# Frontera Resources Corporation and Subsidiaries

## Condensed Consolidated Financial Statements
## Three and Nine Months Ended September 30, 2009 and 2008

# Frontera Resources Corporation and Subsidiaries
## Index

**Page(s)**

**Condensed Consolidated Financial Statements** *(Unaudited)*

Balance Sheets ........................................ 1

Statements of Operations ........................................ 2

Statement of Stockholders' Equity ........................................ 3

Statements of Cash Flows ........................................ 4

Notes to Financial Statements ........................................ 5–13

Management's Discussion and Analysis of Financial Condition and Results of Operations ................ 14–22

# Frontera Resources Corporation and Subsidiaries

## Condensed Consolidated Balance Sheets *(Unaudited)*

| | September 30, 2009 | December 31, 2008 |
|---|---|---|
| **Assets** | | |
| Current assets | | |
| Cash and cash equivalents | $ 6,098,221 | $ 7,662,891 |
| Restricted cash | - | 5,000,000 |
| Accounts receivable | 588,956 | 976,695 |
| Inventory | 8,185,545 | 7,454,584 |
| Prepaid expenses and other current assets | 322,681 | 774,311 |
| Total current assets | 15,195,403 | 21,868,481 |
| Property and equipment, net | 1,645,729 | 1,818,269 |
| Oil and gas properties, full cost method | | |
| Properties being depleted | 74,120,029 | 69,718,752 |
| Properties not subject to depletion | 40,719,967 | 40,458,694 |
| Less: Accumulated depletion | (71,098,029) | (69,718,752) |
| Net oil and gas properties | 43,741,967 | 40,458,694 |
| Investments | 9,400,000 | 11,500,000 |
| Other assets | 4,045,288 | 5,159,704 |
| Total assets | $ 74,028,387 | $ 80,805,148 |
| **Liabilities and Stockholders' Equity** | | |
| Current liabilities | | |
| Accounts payable | $ 157,364 | $ 304,992 |
| Accrued liabilities | 3,883,573 | 3,128,288 |
| Short-term notes payable | 9,450,000 | 9,450,000 |
| Line of credit | - | 1,978,414 |
| Total current liabilities | 13,490,937 | 14,861,694 |
| Convertible notes payable | 101,594,088 | 94,393,483 |
| Other long-term liabilities | 23,555 | 32,037 |
| Derivative stock warrant liabilities | 8,067,778 | - |
| Commitments and contingencies | | |
| Stockholders' equity | | |
| Common stock | 4,712 | 2,997 |
| Additional paid-in capital | 168,955,147 | 162,599,116 |
| Common stock warrants | - | 3,114,055 |
| Treasury stock, at cost | (567,832) | (567,832) |
| Accumulated deficit | (216,939,998) | (192,530,402) |
| Accumulated other comprehensive loss | (600,000) | (1,100,000) |
| Total stockholders' equity | (49,147,971) | (28,482,066) |
| Total liabilities and stockholders' equity | $ 74,028,387 | $ 80,805,148 |

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

## Frontera Resources Corporation and Subsidiaries

### Condensed Consolidated Statements of Operations *(Unaudited)*

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| **Revenue - crude oil sales** | $ - | $ - | $ 1,695,503 | $ 2,874,437 |
| **Operating expenses** | | | | |
| Field operating and project costs | 700,154 | 1,319,119 | 4,061,142 | 4,006,274 |
| General and administrative | 5,440,323 | 6,190,154 | 12,000,647 | 14,357,066 |
| Depreciation, depletion and amortization | 303,242 | 175,313 | 584,659 | 510,114 |
| Impairment of oil and gas properties | 229,357 | - | 1,088,304 | - |
| Total operating expenses | 6,673,076 | 7,684,586 | 17,734,752 | 18,873,454 |
| Loss from operations | (6,673,076) | (7,684,586) | (16,039,249) | (15,999,017) |
| **Other income (expense)** | | | | |
| Interest income | 60,441 | 285,205 | 281,746 | 968,190 |
| Interest expense | (3,025,234) | (2,951,385) | (8,702,214) | (6,975,624) |
| Derivative expense | (3,385,521) | - | (3,385,521) | - |
| Other, net | (411,897) | (42,738) | 1,223,307 | (35,660) |
| Total other income (expense) | (6,762,211) | (2,708,918) | (10,582,682) | (6,043,094) |
| Net loss | $ (13,435,287) | $ (10,393,504) | $ (26,621,931) | $ (22,042,111) |
| **Loss per share** | | | | |
| Basic and diluted | $(0.17) | $(0.14) | $(0.35) | $(0.31) |
| **Number of shares used in calculating loss per share** | | | | |
| Basic and diluted | 81,384,754 | 73,168,765 | 77,069,028 | 71,711,170 |

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

# Frontera Resources Corporation and Subsidiaries

## Condensed Consolidated Statement of Stockholders' Equity *(Unaudited)*

| | Common Stock | Additional Paid-in Capital | Common Stock Warrants | Treasury Stock | Accumulated Deficit | Accumulated Other Comprehensive Loss | Total Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| **Balances at December 31, 2008** | $ 2,997 | $ 162,599,116 | $3,114,055 | $ (567,832) | $ (192,530,402) | $ (1,100,000) | $ (28,482,066) |
| Conversion of convertible debt | 2 | 54,021 | - | - | - | - | 54,023 |
| Issuance of common stock | 1,259 | 2,181,674 | - | - | - | - | 2,182,933 |
| Cumulative effect of change in accounting principle (Note 7) | - | - | (3,114,055) | - | 2,212,335 | - | (901,720) |
| Stock based compensation expense | 454 | 4,120,336 | - | - | - | - | 4,120,790 |
| Reclassification adjustment for realized losses on investments included in net loss | - | - | - | - | - | 666,559 | 666,559 |
| Unrealized gain (loss) on short-term investments | - | - | - | - | - | (166,559) | (166,559) |
| Net loss | - | - | - | - | (26,621,931) | - | (26,621,931) |
| Total comprehensive loss for the year | - | - | - | - | (26,621,931) | - | (26,121,931) |
| **Balances at September 30, 2009** | $ 4,712 | $ 168,955,147 | $ - | $ (567,832) | $ (216,939,998) | $ (600,000) | $ (49,147,971) |

