CONTANGO OIL & GAS CO
Form 10-K
September 13, 2010

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended June 30, 2010

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

For the transition period from to

Commission file number 001-16317

CONTANGO OIL & GAS COMPANY

(Exact name of registrant as specified in its charter)

Delaware	**95-4079863**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**

3700 Buffalo Speedway, Suite 960

Houston, Texas 77098

(Address of principal executive offices)

(713) 960-1901

(Registrant s telephone number, including area code)

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

Common Stock, Par Value $0.04 per share	**NYSE Amex**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 x 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

Large accelerated filer ¨	Accelerated filer x
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	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 x

At December 31, 2009, the aggregate market value of the registrant s common stock held by non-affiliates (based upon the closing sale price of shares of such common stock as reported on the NYSE Amex was $589,189,869. As of August 31, 2010, there were 15,664,666 shares of the registrant s common stock outstanding.

Documents Incorporated by Reference

Items 10, 11, 12, 13 and 14 of Part III have been omitted from this report since registrant will file with the Securities and Exchange Commission, not later than 120 days after the close of its fiscal year, a definitive proxy statement, pursuant to Regulation 14A. The information required by Items 10, 11, 12, 13 and 14 of this report, which will appear in the definitive proxy statement, is incorporated by reference into this Form 10-K.

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED JUNE 30, 2010

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PART III

CAUTIONARY STATEMENT ABOUT FORWARD-LOOKING STATEMENTS

Some of the statements made in this report may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934, as amended. The words and phrases should be , will be , believe , expect , anticipate , estimate , forecast , goal and similar expressions identify forward-looking statements and express our expectations about future events. These include such matters as:

Our financial position

Business strategy, including outsourcing

Meeting our forecasts and budgets

Anticipated capital expenditures

Drilling of wells

Natural gas and oil production and reserves

Timing and amount of future discoveries (if any) and production of natural gas and oil

Operating costs and other expenses

Cash flow and anticipated liquidity

Prospect development

Property acquisitions and sales

- New governmental laws and regulations

Although we believe the expectations reflected in such forward-looking statements are reasonable, such expectations may not occur. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from actual future results expressed or implied by the forward-looking statements. These factors include among others:

- Low and/or declining prices for natural gas and oil
- Natural gas and oil price volatility
- Operational constraints, start-up delays and production shut-ins at both operated and non-operated production platforms, pipelines and gas processing facilities
- The risks associated with acting as the operator in drilling deep high pressure and temperature wells in the Gulf of Mexico
- The risks associated with exploration, including cost overruns and the drilling of non-economic wells or dry holes, especially in prospects in which the Company has made a large capital commitment relative to the size of the Company s capitalization structure
- The timing and successful drilling and completion of natural gas and oil wells
- Availability of capital and the ability to repay indebtedness when due

- Availability of rigs and other operating equipment
- Ability to raise capital to fund capital expenditures
- Timely and full receipt of sale proceeds from the sale of our production
- The ability to find, acquire, market, develop and produce new natural gas and oil properties
- Interest rate volatility
- Uncertainties in the estimation of proved reserves and in the projection of future rates of production and timing of development expenditures
- Operating hazards attendant to the natural gas and oil business
- Downhole drilling and completion risks that are generally not recoverable from third parties or insurance
- Potential mechanical failure or under-performance of significant wells, production facilities, processing plants or pipeline mishaps
- Weather
- Availability and cost of material and equipment
- Delays in anticipated start-up dates
- Actions or inactions of third-party operators of our properties
- Actions or inactions of third-party operators of pipelines or processing facilities
- Ability to find and retain skilled personnel
- Strength and financial resources of competitors

- Federal and state regulatory developments and approvals
- Environmental risks
- Worldwide economic conditions
- The ability to construct and operate offshore infrastructure, including pipeline and production facilities
- The continued compliance by the Company with various pipeline and gas processing plant specifications for the gas and condensate produced by the Company
- Drilling and operating costs, production rates and ultimate reserve recoveries in our Eugene Island 10 (Dutch) and State of Louisiana (Mary Rose) acreage
- Restrictions on permitting activities
- Expanded rigorous monitoring and testing requirements
- Legislation that may regulate drilling activities and increase or remove liability caps for claims of damages from oil spills
- Ability to obtain insurance coverage on commercially reasonable terms
- Accidental spills, blowouts and pipeline ruptures
- Impact of potential legislative and regulatory changes on Gulf of Mexico operating and safety standards due to the Deepwater Horizon incident

