UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2006

Commission file number 001-16317

CONTANGO OIL & GAS COMPANY

(Exact name of registrant as specified in its charter)

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

3700 BUFFALO SPEEDWAY, SUITE 960

HOUSTON, TEXAS 77098

(Address of principal executive offices)

(713) 960-1901

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant 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. (Check one).

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

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

The total number of shares of common stock, par value $0.04 per share, outstanding as of May 11, 2006 was 14,999,085.

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

QUARTERLY REPORT ON FORM 10-Q

FOR THE NINE MONTHS ENDED MARCH 31, 2006

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

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Unaudited)

	March 31, 2006	June 30, 2005
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 6,593,618	$ 3,985,775
Short-term investments	9,912,482	25,499,869
Accounts receivable, net	1,212,076	1,423,094
Other	483,266	302,926
Total current assets	18,201,442	31,211,664
PROPERTY, PLANT AND EQUIPMENT:		
Natural gas and oil properties, successful efforts method of accounting:		
Proved properties	11,781,476	1,520,530
Unproved properties	20,748,874	7,789,306
Properties held for sale	6,910,090	3,145,518
Furniture and equipment	229,822	197,949
Accumulated depreciation, depletion and amortization	(2,306,924)	(1,328,567)
Total property, plant and equipment, net	37,363,338	11,324,736
OTHER ASSETS:		
Cash and other assets held by affiliates	1,316,306	1,067,263
Investment in Freeport LNG Project	3,243,585	3,006,751
Investment in Contango Venture Capital Corporation	2,978,158	2,274,356
Deferred income tax asset	3,923,426	4,462,329
Other assets	5,822	5,822
Total other assets	11,467,297	10,816,521
TOTAL ASSETS	$ 67,032,077	$ 53,352,921

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

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Unaudited)

	March 31, 2006	June 30, 2005
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 997,910	$ 435,661
Accrued exploration and development	1,841,590	85,608
Income taxes payable	65,709	1,658,548
G&A accrued liabilities	529,416	189,823
Other accrued liabilities	25	3,271
Total current liabilities	3,434,650	2,372,911
ASSET RETIREMENT OBLIGATION	10,171	957
SHAREHOLDERS EQUITY:		
Convertible preferred stock, 6%, Series D, $0.04 par value, 4,000 shares authorized, 2,000 shares issued and outstanding at March 31, 2006, liquidation preference of $10,000,000 at $5,000 per share	80	
Convertible preferred stock, 6%, Series C, $0.04 par value, 4,000 shares authorized, 1,400 shares issued and outstanding at June 30, 2005, liquidation preference of $7,000,000 at $5,000 per share		56
Common stock, $0.04 par value, 50,000,000 shares authorized, 17,574,085 shares issued and 14,999,085 outstanding at March 31, 2006, 15,997,809 shares issued and 13,422,809 outstanding at June 30, 2005	702,961	639,910
Additional paid-in capital	44,903,869	32,800,077
Treasury stock at cost (2,575,000 shares)	(6,180,000)	(6,180,000)
Retained earnings	24,160,346	23,719,010
Total shareholders equity	63,587,256	50,979,053
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 67,032,077	$ 53,352,921

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

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005	Nine Months Ended March 31, 2006	Nine Months Ended March 31, 2005
REVENUES:				
Natural gas and oil sales	$ 123,199	$ 256,632	$ 315,274	$ 630,720
Total revenues	123,199	256,632	315,274	630,720
EXPENSES:				
Operating expenses (credits)	5,512	5,890	(11,216)	43,610
Exploration expenses	152,011	1,741,322	978,682	3,014,786
Depreciation, depletion and amortization	11,909	98,884	99,032	266,205
Impairment of natural gas and oil properties	419,918	124,537	419,918	236,537
General and administrative expense	1,061,518	620,738	3,083,492	2,520,262
Total expenses	1,650,868	2,591,371	4,569,908	6,081,400
LOSS FROM CONTINUING OPERATIONS BEFORE OTHER INCOME AND INCOME TAXES	(1,527,669)	(2,334,739)	(4,254,634)	(5,450,680)
OTHER INCOME (EXPENSE):				
Interest expense	(93)	(93)	(285)	(71,410)
Interest income	165,946	168,466	565,314	201,822
Gain (loss) on sale of assets and other	(18,519)	(12,346)	223,167	(99,166)
LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	(1,380,335)	(2,178,712)	(3,466,438)	(5,419,434)
Benefit for income taxes	524,792	762,549	1,326,191	1,896,802
LOSS FROM CONTINUING OPERATIONS	(855,543)	(1,416,163)	(2,140,247)	(3,522,632)
DISCONTINUED OPERATIONS (Note 3 and 4)				
Discontinued operations, net of income taxes	1,754,965	344,119	3,032,583	17,188,866
NET INCOME (LOSS)	899,422	(1,072,044)	892,336	13,666,234
Preferred stock dividends	150,000	105,000	451,000	315,000
NET INCOME (LOSS) ATTRIBUTABLE TO COMMON STOCK	$ 749,422	$ (1,177,044)	$ 441,336	$ 13,351,234
NET INCOME (LOSS) PER SHARE:				
Basic				
Continuing operations	$ (0.07)	$ (0.12)	$ (0.18)	$ (0.30)
Discontinued operations	0.12	0.03	0.21	1.32
Total	$ 0.05	$ (0.09)	$ 0.03	$ 1.02
Diluted				
Continuing operations	$ (0.07)	$ (0.12)	$ (0.18)	$ (0.30)

Discontinued operations	0.12	0.03	0.21	1.32
Total	$ 0.05	$ (0.09)	$ 0.03	$ 1.02
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:				
Basic	14,865,965	13,108,196	14,675,586	13,030,251
Diluted	14,865,965	13,108,196	14,675,586	13,030,251