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

# Frontera Resources Corporation and Subsidiaries

## Condensed Consolidated Statements of Cash Flows *(Unaudited)*

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2009 | 2008 |
| **Cash flows from operating activities** | | |
| Net loss | $ (26,621,931) | $ (22,042,111) |
| Adjustments to reconcile net loss to net cash used in operating activities | | |
| Depreciation, depletion and amortization | 584,659 | 510,114 |
| Impairment | 1,088,304 | - |
| Derivative expense | 3,385,521 | - |
| Realized loss on sale of investments | 666,559 | - |
| Debt issuance cost amortization | 1,114,416 | 657,842 |
| Noncash interest expense | 7,254,628 | 6,153,345 |
| Stock based compensation | 4,120,790 | 2,314,757 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 387,739 | (51,698) |
| Inventory | (730,961) | 986,674 |
| Prepaid expenses and other current assets | 451,630 | (461,186) |
| Accounts payable | (147,628) | (2,137,161) |
| Accrued liabilities | (1,067,847) | (6,404,784) |
| Other long-term liabilities | (8,482) | (4,803) |
| Net cash used in operating activities | (9,522,603) | (20,479,011) |
| **Cash flows from investing activities** | | |
| Investment in oil and gas properties | (2,839,417) | (24,394,022) |
| Investment in property and equipment | (121,147) | (310,366) |
| Redemption of investments | 1,933,441 | 13,000,000 |
| Net cash used in investing activities | (1,027,123) | (11,704,388) |
| **Cash flows from financing activities** | | |
| Proceeds from line of credit | 3,000,000 | 1,978,414 |
| Repayments of line of credit | (4,978,414) | - |
| Proceeds from convertible debt | - | 23,500,000 |
| Restricted cash | 5,000,000 | 10,118,786 |
| Debt issuance costs | - | (643,709) |
| Proceeds from short-term notes payable | - | 9,450,000 |
| Exercise of common stock options | - | 347,050 |
| Net proceeds from issuance of common stock and warrants | 5,963,470 | - |
| Net cash provided by financing activities | 8,985,056 | 44,750,541 |
| Net increase (decrease) in cash and cash equivalents | (1,564,670) | 12,567,142 |
| **Cash and cash equivalents** | | |
| Beginning of year | 7,662,891 | 4,945,221 |
| End of period | $ 6,098,221 | $ 17,512,363 |
| **Supplemental cash flow information** | | |
| Cash paid for interest | $ 222,524 | $ 115,621 |
| Accrued interest | 110,646 | 48,816 |
| **Supplemental disclosure of noncash investing and financing activities** | | |
| Issuance of convertible notes in lieu of interest payments | $ 7,254,628 | $ 5,673,712 |
| Noncash debt issuance costs | - | 3,114,055 |
| Conversion of debt to common stock | 53,283 | 4,539,634 |
| Noncash common stock and warrant issuance costs | 199,900 | - |

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

## 1. Nature of Operations

Frontera Resources Corporation, a Delaware corporation, and its subsidiaries (collectively "Frontera" or the "Company") are engaged in the development of oil and gas projects in emerging marketplaces. Frontera was founded in 1996 and is headquartered in Houston, Texas. The Company emphasizes development of reserves in known hydrocarbon-bearing basins, and is attracted to projects that have significant exploration upside. Since 2002, the Company has focused substantially all of its efforts on the exploration and development of oilfields within the country of Georgia ("Georgia"), an independent country that was a member of the Former Soviet Union.

In June 1997, the Company entered into a 25-year production sharing agreement with the Ministry of Fuel and Energy of Georgia and State Company Georgian Oil ("Georgian Oil"), which gives the Company the exclusive right to explore, develop and produce crude oil in a 5,500 square kilometer area in eastern Georgia known as Block 12, hereafter referred to as the "Block 12 PSA". The Block 12 PSA can be extended for five years if commercial production remains viable upon its expiration in June 2022.

Under the terms of the Block 12 PSA, the Company is entitled to conduct exploration and production activities and is entitled to recover its cumulative costs and expenses from the crude oil produced from Block 12. Following recovery of cumulative costs and expenses from Block 12 production, the remaining crude oil sales, referred to as Profit Oil, are allocated between Georgian Oil and Frontera in the proportion of 51% and 49%, respectively.

Under the terms of the Block 12 PSA, Frontera is exempt from all taxes imposed by the government of Georgia, and any taxes imposed on the Company are paid by Georgian Oil on behalf of the Company from Georgian Oil's 51% share of Profit Oil. Taxes are defined by the Block 12 PSA to mean all levies, duties, payments, fees, taxes or contributions payable to or imposed by any government agency, subdivision, municipal or local authorities within the government of Georgia.

Frontera's future revenues depend on operating results from its operations in Georgia. The success of Frontera's operations is subject to various contingencies beyond management control. These contingencies include general and regional economic and political conditions, prices for crude oil, competition and changes in regulation. Frontera is subject to various additional political and economic uncertainties in Georgia, which could include restrictions on transfer of funds, import and export duties, quotas and embargoes, domestic and international customs and tariffs, relations with neighboring countries including the Russian Federation, and changing taxation policies, foreign exchange restrictions, political conditions and regulations.

## 2. Liquidity and Capital Resources

In September 2009, the Company issued 46,542,132 units ("Units") each comprised of one share of common stock and one common stock purchase warrant (a "Warrant") at an issue price of £0.103 per Unit, for gross proceeds of approximately $7.6 million, net of $0.3 million in fees associated with the issuance. Of the total proceeds, $1.3 million is expected to be collected during the fourth quarter of 2009. Each Warrant will entitle the holder to purchase from the Company one share of common stock for a period of two years following the transaction closing date at an exercise price of £0.15 per Share. As described in Note 3, the Company has classified these Warrants as derivative warrant liabilities on the Balance Sheet.

The Company has incurred net losses and negative cash flows from operations in most fiscal periods since inception.

The Company's viability is dependent upon producing oil and gas in sufficient quantities and marketing such oil and gas at sufficient prices to provide positive operating cash flow to the Company. The Company is solely responsible for providing all of the funding for the development of Block 12 in Georgia and will require additional funding in order to obtain adequate levels of production and generate sufficient cash flows to meet future capital spending plans and operating spending requirements. This is dependent upon, among other factors, achieving significant increases in production, producing oil and gas at costs that provide acceptable margins, maintaining reasonable levels of taxation from local authorities and marketing the oil and gas produced at or near world prices.

