
| Other expense, net | (860) |
| | \$ 13,046 |

(11) CONDENSED CONSOLIDATING FINANCIAL INFORMATION

The Company's 8% Senior Notes due 2008, 8% Senior Notes due 2011, and 7³/₄% Senior Notes due 2014 have been fully and unconditionally guaranteed by a wholly-owned subsidiary of the Company (the "Subsidiary Guarantor"). The Company's remaining subsidiaries (the "Non-Guarantor Subsidiaries") have not provided guarantees. Based on this distinction, the following presents condensed consolidating financial information as of March 31, 2007 and December 31, 2006 and for the three months ended March 31, 2007 and 2006 on an issuer (parent company), guarantor subsidiary, non-guarantor subsidiary, eliminating entries, and consolidated basis. Elimination entries presented are necessary to combine the entities.

CONDENSED CONSOLIDATING BALANCE SHEETS
(Unaudited)
(In Thousands)

| | March 31, 2007 | | | | | December 31, 2006 | | | | |
|---|---------------------|-------------------------|---|------------------|------------------|-------------------|-------------------------|---|------------------|------------------|
| | Parent Company | Guarantor Subsidiary | Combined Non-Guarantor Subsidiaries | Eliminations | Consolidated | Parent Company | Guarantor Subsidiary | Combined Non-Guarantor Subsidiaries | Eliminations | Consolidated |
| ASSETS | | | | | | | | | | |
| Current assets: | | | | | | | | | | |
| Cash and cash equivalents | \$ 1,079 | 237 | 15,770 | | 17,086 | 771 | 126 | 32,267 | | 33,164 |
| Accounts receivable | 47,022 | 7,656 | 93,751 | (6,608) | 141,821 | 48,010 | 9,428 | 69,709 | (1,701) | 125,446 |
| Other current assets | 51,781 | 7,031 | 24,987 | | 83,799 | 82,227 | 2,380 | 17,783 | | 102,390 |
| Total current assets | 99,882 | 14,924 | 134,508 | (6,608) | 242,706 | 131,008 | 11,934 | 119,759 | (1,701) | 261,000 |
| Property and equipment, at cost | 2,883,213 | 241,430 | 2,135,627 | | 5,260,270 | 2,819,163 | 236,143 | 2,032,142 | | 5,087,448 |
| Less accumulated depreciation, depletion and amortization | 1,629,371 | 67,740 | 668,671 | | 2,365,782 | 1,605,072 | 63,624 | 628,826 | | 2,297,522 |
| Net property and equipment | 1,253,842 | 173,690 | 1,466,956 | | 2,894,488 | 1,214,091 | 172,519 | 1,403,316 | | 2,789,926 |
| Investment in subsidiaries | 658,292 | | | (658,292) | | 648,250 | | | (648,250) | |
| Note receivable from subsidiary | 68,840 | | | (68,840) | | 59,497 | | | (59,497) | |
| Due to (from) parent and subsidiaries | 241,935 | (10,482) | (231,453) | | | 236,075 | (16,276) | (219,799) | | |
| Other assets | 82,877 | 1 | 49,213 | | 132,091 | 91,673 | 1 | 46,472 | | 138,146 |
| | \$ 2,405,668 | 178,133 | 1,419,224 | (733,740) | 3,269,285 | 2,380,594 | 168,178 | 1,349,748 | (709,448) | 3,189,072 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | | | | | | |
| Current liabilities: | | | | | | | | | | |
| Accounts payable | \$ 123,327 | 8,913 | 91,224 | (6,608) | 216,856 | 147,397 | 8,394 | 70,843 | (1,701) | 224,933 |
| | | | 2,500 | | 2,500 | | | 2,500 | | 2,500 |

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March 31, 2007

December 31, 2006

| | | | | | | | | | | |
|-----------------------------------|--------------|---------|-----------|-----------|-----------|-----------|---------|-----------|-----------|-----------|
| Current portion of long-term debt | | | | | | | | | | |
| Other current liabilities | 37,617 | 130 | 7,378 | | 45,125 | 33,978 | (2,111) | 4,641 | | 36,508 |
| Total current liabilities | 160,944 | 9,043 | 101,102 | (6,608) | 264,481 | 181,375 | 6,283 | 77,984 | (1,701) | 263,941 |
| Long-term debt | 778,664 | | 467,146 | | 1,245,810 | 748,115 | | 456,594 | | 1,204,709 |
| Notes payable to parent | | | 68,840 | (68,840) | | | | 59,497 | (59,497) | |
| Other liabilities | 61,239 | 1,882 | 39,009 | | 102,130 | 57,496 | 1,831 | 35,132 | | 94,459 |
| Deferred income taxes | (40,916) | 41,048 | 210,995 | | 211,127 | (40,398) | 40,949 | 191,406 | | 191,957 |
| Total liabilities | 959,931 | 51,973 | 887,092 | (75,448) | 1,823,548 | 946,588 | 49,063 | 820,613 | (61,198) | 1,755,066 |
| Shareholders' equity | 1,445,737 | 126,160 | 532,132 | (658,292) | 1,445,737 | 1,434,006 | 119,115 | 529,135 | (648,250) | 1,434,006 |
| | \$ 2,405,668 | 178,133 | 1,419,224 | (733,740) | 3,269,285 | 2,380,594 | 168,178 | 1,349,748 | (709,448) | 3,189,072 |

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CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS
(Unaudited)
(In Thousands)

| | March 31, 2007 | | | | | March 31, 2006 | | | | |
|---|-------------------|-------------------------|---|----------------|----------------|-------------------|-------------------------|---|--------------|----------------|
| | Parent Company | Guarantor Subsidiary | Combined Non-Guarantor Subsidiaries | Eliminations | Consolidated | Parent Company | Guarantor Subsidiary | Combined Non-Guarantor Subsidiaries | Eliminations | Consolidated |
| Revenue: | | | | | | | | | | |
| Natural gas | \$ 43,588 | 3,152 | 50,557 | | 97,297 | 76,363 | 4,564 | 46,126 | | 127,053 |
| Oil, condensate, and natural gas liquids | 38,111 | 11,890 | 35,258 | | 85,259 | 58,912 | 11,582 | 21,549 | | 92,043 |
| Marketing, processing, and other | 52 | (49) | 1,865 | (1,815) | 53 | 491 | (16) | 1,962 | (87) | 2,350 |
| Total revenue | 81,751 | 14,993 | 87,680 | (1,815) | 182,609 | 135,766 | 16,130 | 69,637 | (87) | 221,446 |
| Operating expenses: | | | | | | | | | | |
| Lease operating expenses | 12,818 | 4,515 | 18,776 | (69) | 36,040 | 34,438 | 2,747 | 8,121 | 25 | 45,331 |
| Other direct operating costs | 6,964 | 1,307 | 3,833 | | 12,104 | 8,835 | 1,884 | 4,738 | | 15,457 |
| General and administrative (including stock-based compensation) | 9,903 | 31 | 3,037 | | 12,971 | 14,801 | 60 | 2,275 | | 17,136 |
| Depreciation and depletion | 24,145 | 4,117 | 32,200 | (3) | 60,459 | 45,005 | 5,377 | 27,286 | | 77,668 |
| Other operating expenses | 573 | 40 | 662 | | 1,275 | 8,403 | 30 | 335 | | 8,768 |
| Total operating expenses | 54,403 | 10,010 | 58,508 | (72) | 122,849 | 111,482 | 10,098 | 42,755 | 25 | 164,360 |
| Earnings from operations | | | | | | | | | | |
| | 27,348 | 4,983 | 29,172 | (1,743) | 59,760 | 24,284 | 6,032 | 26,882 | (112) | 57,086 |
| Equity earnings in subsidiaries | | | | | | | | | | |
| | 8,938 | | | (8,938) | | 18,480 | | | (18,480) | |
| Other income and expense: | | | | | | | | | | |
| Interest expense | 12,012 | 7 | 15,765 | (3,431) | 24,353 | 13,695 | 35 | 3,256 | (1,835) | 15,151 |
| Unrealized (gains) losses on derivative instruments, net | 36,730 | 6,983 | 14,125 | | 57,838 | 19,448 | 2,256 | 2,410 | | 24,114 |

