

Edgar Filing: CRIMSON EXPLORATION INC. - Form 10-Q

CRIMSON EXPLORATION INC.  
Form 10-Q  
May 15, 2006

FORM 10-Q

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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

For the quarterly period ended March 31, 2006

OR

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934  
for the transition period from \_\_\_\_ to \_\_\_\_

Commission file number 1-12108

CRIMSON EXPLORATION INC.  
-----

(Exact name of Registrant as specified in its charter)

Delaware  
(State or other jurisdiction  
of incorporation)

20-3037840  
(IRS Employer  
Identification No.)

480 North Sam Houston Parkway East  
Suite 300  
Houston, Texas  
(Address of principal executive offices)

77060  
(zip code)

(281) 820-1919

(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  No

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

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

The number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date, May 10, 2006 was 33,103,829 shares of Common Stock, \$.001 par value.

Edgar Filing: CRIMSON EXPLORATION INC. - Form 10-Q

FORM 10-Q

CRIMSON EXPLORATION INC.

FORM 10-Q FOR THE QUARTER ENDED  
MARCH 31, 2006

Page of  
Form 10-Q  
-----

Part I: Financial Statements	
Item 1. Financial Statements	
Consolidated Balance Sheets as of March 31, 2006 and December 31, 2005	3
Consolidated Statements of Operations for the Three Months Ended March 31, 2006 and 2005	5
Consolidated Statement of Stockholders' Equity for the Three Months Ended March 31, 2006	6
Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2006 and 2005	7
Notes to Consolidated Financial Statements	8
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	14
Item 3. Quantitative and Qualitative Disclosures about Market Risk	16
Item 4. Controls and Procedures	17
Part II: Other Information	
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	17
Item 6. Exhibits	17
Signatures	19

2

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

CRIMSON EXPLORATION INC.  
CONSOLIDATED BALANCE SHEETS  
(UNAUDITED)

ASSETS

March 31,  
2006

December 31,  
2005

Edgar Filing: CRIMSON EXPLORATION INC. - Form 10-Q

	-----	-----
CURRENT ASSETS		
Cash and cash equivalents	\$ 274,516	\$ 474,393
Accounts receivable - trade, net of allowance for doubtful accounts of \$30,674 in 2006 and 2005	2,642,366	3,498,488
Prepaid expenses	540,307	249,424
Deferred tax asset, net	663,556	1,602,773
	-----	-----
Total current assets	4,120,745	5,825,078
	-----	-----
PROPERTY AND EQUIPMENT		
Oil and gas properties, using the successful efforts method of accounting	74,393,424	65,598,691
Other property and equipment	1,611,731	1,560,464
Less: accumulated depreciation, depletion and amortization	(13,690,473)	(12,936,096)
	-----	-----
Net oil and gas properties and other property and equipment	62,314,682	54,223,059
	-----	-----
OTHER ASSETS		
Deposits	49,502	49,502
Investments	--	225,689
Debt issuance cost, net	247,242	274,214
Deferred tax asset, net	1,218,666	2,517,407
	-----	-----
Total other assets	1,515,410	3,066,812
	-----	-----
TOTAL ASSETS	\$ 67,950,837	\$ 63,114,949
	=====	=====

The Notes to Consolidated Financial Statements are an integral part of these statements.

3

CRIMSON EXPLORATION INC.  
CONSOLIDATED BALANCE SHEETS  
(UNAUDITED)

LIABILITIES AND STOCKHOLDERS' EQUITY

	March 31, 2006	December 31, 2005
	-----	-----
CURRENT LIABILITIES		
Notes payable	\$ 40,300	\$ 40,300
Current portion of long-term debt	80,781	80,883
Accounts payable - trade	4,337,930	4,107,441
Accrued expenses	211,812	487,453
Income taxes payable	133,560	31,075

Edgar Filing: CRIMSON EXPLORATION INC. - Form 10-Q

Derivative instruments	1,297,640	2,108,583
	-----	-----
Total current liabilities	6,102,023	6,855,735
	-----	-----
NONCURRENT LIABILITIES		
Long-term debt, net of current portion	2,100,158	1,103,232
Asset retirement obligations	1,332,127	1,311,133
Derivative instruments	742,250	1,039,587
	-----	-----
Total noncurrent liabilities	4,174,535	3,453,952
	-----	-----
Total Liabilities	10,276,558	10,309,687
	-----	-----
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Preferred stock	1,033	1,033
Common stock	33,041	28,991
Additional paid-in capital	76,383,684	72,851,626
Retained deficit	(18,743,479)	(20,076,388)
	-----	-----
Total stockholders' equity	57,674,279	52,805,262
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 67,950,837	\$ 63,114,949
	=====	=====

The Notes to Consolidated Financial Statements are an integral part of these statements.

