

PETROHAWK ENERGY CORP
Form 10-Q
May 05, 2011

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2011

Commission file number 001-33334

PETROHAWK ENERGY CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

86-0876964
(I.R.S. Employer
Identification Number)

1000 Louisiana, Suite 5600, Houston, Texas 77002
(Address of principal executive offices including ZIP code)

(832) 204-2700
(Registrant's telephone number)

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

Title of each class	Name of each exchange on which registered
Common Stock, par value \$.001 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: **None**

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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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a
smaller reporting company)

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

As of April 27, 2011 the Registrant had 303,787,055 shares of Common Stock, \$.001 par value, outstanding.

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Special note regarding forward-looking statements

This Quarterly Report on Form 10-Q contains, and we may from time to time otherwise make in other public filings, press releases and presentations, forward-looking statements within the meaning of the federal securities laws. All statements, other than statements of historical facts, concerning, among other things, planned capital expenditures, potential increases in oil and natural gas production, the number and location of wells to be drilled in the future, future cash flows and borrowings, pursuit of potential acquisition opportunities, our financial position, business strategy and other plans and objectives for future operations, are forward-looking statements. These forward-looking statements are identified by their use of terms and phrases such as "may," "expect," "estimate," "project," "plan," "believe," "intend," "achievable," "anticipate," "will," "continue," "potential," "should," "could" and similar terms and phrases. Although we believe that the expectations reflected in these forward-looking statements are reasonable, they do involve certain assumptions, risks and uncertainties. Actual results could differ materially from those anticipated in these forward-looking statements. One should consider carefully the statements under the "Risk Factors" section of this report and in our Annual Report on Form 10-K for the year ended December 31, 2010 and the other disclosures contained herein and therein, which describe factors that could cause our actual results to differ from those anticipated in the forward-looking statements, including, but not limited to, the following factors:

our ability to successfully develop our large inventory of undeveloped acreage in our resource plays such as the Haynesville, Lower Bossier, and Eagle Ford Shales;

volatility in commodity prices for oil and natural gas;

the possibility that our industry may be subject to future regulatory or legislative actions (including any additional taxes and changes in environmental regulation);

the presence or recoverability of estimated oil and natural gas reserves and the actual future production rates and associated costs;

the potential for production decline rates for our wells to be greater than we expect;

our ability to generate sufficient cash flow from operations, borrowings or other sources to enable us to fully develop our undeveloped acreage positions;

our ability to replace oil and natural gas reserves;

environmental risks;

drilling and operating risks;

exploration and development risks;

competition, including competition for acreage in resource play areas;

management's ability to execute our plans to meet our goals;

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our ability to retain key members of senior management and key technical employees;

the cost and availability of goods and services, such as drilling rigs, fracture stimulation services and tubulars;

access to and availability of water and other treatment materials to carry out planned fracture stimulations in our resource plays;

access to adequate gathering systems and transportation take-away capacity, necessary to fully execute our capital program;

our ability to secure firm transportation and other marketing outlets for the natural gas, natural gas liquids and crude oil and condensate we produce and to sell these products at market prices;

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general economic conditions, whether internationally, nationally or in the regional and local market areas in which we do business, may be less favorable than expected, including the possibility that the economic conditions in the United States will worsen and that capital markets are disrupted, which could adversely affect demand for oil and natural gas and make it difficult to access financial markets;

social unrest, political instability, armed conflict, or acts of terrorism or sabotage in oil and natural gas producing regions, such as the Middle East, or our markets; and

other economic, competitive, governmental, legislative, regulatory, geopolitical and technological factors that may negatively impact our business, operations or pricing.

All forward-looking statements are expressly qualified in their entirety by the cautionary statements in this paragraph and elsewhere in this document. Other than as required under the securities laws, we do not assume a duty to update these forward-looking statements, whether as a result of new information, subsequent events or circumstances, changes in expectations or otherwise.

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements (Unaudited)****PETROHAWK ENERGY CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)****(In thousands, except per share amounts)**

	Three Months Ended March 31,	
	2011	2010
Operating revenues:		
Oil and natural gas	\$ 350,208	\$ 300,591
Marketing	140,544	130,119
Midstream	972	7,072
Total operating revenues	491,724	437,782
Operating expenses:		
Marketing	154,898	136,622
Production:		
Lease operating	12,611	17,395
Workover and other	4,876	2,378
Taxes other than income	11,735	12,760
Gathering, transportation and other	52,895	28,156
General and administrative	39,975	32,034
Depletion, depreciation and amortization	157,312	104,768
Total operating expenses	434,302	334,113
Amortization of deferred gain	48,468	
Income from operations	105,890	103,669
Other income (expenses):		
Net (loss) gain on derivative contracts	(50,907)	214,703
Interest expense and other	(66,803)	(62,846)
Equity investment income	13,571	
Total other income (expenses)	(104,139)	151,857
Income from continuing operations before income taxes	1,751	255,526
Income tax provision	(571)	(99,234)
Income from continuing operations, net of income taxes	1,180	156,292
Loss from discontinued operations, net of income taxes	(2,408)	(157)
Net (loss) income	\$ (1,228)	\$ 156,135

Net (loss) income per share:

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Basic:		
Continuing operations	\$	\$ 0.52
Discontinued operations		
 Total	 \$	 \$ 0.52
Diluted:		
Continuing operations	\$	\$ 0.52
Discontinued operations		
 Total	 \$	 \$ 0.52
Weighted average shares outstanding:		
Basic	301,021	300,157
Diluted	305,039	302,668

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

Table of Contents**PETROHAWK ENERGY CORPORATION****CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)****(In thousands, except share and per share amounts)**