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March 31, 2007

March 31, 2006

| | March 31, 2007 | | | | March 31, 2006 | | | | | |
|--|----------------|---------|---------|---------------|----------------|-------|-------|--------|--------------|---------------|
| Realized losses (gains) on derivative instruments, net | (16,759) | (3,185) | (5,190) | (25,134) | 2,954 | 709 | 252 | | 3,915 | |
| Other (income) expense, net | (3,189) | 154 | (8,509) | 3,431 | (8,113) | (902) | 35 | (108) | 1,835 | 860 |
| Total other income and expense | 28,794 | 3,959 | 16,191 | 48,944 | 35,195 | 3,035 | 5,810 | | | 44,040 |
| Earnings before income taxes and discontinued operations | 7,492 | 1,024 | 12,981 | (10,681) | 10,816 | 7,569 | 2,997 | 21,072 | (18,592) | 13,046 |
| Income tax expense: | 601 | 273 | 3,051 | 3,925 | 3,898 | 2,922 | 4,977 | | | 11,797 |
| Earnings from continuing operations | 6,891 | 751 | 9,930 | (10,681) | 6,891 | 3,671 | 75 | 16,095 | (18,592) | 1,249 |
| Income from discontinued operations, net of tax | | | | | | | 2,422 | | | 2,422 |
| Net earnings \$ | 6,891 | 751 | 9,930 | (10,681) | 6,891 | 3,671 | 75 | 18,517 | (18,592) | 3,671 |

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CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS
(Unaudited)
(In Thousands)

| | March 31, 2007 | | | | March 31, 2006 | | | |
|---|-------------------|-------------------------|---|------------------|-------------------|-------------------------|---|------------------|
| | Parent Company | Guarantor Subsidiary | Combined Non-Guarantor Subsidiaries | Consolidated | Parent Company | Guarantor Subsidiary | Combined Non-Guarantor Subsidiaries | Consolidated |
| Operating activities: | | | | | | | | |
| Net earnings | \$ (3,790) | 751 | 9,930 | 6,891 | (14,575) | 75 | 18,171 | 3,671 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | | | | | | | |
| Depreciation and depletion | 24,145 | 4,117 | 32,197 | 60,459 | 45,005 | 5,377 | 27,286 | 77,668 |
| Unrealized (gains) losses on derivative instruments, net | 36,730 | 6,983 | 14,125 | 57,838 | 19,448 | 2,256 | 2,410 | 24,114 |
| Deferred income tax expense | 266 | 273 | 2,508 | 3,047 | 2,928 | 2,922 | 6,172 | 12,022 |
| Other, net | 798 | 39 | (6,071) | (5,234) | 26,184 | 29 | 544 | 26,757 |
| Changes in operating assets and liabilities, net of effects of acquisitions and divestitures: | | | | | | | | |
| Accounts receivable | 988 | 1,772 | (12,152) | (9,392) | (13,846) | 1,726 | (1,868) | (13,988) |
| Other current assets | (10,083) | 235 | (4,714) | (14,562) | (22,318) | (95) | 1,697 | (20,716) |
| Accounts payable | (32,759) | (398) | (7,991) | (41,148) | (8,940) | (3,826) | 6,267 | (6,499) |
| Accrued interest and other current liabilities | 15,172 | (91) | 1,858 | 16,939 | 13,633 | (74) | (2,053) | 11,506 |
| Net cash provided by operating activities | 31,467 | 13,681 | 29,690 | 74,838 | 47,519 | 8,390 | 58,626 | 114,535 |
| Investing activities: | | | | | | | | |
| Capital expenditures for property and equipment | (61,955) | (4,509) | (76,532) | (142,996) | (372,567) | (8,323) | (86,928) | (467,818) |
| Other, net | 7,625 | | (5,964) | 1,661 | (457) | | 1,581 | 1,124 |
| Net cash used by investing activities | (54,330) | (4,509) | (82,496) | (141,335) | (373,024) | (8,323) | (85,347) | (466,694) |
| Financing activities: | | | | | | | | |
| Proceeds from bank borrowings | 153,000 | | 29,027 | 182,027 | 654,102 | | 20,716 | 674,818 |
| Repayments of bank borrowings | (121,000) | | (18,759) | (139,759) | (316,000) | | (9,415) | (325,415) |
| Net activity in investments from subsidiaries | (14,870) | (9,258) | 24,128 | | (14,553) | 266 | 14,287 | |
| Other, net | 6,041 | 197 | 2,597 | 8,835 | 2,250 | | (24) | 2,226 |
| Net cash provided (used) by financing activities | 23,171 | (9,061) | 36,993 | 51,103 | 325,799 | 266 | 25,564 | 351,629 |
| Effect of exchange rate changes on cash | | | (684) | (684) | | | (391) | (391) |
| Net increase (decrease) in cash and cash equivalents | 308 | 111 | (16,497) | (16,078) | 294 | 333 | (1,548) | (921) |
| Cash and cash equivalents at beginning of period | 771 | 126 | 32,267 | 33,164 | 2,076 | (114) | 5,269 | 7,231 |
| Cash and cash equivalents at end of period | \$ 1,079 | 237 | 15,770 | 17,086 | 2,370 | 219 | 3,721 | 6,310 |

(12) RECENT ACCOUNTING PRONOUNCEMENTS

In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, *"Accounting for Uncertainty in Income Taxes,"* an interpretation of FAS 109, *"Accounting for Income Taxes"* ("FIN 48"), to create a single model to address accounting for uncertainty in income tax positions. FIN 48 clarifies the accounting for income taxes, by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

The Company adopted FIN 48 on January 1, 2007. As a result of the implementation of FIN 48 the Company recognized a liability for uncertain tax benefits of approximately \$1.0 million which was accounted for as a reduction to the January 1, 2007 balance of retained earnings. The adoption of FIN 48 increased the Company's previously recognized liability for uncertain tax benefits of \$.5 million to \$1.5 million. The \$1.5 million liability does not relate to uncertainties about the timing of items of income or deduction and would affect the Company's effective tax rate if recognized in the Company's income tax provision. The Company records interest accrued related to unrecognized tax benefits in interest expense and penalties in other expense, to the extent they apply. The Company recognized no significant interest or penalties at the date of its adoption of FIN 48.

There was no change in the amount of unrecognized tax benefits during the three months ended March 31, 2007. Furthermore, the Company does not expect any significant change in the total amounts of unrecognized tax benefits within the 12 months ending March 31, 2008.

The statute of limitations is closed for the Company's U.S. federal income tax returns for years ending before and including December 31, 2002. Pre-acquisition returns of acquired businesses are also closed for tax years ending before and including December 31, 2002. However, the Company has utilized, and will continue to utilize, net operating losses ("NOLs") (including NOLs of acquired businesses) in its open tax years. The earliest available NOLs were generated in the tax year beginning January 1, 1989, but are potentially subject to adjustment by the federal tax authorities in the tax year in which they are utilized. Thus, the Company's earliest U.S. federal income tax return that is closed to potential audit adjustments is the tax year ending December 31, 1988. The Company's most recent Canadian income tax return that is closed to potential audit adjustments is the tax year ended December 31, 2002.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *"Fair Value Measurements"* ("SFAS 157"). This statement clarifies the definition of fair value, establishes a framework for measuring fair value, and expands the disclosures on fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. We have not determined the effect, if any, the adoption of this statement will have on our financial position or results of operations.

In February 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 159, *"The Fair Value Option for Financial Assets and Financial Liabilities"* ("SFAS 159"). This statement permits entities to choose to measure many financial instruments and certain other items at fair value. This statement expands the use of fair value measurement and applies to entities that elect the fair value option. The fair value option established by this Statement permits all entities to choose to measure eligible items at fair value at specified election dates. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We have not determined the effect, if any, the adoption of this statement will have on our financial position or results of operations.

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

Forest Oil Corporation ("Forest") is an independent oil and gas company engaged in the acquisition, exploration, development, and production of natural gas and liquids in North America and selected international locations. Forest was incorporated in New York in 1924, as the successor to a company formed in 1916, and has been a publicly held company since 1969.

The following discussion and analysis should be read in conjunction with Forest's Condensed Consolidated Financial Statements and Notes thereto, the information under the heading "Forward-Looking Statements" below, and the information included in Forest's 2006 Annual Report on Form 10-K under the heading "Risk Factors", and "Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies, Estimates, Judgments, and Assumptions." Unless the context otherwise indicates, references in this quarterly report on Form 10-Q to "Forest," "we," "ours," "us," or like terms refer to Forest Oil Corporation and its subsidiaries.

2007 OVERVIEW

Pending Acquisition of Houston Exploration

On January 7, 2007, Forest announced it had entered into a definitive agreement and plan of merger pursuant to which The Houston Exploration Company ("Houston Exploration") will merge with and into Forest in a stock and cash transaction totaling approximately \$1.5 billion plus the assumption of debt. Houston Exploration is an independent natural gas and oil producer engaged in the exploration, development, exploitation, and acquisition of natural gas and oil reserves in North America with operations in the following four producing areas in the United States: South Texas, East Texas, the Arkoma Basin of Arkansas, and the Uinta and DJ Basins in the Rocky Mountains. The boards of directors of Forest and Houston Exploration have each unanimously approved the transaction. The transaction is subject to customary conditions, including both Forest shareholder and Houston Exploration stockholder approvals. Forest management and its board of directors will continue in their current positions with Forest following the completion of the merger. The merger is expected to close in early June 2007, as soon as practicable following Forest shareholder approval and Houston Exploration stockholder approval and satisfaction of the closing conditions.