4

CRIMSON EXPLORATION INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(UNAUDITED)

	Three Months Ended March 31,	
	2006	2005
	-----	-----
OPERATING REVENUES		
Oil and gas sales	\$ 5,113,497	\$ 3,634,160
Operating overhead and other income	26,152	30,173
	-----	-----
Total Operating Revenues	5,139,649	3,664,333
	-----	-----
OPERATING EXPENSES		
Lease operating expenses	1,579,320	1,400,864
Geological and geophysical	8,777	--
Depreciation, depletion and amortization	754,376	655,778
Dry holes, abandoned property and impaired assets	4,386	2,156
Asset retirement obligations	20,994	19,161
General and administrative	1,723,663	618,227
	-----	-----

Edgar Filing: CRIMSON EXPLORATION INC. - Form 10-Q

Total Operating Expenses	4,091,516	2,696,186
	-----	-----
INCOME FROM OPERATIONS	1,048,133	968,147
	-----	-----
OTHER INCOME AND EXPENSE		
Interest expense	(9,922)	(1,198,501)
Financing cost	(45,117)	(1,905,159)
Loss from equity in investments	(1,843)	--
Loss on sale of assets	--	(13,022)
Unrealized gain (loss) on derivative instruments	1,108,280	(2,013,481)
	-----	-----
Total Other Income and (Expense)	1,051,398	(5,130,163)
	-----	-----
INCOME (LOSS) BEFORE INCOME TAXES	2,099,531	(4,162,016)
INCOME TAX (EXPENSE) BENEFIT	(726,722)	1,387,691
	-----	-----
NET INCOME (LOSS)	1,372,809	(2,774,325)
DIVIDENDS ON PREFERRED STOCK		
(Paid 2006 -\$39,900; Paid 2005 - \$1,006,643)	(896,578)	(773,120)
	-----	-----
NET INCOME (LOSS) AVAILABE TO COMMON SHAREHOLDERS	\$ 476,231	\$ (3,547,445)
	=====	=====
NET INCOME (LOSS) PER SHARE,		
BASIC	\$ .02	\$ (.17)
	=====	=====
DILUTED	\$ .02	\$ (.17)
	=====	=====
WEIGHTED AVERAGE SHARES OUTSTANDING,		
BASIC	29,580,387	20,706,619
	=====	=====
DILUTED	89,426,504	20,706,619
	=====	=====

The Notes to Consolidated Financial Statements are an integral part of these statements.

5

CRIMSON EXPLORATION INC.  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
FOR THE THREE MONTHS ENDED MARCH 31, 2006  
(UNAUDITED)

	NUMBER OF SHARES		PREFERRED STOCK	COMMON STOCK	ADDITIONAL PAID-IN CAPITAL	RE D
	PREFERRED STOCK	COMMON STOCK				
BALANCE DECEMBER 31, 2005	103,250	28,990,643	\$ 1,033	\$ 28,991	\$ 72,851,626	\$ (20
Share Based Compensation	-	-	-	-	726,299	
Dividends paid on Preferred H	-	52,500	-	52	39,848	

Edgar Filing: CRIMSON EXPLORATION INC. - Form 10-Q

Stock options exercised	-	38,000	-	38	17,062	
Employee bonuses		262,334		262	16,134	
Acquisition of oil and gas leases	-	3,697,855	-	3,698	2,732,715	
Current period income	-	-	-	-	-	1
	-----	-----	-----	-----	-----	-----
BALANCE MARCH 31, 2006	103,250	33,041,332	\$ 1,033	\$ 33,041	\$ 76,383,684	\$ (18
	=====	=====	=====	=====	=====	=====

The Notes to Consolidated Financial Statements are an integral part of these statements.

6

CRIMSON EXPLORATION INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

	Three Months Ended March 31,	
	2006	2005
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ 1,372,809	\$ (2,774,325)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation, depletion and amortization	754,376	655,778
Asset retirement obligations	20,994	19,161
Stock compensation	723,345	70,250
Debt issuance cost	26,972	1,779,596
Discount on note payable	--	502,120
Deferred tax expense (benefit)	593,237	(1,387,691)
Income tax payable	102,485	--
Loss on sale of assets	--	13,022
Loss from equity in investments	1,843	--
Dry holes, abandoned property, impaired assets	4,386	--
Unrealized (gain) loss on derivative instruments	(1,108,280)	2,013,482
Changes in operating assets and liabilities		
(Increase) decrease in accounts receivable-trade, net	567,428	(949,222)
Increase in prepaid expenses	(290,883)	(174,068)
Decrease in accounts payable and accrued expenses	(25,802)	(2,571,623)
	-----	-----
Net cash provided by (used in) operating activities	2,742,910	(2,803,520)
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of property and equipment	--	41,175
Capital expenditures	(3,955,811)	(2,061,503)
	-----	-----
Net cash used in investing activities	(3,955,811)	(2,020,328)

Edgar Filing: CRIMSON EXPLORATION INC. - Form 10-Q

CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from sale of preferred stock, net	--	38,345,646
Proceeds from common stock options and warrants exercised	16,200	200
Payments on debt	(6,397)	(31,803,219)
Proceeds from debt issuance	--	820,000
Net draws (repayments) under revolver	1,003,221	--
Dividends paid	--	(675,331)
	-----	-----
Net cash provided by financing activities	1,013,024	6,687,296
	-----	-----
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(199,877)	1,863,448
CASH AND CASH EQUIVALENTS,		
Beginning of year	474,393	411,377
	-----	-----
CASH AND CASH EQUIVALENTS,		
End of year	\$ 274,516	\$ 2,274,825
	=====	=====
CASH PAID FOR INTEREST	\$ 13,641	\$ 1,906,616
	=====	=====

The Notes to Consolidated Financial Statements are an integral part of these statements.

