

GASTAR EXPLORATION LTD
Form S-8
January 05, 2006
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As filed with the Securities and Exchange Commission on January 5, 2006

Registration No. 333-

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM S-8

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

GASTAR EXPLORATION LTD.

(Exact name of Registrant as specified in its charter)

Alberta, Canada
(State or other jurisdiction
of incorporation or organization)

38-3324634
(I.R.S. Employer
Identification Number)

1331 Lamar Street, Suite 1080

Houston, Texas 77010

(713) 739-1800

(Address of Principal Executive Offices)

STOCK OPTION PLAN

DATED FEBRUARY 14, 2004

(Full title of the plan)

J. Russell Porter

Chief Executive Officer and President

1331 Lamar Street, Suite 1080

Houston, Texas 77010

(713) 739-1800

(Name, address, including zip code, and telephone number,

including area code, of agent for service)

COPY TO:

T. Mark Kelly

Vinson & Elkins L.L.P.

2300 First City Tower

1001 Fannin

Houston, Texas 77002-6760

CALCULATION OF REGISTRATION FEE

Title of Securities to be Registered	Amount to be Registered (1)	Proposed Maximum Offering Price	Proposed Maximum Aggregate Offering Price (2)	Amount of Registration Fee
		Per Share (2)		

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Common shares, without par value	25,000,000			
	Shares	\$3.63	\$90,801,250	\$9,716

- (1) Pursuant to Rule 416(a) under the Securities Act of 1933, as amended, the number of shares of common stock registered hereby pursuant to the 2005 Stock Incentive Plan are subject to adjustment to prevent dilution resulting from stock splits, stock dividends or similar transactions.

 - (2) Estimated solely for purposes of calculating the registration fee pursuant to Rule 457. The maximum aggregate offering price is based on the average of the high and low sales prices of the registrant's common shares on the The Toronto Stock Exchange on December 30, 2005, and translated into U.S. dollars at the exchange rate of US\$1.00 = CDN\$0.8546, which was the exchange rate in effect on December 30, 2005.
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PART I

INFORMATION REQUIRED IN SECTION 10(A) PROSPECTUS

The documents containing the information required by Part I of Form S-8 will be sent or given to participants in our Stock Option Plan dated February 14, 2004 (the "Plan") as specified by Rule 428(b)(1) under the Securities Act of 1933, as amended (the "Securities Act").

Part I of this Form S-8 includes a Reoffer Prospectus prepared in accordance with Part I of Form S-3 under the Securities Act. The Reoffer Prospectus may be utilized for reoffering and resales of up to 2,499,419 shares acquired pursuant to the Plan by selling shareholders, each of which may be deemed an "affiliate" (as such term is defined in Rule 405 under the Securities Act) of the Company.

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PROSPECTUS

2,499,419 Shares

Gastar Exploration Ltd.

Common Shares

This prospectus relates to the reoffer and resale, from time to time, of up to 2,499,419 common shares of Gastar Exploration Ltd., an Alberta corporation, held by or issuable to the selling shareholders listed on page 17 of this prospectus. The common shares being offered by the selling shareholders are outstanding securities received upon exercise of stock options under our stock option plan. See **Selling Shareholders** . Gastar will not receive any proceeds from the sale of the shares by the selling shareholders. All the proceeds from the sale of shares will be for the respective account of each selling shareholder.

For a description of the plan of distribution of the shares, please see page 19 of this prospectus.

Our common shares are listed on the Toronto Stock Exchange under the symbol **YGA** (in the U.S., **YGA.TO**) and are approved for listing, and may trade in the United States, on the American Stock Exchange under the symbol **GST**. On December 30, 2005, the last reported sale prices for our common shares on The Toronto Stock Exchange and in the United States over-the-counter market were CDN\$4.25 and \$3.63, respectively.

Investing in our common shares involves risks. Please read Risk Factors beginning on page 5.

This prospectus has not been filed in respect of, and will not qualify, any distribution of the common shares in any province or territory of Canada.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this Prospectus is January 5, 2006

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You should rely only on the information contained in this prospectus. We have not authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not making an offer to sell these securities in any jurisdiction where an offer or sale is not permitted. You should assume that the information appearing in this prospectus is accurate as of the date on the front cover of this prospectus only. Our business, financial condition, results of operations and prospects may have changed since that date.