	March 31, 2011	December 31, 2010
Current assets:		
Cash	\$ 1,541	\$ 1,591
Accounts receivable	376,045	356,597
Receivables from derivative contracts	163,111	217,018
Prepays and other	35,568	62,831
Total current assets	576,265	638,037
Oil and natural gas properties (full cost method):		
Evaluated	8,205,478	7,520,446
Unevaluated	2,538,432	2,387,037
Gross oil and natural gas properties	10,743,910	9,907,483
Less accumulated depletion	(4,928,072)	(4,774,579)
Net oil and natural gas properties	5,815,838	5,132,904
Other operating property and equipment:		
Gas gathering systems and equipment	204,010	150,372
Other operating assets	57,671	55,315
Gross other operating property and equipment	261,681	205,687
Less accumulated depreciation	(22,534)	(19,194)
Net other operating property and equipment	239,147	186,493
Other noncurrent assets:		
Goodwill	932,802	932,802
Other intangible assets, net of amortization	86,579	89,342
Debt issuance costs, net of amortization	50,278	45,941
Deferred income taxes	229,818	258,570
Receivables from derivative contracts	36,962	41,721
Assets held for sale		74,448
Equity investment	214,664	217,240
Other	4,402	6,944
Total assets	\$ 8,186,755	\$ 7,624,442
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,009,737	\$ 787,238
Deferred income taxes	16,386	48,499
Liabilities from derivative contracts	32,202	5,820
Payable to equity affiliate	99	976
Long-term debt	14,815	14,790
Total current liabilities	1,073,239	857,323
Long-term debt	2,973,709	2,612,852
Other noncurrent liabilities:		
Liabilities from derivative contracts	36,904	13,575
Asset retirement obligations	34,368	31,741
Deferred gain on sale	515,653	564,121

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Other	563	544
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Common stock: 500,000,000 shares of \$.001 par value authorized; 303,748,482 and 302,489,501 shares issued and outstanding at March 31, 2011 and December 31, 2010, respectively	304	302
Additional paid-in capital	4,640,868	4,631,609
Accumulated deficit	(1,088,853)	(1,087,625)
Total stockholders' equity	3,552,319	3,544,286
Total liabilities and stockholders' equity	\$ 8,186,755	\$ 7,624,442

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

Table of Contents**PETROHAWK ENERGY CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**

(In thousands)

	Three Months Ended March 31,	
	2011	2010
Cash flows from operating activities:		
Net (loss) income	\$ (1,228)	\$ 156,135
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depletion, depreciation and amortization	157,312	106,074
Income tax (benefit) provision	(911)	99,138
Loss on sale	3,950	
Stock-based compensation	6,680	4,089
Net unrealized loss (gain) on derivative contracts	114,965	(190,095)
Amortization of deferred gain	(48,468)	
Equity investment income	(13,571)	
Distributions from equity affiliate	16,147	
Other operating	11,169	8,349
Change in assets and liabilities:		
Accounts receivable	(21,794)	(20,368)
Prepays and other	27,263	(8,452)
Accounts payable and accrued liabilities	(10,343)	(21,673)
Payable to equity affiliate	(877)	
Other	2,758	20,975
Net cash provided by operating activities	243,052	154,172
Cash flows from investing activities:		
Oil and natural gas capital expenditures	(682,898)	(638,999)
Proceeds received from sale of oil and natural gas properties	76,026	16,676
Proceeds received from sale of Fayetteville gas gathering systems	76,898	
Marketable securities purchased	(155,000)	(226,000)
Marketable securities redeemed	155,000	226,000
Increase in restricted cash	(295,748)	
Decrease in restricted cash	295,748	177,528
Other operating property and equipment capital expenditures	(54,315)	(72,591)
Net cash used in investing activities	(584,289)	(517,386)
Cash flows from financing activities:		
Proceeds from exercise of stock options	3,734	503
Proceeds from borrowings	1,449,500	571,000
Repayment of borrowings	(1,100,677)	(204,968)
Debt issuance costs	(7,250)	
Other	(4,120)	(3,439)
Net cash provided by financing activities	341,187	363,096
Net decrease in cash	(50)	(118)
Cash at beginning of period	1,591	1,511

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Cash at end of period	\$	1,541	\$	1,393
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The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. FINANCIAL STATEMENT PRESENTATION

Petrohawk Energy Corporation (Petrohawk or the Company) is an independent oil and natural gas company engaged in the exploration, development and production of predominately natural gas properties located in the United States. The Company operates in two segments, oil and natural gas production and midstream operations. The unaudited condensed consolidated financial statements include the accounts of all majority-owned, controlled subsidiaries. The Company uses the equity method to account for investments in which the Company does not have a majority interest, but does have significant influence. All intercompany accounts and transactions have been eliminated. Certain prior year amounts have been reclassified to conform to the current year presentation. These unaudited condensed consolidated financial statements reflect, in the opinion of the Company's management, all adjustments, consisting only of normal and recurring adjustments, necessary to present fairly the financial position as of, and the results of operations for, the periods presented. During interim periods, Petrohawk follows the accounting policies disclosed in its 2010 Annual Report on Form 10-K, filed with the United States Securities and Exchange Commission (SEC). Please refer to the footnotes in the 2010 Annual Report on Form 10-K when reviewing interim financial results.

