CARACO PHARMACEUTICAL LABORATORIES LTD
Form 10-Q
August 09, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
for the quarterly period ended June 30, 2005

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
for the transition period from __________ to _________
Commission File No. 0-24676

CARACO PHARMACEUTICAL LABORATORIES, LTD.
(Exact name of registrant as specified in its charter)

MICHIGAN (State or other jurisdiction of incorporation or organization)	38-2505723 (IRS Employer Identification No.)
1150 ELIJAH MCCOY DRIVE, DETROIT, MICHIGAN (Address of principal executive offices)	48202 (Zip Code)

TELEPHONE: (313) 871-8400
Registrant s telephone number, including area code

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes x No o

As of August 4, 2005 the registrant had 26,391,394 shares of common stock issued and outstanding.

CARACO PHARMACEUTICAL LABORATORIES LTD.

BALANCE SHEETS

	JUNE 30, 2005	MARCH 31, 2005
	unaudited	audited
ASSETS		
Current assets		
Cash and cash equivalents	$ 5,619,590	$ 6,627,425
Accounts receivable, net	12,458,446	6,736,778
Inventories	18,144,403	18,467,693
Prepaid expenses and deposits	472,530	1,105,618
Total current assets	**36,694,969**	**32,937,514**
Property, plant and equipment		
Land	197,305	197,305
Building and improvements	9,597,808	9,605,888
Equipment	9,947,736	9,701,979
Furniture and fixtures	605,093	589,329
Total	20,347,942	20,094,501
Less: accumulated depreciation	7,504,995	7,197,422
Net property, plant & equipment	12,842,947	12,897,079
Total assets	**$ 49,537,916**	**$ 45,834,593**
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 4,193,982	2,577,668
Accounts payable, Sun Pharma	6,967,473	9,639,890
Accrued expenses	1,816,702	1,931,442
Total current liabilities	12,978,157	14,149,000
Total liabilities	**12,978,157**	**14,149,000**
Stockholders equity		
Common stock, no par value, authorized 30,000,000 shares; issued and outstanding shares - 26,379,494 and 26,360,294 shares	44,943,667	44,927,987
Convertible Series B Preferred Stock, no par value, authorized 15,000,000 shares; issued and outstanding - 6,528,000 and 5,984,000 shares	40,942,650	37,700,410
Additional paid in capital	2,718,735	2,718,735
Accumulated deficit	(52,045,293)	(53,661,539)

Total stockholders equity	36,559,759	31,685,593
Total liabilities and stockholders equity	**$ 49,537,916**	**$ 45,834,593**

See accompanying notes

CARACO PHARMACEUTICAL LABORATORIES, LTD.
UNAUDITED STATEMENTS OF INCOME

	THREE MONTHS ENDED JUNE 30	
	2005	**2004**
Net sales	**$ 17,612,531**	**$ 14,799,865**
Cost of goods sold	9,450,818	5,720,474
Gross profit	8,161,713	9,079,391
Selling, general and administrative expenses	1,704,633	1,410,723
Research and development costs - affiliate (Note 7)	3,242,240	4,663,440
Research and development costs - other	1,629,907	1,360,500
Operating income	1,584,933	1,644,729
Other income (expense)		
Interest expense	0	(135,633)
Interest income	27,143	14,610
Other income	4,170	2,969
Other expense - net	31,313	(118,054)
Net income	**$ 1,616,246**	**$ 1,526,675**
Net income per common share		
Basic	$ 0.06	$ 0.06
Diluted	$ 0.05	$ 0.05

See accompanying notes

CARACO PHARMACEUTICAL LABORATORIES, LTD.
UNAUDITED STATEMENTS OF CASH FLOWS

	THREE MONTHS ENDED JUNE 30	
	2005	**2004**
Cash flows from operating activities		
Net income	$ 1,616,246	$ 1,526,674
Adjustments to reconcile net income to net cash (used in) / provided by operating activities		
Depreciation	306,626	224,675
Capital stock issued or to be issued to affiliate in exchange for product formula	3,242,240	4,663,440
Changes in operating assets and liabilities which provided (used) cash:		
Accounts receivable	(5,721,668)	(3,268,227)
Inventories	323,290	(458,579)
Prepaid expenses and deposits	633,088	185,550
Accounts payable	(1,056,103)	324,204
Accrued expenses	(114,740)	(659,717)
Net cash (used in) / provided by operating activities	(771,021)	2,538,021
Cash flows from investing activities		
Purchases of property, plant and equipment	(252,494)	(1,233,447)
Net cash used in investing activities	(252,494)	(1,233,447)
Cash flows from financing activities		
Proceeds from loans payable to financial institutions	0	6,000,000
Repayments of loans payable to financial institutions	0	(4,000,000)
Proceeds from exercise of stock options	15,680	5,596
Repayments of EDC loan		(5,967,716)
Net cash provided by / (used in) financing activities	15,680	(3,962,120)
Net decrease in cash and cash equivalents	**(1,007,835)**	**(2,657,546)**
Cash and cash equivalents, beginning of period	6,627,425	4,244,815
Cash and cash equivalents, end of period	**$ 5,619,590**	**$ 1,587,269**

See accompanying notes

CARACO PHARMACEUTICAL LABORATORIES, LTD.
UNAUDITED STATEMENTS OF STOCKHOLDERS EQUITY

	PREFERRED STOCK		COMMON STOCK		ADDITIONAL PAID IN CAPITAL	ACCUMULATED DEFICIT	TOTAL STOCKHOLDERS EQUITY
	SHARES	AMOUNT	SHARES	AMOUNT			
		$		$	$	$	$
Balances at April 1, 2005	5,984,000	37,700,410	26,360,294	44,927,987	2,718,735	(53,661,539)	31,685,593
Issuances of preferred stock to affiliate in exchange for product technology transfers	544,000	3,242,240					3,242,240
Common stock options exercised			19,200	15,680			15,680
Net income						1,616,246	1,616,246
Balances at June 30, 2005	6,528,000	40,942,650	26,379,494	44,943,667	2,718,735	(52,045,293)	36,559,759

See accompanying notes

CARACO PHARMACEUTICAL LABORATORIES, LTD.

FORM 10-Q

NOTES TO UNAUDITED FINANCIAL STATEMENTS

1. **BASIS OF PRESENTATION**

The balance sheet as of March 31, 2005 is audited. All other financial statements contained herein are unaudited. In the opinion of management, all adjustments necessary for a fair presentation of such financial statements have been included. Such adjustments consisted only of normal recurring items. Interim results are not necessarily indicative of results for the full year.

The financial statements contained herein should be read in conjunction with the financial statements and notes thereto included in the Transition Report (Transition Report) on Form 10-K/T for the period January 1, 2005 to March 31, 2005 (the Transition Period) of Caraco Pharmaceutical Laboratories, Ltd. (Caraco, the Company, or the Corporation and which is also referred to as we, us, or our).

The accounting policies followed by the Corporation with respect to the unaudited interim financial statements are consistent with those stated in the Corporation s Transition Report on Form 10-K/T.

2. **ORGANIZATION AND NATURE OF BUSINESS**

Caraco is a corporation organized under Michigan law in 1984, to engage in the business of developing, manufacturing and marketing generic pharmaceuticals for prescription and over-the-counter or non-prescription or OTC markets.

A generic pharmaceutical is the chemical and therapeutic equivalent of a brand-name drug as to which the patent and/or market exclusivity has expired. Generic pharmaceuticals are well accepted for substitution of brand pharmaceuticals as they sell at lower prices than the prices of the branded products at their equivalence in quality and bioavailability.

Our present product portfolio includes 17 prescription products in 36 strengths in 89 package sizes. The products are intended to treat a variety of disorders including the following: hypertension, arthritis, epilepsy, diabetes, depression and pain management.

A significant source of our funding has been from Sun Pharmaceutical Industries Limited, a specialty pharmaceutical corporation organized under the laws of India (Sun Pharma). Since August 1997, Sun Pharma has contributed equity capital and has advanced us loans. In addition, among other things, Sun Pharma has acted as a guarantor on loans to Caraco, has supplied us with a substantial portion of raw materials for our products, helped us obtain machinery and equipment to enhance our production capacities at competitive prices and transferred certain generic products to us. (See Current Status of the Corporation and Sun Pharmaceutical Industries, Limited below.)

3. **CURRENT STATUS OF THE CORPORATION**

During the first quarter, the three months ended June 30, 2005, of our new fiscal year (fiscal 2006), we recorded net sales of $17.6 million compared to $14.8 million during the corresponding period of 2004. We incurred $4.9 million in R&D expense during the three months ended June 30, 2005 compared to $6.0 million during the corresponding period of 2004. This included $3.2 million and $4.7 million in non-cash R&D expense during the relevant periods. We used cash in operations of $0.7 million during the three months ended June 30, 2005 compared to generating cash from operations of $2.5 million during the corresponding period. This cash was used primarily to augment working capital. We earned net income of $1.6 million during the three months ended June 30, 2005 compared to net income of $1.5 million during the corresponding period. At June 30, 2005, we had stockholders equity of $36.6 million as compared to stockholders equity of $9.9 million at June 30, 2004. See Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

Pursuant to our products agreement with Sun Pharma Global, Inc. (Sun Global), a wholly-owned subsidiary of Sun Pharma, we have selected, through June 30, 2005, all products out of the 25 products to be transferred to us by Sun Global. Of these, twelve products passed their bio-equivalency studies as of June 30, 2005, and two products since then. Sun Global has thereby earned 544,000 preferred shares for each product. See Sun Pharmaceutical Industries Limited and Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations. Future Outlook.

We filed one ANDA with the FDA during the first quarter of fiscal 2006 and one since then. This brings our total number of ANDAs pending approval by the FDA to eleven.

We filed three ANDAs in the Transition Period. One of these ANDAS was for a generic version of Novo Nordisk s Prandin®, challenging its patent under a Paragraph IV Certification . We believe we are the first company to file such a Paragraph IV certification and therefore there is a potential to be granted 180 days of exclusivity upon successful resolution of the patent litigation recently initiated by Novo Nordisk (see 11 Litigation below) and approval of the ANDA by the FDA.

The FDA commenced an inspection of the Company s facility during the Transition Period. The FDA completed its inspection in May 2005 and issued observations on Form 483. Though we cannot be certain, we believe that the observations are not material. We have responded to the observations and are awaiting a response from the FDA.

4. **RECENT ACCOUNTING PRONOUNCEMENTS**

In May 2005, the FASB issued SFAS 154, Accounting Changes and Error Corrections, which replaces APB Opinion No. 20, Accounting Changes, and supersedes FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements an amendment of APB Opinion No. 28. SFAS 154 requires retrospective application to prior periods financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. When it is impracticable to determine the period-specific effects of an accounting change on one or more individual prior periods presented, SFAS 154 requires that the new accounting principle be applied to the balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable and that a corresponding adjustment be made to the opening balance of retained earnings for that period rather than being reported in an income statement.

When it is impracticable to determine the cumulative effect of applying a change in accounting principle to all prior periods, SFAS 154 requires that the new accounting principle be applied as if it were adopted prospectively from the earliest date practicable. SFAS 154 shall be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. We do not expect the provisions of the SFAS 154 will have a significant impact on our results of operations.

In December 2004, the FASB issued SFAS 123(R), Share-Based Payments, which replaces FASB Statement No. 123, Accounting for Stock-Based Compensation, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS 123(R) will require all share-based payments to employees, including grants of employee stock options, to be recognized in the statement of operations based on their fair values. SFAS 123(R) offers alternative methods for determining the fair value. In April 2005, the SEC issued a new rule that allows companies to implement Statement No. 123(R) at the beginning of the next fiscal year, instead of the next reporting period, that begins after June 15, 2005. As a result, we will implement SFAS 123(R) in the reporting period starting April 1, 2006. We expect that SFAS 123(R) will not have a significant impact on our financial statements. At the present time, we have not yet determined which valuation method we will use.

The FASB has proposed amending SFAS 128, Earnings per Share, to make it consistent with International Accounting Standard 33, Earnings per Share, and make earnings per share, or EPS, computations comparable on a global basis. Under the proposed amendment, the year-to-date EPS computation would be performed independently from the quarterly computations. Additionally, for all contracts that may be settled in either cash or shares of stock, companies must assume that settlement will occur by the issuance of shares for purposes of computing diluted EPS, even if they intend to settle by paying cash or have a history of cash-only settlements, regardless of who controls the means of settlement. Lastly, under the proposed amendment, shares that will be issued upon conversion of a mandatory convertible security must be included in the weighted-average number of shares outstanding used in computing basic EPS from the date that conversion becomes mandatory, using the if-converted method, regardless of whether the result is anti-dilutive. The proposed amended standard was expected to be issued during the first quarter of 2005. However, the FASB has not yet finalized the revised effective date of the proposed amendment or its transition provisions. Retrospective application in all periods presented would be required, and could require the restatement of previously reported EPS. We do not expect the provisions of the amended SFAS 128 will have a significant impact on our results of operations.

In July 2005, the FASB published an Exposure Draft of a proposed Interpretation, Accounting for Uncertain Tax Positions. The Exposure Draft seeks to reduce the significant diversity in practice associated with recognition and measurement in the accounting for income taxes. It would apply to all tax positions accounted for in accordance with SFAS 109, Accounting for Income Taxes. The Exposure Draft requires that a tax position meet a probable recognition threshold for the benefit of the uncertain tax position to be recognized in the financial statements. This threshold is to be met assuming that the tax authorities will examine the uncertain tax position. The Exposure Draft contains guidance with respect to the measurement of the benefit that is recognized for an uncertain tax position, when that benefit should be de-recognized and other matters. This proposed Interpretation would clarify the accounting for uncertain tax positions in accordance with SFAS 109. This Interpretation, once approved, is expected to be effective as of the end of the first fiscal year ending after December 15, 2005. We are currently evaluating the impact this proposed Interpretation would have on our results of operations.

5. **COMPUTATION OF EARNINGS PER SHARE**

Earnings per share is computed using the weighted average number of common shares outstanding during each period and considers a dual presentation and reconciliation of basic and diluted per share amounts. Diluted reflects the potential dilution of all common stock equivalents.

The basic and diluted weighted average numbers of common shares outstanding for the three months ended June 30, 2005 were 26,362,776 and 32,890,776 compared to 24,578,333 and 28,259,327 for the corresponding period of 2004.

6. **SUN PHARMACEUTICAL INDUSTRIES LIMITED**

Pursuant to a stock purchase agreement, Sun Pharma made an initial investment of $7.5 million for the purchase of 5.3 million common shares of Caraco in 1997.

Sun Pharma and its affiliates had loaned us approximately $10 million since August 1997. As of December 31, 2003, we have repaid all of such loans. Sun Pharma has also assisted us, by acting as guarantor, in obtaining line of credit loans from ICICI Bank Limited, The Bank of Nova Scotia and Citibank FSB in the amounts of $5.0 million, $12.5 million and $10.0 million, respectively. As of December 31, 2004, we have repaid all of such loans.

In August 1997, we entered into an agreement, whereby Sun Pharma was required to transfer to us the technology formula for 25 generic pharmaceutical products over a period of five years through August 2003. We exchanged 544,000 shares of our common stock for each technology transfer of an ANDA product (when bio-equivalency studies were successfully completed) and 181,333 shares for each technology transfer of a DESI product. The products provided to us from Sun Pharma were selected by mutual agreement. Under such agreement, we conducted, at our expense, all tests including bio-equivalency studies. Pursuant to such agreement, Sun Pharma delivered to us the technology for 13 products. This agreement expired and, as noted below, we have entered into a new agreement, with Sun Global.

On November 21, 2002, we entered into a products agreement with Sun Global. Under the agreement, which was approved by our Independent Committee (comprised of independent directors), Sun Global has agreed to provide us with 25 new generic drugs over a five-year period. Our rights to the products are limited to the United States and its territories or possessions, including Puerto Rico. Sun Global retains rights to the products in all other territories. The products are selected by mutual agreement. Under such agreement, we conduct, at our expense, all tests including bio-equivalency studies. We are also obligated to market the products consistent with our customary practices and to provide marketing personnel. In return for the technology transfer, Sun Global will receive 544,000 shares of a newly created Series B Preferred Stock for each generic drug transferred when such drug has passed its bio-equivalency studies. The preferred shares are non-voting, do not receive dividends and are convertible into common shares after three years (or immediately upon a change in control) on a one-to-one basis. The preferred shares have a liquidation preference equal to the value attributed to them on the dates on which they were earned. While such preferred shares are outstanding, we cannot, without the consent of the holders of a majority of the outstanding shares of the preferred stock, amend or repeal our articles of incorporation or bylaws if such action would adversely affect the rights of the preferred stock. In addition, without such consent, we cannot authorize the issuance of any capital stock having any preference or priority superior to the preferred stock.