7

CRIMSON EXPLORATION INC. AND SUBSIDIARIES  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2006 AND 2005  
(UNAUDITED)

1. BASIS OF PRESENTATION

During interim periods, we follow the accounting policies set forth in our Annual Report on Form 10-K filed with the Securities and Exchange Commission. Users of financial information produced for interim periods are encouraged to refer to the footnotes contained in the Annual Report when reviewing interim financial results.

The accompanying financial statements include the Company and its wholly-owned subsidiaries: Crimson Exploration Operating, Inc., formed January 5, 2006, and LTW Pipeline Co., formed April 19, 1999. All material intercompany transactions and balances are eliminated upon consolidation.

On January 5, 2006 we formed Crimson Exploration Operating, Inc., a Delaware corporation, as our wholly owned subsidiary through which all oil and gas operations will be conducted. Effective March 2, 2006, we merged all our subsidiaries, with the exception of LTW Pipeline Co., into this newly formed corporation. LTW Pipeline Co. remains an inactive subsidiary of Crimson Exploration Inc.

In management's opinion, the accompanying interim financial statements contain all material adjustments, consisting only of normal recurring adjustments necessary to present fairly the financial condition, the results of operations, and the cash flows of Crimson Exploration Inc. for

## Edgar Filing: CRIMSON EXPLORATION INC. - Form 10-Q

the interim periods.

### 2. STOCKHOLDERS' EQUITY

On March 20, 2006, the Company issued a total of 3,235,624 shares of unregistered common stock as partial consideration for the acquisition, by merger, of Core Natural Resources, Inc., and an additional 462,231 shares to a Core shareholder for a 2% overriding royalty interest owned by him in the Core leasehold interests. The stock was valued at \$0.74 per share, the closing market price of the stock on the day preceding the closing of the merger. The stock issued is restricted stock subject to resale limitations under Rule 144 of the Securities Act of 1933. Holders of the restricted stock were also granted limited piggyback registration rights that expire one year after the closing of the merger.

Effective March 1, 2006, the Company issued 262,334 shares of unregistered, restricted common stock to members of Company management in lieu of cash performance bonuses for calendar year 2005. The restricted stock vests one year after the date of grant, and should a recipient's employment with the Company terminate prior to that date, entitlement to the stock is forfeited. The stock was valued at \$0.75 per share on the grant date, the closing market price of the stock on the date of grant. Upon vesting, this restricted stock will also be subject to resale limitations under Rule 144 of the Securities Act of 1933.

### 3. NON-CASH INVESTING AND FINANCING ACTIVITIES

During the three month period ended March 31, 2006 we issued 3,235,624 shares of common stock, valued at \$2,394,362, as partial consideration for the acquisition of oil and gas leases via merger with Core Natural Resources, Inc. As a result of this transaction we also increased the book value of oil and gas leases by recording a \$1,644,721 deferred tax liability related to the difference in the fair market value of the assets acquired and their underlying tax basis. Related to this transaction, we also acquired a 2% overriding royalty interest in that leasehold acreage by issuing 462,231 shares of common stock valued at \$342,051. In a separate transaction in the first quarter of 2006, we recorded an increase in oil and gas leases of \$513,440 through the exchange of a \$289,594 account receivable and through the reclassification of a \$223,846 investment in a partnership upon distribution of assets by that partnership. During the period we recorded \$16,396 in employee compensation by issuing 262,334 shares of common stock. We also paid \$39,900 in dividends to the holders of Series H Preferred Stock by issuing 52,500 shares of common stock. Also, one of our employees exercised 2,000 common stock options for \$900 which was recorded as an account receivable. Under our cashless exercise procedures, the stock was posted for sale by a broker and the receivable was subsequently settled.

8

During the three month period ended March 31, 2005, we paid \$331,313 in dividends by issuing 356,250 shares of common stock and we issued 29,100 shares of common stock to satisfy and record a \$23,280 fee for a loan extension. Also, on March 30, 2005 one of our employees exercised 25,000 common stock options for \$11,250, which was reflected as an account receivable. Under our cashless exercise procedures, the stock was posted for sale by a broker and the receivable was settled when the stock was sold. During the period we invested \$23,006 in an oil and gas partnership by contributing our cost basis in undrilled oil and gas leases. In addition, we financed new field trucks for the \$45,724 cost.



## Edgar Filing: CRIMSON EXPLORATION INC. - Form 10-Q

### 4. DERIVATIVE INSTRUMENTS

In the past we have entered into, and may in the future enter into, certain derivative arrangements with respect to portions of our oil and natural gas production to reduce our sensitivity to volatile commodity prices. We believe that these derivative arrangements, although not free of risk, allow us to achieve a more predictable cash flow and to reduce exposure to price fluctuations. However, derivative arrangements limit the benefit to us of increases in the prices of crude oil and natural gas sales. Moreover, our derivative arrangements apply only to a portion of our production and provide only partial price protection against declines in price. Such arrangements may expose us to risk of financial loss in certain circumstances. We expect that the monthly volume of derivative arrangements will vary from time to time. We continuously reevaluate our price hedging program in light of increases in production, market conditions, commodity price forecasts, capital spending and debt service requirements. The following derivatives were in place at March 31, 2006.