Use of Estimates

The preparation of the Company's unaudited condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States requires the Company's management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, if any, at the date of the unaudited condensed consolidated financial statements and the reported amounts of revenues and expenses during the respective reporting periods. The Company bases its estimates and judgments on historical experience and on various other assumptions and information that are believed to be reasonable under the circumstances. Estimates and assumptions about future events and their effects cannot be perceived with certainty and, accordingly, these estimates may change as new events occur, as more experience is acquired, as additional information is obtained and as the Company's operating environment changes. Actual results may differ from the estimates and assumptions used in the preparation of the Company's unaudited condensed consolidated financial statements.

Interim period results are not necessarily indicative of results of operations or cash flows for the full year and accordingly, certain information normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States has been condensed or omitted. The Company has evaluated events or transactions through the date of issuance of these unaudited condensed consolidated financial statements.

Marketing Revenue and Expense

A subsidiary of the Company purchases and sells the Company's own and third party natural gas produced from wells which the Company and third parties operate. The revenues and expenses related to these marketing activities are reported on a gross basis as part of operating revenues and operating expenses. Marketing revenues are recorded at the time natural gas is physically delivered to third parties at a fixed or index price. Marketing expenses attributable to gas purchases are recorded as the Company takes physical title to natural gas and transports the purchased volumes to the point of sale.

Table of Contents**PETROHAWK ENERGY CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)****1. FINANCIAL STATEMENT PRESENTATION (Continued)****Midstream Revenues**

Revenues from the Company's midstream operations are derived from providing gathering and treating services for the Company and other owners in wells which the Company and third parties operate. Revenues are recognized when services are provided at a fixed or determinable price, collectability is reasonably assured and evidenced by a contract. The midstream operations segment does not take title to the natural gas for which services are provided, with the exception of imbalances that are monthly cash settled. The imbalances are recorded using published natural gas market prices.

Gas Gathering Systems and Equipment and Other Operating Assets

Gas gathering systems and equipment are recorded at cost. Depreciation is calculated using the straight-line method over a 30-year estimated useful life. Upon disposition, the cost and accumulated depreciation are removed and any gains or losses are reflected in current operations. Maintenance and repair costs are charged to operating expense as incurred. Material expenditures which increase the life of an asset are capitalized and depreciated over the estimated remaining useful life of the asset. The Company capitalized \$0.7 million and \$1.2 million of interest for the three months ended March 31, 2011 and 2010, respectively, related to the construction of the Company's gas gathering systems and equipment.

Gas gathering systems and equipment as of March 31, 2011 and December 31, 2010 consisted of the following:

	March 31, 2011	December 31, 2010 ⁽¹⁾
(In thousands)		
Gas gathering systems and equipment	\$ 204,010	\$ 305,096
Less accumulated depreciation	(4,248)	(13,729)
Net gas gathering systems and equipment	\$ 199,762	\$ 291,367

(1)

Includes gas gathering systems and equipment of approximately \$155 million and related accumulated depreciation of approximately \$11 million associated with the Fayetteville Shale midstream assets, which were classified as "Assets held for sale" in the unaudited condensed consolidated balance sheet at December 31, 2010. "Assets held for sale" were recorded at the lesser of the carrying amount or the fair value less costs to sell, which resulted in a write down of approximately \$69.7 million that was recorded in the year ended December 31, 2010. "Assets held for sale" were approximately \$74 million as of December 31, 2010. The Company divested its Fayetteville Shale midstream operations on January 7, 2011.

Other operating property and equipment are recorded at cost. Depreciation is calculated using the straight-line method over the following estimated useful lives: automobiles, leasehold improvements, furniture and equipment, five years or the lesser of lease term; rental equipment, seven years; and computers, three years. Upon disposition, the cost and accumulated depreciation are removed and any gains or losses are reflected in current operations. Maintenance and repair costs are charged to operating expense as incurred. Material expenditures which increase the life of an asset are capitalized and depreciated over the estimated remaining useful life of the asset.

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

1. FINANCIAL STATEMENT PRESENTATION (Continued)

The Company reviews its gas gathering systems and equipment and other operating assets in accordance with ASC 360, *Property, Plant, and Equipment* (ASC 360). ASC 360 requires the Company to evaluate gas gathering systems and equipment and other operating assets as events occur or circumstances change that would more likely than not reduce the fair value below the carrying amount. If the carrying amount is not recoverable from its undiscounted cash flows, then the Company would recognize an impairment loss for the difference between the carrying amount and the current fair value. Further, the Company evaluates the remaining useful lives of its gas gathering systems and equipment and other operating assets at each reporting period to determine whether events and circumstances warrant a revision to the remaining depreciation periods.

Equity Method Investment

On May 21, 2010, the Company contributed its Haynesville Shale gas gathering and treating business for a 50% membership interest in a new joint venture entity, KinderHawk Field Services LLC (KinderHawk), and approximately \$917 million in cash. The Company's investment in KinderHawk, in which the Company does not have a majority interest, but does have significant influence, is accounted for under the equity method of accounting. Under the equity method of accounting, the Company's share of net income (loss) from KinderHawk is reflected as an increase (decrease) in its investment account in "*Other noncurrent assets*" and is also recorded as "*Equity investment income*" in "*Other income (expenses)*." Distributions from KinderHawk are recorded as reductions of the Company's investment and contributions to KinderHawk are recorded as increases of the Company's investment. The Company reviews its equity method investment for potential impairment whenever events or changes in circumstances indicate that an other-than-temporary decline in the value of the investment has occurred. See Note 13, "*Equity Method Investment*," for further discussion.