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

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended March 31, 2006	Nine Months Ended March 31, 2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
(Loss) from continuing operations	$ (2,140,247)	$ (3,522,632)
Plus income from discontinued operations, net of income taxes	3,032,583	17,188,866
Net income	892,336	13,666,234
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion and amortization	1,065,766	2,525,530
Impairment of natural gas and oil properties	419,918	236,537
Exploration expenditures	1,759,438	2,259,019
Deferred income taxes	538,905	(3,146,741)
Gain on sale of assets and other	(1,081,271)	(16,188,274)
Stock-based compensation	599,695	274,573
Tax benefit from exercise of stock options	(414,854)	
Changes in operating assets and liabilities:		
Decrease in accounts receivable and other	240,789	3,855,874
(Increase) in prepaid insurance	(59,594)	(70,570)
Decrease (increase) in accounts payable	537,528	(322,730)
Increase (decrease) in other accrued liabilities	294,698	(302,554)
Increase (decrease) in income taxes payable	(1,177,985)	4,026,501
Other	(38,474)	3,968
Net cash provided by operating activities	3,576,895	6,817,367
CASH FLOWS FROM INVESTING ACTIVITIES:		
Natural gas and oil exploration and development expenditures	(21,783,141)	(4,982,088)
Natural gas and oil exploration and development reimbursements		2,560,689
Increase in net investment in affiliates	26,634	(755,877)
Investment in Freeport LNG Project	(236,834)	(673,418)
Sale (Purchase) of short-term investments	15,587,387	(27,555,658)
Proceeds from the sale of assets	1,744,215	40,126,428
Sales costs		(168,686)
Additions to furniture and equipment	(18,370)	(6,614)
Decrease in advances to operators	1,802,906	215,230
Investment in Contango Venture Capital Corporation	(708,021)	(770,432)
Acquisition of overriding royalty interests	(1,000,000)	
Acquisition of Republic Exploration LLC and Contango Offshore Exploration LLC interests	(7,500,000)	
Net cash (used) provided by investing activities	(12,085,224)	7,989,574
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings under credit facility		2,200,000
Repayments under credit facility		(9,289,000)
Proceeds from exercised options, warrants and others	1,535,880	1,086,168
Tax benefit from exercise of stock options	414,854	
Preferred stock dividends	(451,000)	(315,000)

Proceeds from preferred equity, net of issuance costs	9,616,438	
Debt issue costs		(20,200)
Net cash (used) provided by financing activities	11,116,172	(6,338,032)
NET INCREASE IN CASH AND CASH EQUIVALENTS	2,607,843	8,468,909
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	3,985,775	396,753
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 6,593,618	$ 8,865,662
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for taxes	$ 945,816	$ 6,475,221
Cash paid for interest	$ 285	$ 83,061

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

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY

(Unaudited)

	For the Nine Months Ended March 31, 2006							
	Preferred Stock		Common Stock					Total
					Paid-in	Treasury	Retained	Shareholders
	Shares	Amount	Shares	Amount	Capital	Stock	Earnings	Equity
Balance at June 30, 2005	1,400	$ 56	13,422,809	$ 639,910	$ 32,800,077	$ (6,180,000)	$ 23,719,010	$ 50,979,053
Exercise of stock options and warrants			125,000	5,000	377,500			382,500
Tax benefit from exercise of stock options					6,536			6,536
Expense of stock options					177,939			177,939
Cashless exercise of stock options			1,576	63	(63)			
Conversion of Series C preferred stock	(1,400)	(56)	1,166,662	46,666	(46,610)			
Issuance of Series D preferred stock	2,000	80			9,616,358			9,616,438
Net income							211,301	211,301
Preferred stock dividends							(151,000)	(151,000)
Balance at September 30, 2005	2,000	$ 80	14,716,047	$ 691,639	$ 42,931,737	$ (6,180,000)	$ 23,779,311	$ 61,222,767
Expense of stock options					192,428			192,428
Cashless exercise of stock options			1,538	62	(62)			
Net loss							(218,387)	(218,387)
Preferred stock dividends							(150,000)	(150,000)
Balance at December 31, 2005	2,000	$ 80	14,717,585	$ 691,701	$ 43,124,103	$ (6,180,000)	$ 23,410,924	$ 61,046,808
Exercise of stock options and warrants			281,500	11,260	1,142,120			1,153,380
Tax benefit from exercise of stock options					408,318			408,318
Expense of stock options					229,328			229,328
Net income							899,422	899,422
Preferred stock dividends							(150,000)	(150,000)
Balance at March 31, 2006	2,000	$ 80	14,999,085	$ 702,961	$ 44,903,869	$ (6,180,000)	$ 24,160,346	$ 63,587,256

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

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The accompanying unaudited consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States for interim financial information, pursuant to the rules and regulations of the Securities and Exchange Commission, including instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States for complete annual financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. All such adjustments are of a normal recurring nature. Certain prior year amounts have been reclassified to conform to the current year presentation. The financial statements should be read in conjunction with the audited financial statements and notes included in the Company s Form 10-K for the fiscal year ended June 30, 2005. The results of operations for the three and nine months ended March 31, 2006 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2006.

1. Summary of Critical Accounting Policies

The application of generally accepted accounting principles involves certain assumptions, judgments, choices and estimates that affect reported amounts of assets, liabilities, revenues and expenses. Thus, the application of these principles can result in varying results from company to company. Contango s critical accounting principles, which are described below, relate to the successful efforts method for costs related to natural gas and oil activities, consolidation principles and stock based compensation, cash and cash equivalents, and short-term investments.

Successful Efforts Method of Accounting. The Company follows the successful efforts method of accounting for its natural gas and oil activities. Under the successful efforts method, lease acquisition costs and all development costs are capitalized. Unproved properties are reviewed quarterly to determine if there has been impairment of the carrying value, and any such impairment is charged to expense in the period. Exploratory drilling costs are capitalized until the results are determined. If proved reserves are not discovered, the exploratory drilling costs are expensed. Other exploratory costs, such as seismic costs and other geological and geophysical expenses, are expensed as incurred. The provision for depreciation, depletion and amortization is based on the capitalized costs as determined above. Depreciation, depletion and amortization is on a cost center by cost center basis using the unit of production method, with lease acquisition costs amortized over total proved reserves and other costs amortized over proved developed reserves.

When circumstances indicate that proved properties may be impaired, the Company compares expected undiscounted future cash flows on a cost center basis to the unamortized capitalized cost of the asset. If the future undiscounted cash flows, based on the Company s estimate of future natural gas and oil prices and operating costs and anticipated production from proved reserves, are lower than the unamortized capitalized cost, then the capitalized cost is reduced to fair market value.

In accordance with Statement of Financial Accounting Standards No. 144 (SFAS 144), Accounting for the Impairment or Disposal of Long-Lived Assets, the Company classified its property sale to Edge Petroleum Corporation (Edge Petroleum), effective July 1, 2004, and its property sale to an independent oil and gas company effective February 1, 2006, as discontinued operations. In addition, as of March 31, 2006, all of the Company s onshore producing assets were also classified as discontinued operations. These properties were sold effective April 1, 2006. An integral and on-going part of our business strategy is to sell our proved reserves from time to time in order to generate additional capital to reinvest in our onshore and offshore exploration programs.