Crude Oil -----		Volume/ Month -----	Average Price/ Unit -----
Apr 2006 - Dec 2006	Collar	9,000 Bbls	Floor \$50.00-\$59.00 Ceiling
Jan 2007 - Dec 2007	Collar	3,000 Bbls	Floor \$45.00-\$59.45 Ceiling

Natural Gas -----		Volume/ Month -----	Average Price/ Unit -----
Jan 2006 - Dec 2006	Collar	70,000 MMBTU	Floor \$6.00-\$8.25 Ceiling
Jan 2007 - Dec 2007	Collar	20,000 MMBTU	Floor \$6.00-\$6.95 Ceiling

Total fair value  
Current portion

Noncurrent portion

9

We also had the following put options in place at March 31, 2006, for the months reflected.

Crude Oil -----	Monthly Volume -----	Price per Bbl -----
Jan 2006 - Apr 2006	7,000 Bbls	\$25.75
May 2006 - Oct 2006	6,000 Bbls	\$25.75

## Edgar Filing: CRIMSON EXPLORATION INC. - Form 10-Q

Nov 2006 - Apr 2007

5,000 Bbls

\$25.75

The value of these put options was minimal.

At the end of each reporting period we are required by SFAS 133 "Accounting for Derivative Instruments and Hedging Activities," to record on our balance sheet the marked to market valuation of our derivative instruments. We recorded a net liability for derivative instruments at March 31, 2006 and December 31, 2005 of \$2,039,890 and \$3,148,170 respectively. As a result of these agreements, we recorded a non-cash increase in earnings, for unsettled contracts, of \$1,108,280 for the three month period ended March 31, 2006 and a non-cash charge of \$2,013,481 for the three month period ended March 31, 2005. The estimated change in fair value of the derivatives is reported in Other Income and Expense as unrealized (gain) loss on derivative instruments.

For settled contracts, we realized losses, reflected as reductions in oil and gas revenues, of \$164,400 and \$656,550 for the three month periods ended March 31, 2006, and 2005, respectively.

### 5. STOCK BASED COMPENSATION

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004) "Share-Based Payment" ("SFAS No. 123R"), which replaces SFAS No. 123, "Accounting for Stock-Based Compensation" and supersedes APB Opinion 25. SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on the fair values beginning with the first interim period in fiscal year 2006. The pro forma disclosures previously permitted under SFAS No. 123 no longer will be an alternative to financial statement recognition.

The Company adopted SFAS No. 123R on January 1, 2006 using the modified prospective method in which compensation cost is recognized beginning with the effective date based: (a) on the requirements of SFAS No. 123R for all share-based payments granted after January 1, 2006; and (b) on the requirements of SFAS No. 123 for all awards granted to employees prior to January 1, 2006 that remain unvested on January 1, 2006. Under our 2005 Stock Incentive Plan we had 22,400,000 unvested options outstanding at January 1, 2006 with authorization to issue an additional 4,600,000 under that plan. It is our policy to issue new shares for any options exercised. We use the Black-Scholes option pricing model to measure the fair value of stock options. For the unvested options the previously measured but unrecognized compensation expense, based on the fair value at the original grant date, will be recognized in our financial statements over the remaining vesting period. Prior to the adoption of SFAS No. 123R, we followed the intrinsic value method in accordance with APB 25 to account for employee stock-based compensation. Prior period financial statements have not been restated.

The modified prospective method requires us to estimate forfeitures in calculating the expense related to stock-based compensation as opposed to recognizing forfeitures as they occur. All our unvested options at January 1, 2006 were held by our executive officers. As we have no prior history of executive officers forfeiting options, we do not believe any of these options will be forfeited prior to vesting.

For options issued under our 2005 plan we recorded \$726,299 in expense (included in general and administrative expense on the Statement of

## Edgar Filing: CRIMSON EXPLORATION INC. - Form 10-Q

Operations) in the first quarter and estimate \$14,054,333 will be expensed over the remaining vesting period of thirty six months. We assumed weighted average risk free interest rate of 4%, weighted average expected life of 6 years, weighted average expected volatility of 92.70% and no expected dividends.

10

The following table summarizes stock option activity for the three months ended March 31, 2006:

	Number of Shares Underlying Options	Weighted Average Exercise Price
	-----	-----
Outstanding at December 31, 2005	24,110,000	\$ 1.36
Granted	-	-
Exercised	(38,000)	\$ (0.45)
Expired	-	-
Forfeited	-	-
	-	
	-----	-----
Outstanding at March 31, 2006	24,072,000	\$ 1.36
	=====	
Exercisable at March 31, 2006	3,867,000	\$ 1.09
	=====	

The following table summarizes information about stock options outstanding at March 31, 2006:

Exercise Prices	Number Outstanding	Weighted Average Remaining Life (Years)	Number Exercisable
-----	-----	-----	-----
\$ 0.45	1,262,000	2.9	1,027,000
\$ 0.75	285,000	2.1	285,000
\$ 0.83	65,000	0.1	65,000
\$ 0.97	3,600,000	8.9	540,000
\$ 1.16	2,066,333	9.0	-
\$ 1.25	5,400,000	8.9	810,000
\$ 1.70	11,333,667	8.9	1,080,000
\$ 1.81	60,000	2.0	60,000
	-----		-----
	24,072,000	8.5	3,867,000
	=====		=====