Management's plan for addressing the above uncertainties is partially based on forward looking events which have yet to occur, including the successful completion of its development program, and accordingly, there is no assurance that those events will transpire as initially contemplated.

The following key financial measurements reflect the Company's financial position and capital resources as of September 30, 2009 and December 31, 2008 (dollars in thousands):

| | September 30,2009 | December 31, 2008 |
|---|---|---|
| Cash and cash equivalents | $ 6,098 | $ 7,663 |
| Working capital | $ 1,704 | $ 7,007 |
| Total debt | $ 112,993 | $ 105,822 |
| Debt to debt and equity | 177% | 137% |

Cash and cash equivalents consist of highly liquid investments in deposits held at major financial institutions.

Operating cash flow is influenced mainly by the prices received for the Company's oil production, the quantity of oil produced and the success of the Company's development and exploration activities. Currently the Company does not generate sufficient operating cash flows to cover general corporate activities or planned capital expenditure programs. The principal factors that could adversely affect the amount and availability of internally generated cash flows from operations include:

- Further deterioration in the sales price of crude oil.
- Decline in current production volumes or production volumes of future wells being less than anticipated.
- Inability to attract outside financing to continue discretionary capital expenditures for future drilling.

The principal factors that could adversely affect the ability to obtain financing from external sources include:

- Covenants contained in the Company's 10% convertible notes.
- Volatility in the markets for corporate debt, continued market instability, unavailability of credit or inability to access the capital markets as a result of the global financial crisis.
- Fluctuations in the market price of the Company's common stock.

### 3. Basis of Presentation and Summary of Significant Accounting Policies

The condensed consolidated balance sheet of the Company at December 31, 2008 was derived from the Company's audited consolidated financial statements as of that date, but does not include all disclosures required by accounting principles generally accepted in the United States of America. The condensed consolidated balance sheet at September 30, 2009, the condensed consolidated statements of operations for the three and nine month periods ended September 30, 2009 and 2008, the condensed consolidated statement of changes in stockholders' equity for the nine month period ended September 30, 2009, and the condensed consolidated statements of cash flows for the nine periods ended September 30, 2009 and 2008 were prepared by the Company.

In the opinion of Company management, all adjustments, consisting of normal recurring adjustments, necessary to state fairly the consolidated financial position, results of operations and cash flows were recorded. The results of operations for the nine month period ended September 30, 2009 are not necessarily indicative of the operating results for a full year or of future operations.

Certain information and footnote disclosures normally included in financial statements presented in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. The accompanying condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto contained in the Company's consolidated financial statements for the year ended December 31, 2008.

Certain amounts in the unaudited condensed consolidated financial statements have been reclassified in the prior period to conform with current period presentation. Reclassifications have no impact on the Company's financial position or results of operations.

Events occurring after September 30, 2009, were evaluated as of November 18, 2009, the date this Quarterly Report was issued, to ensure that any subsequent events that met the criteria for recognition and/or disclosure in this report have been included.

For a description of the Company's accounting policies, refer to Note 3 of the 2008 consolidated financial statements.

In June 2009, the FASB issued "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles", which establishes the FASB Accounting Standards Codification ("ASC") as the source of authoritative accounting principles recognized by the FASB to be applied in preparation of financial statements in conformity with GAAP. The ASC is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Codification does not change or alter existing GAAP. The implementation had no impact to the Company's financial position or results of operations.

The Company follows the United States Security Exchange Commission's ("SEC") guidance related to the full cost method of accounting for oil and gas activities. In December 2008, the SEC issued a final rule, *Modernization of Oil and Gas Reporting* which is effective January 1, 2010. The new disclosure requirements permit the use of new technologies to determine proved reserves if those technologies have been demonstrated empirically to lead to reliable conclusions about reserve volumes. Currently, the SEC requires that reserve volumes are determined using prices on the last day of the reporting period; however, the new disclosure requirements provide for reporting and oil and natural gas reserves using a 12-month average price rather than the last day of reporting period prices. The new requirements also will allow companies to disclose their

probable and possible reserves to investors. The new disclosure requirements also require companies to report the independence and qualifications of a reserve preparer or auditor. We will adopt the provisions of the final rule in connection with our December 31, 2009 financial statements.

**Use of Estimates**

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent asset and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Estimates of oil and natural gas reserves and their values, future production rates and future costs and expenses are inherently uncertain for numerous reasons, including many factors beyond the Company’s control. Reservoir engineering is a subjective process of estimating underground accumulations of oil and natural gas that cannot be measured in an exact manner. The accuracy of any reserve estimate is a function of the quality of data available and of engineering and geological interpretation and judgment. In addition, estimates of reserves may be revised based on actual production, results of subsequent exploitation and development activities, prevailing commodity prices, operating costs and other factors. These revisions may be material and could materially affect the Company’s future depletion, depreciation and amortization expenses.

The Company’s revenue, profitability, and future growth are substantially dependent upon the prevailing and future prices for oil and natural gas, which are dependent upon numerous factors beyond its control such as economic, regulatory developments and competition from other energy sources. The energy markets have historically been volatile and there can be no assurance that oil and natural gas prices will not be subject to wide fluctuations in the future. A substantial or extended decline in oil and natural gas prices could have a material adverse effect on the Company’s financial position, results of operations, cash flows and quantities of oil and natural gas reserves that may be economically produced.

**Fair Value Measurements**

Our financial instruments include cash, receivables, investments, payables, derivatives and debt. At September 30, 2009 the estimated fair value of such financial instruments approximated their carrying value as reflected in our balance sheet. See Derivative Stock Warrant Liabilities and Investments below for further discussion of the Company's fair value measurement of investments.