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Cash Equivalents. Cash equivalents are considered to be highly liquid investment grade debt investments having an original maturity of 90 days or less. As of March 31, 2006, the Company had $6,593,618 in cash and cash equivalents, of which $2,161,737 was invested in highly liquid AAA-rated tax-exempt money market funds.

Short Term Investments. As of March 31, 2006, the Company had $9,912,482 invested in a portfolio of periodic auction reset (PAR) securities, which have coupons that periodically reset to market interest rates at intervals ranging from 7 to 35 days. These PAR securities are being classified as short term investments and consist of AAA-rated tax-exempt municipal bonds. PAR securities are highly liquid and have minimal interest rate risk.

Principles of Consolidation. The Company s consolidated financial statements include the accounts of Contango Oil & Gas Company and its subsidiaries and affiliates, after elimination of all intercompany balances and transactions. Wholly-owned subsidiaries are fully consolidated. Exploration and development subsidiaries not wholly owned, such as 42.7% owned Republic Exploration LLC (REX), 50% owned Magnolia Offshore Exploration LLC (MOE), and 76.0% owned Contango Offshore Exploration LLC (COE) (see Offshore Gulf of Mexico Exploration Joint Ventures) are not controlled by the Company and are proportionately consolidated. By agreement, REX, MOE and COE have disproportionate allocations of their profits and losses among the owners. Accordingly, the Company determines its income or losses from the ventures based on a hypothetical liquidation determination of how increases or decreases in the book value of the ventures net assets will ultimately affect the cash payments to the Company in the event of dissolution.

By agreement, since the Company was the only owner that contributed cash to REX, MOE and COE upon formation of these three ventures, the Company consolidated 100% of the ventures net assets and results of operations until the ventures expended all of the Company s initial cash contributions. Subsequent to that event, the owners share in the net assets of the ventures is based on their stated ownership percentages. By agreement, the owners in COE immediately share in the net assets of COE, including the Company s initial cash contribution, based on their stated ownership percentages. The other owners of REX, MOE and COE who participated in the initial formation of these entities contributed seismic data and related geological and geophysical services to the ventures in exchange for ownership interests.

On September 2, 2005, the Company purchased an additional 9.4% ownership interest in each of REX and COE. Both ownership interests were purchased from an existing owner, which prior to the sale, owned 33.3% of each of the two subsidiaries. As a result of these two purchases, the Company s equity ownership interest in REX has increased from 33.3% to 42.7% and in COE from 66.6% to 76.0%. On September 2, 2005, an independent third party also purchased, on the same terms as the Company, a 9.4% interest in each of REX and COE and the selling owner s ownership interest thus decreased from 33.3% to 14.6% in each such entity.

Contango s 10% limited partnership interest in Freeport LNG Development, L.P. (Freeport LNG) is accounted for at cost. As a 10% limited partner, the Company has no ability to direct or control the operations or management of the general partner.

Contango s 32% ownership in Contango Capital Partnership Management, LLC (CCPM) and Contango s 25% limited partnership interest in Contango Capital Partners, L.P. (CCPLP) are accounted for using the equity method. Under the equity method, only Contango s investment in and amounts due to and from the equity investee are included in the consolidated balance sheet. CCPLP formed the Contango Capital Partners Fund, LP (the Fund) in January 2005. The Fund owns equity interests in a portfolio of alternative energy companies. The Fund marks these equity interests to market according to fair market values on a quarterly basis.

CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Stock-Based Compensation. Effective July 1, 2001, the Company adopted the fair value based method prescribed in Statement of Financial Accounting Standards No. 123, Accounting for Stock Based Compensation . Under the fair value based method, compensation cost is measured at the grant date based on the fair value of the award and is recognized over the award vesting period. The fair value of each award is estimated as of the date of grant using the Black-Scholes options-pricing model. Effective July 1, 2005, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004) (SFAS 123(R)), Share-Based Payment . Prior to the adoption of SFAS 123(R), the Company presented all benefits from the exercise of share-based compensation as operating cash flows in the statement of cash flows. SFAS 123(R) requires the benefits of tax deductions in excess of the compensation cost recognized for the options (excess tax benefit) to be classified as financing cash flows. The fair value of each option is estimated as of the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants during the quarters ended March 31, 2006 and 2005, respectively: (i) risk-free interest rate of 4.5 percent and 4.25 percent; (ii) expected lives of five years; (iii) expected volatility of 40 percent and 26 percent, and (iv) expected dividend yield of zero percent.

During the three months ended March 31, 2006 and 2005, the Company recorded stock-based compensation charges of $229,328 and $97,529 to general and administrative expense, respectively.

2. Natural Gas and Oil Exploration Risk

The Company s future financial condition and results of operations will depend upon prices received for its natural gas and oil production and the cost of finding, acquiring, developing and producing reserves. Substantially all of its production is sold under various terms and arrangements at prevailing market prices. Prices for natural gas and oil are subject to fluctuations in response to changes in supply, market uncertainty and a variety of other factors beyond the Company s control.

Other factors that have a direct bearing on the Company s financial condition are uncertainties inherent in estimating natural gas and oil reserves and future hydrocarbon production and cash flows, particularly with respect to wells that have not been fully tested and with wells having limited production histories; the timing and costs of our future drilling; development and abandonment activities; access to additional capital; changes in the price of natural gas and oil; availability and cost of services and equipment; and the presence of competitors with greater financial resources and capacity. The preparation of our financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect our reported results of operations, the amount of reported assets, liabilities and contingencies, and proved natural gas and oil reserves. We use the successful efforts method of accounting for our natural gas and oil activities.

3. Sale of Properties - Discontinued Operations

In December 2004, the Company completed the sale of the majority of its south Texas natural gas and oil interests to Edge Petroleum for $50.0 million. The sale was approved by a majority of the Company s stockholders at a Special Meeting of Stockholders on December 29, 2004. Approximately 16 billion cubic feet per day equivalent (Bcfe/d) of proven reserves were sold having a pre-tax net present value when using a 10% discount rate as of June 30, 2004 of $54.3 million. Pre-tax proceeds after netting adjustments were $40.1 million. Adjustments were made for net revenues that Contango received for production occurring after July 1, 2004, the effective date of sale, up to the post-closing date of March 29, 2005. The Company recognized a gain on sale of $16.3 million for the year ended June 30, 2005. Our sale of assets to Edge Petroleum has been classified as discontinued operations in our financial statements for all periods presented.