The following table reflects the impact of adopting SFAS No. 123R:

	Three Months Ended March 31, 2006
	-----
Compensation expense related to stock options, net of tax of \$275,994 and \$54,549 respectively	\$ 450,305

## Edgar Filing: CRIMSON EXPLORATION INC. - Form 10-Q

Basic earnings per share impact	0.01
Diluted earnings per share impact	0.00

### 6. FINANCING ACTIVITY

On February 28, 2005, we sold in a private placement, 81,000 shares of our Series G Preferred Stock to OCM GW Holdings, LLC ("OCMGW") for an aggregate offering price of \$40.5 million. GulfWest Oil and Gas Company, ("GWOG") a then subsidiary of the Company, issued, in a private placement, 2,000 shares of our Series A Preferred Stock, having a liquidation preference of \$1.0 million, to OCMGW for \$1.5 million. Net proceeds of the offerings of approximately \$38 million after expenses were used for the repayment of substantially all of our outstanding debt and other past due liabilities and for general corporate purposes.

11

The Series G Preferred Stock bears a coupon of 8% per year, has an aggregate liquidation preference of \$40.5 million, is convertible into Common Stock at \$0.90 per share and is senior to all of our capital stock. For the first four years after issuance, we may defer the payment of dividends on the Series G Preferred Stock and these deferred dividends will also be convertible into our Common Stock at \$0.90 per share. In addition, the Series G Preferred Stock is entitled to nominate and elect a majority of the members of the Board of Directors of Crimson.

In connection with these transactions, the terms of the Series A Preferred Stock were amended such that by March 15, 2005, all such stock would either convert into a newly created Series H Preferred Stock on a one for one basis or into Common Stock at a conversion price of \$0.35 per share. The Series H Preferred Stock is required to be paid a dividend of 40 shares of Common Stock per share of Series H Preferred Stock per year. In addition, the Series H Preferred Stock is convertible into Common Stock at a conversion price of \$0.35 per share. At March 15, 2005, holders of 6,700 shares of Series A Preferred Stock converted to Series H Preferred Stock and holders of 3,250 shares of Series A Preferred Stock converted to an aggregate 4,642,859 shares of Common Stock. Subsequently in 2005, holders of Series H Preferred Stock converted 1,450 of their shares into 2,071,429 shares of Common Stock. The outstanding Series H Preferred Stock has an aggregate liquidation preference of \$2.625 million. The Series H Preferred Stock is senior to all of our capital stock other than Series G Preferred Stock.

In addition, we amended the terms of our 9,000 shares of Series E Preferred Stock such that the coupon of 6% per year may be deferred for the next four years and these deferred dividends will be convertible into Common Stock at a conversion price of \$0.90 per share. The original liquidation preference of the Series E Preferred Stock of \$500 per share remains convertible into Common Stock at \$2.00 per share. The Series E Preferred Stock has an aggregate liquidation preference of \$4.5 million, and is senior to all of our Common Stock, of equal preference with our Series D Preferred Stock as to liquidation and junior to our Series G and Series H Preferred Stock.

On July 15, 2005, we entered into a \$100 million senior secured revolving credit facility with Wells Fargo Bank, National Association. Borrowings under the new credit facility will be subject to a borrowing base limitation based on our current proved oil and gas

## Edgar Filing: CRIMSON EXPLORATION INC. - Form 10-Q

reserves. The current borrowing base is set at \$20 million and will be subject to semi-annual redeterminations. The facility is secured by a lien on all our assets, and the assets of our subsidiaries, as well as a security interest in the stock of all our subsidiaries. The credit facility has a term of three years, and all principal amounts, together with all accrued and unpaid interest, will be due and payable in full on June 30, 2008. Proceeds from extensions of credit under the facility will be for acquisitions of oil and gas properties and for general corporate purposes. The facility also provides for the issuance of letters-of-credit up to a \$3 million sub-limit. We incurred \$323,662 in issuance costs associated with the credit facility which are being amortized over its life.

Advances under the facility will be in the form of either base rate loans or Eurodollar loans. The interest rate on the base rate loans fluctuates based upon the higher of (1) the lender's "prime rate" and (2) the Federal Funds rate, plus a margin of 0.50%, plus a margin of between 0.0% and 0.5% depending on the percent of the borrowing base utilized at the time of the credit extension. The interest rate on the Eurodollar loans fluctuates based upon the rate at which Eurodollar deposits in the London Interbank market ("Libor") are quoted for the maturity selected, plus a margin of 1.25% to 2.00% depending on the percent of the borrowing base utilized at the time of the credit extension. Eurodollar loans of one, three and nine months may be selected by us. A commitment fee of 0.375% on the unused portion of the borrowing base will accrue, and be payable quarterly in arrears. Our interest rate at March 31, 2006 was the prime rate of 7.75%.