The products agreement was amended by the Independent Committee in the quarter ended March 31, 2004 to eliminate the provision requiring that the Independent Committee concur in the selection of each product, and to provide instead, that each product satisfy certain objective criteria developed by management and approved by the Independent Committee. Pursuant to such objective criteria, we have selected all the 25 products, twelve of which passed bio-equivalency studies as of June 30, 2005, and two products since then. See Management s Discussion and Analysis of Financial Condition and Results of Operations Future Outlook.

Sun Pharma has established Research and Development Centers in Mumbai and Vadodara in India, where the development work for products is performed.

Sun Pharma and its subsidiaries supply us with certain raw materials and formulations. In addition, Sun Pharma assists us in acquiring machinery and equipment to enhance our production capacities. We acquire machinery and equipment from Sun Pharma which is sold to us at its cost.

Sun Pharma also assists us by sending qualified technical professionals who work as Caraco employees.

Sun Pharma and its affiliates are using Caraco as a contract manufacturer and/or distributor for two of its products pursuant to agreements entered into in December 2004 and January 2005.

During the Transition Period, SPARC Bioresearch Private Limited (SPARC), an affiliate of Sun Pharma, performed certain analytical studies required as part of the bio-equivalency process for two products. The Corporation incurred approximately $172,000 of costs during this period for the studies performed by SPARC. No similar studies were performed by SPARC during the three months ended June 30, 2005 or 2004.

Sun and its affiliates beneficially own 64% of the outstanding shares of Caraco (72% including the convertible Series B Preferred Stock).

7. **ACCOUNTING FOR STOCK BASED COMPENSATION**

The Corporation follows only the disclosure aspects of Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation* . Management believes that the fair value and pro-forma disclosures, required by SFAS No. 123, are not material to the financial statements. The Corporation continues to apply Accounting Principles Board (APB) Opinion No. 25 in accounting for its plans and, accordingly, no compensation cost has generally been recognized in the financial statements for its outstanding stock options. Options to purchase 40,000 shares of common stock were granted for the three-month period ended June 30, 2005 to the CEO of the Corporation, which will vest in the amount of 1/3rd every anniversary date of joining. Additionally, the Company granted 45,000 shares of common stock during the three month period ended June 30, 2005 to the CEO of the Corporation, which will vest in the amount of 1/3rd every anniversary date of joining. No options or stock grants were granted during the corresponding period of 2004.

8. **COMMON STOCK ISSUANCES**

We issued 19,200 and 5,000 shares of common stock to our employees upon exercise of their stock options during the three months ended June 30, 2005 and 2004, respectively.

9. **PREFERRED STOCK ISSUANCES**

We issued 544,000 shares of preferred stock to Sun Global during each of the three month periods ended June 30, 2005 and 2004, respectively.

10. **SALES AND CUSTOMERS**

Our sales team effectively addressed the challenges in 2004, during the Transition Period, and during the first quarter of fiscal 2006. The sales team is being strengthened to meet the demands of continued growth.

Certain of our end-use customers purchase our products through designated wholesalers, such as Amerisource-Bergen Corporation, McKesson Corporation and/or Cardinal Health, who act as intermediary distribution channels for our products. For example, the Veterans Administration, which has entered into a sales contract with Caraco, as discussed below, has selected McKesson as its designated wholesaler.Accordingly, shipments to two large wholesale customers accounted for approximately 70% of gross sales during the three months ended June 30, 2005 and 62% in the corresponding period of 2004. Balances due from these customers represented approximately 75% and 25% of gross accounts receivable at June 30, 2005 and 2004, respectively. No other single customer represented more than 10% of our gross sales during the relevant periods.

As referenced above, in 2002, we entered into a sales contract with the Veterans Administration, an agency of the U.S. government. Our agreement, which commenced on June 21, 2002, with four 1-year option periods, is for the purchase of one product, Metformin Hydrochloride. The first three option periods have been exercised. The agreement may be terminated by the purchaser without cause and in such case, we would only be entitled to a percentage of the contract price reflecting the percentage of the work performed prior to the notice of termination, plus reasonable charges that have resulted from the termination. The agreement provides that certain penalties would be incurred if we are unable to meet our sales commitment.

11. **LITIGATION**

On June 9, 2005, Novo Nordisk A/S and Novo Nordisk, Inc. (Novo Nordisk) filed a complaint in the United States District Court for the Eastern District of Michigan alleging that the Company s filling of an ANDA seeking approval to market its generic version of Novo Nordisk s Prandin® drug product infringed Novo Nordisk s patent, which expires June 12, 2018. Novo Nordisk seeks an order from the Court which, among other things, directs the FDA not to approve Caraco s ANDA any earlier than the claimed expiration date. The ANDA filed by Caraco contains a Paragraph IV certification challenging the Novo Nordisk patent. We believe that the Novo Nordisk patent is invalid and / or will not be infringed by Caraco s manufacture, use or sale of the product, and we intend to vigorously defend this action in order to capitalize on potential 180 days of marketing exclusivity available for this product.

On September 22, 2004, Ortho-McNeil Pharmaceutical, Inc. (Ortho-McNeil) filed a complaint in the United States District Court for the Eastern District of Michigan alleging that the Company s filing of an ANDA seeking approval to market its generic version of Ortho-McNeil s Ultracet® drug product infringed Ortho-McNeil s patent, which expires on September 6, 2011. Ortho-McNeil seeks an order from the Court which, among other things, directs the FDA not to approve Caraco s ANDA any earlier than the claimed expiration date. The ANDA filed by Caraco contained a Paragraph IV Certification challenging the Ortho-McNeil patent. We believe that the Ortho-McNeil patent is invalid and/or will not be infringed by Caraco s manufacture, use or sale of the product, and we intend to vigorously defend this action. Since this action, Ortho-McNeil has entered into a license agreement with another manufacturer and has launched its product generically while another manufacturer has launched its approved generic at risk.

As previously disclosed, on February 12, 2003, C. Arnold Curry filed a complaint in the Wayne County Circuit Court alleging breach of a written employment agreement. Dr. Curry is seeking 175,000 shares of our common stock (35,000 shares for each of the first five ANDAs approved by the FDA). We and the plaintiff each filed a motion for summary disposition. Both parties motions were denied, and the parties have submitted the matter to binding arbitration. We intend to vigorously defend ourselves against these claims, which we believe have no merit.

From time to time, we are also involved in other legal proceedings incidental to our normal business activities, and while the outcome of any such proceedings cannot be accurately predicted, we do not believe the ultimate resolution of any existing matters would have a material adverse effect on our financial position or results of operations.

12. **INVENTORIES**

Inventories consist of the following amounts at June 30, 2005 and March 31, 2005:

	June 2005	March 2005
Raw materials	$ 5,411,620	$ 5,504,006
Goods in transit	2,080,210	3,700,651
Work in process	2,518,663	2,607,903
Finished goods	8,133,910	6,655,133
Total	$ 18,144,413	$ 18,467,693

REVIEW REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Stockholders and Board of Directors
Caraco Pharmaceutical Laboratories, Ltd.
Detroit, Michigan

We have reviewed the balance sheet of Caraco Pharmaceutical Laboratories, Ltd. as of June 30, 2005 and the related statements of income, stockholders equity, and cash flows for the three-months ended June 30, 2005 and 2004. These financial statements are the responsibility of the Company s management.

We conducted our review in accordance with standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the balance sheet of Caraco Pharmaceutical Laboratories, Ltd. as of March 31, 2005, and the related statements of operations, stockholders equity, and cash flows for the three-month period then ended (not presented herein), and in our report dated June 7, 2005, we expressed an unqualified opinion on those financial statements.

REHMANN ROBSON/s/

Troy, Michigan
July 22, 2005

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

The following discussion and analysis provides information that management believes is relevant to an understanding of the Corporation s results of operations and financial condition. The discussion should be read in conjunction with the financial statements and notes thereto and Management s Discussion and Analysis of Financial Condition and Results of Operations included in the Company s 2004 Annual Report on Form 10-K as of and for the year ended December 31, 2004 (the Annual Report), the Company s Transition Report as of and for the three months ended March 31, 2005, and the unaudited interim financial statements included in Item 1 of this Quarterly Report on Form 10-Q.

OVERVIEW

The first quarter of fiscal 2006 (the three months ended June 30, 2005) represents 17 quarters of successive growth of sales revenue. During the three months ended June 30, 2005, we recorded net sales of $17.6 million compared to $14.8 million during the corresponding period of 2004. We incurred $4.9 million in R&D expenses during the three months ended June 30, 2005 compared to $6.0 million during the corresponding period of 2004. This included $3.2 million and $4.7 million in non-cash R&D expense during the relevant periods. We used cash in operations of $0.7 million during the three months ended June 30, 2005 compared to generating cash from operations of $2.5 million during the corresponding period of 2004. This cash was used primarily to augment working capital. We earned net income of $1.6 million during the three months ended June 30, 2005 compared to net income of $1.5 million during the corresponding period of 2004. At June 30, 2005, we had stockholders equity of $36.6 million as compared to stockholders equity of $9.9 million at June 30, 2004.

FDA COMPLIANCE

The FDA commenced an inspection of the Company s facility during the Transition Period. The FDA completed its inspection in May 2005 and issued observations on Form 483. Though we cannot be certain, we believe that the observations are not material .We have responded to the observations and we are awaiting a response from the FDA.

CRITICAL ACCOUNTING POLICIES

Our significant accounting policies are described in Note 1 to our financial statements included in our Annual Report and in Note 1 to our financial statements included in our Transition Report filed with the Securities and Exchange Commission. Certain of our accounting policies are particularly important to the portrayal of our financial position and results of operations and require management s subjective judgments. As a result these judgments are subject to an inherent degree of uncertainty. In applying these policies, management makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. Significant estimates include, but are not limited to, provisions for estimated customer returns, discounts, rebates and other price adjustments, including customer chargebacks, valuation allowances for deferred tax assets, and valuation of overhead components in inventory. As stated previously, these are discussed in more detail in Note 1 to our Annual Report and in Note 1 to our Transition Report. We have reviewed and determined that these policies remain our critical accounting policies for the first fiscal quarter of 2006. We did not make any changes in these policies during this period.

Three Months Ended June 30, 2005 Compared to Three Months Ended June 30, 2004

Net Sales. Net sales for the relevant periods of 2005 and 2004 were $17.6 and $14.8 million, reflecting an increase of almost 19%. The increase is due to the higher production and marketing of our products to new and existing customers. Currently, we manufacture and market all except one of the approved products. Sales of three products accounted for approximately 82% and 89% of net sales for the relevant periods, respectively.

Gross Profit. We earned a gross profit of $8.2 million as compared to a gross profit of $9.1 million during the relevant periods, reflecting a decrease of 10%. The reduction in gross profit has primarily been due to continual declining sales prices of our products, as previously disclosed. In addition the class of trade or the customer mix has changed and product selection being offered has contributed to the reduction of gross profit during the quarter.

The gross profit margin declined to 46% as compared to 61% during the relevant periods. The decrease was primarily the result of increased competition, both domestic and foreign, resulting in erosion of prices and profit margins.

Selling, General and Administrative Expenses. Selling, general and administrative expenses during the relevant periods were $1.7 million and $1.4 million, representing an increase of 21%. The selling, general and administrative expenses have remained at approximately 10% of net sales during the relevant periods.

The increase in SG&A of approximately $0.3 million has been due to the increase in regulatory costs for compliance with SEC regulations, including Sarbanes Oxley requirements, and increased SG&A expenses associated with higher sales volumes.

Research and Development Expenses. Total R&D expenses for the relevant periods were $4.9 million and $6.0 million. Cash research and development expenses were $1.6 million and $1.4 million during the relevant periods. We incurred non-cash research and development expenses (technology transfer cost) of $3.2 million as compared to $4.7 million for the 544,000 shares of preferred stock for one product transfer during each of the corresponding periods.

Interest Expense. We did not incur any interest cost during the during the three months ended June 30, 2005. Interest expense on loans from the Economic Development Corporation of the City of Detroit (the EDC), ICICI Bank, the Bank of Nova Scotia and Citibank was $0.1 million during the corresponding period of 2004. The decrease in the amount of interest is primarily due to paying off the entire loans due to the EDC, ICICI Bank, the Bank of Nova Scotia and CitiBank during 2004.

Results of Operations. We earned net income of $1.6 million and $1.5 million during the relevant periods.

Liquidity and Capital Resources

We used cash in operations of $0.7 million as compared to generating cash of $2.5 million from operations during the relevant periods. In addition to augmenting working capital, the cash generated from operations was used to finance our capital expenditures of $0.3 million and $1.2 million during the relevant periods.

During the three months ended June 30, 2004, we repaid the entire balance of $6.0 million due to the EDC. These payoffs were funded from internal cash flow and by utilizing a $10.0 million credit line arranged with Citibank, FSB.

At June 30, 2005 we had working capital of $23.7 million compared to working capital of $1.4 million at June 30, 2004. We had working capital of $ 18.8 million at March 31, 2005. The lower working capital as of June 30, 2004 was primarily due to classification of loans as current of $11.25 million due to the Bank of Nova Scotia.]

Future Outlook

Management is optimistic about our future outlook. We have been substantially compliant with cGMPs since 2001, and received approvals of 13 ANDAs, expanded and upgraded our facilities and expanded our customer base during the last four years. Our efforts in developing new products have also picked up momentum and this should permit us to grow at a reasonable level. We have now four products, Metformin, Metoprolol, Mirtazapine and Salsalate whose market share is ranked third or higher against the same products of our competitors. We continue to be optimistic that we will achieve our previously stated guidance of 15% to 20% revenue growth during fiscal 2006.

We believe, that though we continue to have lower gross profits due to price erosion, that our sales growth will offset any long term impact. However should the pricing pressures become more severe than anticipated, the result may be lower growth rates and gross margins. Management has and will continue to work diligently to counter the pricing pressures through increased sales volumes, improved productivity, expansion of our customer base, better-cost absorption of operational overheads, and cost reductions.

As disclosed, under the products agreement dated November 21, 2002 between Sun Global and the Company, Sun Global has agreed to transfer the technology for 25 products to the Company over a five year period in exchange for 544,000 preferred shares (which are convertible on a one-to-one basis into common shares) per product. Since the date of the products agreement, the Company has selected all 25 products for development and fourteen of these products have passed their respective bio-equivalency studies (one in December 2003, seven in 2004, three during the Transition Period one during the first quarter of fiscal 2006 and two since then). If some or all of the remaining products pass their bio-equivalency studies in fiscal 2006, the fair value of the preferred shares earned by Sun Global in exchange for such products could cause our non-cash research and development expenses to increase to an amount which would significantly decrease profit or create a loss.

While the development of new products will increase both our cash and non-cash R&D expense and will impact EPS, we expect that cash will be available, among other things, to meet increased working capital requirements, fund potential Paragraph IV Certification litigation and finance further capital investments.

The Company will continue to aggressively move forward with the development of new products. We believe that receiving products from Sun provides us with a partner with a proven track record; one that already has provided us with quality products. Moreover, Sun Pharma s increased beneficial ownership in us to approximately 64%, should, we believe, provide it with the incentive to continue to help us succeed. Sun Pharma has previously provided us with capital, loans, guarantees of loans, personnel, raw materials and equipment, which have significantly helped us to date.

Management s plans for fiscal 2006 include:

(a) Continued focus and improvement on FDA compliance.

(b) Increased pace of research and development activities, with a view to maximize ANDA filings.

(c) Continue to invest in equipment and facility to expand capacity to meet requirements of projected growth in near term.

(d) Increased market share for certain existing products and recently introduced new products and enhanced customer reach and satisfaction.

(e) Prompt introduction of new approved products to the market.

(f) Achieving further operational efficiencies by attaining economies of scale and cost reduction per unit.

(g) Increase the number of products, as well as anticipated volume increases for existing products, which, in turn, will improve manufacturing capacity utilization.

(h) Considering alternative ways of increasing cash flow including developing, manufacturing and marketing ANDAs owned by Sun Pharma.

(i) Locating and utilizing facilities of contract-manufacturers to enhance production and therefore sales.