You should not unduly rely on these forward-looking statements in this report, as they speak only as of the date of this report. Except as required by law, we undertake no obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances occurring after the date of this report or to reflect the occurrence of unanticipated events. See the information under the heading Risk Factors referred to on page 14 of this report for some of the important factors that could affect our financial performance or could cause actual results to differ materially from estimates contained in forward-looking statements.

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All references in this Form 10-K to the Company , Contango , we , us or our are to Contango Oil & Gas Company and wholly-owned Subsidiaries. Unless otherwise noted, all information in this Form 10-K relating to natural gas and oil reserves and the estimated future net cash flows attributable to those reserves are based on estimates prepared by independent engineers and are net to our interest.

PART I

Item 1. Business

Overview

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

Our Strategy

Our exploration strategy is predicated upon two core beliefs: (1) that the only competitive advantage in the commodity-based natural gas and oil business is to be among the lowest cost producers and (2) that virtually all the exploration and production industry s value creation occurs through the drilling of successful exploratory wells. As a result, our business strategy includes the following elements:

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

Using our limited capital availability to increase our reward/risk potential on selective prospects. We have concentrated our risk investment capital in our offshore Gulf of Mexico prospects. Exploration prospects are inherently risky as they require large amounts of capital with no guarantee of success. COI drills and operates our offshore prospects. Should we be successful in any of our offshore prospects, we will have the opportunity to spend significantly more capital to complete development and bring the discovery to producing status.

Operating in the Gulf of Mexico. COI was formed for the purpose of drilling and operating exploration wells in the Gulf of Mexico. While the Company has historically drilled turnkey wells, adverse weather conditions as well as difficulties encountered while drilling our offshore wells could cause our contracts to come off turnkey and thus lead to significantly higher drilling costs.

Sale of proved properties. From time-to-time as part of our business strategy, we have sold and in the future expect to continue to sell some or a substantial portion of our proved reserves and assets to capture current value, using the sales proceeds to further our offshore exploration activities. Since its inception, the Company has sold approximately $484 million worth of natural gas and oil properties, and views periodic reserve sales as an opportunity to capture value, reduce reserve and price risk, and as a source of funds for potentially higher rate of return natural gas and oil exploration opportunities.

Controlling general and administrative and geological and geophysical costs. Our goal is to be among the most efficient in the industry in revenue and profit per employee and among the lowest in general and administrative costs. We plan to continue outsourcing our geological, geophysical, and reservoir engineering and land functions, and partnering with cost efficient operators. We have eight employees.

Structuring transactions to share risk. JEX, our alliance partner, shares in the upfront costs and the risk of our exploration prospects.

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Structuring incentives to drive behavior. We believe that equity ownership aligns the interests of our employees and stockholders. Our directors and executive officers beneficially own or have voting control over approximately 22% of our common stock.

Exploration Alliance with JEX

JEX is a private company formed for the purpose of assembling domestic natural gas and oil prospects. Under our agreement with JEX, JEX generates natural gas and oil prospects and evaluates exploration prospects generated by others. JEX focuses on the Gulf of Mexico, and generates offshore exploration prospects either individually, or via our affiliated company, Republic Exploration, LLC (REX) (see Offshore Gulf of Mexico Exploration Joint Ventures below). Prior to June 1, 2010, JEX would also generate offshore exploration prospects via a second company affiliated with us, Contango Offshore Exploration, LLC (COE). Effective June 1, 2010, COE was dissolved and all properties owned by COE were transferred to its respective members. We do not have a written agreement with JEX which contractually obligates them to provide us their services.

Offshore Gulf of Mexico Exploration Joint Ventures

Contango, through its wholly-owned subsidiary COI, and its partially-owned affiliate, REX, conducts exploration activities in the Gulf of Mexico. As of August 31, 2010, Contango, through COI and REX, had an interest in 28 offshore leases. See Offshore Properties below for additional information on our offshore properties.