Amortization of Deferred Gain

As part of the KinderHawk transaction, the Company contributed its Haynesville Shale gathering and treating business in Northwest Louisiana to KinderHawk and Kinder Morgan contributed approximately \$917 million (\$875 million for a 50% membership interest in KinderHawk and \$42 million for certain closing adjustments, including 2010 capital expenditures through the closing date) in cash to the new entity which was distributed to the Company. At May 21, 2010, as a result of the transaction, the Company recorded a deferred gain of approximately \$719.4 million for the difference between 50% of the net carrying value of the assets it contributed to the joint venture and the net cash proceeds from KinderHawk, representing the cash contributed by Kinder Morgan at closing for its 50% membership interest in KinderHawk. The Company will recognize the portion of the deferred gain equal to its capital commitment as contributions to KinderHawk are made or upon expiration of the capital commitment at December 31, 2011. In addition to the capital commitment, the Company guaranteed to deliver certain minimum volumes of natural gas through the Haynesville gathering system through May 2015. The Company will recognize the remaining deferred gain as volumes are delivered through the Haynesville gathering system through May 2015. The recognition of the deferred gain is included in "*Amortization of deferred gain*" in the unaudited condensed consolidated statements of operations.

Table of Contents**PETROHAWK ENERGY CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)****1. FINANCIAL STATEMENT PRESENTATION (Continued)****Goodwill**

Goodwill represents the excess of the purchase price over the estimated fair value of the assets acquired net of the fair value of liabilities assumed in an acquisition. ASC 350, *Intangibles Goodwill and Other* (ASC 350) requires that intangible assets with indefinite lives, including goodwill, be evaluated on an annual basis for impairment or more frequently if events occur or circumstances change that could potentially result in impairment. The goodwill impairment test requires the allocation of goodwill and all other assets and liabilities to reporting units. The Company has determined that it has two reporting units: oil and natural gas production and midstream operations. All of the Company's goodwill has been allocated to its oil and natural gas production reporting unit as all of its historical goodwill relates to its acquisitions of oil and natural gas properties.

Other Intangible Assets

The Company treats the costs associated with acquired transportation contracts as other intangible assets. The initial amount recorded represents the fair value of the contract at the time of acquisition, which is amortized using the straight-line method over the life of the contract. Any unamortized balance of the Company's other intangible assets is subject to impairment testing pursuant to the *Impairment or Disposal of Long-Lived Assets Subsections* of ASC Subtopic 360-10. The Company reviews its intangible assets for potential impairment whenever events or changes in circumstances indicate that an other-than-temporary decline in the value of the investment has occurred.

Amortization expense was \$2.8 million for the three months ended March 31, 2011 and 2010, and was allocated to operating expenses between "Marketing" and "Gathering, transportation and other" on the unaudited condensed consolidated statements of operations based on the usage of the contract. The estimated amortization expense will be approximately \$11.1 million per year for the remainder of the contract through 2019.

Other intangible assets subject to amortization at March 31, 2011 and December 31, 2010 are as follows:

	March 31, 2011	December 31, 2010
	(In thousands)	
Transportation contracts	\$ 105,108	\$ 105,108
Less accumulated amortization	(18,529)	(15,766)
Net transportation contracts	\$ 86,579	\$ 89,342

Assets Held for Sale

As discussed in Note 2, "Acquisitions and Divestitures," the Company divested its Fayetteville Shale midstream operations on January 7, 2011 for approximately \$75 million in cash, before customary closing adjustments. The Company's assets related to the Fayetteville Shale midstream operations were presented separately as "Assets held for sale" in the unaudited condensed consolidated balance sheet at December 31, 2010, in accordance with ASC 360. Assets held for sale were recorded at the lesser of the carrying amount or the fair value less costs to sell, which resulted in a write down of the carrying amount of approximately \$69.7 million that was recorded in the year ended December 31, 2010.

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

1. FINANCIAL STATEMENT PRESENTATION (Continued)

Discontinued Operations

Certain amounts related to the Company's Fayetteville Shale midstream operations and other operating property and equipment have been reclassified to discontinued operations for all periods presented. Unless otherwise noted, information contained in the notes to the unaudited condensed consolidated financial statements relates to the Company's continuing operations. See Note 14, "Discontinued Operations," for further discussion of the presentation of the Company's Fayetteville Shale midstream and other operating assets as discontinued operations.

Recently Issued Accounting Pronouncements

In December 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-28, *When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts* (ASU 2010-28). This codification update modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts and requires reporting units with such carrying amounts to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. ASU 2010-28 is effective for fiscal years and interim periods beginning after December 15, 2010 and early adoption is not permitted. The Company adopted the provisions of this update for the three months ended March 31, 2011 and will apply the provisions of ASU 2010-28 when the Company's annual goodwill test is performed in 2011. The Company does not expect a material impact on its operating results, financial position, cash flows or disclosures as a result of the adoption.

In December 2010, the FASB issued ASU No. 2010-29, *Disclosure of Supplementary Pro Forma Information for Business Combinations* (ASU 2010-29). ASU 2010-29 requires a public entity who discloses comparative pro forma information for business combinations that occurred in the current reporting period to disclose revenue and earnings of the combined entity as though the business combination(s) occurred as of the beginning of the comparable prior annual period only. This update also expands the supplemental pro forma disclosures required to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. ASU 2010-29 is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010 and early adoption is permitted. The Company will apply the provisions of this update for any business combinations that occur after January 1, 2011.