Under the terms of the merger agreement, Houston Exploration stockholders are to receive total consideration equal to 0.84 shares of Forest common stock and \$26.25 in cash for each share of Houston Exploration common stock outstanding. This represents estimated merger consideration of 23.8 million shares of Forest common stock and cash of approximately \$740 million, or \$52.47 per share, to be received by the Houston Exploration stockholders (based on the closing price of Forest's common stock on January 5, 2007 and the number of shares of Houston Exploration common stock outstanding on April 30, 2007 and subject to increase in the event that any additional shares of Houston Exploration common stock are issued prior to the merger closing date in connection with the exercise of outstanding stock options pursuant to the terms of the merger agreement). The actual amount of total cash and stock consideration to be received by each Houston Exploration stockholder will be determined by elections, an equalization formula, and a proration procedure. It is anticipated that the transaction will be tax free to Houston Exploration and the stock portion of the consideration will be received tax free by its stockholders. The cash component of the acquisition is expected to be financed under an amended and restated revolving credit facility of up to \$1.4 billion for which JPMorgan Chase Bank, N.A. has provided us a commitment letter.

At the request of Forest, and in connection with the pending merger, Houston Exploration commenced a tender offer and consent solicitation to repurchase any or all of its \$175 million senior subordinated notes immediately prior to the completion of the merger. Houston Exploration expects to fund the repurchase with cash on hand and borrowings under its revolving credit facility.

In the event the merger is not consummated, Forest has agreed to reimburse Houston Exploration for all expenses and indemnify it against certain liabilities associated with the repurchase. In the event the merger is consummated but the consent solicitation is delayed, terminated or otherwise modified in a manner that does not result in the adoption of the proposed amendments, then following the closing of the pending merger and pursuant to the terms of the existing indenture, Forest will be required to offer to purchase any or all of the notes at a price equal to 101% of the aggregate principle amount, plus accrued and unpaid interest and liquidated damages.

In connection with the pending acquisition of Houston Exploration, Forest may elect to access the debt capital markets to finance a portion of the cash component of the merger consideration and the related transactions or to refinance borrowings under its bank credit facilities.

Production Increase

Production from the Retained Properties (see definition below) increased 6% during the three months ended March 31, 2007 from the corresponding period in 2006. The production increase is discussed further in Results of Operations, *Oil and Gas Production and Revenues*, below.

Sale of Australian Royalty Interests

In February 2007, Forest sold its overriding royalty interests in Australia for net proceeds of \$7.2 million which resulted in a gain on the sale of \$7.2 million (\$4.5 million net of tax). As of March 31, 2006, Forest had received an initial payment of \$.7 million and received the remaining proceeds in April and May 2007.

RESULTS OF OPERATIONS

General

On March 2, 2006, Forest completed the spin-off of its Gulf of Mexico operations. The revenues and expenses associated with the offshore Gulf of Mexico operations are only included in the consolidated results of operations through February 28, 2006. As a result, the operational results for the three month period of 2007 presented are not comparable to the corresponding period in 2006. In the following discussions, revenues and expenses directly attributable with the properties included in the spin-off of the Gulf of Mexico operations (the "Spin-off Properties") and those retained (the "Retained Properties") are discussed separately.

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Oil and Gas Production and Revenues

Production volumes, revenues, and weighted average sales prices by product and location for the three months ended March 31, 2007 and 2006 were as follows:

Three Months Ended March 31,

| | 2007 | | | | 2006 | | | |
|------------------------------------|------------------|---------------|---------------|----------------|----------------|---------------|---------------|-----------------|
| | Gas | Oil | NGLs | Total | Gas | Oil | NGLs | Total |
| | (MMcf) | (MBbls) | (MBbls) | (MMcfe) | (MMcf) | (MBbls) | (MBbls) | (MMcfe) |
| Production volumes: | | | | | | | | |
| Retained Properties: | | | | | | | | |
| United States | 10,347 | 1,110 | 441 | 19,653 | 9,291 | 1,143 | 336 | 18,165 |
| Canada | 5,974 | 206 | 59 | 7,564 | 5,729 | 191 | 97 | 7,457 |
| Total Retained Properties | 16,321 | 1,316 | 500 | 27,217 | 15,020 | 1,334 | 433 | 25,622 |
| Spin-off Properties | | | | | 6,378 | 193 | 82 | 8,028 |
| Totals | 16,321 | 1,316 | 500 | 27,217 | 21,398 | 1,527 | 515 | 33,650 |
| Revenues (in thousands): | | | | | | | | |
| Retained Properties: | | | | | | | | |
| United States | \$ 64,074 | 60,606 | 12,744 | 137,424 | 65,379 | 67,481 | 9,801 | 142,661 |
| United States hedging losses | | | | | (7,707) | (6,653) | | (14,360) |
| Canada | 33,223 | 10,089 | 1,820 | 45,132 | 32,332 | 8,077 | 4,097 | 44,506 |
| Total Retained Properties | 97,297 | 70,695 | 14,564 | 182,556 | 90,004 | 68,905 | 13,898 | 172,807 |
| Spin-off Properties | | | | | 53,975 | 11,614 | 3,020 | 68,609 |
| Spin-off Properties hedging losses | | | | | (16,926) | (5,394) | | (22,320) |
| Total Spin-off Properties | | | | | 37,049 | 6,220 | 3,020 | 46,289 |
| Totals | \$ 97,297 | 70,695 | 14,564 | 182,556 | 127,053 | 75,125 | 16,918 | 219,096 |
| Average sales price: | | | | | | | | |
| Retained Properties: | | | | | | | | |
| United States | \$ 6.19 | 54.60 | 28.90 | 6.99 | 7.04 | 59.04 | 29.17 | 7.85 |
| United States hedging losses | | | | | (.83) | (5.82) | | (.79) |
| Canada | 5.56 | 48.98 | 30.85 | 5.97 | 5.64 | 42.29 | 42.24 | 5.97 |
| Total Retained Properties | 5.96 | 53.72 | 29.13 | 6.71 | 5.99 | 51.65 | 32.10 | 6.74 |

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Three Months Ended March 31,

| | | | | | | | | | |
|------------------------------------|----|------|-------|-------|-------------|---------|-------|---------------|-------------|
| Spin-off Properties | | | | | 8.46 | 60.18 | 36.83 | 8.55 | |
| Spin-off Properties hedging losses | | | | | (2.65) | (27.95) | | (2.78) | |
| Total Spin-off Properties | | | | | 5.81 | 32.23 | 36.83 | 5.77 | |
| Totals | \$ | 5.96 | 53.72 | 29.13 | 6.71 | 5.94 | 49.20 | 32.85 | 6.51 |

Net oil and gas production from the Retained Properties in the first quarter of 2007 was 27.2 Bcfe or an average of 302.4 MMcfe per day, a 6% increase from 25.6 Bcfe or an average of 284.7 MMcfe per day in the first quarter of 2006. The net increase in oil and gas production for the period was primarily attributable to the acquisition and subsequent development of the Cotton Valley assets which were acquired on March 31, 2006.

Oil and natural gas revenues from the Retained Properties were \$182.6 million during the three months ended March 31, 2007, a 6% increase as compared to \$172.8 million for the same period in the

prior year, which included realized hedging losses of \$14.4 million. The increase in oil and natural gas revenues was due to the 6% increase in production and a \$14.4 million decrease in hedging losses on derivatives accounted for as cash flow hedges, offset by an 8% decrease in average realized sales price before the effects of hedging. No hedging gains or losses were included in the average sales prices presented for the first quarter of 2007 given our election to discontinue cash flow hedge accounting effective in March 2006. See *Realized and Unrealized Gains and Losses on Derivative Instruments* below for information on gains and losses recognized on derivative instruments not designated as cash flow hedges.