Unless otherwise specified or the context otherwise requires, all dollar amounts in this prospectus are expressed in U.S. dollars. Canadian dollars, when used, are expressed with the symbol "CDN\$". Unless otherwise specified, where dollars are shown on a converted basis, the conversion is based upon an exchange ratio of CDN\$1.00 = \$0.8546, the exchange rate in effect on December 30, 2005, except for dollars set forth in or derived from the financial statements, where the exchange rate is derived as of the date of the financial statements.

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PROSPECTUS SUMMARY

This summary highlights information contained elsewhere in this prospectus. You should read the entire prospectus carefully, including the detailed information contained under the heading "Risk Factors", consolidated financial statements and the accompanying notes to those financial statements included elsewhere in this prospectus. Unless otherwise indicated or required by the context, (i) we, us, and our refer to Gastar Exploration Ltd. and its subsidiaries and predecessors, (ii) Geostar acquisition refers to our June 2005 acquisition from Geostar Corporation (Geostar) of additional reserves and working interests in the Powder River Basin and in East Texas, (iii) convertible debentures refers to our \$30.0 million principal amount of 9.75% convertible senior unsecured debentures, (iv) warrants refers to the warrants to purchase common shares issued to investors in connection with certain financing transactions or to our placement agents in connection with the offering of convertible debentures and certain other subordinated notes as partial compensation for their services, (v) senior secured notes refers to our \$73.0 million principal amount of senior secured notes issued in 2005, (vi) all dollar amounts appearing in this prospectus are stated in U.S. dollars unless specifically noted in Canadian dollars (CDN\$), and (vii) all financial data included in this prospectus has been prepared in accordance with generally accepted accounting principles in the United States.

Gastar Exploration Ltd.

Our Business

We are an independent energy company engaged in the exploration, development and production of natural gas and oil in the United States and Australia. Our principal business activities include the identification, acquisition, and subsequent exploration and development of natural gas and oil properties. Our emphasis is on prospective deep structures identified through seismic and other analytical techniques as well as unconventional natural gas reserves, such as coal bed methane. Our current areas for natural gas or oil activities are:

Deep Bossier play in East Texas;

Powder River Basin in Wyoming and Montana;

Gunnedah Basin in New South Wales, Australia;

Gippsland Basin in Victoria, Australia;

Appalachian Basin in West Virginia;

San Joaquin Basin in California; and

Cherokee Basin in Southeast Kansas.

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We currently are pursuing conventional natural gas exploration in the Deep Bossier play in the Hilltop area in East Texas and the Appalachian Basin in West Virginia. As of September 30, 2005, we had leases on approximately 51,800 gross acres (34,000 net) in Texas and approximately 26,700 gross acres (13,300 net) in Appalachia. For the nine months ended September 30, 2005, our daily net production from the Hilltop area averaged approximately 6.9 MMcfed, and from the Appalachian Basin, it averaged 0.1 MMcfed.

In our coal bed methane, or CBM, projects, we use industry technologies to assist us in developing commercial natural gas production from known coal beds. Our primary CBM properties are in the United States in the Powder River Basin and in the Gunnedah and Gippsland Basins of Australia. As of September 30, 2005, our acreage position in the Powder River Basin was approximately 55,800 gross acres (21,600 net), and our Australian acreage totaled approximately 3.4 million gross acres (1.8 million net). For the nine months ended September 30, 2005, our average net daily production from our CBM properties in the Powder River Basin was approximately 2.6 MMcfed. Exploration and long term production testing on our Australian CBM properties is currently underway. Thus, we currently have no natural gas sales from our Australian CBM properties.

We have not been profitable since we started our business. We incurred net losses of \$12.8 million and \$4.9 million for the years ended December 31, 2004 and 2003, respectively. We have incurred a net loss of \$20.9 million for the nine months ended September 30, 2005. Our capital has been employed in an increasingly expanding natural gas and oil exploration and development program with the focus on finding significant natural gas and oil reserves and producing from them over the long term rather than focusing on achieving immediate net income. The uncertainties described in the Risk Factors section may impede our ability to ultimately find, develop and exploit natural gas and oil reserves. As a result, we may not be able to achieve or sustain profitability or positive cash flows from operating activities in the future.