**Derivative Stock Warrant Liabilities**

In June 2008, the FASB issued authoritative guidance “Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity’s Own Stock”. The adoption of this guidance required us to (1) evaluate our instrument’s contingent exercise provisions and (2) evaluate the instrument’s settlement provisions. Based upon applying this approach to instruments within the scope of the consensus, we have determined that our warrants which were classified in stockholders’ equity on December 31, 2008, no longer meet the definition of Indexed to a Company’s Own Stock provided in the Consensus. Accordingly, we were required to reclassify those Warrants, at their fair value to liabilities. This requires that the fair value of these liabilities be re-measured at the end of every reporting period with the change in value reported in the statement of operations. The difference between the amount the warrants were originally recorded in the financials and the fair value of the instruments on January 1, 2009 was considered a cumulative effect of a change in accounting principle and required an adjustment to the opening balance of retained earnings in the amount of $2,212,335 and a reduction of common stock warrants of $3,114,055.

The fair value of the derivative stock warrant liabilities was $901,720 at the remeasurement date of January 1, 2009. During September 2009, the Company issued additional warrants with a grant date fair value of $3,780,537 (Note 2). The fair value of the combined derivative stock warrant liabilities on September 30, 2009 was $8,067,778. The change in the warrant liability resulted in a derivative expense of $3,385,521 for the three and nine month periods ended September 30, 2009.

**Investments**

Investments consist of Municipal Short Term Auction Rate Securities ("M-STARS") and corporate bonds both of which represent funds available for current operations. Based on guidance for investments in debt and equity securities, these M-STARS are classified as available-for-sale and are carried at estimated fair market value. These securities have stated maturities beyond three months but are priced and traded as short-term instruments due to the liquidity provided through the interest rate mechanism of 7 to 35 days.

The auction process resets the applicable interest rates at prescribed calendar intervals and is intended to provide liquidity to the holders of auction rate securities by matching buyers and sellers in a market context, enabling the holders to gain immediate liquidity by selling such securities at par, or rolling over their investment. If there is an imbalance between buyers and sellers, there is a risk of a failed auction. Due to recent credit issues experienced by short-term funding markets, some of these securities, including our M-STARS, have failed at auction in 2008 and 2009; however, we successfully liquidated $13.0 million of our M-STARS during 2008 at face value. During 2009 the Company liquidated $2.6 million in face value of its M-STARS for total proceeds of $1.9 million. An auction failure is not a default, and in some cases it could reset the applicable interest rates to a higher rate as outlined by the security. Based on the Company's inability to currently liquidate the remaining M-STARS at par value, these investments have been classified as noncurrent investments at September 30, 2009 and December 31, 2008.

The Company classifies financial assets and liabilities based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of the fair value of assets and liabilities and their placement within the fair value hierarchy levels. The Company has classified its derivative stock warrant liabilities into level 2 and its investments into level 3 under the fair value hierarchy based upon the data relied upon to determine the fair value.

The following table summarizes the valuation of the Company's financial assets and liabilities by pricing levels as of September 30, 2009.

| | Fair Value Measurement Using: | | | |
|---|---|---|---|---|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Fair Value |
| Assets: | | | | |
| Investments - M-STARS | $ - | $ - | $ 9,400,000 | $ 9,400,000 |
| Total assets | $ - | $ - | $ 9,400,000 | $ 9,400,000 |
| Liabilities: | | | | |
| Derivative stock warrant liabilities | $ - | $8,067,778 | $ - | $ 8,067,778 |
| Total liabilities | $ - | $8,067,778 | $ - | $ 8,067,778 |

The table below sets forth a reconciliation for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the nine months ended September 30, 2009:

| | |
|---|---|
| Investments – M-STARS as of December 31, 2008 | $ 11,500,000 |
| Change in unrealized gain (loss) | 500,000 |
| Redemption of investments | (2,600,000) |
| Investments – M-STARS as of September 30, 2009 | $ 9,400,000 |

## 4. Detail of Certain Balance Sheet Accounts

**Accounts Receivable**
Accounts receivable consists of the following:

| | September 30, 2009 | December 31, 2008 |
|---|---|---|
| Trade receivables | $ - | $ - |
| Other receivables | 588,956 | 976,695 |
| Total accounts receivable | $ 588,956 | $ 976,695 |

**Inventory**
Inventory consists of the following:

| | September 30, 2009 | December 31, 2008 |
|---|---|---|
| Materials and supplies | $ 5,835,015 | $ 6,552,599 |
| Crude oil | 2,350,530 | 901,985 |
| | $ 8,185,545 | $ 7,454,584 |

## 5. Notes Payable

**Line of Credit**

The Company previously held a $5.0 million line of credit with a commercial bank collateralized by $5.0 million of cash and cash equivalents. The line was primarily set up to support letters of credit issued by the Company from time to time in support of its oil and gas operations. The line of credit was paid in full upon expiration and the related $5.0 million of cash collateral was released during the second quarter of 2009.

In February 2009, the Company renewed a short-term note of approximately $9.5 million under an agreement with a bank, collateralized by its long-term investments in M-STARS. The note was due in May 2009. In May 2009, the note was renewed for six months and is collateralized by $10.0 million in face value of its long term investments in M-STARS.

## 6. Convertible Notes

During May 2007, the Company raised approximately $67.0 million through a private placement of convertible unsecured notes due May 2012. The notes were issued at par and bear interest at 10% per annum, payable quarterly in arrears in cash or in kind at the Company's discretion. The notes are convertible into shares of common stock at conversion price of $1.67 per share. The notes will be automatically converted into common stock at the conversion price if the stock price exceeds two times the conversion price for at least 20 consecutive trading days. As part of the closing of the note placement, debt issuance costs of approximately $2.7 million were incurred, of which approximately $1.5 million was paid in cash and $1.2 million was paid in additional convertible notes and stock options.

During July 2008, the Company raised $23.5 million through a private placement of convertible unsecured notes due July 2013. The notes were issued at par and bear interest at 10% per annum, payable quarterly in arrears in cash or in kind at the Company's discretion. The notes were initially convertible into common stock at a conversion price of $2.14 per share. The conversion price was subsequently reset to $1.71 per share, pursuant to the terms of the notes, since the price of the common stock closed at or below $1.71 per share for 10 out of 20 consecutive trading days. The notes will be automatically converted into common stock at the conversion price if the closing stock price exceeds two times the conversion price for at least 20 consecutive trading days.