12

The credit agreement includes usual and customary affirmative covenants for credit facilities of this type and size, as well as customary negative covenants, including, among others, limitation on liens, hedging, mergers, asset sales or dispositions, payments of dividends, incurrence of additional indebtedness, certain leases and investments outside of the ordinary course of business. The credit agreement also requires us to maintain a ratio of current assets to current liabilities, except that any availability under the borrowing base will be considered as an addition to current assets, and any current assets or liabilities resulting from hedging agreements will be excluded, of at least 1.0 to 1.0, an interest coverage ratio of EBITDAX (earnings before interest, taxes, depreciation and amortization and exploration expense) to cash interest expense of 3.0 to 1.0 and a tangible net worth of at least \$45 million, subject to adjustment based on future results of operations and any sales of equity securities. EBITDAX and tangible net worth are calculated without consideration of unrealized gains and losses related to stock derivatives accounted for under variable accounting rules or mark to market adjustments for commodity hedges. At March 31, 2006 we were in compliance with the aforementioned financial covenants.

### 7. OIL AND GAS PROPERTIES

On March 20, 2006 we purchased a 100% working interest (75% net revenue interest) in leases on approximately 22,000 undeveloped acres in Culberson County Texas. The acreage, believed to contain producible reserves in the Barnett Shale and Atoka formations, was acquired through our acquisition, by merger, of Core Natural Resources, Inc. ("Core"), a privately-held entity that was incorporated solely to hold the leases acquired by us. Pursuant to the merger agreement, each

## Edgar Filing: CRIMSON EXPLORATION INC. - Form 10-Q

issued and outstanding share of common stock of Core was converted into the right to receive (i) 5.39270725 shares of the common stock, par value \$.001 per share, of the Company (the "Stock Consideration") and (ii) cash in an amount determined by dividing \$706,123.25 by 600,000 (the "Cash Consideration," and, together with the Stock Consideration, the "Merger Consideration"). Pursuant to the merger agreement, we assumed \$2,045,258 of Core indebtedness that was paid off at the closing of the merger. The cash paid at closing was funded from cash on hand and temporary borrowings under our credit facility. At closing of the merger agreement, 600,000 shares of Core Common Stock were issued and outstanding. We issued 3,235,624 shares of our common stock as the Stock Consideration. In a separate transaction, the Company also issued an additional 462,231 shares of common stock of the Company to a Core stockholder as consideration for the assignment of a 2% overriding royalty interest owned by that stockholder in the oil and gas leases of Core (giving us a total 77% net revenue interest). All stock issued in conjunction with these transactions is restricted stock subject to resale limitations under Rule 144 of the Securities Act of 1933. Core stockholders were also granted certain limited piggyback registration rights that will expire one year from the closing.

As a result of this transaction we recorded a \$1,644,721 deferred tax liability related to the difference in the fair market value of the assets acquired and their underlying tax basis.

### 8. DEFERRED TAXES

Our deferred tax asset decreased by approximately \$2.2 million during the quarter. The major components of the decrease were \$.5 million from the utilization of net operating loss carryforwards and the recording of the \$1.6 million deferred tax liability related to the Core merger.

Deferred tax assets are shown net of a \$3.1 million valuation allowance. The valuation allowance was recorded because we expect we will not be able to use net operating loss carryforwards of approximately \$9.1 million due to the limitations of Internal Revenue Code Section 382.

13

### 9. PREFERRED STOCK

Dividends on all classes of our preferred stock are cumulative until declared as payable by our Board of Directors. Our Series E Preferred Stock accumulates at 6% per annum payable in cash, Series G Preferred Stock accumulates at 8% per annum payable in cash and Series H Preferred Stock accumulates at 40 shares of our common stock per share of the Series H Preferred Stock per annum, payable quarterly as declared. Our Series D Preferred Stock bears no dividends.

The following table sets forth the accumulated value of undeclared dividends of our preferred stock at March 31, 2006.

Series E Preferred Stock	\$	293,671
Series G Preferred Stock		3,524,055
Series H Preferred Stock		41,998
		-----
	\$	3,859,724
		=====

## Edgar Filing: CRIMSON EXPLORATION INC. - Form 10-Q

The Series E and Series G dividends are convertible to our common stock at \$.90 per common share. The Series H Preferred Stock has no conversion feature for unpaid dividends. These dividends call for payment of 10 common shares per quarter for each preferred share. Payments on the Series H are current.

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

#### Overview.

We are primarily engaged in the acquisition, development, exploitation and production of crude oil and natural gas, primarily in the onshore producing regions of the United States. Our focus is on increasing production from our existing properties through further exploitation, development and exploration, and on acquiring additional interests in undeveloped crude oil and natural gas properties. Our gross revenues are derived from the following sources:

1. Oil and gas sales that are proceeds from the sale of crude oil and natural gas production to midstream purchasers. This represents over 99% of our gross revenues.
2. Operating overhead and other income that consists of administrative fees received for operating crude oil and natural gas properties for other working interest owners, and for marketing and transporting natural gas for those owners. This also includes earnings from other miscellaneous activities.

The following discussion should be read in conjunction with the consolidated financial statements and the notes thereto included in this quarterly report on Form 10-Q and with the consolidated financial statements, notes and management's discussion and analysis reported on our 2005 Form 10-K. Statements in this discussion may be forward-looking. These forward-looking statements involve risks and uncertainties. We caution that a number of factors could cause future production, revenues and expenses to differ materially from our expectations. For a discussion on risk factors affecting our business, see the information in ITEM 1. A in our 2005 Annual Report on Form 10-K.