Our Strategy

Management believes that:

Natural gas is an environmentally friendly fuel that will be increasingly valued in the United States and Australia;

CBM projects provide us with lower risk exposure to long-lived natural gas production and reserves;

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We have made a significant natural gas discovery in the Deep Bossier play in the Hilltop area of East Texas that will require additional exploration and development;

We have the ability to assemble the technical and commercial resources needed to pursue these potential projects; and

Our successful development of one or more large potential natural gas projects will create substantial shareholder value.

Based on these beliefs, we have pursued a strategy that includes:

Accelerating exploration and development drilling on our Deep Bossier play in East Texas;

Combining lower risk CBM projects, such as the Powder River Basin and Australia, with higher risk conventional natural gas exploration;

Assembling a portfolio of high-potential natural gas exploration and development projects in East Texas and in the Appalachian Basin; and

Limiting capital commitments and reducing risk by maintaining financial flexibility through accessing various sources of capital and monetizing certain assets through joint venture arrangements with industry participants.

Recent Developments

Issuance of Senior Secured Notes and Common Shares. On June 17, 2005, we completed the private placement of \$63.0 million in principal amount of senior secured notes and 1,217,269 common shares. The notes bear interest at three month LIBOR plus 6% and mature on June 18, 2010. LIBOR is an abbreviation for London Interbank Offered Rate, and is the interest rate offered by a specific group of London banks for U.S. dollar deposits of a stated maturity. We also issued to the purchasers of the notes, for no additional consideration, subscription receipts entitling the holders to receive additional common shares in CDN\$4.5 million increments on each of the six, twelve and eighteen-month anniversaries of the original note issuance date valued on a five-day weighted average trading price immediately prior to the date of issuance.

On September 19, 2005, we issued to the holders of our senior secured notes an additional \$10.0 million of senior secured notes on substantially the same terms as the original June 2005 private placement, including the issuance of 206,354 common shares to the note holders. The common shares issued in the transaction represented an aggregate value of CDN\$714,286 based upon the five day weighted average trading price of CDN\$3.4615 per share for the five trading days immediately prior to closing. In connection with the sale of the additional notes, we issued subscription receipts to the purchasers of the notes, for no additional consideration, entitling the holders to receive additional common shares in CDN\$714,286 increments on each of the six, twelve and eighteen-month anniversaries of the closing date, valued on a five day weighted average trading price immediately prior to the date of issuance.

On December 19, 2005, pursuant to the Senior Secured Notes, we issued to the Senior Secured Notes holders, for no additional consideration, an additional 1,082,105 common shares valued at CDN\$4.1586, the five day weighted average trading price immediately prior to the date of issuance. Such shares were issued to the purchasers of the Senior Secured Notes on the six month anniversary of the original \$63.0 million note issuance pursuant to subscription receipts.

We have the right, exercisable quarterly to June 16, 2007, to require the original purchaser of the senior secured note to purchase additional notes in an amount limited to an additional \$10.0 million in principal. If additional notes are issued, the purchasers will also be entitled to receive, for no additional consideration, additional common shares and subscription receipts on similar terms as those issued with the original notes in a pro rata amount based on the additional principal amount of the notes. To issue these additional notes, we must meet certain requirements, as set forth in the senior secured notes.

Geostar Acquisition. Concurrently with the private placement of senior secured notes, we closed the acquisition of additional leasehold and working interest properties from Geostar in the Hilltop area of East Texas and in the Powder River Basin of Wyoming and Montana. We paid a total of \$68.5 million for the interests acquired from Geostar consisting of \$30.5 million in cash, 1,650,133 common shares valued at CDN\$4.50 per share and \$32.0 million in unsecured subordinated notes maturing on January 31, 2006. The acquisition increased our working interest position in the Hilltop area to an average of over 90% and gave us operational control of the properties. The acquisition of additional Powder River Basin interests provides us with a larger interest in properties currently being developed through an existing joint venture.

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On August 11, 2005, we executed an agreement with Geostar whereby the Geostar \$32.0 million unsecured subordinated note was cancelled. In conjunction with the note cancellation, we agreed to issue Geostar 6,373,694 common shares, calculated by dividing \$17.0 million by an assumed value of CDN\$3.25 per share and a new unsecured subordinated note for \$15.0 million. The new Geostar note bears interest, payable monthly commencing February 15, 2006, at three-month LIBOR plus 4.5% and matures November 15, 2006. The note requires monthly principal payments of \$1.5 million commencing February 15, 2006 and continuing for nine months thereafter with a final principal payment of \$1.5 million due on November 15, 2006. We may elect to pay interest in kind through the issuance of additional notes with such notes maturing on January 15, 2007. We may also be required to issue additional common shares to Geostar in the future based on the results of East Texas drilling, as described in *Certain Relationships and Related Party Transactions*. Pursuant to the terms of the Geostar agreement, we will utilize a portion of the proceeds of the Chesapeake Energy Corporation transaction to pay the Geostar note in full. See *Transaction with Chesapeake Energy Corporation* below.