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In March 2006, the Company completed the sale of its interest in a well in Zapata County, Texas to an independent oil and gas company for approximately $2.0 million. Approximately 227 million cubic feet (MMcf) of proven reserves were sold. Pre-tax proceeds after netting adjustments were $2.0 million. The Company recognized a pre-tax gain on sale of $1.1 million for the three and nine months ended March 31, 2006. This sale has been classified as discontinued operations in our financial statements for all periods presented.

4. Properties Held for Sale

On March 24, 2006, the Company s Board of Directors approved the sale of all of the Company s onshore producing assets for an aggregate purchase price of $11.5 million. These properties were held by Contango STEP, LP (STEP), an indirect wholly-owned subsidiary of the Company, and substantially all of such properties were sold in April 2006. These properties had a net carrying amount of approximately $5.2 million as of March 31, 2006. All STEP producing properties were classified as properties held for sale as of March 31, 2006, and were included in discontinued operations in our financial statements for all periods presented. Approximately $37,000 in depreciation expense was not recorded from March 24, 2006 through March 31, 2006.

In accordance with Statement of Financial Accounting Standards No. 144 (SFAS 144), Accounting for the Impairment or Disposal of Long-Lived Assets, we classified our properties held for sale as discontinued operations as of March 31, 2006.

The summarized financial results for discontinued operations for each of the periods ended March 31, are as follows:

Operating Results:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2006	**2005**	**2006**	**2005**
Revenues	$ 1,555,134	$ 774,449	$ 4,377,017	$ 14,357,236
Operating (expenses) credits *	466,362	178,392	1,266,320	(1,226,890)
Depreciation expense	(380,000)	(223,666)	(966,734)	(2,259,325)
Exploration expense		(229,119)	(1,093,139)	(714,906)
Gain on sale of discontinued operations	1,058,450	29,358	1,082,048	16,288,294
Gain before income taxes	2,699,946	529,414	4,665,512	26,444,409
Provision for income taxes	(944,981)	(185,295)	(1,632,929)	(9,255,543)
Gain from discontinued operations, net of income taxes	$ 1,754,965	$ 344,119	$ 3,032,583	$ 17,188,866

* Credits due to severance tax refunds

For the three and nine months ended March 31, 2006, operating expenses from discontinued operations resulted in a net credit of $466,362 and $1,266,320, respectively. The net credits were attributable to credits issued for previously paid severance taxes. The Railroad Commission of Texas allows for a severance tax reduction on tight sand gas wells. As a result, some of our south Texas Queen City formation properties, which were included in the sale of our south Texas natural gas and oil interests to Edge Petroleum, were eligible for severance tax reduction. By contractual agreement, revenues and expenses prior to July 1, 2004, the effective date of the sale, accrue to us.

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. Net Income (Loss) Per Common Share

A reconciliation of the components of basic and diluted net income (loss) per share of common stock is presented in the tables below.

	Three Months Ended March 31, 2006			Three Months Ended March 31, 2005		
	Income (Loss)	**Weighted Average Shares**	**Per Share**	**Income (Loss)**	**Weighted Average Shares**	**Per Share**
Loss from continuing operations including preferred dividends	$ (1,005,543)	14,865,965	$ (0.07)	$ (1,521,163)	13,108,196	$ (0.12)
Discontinued operations, net of income taxes	1,754,965	14,865,965	0.12	344,119	13,108,196	0.03
Basic Earnings per Share:						
Net income (Loss)	$ 749,422	14,865,965	$ 0.05	$ (1,177,044)	13,108,196	$ (0.09)
Effect of Potential Dilutive Securities:						
Stock options and warrants		(a)			(a)	
Series C preferred stock				(a)	(a)	
Series D preferred stock	(a)	(a)		(a)	(a)	
Loss from continuing operations including preferred dividends	$ (1,005,543)	14,865,965	$ (0.07)	$ (1,521,163)	13,108,196	$ (0.12)
Discontinued operations, net of income taxes	1,754,965	14,865,965	0.12	344,119	13,108,196	0.03
Diluted Earnings per Share:						
Net income (Loss)	$ 749,422	14,865,965	$ 0.05	$ (1,177,044)	13,108,196	$ (0.09)
Anti-dilutive Securities:						
Shares assumed not issued from options to purchase common shares as income from continuing operations was in a loss position for the period	$	952,000	$ 7.87	$	1,098,000	$ 4.58
Series C preferred stock (converted during the period)	$		$	$ 105,000	1,166,667	$ 0.09
Series D preferred stock	$ 150,000	833,333	$ 0.18			

(a) Anti-dilutive.

	Nine Months Ended March 31, 2006			Nine Months Ended March 31, 2005		
	Income (Loss)	**Weighted Average Shares**	**Per Share**	**Income (Loss)**	**Weighted Average Shares**	**Per Share**
Loss from continuing operations including preferred dividends	$ (2,591,247)	14,675,586	$ (0.18)	$ (3,837,632)	13,030,251	$ (0.30)
Discontinued operations, net of income taxes	3,032,583	14,675,586	0.21	17,188,866	13,030,251	1.32
Basic Earnings per Share:						
Net income	$ 441,336	14,675,586	$ 0.03	$ 13,351,234	13,030,251	$ 1.02
Effect of Potential Dilutive Securities:						

Stock options and warrants		(a)			(a)	
Series C preferred stock	(a)	(a)		(a)	(a)	
Series D preferred stock	(a)	(a)		(a)	(a)	
Loss from continuing operations including preferred dividends	$ (2,591,247)	14,675,586	$ (0.18)	$ (3,837,632)	13,030,251	$ (0.30)
Discontinued operations, net of income taxes	3,032,583	14,675,586	0.21	17,188,866	13,030,251	1.32
Diluted Earnings per Share:						
Net income	$ 441,336	14,675,586	$ 0.03	$ 13,351,234	13,030,251	$ 1.02
Anti-dilutive Securities:						
Shares assumed not issued from options to purchase common shares as income from continuing operations was in a loss position for the period	$	952,000	$ 7.87	$	1,098,000	$ 4.58
Series C preferred stock (converted during the period)	$ 21,000	1,166,667	$ 0.02	$ 315,000	1,185,180	$ 0.27
Series D preferred stock	$ 430,000	791,667	$ 0.54			

(a) Anti-dilutive.