2. ACQUISITIONS AND DIVESTITURES

Divestitures

Fayetteville Shale

On December 22, 2010, the Company completed the sale of its interest in natural gas properties and other operating property and equipment in the Fayetteville Shale for \$575 million in cash, before customary closing adjustments. Proceeds from the sale of the interest in natural gas properties were recorded as a reduction to the carrying value of the Company's full cost pool with no gain or loss recorded. In conjunction with the sale of the other operating property and equipment, the Company recorded a loss of approximately \$0.5 million in the year ended December 31, 2010. On January 7, 2011, the Company completed the sale of its midstream assets in the Fayetteville Shale for

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

2. ACQUISITIONS AND DIVESTITURES (Continued)

approximately \$75 million in cash, before customary closing adjustments. As of December 31, 2010, the Fayetteville Shale midstream assets were classified as "*Assets held for sale*" on the Company's unaudited condensed consolidated balance sheet. "*Assets held for sale*" were recorded at the lesser of the carrying amount or the fair value less costs to sell, which resulted in a write down of the carrying amount of approximately \$69.7 million in the year ended December 31, 2010. Both transactions had an effective date of October 1, 2010.

Mid-Continent Properties

On September 29, 2010, the Company completed the sale of its interest in certain Mid-Continent properties in Texas, Oklahoma and Arkansas for \$123 million in cash, before customary closing adjustments. Proceeds from the sale were recorded as a reduction to the carrying value of the Company's full cost pool with no gain or loss recorded. The transaction had an effective date of July 1, 2010.

Hawk Field Services, LLC Joint Venture

On May 21, 2010, Hawk Field Services, LLC (Hawk Field Services), a wholly owned subsidiary of Petrohawk, and KM Gathering LLC (Kinder Morgan), an affiliate of Kinder Morgan Energy Partners, L.P., a publicly traded master limited partnership, formed a new joint venture pursuant to a Formation and Contribution Agreement (Contribution Agreement). The new joint venture entity, KinderHawk, engages in the natural gas midstream business in Northwest Louisiana, focused on the Haynesville and Lower Bossier Shales. Pursuant to the Contribution Agreement, Hawk Field Services contributed to KinderHawk its Haynesville Shale gathering and treating business in Northwest Louisiana, and Kinder Morgan contributed approximately \$917 million in cash (\$875 million for a 50% membership interest in KinderHawk and \$42 million for certain closing adjustments including 2010 capital expenditures through the closing date) to KinderHawk. Each of Hawk Field Services and Kinder Morgan own a 50% membership interest in KinderHawk. KinderHawk distributed approximately \$917 million to Hawk Field Services. The joint venture had an economic effective date of January 1, 2010, and Hawk Field Services continued to operate the business until September 30, 2010, at which date Hawk Field Services and Kinder Morgan terminated the transition services agreement and KinderHawk assumed operations of the joint venture. The Company accounts for its interest in KinderHawk under the equity method of accounting.

The Company is obligated to deliver to KinderHawk agreed upon minimum annual quantities of natural gas from Petrohawk operated wells producing from the Haynesville and Lower Bossier Shales with specified acreage in Northwest Louisiana through May 2015, or in the alternative, pay an annual true-up fee to KinderHawk if such minimum annual quantities are not delivered. The Company pays KinderHawk negotiated gathering and treating fees, subject to an annual inflation adjustment factor. The gathering fee is equal to \$0.34 per thousand cubic feet (Mcf) of natural gas delivered at KinderHawk's receipt points. The treating fee is charged for gas delivered containing more than 2% by volume of carbon dioxide. For gas delivered containing between 2% and 5.5% carbon dioxide, the treating fee is between \$0.030 and \$0.345 per Mcf, and for gas containing over 5.5% carbon dioxide, the treating fee starts at \$0.365 per Mcf and increases on a scale of \$0.09 per Mcf for each additional 1% of carbon dioxide content. KinderHawk charges included in "*Gathering, transportation and other*" in the unaudited condensed consolidated statements of operations totaled approximately \$27 million for the three months ended March 31, 2011.

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

2. ACQUISITIONS AND DIVESTITURES (Continued)

Terryville

On May 12, 2010, the Company completed the sale of its interest in Terryville Field, located in Lincoln and Claiborne Parishes, Louisiana for \$320 million in cash, before customary closing adjustments. Proceeds from the sale were recorded as a reduction to the carrying value of the Company's full cost pool with no gain or loss recorded. The transaction had an effective date of January 1, 2010. In conjunction with the closing, the Company deposited \$75 million with a qualified intermediary to facilitate like-kind exchange transactions all of which had been spent as of December 31, 2010.

West Edmond Hunton Lime Unit

On April 30, 2010, the Company completed the sale of its interest in the West Edmond Hunton Lime Unit (WEHLU) Field in Oklahoma County, Oklahoma for \$155 million in cash, before customary closing adjustments. Proceeds from the sale were recorded as a reduction to the carrying value of the Company's full cost pool with no gain or loss recorded. The transaction had an effective date of April 1, 2010.

3. OIL AND NATURAL GAS PROPERTIES

The Company uses the full cost method of accounting for its investment in oil and natural gas properties. Under this method of accounting, all costs of acquisition, exploration and development of oil and natural gas reserves (including such costs as leasehold acquisition costs, geological expenditures, dry hole costs, tangible and intangible development costs and direct internal costs) are capitalized as the cost of oil and natural gas properties when incurred. To the extent capitalized costs of evaluated oil and natural gas properties, net of accumulated depletion exceed the discounted future net revenues of proved oil and natural gas reserves net of deferred taxes, such excess capitalized costs are charged to expense. Beginning December 31, 2009, full cost companies use the unweighted arithmetic average first day of the month price for oil and natural gas for the 12-month period preceding the calculation date to calculate the future net revenues of proved reserves.