Transaction with Chesapeake Energy Corporation. On November 4, 2005, we closed a transaction with Chesapeake Energy Corporation whereby Chesapeake:

Acquired approximately 27.2 million newly issued common shares from us equal to 19.9% of its then outstanding common shares for \$76.0 million (CDN\$89.9 million) in cash or CDN\$3.31 per share, before fees and expenses;

Acquired a 33.33% working interest in our Deep Bossier play in the Hilltop prospect area of Leon and Robertson Counties of East Texas; and

Formed an area of mutual interest to explore jointly in 13 counties in East Texas.

Chesapeake agreed to pay approximately \$7.8 million, before fees and expenses, to acquire the shares described above and to pay a disproportionate amount off future drilling costs described below, in exchange for an undivided 33.33% of our leasehold working interests in the Deep Bossier Hilltop prospect, less and except 160 acres surrounding each of our existing well bores. Chesapeake agreed to pay 44.44% of the drilling costs through casing point in the first six wells drilled by the parties in the Hilltop prospect to a depth sufficient to test the Deep Bossier formation (an approximate depth of 19,000 feet) in order to earn its 33.33% leasehold working interest.

Pursuant to the terms of the Geostar agreement, we will utilize a portion of the proceeds of the Chesapeake transaction to pay the Geostar note in full.

Common Share Placement. On June 30, 2005, we completed a private placement of 6,617,736 common shares at CDN\$3.31 per share. The estimated net proceeds from this placement were \$16.4 million (CDN\$20.5 million), after deducting placement fees and expenses.

Corporate Information

We are a Canadian corporation that is subsisting under the *Business Corporations Act* (Alberta). Our principal office is located at 1331 Lamar Street, Suite 1080, Houston, Texas 77010, and our telephone number is (713) 739-1800. Our website address is <http://www.gastar.com>. Information on our website or about us on any other website is not incorporated by reference into this prospectus and does not constitute a part of this prospectus.

We were originally incorporated in 1987 under the name CopperQuest Inc. pursuant to the *Business Corporations Act* (Ontario). On May 16, 2000, we continued from the Province of Ontario into the Province of Alberta to subsist pursuant to the *Business Corporations Act* (Alberta), changed our name to Gastar Exploration Ltd. and, pursuant to a reverse takeover, acquired 1075191 Ontario Ltd. and its resource property in Wyoming. Our common shares were quoted on the Canadian Dealing Network Inc. and its successor, the Canadian Venture Exchange, from June 5, 2000 until January 24, 2002 when our common shares began trading on The Toronto Stock Exchange under the symbol YGA (in the U.S., YGA.TO). Our common shares have been approved for listing on the American Stock Exchange and are expected to trade on that exchange shortly after the date of this prospectus under the symbol GST .

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THE OFFERING

Common shares to be offered by the
selling shareholders shares 2,499,419 shares

Use of proceeds We will not receive any of the proceeds from the sale of the shares by the selling shareholders. All the proceeds from the sale of shares will be for the respective accounts of the selling shareholders.

Exchange listing Our common shares are listed on the Toronto Stock Exchange under the symbol YGA (in the U.S., YGA.TO) and are approved for listing, and may trade in the United States, on the American Stock Exchange under the symbol GST .

This prospectus relates to the offer and sale, from time to time, of the common shares by selling shareholders in transactions described under Plan of Distribution . The common shares being offered by the selling shareholders are outstanding securities received upon exercise of stock options under our stock option plan

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RISK FACTORS

In addition to the other information set forth elsewhere in this prospectus, you should carefully consider the following material risk factors associated with our business and the offering of shares of our common stock when evaluating Gastar. An investment in Gastar will be subject to risks inherent in our business. The trading price of the common shares of Gastar will be affected by the performance of our business relative to, among other things, competition, market conditions and general economic and industry conditions. The value of an investment in Gastar may decrease, resulting in a loss.

Risks Related to our Business

Natural gas and oil prices are volatile and a decline in natural gas and oil prices can significantly affect our financial condition.