Contango Operators, Inc

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

The Company s offshore production consists of 11 wells located on federal and State of Louisiana leases in the shallow waters of the Gulf of Mexico. These 11 wells produce via the following three platforms:

Eugene Island 11 Platform

As of August 31, 2010, the Company-owned and operated platform at Eugene Island 11 was processing approximately 54 Mmcfed, net to Contango. This platform was designed with a capacity of 500 million cubic feet per day (Mmcfd) and 6,000 barrels of oil per day (bopd). This platform services production from the Company s four Mary Rose wells and Eloise North well, which are all located in State of Louisiana waters, as well as our Dutch #4 well and Eloise South well, which are both located in federal waters. From the Eugene Island 11 platform, the gas and condensate flow to our Eugene Island 63 auxiliary platform via our 20 pipeline, which has been designed with a capacity of 330 Mmcfd and 6,000 bopd, and then from the Eugene Island 63 auxiliary platform to third-party owned and operated on-shore processing facilities near Patterson, Louisiana.

On February 24, 2010, a dredge contracted by the Army Corps of Engineers to dredge the Atchafalaya River Channel ruptured the Company s 20 pipeline that runs from our Eugene Island 11gathering platform to our Eugene Island 63 auxiliary platform. All wells serviced by the platform were immediately shut-in upon pipeline rupture, and we immediately implemented our spill response plan. The Company estimates that a minimal and immaterial quantity of production was lost. The pipeline was repaired and production resumed on March 31, 2010. We believe the repairs will be covered by our insurance policy subject to a deductible. We have an approximate 53% ownership interest in the pipeline.

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Eugene Island 24 Platform

The third-party owned and operated production platform at Eugene Island 24 was processing approximately 30 Mmcfed, net to Contango as of August 31, 2010. This platform was designed with a capacity of 100 Mmcfd and 3,000 bopd. This platform services production from the Company s Dutch #1, #2 and #3 federal wells.

Ship Shoal 263 Platform

Ship Shoal 263 (Nautilus) was spud in October 2009 and announced as a discovery in January 2010. The Company-owned and operated Ship Shoal 263 platform was designed with a capacity of 40 Mmcfd and 5,000 bopd. This platform services production from our Nautilus well which began producing in June 2010 and is currently producing approximately 18 Mmcfed, net to Contango.

Other Activities

In March 2010, we obtained a farm-in and spud a well on block Eugene Island 10 to drill a well on our Eloise South prospect. This well was spud in March 2010, announced as a discovery in June 2010, and began producing in July 2010. The well tested the Rob L sands identified in our Eloise North well, and was drilled in a location so that upon depletion of our Eloise South well, our well bore may be completed up-hole and produce in the Cib-op sand as our Dutch #5 well. The Company has a 26.9% working interest (21.5% net revenue interest) in Eloise South, inclusive of our ownership interest in REX, and a 47.05% working interest (38.1% net revenue interest) in Dutch #5. As of August 31, 2010, the Company had invested approximately $12.7 million, inclusive of our ownership interest in REX, to drill, complete and bring the well to production.

In the third quarter of the fiscal year ended June 30, 2010 we drilled two dry holes in the Gulf of Mexico. The first was on a farm-in we obtained on block Vermillion 155 (Paisano). This well had a dry hole cost of approximately $5.3 million and the Company had a 100% working interest. The second was our Matagorda Island 617 well (Dude), which was drilled in mid-February 2010 and determined to be a dry hole in April 2010. This well had a dry hole cost of approximately $14.9 million and the Company had a 100% working interest.

During the fiscal year ended June 30, 2010, COI was awarded three lease blocks from the Western Gulf of Mexico Lease Sale No. 210 held on August 19, 2009, five leases from the State of Texas Lease Sale held on October 6, 2009, and three lease blocks from the Central Gulf of Mexico Lease Sale No. 213 held on March 17, 2010. COI was awarded the following leases for the following bid amounts:

Matagorda Island Block 607	$ 317,000
Matagorda Island Block 616	$ 317,000
Matagorda Island Block 617	$ 1,017,000
Galveston Area 248L	$ 144,000
Galveston Area 276L	$ 144,000
Galveston Area 277L (N/2 of NE/4)	$ 291,787
Galveston Area 277 L (S/2 of NE/4)	$ 144,000
Galveston Area 338S	$ 64,000
Ship Shoal 121	$ 3,017,777
Ship Shoal 122	$ 277,777
Vermillion 170	$ 3,017,777