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

6. Acquisition of Interest in Partially-Owned Subsidiaries and Overriding Royalties

On September 2, 2005, we purchased an additional 9.4% ownership interest in each of our two partially-owned offshore Gulf of Mexico exploration subsidiaries, REX for $5.6 million and COE for $1.9 million, for a total expenditure of $7.5 million. Both interests were purchased from Juneau Exploration, L.P. (JEX), which prior to the sale, owned 33.3% of each of the two subsidiaries. As a result of these two purchases, the Company s equity ownership interest in REX has increased from 33.3% to 42.7% and in COE from 66.6% to 76.0%. The purchases were financed from the Company s existing cash on hand. An independent third party also purchased a 9.4% interest in each of REX and COE from JEX for the same total purchase price of $7.5 million. JEX will continue in its capacity as the managing member of both REX and COE and following these two sales, now owns a 14.6% interest in each of REX and COE.

During the quarter ended March 31, 2006, the purchase price paid in excess of the subsidiaries net assets acquired (purchase price allocation) was allocated to the various assets owned by the subsidiaries. These assets include planned drilling commitments, unevaluated exploration blocks, and proven developed producing (PDP) properties. A significant portion of the purchase price allocation was allocated to our Eugene Island 10 (Dutch) and Grand Isle 63/72/73 (Liberty) exploration prospects. Should Dutch or portions of Liberty not be successful, the Company will be required under successful efforts accounting to expense all or a portion of this allocation in addition to the drilling costs. During the quarter ended March 31, 2006, we wrote off $0.3 million of the purchase price relating to our Main Pass 221 prospect which was a dry hole, and $0.1 million relating to our East Cameron 107 prospect, as a result of the expiration of its lease.

On November 7, 2005, the Company, in a separate transaction, also acquired certain overriding royalty interests in REX, COE and MOE offshore prospects for the purchase price of $1.0 million.

7. Series D Perpetual Cumulative Convertible Preferred Stock

On July 15, 2005, we sold $10.0 million of our Series D preferred stock to a group of private investors. The Series D preferred stock is perpetual and cumulative, is senior to our common stock and is convertible at any time into shares of our common stock at a price of $12.00 per share. The dividend on the Series D preferred stock can be paid quarterly in cash at a rate of 6.0% per annum or paid-in-kind at a rate of 7.5% per annum. Our registration statement filed with the Securities and Exchange Commission, covering the 833,330 shares of common stock issuable upon conversion of the Series D preferred stock, became effective on October 26, 2005. Net proceeds associated with the private placement of the Series D preferred stock was $9,616,438, net of stock issuance costs.

8. Conversion of Series C Cumulative Convertible Preferred Stock into Common Stock

On July 19, 2005, we exercised our mandatory conversion rights pursuant to the terms of our Series C preferred stock, and converted all of the remaining 1,400 shares of our Series C preferred stock issued and outstanding into 1,166,662 shares of common stock. The outstanding shares of the Series C preferred stock had a face value of $7.0 million, and paid a 6.0% per annum quarterly cash dividend.

9. Investment in Freeport LNG

As of March 31, 2006, the Company has invested $3.2 million and owns a 10% limited partnership interest in Freeport LNG Development, L.P. (Freeport LNG), a limited partnership formed to develop, construct and operate a 1.5 billion cubic feet per day (Bcf/d) liquefied natural gas (LNG) receiving terminal in Freeport, Texas.

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

10. Contango Venture Capital Corporation

Contango Venture Capital Corporation (CVCC), a wholly-owned subsidiary of Contango Oil & Gas Company, owns a 32% membership interest in Contango Capital Partnership Management, LLC (CCPM). CCPM was formed by us and other investors to invest in the energy venture capital market with a focus on domestically sourced, environmentally preferred energy technologies and to expose us to opportunities in alternative energy markets.

In January 2005, CCPM formed a venture capital fund, the Contango Capital Partners, L.P. (the Fund), for the purpose of investing in alternative energy companies. As of March 31, 2006, the Fund held investments in five portfolio alternative energy companies, Trulite, Inc. Synexus Energy, Inc., Protonex Technology Corp., Jadoo Power Systems, and Moblize. CCPM is the general partner and manager of the Fund. As of March 31, 2006, CVCC, a 25% limited partner of the Fund, has contributed $1.6 million in cash to the Fund.

In July 2005, the Fund invested $0.3 million in its fifth portfolio company, Moblize, along with CTTV Investments LLC, a subsidiary of Chevron Corporation. Moblize develops real time diagnostics and field optimization solutions for the oil and gas industry using open-standards based technologies. Moblize is currently deploying its technology in oil fields near Houston belonging to Chevron U.S.A. Inc.

During the quarter ended March 31, 2006, the Fund invested an additional $0.2 million in Trulite, Inc. Our limited partnership s cumulative cash investment in the Fund is approximately $2.2 million, bringing our total investment in alternative energy investments, including cumulative mark-to-market adjustments, to approximately $2.9 million. In the future, the Fund may make additional investments in these same alternative energy companies or in other alternative energy companies.

11. Long-Term Debt

The Company s credit facility with Guaranty Bank, FSB is an unsecured revolving line of credit. Although the Company has no debt outstanding under this credit facility as of March 31, 2006, the revolving line of credit is being maintained and provides for a borrowing capacity of $0.1 million and matures on June 29, 2006. Borrowings will bear interest, at the Company s option, at either (i) LIBOR plus two percent (2%) or (ii) the bank s base rate plus one-fourth percent (1/4%) per annum. Additionally, the Company pays a quarterly commitment fee of three-eighths percent (3/8%) per annum on the average availability.

The hydrocarbon borrowing base is subject to semi-annual redetermination based primarily on the value of our proved reserves. The credit facility requires the maintenance of certain ratios, including those related to working capital, funded debt to EBITDAX, and debt service coverage, as defined in the credit agreement. Additionally, the credit agreement contains certain negative covenants that, among other things, restrict or limit our ability to incur indebtedness, sell assets, pay dividends and reacquire or otherwise acquire or redeem capital stock. Failure to maintain required financial ratios or comply with the credit facility s covenants can result in a default and acceleration of all indebtedness under the credit facility.

As of March 31, 2006, the Company was in compliance with its financial covenants, ratios and other provisions of its credit facility.