Comparative results of operations for the periods indicated are discussed below.

Three-Month Period Ended March 31, 2006 compared to Three Month Period Ended March 31, 2005.

14

#### Revenues

**Oil and Gas Sales.** During the 2006 first quarter, revenues from the sale of crude oil and natural gas, net of realized losses from our hedging instruments, were \$5,113,000, up 41% from \$3,634,000 in 2005. Losses realized on our hedges during the 2006 quarter were \$134,000 for oil and \$30,000 for gas, compared to \$535,000 for oil and \$121,000 for gas in the 2005 quarter. The significant increase in revenues was due to higher crude oil and natural gas prices.

Our first quarter 2006 sales volumes were 45,846 barrels of crude oil and 317,606 mcf of natural gas, or 592,682 natural gas equivalents

## Edgar Filing: CRIMSON EXPLORATION INC. - Form 10-Q

(mcf) compared to 44,708 barrels of crude oil and 344,015 mcf of natural gas, or 612,263 mcf in the first quarter of 2005. On a daily basis we produced an average of 6,600 mcf in the first quarter of 2006 compared to a daily average of 6,800 mcf in the 2005 quarter. The lower volumes were primarily due to curtailed production of 1,000 mcfpd at our Cameron Parish fields as we worked to finish repairs from the effects of Hurricane Rita. These repairs were completed at the end of April.

Oil and gas prices are reported net of the realized effect of our hedging agreements. Prices realized in the first quarter of 2006 were \$58.11 per bbl and \$7.71 per mcf compared to \$35.84 per bbl and \$5.91 per mcf in the first quarter of 2005. Prices before the effects of the hedging agreements were \$61.04 per bbl and \$7.81 per Mcf in the first quarter of 2006 compared to \$47.82 per bbl and \$6.26 per mcf in the first quarter of 2005.

### Costs and Expenses

**Lease Operating Expenses.** Lease operating expenses for the first quarter of 2006 were \$1,579,000, an increase of 13% from \$1,401,000 in 2005. The increase was due to higher production taxes from higher revenues and general increases in the price of industry services.

On a per unit basis, expenses increased from \$ 2.29 per mcf in 2005 to \$2.66 per mcf in 2006, due primarily to the higher rental costs and water disposal costs and the production shut-in due to the hurricane.

**Depreciation, Depletion and Amortization (DD&A).** DD&A expense for the first quarter of 2006 was \$754,000 compared to expense of \$656,000 for the prior year quarter, due to the increase in the DD&A rate per unit from \$1.07 per mcf in 2005 to \$1.27 per mcf in 2006.

**General and Administrative (G&A) Expenses.** Our G&A expenses were \$1,724,000 in the 2006 quarter compared to \$618,000 in 2005 due to additions to our management team to carry out our post recapitalization growth strategy and stock option expense of \$726,000 related to our adoption of SFAS 123R. On a per unit basis, and exclusive of the non-cash SFAS 123R expense, and the employee bonuses, expenses increased from \$1.01 per mcf in 2005 to \$1.64 per mcf in 2006.

**Interest Expense.** Interest expense decreased 99% from \$1,199,000 in 2005 to \$10,000 in 2006, primarily due to the retirement of debt associated with our February 2005 recapitalization.

**Geological and Geophysical Expense (G&G).** G&G expense was \$9,000 in 2006. No G&G costs were incurred in 2005 as we focused our capital program on the development of our proved reserves.

**Dry Holes, Abandonment Costs and Impaired Assets.** Dry hole, abandonment and impairment expense was minimal in the 2006 and 2005 quarters.

**Debt Issuance Costs.** Debt issuance costs were \$45,000 in 2006 compared with \$1,905,000 in 2005. The expense in 2006 was comprised primarily of the amortization of capitalized costs associated with the revolving credit facility we entered into in July 2005 and fees related to the unused portion of the borrowing base of the credit facility. Costs in 2005 included the writeoff of previously capitalized debt issuance costs associated with previous financings that were repaid with



## Edgar Filing: CRIMSON EXPLORATION INC. - Form 10-Q

proceeds from the sale of the Series G Preferred Stock in February 2005.

15

Unrealized (Gain)/Loss on Derivative Instruments. Unrealized gain or loss on derivative instruments is the change during the quarter in the mark-to-market exposure under our commodity price hedging instruments. This non-cash increase in earnings for 2006 was \$1,108,000 compared with a non-cash expense of \$2,013,000 for the 2005 quarter. This expense will vary period to period, and will be a function of the hedges in place, and the strike prices of those hedges, at each balance sheet date.

Income Tax. Our net income before taxes was \$2,100,000 for the 2006 quarter. After adjusting for permanent tax differences, we recorded \$727,000 in income tax expense. We reported a net loss before taxes of \$4,162,000 for the 2005 quarter resulting in an income tax benefit of \$1,388,000.