The Company solicited consents from holders of its 10% convertible notes due 2012 to amend the note purchase agreements governing such notes to permit the issuance of the new notes and to release the remaining escrowed proceeds of $5.0 million from the May 2007 private placement. In connection with the solicitation, each consenting holder received a warrant exercisable into shares of common stock in an amount equal to 7.5% of the number of shares of common stock into which such consenting holder's existing notes were convertible. The warrants were initially exercisable for approximately 3,151,000 shares of common stock in the aggregate at an exercise price of $3.50 per share, and include a cashless exercise provision. The warrants have a five-year term and contain other customary terms and provisions. Due to anti-dilution provisions of the warrants, the Company's September 2009 equity financing discussed in Note 2 caused the number of warrants exercisable to increase to 6,527,838 and the exercise price was reduced to $1.69 per share.

During 2009 and 2008, noteholders of the Company's convertible notes elected to convert approximately $50,000 and $5.7 million of convertible notes into 31,906 and 3,392,240 shares of common stock, respectively. During 2009 and 2008, noteholders also elected to convert approximately $1,000 and $0.5 million of related interest into 443 shares and 278,792 shares of common stock, respectively.

During 2009 and 2008, the Company elected to pay the quarterly interest payments on the May 2007 and July 2008 convertible notes in kind and issued approximately $7.3 million and $8.0 million, respectively, in additional convertible notes in accordance with terms of the note purchase agreements.

## 7. Commitments and Contingencies

### SOCAR Arbitration

In June 1998, Frontera Resources Azerbaijan Corporation, an indirect wholly owned subsidiary of the Company, entered into a production sharing agreement with the State Oil Company of the Azerbaijan Republic (SOCAR), hereafter referred to as the "Azerbaijan PSA". The Azerbaijan PSA covered the Kursangi and Karabagli onshore oilfields in an area of Azerbaijan known as the "K&K Block". The Company and an operating partner (the "Partners") undertook an exploration and development program on the K&K Block. The Company's relationship with SOCAR deteriorated as a result of several disputes under the Azerbaijan PSA, and the Company was unsuccessful at reaching a settlement with SOCAR.

Frontera initiated binding arbitration against SOCAR in October 2003 related to claims resulting from SOCAR's halting of oil exports and seizure of oil from the K&K Block during the fourth quarter of 2000. The arbitration was held in Stockholm under the rules of the United Nations Commission on International Trade Law. In January 2006, the arbitral panel found that the seizure of crude oil from the K&K Block was in violation of the Azerbaijan PSA and awarded Frontera approximately $1.2 million plus interest from January 2001 until payment is made. Including interest, the amount of the award is approximately $2.0 million. The arbitral panel directed Frontera to pay approximately $0.3 million of SOCAR's costs and rejected all other claims and counterclaims between the parties. SOCAR refused to pay the award and filed an action in the Svea Court of Appeal in Stockholm to annul the award. A final hearing was held in March 2009, and in May 2009, the court upheld the original award and directed SOCAR to pay Frontera additional costs of approximately $0.3 million. The court's decision states that it is not subject to appeal. In June 2009, SOCAR paid the award and related costs in accordance with the rulings of the arbitral panel and the court of appeal.

In February 2006, the Company commenced an action in the United States District Court for the Southern District of New York, seeking to enforce the award. In March 2007, the District Court granted SOCAR's motion to dismiss, and the Company appealed that decision in July 2007 to the United States Court of Appeals for the Second Circuit. The hearing on the appeal occurred in October 2008. In September 2009, the Second Circuit issued its opinion and remanded the case to the District Court for further consideration in view of its ruling. Upon stipulation by the parties, the District Court dismissed the case in October 2009.

### ARAR Arbitration

In January 2008, Frontera Eastern Georgia Ltd. ("FEGL"), a wholly owned subsidiary of the Company, served a notice of arbitration and claim on ARAR, Inc. ("ARAR"), for breach of contract under a drilling services contract dated May 2007, specifically for, among other things, failure to commence work by the time specified in the contract, failure of the drilling rig to meet required specifications and failure to reconcile advance payments made by FEGL with work actually performed. FEGL terminated the contract after ARAR failed to mobilize the rig to the required location and failed to commence work as otherwise required under the contract. FEGL claimed damages of approximately $7.0 million in the arbitration. ARAR denied FEGL's claims and filed counterclaims against FEGL, seeking payments of approximately $7.1 million for, among other things, standby charges for the period of time the rig was undergoing inspection and repairs to bring it into contract specification, early termination fees and demobilization fees. The parties entered into a settlement agreement in December 2008 pursuant to which ARAR is required to

make a series of payments to FEGL through December 2009. The settlement resolves all outstanding claims and counterclaims between Frontera and ARAR arising out of the drilling services contract. Beginning in August 2009, ARAR defaulted on its monthly payments due August and September 2009. The Company has applied to the arbitration panel for entry of an agreed award pursuant to the settlement agreement. The panel has scheduled a hearing for November 30, 2009.

## Introduction

The following discussion and analysis should be read in conjunction with the accompanying financial statements and related notes thereto. The following discussion contains forward-looking statements that reflect our future plans, estimates, beliefs and expected performance. The forward-looking statements are dependent upon events, risks and uncertainties that may be outside our control. Our actual results could differ materially from those discussed in these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, market prices for natural gas and oil, economic and competitive conditions, regulatory changes, estimates of proved reserves, potential failure to achieve production from development projects, capital expenditures and other uncertainties, as well as those factors discussed below, particularly in “Risk Factors” and “Cautionary Statement Concerning Forward-Looking Statements,” all of which are difficult to predict. In light of these risks, uncertainties and assumptions, the forward-looking events discussed may not occur.

## Overview of Our Company

Frontera Resources Corporation, a Delaware corporation, and its subsidiaries (collectively “Frontera” or the “Company”) are engaged in the development of oil and gas projects in emerging marketplaces. Frontera was founded in 1996 and is headquartered in Houston, Texas. The Company emphasizes development of reserves in known hydrocarbon-bearing basins, and is attracted to projects that have significant exploration upside. Since 2002, the Company has focused substantially all of its efforts on the exploration and development of oilfields within the country of Georgia (“Georgia”), a member of the Former Soviet Union. Prior to 2002, the Company’s other significant operating focus was on the exploration and development of an oilfield within the Azerbaijan Republic (“Azerbaijan”), which was sold during 2002 and all operating activities in Azerbaijan ceased at that time.