12. Subsequent Events

Term Loan Facility. On April 27, 2006, the Company completed the arrangement of a new three-year $20.0 million secured term loan agreement with The Royal Bank of Scotland (RBS). The term loan agreement is secured with the stock of Contango Sundance, Inc. (Sundance), our wholly-owned subsidiary. Sundance owns a 10% limited partnership interest in Freeport LNG Development, LP, which owns the Freeport LNG facility. The

CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Company has borrowed the first $10.0 million under the term loan agreement and may borrow the remaining $10.0 million at anytime prior to October 27, 2006. Borrowings under the term loan agreement bear interest, at the Company s option, at either (i) 30 day LIBOR, (ii) 60 day LIBOR or (iii) 90 day LIBOR, all plus 6.5%. Interest is due at the end of the LIBOR period chosen. The principal is due April 27, 2009, but we may prepay after April 27, 2008 with no prepayment penalty. The term loan agreement requires an arrangement fee of 2%, or $400,000, which was paid upon closing.

The term loan agreement requires the maintenance of certain ratios, including those related to working capital, as defined in the term loan agreement. Additionally, the term loan agreement contains certain negative covenants that, among other things, restrict or limit our ability to incur indebtedness, sell certain assets, and pay dividends. Failure to maintain required financial ratios or comply with the term loan agreement s covenants could result in a default and acceleration of all indebtedness under the term loan agreement. As of May 11, 2006, the Company was in compliance with its financial covenants, ratios and other provisions of the term loan agreement.

Sale of Properties. On April 28, 2006, the Company completed the sale of substantially all of its onshore producing Texas and Alabama natural gas and oil interests for $11.1 million pursuant to a purchase and sale agreement. The sold properties had net reserves of approximately 203 Mbbl of oil and 656 MMcf of gas, or 1.9 Bcfe. The sale of an additional two wells under the same purchase and sale agreement for an aggregate purchase price of approximately $0.4 million remains contingent upon the receipt of third party consents to the transfer of such wells.

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Available Information

General information about us can be found on our Website at www.contango.com. Our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, as well as any amendments and exhibits to those reports, are available free of charge through our Website as soon as reasonably practicable after we file or furnish them to the Securities and Exchange Commission.

Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the financial statements and the accompanying notes and other information included elsewhere in this Form 10-Q and in our Form 10-K for the fiscal year ended June 30, 2005, previously filed with the Securities and Exchange Commission.

Cautionary Statement about Forward-Looking Statements

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

Our financial position

Business strategy and budgets

Anticipated capital expenditures

Drilling of wells

Natural gas and oil reserves

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

Operating costs and other expenses

Cash flow and anticipated liquidity

Prospect development

Property acquisitions and sales

- Development, construction and financing of our liquefied natural gas (LNG) receiving terminal
- Investment in alternative energy

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

- Low and/or declining prices for natural gas and oil
- Natural gas and oil price volatility
- The risks associated with acting as the operator in drilling deep high pressure wells in the Gulf of Mexico
- The risks associated with exploration, including cost overruns and the drilling of non-economic wells or dry holes, especially in prospects in which the Company has made a large capital commitment relative to the size of the Company s capitalization structure
- Availability of capital and the ability to repay indebtedness when due
- Availability of rigs and other operating equipment
- Ability to raise capital to fund capital expenditures
- The ability to find, acquire, market, develop and produce new natural gas and oil properties

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- Uncertainties in the estimation of proved reserves and in the projection of future rates of production and timing of development expenditures
- Operating hazards attendant to the natural gas and oil business
- Downhole drilling and completion risks that are generally not recoverable from third parties or insurance
- Potential mechanical failure or under-performance of significant wells or pipeline mishaps
- Weather
- Availability and cost of material and equipment
- Delays in anticipated start-up dates
- Actions or inactions of third-party operators of our properties
- Ability to find and retain skilled personnel
- Strength and financial resources of competitors
- Federal and state regulatory developments and approvals
- Environmental risks
- Worldwide economic conditions
- Ability of LNG to become a competitive energy supply in the United States
- Ability to fund our LNG project, cost overruns and third party performance
- Successful commercialization of alternative energy technologies

You should not unduly rely on these forward-looking statements in this report, as they speak only as of the date of this report. Except as required by law, we undertake no obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances occurring after the date of this report or to reflect the occurrence of unanticipated events. See the information under the heading Risk Factors in this Form 10-Q for some of the important factors that could affect our financial performance or could cause actual results to differ materially from estimates contained in forward-looking statements.

Overview

Contango is a Houston-based, independent natural gas and oil company. The Company s core business is to explore, develop, produce and acquire natural gas and oil properties primarily offshore in the Gulf of Mexico and in the Arkansas Fayetteville Shale. As a recent addition to our business, we now operate certain offshore prospects through our wholly-owned subsidiary, Contango Operators, Inc. (COI). The Company also owns a 10% interest in a limited partnership formed to develop an LNG receiving terminal in Freeport, Texas, and holds investments in companies focused on commercializing environmentally preferred energy technologies.

Our Strategy

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

Using our capital availability to increase our reward/risk potential on selective prospects. Beginning in the spring of 2005, we decided to increase our capital investment in certain exploration prospects, including our onshore Arkansas Fayetteville Shale prospect and offshore Gulf of Mexico prospects. This represents a major increase in the risk profile of the Company which in the past has limited its dry hole risk exposure on any one well to approximately $1.0 million. COI, our wholly-owned subsidiary, will drill and operate our offshore prospects. Should we be successful in any of our offshore prospects, we will have the opportunity to spend significantly more capital to complete development and bring the discovery to producing status.

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Operating in the Gulf of Mexico. COI was formed for the purpose of drilling and operating exploration wells in the Gulf of Mexico and is a new element of our business strategy. Our Liberty prospect was COI s first exploration well in the Gulf of Mexico and COI plans to drill at least three additional exploration wells in the Gulf of Mexico in 2006. This represents a significant increase in the risk profile of the Company since the Company has never before operated. Our estimated drilling costs could be significantly higher if we encounter difficultly in drilling offshore exploration wells.

Sale of proved properties. From time-to-time as an integral part of our business strategy, we have sold and in the future may sell some or a substantial portion of our proved reserves to capture current value, using the sales proceeds to further our exploration, development, LNG and alternative energy investment activities. Since its inception, the Company has sold over $80.5 million worth of oil and natural gas properties.