(j) Research alternate product development sources and product licenses such as in licensing authorized generics from brand innovator companies and acquisitions of ANDAs from competitor manufacturers

Forward Looking Statements

This report, other than the historical financial and business information, 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. Without limitation, the words believes, plans, expects, and similar expressions are intended to identify forward-looking statements. Those statements include statements regarding our intent, belief, and current expectation. These statements are not guarantees of future performance and are subject to risks and uncertainties that cannot be predicted or quantified. Consequently, actual results could differ materially from those expressed or implied by such forward-looking statements.

Such risks and uncertainties include, but are not limited to: (i) that the information is of a preliminary nature and may be subject to further adjustment; (ii) not obtaining FDA approval for new products or delays in receiving FDA approvals; (iii) governmental restrictions on the sale of certain products; (iv) dependence on key personnel; (v) development by competitors of new or superior products or cheaper products or new technology for the production of products or the entry into the market of new competitors; (vi) market and customer acceptance and demand for new pharmaceutical products; (vii) availability of raw materials in a timely manner, at competitive prices, and in required quantities; (viii) timing and success of product development and launch; (ix) integrity and reliability of the Company s data; (x) lack of success in attaining full compliance with regard to regulatory and cGMP compliance; (xi) experiencing difficulty in managing our recent rapid growth and anticipated future growth; (xii) dependence on limited customer base; (xiii) occasional credits to certain customers reflecting price reductions on products previously sold to them and still available as shelf-stock; (xiv) possibility of an incorrect estimate of charge-backs and the impact of such an incorrect estimate on net sales, gross profit and net income; (xv) dependence on few products generating majority of sales; (xvi) product liability claims for which the Company may be inadequately insured; (xvii) subjectivity in judgment of management in applying certain significant accounting policies derived based on historical experience, terms of contracts, our observations of trends of industry, information received from our customers and other sources, to estimate revenues, accounts receivable allowances including chargebacks, rebates, income taxes, values of assets and inventories; (xviii) litigation involving claims of patent infringement; (xix) litigation involving claims for royalties relating to a prior contract for one product and (xx) other risks identified in this report and identified from time to time in our reports and registration statements filed with the Securities and Exchange Commission. These forward-looking statements represent our judgment as of the date of this report. We disclaim, however, any intent or obligation to update our forward-looking statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company has no debt or other market risk securities or transactions in foreign exchange.

ITEM 4. CONTROLS AND PROCEDURES

a. The term disclosure controls and procedures is defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (the Exchange Act). These rules refer to the controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized and reported within required time periods. Our Chief Executive Officer and our Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report (the Evaluation Date), and have concluded that, as of the Evaluation Date, our disclosure controls and procedures are effective in providing them with material information relating to the Company known to others within the Company which is required to be included in our periodic reports filed under the Exchange Act.

b. There has been no change in the Company s internal control over financial reporting that occurred during the first quarter of fiscal 2006 that materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information presented in Note 11 of Part I, Notes to Financial Statements, is incorporated herein by reference.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

During the quarter ended June 30, 2005, registrant issued 544,000 Series B preferred shares to Sun Global in exchange for the transfer of one product pursuant to registrant s products agreement with Sun Global. Such preferred shares were issued to Sun Global pursuant to exemptions from registration under Section 4(2), Section 4(6) and Regulation D under the Securities Act of 1933.

The above Series B preferred shares are convertible into common stock on a one-for-one basis after three years from the date of issuance or following a person (other than Sun Pharma and its affiliates) acquiring control of registrant.

ITEM 4. SUBMISSIONS OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Annual Meeting of Shareholders of the Corporation was held on June 20, 2005 in Dearborn, Michigan for the purpose of electing three directors for the three-year terms expiring in 2008 and upon the election and qualification of their successors.

Name of the Director	Votes FOR	Votes Withheld
Sailesh T. Desai	24,641,096	1,053,144
Daniel H. Movens	24,696,535	997,705
Georges Ugeux	25,498,823	195,417

The names of the other directors and their remaining terms are as follows:

Name of the Director	Term
Timothy S. Manney	2007
Sudhir Valia	2007
Dilip S. Shanghvi	2006
Jitendra N. Doshi	2006

On July 20, 2005, two independent directors, John D. Crissman and Madhava Reddy, were appointed to the Board of Directors by the Board:

ITEM 5. OTHER INFORMATION

The information in Item 2 above relating to the sale of the shares of Series B Preferred Stock to Sun Global during the first quarter of fiscal 2006 is hereby incorporated by reference.

ITEM 6. EXHIBITS

31.1 Certification of Chief Executive Officer

31.2 Certification of Chief Financial Officer.

32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

CARACO PHARMACEUTICAL LABORATORIES, LTD.

Date: August 8, 2005 By: /s/ Daniel H. Movens

Daniel H. Movens
Chief Executive Officer

Date: August 8, 2005 By: /s/ Jitendra N. Doshi

Jitendra N. Doshi
Chief Financial Officer

EXHIBIT INDEX

31.1 Certificate of Chief Executive Officer

31.2 Certificate of Chief Financial Officer

32.1 Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Surbanes Oxley Act of 2002.

> 939,000 1,195,000

Liabilities settled

(1,253,000)

Accretion expense

491,000 461,000

Asset retirement obligation as of end of period

12,275,000 10,556,000

Less current portion

635,000 635,000

Asset retirement obligation, long-term

$11,640,000 $9,921,000

4. EQUITY INVESTMENTS

	September 30, 2011	December 31, 2010
Investment in Tatex Thailand II, LLC	$ 1,150,000	$ 1,907,000
Investment in Tatex Thailand III, LLC	7,414,000	4,660,000
Investment in Grizzly Oil Sands ULC	41,161,000	26,454,000
Investment in Bison Drilling and Field Services LLC	6,304,000	
	$ 56,029,000	$ 33,021,000

Tatex Thailand II, LLC

During 2005, the Company purchased a 23.5% ownership interest in Tatex Thailand II, LLC (Tatex) at a cost of $2,400,000. The remaining interests in Tatex are owned by entities controlled by Wexford. Tatex, a non-public entity, holds 85,122 of the 1,000,000 outstanding shares of APICO, LLC (APICO), an international oil and gas exploration company. APICO has a reserve base located in Southeast Asia through its ownership of concessions covering two million acres which includes the Phu Horm Field. During the nine months ended September 30, 2011, Gulfport received $750,000 in distributions, reducing its total net investment in Tatex to $1,150,000. The loss on equity investment related to Tatex was immaterial for the nine months ended September 30, 2011 and 2010.

Tatex Thailand III, LLC

During the first quarter of 2008, the Company purchased a 5% ownership interest in Tatex Thailand III, LLC (Tatex III) at a cost of $850,000. In December 2009, the Company purchased an additional approximately 12.9% ownership interest at a cost of approximately $3,385,000 bringing its total ownership interest to approximately 17.9%. Approximately 68.7% of the remaining interests in Tatex III are owned by entities controlled by Wexford. During the nine months ended September 30, 2011, Gulfport paid $2,953,000 in cash calls, increasing its total net investment in Tatex III (including previous investments) to $7,414,000. The Company recognized a loss on equity investment of $199,000 and $149,000 for the nine months ended September 30, 2011 and 2010, respectively, which is included in (income) loss from equity method investments in the consolidated statements of operations.

Grizzly Oil Sands ULC

During the third quarter of 2006, the Company, through its wholly owned subsidiary Grizzly Holdings Inc., purchased a 24.9999% interest in Grizzly, a Canadian unlimited liability company, for approximately $8,199,000. The remaining interests in Grizzly are owned by entities controlled by Wexford. During 2006 and 2007, Grizzly acquired leases in the Athabasca region located in the Alberta Province near Fort McMurray near other oil sands development projects. Grizzly has drilled core holes and water supply test wells in nine separate lease blocks for feasibility of oil production and conducted a seismic program. In March 2010, Grizzly filed an application in Alberta, Canada for the development of an 11,300 barrel per day SAGD facility at Algar Lake. In October 2011, the Alberta Energy Resources Conservation Board (ERCB) and Ministry of Environment completed their review of Grizzly s Algar Lake Project and have prepared their approval documents. A request has been made to the Government of Alberta to provide an Order-in Council authorizing the ERCB to issue the formal approval to Grizzly. As of September 30, 2011, Gulfport s net investment in Grizzly was $41,161,000. During the nine months ended September 30, 2011, the Company paid $17,902,000 in cash calls. Grizzly s functional currency is the Canadian dollar. The Company s investment in Grizzly was decreased by $3,138,000 and $2,200,000 as a result of a currency translation loss for the three months and nine months ended September 30, 2011, respectively. The Company recognized a loss on equity investment of $182,000 and $995,000 for the three months and nine months ended September 30, 2011, respectively, and $171,000 and $336,000 for the three months and nine months ended September 30, 2010, respectively, which is included in (income) loss from equity method investments in the consolidated statements of operations.

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The Company, through its wholly owned subsidiary Grizzly Holdings Inc., entered into a loan agreement with Grizzly effective January 1, 2008, under which Grizzly may borrow funds from the Company. Borrowed funds initially bore interest at LIBOR plus 400 basis points and had an original maturity date of December 31, 2012. Effective April 1, 2010, the loan agreement was amended to modify the interest rate to 0.69% and change the maturity date to December 31, 2011. Effective October 15, 2010, the loan agreement was further amended to change the maturity date to December 31, 2012. Interest is paid on a paid-in-kind basis by increasing the outstanding balance of the loan. The Company loaned Grizzly approximately $3,182,000 during the nine months ended September 30, 2011. The Company recognized interest income of approximately $41,000 and $117,000 for the three months and nine months ended September 30, 2011, respectively, and $31,000 and $232,000 for the three months and nine months ended September 30, 2010, respectively, which is included in interest income in the consolidated statements of operations. The note balance was decreased by approximately $1,717,000 and $1,085,000 as a result of a currency translation loss for the three months and nine months ended September 30, 2011, respectively. The total $22,220,000 due from Grizzly at September 30, 2011 is included in note receivable related party on the accompanying consolidated balance sheets.

Bison Drilling and Field Services LLC

During the third quarter of 2011, the Company purchased a 25% ownership interest in Bison Drilling and Field Services LLC (Bison) at a cost of $6,009,000, subject to adjustment. The remaining interests in Bison are owned by entities controlled by Wexford. Bison owns and operates four drilling rigs. The Company recognized income on equity investment of $295,000 for the nine months ended September 30, 2011, which is included in (income) loss from equity method investments in the consolidated statements of operations.

5. OTHER ASSETS

Other assets consist of the following as of September 30, 2011 and December 31, 2010:

	September 30, 2011	December 31, 2010
Plugging and abandonment escrow account on the WCBB properties (Note 12)	$ 3,121,000	$ 3,129,000
Certificates of deposit securing letter of credit	275,000	275,000
Prepaid drilling costs	244,000	7,000
Loan commitment fees	1,345,000	767,000
Deposits	4,000	4,000
	$ 4,989,000	$ 4,182,000

6. LONG-TERM DEBT

A breakdown of long-term debt as of September 30, 2011 and December 31, 2010 is as follows:

	September 30, 2011	December 31, 2010
Revolving credit agreement (1)	$	$ 49,500,000
Building loans (2)	2,317,000	2,417,000
Less: current maturities of long term debt	(139,000)	(2,417,000)
Debt reflected as long term	$ 2,178,000	$ 49,500,000

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Maturities of long-term debt as of September 30, 2011 are as follows:

2012	$ 139,000
2013	147,000
2014	156,000
2015	166,000
2016	1,709,000
Thereafter	
Total	$ 2,317,000

(1) On September 30, 2010, the Company entered into a $100.0 million senior secured revolving credit agreement with The Bank of Nova Scotia, as administrative agent and letter of credit issuer and lead arranger, and Amegy Bank National Association (Amegy Bank). This revolving credit facility initially matured on September 30, 2013 and had a borrowing base availability of $50.0 million, which was increased to $65.0 million effective December 24, 2010. The credit agreement is secured by substantially all of the Company s assets. The Company s wholly-owned subsidiaries guarantee the obligations of the Company under the credit agreement.

On May 3, 2011, the Company entered into a first amendment to the revolving credit agreement with The Bank of Nova Scotia, Amegy Bank, Key Bank National Association (Key Bank) and Société Générale. Pursuant to the terms of the first amendment, Key Bank and Société Générale were added as additional lenders, the maximum amount of the facility was increased to $350.0 million, the borrowing base was increased to $90.0 million, certain fees and rates payable by the Company under the credit agreement were decreased, and the maturity date was extended until May 3, 2015. On October 31, 2011, the Company entered into subsequent amendments to its revolving credity facility pursuant to which the borrowing base under this facility was increased to $125.0 million. As of September 30, 2011, the Company had no balance outstanding under the credit agreement.

Advances under the credit agreement, as amended, may be in the form of either base rate loans or eurodollar loans. The interest rate for base rate loans is equal to (1) the applicable rate, which ranges from 1.00% to 2.50%, plus (2) the highest of: (a) the federal funds rate plus 0.5%, (b) the rate of interest in effect for such day as publicly announced from time to time by agent as its prime rate, and (c) the eurodollar rate for an interest period of one month plus 1.00%. The interest rate for eurodollar loans is equal to (1) the applicable rate, which ranges from 2.00% to 3.50%, plus (2) the London interbank offered rate that appears on Reuters Screen LIBOR01 Page for deposits in U.S. dollars, or, if such rate is not available, the offered rate on such other page or service that displays the average British Bankers Association Interest Settlement Rate for deposits in U.S. dollars, or, if such rate is not available, the average quotations for three major New York money center banks of whom the agent shall inquire as the London Interbank Offered Rate for deposits in U.S. dollars. At July 20, 2011 (the latest date during the nine months ended September 30, 2011 on which the Company had borrowings outstanding), amounts borrowed under the credit agreement bore interest at the Eurodollar rate (2.44%).

The credit agreement contains customary negative covenants including, but not limited to, restrictions on the Company s and its subsidiaries ability to: incur indebtedness; grant liens; pay dividends and make other restricted payments; make investments; make fundamental changes; enter into swap contracts and forward sales contracts; dispose of assets; change the nature of their business; and enter into transactions with their affiliates. The negative covenants are subject to certain exceptions as specified in the credit agreement. The credit agreement also contains certain affirmative covenants, including, but not limited to the following financial covenants: (1) the ratio of funded debt to EBITDAX (net income, excluding any non-cash revenue or expense associated with swap contracts resulting from ASC 815, plus without duplication and to the extent deducted from revenues in determining net income, the sum of (a) the aggregate amount of consolidated interest expense for such period, (b) the aggregate amount of income, franchise, capital or similar tax expense (other than ad valorem taxes) for such period, (c) all amounts attributable to depletion, depreciation, amortization and asset or goodwill impairment or writedown for such period, (d) all other non-cash charges, (e) non-cash losses from minority investments, (f) actual cash distributions received from minority investments, (g) to the extent actually reimbursed by insurance, expenses with respect to liability on casualty events or business interruption, and (h) all reasonable transaction expenses related to dispositions and acquisitions of assets, investments and debt and equity offering, and less non-cash income attributable to equity income from minority investments) for a twelve-month period may not be greater than 2.00 to 1.00; and (2) the ratio of EBITDAX to interest expense for a twelve-month period may not be less than 3.00 to 1.00. The Company was in compliance with all covenants at September 30, 2011.

(2) In June 2004, the Company purchased the office building it occupies in Oklahoma City, Oklahoma, for $3.7 million. One loan associated with this building matured in March 2006 and bore interest at the rate of 6% per annum, while a second loan was scheduled to mature in June 2011. The Company entered into a new building loan agreement in March 2011 to refinance the $2.4 million outstanding at that time. The new agreement extends the maturity date of the building loan to February 2016 and reduces the interest rate from 6.5% per annum to 5.82% per annum. The new building loan requires monthly interest and principal payments of approximately $22,000 and is collateralized by the Oklahoma City office building and associated land.

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7. COMMON STOCK OPTIONS, RESTRICTED STOCK, WARRANTS AND CHANGES IN CAPITALIZATION

Restricted Stock

On May 3, 2011, the Company granted 106,666 shares of restricted common stock of the Company to employees of the Company at a fair value of approximately $3,234,000. The shares vest annually over five years beginning on June 17, 2011. All shares of restricted common stock of the Company were granted under the Amended and Restated 2005 Stock Incentive Plan.

On August 3, 2011, the Company granted 30,000 shares of restricted common stock of the Company to employees of the Company at a fair value of approximately $1,024,000. The shares vest annually over five years beginning on September 17, 2011. All shares of restricted common stock of the Company were granted under the Amended and Restated 2005 Stock Incentive Plan.