During the fiscal year ended June 30, 2009, the Company s Mary Rose #1 well was successfully worked over at a cost of approximately $11.5 million ($6.1 million net to Contango), to reduce water production from a water bearing sand above our production reservoir. We also installed line heaters at the Eugene Island 11 platform which allowed us to further increase our production rate. Production had been constrained due to entrained water that attached to the paraffin in our condensate. The line heaters were installed at a cost of approximately $1.9 million ($0.9 million net to Contango).

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The Company s Mary Rose #2 well was successfully worked over in May 2009 at a cost of approximately $5.6 million ($3.0 million net to Contango), to also reduce water production from a water bearing sand above our production reservoir.

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

During the fiscal year ended June 30, 2008, the Company acquired additional working interests in the Eugene Island 10 (Dutch) and State of Louisiana (Mary Rose) discoveries in a like-kind exchange, using funds from the sale of its Arkansas Fayetteville Shale properties held by a qualified intermediary. The Company purchased an additional 12.5 % working interest and 10.0% net revenue interest in Dutch and an additional average 13.67% working interest and 10.0% net revenue interest in Mary Rose from three different companies for $300 million. The Company also purchased an additional 0.3% overriding royalty interest in the Dutch and Mary Rose discoveries for $9.0 million.

Republic Exploration LLC (REX)

West Delta 36, a REX prospect, is operated by a third party. The Company depends on a third-party operator for the operation and maintenance of this production platform. As of August 31, 2010, the well was temporarily shut-in. As of August 25, 2010 however, the well was producing at an 8/8ths rate of approximately 2.9 million cubic feet equivalent per day (Mmcfed). REX has a 25.0% working interest (WI), and a 20.0% net revenue interest (NRI), in this well.

During the fiscal year ended June 30, 2009, COI spud Eugene Island 56 #1 (High Country West) and West Delta 77 (Devil s Elbow), both REX prospects, which were both determined to be dry holes. COI had a 100% WI and paid 100% of the drilling costs for both wells totaling approximately $16.5 million. These costs together with associated leasehold costs and prospect fees of approximately $2.3 million are reflected as exploration expenses in the Company s Consolidated Statements of Operations for the fiscal year ended June 30, 2009.

During the fiscal year ended June 30, 2009, the Company sold a portion of its ownership interest in REX to an existing member of REX for approximately $0.8 million. This sale decreased the Company s equity ownership interest in REX to its present 32.3%. REX was formed for the purpose of generating exploration opportunities in the Gulf of Mexico. REX focuses on identifying prospects, acquiring leases at federal and state lease sales and then selling the prospects to third parties, including Contango, subject to timed drilling obligations plus retained reversionary interests in favor of REX. See Exhibit 21.2 for an organizational chart of our subsidiaries.

During the fiscal year ended June 30, 2008, the members of REX entered into an Amended and Restated Limited Liability Company Agreement (the REX LLC Agreement), effective as of April 1, 2008, to, among other things, distribute REX s interest in Dutch and Mary Rose to the individual members of REX or their designees. In connection with this distribution, REX repaid in full all amounts owed by REX to a private investment firm under a $50.0 million demand promissory note with such private investment firm (the REX Demand Note). All security interests and other liens granted in favor of such private investment firm as security for the obligations under the REX Demand Note have been released and terminated. The Company s portion of such repayment was approximately $22.5 million.

Contango Offshore Exploration LLC (COE)

Prior to its dissolution on June 1, 2010, the Company owned a 65.6% equity interest in COE. As of June 1, 2010, COE had borrowed $4.3 million from the Company under a non-recourse promissory note (the Note) payable on demand. As of June 1, 2010, accrued and unpaid interest on the Note was approximately $1.6 million. In connection with the dissolution, the Company assumed its 65.6% share of the obligation under the Note, while the other member of COE assumed the remaining 34.4%, or approximately $2 million. This $2 million is reflected as a receivable in the Consolidated Balance Sheet of the Company as of June 30, 2010.