In December 2004, we sold producing properties consisting of 39 wells in south Texas, a majority of our natural gas and oil interests, for $50.0 million to Edge Petroleum Corporation. The sale was approved by a majority of the Company s stockholders at a Special Meeting of Stockholders on December 29, 2004. Approximately 16 Bcfe of proven reserves were sold having a pre-tax net present value when using a 10% discount rate as of June 30, 2004 of $54.3 million. Pre-tax proceeds after netting adjustments were $40.1 million.

In March 2006, we sold a producing well in south Texas for approximately $2.0 million to an independent oil and gas company. Approximately 227 million cubic feet (MMcf) of proven reserves were sold. Pre-tax proceeds after netting adjustments were $2.0 million.

In April 2006, the Company completed the sale of all of its onshore producing Texas and Alabama natural gas and oil interests for $11.1 million pursuant to a purchase and sale agreement. The sold properties had net reserves of approximately 203 Mbbl of oil and 656 MMcf of gas, or 1.9 Bcfe. The sale of an additional two wells under the same purchase and sale agreement for an aggregate purchase price of approximately $0.4 million remains contingent upon the receipt of third party consents to the transfer of such wells.

In accordance with Statement of Financial Accounting Standards No. 144 (SFAS 144), Accounting for the Impairment or Disposal of Long-Lived Assets, we classified all our property sales as discontinued operations.

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

Diversified energy investments. While our core focus is the domestic exploration and production business, we will continue to seek opportunities that may include foreign exploration prospects or investments related to new and developing energy sources such as LNG and alternative energy.

Structuring incentives to drive behavior. We believe that equity ownership aligns the interests of our partners, employees, and stockholders. Our directors and executive officers beneficially own or have voting control over approximately 24% of our common stock. In addition, our alliance partners co-invest in prospects that they recommend to us.

Exploration Alliances with JEX and Alta

Alliance with JEX. JEX is a private company formed for the purpose of assembling domestic natural gas and oil prospects. Under our agreement with JEX, JEX generates natural gas and oil prospects and evaluates exploration prospects generated by others. JEX focuses on the Gulf of Mexico, and generates offshore exploration prospects via our affiliated companies, REX, COE and MOE (see Offshore Gulf of Mexico Exploration Joint Ventures below).

Alliance with Alta. Alta Resources, LLC (Alta) is a private company formed for the purpose of assembling domestic, onshore natural gas and oil prospects. Our arrangement with Alta generally provides for us to pay our share of seismic and lease costs, with Alta generally receiving a negotiated overriding royalty interest and a carried or back-in working interest.

As a result of the Company s intent to focus on developing our Fayetteville Shale play in Arkansas and our offshore Gulf of Mexico prospects, we have elected to discontinue our south Texas drilling program with Ameritex Minerals and Exploration, Ltd. (Ameritex) and Coastline Exploration, Inc. (Coastline).

Onshore Exploration and Properties

Alta Activities

Escambia County, Alabama

In January 2005, Contango and Alta elected to participate in three exploratory wells in Escambia County, Alabama: the Alta-Blackstone 10-4, the Alta-Blackstone 31-14 and the Alta-Blackstone 10-2.

During the quarter ended September 30, 2005, we drilled our first exploratory well, the Alta-Blackstone 10-4, which has been completed and began producing in February 2006 at a rate of approximately 300 barrels of oil per day. Our net revenue interest in the well is 42.9%.

During the quarter ended December 31, 2005, we successfully drilled a second exploratory well, the Alta-Blackstone 31-14, for which our 75% share of the dry hole costs was approximately $1.1 million. This well has been completed with our share of completion costs estimated at $0.5 million and is currently waiting on a pipeline hook-up.

Also during the quarter ended December 31, 2005, we drilled a third exploratory well, the Alta Blackstone 10-2, which was determined to be a dry hole and is in the process of being converted into a salt water disposal well for future use. Our 75% share of dry hole costs was $1.1 million.

These three wells were sold in April 2006, as part of the $11.1 million south Texas and Alabama property sale.

Fayetteville Shale

In March 2005, Contango and Alta entered into an agreement to acquire natural gas, oil, and mineral leases in the Arkansas Fayetteville Shale play area located in Pope, Van Buren, Conway, Faulkner, Cleburne, and White Counties, Arkansas. As of May 11, 2006, we and our partners have acquired or received commitments on approximately 42,000 net mineral acres at a cost of approximately $10.4 million. Our 70% share of the acquisition costs is approximately $7.3 million.

The Arkansas Oil & Gas Commission has now approved eleven 640-acre drilling units in Conway County, Arkansas that we estimate will allow our partnership to drill and operate approximately 100 horizontal wells. The horizontal wells are estimated to cost approximately $1.0 million each, net to the Company. We estimate our net revenue interest in these wells will average approximately 45%.

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In March, we spudded the first of three wells to be operated by our alliance partner, Alta: the Alta-Beck #1-32H, the Alta-Briggler #1-31H and the Alta-Thines #1-30H, with working interests of 38.65%, 63.60%, and 34.87%, respectively. We logged 240 feet of Fayetteville Shale in the Alta-Beck #1-32H and are currently drilling horizontally. Depending on our continuing drilling results, we will attempt to move a second rig to this play by this fall, and a third by the end of the year.

In addition, as of May 11, 2006, we have been integrated into 35 wells located in the Arkansas Fayetteville Shale that are being operated by a third party independent oil and gas exploration company. Three of these wells are vertical natural gas wells that are currently producing. Four more are producing horizontal wells. The remaining 28 horizontal wells are either being drilled or are expected to be drilled over the next three months with our net share of the total drilling costs estimated at $3.1 million. Our average working interest in these integrated wells thus far is 6.3%.

Offshore Gulf of Mexico Exploration Joint Ventures

Contango directly and through affiliated companies conducts exploration activities in the Gulf of Mexico. As of May 11, 2006, Contango and its affiliates have interests in 61 offshore leases. On March 15, 2006, REX and COE were the apparent high bidders on 12 and 4 lease blocks, respectively, at the Central Gulf of Mexico Lease Sale # 198. To date, REX has been awarded 6 of the 12 lease blocks and COE has been awarded all 4 lease blocks. The sale covered areas in the central part of the Outer Continental Shelf, offshore from the Louisiana coastline. If the remaining 6 lease blocks are awarded, Contango and its affiliates will have interests in 67 offshore leases. See Offshore Properties below for additional information on our offshore properties.