Sale of Common Stock

On March 30, 2011, the Company completed the sale of an aggregate of 2,760,000 shares of its common stock in an underwritten public offering at a public offering price of $32.00 per share less the underwriting discount. The Company received aggregate net proceeds of approximately $84.3 million from the sale of these shares after deducting the underwriting discount and before offering expenses. The Company used the net proceeds from the equity offering to fund the Company s Utica Shale acquisition as discussed in Note 1 and for general corporate purposes. Pending the application of the Company s net proceeds for such purposes, the Company repaid all of its outstanding indebtedness under its revolving credit agreement.

On July 15, 2011, the Company completed the sale of an aggregate of 3,450,000 shares of its common stock in an underwritten public offering at a public offering price of $28.75 per share less the underwriting discount. The Company received aggregate net proceeds of approximately $94.7 million from the sale of these shares after deducting the underwriting discount and before offering expenses. The Company used a portion of the net proceeds from the equity offering to fund the Company s acquisition of leases in the Utica Shale as discussed in Note 1 and intends to use the remaining proceeds for additional Utica Shale lease acquisitions and for general corporate purposes, which may include expenditures associated with the Company s 2011 drilling programs. Pending the application of the Company s net proceeds for such purposes, the Company repaid all of its outstanding indebtedness under its revolving credit agreement.

8. STOCK-BASED COMPENSATION

During the three months and nine months ended September 30, 2011, the Company s stock-based compensation expense was $384,000 and $837,000, respectively, of which the Company capitalized $154,000 and $335,000, respectively, relating to its exploration and development efforts. During the three months and nine months ended September 30, 2010, the Company s stock based compensation expense was $105,000 and $338,000, respectively, of which the Company capitalized $42,000 and $135,000, respectively, relating to its exploration and development efforts. Stock based compensation included in general and administrative expense reduced basic and diluted earnings per share by $0.00 and $0.01 each for the three months and nine months ended September 30, 2011, and $0.00 and $0.00 each for the three months and nine months ended September, 30, 2010, respectively. Options and restricted common stock are reported as share based payments and their fair value is amortized to expense using the straight-line method over the vesting period. The shares of stock issued once the options are exercised will be from authorized but unissued common stock.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option valuation model that uses certain assumptions. Expected volatilities are based on the historical volatility of the market price of Gulfport s common stock over a period of time ending on the grant date. Based upon historical experience of the Company, the expected term of options granted is equal to the vesting period plus one year. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. The 2005 Stock Incentive Plan provides that all options must have an exercise price not less than the fair value of the Company s common stock on the date of the grant.

No stock options were issued during the nine months ended September 30, 2011 and 2010.

The Company has not declared dividends and does not intend to do so in the foreseeable future, and thus did not use a dividend yield. In each case, the actual value that will be realized, if any, depends on the future performance of the common stock and overall stock market conditions. There is no assurance that the value an optionee actually realizes will be at or near the value estimated using the Black-Scholes model.

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A summary of the status of stock options and related activity for the nine months ended September 30, 2011 is presented below:

	Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Options outstanding at December 31, 2010	458,241	$ 7.23	4.48	$ 6,621,000
Granted				
Exercised	(41,000)	9.67		710,000
Forfeited/expired				
Options outstanding at September 30, 2011	417,241	$ 6.99	3.71	$ 7,172,000
Options exercisable at September 30, 2011	417,241	$ 6.99	3.71	$ 7,172,000

Unrecognized compensation expense as of September 30, 2011 related to outstanding stock options and restricted shares was $4,750,000. The expense is expected to be recognized over a weighted average period of 2.23 years.

The following table summarizes information about the stock options outstanding at September 30, 2011:

Exercise Price	Number Outstanding	Weighted Average Remaining Life (in years)	Number Exercisable
$3.36	217,241	3.31	217,241
$9.07	25,000	3.94	25,000
$11.20	175,000	4.17	175,000
	417,241		417,241

The following table summarizes restricted stock activity for the nine months ended September 30, 2011:

	Number of Unvested Restricted Shares	Weighted Average Grant Date Fair Value
Unvested shares as of December 31, 2010	113,386	$ 11.72
Granted	136,666	31.15
Vested	(47,819)	11.65
Forfeited		
Unvested shares as of September 30, 2011	202,233	$ 24.87

9. EARNINGS PER SHARE

	For the Three Months Ended September 30, 2011			2010		
	Income	Shares	Per Share	Income	Shares	Per Share
Basic:						
Net income	$ 29,009,000	50,407,240	$ 0.58	$ 12,678,000	44,571,478	$ 0.28
Effect of dilutive securities:						
Stock options and awards		498,722			301,628	
Diluted:						
Net income	$ 29,009,000	50,905,962	$ 0.57	$ 12,678,000	44,873,106	$ 0.28

	For the Nine Months Ended September 30, 2011			2010		
	Income	Shares	Per Share	Income	Shares	Per Share
Basic:						
Net income	$ 77,448,000	47,549,672	$ 1.63	$ 33,048,000	43,612,468	$ 0.76
Effect of dilutive securities:						
Stock options and awards		458,696			364,797	
Diluted:						
Net income	$ 77,448,000	48,008,368	$ 1.61	$ 33,048,000	43,977,265	$ 0.75

There were no potential shares of common stock that were considered anti-dilutive during the three month and nine month periods ended September 30, 2011 and 2010.

10. OTHER COMPREHENSIVE INCOME

Other comprehensive income for the three months and nine months ended September 30, 2011 and 2010 is as follows:

	Three Months Ended September 30, 2011	2010	Nine Months Ended September 30, 2011	2010
Net income	$ 29,009,000	$ 12,678,000	$ 77,448,000	$ 33,048,000
Other comprehensive income (loss):				
Change in fair value of derivative instruments	10,333,000	(2,251,000)	9,611,000	709,000
Reclassification of settled contracts	1,331,000	4,548,000	3,342,000	13,926,000
Foreign currency translation adjustment	(4,855,000)	1,235,000	(3,285,000)	694,000
Total comprehensive income	$ 35,818,000	$ 16,210,000	$ 87,116,000	$ 48,377,000

11. NEW ACCOUNTING STANDARDS

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, *Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS,* which provides amendments to FASB ASC Topic 820, *Fair Value Measurements and Disclosure* (FASB ASC 820). The purpose of the amendments in this update is to create common fair value measurement and disclosure requirements between GAAP and IFRS. The amendments change certain fair value measurement principles and enhance the disclosure requirements. The amendments to FASB ASC 820 are effective for interim and annual periods beginning after December 15, 2011.

In June 2011, the FASB issued Accounting Standards Update No. 2011-05, *Comprehensive Income: Presentation of Comprehensive Income,* which provides amendments to FASB ASC Topic 220, *Comprehensive Income* (FASB ASC 220). The purpose of the amendments in this update is to provide a more consistent method of presenting non-owner transactions that affect an entity s equity. The amendments eliminate the option to report other comprehensive income and its components in the statement of

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changes in stockholders equity and require an entity to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement or in two separate but consecutive statements. The amendments to FASB ASC 220 are effective for interim and annual periods beginning after December 15, 2011 and should be applied retrospectively.

12. COMMITMENTS AND CONTINGENCIES

Plugging and Abandonment Funds

In connection with the acquisition in 1997 of the remaining 50% interest in the WCBB properties, the Company assumed the seller s (Chevron) obligation to contribute approximately $18,000 per month through March 2004, to a plugging and abandonment trust and the obligation to plug a minimum of 20 wells per year for 20 years commencing March 11, 1997. Chevron retained a security interest in production from these properties until abandonment obligations to Chevron have been fulfilled. Beginning in 2009, the Company could access the trust for use in plugging and abandonment charges associated with the property, although it has not yet done so. As of September 30, 2011, the plugging and abandonment trust totaled approximately $3,121,000. At September 30, 2011, the Company had plugged 311 wells at WCBB since it began its plugging program in 1997, which management believes fulfills its current minimum plugging obligation.

Litigation

The Louisiana Department of Revenue (LDR) is disputing Gulfport s severance tax payments to the State of Louisiana from the sale of oil under fixed price contracts during the years 2005 to 2007. The LDR maintains that Gulfport paid approximately $1,800,000 less in severance taxes under fixed price terms than the severance taxes Gulfport would have had to pay had it paid severance taxes on the oil at the contracted market rates only. Gulfport has denied any liability to the LDR for underpayment of severance taxes and has maintained that it was entitled to enter into the fixed price contracts with unrelated third parties and pay severance taxes based upon the proceeds received under those contracts. Gulfport has maintained its right to contest any final assessment or suit for collection if brought by the State. On April 20, 2009, the LDR filed a lawsuit in the 15th Judicial District Court, Lafayette Parish, in Louisiana against Gulfport seeking $2,275,729 in severance taxes, plus interest and court costs. Gulfport filed a response denying any liability to the LDR for underpayment of severance taxes and is defending itself in the lawsuit. The LDR had taken no further action on this lawsuit since filing its petition two years ago until recently when it propounded discovery requests to which Gulfport has responded.

In December 2010, the LDR filed two identical lawsuits against Gulfport in different venues to recover allegedly underpaid severance taxes on crude oil for the period January 1, 2007 through December 31, 2010, together with a claim for attorney s fees. The petitions do not make any specific claim for damages or unpaid taxes. As with the first lawsuit filed by the LDR in 2009, Gulfport denies all liability and will vigorously defend the lawsuit. The cases are in the early stages, and Gulfport has not yet filed a response to the recent lawsuits. Recently, the LDR filed motions to stay the lawsuits before Gulfport filed any responsive pleadings. The LDR has advised Gulfport that it intends to pursue settlement discussions with Gulfport and other similarly situated defendants in separate proceedings.

In November 2006, Cudd Pressure Control, Inc. (Cudd) filed a lawsuit against Gulfport, Great White Pressure Control LLC (Great White) and six former Cudd employees in the 129th Judicial District Harris County, Texas. The lawsuit was subsequently removed to the United States District Court for the Southern District of Texas (Houston Division). The lawsuit alleged RICO violations and several other causes of action relating to Great White s employment of the former Cudd employees and sought unspecified monetary damages and injunctive relief. On stipulation by the parties, the plaintiff s RICO claim was dismissed without prejudice by order of the court on February 14, 2007. Gulfport filed a motion for summary judgment on October 5, 2007. The court entered a final interlocutory judgment in favor of all defendants, including Gulfport, on April 8, 2008. On November 3, 2008, Cudd filed its appeal with the U.S. Court of Appeals for the Fifth Circuit. The Fifth Circuit vacated the district court decision finding, among other things, that the district court should not have entered summary judgment without first allowing more discovery. The case was remanded to the district court, and Cudd filed a motion to remand the case to the original state court, which motion was granted. On February 3, 2010, Cudd filed its second amended petition with the state court (a) alleging that Gulfport conspired with the other defendants to misappropriate, and misappropriated Cudd s trade secrets and caused its employees to breach their fiduciary duties, and (b) seeking unspecified monetary damages. On April 13, 2010, Gulfport s motion to be dismissed from the proceeding for lack of personal jurisdiction was denied. This state court proceeding is in its initial stages. In 2011, the parties have continued with written discovery and production of documents. On February 15, 2011, Cudd filed a third amended petition seeking $26.5 million (based on a report prepared by its expert) plus disgorgement of $6 million in payments by Great White to the individual defendants and punitive damages. Gulfport denies these claims with respect to itself. Recently, the parties began the process of scheduling and taking additional depositions and it is anticipated that the case will remain in the discovery phase for at least the next several months.

On July 30, 2010, six individuals and one limited liability company sued 15 oil and gas companies in Cameron Parish Louisiana for contamination across the surface of where the defendants operated in an action entitled *Reeds et al. v. BP American Production Company et al.,* 38th Judicial District. No. 10-18714. The plaintiffs original petition for damages, which did not name Gulfport as a defendant, alleges that the plaintiffs property located in Cameron Parish, Louisiana within the Hackberry oil field is contaminated as

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a result of historic oil and gas exploration and production activities. Plaintiffs allege that the defendants conducted, directed and participated in various oil and gas exploration and production activities on their property which allegedly have contaminated or otherwise caused damage to the property, and have sued the defendants for alleged breaches of oil, gas and mineral leases, as well as for alleged negligence, trespass, failure to warn, strict liability, punitive damages, lease liability, contract liability, unjust enrichment, restoration damages, assessment and response costs and stigma damages. On December 7, 2010, Gulfport was served with a copy of the plaintiffs first supplemental and amending petition which added four additional plaintiffs and six additional defendants, including Gulfport, bringing the total number of defendants to 21. It also increased the total acreage at issue in this litigation from 240 acres to approximately 1,700 acres. In addition to the damages sought in the original petition, the plaintiffs now also seek: damages sufficient to cover the cost of conducting a comprehensive environmental assessment of all present and yet unidentified pollution and contamination of their property; the cost to restore the property to its pre-polluted original condition; damages for mental anguish and annoyance, discomfort and inconvenience caused by the nuisance created by defendants; land loss and subsidence damages and the cost of backfilling canals and other excavations; damages for loss of use of land and lost profits and income; attorney fees and expenses and damages for evaluation and remediation of any contamination that threatens groundwater. In addition to Gulfport, current defendants include ExxonMobil Oil Corporation, Mobil Exploration & Producing North America Inc., Chevron U.S.A. Inc., The Superior Oil Company, Union Oil Company of California, BP America Production Company, Tempest Oil Company, Inc., ConocoPhillips Company, Continental Oil Company, WM. T. Burton Industries, Inc., Freeport Sulphur Company, Eagle Petroleum Company, U.S. Oil of Louisiana, M&S Oil Company, and Empire Land Corporation, Inc. of Delaware. On January 21, 2011, Gulfport filed a pleading challenging the legal sufficiency of the petitions on several grounds and requesting that they either be dismissed or that plaintiffs be required to amend such petitions. In response to the pleadings filed by Gulfport and similar pleadings filed by other defendants, the plaintiffs filed a third amending petition with exhibits which expands the description of the property at issue, attaches numerous aerial photos and identifies the mineral leases at issue. In response, Gulfport and numerous defendants re-urged their pleadings challenging the legal sufficiency of the petitions. Some of the defendants grounds for challenging the plaintiffs petitions were heard by the court on May 25, 2011 and were denied. As of October 28, 2011, the court had not entered a judgment regarding its ruling. Once it does, the defendants will have 30 days to file a supervisory writ with the apellate court seeking to overturn the lower court s ruling. Many of the defendants other grounds for challenging the plaintiffs petitions have yet to be heard by the court. It is anticipated that the discovery phase of this case will become more active in the upcoming months.

Due to the current stages of the above litigation, the outcomes are uncertain and management cannot determine the amount of loss, if any, that may result. Litigation is inherently uncertain. Adverse decisions in one or more of the above matters could have a material adverse effect on the Company s financial condition or results of operations.

The Company has been named as a defendant in various other litigation matters. The ultimate resolution of these matters is not expected to have a material adverse effect on the Company s financial condition or results of operations for the periods presented in the consolidated financial statements.

13. HEDGING ACTIVITIES

The Company seeks to reduce its exposure to unfavorable changes in oil prices, which are subject to significant and often volatile fluctuation, by entering into fixed price swaps. These contracts allow the Company to predict with greater certainty the effective oil prices to be received for hedged production and benefit operating cash flows and earnings when market prices are less than the fixed prices provided in the contracts. However, the Company will not benefit from market prices that are higher than the fixed prices in the contracts for hedged production.

The Company accounts for its oil derivative instruments as cash flow hedges for accounting purposes under FASB ASC 815 and related pronouncements. All derivative contracts are marked to market each quarter end and are included in the accompanying consolidated balance sheets as derivative assets and liabilities.

During the fourth quarter of 2010, the Company entered into fixed price swap contracts for 2011 with the purchaser of the Company s WCBB oil and with a financial institution. The Company s 2011 fixed price swap contracts are tied to the commodity prices on the New York Mercantile Exchange (NYMEX). The Company will receive the fixed price amount stated in the contract and pay to its counterparty the current market price for oil as listed on the NYMEX West Texas Index (WTI). During the third quarter of 2011, the Company entered into fixed price swap contracts for 2012 with the purchaser of the Company s WCBB oil. The Company s 2012 fixed price swap contracts are tied to the commodity prices on the International Petroleum Exchange (IPE). The Company will receive the fixed price amount stated in the contract and pay to its counterparty the current market price for oil as listed on the IPE Brent Crude. However, due to the geographic location of the Company s assets and the cost of transporting oil to another market, the amount that the Company receives when it actually sells its oil differs from the index price. At September 30, 2011, the Company had the following fixed price swaps in place:

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	Daily Volume (Bbls/day)	Weighted Average Price
October - December 2011	2,000	$ 86.96
January - December 2012	2,000	$ 108.00

At September 30, 2011, the fair value of derivative assets related to the fixed price swaps is as follows:

	September 30, 2011
Short-term derivative instruments - asset	$ 6,752,000
Long-term derivative instruments - asset	$ 1,987,000

All fixed price swaps have been executed in connection with the Company s oil price hedging program. For fixed price swaps qualifying as cash flow hedges pursuant to FASB ASC 815, the realized contract price is included in oil sales in the period for which the underlying production was hedged.