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Prior to its dissolution, COE had generated three prospects which were all drilled by COI: Ship Shoal 263, Grand Isle 70 and Grand Isle 72. In connection with its dissolution, COE distributed its ownership interest in Ship Shoal 263 to its members. As a result, Contango has a working interest of approximately 92.46% and a net revenue interest of approximately 74% in this well. As of August 31, 2010 we had invested approximately $38.2 million to drill, complete and bring Ship Shoal 263 to full production status.

Grand Isle 70 (Red Queen) was drilled in July 2006 and was temporarily abandoned while alternative development scenarios were being evaluated. Effective December 1, 2009 the Company and COE sold their respective interests in Grand Isle 70 to an independent third-party oil and gas company in exchange for an overriding royalty interest. The Company subsequently sold its overriding royalty interests to JEX for a gain of $112,868.

Grand Isle 72 (Liberty) ceased producing in October 2009 and the well was plugged and abandoned in June 2010. The Company invested approximately $500,000 to permanently abandon the site. This lease was relinquished to the Bureau of Ocean Energy Management, Regulation and Enforcement (BOEMRE) (previously the Minerals Management Service) during the fourth quarter of our fiscal year ending June 30, 2010.

In June 2010, the Company withdrew from Ship Shoal 358, a COE prospect, and transferred all future plugging and abandonment liabilities to the third party operator responsible for operation and maintenance of the production platform.

Impact of Hurricanes Gustav and Ike

During the fiscal year ended June 2009, Hurricanes Gustav and Ike moved through the Gulf of Mexico and it was necessary for us to shut-in our Dutch and Mary Rose production at various times before, during and after the storms. Our offshore facilities sustained minor damage from Hurricane Ike. Repairs were completed on the damaged wells at an 8/8ths cost of approximately $2.4 million, which was covered by the Company s insurance subject to a deductible. The on-shore third-party processing and pipeline facilities on which we rely, however, incurred significant damage from Hurricane Ike and necessitated approximately three months of downtime for our production while repairs were being made.

Offshore Properties

Producing Properties. The following table sets forth the interests owned by Contango through its related entities in the Gulf of Mexico which were producing natural gas or oil as of August 31, 2010:

Area/Block	WI	NRI	Status
Contango Operators, Inc.:			
Eugene Island 10 #D-1 (Dutch #1)	47.05%	38.1%	Producing
Eugene Island 10 #E-1 (Dutch #2)	47.05%	38.1%	Producing
Eugene Island 10 #F-1 (Dutch #3)	47.05%	38.1%	Producing
Eugene Island 10 #G-1 (Dutch #4)	47.05%	38.1%	Producing
Eugene Island 10 #I-1 (Eloise South)	23.76%	19.0%	Producing
S-L 18640 #1 (Mary Rose #1)	53.21%	40.5%	Producing
S-L 19266 #1 (Mary Rose #2)	53.21%	38.7%	Producing
S-L 19266 #2 (Mary Rose #3)	53.21%	38.7%	Producing
S-L 18860 #1 (Mary Rose #4)	34.58%	25.5%	Producing
S-L 19266 #3 (Eloise North)	36.90%	26.9%	Producing
Ship Shoal 263	92.46%	74.0%	Producing
Republic Exploration LLC			
West Delta 36	25.0%	20.0%	Producing

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Leases. The following table sets forth the interests owned by Contango through its related entities in leases in the Gulf of Mexico as of August 31, 2010:

Area/Block	WI	Lease Date	Expiration Date
Contango Operators, Inc.:			
Ship Shoal 14	50.00%	May-06	May-11
Viosca Knoll 383 (1)	(2)	Jun-06	Jun-11
S-L 19261	53.21%	Feb 07	Feb 12
S-L 19396	53.21%	Jun 07	Jun 12
Eugene Island 11	53.21%	Dec 07	Dec-12
East Breaks 369 (1)(3)	(4)	Dec-03	Dec-13
East Breaks 370 (1)	65.63%	Dec-03	Dec-13
Galveston Area 248L	100.00%	Oct-09	Oct-14
Galveston Area 276L	100.00%	Oct-09	Oct-14
Galveston Area 277L (N/			