As of March 31, 2006, Contango owned a 42.7% equity interest in REX, a 76.0% equity interest in COE, and a 50.0% equity interest in MOE, all of which were formed for the purpose of generating exploration opportunities in the Gulf of Mexico. These companies have collectively licensed approximately 4,400 blocks of 3-D seismic data and have focused on identifying prospects, acquiring leases at federal and state lease sales and then selling the prospects to third parties, including Contango, subject to timed drilling obligations plus retained reversionary interests in favor of REX, COE and MOE.

Republic Exploration LLC. On September 2, 2005, Contango purchased an additional 9.4% ownership interest in REX for $5.625 million from JEX. As a result of this purchase, our equity ownership interest in REX increased from 33.3% to 42.7% and as of March 31, 2006, Contango had approximately $11.4 million invested in REX. The three other members of REX are JEX, its managing member, a privately held investment company, and a privately held seismic company. REX holds a non-exclusive license to approximately 2,030 blocks of 3-D seismic data in the shallow waters of the Gulf of Mexico. This data is used to identify, acquire and exploit natural gas and oil prospects. All leases owned by REX are subject to a 3.3% overriding royalty interest in favor of the JEX prospect generation team. See Offshore Properties below for more information on REX s offshore properties.

Contango Offshore Exploration LLC. On September 2, 2005, Contango purchased an additional 9.4% ownership interest in COE for $1.875 million from JEX. As a result of this purchase, our equity ownership interest in COE increased from 66.6% to 76.0%. As of March 31, 2006, Contango had approximately $15.7 million invested in COE. The two other members of COE are JEX, its managing member, and a privately held investment company and as of March 31, 2006, COE had invested approximately $13.8 million to acquire and reprocess 1,775 blocks of 3-D seismic data and to acquire leases in the Gulf of Mexico. All leases are subject to a 3.3% overriding royalty interest in favor of the JEX prospect generation team. See Offshore Properties below for additional information on COE s offshore properties.

Grand Isle 72 (Liberty), a COE prospect, was successfully tested in March 2006. We believe the well will be on-stream by September 2006, with an estimated initial 8/8ths equivalent production rate of 7-10 Mmcfe/d.

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Magnolia Offshore Exploration LLC. As of March 31, 2006, Contango had approximately $0.9 million invested in MOE. Contango purchased a 50.0% working interest in MOE in October 2001. JEX is the only other member of MOE and acts as the managing member, deciding which prospects MOE may acquire, develop, and exploit. MOE owns license rights to 3-D seismic data covering 600 blocks of the Gulf of Mexico continental shelf. All leases are subject to a 3.3% overriding royalty interest in favor of the JEX prospect generation team. See Offshore Properties below for additional information on MOE s offshore properties.

Current Activities. In August 2005, Hurricane Katrina struck the Gulf of Mexico and the Gulf Coast of the United States, and in September 2005, Hurricane Rita struck the same region. The Company does not at present operate or own any production platforms or pipeline facilities in the Gulf of Mexico. However, the Company does have non-operating working interests in three offshore blocks: Ship Shoal 358, Eugene Island 113-B and Eugene Island 76 and depends on third-party operators for the operation and maintenance of these production platforms. In the aftermath of the hurricanes, the Ship Shoal 358 and the Eugene Island 113-B platforms sustained damage and have now been repaired. Eugene Island-113B resumed production in April 2006 at a rate of 16 MMcfe/d, while the Ship Shoal 358 well resumed production in April 2006 at a rate of 5 MMcfe/d. Contango s net revenue interest in these wells is 3.1% and 5.8%, respectively. The Company was not responsible for any of the capital costs required to repair the damaged platforms, pipelines, or other damaged facilities related to these wells. The Company was not materially impacted by the temporary loss of production from these two wells. Eugene Island 76, a REX prospect, was successfully tested in 2005 and began producing in January 2006. The well is currently producing at approximately 12 MMcfe/d. REX owns an overriding royalty interest of 5% until payout, after which REX has the option to elect an 8.33% overriding royalty interest or a 25% working interest upon payout.

Throughout the remainder of the year, we will continue to focus on developing our three offshore prospects, Eugene Island 10, High Island A-279 and West Delta 43, which we will operate through our wholly owned subsidiary, Contango Operators, Inc. Our capital expenditure budget calls for us to invest approximately $4.0 million in estimated dry hole costs in the drilling of Eugene Island 10, approximately $3.0 million in estimated dry hole costs in the drilling of High Island A-279, approximately $3.5 million in estimated dry hole costs in the drilling of West Delta 43. In the event we have exploration success at any of our offshore prospects, our capital budget will be significantly increased as we will incur additional costs to complete these wells and pay for production facilities.

In July 2005, REX acquired State Lease No. 18640, a 474.5 acre tract located off the coast of Louisiana covering a portion of offshore blocks Eugene Island 10 and 11 and is located approximately three miles offshore. The purchase price for the acreage was approximately $0.7 million. In January 2006, REX acquired for a purchase price of approximately $0.1 million, State Lease No. 18860, a 335.91 acre tract located in proximity to State Lease No. 18640.

In March 2006, REX was awarded the following six lease blocks from the Central Gulf of Mexico Lease Sale # 198 for an aggregate purchase price of approximately $0.9 million: South Marsh Island 57, South Marsh Island 59, South Marsh Island 75, South Marsh Island 282, Ship Shoal 14 and Ship Shoal 25. The blocks are complimentary to our existing Ship Shoal and South Marsh Island prospects.

In April 2006, COE was awarded the following two lease blocks from the Central Gulf of Mexico Lease Sale # 198 for an aggregate purchase price of approximately $1.4 million: Grand Isle Block 70 and Ship Shoal Block 263. In May 2006, COE was awarded the Viosca Knoll 119 and 383 lease blocks for an aggregate purchase price of approximately $0.4 million.

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REX and COE have farmed out the following lease blocks: Main Pass 221, East Breaks 369/370, and Vermillion 154. Main Pass 221 was drilled and was determined to be a dry hole. East Breaks 369 and East Breaks 370 are expected to spud in 2007. COE will receive a 4.3% overriding royalty interest before project payout and a 7.2% overriding royalty interest after project payout on the East Breaks 369/370 prospects. Vermillion 154 has been farmed out, and the operator expects to drill an exploratory well prior to July 2008. During the last quarter, the agreement to farm out and drill an exploratory well on West Cameron 133 was cancelled and two lease blocks, Viosca Knoll 116 and 119, were relinquished to the MMS. West Delta 36 was farmed out during the quarter, and is expected to be drilled in August 2006.

Record title interests i