For derivatives designated as cash flow hedges and meeting the effectiveness guidelines of FASB ASC 815, changes in fair value are recognized in accumulated other comprehensive income until the hedged item is recognized in earnings. Amounts reclassified out of accumulated other comprehensive income into earnings as a component of oil and condensate sales for the nine months ended September 30, 2011 and 2010 are presented below.

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
(Reduction) addition to oil and condensate sales	$ (1,331,000)	$ (4,548,000)	$ (3,342,000)	$ (13,926,000)

The Company expects to reclassify $1,437,000 out of accumulated other comprehensive income into earnings as a component of oil and condensate sales during the remainder of the year ended December 31, 2011 related to fixed price swaps.

Hedge effectiveness is measured at least quarterly based on the relative changes in fair value between the derivative contract and the hedged item over time. Any change in fair value resulting from ineffectiveness is recognized immediately in earnings. The Company recognized a gain of $506,000 related to hedge ineffectiveness for the three months and nine months ended September 30, 2011, which is included in oil and condensate sales in the consolidated statements of operations. No amounts were recognized into earnings for the three months and nine months ended September 30, 2010.

14. FAIR VALUE MEASUREMENTS

The Company follows FASB ASC 820 for all financial and non-financial assets and liabilities. FASB ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (exit price) in an orderly transaction between market participants at the measurement date. The statement establishes market or observable inputs as the preferred sources of values, followed by assumptions based on hypothetical transactions in the absence of market inputs. The statement requires fair value measurements be classified and disclosed in one of the following categories:

Level 1 Quoted prices in active markets for identical assets and liabilities.

Level 2 Quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar instruments in markets that are not active and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3 Significant inputs to the valuation model are unobservable.

Financial assets and liabilities are classified based on the lowest level of input that is significant to the fair value measurement.

The following table summarizes the Company s financial assets and liabilities by FASB ASC 820 valuation level as of September 30, 2011:

	Level 1	Level 2	Level 3
Assets:			
Fixed price swaps	$	$ 8,739,000	$
Liabilities:			
Fixed price swaps	$	$	$

The estimated fair value of the Company s fixed price swaps was based upon forward commodity prices based on quoted market prices, adjusted for differentials.

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The Company estimates asset retirement obligations pursuant to the provisions of FASB ASC Topic 410, *Asset Retirement and Environmental Obligations* (FASB ASC 410). The initial measurement of asset retirement obligations at fair value is calculated using discounted cash flow techniques and based on internal estimates of future retirement costs associated with oil and gas properties. Given the unobservable nature of the inputs, including plugging costs and reserve lives, the initial measurement of the asset retirement obligation liability is deemed to use Level 3 inputs. See Note 3 for further discussion of the Company s asset retirement obligations. Asset retirement obligations incurred during the nine months ended September 30, 2011 were approximately $939,000.

The carrying amounts on the accompanying consolidated balance sheet for cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, and current and long-term debt are carried at cost, which approximates market value.

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

The following discussion and analysis should be read in conjunction with the Management s Discussion and Analysis of Financial Condition and Results of Operations section and audited consolidated financial statements and related notes thereto included in our Annual Report on Form 10-K and with the unaudited consolidated financial statements and related notes thereto presented in this Quarterly Report on Form 10-Q.

Disclosure Regarding Forward-Looking Statements

This report includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. All statements other than statements of historical facts included in this report that address activities, events or developments that we expect or anticipate will or may occur in the future, including such things as estimated future net revenues from oil and gas reserves and the present value thereof, future capital expenditures (including the amount and nature thereof), business strategy and measures to implement strategy, competitive strength, goals, expansion and growth of our business and operations, plans, references to future success, reference to intentions as to future matters and other such matters are forward-looking statements. These statements are based on certain assumptions and analyses made by us in light of our experience and our perception of historical trends, current conditions and expected future developments as well as other factors we believe are appropriate in the circumstances. However, whether actual results and developments will conform with our expectations and predictions is subject to a number of risks and uncertainties, general economic, market or business conditions; the opportunities (or lack thereof) that may be presented to and pursued by us; competitive actions by other oil and natural gas companies; changes in laws or regulations; hurricanes and other natural disasters and other factors, including those listed in the Risk Factors section of our most recent Annual Report on Form 10-K, many of which are beyond our control. Consequently, all of the forward-looking statements made in this report are qualified by these cautionary statements, and we cannot assure you that the actual results or developments anticipated by us will be realized or, even if realized, that they will have the expected consequences to or effects on us, our business or operations. We have no intention, and disclaim any obligation, to update or revise any forward-looking statements, whether as a result of new information, future results or otherwise.

Overview

We are an independent oil and natural gas exploration and production company with our principal producing properties located along the Louisiana Gulf Coast in the West Cote Blanche Bay, or WCBB, and Hackberry fields, and in West Texas in the Permian Basin. During 2010, we acquired an acreage position in the Niobrara Formation of Western Colorado, and in May 2011, we acquired our initial acreage position in the Utica Shale in Eastern Ohio and have commitments to acquire additional acreage there. We also hold a significant acreage position in the Alberta oil sands in Canada through our interest in Grizzly Oil Sands ULC, and have interests in entities that operate in Southeast Asia, including the Phu Horm gas field in Thailand. We seek to achieve reserve growth and increase our cash flow through our annual drilling programs.

Third Quarter 2011 Operational Highlights

Oil and natural gas revenues increased 74% to $58.0 million for the three months ended September 30, 2011 from $33.3 million for the three months ended September 30, 2010.

Net income increased 129% to $29.0 million for the three months ended September 30, 2011 from $12.7 million for the three months ended September 30, 2010.

Production increased 12% to approximately 590,000 barrels of oil equivalent, or BOE, for the three months ended September 30, 2011 from approximately 527,000 BOE for the three months ended September 30, 2010.

During the three months ended September 30, 2011, we drilled 27 gross wells and recompleted 23 gross wells.

As of September 30, 2011, we had acquired leasehold interests in approximately 75,000 gross (37,500 net) acres in the Utica Shale in Eastern Ohio. As of October 31, 2011, we had closed on additional acquisitions bringing our leasehold interests to approximately

85,000 gross (42,500 net) acres. We intend to continue to pursue opportunities in this area and have commitments which could increase our acreage position in the Utica Shale to an aggregate of approximately 125,000 gross (62,500 net) leasehold acres. We currently plan to begin drilling our Utica Shale acreage in January 2012. In addition, we are also evaluating other potential alternatives with regard to our Utica Shale position, including a joint venture and/or sale.

2011 Production and Drilling Activity

During the three months ended September 30, 2011, our total net production was 545,000 barrels of oil, 196,000 thousand cubic feet of gas, or Mcf, and 505,000 gallons of liquids, for a total of 590,000 BOE as compared to 468,000 barrels of oil, 243,000 Mcf of gas, and 768,000 gallons of liquids, or 527,000 BOE, for the three months ended September 30, 2010. Our total net production averaged approximately 6,414 BOE per day during the three months ended September 30, 2011 as compared to 5,728 BOE per day during the same period in 2010. The 12% increase in production is primarily related to the 2011 drilling and recompletion activities in our fields.

WCBB. From January 1, 2011 through October 31, 2011, we recompleted 54 existing wells. We also drilled 17 wells, of which 15 were completed as producers, one was non-productive and one was being drilled. During 2011, we currently intend to recomplete approximately 60 existing wells and drill 20 wells.

Aggregate net production from the WCBB field during the three months ended September 30, 2011 was 358,680 BOE, or 3,899 BOE per day, 97% of which was from oil and 3% of which was from natural gas. During October 2011, our average daily net production at WCBB was approximately 3,951 BOE, 99% of which was from oil and 1% of which was from natural gas. The increase in October 2011 production was the result of our 2011 drilling and recompletion program.

East Hackberry Field. From January 1, 2011 through October 31, 2011, we recompleted 20 existing wells. We also drilled 18 wells, of which 13 were completed as producers, two were non-productive, one was waiting on completion and two were being drilled. During 2009, we entered into a two year exploration agreement with an active gulf coast operator covering approximately 2,868 net acres adjacent to our field. We are the designated operator under the agreement and will participate in proposed wells with at least a 70% working interest. One of the two wells currently being drilled in East Hackberry is in this joint development area. We have licensed approximately 54 square miles of 3-D seismic data covering a portion of the area and are reprocessing the data.

Aggregate net production from the East Hackberry field during the three months ended September 30, 2011 was approximately 143,964 BOE, or 1,565 BOE per day, 91% of which was from oil and 9% of which was from natural gas. During October 2011, our average daily net production at East Hackberry was approximately 1,844 BOE, 96% of which was from oil and 4% of which was from natural gas. The increase in October 2011 production was the result of our 2011 drilling and recompletion program.

West Hackberry Field. Aggregate net production from the West Hackberry field during the three months ended September 30, 2011 was approximately 3,317 BOE, or 36 BOE per day. During October 2011, our average daily net production at West Hackberry was approximately 42 BOE, 100% of which was from oil.

Permian Basin. On December 20, 2007, we completed the acquisition of approximately 4,100 net acres and 32 producing wells in West Texas in the Permian Basin, with an effective date of November 1, 2007. Subsequently, we have acquired approximately 11,200 additional net acres, bringing our total acreage position to approximately 15,300 net acres.

From January 1, 2011 to October 31, 2011, 35 gross (15.2 net) wells were drilled on this acreage, of which 27 were completed as producers, four were waiting on completion and four wells were being drilled. We currently anticipate that five additional gross (2.5 net) wells will be drilled on this acreage during 2011.

Aggregate net production from the Permian field during the three months ended September 30, 2011 was approximately 72,719 BOE, or 790 BOE per day. During October 2011, average daily net production at Permian was approximately 966 BOE, of which approximately 70% was oil, 18% was natural gas liquids and 12% was natural gas. The increase in October 2011 production was the result of our 2011 drilling program.

Niobrara Formation. Effective as of April 1, 2010, we acquired leasehold interests in the Niobrara formation in Colorado and held leases for approximately 17,600 acres as of September 30, 2011. We recently completed a 60 square mile 3-D seismic survey and expect to complete data processing by year-end. From January 1, 2011 to October 31, 2011, we drilled three wells, two of which are waiting on completion and one of which is being drilled.

Aggregate net production from the Niobrara play during the three months ended September 30, 2011 was approximately 3,619 BOE, or 39 BOE per day. During October 2011, average daily net production in Niobrara was approximately 38 BOE.

Bakken. During 2009, we sold approximately 18,000 net acres and approximately 190 net BOEPD of production for approximately $18.8 million. As of September 30, 2011, we held approximately 900 net acres, interests in six wells and an overriding royalty interest in wells drilled prior to our sale, wells drilled subsequent to our sale and wells that might be drilled in the future.

Aggregate net production from the Bakken formation during the three months ended September 30, 2011 was approximately 7,325 BOE, or 80 BOE per day. During October 2011, average daily net production in Bakken was approximately 65 BOE.

Grizzly. During the third quarter of 2006, we, through our wholly owned subsidiary Grizzly Holdings Inc., purchased a 24.9999% interest in Grizzly Oil Sands ULC, or Grizzly. The remaining interests in Grizzly are owned by entities controlled by Wexford Capital LP, or Wexford. During 2006 and 2007, Grizzly acquired leases in the Athabasca region located in the Alberta Province near Fort McMurray and other oil sands development projects. Grizzly had approximately 712,000 acres under lease and our net investment in Grizzly was $41.2 million at

September 30, 2011. In addition, we had loaned Grizzly $22,220,000 including interest and net of foreign currency adjustments, as of September 30, 2011. As of September 30, 2011, Grizzly had drilled an aggregate of 203 core holes and three water supply test wells, tested nine separate lease blocks and conducted a seismic program. In March 2010, Grizzly filed an application for the development of an 11,300 barrel per day oil sand project at Algar Lake. In October 2011, the Alberta Energy Resources Conservation Board (ERCB) and Ministry of Environment completed their review of Grizzly s Algar Lake Project and have prepared their approval documents. A request has been made to the Government of Alberta to provide an Order-in Council authorizing the ERCB to issue the formal approval to Grizzly. Construction on the first phase of the facility is expected to begin in the fourth quarter of 2011. The engineering and procurement contract for Grizzly s proposed steam assisted gravity drainage facility at Algar Lake has been awarded to SNC-Lavin.

Thailand. We own a 23.5% ownership interest in Tatex Thailand II, LLC, or Tatex. The remaining interests in Tatex are owned by entities controlled by Wexford. Tatex, a privately held entity, holds 85,122 of the 1,000,000 outstanding shares of APICO, LLC, or APICO, an international oil and gas exploration company. APICO has a reserve base located in Southeast Asia through its ownership of concessions covering two million acres which include the Phu Horm Field. As of September 30, 2011, our net investment in Tatex was $1.2 million. Our investment is accounted for on the equity method. Tatex accounts for its investment in APICO using the cost method. In December 2006, first gas sales were achieved at the Phu Horm field located in northeast Thailand. Phu Horm s initial gross production was approximately 60 million cubic feet, or MMcf, per day. Gross production during the third quarter of 2011 was approximately 86 MMcf and 392 Bbls of oil per day. Hess Corporation operates the field with a 35% interest. Other interest owners include APICO (35% interest), PTTEP (20% interest) and ExxonMobil (10% interest). Our gross working interest (through Tatex as a member of APICO) in the Phu Horm field is 0.7%. Since our ownership in the Phu Horm field is indirect and Tatex s investment in APICO is accounted for by the cost method, these reserves are not included in our year-end reserve information.

We also own a 17.9% ownership interest in Tatex Thailand III, LLC, or Tatex III. Approximately 68.7% of the remaining interests in Tatex III are owned by entities controlled by Wexford. Affiliates of Wexford own approximately 17% of our outstanding common stock. Tatex III owns a concession covering one million acres. In 2009, Tatex III completed a 3-D seismic survey on this concession. The first well was drilled on our concession in 2010 and was temporarily abandoned pending further scientific evaluation. Drilling of the second well concluded in March 2011. The second well was drilled to a depth of 15,026 feet and logged approximately 5,000 feet of apparent possible gas saturated column. The well experienced gas shows and carried a flare measuring up to 25 feet throughout drilling below the intermediate casing point of 9,695 feet. Tatex III attempted to test the well but encountered a debris blockage in the open-hole portion of the wellbore that prevented the completion of the testing. Tatex III conducted a coil tubing operation to remove compacted debris blockage but was not successful. A drilling rig is on site and Tatex III has commenced operations to remove the debris and test the well. During the nine months ended September 30, 2011, we paid $3.0 million in cash calls bringing our total investment in Tatex III to $7.4 million.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. We have identified certain of these policies as being of particular importance to the portrayal of our financial position and results of operations and which require the application of significant judgment by our management. We analyze our estimates including those related to oil and natural gas properties, revenue recognition, income taxes and commitments and contingencies, and base our estimates on historical experience and various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Oil and Natural Gas Properties. We use the full cost method of accounting for oil and natural gas operations. Accordingly, all costs, including non-productive costs and certain general and administrative costs directly associated with acquisition, exploration and development of oil and natural gas properties, are capitalized. Companies that use the full cost method of accounting for oil and gas properties are required to perform a ceiling test each quarter. The test determines a limit, or ceiling, on the book value of the oil and gas properties. Net capitalized costs are limited to the lower of unamortized cost net of deferred income taxes or the cost center ceiling. The cost center ceiling is defined as the sum of (a) estimated future net revenues, discounted at 10% per annum, from proved reserves, based on the 12-month unweighted average of the first-day-of-the-month price for the period 2010 and 2009, and prior to 2009, unescalated year-end prices and costs, adjusted for any contract provisions or financial derivatives, if any, that hedge our oil and natural gas revenue, and excluding the estimated abandonment costs for properties with asset retirement obligations recorded on the balance sheet, (b) the cost of properties not being amortized, if any, and (c) the lower of cost or market value of unproved properties included in the cost being amortized, including related deferred taxes for differences between the book and tax basis of the oil and natural gas properties. If the net book value, including related deferred taxes, exceeds the ceiling, an impairment or noncash writedown is required. Such capitalized costs, including the estimated future development costs and site remediation costs, if any, are depleted by an equivalent units-of-production method, converting gas to barrels at the ratio of six Mcf of gas to one barrel of oil. No gain or loss is recognized upon the disposal of oil and natural gas properties, unless such dispositions significantly alter the relationship between capitalized costs and proven oil and natural gas reserves. Oil and natural gas properties not subject to

amortization consist of the cost of undeveloped leaseholds and totaled $108.7 million at September 30, 2011 and $16.8 million at December 31, 2010. These costs are reviewed quarterly by management for impairment, with the impairment provision included in the cost of oil and natural gas properties subject to amortization. Factors considered by management in its impairment assessment include our drilling results and those of other operators, the terms of oil and natural gas leases not held by production and available funds for exploration and development.