The Company assesses all items classified as unevaluated property on a quarterly basis for possible impairment or reduction in value. The Company assesses properties on an individual basis or as a group if properties are individually insignificant. The assessment includes consideration of the following factors, among others: intent to drill; remaining lease term; geological and geophysical evaluations; drilling results and activity; the assignment of proved reserves; and the economic viability of development if proved reserves are assigned. During any period in which these factors indicate an impairment, the cumulative drilling costs incurred to date for such property and all or a portion of the associated leasehold costs are transferred to the full cost pool and are then subject to amortization.

At March 31, 2011 the ceiling test value of the Company's reserves was calculated based on the first day average of the 12-months ended March 31, 2011 of the West Texas Intermediate (WTI) spot price of \$83.55 per barrel, adjusted by lease or field for quality, transportation fees, and regional price differentials, and the first day average of the 12-months ended March 31, 2011 of the Henry Hub price of \$4.10 per million British thermal units (Mmbtu), adjusted by lease or field for energy content, transportation fees, and regional price differentials. Using these prices, the Company's net book value of oil and natural gas properties at March 31, 2011, did not exceed the ceiling amount. Changes in production rates, levels of reserves, future development costs, and other factors will determine the Company's actual ceiling test calculation and impairment analyses in future periods.

Table of Contents**PETROHAWK ENERGY CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)****3. OIL AND NATURAL GAS PROPERTIES (Continued)**

At March 31, 2010 the ceiling test value of the Company's reserves was calculated based on the first day average of the 12-months ended March 31, 2010 of the WTI posted price of \$69.64 per barrel, adjusted by lease or field for quality, transportation fees, and regional price differentials, and the first day average of the 12-months ended March 31, 2010 of the Henry Hub price of \$3.99 per Mmbtu, adjusted by lease or field for energy content, transportation fees, and regional price differentials. Using these prices, the Company's net book value of oil and natural gas properties at March 31, 2010, did not exceed the ceiling amount.

4. LONG-TERM DEBT

Long-term debt as of March 31, 2011 and December 31, 2010 consisted of the following:

	March 31, 2011 ⁽¹⁾	December 31, 2010 ⁽¹⁾
(In thousands)		
Senior revolving credit facility	\$ 364,000	\$ 146,000
7.25% \$1.2 billion senior notes ⁽²⁾	1,232,371	825,000
10.5% \$600 million senior notes ⁽³⁾	564,262	562,115
7.875% \$800 million senior notes	800,000	800,000
7.125% \$275 million senior notes ⁽⁴⁾		268,922
Deferred premiums on derivatives	13,076	10,815
	\$ 2,973,709	\$ 2,612,852

- (1) Table excludes \$14.6 million of deferred premiums on derivative contracts which have been classified as current at March 31, 2011 and December 31, 2010. Table also excludes \$0.2 million of 9.875% senior notes due 2011 which have been classified as current at March 31, 2011 and December 31, 2010.
- (2) On August 17, 2010 and January 31, 2011, the Company issued an initial \$825 million principal amount and an additional \$400 million principal amount, respectively, of its 7.25% senior notes due 2018. Amount includes a \$7.4 million premium at March 31, 2011, recorded by the Company in conjunction with the issuance of the additional \$400 million principal amount. See "7.25% Senior Notes" below for more details.
- (3) Amount includes a \$35.8 million and \$37.9 million discount at March 31, 2011 and December 31, 2010, respectively, recorded by the Company in conjunction with the issuance of the 10.5% \$600 million senior notes. See "10.5% Senior Notes" below for more details.
- (4) The 7.125% \$275 million senior notes were redeemed during the first quarter of 2011. Amount includes a \$3.5 million discount at December 31, 2010, recorded by the Company in conjunction with the assumption of the notes. See "7.125% Senior Notes" below for more details.

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

4. LONG-TERM DEBT (Continued)

Senior Revolving Credit Facility

Effective August 2, 2010, the Company amended and restated its existing credit facility dated October 14, 2009 by entering into the Fifth Amended and Restated Senior Revolving Credit Agreement (the Senior Credit Agreement), among the Company, each of the lenders from time to time party thereto (the Lenders), BNP Paribas, as administrative agent for the Lenders, Bank of America, N.A. and Bank of Montreal as co-syndication agents for the Lenders, and JPMorgan Chase Bank, N.A. and Wells Fargo Bank, N.A., as co-documentation agents for the Lenders. The Senior Credit Agreement provides for a \$2.0 billion facility. As of March 31, 2011, the borrowing base was approximately \$1.6 billion, \$1.5 billion of which related to the Company's oil and natural gas properties and up to \$100 million (currently limited as described below) related to the Company's midstream assets. The portion of the borrowing base relating to the Company's oil and natural gas properties is redetermined on a semi-annual basis (with the Company and the Lenders each having the right to one annual interim unscheduled redetermination) and adjusted based on the Company's oil and natural gas properties, reserves, other indebtedness and other relevant factors. The component of the borrowing base relating to the Company's midstream assets is limited to the lesser of \$100 million or 3.5 times midstream earnings before interest, taxes, depreciation and amortization (EBITDA), and is calculated quarterly. As of March 31, 2011, the midstream component of the borrowing base was limited to approximately \$95.2 million based on midstream EBITDA. At March 31, 2011, the Company had approximately \$34.7 million outstanding letters of credit with various customers, vendors and others. The Company's borrowing base is subject to a reduction equal to the product of \$0.25 multiplied by the stated principal amount (without regard to any initial issue discount) of any unsecured senior or senior subordinated notes that the Company may issue.