Oil and Gas Production Expense

The table below sets forth the detail of oil and gas production expense, for the three months ended March 31, 2007 and 2006:

| | Three Months Ended March 31, | | | | | |
|--|--------------------------------------|---------------------|--------|---------------------|---------------------|--------|
| | 2007 | | | 2006 | | |
| | Retained Properties | Spin-off Properties | Total | Retained Properties | Spin-off Properties | Total |
| | (In Thousands, Except per Mcfe Data) | | | | | |
| Lease operating expenses: | | | | | | |
| Direct operating expense and overhead | \$ 32,421 | | 32,421 | 24,919 | 9,535 | 34,454 |
| Workover expense | 3,619 | | 3,619 | 2,116 | 8,761 | 10,877 |
| Lease operating expenses | \$ 36,040 | | 36,040 | 27,035 | 18,296 | 45,331 |
| Lease operating expenses per Mcfe | \$ 1.32 | | 1.32 | 1.06 | 2.28 | 1.35 |
| Production and property taxes | \$ 7,910 | | 7,910 | 10,577 | 151 | 10,728 |
| Production and property taxes per Mcfe | \$.29 | | .29 | .41 | .02 | .32 |
| Transportation and processing costs | \$ 4,194 | | 4,194 | 4,385 | 344 | 4,729 |
| Transportation and processing costs per Mcfe | \$.15 | | .15 | .17 | .04 | .14 |

Lease operating expenses in the first quarter of 2007 for the Retained Properties increased 33%, or \$9.0 million, to \$36.0 million from \$27.0 million in the first quarter of 2006. On a per-Mcfe basis, lease operating expenses increased 25% to \$1.32 per Mcfe in the first quarter of 2007 from \$1.06 per Mcfe in the first quarter of 2006. The increase in lease operating costs was primarily attributable to an increase in repairs and maintenance costs incurred in non-operated properties in Alaska. Production and property taxes on the Retained Properties decreased by 25% or \$2.7 million during the first quarter of 2007 as compared to the prior year's first quarter. The decrease from the prior year was attributable to lower commodity prices, lower state severance tax rates, and additional severance tax incentive credits recognized during the first quarter of 2007 than compared to the same period in the prior year. Transportation and processing costs for the Retained Properties decreased slightly to \$4.2 million or \$.15 per Mcfe in the three months ended March 31, 2007 from \$4.4 million or \$.17 per Mcfe for the corresponding 2006 period.

General and Administrative Expense

The following table summarizes the components of general and administrative expense and stock-based compensation expense incurred during the three months ended March 31, 2007 and 2006:

| | Three Months Ended March 31, | |
|---|---|--------------|
| | 2007 | 2006 |
| (In Thousands, Except per Mcf Data) | | |
| Total general and administrative costs | \$ 18,515 | 15,344 |
| General and administrative costs capitalized | (7,340) | (6,062) |
| | 11,175 | 9,282 |
| General and administrative expense | \$ 11,175 | 9,282 |
| General and administrative expense per Mcfe | \$.41 | .28 |
| Total stock-based compensation costs | \$ 2,663 | 12,853 |
| Stock-based compensation costs capitalized | (867) | (4,999) |
| | 1,796 | 7,854 |
| Stock-based compensation expense | \$ 1,796 | 7,854 |
| Stock-based compensation expense per Mcfe | \$.07 | .23 |
| Total general administrative expense including stock-based compensation | \$ 12,971 | 17,136 |

The increase in general and administrative expense of \$1.9 million for the three month period in 2007 as compared to the same period in 2006 is primarily related to increased employee salary and benefit costs. Stock-based compensation expense decreased \$6.1 million during the three month period in 2007 as compared to the same period in 2006 and is the result of the partial settlement of our restricted stock awards and phantom stock unit awards in connection with the spin-off of the Gulf of Mexico operations during the first quarter of 2006.

Depreciation and Depletion

Depreciation, depletion and amortization expense ("DD&A") for the three months ended March 31, 2007 was \$60.5 million compared to \$77.7 million for the same period in 2006. On an equivalent Mcf basis, DD&A expense was \$2.22 per Mcfe for the three months ended March 31, 2007 as compared to \$2.31 per Mcfe for the same period in the prior year. The decrease of \$.09 per Mcfe was primarily due to the spin-off of our offshore Gulf of Mexico properties on March 2, 2006.

Interest Expense

Interest expense in the first quarter of 2007 totaled \$24.4 million compared to \$15.2 million in the first quarter of 2006. The increase in interest expense during the period in 2007 as compared to the corresponding period in 2006 was due to increased average debt balances and higher average interest rates caused by the term loans issued by Forest's wholly-owned subsidiaries, Forest Alaska Operating LLC and Forest Alaska Holding LLC (together "Forest Alaska").

Realized and Unrealized Gains and Losses on Derivative Instruments

In March 2006, Forest elected to discontinue cash flow hedge accounting for all of its derivative instruments. As a result, subsequent to March 2006, Forest has recognized mark-to-market gains and losses in earnings, rather than deferring such amounts in accumulated other comprehensive income included in shareholders' equity. In addition, cash settlement on derivative instruments are recorded as realized hedging gains and losses in other income and expense in the Condensed Consolidated

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Statements of Operations rather than an adjustment to oil and gas revenues. This change in reporting has had no impact on Forest's reported cash flows, although results of operations have been affected by mark-to-market gains and losses, which fluctuate with volatile oil and gas prices. See Note 9 to the Condensed Consolidated Financial Statements.

The table below sets forth realized and unrealized gains and losses on oil and natural gas derivatives recognized under "Other income and expense" in our Condensed Consolidated Statements of Operations for the periods indicated. During the first quarter ended March 31, 2007, Forest terminated two oil swaps covering 1,000 barrels per day in 2009 and 500 barrels per day in 2010 for total proceeds of \$6.9 million. This amount has been included in realized gains and losses on derivative instruments during the quarter ended March 31, 2007.

Three Months Ended March 31,

| | 2007 | | | 2006 | | |
|--|-----------------|-------------------------|----------|-----------------|-------------------------|--------|
| | Oil Derivatives | Natural Gas Derivatives | Total | Oil Derivatives | Natural Gas Derivatives | Total |
| | (In Thousands) | | | | | |
| Unrealized losses (gains) | \$ 25,861 | 32,027 | 57,888 | 31,355 | (7,241) | 24,114 |
| Realized (gains) losses | (17,077) | (8,057) | (25,134) | 4,378 | (463) | 3,915 |
| Current and Deferred Income Tax Expense | | | | | | |

Forest recorded income tax expense of \$3.9 million in the three months ended March 31, 2007 as compared with \$11.8 million in the same period of 2006. The reduction in income tax expense was primarily due to significant non-recurring tax adjustments made in 2006. Together, non-deductible costs and state income tax rate adjustments related to the spin-off of the offshore Gulf of Mexico operations added approximately \$6.9 million to the income tax expense reflected in first three months of 2006. Other items causing the decrease in income tax expense relate to lower financial statement income and reduced statutory rates that are applicable in 2007 with respect to Canada and the state of Texas.

Discontinued Operations

On March 1, 2004, Forest sold the assets and business operations of Producers Marketing, Ltd. ("ProMark") to Cinergy Canada, Inc. ("Cinergy") for \$11.2 million CDN. As a result of the sale, ProMark's results of operations were reported as discontinued operations in the historical financial statements. Under the terms of the purchase and sale agreement, Forest may receive additional contingent consideration payments over a period of five years through February 2009. During the three months ended March 31, 2006, Forest recognized an additional \$3.6 million contingent payment (\$2.4 million net of tax) due under the agreement, which has been reflected as income from discontinued operations in the Condensed Consolidated Statements of Operations. No contingent payments are expected to be received in 2007.

Liquidity and Capital Resources

In 2007, as in 2006, we expect our cash flow from operations to be our primary source of liquidity to meet operating expenses and fund capital expenditures other than large acquisitions. Any remaining cash flow from operations will be available for acquisitions, in whole or in part, or other corporate purposes, including the repayment of indebtedness.

The prices we receive for our oil and natural gas production have a significant impact on operating cash flows. While significant price declines in 2007 would adversely affect the amount of cash flow generated from operations, we utilize a hedging program to partially mitigate that risk. As of May 1, 2007, Forest has hedged approximately 44 Bcfe of its remaining 2007 production. This level of hedging

provides a measure of certainty of the cash flow we will receive for a large portion of our production through 2007. Depending on changes in oil and gas futures markets and management's view of underlying oil and natural gas supply and demand trends, we may increase or decrease our current hedging positions. For further information concerning our hedging contracts, see Item 3 "Quantitative and Qualitative Disclosures about Market Risk Commodity Price Risk," below.

Our \$600 million revolving bank credit facilities, which we entered into in September 2004, provide another source of liquidity. These credit facilities, which mature in September 2009, are used to fund daily operating activities and acquisitions in the United States and Canada as needed. See "Bank Credit Facilities" below for details.

The public capital markets have been our principal source of funds to finance large acquisitions. We have issued debt and equity securities in both public and private offerings in the past, and we expect that these sources of capital will continue to be available to us in the future for acquisitions. In July 2004, we filed a shelf registration statement that allows Forest to issue equity and debt securities of up to \$600 million, all of which is still available. Nevertheless, ready access to capital on reasonable terms can be impacted by our debt ratings assigned by independent rating agencies and are subject to many uncertainties, including restrictions contained in our bank credit facilities and indentures for our senior notes, macroeconomic factors outside of our control, and other risks as explained in Part 1, Item 1A "Risk Factors" of our 2006 Annual Report on Form 10-K and Part II, Item 1A of this report.