Ceiling Test. Companies that use the full cost method of accounting for oil and gas properties are required to perform a ceiling test each quarter. The test determines a limit, or ceiling, on the book value of the oil and gas properties. Net capitalized costs are limited to the lower of unamortized cost net of deferred income taxes or the cost center ceiling. The cost center ceiling is defined as the sum of (a) estimated future net revenues, discounted at 10% per annum, from proved reserves, based on the 12-month unweighted average of the first-day-of-the-month price for the period January December of the applicable year beginning with 2009, and prior to 2009, unescalated year-end prices and costs, adjusted for any contract provisions or financial derivatives, if any, that hedge our oil and natural gas revenue, and excluding the estimated abandonment costs for properties with asset retirement obligations recorded on the balance sheet, (b) the cost of properties not being amortized, if any, and (c) the lower of cost or market value of unproved properties included in the cost being amortized, including related deferred taxes for differences between the book and tax basis of the oil and natural gas properties. If the net book value, including related deferred taxes, exceeds the ceiling, an impairment or noncash writedown is required. Ceiling test impairment can give us a significant loss for a particular period; however, future depletion expense would be reduced. A decline in oil and gas prices may result in an impairment of oil and gas properties. For instance, as a result of the drop in commodity prices on December 31, 2008 and subsequent reduction in our proved reserves, we recognized a ceiling test impairment of $272.7 million for the year ended December 31, 2008. If prices of oil, natural gas and natural gas liquids decline, we may be required to further write down the value of our oil and gas properties, which could negatively affect our results of operations. No ceiling test impairment was required for the quarter ended September 30, 2011.

Asset Retirement Obligations. We have obligations to remove equipment and restore land at the end of oil and gas production operations. Our removal and restoration obligations are primarily associated with plugging and abandoning wells and associated production facilities.

We account for abandonment and restoration liabilities under FASB ASC 410 which requires us to record a liability equal to the fair value of the estimated cost to retire an asset. The asset retirement liability is recorded in the period in which the obligation meets the definition of a liability, which is generally when the asset is placed into service. When the liability is initially recorded, we increase the carrying amount of the related long-lived asset by an amount equal to the original liability. The liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related long-lived asset. Upon settlement of the liability or the sale of the well, the liability is reversed. These liability amounts may change because of changes in asset lives, estimated costs of abandonment or legal or statutory remediation requirements.

The fair value of the liability associated with these retirement obligations is determined using significant assumptions, including current estimates of the plugging and abandonment or retirement, annual inflations of these costs, the productive life of the asset and our risk adjusted cost to settle such obligations discounted using our credit adjustment risk free interest rate. Changes in any of these assumptions can result in significant revisions to the estimated asset retirement obligation. Revisions to the asset retirement obligation are recorded with an offsetting change to the carrying amount of the related long-lived asset, resulting in prospective changes to depreciation, depletion and amortization expense and accretion of discount. Because of the subjectivity of assumptions and the relatively long life of most of our oil and natural gas assets, the costs to ultimately retire these assets may vary significantly from previous estimates.

Oil and Gas Reserve Quantities. Our estimate of proved reserves is based on the quantities of oil and natural gas that engineering and geological analysis demonstrate, with reasonable certainty, to be recoverable from established reservoirs in the future under current operating and economic parameters. Netherland, Sewell & Associates, Inc., Pinnacle Energy Services, LLC and to a lesser extent our personnel have prepared reserve reports of our reserve estimates at December 31, 2010 on a well-by-well basis for our properties.

Reserves and their relation to estimated future net cash flows impact our depletion and impairment calculations. As a result, adjustments to depletion and impairment are made concurrently with changes to reserve estimates. Our reserve estimates and the projected cash flows derived from these reserve estimates have been prepared in accordance with SEC guidelines. The accuracy of our reserve estimates is a function of many factors including the following:

- the quality and quantity of available data;
- the interpretation of that data;

the accuracy of various mandated economic assumptions; and

the judgments of the individuals preparing the estimates.

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Our proved reserve estimates are a function of many assumptions, all of which could deviate significantly from actual results. As such, reserve estimates may materially vary from the ultimate quantities of oil and natural gas eventually recovered.

Income Taxes. We use the asset and liability method of accounting for income taxes, under which deferred tax assets and liabilities are recognized for the future tax consequences of (a) temporary differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities and (b) operating loss and tax credit carryforwards. Deferred income tax assets and liabilities are based on enacted tax rates applicable to the future period when those temporary differences are expected to be recovered or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income during the period the rate change is enacted. Deferred tax assets are recognized in the year in which realization becomes determinable. Periodically, management performs a forecast of its taxable income to determine whether it is more likely than not that a valuation allowance is needed, looking at both positive and negative factors. A valuation allowance for our deferred tax assets is established, if in management s opinion, it is more likely than not that some portion will not be realized. At September 30, 2011, a valuation allowance of $54.4 million had been provided for deferred tax assets based on the uncertainty of future taxable income.

Revenue Recognition. We derive almost all of our revenue from the sale of crude oil and natural gas produced from our oil and gas properties. Revenue is recorded in the month the product is delivered to the purchaser. We receive payment on substantially all of these sales from one to three months after delivery. At the end of each month, we estimate the amount of production delivered to purchasers that month and the price we will receive. Variances between our estimated revenue and actual payment received for all prior months are recorded at the end of the quarter after payment is received. Historically, our actual payments have not significantly deviated from our accruals.

Commitments and Contingencies. Liabilities for loss contingencies arising from claims, assessments, litigation or other sources are recorded when it is probable that a liability has been incurred and the amount can be reasonably estimated. We are involved in certain litigation for which the outcome is uncertain. Changes in the certainty and the ability to reasonably estimate a loss amount, if any, may result in the recognition and subsequent payment of legal liabilities.

Derivative Instruments and Hedging Activities. We seek to reduce our exposure to unfavorable changes in oil prices by utilizing energy swaps and collars, or fixed-price contracts. We follow the provisions of FASB ASC 815, *Derivatives and Hedging.* It requires that all derivative instruments be recognized as assets or liabilities in the balance sheet, measured at fair value. We estimate the fair value of all derivative instruments using established index prices and other sources. These values are based upon, among other things, futures prices, correlation between index prices and our realized prices, time to maturity and credit risk. The values reported in the financial statements change as these estimates are revised to reflect actual results, changes in market conditions or other factors.

The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation. Designation is established at the inception of a derivative, but re-designation is permitted. For derivatives designated as cash flow hedges and meeting the effectiveness guidelines of FASB ASC 815, changes in fair value are recognized in accumulated other comprehensive income until the hedged item is recognized in earnings. Hedge effectiveness is measured at least quarterly based on the relative changes in fair value between the derivative contract and the hedged item over time. We recognize any change in fair value resulting from ineffectiveness immediately in earnings. We currently have fixed price swaps in place for the remainder of 2011 and 2012 that are accounted for as cash flow hedges and recorded at fair value pursuant to FASB ASC 815 and related pronouncements.

RESULTS OF OPERATIONS

Comparison of the Three Months Ended September 30, 2011 and 2010

We reported net income of $29,009,000 for the three months ended September 30, 2011 as compared to $12,678,000 for the three months ended September 30, 2010. This 129% increase in period-to-period net income was due primarily to a 12% increase in net production to 590,000 BOE, a 56% increase in realized BOE prices to $98.32 and a 73% reduction in interest expense, partially offset by a 41% increase in lease operating expenses, a 32% increase in general and administrative expenses and a 72% increase in production taxes.

Oil and Gas Revenues. For the three months ended September 30, 2011, we reported oil and natural gas revenues of $58,023,000 as compared to oil and natural gas revenues of $33,273,000 during the same period in 2010. This $24,750,000, or 74%, increase in revenues was primarily attributable to a 12% increase in net production to 590,000 BOE from 527,000 BOE and a 56% increase in realized BOE prices to $98.32 from $63.14, in each case for the quarter ended September 30, 2011 as compared to the quarter ended September 30, 2010.

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The following table summarizes our oil and natural gas production and related pricing for the three months ended September 30, 2011 as compared to such data for the three months ended September 30, 2010:

	Three Months Ended September 30,	
	2011	**2010**
Oil production volumes (MBbls)	545	468
Gas production volumes (MMcf)	196	243
Liquid production volumes (MGal)	505	768
Oil equivalents (Mboe)	590	527
Average oil price (per Bbl)	$ 103.50	$ 67.39
Average gas price (per Mcf)	$ 4.70	$ 4.37
Average liquids price (per gallon)	$ 1.29	$ 0.85
Oil equivalents (per Boe)	$ 98.32	$ 63.14

Lease Operating Expenses. Lease operating expenses, or LOE, not including production taxes increased to $5,744,000 for the three months ended September 30, 2011 from $4,063,000 for the same period in 2010. This increase was mainly the result of an increase in expenses related to chemicals and fuel, equipment repairs, rentals and well workovers.

Production Taxes. Production taxes increased to $6,281,000 for the three months ended September 30, 2011 from $3,657,000 for the same period in 2010. This increase was primarily related to a 12% increase in production and a 56% increase in the average realized BOE price received, resulting in a 74% increase in oil and gas revenues.

Depreciation, Depletion and Amortization. Depreciation, depletion and amortization, or DD&A, expense increased to $14,736,000 for the three months ended September 30, 2011, and consisted of $14,646,000 in depletion of oil and natural gas properties and $90,000 in depreciation of other property and equipment, as compared to total DD&A expense of $10,299,000 for the three months ended September 30, 2010. This increase was due to an increase in our full cost pool as a result of our capital activities and an increase in our production used to calculate our total DD&A expense.

General and Administrative Expenses. Net general and administrative expenses increased to $2,034,000 for the three months ended September 30, 2011 from $1,538,000 for the same period in 2010. This $496,000 increase was due to an increase in salaries, stock compensation expenses and benefits resulting from an increased number of employees, increases in legal expenses and bank fees, partially offset by an increase in administrative services reimbursements and an increase in general and administrative overhead related to exploration and development activity capitalized to the full cost pool.

Accretion Expense. Accretion expense increased slightly to $168,000 for the three months ended September 30, 2011 from $156,000 for the same period in 2010.

Interest Expense. Interest expense decreased to $225,000 for the three months ended September 30, 2011 from $823,000 for the same period in 2010 due to a decrease in the interest rate paid and the repayment of all of our outstanding debt under our revolving credit facility during the third quarter of 2011 so that no balance was outstanding as of September 30, 2011, as compared to $45.7 million outstanding as of the same date in 2010. Total weighted debt outstanding under our facility was $6.5 million for the three months ended September 30, 2011 and $44.9 million for the same period in 2010. As of July 20, 2011 (the latest date on which we had borrowings outstanding during the third quarter), amounts borrowed under our revolving credit facility bore interest at the Eurodollar rate of 2.44%.

Income Taxes. As of September 30, 2011, we had a net operating loss carry forward of approximately $52.4 million, in addition to numerous temporary differences, which gave rise to a deferred tax asset. Periodically, management performs a forecast of our taxable income to determine whether it is more likely than not that a valuation allowance is needed, looking at both positive and negative factors. A valuation allowance for our deferred tax assets is established if, in management s opinion, it is more likely than not that some portion will not be realized. At September 30, 2011, a valuation allowance of $54.4 million had been provided for deferred tax assets, with the exception of $573,000 related to alternative minimum taxes.

Comparison of the Nine Months Ended September 30, 2011 and 2010

We reported net income of $77,448,000 for the nine months ended September 30, 2011 as compared to $33,048,000 for the nine months ended September 30, 2010. This 134% increase in period-to-period net income was due primarily to a 16% increase in net production to 1,671,000 BOE and a 54% increase in realized BOE prices to $95.76 for the nine months ended September 30, 2011, partially offset by a 24% increase in lease operating expenses, a 40% increase in general and administrative expenses and a 78% increase in production taxes.

Oil and Gas Revenues. For the nine months ended September 30, 2011, we reported oil and natural gas revenues of $160,060,000 as compared to oil and natural gas revenues of $89,661,000 during the same period in 2010. This $70,399,000, or 79%, increase in revenues was primarily attributable to a 16% increase in net production to 1,671,000 BOE from 1,439,000 BOE and a 54% increase in realized BOE prices to $95.76 from $62.31, in each case for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010.

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The following table summarizes our oil and natural gas production and related pricing for the nine months ended September 30, 2011 as compared to such data for the nine months ended September 30, 2010:

	Nine Months Ended September 30,	
	2011	2010
Oil production volumes (MBbls)	1,510	1,286
Gas production volumes (MMcf)	692	624
Liquid production volumes (MGal)	1,933	2,053
Oil equivalents (Mboe)	1,671	1,439
Average oil price (per Bbl)	$ 102.35	$ 65.98
Average gas price (per Mcf)	$ 4.56	$ 4.51
Average liquids price (per gallon)	$ 1.21	$ 0.97
Oil equivalents (per Boe)	$ 95.76	$ 62.31

Lease Operating Expenses. Lease operating expenses, or LOE, not including production taxes increased to $15,103,000 for the nine months ended September 30, 2011 from $12,212,000 for the same period in 2010. This increase was mainly the result of an increase in expenses related to chemicals and fuel, equipment repairs and maintenance, field supervision, overhead, property taxes, rentals, salt water disposal and well workovers.

Production Taxes. Production taxes increased to $18,520,000 for the nine months ended September 30, 2011 from $10,390,000 for the same period in 2010. This increase was primarily related to a 16% increase in production and a 54% increase in the average realized BOE price received resulting in a 79% increase in oil and gas revenues.

Depreciation, Depletion and Amortization. Depreciation, depletion and amortization, or DD&A, expense increased to $40,606,000 for the nine months ended September 30, 2011, and consisted of $40,345,000 in depletion of oil and natural gas properties and $261,000 in depreciation of other property and equipment, as compared to total DD&A expense of $26,912,000 for the nine months ended September 30, 2010. This increase was due to an increase in our full cost pool as a result of our capital activities and an increase in our production used to calculate our total DD&A expense.

General and Administrative Expenses. Net general and administrative expenses increased to $6,209,000 for the nine months ended September 30, 2011 from $4,438,000 for the same period in 2010. This $1,771,000 increase was due to an increase in salaries, stock compensation expenses and benefits resulting from an increased number of employees, increases in legal expenses, franchise taxes and bank fees, partially offset by an increase in administrative services reimbursements and an increase in general and administrative overhead related to exploration and development activity capitalized to the full cost pool.

Accretion Expense. Accretion expense increased slightly to $491,000 for the nine months ended September 30, 2011 from $461,000 for the same period in 2010.

Interest Expense. Interest expense decreased to $1,163,000 for the nine months ended September 30, 2011 from $2,154,000 for the same period in 2010 due to a decrease in the interest rate paid and the repayment of all of our outstanding debt under our revolving credit facility during the third quarter of 2011 so that no balance was outstanding as of September 30, 2011, as compared to $45.7 million outstanding as of the same date in 2010. Total weighted debt outstanding under our facility was $25.9 million for the nine months ended September 30, 2011 and $47.0 million for the same period in 2010. As of July 20, 2011 (the latest date on which we had borrowings outstanding during the third quarter), amounts borrowed under our revolving credit facility bore interest at the Eurodollar rate of 2.44%.

Income Taxes. As of September 30, 2011, we had a net operating loss carry forward of approximately $52.4 million, in addition to numerous temporary differences, which gave rise to a deferred tax asset. Periodically, management performs a forecast of our taxable income to determine whether it is more likely than not that a valuation allowance is needed, looking at both positive and negative factors. A valuation allowance for our deferred tax assets is established if, in management s opinion, it is more likely than not that some portion will not be realized. At September 30, 2011, a valuation allowance of $54.4 million had been provided for deferred tax assets, with the exception of $573,000 related to alternative minimum taxes. We paid $1,000 in state taxes for the nine months ended September 30, 2011.