The success of our business greatly depends on market prices of natural gas and oil. The higher market prices are, the more likely it is that we will be financially successful. On the other hand, declines in natural gas or oil prices may materially adversely affect our financial condition, profitability and liquidity. Lower prices also may reduce the amount of natural gas or oil that we can produce economically.

Natural gas and oil are commodities whose prices are set by broad market forces. Historically, the natural gas and oil markets have been volatile. We do not see any reason why natural gas or oil prices will not continue to be volatile in the future. Prices for natural gas and oil are subject to wide fluctuations in response to relatively minor changes in the supply of and demand for natural gas or oil, market uncertainty and a variety of additional factors that are beyond our control. These factors include:

The domestic and foreign supply of natural gas and oil;

Overall economic conditions;

Weather conditions;

Political conditions in the Middle East and other oil producing regions;

Domestic and foreign governmental regulations;

The level of consumer product demand; and

The price and availability of alternative fuels.

Rising demand for natural gas to fuel power generation and to meet increasingly stringent environmental requirements has led some observers to believe that long term demand for natural gas is increasing.

Our success depends on natural gas prices in the specific areas where we operate, and these prices may be lower than prices at major markets.

Even though overall natural gas prices at major markets, such as Henry Hub in Louisiana, may be high, regional natural gas prices may move somewhat independent of broad industry price trends. Because some of our operations are located outside major markets, we are directly impacted by regional natural gas prices regardless of Henry Hub or other major market pricing. For example, surplus natural gas supplies relative to available transportation in the Powder River Basin in 2002 caused local natural gas prices to be much less than national natural gas prices, and we, therefore, were unable to take advantage of those higher national natural gas prices. Low natural gas prices in any or all of the areas where we operate would negatively impact our financial condition and results of operations.

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

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

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

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

Unexpected drilling conditions;

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

Pressure or irregularities in formations;

Equipment failures or accidents;

Adverse weather conditions;

Compliance with governmental requirements and laws, present and future; and

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

We use available seismic data to assist in the location of potential drilling sites. Even when properly used and interpreted, 2-D and 3-D seismic data and other visualization techniques are only tools used to assist geoscientists in identifying subsurface structures and hydrocarbon indicators. They do not allow the interpreter to know conclusively if hydrocarbons are present or economically producible. Poor results from our drilling activities would materially and adversely affect our future cash flows and results of operations. In addition, using seismic data and other advanced technologies involves substantial upfront costs and is more expensive than traditional drilling strategies, and we could incur losses as a result of these expenditures.

We have incurred significant net losses since our inception and may incur additional significant net losses in the future.

We have not been profitable since we started our business. We incurred net losses of \$12.8 million and \$4.9 million for the years ended December 31, 2004 and 2003, respectively. We have incurred a net loss of \$20.9 million for the nine months ended September 30, 2005. Our capital has been employed in an increasingly expanding natural gas and oil exploration and development program with the focus on finding significant natural gas and oil reserves and producing from them over the long term rather than focusing on achieving immediate net income. The uncertainties described in this section may impede our ability to ultimately find, develop and exploit natural gas and oil reserves. As a result, we may not be able to achieve or sustain profitability or positive cash flows from operating activities in the future.

Our level of indebtedness reduces our financial and operational flexibility, and our level of indebtedness may increase.

As of September 30, 2005, the principal amount of our total indebtedness was \$124.1 million. Our level of indebtedness affects our operations in several ways, including the following:

A significant portion of our cash flow must be used to service our indebtedness;

A high level of debt increases our vulnerability to general adverse economic and industry conditions;

The covenants contained in the agreements governing our outstanding indebtedness limit our ability to borrow additional funds, dispose of assets, pay dividends, sell common shares below certain prices and make certain investments;

Although we have the ability, subject to the limitations specified in the agreement, to borrow an additional \$10.0 million of senior secured notes through June 2007, the terms of our senior secured notes prohibit us from borrowing funds senior or pari passu to the senior secured notes and may limit our ability to borrow subordinated funds;

Our debt covenants may also affect our flexibility in planning for, and reacting to, changes in the economy or in our industry;

A high level of debt may impair our ability to obtain additional financing in the future for working capital, capital expenditures, acquisitions or general corporate purposes;

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A default under our senior loan covenants could result in required principal payments that we may not be able to meet, resulting in higher penalty interest rates and/or debt maturity acceleration; and

The Geostar agreement requires that we utilize a portion of the proceeds of the Chesapeake transaction to repay the \$15.0 million Geostar note in full.