Dividends on Preferred Stock. Dividends on preferred stock were \$897,000 in 2006 compared with \$773,000 in 2005. Dividends in 2006 included \$799,000 on the Series G Preferred Stock, \$31,000 on the Series H Preferred Stock and \$67,000 on the Series E Preferred Stock. Dividends on preferred stock for 2005 included \$284,000 on the Series G Preferred Stock, \$26,000 on the Series H Preferred Stock, \$24,000 on the Series E Preferred Stock and \$439,000 for the other series of preferred stock previously issued by the Company and/or its subsidiaries and retired as part of the February 28, 2005 recapitalization.

### Financial Condition and Capital Resources

At March 31, 2006, our current liabilities exceeded our current assets by \$1,981,278, while at December 31, 2005 our current liabilities exceeded our current assets by \$1,030,657. At March 31, 2006 we had \$17,960,497 available on our revolving line of credit. During the quarter, we generated \$2,742,910 in cash flow from operations. We believe cash flow, along with temporary borrowings under our revolver, will be sufficient to fund our daily operations, debt service and planned capital development program in 2006.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The following market rate disclosures should be read in conjunction with the quantitative disclosures about market risk contained in our 2005 Annual Report on Form 10-K, as well as with the consolidated financial statements and notes thereto included in this quarterly report on Form 10-Q.

All of our financial instruments are for purposes other than trading. We only enter into derivative financial instruments in conjunction with our oil and gas hedging activities.

Hypothetical changes in interest rates and prices chosen for the following stimulated sensitivity effects are considered to be reasonably possible near-term changes generally based on consideration of past fluctuations for each risk category. It is not possible to accurately predict future changes in interest rates and product prices. Accordingly, these hypothetical changes may not be an

## Edgar Filing: CRIMSON EXPLORATION INC. - Form 10-Q

indicator of probable future fluctuations.

### Interest Rate Risk

We are exposed to interest rate risk on debt with variable interest rates. At March 31, 2006, we carried variable rate debt of \$2,039,503. Assuming a one percentage point change in interest rates on variable rate debt outstanding at March 31, 2006, the annual pretax results of operations would change by \$20,395.

16

### Commodity Price Risk

We hedge a portion of price risk associated with our oil and natural gas sales through contractual arrangements which are classified as derivative instruments. As of March 31, 2006, these derivative instruments had an estimated fair value liability of \$2,039,890. A hypothetical change in oil and gas prices could have an effect on oil and gas futures prices, which are used to estimate the fair value of our derivative instruments. Considering the highly volatile nature of energy commodity prices in the near and long term consideration of attributes impacting them, it is not practicable to estimate the resultant change.

## ITEM 4. CONTROLS AND PROCEDURES

As of March 31, 2006, our President and Chief Executive Officer and our Chief Financial Officer evaluated 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, as amended ("the Exchange Act"). Based upon this evaluation, they concluded that, subject to the limitations described below, the Company's disclosure controls and procedures offer reasonable assurance that the information required to be disclosed by the Company in the reports it files under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms adopted by the Securities and Exchange Commission.

During the period covered by this report, there has been no change in the Company's internal controls over financial reporting that materially affected, or is reasonably likely to materially affect, these controls.

Limitations on the Effectiveness of Controls. Our management, including the President and Chief Executive Officer and the Chief Financial Officer, does not expect that the Company's disclosure controls and procedures will prevent all error and all fraud. A well conceived and operated control system is based in part upon certain assumptions about the likelihood of future events and can provide only reasonable, not absolute, assurance that the objectives of the control systems are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. There have been no significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to March 31, 2006.

## PART II. OTHER INFORMATION

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

## Edgar Filing: CRIMSON EXPLORATION INC. - Form 10-Q

On February 28, 2006, our board of directors approved restricted stock awards representing 262,334 shares of our Common Stock to our executive officers for services performed during fiscal year 2005. We believe that the issuances described in this Item would be private placements exempt under Section 4(2) of the Securities Act of 1933 due to the nature of each transaction, the relationship of such investors with us and their knowledge of the company.

### ITEM 6. EXHIBITS.

Number	Description
-----	-----
2.1	Agreement and Plan of Merger, dated March 14, 2006, among Crimson Exploration Inc., Exploration Operating, Inc., Core Natural Resources, Inc. and its stockholders. (Previously filed with our Annual Report on Form 10-K for the year ended December 31, 2005, File No. 000-21644 filed with the Commission on March 31, 2006.)

17

4.1	Registration Rights Agreement, dated March 20, 2006, among Crimson Exploration Inc. and the stockholders of Core Natural Resources, Inc. (Previously filed with our Annual Report on Form 10-K, as amended, for the year ended December 31, 2005, File No. 000-21644 initially filed with the Commission on March 31, 2006.)
*31.1	Certification of Chief Executive Officer pursuant to Exchange Rule 13a-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*31.2	Certification of Chief Financial Officer pursuant to Exchange Rule 13a-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*32	Certification pursuant to 18.U.S.C Section 1350 pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. *Filed herewith.

18

### SIGNATURES

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

CRIMSON EXPLORATION INC.  
(Registrant)

Date: May 15, 2006

By: /s/ Allan D. Keel

Edgar Filing: CRIMSON EXPLORATION INC. - Form 10-Q

-----  
Allan D. Keel  
President and Chief Executive Officer

Date: May 15, 2006

By: /s/ E. Joseph Grady  
-----  
E. Joseph Grady  
Senior Vice President and Chief Financial Officer