In accordance with full cost accounting rules, we are subject to a limitation on capitalized costs. The capitalized cost of natural gas and oil properties, net of accumulated depreciation, depletion and amortization, may not exceed the estimated future net cash flows from proved oil and gas reserves discounted at 10%, plus the lower of cost or fair market value of unproved properties as adjusted for related tax effects, which is known as the ceiling limitation. If capitalized costs exceed the ceiling limitation, the excess must be charged to expense. We did not have any adjustment to earnings due to the ceiling limitation for the 2008 periods presented herein. For the 2009 periods presented herein we recorded an impairment provision of $1.1 million related to the Company’s fields in Georgia.

## Results of Operations

### *Nine Months Ended September 30, 2009 Compared to Nine Months Ended September 30, 2008*

*Revenue.* Revenues for the nine months ended September 30, 2009 decreased $1.2 million to $1.7 from $2.9 million for the comparable 2008 period. The decrease was due to decreases in both sales volumes and commodity prices in the 2009 period.

*Operating Costs and Expenses.* Total operating costs and expenses decreased to $17.7 million for the nine months ended September 30, 2009 compared to $18.9 million for the same period in 2008.

Field operating and project costs includes the costs associated with our exploration and production activities, including, but not limited to, drilling, field operating expense and processing costs. These costs increased $0.1 million to $4.1 million during the nine months ended September 30, 2009 as compared to $4.0 million for the nine months ended September 30, 2008. Substantially all of the increase was due to

the cost of expatriate drilling personnel charged to operating expense in the 2009 period versus capitalized in drilling costs for the 2008 period.

Depreciation, depletion and amortization and impairment increased $1.2 million during the nine months ended September 30, 2009 to $1.7 million as compared to $0.5 million for the nine months ended September 30, 2008. The increase was primarily attributable to the $1.1 million ceiling test write-down during the nine months ended September 30, 2009 with no like adjustment required in the 2008 period.

General and administrative expenses decreased $2.4 million to $12.0 million for the nine months ended September 30, 2009 from $14.4 million for the comparable period in 2008. The decrease was generally attributable to a series of cost cutting measures instituted in the first quarter of 2009, primarily related to headcount reductions in Georgia and Houston.

*Other Income (Expense).* Total other expense increased to $10.6 million in the nine month period ended September 30, 2009 from $6.0 million in the nine month period ended September 30, 2008. The $4.6 million increase is primarily attributable to an increase in interest expense of $1.8 million, an increase in derivative expense of $3.4 million, a $0.7 million decrease in interest income and a $0.7 million loss on sale of investments. These increases were offset by a $2.0 million arbitral award collected in the second quarter of 2009.

Interest income decreased to $0.3 million for the nine months ended September 30, 2009 from $1.0 million for the same period in 2008. This decrease was due to lower available cash for investment in the 2009 period as compared to the same period in 2008 primarily due to the $23.5 million convertible debt offering which occurred in July 2008.

Interest expense increased to $8.7 million for the nine months ended September 30, 2009 from $6.9 million for the same period in 2008. This increase was primarily attributable to interest on the $23.5 million convertible debt offering in July 2008 and to additional debt incurred by making interest payments in kind on the 2007 and 2008 convertible debt offerings.

Derivative expense increased to $3.4 million for the nine months ended September 30, 2009 from zero for the same period in 2008. The increase is due mainly to the required marking to market of 46.5 million warrants issued as part of the Company's September 2009 $7.6 million equity financing. See Note 2 of the accompanying financial statements for further discussion.

***Three Months Ended September 30, 2009 Compared to Three Months Ended September 30, 2008***

*Revenue.* Revenues for the three months ended September 30, 2009 and 2008 were zero for both periods, as no oil sales were made.

*Operating Costs and Expenses.* Total operating costs and expenses decreased to $6.7 million for the three months ended September 30, 2009 compared to $7.7 million for the same period in 2008.

Field operating and project costs includes the costs associated with our exploration and production activities, including, but not limited to, drilling, field operating expense and processing costs. These costs decreased $0.6 million to $0.7 million during the three months ended September 30, 2009 as compared to $1.3 million for the three months ended September 30, 2008. Substantially all of the decrease was attributable to a decrease in expatriate and national staff in the 2009 period.

Depreciation, depletion and amortization and impairment increased $0.3 million during the three months ended September 30, 2009 to $0.5 million as compared to $0.2 million for the three months ended September 30, 2008. The increase was primarily attributable to the $0.2 million ceiling test write-down during the third quarter of 2009 with no like adjustment required in the 2008 period, and higher depletion due to higher volumes of oil produced in the 2009 period.

General and administrative expenses decreased $0.8 million to $5.4 million for the three months ended September 30, 2009 from $6.2 million for the comparable period in 2008. The decrease was generally attributable to a series of cost cutting measures instituted in the first quarter of 2009, primarily related to headcount reductions in Georgia and Houston.

*Other Income (Expense).* Total other expense increased to $6.8 million in the three month period ended September 30, 2009 from $2.7 million in the three month period ended September 30, 2008. The $4.1 million increase is primarily attributable to an increase in interest expense of $0.1 million, an increase in derivative expense of $3.4 million, a $0.2 million decrease in interest income and a $0.4 million loss on sale of investments.

Interest income decreased to $0.1 million for the three months ended September 30, 2009 from $0.3 million for the same period in 2008. This decrease was due to lower available cash for investment in the 2009 period as compared to the same period in 2008 primarily due to the $23.5 million convertible debt offering which occurred in July 2008.

Interest expense increased to $3.0 million for the three months ended September 30, 2009 from $2.9 million for the same period in 2008. This increase was primarily attributable to interest on the additional debt incurred by making interest payments in kind on the 2007 and 2008 convertible debt offerings.

Derivative expense increased to $3.4 million for the three months ended September 30, 2009 from zero for the same period in 2008. The increase is due mainly to the required marking to market of 46.5 million warrants issued as part of the Company's September 2009 $7.6 million equity financing. See Note 2 of the accompanying financial statements for further discussion.