In connection with the pending acquisition of Houston Exploration, Forest may elect to access the debt capital markets to finance a portion of the cash component of the merger consideration and the related transactions or to refinance borrowings under its credit facilities. Also, in conjunction with the announcement of the pending acquisition of Houston Exploration, we announced our plans to sell our Alaska business unit and certain other non-core assets, which should provide another source of liquidity in 2007.

In addition to the aforementioned transactions, we believe that our available cash, cash provided by operating activities, and funds available under our bank credit facilities will be sufficient to fund our operating, interest, and general and administrative expenses, our capital expenditure budget, and our short-term contractual obligations at current levels for the foreseeable future.

Bank Credit Facilities

Forest currently has credit facilities totaling \$600 million, consisting of a \$500 million U.S. credit facility through a syndicate of banks led by JPMorgan Chase Bank and a \$100 million Canadian credit facility through a syndicate of banks led by JPMorgan Chase Bank, Toronto Branch. The credit facilities mature in September 2009. Subject to the agreement of Forest and the applicable lenders, the size of the credit facilities may be increased by \$200 million in the aggregate.

Availability under the credit facilities is based either on certain financial covenants included in the credit facilities or on the loan value assigned to Forest's oil and gas properties. If Forest's corporate credit rating by Moody's is "Ba1" or higher and "BB+" or higher by S&P, availability under the credit facilities may, at Forest's election, be governed by certain financial covenants. Alternatively, if Forest's senior unsecured long-term debt credit rating is "Ba2" or lower by Moody's or "BB" or lower by S&P, availability under the credit facilities will be governed by a borrowing base ("Global Borrowing Base"). Currently, the amount available under the credit facilities is determined by the Global Borrowing Base. Effective September 29, 2006, the syndicate of banks approved a Global Borrowing Base of \$900 million; however, Forest did not elect to change the Global Borrowing Base allocation and the U.S. allocated borrowing base was kept at \$500 million and the Canadian allocated borrowing base was kept at \$100 million.

The determination of the Global Borrowing Base is made by the lenders taking into consideration the estimated value of Forest's oil and gas properties in accordance with the lenders' customary practices for oil and gas loans. This process involves reviewing Forest's estimated proved reserves and their valuation. While the Global Borrowing Base is in effect, it is redetermined semi-annually, and the available borrowing amount could be increased or decreased as a result of such redeterminations. In addition, Forest and the lenders each have discretion at any time, but not more often than once during any calendar year, to have the Global Borrowing Base redetermined. A revision to Forest's reserves may prompt such a request on the part of the lenders, which could possibly result in a reduction in the Global Borrowing Base and availability under the credit facilities. If outstanding borrowings under either of the credit facilities exceed the applicable portion of the Global Borrowing Base, Forest would be required to repay the excess amount within a prescribed period. If we are unable to pay the excess amount, it would cause an event of default.

The credit facilities include terms and covenants that place limitations on certain types of activities, including restrictions or requirements with respect to additional debt, liens, asset sales, hedging activities, investments, dividends, mergers, and acquisitions. The credit facilities also include several financial covenants. Availability, interest rates, security requirements, and other terms of borrowing under the credit facilities will vary based on Forest's credit ratings and financial condition, as determined by certain financial tests. In particular, any time that availability is not determined by the Global Borrowing Base, the amount available and our ability to borrow under the credit facilities is determined by certain financial covenants. Also, even when availability is determined by the Global Borrowing Base, certain financial covenants may affect the amount available and Forest's ability to borrow amounts under the credit facilities.

The credit facilities are collateralized by a portion of our assets. We are required to mortgage, and grant a security interest in, 75% of our consolidated proved oil and gas properties, measured by value. We have also pledged the stock of several subsidiaries to the lenders to secure the credit facilities. Under certain circumstances, we could be obligated to pledge additional assets as collateral. If our corporate credit ratings by Moody's and S&P improve and meet pre-established levels, the collateral requirements would not apply and, at our request, the banks would release their liens and security interests on our properties.

At March 31, 2007, there were outstanding borrowings of \$55.0 million under the U.S. credit facility at a weighted average interest rate of 6.63%, and there were outstanding borrowings of \$95.3 million under the Canadian credit facility at a weighted average interest rate of 5.65%. We also had used the credit facilities for approximately \$3.3 million in letters of credit, leaving an unused borrowing amount under the Global Borrowing Base of approximately \$446.4 million at March 31, 2007. At April 30, 2007, there were outstanding borrowings of \$80.0 million under the U.S. credit facility at a weighted average interest rate of 6.63%, and there were outstanding borrowings of \$87.1 million under the Canadian credit facility at a weighted average interest rate of 5.69%. We also had used the credit facilities for approximately \$3.3 million in letters of credit, leaving an unused borrowing amount under the Global Borrowing Base of approximately \$429.6 million.

On January 5, 2007, Forest, J.P. Morgan Securities Inc., and JPMorgan Chase Bank, N.A. entered into a commitment letter and fee letter with respect to the financing of the merger with Houston Exploration and the related transactions and the refinancing of certain of Forest's existing debt. The commitment letter, as amended, provides for a commitment of an aggregate of up to \$1.4 billion in financing under a five-year amended and restated revolving credit facility. Initially, we anticipate the commitments for the amended and restated U.S. and Canadian credit facilities will consist of a U.S. facility of up to \$1.25 billion and a Canadian facility of up to \$150 million. We expect the terms of the amended and restated credit facilities to be substantially similar to those of the existing credit facilities. We expect to finance the cash portion of the merger consideration, which is expected to be approximately \$740 million in cash (based on the outstanding shares of Houston Exploration common

stock on April 30, 2007 and subject to increase), through borrowings under these amended and restated credit facilities. Forest also expects to use these credit facilities to pay for related merger costs and expenses and for general corporate purposes following the merger. In addition, Forest intends to use the credit facilities, immediately after the merger occurs, to refinance borrowings incurred by Houston Exploration under its credit facility to fund the repurchase by Houston Exploration, immediately prior to the merger, of up to \$175 million of its outstanding senior subordinated notes through a tender offer and consent solicitation, as requested by Forest. The commitment letter expires June 30, 2007 and is subject to customary closing conditions.

Term Loan Financing Agreements

On December 8, 2006, Forest Alaska issued, on a non-recourse basis to Forest, term loan financing facilities in the aggregate principal amount of \$375 million. The issuance was comprised of two term loan facilities, including a \$250 million first lien credit agreement and a \$125 million second lien credit agreement (together the "Credit Agreements"). The loan proceeds were used to fund a \$350 million distribution to Forest, which Forest used to pay down its U.S. credit facility, and to provide Forest Alaska working capital for its operations and pay transaction fees and expenses. Interest on the loans are based on an adjusted LIBO rate ("LIBOR") (LIBOR plus 3.50% under the first lien credit agreement and LIBOR plus 6.50% under the second lien credit agreement) or on a rate based on the federal funds rate (federal funds rate plus 3.0% under the first lien credit agreement and federal funds rate plus 6.0% under the second lien credit agreement), at the election of Forest Alaska. The loans under the first lien agreement will become due on December 8, 2010 and the loans under the second lien agreement will become due on December 8, 2011. The Credit Agreements are secured by substantially all of Forest Alaska's assets.

Partial repayments on the loans outstanding under the first lien agreement are due at the end of each calendar quarter, while the loans under the second lien agreement are scheduled for repayment on the maturity date. In addition, Forest Alaska is obligated to make mandatory prepayments annually using its excess cash flow and the proceeds associated with certain equity issuances, asset sales, and incurrence of additional indebtedness. Under certain circumstances involving a change in control involving Forest Alaska, the Credit Agreements also require Forest Alaska to offer to repurchase outstanding loans and purchase loans put to it by the lenders and, depending on the date of any such repurchase, the repurchase price may include a premium. Upon an event of default, a majority of the lenders under each of the Credit Agreements may request the agent to declare the loans immediately payable. Under certain circumstances involving insolvency, the loans will automatically become immediately due and payable.

The Credit Agreements include terms and covenants that place limitations on certain types of activities that may be conducted by Forest Alaska. The terms include restrictions or requirements with respect to additional debt, liens, investments, hedging activities, acquisitions, dividends, mergers, sales of assets, transactions with affiliates, and capital expenditures. In addition, the Credit Agreements include financial covenants addressing limitations on present value to total debt and first lien debt, interest coverage and leverage ratios. In the event Forest Alaska should not meet the prescribed financial or non-financial covenants and enter into a default position, the creditor may take action to terminate the committed term loan facilities and declare amounts outstanding to be immediately due and payable in whole or in part including accrued interest.