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Liquidity and Capital Resources

Overview. Historically, our primary sources of funds have been cash flow from our producing oil and natural gas properties, borrowings under our bank and other credit facilities and the issuance of equity securities. Our ability to access any of these sources of funds can be significantly impacted by decreases in oil and natural gas prices or oil and natural gas production. During 2010, we received net proceeds (before offering expenses) of approximately $21.6 million from the sale of our common stock. In the first quarter of 2011, we received net proceeds (before offering expenses) of approximately $84.3 million from the sale of our common stock. In July 2011, we received net proceeds (before offering expenses) of approximately $94.7 million from the sale of our common stock.

Net cash flow provided by operating activities was $122,046,000 for the nine months ended September 30, 2011 as compared to net cash flow provided by operating activities of $58,234,000 for the same period in 2010. This increase was primarily the result of an increase in cash receipts from our oil and natural gas purchasers due to a 54% increase in net realized BOE prices and a 16% increase in our net BOE production.

Net cash used in investing activities for the nine months ended September 30, 2011 was $230,205,000 as compared to $75,198,000 for the same period in 2010. During the nine months ended September 30, 2011, we spent $202,164,000 in additions to oil and natural gas properties, of which $62,441,000 was spent on our 2011 drilling and recompletion programs, $32,092,000 was spent on expenses attributable to the wells drilled and recompleted during 2010, $6,362,000 was spent on compressors and other facility enhancements, $153,000 was spent on plugging costs, $89,732,000 was spent on lease related costs, primarily the acquisition of leases in the Utica Shale, and $2,634,000 was spent on tubulars, with the remainder attributable mainly to capitalized general and administrative expenses. In addition, $3,182,000 was loaned to and $17,902,000 was invested in Grizzly during the nine months ended September 30, 2011. During the nine months ended September 30, 2011, we used cash from operations and proceeds from our equity offering for our investing activities.

Net cash provided by financing activities for the nine months ended September 30, 2011 was $128,402,000 as compared to $17,313,000 for the same period in 2010. The 2011 amount provided by financing activities was primarily attributable to the net proceeds of $178,676,000 from our equity offerings and exercise of stock options, partially offset by net principal payments of $49,500,000 on borrowings under our credit facility. The 2010 amount provided by financing activities was primarily attributable to the net proceeds from our equity offerings of $21,595,000.

Credit Facility. On September 30, 2010, we entered into a $100.0 million senior secured revolving credit agreement with The Bank of Nova Scotia, as administrative agent and letter of credit issuer and lead arranger, and Amegy Bank National Association, or Amegy Bank, which revolving credit facility initially matured on September 30, 2013 and had a borrowing base availability of $50.0 million, which was increased to $65.0 million effective December 24, 2010. On July 21, 2011, we repaid all outstanding borrowings with a portion of the net proceeds of our equity offering completed on July 15, 2011 pending the application of such proceeds to fund our additional Utica Shale lease acquisitions and for general corporate purposes. Our revolving credit agreement is secured by substantially all of our assets. Our wholly-owned subsidiaries guaranteed our obligations under the credit agreement.

On May 3, 2011, we entered into a first amendment to the revolving credit agreement with the Bank of Nova Scotia, Amegy Bank, Key Bank National Association, or Key Bank, and Société Générale. Pursuant to the terms of the first amendment, Key Bank and Société Générale were added as additional lenders, the maximum amount of the revolving credit facility was increased to $350.0 million, the borrowing base was increased to $90.0 million, certain fees and rates payable by us under the credit agreement were decreased, and the maturity date was extended until May 3, 2015. On October 31, 2011, we entered into additional amendments to our revolving credit facility pursuant to which, among other things, the borrowing base under this facility was increased to $125.0 million.

Advances under our revolving credit agreement, as amended, may be in the form of either base rate loans or Eurodollar loans. The interest rate for base rate loans is equal to (1) the applicable rate, which ranges from 1.00% to 2.50%, plus (2) the highest of: (a) the federal funds rate plus 0.5%, (b) the rate of interest in effect for such day as publicly announced from time to time by agent as its prime rate, and (c) the eurodollar rate for an interest period of one month plus 1.00%. The interest rate for eurodollar loans is equal to (1) the applicable rate, which ranges from 2.00% to 3.50%, plus (2) the London interbank offered rate that appears on Reuters Screen LIBOR01 Page for deposits in U.S. dollars, or, if such rate is not available, the offered rate on such other page or service that displays the average British Bankers Association Interest Settlement Rate for deposits in U.S. dollars, or, if such rate is not available, the average quotations for three major New York money center banks of whom the agent shall inquire as the London Interbank Offered Rate for deposits in U.S. dollars. As of July 20, 2011 (the latest date during the third quarter on which we had borrowings outstanding), amounts borrowed under our revolving credit agreement bore interest at the Eurodollar rate (2.44%).

Our revolving credit agreement contains customary negative covenants including, but not limited to, restrictions on our and our subsidiaries ability to: incur indebtedness; grant liens; pay dividends and make other restricted payments; make investments; make fundamental changes; enter into swap contracts and forward sales contracts; dispose of assets; change the nature of their business; and enter into transactions with their affiliates. The negative covenants are subject to certain exceptions as specified in the credit agreement. The credit agreement also contains certain affirmative covenants, including, but not limited to the following financial

covenants: (1) the ratio of funded debt to EBITDAX (net income, excluding any non-cash revenue or expense associated with swap contracts resulting from ASC 815, plus without duplication and to the extent deducted from revenues in determining net income, the sum of (a) the aggregate amount of consolidated interest expense for such period, (b) the aggregate amount of income, franchise, capital or similar tax expense (other than ad valorem taxes) for such period, (c) all amounts attributable to depletion, depreciation, amortization and asset or goodwill impairment or writedown for such period, (d) all other non-cash charges, (e) non-cash losses from minority investments, (f) actual cash distributions received from minority investments, (g) to the extent actually reimbursed by insurance, expenses with respect to liability on casualty events or business interruption, and (h) all reasonable transaction expenses related to dispositions and acquisitions of assets, investments and debt and equity offering, and less non-cash income attributable to equity income from minority investments) for a twelve-month period may not be greater than 2.00 to 1.00; and (2) the ratio of EBITDAX to interest expense for a twelve-month period may not be less than 3.00 to 1.00. We were in compliance with all covenants at September 30, 2011.

Building Loans. In June 2004, we purchased the office building we occupy in Oklahoma City, Oklahoma, for $3.7 million. One loan associated with this building matured in March 2006 and bore interest at the rate of 6% per annum, while a second loan was scheduled to mature in June 2011. We entered into a new building loan in March 2011 to refinance the $2.4 million outstanding at that time. The new agreement extends the maturity date of the building loan to February 2016 and reduces the interest rate from 6.5% per annum to 5.82% per annum. The new building loan requires monthly interest and principal payments of approximately $22,000 and is collateralized by the Oklahoma City office building and associated land. As of September 30, 2011, approximately $2.3 million was outstanding on this loan.

Capital Expenditures. Our recent capital commitments have been primarily for the execution of our drilling programs, to fund Grizzly s delineation drilling program and initial preparation of the Algar Lake facility and for acquisitions, primarily in the Permian Basin, the Niobrara Formation and Utica Shale. Our strategy is to continue to (1) increase cash flow generated from our operations by undertaking new drilling, workover, sidetrack and recompletion projects to exploit our existing properties, subject to economic and industry conditions, and (2) explore acquisition and disposition opportunities. We have upgraded our infrastructure and our existing facilities in Southern Louisiana with the goal of increasing operating efficiencies and volume capacities and lowering lease operating expenses. These upgrades were also intended to better enable our facilities to withstand future hurricanes with less damage. Additionally, we completed the reprocessing of 3-D seismic data in one of our principal properties, WCBB, and shot 3-D seismic for the first time in our Hackberry field. The new and reprocessed data enables our geophysicists to continue to generate new prospects and enhance existing prospects in the intermediate zones in the fields, thus creating a portfolio of new drilling opportunities.

Of our net reserves at December 31, 2010, 63% were categorized as proved undeveloped. Our proved reserves will generally decline as reserves are depleted, except to the extent that we conduct successful exploration or development activities or acquire properties containing proved developed reserves, or both. To realize reserves and increase production, we must continue our exploratory drilling, undertake other replacement activities or use third parties to accomplish those activities.

At December 31, 2010, our booked inventory of prospects included approximately 29 drilling locations at WCBB. The drilling schedule used in our December 31, 2010 reserve report anticipates that all of those wells will be drilled by 2013. From January 1, 2011 through October 31, 2011, we recompleted 54 wells. We also drilled 17 wells, of which 15 were completed as producers, one was non-productive and one was being drilled. We currently intend to recomplete an additional six wells and drill an additional three new wells during 2011. Our aggregate drilling and recompletion expenditures are currently estimated to be approximately $38.0 million to $40.0 million to drill 20 wells and recomplete approximately 60 existing wells in our WCBB field during 2011.

In our East Hackberry field, from January 1, 2011 through October 31, 2011, we recompleted 20 existing wells. We also drilled 18 wells, of which 13 were completed as producers, two were non-productive, one was waiting on completion and two wells were drilling. We may drill two additional wells during 2011. Total capital expenditures for our East Hackberry field during 2011 are estimated at $53.0 million to $55.0 million to drill 20 wells and recomplete 20 wells during 2011.

In the Permian Basin, our booked inventory of prospects at December 31, 2010 included 226 gross (113 net) future development drilling locations. From January 1, 2011 through October 31, 2011, 35 gross (15.2 net) wells were drilled on this acreage, of which 27 were completed as producers, four were waiting on completion and four wells were being drilled. We currently anticipate drilling five additional gross (2.5 net) wells during 2011. We currently anticipate that our capital requirements to drill 40 gross (20 net) wells in the Permian Basin in West Texas will be approximately $38.0 million to $40.0 million, including recompletion activity. To date, we have recompleted eight gross (four net) wells in the Permian Basin. To help facilitate the drilling of these and future wells, we acquired a 25% equity interest in Bison Drilling and Field Services LLC, or Bison, from Windsor Energy Group LLC, or Windsor. Windsor is the operator of our Permian properties and an entity controlled by Wexford. Bison owns and operates four drilling rigs. Our purchase price for this interest was approximately $6.0 million, subject to adjustment. The remaining 75% equity interest is owned by entities controlled by Wexford. We have also agreed to purchase up to a 25% interest in Muskie Holdings LLC, or Muskie, which holds certain rights in a lease covering land in Wisconsin that is prospective for mining oil and natural gas fracture grade sand. Muskie is controlled by Wexford. We currently estimate that our expenditures in connection with our investment in Muskie during the next twelve months will be approximately $8.0 million.

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In the Niobrara formation in Western Colorado, we have completed a 60 square mile 3-D seismic survey and expect to complete data processing by year-end. We have drilled two wells in the Niobrara and are drilling on our third well. We currently anticipate that our total capital expenditures in the Niobrara formation will be approximately $4.0 million in 2011 relating to the seismic survey and drilling of three to four gross wells.

During the third quarter of 2006, we purchased a 24.9999% interest in Grizzly. As of September 30, 2011, our net investment in Grizzly was approximately $41.2 million. In addition, we have loaned Grizzly $22.2 million including interest and net of foreign currency adjustments as of September 30, 2011. Our capital requirements in 2011 for this project are estimated to be approximately $26.0 million, primarily for the expenses associated with the initial preparations of the Algar Lake facility and drilling activity during the 2010-2011 winter drilling season.

Capital expenditures in 2011 relating to our interests in Thailand are expected to be approximately $2.5 million, which we believe will be mostly funded from our share of production from the Phu Horm field.

Our total capital expenditures for 2011 are currently estimated to be in the range of $162.0 million to $168.0 million, excluding the cost of our Utica Shale and any other potential acquisitions. This is up significantly from the $85.8 million spent in 2010 due to improved commodity pricing and cost environment. We intend to continue to monitor pricing and cost developments and make adjustments to our future capital expenditure programs as warranted.

We believe that our cash on hand, cash flow from operations and borrowings under our revolving credit agreement will be sufficient to meet our normal recurring operating needs and our WCBB, Hackberry, Permian Basin, Niobrara and Grizzly capital requirements for the next twelve months and fund our investment in Muskie and our pending acquisitions of acreage in the Utica Shale. In the event we elect to further expand or accelerate our drilling programs, pursue additional acquisitions or accelerate our Canadian oil sands project, we would be required to obtain additional funds which we would seek to do through traditional borrowings, offerings of debt or equity securities or other means, including the sale of assets. Needed capital may not be available to us on acceptable terms or at all. If we are unable to obtain funds when needed or on acceptable terms, we may be required to delay or curtail implementation of our business plan or not be able to complete acquisitions that may be favorable to us.

Commodity Price Risk

For the period January 2010 through February 2010, we entered into forward sales contracts for the sale of 3,000 barrels of WCBB production per day at a weighted average daily price of $54.81 per barrel, before transportation costs and differentials. For the period March 2010 through December 2010, we entered into forward sales contracts for the sale of 2,300 barrels of WCBB production per day at a weighted average daily price of $58.24 per barrel, before transportation costs and differentials. In November 2010, we entered into fixed price swaps for 2,000 barrels of oil per day at a weighted average price of $86.96 per barrel, before transportation costs and differentials, for the period from January 2011 through December 2011. In September 2011, we entered into fixed price swaps for 2,000 barrels of oil per day at a weighted average price of $108.00 per barrel, before transportation costs and differentials, for the period from January 2012 through December 2012. Under the 2010 contracts, we delivered approximately 45% of our 2010 production. Under the 2011 contracts, we have committed to deliver approximately 30% to 33% of our estimated 2011 production. Under the 2012 contracts, we have committed to deliver approximately 23% to 24% of our estimated 2012 production. Such arrangements may expose us to risk of financial loss in certain circumstances, including instances where production is less than expected or oil prices increase. These forward sales contracts and fixed price swaps are accounted for as cash flow hedges and recorded at fair value pursuant to FASB ASC 815 and related pronouncements.

Commitments

In connection with the acquisition in 1997 of the remaining 50% interest in the WCBB properties, we assumed the seller s (Chevron) obligation to contribute approximately $18,000 per month through March 2004, to a plugging and abandonment trust and the obligation to plug a minimum of 20 wells per year for 20 years commencing March 11, 1997. Chevron retained a security interest in production from these properties until abandonment obligations to Chevron have been fulfilled. Beginning in 2009, we could access the trust for use in plugging and abandonment charges associated with the property, although we have not yet done so. As of September 30, 2011, the plugging and abandonment trust totaled approximately $3,121,000. At September 30, 2011, we had plugged 311 wells at WCBB since we began our plugging program in 1997, which management believes fulfills our current minimum plugging obligation.

New Accounting Pronouncements

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, *Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS,* which provides amendments to FASB ASC Topic 820, *Fair*

Value Measurements and Disclosure, or FASB ASC 820. The purpose of the amendments in this update is to create common fair value measurement and disclosure requirements between GAAP and IFRS. The amendments change certain fair value measurement principles and enhance the disclosure requirements. The amendments to FASB ASC 820 are effective for interim and annual periods beginning after December 15, 2011.

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In June 2011, the FASB issued Accounting Standards Update No. 2011-05, *Comprehensive Income: Presentation of Comprehensive Income,* which provides amendments to FASB ASC Topic 220, *Comprehensive Income* , or FASB ASC 220. The purpose of the amendments in this update is to provide a more consistent method of presenting non-owner transactions that affect an entity s equity. The amendments eliminate the option to report other comprehensive income and its components in the statement of changes in stockholders equity and require an entity to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement or in two separate but consecutive statements. The amendments to FASB ASC 220 are effective for interim and annual periods beginning after December 15, 2011 and should be applied retrospectively.

ITEM 3. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK.