We may incur additional debt, including significant additional secured indebtedness, in order to make future acquisitions or to develop our properties. A higher level of indebtedness increases the risk that we may default on our debt obligations. Our ability to meet our debt obligations and to reduce our level of indebtedness depends on our future performance. General economic conditions, natural gas and oil prices and financial, business and other factors affect our operations and our future performance. Many of these factors are beyond our control. We may not be able to generate sufficient cash flow to pay the interest on our debt and future working capital, borrowings or equity financing may not be available to pay or refinance such debt. Factors that will affect our ability to raise cash through an offering of our capital stock or a refinancing of our debt include financial market conditions, the value of our assets and our performance at the time we need capital.

If we are unable to raise substantial amounts of additional capital, we may not be able to maximize our business plan.

In order to maximize our business plan, we will need to raise substantial amounts of new capital. If we experience difficulties in raising equity or debt capital, we may be required to scale back our business plan by limiting acquisitions and our drilling and development program. Restrictions imposed under our senior secured notes may limit our ability to borrow additional funds.

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

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

There are many uncertainties inherent in estimating natural gas and oil reserves and their values, many of which are beyond our control. Reservoir engineering is a subjective process of estimating underground accumulations of natural gas or oil that cannot be measured in an exact manner. Estimates of economically recoverable natural gas or oil reserves and of future net cash flows necessarily depend on many variables and assumptions, such as:

Historical natural gas or oil production from that area, compared with production from other producing areas;

The assumed effects of regulations by governmental agencies;

Assumptions concerning future prices;

Assumptions concerning future operating costs;

Assumptions concerning severance and excise taxes; and

Assumptions concerning development costs and workover and remedial costs.

Any of these assumptions could vary considerably from actual results. For these reasons, estimates of the economically recoverable quantities of natural gas or oil attributable to any particular group of properties, classifications of those reserves based on risk recovery and estimates of the future net cash flows expected from them prepared by different engineers, or by the same engineer at different times, may vary substantially. Because of this, our reserve estimates may materially change at any time.

You should not consider the present values of estimated future net cash flows referred to in this prospectus to be the current market value of the estimated reserves attributable to our properties. The estimated discounted future net cash flows from proved reserves are generally based on prices and costs in effect when the estimate is made. However, actual future prices and costs may be materially higher or lower. Actual future net cash flows also will be affected by factors such as:

The amount and timing of actual production, supply and demand for natural gas or oil;

Curtailments or increases in consumption by natural gas or oil purchasers;

Changes in governmental regulations or taxation; and

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The timing of both production and expenses in connection with the development and production of natural gas or oil properties.

In this prospectus, the net present value of future net revenues is calculated using a 10% discount rate. This rate is not necessarily the most appropriate discount factor based on interest rates in effect from time to time and risks associated with our reserves or the natural gas and oil industry in general.

The imprecise nature of estimating proved natural gas and oil reserves, future downward revisions of proved reserves and increased drilling expenditures without current additions to proved reserves may lead to write downs in the carrying value of our natural gas and oil properties.

Due to the imprecise nature of estimating natural gas and oil reserves as well as the potential volatility in natural gas and oil prices and their effect on the carrying value of our natural gas and oil properties, write downs in the future may be required as a result of factors that may negatively affect the present value of proved natural gas and oil reserves. These factors can include volatile natural gas and oil prices, downward revisions in estimated proved natural gas and oil reserve quantities, limited classification of proved reserves associated with successful wells and unsuccessful drilling activities.

A majority of our proved reserves are classified as proved developed non-producing and proved undeveloped and may ultimately prove to be less than estimated.

At December 31, 2004, approximately 77% of our total proved reserves were classified as proved developed non-producing and proved undeveloped. It will take substantial capital to recomplete or drill our non-producing and undeveloped locations. Further, our drilling efforts may be delayed or unsuccessful, and actual reserves may prove to be less than current reserve estimates, which could have a material effect on our financial condition and results of operations.

Deficiencies of title to our leased interests could significantly affect our financial condition.

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

We may experience shortages of equipment and personnel, which could significantly disrupt or delay our operations.