Amounts outstanding under the Senior Credit Agreement bear interest at specified margins over the London Interbank Offered Rate (LIBOR) of 2.00% to 3.00% for Eurodollar loans or at specified margins over the Alternate Base Rate (ABR) of 1.00% to 2.00% for ABR loans. Such margins will fluctuate based on the utilization of the facility. Borrowings under the Senior Credit Agreement are secured by first priority liens on substantially all of the Company's assets, including pursuant to the terms of the Fifth Amended and Restated Guarantee and Collateral Agreement, all of the assets of, and equity interests in, the Company's subsidiaries. Amounts drawn down on the facility will mature on July 1, 2014.

The Senior Credit Agreement contains customary financial and other covenants, including minimum working capital levels (the ratio of current assets plus the unused commitment under the Senior Credit Agreement to current liabilities) of not less than 1.0 to 1.0 and minimum coverage of interest expenses (as defined in the Senior Credit Agreement) of not less than 2.5 to 1.0. In addition, the Company is subject to covenants limiting dividends and other restricted payments, transactions with affiliates, incurrence of debt, changes of control, asset sales, and liens on properties. At March 31, 2011, the Company was in compliance with its financial debt covenants under the Senior Credit Agreement.

See Note 15, "*Subsequent Event*" for discussion of the amendment of the Company's Senior Credit Agreement subsequent to March 31, 2011.

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

4. LONG-TERM DEBT (Continued)

7.25% Senior Notes

On August 17, 2010, the Company completed a private placement offering to eligible purchasers of an aggregate principal amount of \$825 million of its 7.25% senior notes due 2018 (the initial 2018 Notes) at a purchase price of 100% of the principal amount of the initial 2018 Notes. The initial 2018 Notes were issued under and are governed by an indenture dated August 17, 2010, between the Company, U.S. Bank Trust National Association, as trustee, and the Company's subsidiaries named therein as guarantors (the 2018 Indenture). The Company applied the net proceeds from the sale of the initial 2018 Notes to redeem its 9.125% \$775 million senior notes due 2013.

On January 31, 2011, the Company completed the issuance of an additional \$400 million aggregate principal amount of its 7.25% senior notes due 2018 (the additional 2018 Notes) in a private placement to eligible purchasers. The additional 2018 Notes are issued under the same Indenture and are part of the same series as the initial 2018 Notes. The additional 2018 Notes together with the initial 2018 Notes are collectively referred to as the 2018 Notes.

The additional 2018 Notes were sold to Barclays Capital Inc. at 101.875% of the aggregate principal amount of the additional 2018 Notes plus accrued interest. The net proceeds from the sale of the additional 2018 Notes were approximately \$400.5 million (after deducting offering fees and expenses). A portion of the proceeds of the additional 2018 Notes were utilized to redeem all of the Company's outstanding 7.125% \$275 million senior notes due 2012.

Interest on the 2018 Notes is payable on February 15 and August 15 of each year, beginning on February 15, 2011. Interest on the 2018 Notes accrued from August 17, 2010, the original issuance date of the series. The 2018 Notes are senior unsecured obligations of the Company and rank equally with all of the Company's current and future senior indebtedness. The 2018 Notes are jointly and severally, fully and unconditionally guaranteed on a senior unsecured basis by the Company's subsidiaries. Petrohawk Energy Corporation, the issuer of the 2018 Notes, has no material independent assets or operations apart from the assets and operations of its subsidiaries.

On or prior to August 15, 2013, the Company may redeem up to 35% of the aggregate principal amount of the 2018 Notes with the net cash proceeds of certain equity offerings at a redemption price of 107.25% of the principal amount, plus accrued and unpaid interest to the redemption date; provided that at least 65% in aggregate principal amount of the 2018 Notes originally issued under the 2018 Indenture remain outstanding immediately after the redemption. In addition, at any time prior to August 15, 2014, the Company may redeem some or all of the 2018 Notes for the principal amount, plus accrued and unpaid interest, plus a make whole premium equal to the excess, if any of (a) the present value at such time of (i) the redemption price of such note at August 15, 2014, (ii) any required interest payments due on the notes (except for currently accrued and unpaid interest), computed using a discount rate equal to the Treasury Rate plus 50 basis points, discounted to the redemption date on a semi-annual basis, over (b) the principal amount of such note.

On or after August 15, 2014, the Company may redeem all or part of the 2018 Notes at any time or from time to time at the redemption prices (expressed as a percentage of principal amount) set

Table of Contents**PETROHAWK ENERGY CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)****4. LONG-TERM DEBT (Continued)**

forth in the following table plus accrued and unpaid interest, if any, to the applicable redemption date, if redeemed during the 12-month period beginning August 15 of the years indicated below:

Year	Percentage
2014	103.625
2015	101.813
2016 and thereafter	100.000

The Company may be required to offer to repurchase the 2018 Notes at a purchase price of 101% of the principal amount, plus accrued and unpaid interest, if any, to the redemption date, in the event of a change of control as defined in the 2018 Indenture. The 2018 Indenture contains covenants that, among other things, restrict or limit the ability of the Company and its subsidiaries to: borrow money; pay dividends on stock; purchase or redeem stock or subordinated indebtedness; make investments; create liens; enter into transactions with affiliates; sell assets; and merge with or into other companies or transfer all or substantially all of the Company's assets.

In conjunction with the issuance of the additional 2018 Notes, the Company recorded a premium of \$7.5 million to be amortized over the remaining life of the notes utilizing the effective interest rate method. The remaining unamortized premium was \$7.4 million at March 31, 2011.

10.5% Senior Notes

On January 27, 2009, the Company completed a private placement offering to eligible purchasers of an aggregate principal amount of \$600 million of its 10.5% senior notes due 2014 (the 2014 Notes). The 2014 Notes were issued under and are governed by an indenture dated January 27, 2009, between the Company, U.S. Bank Trust National Association, as trustee, and the Company's subsidiaries named therein as guarantors (the 2014 Indenture).