## Liquidity and Capital Resources

### *Summary*

The Company has incurred net losses and negative cash flows from operations in most fiscal periods since inception. The Company's viability is dependent upon production oil and gas in sufficient quantities and marketing such oil and gas at sufficient prices to provide positive operating cash flow to the Company. The Company is solely responsible for providing all of the funding for the development of Block 12 in Georgia and will require additional funding in order to obtain adequate levels of production and generate sufficient cash flows to meet future capital spending plans and operating spending requirements. This is dependent upon, among other factors, achieving significant increases in production, producing oil and gas at costs that provide acceptable margins, maintaining reasonable levels of taxation from local authorities, and marketing the oil and gas produced at or near world prices.

Management's plan for addressing the above uncertainties is partially based on forward looking events which have yet to occur, including the successful completion of its development program, and accordingly, there is no assurance that those events will transpire as initially contemplated.

The following key financial measurements reflect our financial position and capital resources as of September 30, 2009 and December 31, 2008 (dollars in thousands):

| | September 30, 2009 | December 31, 2008 |
|---|---|---|
| Cash and cash equivalents | 6,098 | 7,663 |
| Working capital | 1,704 | 7,007 |
| Total debt | 112,993 | 105,822 |
| Debt to debt and equity | 177% | 137% |

Our cash and cash equivalents consist of highly liquid investments in deposits we hold at major financial institutions.

Our operating cash flow is influenced mainly by the prices that we receive for our oil production, the quantity of oil we produce and the success of our development and exploration activities. Currently we do not generate sufficient operating cash flows to cover our general corporate activities or our planned capital expenditure programs. The principal factors that could adversely affect the amount and availability of our internally generated cash flows from operations include:

- Further deterioration in the sales price of crude oil.
- Decline in current production volumes or production volumes of future wells being less than anticipated.
- Inability to attract outside financing to continue discretionary capital expenditures for future drilling.

We have met all minimum expenditure requirements under our production sharing contract in Georgia and therefore our planned capital expenditure programs are entirely discretionary.

As of September 30, 2009, our cash and cash equivalents were $6.1 million, and our long term investments were $9.4 million. At September 30, 2009 the Company had $101.6 million of convertible long term debt outstanding. The Company also had a $9.5 million short term note payable to a bank which was collateralized by $9.4 million in long term investments in M-STARS. The Company had no other outstanding debt at September 30, 2009.

Liquidity in certain auction rate securities markets remained significantly reduced in the nine months ended September 30, 2009, resulting in wide-spread auction failures, including the market for our M-STARS. Third-party pricing services are either no longer providing valuations for failed auction rate securities or are valuing such securities at par (which may not necessarily reflect prices that would be obtained in the secondary market for such securities if such a market were to develop). In the absence of a secondary market, fair value was estimated based on a number of factors including the credit quality of the obligor, the credit quality of the bond insurer, the coupon, and the likelihood of refinancing by the issuer. Based on this analysis, a temporary impairment of $0.6 million was recorded to accumulated other comprehensive loss on the accompanying condensed consolidated balance sheet. See Notes 2 and 3 of the accompanying notes to the condensed consolidated financial statements for further discussion.

***Capital Expenditures***

We have met all capital expenditure requirements under the terms of our production sharing agreement with Georgia and as a result, our capital expenditures are now discretionary. While we make and expect to continue to make substantial capital expenditures in the exploration, development, and production of natural gas and oil reserves, we are able to adjust our expenditures according to available capital resources.

Our total capital expenditures for the nine months ended September 30, 2009 were approximately $4.6 million. Our 2009 capital expenditures represent a 83% decrease over actual 2008 capital expenditures during the same period. Our 2009 capital expenditures have been focused on growing and developing our reserves and production on our existing Block 12 acreage. Of our total $4.6 million of 2009 capital expenditures, substantially all was directed to exploration and production activities in the Shallow Fields Production units.

In order to fund discretionary capital expenditures planned for 2010, we will require additional outside financing. In recent months there has been extreme volatility and disruption in the global capital and credit markets. While these market conditions persist, our ability to access the capital and credit markets may be adversely affected.

The principal factors that could adversely affect the amount and availability of our internally generated cash flows from operations include:

- Further deterioration in the sales price of crude oil.
- Decline in current production volumes or production volumes of future wells being less than anticipated.
- Inability to attract outside financing to continue discretionary capital expenditures for future drilling.

The principal factors that could adversely affect our ability to obtain financing from external sources include:

- Covenants contained in our 10% convertible notes.
- Volatility in the markets for corporate debt, continued market instability, unavailability of credit or inability to access the capital markets as a result of the global financial crisis.
- Fluctuations in the market price of our common stock.

***Cash Flow Activity***

*Operating Activities.* Cash flows used in operating activities decreased $11.0 million to $9.5 million for the nine months ended September 30, 2009 from $20.5 million for the nine months ended September 30, 2008. The decrease was primarily attributable higher non-cash charges and lower changes in operating assets and liabilities for the nine months ended September 30, 2009 as compared to the same period in 2008.

*Investing Activities.* Cash flows used in investing activities decreased $10.7 million to $1.0 million in the nine month period ended September 30, 2009 from $11.7 million in the 2008 period. The increase was primarily attributable to a net decrease of $11.1 million in investment redemptions. This was offset by a $21.8 million decrease in capital expenditures for the nine months ended September 30, 2009 as compared to September 30, 2008 as the Company's drilling campaign was significantly reduced in the 2009 period.

*Financing Activities.* Since March 2005, we have used equity issuances, borrowings and, to a lesser extent, our cash flows from oil sales to fund our exploration and production costs and general corporate overhead. Cash provided by financing activities decreased $35.8 million to $9.0 million for the nine months ended September 30, 2009 from $44.8 million for the nine months ended September 30, 2008. Our primary financing activities for the 2009 period included $5.0 million of restricted cash that was released as collateral when the Company's $5.0 million line of credit was repaid in full and net proceeds of $6.0 million from an equity financing in September 2009. We used the net proceeds to fund our capital expenditure programs and for general corporate purposes.