The Credit Agreements contain a covenant requiring that, for rolling time periods equal to four consecutive fiscal quarters, Forest Alaska may not have a "Leverage Ratio" greater than a defined amount. The Leverage Ratio is the ratio of (i) the total debt outstanding under the Credit Agreements at the end of the applicable four quarters to (ii) Forest Alaska's net income plus interest expense, depreciation, depletion expense, amortization expense, incomes taxes, exploration expense, and other non-cash charges and expenses, subject to certain adjustments (defined in the Credit Agreements as

"Consolidated EBITDAX"), for the applicable four quarters. In addition, the first lien credit agreement (but not the second lien credit agreement) contains a covenant requiring that, for the same rolling time periods, Forest Alaska may not have an "Interest Coverage Ratio" less than a defined amount. The Interest Coverage Ratio is the ratio of (i) Forest Alaska's Consolidated EBITDAX for the applicable four quarters to (ii) the total interest expense under the two credit agreements, subject to certain adjustments, for the same time period.

In April 2006, based on a preliminary assessment of Forest Alaska's results of operations through March 31, 2007, Forest Alaska believed that it would likely fail to meet the Leverage Ratio and Interest Coverage Ratio requirements for the four-quarter period that ended on March 31, 2007. Unless waived by the lenders of more than 50 percent of the outstanding debt under the Forest Alaska Credit Agreements, a failure to meet the Leverage Ratio and the Interest Coverage ratio constitutes an event of default, entitling the lenders to declare the Credit Agreements terminated and demand immediate payment by Forest Alaska of all outstanding borrowings at par (approximately \$374 million as of March 31, 2007), accrued interest, and unpaid accrued fees. On April 26, 2007, Forest Alaska entered into amendments to the first lien credit agreement and second lien credit agreement, which amended certain definitions in the Credit Agreements and added a new provision to Article VII of the first lien credit agreement. Forest Alaska believes that the amendments to the Credit Agreements will prevent any default with respect to the four quarters ended March 31, 2007.

Cash Flow

Net cash provided by operating activities, net cash used by investing activities, and net cash provided by financing activities for the three months ended March 31, 2007 and 2006 were as follows:

| | Three Months Ended March 31, | |
|---|-------------------------------------|-------------|
| | 2007 | 2006 |
| | (In Thousands) | |
| Net cash provided by operating activities | \$ 74,838 | 114,535 |
| Net cash used by investing activities | (141,335) | (466,694) |
| Net cash provided by financing activities | 51,103 | 351,629 |

The decrease in net cash provided by operating activities in the three months ended March 31, 2007 compared to the same period of 2006 was due primarily to lower oil and gas revenues due to the spin-off of the offshore Gulf of Mexico operations. The decrease in cash used by investing activities in the three months ended March 31, 2007 was due primarily to the acquisition of oil and gas assets in the Cotton Valley trend in East Texas for approximately \$255 million in the three months ended March 31, 2006, as well as lower capital expenditures for exploration and development in the three months ended March 31, 2007 as compared to the same period in 2006. Net cash provided by financing activities in the three months ended March 31, 2007 included net bank proceeds of \$42.3 million and proceeds from the exercise of stock options of \$1.0 million. Net cash provided by financing activities in the three months ended March 31, 2006 included net bank proceeds of \$349.4 million, of which \$176.1 million was drawn on a bank credit facility established by Mariner Energy Resources, Inc. in March 2006, immediately prior to the spin-off of the offshore Gulf of Mexico operations. This credit facility and associated liability was included in the spin-off of the offshore Gulf of Mexico operations. The 2006 period also included proceeds from the exercise of stock options of approximately \$2.3 million.

Capital Expenditures

Expenditures for property acquisition, exploration, and development were as follows:

| | Three Months Ended March 31, | |
|---|---|----------------|
| | 2007 | 2006 |
| (In Thousands) | | |
| Property acquisition costs⁽¹⁾: | | |
| Proved properties | \$ | 233,886 |
| Unproved properties | | 51,400 |
| | | 285,286 |
| Exploration costs: | | |
| Direct costs | 40,043 | 74,145 |
| Overhead capitalized | 3,212 | 4,548 |
| | 43,255 | 78,693 |
| Development costs: | | |
| Direct costs | 107,179 | 103,902 |
| Overhead capitalized | 4,995 | 6,513 |
| | 112,174 | 110,415 |
| Total capital expenditures for property acquisition, exploration, and development⁽¹⁾⁽²⁾ | \$ | 474,394 |

(1) Total capital expenditures include both cash expenditures and accrued expenditures.

(2) Does not include the effect of estimated discounted asset retirement obligations.

For the three months ended March 31, 2007, expenditures for exploration and development activities totaled \$155 million. Forest's anticipated expenditures for exploration and development in 2007 are estimated to range from \$480 million to \$520 million. Some of the factors impacting the level of capital expenditures in 2007 include crude oil and natural gas prices, the volatility in these prices, the cost and availability of oil field services, and weather disruptions.

Forward-Looking Statements

The information in this Form 10-Q includes "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. All statements, other than statements of historical facts or present facts, that address activities, events, outcomes, and other matters that Forest plans, expects, intends, assumes, believes, budgets, predicts, forecasts, projects, estimates, or anticipates (and other similar expressions) will, should, or may occur in the future are forward-looking statements. Generally, the words "expects," "anticipates," "targets," "goals," "projects," "intends," "plans," "believes," "seeks," "estimates," variations of such words and similar expressions identify forward-looking statements, and any statements regarding Forest's future financial condition, results of operations and business, are also forward-looking statements. These forward-looking statements are based on our current expectations and assumptions about future events and are based on currently available information as to the outcome and timing of future events. When considering forward-looking statements, you should keep in mind the risk factors and other cautionary statements described under the heading "Risk Factors" included in Part I of our 2006 Annual Report on Form 10K.

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These forward-looking statements appear in a number of places and include statements with respect to, among other things:

estimates of our oil and gas reserves;

estimates of our future natural gas and liquids production, including estimates of any increases in oil and gas production;

the amount, nature and timing of capital expenditures, including future development costs, and availability of capital resources to fund capital expenditures;

the amount, nature and timing of any synergies or other benefits expected to result from acquisitions, including the proposed merger with Houston Exploration;

our outlook on oil and gas prices;

the impact of political and regulatory developments;

our future financial condition or results of operations and our future revenues and expenses; and

our business strategy and other plans and objectives for future operations.

We caution you that these forward-looking statements are subject to all of the risks and uncertainties, most of which are difficult to predict and many of which are beyond our control, incident to the exploration for and development, production, and sale of oil and gas. These risks include, but are not limited to, commodity price volatility, inflation, lack of availability of drilling and production equipment and services, environmental risks, drilling and other operating risks, regulatory changes, the uncertainty inherent in estimating proved oil and natural gas reserves and in projecting future rates of production, cash flow and access to capital, the timing of development expenditures, and the other risks described in the Form 10-K under the caption "Risk Factors." The financial results of our foreign operations are also subject to currency exchange rate risks.

Reserve engineering is a process of estimating underground accumulations of oil and natural gas that cannot be measured in an exact way. The accuracy of any reserve estimate depends on the quality of available data, the interpretation of such data, and price and cost assumptions made by reservoir engineers. In addition, the results of drilling, testing, and production activities may justify revisions of estimates that were made previously. If significant, such revisions would change the schedule of any further production and development drilling. Accordingly, reserve estimates may differ significantly from the quantities of oil and natural gas that are ultimately recovered.

Factors that could cause actual results to differ materially from those contemplated by the forward-looking statements include, among others, the following factors related to the proposed merger with Houston Exploration:

the ability to consummate the merger;

difficulties and delays in achieving synergies and cost savings from the merger; and

potential difficulties in meeting conditions set forth in the merger agreement.

Should one or more of the risks or uncertainties described above or elsewhere in this Form 10-Q occur, or should underlying assumptions prove incorrect, our actual results and plans could differ materially from those expressed in any forward-looking statements.

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All forward-looking statements, expressed or implied, included in this Form 10-Q and attributable to Forest are expressly qualified in their entirety by this cautionary statement. This cautionary statement should also be considered in connection with any subsequent written or oral forward-looking statements that Forest or persons acting on its behalf may issue. Forest does not undertake to update any forward-looking statements to reflect events or circumstances after the date of filing this Form 10-Q with the Securities and Exchange Commission, except as required by law.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk, including the effects of adverse changes in commodity prices, foreign currency exchange rates, and interest rates as discussed below.