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From time to time, there has been a general shortage of drilling rigs, equipment, supplies and oilfield services in North America and Australia, which we believe may intensify because of current increased industry activity. In addition, the costs and delivery times of rigs, equipment and supplies have risen. Shortages of drilling rigs, equipment, supplies or trained personnel could delay and adversely affect our operations and drilling plans, which could have an adverse effect on our results of operations. While we intend to enter into contracts for the services of drilling rigs in North America and Australia, we may not be successful in doing so.

The demand for, and wage rates of, qualified rig crews have begun to rise in the drilling industry due to the increasing number of active rigs in service. Personnel shortages have occurred in the past during times of increasing demand for drilling services. If the number of active drilling rigs increases, we may experience shortages of qualified personnel to operate our drilling rigs, which could delay our drilling operations and adversely affect our business.

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

Our exploration and production interests and operations are subject to stringent and complex federal, state and local laws and regulations governing the operation and maintenance of our facilities and the handling and discharge of substances into the environment. These existing laws and regulations impose numerous obligations that are applicable to our interests and operations including:

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Air and water discharge permits for drilling and production operations;

Drilling and abandonment bonds or other financial responsibility assurances;

Reports concerning operations;

Spacing of wells;

Access to properties, particularly in the Powder River Basin;

Taxation; and

Other regulatory controls on operating activities.

In addition, regulatory agencies have from time to time imposed price controls and limitations on production by restricting the flow rate of wells below actual production capacity in order to conserve supplies of natural gas and oil.

Failure to comply with environmental and other laws and regulations applicable to our interests and operations could result in the assessment of administrative, civil, and criminal penalties, the imposition of remedial requirements, and the issuance of orders enjoining or limiting future operations; any of which could have a material adverse affect on our financial condition. Legal requirements are sometimes unclear and are frequently changed in response to economic or political conditions. As a result, it is hard to predict the ultimate cost of compliance with these requirements or their affect on our interests and operations. In addition, existing laws or regulations, as currently interpreted or reinterpreted in the future, or future laws or regulations may have a material adverse affect on our results of operations.

The production, handling, storage, transportation and disposal of natural gas and oil, by-products of natural gas and oil and other substances produced or used in connection with natural gas and oil production operations are regulated by laws and regulations focused on the protection of human health and the environment. Consequently, the discharge or release of natural gas, oil or other substances into the air, soil or water could subject us to liabilities arising from environmental cleanup and restoration costs, claims made by neighboring landowners and other third parties for personal injury and property damage, and fines or penalties for related violations of environmental laws or regulations. Moreover, the possibility exists that stricter laws, regulations or enforcement policies could significantly increase our compliance costs and the cost of any remediation that may become necessary. We may not be able to recover some or any of these costs from insurance.

Our Australian operations are subject to unique risks relating to Aboriginal land claims and government licenses.

Our Australian operations could be affected by native title claims by Aboriginal groups. Australian law recognizes that in some instances native title, that is the laws and customs of the Aboriginal inhabitants, has survived European settlement. Native title will only survive if it has not been extinguished. Native title may be extinguished by an Act of Government, such as the creation of a title that is inconsistent with native title. This may include a grant of the right to exclusive possession through freehold title or lease. Native title may also be extinguished if the connection between the land and the group of Aboriginal people claiming native title has been lost. Each authority to prospect, and license in areas in which we desire to engage in exploration or production activities must be examined individually in order to determine the validity of any native title claim. We may be required to negotiate with any Aborigines who can make a valid claim to having ancestral ties to the areas in which we desire

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to engage in exploration or production activities. These negotiations could both delay the timing of our exploration or production activities, as well as add an additional layer of cost or a requirement to share revenues if any Aboriginal claimants are proved to have native title rights in the exploration areas. Approximately 27.5% of our Gippsland Basin property in Victoria may be subject to native title claims. We have been informed by the government of New South Wales that the proportion of land within PEL 238 in the Gunnedah Basin, New South Wales, which is potentially subject to native title claims, cannot be readily determined.

The process of drilling for and producing natural gas and oil involves many operating risks that can cause substantial losses, and we may not have enough insurance to cover these risks adequately.

The natural gas and oil business involves many operating hazards, such as:

Well blowouts, fires and explosions;

Surface craterings and casing collapses;

Uncontrollable flows of natural gas, oil or well fluids;

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Pipe and cement failures;

Formations with abnormal pressures;

Stuck drilling and service tools;

Pipeline ruptures or spills;

Natural disasters; and

Releases of toxic natural gas.