**Contractual Obligations and Commitments-**

The following table outlines our contractual obligations and commitments by payment due dates as of September 30, 2009 (in millions):

| | Payments Due by Period | | | | |
|---|---|---|---|---|---|
| | Total | Less than 1 Year | 2-3 Years | 4-5 Years | After 5 Years |
| **Contractual Obligations and Commitments** | | | | | |
| Long-term debt–principal | 101.6 | $ - | $ 75.0 | $ 26.6 | $ - |
| Long-term debt–interest | 29.7 | 10.2 | 17.5 | 2.0 | - |
| Lease agreements | 0.8 | 0.6 | 0.2 | - | - |
| Total contractual obligations and commitments | $ 132.1 | $ 10.8 | $ 92.7 | $ 28.6 | $ - |

**Critical Accounting Policies and Estimates**

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of our financial statements requires us to make assumptions and prepare estimates that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and revenues and expenses. We base our estimates on historical experience and various other assumptions that we believe are reasonable; however, actual results may differ. See Notes 1 and 3 ("Nature of Operations" and "Summary of Significant Accounting Policies") to our consolidated financial statements for a discussion of our significant accounting policies.

## Risk Factors

### Risks Related to the Natural Gas and Oil Industry and Our Business

Our revenue, profitability and cash flow depend upon the prices and demand for natural gas and oil. The markets for these commodities are very volatile. Even relatively modest drops in prices can significantly affect our financial results and impede our growth. Changes in natural gas and oil prices have a significant impact on the value of our reserves and on our cash flow. Prices for natural gas and oil may fluctuate widely in response to relatively minor changes in the supply of and demand for natural gas and oil and a variety of additional factors that are beyond our control, such as:

- the domestic and foreign supply of natural gas and oil;
- the price of foreign imports;
- worldwide economic conditions;
- political and economic conditions in oil producing countries;
- the ability of members of the Organization of Petroleum Exporting Countries to agree to and maintain oil price and production controls;
- the level of consumer product demand;
- weather conditions;
- technological advances affecting energy consumption;
- availability of pipeline infrastructure, treating, transportation and refining capacity;
- domestic and foreign governmental regulations and taxes;
- the price and availability of alternative fuels;
- the inability to obtain financing on satisfactory terms.

Lower oil and natural gas prices may not only decrease our revenues on a per share basis, but also may reduce the amount of oil and natural gas that we can produce economically. This may result in our having to make substantial downward adjustments to our estimated proved reserves, and could result in a ceiling test writedown.

Our estimated reserves are based on many assumptions that may turn out to be inaccurate. Any significant inaccuracies in these reserve estimates or underlying assumptions will materially affect the quantities and present value of our reserves.

The present value of future net cash flows from our proved reserves will not necessarily be the same as the current market value of our estimated natural gas and oil reserves.

Unless we replace our natural gas and oil reserves, our reserves and production will decline, which would adversely affect our business, financial condition and results of operations.

Our potential drilling location inventories are scheduled over several years, making them susceptible to uncertainties that could materially alter the occurrence or timing of their drilling.

We will not know conclusively prior to drilling whether natural gas or oil will be present in sufficient quantities to be economically viable.

Our use of 2-D and 3-D seismic data is subject to interpretation and may not accurately identify the presence of natural gas and oil, which could adversely affect the results of our drilling operations.

Market conditions or operational impediments may hinder our access to natural gas and oil markets or delay our production.

We have a substantial amount of indebtedness, which may adversely affect our cash flow and our ability to operate our business.

Competition in the natural gas and oil industry is intense, which may adversely affect our ability to succeed.

Our operations expose us to potentially substantial costs and liabilities with respect to environmental, health and safety matters.

The volatility and disruptions in the global capital and credit markets in recent months have created conditions that may adversely affect the financial condition of our insurers, oil and natural gas purchasers and other counterparties with whom we deal. The inability of one or more of our customers or vendors to meet their obligations may adversely affect our financial results.

Our development and exploration operations require substantial capital and we may be unable to obtain needed capital or financing on satisfactory terms, which could lead to a loss of properties and a decline in our natural gas and oil reserves.

We are subject to commodity price risk on our production, and our liquidity may be adversely affected if commodity prices continue to decline. In the last several months, growth in global economic activity has slowed substantially. At the present time, the rate at which the global economy recover is uncertain. A continued slowing of global economic growth, and, in particular, in the United States, will likely continue to reduce demand for oil and gas. A reduction in the demand for, and the resulting lower prices of, oil and gas could adversely affect our results of operations.

**Foreign Operations**

Frontera's future revenues depend on operating results from its operations in the Republic of Georgia. The success of Frontera's operations is subject to various contingencies beyond management control. These contingencies include general and regional economic and political conditions, prices for crude oil, competition and changes in regulation. Frontera is subject to various additional political and economic uncertainties in Georgia which could include restrictions on transfer of funds, import and export duties, quotas and embargoes, domestic and international customs and tariffs, relations with neighboring countries including the Russian Federation, and changing taxation policies, foreign exchange restrictions, political conditions and regulations.

## Cautionary Statement Concerning Forward-Looking Statements

Various statements contained in this management's discussion and analysis (MD&A), including those that express a belief, expectation, or intention, as well as those that are not statements of historical fact, are forward-looking statements. These forward-looking statements may include projections and estimates concerning the timing and success of specific projects and our future production, revenues, income and capital spending. Our forward-looking statements are generally accompanied by words such as "estimate," "project," "predict," "believe," "expect," "anticipate," "potential," "could," "may," "foresee," "plan," "goal" or other words that convey the uncertainty of future events or outcomes. The forward-looking statements in this MD&A speak only as of the date of this MD&A; we disclaim any obligation to update these statements unless required by securities law, and we caution you not to rely on them unduly. We have based these forward-looking statements on our current expectations and assumptions about future events. While our management considers these expectations and assumptions to be reasonable, they are inherently subject to significant business, economic, political, competitive, regulatory and other risks, contingencies and uncertainties relating to, among other matters, the risks discussed under the heading "Risk Factors" and the following:

- the volatility of natural gas and oil prices;
- discovery, estimation, development and replacement of natural gas and oil reserves;
- cash flow and liquidity;
- financial position;
- business strategy;
- amount, nature and timing of capital expenditures, including future development costs;
- availability and terms of capital;
- timing and amount of future production of natural gas and oil;
- availability of drilling and production equipment;
- availability of oil field labor;
- operating costs and other expenses;
- prospect development and property acquisitions;
- availability of pipeline infrastructure to transport natural gas production;
- marketing of natural gas and oil;
- competition in the natural gas and oil industry;
- regional and worldwide political conditions and uncertainties;
- governmental regulation and taxation of the natural gas and oil industry; and
- developments in oil-producing and natural gas-producing countries.