Commodity Price Risk

We produce and sell natural gas, crude oil, and natural gas liquids for our own account in the United States and Canada. As a result, our financial results are affected when prices for these commodities fluctuate. Such effects can be significant. In order to reduce the impact of fluctuations in prices on our revenues, or to protect the economics of property acquisitions, we make use of an oil and gas hedging strategy. Under our hedging strategy, we enter into commodity swaps, collars, and other financial instruments with counterparties who, in general, are participants in our credit facilities. These arrangements, which are based on prices available in the financial markets at the time the contracts are entered into, are settled in cash and do not require physical deliveries of hydrocarbons.

Swaps

In a typical commodity swap agreement, we receive the difference between a fixed price per unit of production and a price based on an agreed upon published, third-party index if the index price is lower than the fixed price. If the index price is higher, we pay the difference. By entering into swap agreements, we effectively fix the price that we will receive in the future for the hedged production. Our current swaps are settled in cash on a monthly basis. As of March 31, 2007, we had entered into the following swaps:

| | Swaps | | | | | |
|---------------------|------------------------|---|------------------------------|--------------------|---|------------------------------|
| | Natural Gas (NYMEX HH) | | | Oil (NYMEX WTI) | | |
| | Bbtu per Day | Weighted Average Hedged Price per MMBtu | Fair Value (In Thousands) | Barrels per Day | Weighted Average Hedged Price per Bbl | Fair Value (In Thousands) |
| Second Quarter 2007 | 60 | \$ 7.88 | \$ 1,099 | 7,000 | \$ 70.03 | \$ 1,604 |
| Third Quarter 2007 | 60 | 7.88 | (1,162) | 7,000 | 70.03 | 570 |
| Fourth Quarter 2007 | 60 | 7.88 | (5,680) | 7,000 | 70.03 | 191 |
| Calendar 2008 | | | | 6,500 | 69.72 | (783) |
| Calendar 2009 | | | | 4,500 | 69.01 | 15 |
| Calendar 2010 | | | | 1,500 | 72.95 | 2,846 |

Forest also uses basis swaps in connection with natural gas swaps in order to fix the price differential between the NYMEX price and the index price at which the hedged gas is sold. At March 31, 2007, there were three basis swaps in place covering 35.0 Bbtu per day in 2007 with a fair market value of \$.1 million.

Collars

Forest also enters into collar agreements with third parties. A collar agreement is similar to a swap agreement, except that we receive the difference between the floor price and the index price only if the index price is below the floor price; and we pay the difference between the ceiling price and the index

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price only if the index price is above the ceiling price. As of March 31, 2007, we had entered into the following collars:

Costless Collars

| | Natural Gas (NYMEX HH) | | | Oil (NYMEX WTI) | | |
|---------------------|------------------------|---|---------------------------|-----------------|---|---------------------------|
| | Bbtu per Day | Weighted Average Hedged Floor and Ceiling Price per MMBtu | Fair Value (In Thousands) | Barrels per Day | Weighted Average Hedged Floor and Ceiling Price per Bbl | Fair Value (In Thousands) |
| Second Quarter 2007 | 35 | \$ 8.76/11.70 | \$ 3,769 | 4,000 | \$ 65.81/87.18 | \$ 666 |
| Third Quarter 2007 | 35 | 8.76/11.70 | 3,327 | 4,000 | 65.81/87.18 | 971 |
| Fourth Quarter 2007 | 35 | 8.76/11.70 | 2,142 | 4,000 | 65.81/87.18 | 1,050 |
| Calendar 2008 | 10 | 7.75/9.57 | (814) | | | |

Three-Way Collars

Forest also enters into three-way collars with third parties. These instruments establish two floors and one ceiling. Upon settlement, if the index price is below the lowest floor, Forest receives the difference between the two floors. If the index price is between the two floors, Forest receives the difference between the higher of the two floors and the index price. If the index price is between the higher floor and the ceiling, Forest does not receive or pay any amounts. If the index price is above the ceiling, Forest pays the excess over the ceiling price. As of March 31, 2007, we had entered into the following three-way collars:

Three-Way Costless Collars

| Natural Gas (NYMEX HH) | | |
|------------------------|---|---------------------------|
| Bbtu per Day | Weighted Average Hedged Lower Floor, Upper Floor, and Ceiling Price per MMBtu | Fair Value (In Thousands) |
| Calendar 2008 | 20 \$ 6.00/8.00/10.00 | \$ (1,667) |

The fair value of our commodity derivative instruments based on the futures prices quoted on March 31, 2007 was a net asset of approximately \$8.2 million.

In April 2007, the Company entered into an additional collar agreement. The table below sets forth the weighted average terms of the agreement.

Costless Collar

| Natural Gas (NYMEX HH) | |
|------------------------|---|
| Bbtu per Day | Weighted Average Hedged Floor and Ceiling Price per MMBtu |
| Calendar 2008 | 10 \$ 8.00/10.50 |

Interest Rate Swaps

In fulfillment of requirements required by the term loan agreements, Forest Alaska entered into two floating to fixed interest rate swaps. In March 2007, Forest Alaska entered into a \$75 million floating to fixed interest rate swap for three years at a one month LIBOR fixed rate of 4.80%. At March 31, 2007, the fair value of Forest Alaska's interest rate derivative contract was an asset of \$.1 million. In April 2007, Forest Alaska entered into a \$112.5 million floating to fixed interest rate swap for three years at a one month LIBOR fixed rate of 4.96%.

Fair Value Reconciliation

The following table reconciles the changes that occurred in the fair values of our open derivative contracts during the three months ended March 31, 2007, beginning with the fair value of our derivative contracts on December 31, 2006:

| | Fair Value of Derivative Contracts | | |
|---------------------------------------|------------------------------------|---------------|----------|
| | Commodity | Interest Rate | Total |
| (In Thousands) | | | |
| As of December 31, 2006 | \$ 66,119 | | 66,119 |
| Net (decrease) increase in fair value | (32,755) | 52 | (32,703) |
| Net contract gains recognized | (25,134) | | (25,134) |
| As of March 31, 2007 | \$ 8,230 | 52 | 8,282 |

Foreign Currency Exchange Risk

We conduct business in several foreign currencies and thus are subject to foreign currency exchange rate risk on cash flows related to sales, expenses, financing, and investing transactions. In the past, we have not entered into any foreign currency forward contracts or other similar financial instruments to manage this risk. Expenditures incurred relative to the foreign concessions held by Forest outside of North America have been primarily United States dollar-denominated, as have cash proceeds related to property sales and farmout arrangements. Substantially all of our Canadian revenues and costs are denominated in Canadian dollars. While the value of the Canadian dollar does fluctuate in relation to the U.S. dollar, we believe that any currency risk associated with our Canadian operations would not have a material impact on our results of operations.

Interest Rate Risk

The following table presents principal amounts and related weighted average fixed interest rates by year of maturity for Forest's debt obligations and the fair value of our debt obligations at March 31, 2007:

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2014 | Total | Fair Value |
|--|------|---------|---------|---------|---------|---------|---------|------------|
| (Dollar Amounts in Thousands) | | | | | | | | |
| Bank credit facilities: | | | | | | | | |
| Variable rate | \$ | | 150,271 | | | | 150,271 | 150,271 |
| Average interest rate ⁽¹⁾ | | | 6.01% | | | | 6.01% | |
| Term debt: | | | | | | | | |
| Variable rate | \$ | 1,875 | 2,500 | 2,500 | 242,500 | 125,000 | 374,375 | 375,635 |
| Average interest rate ⁽¹⁾ | | 8.82% | 8.82% | 8.82% | 8.82% | 11.82% | 9.82% | |
| Total variable rate debt: | | | | | | | | |
| Variable rate | \$ | 1,875 | 2,500 | 152,771 | 242,500 | 125,000 | 524,646 | 525,906 |
| Average interest rate ⁽¹⁾ | | 8.82% | 8.82% | 6.05% | 8.82% | 11.82% | 8.73% | |
| Long-term debt: | | | | | | | | |
| Fixed rate | \$ | 265,000 | | | 285,000 | 150,000 | 700,000 | 719,994 |
| Coupon interest rate | | 8.00% | | | 8.00% | 7.75% | 7.95% | |
| Effective interest rate ⁽²⁾ | | 7.13% | | | 7.71% | 6.56% | 7.24% | |

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- (1) As of March 31, 2007.
- (2) The effective interest rate on the 8% Senior Notes due 2008, the 8% Senior Notes due 2011, and the 7³/₄% Senior Notes due 2014 is reduced from the coupon rate as a result of amortization of gains related to the termination of related interest rate swaps.

Item 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We have established disclosure controls and procedures to ensure that material information relating to Forest and its consolidated subsidiaries is made known to the Officers who certify Forest's financial reports and the Board of Directors.

Our Chief Executive Officer, H. Craig Clark, and our Chief Financial Officer, David H. Keyte, evaluated the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of the end of the quarterly period ended March 31, 2007 (the "Evaluation Date"). Based on this evaluation, they believe that as of the Evaluation Date our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms.