Our revenues, operating results, profitability, future rate of growth and the carrying value of our oil and natural gas properties depend primarily upon the prevailing prices for oil and natural gas. Historically, oil and natural gas prices have been volatile and are subject to fluctuations in response to changes in supply and demand, market uncertainty and a variety of additional factors, including: worldwide and domestic supplies of oil and natural gas; the level of prices, and expectations about future prices, of oil and natural gas; the cost of exploring for, developing, producing and delivering oil and natural gas; the expected rates of declining current production; weather conditions, including hurricanes, that can affect oil and natural gas operations over a wide area; the level of consumer demand; the price and availability of alternative fuels; technical advances affecting energy consumption; risks associated with operating drilling rigs; the availability of pipeline capacity; the price and level of foreign imports; domestic and foreign governmental regulations and taxes; the ability of the members of the Organization of Petroleum Exporting Countries to agree to and maintain oil price and production controls; political instability or armed conflict in oil and natural gas producing regions; and the overall economic environment. These factors and the volatility of the energy markets make it extremely difficult to predict future oil and natural gas price movements with any certainty. For example, the West Texas Intermediate posted price for crude oil has ranged from a low of $30.28 per barrel, or bbl, in December 2008 to a high of $145.31 per bbl in July 2008. The Henry Hub spot market price of natural gas has ranged from a low of $1.83 per million British thermal units, or MMBtu, in September 2009 to a high of $15.52 per MMBtu in January 2006. On September 30, 2011, the West Texas Intermediate posted price for crude oil was $79.20 per bbl and the Henry Hub spot market price of natural gas was $3.67 per MMBtu. Any substantial decline in the price of oil and natural gas will likely have a material adverse effect on our operations, financial condition and level of expenditures for the development of our oil and natural gas reserves, and may result in write downs of oil and natural gas properties due to ceiling test limitations.

For the period January 2010 through February 2010, we entered into forward sales contracts for the sale of 3,000 barrels of WCBB production per day at a weighted average daily price of $54.81 per barrel, before transportation costs and differentials. For the period March 2010 through December 2010, we entered into forward sales contracts for the sale of 2,300 barrels of WCBB production per day at a weighted average daily price of $58.24 per barrel, before transportation costs and differentials. In November 2010, we entered into fixed price swaps for 2,000 barrels of oil per day at a weighted average price of $86.96 per barrel, before transportation costs and differentials, for the period from January 2011 through December 2011. In September 2011, we entered into fixed price swaps for 2,000 barrels of oil per day at a weighted average price of $108.00 per barrel, before transportation costs and differentials, for the period from January 2012 through December 2012. Under the 2010 contracts, we delivered approximately 45% of our 2010 production. Under the 2011 contracts, we have committed to deliver approximately 30% to 33% of our estimated 2011 production. Under the 2012 contracts, we have committed to deliver approximately 23% to 24% of our estimated 2012 production. Such arrangements may expose us to risk of financial loss in certain circumstances, including instances where production is less than expected or oil prices increase. These forward sales contracts and fixed price swaps are accounted for as cash flow hedges and recorded at fair value pursuant to FASB ASC 815 and related pronouncements.

At September 30, 2011, we had a net asset derivative position of $8.7 million related to our fixed price swaps. Utilizing actual derivative contractual volumes, a 10% increase in underlying commodity prices would have reduced the fair value of these instruments by approximately $8.6 million, while a 10% decrease in underlying commodity prices would have increased the fair value of these instruments by $8.6 million. However, any realized derivative gain or loss would be substantially offset by a decrease or increase, respectively, in the actual sales value of production covered by the derivative instrument.

Our revolving credit facility is structured under floating rate terms, as advances under this facility may be in the form of either base rate loans or Eurodollar loans. As such, our interest expense is sensitive to fluctuations in the prime rates in the U.S. or, if the Eurodollar rates are elected, the Eurodollar rates. On July 20, 2011 (the latest date during the third quarter on which we had borrowings outstanding), amounts borrowed under our revolving credit agreement bore interest at the Eurodollar rate of 2.44%. Based on the current debt structure, a 1% increase in interest rates would increase interest expense by approximately $300,000 per year, based on $30.0 million outstanding under our credit facility as of June 30, 2011. As of September 30, 2011, we had no amounts outstanding under our revolving credit facility. As of September 30, 2011, we did not have any interest rate swaps to hedge our interest risks.

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ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Control and Procedures. Under the direction of our Chief Executive Officer and Vice President and Chief Financial Officer, we have established disclosure controls and procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms. The disclosure controls and procedures are also intended to ensure that such information is accumulated and communicated to management, including our Chief Executive Officer and Vice President and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures.

As of September 30, 2011, an evaluation was performed under the supervision and with the participation of management, including our Chief Executive Officer and Vice President and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934. Based upon our evaluation, our Chief Executive Officer and Vice President and Chief Financial Officer have concluded that as of September 30, 2011, our disclosure controls and procedures are effective.

Changes in Internal Control over Financial Reporting. There have not been any changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, internal controls over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Louisiana Department of Revenue, or LDR, is disputing our severance tax payments to the State of Louisiana from the sale of oil under fixed price contracts during the years 2005 through 2007. The LDR maintains that we paid approximately $1.8 million less in severance taxes under fixed price terms than the severance taxes we would have had to pay had we paid severance taxes on the oil at the contracted market rates only. We have denied any liability to the LDR for underpayment of severance taxes and have maintained that we were entitled to enter into the fixed price contracts with unrelated third parties and pay severance taxes based upon the proceeds received under those contracts. We have maintained our right to contest any final assessment or suit for collection if brought by the State. On April 20, 2009, the LDR filed a lawsuit in the 15th Judicial District Court, Lafayette Parish, in Louisiana against our company seeking $2,275,729 in severance taxes, plus interest and court costs. We filed a response denying any liability to the LDR for underpayment of severance taxes and are defending our company in the lawsuit. The LDR had taken no further action on this lawsuit since filing its petition two years ago until recently when it propounded discovery requests to which we have responded.

In December 2010, the LDR filed two identical lawsuits against us in different venues to recover allegedly underpaid severance taxes on crude oil for the period January 1, 2007 through December 31, 2010, together with a claim for attorney s fees. The petitions do not make any specific claim for damages or unpaid taxes. As with the first lawsuit filed by the LDR in 2009, we have denied all liability and will vigorously defend the lawsuit. The cases are in the very early stages, and we have not yet filed a response to these lawsuits. Recently, the LDR filed motions to stay the lawsuits before we filed any responsive pleadings. The LDR has advised us that it intends to pursue settlement discussions with us and other similarly situated defendants in separate proceedings.

In November 2006, Cudd Pressure Control, Inc., or Cudd, filed a lawsuit against us, Great White Pressure Control LLC, or Great White, and six former Cudd employees in the 129th Judicial District Harris County, Texas. The lawsuit was subsequently removed to the United States District Court for the Southern District of Texas (Houston Division). The lawsuit alleged RICO violations and several other causes of action relating to Great White s employment of the former Cudd employees and sought unspecified monetary damages and injunctive relief. On stipulation by the parties, the plaintiff s RICO claim was dismissed without prejudice by order of the court on February 14, 2007. We filed a motion for summary judgment on October 5, 2007. The Court entered a final interlocutory judgment in favor of all defendants, including us, on April 8, 2008. On November 3, 2008, Cudd filed its appeal with the U.S. Court of Appeals for the Fifth Circuit. The Fifth Circuit vacated the district court decision finding, among other things, that the district court should not have entered summary judgment without first allowing more discovery. The case was remanded to the district court, and Cudd filed a motion to remand the case to the original state court, which motion was granted. On February 3, 2010, Cudd filed its second amended petition with the state court (a) alleging that we conspired with the other defendants to misappropriate, and misappropriated Cudd s trade secrets and caused its employees to breach their fiduciary duties, and (b) seeking unspecified monetary damages. On April 13, 2010, our motion to be dismissed from the proceeding for lack of personal jurisdiction was denied. This state court proceeding is in its initial stages. In 2011, the parties have continued with written discovery and production of documents. On February 15, 2011, Cudd filed a third amended petition seeking $26.5 million (based on a report prepared by its expert) plus disgorgement of $6.0 million in payments by Great White to the individual defendants and punitive damages. Gulfport denies these claims with respect to itself. Recently, the parties began the process of scheduling and taking depositions and it is anticipated that the case will remain in the discovery phase for at least the next several months.

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On July 30, 2010, six individuals and one limited liability company sued 15 oil and gas companies in Cameron Parish Louisiana for contamination across the surface of where the defendants operated in an action entitled *Reeds et al. v. BP American Production Company et al.,* 38th Judicial District. No. 10-18714. The plaintiffs original petition for damages, which did not name us as a defendant, alleges that the plaintiffs property located in Cameron Parish, Louisiana within the Hackberry oil field is contaminated as a result of historic oil and gas exploration and production activities. Plaintiffs allege that the defendants conducted, directed and participated in various oil and gas exploration and production activities on their property which allegedly have contaminated or otherwise caused damage to the property, and have sued the defendants for alleged breaches of oil, gas and mineral leases, as well as for alleged negligence, trespass, failure to warn, strict liability, punitive damages, lease liability, contract liability, unjust enrichment, restoration damages, assessment and response costs and stigma damages. On December 7, 2010, we were served with a copy of the plaintiffs first supplemental and amending petition which added four additional plaintiffs and six additional defendants, including us, bringing the total number of defendants to 21. It also increased the total acreage at issue in this litigation from 240 acres to approximately 1,700 acres. In addition to the damages sought in the original petition, the plaintiffs now also seek: damages sufficient to cover the cost of conducting a comprehensive environmental assessment of all present and yet unidentified pollution and contamination of their property; the cost to restore the property to its pre-polluted original condition; damages for mental anguish and annoyance, discomfort and inconvenience caused by the nuisance created by defendants; land loss and subsidence damages and the cost of backfilling canals and other excavations; damages for loss of use of land and lost profits and income; attorney fees and expenses; and damages for evaluation and remediation of any contamination that threatens groundwater. In addition to us, current defendants include ExxonMobil Oil Corporation, Mobil Exploration & Producing North America Inc., Chevron U.S.A. Inc., The Superior Oil Company, Union Oil Company of California, BP America Production Company, Tempest Oil Company, Inc., ConocoPhillips Company, Continental Oil Company, WM. T. Burton Industries, Inc., Freeport Sulphur Company, Eagle Petroleum Company, U.S. Oil of Louisiana, M&S Oil Company, and Empire Land Corporation, Inc. of Delaware. On January 21, 2011, we filed a pleading challenging the legal sufficiency of the petitions on several grounds and requesting that they either be dismissed or that plaintiffs be required to amend such petitions. In response to the pleadings filed by us and similar pleadings filed by other defendants, the plaintiffs filed a third amending petition with exhibits which expands the description of the property at issue, attaches numerous aerial photos and identifies the mineral leases at issue. In response, we and numerous defendants re-urged their pleadings challenging the legal sufficiency of the petitions. Some of the defendants grounds for challenging the plaintiffs petitions were heard by the court on May 25, 2011 and were denied. As of October 28, 2011, the court had not entered a judgment regarding its ruling. Once it does, the defendants will have 30 days to file a supervisory writ with the appellate court seeking to overturn the lower court s ruling. Many of the defendants other grounds for challenging the plaintiffs petitions have yet to be heard by the court. It is anticipated that the discovery phase of this case will become more active in the upcoming months.

Due to the current stages of the above litigation, the outcomes are uncertain and management cannot determine the amount of loss, if any, that may result. Litigation is inherently uncertain. Adverse decisions in one or more of the above matters could have a material adverse affect on our financial condition or results of operations.

In addition to the above, we have been named as a defendant in various other lawsuits related to our business. The ultimate resolution of such other matters is not expected to have a material adverse effect on our financial condition or results of operations.

ITEM 1A. RISK FACTORS.

See risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2010 and our Quarterly Report on Form 10-Q for the quarter ended June 30, 2011.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) None

(b) Not Applicable.

(c) We do not have a share repurchase program, and during the three months ended September 30, 2011, we did not purchase any shares of our common stock.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

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ITEM 4. REMOVED AND RESERVED

ITEM 5. OTHER INFORMATION

(a) On October 31, 2011, we entered into a second amendment to our senior revolving credit agreement, dated as of September 30, 2010, as amended on May 3, 2011, with The Bank of Nova Scotia, as administrative agent and letter of credit issuer and lead arranger, Amegy Bank National Association, as syndication agent, and KeyBank National Association and Société Générale, as co-documentation agents. In the second amendment, certain changes were made to the terms of our revolving credit facility to conform the provisions relating to the administrative agent and other lenders to the model provisions promulgated by the Loan Syndications and Trading Association.

On October 31, 2011, we also entered into a third amendment to our revolving credit which (1) increased the borrowing base from $90.0 million to $125.0 million, (2) increased the highest applicable rate for base rate loans and eurodollar loans in certain circumstances to 2.50% and 3.50%, respectively and (3) adjusted the commitment percentage of each of the lenders. Other material terms of the revolving credit agreement remained unchanged.

The preceding summary of the amendments is qualified in its entirety by reference to the full text of such amendments, copies of which are filed as Exhibit 10.1 and 10.2 to this report.

(b) None.

ITEM 6. EXHIBITS

Exhibit Number	Description
3.1	Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Form 8-K, File No. 000-19514, filed by the Company with the SEC on April 26, 2006).
3.2	Certificate of Amendment No. 1 to Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.2 to Form 10-Q, File No. 000-19514, filed by the Company with the SEC on November 6, 2009).
3.3	Amended and Restated Bylaws (incorporated by reference to Exhibit 3.2 to Form 8-K, File No. 000-19514, filed by the Company with the SEC on July 12, 2006).
4.1	Form of Common Stock certificate (incorporated by reference to Exhibit 4.1 to Amendment No. 2 to the Registration Statement on Form SB-2, File No. 333-115396, filed by the Company with the SEC on July 22, 2004).
4.2	Form of Warrant Agreement (incorporated by reference to Exhibit 10.4 to Amendment No. 2 to the Registration Statement on Form SB-2, File No. 333-115396, filed by the Company with the SEC on July 22, 2004).
4.3	Registration Rights Agreement, dated as of February 23, 2005, by and among the Company, Southpoint Fund LP, a Delaware limited partnership, Southpoint Qualified Fund LP, a Delaware limited partnership and Southpoint Offshore Operating Fund, LP, a Cayman Islands exempted limited partnership (incorporated by reference to Exhibit 10.7 of Form 10-KSB, File No. 000-19514, filed by the Company with the SEC on March 31, 2005).
4.4	Registration Rights Agreement, dated as of March 29, 2002, by and among Gulfport Energy Corporation, Gulfport Funding LLC, certain other affiliates of Wexford and the other Investors Party thereto (incorporated by reference to Exhibit 10.3 of Form 10-QSB, File No. 000-19514, filed by the Company with the SEC on November 11, 2005).
4.5	Amendment No. 1, dated February 14, 2006, to the Registration Rights Agreement, dated as of March 29, 2002, by and among Gulfport Energy Corporation, Gulfport Funding LLC, certain other affiliates of Wexford and the other Investors Party thereto (incorporated by reference to Exhibit 10.15 of Form 10-KSB, File No. 000-19514, filed by the Company with the SEC on March 31, 2006).

10.1*

	Second Amendment to Credit Agreement, dated as of October 31, 2011, by and among the Company, as borrower, The Bank of Nova Scotia, as administrative agent, letter of credit issuer and lead arranger, Amegy Bank National Association, as syndication agent, KeyBank National Association, as co-documentation agent, and the other lenders party thereto.
10.2*	Third Amendment to Credit Agreement, dated as of October 31, 2011, by and among the Company, as borrower, The Bank of Nova Scotia, as administrative agent, letter of credit issuer and lead arranger, Amegy Bank National Association, as syndication agent, KeyBank National Association and Société Générale, as co-documentation agents, and the other lenders party thereto.
31.1*	Certification of Chief Executive Officer of the Registrant pursuant to Rule 13a-14(a) promulgated under the Securities Exchange Act of 1934, as amended.

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31.2*	Certification of Chief Financial Officer of the Registrant pursuant to Rule 13a-14(a) promulgated under the Securities Exchange Act of 1934, as amended.
32.1*	Certification of Chief Executive Officer of the Registrant pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended, and Section 1350 of Chapter 63 of Title 18 of the United States Code.
32.2*	Certification of Chief Financial Officer of the Registrant pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended, and Section 1350 of Chapter 63 of Title 18 of the United States Code.
101.INS**	XBRL Instance Document
101.SCH**	XBRL Taxonomy Extension Schema Document
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF**	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB**	XBRL Taxonomy Extension Labels Linkbase Document
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith.
** Furnished herewith, not filed.

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SIGNATURES

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

GULFPORT ENERGY CORPORATION

Date: November 4, 2011

/s/ James D. Palm
James D. Palm
Chief Executive Officer

/s/ Michael G. Moore
Michael G. Moore
Chief Financial Officer