The 2014 Notes bear interest at a rate of 10.5% per annum, payable semi-annually on February 1 and August 1 of each year. The 2014 Notes will mature on August 1, 2014. The 2014 Notes are senior unsecured obligations of the Company and rank equally with all of its current and future senior indebtedness. The 2014 Notes are jointly and severally, fully and unconditionally guaranteed on a senior unsecured basis by the Company's subsidiaries. Petrohawk Energy Corporation, the issuer of the 2014 Notes, has no material independent assets or operations apart from the assets and operations of its subsidiaries.

In conjunction with the issuance of the 2014 Notes, the Company recorded a discount of \$52.3 million to be amortized over the remaining life of the notes utilizing the effective interest rate method. The remaining unamortized discount was \$35.8 million at March 31, 2011.

7.875% Senior Notes

On May 13, 2008 and June 19, 2008, the Company issued \$500 million principal amount and \$300 million principal amount, respectively, of its 7.875% senior notes due 2015 (the 2015 Notes). The 2015 Notes were issued under and are governed by an indenture dated May 13, 2008, between the Company, U.S. Bank Trust National Association, as trustee, and the Company's subsidiaries named therein as guarantors.

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

4. LONG-TERM DEBT (Continued)

The 2015 Notes bear interest at a rate of 7.875% per annum, payable semi-annually on June 1 and December 1 of each year. The 2015 Notes will mature on June 1, 2015. The 2015 Notes are senior unsecured obligations of the Company and rank equally with all of its current and future senior indebtedness. The 2015 Notes are jointly and severally, fully and unconditionally guaranteed on a senior unsecured basis by the Company's subsidiaries. Petrohawk Energy Corporation, the issuer of the 2015 Notes, has no material independent assets or operations apart from the assets and operations of its subsidiaries.

7.125% Senior Notes

On July 12, 2006, the date of the Company's merger with KCS Energy, Inc. (KCS), the Company assumed (pursuant to the Second Supplemental Indenture relating to the 7.125% Senior Notes, also referred to as the 2012 Notes), and subsidiaries of the Company guaranteed (pursuant to the Third Supplemental Indenture relating to such notes), all the obligations (approximately \$275 million) of KCS under the 2012 Notes and the Indenture dated April 1, 2004 (the 2012 Indenture) among KCS, U.S. Bank National Association, as trustee, and the subsidiary guarantors named therein, which governs the terms of the 2012 Notes. Interest on the 2012 Notes is payable semi-annually, on each April 1 and October 1. The 2012 Notes are jointly and severally, fully and unconditionally guaranteed on a senior unsecured basis by the Company's subsidiaries. Petrohawk Energy Corporation, the issuer of the 2012 Notes, has no material independent assets or operations apart from the assets and operations of its subsidiaries.

In conjunction with the assumption of the 7.125% Senior Notes from KCS, the Company recorded a discount of \$13.6 million to be amortized over the remaining life of the notes utilizing the effective interest rate method. The Company had no remaining unamortized discount at March 31, 2011 and \$3.5 million at December 31, 2010.

On March 17, 2011, the Company redeemed all of the outstanding 2012 Notes with a portion of the proceeds received from the issuance of the additional 2018 Notes.

9.875% Senior Notes

On April 8, 2004, Mission Resources Corporation (Mission) issued \$130 million of its 9.875% senior notes due 2011 (the 2011 Notes). The Company assumed these notes upon the closing of the Company's merger with Mission. In conjunction with the Company's merger with KCS, the Company repurchased substantially all of the 2011 Notes. There were approximately \$0.2 million of the notes were not redeemed and are still outstanding and classified as current as of March 31, 2011 and December 31, 2010. In connection with the extinguishment of substantially all of the 2011 Notes, the Company requested and received from the noteholders consent to eliminate the debt covenants associated with the 2011 Notes.

On April 1, 2011, the Company repaid the \$0.2 million of 2011 Notes that were outstanding.

Debt Issuance Costs

The Company capitalizes certain direct costs associated with the issuance of long-term debt. During the first quarter of 2011, the Company capitalized approximately \$7.3 million in costs associated with its issuance of the additional 2018 Notes. In the first quarter of 2011, the Company wrote off

Table of Contents**PETROHAWK ENERGY CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)****4. LONG-TERM DEBT (Continued)**

\$0.2 million of debt issuance costs as a result of the additional 2018 Notes issuance and the corresponding reduction of the Company's Senior Credit Agreement's borrowing base. At March 31, 2011 and December 31, 2010, the Company had approximately \$50.3 million and \$45.9 million, respectively, of debt issuance costs remaining that are being amortized over the lives of the respective debt.

5. FAIR VALUE MEASUREMENTS

Pursuant to ASC 820, *Fair Value Measurements and Disclosures* (ASC 820) the Company's determination of fair value incorporates not only the credit standing of the counterparties involved in transactions with the Company resulting in receivables on the Company's unaudited condensed consolidated balance sheets, but also the impact of the Company's nonperformance risk on its own liabilities. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). The Company utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable. The Company classifies fair value balances based on the observability of those inputs.

The following tables set forth by level within the fair value hierarchy the Company's financial assets and liabilities that were accounted for at fair value as of March 31, 2011 and December 31, 2010. As required by ASC 820, a financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. There were no transfers between fair value hierarchy levels for the three months ended March 31, 2011 and for the year ended December 31, 2010.

	March 31, 2011			Total
	Level 1	Level 2	Level 3	
	(In thousands)			
Assets:				
Receivables from derivative contracts	\$	\$ 200,073	\$	\$ 200,073