Changes in Internal Control Over Financial Reporting

There has not been any change in our internal control over financial reporting that occurred during our quarterly period ended March 31, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1A. RISK FACTORS

The following risk factors update the Risk Factors included in our Annual Report on Form 10-K for fiscal year ended December 31, 2006 ("Annual Report"). Except as set forth below, there have been no material changes to the risks described in Part I, Item 1A, of our Annual Report.

Risk Factors Relating to Forest

Forest Alaska could default on its term loan agreements.

Forest Alaska Operating LLC and Forest Alaska Holding LLC (together, "Forest Alaska") are wholly-owned subsidiaries of Forest. After their creation, Forest designated Forest Alaska as "unrestricted subsidiaries" under the terms of Forest's senior subordinated notes and Forest's bank credit facilities. During 2006, Forest transferred all of its producing oil and gas properties located in Alaska to Forest Alaska. In December 2006, Forest Alaska entered into a \$250 million first lien credit agreement and a \$125 million second lien credit agreement. As explicitly contemplated in the two credit agreements, the borrowings under the credit agreements were used in part to fund a \$350 million dividend from Forest Alaska to their parent, Forest. Both credit agreements are secured by Forest Alaska's oil and gas properties and are non-recourse to Forest. The first lien credit agreement and the second lien credit agreement contain a covenant requiring that, for rolling time periods equal to four consecutive fiscal quarters, Forest Alaska may not have a "Leverage Ratio" greater than a defined amount. The Leverage Ratio is the ratio of (i) the total debt outstanding under the credit agreements at the end of the applicable four quarters to (ii) Forest Alaska's net income plus interest expense, depreciation, depletion expense, amortization expense, incomes taxes, exploration expense, and other non-cash charges and expenses, subject to certain adjustments (defined in the credit agreements as "Consolidated EBITDAX"), for the applicable four quarters. In addition, the first lien credit agreement (but not the second lien credit agreement) contains a covenant requiring that, for the same rolling time periods, Forest Alaska may not have an "Interest Coverage Ratio" less than a defined amount. The Interest Coverage Ratio is the ratio of (i) Forest Alaska's Consolidated EBITDAX for the applicable

four quarters to (ii) the total interest expense under the two credit agreements, subject to certain adjustments, for the same time period.

Based on its preliminary assessment of Forest Alaska's Consolidated EBITDAX in April 2007, Forest believed that Forest Alaska would fail to meet the Leverage Ratio and Interest Coverage Ratio requirements for the four-quarter period that ended on March 31, 2007. A failure to meet the Leverage Ratio and the Interest Coverage Ratio constitutes an event of default, entitling the lenders to declare the credit agreements terminated and demand immediate payment by Forest Alaska of all outstanding borrowings at par (approximately \$374 million as of March 31, 2007), accrued interest and unpaid accrued fees. Forest Alaska subsequently negotiated amendments to its credit agreements that it believes will prevent any default with respect to the four quarters ended March 31, 2007. Forest Alaska also believes that the amendments provide it an enhanced ability to comply with the Leverage Ratio and Interest Coverage Ratio requirements in the future. However, there is no assurance that Forest Alaska will be able to meet the Leverage Ratio and Interest Coverage Ratio tests in future quarters, which means that future waivers or amendments to the credit agreements may have to be negotiated. Forest does not believe that a default by Forest Alaska under the two Forest Alaska credit agreements would have a material effect upon Forest's financial results. In addition, such a default by Forest Alaska would not constitute a cross-default under Forest's senior notes, bank credit facilities, or other material contracts. Any future default by Forest Alaska that was not resolved to the satisfaction of the lenders could have a negative impact on Forest's ability to raise funds in the capital markets in the future.

Our international operations may be adversely affected by currency fluctuations and economic and political developments.

We have significant oil and gas operations in Canada. The expenses and revenues of such operations, which represented approximately 19% of our 2006 consolidated production costs, and 22% of our 2006 consolidated oil and gas revenues, are denominated in Canadian dollars. As a result, the profitability of our Canadian operations is subject to the risk of fluctuations in the relative value of the Canadian and United States dollars. We have oil and gas assets in other countries including Italy, Gabon and South Africa. Although there are no material operations in these countries, our operations in these countries may also be adversely affected by political and economic developments, royalty and tax increases, and other laws or policies in these countries, as well as United States policies affecting trade, taxation, and investment in other countries.

In South Africa, we have an interest in offshore properties that have tested natural gas. While no proved reserves have been assigned to these properties as commercial sales contracts have not been established, and if we are unable to arrange for commercial use of these properties, we may not be able to recoup our investment and may not realize our anticipated financial and operating results from these properties. The South African national government has recently adopted legislation to revise the process pursuant to which it grants petroleum exploration and production licenses. Under the new regulations, we have applied to the government to convert one existing prospecting sublease into an exploration right. In addition, we have applied for a production right covering the geographic area of our other existing prospecting sublease. We cannot predict whether these applications will be granted or whether any granted rights will meet our economic or operational requirements, in which event we may choose to relinquish these leases and lose our investment, which totals approximately \$50 million.

Additional Risk Factors Relating to Forest if the Merger with Houston Exploration is Consummated

Forest will have substantial debt after the effective time of the merger, which could have a material adverse effect on its financial health and limit its future operations.

Forest will have a significant amount of debt after the effective time of the merger. As of December 31, 2006, on a pro forma basis to reflect the merger and Forest's borrowing under its credit facilities to finance the cash component of the merger consideration, Forest's total outstanding long-term debt would have been \$2.18 billion.

Forest's substantial debt could have important consequences. In particular, it could:

increase its vulnerability to general adverse economic and industry conditions;

require it to dedicate a substantial portion of its cash flow from operations to payments on its indebtedness, thereby reducing the availability of its cash flow to fund working capital, capital expenditures and other general corporate purposes;

place it at a competitive disadvantage compared to its competitors that have less debt; and

limit, along with the financial and other restrictive covenants of its indebtedness, among other things, its ability to borrow additional funds.

Further, as described above in the risk factor entitled "Forest Alaska could default on its term loan agreements," Forest Alaska could default on its two term loan credit agreements. If that happens, Forest may face additional difficulties in raising needed funds in the capital markets.

Forest will be more vulnerable to a ceiling test writedown following the merger with Houston Exploration.

As described above in the risk factor entitled, "Risk Factors Relating to the Merger Houston Exploration could incur a ceiling test writedown prior to completion of the merger," Forest uses the full cost method of accounting and is subject to quarterly ceiling tests. After completion of the merger, Forest will add to net capitalized costs the estimated fair value of Houston Exploration's oil and gas properties. It will also add the estimated proved reserves associated with those properties. Forest expects that the net effect of these additions will be to reduce the difference between the ceiling limit and the net capitalized costs of its U.S. cost center. Based on Forest's current estimate of the fair value of Houston Exploration's oil and gas properties and the estimated discounted future net revenues associated with those properties at December 31, 2006, Forest estimates that, on a pro forma basis, the ceiling limit in excess of the net capitalized costs in its U.S. cost center would have been reduced by approximately \$500 million had the pending merger with Houston Exploration occurred on that date. At December 31, 2006, Forest's ceiling limit exceeded its net capitalized costs in its U.S. cost center by approximately \$535 million. The final impact of the merger on Forest's ceiling test will not be known until Forest completes its analysis of the relative fair values of Houston Exploration's net assets, including its oil and gas properties, as of the date of the merger's closing under the purchase method of accounting for business combinations. Based on its current assessment, and without regard to the potential results of future investments on the acquired properties, Forest believes that following the merger there is a greater risk of a ceiling test writedown of its U.S. full cost pool.

Item 6. EXHIBITS

(a) Exhibits.

- | | |
|-------|--|
| 31.1* | Certification of Principal Executive Officer of Forest Oil Corporation as required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended. |
| 31.2* | Certification of Principal Financial Officer of Forest Oil Corporation as required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended. |
| 32.1+ | Certification of Chief Executive Officer of Forest Oil Corporation pursuant to 18 U.S.C. §1350. |
| 32.2+ | Certification of Chief Financial Officer of Forest Oil Corporation pursuant to 18 U.S.C. §1350. |
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* Filed herewith.

+ Not considered to be "filed" for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that section.

SIGNATURES

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

May 10, 2007

FOREST OIL CORPORATION
(Registrant)

By: /s/ DAVID H. KEYTE

David H. Keyte
*Executive Vice President and
Chief Financial Officer
(on behalf of the Registrant and as
Principal Financial Officer)*

By: /s/ VICTOR A. WIND

Victor A. Wind
*Corporate Controller
(Principal Accounting Officer)*

Exhibit Index

| Exhibit Number | Description |
|-----------------------|--|
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+
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