Any of these events could cause substantial losses to us as a result of:

Injury or death;

Damage to and destruction of property, natural resources and equipment;

Pollution and other environmental damage;

Regulatory investigations and penalties;

Suspension of operations; and

Repair and remediation costs.

We could also be responsible for environmental damage caused by previous owners of property that we purchase or lease. As a result, we may incur substantial liabilities to third parties or governmental entities. See Business Governmental Regulation and Business Environmental Regulation . Although we maintain what we believe is appropriate and customary insurance for these risks, the insurance may not be available or sufficient to cover all of these liabilities. If these liabilities are not covered by our insurance, paying them could reduce or eliminate the funds available for exploration, development or acquisitions or result in the loss of our properties.

Approximately 75% of our revenues for the nine months ended September 30, 2005 was from the production of wells located in our Deep Bossier play in East Texas. Any disruption in production or our ability to process and sell our natural gas production from this area would have an adverse effect on our results of operations.

Production of natural gas could unexpectedly be disrupted or curtailed due to reservoir or mechanical problems. Additionally, a majority of our East Texas production is processed through two on-site processing facilities. If these facilities ceased to operate, were destroyed or otherwise

needed replacement, it could require 60 to 90 days to replace either one or both of these facilities. A 60 to 90 day curtailment of our east Texas production could reduce current revenues by \$4.0 to \$6.0 million, with a corresponding reduction in our cash flow.

Our ability to market our natural gas and oil may be impaired by capacity constraints on the gathering systems and pipelines that transport our natural gas and oil.

The availability of a ready market for our natural gas production depends on the proximity of our reserves to and the capacity of natural gas gathering systems, pipelines and trucking or terminal facilities. We enter into agreements with companies that own pipelines used to transport natural gas from the wellhead to contract destination. Those pipelines are limited in size and volume of natural gas flow. Should production begin, other outstanding contracts with other producers and developers could interfere with our access to a natural gas line to deliver natural gas to the market. We do not own or operate any natural gas lines or distribution facilities. Further, interstate transportation and distribution of natural gas is regulated by the federal government through the Federal Energy Regulatory Commission, or FERC. FERC sets rules and carries out administratively the oversight of interstate markets for natural gas and other energy policy. Among FERC's powers is the ability to dictate sale and delivery of natural gas to any markets it oversees.

Additionally, state regulators have vast powers over sale, supply and delivery of natural gas and oil within their state borders. While we do employ certain companies to represent our interests before state regulatory agencies, our interests may not receive favorable rulings from any state agency, or some future occurrence may drastically alter our ability to enter into contracts or deliver natural gas to the market.

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Competition in the natural gas and oil industry is intense, and we are smaller and have a more limited operating history than most of our competitors and increased competitive pressure could adversely affect our results of operations.

We operate in a highly competitive environment. We compete with other natural gas and oil companies in all areas of our operations, including the acquisition of exploratory prospects and proven properties. Our competitors include major integrated natural gas and oil companies, numerous independent natural gas and oil companies, individuals and drilling and income programs. Many of our competitors are large, well-established companies that have substantially larger operating staffs and greater capital resources than we do and that, in many instances, have been engaged in the natural gas and oil business for a much longer time than we have. These companies may be able to pay more for exploratory prospects and productive natural gas and oil properties and may be able to define, evaluate, bid for and purchase more properties and prospects than our financial and human resources permit. In addition, these companies may be able to spend more on the existing and changing technologies that we believe are and will be increasingly important to the current and future success of natural gas and oil companies. Our ability to explore for natural gas and oil prospects and to acquire additional properties in the future will depend on our ability to conduct our operations, to evaluate and select suitable properties and to consummate transactions in this highly competitive environment. Increased competitive pressure could adversely affect our results of operations.

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

Where appropriate, we may evaluate and pursue acquisition opportunities on terms our management considers favorable. In particular, we expect to pursue acquisitions that have the potential to economically increase our natural gas and oil reserves. The successful acquisition of natural gas and oil properties requires an assessment of:

Recoverable reserves;

Exploration potential;

Future natural gas and oil prices;

Operating costs;

Potential environmental and other liabilities; and

Permitting and other environmental authorizations required for our operations.

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

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

Problems integrating the purchased operations, personnel or technologies;

Unanticipated costs;

Diversion of resources and management attention from our exploration business;

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

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